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EPIC CAPITAL

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Understanding the Gift Tax

Most of us will never face taxes related to money or assets we give away.

How can I avoid the federal gift tax? If this question is on your mind, you aren't alone. The good news is that few taxpayers or estates will ever have to pay it.

Misconceptions surround this tax. The I.R.S. sets both a yearly gift tax exclusion amount and a lifetime gift tax exemption amount, and this is where the confusion develops.

Here's what you need to remember: practically speaking, *the federal gift tax is a tax on estates*. If it wasn't in place, the rich could simply give away the bulk of their money or property, while living, to spare their heirs from inheritance taxes.

Now that you know the reason the federal government established the gift tax, you can see that the lifetime gift tax exclusion matters more than the annual one.

"What percentage of my gifts will be taxed this year?" Many people wrongly assume that if they give a gift exceeding the annual gift tax exclusion, their tax bill will go up next year. Unless the gift is huge, that won't likely occur.

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The I.R.S. has set the annual gift tax exclusion at $14,000 this year. What this means is that you can gift up to $14,000 *each* to as many individuals as you like in 2017 without having to pay any gift taxes. A married couple may gift up to $28,000 each to an unlimited number of individuals tax free this year – this is known as a "split gift." Gifts may be made in cash, stock, collectibles, real estate – just about any form of property with value so long as you cede ownership and control of it.[1]

So, how are amounts over the $14,000 annual exclusion handled? The excess amounts count against the $5.49 million lifetime gift tax exemption (which is periodically adjusted upward in response to inflation). While you will need to file a gift tax return if you make a gift larger than $14,000 in 2017, you owe no gift tax until your total gifts exceed the lifetime exemption.[1]

"What happens if I go over the lifetime exemption?" If that occurs, then you will pay a 40% gift tax on gifts above the $5.49 million lifetime exemption amount. One exception, though: all gifts that you make to your spouse are tax free, provided he or she is a U.S. citizen. This is known as the marital deduction.[2,3]

"The lifetime gift tax exemption, estate tax exemption, and the generation-skipping tax (GST) exemption are conjoined."

"But aren't the gift tax and estate tax exemptions linked?" They are. The lifetime gift tax exemption, estate tax exemption, and generation-skipping tax (GST) exemption are conjoined. Sometimes they are simply called the *unified credit*. If you have already made taxable lifetime gifts that have used up $4 million of the current $5.49 million unified credit, then only $1.49 million of your estate will be exempt from inheritance taxes if you die in 2017.[2]

That unified credit is portable, however. That means that if you don't use all of it up during your lifetime, the unused portion of the credit can pass to your spouse at your death. (One footnote: the lifetime GST exemption regarding asset transfer to recipients two or more generations younger than the donor is not portable.)[1,2]

In sum, most estates can make larger gifts during the individual's life without any estate, gift, or income tax consequences. If you have estate planning questions in mind, turn to a legal or financial professional, well versed in these matters, for answers.

Medicare Enrollment Options for 2017-18

A summary of what you need to know.

Key Medicare enrollment periods are approaching. This fall and winter, there are three periods in which Medicare beneficiaries can either enroll or disenroll in forms of coverage.

>> *Oct. 15-Dec. 7, 2017: Open enrollment period.* This is when you can exit Original Medicare (Part A & B) for a Medicare Advantage Plan (Part C) and change your prescription drug coverage (Part D). You can also get out of a Part C plan and go back to Part A & B during this period; although, you will certainly want a Medicare Supplement (Medigap policy) in place before you make such a move. (In most cases, that means having to pass underwriting.)[1]

>> *Dec. 8, 2017: Annual enrollment period begins for 5-star plans.* All Part C and Part D plans are assigned ratings. Beginning December 8, 2017 and ending November 30, 2018, a window opens for you to enroll in a 5-star Part C or Part D plan. You can do this once per 365 days. How do you find the 5-star plans? Visit the Medicare Plan Finder: medicare.gov/find-a-plan.[2]

>> *Jan. 1-Feb. 14, 2018: Medicare Advantage plan disenrollment period.* If you join a Part C plan in late 2017 and decide you want to leave it, you can do so within this window of time and go back to Original Medicare (Part A & B) with a stand-alone Prescription Drug Plan (Part D). Again, having a Medigap policy before making such a switch is only prudent.[1]

Do you have to confirm Medicare enrollment at the Health Insurance Marketplace? No. If you have Original Medicare or a Medicare Advantage plan through an HMO or PPO, you are covered under the Affordable Care Act. If you need to make changes to your Medicare coverage, you don't need to go to the HIM to do so. (For the record, you can't buy any Medicare plan through the HIM.)[3]

"If you need to make changes to your Medicare coverage, you don't need to go to the Health Insurance Marketplace to do so."

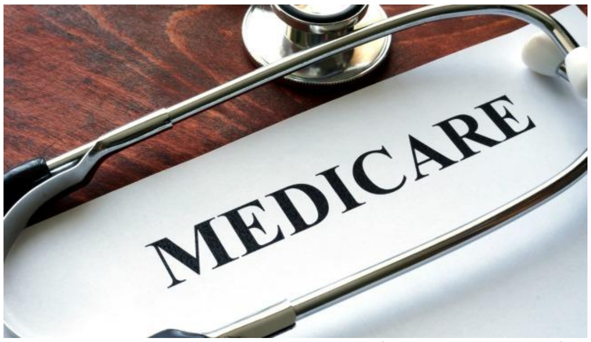
The ACA has enhanced Medicare benefits. It gives Medicare recipients in the "donut hole" avenues to brand-name prescription drug discounts, and recipients may now take advantage of free preventive benefits, cancer screenings, and a yearly wellness visit.[3]

If you only have Medicare Part B coverage (medical insurance), then you lack minimum essential coverage under the ACA, and you may have to pay a penalty. If you just have Medicare Part A coverage (hospital insurance), you are considered covered under the ACA.[3]

Should you get Medigap coverage if you have Part A & B? This third-party health insurance may save you money over time by picking up co-payments and deductibles not covered by Part A & B, but a Medicare Advantage plan provides more comprehensive coverage than Medigap does. Today's Medigap policies don't include prescription drug coverage, and they won't pay for extended long-term care, dental or vision care, or hearing aids or glasses. If you want or need Medigap coverage, you can evaluate policies using Medicare's Personal Plan Finder at Medicare.gov.[4]

What should you look for in a Part C plan? Scrutinize the out-of-pocket spending limit, the copays, and the co-insurance. Attractively low premiums might not tell you the whole story about the value of a Part C plan. Also, how inclusive is the plan network? Does it include hospitals you would choose and the physicians that now treat you?

The Medicare Plan Finder can help you determine an appropriate Part D plan. After you enter your medications, it will go to work. Each Part D plan has its own formulary (list of approved drugs), categorized into higher and lower "tiers" by cost. Formularies do change; if a drug you take drops off of one, that Part D plan has to give you 60 days of notice (or alternately, written notice of the change when you get a refill with a 60-day supply of the medication).[5]



It is vital to check up on your Part D plan each fall, as your plan could change the way it pays for your specific drugs in the next year – for example, the drug you need could wind up in a more expensive tier. The co-insurance and co-payments could even be altered. Most plans send out notices of formulary changes with plenty of lead time, but sometimes they go unread.

Medicare is slowly reducing the Part D "donut hole." In 2017, Medicare recipients with Part D coverage are paying 40% of the cost of covered brand-name drugs and 51% of the cost of generics once they fall into the Part D coverage gap. Next year, that shrinks to 35% of the cost of brand-name medicines and 44% of the cost of generics. A gradual reduction will occur until 2020, when enrollees with Part D plans will pay no more than 25% of the cost of covered generic and brand-name drugs.[6]

Medicare plans mail Annual Notice of Change (ANOC) letters to their members. Use this notice to determine if your current plan is still right for you and your medical care needs. If you don't receive such a letter in September, contact your plan.[7]

Life Insurance Products with Long-Term Care Riders

Are they worthwhile alternatives to traditional LTC policies?

The price of long-term care insurance has really gone up. If you are a baby boomer and you have kept your eye on it for a few years, chances are you have noticed this. Last year, the American Association for Long-Term Care Insurance (AALTCI) noted that married 60-year-olds would pay between $2,000-3,500 annually in premiums for a standalone LTC policy.[1]

Changing demographics and low interest rates have prompted major insurers to stop offering LTC coverage. As the AALTCI notes, the number of LTC policies sold in this country fell from 750,000 in 2000 to 105,000 in 2015. Today, only about 15 insurers offer these policies at all. The demand for the coverage remains, however – and in response, insurance providers have introduced new options.[1,2]

Hybrid LTC products have emerged. Some insurers offer "cash rich" permanent life insurance policies that let you tap part of the death benefit to pay for long-term care. Other insurance products feature similar potential benefits.[1,2]

As these insurance products are doing "double duty" (i.e., one policy or product offering the potential for two kinds of coverage), their premiums are costlier than that of a standalone LTC policy. On the other hand, you can get what you want from one insurance product, rather than having to pay for two.[3]

Another nice perk offered by these hybrid LTC products: sometimes, insurers guarantee that the premiums you pay will never rise. (Many retirees wish that were the case with their traditional LTC policies.) Whether the premiums are locked in at the initial level or not, the death benefit, coverage amount, and cash value are all, commonly, guaranteed.[3]

Hybrid LTC policies provide a death benefit, a percentage of which will go to your heirs. Do traditional LTC policies offer a death benefit? No. If you buy a discrete LTC policy, but die without needing long-term care, all those LTC policy premiums you paid will not return to you.[3]

The basics of securing LTC coverage applies to these policies. The earlier in life you arrange the coverage, the lower the premiums will likely be. If you are not healthy enough to qualify for a standalone LTC insurance policy, you might qualify for a hybrid policy – sometimes no medical exam is required. The LTC insurance benefit may be used when a doctor certifies that the policyholder is unable to perform two or more of the six activities of daily living (eating, dressing, bathing, transferring in and out of bed, toileting, and maintaining continence).[4,5]

> *"The earlier in life you arrange the coverage, the lower the premiums will likely be."*

These hybrid LTC policies usually require lump-sum funding. A single premium payment of $75,000-$100,000 is not unusual. For a high net worth individual or couple, this is no major hurdle, especially since appreciated assets from other life insurance products can be transferred into a hybrid product through a 1035 exchange.[2,3,4,6]

Are these hybrid policies just mediocre compromises? They have critics as well as fans. Detractors cite their two sets of fees per their two forms of insurance coverage. They also point out that hybrid LTC policies are not inflation protected, so the insurance benefit is worth less with the passage of time. Also, while the premiums paid on conventional LTC policies are tax deductible, premiums paid on these hybrid policies are not.[3]

Funding the whole policy up front with a single premium payment has both an upside and a downside. You will not contend with potential premium increases over time, as owners of stock LTC policies often do; on the other hand, the return on the insurance product may be locked into today's low interest rates.

Another reality is that many middle-class seniors have little or no need to buy a life insurance policy. Their heirs will not face inheritance taxes, because their estates will not exceed the federal estate tax exemption. Moreover, their children may be adults and financially stable, themselves; a large death benefit for these heirs is nice, but the opportunity cost of paying the life insurance premiums may be significant.

Cash value life insurance can be a crucial element in estate planning for those with large or complex estates, however – and if some of its death benefit can be directed toward long-term care for the policyholder, it may prove even more useful than commonly assumed.

** Guarantees are based on the claims paying ability of the issuing insurance company.*

A Primer for Estate Planning

Things to check and double-check.

Estate planning is a task that people tend to put off, as any discussion of "the end" tends to be off-putting. However, people without their financial affairs in good order risk leaving their heirs some significant problems along with their legacies.

No matter what your age, here are some things you may want to accomplish this year regarding estate planning.

Create a will if you don't have one. Many people never get around to creating a will, not even buying a will-in-a-box at a stationery store or setting one up online.

A solid will drafted with the guidance of an estate planning attorney may cost you more than a will-in-a-box, but it may prove to be some of the best money you have ever spent. A valid will may save your heirs from some expensive headaches linked to probate and ambiguity.

Complement your will with related documents. Depending on your estate planning needs, this could include a trust (or multiple trusts), durable financial and medical powers of attorney, a living will, and other items.

You should know that a living will is not the same thing as a durable medical power of attorney. A living will makes your wishes known when it comes to life-prolonging medical treatments, and it takes the form of a directive. A durable medical power of attorney authorizes another party to make medical decisions for you (including end-of-life decisions) if you become incapacitated or otherwise unable to make these decisions.

Review your beneficiary designations. Who is the beneficiary of your IRA? How about your 401(k)? How about your annuity or life insurance policy? If you aren't sure, then be sure to check the documents and verify who is the designated beneficiary.

When it comes to retirement accounts and life insurance, many people don't know that beneficiary designations take priority over bequests made in wills and living trusts. If you long ago named a child now estranged from you as the beneficiary of your life insurance policy, he or she will receive the death benefit when you die, regardless of what your will states.[1]

Time has a way of altering our beneficiary decisions. This is why some estate planners recommend that you review your beneficiaries every two years.

In some states, you can authorize transfer-on-death (payable-on-death) designations. This is a tactic against probate: TOD designations may permit the ownership transfer of securities (and in a few states, forms of real property and other assets) immediately at your death to the person designated.[2]

Create asset and debt lists. Does this sound like a lot of work? It may not be. You should provide your heirs with an asset and debt "map" they can follow should you pass away, so that they will be aware of the little details of your wealth.

***** One list should detail your real property and personal property assets. It should list any real estate you own and its worth; it should also list personal property items in your home, garage, backyard, warehouse, storage unit, or small business that have notable monetary worth.
***** Another list should detail your bank and brokerage accounts, your retirement accounts, and any other forms of investment, plus any insurance policies.
***** A third list should detail your credit card debts, your mortgage and/or HELOC, and any other outstanding consumer loans.

Think about consolidating your "stray" IRAs and bank accounts. This could make one of your lists a little shorter. Consolidation means fewer account statements, less paperwork for your heirs, and fewer administrative fees to bear.

"Keep in mind: money isn't the only reason for an estate plan."

Let your heirs know the causes and charities that mean the most to you. Have you ever seen bereavement notices requesting that donations be made to an organization or charity in lieu of flowers? If that's something you would like to happen, write down the associations you belong to and the organizations you support.

Select a reliable executor. Who have you chosen to administer your estate when the time comes? The choice may seem obvious, but consider a few factors. Is there a possibility that your named executor might die before you do? How well does he or she comprehend financial matters or the basic principles of estate law? What if you change your mind about the way you want your assets distributed – can you easily communicate those wishes to that person?

Your executor should have copies of your will, forms of power of attorney, and any kind of health care proxy or living will. In fact, any of your loved ones referenced in these documents should also receive copies of them.

Talk to the professionals. Do-it-yourself estate planning is not recommended, especially if your estate is complex enough to trigger financial, legal, and/or emotional issues among your heirs upon your passing.

Many people have the idea that they don't need an estate plan because they aren't "wealthy." Keep in mind: money isn't the only reason for an estate plan. You may not be a multimillionaire yet, but if you own a business, have a blended family, have kids with special needs, worry about dementia, or cannot stand the thought of probate delays, plus probate fees whittling away at assets you have amassed, these are all good reasons to create and maintain an estate planning strategy.

If you would like to further discuss any of the topics written about in this newsletter, or inquire about any of our other services, please feel free to contact us

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