Planning Considerations
Is 2012 the year to look at Estate Planning?

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Is 2012 the year for you to look at Estate Planning?
Definitely! Especially, if your estate is valued at more than $1,000,000.

There are many unique opportunities for estate and gift planning that are set to expire on December 31, 2012 and many people who are caught unaware may end up paying rates higher than 50% when almost all of the taxation could have been avoided. Since the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 and its expansion through the Tax Relief Act of 2010, wealth transfer taxes have been constantly changing and hard to plan around. But, if Congress does not act (and act fast) the taxes in place in 2002 will be the effective rates for 2013 and beyond.

Schedules of Exemption and Rates for Various Years:

Year	Estate Tax Exemption	Gift Tax Exemption	GST Tax Exemption	Top Tax Rate
2001	$640,000	$640,000	$640,000	55%
2002	$1,000,000	$1,000,000	$1,000,000	55%
2005	$1,500,000	$1,500,000	$1,500,000	47%
2009	$3,500,000	$3,500,000	$3,500,000	45%
2010	Repealed *	$1,000,000	Repealed	35%
2011	$5,000,000	$5,000,000	$5,000,000	35%
2012	$5,120,000	$5,120,000	$5,120,000	35%
2013	$1,000,000	$1,000,000	$1,140,000**	55%

* The Estate of a Decedent dying in 2010 could elect a $5,000,000 exemption with a step-up in basis or no estate tax, but have a modified carryover basis for future income taxation.
** This amount is indexed for inflation, so it could be more or less than figure shown.

Reviewing the chart above, you can see that the law, as it is now, will take away the ability of a taxpayer to pass more than $4,000,000 tax free to his children and/or grandchildren. In addition, the tax rate will jump a real 20% (an over 57% increase) over the one minute as the clock strikes 12:00 a.m. on January 1, 2013. Below are a few options for the persons who will be affected by this change and what you can do to start putting your plan in place.

Basic Goals of Estate Planning

Generally, there are three basic goals of estate and gift tax planning: (1) the reduction of estate and gift taxes upon transfer; (2) the deferral of the estate or gift tax burden; and (3) ensuring the legacy left does not cause family discord after the estate or gift is distributed. As shown in the above table, 2012 is the last year for high exemptions and low tax rates that enable the informed estate planner to meet the first two basic goals of estate and gift tax planning. We will discuss all three goals in the following paragraphs.

Reduction of Wealth Transfer Taxes

Currently, the law allows an individual to pass to any other person or persons, a lifetime total of $5,120,000 before he or she must pay gift or estate taxes. Two important things need to be understood about this lifetime amount: (1) it is exclusive of the "annual exclusion amount", currently $13,000 per person, per year; and (2) the lifetime amount applies to both life and death,

meaning you can pass $5,120,000 (in 2012) during life ***or*** after death. Gifts in excess of the annual exclusion amount each year lessen the amount you can pass after your death.

Gifting this year will reduce transfer taxes, but only if the giver has assets in excess of $5M. If assets are less than that, gifting could actually harm you for taxes.

This year the amount that is permitted to be transferred tax-free is $4,120,000 higher than it will be next year. For individuals with an estate that exceeds $1,000,000 ($2,000,000 for a married couple), transfers this year *could* save your children taxes in the future. For individuals with estates that exceed $5,000,000 ($10,000,000 for a married couple), the lack of planning *will* cost your children taxes in the future. From all indications from Congress, keeping the estate tax exemption high is a low priority, so taking action this year may be the only way to ensure a full reduction in wealth transfer taxes without adding complexity to your estate plan.

I also would like you to know that although these numbers are very high, they are also easily reached by the average American landowner. When the IRS looks at the value of the Estate, they look at the fair market value of all incidences of ownership of the deceased. This includes not only cash, CDs, investments, livestock, your home and other real property, *but also mineral interests, life insurance, and retirement accounts*. Something that is a new phenomenon in southwest Oklahoma is the development of oil and gas leases. The standard valuation of these is up to 84 times the average monthly payment, so a moderate lease making $1,500/month would have a tax inclusion value of $126,000 in addition to your other land and financial holdings.

Deferral of Wealth Transfer Taxes

The second main goal of estate planning is the ability to defer estate and gift taxes. If you find yourself in the position that you may have more than $1,000,000 ($2,000,000 as a married couple) in assets, but you are not ready to take full advantage of the increased exemption, then you should still consult with a qualified estate planner to find out how to defer taxes until as late as possible, and in some cases, even eliminate taxes by proper pre-planning.

The wealth transfer taxes have a commonly used provision for the deferral of tax: the unlimited spousal deduction. This provision is used because the government has an interest in ensuring that the surviving spouse has enough assets to take care of his or her own needs, but the catch is that most surviving spouses die within a few years of the first spouse. So although there won't be tax when Husband dies, if he passes everything to Wife, there may be more tax due when she passes. Proper planning should be able to account for ensuring that both spouses pass as much tax-free as possible *while* ensuring proper care of the surviving spouse.

Ensuring a Proper Legacy Endures

The last main goal of estate planning is the ability to ensure the legacy you leave does not cause family discord. For estates that are non-taxable, this goal moves to the top because even for smaller estates steps can be taken to ensure that probate is avoided, special needs are addressed, and important inheritances are treated with the respect each deserves.

The main reason people want to look at estate planning options is for the avoidance of probate. The main problem with probate is that it has to go through the court system (and sometimes multiple court systems). Whenever court is involved, there are corresponding delays to get court dates, there are attorney fees that must be incurred, and everything is open to viewing as part of the public court record. What does all of this amount to? Quite simply, more administrative costs and more delays in passing property. This should lead you to think, that a smaller estate should look closer into proper planning because the cost will cut into the estate at a faster rate, thus leaving smaller amounts for your children and grandchildren. Is the last legacy you want to leave to your children a two year court case?

Top Non-Tax Reasons for Estate Planning:
1. Avoidance of Probate and costs and delays associated with court
2. Keeping things private
3. Ability of Trust to stretch distributions over a longer period
4. More flexibility in planning options
5. Peace of mind of knowing plan works now and will continue after you pass.

Additional considerations that should be addressed in your estate and gift plan should be special gifts and legacies. With these, I don't mean just money values; I mean the family homestead acres that were settled by your great-grandparents, the antique ring that was your great aunt's, the work ethic you have instilled into building your own farming enterprise or business. When you look at your plan, you should ensure these things are passed to the person who will cherish them as you have, not the person who is looking for quick liquidation.

The best example of this I can give is if you can imagine a farmer with a son and daughter. The son went off and worked in the city, but the daughter and her family stayed on the farm and helped mom and dad work the land and build the farm. When mom and dad die, is it equitable to give the son, who had no interest or input to the farm for the last 20 years, one-half of what is now the daughter's only livelihood? Conversely, should the son be completely disinherited? I would answer "No" to both of these questions, because the true answer rests with each client and options available to him, once he is able to make an informed decision.

A Sample Scenario

Let's run a scenario of a couple I know in southwest Oklahoma. Both spouses are alive now in 2012, but Husband (H) is 92 and in failing health and Wife (W) is 90 and still pretty spry. H & W farm and through saving, hard work, and a little inheritance were able to accumulate around 2,600 acres near the El Dorado area. Luckily for them, oil was discovered under large portions of their land and because they have owned most of it for many years, they have almost all of the mineral rights. They have finally retired and are just now enjoying "comfortable" years with mineral incomes around $18,000 per month. If you talk with H, he still considers himself a lucky farmer and still drives the same old pick-up. All they really have done is built a few barns, remodeled their old farmhouse, and put the rest of the oil money in CDs at the local banks. Right now, they still have the same Wills they created 60 years ago that say give everything to my spouse when I die and when he/she passes, split it equally among our three children.

First, we should look at the tax inclusion value of H & W's assets. Based on land prices in the area, the surface acres would be worth about $600 per acre ($1,560,000). In addition, the mineral interests would be valued about $1,296,000. H & W have also accumulated about $300,000 in banking accounts from the minerals and have a few other assets (cattle, cars, tractors, their home) worth about $180,000 total. This gives H & W a taxable estate of

$3,336,000. If they were to plan properly and give everything away this year, they could do so without any transfer taxes being due. However, H & W are independent, so that doesn't work for their needs; they want to enjoy what they have spent a lifetime accumulating.

Next, let's assume that H & W do nothing to change their estate plan (the 60 year old Wills). If H were to pass this year, he would be entitled to pass up to $5,120,000 without taxation. But, H's Last Will and all the joint tenancy property says that all goes to W, and as stated above, there is an unlimited marital deduction, so nothing is protected against future taxation.

So now W has the whole $3.3 Million in assets. As we said, W is spry, but she will ultimately pass away too. Let's assume that W lives until July 2013 and then passes away in her sleep. In 2013, we can no longer take advantage of the increased exemption amount and all assets in excess of $1,000,000 will be subject to about 50% taxation. In this scenario, the lack of proper planning has cost H & W's children about $1,168,000 in taxes. In addition to the taxation, all of W's assets will be subject to probate, which will result in about a one year delay in being distributed to the kids and will cost them about $50,000 or about 1.5% (standard rate in the Altus area for a probate attorney) of the Estate's total value.

The better planning alternative would have been to utilize a trust that could have ensured that H used the majority of his lifetime exemption and that W would have had a non-taxable (or as minimal as possible) estate at the time of her passing. Proper planning could also ensure that H & W's three children know how to split the farming assets and would provide for equitable treatment of all three, even if the elder daughter, who lives in Dallas, has no interest in the farming operation.

Final Considerations

While 2012 offers unique opportunities for tax planning, everyone should look at having an estate plan in place as soon as possible. The benefits may not just be tax savings, but could also be peace of mind in knowing that you have planned for your children's future and that your legacy after death will be as solid as your reputation during your life.

If you are concerned about your legacy and you think you will benefit from proper planning, then contact my office for advice specific to your situation. I can be reached by phone at (580) 318-8829 or by email at swokestateplanner@gmail.com.

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