Don't Leave Your Estate Unprotected (part 1)

Dale Guest

Many who plan carefully to keep income taxes at a minimum don't give any thought to estate taxes. They assume estate taxes affect only the very wealthy. Not true. Currently, any estate worth more than $1 million may be subject to federal estate taxes, at rates up to 50%.

Some Basics

The federal estate tax is based on property value transferred at death. However, not all of your property will be taxed. Before estate tax is applied, your estate can deduct such items as estate administration fees, funeral expenses, valid debts, charitable contributions, and any bequests to your surviving spouse.

Also, every individual is allowed a credit that permits a certain amount of property to pass free of estate and gift tax. In 2002, the credit shelters up to $1 million. So, if your total *taxable* estate (after deductions) and your lifetime gifts total no more than $1 million, no federal estate tax will be due.

Under the Economic Growth and Tax Relief Reconciliation Act of 2001, the credit equivalent is scheduled to increase gradually, and the estate tax will be repealed in 2010.* But don't let that increase lure you into being complacent about your estate planning. Under the 2001 Act, the estate tax returns in 2011, and the credit equivalent returns to $1 million.

An Ongoing Process

Your estate plan may change considerably over time. While young and single, you might simply have a will. After marriage, you might have wills, own a modest home, and have joint bank accounts. When children arrive, you may select a guardian and make provisions to provide for children and spouse in the event of unexpected death or incapacity.

Once you begin to realize your financial goals, asset preservation and the avoidance of estate taxes become important factors in your estate planning. Accomplishing these objectives may require more sophisticated estate planning techniques, such as trusts.

Charitable Remainder Unitrusts

Lifetime gifts to qualified charities can provide income-, gift-, and estate-tax savings, and help organizations you want to support. If you would like to make a significant gift to charity, you might consider using a charitable remainder unitrust (CRUT) to make that gift. You can gain a current income-tax deduction in addition to removing assets from your estate for estate-tax purposes and potentially avoid capital gains tax on highly appreciated assets transferred to the trust.

An added benefit is that a charitable remainder unitrust pays you, you and your spouse, or another beneficiary you've chosen an income for life or for a period of years. The trust ends at the death of the last income beneficiary (or earlier, if that's what your trust document specifies), and the charity receives the trust property at that time.

The annual payments you'll receive from a CRUT are based on a fixed percentage (at least 5%) of the trust property's fair market value, recalculated annually. So, if the value of the trust property increases, your income increases — and vice versa. CRUTs are popular among retirees because they have the potential to provide supplemental retirement income, along with tax benefits.

*Unlike the estate tax credit, the gift tax credit equivalent is not scheduled to increase above $1 million.

Next week: additional estate planning techniques to consider.

Dale Guest, PHR, Cornerstone Financial Planning, is a registered representative and investment advisor representative of Lincoln Financial Advisors Corp., 917 2nd Street South, Nampa, phone 466-1971, offering insurance through Lincoln affiliates and other fine companies. *This information should not be construed as legal or tax advice. You may want to consult a tax advisor regarding this information as it relates to your personal circumstances.*

Don't Leave Your Estate Unprotected (part 2)

Dale Guest

This is the second of a two-part article. Last week we talked about why it is important to focus on your estate planning, and introduced charitable reminder unitrusts. Here are a few additional techniques to consider.

GRATs and GRUTs

Another way to potentially reduce estate taxes while retaining an income from property you have transferred is to use a grantor retained annuity trust (GRAT) or a grantor retained unitrust (GRUT). With a properly structured GRAT or GRUT, you can remove property, including future appreciation, from your estate for estate-tax purposes while retaining an income interest in the trust property for the term of the trust. When the trust ends, all the trust property goes to the beneficiaries you have chosen — your children or grandchildren, for instance.

Payments from GRATs and GRUTs are determined differently. A GRAT pays a fixed annual dollar amount. Payments from GRUTs, like those from CRUTs, can vary from year to year because they are based on a fixed percentage of the fair market value of the trust assets, recalculated annually.

To successfully reduce the value of your estate and reduce estate taxes, you must make an irrevocable legal commitment to transfer the GRAT or GRUT property to family members (or other beneficiaries) at a specified future date. In the interim, you retain an interest in the trust. When you create the trust, you'll have to pay any gift tax due on the *present value* of the property transferred, minus the value of your retained interest.

You must outlive the trust term to successfully remove the trust property from your estate. Thus, planning a GRAT or GRUT requires a thoughtful balancing of the trust term and tax effect. If you don't outlive the trust, however, your estate's tax status will be essentially the same as it would have been without the trust.

Irrevocable Life Insurance Trusts

Life insurance plays a part in most estate plans. Make sure you have coverage on your life that will allow family members to maintain their current lifestyle. For larger estates that may be subject to tax, life insurance can provide the funds needed to pay estate taxes — and, thus, avoid the liquidation of estate assets.

If you have substantial life insurance, you may want to create an irrevocable life insurance trust (ILIT) to help family members manage the proceeds and potentially reduce estate taxes. You can also use an ILIT in conjunction with a charitable remainder unitrust to replace the value of property given to charity. In this way, you can pass more assets to your children or other heirs free of estate tax.

With a life insurance trust, the trust is the owner and beneficiary of life insurance policies on your life. At your death, the trustee collects the proceeds and manages them for the benefit of your family or other beneficiaries. As long as the trust is properly structured, the insurance proceeds won't be included in your estate for estate-tax purposes. Please note that applications for insurance are subject to underwriting approval.

The proceeds of any insurance policies you transfer to a trust within three years of death, however, will be included. By transferring insurance policies to a trust while you are still in good health, you stand a better chance of avoiding the three-year rule. Or you can simply have your trustee buy new policies on your life.

Everyone's family and financial situation are different. So these estate-planning techniques may or may not be right for you. You'll want to consult with a professional financial adviser before implementing any of them.

Dale Guest, PHR, Cornerstone Financial Planning, is a registered representative and investment advisor representative of Lincoln Financial Advisors Corp., 917 2nd Street South, Nampa, phone 466-1971, offering insurance through Lincoln affiliates and other fine companies. This information should not be construed as legal or tax advice. You may want to consult a tax advisor regarding this information as it relates to your personal circumstances.