PLANNING FOR YOUR ESTATE TAXES, NOW AND LATER

You may be surprised to learn that there are several ways you could end up paying unnecessary taxes after your death. Strictly speaking, you won't be the one paying. But your estate will, and that could mean your heirs won't receive the amounts you intend. Like most people, you probably would like to pay the taxes you owe — nothing more.

DECISIONS, DECISIONS — THINKING AHEAD

The time to plan is now. Because the tax code is so complex, our first suggestion is that you seek out qualified advice to make decisions that are in the best interests of you and your family.

Is it really that complicated? In short, yes. There are a variety of asset types, each of which may be taxed differently; you may wish to pass your assets to a variety of heirs, each of whom may be taxed differently; decisions you make now, and your heirs make later, have an impact; and there are at least two overarching tax laws that can come into play.

If you're like most people, your primary residence and your qualified retirement plan are your two largest assets. Some people also have an investment portfolio, real estate, collectibles, or other valuables. All of these are individual pieces of the puzzle. It's important to seek advice from someone who understands the complete picture, and can help you make decisions. Otherwise, your estate may be divided differently than you intend, and with a larger-than-necessary tax burden on your estate, meaning your heirs stand to inherit less than you expect.

When you discuss your estate planning goals with an expert, the big picture is important. Accounts with beneficiary designations and those without must be coordinated, to ensure your assets are distributed as you wish. For example, if you want to distribute 25% of your total estate to each of your four children, look at the big picture. You could divide all of your assets equally among the four, or you could pass one asset type that is valued at 25% of your total assets to each one of them. But that balance could shift as one asset type increases in value as compared to the others, so allowing an expert to help you is time and money well spent.

HOUSEKEEPING NOTE:

By making sure your beneficiary designations are up to date, you can help your money and other assets get where you want them to go. Anytime there is a major change in your life — birth, death, marriage, divorce, etc. — consider it a signal to update the beneficiaries on your retirement accounts, life insurance, bank accounts, annuities, and investment accounts. Think about your other assets, too, like cars, boats, valuables and sentimental items, and record those decisions in your will. By making sure you properly name beneficiaries, you can remove a needless (and unpleasant) surprise for your heirs.

Some of your assets will be valued as of the date of your death for future tax purposes. For example, real estate, collections, and closely held businesses (among others) can receive a step-up in value to your date of death. This is important so your heirs won't face capital gains taxes based on a gain they did not receive. If you bought your home in 1985 for $65,000, for example, and sold it on January 1, 2023 for $650,000, your capital gain would be $585,000,

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which could mean a substantial tax bill. But, if you died on January 1, 2023 and passed the home to your children, the step-up in value means they start with a tax basis of $650,000 and only pay capital gains taxes on an increase from that point.

Assets in a qualified retirement plan, such as a 401(k), 403(b) or an Individual Retirement Account, are taxed uniquely as compared with your other assets. If you die before receiving all of the money in these qualified plans, there are stringent rules that must be followed to maintain their tax-qualified status. Tax consequences may also differ depending upon who eventually receives the accounts. For example, if your spouse inherits your IRA, it becomes his or hers. They will need to follow the rules, such as taking annual Required Minimum Distributions once they reach age 72, or as mandated by current legislation.

If your children inherit the account, though, the rules are different. It's important to understand what the options are and how each will impact your heirs. In general, the person who takes a distribution from a qualified plan will be responsible for the taxes. If your IRA goes to your child who takes it out in a lump sum in the same tax year in which he or she earns a high salary, the tax burden could be significant.

As you go through your estate tax planning session, you'll need to consider at least two kinds of taxes: estate taxes and income taxes. Each type is complex, and how your estate is impacted will depend on the decisions you make today and those your heirs make after your death. An expert can help you sort it out, preserving your estate to the fullest extent possible.

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