360 Degrees of Financial Literacy

MINIMIZE TAXES THROUGH ESTATE PLANNING

Through proper estate planning, you can have your assets distributed according to your wishes after your death. Successful estate planning transfers your assets to your beneficiaries quickly with minimal tax consequences.

Following is a general overview of estate planning. You should consult an attorney, CPA or tax adviser for additional guidance.

NOT JUST FOR WEALTHY

You may think estate planning is only for the wealthy. If your assets are worth $1.5 million or more, estate planning may benefit your heirs.

Generally, taxable estates worth in excess of the amounts in the chart below may be subject to federal estate taxes. By the time you account for your home, investments, retirement savings and life insurance policies you own, you may find your estate in the taxable category.

YEAR	EXCLUSION AMOUNT	HIGHEST ESTATE TAX RATE
2005	$1,500,000	47%
2006	$2,000,000	46%
2007	$2,000,000	45%
2008	$2,000,000	45%
2009	$3,500,000	45%

Even if your estate is not likely to be subject to federal estate taxes, you may need estate planning to ensure your assets are disposed of as you wish.

TAKING STOCK OF ASSETS

The first step in estate planning is to inventory and assign a value to everything you own. Here's a list to get you started. You may need to delete or add categories.

- Residence
- Other real estate
- Savings
- Investments
- 401(k), IRA, pension and other retirement accounts
- Life insurance policies and annuities
- Ownership interest in a business
- Motor vehicles (cars, boats, planes)
- Jewelry
- Other personal property

Once you've estimated the value of your estate, you're ready to plan. Keep in mind that estate planning is not a one-time job. There are a number of changes that may call for a review of your plan. Take a fresh look at your estate plan if:

- The value of your assets changes significantly.
- You marry, divorce or remarry.
- You have a child.
- You move to a different state.
- The executor of your will or the administrator of your trust dies or becomes incapacitated, or your relationship with that person changes significantly.
- One of your heirs dies or has a permanent change in health.
- The laws affecting your estate change.

HOW ESTATES ARE TAXED

Federal gift and estate tax law permits each taxpayer to transfer a certain amount of assets free from tax during his or her lifetime or at death. In addition, as discussed in the next section, certain gifts valued at $11,000 or less can be made that are not counted against this amount.

The amount of money you can shield from federal estate or gift taxes is determined by the federal unified tax credit. The credit is used during your lifetime when you make certain taxable gifts, and your estate can use the balance, if any, after your death.

Keep in mind that while you can plan to minimize taxes, your estate may still have to pay some federal estate taxes. What's more, your estate may be subject to state estate or inheritance taxes. An estate planning professional can provide more information regarding state taxes.

MINIMIZING ESTATE TAXATION

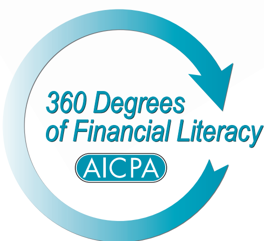
There are a number of estate planning methods that you can use to minimize federal taxes on your estate.

1. Give away assets during your lifetime. Federal tax law generally allows each individual to give up to $11,000* per year to anyone without paying gift taxes, subject to certain restrictions. That means you can transfer some of your wealth to your children or others during your lifetime to reduce your taxable estate.

For example, you could give $11,000 a year to each of your children, and your spouse could do likewise (for a total of $22,000 per year to each child). You may make $11,000 annual gifts to as many people as you wish.

You also may give your child or another person more than $11,000 a year without having to pay federal gift taxes, but the excess amount will count against the amount shielded from tax by your unified credit.

For example, if you gave your favorite niece $30,000



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MINIMIZE TAXES

a year for the last three years, you would have reduced your unified credit by $57,000 (a $19,000 excess gift each year).

** The $11,000 annual gift tax exclusion will be adjusted for inflation, as measured by the Consumer Price Index (CPI) published by the Department of Labor. The increases will be in multiples of $1,000. This exclusion applies only to a gift of a present interest in property. Therefore, gifts made intrust generally will not qualify for this exclusion.*

2. Shield property transferred to a spouse from taxes. Federal tax law generally permits you to transfer assets to your spouse without incurring gift or estate taxes, regardless of the amount. Marital deductions, however, may increase the total combined federal estate tax liability of the spouses upon the subsequent death of the surviving spouse. To avoid this problem, many couples choose to establish a bypass trust.

3. Bypass trusts or credit shelter trusts can give a couple the advantages of the marital deduction while using the unified credit to its fullest. Let's say, for example, that a married couple has a federal taxable estate worth $4 million (or $2 million each). Using the marital deduction, if one spouse dies in 2006 the full $2 million can be left to the other spouse without incurring taxes.

When the second spouse dies in 2007 and passes his or her $4 million estate on to their children, taxes will be levied on the excess over the amount of assets shielded by the unified credit ($4 million – $2 million = $2 million subject to estate tax).

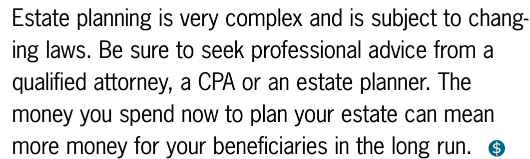
With a bypass or credit shelter trust, the first spouse to die can leave the amount shielded by the unified credit to the trust. The trust can provide income to the surviving spouse for life.

Upon the death of the surviving spouse, the assets are distributed to beneficiaries. This permits the spouse who dies first to fully use his or her unified credit.

4. Charitable gifts are not taxed as long as the contribution is made to an organization that operates for religious, charitable or educational purposes.

5. Life insurance trusts can be designed to keep the proceeds of a life insurance policy out of your estate and give your estate the liquidity it needs. Generally, you can fund a life insurance trust either by transferring an existing life insurance policy or by having the trust purchase a new policy.* With proper planning, the proceeds from life insurance held by the trust may pass to trust beneficiaries without income or estate taxes.

**Transferring an existing policy may have gift tax consequences. Consult your tax advisor.*



Estate planning is very complex and is subject to changing laws. Be sure to seek professional advice from a qualified attorney, a CPA or an estate planner. The money you spend now to plan your estate can mean more money for your beneficiaries in the long run.

(Adapted from a Federal Citizen Information Center pamphlet.)

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