WHAT IS THE FEDERAL ESTATE TAX?

We have had a federal estate tax for 106 years and while Congress has repealed it on seven occasions, it always promptly brought the tax back within six months. Congress has repealed the estate tax for the year 2010 and true to form it is scheduled to be back in effect in 2011.

The fact that George Steinbrenner and the owner of Taco Bell avoided paying billions in estate tax by dying during the year 2010 did not escape the notice of a lot of people in the media and the Congressional budget committee. Historically, less than 2% of all estates were subject to the federal estate tax because the exemption used to be $3,500,000. Those estates that do pay the tax are often stung by the fact that the tax rate is 53% of everything that the deceased person owned above the exempt amount including assets located overseas. Here are some of the important things to know about our federal estate tax.

First, any asset, which is transferred to a spouse is completely exempt from the tax. Obviously, this is because most congressmen are married. During the Clinton administration, Congress adopted the Defense of marriage act so this benefit is not available to people in domestic partnerships or civil unions. It is also limited in some ways to United States citizens only.

While the proceeds of most life insurance policies are exempt from income tax, they are not exempt from the federal estate tax. This is an important consideration for people who have large life insurance policies. Pensions and IRA 's are also subject to the tax which can cause both estate and income tax inclusion. This can be a triple whammy when you consider state income taxes.

Aside from the exemption for property going to a spouse, there will also be a $1 million exemption for each estate. The fact that so few people have assets which exceed this amount is the reason that so few estates are actually subject to the tax. However, if house prices begin to go back up, and the stock market ticks up a bit, more and more people will be subject to the tax when they add up insurance, property, pensions and portfolios. A second reason why so few estates used to pay the tax is that the exemption used to be $3,500,000. Now that Congress has cut the exemption down to $1,000,000, the tax and it's 53% bite will impact more families.

With careful planning, some of the impact of the tax can be avoided. Some of the more common techniques include gifting, the use of credit shelter trusts, life insurance trusts, valuation discounts and charitable trusts. Like the home mortgage interest deduction, these techniques must be limited to estate tax benefits authorized by Congress and approved under the Internal Revenue Code.

No one likes to deal with death or taxes, but it does make some sense to plan ahead. The 53% tax is one of the highest rates in the Internal Revenue Code. The estate tax returns on January 1, 2011 and that makes this year a good year to do some planning with your financial and legal experts.

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