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BASIC ESTATE PLANNING FOR MARRIED COUPLES TO REDUCE ESTATE TAXES

Under present tax laws, U.S. citizens are allowed to leave up to \$1,000,000 in property, without paying estate taxes. However, all of your life insurance benefits, pension benefits, and any other property that passes when you die are included in your "estate" in determining whether your assets exceed \$1,000,000 for estate tax purposes. Although common sense might tell you that a husband and wife can each leave up to \$1,000,000 tax-free to their children, that is not true unless proper estate planning has been done, because the \$1,000,000 estate tax exemption of the first spouse to die will be wasted in most cases. Therefore, even younger couples who have sizeable life insurance or other large assets can have a serious estate tax problem.

In the case of a married couple with combined assets over \$1,000,000, there is no estate tax due when the first spouse dies, if he or she leaves everything to the surviving spouse. However, when a spouse leaves all of his or her property to the surviving spouse outright, the \$1,000,000 estate tax exemption of the first spouse to die is wasted. The estate tax on property given to the surviving spouse is basically just deferred until the death of the surviving spouse; but that property will eventually be subject to estate tax when the surviving spouse dies. The estate tax starts at about 40% of all assets over \$1,000,000, and goes as high as 50%, so the estate tax can be quite substantial. For example, the Federal estate tax on an estate of \$1,500,000 would be about \$200,000. (The estate tax exemption amount will gradually increase to \$3,500,000 by the year 2009. Under current law, the estate tax will be repealed in 2009, but will be reinstated the following year.)

A husband and wife who are U.S. citizens can completely avoid or minimize Federal estate taxes, and save tens or hundreds of thousands of dollars in estate taxes, by doing some relatively basic estate planning. This involves two steps, which are explained below:

1. Credit-Shelter Wills: The first step is for both the husband and wife to have what are known as "Credit-Shelter" Wills (or Living Trusts). Instead of leaving property outright to the surviving spouse, a Credit-Shelter Will "shelters" the estate tax exemption amount of the first spouse to die, so that those assets are not taxed in the estate of the surviving spouse. Under a Credit-Shelter Will, the surviving spouse has the right to use the "sheltered" trust funds for his or

her support, maintenance, education and health care. Any property over the “sheltered” trust funds can be given outright to the surviving spouse. However, by limiting the surviving spouse’s right to use the trust funds for his or her “support, maintenance, education and health care,” the trust funds are not taxed in the estate of the surviving spouse, which can save \$200,000 or more in estate taxes.

2. Take Property Out of Joint Tenancy: The Credit-Shelter Wills can only shelter property from estate taxes to the extent that the first spouse to die owns property individually, not in joint tenancy. When an owner of joint tenancy property dies, the surviving joint tenant automatically owns the property, no matter what the Will of the deceased spouse says. Therefore, if husband and wife own all of their property as joint tenants, that property will automatically be owned by the surviving spouse, and the Will of the first spouse to die will have no effect. This problem is easily resolved, by making sure that both husband and wife own assets as “tenants in common” (instead of in joint tenancy), or if husband and wife each own individual assets in their own name.

Of course, this is only a general explanation of the basic steps a married couple can take to reduce estate taxes. For example, most kinds of life insurance can be transferred to an Irrevocable Life Insurance Trust, so that the death benefits are not included in your estates for tax purposes. If you are financially secure, you can also reduce the size of your estate by making “Annual Exclusion” gifts to your children, grandchildren, and other loved ones. Although there are certain rules that must be followed, an annual giving program can be very effective in reducing estate taxes.

If you would like more information on estate planning, feel free to call us to discuss your individual needs. You should not rely on this general summary for specific legal advice.