

# Estate Taxation

Lions and tigers and bears . . .

Ever since the estate tax was instituted in 1916, whatever an individual owns has been subject to the federal estate tax upon his or her death – until 2010, that is. The estates of those dying during that year were entirely free from federal taxation because Congress could not reach an agreement extending the federal estate tax in some form. An agreement was finally reached at the end of 2010 that cemented the federal estate tax rules for 2011 and 2012. If Congress fails to act before the end of 2012, the rules for 2013 will revert to the provisions prevailing in 2001. For 2011 and 2012, the tax rate on estates is 35 percent (see chart below).

That said, not all estates will be taxed. First, spouses can leave any amount of property to their spouses, if the spouses are U.S. citizens, free of federal estate tax. Second, the estate tax applies only to individual estates valued at more than \$5.12 million (\$10.24 million for couples) in 2012 (see chart). The federal government allows you this tax credit for gifts made during your life or for your estate upon your death. Third, gifts to charities are not taxed.

The heirs of those dying in 2010 will have a choice between applying the new rules for 2011 and 2012 or electing to be covered under the rules that applied in 2010 – no estate tax but only a limited step-up in the cost basis of inherited assets. The law for 2011 and 2012 also makes the estate tax exemption “portable” between spouses. This means that if the first spouse to die does not use all of his or her \$5 million or \$5.12 million exemption, the estate of the surviving spouse may use it. So, for example, John dies in 2011 and passes on \$3 million. He has no taxable estate and his wife, Mary, can pass on \$7 million (her own \$5 million exclusion plus her husband’s unused \$2 million exclusion) free of federal tax. (However, to take advantage of this Mary must make an

“election” on John’s estate tax return. Check with your attorney.)

<b>Tax Year</b>	<b>Tax Rate</b>	<b>Exemption Equivalent</b>
2009	45%	\$3,500,000
2010	N/A or 35%	N/A or \$5,000,000
2011	35%	\$5,000,000
2012	35%	\$5,120,000
2013	55%	\$1,000,000

The currently high federal estate tax exemption, coupled with the portability feature, might suggest that “credit shelter trusts” (also called bypass or AB trusts) and other forms of estate tax planning are needless for other than multi-millionaires, but there are still reasons for those of more modest means to do planning, and one of the main ones is *state* taxes. Nearly half the states also have an estate or inheritance tax and in many cases the thresholds are far lower than the current federal one. Many states used to take advantage of what was known as a “sponge” tax, which ultimately didn’t cost your estate. The way this worked was that the states took advantage of a provision in the federal estate tax law permitting a deduction for taxes paid to the state up to certain limits. The states simply took the full amount of what you were allowed to deduct off the federal taxes. However, the allowable state deduction was phased out under the Bush tax cuts enacted in 2001, and it disappeared entirely in 2005. This means that many states are changing their estate tax laws to make up the difference, and more changes at the state level can be expected as state politicians react to the new federal estate tax landscape. These changes may call for a restructuring of your estate plan; check with your attorney.

### *Making Gifts: The \$13,000 Rule*

One simple way you can reduce estate taxes or shelter assets

in order to achieve Medicaid eligibility is to give some or all of your estate to your children (or anyone else) during their lives in the form of gifts. Certain rules apply, however. There is no actual limit on how much you may give during your lifetime. But if you give any individual more than \$13,000 (in 2012), you must file a gift tax return reporting the gift to the IRS. Also, the amount above \$13,000 will be counted against a \$5 million lifetime tax exclusion for gifts. (This exclusion was \$1 million for many years but was raised to \$5 million in 2011 and \$5.12 million in 2012.) Each dollar of gift above that threshold reduces the amount that can be transferred tax-free in your estate.

The \$13,000 figure is an exclusion from the gift tax reporting requirement. You may give \$13,000 to each of your children, their spouses, and your grandchildren (or to anyone else you choose) each year without reporting these gifts to the IRS. In addition, if you're married, your spouse can duplicate these gifts. For example, a married couple with four children can give away up to \$104,000 in 2012 with no gift tax implications. In addition, the gifts will not count as taxable income to your children (although the earnings on the gifts if they are invested will be taxed).

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## Estate Planning Fees

How much do you charge for estate planning documents?" or "How much does a will cost?" These are the most asked questions of estate planning attorneys. Fees generally are less than you fear but more than you wish to pay – but hey, you're not buying a flat screen tv here. It really IS about your

family's security, and estate planning costs are a significant financial commitment for most clients.

Wherever possible, however, we try to charge a predetermined or "flat" fee that takes into account the time spent in an initial conference with you as well as later conferences, whether in person or by phone, and the necessary time to draft and revise all documents. But note that I said "whenever possible." In many years of experience I have encountered a wide variety of situations: Clients are both old and young; married to the same person for many years, or divorced three times; wealthy and very poor; come from dysfunctional families or have a close-knit family, etc. Estate planning is the process of evaluating your specific financial and family circumstances and preparing appropriate documents that will comply with your dispositive wishes and minimize taxes.

Because of the variety of persons and situations, I tell clients that after the initial consultation, I will be able to evaluate their needs and answer the question "How much will it cost." Although we have [standard estate planning fees](#), situations that do not fit neatly into these "Plans" will require a different fee quote.

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## Estate Planning FAQ

### Why should I pay a lawyer a lot of money for some simple documents?

You can buy software that produces most of the estate planning documents an attorney will prepare for you. Using such

documents could turn out all right for you and your heirs, but things could go horribly wrong as well, and you'll never know if you did it right until it's too late. You could end up paying a nursing home unnecessarily or your heirs could pay unnecessary taxes or expend legal fees fighting each other.

Only a qualified attorney can educate clients on what issues they should be aware of in their individual circumstances and then recommend appropriate language to deal with the client's specific situation. Do you have a taxable estate? Do you own significant amounts of tax-deferred retirement plans? Do you know how to fund the revocable trust provided on the computer program? Is there anything about your estate that is unusual, such as having a disabled child? In short, if there's anything about your situation that's not plain vanilla, you need to see a lawyer. And only a lawyer can determine whether your situation qualifies as "plain vanilla." As with joint accounts, the problems you may create by not getting competent legal advice probably won't be yours, but may well be your children's. Do you want to risk leaving that legacy?

For more on this subject, see my article, ["Should You Do It Yourself?"](#)

## **Can the attorney-in-fact be compensated for his or her work?**

Yes, if the principal has agreed to pay the attorney-in-fact. In general, the attorney-in-fact is entitled to "reasonable" compensation for his or her services. However, in most cases, the attorney-in-fact is a family member and does not expect to be paid. If an attorney-in-fact would like to be paid, it is best that he or she discuss this with the principal, agree on a reasonable rate of payment, and put that agreement in writing. That is the only way to avoid misunderstandings in the future.

## **How does one draw up a health care power of attorney or advance directive?**

People should contact an attorney who is skilled and experienced in this area. Although many hospitals and nursing homes also provide forms, as do some public agencies, these forms are often inadequate.

## **Can I move my Individual Retirement Account (IRA) from one financial institution to another?**

You may withdraw the funds tax-free if you roll them over into a new IRA within 60 days. If you fail to complete the rollover in time, you will have to pay income taxes on the amount withdrawn and, if you are under 59  $\frac{1}{2}$ , a 10 percent penalty. But you may only do this once a year unless the transfer is effected from institution to institution without the funds passing through your hands. If the transaction is purely between institutions, you may move your IRA as often as you like without incurring any penalty. The 60-day rollover offers an opportunity for people who want to consolidate accounts, are moving, or expect to get a better return with a new institution. It can also be used in the event of a short-term cash shortage. But be careful to complete the rollover. If you do not, taxes and a penalty will be due on the amount withdrawn.

## **How do I find a good financial planner?**

The best way (as with any professional) is to ask your friends, colleagues and relatives if they have worked with

anyone they can recommend. Also, ask your lawyer or accountant, since they often work with financial planners. If these inquiries don't turn up someone appropriate for you, check the Yellow Pages, call your Chamber of Commerce, or call 800-282-PLAN (7526) for the name of a Certified Financial Planner (CFP) in your area. Some planners charge a fee, while others provide the service without charge, hoping to make commissions on your investments. You may be able to find a fee-only financial planner by calling 888-FEE-ONLY (333-6659), which lists members of the National Association of Personal Financial Advisors. Interview your candidates over the phone to learn their approach to planning and investments. Ask for references, and make sure you follow up and call the references. After you have narrowed your field of prospects, meet at least two in person before you make your final selection.

## **Does it matter whether the financial planner has any particular credentials?**

Many financial planners have initials after their names, such as CFP (Certified Financial Planner), CLU (Certified Life Underwriter), or PFS (Personal Financial Specialist). There are about 300,000 people in the United States who call themselves financial planners. Of these, about 32,000 are CFPs and about 1,600 PFSs. The fact that a planner is certified indicates that he or she has enough interest and training in the field to take the required courses and pass the appropriate tests for certification. That's important. But it's no guarantee that the financial planner will do a good job for you, or that someone without the certification will not.

# **Can a person object to a proposed guardianship for him- or herself or for someone else?**

While the rules differ from state to state, someone who is the object of a proposed guardianship has the right to object to the appointment of a guardian. Generally, next-of-kin also has the right to object. In many states, the proposed ward has the right to a court-appointed attorney if she cannot afford one on her own.

# **How does the SSA calculate a retired worker's monthly benefit?**

The Social Security Administration (SSA) bases its benefit calculation on the retiree's highest 35 years of earnings up to the amount subject to Social Security withholding each year. If necessary, it will use years in which the retiree has low earnings or no earnings to bring the total years of earnings up to 35. The SSA then calculates the retiree's average monthly earnings over those 35 years adjusted for inflation. The retiree's monthly Social Security check is arrived at by adding together 90 percent of the first \$627 of the average monthly earnings, 32 percent of the next \$3,152 and 15 percent of any average monthly earnings above \$3,779. (These are the figures for 2005; they are adjusted each year to reflect inflation.) As you can see, the formula is weighted to favor those who earned less during their working lives, giving them a 90 percent retirement benefit on most of their earnings, while giving the highest earners only a 15 percent benefit on a large portion of their working income (and no benefit on earnings above what was subject to tax, which in 2005 is \$90,000). You can calculate your future Social Security benefit based on your current and projected earnings by using the SSA's online [Benefits Calculator](#).



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# Why You Need A Will

Contrary to a widely-held belief, dying without a will doesn't mean your property passes to the State, which then uses the money to buy new park benches. Instead, local laws determine your estate's beneficiaries; these are the laws of "intestacy." In most states, one half of non-jointly owned property (titled in your name alone) passes to your spouse, the other half to your child or children. If you are single and have children, your assets generally pass to your children and/or your parents, if alive. If you don't have children, typically your assets pass to your parents and/or siblings.

Having a will allows you to name the individuals you wish to inherit your assets, and the manner they will do so, regardless of state law. In addition, if you do not have a will, the local court will appoint your "personal representative" – an executor to administer your estate, based on statutory rules of priority. Again, this might not be the person you would prefer. You also may wish to specify funeral arrangements,.

If you are married with children, and you and your spouse die together in an accident, your child or children would receive your entire estate, but a court would have to choose the child's legal guardian. Judges usually appoint the nearest relatives of the child, often causing titanic court battles between sets of grandparents. Even worse are those situations where the child's closest living relative is Uncle Harold, a tambourine player with the Hare Krishnas. A properly drafted will names your beneficiaries, your child's guardian and a

trustee for his or her estate while a minor. (The guardian and trustee you select need not be a relative).

Both husband and wife should have their own wills. Although joint wills are legal, it's generally undesirable to tie yourself together in this way; you run the risk of being unable to deal with changed circumstances arising from the death of one spouse

Perhaps you're interested in going online, buying a book or computer program that tells you how to write your own will. These can be informative tools, but in some cases might cause you to miss an essential requirement or have less than the best plan. Making the best plan and the best usually takes knowledge and expert advice. For example, do you know that property held jointly with another may not be distributed by will? Or that life insurance may or may not be distributed by will, depending who is named as beneficiary? Or that the same can be said of individual retirement accounts, pension plans and other assets? That the beneficiary designation on retirement plans can have major tax consequences? That a spouse has a right to a large share of your property no matter what your will may say? The best plan recognizes that the best will is only part of the total plan for the distribution of your property.

When choosing a lawyer, seek references from friends and co-workers. Lawyers generally charge a flat fee for routine wills and estate planning. Preparation of a detailed estate plan and tax-saving wills, however, is done on an hourly fee basis.

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# What Lawyers Do

## Or, Big Words Sound The Same In Any Language.

Contrary to what you were taught in school, the true religion of most of the population of the United States is litigation. The word "litigation," by the way, is derived from the Latin word *litis*, meaning "ritual," and *agere*, meaning "screwing."

It is said that litigation touches everyone all the time, occasionally in very intimate places. Before you can achieve an understanding of litigation, you must understand lawyers. Although millions of words have been written on the subject, people are genuinely mystified by what happens behind the sacred doors of the Conference Room.

Here are the things that lawyers do, in general:

1. **Produce Paper.** Obviously.
2. **Resolve Conflicts.** Some commentators have pointed out that this is a vital function, necessary to any advanced civilization, such as ours, without any cultural inhibitions against violence. These commentators point out that lawyers are a necessary social lubricant. You should probably visualize lawyers as the K-Y jelly of society, easing the friction between... well, you get the idea.
3. **Serve As Butts of Jokes.** With the rise of political correctness, Polish jokes are no longer acceptable. Lawyer jokes have taken their place, thus providing a safety valve without which much of American humor would back up and blow itself out through Mexico.

**Big firm, little firm.** Despite the prevalent image of lawyers in large law firms, most American lawyers still practice in

small firms or as sole practitioners. They are small businessmen, no different than the local dry cleaner, shoe store owner, car mechanic, or accountant, except they wear natural fiber suits and are more honest than the car mechanic. Lawyers work long hours, and – outside of the big firms – generally don't make more than the average Joe, if the average Joe happens to have seven years of post-high school education. Anyway, they certainly make less than a specialist physician.

In fact, most lawyers are solidly middle class, with spouses and families and mortgages and tuition bills and orthodontist bills and staff problems and stop this is getting depressing.

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