

Autumn 2006

2006 Estate and Gift Tax Update

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Every year seems to bring new changes to the State and Federal estate tax laws and this year is no exception. This year has seen the increase of both the State and Federal estate tax exemption amounts. As of January 1 an individual may pass up to \$2,000,000 free of Federal estate taxes under the Federal applicable exclusion amount. (Last year's exemption amount was \$1,500,000). This means that, with proper planning, a married couple may leave \$4,000,000 to their children free of Federal estate taxes. On January 1 the Minnesota exemption amount was increased from \$950,000 to \$1,000,000. Under Minnesota law a married couple, with proper planning, may pass up to \$2,000,000 to their children free of state estate taxes.

The considerable difference between the size of the Federal applicable exclusion amount and the Minnesota exemption amount can have significant implications for the estate plans of Minnesota residents (or non-residents owning property located in Minnesota). If a Minnesota resident dies leaving property with a value equal to the \$2,000,000 Federal applicable exclusion amount to non-spousal beneficiaries a Minnesota estate tax liability will be imposed on the \$1,000,000 of assets in excess of the Minnesota exemption amount. The Minnesota estate tax liability a decedent's estate would incur under those circumstances would be \$99,600.

It is expected there are likely to be many instances where a Minnesota decedent will have no Federal estate tax liability but will owe significant Minnesota estate taxes. Individuals with gross estates in excess of \$1,000,000 or married couples with gross estates in excess of \$2,000,000 are advised to review their estate plans to ensure they are properly structured so as to reduce or eliminate both the state and Federal estate taxes that may be imposed at death.

As of January 1 the Federal estate tax has entered a "flat tax" world. Federal estate taxes will be imposed on amounts in excess of the \$2,000,000 applicable exclusion amount at a rate of 46%, the maximum rate under the Federal estate tax laws. The Minnesota estate tax will be imposed at an average



rate of 16%.

We anticipate additional changes to the Federal estate laws. The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") provided for increasing exemption amounts through 2009 and a repeal of the Federal estate tax in 2010. However, because of budgetary requirements the provisions of EGTRRA are to sunset at the end of 2010. At that time the Federal exemption amounts are scheduled to revert to \$1,000,000 and the Federal estate tax will again be imposed at the rates provided for in the Tax Relief Act of 1997.

President Bush has long expressed his desire to make EGTRRA's repeal of the Federal estate tax permanent. Most commentators and political observers do expect Congress to revisit the Federal estate tax laws in the near future. However, few commentators believe the Federal estate tax will be permanently repealed. Most observers believe permanent repeal is no longer politically feasible given the colossal rebuilding costs required in the wake of Hurricane Katrina and the mounting size of the Federal deficit. It now appears that those formerly advocating a permanent repeal of the Federal estate tax are prepared to accept an estate tax but are seeking a drastic reduction in the estate tax rates from 46% to 15% and an increase in the applicable exclusion amount to either \$3,500,000 or \$5,000,000.

At this time it is impossible to predict what Congress may do to the Federal estate tax. This is politically charged issue and its resolution is sure to be influenced not only by the upcoming mid-term Congressional elections but the 2008 presidential election which will begin in earnest a little over a year from now. We urge everyone should keep an eye on this issue as changes are almost certain to occur and they could have a significant impact on your estate plan.

The changes to the Federal gift tax laws have been much more modest. EGTRRA increased the Federal gift tax exclusion amount to \$1,000,000 in 2004. It has not nor is it scheduled to increase beyond that level. There has been a change to the

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Federal gift tax annual exclusion amount however. Effective January 1 of this year the annual exclusion amount is \$12,000. (This is an increase from the \$11,000 annual exclusion amount that was in effect from 2002).

Recent changes to state and Federal gift and estate tax laws may have a significant effect on your estate plan. We urge you to have your plan reviewed by a qualified attorney in order to determine whether it will continue to achieve your goals in the most tax efficient manner.

Several weeks ago the United States House of Representatives passed a bill that would provide for a phased increase of the estate tax exemption amount to \$5,000,000 per person. The bill has been sent to the U.S. Senate for consideration. If enacted, the new law would impose the federal estate tax on approximately the top 1/4 of 1% of the wealthiest Americans. However, as of this time the fate of the federal estate tax still remains uncertain.

The U.S. Treasury Department requires us to advise you that this written advice is not intended or written to be used, and it cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer. Moreover, this advice may not be used to support the promotion or marketing or recommendation of any entity, investment plan or arrangement to any taxpayer. The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

The opinions and ideas expressed herein do not constitute legal advice and should not be relied upon as such. If you have a specific legal problem, please consult a lawyer.

Meet Red Wing City Council Candidates

The League of Women Voters will host a *Meet the Candidates* session for all City Council Candidates on September 6 from 5:00 to 7:00pm in the Foot Room of the Red Wing Public Library. Citizens are encouraged to visit with candidates about issues of concern. Candidate will make brief presentations beginning at 6:00pm.

Remember to Vote . . .

September 12 Primary

November 7 Election Day



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