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How to Get the Most Out of Your Estate Tax Exemption

Your estate will have to pay federal estate taxes if its net value when you die is more than the exempt amount set by Congress. In 2016, the federal estate tax exemption is $5.45 million, and every dollar over the exempt amount is taxed at 40%. The exempt amount adjusts for inflation annually and is expected to increase over time. State estate/inheritance taxes vary. Because they can apply at a lower threshold, your estate could be exempt from federal tax and still have to pay a state death tax.

To determine the current net value of your estate, add your assets then subtract your debts. Be sure to include your home, business interests, bank accounts, investments, personal property, IRAs, and retirement plans. You must also include death benefits from any life insurance policies for which you have any "incidents of ownership." These include policies you can borrow against, assign or cancel, or for which you can revoke an assignment, or can name or change the beneficiary.

If the net value of your estate is less than the exempt amount, you'll pay no estate taxes. But if it's more, every dollar over the exempt amount will be taxed.

So, what can you do to get the most out of your estate tax exemption?

1. Married? You can "double" your exemption. By setting up an A-B living trust, both spouses can use their estate tax exemptions, protect up to $10.9 million (in 2016) from estate taxes, and save up to $2.18 million in federal estate taxes. As the exemption increases with inflation adjustments, you will be able to save even more for your family. This type of estate tax planning can be done using a will, but you would not avoid probate or enjoy the other benefits of a living trust.

2. Check the wording. If you already have an A-B living trust, make sure the language to use your exemptions is flexible and does not state a specific dollar amount (e.g., $1 million or $2 million). Instead, it should apply a formula or use language such as "the amount that is exempt from estate taxes at the time of the grantor's death." Your attorney will know the best way to handle this.

3. Shift assets. If you and your spouse have separate trusts, you may need to move assets from one trust to the other as the exemption increases.

4. Switch to a trust. If a will is the centerpiece of your estate plan, consider changing to a living trust now. It will probably cost more initially, but it can avoid probate, prevent court control of assets at incapacity, and will give you more control over the distribution of your estate after you die. For most people, a living trust is a far better estate planning tool.

5. Make gifts. If you have a sizeable estate, you may want to consider giving some of your assets now to the people or organizations who will receive them after you die. Why? First, it can be very satisfying to see the results of your gifts -- something you can't do if you hold onto everything until you die. Second, gifting is an excellent way to reduce estate taxes because you are reducing the size of your taxable estate. (Just make sure you don't give away any assets you may need later.) As is the case with any legal strategy, there are right and wrong ways to do this. If this is something that interests you, check with your attorney before you make any gifts because there can *income* tax implications if the “wrong” assets are gifted. However, with the exemption currently so high, many families will be able to give as much as they want to family members without having to worry about gift taxes.

6. Remove assets from your estate at a discount. If your estate is larger than the exempt amount (or larger than two exemptions if you are married), your attorney can suggest some additional planning options that will let you transfer assets to your loved ones at reduced values, leveraging the amount of your exemption(s). Some of these options may be discontinued in the future, as the IRS and many in Congress seem to always be looking for more ways to increase tax revenues. So this is an excellent time to incorporate them in your planning, while they are still available.

7. Review your plan annually with a qualified attorney. Your estate plan is a snapshot of you, your assets, your family, your goals and the tax laws in effect at the time it was prepared. Any time one of these changes, you need to review your plan. This year is a perfect time to have your plan reviewed.