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IRS Clarifies Estate Rules



The Internal Revenue Service last week clarified a provision of the estate tax affecting people who die in 2011 and 2012. The good news: The paperwork process is now clearer for surviving spouses. But the new rules could pose problems for some.

Last December, Congress reinstated the estate tax after allowing it to lapse in 2010, and raised the amount of money exempt from the tax to \$5 million per individual or \$10 million per married couple.

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In 2013, the federal estate tax exemption drops to \$1 million as the federal estate tax rate jumps to 55%. **In addition to federal taxes, a number of states (including New Jersey), assess estate or inheritance taxes on assets below \$5 million.** New Jersey is one of the most abusive states in the country, with a mere \$675,000 state estate tax exemption and startling high 16% maximum state estate tax rate.

One powerful tool to mitigate federal and state estate taxes is the Credit Shelter Trust (CST). The CST, sometimes called a bypass trust allows each spouse to take advantage of his or her full federal or state estate tax exemptions. The trust comes alive, as defined by the wills, when the first spouse passes. To maximize the tax benefits, the wills dictate the funding of the CST at the maximum amount permitted by the exemptions in that year.

Another powerful tool to mitigate federal and state estate taxes is the Irrevocable Life Insurance Trust (ILIT). While the beneficiaries of life insurance policies are not subject to taxation, the owner's estate could be – as life insurance is added to the estate's value. An estate that would normally be exempt from both federal and state estate taxes could become subject to both when life insurance proceeds are included.

With the ILIT, the trust is the beneficiary of the life insurance proceeds, not your estate. Once the ILIT is established, the trust can purchase a life insurance policy on your behalf, with the trust stipulating who will receive the assets and under what conditions.

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