Is Estate Planning Still Necessary?

The estate tax is generally paid by the most affluent Americans, however, it can also hit families with smaller assets, especially if they fail to plan for a possible estate tax liability. If the combined value of all of your property, including real estate, investments, insurance policies, savings, pensions, and valuable items, such as jewelry, artwork, and antiques, exceeds the estate tax exemption amount, your family members may have to pay both Federal and state taxes on the inheritance.

Under current law, the estate tax exemption for an individual is set at $5.25 million for 2013. While it may be impossible to predict whether, or to what extent, your estate will be subject to taxation at the time of your death, creating and maintaining an estate plan provides essential legal and financial protection for your heirs. If you fail to leave behind a well-structured plan for the distribution of your assets, disagreements between family members may arise, and your estate could end up in probate court.

You can reduce the size of your estate by giving away some of your assets to family members during your lifetime. Gifting is especially beneficial from a tax perspective when income is shifted to a recipient in a lower tax bracket. The annual gift tax exclusion in 2013 allows a donor to give away up to $14,000 per year, per recipient, without incurring a gift tax liability. If you are married and your spouse consents to “splitting” the gift, the annual gift tax exclusion increases to $28,000, even if only one spouse actually makes the entire gift. No gift tax is paid out of pocket until taxable gifts exceed the lifetime gift exemption, currently set at $5.25 million through 2013.

Trusts are also valuable tools for minimizing taxes and protecting your assets from the potentially expensive probate process. A **bypass trust** is particularly useful for married couples, who can choose to make children or grandchildren, rather than each other, the beneficiaries of the estate. In what is commonly referred to as an A/B arrangement, the bypass trust is combined with a **marital trust**. Used together, these trusts can help minimize estate taxes on transfers to the next generation, while still allowing the surviving spouse to withdraw funds from the trust for reasonable living expenses. To preserve family harmony and avoid future conflicts over inheritances, you may choose to supplement A/B trusts with a **qualified terminable interest property (QTIP) trust**, which gives you greater control over the distribution of your assets after your death.

The **irrevocable life insurance trust (ILIT)** is also frequently recommended as a means of shielding a life insurance policy from federal taxes. When properly implemented, the proceeds of an ILIT will not be included in your estate and will, therefore, be paid out to the trust’s beneficiaries without incurring any estate tax consequences. The trust may be used to finance your children’s education or to provide a staggered income for your heirs.

Clearly, these trusts do more than simply protect your family's assets from taxation. By planning your estate, you can resolve potential inheritance disputes prior to your death.

Unresolved questions about the future of estate tax rates, exemptions, and the tax basis of assets can make estate planning challenging. Therefore, be sure to consult regularly with your tax and legal professionals to help ensure that your strategies remain consistent with your financial and personal objectives.

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