

WHAT'S THE DEAL WITH ESTATE TAXES?

By Bob Prior



One of the most frequently asked questions I get relates to taxes at death. How is my estate taxed? Will my heirs have to pay tax on anything they inherit from me? What about life insurance?

When it comes to death and taxes, there is good news: there is no income tax on any inheritance you leave to your heirs. You can die and leave your spouse or children a modest estate or a huge one, and the government does not take a bite to pay any income taxes.

Any income that is generated in the future from those assets, of course, will be taxed to the heir who now owns the assets. And if the heir later sells an asset he/she inherited from you, he/she will typically pay a capital gains tax on the increase in the fair market value of the asset measured from the date of your death to the date of sale.

The taxes that are often referred to at death are estate taxes. Estate taxes are a separate transfer tax assessed on the value of your estate when you die. Your “estate” for purposes of determining its value at your death, includes anything that you own: cash, real estate, stock, tangible personal property (like automobiles and art collections) and even life insurance (if you “own” the policy).

To be liable for any federal estate tax, Congress has established a minimum threshold. Estates below this threshold do not pay any estate tax; estates above the threshold pay a tax of 40% on the value above the threshold amount. The good news for most is that in 2010, Congress increased the threshold amount for each individual to \$5,000,000. In 2015, that number has been indexed to \$5,430,000. So if you die in 2015 and the value of your estate is less than \$5,430,000, you will not owe any estate taxes to the government.

“This tool is powerful”

Even if you are one of the fortunate few who have an estate larger than \$5,430,000, there are still many techniques available to reduce or eliminate estate taxes. The first is what is known as the marital deduction which is available for married taxpayers. This generally means that you can leave anything to your surviving spouse and there is no estate tax due at your death, even if the threshold amount is exceeded. The tax is not owed until the surviving spouse dies. The amount to the surviving spouse can be left outright or in a trust carefully designed to qualify for the marital deduction.

With proper planning for the marital deduction and using techniques to utilize both spouses' threshold amount, a married couple can shelter up to \$10,860,000 (in 2015).

For estates that exceed \$10,860,000, more sophisticated techniques are available, most of which are beyond the scope of this article. However, one common technique is what are known as annual exclusion gifts. Every person can gift up to \$14,000 per year (in 2015) to anyone without any gift tax implications. This means that together, a married couple can gift \$28,000 to every child, child's spouse, and grandchild in the family. The gifts can be in cash, or often as interests in family partnerships or other assets. This tool is powerful and can be used to transfer a great deal of wealth tax free to later generations if done properly.

Another issue related to taxes and death is tax basis. Tax basis, in its simplest form, means what you paid for an asset. For example, if you buy a share of stock for \$1,000, your tax basis in that share of stock is \$1,000. If you later sell that share of stock, you only pay tax on the difference in the tax basis and the sales price. So if you sell the stock for \$1,500 you pay capital gains tax on \$500. If you leave assets to your heirs, the tax basis in those assets "steps up" to the value of the asset on your date of death. So your heirs could sell the same share of stock the next day and pay no capital gains tax.

Finally, death proceeds paid on a life insurance policy are generally not income to the beneficiaries of the policy. They are, however, included in your estate for estate tax purposes unless ownership of the policy is carefully structured.

Like anything regarding taxes, proper planning is essential. Talk to your advisor about strategies for minimizing your tax liability.



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