

MURRAY & YOUNG

An Accountancy Corporation Estate Tax Planning

Estate tax planning has never been a particularly popular topic because it's something that seems easy to put off for another day. Besides, didn't Congress do away with the estate tax a few years ago? The short answer is no. The federal estate tax was significantly (and gradually) scaled back because of the 2001 Tax Act and is scheduled to be repealed completely in 2010. However, between now and then, it is still very much with us (with a current per person exemption of \$1.5 million that will rise to \$3.5 million by 2009). Plus, unless Congress makes a change, the estate tax is scheduled to spring back to life in 2011 (with a reduced \$1 million exemption).

The IRS recently released some important guidance concerning a helpful estate tax planning opportunity for the relatively well-to-do. However, before we discuss this new release, let's cover some basic estate planning that should apply to nearly everyone.

With the current federal estate tax exemption covering up to \$1.5 million of property, single individuals (and married couples who are both U.S. citizens and who have combined assets of no more than this amount) may not need to do anything. They still need wills (to provide guardians for minor children and to direct the disposition of their assets), general powers of attorneys, and powers of attorneys for health care (in the event of a disability that prevents them from handling their own affairs), and perhaps a living will (or directive to physician). But, they probably don't need any fancy estate planning.

The catch (and isn't there always one?) is that circumstances can change or be different than you think. You may have more property subject to the estate tax than anticipated (including life insurance or a surprisingly large inheritance) or the federal estate tax exemption could drop back down to \$1 million. Thus, for most people it makes sense to take one or two basic estate planning steps.

For married individuals, the first objective is to make sure both spouse's estates benefit from the federal estate exemption (which again, is \$1.5 million at the moment). All other things being equal, this generally requires couples who hold separate (rather than community) property to try to make sure each spouse owns roughly the same portion of the couple's total assets, especially if their combined assets exceed \$3 million. It also typically requires that the couple's wills provide for what are referred to as credit shelter or by-pass trusts.

For single individuals and married couples alike, the next step up the estate planning letter is normally to make sure any significant life insurance policies are held in such a way as to keep the proceeds out of the insured's estate (usually using an irrevocable life insurance trust). If estate tax still looks like it will be due even after these moves, the next options up the complexity letter include family limited partnerships (FLPs) and intentionally defective grantor trusts (IDGTs). It was IDGTs that were the subject of the recent IRS guidance.

IDGTs get their name from the fact that they allow property (put in a trust) to be shifted out of a taxpayer's estate, while still taxing the grantor of the trust on the income earned by the trust. It has always been assumed that when the grantor paid the tax on this income that it wasn't treated as a gift to the trust beneficiaries nor would it cause the trust's property to be dragged back into the grantor's estate. If it works, an IDGT allows grantors to shift property (the tax payments made by the grantor on the trust's income) out of their estate and to their heirs without any gift or estate tax. But, the IRS had never officially said whether this technique works—until now. According to the IRS, as long as the trust doesn't have an obligation to reimburse the grantor for the taxes paid, no negative gift or estate tax issues result when the grantor pays the tax.

Although we've given you just a very brief explanation of some basic estate planning techniques and the new IRS guidance, we'd be glad to discuss any of these items in more detail with you if you'd like. Please feel free to give us a call.

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