

Understanding Estate Taxes

The federal estate and gift tax law provides that a tax will be imposed on the *transfer of property* either as a lifetime gift or testamentary bequest at death by will, trust, joint title, or any other contract. Estate taxes are assessed over and above probate expenses and final income taxes. This is the "unkindest tax" because it is assessed against wealth accumulated after payment of income and capital gains tax.

ASSETS INCLUDED IN YOUR TAXABLE ESTATE

- BANK ACCOUNTS
- LIFE INSURANCE
- REAL ESTATE
- BUSINESS INTERESTS
- STOCKS & BONDS
- IRA's & PENSIONS
- PERSONAL PROPERTY
- CERTIFICATES OF DEPOSIT

If your net estate (assets less debts) is more than the exempt amount, federal estate taxes must be paid starting at 37% and run as high as 50%.

UNIFIED ESTATE & GIFT TAX

One of the most important concepts of federal estate and gift tax is that both taxes work in a unified law. Gifts made during a person's lifetime or property transferred on death are subject to a single graduated tax schedule. This tax begins at 18% for taxable gifts in excess of \$11,000 per year and increases to 37% on amounts over \$1,000,000 and finally to 55% on total gifts and bequests of more than \$3 million. The unified credit of up to \$1,000,000 may be used on lifetime gifts or bequests at death.

ANNUAL GIFT TAX EXCLUSION

During a person's lifetime, gifts of up to \$11,000 a year may be given to as many individuals as he or she wants and will produce no gift tax whatsoever. There is no need to even file a gift tax return. Gifts of any amount may be made between husband and wife without a tax. Gifts by a husband and wife to a third party (split gifts) are treated as if half the gift was given by each spouse. Married couples may then give an unlimited number of \$22,000.00 gifts per year without paying gift tax. Please note the \$11,000 per year gift exclusion is adjusted for inflation.

UNIFIED CREDIT

In addition to the annual exclusion of \$11,000, federal estate and gift tax credits are available for each person. This system is called the "unified credit" and is calculated on amounts in excess of an annual exclusion (\$11,000) up to a lifetime/death total, which in the year 2003 equals

\$1,000,000. The tax on a transfer of \$1,000,000 exactly matches the maximum unified credit available to offset the tax. Long story short, a person who dies in the year 2003 with an estate of \$1,000,000 may leave it to anyone free of tax. All amounts over \$1,000,000 are subject to estate tax. This amount of unified credit will go up each year as follows:

Year	Top Estate Tax Rate	Exemption Amount
2002	50%	\$1 million
2003	49%	\$1 million
2004	48%	\$1.5 million
2005	47%	\$1.5 million
2006	46%	\$2 million
2007	45%	\$2 million
2008	45%	\$2 million
2009	45%	\$3.5 million
2010	repealed	all
2011	55%	\$1 million, if no new legislation is passed

MARITAL DEDUCTION

There is a special unlimited deduction for transfers between husband and wife. In other words, spouses may give an unlimited amount of property to each other in life or on death without paying any estate or gift tax.

A slight twist on the marital deduction on death is a special trust called the qualified terminal interest property or "QTIP trust" which pays to the surviving spouse all current income and principal to maintain a standard of living. The QTIP trust is a powerful instrument in sophisticated estate planning and is often used to defer tax on first death but insures that certain assets go on second death to a specific group of beneficiaries such as your family.

GENERATION-SKIPPING TAX

In addition to federal estate and gift tax, a special tax is imposed on transfers that bypass one or more generations. This generation-skipping transfer tax is imposed on gifts and bequests to individuals in a second or subsequent generation (grandchildren, for instance). For example, a gift or bequest directly to grandchildren may be subject to a generation-skipping tax. The generation-skipping transfer tax also allows an annual exclusion of \$11,000 per beneficiary. In addition, the generation-skipping transfer tax allows a \$1,060,000 million lifetime/death exemption per donor. The lifetime exclusion will increase in tandem with the tax exclusion.

MISSOURI DEATH TAX

The federal estate and gift tax law coordinates with the Missouri state death tax. The Internal Revenue Code permits a credit against the federal tax for the amount of the death tax imposed by individual states, such as Missouri. Missouri has what is known as a "pick-up tax" which is

calculated as the allowable credit on the federal estate tax return. Because Missouri's tax is only the amount of the credit allowed against the federal tax, there is really no Missouri death tax which requires additional estate planning.

CONCLUSION

Benjamin Franklin said the only things certain are death and taxes. We can add a third: Congress continually alters the federal estate and gift tax laws, largely for political reasons. This constant changing of the law requires all individuals, as well as estate planners, to continually review and update financial plans. Additionally, the growth in the economy, and particularly the stock market, makes it imperative that everyone vigilantly monitor the size and planning of their estate. While estate and gift taxes are severe in amount, there are many opportunities for tax deferral and avoidance. Estate planning is an essential part of any family's financial well being.

REPEAL OF ESTATE TAX

There has been much discussion on the so-called repeal of estate taxes. It is important to remember the 2001 Tax Relief Act is not permanent. Additionally, the gift tax was retained and not eliminated. Expect Congress to continue changing these laws in the coming years.