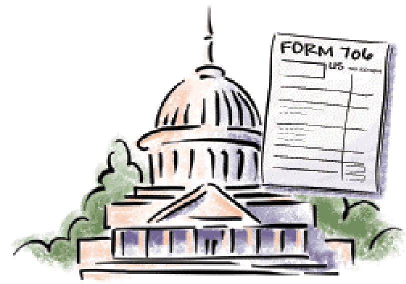
The Federal Estate Tax

An Overview for 2006



The federal estate tax is an excise tax on the right to transfer property at date of death. The gross estate includes the fair market value of all assets owned by the decedent as of the date of death, including life insurance policies. The top estate tax bracket is 46%[1] on taxable estates over $2,000,000.

The tax applies only to taxable estates that exceed the applicable exclusion amount ($2,000,000[2] for 2006).

Transfers between spouses generally qualify for the unlimited marital deduction and are free of current tax. See IRC Sec. 2056.

The estate tax return (Form 706) and any taxes due are generally payable nine months after date of death. In some situations, a portion of the taxes may be paid to the IRS in installments. See IRC Secs. 6161 and 6166.

If the value of the estate assets declines during the first six months after death (which often happens if the decedent owned a business), the value (for all assets) as of six months after death may be used on the tax return.

Lifetime gifts that exceed the annual gift tax exclusion ($12,000 per donee per year)[3] will also reduce the estate owner's applicable credit amount.

Some transfers made during one's lifetime may be brought back into the decedent's estate. A few examples are listed below.

- Transfer of life insurance policies within three years prior to death. See IRC Sec. 2035.
- Transfer of an asset from which the donor retains an income for his or her life. See IRC Sec. 2036.
- Transfer of an asset where donor retains the right to alter or terminate the transfer. See IRC Sec. 2038.
- Assets placed in joint tenancy with another are included in the gross estate.

Note: Under the Tax Act of 2001, the federal estate tax is gradually phased out until its final repeal in the year 2010. If Congress does not act at that time to repeal it for the years following, it will automatically revert back to the rates in effect during the year 2001, with an exemption for the first $1,000,000 of assets.

[1] The top bracket will reduce as follows: 47% in 2005; 46% in 2006; 45% from 2007 through 2009; and zero taxes in 2010. If Congress does not act at that time to repeal the federal estate tax for the years following, in the year 2011 the top bracket of 55% will automatically return.

[2] The applicable exclusion amount is the dollar value of assets protected from federal estate tax by an individual's applicable credit amount. It is scheduled to change as follows: $1,500,000 in 2005; $2,000,000 for 2006-2008; $3,500,000 for 2009, zero federal estate tax for the year 2010; and $1,000,000 for 2011 and thereafter (unless permanently repealed or otherwise modified).

[3] The annual gift tax exclusion ($12,000 in 2006) is indexed for inflation in increments of $1,000.

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