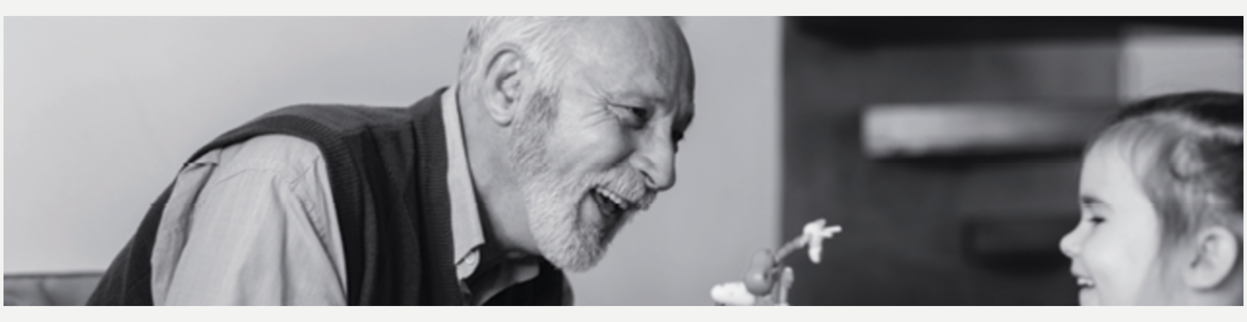
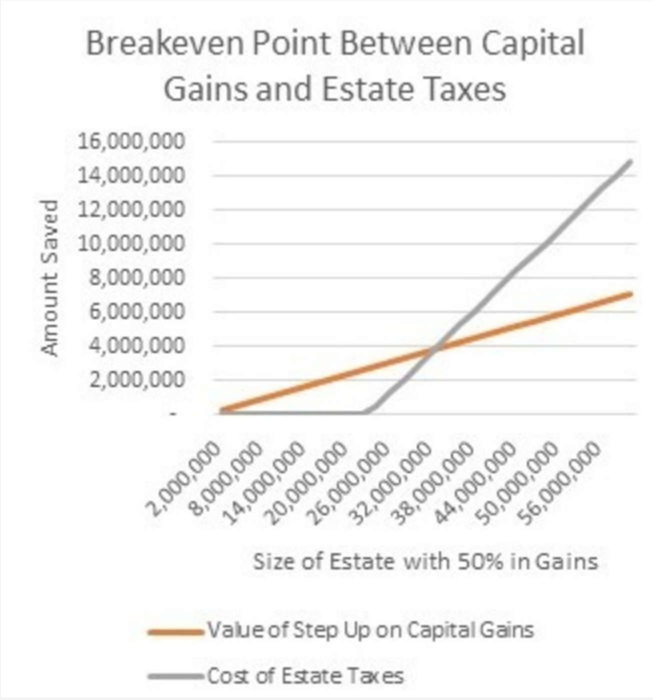
BANK & TRUST INSIGHTS

Traditionally, planning for either capital gains tax or estate tax mitigation in your own estate has been selfless work. By it's very nature, ultimately only your heirs will know if your planning was successful. *What if you could benefit from this type of planning while you are alive?*



How to Reduce Income Taxes with Estate Planning

Historically, estate planning focused on reducing the amount of estate tax imposed on every dollar over the estate tax exclusion. In 1999, an estate tax of 55% was imposed on estates that exceeded $675,000, amplifying the importance of estate tax planning. An often ignored, ancillary benefit of assets being included in an estate is the stepped up cost basis for capital gains. The capital gains tax in 1999 was 20%. All assets included in the estate receive a new cost basis that is equal to the value of the assets on the date of death. The benefit of the basis step up on the first $675,000 was often overlooked. Back then, with the estate tax so high relative to capital gains tax, removing assets from one's estate and foregoing the basis step up was often beneficial.



Over the past two decades, many changes have been made to estate tax laws. Today, with inflation adjustments, the individual exemption is $11.4 million ($22.8 million for couples) and the estate tax rate is 40% on balances in excess of this amount. The current capital gains tax remains at 20%, as it was in 1999, but most affluent families pay a $1411 tax of 3.8% for a total tax of 23.8%. Taking advantage of the stepped up cost basis on the first $11.4 million at 23.8% could be worth as much as $2.7 million today. As a result, affluent families now benefit by planning ahead to avoid capital gains tax and mitigate estate taxes. In fact, a case can be made that estates as large as $30 million should be more focused on capital gains planning than estate planning when half of their estate is at a gain.

General Power of Appointment

Can you benefit from planning while you are alive? Yes - You potentially can with the new application of a very old concept: *the general power of appointment (GPOA).* Within a trust, we can cause assets to be included in a person's estate and receive a step up in cost basis by providing a general power of appointment to them. A GPOA allows the holder to appoint, or leave assets to any one of themselves, their estate, their creditors, or the creditors of their estate. However, the power does not need to be exercised to cause estate inclusion and the corresponding basis increase. The mere existence of the power in the trust is sufficient to include the assets in the decedent's estate and cause the basis to be stepped up. Logically, if a person has control over assets to the extent they can include them in their estate, they should include them.

How can this strategy benefit our clients?

In specific situations, a properly drafted GPOA provided to an elderly, less affluent relative can cause assets placed in the trust by a younger party to receive a stepped up cost basis when that relative passes. When assets are later sold by the younger beneficiaries, the cost basis used to calculate the capital gain is equal to the value on the date of the elderly power holder's death. This is often referred to as a Power of Appointment Support Trust.

Power of Appointment Support Trust

This strategy is well-suited for a client who is currently providing financial assistance to an elderly relative who has a modest estate compared to the current exemption. Simultaneously, the client has appreciated assets in their own estate, does not plan to sell those assets today, but is likely to sell the assets in the future. If executed properly, this strategy can result in capital gains tax savings allowing for the more efficient diversification of the portfolio and greater financial flexibility.

Depending on a client's goals, the beneficiaries of the trust can be an elderly relative *AND* the client and spouse. With the client serving as trustee, the trust can provide distributions to any beneficiary, at the trustee's discretion, as needed.

What If?

Each family's situation is unique, and the appropriate consideration needs to be given to plan for certain "what ifs."

What if the relative exercises their power in favor an unintended party? A Trust Protector can be utilized to approve an appointment exercised by the power holder.

What if the power holder suddenly has a taxable estate of their own, either due to reduced exemption or an influx of wealth? By limiting the amount of trust assets the power holder can appoint to their remaining estate tax exclusion, you may be able to create a more desirable outcome. As a result, only the portion of the elderly relative's unused exclusion is included in the estate getting a basis step up.

The Power of Appointment Support Trust uses an old concept, the general power of appointment, under the newly expanded $11.4 million estate tax exclusion to achieve income tax savings. Given the appropriate circumstances, this strategy can deliver benefits to a client while they are alive, which may be more valuable than estate tax planning for when they are gone.

If you would like to learn more about this strategy, please contact a member of our team.

Contact Us

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