Estate Tax Planning

Plan Early To Minimize Your Estate Taxes

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Death and taxes. Both may be inevitable, but there's no reason to allow the former to increase the latter. Taking steps while you are alive to reduce or eliminate any taxes on your estate can spare your heirs a lot of headaches and perhaps keep the family business intact.

Consider the cases of television producer Mark Goodson, retail king Sam Walton, publisher Malcomb Forbes, and Miami Dolphins owner Joe Robbie. Each was a savvy, successful businessman. But when each of them died, their families confronted enormous tax burdens that required selling family business assets to satisfy the Internal Revenue Service (IRS). More careful estate tax planning could have minimized those burdens. While few people are as affluent as those entrepreneurs -- the Robbie family reportedly faced an estimated $47 million estate tax bill and sold the Dolphins to pay it -- estate tax planning is an issue that's relevant for almost everyone.

Currently, the *estate tax credit* allows estates of $1,000,000 or less to pass from one generation to the next unencumbered by federal estate taxes that otherwise might range from 37 to 49 percent.

If a $1,000,000 estate sounds like a lot, consider that a home purchased in the late 1950s and shares of Merck common stock bought in 1960 could have a combined valuation today (because of appreciation and splits) of well over the $1,000,000 mark. When evaluating an estate, the IRS takes *everything* into consideration.

Many alternative estate planning vehicles can meet specific family needs. It's important to ask a competent professional to help organize your estate, however, as various details can determine whether you are able to accomplish what you intend.

The Need for Liquidity

Most individuals want to provide liquidity for heirs to pay estate taxes, minimize estate transfer costs, provide income for survivors, allow for business continuity, equalize estate inheritances among heirs, and preserve family wealth.

"Everyone needs estate planning of some type, and should have at least a simple will regardless of estate size," asserts Sonja Hayes, J.D., L.L.M., advanced marketing attorney for GenAmerica Financial Corporation, St. Louis, Missouri. "If you have minor children, you need to appoint a guardian."

Estate tax planning is simply " planning how much of your wealth goes to the IRS, and how much goes to your beneficiaries," Hayes says. "Assume the check will be written, you simply must decide who the payee is. The goal is to pass as much as possible to beneficiaries and as little as possible to the IRS. This is no simple task, considering that estate taxes are among the highest of all federal taxes."

Individuals with assets that are primarily *liquid* (i.e., bank accounts, stocks, bonds, cash) may need only basic planning, such as creating a will or a revocable trust that maximizes all available deferrals and exemptions. A revocable trust allows an estate to by-pass probate and enables you to appoint a successor trustee to manage your assets in the event you become incapacitated before death. But the assets in the trust, including insurance policies, are included when computing the value of the estate. People whose assets are tied up in illiquid investments (such as real estate or family businesses) have special needs, including at least some liquidity to pay any estate tax that might come due.

Establishing a Family Limited Partnership

The *family limited partnership* is a vehicle that helps meet such needs by offering three-fold benefits: It allows you to make a gift of assets to your heirs on a discounted valuation basis and, in so doing, reduces the size of your estate. Also, unlike other planning vehicles, it allows you to retain full control of your assets.

Hayes explains how this tax-reducing tool works: "Mom and Dad set up a family limited partnership. As the general partners, they transfer assets to that partnership, such as securities, real estate, or life insurance. Once they have placed assets in the partnership, they are free to transfer or `gift' those assets to their children or grandchildren in the form of limited partnership interests."

Because those limited partnership interests aren't readily marketable, they can be gifted with discounts in value that can range from twenty to fifty percent. Using thirty percent as the discount, that's roughly $14,000 in property that can be gifted by a parent to a beneficiary each year, instead of $11,000 under the annual exclusion.

Hence you can leverage that $1,000,000 estate tax credit into about $1.3 million of property transfer by using the discount. "By utilizing their estate tax credits equivalent, Mom and Dad could turn their joint credit equivalents of $1 million into $2.6 million of tax-free assets transferred to the children," Hayes points out.

Advantages of a Limited Liability Company

The *limited liability company* is quite similar to a family limited partnership. Limited liability companies are taxed as a partnership. Yet, unlike a partnership with potentially unlimited liability for its general partners, a limited liability company gives each member limited personal liability.

"LLC's are very popular with doctors, lawyers, and other professionals who may face liability concerns because of the nature of their business," notes Hayes. Like a family limited partnership, an LLC allows you to gift non-voting shares to children or grandchildren on a gift-tax leveraged basis and place an insurance policy in the company to pay estate taxes -- *without* counting the insurance in the valuation of the donor's estate. (Hayes recommends gift discounts that don't exceed thirty percent for both family limited partnerships and limited liability companies. "If they do, you're probably asking for trouble with the IRS.")

Develop Your Strategy Early

It's important to develop your estate tax strategy early; in other words, don't die without one. Begin by preparing an inventory of the assets you own and decide whom you want to benefit. Normally it will be your children, grandchildren, or a charity.

Inventory *all* your assets: insurance policies you own, as well as the value of Individual Retirement Accounts, qualified plans, pension plans, profit-sharing plans, vacation homes, farms, and residences. "Virtually everything is subject to estate taxes, so an estate rate reaches $1 million very quickly when IRA balances and life insurance policies are included," Hayes says.

Once you have completed your inventory and decided whom you want to benefit, see your accountant, attorney, or insurance agent. He or she should be able to determine how to pass on your assets without incurring any tax, incurring the least possible tax or by providing a vehicle to help pay any estate taxes.

"In most instances, through good, sound estate and liquidity planning, many taxes can be avoided," notes Hayes. "Many business owners put off estate planning until it's too late; then their children find themselves in a bind. If you don't do anything about estate tax planning during your life, you leave your family with very limited opportunities after your death."

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