



The Principal Financial Group®

# Ways to Minimize Transfer Taxes

## What are transfer taxes?

Transfer or estate taxes are levied against an individual's estate at death. The portion of an estate that is so taxed is the part exceeding a specific exempt amount. In 2007 and 2008, the amount is \$2 million (which means an estate under this amount is not taxed). This figure increases to \$3.5 million in 2009. The federal estate tax is scheduled for repeal for a single year—2010—resuming again in 2011.

## How bad is the effect of these taxes?

The estate tax rate is 45% in 2007–2009. In 2011 when the tax is reinstated, the top rate will jump to 55%. In larger estates, these high tax rates can result in millions of dollars going to the IRS instead of to an individual's heirs.

## How can these taxes be minimized?

One method involves making **nontaxable gifts** while the individual is still living, thus gradually depleting the amount of the estate subject to taxation when the individual dies. The maximum amount that may be given gift tax-free each year to any one person is \$12,000 in 2007 (indexed for inflation in \$1,000 increments). Up to this amount may be given to as many people as the taxpayer chooses. A married person's spouse may also give the permitted amount to any number of people. The estate is reduced and the heirs can enjoy their inheritance while the individual is still alive.

Another method is an **irrevocable life insurance trust**. The individual pays premiums for a life insurance policy owned by the trust.

The annual premium may be any amount up to the gift tax-free maximum (e.g., \$12,000 in 2007). The taxpayer's heirs are beneficiaries of the trust. The estate is, again, reduced significantly, and when the taxpayer dies, policy proceeds are paid to the trust, free of both federal income and estate taxation.

Married couples get some special breaks. The **marital deduction** rules allow spouses to give and receive from each other unlimited assets without incurring current taxes. Taxes are payable only when the second spouse dies.

A **bypass or credit shelter trust** also helps married couples ensure they use both of their estate tax exemptions to full benefit. When the first spouse dies, part of the assets go into a bypass trust from which the survivor may receive lifetime income. The remainder of the assets may be given outright to the survivor or placed in a marital trust. When the second person dies, amounts in the bypass trust are excluded from the estate, but any assets in the marital trust are included in the survivor's estate.

Other strategies to minimize taxes include **charitable gifts, private annuities and installment sales**. When considering any strategy to minimize transfer taxes, individuals must first carefully analyze their personal financial situations and understand the details of all available options.



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