

U N D E R S T A N D I N G E S T A T E T A X E S

Quick Guide

This information is provided by West Coast Trust to help clients stay abreast of estate planning issues. It should not be viewed as legal advice, which can only be provided by your personal attorney.

Let us Introduce Ourselves



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As an attorney with 34 years of experience working throughout the Willamette Valley, Tom helps business owners and investors create and execute wealth management and estate plans. Tom is well known to local estate planning professionals, is active in Salem Rotary, and on the board of the Salem and Eugene Estate Planning Councils and Marion Polk Food Share.

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With over 20 years of trust, retirement planning, and portfolio management experience, Ed leads our Portland Wealth Management & Trust team. Clients count on Ed's intimate knowledge of retirement plans to help them rollover and manage their retirement accounts in conjunction with their estate planning.

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CAUTION: This guide is intended to introduce some of the basic issues and steps involved in estate planning. It is not intended to be all-inclusive. There are many issues and topics to be addressed in a complete estate plan, and working with a qualified professional is strongly recommended.

There is an old expression that says, “You can’t take it with you.” One of the reasons that expression is true has to do with your federal and state governments. If you are lucky enough to have a large estate, one of the biggest transfers at your death may be to the tax collector. *You can discuss ways to reduce these taxes with a qualified estate planner. This may include use of trusts as well as conveying or gifting certain assets.*

As important as it is to reduce taxes, these strategies should never come before having your assets go to satisfy your other desires. It’s all right if you want to set up your estate in such a way that results in paying more tax than you might otherwise have to, yet allow you and your spouse complete control of you assets or to benefit someone in particular. No matter what anyone tells you, it’s your money.

Basics of Estate Taxes

The federal government has set up a tax system to collect a certain amount when you die if you leave an estate over a certain amount. This tax was originally intended to prevent extremely wealthy families from holding onto their fortunes from generation to generation instead of turning assets back to the government to help run the country. With rising real estate and pension values and more people owning life insurance policies, a lot of Americans find themselves among this “elite” group. The tax rates on estates can be as high as 45% in 2007 and 2008, potentially making the federal government one of your major beneficiaries when you die with a sizable estate.

Generally, if you have more than the applicable exclusion amount (\$2,000,000 in 2007 and 2008) in your estate, you may have to pay an estate tax. For tax purposes, your taxable estate is defined as your estate (including assets that are not part of probate such as pensions, joint property, life insurance, and IRAs) less expenses, certain deductions, and exemptions.

Caution: If you are trustee in a trust where you can appoint assets back to yourself (or pay your creditors) the entire value of this trust may be included in your estate.

Caution: Estate taxes have nothing to do with the income taxes that you have to pay every April 15.

In determining your taxable estate, you are generally allowed to deduct any debts the estate has (excluding estate tax), any expenses paid to the executor, attorneys or accountants in settling the estate, state death taxes (state estate, inheritance, legacy, or succession taxes), and qualified charitable donations.

Any property transferred to a spouse is deducted from your taxable estate. This is called the Unlimited Marital Deduction. In many cases, this is how you can postpone estate tax until the surviving spouse dies. There are a few limitations on this deduction, so if you are thinking of leaving assets to your spouse in a trust or otherwise restricting his or her use of the assets, ask your attorney or other estate planning professional if you will be jeopardizing this important deduction.

Caution: The unlimited marital deduction does not apply to transfers to a spouse who is not a U.S. citizen. Special rules have to be followed. If this applies to your spouse, find an attorney that is knowledgeable in this area of estate planning.

Estate Applicable Credit Amount

The estate applicable credit amount essentially allows you to transfer a certain amount of assets at death free of estate tax. The amount of assets you can transfer is known as the Applicable Exclusion Amount (\$2,000,000 in 2007 and 2008). The estate applicable credit amount will increase based on a phased-in schedule so that by the year 2009 every person may transfer \$3.5 million of assets at their death free from estate tax. For lifetime transfers; i.e., gifts, the applicable exclusion amount is \$1,000,000.

Unfortunately, the applicable credit is one thing you cannot pass on to your family. If you do not use your applicable credit on your estate taxes, it is not passed on to your spouse. The credit simply vanishes. If the first spouse to die has not used his or her applicable credit, the surviving spouse’s estate may ultimately have to pay more estate tax.

The value of assets excluded from estate tax is scheduled to increase as follows:

Year	Value of Excluded Assets
2007 and 2008	\$2,000,000
2009	\$3,500,000
2010	Estate tax is scheduled to be repealed
2011	Current law has the estate tax being reinstated to the law in effect in 2001

Tip: Your estate plan should consider the increases in the applicable exclusion amount. Revisit wills and trust documents to determine if changes are required. Married couples should ensure that they have enough assets in their own names in order to take full advantage of the exclusion amounts.

Transfer Tax Rate Schedule for 2007 and 2008

Here is a table you can use to estimate the tax on your estate or a large gift. The figures are as stated under current law. Contact your tax advisor to verify any rate changes.

Taxable Amount	Times	Tax Rate	Minus	Equals	Tax*
\$500,001 to \$750,000	×	37%	– \$29,200	=	Tax*
\$750,001 to \$1,000,000	×	39%	– \$44,200	=	Tax*
\$1,000,001 to \$1,250,000	×	41%	– \$64,200	=	Tax*
\$1,250,001 to \$1,500,000	×	43%	– \$89,200	=	Tax*
Over \$1,500,000	×	45%	– \$119,200	=	Tax*

*Equals tax before applicable credit

Once you have calculated your estate tax using the chart above, you can reduce that figure by the estate applicable credit amount below. The amount of the credit depends upon the year of death. (The gift tax applicable credit amount is separate and is fixed at \$345,800.)

Estate Applicable Credit Amount

Year of Death	Applicable Credit
2007 and 2008	\$780,800
2009	\$1,455,800
2010	Estate tax repealed
2011	Estate tax reinstated under 2001 law

Here is an example to show you how the calculation works:

Tom dies in the year 2008 with a taxable estate of \$2,050,000. His federal estate tax liability is calculated as follows:	
Taxable estate	\$2,050,000
× Tax rate	× 45%
	\$922,500
Minus	– \$119,200
Tax before applicable credit	\$803,300
Minus applicable credit—Year 2007	– 780,800
Federal Estate Tax Liability	\$22,500

Caution: Consult with your tax advisor for an exact calculation of your estate tax liability.

Comprehensive Estate Tax Example

The following example illustrates the estate tax calculation.

Assume your will splits your estate between your spouse and your son. You die in 2008 with the following assets:	
House (son is designated beneficiary)	\$350,000
Pension (spouse as beneficiary)	\$200,000
Stock account	\$150,000
Cash and savings	\$130,000
Group life insurance (payable to your estate)	\$400,000
Jewelry and other personal property	\$40,000
Total assets	\$1,270,000
Less mortgage	– \$50,000
Less executor fees	– \$20,000
Taxable estate before exclusions	\$1,200,000
Assets passing to son	\$350,000
Total to spouse (eligible for the unlimited marital deduction)	\$850,000
Taxable estate	\$350,000
Federal Estate Tax	\$0

In this example, the \$850,000 going to the spouse qualifies for the marital deduction and is not taxed. The \$350,000 going to the son is less than the 2008 applicable estate exclusion amount of \$2,000,000, so the applicable credit reduces the tax to zero.

Planning Based on Size of Estate

There are basically two separate ways to look at estate planning, depending on the size of your estate. The first is for those whose taxable estate is less than the Applicable Exclusion Amount (\$2 Million in 2007 and 2008). The second is for those with estates greater than the Applicable Exclusion Amount.

Although there are some general strategies to follow for all people, if you have more than a certain amount of money and property (the applicable exclusion amount, currently \$2,000,000 in 2007 and 2008) when you die, there are some extra steps you will need to take today. To decide what steps to follow, you need to estimate the value of your estate.

What is Included in Your Estate?

The assets and debts that you leave behind are collectively called your estate. The value of your estate is calculated on the date of your death (or in some cases, six months later). Your estate includes the fair market value of all assets you own outright and one-half the value of property owned jointly with your spouse. Any joint property you own with anyone else is included in your estate either (1.) at full value (if you cannot prove your original contribution) or (2.) at your share of the value (if you can prove your

contribution). A life insurance policy in which you had certain rights is also included.

You have to include the value of IRAs, 401(k) accounts, and even money people owe you (such as loans you made or money you earned and haven't received yet). You are allowed to reduce this amount by debts such as medical bills, mortgages, and bona fide personal loans; taxes due; charitable transfers; exemptions; and certain deductions such as the unlimited marital deduction.

What Is Your Estate Worth?

Add up everything you own and subtract everything you owe. The amount left over is your Net Worth. Certain adjustments are then made to determine your estate net worth. Use the attached worksheet "What's Your Estate Worth?"

Caution: If you have prepared a Gift Tax return (IRS Form 709) or gave anyone more than \$12,000 in a single year, you may need to adjust your calculations. These tracks are based on not having made large gifts in the past. As you review this worksheet with your attorney he or she can assist you to make sure you have included all of your assets and liabilities.

Steps to Follow Now!

1. Talk to your significant other about your wishes for your assets and family upon your death. Commit to this process as a joint effort.
2. Estimate the value of your estate. Each person should do this separately. Prepare the attached worksheets - *What is Your Estate Worth?*
3. Identify a guardian for minor children and name alternates. See *Guide to Making Critical Estate Decisions*.
4. Identify executors (with alternates) for your estate. See *Guide to Making Critical Estate Decisions*.
5. Make a list of people that will depend on you after your death and determine how much they will need to live on. Make sure your plan adequately provides for them.
6. Decide how to give away your assets—under the scenarios that you and your spouse (a) die together and (b) survive each other. Name alternate beneficiaries in case the people you select die before you. Prepare *Estate Wishes Worksheet* from *Guide to Making Critical Estate Decisions*.
7. Determine which assets are held in joint names, have beneficiaries, or are community property, as the form of property ownership can override the will. See *Guide to Wills, Trust & Probate*.
8. Decide if you want to make gifts to people while you are still alive. Can you afford to part with these assets?
9. Figure out which assets will be tied up in a probate hearing. Does your family have enough to live off of while the courts review your estate? See *Guide to Wills, Trust & Probate*.

10. Provide special attention to children from a prior marriage. Leaving everything to your current partner may not be the best idea.
11. Review the people you designated to inherit money and property when you die. Would any of these people have trouble managing their inheritances? Consider trust alternatives if there is a concern here.
12. Find an attorney to help draft a will, trusts, and other important legal documents. Both you and your significant other should have a separate will.
13. Make certain that, if appropriate, assets going to children are protected in trust. See *Guide to Wills, Trusts & Probate*.
14. There are special considerations if your spouse is not a citizen of the United States. You'll need to find an attorney that is knowledgeable in this area of estate planning.
15. If your estate is very large, contact an estate planning specialist to get information on more sophisticated planning techniques.
16. Consider leaving part of the inheritance to your spouse in a QTIP trust if you are not sure he or she will be able to manage the assets after your death (or you are concerned about who will get those assets upon your spouse's death).
17. Make sure that each estate has enough assets to take advantage of the applicable credit amount of each spouse. Before you split assets, make sure that you feel comfortable having your spouse own assets outright.
18. Consider giving gifts, but don't give away assets unless all your financial needs are taken care of.
19. Consider moving life insurance out of your estate and into an irrevocable life insurance trust. If the death proceeds from the policy are less than \$200,000, you may consider a direct transfer of the policy to the named beneficiary.
20. Consider placing out-of-state real estate into a trust to simplify probate.

Additional Steps If The Value Of Your Estate Is Over \$2 Million (2007 & 2008)

Checklist

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- | | |
|--|---|
| <ul style="list-style-type: none"> <input type="checkbox"/> Identify your wishes for your loved ones after your death (your estate plan) and complete the Estate Wishes Worksheet. See <i>Guide to Making Critical Estate Decisions</i>. <input type="checkbox"/> Pinpoint which legal documents you will need to effectively put your plan into action. Read the <i>Guide to Making Critical Estate Decisions</i> to learn more about each of these documents. <input type="checkbox"/> Review assets that pass outside your will to see if they contradict your estate plan. If so, consider changing beneficiary designations or titles. Read the <i>Guide to Wills, Trusts & Probate</i> to understand which assets your will does not control. | <ul style="list-style-type: none"> <input type="checkbox"/> Determine if you have enough assets to provide for your family after you die. If not, consider buying additional life insurance. If you need additional insurance, consider having a trust directly purchase the insurance for you. <input type="checkbox"/> Make an appointment with a lawyer and get documents prepared. Review each document carefully; once you feel comfortable that you understand what they say, sign the documents. <input type="checkbox"/> Prepare your Letter of Instruction as soon as possible. Read about this important document in the <i>Guide to Making Critical Estate Decisions</i>. <input type="checkbox"/> If your estate is over \$2 Million, evaluate shifting life insurance out of your estate and into an irrevocable life insurance trust to reduce your estate. |
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Appendix — What Is Your Estate Worth?

The major difference between your net worth when you are alive and your net worth when you die is the amount of the proceeds from life insurance you own. Since life insurance does not get paid until you die, you need to add the total proceeds from your life insurance to your net worth to determine what your estate is worth.

Determine what your estate is worth:	
1. Place your Net Worth amount here:	\$ _____
2. If you included life insurance cash value in our net worth amount, subtract this number out here (with some exceptions for Universal Life insurance):	\$ _____
3. Subtract Line 2 from Line 3:	\$ _____
4. Add up proceeds you will receive from all of your life insurance*:	
a. Company-provided group life insurance	+\$ _____
b. Term life insurance outside of work	+\$ _____
c. All other life insurance (net of outstanding loans)	+\$ _____
5. Total: add Lines 4a, 4b and 4c	\$ _____
6. What Is Your Estate Worth? Add Lines 3 and 5	\$ _____

* Payable to your estate or in which you possess ownership benefits (for example, the right to name beneficiaries of the policies).

Net Worth Calculation

Add up everything you own and subtract everything you owe. The amount left over is your **Net Worth**.

- Take all the things you *own* \$ _____
- Subtract all the money you *owe* to others \$ _____
- The amount left over is your *Net Worth* \$ _____