When a Loved One Passes

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Disclaimer

The information contained in this presentation presumes the participant already has general understanding of individual federal income tax rules. The content does not cover Estate Tax (on assets), Social Security claiming strategies or Probate. It is not tax advice, nor is it tax planning.

This presentation is not based on any taxpayer's specific facts or circumstances. It also does not predict positions the IRS may take as it continues publishing proposed or temporary regulations.

Please refer to IRS Publication 559.

Objective

Inform participants of steps they may take to reduce the pain and complexity related to income taxes after a loved one passes. Before taking any action, please consult a CPA who handles Fiduciary Income Tax returns (a/k/a Income Tax Returns for Estates and Trusts).

Today’s Topics

- Myths
- Vocabulary
- Basis Step Up
- Notifications
- Transfer on Death (TOD) Designations
- When there is a Surviving Spouse
- When there is No Surviving Spouse
- Gotchas

Myths

- There is no Estate
- They left very little, so I don’t have to worry about taxes
- The will governs how everything flows
- I don’t have to take Required Minimum Distributions (RMDs) from an inherited Roth
- I have to make all these financial decisions within weeks of death – BEWARE OF VULTURES

Vocabulary

- Estate – Anything owned by the decedent and not yet paid to creditors or distributed to beneficiaries
- Probate – Legal process to settle decedent’s financial affairs
- Transfer On Death (TOD) – Names beneficiaries for that specific asset and overrides any provisions in a will
- Estate Tax – One-time tax on the value of estate (Form 706)
- Estate Income Tax – Tax on the estate’s income each year (Form 1041)
- Income in Respect of a Decedent (IRD) – Any income earned while still alive but received after death (wages, interest, dividends, refund of SSA clawback). Also any investment income, rent, etc. received after death under the decedent’s Social Security number.
- Required Minimum Distribution (RMD) – The amount calculated each year to determine how much a decedent or heir must take from a retirement account.

Basis Step Up

Upon death, what a decedent paid for assets no longer matters because that cost (a/k/a basis) gets replaced with the asset's fair market value. This "step up" determines the income tax gain or loss when those assets eventually get sold.

- Joint Account with One Other Person
  - Cash is cash. No step-up applies.
  - Investments get 50% step-up since only one owner died. Take original cost basis plus 50% of the difference between cost and market. Holding period on decedent's share is "inherited" but survivor's share retains original holding period.
  - Special Exception: If a joint account was established for signature authority to help someone manage their affairs, and that non-spouse took nothing for themselves, that account might get a full basis step-up and all "inherited" holding period.
- Single Owner on Account
  - Full basis step up. Holding period is "inherited"

Basis Step Up

Real Estate

  - Same concepts as investment accounts.
  - Need reliable valuation done near time of death.
  - Special rules for sale of home by surviving spouse.
  - Net realizable value may be below fair market value.

- In theory, personal property stepped up in basis won’t create gain or loss.
- Closely held business is too complex to cover today.

Notifications

- Social Security
  - Turn off or adjust benefits promptly to avoid paying them back
  - Keep at least one month’s worth of benefits in that direct deposit account in case SSA does clawback
  - If SSA does clawback, you can file claim to get some of it back
- Life Insurance
- Workplace Retirement Plans and ESOPs (like Hy-Vee)
  - Limited time to respond to letter outlining your options
  - If that company’s stock is in the plan, you need a CPA familiar with NUA

Transfer on Death Designations

- Follow these no matter what the will says
- Unless the estate is insolvent (including Medicaid liens), moving quickly on these will simplify Estate Income Tax
- Most 1099 issuers will split the income between the decedent and the beneficiary if you notify them during the tax year of death

Surviving Spouse

- Simplest option is to report everything on a joint tax return signed by the surviving spouse.
- May have to take decedent’s RMD (if any) before deciding how to handle each retirement account.
- Need to be emphatic that investment accounts do appropriate basis step up.
  - Get values as of date of death
  - Apply basis step up rules
  - Consider “in kind” transfer to new account
  - Inform tax preparer of any inherited assets reported as short-term gains

No Surviving Spouse

- Welcome to Estate Income Tax – Form 1041
  - If income after death exceeds $600 in any year, you must file Estate Income Tax Return
  - EIN required (apply on line)
  - Typically choose fiscal year ending the last day of the month prior to the anniversary of death (died in May, use April fiscal)
- Final 1040 of the decedent will be signed by whomever manages the estate
- Income in Respect of a Decedent (IRD) must be split between the Final 1040 of the decedent and the initial 1041. Expect a reconciliation.
- SSA Clawback Refund Claim
- Required Minimum Distributions on ALL Inherited Retirement Plans

Gottchas

- Broker omits basis step-up on 1099-B when the estate or heir sold the investment
- Broker fails to adjust holding period to “inherited” and misreports it as short-term gain
- Failing to coordinate decedent’s final 1040 with the estate’s initial income tax return can double-tax IRD (Income in Respect of Decedent)
- Revocable Trust just became Irrevocable and requires Trust EIN and its own income tax filings
- Decedent was behind on income tax filings or had unpaid tax debt
- Overlooking forms to accelerate statute of limitations or get acquittance

Questions?

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