Gift and Estate Taxes

Laws affecting gift and estate taxes have been subject to constant change over the years. Under current federal law, the individual unified gift and estate tax exemption stands at $5,450,000 in 2016. For a married couple, the effective exemption rate can be double that amount. The exemption is adjusted annually for inflation. Even at these levels, it may be important to manage assets and gifting strategies throughout life to limit your estate tax liability.

One effective way to reduce the size of your estate during your lifetime is to make gifts to individuals and others up to the legally allowed limit that avoids gift taxes. This is an efficient way to reduce the tax exposure facing your estate.

Here are answers to important questions about gift and estate strategies:

How large of a gift can I make without incurring gift taxes in a given year?
Each individual is entitled to make gifts of up to $14,000 per year to any recipient without incurring gift tax consequences or reducing his or her lifetime estate and gift tax exclusion. Married couples can combine gifts, allowing them to gift up to $28,000 per year to recipients without gift tax consequences.

One effective way to reduce the size of your estate, and its potential tax exposure, is to make gifts during your lifetime to individuals and others up to the legally allowed limit that avoids gift taxes.

While the annual gift tax exclusion is adjusted for inflation, this adjustment only occurs in $1,000 increments, so this only occurs every few years. The most important benefit is that you can use this exclusion each year for each recipient, so you can reduce the size of your estate annually by “maxing out” your gifts up to the exclusion amount.

Are there circumstances where I can make gifts without being subject to the annual gift tax exclusion?
There are two gifting options you can consider where no dollar limits apply:

1. Direct payment of tuition to an educational institution for the benefit of another person.
2. Medical expenses you pay directly to the medical facility for someone else.

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Another option is to contribute to a 529 education savings plan. Your contribution is treated as a gift to the beneficiary, your child or grandchild, for example, named on the account for gift tax purposes. If you are making 529 plan contributions for grandchildren, this is also treated as a gift for generation-skipping transfer tax purposes. 529 plan contributions can be combined with other gifts to the same beneficiary during the same tax year. Your 529 contributions are counted as part of the $14,000 annual gift tax exclusion, but special provisions in the law apply to 529 plan contributions as gifts. Any individual can make a 529 contribution of up to $70,000 per beneficiary in a single year, then treat the contribution as if it were made over a five-year period (in $14,000 increments per year). This is a strategy that will not reduce the unified gift and estate tax exemption. Should the beneficiary decide that college isn’t in their plans, the grantor has the flexibility to change the name of the beneficiary at a later date.

How are gifts to charitable and other types of organizations treated for tax purposes?

Gifts of any value to qualifying charities are deductible from federal income tax and can be deducted from your estate. If you choose to leave your entire estate to charity, it will eliminate any estate tax liability. Also, the gift tax does not apply to gifts made to political organizations.

Gifting appreciated assets to a qualified charity is a particularly effective tax-saving technique, as you can claim the income tax deduction and reduce your estate by the full value of the appreciated asset that was gifted. You will avoid capital gains taxes that would have applied had you first sold the asset. In addition to the tax advantages, gifts to charity represent a meaningful way to leave a legacy in your community or instill a sense of social responsibility among your heirs.

If you want to leave part of your estate to charity and the rest to family members or other beneficiaries, consider using a trust. Two options are commonly used:

1. **Charitable Remainder Trust (CRT)**—Assets are transferred to a trust. Income generated by the trust is paid to you or to other beneficiaries for a stated period of time. After that time expires, the remainder of the trust is transferred to the charities named as beneficiaries in the trust.

2. **Charitable Lead Trust (CLT)**—In this case, assets are transferred to the trust and income generated can be directed toward named charities for a specified period of time. After that period, the remainder of the trust can be directed to other non-charitable beneficiaries.

When appreciated assets are transferred to a CRT or CLT, the trust can choose to sell the asset immediately with no capital gains tax consequences. The trustee can then reinvest the proceeds, and potentially increase the annual distributions made to you or to your chosen beneficiaries.

**Could I gift money to my spouse to reduce my estate?**

While you can make unlimited gifts to a spouse (who is a U.S. citizen) with no tax implications, it does not reduce the size of your combined estate. Gifts to non-citizen spouses are limited. Only the first $148,000 in gifts to a non-citizen spouse are excluded from the total amount of gifts made in that year.

How can I make gifts that will effectively reduce my estate without forfeiting control of the assets?

To take advantage of the annual exclusion, the law requires that the donor give a present interest in the property to the recipient. This means the recipient must have complete access to the funds. As a parent or guardian making a gift, you might find the prospect of giving complete control of a large sum of money to a child, teen or young adult a bit unsettling. There are two accepted ways to deal with concerns over control of gifted assets:

1. **Crummey Trusts**—Named for the first person to use such a structure, language in this type of trust can encourage recipients of gifts to understand that they are better off not withdrawing funds so the proceeds can be passed to them
tax-free at the death of the grantor. Talk to your tax or legal advisor about effective ways to draft a trust document to discourage immediate withdrawals.

2. Trusts for minors—You can establish a trust for a minor designed to provide future benefits (such as paying for a college education). These trusts can require that:

- The income and principal of the trust be used for the benefit of the minor until age 21.
- Any income and principal not used passes to the minor at age 21.

This type of trust qualifies for the annual gift tax exclusion even though the child is prevented from having immediate access to the funds. This allows a parent to make annual gifts to the trust while the child is a minor. Funds can accumulate for the future benefit of the child. The trust can even be established without informing the child about it. The law requires that the child have complete access to assets in the trust once he or she reaches age 21.

Should I consider making gifts of assets that have the potential to appreciate in value?
This can be a very effective strategy. Gifts can be in cash or in the form of other assets you own. The greatest potential estate tax savings can come from gifting assets with high future appreciation potential. Rather than gifting a municipal bond valued at $14,000 with limited appreciation value, you could retain that bond and instead gift shares of stock worth $14,000 that have the potential for future appreciation. If, for example, that stock increases in value by 50% in the coming years, the appreciated value of $21,000 would not be reflected in your estate because you no longer own it.

One consideration is to make gifts of assets positioned for future appreciation now, even to the extent you reduce your lifetime unified gift and estate tax exemption of $5.45 million. The impact of eliminating assets with future appreciation potential will help to minimize the future value of your estate. Talk to your tax advisor to determine whether this strategy might be effective for you.

If I hold assets that have experienced significant appreciation in value, should I consider those for gifting?

You might want to be careful about gifting assets that have already appreciated in value. This is because when you make such a gift while living, the donee assumes your cost basis in the asset. If you paid $7,500 for shares of a stock that are worth $15,000 today, the recipient will assume the $7,500 cost basis and face a potentially higher capital gains tax when he or she sells the asset. If they inherited that stock after your death, their cost basis would step-up to the value of the stock at the time of your death. If they sell the stock at that time, they only have to recognize a gain that occurred after your death for income tax purposes.

If my estate is larger than the $5.45 million limit that applies in 2016, how much will my estate be taxed?
If the value of your estate exceeds the personal exemption (or in the case of a married couple, the combined exemption), any amount in excess of that will be subject to an estate tax of up to 40% at the federal level. You will need to check on the estate tax laws of your state to determine the potential state estate or inheritance tax liability you face. If you make annual gifts in excess of the annual gift tax exclusion (currently $14,000), it reduces your available estate tax exclusion amount. You are expected to file gift tax returns and keep a running tally of these gifts so your estate can report to the IRS how much of the unified gift and estate tax exemption was used prior to your death.

Please see important information on page 4.
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