Business

36.07 10305.19 Down 0.35 percent DOW | 1.98 1094.04 Down 0.18 percent S&P 500 | 2.68 552.35 Down 0.48 percent RUSSELL 2000

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Estate tax planning not just for the wealthy

By Arthur S. Littlefield
SPECIAL TO THE SUN

Whether you are a celebrity, a business owner, an executive or a professional, the estate planning lesson is the same: Careful planning can make a big difference in how much you leave to your heirs and/or charity. Estate planning techniques range from the straightforward to the complex, and you don't have to be a millionaire to take advantage of them.

The Internal Revenue Service reports that the number of taxpayers subject to estate taxes has risen every year in the past decade. Two primary reasons for this increase: Aging baby boomers are amassing wealth, reaching their peak earning power and emphasizing saving; and baby boomers are experiencing a tremendous intergenerational transfer of wealth. Over the next 20 years, a Cornell University study says, 77 million baby boomers will inherit more than $10 trillion dollars from their parents. The taxes owed on much of that money can be reduced with proper estate planning.

An effective estate plan and a business succession plan can protect your family and business from estate taxes. Under current law, you may leave an unlimited amount to your spouse using the marital deduction. You may also transfer up to $1 million (increasing to $1.5 million in 2004) in the aggregate to your other heirs tax free under the unified credit exemption.

Assets in excess of $1 million (increasing to $1.5 million in 2004) are subject to a steeply graduated estate tax of between 41 percent and 49 percent. But you and your spouse may forfeit an available exemption if one of you holds sole title to all of your assets, or if your assets are jointly owned with rights of survivorship (known as "joint tenancy").

Here is an example of minimizing the government's share of your estate: For a large estate, dividing ownership of your assets with your spouse can help ensure each of you have the opportunity to use your individual exemptions. This is achieved with a commonly used bypass or credit-shelter trust.

Suppose you and your spouse have a $2 million estate – half of which you each own separately – and establish a bypass trust in your will. At your death, your $1 million of assets go into the trust, with your children as the eventual beneficiaries. The trust may be designed to provide income to your surviving spouse and principal for living expenses. No estate taxes are owed when you die because of your available exemption.

Later, when your spouse dies, the trust assets will pass estate tax free to your children because the trust, not your spouse, is the owner. The other $1 million owned by your spouse can pass to your children's estate tax free due to your spouse's own $1 million exemption. The result is that after both you and your spouse have died, your children inherit $2 million with no federal estate taxes.

One last important point to be made about estate taxes relates to the common misconception that life insurance is tax free. If you have named your spouse as the beneficiary of a personally owned life insurance policy or a group life policy through work, then the death benefit paid to your spouse will be included in your taxable estate. However, this is not a tax concern at your death because of the unlimited marital deduction for passing assets between spouses. However, this death benefit may become an estate tax problem when your spouse's estate is passed on to the heirs. The inclusion of your life insurance death benefit and any death benefit from your spouse's life insurance policy (regardless of whom she named as beneficiary) will be included as part of your spouse's taxable estate. Unknowingly, the death benefit inclusion in the taxable estate may cause it to exceed the $1 million (increasing to $1.5 million in 2004) unified credit exemption. Amounts over the exemption will then become subject to the 41 percent to 49 percent estate tax. Life insurance death benefits are income tax free. However, they may be subject to estate taxes at the death of the second spouse if the exemption amount is exceeded.

There are many other estate planning strategies and concerns that may impact you. This is an area you don't want to tackle on your own, as an estate plan involves compliance with complex rules and tax laws.

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