ESTATE TAXES

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The Economic Growth and Tax Relief Reconciliation Act of 2001 has substantially liberalized the estate taxes that may be owed to the federal government beginning on January 1, 2002 through the end of December in the year 2010. The exemptions available under the old law in 2001 is $675,000. The new act increases the estate tax exemption beginning January 1, 2002 to 1 million dollars. It will remain the same 1 million dollars for calendar year 2003. In 2004 and 2005 the exemption equivalent is 1.5 million dollars. In 2006 through 2008 the estate tax exemption equivalent is 2 million dollars. In 2009 the exemption equivalent becomes 3.5 million. In 2010 the federal estate tax is abolished. However, in 2011, the estate tax exemption reverts back to 1 million dollars. The tax will be levied on the gross amount net of debts and expenses of probate administration and funeral bills of a decedent's estate less any amount that goes to a surviving spouse and is covered by the marital deduction.

Since January 1, 1980, Congress has provided for an unlimited marital exemption. This means that any assets in a deceased person's estate which go to the surviving spouse will not have any federal estate tax owed no matter what the size of the estate.

Starting in 2002 the highest estate tax bracket is 50%. The highest bracket declines under the law to 45% starting January 1, 2007. The estate tax rates have been and still are progressive, which means that they are bracketed just like the income taxes and the larger the value of an estate, the higher tax bracket is achieved and, therefore, more estate taxes are owed to the federal government.

The practical implications of the federal estate tax laws as they now exist are as follows:

First, there is no estate tax on any estate to the extent that the estate goes to a surviving spouse;

Second, if an estate is over the exemption amounts listed above and the estate does not go to a surviving spouse, the estate tax rates start at about one-third of any amount over the exemption, and escalate to increasingly higher percentages thereafter. This means that the government will normally tax estates when property passes from one generation to the next generation. If a husband and wife own everything in joint tenancy, because of the unlimited marital exemption, when one spouse dies, everything will go to the surviving spouse and there will be no tax. However, when the surviving spouse dies, the federal government will tax at a beginning rate of approximately one-third, everything over the exemption amount. Fortunately, with reasonable estate planning, it is possible to pass the amount of the exempt estate for each of the spouses to the next generation without paying any estate taxes. In addition, it is also possible to make lifetime gifts which will further reduce estate tax obligations.

The most common method of estate planning to avoid estate taxes is based on a very simple concept. Every person can transfer property at their death to anyone other than a spouse up to the level for that year below which there will be no federal estate tax. This means that both a husband and a wife each have a federal exemption. If a husband and a wife have a combined net worth of $2,000,000, and instead of owning those assets in joint tenancy, the husband and wife divide them so each spouse owns $1,000,000 of assets, each spouse can then make a simple will saying that when either of them dies, none of their estate will go to the spouse but it will all go to their children. If each of the spouses die after January 1, 2002, since each spouse has $1,000,000 of exemptions when both spouses die a total of $2,000,000 will have been transferred to their children without any estate taxes being paid. The same $2,000,000 going first to a surviving spouse and then to the children would result in a federal estate

tax in excess of $300,000 up until January 1, 2004.

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The problem with simply dividing a husband's and wife's assets in half and having each spouse make a simple will providing that each spouse's assets will go to the children is that most couples feel they have earned the equity in their estate by their joint efforts and they wish to ensure that the surviving spouse will have the benefits of all of the assets of both spouses' estates. In other words, most spouses want to give priority to a surviving spouse rather than have half of their combined estate go to their children immediately when one spouse dies leaving a surviving spouse. Fortunately, federal tax laws provide that a trust can be created either during a person's lifetime or by will upon their death so that when one spouse dies leaving a surviving spouse, whatever is in that spouse's estate can go to the children but be held in trust with all of the income paid over to the surviving spouse during his or her lifetime. The surviving spouse can also have almost complete control over how the deceased spouse's assets are invested.

Estate planning to avoid estate taxes can be very cost effective because investing a small amount of money to do the planning and prepare the appropriate documents is very small compared to the amount of federal estate taxes that can be saved. However, you should note that estate planning to avoid estate taxes requires a longer term outlook because it is necessary for the parents to invest money during their lifetime to create an estate plan which will not save the parents any money but will save substantial amounts of money for their children. It has been my experience that most Americans, even those who are very patriotic, do not wish to pay any more taxes than are essential, even if those taxes might be paid after their death. Estate planning to avoid estate taxes should be seriously explored by any husband and wife who have an estate over the estate exemption amount for that year and wish to organize their estate in such a way as to minimize the estate taxes that their children will otherwise have to pay. The cost of planning and implementing a plan to avoid estate taxes is very small in comparison to the estate taxes that can be saved.

There are other estate planning techniques which are available to anyone having more than the current estate exemption amount of net worth. Estate planning is simply another form of financial planning. For those people who planned well enough to have accumulated an estate above the estate exemption amount, it is no less important to do estate planning to avoid estate taxes when your estate transfers to your children. If you have a net worth in excess of the federal estate tax exemption amount, you should contact a person experienced in estate planning so that you can become fully aware of the estate tax liability your children will have and also be fully aware of what the options are to minimize or eliminate those estate taxes. Since the most common method of avoiding estate taxes is to cumulate the federal exemption that every person has under federal estate tax laws, it is essential for a family that this planning be done by both spouses during their lifetimes. If one spouse dies and no planning has been done, one federal exemption amount will have already been wasted. Nothing is so easy as putting off reasonable estate planning. However, for those who have an estate over the federal exemption amount, putting off the planning process runs a substantial risk. Once one spouse dies, the surviving spouse has far less flexibility in avoiding estate taxes.

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