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Estate Tax and Death

Many people do not understand the federal estate tax. Many people are also confused as to whether the executor of his/her estate will be required to pay estate tax. Proper estate planning can help eliminate and/or reduce the amount of estate tax that may become due upon your death.

What is estate tax?

Estate tax is a tax on your right to transfer property at your death. A decedent's gross estate is defined by the IRC § 2031(a) as the value of "all property, real or personal, tangible or intangible, where ever situated." Basically, it is an accounting of the fair market value of everything you own upon your date of death.

You can avoid paying estate tax if you choose to create an irrevocable trust. When the grantor puts property in an irrevocable trust, he/she permanently gives the property to another person, entity or charity. Since the grantor no longer owns the property upon the creation of the irrevocable trust, it is no longer part of his/her gross estate. Thus, it will not be subject to federal estate tax.

So what is my gross estate?

The total of everything you own is considered your "gross estate". Your gross estate can include: money, stock/securities, real estate, trusts, insurance, annuities, business interests, probate assets, and even non-probate assets. There are certain deductions, such as mortgage payments, charitable donations, estate administration expenses, business interest deductions, martial deductions, etc…that may apply to you so you can reduce the total value of your gross estate. Basically, the total of your gross estate minus any applicable deductions = your taxable estate. Next, calculate the value of any applicable lifetime taxable gifts and subtract them. At last, you arrive at the total of your taxable estate. If your estate exceeds the current unified credit, you will owe federal estate tax. The 2008 and 2009 estate tax rate is currently set at 45%.

What is the unified credit?

The unified credit is currently set at $2,000,000. This unified credit reduces the computed tax so that you will only be taxed on your taxable estate and any lifetime gifts, if this amount exceeds $2,000,000. The unified credit will increase to $3,500,000 in 2009. In 2010 – there is currently no established estate tax. However, in 2011, it is anticipated that the tax rate will increase to 55%.

If an irrevocable trust is not for you, there are other options. However, if you choose to create a revocable living trust, you will not avoid any income, estate or gift taxes. But you can incorporate standard trust provisions for saving estate and gift taxes in a revocable trust.

Moreover, there are great benefits to creating a revocable trust. You can avoid probate and the expenses thereto, it is confidential and it is effective immediately. A revocable trust is also used to manage your assets during your lifetime and thereafter. During your life you have complete control over the trust and the trust assets. You can also incorporate provisions into the revocable trust, as a means to reduce estate taxes, such as, the unlimited marital deduction and the $600,000 credit shelter exemption equivalent. This deduction allows an individual to give during life, or at death, an unlimited amount to a spouse, free of estate and gift taxes. All together, revocable trusts are an integral part of estate planning.

In conclusion, estate tax affects less that 5% of all American citizens. However, this should not deter you from creating your estate plans to protect your family and your assets.

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Estate Planning & Administration [1]
Probate [2]

Back to Articles [3]
