Minimize Federal and State Taxes

Perhaps one of the most important reasons to develop an estate plan for transferring property throughout one's lifetime and after death is to minimize federal and state estate taxes. The federal estate tax is a tax imposed on the transfer of property to a beneficiary at death. It kicks in when the total estate—including investments, retirement plans, insurance proceeds, real estate, and other property—exceeds the limits shown in Table 8.1. However, property that qualifies for the marital deduction (discussed later in this chapter) is exempt from estate taxation, as is property left to charity.

The **unified credit exemption equivalent** is the amount a person can transfer free of federal estate taxes at death. In 2016, a person can transfer up to $5.45 million estate tax free.

The federal estate tax exemption is transferable between spouses, which is referred to as **portability**. If a deceased spouse does not use his or her entire exemption, the executor of the deceased spouse's estate can transfer any unused exemption to the surviving spouse by filing a federal estate tax return and making the appropriate election.

Calculating the Federal Estate Tax

There are four main steps used to calculate the federal estate tax:

1. Determine the property that is included in the gross estate and calculate its value.
2. Subtract the allowable expenses (such as funeral expenses, claims against the estate, casualty losses, and administration expenses) and deductions (including the marital deduction and charitable deduction).
3. Apply the appropriate tax rates and compute the estate tax.
4. Deduct any credits to which the estate is entitled from the estate tax (including the estate tax unified credit).

The result is the net amount of federal estate tax payable.

Federal Estate Tax Rates			
Year of Death	**Top Estate Tax Rate**	**Estate Tax Unified Credit**	**Exemption Equivalent Amount**
2007 – 2008	45%	$780,800	$2,000,000
2009	45%	$1,455,800	$3,500,000
2010	Estate tax repealed	N/A	N/A
2011	35%	$1,730,800	$5,000,000
2012	35%	$1,772,800	$5,120,000
2013	40%	$2,045,080	$5,250,000
2014	40%	$2,081,800	$5,340,000
2015	40%	$2,117,800	$5,430,000
2016	40%	$2,125,800	$5,450,000

Many of your clients will undoubtedly be concerned with minimizing taxes in order to preserve their wealth for their loved ones, and with good reason: federal estate taxes alone can reduce an estate by as much as 40 percent. And, when state taxes and administration costs are also figured in, the need for smart estate planning becomes even more apparent.

State Estate Taxes

Many clients with estates that are not large enough to owe federal estate tax may be surprised to find that **state estate taxes** may still be a problem. Until recently, most states did not impose their own estate tax but instead took a share of the federal estate tax paid by large estates (called a “pick-up” tax). However, because the federal estate tax laws eliminated this revenue-sharing mechanism, many states now collect their own estate tax, typically from estates that are not big enough to owe any federal tax. For example, the amount that is exempt from state estate tax is capped at amounts ranging from $675,000 to over $5 million depending on the state. Estates exceeding these amounts are subject to state estate tax.

A few states have an **inheritance tax**, which is imposed on the portion of an estate received by an individual. The tax rate depends on who inherits the property; although spouses are exempt from this tax, other close relatives may pay a low tax rate and those who are not related may be taxed at a higher rate.