

AN OVERVIEW OF ESTATE PLANNING

An Honors Thesis (ID 499)

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Table of Contents

	Page
I. Introduction	1
II. The Gross Estate	1
III. Gratuitous Transfers	3
IV. Programs of Lifetime Giving	4
A. Requirements for Lifetime Gift	4
B. The Gift Splitting Election	5
C. Selection of Gift Property	6
D. Valuation of Gift Property	7
E. The Generation Skipping Transfer Tax	8
V. The Effect of Disclaimers on the Gross Estate	9
VI. The Marital Deduction	10
A. Requirements for the Marital Deduction	11
B. Qualified Terminable Interest Property	12
C. The Deferral and Equalization Approaches	14
VII. Charitable Contributions	15
A. Estate Tax Charitable Organizations	16
B. Charitable Remainder Trusts	17
C. Factors affecting Charitable Contributions	18
VIII. The Employee Stock Ownership Plan	19
IX. Other Estate Tax Deductions	19
X. The Unified Tax Credit	20
XI. Conclusion	21
XII. Endnotes	22
XIII. Bibliography	24

An Overview of Estate Planning

Introduction

Many people do not realize the importance of estate planning. Estate planning is not only for the wealthy, but for every individual regardless of their income bracket. If an individual has not taken any steps toward protecting his personal assets and planning for his death, family members and loved ones will have little control over the distribution of his assets because the court will then distribute the assets in a predetermined manner. Lack of estate planning will cost more, take longer and create more hassle for surviving family members. The advantages of planning ahead greatly outweigh the consequences of not planning for one's death. The overall objective of estate planning is to reduce the taxable estate through programs of lifetime giving, the marital deduction and charitable transfers. Thus, the goal is to achieve the lowest overall tax liability for the estate and beneficiaries. Estate planning can also be viewed as a method used to reduce the excise taxes imposed on estates. Such taxes include the Federal gift tax which is placed on inter vivos or life transfers and also the Federal estate tax which is imposed on testamentary or death transfers.

The Gross Estate

Before attempting to reduce the gross estate, the composition of the gross estate must be known. The gross estate includes the property owned by the decedent at the time of his death, gifts made within three years of death, transfers with retained life estates, revocable transfers, annuities, joint interests and life insurance proceeds.¹

First, no distinction is made between tangible or intangible, depreciable or nondepreciable, and business or personal assets. Second, the gift tax paid on gifts and certain property interests transferred by gift qualify as gifts made within three years of death. Third, transfers with retained life estates are included in the gross estate only if the decedent retains control of the property through possession or enjoyment of, or right to the income from the property. The decedent also retains control if he has the right to designate the persons who should possess or enjoy the property. If the decedent does not retain any control, the property is deductible from the gross estate. Fourth, revocable transfers are considered lifetime transfers in which the decedent maintains power, up to the time of his death, to alter, amend, revoke or terminate the transfer. Even if power is relinquished within three years of death, revocable transfers are still not deductible from the gross estate. Fifth, annuities consist of one or more payments over a period of time. There are several types of annuities such as the straight life annuity which terminates at death and annuities for married couples which include the joint and survivor annuity and the self and survivor annuity. Annuities also have a refund feature for premature death in which the company returns a portion of the investment in the contract to the estate or beneficiary. Sixth, joint interests can be classified into four categories which are joint tenancy, tenancy by the entirety, tenancy in common and community property.² Rights extend beyond the owner's death where there is a tenancy in common or community property. Under joint interests, the automatic inclusion rule is enacted for married couples. As a result of this rule, one-half of the value of property is included in the estate of the spouse that

predeceases. The marital deduction will then neutralize the automatic inclusion rule. Lastly, life insurance proceeds are included in the gross estate if receivable by the estate, receivable by another for the benefit of the estate or the decedent possesses incident of ownership in the policy. If the proceeds do not meet one of the three conditions, they are excludible from the gross estate.

Gratuitous Transfers

The first factor to consider in estate planning is the reduction of the gross estate through the use of gratuitous transfers and lifetime giving. Gratuitous transfers should be made because they reduce or eliminate the gift tax which is a component of estate planning. Only individuals are subject to the gift tax which must be considered when gifts or gratuitous transfers occur while trying to reduce the taxable estate. In order for individuals to reduce their gift tax, they must distinguish between taxable and nontaxable transfers. To benefit, nontaxable transfers should be made if possible. Nontaxable transfers include political transfers, transfers for business purposes, revocable transfers, bargain purchases, support payments within the standard of living, qualified disclaimers and employment related gifts, while taxable transfers include gift loans, certain property settlements and other transfers.³ Gift loans include any below market loans where the foregoing of interest is in the nature of a gift. The settlement of certain marital rights with the exception of written agreements between spouses in settlement of marital or property rights are listed as types of property settlements. Transfers are most beneficial if they are nontaxable. In addition, the sooner the transfer is made, the better.

Programs of Lifetime Giving

The creation of a program of lifetime giving is one of the most popular methods of reducing the size of the potential gross estate. Lifetime gifts are also known as family or intervivos gifts since they are made throughout the life of an individual. The main advantage of lifetime giving is the annual exclusion of \$10,000 per donee per year.⁴ If the gift is in trust, each beneficiary of the trust is treated as a separate person. One must remember that the exclusion is not cumulative. If an individual does not make the gift in one year, he can not have a \$20,000 tax free transfer in the following year as a "catch-up".⁵ As a result of the exclusion, only gifts in excess of \$10,000 are included in taxable gifts.

Requirements for Lifetime Gifts. Gifts must be of present interest, not of future interest, to qualify as lifetime gifts. Direct cash gifts which are unrestricted as to immediate use, possession or enjoyment of property or income therefrom are gifts of present interest.⁶ Individuals should also be aware of future interest gifts because if they make such a gift, it will not qualify as a lifetime gift and the \$10,000 annual exclusion will be lost. A gift of cash put into a trust fund for later distribution is a gift of future interest, thus does not qualify as a lifetime gift. In future interests, the transferor most often retains rights in the property as opposed to present interests in which no incidents of ownership are retained. The trust for minors is an exception to the present interest rule. According to the exception, if an individual is under the age of twenty one on the date of the gift, he can consider it one of present interest although he was not given unrestricted use.⁷ There is a condition that

when the minor reaches the age of twenty one, all property and its income must be made available to him. In addition to gifts of present interests, other requirements for lifetime gifts include a competent donor, a donee capable of receiving and possessing property, a donative intent, actual or constructive delivery of property to a donee or a donee's representative and the acceptance of the gift by the donee.

Lifetime gifts offer many advantages and benefits in addition to the \$10,000 annual exclusion. For instance, there is no limit to the number of donees in any one year or during the donor's lifetime. By maximizing the number of donees, individuals can save many tax dollars since the \$10,000 exclusion is permitted for each donee. By also providing gifts of income producing properties and gifts of nonterminable interests to a spouse which are tax free results in substantial tax savings. A nontax advantage of lifetime gifts is that transfers can be made to children who are still in a position to benefit from the gift. They could put the gift towards a college education, starting a new business or getting married. Another important factor to remember is that no gift tax is payable until its unified credit is exhausted. Thus, lifetime gifts up to \$600,000 or doubled (\$1,200,000) if married and the annual exclusion of \$10,000 or \$20,000 if married are essentially tax free.⁸ One can reduce the gift tax by a total unified credit of \$192,800, but once all of the credit is used up, none is left for the reduction of estate taxes.

The Gift Splitting Election. Married couples should always consider the gift splitting election in which they are treated as two separate donors. The gift splitting election originated to prevent married donors in community property jurisdictions from having a

significant gift tax advantage over those residing in common law states. If elected, the gift splitting election provides many beneficial opportunities. It offers double tax free amounts by providing two annual exclusions of \$10,000 rather than only one.⁹ The gap between the size of the spouses' estates can also be narrowed because only one-half of the gifts will come back as "adjustable taxable gifts" in the estate tax return of the contributing spouse.¹⁰ By gift splitting two sets of unified credits become available. Before the gift splitting election can be made, certain requirements must be satisfied. First, the couples must consent to such treatment. Secondly, spouses must be legally married at the time of the gift. If divorce occurs later during the calendar year, they may still split the gift if neither remarries during the year. Lastly, spouses must be citizens or residents of the United States on the date of the gift. Once elected, the gift splitting election can not be revoked. Spouses become jointly liable for gift taxes and can not split the gift from one spouse to the other, but they may be eligible for the marital deduction.

Selection of Gift Property. Although individuals can give away basically anything they own, such as the family business, bonds, real estate or interests in partnerships, certain selected gift properties yield more tax advantages than others. High income producing assets are good for income splitting while properties that are hard to value, sell or split up make excellent gifts. While real estate with appreciation potential is the most popular gift, long term gift programs are the most beneficial.¹¹ Interest free loans, business interests and property with appreciation potential are also often selected as gift properties.

Valuation of Gift Property. Once the gift property is selected, its value must be determined. The amount of the gift is the fair market value of the property on the date of the gift.¹² Today, the special use valuation method can also be used for family farms and closely held businesses. The property is valued at its special use, current use, value rather than at its fair market value, or its highest and best value. The special use valuation method allows a maximum deduction of \$750,000 on property.¹³ Discounts in the estate tax value also result from the special use valuation method. The discount benefits are allowed if at least 50% of the adjusted gross estate consists of real or personal property used as a farm or a closely held business and at least 25% of the adjusted gross estate is real property.¹⁴ Other requirements that must be met before the special use valuation method can be applied are that the actual use results in less value than the best possible use and also that the actual or qualifying use has been carried on by the decedent or a family member as the owner for at least five of the last eight years prior to death. The special use valuation method provides individuals with an opportunity to reduce the value of their estate if certain conditions are met and the current use is less than the fair market value which would otherwise have to be used if the special use valuation method was disallowed.

Valuation tax planning helps alleviate complications which are encountered in estate planning and in reducing the taxable estate. Individuals should collect and save comparable sales information. They should also be careful to choose the correct appraiser because special and different training is needed to value different types of property. Furthermore, individuals should also keep a record of acquisition costs,

dates of securities and real estate purchases. Lastly, gift tax returns should be filed because lifetime transfers and transfers at death are looked at as continuous under the unified transfer tax.

The Generation Skipping Transfer Tax. The generation skipping transfer tax (GST) should also be considered when trying to reduce the gross estate. In the past, generations were skipped to avoid payment of high estate taxes, but today, there is a tax imposed on certain generation skipping transfer taxes. The purpose of the tax is to subject property to at least one wealth transfer tax every generation. Congress also felt that there should be no special estate tax advantages just because a trust or its equivalent is used. The generation skipping transfer tax is imposed on three types of transfers. The first is taxable distributions in which the distribution is out of income to a beneficiary at least two generations below grantor, while an older generation beneficiary has an interest in the trust. Next is the taxable termination which is overridden by the taxable distribution. A taxable termination occurs when by reason of death, expiration of time or otherwise the interest of a non-skip person terminates and a skip person becomes the recipient of trust property or the sole beneficiary. Last is the direct skip which has more influence than both the taxable distribution and the taxable termination. A transfer to someone at least two generations below transferor or donor is considered a direct skip. Another effect of the direct skip is that one or more generations are bypassed altogether and the property is directly transferred to, or in trust for, a skip person. Generations are determined along family lines, adoption, whole or half blood. A transferee twelve and one-half years to thirty seven and one-half years younger than the transferor is

considered to be one generation below transferor while a transferee more than thirty seven and one-half years younger than the transferor is considered to be two generations below him.¹⁵ Under the generation skipping transfer tax, a \$1,000,000 exemption is allowed for each transferor or a \$2,000,000 exemption if gift splitting is elected. A \$2,000,000 exemption is also allowed per grandchild for pre 1990 direct skips and the \$10,000 annual exclusion per gift is still allowed per donor.¹⁶

Effects of Disclaimers on the Gross Estate

Disclaimers also have an effect on the reduction of the gross estate and on exclusions. Because no one has to accept a gift or bequest if they do not want it, disclaimers arise. To qualify as a disclaimer it must be in writing, irrevocable, unqualified, and made within nine months of the transfer or nine months after the beneficiary reaches the age of twenty one. In addition, the disclaimant must not have accepted the bequest or any benefit from it initially, and lastly, the disclaimant can not direct to whom the disclaimed property will pass. The importance of disclaimers is that they often result in substantial savings. For example, a surviving spouse may wish to disclaim property in excess of the marital deduction, but this can only occur if the survivor would not consume the excess for living expenses in any event, or a third party, such as a child, may wish to disclaim a bequest to favor a surviving spouse and increase the marital deduction. Such disclaimers save a great deal in estate taxes. Another situation in which disclaimers may occur is when someone receives interest income and disclaims it to favor a lower tax bracket family member. Disclaimers do not have to be made in order to favor a relative or

person, but may also be made to benefit a charity. For instance, the beneficiary may disclaim interest and reduce estate taxes with the interest then going to one of the beneficiary's favorite charities.

The Marital Deduction

Proper use of the marital deduction is another effective tool used in estate planning. It originated with the Revenue Act of 1948 with its main purpose being statutory change to eliminate major tax variations that could develop between taxpayers residing in community property and in common law states.¹⁷ In community property states the surviving spouse already owns one-half of the estate; therefore, that portion is not included in the gross estate. Since all property belongs to the breadwinner of the family in common law states, all of the assets are included in the gross estate. The marital deduction is designed to provide equity in estate and gift tax areas and to alleviate such differences between community property and common law states. Under the marital deduction, Congress recognizes a husband and wife as a single economic unit. The deduction should be maximized on the death of the first spouse to obtain the most benefits from the marital deduction. Gifts to an individual's spouse offer unique transfer saving potential since an unlimited deduction is allowed for property in the deceased spouse's gross estate that passes or has passed to the surviving spouse. A marital deduction of 100% of the transfer is allowed and is deductible to the extent that it is included in the gross estate.¹⁸ Neither a gift nor an estate tax will be imposed on outright interspousal transfers of property. An advantage of the marital deduction is that unlimited amounts of property can be transferred free of estate taxes with the exceptions of life estates, terminable interests and annuities.¹⁹

Although the marital deduction merely postpones the transfer tax on the death of the first spouse and operates to shift any such tax to the surviving spouse, the surviving spouse can trim his future estate by entering a program of lifetime giving.

Requirements for the Marital Deduction. Before the marital deduction can be enacted, an individual must qualify as a surviving spouse. If the individual is no longer married, he does not qualify as a surviving spouse, but a legal separation that has not terminated the marriage at the time of death does not change the status of a surviving spouse. The surviving spouse must also be a citizen of the United States. Another requirement for the marital deduction is that the interest must be nonterminable. A life interest plus a general power of appointment is nonterminable. An individual is entitled to all income from the property for life which is to be paid at least annually if he retains a life interest. One example of a nonterminable interest is a disclaimer of property by a surviving spouse in favor of some other heir which will affect the amount that passes to the surviving spouse and qualifies for the marital deduction. For instance, a wife is entitled to \$400,000, but disclaims \$100,000 in favor of her son. The \$100,000 will then pass from the husband to the son, not from the husband to the wife; therefore, the marital deduction is only \$300,000 rather than the full \$400,000. Disclaimers by some other heir to the surviving spouse also have a similar effect. In the previous illustration rather than the wife receiving \$400,000, she now only receives \$300,000 and her son receives the remaining \$100,000. The son then files a disclaimer in favor of the wife, thus increasing the marital deduction to \$400,000 rather than \$300,000. Property interest subject to a mortgage where

only the net value of interest after the reduction of the mortgage or other encumbrance that qualifies for the marital deduction also qualifies as a nonterminable interest. Only the net value of interest is allowed, otherwise an individual would have a double deduction since the liabilities of a decedent are separately deductible. Unless an executor is required by a will or by law to discharge the mortgage out of other assets of the estate or reimburse the surviving spouse, the payment constitutes additional interest. It is also preferable for a deceased spouse's will to provide that death taxes be paid out of the portion of the estate that does not qualify for the marital deduction. Although a nonterminable interest qualifies for the marital deduction, a terminable interest does not. Life estates, annuities, estates for terms of years and patents terminate or fail after the passage of time; therefore, they are listed as terminable interests.²⁰ For example, another interest in the same property which is passed to some other person for less than adequate or full consideration does not qualify for the marital deduction. No other person can possess or enjoy property after the survivor's death or the termination of his interest. The marital deduction is not permitted for other person's or survivor's heirs if they may enjoy part of the property after the termination of the surviving spouse's interest.

Qualified Terminable Interest Property. Qualified terminable interest property (QTIP) is an exception to the nonterminable interest requirement. QTIP is created through an election to convert terminable interest into nonterminable interest property which is eligible for the marital deduction. Although the individual's interest in property may terminate, an unlimited 100% marital deduction is still allowed as a

result of the election.²¹ Before the QTIP election can be made, certain conditions must be met. Most importantly, the transferee spouse needs a qualifying income interest for life. The spouse receiving interest in the property must also be entitled to all of the income from the property for life which must be paid to the spouse annually. A third condition for QTIP is that no one, including the spouse, has the power to appoint any part of the property to any person other than the surviving spouse during his life. When the conditions are satisfied, the irrevocable election for the marital deduction can be claimed. If the election is made by the donor, it is considered a lifetime transfer, but if the election is made by the executor, it is a testamentary transfer.²²

For estate tax purposes, the executor makes the election on Form 706, the Estate Tax Return. Since the interest is QTIP, the fair market value of the property on the date of death will be included in the gross estate of the transferee spouse regardless of who receives the remainder. The value of the property is included in the surviving spouse's estate unless the qualifying income interest for life is disposed of before the survivor's death. Individuals must be very careful when making out their will because improper wording in a will can disqualify a QTIP trust. Everyone should have their wills reviewed to be sure that there is no defective language. Defective language in a will results in many complications and court costs. Some advantages of QTIP are that the surviving spouse never has to accept income interest, but may insist on a statutory share, typically one-third of the net probate estate, and that the spouse can be granted any number of powers over the principal.²³ The QTIP election is most useful for wealthy

individuals who wish to provide for a second spouse for life, but also wish to ensure that the children from a previous marriage will receive the principal. A disadvantage of QTIP is that the full value of the property at the death of a spouse is included in the gross estate.

The Deferral and Equalization Approaches. When using the marital deduction as a method of reducing estate taxes, individuals must consider both tax and nontax factors. Two major approaches of the tax area are the deferral approach and the equalization approach. The deferral approach which postpones estate taxation as long as possible is the most preferable approach. Although the deferral method is the better approach, the equalization method which equalizes the estates of both spouses is the best approach in certain circumstances. When both spouses are of advanced age and/or in poor health and neither is expected to survive the other for a prolonged period of time, the equalization approach should be used. A second situation in which the equalization method is best is when one spouse is expected to survive the other and has considerable assets of his own. For instance, a spouse who passes a \$250,000 estate to a survivor with assets of \$1,000,000 is in effect trading a 32% bracket for a later 43% bracket. Another exception occurs when appreciation is involved. Property only worth \$250,000 today may be worth \$1,000,000 five years later when it passes to the survivor.

Although the marital deduction is an excellent estate planning function, leaving the surviving spouse all of the property may not always be good planning. Potential credit may be wasted if the before credit tax is not at least equal to the available credit. Despite this fact, the marital deduction has become a function of taxes, the

propensity to consume, love and affection, the degree of confidence in a spouse, respective wealth and the number of children.²⁴ As the function of the marital deduction continues to grow so do the number of potential benefits. Disclaimers help to enhance and increase the marital deduction since disclaimers by other beneficiaries often lead to additional amounts passing to the surviving spouse. For the marital deduction to remain effective, tax planning must remain flexible and be tailored to individual circumstances of the parties involved.

Charitable Contributions

Charitable contributions have become the hottest opportunity on the market to reduce the estate tax liability.²⁵ The estate tax value of all charitable gifts included in the gross estate is deductible in full without a percentage of limitations whether a testator wills property to a private foundation or to a public charity. There are three basic charitable giving techniques. First of all, an individual could purchase a life insurance policy for a charity. Life insurance policies enable an individual to claim a deduction for the premiums and the cash value every year.²⁶ Secondly, a bequest to a charity through a will could be made. Bequests through a will have become a simple planning tool. An individual can leave his property to a spouse who will be able to claim a marital deduction but also leave with the suggestion that the spouse then leave the money to a charity. Lastly, a charitable foundation could be created. The foundation can be either private or supporting. While a private foundation is family run, a supporting foundation is the same as a public foundation which is governed by a board. A supporting foundation also offers larger deductions.

Billionaire Howard Hughes's estate provides an excellent illustration of

the tax saving opportunities resulting from the creation of a charitable foundation. For example, Hughes left two wills for his two billion dollar estate. The first will resulted in 1.4 billion dollars of estate taxes while the other will reduced the estate taxes to zero. Because Hughes bequeathed two billion dollars to the Hughes Medical Foundation, he eliminated his estate taxes through his creation of a charitable foundation.²⁷

Estate Tax Charitable Organizations. A deduction is allowed for the value of property in the decedent's gross estate that was transferred through testamentary disposition to estate tax charitable organizations. Such organizations include those organized for religious, charitable, scientific, literary or educational affairs.²⁸ These organizations provide no benefit to individuals, have no activity that influences legislation and do not participate in political campaigns on behalf of a candidate for public office. Other charitable organizations include a corporation, trustee or fraternal society, veteran's organizations incorporated by an act of Congress and foreign charities.²⁹ Another condition to be satisfied before the charitable deduction is allowed is that the charitable bequest must be stated in the decedent's will or the transfer made before death. The deduction does not materialize when a person dies without leaving a valid will, intestate. An important fact to remember is that contributions made before death do double duty. They are not includible in the gross estate, and they are also deductible for income tax purposes. The amount to the charity must be stated. No one besides the decedent can decide the bequest amount, but someone else can decide to which charity to give the donation. The bequest to a charity can be expressed as an

alternative. For instance, the bequest is still effective if the noncharitable beneficiary disclaims before the due date for filing the estate tax return.

Charitable Remainder Trusts. Charitable remainder trusts allow a donor to maintain current income and/or control and also let a spouse and/or children enjoy property after his death. In addition, such trusts permit estate tax deductions. When a gift of a remainder is given to a charity, it constitutes a transfer of property subject to the retention of a life estate. Although it is a present gift, it is of future interest. The life estate plus the remainder equals 100% of the property.³⁰ The deduction is equal to the value of the property less the present value of interest retained based on mortality tables.³¹ Upon the donor's death, the full value of the property is included in the gross estate because of the retained life estate, but the full value is then subtracted out as a charitable deduction. Forms of retained interest include life estates for a term of years, life estates for the life of the donor, life estates for the joint lives of donor and spouse and also one or more life estates for the life or lives of any other person.

Eligible remainder trusts include pooled income funds, charitable remainder annuity trusts and charitable remainder unitrusts. In pooled income funds properties are pooled or commingled. Many donors irrevocably transfer interests while individuals are only entitled to the income actually earned by the fund. Under pooled income funds no tax exempt bonds are allowed and no grantor or beneficiary can be the trustee. The funds are managed by the charity. Charitable remainder annuity trusts allow a specified sum or percentage to be paid annually

to one or more named individuals as income beneficiaries. When the payments terminate, usually less than twenty years, the remainder goes to a charitable organization. The remainder is equal to 10% of the discount rate.³² The last eligible remainder trusts are charitable remainder unitrusts. Rather than transfer a lump sum of money to a charitable trust, the donor makes a partially tax deductible contribution to a charitable remainder trust. Unitrusts are similar to annuity trusts, but they receive a fixed percentage rather than a set amount. The percentage will not be less than 5% of the net fair market value of the assets.³³ The amount will fluctuate from year to year due to the percentage factor. The remainder is valued using the payout rate as the discount rate.

Factors affecting Charitable Contributions. Stringent new tax laws, IRS audit crackdowns and adverse tax court decisions have lead to a decrease in the number of contributions. According to the latest AAFRC Trust for Philanthropy Council statistics, the 11% annual rate over the past five years dropped to just 6% in 1987.³⁴ Charitable impulses have been dampened by the fact that if the property appreciates in value, the taxpayer has a potential gain even though he does not profit from using the property. Taxpayers should keep in mind that it is not advisable for anyone running the risk of the alternative minimum tax (AMT) to give away appreciated property. Even if the donor avoids the AMT, he can still get hit with extra taxes under an "enforcement campaign" begun last year which was aimed at nonprofits and their donors who claim full deductions even though they received some type of service in return for their gift to nonprofits.³⁵ More tightening, more investigations, more tax forms to fill out and more records to keep have

had discouraging effects on charitable contributions. Tax court judges have also had an effect on contributions since they will accept either the IRS's claim or the donor's claim. There is no middle ground. They either choose one or the other. Because of constantly changing economic views and tax laws, individuals now need to plan ahead more carefully.

The Employee Stock Ownership Plan

In addition to the three main gross estate reduction tools of lifetime giving, the marital deduction and charitable giving, the use of an employee stock ownership plan (ESOP) also provides an opportunity for an estate tax deduction. Employer securities which are owned at death can be sold by an estate to an ESOP or eligible worker owned cooperative. Such securities consist of closely held common stock and certain preferred stock which is convertible into common stock. When the employer securities are sold to the ESOP, the estate is allowed a deduction of 50% of the sales proceeds that are received.³⁶ To be eligible for the deduction, the sale must be of securities that are publically traded and must take place after October 22, 1986 and before 1992. The deduction is limited to 50% of the taxable estate. Another limitation is that estate taxes can not be reduced by more than \$750,000.³⁷

Other Estate Tax Deductions

Other estate tax deductions include expenses, indebtedness and taxes. Although these deductions may not result in a substantial reduction of the gross estate as do programs of lifetime giving, the marital deduction and charitable contributions, they do help chip away at the gross estate. Any little deduction helps reduce the tax liability. Such reductions include funeral expenses and expenses

incurred in administering the property. Funeral expenses consist of interment costs for the gravestone and burial plot and also the costs associated with the funeral and the care of the gravesite. Court costs, the commissions of the executor, the attorney's fees of the estate and the accounting fees are expenses incurred in the administration of the estate. To be deductible, the expenses must be allowable by law and also actually and necessarily incurred. Unpaid mortgages and certain claims against the estate for enforceable personal obligations of the decedent at the time of death are some additional deductions. The claims against the estate include property taxes, unpaid income taxes and unpaid gift taxes. In addition, casualty or theft losses which occur during the period of settlement of the estate can also be used as a means of reducing the estate tax liability, while the fair market value of the property on the date of death plus any insurance recovery is included in the gross estate. The IRS even agrees that bad debts can be deductible. For instance, if an individual lends money to a family member or a friend and the debt goes sour, the amount of the debt is deductible. To qualify for the deduction, the loan can not be based on a handshake deal. A witness's signature may be needed, a realistic interest rate needs to be charged, the borrower's signature is needed and the amount borrowed and the repayment schedule should also be spelled out in the note.

The Unified Tax Credit

After the deductions have been applied, the remaining tax liability can be reduced by the unified tax credit. Because the credit is allowed against both estate and gift taxes, taxpayers must be aware that the portion used to offset gift taxes is no longer available to offset

estate taxes. Once the credit is used, it is gone. The unified tax credit has been phased in for estates of decedents dying after 1981. Estates after 1986 have a unified credit equal to \$192,800 with an exemption equivalent of \$600,000.³⁸ For example an estate with a value of \$600,000 will have no estate tax since the unified credit will eliminate the liability.

Conclusion

Programs of lifetime giving, the marital deduction, charitable contributions, other estate tax deductions and the unified tax credit are efficient tools of estate planning. These tools provide many advantages such as the saving of time, money and hassle. Everyone should be aware that the government will take 55% to 60% of a decedent's estate in taxes if an estate plan is not implemented; therefore, they should become involved in estate planning as soon as feasible.³⁹ By reducing the taxable estate through the use of estate planning tools, there is less tax liability upon an individual's death. Estate planning works to benefit family members and loved ones as well as the decedent himself. The utilization of estate planning tools enables an individual to retain some control upon his death. Family members and loved ones receive the benefits rather than the government. Such preplanning also results in fewer complications for the grieving. For estate planning to be effective, it must remain flexible and be tailored to the individual circumstances of the parties involved, but knowledge is still the overall key to estate planning.

Endnotes

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