Planning Your Estate

The Planning Process

A primary purpose of estate planning is to distribute your assets according to your wishes after your death. Successful estate planning transfers your assets to your beneficiaries quickly and usually with minimal tax consequences. The process of estate planning includes inventorying your assets and making a will and/or establishing a trust, often with an emphasis on minimizing taxes. This pamphlet provides only a general overview of estate planning. You should consult an attorney, or perhaps a CPA or tax advisor for additional guidance.

Do I Need to Worry?
You may think estate planning is only for the wealthy. If your assets are worth $1,000,000 or more, estate planning may benefit your heirs. That's because generally taxable estates worth in excess of the amounts in the chart below may be subject to federal estate taxes, with rates as high as 45% to 55% of the taxable estate.

Adding up the value of your assets can be an eye-opening experience. 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.

Even if your estate is not likely to be subject to federal estate taxes, estate planning may be necessary to be sure your intentions for disposition of your assets are carried out.

Taking Stock

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

- Residence
- Other real estate
- Savings (bank accounts, CDs, money markets)
- Investments (stocks, bonds, mutual funds)
- 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 do some planning. 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 $10,000 or less can be made that are not counted against this amount.) The amount of money that can be shielded 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. The balance, if any, can be used by your estate 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, which are beyond the scope of this pamphlet. An estate planning professional can provide more information regarding state taxes.

Minimizing Estate Taxation
There are a number of estate planning methods that can be used to minimize federal taxes on your estate.

Giving away assets during your lifetime.
Federal tax law generally allows each individual to give up to $10,000* 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 $10,000 a year to each of your children, and your spouse could do likewise (for a total of $20,000 per year to each child). You may make $10,000 annual gifts to as many people as you wish. You may also give your child or another person more than $10,000 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 a year for the last three years, you would have reduced your unified credit by $60,000 (a $20,000 excess gift each year).

* The $10,000 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 in-trust generally will not qualify for this exclusion.

The marital deduction shields 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. This is not, however, without its drawbacks. Marital deductions 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.

Bypass trusts or credit shelter trusts can give a couple the advantages of the marital deduction while utilizing the unified credit to its fullest. Let's say, for example, that a married couple has a federal taxable estate worth $2 million (or $1,000,000 each). Using the marital deduction, if one spouse dies in 2002 the full $1,000,000 can be left to the other spouse without incurring taxes. However, when the second spouse dies in 2003 and passes his or her $2 million estate on to their children, taxes will be levied on the excess over the amount of assets shielded by the unified credit ($2,000,000–$1,000,000 = $1,000,000 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, then upon the death of the surviving spouse the assets are distributed to beneficiaries, such as children. This permits the spouse who dies first to fully utilize his or her unified credit. If the trust document is drawn properly, the assets in the trust are not included in the surviving spouse's estate. Thus, the surviving spouse's estate will be smaller and can also utilize the unified credit. In the example above, the surviving spouse's estate would not have to pay federal estate taxes. Because both partners have made use of their unified credits, the couple is able to pass on a substantial estate tax free to their beneficiaries.

Charitable gifts are not taxed as long as the contribution is made to an organization that operates for religious, charitable or educational purposes. Check to see if the organization you want to give money to is an eligible charity in the eyes of the Internal Revenue Service. You, or your estate may be entitled to a tax deduction for contributions to a qualifying charity. Consult your tax advisor.

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.* To avoid inclusion in your estate, such trusts must be irrevocable—meaning that you cannot dissolve the trust or change the terms of the trust if you change your mind later. With proper planning, the proceeds from life insurance held by the trust may pass to trust beneficiaries without income or estate taxes. This gives them cash, which may be used to help pay estate taxes or other expenses, such as debts or funeral costs.

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

Estate planning is very complex and is subject to changing laws. This pamphlet by no means covers all estate planning methods. Be sure to seek professional advice from a qualified attorney, and perhaps a CPA or estate planner. The money you spend now to plan your estate can mean more money for your beneficiaries in the long run.

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