

# The federal estate tax is back in 2011

The federal estate tax is back in effect as of January 1, 2011.

Originally, the tax was to apply to all estates over \$1 million, at a rate of 55%.

As a result of a last-minute compromise in Congress, the estate tax will be temporarily reduced for two years. In 2011 and 2012, the tax will apply to estates over \$5 million, at a rate of 35%. However, unless Congress changes the law again, after 2012 the tax will apply to any estate over \$1 million, at a rate of 55%.

And this means that it's important for many people to begin to plan for the estate tax now, if they

haven't already done so.

The estate tax has always been a problem for the rich, but today a huge swath of the middle class may be affected if the value of their house, their business interests, their retirement savings and the face value of their life insurance policies tops \$1 million.

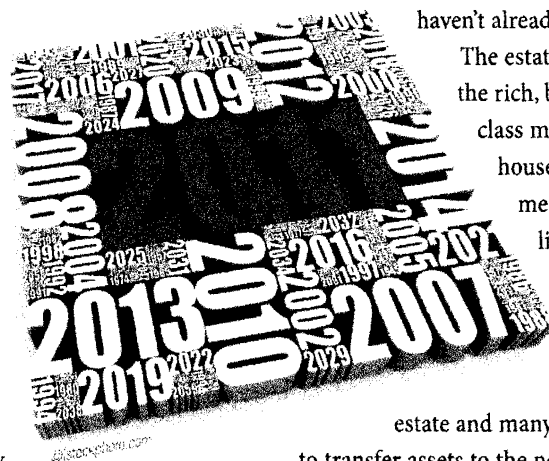
On the positive side, the current economic environment – with ultra-low interest rates and depressed valuations of real

estate and many businesses – is a great time to plan

to transfer assets to the next generation.

That's because it's often possible to give away partial interests in assets and "lock in" today's low valuations, so that any future appreciation in their value will escape tax.

Also, there are many techniques for avoiding tax that work best when interest rates are low – and interest rates have almost never been lower than they are today.



## ***Return of estate tax creates a danger for life insurance policies...***

With the federal estate tax back in effect in 2011, many people need to take a second look at their life insurance policies.

Life insurance proceeds are not subject to income tax. But what many people don't realize is that if you own your life insurance policy, then the proceeds will be considered part of your estate when you die. If those proceeds – combined with all your other assets – amount to more the estate tax exemption amount, then your estate may be subject to estate taxes.

That exemption amount could well be as low as \$1 million at some points during the next few years.

If the beneficiary of your policy is your spouse (and your spouse is a U.S. citizen), then no estate tax will be due at the time of your death. However, the proceeds will become part of your spouse's estate when he or she dies, and will be subject to estate taxes then.

A good solution is to transfer ownership of the policy. You could transfer ownership to your children, but it's usually better to put the policy into a trust. The advantage of a trust is that, when you die, the proceeds in the trust can be used to benefit your spouse during his or her lifetime if necessary, and when your spouse dies, the remaining proceeds can pass tax-free to your children or other heirs. In this way the bulk of the proceeds can go to your heirs without being taxed either as part of your estate or as part of your spouse's estate.

There are some complexities to life insurance trusts. For instance, if you transfer a policy to a trust and you die within three years, the tax benefits will be lost. (You can avoid this problem if you set up the trust first and have the trust buy the policy.)

Also, there are some notice and paperwork requirements each year in order to properly pay the premiums without jeopardizing the tax advantages. But for many people, the huge tax savings and added control provided by a trust are worth it – especially with the uncertainty in the estate tax rules.

## ***... and a problem for unmarried couples***

Seniors who are living together but are not married may be facing a significant problem now that the federal estate tax is back in effect.

Under federal law, a person who dies can leave an unlimited amount of money or property to a spouse without any of it being subject to the estate tax.

But if you leave money or property to someone you live with but aren't married to, the same rules don't apply. If the total value of all your assets when you die (including the face value of any life insurance policies) is more than estate tax exemption amount, your estate may be subject to tax.

For this reason, many seniors who are living together face much more difficult tax issues than married couples, and should speak to an attorney soon about estate planning under the new rules, if they haven't already done so.

This is also true for gay couples. Some states now allow gay people to marry – or to have "civil unions" in which they are treated the same as married couples for tax purposes – but that only applies to state taxes. The federal government doesn't accept gay marriages or civil unions for purposes of federal taxes, so gay couples need to take extra care now that the federal estate tax is back in effect.