Coping With the New Estate Tax

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The estate tax looks like it's here to stay, so for most, careful planning to minimize the impact should be considered. The political shift in Congress has likely doomed any hope for complete repeal of the estate tax and now the issues on the table are who should be taxed and how much.

Under the peculiar current scheme, estates under $2 million are exempt now with this threshold rising to $3.5 million in 2009. The following year there is no estate tax. But then, starting in 2011, the full tax is back with rates ranging from 50-60% for estates over $1 million. This is a challenging landscape to navigate for planning purposes since the rate and the amount of tax is based on multiple uncertain variables like how long you live and what the tax will be. Perhaps Congress will provide some relief and adopt a new permanent exemption of some amount. Our concern remains that when the value of your home, life insurance, retirement plans and investments is added together, the tax applied at some point in the future may cut away a large piece of what you have saved. The most cautious approach may be that those who are likely to have taxable estates should put together a sound tax planning strategy and those with smaller estates just need to make sure that the basics are properly covered.

Can the estate tax be avoided? Depending on the type of assets you have and what your future needs will be, estate planning can indeed create some very large tax savings. Strategies vary from traditional to highly aggressive. The specific requirements for avoiding a tax on particular assets may be set out directly in the Internal Revenue Code or sometimes the rules may be subject to interpretation, bending and creative construction. Depending on what you want to accomplish and the amounts involved, you and your advisors can determine how far your planning should go.

What is taxed in your estate?

The estate tax applies to everything "owned" at death. Initially the concept is pretty simple because it certainly includes all property and accounts in your name. It gets a little fuzzier though because the term "owned" also includes property you've given away, when you have retained the right to use it or control it in some manner. A common example is giving money or property to your kids but retained too much control over how it's used or spent. If too many strings are attached, this property is included in your estate and subject to tax.

Another example involves life insurance. Even though you might not get any benefit from your life insurance policy, you are considered the owner if you are able to change

beneficiaries or exercise other particular powers. It doesn't matter whether the policy is term or whole life or variable, the full amount of the proceeds is added to your estate. Most of my clients have million dollar plus policies calculated to protect family members but if more than 50% of the proceeds is lost in taxes, the balance may not be sufficient to meet family needs.

Three Techniques to Consider

There are hundreds of strategies which effectively reduce or eliminate estate taxes but for now I'll mention three popular and longstanding vehicles which you can investigate further: 1- the Qualified Personal Residence Trust ("QPRT"), 2- the Irrevocable Life Insurance Trust (" ILIT") and 3- the Family Limited Partnership ("FLP").

Qualified Personal Residence Trust. The family home often represents a large part of the nest egg and you can judge whether it may be worth considerably more at some point in the future. A QPRT removes the value of the property from your estate and at the same time provides excellent asset protection. There is a detailed article about the workings of the QPRT at http://www.nysscpa.org/cpajournal/2005/1205/essentials/p52.htm.

Irrevocable Life Insurance Trust. The ILIT is a special trust, designed to hold your policies so the proceeds that go to your designated beneficiaries will pass free of estate taxes. You can read a more complete discussion of this at http://www.rjmintz.com/types-of-trusts/life-insurance-trust.

Family Limited Partnership. Think of the FLP as your holding company, to own and consolidate your investments. Interests in the FLP can be passed to your children or other family members at a discounted value which can produce very significant tax savings. It also has very strong asset protection features. A great amount has been written about the unique role of the FLP as a strategy to accomplish a variety of planning goals as you can see at http://www.rjmintz.com/family-limited-partnership/overview.

Conclusion

There are certainly other planning vehicles and possible solutions with varying levels of sophistication and complexity. Consider the amounts involved, your tolerance for risk and how a strategy impacts your current living standard and future goals. And certainly the wisest course is to consult with your tax advisors to make sure that the strategies you choose will properly accomplish all of your planning goals.