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BRIEF OVERVIEW OF DEATH AND GIFT TAXES (2007)

- 1. Due Date.** A federal estate tax ("death tax") is a tax imposed on the right of a decedent to give away assets at death. The tax is due and payable in full nine months following a decedent's death unless an extension or long term payment plan is available.
- 2. Computation.** The death tax is assessed against a person's "net estate". To determine the "net estate", you first value the decedent's gross assets at fair market value, not cost (this includes proceeds payable at death from life insurance policies and pension and profit-sharing plan benefits if the decedent has the right to designate who will receive them at death); and then you deduct any mortgages, tax liabilities, debts, funeral and administration expenses.
- 3. Spousal Exclusion.** Any part of a decedent's net estate which passes to a spouse **who is a United States citizen** (either outright or in a qualifying manner such as a Qualified Terminable Interest Property - or "QTIP"- Trust) passes free of death tax. Effective January 1, 1989, any property passing to a **non-citizen spouse** may escape the death tax at the first spouse's death only if the disposition is in a "Qualified Domestic Trust" ("QDOT").
- 4. Charitable Exclusion.** Any part of a decedent's net estate which passes to a charity (either outright or in a qualifying manner, such as a charitable remainder trust) passes free of death tax.
- 5. Exempt Amount; Tax Rates.** For deaths in 2007, the first \$2,000,000 of assets which passes to persons other than a spouse or charities is free of any death tax. Any assets in excess of \$2,000,000 are taxed at 45%. For deaths after 2007, the exempt amount is scheduled to increase as follows:

2008	\$2,000,000
2009	\$3,500,000
2010	No death tax whatsoever
2011	\$1,000,000
- 6. No Separate California Death Tax.** On June 9, 1982, California abolished its separate "inheritance tax" system. For deaths prior to 2005, any death tax computed under paragraph 5 above was divided between the federal and California governments. For deaths in 2005 and later, the federal government eliminated California's right to receive any portion of the federal death tax. We no longer file any death tax return with California. If a decedent owns real properties outside California, other states may impose an estate or inheritance tax.
- 7. What Changes Do We Anticipate Will Occur To Our Federal Death Tax System?** Our federal death tax system is likely to change, but any changes involve politics, and we can only guess at future changes. In 2002 Congressional Democrats proposed immediately increasing the exempt amount to \$3,000,000 per decedent (with planning, a husband and wife could have thus sheltered two exemptions, or \$6,000,000, from death tax). Congressional Republicans argued for a complete repeal of death taxes, but insisted that the repeal be gradually "phased in" over a ten year period. In late 2006 Congress proposed increasing the death tax exemption to \$5,000,000 per decedent, with a 15% death tax rate on the next \$20,000,000 in assets, and a 30% death tax rate on all assets above \$25,000,000, all of which changes would occur for deaths in 2015 and later. 2002 and 2006 were election years, so nothing passed, but these proposals may give us some hint about how our future death tax laws may change.
- 8. Gift Tax Rules.** We also have a lifetime gift tax. Our present gift tax rules allow any person (called a "donor") to make annual gifts to each of any number of recipients (called "donees") of \$12,000 or less without any reporting

requirement or gift tax assessed; and to make additional lifetime gifts of up to \$1,000,000 (in the aggregate) without any gift tax being imposed (but with a reporting required on US Treasury Form 709, and a corresponding dollar for dollar decrease in the exempt amount available for death tax purposes). Any lifetime gifts made in excess of these amounts will be taxed at 45%. For high net worth individuals, a program of lifetime gifts can prove to be very beneficial from both a tax standpoint and also from a practical non-tax standpoint. Such a program may involve annual exclusion gifts, 529 Plan (educational) gifts, direct payments to providers for tuition and medical expenses, qualified personal residence trusts (QPRTs), charitable remainder trusts (CRTs), private annuities, the creation of limited partnerships and limited liability companies (LLCs), and other vehicles.