

If you own a home and some life insurance and are entitled to retirement plan benefits from work, your gross estate may already exceed the threshold at which estate tax liability begins. Since the top estate tax rate is 45%, planning to make the best use of your exemption is essential.

In 2009, the first \$3.5 million of your taxable estate is exempt from federal estate tax. (Technically, the law provides for this exemption by allowing a credit of \$1,455,800, which is the amount of tax on the first \$3.5 million of a taxable estate, calculated under the estate tax rate schedule.) Your spouse is also entitled to an exemption of \$3.5 million.

The estate tax is currently scheduled to expire on January 1, 2010, but it is scheduled to be restored (with only a \$1 million exemption) on January 1, 2011.

If the value of all assets owned by you and your spouse exceeds the exemption amount described above, an estate plan which results in the surviving spouse receiving all the assets will result in estate tax liability at the death of the second spouse. This, in turn, reduces the amount available for your children or other beneficiaries.

A married couple can escape estate tax on assets of up to two times the exemption amount (\$7 million in 2009) if the couple's wills are drafted to take full advantage of each spouse's own credit. The wills should provide that, when the first spouse dies, the amount protected from estate tax by the available credit passes to a trust (the "credit shelter trust") from which the surviving spouse can benefit during his or her remaining lifetime but which will not be included in the surviving spouse's estate at death. The following example illustrates the tax savings that result from using a credit shelter trust in the will of the first spouse to die instead of leaving the entire estate outright to the surviving spouse.

Assume a husband (H) and wife (W) have assets worth \$5 million and \$2 million, respectively, and that H predeceases W. If H leaves his entire estate outright to W, there will be no estate tax at H's death, because his \$5 million qualifies for the marital deduction. However, when W dies, her estate includes the \$5 million inherited from H (assuming no intervening changes in wealth) plus her own \$2 million, for a gross estate of \$7 million. If W were to die later in 2009, her estate tax liability would be \$1,575,000, determined as shown in the following example. (For purposes of simplicity, the example ignores an estate tax credit that may apply when someone inherits property and then dies shortly afterwards.)

Gross Estate:	.....	
		\$7,000,000
Marital Deduction:	.....	
		0
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		----
Taxable Estate:	.....	
		\$7,000,000
Estate Tax:	.....	
		\$3,030,800
Less unified credit:	.....	
		1,455,800
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Tax Due:	.....	
		\$1,575,000

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After the estate taxes are paid, \$5,425,000 (\$7,000,000 - 1,575,000) is left for the children.

If, instead, H's will provided that an amount equal to the estate tax exemption equivalent passed to a credit shelter trust (from which W and/or the children would receive income and could have principal paid to them if they needed it), and the balance of H's estate passed outright to W, there would be no estate tax due, as shown in the following example.

H's Estate

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Gross Estate: .....	
\$5,000,000	
Less Marital Deduction: .....	
1,500,000	-----
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Taxable Estate: .....	
\$3,500,000	
Estate Tax: .....	
1,455,800	
Credit: .....	-
1,455,800	-----
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Tax Due: .....	
0	
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W's Estate

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Gross Estate (her own \$2 million plus the \$1.5 million inherited outright from H): .....	
\$3,500,000	
Marital Deduction: .....	
0	---
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Taxable Estate: .....	
\$3,500,000	
Estate Tax: .....	
1,480,800	
Credit: .....	-
1,480,800	---
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Tax Due: .....	
0	
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Thus, with the credit shelter trust, \$1,575,000 in estate taxes is saved, and the full \$7 million is available for the children.