

ESTATE PLANNING

The purpose of estate planning depends on the type and size of estate. Where small estates are concerned, the primary purpose is whether the Decedent can provide for his family if he/she dies prematurely.

With large estates, the concern is the reduction of tax liability, in addition to the above. This may be accomplished by inter vivos (while still alive) gifts, trusts (both revocable and irrevocable), life insurance, and possibly restructuring the family business.

The federal government imposes a federal estate tax on the taxable estate of a decedent. In practical terms, the tax is assessed on the net estate (the estate that's left over after deductions for mortgages and liens, funeral expenses, attorney fees, etc.). Since there is a great temptation to give one's property away shortly before death (in order to avoid the estate tax), the government also imposes a Federal Gift Tax on inter vivos transfers (for less than full value). The rate of tax is the same for both gifts and estates, and the tax is called the Federal Gift and Estate Tax. There is a \$600,000.00 tax exemption of federal estate taxes, so net estates of less than this amount pay no tax. By properly planning your estate with, for example, a husband and wife "A-B Trust", a married couple can exempt up to \$1,200,000.00 net from estate taxes. (See current Federal Estate Tax tables for the present list of exemptions - Economic Growth and Tax Relief Reconciliation Act of 2001¹.) This type of trust contains at least two sub-trusts, variously called a "Marital Deduction Trust" and an "Exemption Trust". The general idea is to pass half of the trust property to the husband and wife's children on the death of the first to die (subject to the survivor's life interest in the property). The other half, then, passes at the survivor's death to the children. Since the exemption is \$600,000 per individual estate, the spouses have effectively given double that amount tax free.

In addition, federal law provides for an annual gift tax exemption of (presently) \$11,000 per donor per donee. By making effective use of the annual gift tax exemption, a mother and father can give \$44,000.00 to their son and his wife, and another \$44,000.00 to their daughter and her husband, for a total of \$88,000.00 per year. Over a ten year period of time, the spouses have lowered the value of their estate, and have no tax to pay on the amount of the gifts. There will be tax returns to file, of course, showing these gifts, but no tax will be applied.

¹	2001 Federal Estate Tax Exemptions:
2003:	\$1,000,000
2004:	\$1,500,000
2005:	\$1,500,000
2006:	\$2,000,000
2007:	\$2,000,000
2008:	\$2,000,000
2009:	\$3,500,000
2010:	NO TAX
2011:	\$1,000,000 (estate tax reinstated)

Further, there is an unlimited exclusion for tuition and medical expenses made directly to a rendering institution on behalf of another. So, mom and dad can pay junior's college tuition and medical expenses, as long as junior doesn't get his hands on it.

California's Inheritance and Gift Taxes were eliminated as of June 8, 1982, by Proposition 6, so for any person dying after that date there is no tax. However, California has imposed a "Pickup Tax", which is the commonly used name for the California Estate Tax. This tax is, in reality, a deduction on the federal estate tax form (form 706). Since the federal government allows the estate to deduct estate taxes paid to any state, California "picks up" this deduction. However, under the new tax relief act of 2001, the feds will be phasing out the state death tax credit, so that by 2005, it will be repealed!