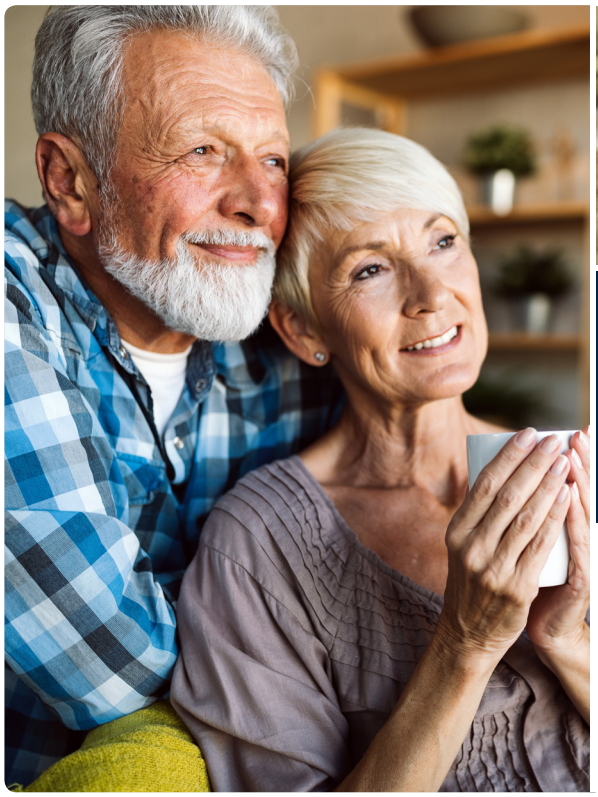

ADVANCED PLANNING

Tax Erosion

How Taxes Affect Your Assets at Death

Life Insurance

Prudential

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Tax laws are about to change. Are you ready?

Although you might not be concerned about being affected under current laws, if history has taught us anything, it's that the tax rules will most likely change in the future. For example, the federal estate tax laws alone have averaged one change almost every decade for over 200 years.

For this reason, it's imperative to have a plan in place to protect the wealth you've built. This guide will help you understand the taxes that have the potential to erode the value of your estate.

1. FEDERAL INCOME TAXES

HIGHLIGHTS	EXAMPLE
Assets such as traditional IRAs, 401(k)s, and deferred annuities have built-in income tax consequences called "income in respect of a decedent" (or IRD) when the owner dies. This income tax is paid by the recipient and not the estate (unless the estate is the beneficiary). Assets such as stocks or bonds that are sold when settling an estate may be subject to capital gains if they have appreciated in value since the date of death.	**IRA value of $1 million (part of overall $2 million estate)** • Federal income tax due: $290,000 (assuming 29% effective tax rate*) **IRA value: $5 million (part of overall $20 million estate)** • Federal income tax due: $1.75 million (assuming 35% effective tax rate*)

Almost everyone is affected by income taxes, especially if unused retirement funds are a significant part of the estate.

2. STATE INCOME TAXES

HIGHLIGHTS	EXAMPLE
Some states and the District of Columbia have an income tax rate that can be as high as 13.3% (California). Most do not have special rates for dividends and capital gains. States without state income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.	**PA residents: Same $1 million IRA from prior example** • $30,700 state income tax, in addition to the $290,000 federal tax **NY residents: Same $5 million IRA from prior example** • $395,000 state income tax, in addition to the $1.75 million federal tax (assumes 3.07% PA flat tax rate and 7.9% NY effective tax rate)

This tax would be in addition to any federal income tax. And 43 states have a state income tax.

3. FEDERAL ESTATE TAXES

HIGHLIGHTS	EXAMPLE
An individual's estate exceeding the exempt amount of $11.58 million is generally taxed at the top rate of 40%. The exemption amount for a married couple doubles to roughly $23 million.	**Married couple with $20 million estate** • Today: $0 federal estate tax • In 10 years: $2.8 million in tax (Assuming the exemption is then $13 million, they likely would pay 40% tax on $7 million.)

*The current exemption is set to be cut in half in 2026, subjecting many more taxpayers to this tax.**

4. INHERITANCE TAXES

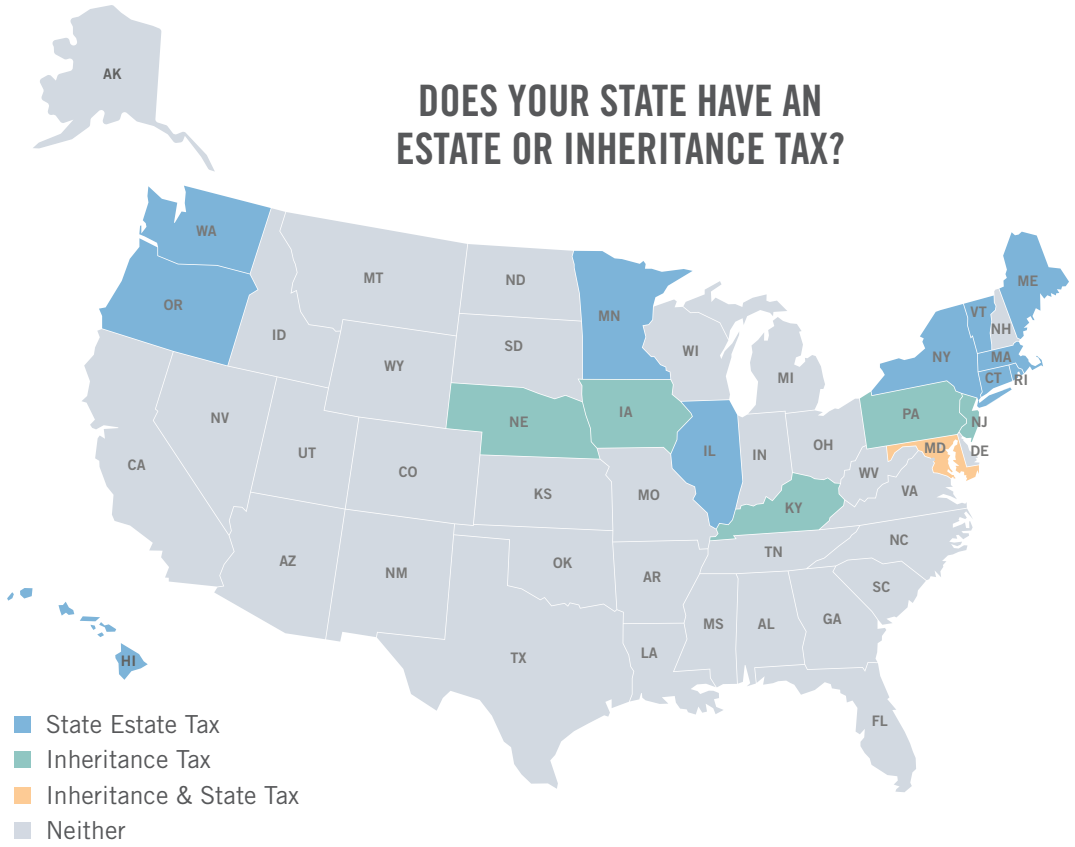
HIGHLIGHTS	EXAMPLE
Five states collect taxes on inherited property: Iowa, Kentucky, Nebraska, New Jersey, and Pennsylvania.	**PA residents leave entire $2 million net worth to adult child** • Inheritance tax: $90,000 (4.5%) • NY residents own a $3 million vacation home in PA • Inheritance tax if left to children: $135,000 (4.5%) • Inheritance tax if left to grandchildren: $450,000 (15%)

*Tax rates range from **1%** to **18%** depending on the state.*

5. STATE ESTATE TAXES

HIGHLIGHTS	EXAMPLE
The District of Columbia and 12 states currently levy an estate tax: Connecticut, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, and Washington.	**NY residents: Same $20 million estate from federal estate tax example** • Today: $2.7 million state estate tax, $0 federal estate tax • In 10 years: $2.7 million state estate tax PLUS $2.8 million federal estate tax = $5.5 million total (Assumes NY effective estate tax rate of 13.33% on the full value of the estate.)

The rate ranges from 0.8% to 20% (depending on state and estate size) and will be in addition to any federal estate tax. All states that impose this tax have their own exempt amounts.



6. FEDERAL GIFT TAXES

HIGHLIGHTS	EXAMPLE
Exempts up to $15,000 per year in gifts made by any individual to any number of other individuals (referred to as the annual exclusion from gift taxes). The federal estate tax exemption mentioned above, $11.58 million, is "unified" with the federal gift tax, meaning that you can use some or all this exemption during life.	Giving away an entire $20 million net worth today (using the couple's combined $23.16 million federal exemption) would leave them with $3.16 million of the federal exemption under today's exemption amount.

This is often the most ignored tax that can affect an estate.

7. FEDERAL GENERATION-SKIPPING TRANSFER TAX (GSTT)

HIGHLIGHTS	EXAMPLE
This tax results when there is a transfer of property by gift or inheritance to a beneficiary (other than a spouse) who is at least 37½ years younger than the donor, whether at life or at death. This typical "skip" person is usually a grandchild. The current federal GSTT rate is 40%. The current federal GSTT exemption is the same as for the estate and gift tax, $11.58 million. However, unlike the gift tax exemption, it is not automatically used when gifts are made. Taxpayers can elect to use it for gifts or leave it for their estate. If part of the GSTT exemption is used during life, the remainder will be available to the estate at death.	**Using the same $3 million vacation home left to grandchildren from the inheritance tax example** • Federal GSTT: $1.2 million, in addition to $1.2 million federal estate tax and $450,000 inheritance tax. (Total tax = 95% of home's value)

Unlike the "unified" system of gift and estate tax, the GSTT tax is in addition to gift or estate tax. Taxable generation-skipping transfers are taxed at a combined rate of 80%.

PUTTING IT ALL TOGETHER

Totaling the bill from all hypothetical examples we've provided, we can see the impact on the estates:

NET WORTH/ESTATE VALUE	$2,000,000	$20,000,000
Federal income tax	-$290,000	-$1,750,000
State income tax	-$30,700	-$395,000
Local income tax		-$193,800
Federal estate tax		-$2,800,000
State estate tax		-$2,700,000
Inheritance tax	-$90,000	-$450,000
Federal generation-skipping tax		-$1,200,000
Total Tax	**-$410,700**	**-$9,488,800**
Net to Heirs	**$1,589,300**	**$10,511,200**

These are hypothetical examples for illustrative purposes only. There is a federal estate tax deduction for state estate and inheritance taxes, not shown. In addition, recipients of income in respect of a decedent (IRD) are entitled to a certain federal income tax deduction based on federal estate tax paid on the inherited amount.

STRATEGIES TO HELP LESSEN THE IMPACT OF TAXES

To reduce or mitigate almost all these taxes, you can use certain strategies, such as:

- Evaluating the types of assets you have and how they will be taxed; exploring ways to diversify the taxation of your assets.
- Strategic gifting of highly appreciating assets to exclude future appreciation from estate tax.
- Creating trusts for a surviving spouse to avoid wasting state estate tax exemption amounts, lowering the size of the survivor's taxable estate.
- Allocating generation-skipping tax exemption to transfers to skip persons, such as grandchildren.
- Ensuring the estate has access to cash to avoid sale of appreciating, illiquid, or cherished assets.

LIFE INSURANCE CAN HELP ENSURE SUCCESS

Life insurance can be a very effective tool in the estate planning process and can help you:

- Provide your heirs with a death benefit that is generally income and estate tax-free (if structured properly).
- Provide liquidity to help pay any estate taxes that may be due.
- Ensure any outstanding debts are paid.
- Manage probate costs.
- Protect against potential creditor issues.

CALL YOUR FINANCIAL PROFESSIONAL TODAY.

Only taxpayers who are aware of all these rules and strategies may take full advantage of them. Make sure you're one of them by speaking with your financial professional.

*The 2026 federal estate tax exemption is scheduled to be $5 million, adjusted for inflation. As such, this is a projected estimate of the 2026 exemption and is subject to change and/or a different inflation calculation. This projection is shown for illustrative purposes.

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