

Don't give away the farm: With proper planning you can eliminate estate tax

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by [Michael Fuller](#)

Being of sound mind, but taking no further action, I hereby bequeath half my farm, half my real estate, and half of my retirement accounts to the [Internal Revenue Service](#) (now my largest heir). The other half can be split up between my children and grandchildren.

As my daughter often tells me, "Do what?"

This is certainly a worst case scenario, but you need to know when these rules apply to your situation. The Federal Estate Tax is applicable to individuals who have estates valued in excess of \$2 million. If arranged properly, a married couple can protect an estate valued up to \$4 million.

These amounts will gradually increase over the next five years until the federal estate tax will be totally repealed in 2010, for one year and one year only. After 2011 the federal estate tax is scheduled to apply once again to estates in excess of \$1 million (\$2 million per couple with proper planning).

In the run to become financially successful, it seems like we are weighted down with a tax burden at every twist and turn. Not only are we taxed on the income we make, but also whenever we spend it.

Taxes like Social Security, income, sales, property and capital gains can hinder a person's ability to save money and build financial security. In addition, without proper planning there is one final tax on your assets as they are passed down to your heirs. Commonly referred to as an inheritance tax, the estate tax can

cause an extreme burden, especially on the small business owner, those with substantial retirement assets and those who own land (like a farmer).

Throughout our nation's early years, the estate tax was temporarily enacted, primarily to pay for costs associated with national defense. Our modern day estate tax was permanently enacted into law in 1916. The Congressional Ways and Means Committee justified the tax based in part on the redistribution of wealth.

According to their documents, it was meant to tax, "the incomes and inheritances of those deriving the most benefit and protection from the Government."

And tax it they did. Initially, the top estate tax bracket was 10%, but by 1935 Congress and President Theodore Roosevelt had quickly pushed those rates to 70%.

Over the years, the estate tax has gone through many revisions, but the most recent ones have made the tax code challenging to navigate when creating a proper estate plan.

The Economic Growth & Tax Reconciliation Act of 2001 is the primary source for all of the complexity. It increased the amount of personal wealth that can be passed from one generation to the next each year, until the year 2010. At that time the estate tax is eliminated. The



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very next year, in 2011, the estate tax returns again. The Act also lowered the top marginal tax rate over a period of years, to 45%, which is due within nine months of death.

Even though the federal estate tax law is allowing more assets to be passed down to the heirs, many states are enacting legislation to capture the tax revenue that would have gone to the federal government. (Presently, Tennessee's inheritance tax brackets range from 5.5%-9.5%).

The logical question is, "Can I keep from paying almost half of my family's wealth to the Internal Revenue Service?" And the answer is a very simple, "Yes." With proper planning you can completely eliminate the tax.

Again, as my daughter says, "Do what?"

So how do you convince the IRS to give up these taxes

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without going to jail? There is a school of thought that identifies all taxation as a form of "social capital." It recognizes that there is a certain amount of each person's wealth and income that must be used for the benefit of society.

We either donate it ourselves or we let the government take it in the form of taxes. If we do nothing, we allow the government to choose the beneficiaries of our social capital; however, the government will gladly allow us to pick and choose our own beneficiaries and thereby reduce or eliminate our taxes.

This works in life and at death and allows us to leave our money to our favorite college or religious organization, and offset any taxes that would be due on those funds.

"But," you say, "If I give my social capital away to my favorite charity, I can't give it to my family." A common technique to replace those assets given to charity is an Irrevocable Life Insurance Trust. Properly drafted and funded, it can create estate and income tax free dollars for the heirs while reducing or eliminating the estate tax, especially when combined with charitable estate planning techniques. Our heirs get tax free dollars, our favorite church or charity gets badly needed operating funds and the IRS gets nothing.

Knowing this, why would anyone voluntarily pay almost half of their wealth in taxes? The answer is three-fold: The failure to understand the estate tax, the failure to plan for the tax burden and the failure to take the proper steps to eliminate the tax.

It's also known as human inertia -- which is the inability to take action, even when the outcome could be beneficial to our

family or us. By not taking the proper steps, we accept the government's offer to redistribute our wealth according to their design. Unfortunately for our family this could result in a forced sale of the farm, or selling family heirlooms to pay the taxes.

The last will and testament, a credit shelter trust, an irrevocable life insurance trust and a wealth replacement trust are just a few of the tools used by your financial adviser and estate attorney to properly structure your estate. Contact your financial adviser to make plans for the two certainties in every person's life - death and taxes.

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