How to Spend Down Assets to Limit Estate Taxes

A simple approach to pay less to the government and give more to those you love.

By:

Kathryn E. McGough, Esq.
CFP®
Wealth Advisor
kmcgough@tcwealthpartners.com
630-545-3657

Twentieth century advice columnist Ann Landers once wrote, “A person doesn’t know how much he has to be thankful for until he has to pay taxes on it.”

For a moment, a positive spin like Landers’ can help us reframe our thinking about taxes. Even so, no one likes to pay taxes. And there’s a special disdain of estate taxes, when we think of our loved ones not benefitting from the wealth we created for their future wellbeing.

If you have assets in excess of the estate tax exemption at a state or federal level (currently $4 million per person in Illinois and 11.7 million per person at the federal level), you’re going to be taxed.

The good news is a well-crafted estate plan, including a thoughtful spending plan, can help a family limit or even eliminate estate taxes due upon your passing.

In recent years, I met with a successful retired couple, who had not titled their assets properly based on their estate plan. We collected their assets in one place, worked with their attorney to title all of the assets in trusts, and discussed charitable gifting strategies.

When the husband passed away, the wife was able to maintain her lifestyle free of any tax burdens. A few years later, the wife passed away. Because of their planning, taxes due were minimal and assets were organized so that the process was easier for their children.

You too can make the process easier for your heirs with a thoughtful spending plan. Here’s how:

SPEND DOWN YOUR ASSETS

Let's say a Husband and Wife have total assets over $25 MM, and their main goal is to limit estate taxes. Each has an IRA, a ROTH IRA, a Revocable Living Trust ("Trust") and an Irrevocable Living Trust ("Irrev Trust"). The IRAs, ROTHs, and Trusts are all part of Husband and Wife's taxable estate.

But the Irrev Trusts are outside of the estate.

Husband and Wife have confirmed that all their accounts and property are titled correctly. This is a crucial step, but it is often overlooked.

Once it's confirmed that all assets are correctly labeled, then the two can follow these spending steps:

1. Husband and Wife should spend down the assets that are in their IRAs, ROTHs, and Revocable Trusts. The exact order among these accounts will vary yearly based on the Husband and Wife's age and estimated tax bracket for the year. For example, in a lower income year it may make sense to draw additional funds from the IRA accounts.

2. Husband and Wife should not spend from the Irrev Trusts unless needed. These assets are already out of the estate and will not be subject to estate tax on their passing. They should also look to invest growth assets in these accounts, because any growth on the assets is also excluded from their taxable estate.

3. In addition to funding their own spending needs, Husband and Wife can consider additional action to decrease the values of these accounts over time. One way to accomplish this is via gifting. Husband and Wife can gift to family annually.

   The current gifting limit is $15,000 per person per year. Husband can gift $15,000 and Wife can also gift $15,000 to each family member individually, or to an account in their name. They can even deposit 5-years' worth of gifts into a 529 plan for children or grandchildren's college expenses. Gifts can also be made to charities, including a family donor advised fund or charitable foundation.

   Any gifts should come from the assets currently held in the taxable estate.

When one spouse passes away, this spending order should be revisited. When Husband and Wife are making spending decisions, it is important that their advisor and attorney work together to confirm that the right assets are being accessed first. This will limit estate taxes due upon passing of each spouse, while also making this transition easier for the remaining family. And that is something to be thankful for.