Estate Planning and You - 4/17/2001
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It may surprise you that you are taxed twice in your life. First, you pay yearly income tax on all your gross taxable income. Finally, if you manage to put away a nice nest egg, you are taxed on your assets in your estate for estate tax. This estate tax is no wimpy tax. The maximum rate is a whopping 55% of your taxable estate. Finally, any assets in your name need to pass through probate, which can cost another 20-30% of your estate. You do get an exemption for the years 2002 and 2003 of $1,000,000. This may sound high to you, but if you add in all the net equity from your home and other real estate, your stocks and bonds, collectibles, cash, and life insurance at face value, you may easily exceed this exemption.

This can be deadly if you have a substantial pension plan or a small business such as a network marketing distributorship. With pensions, by the time your heir pay their income tax and estate tax, they can be as high as the 85% tax bracket; which means that they will keep only 15% of what you have. With small businesses, they may be forced to sell the business in order to raise the tax. Thus, what can you do to avoid some of these problems?

The good news is that many people can significantly eliminate estate tax and even probate if planned right in advance. The key is proper advance planning. The following are some of the major devices used by estate planners.

1.Annual Gifts: If you are single, you can make yearly gifts of $11,.000 per person without any gift or estate tax for the year 2002 . Thus, if you have 3 children and 3 grandchildren, you can make each of them a $11,000 gift to avoid the tax. In this case, it would be up to $63,000 per year gift tax-free. If you are married, you can give double this amount, which is $22,000 per person, per year gift tax-free. This may not be fair, but that's the law. You may, however, have to file a gift tax return noting the gift, although there will be no tax due if the amount given is equal to or less than the annual exclusion to any one person.

2.Insurance Trusts: The good news is that this is one of the simplest yet powerful estate planning tips that I can give. Sadly, 98% of all of you who are reading this probably do not have this type of trust. Although life insurance paid to some heir avoids probate, life insurance that is owned by you or paid by you is included in your estate at the full face value of the policy! It is so easy to avoid having insurance included in you or your spouse's estate. Set up an irrevocable insurance trust. This is a trust that you can't revoke that has the ownership of the insurance. All proceeds are paid to the trust upon your death. The trust either owns enough property to pay the premiums or you can fund the payments through the trustee of the trust. This trust will avoid probate, avoid all estate taxes upon your death (as long as you live at least 3 years after the transfer to the trust), and avoid all probate and estate taxes upon your spouse's death. Not bad! The cash can be used to pay any taxes owed on your business or on other property or for the support of your family. This is a major planning technique that most people should immediately institute.

3.Qualified Personal Residence Trust(QPRT): This is a special trust for your personal residence or residences if you have a vacation home. You would live in the residence for a period of years and after a set time limit the residences pass to your family. There would be a gift tax but the tax would not be on the full value of the house, just on the remainder interest. This interest would be valued by your accountant using life expectancy tables and will also depend on how long you have given yourself before the hours reverts to your kids. The shorter the time that you get the ownership in the house, the bigger the tax.

Example: Tom and Mary, age 65,set up a QPRT for their home, which is worth $500,000 net of all mortgages. If they choose to keep the ownership for 12 years, the value for gift tax purposes would be only $151,000.

Caution: Property held at death would get a step up in basis. Property given away gets a carryover bases. Thus, if Tom and Mary only paid $100,000 for the house, their heirs would get a basis of $100,000 plus any gift tax paid. This would not be a bad deal however, because the capital gains rates of 20% would be less than the estate tax and probate costs. One other note of caution is that you don't want to make the time that you keep control of the property too long. If you die before the expiration date of your life interest, the whole property may be brought back into the estate.

4.Use the Marital Exemption to the Max; One big mistake that many small business people and network marketing distributors make is to leave all their assets in their spouses name under joint ownership. They do this because jointly owned property avoids probate and all property left to the spouse gets an unlimited exemption from estate tax; thus, all estate tax is eliminated. Sounds like a good deal, right? Wrong! The problem is that when the spouse dies, he/she may have a major taxable estate since everything was left to them.

The better way is to set up a trust in the will and leave half the estate to the spouse in trust and the rest to the kids and utilize the $1,000,000 exemption. This way, upon your death, you have used the $1,000,000 exclusion and when your spouse dies the property will not be included in his/her estate because it is in trust. Have your lawyer examine the benefits of a marital trust.

5.Charitable Remainder Trusts: How would you like to get a major charitable deduction for your distributorship interest or stocks, not pay and capital gains upon sale of any of these items and keep a long-term income interest flowing through to you? You can with charitable remainder and annuity trusts. Here you would set up a trust that pays you for a number of years such as 10 or 20 years a fixed amount or fixed percentage of the assets. If the stocks or distributorship is sold to pay this amount off, you are not taxed on the sale. Upon your death, the assets go to a charity, which could be your own foundation. Thus, there is no estate tax. Not a bad deal! The only problem is that the assets used don't go to your family upon you or your spouse's death, but to the charity.

6. Revocable Trusts: Many people have heard about the wonders of these types of trusts that you can cancel at any time. Lets make one point clear: revocable trusts will not save estate taxes. All assets in these trusts are included in your estate. They do, however, allow for the avoidance of probate. The key is to have the assets titled in the name of the trust. It's that simple and of course, have a trust document drawn up by your lawyer.

There are a lot more techniques that time and space do not permit me to discuss; however, the planning opportunities to avoid most of the estate tax and probate costs are enormous. The key is that these plans must be implemented while you are alive! Don't make the mistake of putting off estate planning. Your family will pay the price!

Sandy Botkin is a CPA, attorney and former trainer of IRS attorneys nationwide. He lectures all over the nation on tax planning for self-employed and corporate taxpayers and can be seen in the big events with Donald Trump, Anthony Robbins and many others. He has been written up in Newsweek and in many other magazines. He is also a syndicated writer and noted author of this famed tape series "Tax Strategies for Business Professionals" and "Tax and Financial Strategies for Residential Real Estate." To find out more about Sandy and his products, check out his terrific small business web site at: www.taxreductioninstitute.com or by calling his office at 301-972-3600 in Maryland.