

Estate Taxes Are Voluntary

How to avoid huge estate taxes

By Cal Brown, CFP

Let's discuss something that is usually at the very bottom of your "to-do" list – reducing your inheritance (estate) taxes! This is not exactly the most exciting subject to think about. But there are people who should get very excited about this: the adult children of parents who will leave them a huge estate tax bill!

Many mature parents today have the attitude, "Well, I started with nothing, and even after my children pay the taxes, there will still be plenty left over. It's a heck of a lot more than we ever had!" If that is your attitude, then you can stop reading now. But if you are concerned that your children and grandchildren could get stuck with a bill from the IRS for 700,000 or more, then read on!

The good news is that Congress has changed the rules a bit regarding the amount you can pass to your children tax-free. The number increases every few years until 2010 and is currently set at \$1,500,000 for 2005. Unless the law is changed, it will increase to \$2 million in 2006. If your combined "gross estate" is less than that figure, you have no estate tax problem (and you can stop reading now!) But don't forget that your life insurance amounts must be included in the total. Also, if you own a small business, what value will the IRS place on it?

Your first step should be to contact an attorney who specializes in estate planning (not all attorneys do – similar to medicine, there are specialists in this complex field). The attorney can help you draft a special type of trust – called an "A-B" or "Credit Shelter" Trust. This document will double your exemption from \$1.5 million to \$3 million if you are married. And this will save your kids about \$700,000 in estate taxes!

If you own life insurance, you should remove it from your estate. How? The policy can be owned by another kind of trust – called an "Irrevocable Life Insurance Trust." The premiums can be part of your "gifting" program (you know, the \$12,000 per person you can give away each year tax free.) Instead of giving that money directly to your children, why not redirect the money to pay insurance premiums and leverage the value so that your \$12,000 gifts save them hundreds of thousands of dollars in estate taxes? These two simple steps could preserve up to 97 percent of your estate. Frankly, there is no reason that your family should have to cough up 30 to 50 percent of the value of your estate in taxes if you have a solid estate plan.

Estate taxes are voluntary. There is a way to set things up so the IRS gets nothing. How? Specify in your will that everything above \$1.5 million should be donated to your favorite charity. That may sound ridiculous, but it illustrates a very important point: it is possible to totally eliminate estate taxes. Regarding your family, the government, and charities, remember that you have the power to decide how much each of those groups will receive.