# Ten income and estate tax planning strategies for 2017

## Key tax facts for 2017

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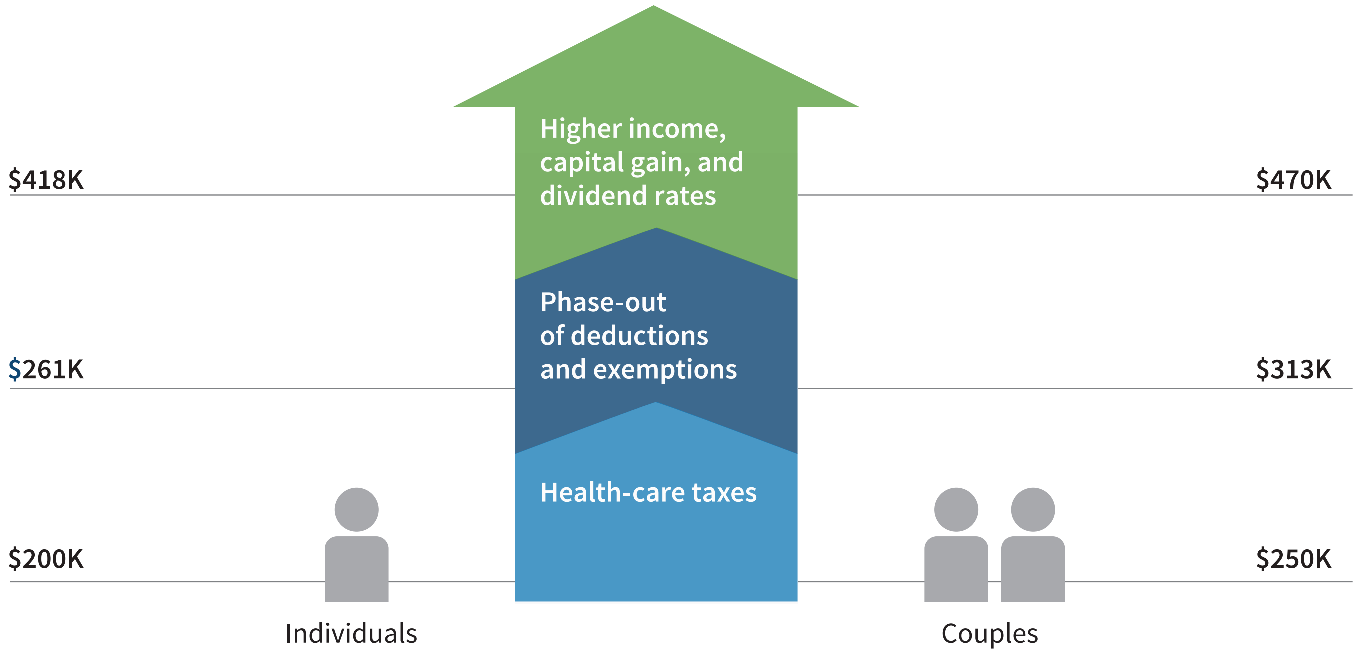
|---|---|
| Highest marginal tax rates | 39.6% on ordinary income, 20% on capital gains and dividends applied on taxable income exceeding $418,400 ($470,700 for couples) |
| Medicare investment income surtax | 3.8% surtax on net investment income (e.g., interest, capital gains, dividends, rental income, royalties, income from non-qualified annuities, "passive" business income) affecting taxpayers with more than $200,000 in modified adjusted gross income ($250,000 for couples) |
| Additional Medicare payroll tax | Extra tax of 0.9% on salary and wages as Medicare payroll tax increases from 1.45% to 2.35% on earnings above $200,000 ($250,000 for couples) |
| AGI phaseouts for itemized deductions and personal exemptions | $261,500 ($313,800 for couples) |
| Estate/gift tax exemption | $5.49 million |
| Annual gift tax exclusion amount | $14,000 |

## Summary of key income threshold

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## Ten tax-smart strategies to consider in 2017:

### 1. Invest in municipal bonds to generate tax-free income

Municipal bonds become more attractive on a relative tax basis for taxpayers who find themselves subject to the 3.8% surtax and who may also be subject to the highest (39.6%) marginal rate. The tax equivalent yield, i.e., the yield an investor would require in a taxable bond investment to equal the yield of a comparable tax-free municipal bond, is higher for those taxpayers.

### 2. Utilize strategies to reduce or avoid taxable income

Contributing to a retirement plan or IRA, funding a flexible spending account (FSA), or deferring compensation income can reduce adjusted gross income (AGI) and prevent a taxpayer from reaching key income thresholds that may result in a higher tax bill. Maximizing use of tax deductions such as charitable contributions or mortgage interest can offset income as well. Conversely, be mindful of transactions, such as the sale of a highly appreciated asset, which may increase your overall income above thresholds for the 3.8% surtax, the income phaseout of itemized deductions, or the highest marginal tax rates.

### 3. Consider Roth IRA/401(k) contributions or conversions

A thoughtful strategy utilizing Roth accounts can be an effective way to hedge against the direction of future tax rates in light of the longer-term federal budget deficit challenge. Younger investors or taxpayers in lower tax brackets should consider using Roth accounts to create a source of tax-free income in retirement. It is virtually impossible to predict tax rates in the future or to have a good idea of what your personal tax circumstances will look like years from now. Like all income from retirement accounts, Roth income is not subject to the new 3.8% surtax and is also not included in the calculation for the $200,000 income threshold ($250,000 for couples) to determine if the surtax applies.

### 4. Asset "location": Allocate assets by tax status

In general, consider placing a larger percentage of your stock holdings outside of retirement accounts and a larger percentage of your fixed-income holdings inside retirement accounts. With respect to stock investments, allocating a greater proportion of your buy-and-hold or dividend-paying investments to taxable (i.e., non-retirement) accounts may increase your ability to benefit from a lower tax rate on qualified dividends and long-term capital gains.

### 5. Be mindful of irrevocable trusts and taxes

Because of the low income threshold ($12,500 for 2017), which will subject income retained within an irrevocable trust to the highest marginal tax rates and the 3.8% Medicare surtax, trustees may want to reconsider investment choices inside of the trust (municipal bonds, life insurance, etc.). Or, maybe trustees should consider (if possible) distributing more income out of the trust to beneficiaries who may be in lower income tax brackets.

### 6. Review estate planning documents and strategies

The permanency of the historically high $5,000,000 exemption (indexed for inflation) amount may have unintended consequences for some individuals and families with wealth under that threshold. They may think that they do not have to plan for their estate. However, the taxes are just one facet of estate planning. It is still critical to plan for an orderly transfer of assets or for unforeseen circumstances such as incapacitation. Strategies to consider include proper beneficiary designations on retirement accounts and insurance contracts, wills, powers of attorney, health-care directives, and revocable trusts.

7. **Plan for potential state estate taxes**

   While much attention is focused on the federal estate tax, certain residents need to know that many states have estate or inheritance taxes. There are a number of states that are "decoupled" from the federal estate tax system. This means the state applies different tax rates or exemption amounts. A taxpayer may have net worth comfortably below the $5,490,000 exemption amount for federal estate taxes, but may be well above the exemption amount for his or her particular state. It is important to consult with an attorney on specific state law and potential options to mitigate state estate or inheritance taxes.

8. **Evaluate whether to transfer wealth during lifetime or at death**

   The unified lifetime exemption amount ($5,490,000 for 2017) for gifts and estates provides flexibility for taxpayers to decide whether to transfer wealth while living or at death. Lifetime gifting shelters appreciation of assets post-gift from potential estate taxes, helps heirs now, and utilizes certain valuation discounts available through strategies such as family limited partnerships. Transferring assets at death allows individuals to maintain full control of property while living and benefit from step-up in cost basis at death.

9. **Consult with an attorney to see if more complex wealth transfer techniques may be appropriate**

   Individuals and families with significant wealth, especially within non-liquid assets such as real estate or closely held businesses may benefit from a range of more complicated strategies to efficiently transfer wealth. Examples include grantor trusts, family limited partnerships, and dynasty trusts. Recently, there has been more scrutiny among lawmakers, which could prompt restrictions in how these strategies are implemented. It may be prudent to examine these options while they are still viable alternatives.

10. **Evaluate whether a Credit Shelter Trust (CST) makes sense**

    A properly designed CST will shelter appreciation of assets from the estate tax after the death of the first spouse. However, since the portability provision allowing a surviving spouse to utilize the unused exemption amount of a deceased spouse is permanent, is trust planning actually necessary? There are some benefits for still utilizing a credit shelter trust including protection of assets from potential creditors, spendthrift protection for trust beneficiaries, planning for state death taxes, and preserving the Generation Skipping exemption, which is not portable. However, costs and effort are required to establish the trust while the portability provision does not involve any special planning. Additionally, assets transferred to a trust at the death of the first spouse do not receive a "step-up" in cost basis at the death of the second spouse.

**Consult a qualified tax or legal professional and your financial advisor to discuss these types of strategies to prepare for the risk of higher taxes in the future. Personal circumstances vary widely so it is critical to work with a professional who has knowledge of your specific goals and situation.**

While all bonds have risks, municipal bonds may have a higher level of credit risk as compared with government bonds and CDs. Capital gains, if any, are taxable for federal and, in most cases, state purposes. Income from federally tax-exempt funds may be subject to state and local taxes.

**This information is not meant as tax or legal advice. Please consult with the appropriate tax or legal professional regarding your particular circumstances before making any investment decisions.**

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