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## FINANCIAL ASSOCIATES

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Guide...Protect...Preserve

## 5 Estate Planning Steps To Benefit Your Elders

**E**state planning normally involves strategies to preserve wealth for a family's younger generation. But it may also involve elderly relatives—your parents and in-laws or maybe an aunt or an uncle—who could use your assistance. Indeed, this older generation might need your help even more than your offspring who are already making their way in the world.

Consider these five steps to help your older relatives.

1. Have “the talk.” As difficult as it can be to sit down with a parent to talk about money and end-of-life decision-making, there's really no alternative to having a candid discussion of these sensitive matters. Your mom and dad may not like what you have to say, but if you start by really listening, giving them



the opportunity to provide their point of view, it could launch a productive discussion. Try to address tough issues such as the possibility of relocating to an assisted-living facility or a nursing home, and don't be surprised if things get heated and emotional. Including other family members, such as your siblings, in this discussion will also be helpful, and whenever possible, have the family meetings in person rather than over the phone.

2. Create a contact list. You've probably already done this for yourself, but compiling all of the names, addresses, phone numbers, and email addresses of crucial contacts

for your older relatives can be particularly crucial. These could include financial advisors, attorneys, accountants, insurance agents, physicians, and dentists. These days, creating a digital version of the list and storing it on multiple computers makes the most sense.

3. Gather financial information.

Along with a contact list, information about the relative's financial affairs and investment holdings is also essential. You'll want to know about bank and investment accounts, 401(k) or other retirement plan accounts and IRAs, life insurance policies, etc. Note current

balances, account numbers, passwords, and information on Social Security benefits. You may find out that your relative has more assets than you'd thought. Use this information to

formulate a plan for the future.

4. Create the necessary documents.

Once everyone agrees on how to move forward, you may need to complement a will or other existing legal documents with new ones. And those your relative has may need to be revised or updated. Such documents may include:

- A will: The centerpiece of an estate plan controls how most worldly possessions—a house, cars, jewelry—will be distributed. A will also specifies an executor of the estate. This might be you, another relative, or

## If Estate Tax Repeal Is Enacted Soon, Will It Stick?

**A**s the drumbeat for tax reform grows louder, the chances that the federal estate tax will be repealed increase. Although there are no guarantees, especially in the current political environment, a repeal taking effect by 2018 is a real possibility.

But this doesn't mean estate tax planning should be abandoned—far from it. In fact, if history is any indication, an outright estate tax repeal isn't likely to be permanent.

Take the example of the monumental tax legislation enacted in 2001, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA). Under EGTRRA, among other related changes, the estate tax rate was gradually reduced from 55% to 45% while the estate tax exemption rose from \$1 million to \$3.5 million. Then the estate tax “vanished” just for just one year—2010—before it was scheduled to be reborn in 2011 at 2001 levels via a “sunset” provision.

Subsequently, a higher estate tax exemption was preserved. Indexed for inflation, it's \$5.49 million in 2017, with a top 40% estate tax rate. These changes are “permanently” written into the tax code.

Suffice it say that you can't foresee the impact of future presidential and congressional elections. Even if the estate tax is eliminated, it could easily return. The best strategy is to continue estate planning that takes a long-term view.

*Mary Jane Callaghan & Mitch Glicksman*

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# Avoid This Installment Sale Trap

**O**ne tried-and-true method for reducing taxes on a sale of real estate is to use installment sale reporting of payments that will extend over two or more tax years. If you meet all of the requirements, you're taxed on the installments as you receive them, avoiding the higher cost of being taxed on the full amount of your profit all at once. That may not only defer some of your tax liability; you may also pay less overall.

But installment sale treatment isn't always a slam dunk. Your tax benefits, could be reduced if you sell property to a relative or to a trust or corporation you control.

When you sell real estate, any profit you make is taxable as a capital gain. If you've held the property for more than one year, your maximum tax rate for that long-term gain will be only 15%, or 20% if you're in the top bracket of 39.6% for ordinary income. In addition, you may be liable for the 3.8% surtax on net investment income (NII).

Normally, you owe tax on the capital gain in the tax year you get the money, and if you finance

the sale and receive payments over two or more years, that delays some of your tax liability. To calculate what you owe each year you first need to determine the "gross profit ratio"—the amount of your gain divided by the price.

Suppose you sold a commercial building for \$1.67 million and made a profit of \$1 million. That gives you a gross profit ratio of 60%. If you receive \$250,000 a year, you are taxed on \$150,000 (60% of \$250,000) of the proceeds annually. Assuming a 20% long-term capital gains tax rate (and excluding any NII surtax complications), your tax each year on the installment sale is \$30,000 (20%

of \$150,000).

However, if you sell the property to a "related party"—that could be a spouse, children, grandchildren, siblings, or parents, but also a partnership or corporation in which you have a controlling interest or an estate or trust you're associated with—and it's then resold within two years, you must report the full amount of the remaining taxable gain in the year of the second sale, even if you haven't received all the installments.

The easiest solution to this problem is to try to make sure the related party you sell to won't resell the property for at least two years.

In addition, if you've claimed depreciation on the property, you'll have to "recapture" it as ordinary income to the extent it exceeds the amount allowed under the straight-line accounting method. Finally, if the sale price of your property (if it's not a farm or personal property) exceeds \$150,000, you may owe interest on the amount of tax you defer through an installment sale. ●



# Ask About Personal Residence Trusts

**B**y using a qualified personal residence trust (QPRT), you might be able to sidestep potential estate tax pitfalls while transferring a home to family members. You can continue to live in the home for a term of years, after which ownership passes from the trust to the designated beneficiaries. Your gift of the home to the trust is taxable, but rather than being based on the home's value when it goes into the trust, that value is reduced by the amount of your "retained interest," which is calculated according to a complicated formula based on interest rates, the term of the trust, and other factors.

But this unique estate planning

technique is often misunderstood. Here are answers to several common questions about QPRTs.

**Q.** What are the estate and gift tax consequences?

**A.** When your home goes into a QPRT, it comes out of your taxable estate. Although the transfer of the remainder interest—the home's value minus your retained interest—is subject to federal gift tax, the resulting tax from this future gift tends to be low, especially while interest rates remain depressed. The IRS relies on the Section 7520 rate, which is updated monthly, to calculate the tax.

**Q.** What happens if I die before the end of the trust term?

**A.** Then the home goes back into your taxable estate. This defeats the purpose of the trust, but your family is no worse off than before the trust was created.

**Q.** Do I have to transfer my principal residence?

**A.** That's normally the home used in a QPRT, but it can also be set up for a second home. In fact, you can have multiple personal residence trusts.

**Q.** How long should the trust term last?

**A.** There's no set period of time. Note that the longer the term, the smaller the value of the remainder interest that's subject to taxes. But a longer term also



# Seven Steps To Get Ready For Your Retirement

**A**re you among the millions of Baby Boomers counting down the days to retirement? Before you move into the next stage of life, it's important to get all of your financial ducks in line. To prepare yourself, consider these seven practical suggestions.

1. Rebuild the budget. You've probably been living on a monthly budget that takes into account your usual expenditures and income. But that's about to change in a big way. For example, once you stop working, your expenses for a business wardrobe and commuting will also end, but so will the regular paychecks you've been living on.

Come up with a new plan. Identify what you expect to have coming in and going out. Remember that you won't be able to rely on 401(k) deferrals to reduce your taxable income after retirement, but you should still keep saving.

2. Zone in on a homestead. You could be planning to pull up stakes and move to a smaller home, perhaps downsizing from the place where your kids grew up and you might hope to end up in a warmer climate or in a less expensive area (or both). Or perhaps you're contemplating a move to a retirement community. But this kind of upheaval isn't for everyone, and you just might decide to stay put. In any event, your choice will affect numerous other

aspects of retirement.

Also, don't assume that you and your spouse share the same vision. If you haven't talked about it yet, bring up the subject before you call it quits.

3. Review your investments. As you head into the home stretch before retirement, compile a list all of the investment assets you own, including amounts parked in taxable accounts, bank savings or checking accounts, and tax-favored retirement accounts such as 401(k)s and IRAs. Consider whether you will want to keep retirement plan assets where they are when you retire or consolidate them into other accounts. Similarly, consider the best use of life insurance policies.

One thing to think about is whether to convert your traditional IRAs to a Roth IRA. Although the conversion is taxable, your future withdrawals from the account will normally be tax-free. Check with a professional to crunch the numbers.

4. Settle on Social Security. If you retire before full retirement age (FRA)—age 66 for most Baby Boomers—you'll receive less in monthly Social Security benefits. You can apply for benefits as early as age 62. Waiting until after you reach FRA, on the other hand, can result in bigger monthly benefits. The longer you wait, until you turn 70, the larger your benefit checks will be.

But if you and your spouse will both

receive Social Security payments, there will be other factors to consider. For instance, a higher-earning spouse might wait longer to claim benefits to provide greater protection for a surviving spouse if the higher-earning spouse dies first.

5. Learn all about Medicare. Usually, retirees opt to be covered by Medicare once they become eligible at age 65. But you will have a number of options to consider, so it's best to familiarize yourself with the key elements of Medicare before then. Estimating your future out-of-pocket costs, including premiums, deductibles, and prescription drug costs will help you decide which Medicare benefits to opt for and whether you'll need to supplement Medicare with coverage from a private insurance plan. Try to investigate all of the possibilities before the time comes to make your decisions.

6. Develop a draw-down strategy. Control the distribution of funds in your retirement by deciding which accounts you want to tap first. Although everyone's circumstances are different, often the best plan is to withdraw funds from your taxable accounts first (because you'll owe only capital gains taxes, which are usually much lower than taxes on distributions from 401(k)s and traditional IRAs), then from those other tax-deferred accounts, and finally from your Roth IRAs. This sequence enables you to benefit from tax-free compounding of investment income within a Roth for as long as possible.

But taxes aren't the only consideration. You may have other reasons for withdrawing funds from some accounts and holding onto others.

7. Meet with your financial advisor. As you can see, you'll be facing some difficult decisions during your countdown to retirement, and the financial consequences can be significant. But you don't have to do it all by yourself.

Schedule a meeting with your advisor to assess and review your situation well before your expected retirement. The countdown to retirement won't be as nerve-racking if you're well prepared. ●

increases the chance that you'll die before it ends and the home will be returned to your estate.

Q. Can I sell the home during the trust term?

A. You can, but you'll have to reinvest the proceeds in another home that will be owned by the QPRT and subject to the same trust provisions.

Q. Who pays for the upkeep of the home?

A. As long as you still live there, you do, for instance, you might pay the costs of monthly maintenance and repair, insurance, and property taxes to the trustee. But you get to deduct qualified expenses on your tax return.

Q. Can I back out of the deal?

A. No, the trust is irrevocable.

However, if you want to stay in the home after the trust term, you can set up a rental agreement with the beneficiaries.

They will have to pay income tax on the rent they receive.

Q. Are there any other drawbacks?

A. There are costs associated with a QPRT, including attorneys' fees,

appraisal fees, and titling expenses. And you can't take out a mortgage on a home that has been transferred to a QPRT. (An existing mortgage is permitted but it complicates matters.) ●



# Lending Money? Watch Your Tax Step

**D**oug Burnside is in a quandary. His daughter, Megan, needs money to get a new business venture going. But Doug can't afford to give her the money outright and she has had trouble getting a loan from a bank.

What can be done? One idea is for Doug to lend his daughter the cash. Megan can repay Doug, with interest, if the business succeeds. Everyone wins.

But this kind of intra-family loan brings several potential tax pitfalls. As long as the loan is for \$10,000 or less, there won't be a problem. However, if the borrowed amount is larger and he doesn't charge the going rate of interest, the IRS will "impute" interest for him, based on its own assumptions. He'll end up being treated as if he had charged his daughter interest, even though he hadn't, and he'll owe tax on that "phantom income" that he didn't receive.

In such cases, if the loan is for

\$100,000 or less, the interest you will be considered to have received annually for tax purposes is limited to the amount of your child's net investment income for the year. And if that amount doesn't exceed \$1,000, you can avoid taxable interest income on the intra-family loan. But the IRS may still intercede if it suspects that you're trying to dodge the tax liability.



How do you figure out what the "going rate" for interest is? It depends on several factors, including the type of loan, its length, and the

interest rates in your local area. You might be able to charge slightly less than a local bank would get, but you can't go overboard.

What happens if Megan's business fails and she can't pay Doug back? The IRS could determine that the "loan" was always meant to be a gift. To avoid that problem, it's best to have an attorney draft a formal loan document. It should include the usual terms that would be found in a bank loan. For instance, the document will usually indicate:

- The amount of the loan;
- The time allowed for repayment;
- The interest rate structure;
- A description of the collateral securing the loan.

Finally, have the loan document witnessed and notarized. This is the best proof you can have if the IRS ever challenges the deal. Also, keep records showing repayments to demonstrate that the arrangement is a bona fide loan. ●

## Steps To Benefit Your Elders

*(Continued from page 1)*

- a professional you trust.
- Power of attorney: This document authorizes someone to act on behalf of the elderly person. The most common version is a durable power of attorney that will remain in effect if the person is incapacitated. This is a vital component of most estate plans.
- Living trust: A living trust can serve as a supplement to a will. The assets transferred to a living trust don't have to go through the probate process that may be required for possessions transferred through a will and that can be drawn out and

expensive. In addition, assets in a living trust are shielded from public inspection.

- Living will/health care directives: These documents provide guidance for end-of-life decisions. You'll want to make sure your relative's doctors and others also have copies so they can act according to your loved one's wishes.

Finally, don't forget about beneficiary designations for retirement plans, IRAs, and life insurance policies—they supersede provisions in a will and are important to keep up to date.

5. Look for ways to minimize

estate and gift taxes. Assets transferred to relatives or friends are shielded from federal estate and gift taxes both by unlimited marital deduction for gifts to spouses and a unified estate and gift tax exemption of \$5.49 million in



2017 covering transfers to anyone who's not a spouse. Your older relative can also make yearly gifts of as much as \$14,000 to multiple recipients.

Estate planning for an elderly relative will inevitably be intertwined with your own plan, so don't do things in a vacuum. Your professional financial advisor can steer you in the right direction. ●

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