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Estate Tax

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Estimating Estate Tax Liability

As the old saying goes, you can't cheat death or taxes. In fact, you might still owe taxes after you die! One of these taxes is the federal gift and estate tax (referred to here simply as estate tax). Generally, this is a tax that may be imposed on:



- Property you own at your death, plus
- Gifts you made during your life

Any U.S. citizen who leaves an estate in excess of the estate tax exemption amount (\$3.5 million in 2009) is subject to estate tax.

Estimating and planning for the estate tax may be important to you because, with rates as high as 45% (in 2009), this could be one of the largest expenses your estate may have to pay. It also means that a significant part of your estate may go to the government and not to your beneficiaries.

Caution: *Transfers of property you make to persons who are more than one generation below you (e.g., a grandchild or great-nephew) may also be subject to generation-skipping transfer tax (GSTT), a separate and additional type of federal gift and estate tax. Some states also impose their own gift tax, estate tax, and GSTT. These taxes are not discussed here, but you should take them into account when planning your estate. See your financial professional for more information.*

The federal unified tax system

Under federal law, all property transfers are taxed under a unified system. This means that lifetime gifts are reported and gift tax owed is paid annually. Upon your death, gifts are added back to your estate for estate tax calculation purposes, even though gift tax may have already been paid on them. Any gift tax paid is subtracted from estate tax owed. The result of this system is that you pay tax on the cumulative amount of wealth you give away, which effectively pushes your estate into a higher tax bracket.

Estimating and planning for the estate tax may be important to you because, with rates as high as 45% (in 2009), this could be one of the largest expenses your estate may have to pay.

Calculating estate tax

Estate tax is imposed on your net taxable estate, which is the value of your property when you die, plus certain gifts you make during life, reduced by various deductions.



A tentative estate tax is computed under the Unified Tax Rate Schedule, which is graduated; the larger the value of your net taxable estate, the greater the tax rate (much like your annual income tax). Credits and gift tax paid are subtracted from the tentative estate tax, resulting in the estate tax that is owed.

The estate tax calculation looks like this:

| | |
|---|---|
| | Value of Your Property When You Die (Gross Taxable Estate) |
| + | Certain Gifts You Made during Life (Taxable Gifts) |
| | Adjusted Gross Taxable Estate |
| - | Various Deductions |
| | Net Taxable Estate |
| x | Unified Tax Rate |
| | Tentative Estate Tax |
| - | Credits |
| - | Gift Tax Paid |
| | Estate Tax Owed |

Determining what is taxable

The first step in estimating estate tax is to determine what is taxable. This includes property owned by you (or deemed to be owned by you) at the time of your death (gross taxable estate), and certain gifts you make during life (taxable gifts).

Gross taxable estate

The gross taxable estate includes all property and property interests—of any description, wherever located—at the time of your death. This includes property that passes through probate and property inherited directly by joint owners or designated beneficiaries. Generally, your property includes:

- Real estate
- Personal property (e.g., cash, insurance proceeds, cars, furniture, jewelry, art objects)
- Intangible property (e.g., copyrights, patents)

Generally, the value assigned to each property item is the fair market value (FMV) on the valuation date, though other valuation methods may apply. Simply stated, FMV means the price at which property would sell for on the open market.

Tip: The valuation date is generally the date of death, but can be six months after the date of death if the executor makes a special election for this. This may be beneficial if property decreases in value during the six-month period. This may happen, for instance, if you own a small business that suffers because of your death.

Taxable gifts

Generally, taxable gifts are gifts made after 1976 that are not "qualified transfers" or transfers that qualify for the annual gift tax exclusion, marital deduction, or charitable deduction (these are all described in the following section). Generally, the value of a gift is the FMV of the property on the date the gift is made.



Now, add your taxable gifts to your gross taxable estate. The result is your adjusted gross taxable estate. Your calculation should look like this:

| | |
|---|--|
| Value of Your Property When You Die (Gross Taxable Estate) | |
| + Certain Gifts You Made during Life (Taxable Gifts) | |
| <hr/> | |
| Adjusted Gross Taxable Estate | |

Determining what isn't taxed

The second step in the estate tax calculation is to determine what isn't taxed. Certain amounts are excluded from, and deductions are subtracted from, your adjusted gross taxable estate. The result is your net taxable estate.

Technical note: An amount classified as an exclusion is one that need not be listed on the gift or estate tax return. Deductions, however, must be shown on the return.

The following exclusions are allowed:

- **Qualified transfers:** Qualified transfers are certain medical expenses and tuition that you pay on behalf of others. Payments must be made directly to the medical or educational provider, and other requirements apply.
- **Annual gift tax exclusion:** The annual gift tax exclusion allows you to exclude gifts of up to \$13,000 (2009 figure) per year made to each

and every person or organization. Certain requirements must be met to qualify for this exclusion.

Tip: The annual gift tax exclusion is indexed for inflation, and can be doubled (to \$26,000 in 2009) as long as the gift is made jointly by spouses.

- **Social Security benefits:** Any benefits payable to your heirs under the Social Security system are excluded from your adjusted gross taxable estate (unlike some life insurance or retirement plan benefits).
- **Workers' compensation death benefits:** Any benefits payable to your heirs under your state's workers' compensation law are excluded from your adjusted gross taxable estate.

An amount classified as an exclusion is one that need not be listed on the gift or estate tax return. Deductions, however, must be shown on the return.

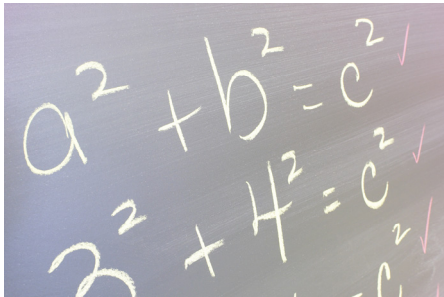
The following deductions are allowed:

- **Estate expenses:** Certain expenses incurred by your estate can be deducted from your adjusted gross taxable estate. These expenses include funeral expenses, administration expenses (e.g., executor's or administrator's fees, court costs, attorney's fees, appraiser's fees), certain debts of the decedent, certain taxes, certain claims against your estate, and casualty losses suffered during the administration of your estate.
- **Unlimited marital deduction:** If your spouse is a U.S. citizen, the unlimited marital deduction lets you deduct the value of property you give to your spouse, either during life or at death, from your adjusted gross taxable estate. Although this deduction is unlimited, only certain property interests qualify, and certain conditions and requirements must be satisfied.

Tip: Transfers to non-U.S. citizen spouses do not qualify for the unlimited marital deduction, but may qualify for a \$133,000 annual exclusion (2009 figure). This exclusion is indexed for inflation.

- **Charitable deduction:** The entire value of property you give to charity, either during life or at death, is deductible from your adjusted gross taxable estate. The gift must be to a qualifying organization and must be for a public purpose. Gifts to individuals, no matter how needy, do not qualify. Certain conditions must be met to qualify for this deduction, but the amount is not limited as it is with the income tax deduction.

- State death tax deduction: For the estates of persons dying in 2005 through 2009, state death taxes paid are deductible from the adjusted gross taxable estate. (For years prior to 2005, a state death tax credit was available. The credit is scheduled to be reinstated in 2011.)



Calculating the tentative estate tax

The third step is to deduct the allowable deductions from the adjusted gross taxable estate. The result is the net taxable estate. Multiply the net taxable estate by the unified tax rate under the published Unified Tax Rate Schedule. The result is your tentative estate tax owed.

This is what your calculation should look like at this point:

| | |
|---|--|
| Value of Your Property When You Die (Gross Taxable Estate) | |
| + Certain Gifts You Made during Life (Taxable Gifts) | |
| Adjusted Gross Taxable Estate | |
| - Various Deductions | |
| Net Taxable Estate | |
| x Unified Tax Rate | |
| Tentative Estate Tax | |

Deducting credits

Once your tentative estate tax has been calculated, there are credits available to apply against the tax.

- The applicable exclusion amount (formerly known as the unified credit): This credit (which is officially called an exclusion, but is often referred to and is understood as an exemption) allows you to pass a certain amount of your property free from estate tax. This credit effectively exempts \$3.5 million in 2009. When the estate tax is reinstated in 2011, the credit will effectively exempt \$1 million.
- Credit for gift taxes paid: You are allowed to

deduct the gift tax paid on taxable gifts included in your adjusted gross taxable estate.

- Foreign death tax credit: This credit is allowed for death taxes paid to a foreign country or U.S. possession on property included in your adjusted gross taxable estate and situated in that country or possession.
- Credit for federal estate tax on prior transfers: If your adjusted gross taxable estate includes property that was transferred to you by will, gift, or inheritance, and on which estate tax has already been paid, you may be entitled to a credit.

This is what your calculation should finally look like:

Achieving peace of mind

| | |
|---|--|
| Value of Your Property When You Die (Gross Taxable Estate) | |
| + Certain Gifts You Made during Life (Taxable Gifts) | |
| Adjusted Gross Taxable Estate | |
| - Various Deductions | |
| Net Taxable Estate | |
| x Unified Tax Rate | |
| Tentative Estate Tax | |
| - Credits | |
| - Gift Tax Paid | |
| Estate Tax Owed | |

Although estimating estate tax can be complicated, you can do it if you proceed step by step. Estimating estate tax is an important step in formulating and implementing a successful estate plan, and the peace of mind that comes with that should be worth your time and trouble.

Federal Estate Exemption Limits and Tax Rates

Current federal estate tax law (1) increases the estate tax exemption from \$2 million in 2008 to \$3.5 million in 2009, (2) imposes a top estate tax rate of 45 percent, (3) repeals the estate tax for 2010 only, and (4) reinstates the estate tax in 2011, with an exemption amount of \$1 million and a top tax rate of 55 percent.

| Year | Amount exempt from federal estate tax | Highest federal estate tax rates |
|------|--|--|
| 2008 | \$2 million | 45% |
| 2009 | \$3.5 million | 45% |
| 2010 | Federal estate tax scheduled to be repealed* | Federal estate tax scheduled to be repealed--no tax* |
| 2011 | Scheduled to revert to prior law* | Scheduled to revert to prior law* |

Dealing with estate planning uncertainty

There is uncertainty about the exact form the federal estate tax system will take in future years. However, it appears that individuals with estates valued at under \$1 million need not worry too much about federal estate taxes, those with estates between \$1 million and \$3.5 million should have some flexibility built into their plans, and those with over \$3.5 million need to implement plans now to avoid having to pay federal estate tax.

A word about federal gift tax

Although the federal estate tax is repealed in 2010, federal gift tax remains. The gift tax applicable exclusion amount is \$1 million. The gift tax rates follow the estate tax rates, except that the top gift tax rate in 2010 will be 35%.

*The previous federal estate tax will be reinstated in 2011 under the sunset provisions of the Tax Relief Act of 2001 unless Congress takes additional action. The top federal estate tax rate will be restored to 55%, and the federal estate tax exemption amount will return to \$1 million.

A word about state death taxes

The individual states also impose their own "death taxes," in the form of an estate tax or an inheritance tax, or both. Whether your estate will be subject to state death taxes depends on the size of your estate and the tax laws in effect in the state in which you are domiciled.

Also, be aware that Connecticut, Louisiana, North Carolina, Tennessee, and Puerto Rico impose their own gift taxes.

A word about generation-skipping transfer tax (GSTT)

GSTT is an additional tax imposed on property you transfer to an individual who is two or more generations below you (e.g., a grandchild or great-nephew). A flat tax rate equal to the highest estate tax rate then in effect (45% in 2009) is imposed on every generation-skipping transfer you make over the estate tax exemption amount (\$3.5 million in 2009).

Some states also impose their own GSTT.

Estate Tax Rate Schedules

2008 Estate Tax Rate Schedule

| Taxable Estate | Tentative Tax Equals Base Tax of | Plus | Of Amount Over |
|---|-------------------------------------|------|----------------|
| 0 - \$10,000 | \$0 | 18% | \$0 |
| \$10,000 - \$20,000 | \$1,800 | 20% | \$10,000 |
| \$20,000 - \$40,000 | \$3,800 | 22% | \$20,000 |
| \$40,000 - \$60,000 | \$8,200 | 24% | \$40,000 |
| \$60,000 - \$80,000 | \$13,000 | 26% | \$60,000 |
| \$80,000 - \$100,000 | \$18,200 | 28% | \$80,000 |
| \$100,000 - \$150,000 | \$23,800 | 30% | \$100,000 |
| \$150,000 - \$250,000 | \$38,800 | 32% | \$150,000 |
| \$250,000 - \$500,000 | \$70,800 | 34% | \$250,000 |
| \$500,000 - \$750,000 | \$155,800 | 37% | \$500,000 |
| \$750,000 - \$1,000,000 | \$248,300 | 39% | \$750,000 |
| \$1,000,000 - \$1,250,000 | \$345,800 | 41% | \$1,000,000 |
| \$1,250,000 - \$1,500,000 | \$448,300 | 43% | \$1,250,000 |
| \$1,500,000----- | \$555,800 | 45% | \$1,500,000 |
| 2008 credit shelter amount \$2,000,000 | 2008 credit amount \$780,800 | | |

2009 Estate Tax Rate Schedule

| Taxable Estate | Tentative Tax Equals Base Tax of | Plus | Of Amount Over |
|---|---------------------------------------|------|----------------|
| 0 - \$10,000 | \$0 | 18% | \$0 |
| \$10,000 - \$20,000 | \$1,800 | 20% | \$10,000 |
| \$20,000 - \$40,000 | \$3,800 | 22% | \$20,000 |
| \$40,000 - \$60,000 | \$8,200 | 24% | \$40,000 |
| \$60,000 - \$80,000 | \$13,000 | 26% | \$60,000 |
| \$80,000 - \$100,000 | \$18,200 | 28% | \$80,000 |
| \$100,000 - \$150,000 | \$23,800 | 30% | \$100,000 |
| \$150,000 - \$250,000 | \$38,800 | 32% | \$150,000 |
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| \$750,000 - \$1,000,000 | \$248,300 | 39% | \$750,000 |
| \$1,000,000 - \$1,250,000 | \$345,800 | 41% | \$1,000,000 |
| \$1,250,000 - \$1,500,000 | \$448,300 | 43% | \$1,250,000 |
| \$1,500,000----- | \$555,800 | 45% | \$1,500,000 |
| 2009 credit shelter amount \$3,500,000 | 2009 credit amount \$1,455,800 | | |

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