

# 2016 Updates

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Each year certain income and estate tax thresholds increase. Throughout Principles of Estate Planning, Second Edition, some of the numbers referenced reflect the 2015 federal income and estate tax numbers. Several key numbers were changes beginning January 1, 2016:

- The federal gift, estate and GST tax exemption amount is \$5,450,000 per taxpayer. (Up from \$5,430,000 in 2015.)
- The Unified Credit or Applicable Credit is \$2,125,800 in 2016.
- The annual gift tax exemption amount remained at \$14,000 per taxpayer for 2016.

## Chapter 9

- Page 138. **Practitioner Tip:** A trust will be taxed at the highest rate of 39.6 percent when income exceeds \$12,400 in 2016, but a single taxpayer generally does not reach the 39.6 percent income tax rate until income exceeds \$414,050, and a married taxpayer does not reach the 39.6 percent income tax rate until income exceeds \$466,950.

## Chapter 10

- Page 161. **Client Situation:** In 2016, John transferred \$6,014,000 into an irrevocable trust for his daughter Gabrielle. Gabrielle can receive all of the income from this trust for life, and she can access the trust corpus without restriction. John can use an annual exclusion of \$14,000 to reduce the taxable gift to \$6 million. The gift tax on \$6 million is \$2,345,800, but John can apply his unified credit of \$2,125,800 to reduce his gift tax liability to \$220,000. John must pay the gift tax when he files his gift tax return, and the \$220,000 tax will be paid from his personal bank account. It is not paid from the \$6,014,000 transferred to the trust because the gift tax is tax exclusive. To date, John's gross estate has been reduced by \$6,234,000 (the sum of the gift and gift tax paid).

## Chapter 11

### Non-Citizen Spouse

- The 2016 annual exclusion for gifts to a non-citizen spouse is \$148,000 (up from \$147,000 in 2015). In the example with Victor giving his wife Juanita one-half of their home worth \$400,000, Victor's taxable gift will be \$52,000 in 2016.

### Estate Tax Calculation

- Page 185. Assuming the 2015 gifts were made in 2016, and Ed and Amy wanted to know how much of their unified credit remained after making those gifts, Ed and Amy would subtract the unified credit used (\$9,400) from the unified credit available (\$2,125,800). Each has \$2,116,400 of their unified credit remaining. No gift tax would be payable because their taxable gifts do not exceed \$5,450,000.

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**(Page 188) Example for 2016:** David gave his daughter Marsha a family heirloom worth \$6,014,000 today. Marsha agreed to pay the tax on the gift. After subtracting the annual exclusion, the taxable gift is \$6 million. This is David's first taxable gift. The tentative tax is \$220,000 (\$2,345,800 - David's unified credit of \$2,125,800). The gift tax paid by Marsha is \$157,143 ( $\$220,000 \div 1.40$ ).

The adjusted taxable gift on David's estate tax return IRS Form 706 is the net amount of the gift, \$5,842,857 (gift of \$6 million - \$157,143 gift tax paid by Marsha).

The gift tax credit on David's IRS Form 706 is \$157,143.

If David dies within three years of making this gift, the \$157,143 gift tax paid goes into his gross estate on IRS Form 706 under the gross-up rule.

The net value of the gift to Marsha is  $\$6,014,000 - \$157,143 = \$5,856,857$ .

David would have taxable income if the gift tax Marsha paid exceeded his adjusted basis in the property. David inherited the family heirloom, so there is no taxable income to report.

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### Chapter 12

- Remember that the GST tax exemption is \$5,450,000 for 2016, up from \$5,430,000 in 2015.
- The standard deduction and kiddie-tax exemptions remain unchanged for 2016.

### Chapter 14

- Remember that the estate tax exemption amount for 2016 is \$5,450,000, and the unified credit amount is \$2,125,800.

- Page 240. **Exhibit 14.7**

2016	Taxable Estate	\$6 million
Plus:	Adjusted taxable gifts	\$20,000
	Tentative Tax Base	\$6,020,000
	Tentative Tax on \$6,020,000	\$2,353,800
Minus:	Gift taxes paid on lifetime transfers	\$0
Minus:	Unified Credit	\$2,125,800
	<b>Estate Tax Due</b>	<b>\$228,000</b>

## ESTATE TAX CALCULATIONS NOTE:

### Example 1: Estate with No Lifetime Taxable Gifts

Joseph, recently divorced, died in 2016. His gross estate was \$5,990,000. Funeral and administrative costs totaled \$25,000. Debts and taxes totaled \$15,000. Joseph made no taxable gifts during his lifetime. The estate tax liability and the estate's cash requirements were computed as shown in Exhibit 14.8.

### Exhibit 14.8

#### Federal Estate Tax Worksheet with Cash Requirements

	1. Gross Estate		\$5,990,000
<i>minus</i>	2. Funeral and Administration Expenses	\$25,000	
	3. Debts and Taxes	\$15,000	
	4. Losses	\$0	
	<b>Total Deductions</b>	<b>\$40,000</b>	
<i>equals</i>	5. Adjusted Gross Estate		\$5,950,000
<i>minus</i>	6. Marital Deduction	\$0	
	7. Charitable Deduction	\$0	
	8. State Death Tax Deduction	\$0	
	<b>Total Deductions</b>	<b>\$0</b>	<b>\$0</b>
<i>equals</i>	9. Taxable Estate		\$5,950,000
<i>plus</i>	10. Adjusted Taxable Gifts		\$0
<i>equals</i>	11. Tentative Tax Base		\$5,950,000
<i>compute</i>	12. Tentative Tax	\$2,325,800	
<i>minus</i>	13. Gift Taxes Payable	\$0	
<i>equals</i>	14. Tax Payable Before Credits		\$2,325,800
<i>minus</i>	15. Tax Credits		
	a. Unified Credit	\$2,125,800	
	b. Credit for Tax on Prior Transfers	\$0	
	c. Credit for Foreign Death Taxes	\$0	
	<b>Total Reductions</b>	<b>\$2,125,800</b>	
<i>equals</i>	16. Net Federal Estate Tax Payable		\$200,000
<i>plus</i>	17. Total Cash Bequests		\$0
<i>equals</i>	18. <b>Total Cash Requirements</b> [(sum of lines 2 + 3) + Estate Tax Payable] = \$40,000 + \$200,000		<b>\$240,000</b>

## Example 2: Estate with Lifetime Taxable Gifts

Tina, a single woman, had a gross estate of \$6.8 million at the time of her death in 2015. Assume funeral and administrative expenses were \$60,000, and that debts and taxes totaled \$40,000. Tina made her first taxable gift of \$100,000 in 2013 (a \$114,000 gift to her niece minus the annual exclusion of \$14,000). The computation of Tina's estate tax and estate cash requirements is presented in Exhibit 14.9.

### Exhibit 14.9

#### Federal Estate Tax Worksheet with Cash Requirements

	1. Gross Estate		\$6,800,000
<i>minus</i>	2. Funeral and Administration Expenses	\$60,000	
	3. Debts and Taxes	\$40,000	
	4. Losses	\$0	
	<b>Total Deductions</b>	<b>\$100,000</b>	
<i>equals</i>	5. Adjusted Gross Estate		\$6,700,000
<i>minus</i>	6. Marital Deduction	\$0	
	7. Charitable Deduction	\$0	
	8. State Death Tax Deduction	\$0	
	<b>Total Deductions</b>	<b>\$0</b>	<b>\$0</b>
<i>equals</i>	9. Taxable Estate		\$6,700,000
<i>plus</i>	10. Adjusted Taxable Gifts		\$100,000
<i>equals</i>	11. Tentative Tax Base		\$6,800,000
<i>compute</i>	12. Tentative Tax	\$2,665,800	
<i>minus</i>	13. Gift Taxes Payable	\$0	
<i>equals</i>	14. Tax Payable Before Credits		\$2,665,800
<i>minus</i>	15. Tax Credits		
	a. Unified Credit	\$2,125,800	
	b. Credit for Tax on Prior Transfers	\$0	
	c. Credit for Foreign Death Taxes	\$0	
	<b>Total Reductions</b>	<b>\$2,125,800</b>	
<i>equals</i>	16. Net Federal Estate Tax Payable		\$540,000
<i>plus</i>	17. Total Cash Bequests		\$0
<i>equals</i>	18. <b>Total Cash Requirements</b> [(sum of lines 2 + 3) + Estate Tax Payable] = \$100,000 + \$540,000		<b>\$640,000</b>

### Example 3: Gross-up Rule

Russell made his first taxable gift in December 2013 of \$5.8 million. The exclusion amount was \$5,250,000 in 2013, so Russell had to pay a gift tax of \$220,000 after using his unified credit to offset the tax. Russell died in January 2016. Funeral and administrative expenses totaled \$25,000. Russell's estate had \$40,000 of expenses. The gift tax he paid in 2013 was included in his gross estate per the **gross-up rule**, (IRC § 2035), because the gift tax was paid within three years of his death. His gross estate in 2015 was valued at \$3.5 million. See Exhibit 14.10 for how the estate tax calculation was determined.

#### Exhibit 14.10

##### Federal Estate Tax Worksheet with Cash Requirements

	1. Gross Estate (includes gift tax paid within three years of death)		\$3,720,000
<i>minus</i>	2. Funeral and Administration Expenses	\$25,000	
	3. Debts and Taxes	\$40,000	
	4. Losses	\$0	
	<b>Total Deductions</b>	<b>\$65,000</b>	
<i>equals</i>	5. Adjusted Gross Estate		\$3,655,000
<i>minus</i>	6. Marital Deduction	\$0	
	7. Charitable Deduction	\$0	
	8. State Death Tax Deduction	\$0	
	<b>Total Deductions</b>	<b>\$0</b>	<b>\$0</b>
<i>equals</i>	9. Taxable Estate		\$3,655,000
<i>plus</i>	10. Adjusted Taxable Gifts		\$5,800,000
<i>equals</i>	11. Tentative Tax Base		\$9,455,000
<i>compute</i>	12. Tentative Tax	\$3,727,800	
<i>minus</i>	13. Gift Taxes Payable	\$220,000	
<i>equals</i>	14. Tax Payable Before Credits		\$3,507,800
<i>minus</i>	15. Tax Credits		
	a. Unified Credit	\$2,125,800	
	b. Credit for Tax on Prior Transfers	\$0	
	c. Credit for Foreign Death Taxes	\$0	
	<b>Total Reductions</b>	<b>\$2,125,800</b>	
<i>equals</i>	16. Net Federal Estate Tax Payable		\$1,382,000
<i>plus</i>	17. Total Cash Bequests		\$0
<i>equals</i>	18. <b>Total Cash Requirements</b> [(sum of lines 2 + 3 = \$65,000) + Estate Tax Payable] = \$1,382,000		<b>\$1,447,000</b>

### Example 4: Transfer under IRC § 2036

In November 2013, Shirley created a life estate in a home she inherited from her husband Rufus. She gifted the remainder interest in her home to her son Reggie. The present value of the remainder interest was valued for gift tax purposes at \$500,000. When Shirley died unexpectedly in March 2016, the fair market value of her home was appraised at \$4 million. Shirley also had \$2.5 million in cash at the time of her death. Her funeral and administrative expenses totaled \$30,000 and debts and taxes totaled \$30,000. (See Exhibit 14.11.)

#### Exhibit 14.11

##### Federal Estate Tax Worksheet with Cash Requirements

	1. Gross Estate (includes cash and the FMV of Shirley's home)		\$6,500,000
<i>minus</i>	2. Funeral and Administration Expenses	\$30,000	
	3. Debts and Taxes	\$30,000	
	4. Losses	\$0	
	<b>Total Deductions</b>	<b>\$60,000</b>	
<i>equals</i>	5. Adjusted Gross Estate		\$6,440,000
<i>minus</i>	6. Marital Deduction	\$0	
	7. Charitable Deduction	\$0	
	8. State Death Tax Deduction	\$0	
	<b>Total Deductions</b>	<b>\$0</b>	<b>\$0</b>
<i>equals</i>	9. Taxable Estate		\$6,440,000
<i>plus</i>	10. Adjusted Taxable Gifts (The \$500,000 gift of the remainder interest in her home is not included because retained life estates are included in the decedent's gross estate per IRC §2036.)		\$0
<i>equals</i>	11. Tentative Tax Base		\$6,440,000
<i>compute</i>	12. Tentative Tax	\$2,521,800	
		0	
<i>minus</i>	13. Gift Taxes Payable	\$0	
<i>equals</i>	14. Tax Payable Before Credits		\$2,521,800
<i>minus</i>	15. Tax Credits		
	a. Unified Credit	\$2,125,800	
	b. Credit for Tax on Prior Transfers	\$0	
	c. Credit for Foreign Death Taxes	\$0	
	<b>Total Reductions</b>	<b>\$2,125,800</b>	
<i>equals</i>	16. Net Federal Estate Tax Payable		\$396,000
<i>plus</i>	17. Total Cash Bequests		\$0
<i>Equals</i>	18. <b>Total Cash Requirements</b> [(sum of lines 2 + 3) + Estate Tax Payable] = \$60,000 + \$396,000		<b>\$456,000</b>

### Chapter 15

- Page 260. The 2016 annual exclusion for gifts to a non-citizen spouse is \$148,000 (up from \$147,000 in 2015).
- Page 264. In 2016, Howard could disclaim \$5,450,000 back to Laura's estate.
- **Question 15-5.** In 2016, Dirk would be able to disclaim \$5,450,000, not \$5,430,000. Otherwise the analysis remains the same.

### Chapter 16

- Because the federal estate tax exemption has increased (to \$5,450,000 in 2016) references to a married couples combined estate in 2016 should be \$10,900,000 (instead of the 2015 amount of \$10,860,000).

#### The Bypass Trust

- Page 272. The bypass trust would be funded with \$5,450,000 in 2016.
- Page 272. A trust will be taxed at the highest rate of 39.6 percent when income exceeds \$12,400 in 2016, but a single taxpayer generally does not reach the 39.6 percent income tax rate until income exceeds \$414,050, and a married taxpayer does not reach the 39.6 percent income tax rate until income exceeds \$466,950.

#### Power of Appointment Trust

- Page 275. In 2016, \$5,450,000 would be transferred to the trust benefitting Natalie, and \$6,550,000 would be subject to estate tax at Natalie's death.

#### QTIP Trust

- Page 276. In 2016, \$5,450,000 would pass to the bypass trust under Leo's estate. If \$5 million was transferred into a power of appointment trust, the remaining \$9,550,000 would be held in the QTIP trust paying Brenda trust income and passing to Leo's children following Brenda's death.
- Page 277. Assuming that assets did not appreciate at the time of Brenda's death, the \$5 million from the power of appointment trust and the \$9,550,000 from the QTIP trust would be included in Brenda's estate.

#### Portability

- Under the concept of portability, each spouse's applicable credit amount is \$5,450,000, therefore a couple with a combined estate of less than \$10,900,000 may not need to implement bypass trust planning.

- Page 279. If Mark had died in 2016 with a \$2 million gross estate and having made taxable gifts of \$1 million, his DSUEA would be \$2,450,000. Eileen would have her basic exemption amount of \$5,450,000 plus Mark's unused exclusion of \$2,450,000. She may use this \$7,900,000 exclusion against either lifetime gifts or it can be applied toward her taxable estate.

#### Bypass Trust with Equalization

- Page 281. In 2016, Kay's taxable estate would be reduced to \$2,094,200. When Michael died, \$5,450,000 was transferred into the bypass trust, and the remaining \$2,550,000 was left outright to Kay. When Kay died, the \$2,550,000 would be included in her estate and she would have a gross estate of \$10,550,000. The tax on her estate was \$4,165,000 reduced to \$2,040,000 after applying her unified credit.
- Page 284. **Practitioner Tip:** If Patty's net worth were \$9 million instead of \$5 million, \$5,450,000 would pass to the bypass trust and the remaining \$3,550,000 would pass either outright to Jim or to a marital trust for his benefit.
- **Figure 16.5.** In 2016, Patty's Bypass Trust would be funded with \$5,450,000 and Jim's Marital Trust would be funded with \$3,550,000. At Jim's death \$8,050,000 will be included in his gross estate

**Question 16-5.** Darnell died in February 2013 with a total gross estate of \$700,000, which he left to his wife Alicia in his will. Alicia married Jesse in October 2013, but Jesse's daughter Faith did not accept Alicia, and the strain of this marriage caused Jesse to die prematurely in January 2016. Jesse had a gross estate of \$4 million and had made prior taxable gifts of \$1 million. He left \$2 million to Faith and \$2 million to Alicia in his will. Alicia died in November 2016. What was Alicia's applicable exclusion amount at her death?

- A. \$2 million
- B. \$2,470,000
- C. \$5,470,000
- D. \$7,900,000
- E. \$10,900,000



**16-5 Answer: D.** Alicia's applicable exclusion amount is the sum of her basic exclusion amount of \$5,450,000 plus Jesse's unused exclusion of \$2,450,000 for a total of \$7,900,000. Jesse had an exclusion of \$5,450,000 at his death, but the \$1 million prior taxable gift and the \$2 million bequest to Faith reduced this amount to \$2,450,000. Alicia could not use Darnell's DSUEA because she had remarried and could use only her most recent spouse's exclusion.

### Chapter 17

- Page 294. Itemized deductions will begin to phase-out for single taxpayers with AGI exceeding \$259,400 in 2016, and married taxpayers with AGI exceeding \$311,300 in 2016.

### Chapter 18

- Page 316. In 2016, Doreen's state-level QTIP trust would be funded with \$3,450,000, and Shawn's Marital Trust would be funded with \$550,000. At Shawn's death \$6,550,000 would be included in his federal gross estate. \$10 million will still be included in his state gross estate.
- If Doreen and Shawn lived in a state that did not recognize QTIP planning, they would have to decide whether they wanted to shelter all of their available \$5,450,000 federal exemption amount and pay a state-level estate tax on the \$3,450,000 difference.
- Page 317. In 2016, the combined exemption amount is \$10,900,000.

### Chapter 19

- Remember that the GST Tax exemption amount is \$5,450,000 in 2016.

### Chapter 28

- Estate Planning for Same Sex Couples: On June 26, 2015, the United States Supreme Court ruled in the landmark case *Obergefell v. Hodges* that states must issue marriage licenses to couples regardless of gender, effectively making marriage equality the law of the land. Prior to the Court's ruling in *Obergefell*, in order to determine which rights were available to same-sex couples, it was necessary to consider whether the couple was legally married in a state that recognized same-sex marriage and whether they lived in a state that recognized their marriage. For same-sex couples living in a state that did not recognize their marriage, planning could be particularly complicated. Since the ruling in *Obergefell*, it does not matter whether a couple is same-sex or opposite sex – as long as they are legally married, their marriage is recognized and all of the rights, privileges and benefits of marriage extend to all married couples. *Obergefell v. Hodges*, 576 U.S. \_\_\_ (2015).

## ESTATE PLANNING FOR SAME-SEX COUPLES

Prior to the Court's ruling in *Obergefell*, in order to determine which rights were available to same-sex married couples, it was necessary to consider whether the couple was legally married in a state that recognized same-sex marriage and whether they lived in a state that recognized their marriage. For same-sex couples living in a state that did not recognize their marriage, planning could be particularly complicated. Since the ruling in *Obergefell*, it does not matter whether a couple is same-sex or opposite sex – as long as they are legally married, their marriage is recognized and all of the rights, privileges and benefits of marriage extend to all married couples.

### Federal Planning Considerations

The Supreme Court's rulings in *Windsor* and *Obergefell* extended hundreds of federal benefits to same-sex married couples. Some of these benefits include:

- The Social Security Administration affords benefits to same-sex married spouses. Spouses are entitled to receive retirement, survivor and disability benefits on their spouse's earnings record.
- Medicaid covers a nursing home stay for a same-sex spouse. For those couples in an unmarried domestic partnership, long-term care insurance may be considered as an alternative because a lien can be placed on a jointly owned home if a partner requires Medicaid assistance.
- Veteran and military spousal benefits are available for all eligible married couples.
- The Internal Revenue Service recognizes same-sex marriage in determining filing status for income and estate tax returns. Same-sex married couples will be required to file their federal income tax returns as a married couple. Further, they will be allowed the unlimited federal estate and gift tax marital deductions, to split gifts and to elect portability. Planning for a married same-sex couple will be the same as planning for a traditional married couple at the federal tax level. One important note, however, is that the couple – whether same-sex or traditional – must be legally married. For example, if a couple is in a registered domestic partnership or civil union, they will not be deemed married for IRS (and many other) purposes.
- US Citizenship and Immigration Services allows same-sex spouses to apply for visas or green cards.
- The US Department of Labor has extended Family Medical Leave Act benefits and benefits afforded under ERISA to same-sex married spouses. This includes benefits under retirement plans, including beneficiary rights afforded to spouses.