

I don't want to die! I'm not ready.

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It's a stressful time. Sadness prevails. And yet, much has to be done. Learn about tax after death, income in respect of decedent, and all the hidden bugaboos resulting from your demise. Don't leave this mess to others. It's not fair! Let Monica Haven, E.A. teach you how to die with personal grace and financial dignity.

The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.

I. Types of Tax

A. Estate Tax

- Assessed on the value of the decedent's estate on the date of death or the alternate valuation date 6 months later
- Currently only applicable if the net estate exceeds \$1.5 million during 2005 (\$2 million during 2006-2008, and \$3.5 million in 2009)
- **Form 706** must be filed 9 months after the date of death, but can be extended another 6 months
- Tax (assessed at maximum rate of 49%) is due 9 months after the date of death
- *Planning Tip:* Request prompt assessment of tax using Form 4810 to limit statute of limitations to 18 months after filing

B. Gift Tax

- Assessed on any gifts made by the decedent prior to death
- \$11,000 annual exclusion applies
- All gifts in excess of exclusion are reportable on **Form 709** within 9 months

C. Inheritance Tax

- Can be assessed to the beneficiary by the state in which the decedent was domiciled
- California repealed the Inheritance Tax in 1982 and instead imposes an estate tax, sometimes referred to as the Pick-Up Tax (as it is a percentage of the federal liability)
- This tax is reportable on **Form ET-1** 9 months after the date of death and is payable to the State Controller's Office, not the Franchise Tax Board
- The federal estate tax return currently allows a credit for estate taxes paid to the state, but this credit will be phased out over a 4-year period by December 2006

D. Income Tax

- Assessed on income earned
- Earned income must be allocated to the decedent for all amounts received prior to the date of death and to the estate thereafter
- The "estate" is created on the date of death and becomes the liability of the fiduciary
- **Form 1040** for the decedent's portion of the income must be filed by April 15th of the year following the death [see 2004 tax rates below]

Filing Status	10%	15%	25%	28%	33%	35%
Single	Under 7,150	Under 29,050	Under 70,350	Under 146,750	Under 319,100	Over 319,100
Married Filing Joint (MFJ)	Under 14,300	Under 58,100	Under 117,250	Under 178,650	Under 319,100	Over 319,100

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- **Form 1041** for the estate's portion of the income must be filed by April 15th of the year following the death and for every year thereafter until the estate is closed

15%	25%	28%	33%	35%
Under 1,950	Under 4,600	Under 7,000	Under 9,551	Over 9,551

II. Will or Trust?

A. Living Trust = Legal, but revocable entity created during grantor's lifetime, which **MUST** be funded

B. Advantages to a living trust: Privacy, avoid or reduce probate costs, multi-state probate proceedings are avoided, provisions for disability, professional management by an expert trustee, less likely to be contested, and complex family situations can be accommodated

Estate Size (\$)	Maximum Fee
Under 1,000,000	638
Up to 2,000,000	2,453
Up to 3,500,000	4,268
Over 3,500,000	4,268 + surcharge

C. Common misconceptions about a living trust

- NO income or estate tax savings unless a married couple establishes an A-B Trust
- A living trust does not replace or eliminate the need for a will
- A living trust does not protect the beneficiaries from collection actions
- Living trusts are typically more costly to establish but will likely save probate fees. However, trustee fees may cost as much as 1-2% annually

D. Alternatives to a living trust

- Accounts with named beneficiaries, such as life insurance, retirement accounts and payable-on-death bank accounts
- Joint Tenancy with Right of Survivorship
- Co-ownership of accounts with adult children
- Durable Powers of Attorney

III. Executor's or Trustee's Duties

A. Personal

- Contact physician to get signed Death certificate if decedent passed away at home
- Notify friends and relatives
- Make burial, cremation and memorial arrangements
- Post an announcement in the obituary section of the local paper *[optional]*
- Relieve caretakers and nursing aides
- Select a charity (or charities) for contributions in memory of the decedent

B. Business

1. Get organized: Request certified death certificates, locate will & codicils or trust document, inventory all personal and financial assets, determine the value of these assets at the date of death, and separate assets into probate and non-probate assets
2. Notify authorities: Apply for Employer Identification Number, notify IRS of fiduciary relationship of executor, court-appointed administrator, or trustee, and notify Social Security Administration of death—a one-time payment of \$255 is payable to the surviving spouse if he or she was living with the beneficiary at the time of death
3. Get help: Contact attorney, accountant, and other financial advisors to decedent, open a checking account for the estate, provide EIN to bank and transfer sufficient assets to cover expenses, and open Probate within 30 days after date of death, if necessary

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4. Gather and consolidate assets: Make claims for life insurance benefits, retirement, pension, and annuity accounts, notify financial institutions of death—request that Forms 1099 be issued to the decedent for income received through the date of death and to the estate for income received after the date of death, manage property during probate period, and file requisite tax returns [see above]

IV. Where to Report What

- A. Retirement Accounts and Annuities
 - The value of these accounts on the date of death must be included in the taxable estate on Form 706
 - The income received from the payout of these accounts is taxable to the estate on Form 1041 or the beneficiary on his personal tax return
 - *Planning Tip:* Consider making a charity the beneficiary of the IRA to avoid income taxation to the estate and beneficiary
- B. Income in Respect of Decedent (IRD)
 - All income to which the decedent had a right but which was received after the date of death must be reported on both Forms 706 and 1041
 - IRD includes uncollected wages, certain deferred-compensation and stock-option plans, qualified pension plans and IRAs, interest and dividends accrued but unpaid at death, gain from the sale of property if the sale occurred before death but proceeds were not collected until after death, interest accrued through the date of death on Series EE bonds, and annuity payments in excess of the decedent's investment in the contract
 - If estate tax was due on this income on Form 706, the estate may claim a deduction on Form 1041 for the tax paid
- C. Funeral Expenses
 - Allowable expenses may be deducted on Form 706
- D. Medical Expenses of the Decedent
 - Medical expenses paid by the decedent before death are deductible as Itemized Deductions on Form 1040, subject to the 7.5% AGI limitation
 - Medical expenses incurred before death but paid by the estate within one year from the date of death may also be deducted on Form 1040 if an election to do so is made
 - Alternatively, medical expenses incurred prior to death but paid by the estate may be deducted on Form 706
- E. Miscellaneous Itemized Deductions
 - Investment expenses and tax preparation fees incurred after death may be deducted either on Form 1041 subject to the 2% AGI limitation or on Form 706
 - Expenses incurred prior to death but paid by the estate may be deducted on both Forms 706 and 1041
- F. Charitable Contributions
 - Amounts contributed before death are deductible on the decedent's Form 1040
 - Contributions are deductible only if required by the decedent's will

V. When Things Get Complicated

- A. Married Decedents
 1. Marital Deduction
 - Transfers between spouses are typically tax-free upon the death of the 1st spouse, but transferred amounts are includible in the estate of the 2nd spouse
 - Transfers to non-citizen spouses do not qualify for the marital deduction

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2. Surviving Spouse

- A decedent's IRA funds may be rolled over to the surviving spouse's IRA if that spouse was the designated IRA beneficiary
- Alternatively, the surviving spouse can leave the funds in the decedent's IRA where distributions do not have to begin until December 31st of the year in which the decedent would have turned 70-1/2
- If distributions had already begun for the decedent, the surviving spouse must either take a lump-sum distribution, continue the payout in the same manner as the decedent, or take the payout over the surviving spouse's life expectancy

3. Qualifying Widower

The surviving spouse may file using the more favorable filing status in the two years following the decedent's date of death if:

- The taxpayer's spouse died in 2002 or 2003
- The taxpayer was entitled to file a joint return for the year the spouse died
- The taxpayer did not remarry before January 1, 2005
- The taxpayer paid more than half the cost of keeping up his or her home
- The taxpayer's home was the main home for the entire year of the taxpayer's dependent child

C. A/B Trusts

The following tax returns may be required upon the death of the 1st spouse:

- Form 706 if decedent's share of the estate is in excess of \$1.5 million
- Form 1041 for income apportioned to decedent from date of death to year-end (and every year beyond)
- Form 1040 for income earned by both spouses prior to date of death and by surviving spouse after date of death to year-end (and every year beyond)—Surviving spouse may file Married-Filing-Jointly

The following tax returns may be required upon the death of the 2nd spouse:

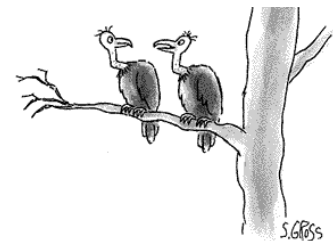
- Form 706 if 2nd spouse's share of the estate is in excess of \$1.5 million
- Form 1041 for income apportioned to 2nd spouse from date of death to year-end (and every year beyond)
- Form 1041 for the income attributable to the trust assets of the 1st spouse
- Form 1040 for income earned by the 2nd spouse's prior to date of death to year-end

D. Generation-Skipping Tax (GST)

- GST tax imposed on transfers of property to a grandchild at the maximum federal estate tax rate in addition to the regularly computed estate and gift tax
- Each transferor has a \$1.5 million exemption and the tax is not applied to qualified transfers for medical and tuition payments

E. Basis

- The heir receives property with a stepped-up basis to the date of death or the value attributed to the asset on Form 706, if filed
- The holding period of all inherited assets is deemed to be long-term, even if the heir sold the inherited asset less than one year after death
- The decedent's capital loss carryovers from Form 1040 cannot be passed on to heirs other than the surviving spouse, but any unused losses on the fiduciary tax return can be passed through to the beneficiaries upon termination of the estate



"Only two things are certain—death and food."

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