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10 Ways to Reduce Estate Taxes

The Federal estate tax, which for 2006 through 2008 is imposed on estates exceeding $2 million, can be reduced through various legitimate estate planning techniques. Following is a list of ten methods you should think about as ways to reduce your estate taxes. There are also other methods which your estate planning attorney can advise you. The benefits and detriments of these various techniques vary greatly depending on the individual circumstances of the persons using them. Further, many individuals or families can benefit from the utilization of several techniques as part of an overall estate plan. An experienced estate planning attorney can help you to sort out the techniques and determine which are best for you.

Note: The personal exemption for estate tax (currently $2 million for 2006 through 2008) is scheduled to increase by increments until it reaches $3.5 million in 2009. The estate tax is scheduled to be repealed altogether for the year 2010, and beginning in 2011 Congress may extend the repeal or allow the currently-scheduled $1 million exemption to take effect. Remember that any time between now and 2010 Congress may also enact different legislation that overrides this schedule.

1.

MARITAL TRANSFERS. Except where a spouse is a noncitizen, neither lifetime gifts nor bequests at death to one's spouse are subject to estate taxes. However, the estate of the spouse will have to pay estate taxes on the spouse's entire taxable estate, including the amount transferred to the spouse pursuant to the lifetime transfer, at the spouse's death. Accordingly, this tool merely defers estate taxes; it does not entirely eliminate them.

2.

LIFETIME GIFTS TO CHILDREN AND GRANDCHILDREN. Each person can make annual gifts of $12,000 to any number of persons, typically children or grandchildren, without incurring a gift tax. If a husband and wife both engage in gifting, they can collectively give away $24,000 per year per recipient without incurring a gift tax. Over a period of several years the amount of money that can be transferred to a couple's intended beneficiaries under this method is substantial, thereby reducing the size of the taxable estate.

3.

UNIFORM TRANSFER TO MINORS. This is a form of gifting used where the children are still minors. The gift is given to a custodian for the benefit of the child, and is distributed to the child when he/she reaches the age of majority. As with other gifts, the annual exclusion for lifetime gifts is used under this approach.

4.

AB TRUSTS AND QTIP TRUSTS. For 2006 through 2008, each person is currently scheduled to have the first $2 million of his/her estate pass to his/her heirs without estate taxes. This is referred to as the "unified credit" or "personal exemption." An AB Trust is a trust designed to make sure the unified credit of each spouse is used to the full extent possible, while allowing the surviving spouse to have the use of the assets of the deceased spouse during the remainder of the surviving spouse's lifetime. A QTIP Trust permits a spouse to transfer assets to his/her trust while still maintaining control over the ultimate disposition of those assets at the spouse's death. QTIP Trusts are particularly popular in situations where a person is married for a second time but has children from a first marriage for whom he/she would like to reserve assets.

5.

IRREVOCABLE LIFE INSURANCE TRUSTS. By transferring small amounts of the estate (equal to the amount of a life insurance premium) to an irrevocable life insurance trust, a person can reduce the size of his or her taxable estate while creating a much larger asset (the life insurance proceeds) outside of the estate. The life insurance proceeds are generally not taxable.

6.

FAMILY LIMITED PARTNERSHIP. The family limited partnership provides a valuable estate planning tool to assist families in transferring ownership of family-owned closely held businesses to the next generation, and in protecting family assets from creditors. It also permits taxation of partnership income at the children's lower tax rates. Additional attractive features of the family limited partnership are flexibility and revocability.

7.

PRIVATE ANNUITY. A private annuity is a sale of an asset to a younger generation in exchange for an unsecured promise to pay annual amounts to the seller for the seller's lifetime. The sold asset is thus removed from the seller's estate, although the amounts of the payments to the seller (unless spent) will be part of the seller's estate.

8.

QUALIFIED FAMILY-OWNED BUSINESS INTEREST (QFOBI). The Internal Revenue Code permits a "qualified family-owned business interest" to be deducted from a gross estate. To qualify for the deduction, the following requirements must be met:

- The decedent or family members must have owned and participated in the business for at least five of the last eight years
- The business interest must make up at least 50 percent of the decedent's adjusted gross estate
- The decedent and his/her family must have owned 50 percent of the business
- The decedent must have been a U.S. citizen or resident
- The business must be located in the U.S.
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SPECIAL USE REAL ESTATE VALUATION. For federal estate tax purposes, real estate is usually valued at its "highest and best use" value. This can sometimes produce unfair results, such as where a family farm is located adjacent to more valuable commercial real estate. To address this unfairness, the Internal Revenue Code permits certain real estate to be valued at its "actual use" rather than its "highest and best use." Specific requirements must be met, so it is best to speak with an experienced tax attorney.

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CHARITABLE TRANSFERS. Lifetime charitable transfers or gifts to charities upon death can reduce the size of the estate and thereby reduce estate taxes. Lifetime gifts provide the added benefit of an income tax deduction. Gifts can also be made in a manner that lets the donor retain the right to use the gifted asset or income therefrom until death.

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