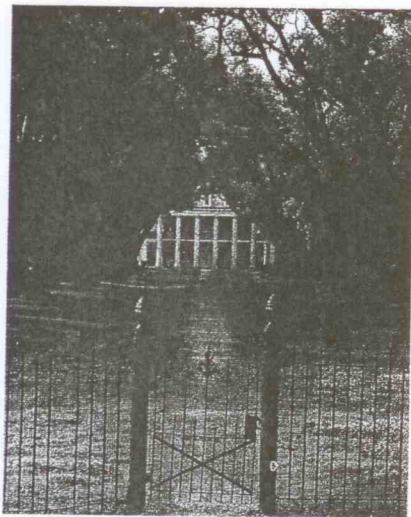


Estate Planning

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Most clients assume their CPAs are experts in all things financial, especially as related to tax matters. They believe that if there is anything important for them to plan for, their CPAs will raise the matter. One particular area that many clients neglect, however, is estate planning. Some do not want to deal with mortality issues, others do not want to confront family issues and still others think that the estate plan they made 20 years ago is fine.

Moreover, clients are generally unaware of the state of the estate tax laws. For example, despite repeated efforts by Congress to repeal the “death tax,” no agreement has been reached. The current law is effective until the end of 2010, then we revert to a prior estate tax law that, unless modified, will result in a big increase in both the amount of wealth subject to tax and the rate of tax applied.

Clients often do not realize that the estate tax, like the gift tax and generation-skipping transfer tax, impose a tax on the transfer of wealth. While clients bemoan the amount of *income tax* they pay, they are often in denial over the fact that they (or their estates) will be subject to a separate tax as their assets are transferred. However, there are exceptions to the imposition of transfer taxes.

Another factor to keep in mind is that estate tax reduction planning should first consider the long-term effects on the donor’s financial planning status. After all, you don’t want clients making gifts they can’t afford.

Enter the CPA to help clients with these matters. CPAs are usually aware of the scope of their client’s assets and often know something about their client’s family relationships.

Estate Planning 101

What Every CPA Should Know

The following primer on federal estate tax rules can help provide CPAs with the tools needed to conduct a meaningful conversation with their clients about their estate planning.

The Common Exceptions

Basic estate planning involves using one or more techniques to reduce the tax cost of transferring assets to family members and other beneficiaries. Which techniques to use depends upon many factors, tax and non-tax related. Also, not every tax-free transfer should be made in all circumstances. Further, estate planning honors the client’s wishes as to the ultimate transfer of their property. For example, charitable giving is often employed because of the client’s love for the charity, not always with intent to reduce costs.

From an income tax perspective, it may not be advantageous to make any lifetime transfers. Assets that pass to a beneficiary upon death frequently receive an increase in tax basis for income tax purposes, which can provide additional depreciation or amortization deductions when applied to depreciable or amortizable assets.

Similarly, the increased income-tax basis can reduce the subsequent gain on the sale of such assets by the beneficiary. Therefore, if the amount of the potential estate in question is small enough that there will be no estate tax, a tax-free transfer taken during the client’s lifetime may not be a tax benefit.

Instead, the client may wish to transfer all assets upon death so the beneficiaries will receive an income-tax basis in the assets equal to the fair market value as of the date of the client’s death.

With that caveat, here are some common estate planning techniques:

Annual Gift Tax Exclusion. The law allows an annual tax-free transfer of property or cash up to \$12,000. These transfers are exempt from gift tax and are not counted toward the amount that can be transferred free of tax as part of the lifetime exemption.

Annual gifts can be made to an unlimited number of people every year and the same person can receive the gift each year. Far better, for married couples, the amount of the

annual gift tax exclusion for each gift is \$24,000 since each spouse can gift \$12,000. Even if all of the property comes from one spouse, an election can be made on a gift tax return to treat it as if made by both, thereby allowing annual gifts by one spouse of \$24,000.

Each of these gifts reduces the value of the estate’s remaining assets. If the estate is going to be a taxable estate, then the savings from these gifts is measured by the highest estate tax rate (currently 45 percent) since these transfers come off the top of the estate.

Further, the gifts carry any future appreciation on the property transferred. Thus, the estate is reduced by the amount of the gift and by all earnings and growth attributable to the property transferred.

Most important, the annual exemption applies on a “use it or lose it basis.” Gifts not made in one year cannot be made up by increased gifts in other years when such gifts were not made. For example, you can’t gift \$24,000 in one year and claim \$12,000 for the previous year.

It’s not just about gifts of cash, however. Some gifts increase the value of the property transferred. For example, a gift of an interest in a limited partnership that is valued at \$12,000 will often have a value on liquidation that is substantially greater.

Gifts can be made outright or in trust. However, most gifts made in trust will not qualify for the annual exemption unless the trust includes special language to create a “present interest” in the beneficiary, often referred to as “Crummey provisions.” These provisions are derived from *Crummey v. Commissioner*, in which the Ninth Circuit U.S. Court of Appeals held that a right of withdrawal granted to a beneficiary made a gift in trust a present interest gift so that it qualified for the annual exclusion.

Payments for Qualified Education and Health Care Expenses. Another gift that is not a gift for tax purposes is a payment made for qualified education (tuition for everything from preschool to grad school) or health care. Here, payments are made directly to the education or medical services provider and are not a

