

Estate Planning - Estate Taxes

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Estate tax, or the death tax as it is sometimes referred to, is an issue often bandied about at election time. If the innuendoes of the sound bites are to be believed, the instant someone dies, the government collects a huge amount of tax from the estate just as a general principle. The specter of estate tax is looming in the corner of every hospital room in America, or so goes the story, waiting to deprive widows of their husbands' hard-earned pensions and children of their college funds, if Mr. X is not elected to Congress or the White House.

While it is true that a decrease in estate tax benefits the wealthiest two percent of Americans, it is also true that only the wealthiest two percent of Americans are subject to estate tax to begin with—at least under present law.

Estate taxes are taxes assessed on property transferred at the time of death. They are based on the gross estate, including real estate, insurance, trusts, annuities, cash, business interests, securities, and all other assets. The items are not assessed at their value at the time they were purchased, but rather at their fair market value at the time of death. For example, if you purchased a home for \$50,000 in 1970 and the value of the property has appreciated in the meantime to be worth \$175,000 based on sales of comparable properties in the same neighborhood, estate taxes would be assessed on the present worth of \$175,000.

Once the gross estate is calculated, applicable deductions are subtracted from that value. Deductions include property that passes to surviving spouses, mortgages and other debts, and estate administration expenses. In some cases the value of operating business interests or farms may be reduced, according to the IRS, "for estates that qualify." The value arrived at after deductions is referred to as the "taxable estate". Lifetime gifts are added back in and an available unified credit is applied before the estate tax is actually assessed. The good news for most of us is that your taxable estate, as an individual, must exceed \$1,000,000 for estate tax to apply, as the law currently stands.

The federal Tax Act of 2001 changed several provisions of the law regarding estate taxes. The rate at which estate taxes were assessed in 2001 was 55% of the gross estate less all applicable exemptions. The 2001 Tax Act began stepping estate taxes down gradually in 2002 to the present rate of 46% in 2006 and on down to 0% in 2010.

The premise behind the 2001 Tax Act is that some of the revenue lost to the U.S. Government through reduction and eventual abolishment of the estate tax will be recouped by capital gains taxes that your heirs will have to pay if and when they dispose of the property bequeathed to them. Prior to 2001, heirs automatically received a "full basis step-up" to fair market value on inherited property and did not have to pay capital gains tax when they sold the property. At present, heirs do not enjoy that benefit. If, for example, you paid \$60,000 for five acres of land in 1965 and you leave it to your son or daughter when you die. The son or daughter sells the land for \$200,000 in 2006 and has to pay capital gains tax on \$140,000, or the difference between what you paid for it at the time of purchase and the fair market value at the time it was sold.

Needless to say, estate tax issues are extremely complicated and, if you fall into the category of wealth that would require payment of estate taxes on your demise, be sure to discuss them with your attorney or other estate planner. Ronald Hudkins is a retired U.S. Army Military Police member that was assigned as a staff researcher. He has coordinated with military and criminal investigators, set on court marshals and worked closely with the Staff Judge Advocate General's Office (JAG). He has a keen sense of legal matters - their interpretation, initiatives and guidelines.

For imperative financial planning needs he suggests his book "Asset Protection and Estate Planning for All Ages." Additionally, he offers a Free Newsletter, Articles and Financial Newsfeed at his web site: <http://www.AssetProtectNow.com>