

DEATH & TAXES

WHAT YOU'RE DYING TO KNOW!

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COURSE OBJECTIVES

- Understand what gets reported on the decedent's final 1040.
- Provide an overview of the two types of estates for tax purposes.
- Learn what information to gather when a taxpayer dies.
- Understand the purpose of wills and trusts.
- Understand how basis "step-up" is calculated.
- Understand when beneficiaries might pay tax on an inheritance.
- Look at examples of death scenarios and learn what basic steps should be taken in each.

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THE DEATH OF A TAXPAYER MARKS TWO THINGS!

1. The close of the decedent's last tax year for personal income tax.
2. The beginning of a new entity – the estate.

○ You must determine:

- Is a final Form 1040 required for the decedent?
- Is a Form 1041 required for the estate?
- Is a Form 706 required for inheritance tax or portability?

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THE TWO TYPES OF ESTATES!

Death Estate or Inheritance Tax – Form 706

- An excise tax imposed for the right to transfer assets at death.
- For deaths in 2017, filing required if decedent's gross assets exceed \$5,490,000.
- This amount is reduced by adjusted taxable gifts from 1977 through death.
- Form 706 is due 9 months from DOD (6 month extension available).

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THE TWO TYPES OF ESTATES!

Death Estate or Inheritance Tax – Form 706

- Tax is based on net taxable estate.
- All tax is due by unextended due date of return.
- Even if filing is not required, surviving spouse may want to file to elect portability (the transfer of a decedent's unused inheritance tax exemption to a surviving spouse).
- Some states have their own inheritance tax filing requirements. (CT, DE, DC, HI, IL, IA, KY, ME, MD, MA, MN, NE, NJ, NY, OR, PA, RI, TN, VT, WA)

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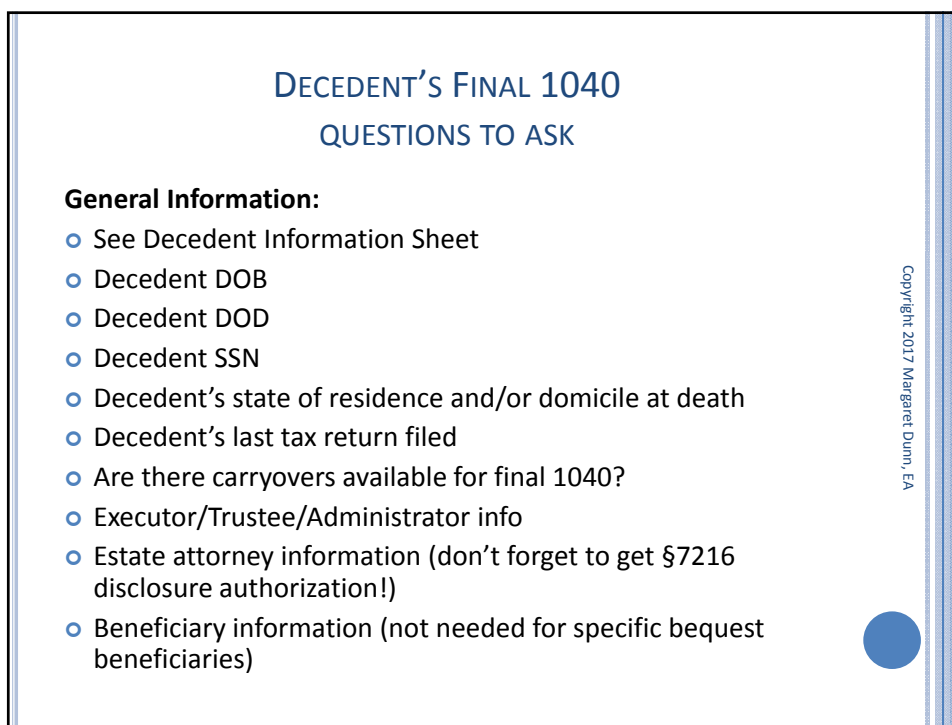
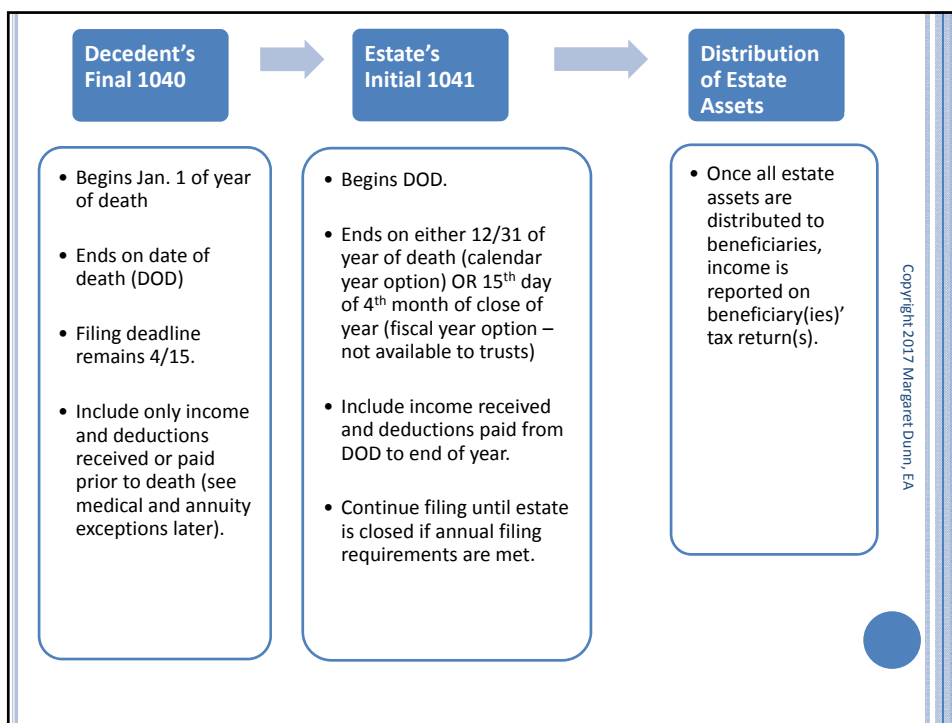
THE TWO TYPES OF ESTATES!

Estate Income Tax (Fiduciary) – Form 1041

- The method of taxing income received by decedent's assets between DOD and distribution of assets.
- Tax may be paid by the decedent's estate or sometimes income can be passed through to estate beneficiary(ies) via Form 1041 K-1.
- Federal tax rates for 1041 estates and trusts reach 39.6% when taxable income reaches \$12,500 for tax year 2017! (Single taxpayer doesn't reach that rate until taxable income exceeds \$418,401)
- LTCG rates are 20% plus 3.8% Medicare tax when income reaches \$12,500!
- Losses can only be passed through to beneficiaries on the final Form 1041.

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DECEDENT'S FINAL 1040 QUESTIONS TO ASK

Was decedent married?

- If yes, a joint return can be filed with Surviving Spouse for year of death provided Surviving Spouse doesn't remarry by end of year.
- MFJ election can only be made by the Personal Representative. This is usually the surviving spouse *but not always!*
- Personal Representative is the Executor(trix), Administrator or a person in charge of the decedent's property. Their duties include gathering decedent's assets, paying decedent's creditors, distributing decedent's assets, filing all required tax returns and paying all taxes.

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DECEDENT'S FINAL 1040 QUESTIONS TO ASK

When were expenses paid?

- Medical expenses for the decedent paid by the estate within one year of DOD can be deducted on decedent's 1040 in the year services were provided.
- Medical expenses before or after death of the decedent paid for a deceased spouse or dependent can be claimed in the year paid.
- If decedent was receiving an annuity prior to death and there was unrecovered basis at the time of death, the unrecovered basis can be claimed on the decedent's final 1040 as a Miscellaneous Itemized Deduction not subject to the 2% floor.
- Other expenses on behalf of decedent are deducted on Form 1041.
- Funeral expenses are only deductible on Form 706.

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DECEDENT'S FINAL 1040 QUESTIONS TO ASK

Did the decedent have a trust?

- **SIMPLE GRANTOR TRUST (Revocable):**
- Generally a trust establishes the following at death:
 - The appointment of a successor trustee(s);
 - Payments of debts and expenses;
 - Specific bequests;
 - Transfers to a surviving spouse;
 - Transfers to any children or other beneficiaries; and
 - Guardian for minor children and their assets.
- These trusts are “invisible” to IRS until a death or incapacity occurs. All income and expenses are reported under grantor’s SSN until grantor is no longer in control. Once grantor is no longer in control – through death or incapacity – the trust becomes irrevocable and must obtain an EIN if/when income is generated.

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DECEDENT'S FINAL 1040 QUESTIONS TO ASK

Did the decedent have a will?

- **SIMPLE WILL:**
- Generally a simple will establishes:
 - The appointment of an Executor(trix);
 - Payments of debts and expenses;
 - Specific bequests;
 - Transfers to a surviving spouse;
 - Transfers to any children or other beneficiaries; and
 - Guardian for minor children and their assets.
- “Pour over will” generally leaves all non-trust assets to an established trust.
- Some wills create a trust upon death.

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DECEDENT'S ASSETS QUESTIONS TO ASK

Differences to note between wills and trusts for tax purposes:

- Wills create a “decedent’s estate”.
- A decedent’s estate can be calendar year or fiscal year.
- Filing requirement begins at \$600 (0 if non-resident alien beneficiary).
- **Trusts can be “simple” or “complex”.**
- Simple trust (exemption amount is \$300):
 - All income distributed currently;
 - No charitable beneficiaries; and
 - No distribution of principal during the year.
- Complex trust (exemption amount is \$100):
 - Any trust that is not a simple trust!
- **All trusts must use a calendar year.**

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DECEDENT'S ASSETS QUESTIONS TO ASK

What assets did the decedent have at death ?

- Needed to determine if Form 706 is required.
- Needed to determine income that might be reported on Form 1041.
- Use a summary sheet similar to handout (Asset Summary).

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DECEDENT'S ASSETS

QUESTIONS TO ASK

How were assets titled or held at DOD?

- Needed to determine if Form 706 is required.
- Needed to determine basis for the income estate.
- Needed to determine basis for assets distributed to beneficiaries.

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BASIS

Basis considerations:

- How was titled held?
 - Community Property = full step-up (100% FMV on DOD)
 - Joint Tenancy = ½ step-up
 - Tenancy In Common = full step-up of decedent's portion
 - Separate (or solely owned) Property = full step-up
 - Community Property states - TWINCLAWN

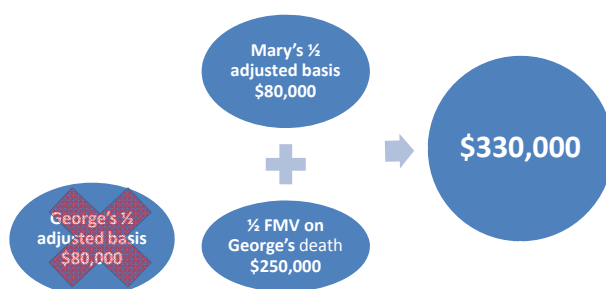
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BASIS

Half Step-up:

- George and Mary live in Fredericksburg VA, a non-community property state. They purchased their jointly owned home in 1980 for \$100,000 and made \$60,000 in improvements over the years. George died in 2015 when the home was worth \$500,000. Mary's basis is now \$330,000 ($\frac{1}{2}$ of \$160,000 plus $\frac{1}{2}$ of \$500,000).

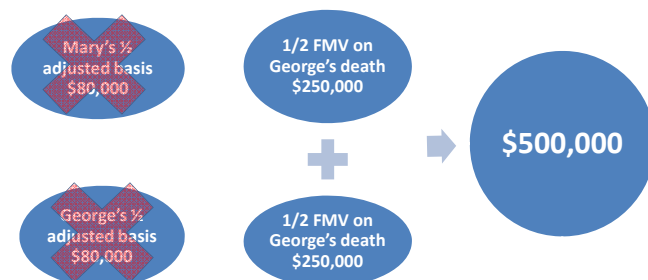


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BASIS

Full Step-up:

- George and Mary live in Monterey CA, a community property state. They purchased their jointly owned home in 1980 for \$100,000 and made \$60,000 in improvements over the years. George died in 2015 when the home was worth \$500,000. Mary's basis is now \$500,000.



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BASIS

Brokerage Accounts / Stocks:

- All stocks and bonds will receive a step-up in basis. Brokerage firms should be notified of taxpayer's death so they can adjust their basis records to reflect FMV on date of death (or possibly a ½ step-up for a surviving joint owner).
- For assets not held jointly with a surviving spouse, generally all assets will be moved to a new account held in the name of the trust or estate with the new TIN. Income will be reported to IRS under that TIN until the assets are sold or transferred to beneficiaries.

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IMPACT ON BENEFICIARIES

- As a general rule, most inheritances are received by the beneficiaries tax free.
- EXCEPTIONS:
 - Interest on savings bonds cashed after death.
 - Retirement accounts.
 - Annuities.
 - Assets held in a irrevocable trust later sold at a gain.
- As a general rule, don't file a beneficiary's tax return until they have consulted with the executor/trustee to see if a K-1 will be issued!
- Remember, there may have been income earned by estate assets between DOD and distribution, and that income may be passed through to a beneficiary via Form 1041 K-1.

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EXAMPLE 1 TOM THUMB

- Tom Thumb is single, has one son, rents his home and was retired at the time of his death. His pension payments stopped upon his death. His only asset is a bank account with \$25,000. He had a simple will that left everything to his son, Tom Jr., who is also the Executor.
- What do you need to tell Tom Jr.?

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ANSWER TO EXAMPLE 1 TOM THUMB

- A final 1040 may need to be filed for Tom.
- The \$25,000 will be tax free to Tom.
- Form 1041 will likely not need to be filed since the small amount of interest earned on the \$25,000 between DOD and its transfer to Tom Jr. will likely be below the 1041 filing requirement.
- No estate TIN will be needed if a 1041 isn't required.

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EXAMPLE 2 JACK O'LANTERN

- Jack O'Lantern is single, has three sons, rents his home and was retired at the time of his death. His pension payments stopped upon his death. He has a bank account with \$30,000 that is Payable On Death (POD) to his three sons. He also has an IRA worth \$300,000 with no named beneficiary. He had a simple will that left everything to his sons. Jack Jr. is the Executor.
- What do you need to tell Jack Jr?

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ANSWER TO EXAMPLE 2 JACK O'LANTERN

- A final 1040 may need to be filed for Jack.
- The \$30,000 will be tax free to the three sons.
- A TIN should be obtained.
- The IRA distribution will be reported on Form 1041 under the new TIN.
- The IRA distributions will be passed through to Jack's three sons via Forms 1041 K-1 and reported on their individual 1040s.
- NOTE: Naming the three sons as beneficiaries would have negated the need to obtain a TIN and file Form 1041!

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EXAMPLE 3
PAPA & MAMA BEAR

- Papa and Mama Bear are married. They own their home and a rental property and hold title as community property. They also have a joint brokerage account at Fidelity that contains a mixture of stocks, mutual funds and money market funds. Papa died July 1 and his will left everything to Mama. Mama plans to continue living in the home and use the rental property as supplemental income.
- What do you need to tell Mama Bear?

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ANSWER TO EXAMPLE 3
PAPA & MAMA BEAR

- Get appraisals on both properties.
- New basis will increase depreciation deduction on the rental.
- Notify Fidelity of Papa's death and ask them to re-set the basis of all stocks and mutual funds.
- Form 1041 will not be required unless their trust required the establishment of another trust upon the first death.

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EXAMPLE 4 BEN & ILENE DOVER

- Ben and Ilene Dover are married. They live in CA and have a joint living (grantor) trust. The trust states that upon the first death, a “decedent’s trust” should be created and ½ of the assets should be allocated to the decedent’s trust. The survivor will remain as trustee and sole beneficiary of the original trust, and survivor has the right to change who will be the beneficiaries of the original trust. The survivor is also the trustee of the decedent’s trust and has the right to all income while the survivor is alive, but all assets in the decedent’s trust will go to their two children upon the second death. They transferred ownership of their home and their rental property to the trust. In addition, they have a brokerage account with Fidelity that consists of stocks and mutual funds titled in the name of their trust. They each have IRAs worth \$100,000 with each other listed as primary beneficiary and their two children as successor beneficiaries. Ilene died July 1, 2015.
- What do you need to tell Ben?

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ANSWER TO EXAMPLE 4 BEN & ILENE DOVER

- Ben should get appraisals for the home and the rental.
- A TIN should be obtained for the decedent’s trust.
- ½ of all assets should be transferred to the decedent’s trust and the new TIN should be used for those assets.
- **CAUTION! Allocation of the assets between the two trusts can cause serious ramifications down the road. Work closely with an estate attorney and/or an experienced tax professional who specializes in this area of tax work!**

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QUESTIONS??????

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Decedent name			Decedent SSN	
State of Residence	DOB		DOD	
Last year 1040 filed	Need copy of last 1040 filed	Carryovers (if any):		
Married?	If yes, spouse name & address			Day Phone
Will?	If yes, need copy of will	Executor(trix)		Day Phone
Trust?	If yes, need copy of trust	Successor Trustee(s)		Day Phone
Attorney?	If yes, attorney name & address			Day Phone
Estate Tax ID (TIN) needed?	Who will obtain?		TIN	
Calendar Year?	Fiscal Year?	Y / N	If fiscal, year ends _____	
BENEFICIARY INFO (NAME)	%	TAX ID	ADDRESS	RELATIONSHIP

ESTATE OF _____

	NAME	TITLED? (TR/CP/JT/ POD/TOD)	VALUE ON DOD	DEBT ON DOD	NET VALUE ON DOD	NOTES
Checking 1*						POD
Checking 2*						POD
Savings 1*						POD
Savings 2*						POD
<i>Savings Bonds</i>						Accrued interest at DOD
CD 1*						POD
CD 2*						POD
Brokerage 1*						TOD
Brokerage 2*						TOD
<i>Annuity 1</i>						Beneficiary(ies)
<i>Annuity 2</i>						Beneficiary(ies)
<i>IRA 1</i>						Beneficiary(ies)
<i>IRA 2</i>						Beneficiary(ies)
<i>401(k)/Other</i>						Beneficiary(ies)
Residence**						
Other home**						

Land**						
Rental 1**						
Rental 2**						
Vehicle 1***						
Vehicle 2***						
Vehicle 3***						
Boat***						
RV***						
Furniture***						
Jewelry*						
TOTAL						

* Get statements showing account value at DOD

** Get appraisal for DOD

*** Get a valuation for DOD

No basis step-up. Taxable to beneficiary same as decedent.