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Client Update

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Estate planning and taxes

When you die, you want to be sure that your estate goes to your desired beneficiaries. Estate planning is the process of naming those beneficiaries and managing the tax consequences of passing your wealth to those institutions or individuals. If your estate exceeds a certain value, you owe estate taxes.

To administer your estate, you may wish to establish a will or trust. Otherwise, you will die intestate, which requires that your estate go through probate. Probate is a relatively expensive and time-consuming process that requires a state court to distribute your estate.

You owe estate taxes on the value of your estate that exceeds the applicable exclusion limit. The Economic Growth and Tax Relief Reconciliation Act of 2001 gradually lowers the maximum estate tax rate, from 55% to 45%, repealing the tax for one year in 2010. The exclusion limit and maximum tax rate revert back to 2001 levels in 2011.

If the value of your estate exceeds the applicable exclusion limit in the year of your death, you must file IRS Form 706.

For 2005, the applicable exclusion limit is \$1 million and maximum tax rate is 47%. The following table shows applicable exclusion limits and maximum tax rates through 2011. Future tax-law changes may affect these figures:

<u>Year</u>	<u>Applicable Exclusion Limit</u>	<u>Maximum tax rate</u>
2004	\$1.5 million	48%
2005	\$1.5 million	47%
2006	\$ 2 million	46%
2007	\$2 million	45%

2008	\$2 million	45%
2009	\$3.5 million	45%
2010	Repeal of estate tax	35% (gift tax only)
2011	\$1 million	55%

The 2001 tax law may make estate planning even more complex than it already can be. For one thing, the law in its current version is set to expire at the end of 2010. Other aspects of estate planning include:

1. **Unexpected events.** In the event you are impaired from a disease or accident, you may wish to arrange for key financial decisions to be made on your behalf. You can establish a living will, power of attorney agreement or revocable living trust.
2. **Marital deduction.** The marital deduction allows you to transfer to your spouse the entire value of your estate free of estate taxes. The marital deduction is a tax-deferral rather than tax-avoidance strategy. When the surviving spouse dies, his or her estate (the combined value of both estates) may be liable for estate taxes.
3. **Gifting.** Beginning in 2006, you can give up to \$12,000 to each individual or charitable organization in a year without paying gift taxes. There is no yearly limit for qualified educational expenses. Gifting lowers the value of your estate and distributes your wealth while you are living. Gifts made to charitable organizations may be tax-deductible, but gifts to your heirs are not tax-deductible.
4. **Unified tax credit.** The unified credit is a cumulative tax credit. If you give more than \$12,000 to an individual or charity in a year, taxes



owed on amounts that exceed the \$12,000 per-person limit are subtracted from your unified credit. To record gifts in excess of the yearly limit complete IRS Form 709 (for gift tax), which is the sister of Form 706 (for estate tax).

http://partners.leadfusion.com/tools/hrblock/lifeplanning_ed01/tool.fcs?toolpage=rpestate



Tax relief for hurricane victims and donors

This year, extra tax breaks go to the victims of recent Gulf Coast hurricanes as well as to hurricane-relief donors. Families who have opened their homes to storm victims rent-free for 60 days or more can claim an additional personal exemption of \$500 for each evacuee, up to a maximum of \$2000. And by special decree of Congress in response to Hurricane Katrina, residents of the affected areas are allowed to deduct the full amount of their uninsured casualty losses, rather than applying the usual restrictions. Residents of any presidentially declared disaster area can claim their casualty losses on their 2005 return next spring, or they can file an amended 2004 return to speed up the refund process.

Kiplinger's Personal Finance Advisor, December 2005

Opportunities in your Portfolio

Your investments offer many tax-saving options. Selling to realize losses now is an easy way to reduce your overall tax bill. Capital losses can offset all your gains and up to \$3000 of other income. Excess losses carry over to later years. But don't let tax consequences be the overriding reason you are selling stocks or bonds.

Beware the wash-sale rule. It bars any deduction for losses if you buy the identical securities within 30 days before or after a sale. Any losses suspended by this rule are added to the tax basis of the replacement securities. Investors in mutual funds can easily avoid this trap. All you need to do is buy replacement shares in a different fund with similar investment goals. For example, you can sell a large-company growth fund and reinvest the

proceeds in another fund family's large-company growth fund.

Watch the rules on capital gains. Long-term gains are taxed at a maximum rate of 15%. Profits are long term if you have owned the assets for more than one year and the holding period starts the day after the purchase and includes the day of the sale. Folks in the 10% and 15% brackets get a 5% rate on long term gains up to the point that their gains lift their income beyond the 15% bracket. The balance of their profit is taxed at the 15% rate.

Some gains face higher rates. Profits on sales of collectibles, such as art, antiques, gems, stamps, coins and bullion, have a top rate of 28%. Depreciation recapture on real estate is taxed at as much as 25%. Short-term gains are taxed as ordinary income at rates up to 35%. But in each case, long-term losses can offset high-tax profits dollar for dollar. So if you face a tax bill on high-tax gains, scour your portfolio for unrealized losses.

Giving appreciated stock to charity is a surefire tax saver. If you've owned the stock for more than a year, you can deduct the full value of your donation and escape paying any income tax on the appreciation. That's a double tax break. Giving appreciated securities is an excellent way to make gifts to your children as well. If the child is age 14 or older when the gift stock is sold, the gain would likely be taxed at 5%.

Dividends enjoy a special rate: 15% or less for dividends that qualify. But watch the holding period. The 15% rate doesn't apply unless you own the shares for at least 60 days during the 121 days that surround and include the ex-dividend date.



Be wary of buying into mutual funds late in the year. If a fund is about to pay a dividend, you should buy it after the record date. Otherwise, you're taxed on the payout this year, with no increase in your wealth. Call your fund to find out how large a distribution is expected.

A Kiplinger Special Report, Cut Your Taxes, November 2005