Estate Tax Avoidance
by Gary Villnow

What is an estate tax?

An estate tax is a tax on a person's right to transfer property at his or her death. The tax is based on the value of everything the deceased person owned or had certain interests in on the date of death. These assets include real estate financial accounts and life insurance proceeds. The fair market value of these items is considered to constitute the "Gross Estate". When the value Gross Estate is determined, certain deductions and reductions in value are allowed. These deductions may include mortgages and other debts, and estate administration expenses. After applying the deductions, the "Taxable Estate" is determined.

Prior to January 1, 2008 Wisconsin's estate tax applied to estates which exceeded $675,000.00. On January 1, 2008 Wisconsin's estate tax expired. The IRS currently allows a $3,500,000.00 exemption from federal estate taxes; therefore, the federal estate tax applies to all estates exceeding 3.5 million dollars.

The current rules governing the federal estate tax will expire in 2011. It is believed that new rules will be adopted that will apply the estate tax to estates of lesser value. It is also believed that Wisconsin will also enact an estate tax.

Although it would appear that the estate tax would not be an issue for many people at the present time, it may be prudent to plan for changes to the rules which are likely to occur in the coming few years.

Can I give money or property away during my lifetime to avoid estate tax?

Under current regulations, each person is given a lifetime exemption from gift tax in the amount of one million dollars. This means that each person can give away one million dollars during his or her lifetime without paying a gift tax. Along with the lifetime exemption, current regulations also provide each person with a $13,000.00 annual exclusion from gift taxes. Therefore each person can give away $13,000.00 per year to other individuals. If more than $13,000.00 is given to any individual in a single year, a gift tax return will be filed and the amount of the gift exceeding $13,000.00 will be counted against the lifetime gift tax exclusion and eventually, the estate tax exclusion. Consequently, giving property during a person's lifetime in amounts not exceeding the annual exclusions for gift tax is a viable strategy for the reduction of estate taxes.

Can I reduce estate taxes without giving property away during my lifetime?

Several strategies are available to assist in planning for a reduction in estate tax. One of the more popular methods would be the establishment of a Bypass trust. The Bypass trust is effective in reducing taxes in a spousal situation. It is important to note that no tax will be imposed when assets pass to a surviving spouse. After the death of the first spouse, an evaluation is performed of the estate's assets to determine if the estate would be taxable if the surviving spouse died. If a determination is made that there would be an estate tax, the surviving spouse can place some of the assets into a bypass trust which will pass to heirs when the surviving spouse dies. The surviving spouse can keep the income from the bypass trust, but can only use the principal amount in the trust to maintain his or her standard of living.

This type of trust preserves both of the spouse's exemptions and allows both of the exemptions to be applied to the estate instead of just the last surviving spouse's exemption. The net effect of the Bypass trust system is that heirs can receive double the amount of inheritance without taxation.

Gary Villnow is an attorney in Amherst and a member of the National Academy of Elder Law Attorneys. He received his Doctor of Jurisprudence degree from Drake University Law School in Des Moines, Iowa.

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