

Clothier & Head Tax Insight

Estate Tax Exemption - Use it or Lose it

If you own a home and life insurance and are entitled to retirement plan benefits from work, your gross estate may already exceed the threshold at which estate tax liability begins. Since the combined Federal and Washington top estate tax rate is 64%, planning to make the best use of your exemption is essential.

In 2008, the first \$2 million of your taxable estate is exempt from federal estate tax. Your spouse is also entitled to an exemption of \$2 million.

In 2009, the exemption equivalent for Federal estate tax purposes will be \$3.5 million. The estate tax is scheduled to expire on January 1, 2010, but it is scheduled to be restored (with only a \$1 million exemption) on January 1, 2011. The Washington estate tax exemption will remain at \$2 million for the foreseeable future.

If the value of all assets owned by you and your spouse exceeds the exemption amount described above, an estate plan which results in the surviving spouse receiving all the assets will result in estate tax liability at the death of the second spouse. This, in turn, reduces the amount available for your children or other beneficiaries.

A married couple can escape estate tax on assets of up to two times the exemption amount (\$4 million in 2008) if the couple's wills are drafted to take full advantage of each spouse's own credit. The wills should provide that, when the first spouse dies, the amount protected from estate tax by the available credit passes to a trust (the "credit shelter trust") from which the surviving spouse can benefit during his or her remaining lifetime but which will not be included in the surviving spouse's estate at death. The following example illustrates the tax savings that result from using a credit shelter trust in the will of the first spouse to die instead of leaving the entire estate outright to the surviving spouse.

Assume a husband (H) and wife (W) have assets worth \$2 million each and that H predeceases W during 2008. If H leaves his entire estate outright to W, there will be no estate tax at H's death, because his \$2 million qualifies for the marital deduction. However, when W dies, her estate includes the \$2 million inherited from H (assuming no intervening changes in wealth) plus her own \$2 million, for a gross estate of \$4 million. If W were to die later in 2008 her estate tax liability would be \$1,032,000 determined as follows:

Gross Estate:	\$4,000,000
Marital Deduction:	0
Washington Estate Taxes:	240,000
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Taxable Estate:	\$3,760,000
Estate Tax:	\$1,572,800
Less unified credit:	780,800
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Federal Estate Tax:	792,000
Washington Estate Tax:	240,000
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Total Estate Tax Due:	1,032,000
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After the estate taxes are paid, \$2,968,000 (\$4,000,000 - \$1,032,000) is left for the children.

If, instead, H's will provided that an amount equal to the estate tax exemption equivalent passed to a credit shelter trust (from which W and/or the children would receive income and could have principal paid to them if they needed it), and the balance of H's estate passed outright to W, there would be no estate tax due, as shown in the following example. (The example assumes that both dates of death are in 2008, when the estate tax exemption equivalent is \$2 million.) Thus, H's estate passes to a credit shelter trust.

H's Estate

Gross Estate:	\$2,000,000
Less Marital Deduction:	0
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Taxable Estate:	\$2,000,000
Estate Tax:	780,800
Credit:	- 780,800
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Tax Due:	0

W's Estate

Gross Estate:	\$2,000,000
Marital Deduction:	0
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Taxable Estate:	\$2,000,000
Estate Tax:	780,800
Credit:	- 780,800
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Tax Due:	0

Thus, with the credit shelter trust, \$1,032,000 in estate taxes is saved, and the full \$4 million is available for the children.

There are many ways to plan and reduce your taxable estate. Please feel free to contact us at 206.622.1326 if you would like to discuss estate planning using a credit shelter trust, or any other estate planning matters.