Estate Planning Kit for the 1990s

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If you're like many people, estate planning is a chore that is being put off till tomorrow, and then the day after tomorrow. The problem is inertia and fear. There's the hassle of finding a lawyer, making difficult choices and plans. And worst of all, estate planning is associated with death. Who wants to deal with that?

But the price of procrastination is heavy. You're sacrificing your family's security. You're risking the hard earned assets that you've intended to leave for your children; your assets may end up, instead, in the hands of lawyers, court administrators, creditors or the IRS.

Dying Without a Will

Take, for instance, the simple estate planning tool of a will. Seven out of ten Americans at present do not have a valid will. If you die without a will, your estate will be divided according to the laws of your state, and not according to your wishes. Your home, or other assets, could end up in the hands of a total stranger. With a will, you decide who gets what of your estate.

Perhaps the most tragic result of dying without a will is that parents give up their say in who'll bring up the minor children if they both die. In such a case, courts are forced to decide the fate of the children.

Minimizing Your Taxes

A carefully drawn estate plan ensures the financial future of the family, particularly the special needs of the children or other members of the family. But you need to go beyond providing for the security of the family. You want to make sure that your estate is not unnecessarily depleted by taxes.

Recent changes in tax laws have done away with many of the popular techniques of the past to avoid taxes, but there are still plenty of opportunities left to reduce, even eliminate entirely, the tax bill so that your children will get the maximum inheritance due them.

The perils of not planning are substantial. Although you'll escape the federal estate tax entirely if your taxable estate is below $600,000, the tax on estates over $600,000 start at 37% and reach the punishing level of 55%. Inflation in real estate values has pushed many of the modest estates into taxable levels, and the whopping tax bill may come as a shock to your heirs.

Say your taxable estate is $700,000, barely above the zero tax level. The federal estate tax will get a bite of $37,000 before your heirs get anything. At $1,000,000, Uncle Sam will get $153,000. As you can see, this is no small matter to leave to haphazard planning. Fortunately, the tax law gives us plenty of loopholes.

Marital Deduction Loophole

The biggest loophole is reserved for married persons and is the so called 'unlimited marital deduction.' The government will let you give during your lifetime or bequeath at your death as much property as you wish to your spouse, all tax free. Without this loophole, the estate tax can be levied first, say, on the husband's death, and then again on the same property, when the wife dies.

That brings us to the problem of how to avoid tax on the death of the second spouse.

Pass Up To $1.2 Million Tax Free

A bypass trust (also called family or credit shelter trust) allows husband and wife to take full advantage of the individual $600,000 estate tax exemption and pass as much as $1.2 million tax free to the children. Under this arrangement, you'd transfer assets worth up to $600,000 to the trust tax free. The balance goes directly to your spouse, and due to marital deduction, there would be no estate tax on this transfer.

Your spouse will be entitled to the trust's income and usually up to $5,000 or 5% a year of the trust principal. For certain necessaries of life, he or she can even invade the trust for larger amounts. After your spouse's death, your children or other heirs will receive the trust assets. The beauty of this arrangement is that upon your spouse's death, as long as his or her own assets were less than $600,000, again there would be no estate tax.

Gift Loophole

Say your estate is worth $800,000. Without any planning, the federal estate tax could be as high as $75,000. How can you trim or eliminate this bill?

Fortunately, the tax law gives everyone a simple but powerful loophole. You can give as mush as $10,000 ($20,000 between husband and wife) a year to as many people as you wish and not pay any gift tax. You can also make tax free gifts of any amount to charities and unlimited payments to health care and educational institutions for a relative or friend's medical or tuition bills. A planned gift giving program can make sure that your children will be the beneficiaries of your estate, and not Uncle Sam.

Probate

A bigger problem than taxes is the problem of probate. When you pass your property to your heirs by a will (worse yet, without a will) it must go through probate. Probate is the legal process by which your will is proved valid in court. Your assets are inventoried, potential heirs notified, creditors paid off, tax returns filed, and finally, whatever is left is distributed to the heirs. In many cases, a lot has been taken out by attorneys, executors, court administrators and others. Attorney's fees, fixed as a percent of the gross estate, can run into thousands of dollars.

To cite just one example: To probate an $800,000 estate in California would cost $34,300 in executor's commissions and attorney's fees. You may find the inequity of such a fee structure appalling, but that's why probate is such a lucrative practice for many attorneys.

But this is not all. Depending on the complexity of your estate and the efficiency of the probate cost, the process can take anywhere from a few months to several years before the beneficiaries can receive their inheritances. There's, however, a solution.

Living Trust

You can avoid the agony of probate with a living trust. The trust would be revocable so that you can change its provisions at will or even eliminate it entirely. During your lifetime, you (and your spouse) remain trustee of the trust. The formal title to the assets is transferred to the trustee, and you maintain full control over these assets. Upon your death (or your spouse's later death) the assets are transferred to the beneficiaries without the hassles and costs of probate.

Minors' Trust

One of the basic aims in your estate planning is to provide security for your children. A prominent tool in this regard is the irrevocable 2503(c) minors' trust. Although the new laws have taken away some of the income tax benefits, there are still left considerable other advantages.

You can use such a trust to provide for your child's college education. You can keep the trust's income and principal out of the beneficiary's hands until he or she reaches the age of 21, when the child will be mature enough to handle the inheritance. The trust assets will stay out of your taxable estate and will escape federal estate tax. Estate planners point out that by splitting income between the trust and the minor, you still might be able to cut your income tax bill.

If you're concerned about providing for your children in the event of your untimely death and keeping the estate out of the hands of your spouse's future mate, "QTIP" trust is your choice. Your spouse will get lifetime income from the trust, but the principal goes to your choice of beneficiaries when your spouse dies.

Life Insurance Trust

Life insurance brings instant liquidity to your estate a relief that evades many a estates. You hear of "estate sales" which are designed to raise fast cash to pay estate taxes by selling real estate or other prized possessions at fire sale prices. Life insurance would take care of such an emergency.

But you also want to make sure that the life insurance proceeds are kept out of your taxable estate so that your family will have the full benefit of the instant liquidity. A life insurance trust will be an answer if you don't die within three years of setting it up. This is where you'll need expert advice. You want to make sure that you do not retain any "incidents of ownership," otherwise the IRS will come back and tax the insurance proceeds in your estate.

The Estate Planning Kit

✓ How to give money to your heirs so the creditors can't touch it. Look up "spendthrift provision" in the Kit. P. 125.

✓ Why you should not be the custodian of an account set up for the benefit of your children. P. 234.

✓ A planned gift giving program, say to your children, may help you reduce income taxes as well as minimize your estate taxes. P. 231.

✓ How to make a Will that will stand up to the scrutiny of courts, disgruntled heirs, the IRS and reduce estate taxes. Chapters 3, 4, and 5.

✓ Husband and wife die simultaneously in a disaster. "Unlimited marital deduction" may be lost unless their wills contain a proper "survivorship clause." Read the Kit and protect your kids from estate tax. P. 154, 371.

✓ Give an income producing property to a charity. Take a full deduction now for the income the charity will receive in the future. After 10 years, get your property back. Sounds good? It is. See Chapter 21.

✓ The law provides a special estate tax break for owners of closely held businesses. Few accountants and lawyers know about it. The Kit will tell you. P. 338.

✓ Probate is costly and time consuming. But there are times when you shouldn't avoid it. P. 114.

✓ If you make this mistake in your will, you could lose your marital deduction and incur estate taxes. P. 367, 371.

✓ The estate tax law allows each individual a credit of up to $192,800. However, the manner in which you and your spouse own the family assets may mean that part or all of this credit will be lost. The Kit shows you how to get the maximum benefit.

✓ Gifts. The law allows you to exclude $10,000 ($20,000 for a married couple) per donee per year from your estate. Are you using this provision to reduce your estate tax and income tax and avoid probate? The Kit shows you how. Chapter 19.

✓ Joint wills. Sounds simple and attractive but could cost a bundle in estate taxes. P. 369.

✓ Use life insurance in your estate planning. Get the additional benefit as "tax shelter" even under the new law. Chapter 16.

✓ Sell your home and avoid paying any capital gains tax. Know all the rules. P. 385.

✓ Planning to retire early? Use this worksheet to figure out what it will take. P. 314.

✓ Employing your children in the business can be a smart move. P. 384.

✓ Proper estate planning means minimizing the impact of three different kinds of taxes: income tax, gift tax and estate tax. The Estate Planning Kit shows you how you may achieve this.

✓ Annuity. Here's a way to make a gift of an asset, still receive income in the form of an "annuity" and reduce your gross estate. Chapter 22.

✓ Last minute estate planning can save your heirs a bundle. P. 309.

✓ Business owners, see Chapter 25. Real estate investors, see Chapter 26. Unmarried individuals, see P. 10.