

Estate Planning— Gift, Estate and Inheritance Taxes

The Federal government levies gift and estate taxes on the right to transfer property in life or after death. The State of Maryland levies inheritance taxes on the right to receive property. Only a small percentage of citizens are liable for gift and estate taxes. The Maryland inheritance tax is not related to the Federal tax, so you may be liable for State death taxes even if there is no tax liability at the Federal level. This publication will help you avoid gift taxes and will suggest strategies to minimize death taxes if your estate will be subject to these taxes.

Federal Gift and Estate Taxes

How are gifts and estates taxed?

All gifts (transfers while living) and bequests (transfers at death) made after January 31, 1976, are subject to a unified tax rate that is both cumulative and progressive. A tax is cumulative if previous gifts are added to current gifts or bequests before the tax calculation is estimated. The tax schedule is progressive because each successive gift or final bequest is taxed at the next higher rate. For example, if you make a taxable gift this year of \$50,000 and another taxable gift next year of the same amount, this year's tax will be at the \$50,000 rate while next year's tax will be levied on the combination of both gifts or \$100,000, which increases the tax rate from 24 percent to 28 percent as seen in Table 1.

Must taxes be paid on all gifts?

You are not required to report or pay taxes on all gifts. To eliminate the payment of tax on small gifts such as birthday or holiday gifts, there is a \$10,000 yearly exclusion for all gifts made to any one person. Each additional person to which a gift is given entitles the giver another maximum \$10,000 (or \$20,000 joint) exclusion. After 1997, these amounts are indexed annually for inflation.

Several other classifications of gifts also go untaxed. These include amounts transferred between husband and wife, amounts transferred directly to an educational institution for tuition, amounts transferred to a health care provider for medical expenses on behalf of another person, and gifts to charity. In addition, your deduction for charitable contributions is generally limited to 50 percent of your adjusted gross income. This deduction increases the tax benefit for charitable giving.

What must be done if gifts to any one person total more than \$10,000 in any one year?

In such an event, the donor (gift-giver) must file a Federal Gift Tax Form by April 15th of the year following the gift. The donor may not have to pay the tax due because there is a unified credit that eliminates the payment of gift and estate taxes up to the current exemption amount (see Table 2). The donor must deplete his or her unified credit before the Internal Revenue Service will accept the cash payment of the tax.

Table 1. Unified estate and gift tax tables, 1993 and thereafter.

If the amount is:		Tentative tax is:		
Over	But not over	Tax	+ Percentage	On excess over
0	\$10,000	0	18	0
\$10,000	20,000	\$1,800	20	\$10,000
20,000	40,000	3,800	22	20,000
40,000	60,000	8,200	24	40,000
60,000	80,000	13,000	26	60,000
80,000	100,000	18,200	28	80,000
100,000	150,000	23,800	30	100,000
150,000	250,000	38,800	32	150,000
250,000	500,000	70,800	34	250,000
500,000	750,000	155,800	37	500,000
750,000	1,000,000	248,300	39	750,000
1,000,000	1,250,000	345,800	41	1,000,000
1,250,000	1,500,000	448,300	43	1,250,000
1,500,000	2,000,000	555,800	45	1,500,000
2,000,000	2,500,000	780,800	49	2,000,000
2,500,000		1,025,800	50	2,500,000

For estates exceeding \$10,000,000, there is an add-on tax of 5 percent. See your estate planning professional for further details.

How does the unified credit work?

The unified credit offsets the tax due, dollar for dollar, up to the limits discussed previously. It is called a unified credit because the amount of the credit used for taxable gifts reduces the amount available for the payment of estate taxes.

To determine the schedule of increases in the unified credit and the amount that can be left tax free, see Table 2. The table starts with 1987 to allow taxes to be estimated on taxable gifts that have been given in previous years.

How can a split gift reduce gift taxes?

A gift made by a married couple that exceeds the yearly \$10,000 exclusion may be split for gift tax purposes when only one owns the gifted assets. By splitting the gift, each spouse is assumed to have given half of it, thereby allowing each to use the yearly exclusion or unified credit. The tax is eliminated if the gift does not exceed \$20,000. When a split gift exceeding \$10,000 is made, a gift tax form must be filed by the owner of the assets declaring the intent to split the gift even when no tax is due. While the other

spouse is not required to file, it is desirable to do so. When the assets gifted exceed \$20,000, splitting the excess causes each half to be taxed at the lowest rate. Because the tax is progressive, the tax on two \$50,000 gifts is less than one \$100,000 gift.

How do I know if my estate will have to pay estate taxes?

It is necessary to estimate the value of everything you own along with rights to property owned by someone else. Some examples include property in which you have a right to income such as unpaid loans or uncollected fees; property where you have a right to income for life such as a trust; property in which you can designate who shall have the right to income or possession; property transferred during your life when you have retained the power to alter, amend, revoke or terminate the trust; property owned as a joint tenant; and the value of life insurance if you are the owner. A properly completed net worth statement with estimates of the value of your assets at death will help you determine if your estate is likely to be taxed. Estates valued at less than the current exemption amount are not taxed.

Table 2. The unified credit and the exemption amount that can be left tax free.

Year	Unified credit	Exemption amount
1987-1997	\$192,000	\$600,000
1998	202,050	625,000
1999	211,300	650,000
2000-2001	220,550	675,000
2002-2003	229,800	700,000
2004	287,300	850,000
2005	326,300	950,000
2006 and later	345,800	1,000,000

What should I do if my estate will be subject to taxation?

At your death, you may leave your estate to your spouse without taxation; however, at your spouse’s death the remainder of your estate plus any assets owned by your spouse will be taxed if the combined assets exceed the amount of the unified credit. To avoid taxation on the second estate, another strategy must be used. Instead of giving your assets outright to your spouse, establish a bypass trust. A bypass trust takes advantage of the unified credit discussed earlier. When assets are given directly to a spouse, the unified credit is not used and is, therefore, lost. To use the credit, establish a bypass trust in the amount of the current exemption amount. Your spouse is able to receive income from this trust, and any amount remaining in the trust goes to your children or other heirs tax free at your spouse’s death. This strategy is particularly important if your estates are equal in size so that an outright bequest doubles the size of the remaining estate subjecting it to a much higher tax rate. The use of a bypass trust would allow a joint estate of up to twice the value of the exemption amount to pass to the next generation without taxation.

Special Situations

I have married for the second time and would like to support my new spouse for life, but I really want any remaining property to go to my children. Is this possible?

Under present law, it is possible to set up a qualified terminable interest property (QTIP) trust. This is a form of a marital deduction trust that allows you to support a surviving spouse and at the surviving spouse’s death direct the remainder to whomever you choose. This trust qualifies for the marital deduction, but whatever remains will be taxed in the estate of the surviving spouse.

To equalize the size of our estates while we are both alive, should I give my spouse my portfolio of appreciated stocks and my half of the house that we own jointly?

No, because if you die first, such a gift will increase the income taxes due on these assets when your survivor sells them. If you wait until you die to pass on these assets, they will be valued as of your date of death not at the much lower purchase price, thus saving on the amount of income tax due.

What is the extra exclusion for family-owned businesses including farms?

When the value of the family-owned business is greater than 50 percent of the value of the decedent’s estate and certain other requirements (see your tax advisor), the maximum exemption amount rises to \$1.3 million in 1998.

Estimation of Estate Taxes

Now that I know some of the strategies for minimizing taxes, how can I actually take a look at my present estate tax situation?

To estimate your taxes, use the form included in this fact sheet. First, estimate the value of your possessions to determine your gross estate. Your gross estate is used for the calculation of Federal taxes. It includes your probate estate, which passes through your will, as well as the property discussed previously that may not pass through your will.

Second, deduct expected medical, funeral and estate administration expenses, and expenses that will result from taxes and debts. Because the exact amount of these expenses is not known before death, financial advisors generally suggest entering an amount equal

to 5 percent of your gross estate. The result is your adjusted gross estate.

Third, enter the amount you plan to leave your spouse tax free and the amount you plan to leave to charity. The amount you leave to your spouse tax free may be reduced through the use of a bypass trust. These deductions will provide an estimate of your taxable estate.

Fourth, add taxable gifts made after 1976, or adjusted taxable gifts, to your calculations. This addition indicates your tentative tax base.

Fifth, determine your tentative tax (see Table 1).

Sixth, subtract gift taxes paid since 1976. This will yield the tax payable before reduction by credits. The credits include the unified credit (see Table 2), the state death tax credit that can be estimated from Table 3, credit for foreign death taxes, and the credit for tax on prior transfers for which a tax was actually paid in the estate of a previous decedent thus preventing double taxation.

Table 3. State death tax credit*

If the amount is:		Tentative tax is:		
Over	But not over	Tax	+ Percentage	On excess over
\$100,000	\$150,000	0	0.8	\$100,000
150,000	200,000	\$400	1.6	150,000
200,000	300,000	1,200	2.4	200,000
300,000	500,000	3,600	3.2	300,000
500,000	700,000	10,000	4.0	500,000
700,000	900,000	18,000	4.8	700,000
900,000	1,100,000	27,600	5.6	900,000
1,100,000	1,600,000	38,800	6.4	1,100,000
1,600,000	2,100,000	70,800	7.2	1,600,000
2,100,000	2,600,000	106,800	8.0	2,100,000
2,600,000	3,100,000	146,800	8.8	2,600,000
3,100,000	3,600,000	190,800	9.6	3,100,000
3,600,000	4,100,000	238,800	10.4	3,600,000
4,100,000	5,100,000	290,800	11.2	4,100,000
5,100,000	6,100,000	402,800	12.0	5,100,000
6,100,000	7,100,000	522,800	12.8	6,100,000
7,100,000	8,100,000	650,800	13.6	7,100,000
8,100,000	9,100,000	786,800	14.4	8,100,000
9,100,000	10,100,000	930,800	15.2	9,100,000
10,000,000	amounts in excess of	1,082,800	16.0	10,100,000
		10,100,000		

* To determine the amount to be taxed, subtract \$60,000 from the amount of the taxable estate.

You now have an estimate of the net Federal tax payable. If you find that you must pay taxes, consider reducing the amount in the marital deduction and setting up a bypass trust. Competent legal advice must be sought to carry out this strategy.

Maryland Inheritance and Estate Taxes

What about the Maryland inheritance tax?

The Maryland inheritance tax is a tax paid by beneficiaries on what they inherit. The decedent may specify that the tax be paid from the estate. The tax is collected by the Register of Wills from the personal representative as a part of the accounting process. There is no specific form for the tax itself. On inheritances to direct descendants and the surviving spouse, the rate is 1 percent. Jointly owned property passing to the spouse is not taxed. Additionally, life insurance proceeds passing to a named beneficiary are not taxed. Real estate and \$100,000 of personal property passing to a surviving spouse are not taxed for deaths occurring after July 1, 1985.

Distributions to all others are taxed at the rate of 10 percent.

A law that went into effect on July 1, 1988, exempts small estates up to \$20,000 from Maryland inheritance taxes. Also eliminated for small estates are probate accounting and publishing requirements, such as death notices setting a specific time for dealing with debts, inventory listings and accounts of costs.

What is the Maryland estate tax?

When the Federal estate tax form is completed, a credit is allowed for State taxes paid (see Table 3). This credit may be more than or less than the amount actually due in Maryland. If the amount paid for the Maryland inheritance tax does not equal the Federal estate tax credit, the difference is due Maryland as the Maryland estate tax.

If your estate will be subject to estate taxes, consult an attorney or accountant specializing in estate tax minimization. For further information on estate planning, request the series of fact sheets called "Estate Planning" from your local Cooperative Extension office. Titles in this series include: Fact Sheet 382, "Writing Wills in Maryland;" Fact Sheet 414 "Goals, Net Worth and Last Instructions;" Fact Sheet 410, "Owning and Transferring Property."

Estimating Estate Taxes Due

Start with	Value of all property at death plus rights to property	self	spouse
Equals	Gross Estate	_____	_____
Subtract	Deductions	<u>self</u>	<u>spouse</u>
	Medical expenses	_____	_____
	Funeral expenses	_____	_____
	Administrative expenses	_____	_____
	Debts and mortgages	_____	_____
	Certain taxes	_____	_____
	Total	- ()	()
Equals	Adjusted Gross Estate	= _____	_____
Subtract	Marital deduction	- ()	()
	Charitable deductions	- ()	()
Equals	Taxable Estate	= _____	_____
Add	Adjusted Taxable Gifts	+ _____	_____
Equals	Tentative Tax Base	= _____	_____
Determine	Tentative Tax (Table 1)	_____	_____
Subtract	Gift Taxes Paid Since 1976	- ()	()
Equals	Tax Payable Before Reduction by Credits	= _____	_____
Subtract	Unified credit (Table 2)	- ()	()
	State death tax credit (Table 3)	- ()	()
	Credit for foreign death taxes	- ()	()
	Credit for tax on prior transfers	- ()	()
Equals	Net Federal Estate Tax Payable	= _____	_____

Estate Planning—Gift, Estate and Inheritance Taxes

by

Patricia M. Tengel

Family Resource Management Specialist

Family and Consumer Sciences

Issued in furtherance of Cooperative Extension work, acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, University of Maryland, College Park, and local governments. Bruce L. Gardner, Interim Director of Maryland Cooperative Extension, University of Maryland.

The University of Maryland is equal opportunity. The University's policies, programs, and activities are in conformance with pertinent Federal and State laws and regulations on nondiscrimination regarding race, color, religion, age, national origin, gender, sexual orientation, marital or parental status, or disability. Inquiries regarding compliance with Title VI of the Civil Rights Act of 1964, as amended; Title IX of the Educational Amendments; Section 504 of the Rehabilitation Act of 1973; and the Americans With Disabilities Act of 1990; or related legal requirements should be directed to the Director of Human Resources Management, Office of the Dean, College of Agriculture and Natural Resources, Symons Hall, College Park, MD 20742.