

TAXES

Probate can mean that all different types of taxes are due: income taxes, property taxes, and, of course, death taxes. The latter, federal and state estate taxes, come into play when the net estate exceeds the federal exclusion amount (see page 11-3). "Net" means the value of the estate after deducting for mortgages, attorney's fees, court costs, funeral expenses, and so forth. The federal estate tax return, form 706, is a detailed report on a decedent's estate, including both probatable and non-probatable assets. Since the IRS typically checks every estate for which a 706 is filed, but audits can delay the closing of an estate, it is wise to request an early audit whenever a 706 is filed. The IRS, then, has one year to do the audit or it's waived.

Prior to June 8, 1982, California required the filing of an inheritance tax return, known as an IT-22 (plus the IT-3 for marital property). The inheritance tax, which was repealed by the voters on that day with the passage of Proposition 6, was fixed by the probate referee (then called Inheritance Tax Referees). The schedule of tax, which varied according to an individual's relationship to the decedent, was slowly eroded over the years, until it was finally eliminated. In its place, an estate tax (for state purposes) was enacted as a credit against the federal estate tax. Since the federal 706 allows a credit against any state estate taxes paid, California decided to "pick up" the deduction in the form of an estate tax; hence, the common term, the "pick-up tax". The pickup tax has since been eliminated.

Once the referee has calculated the tax and determined how much each heir must pay out of his or her inheritance, the report of tax referee is mailed to the attorney. The attorney has ten days to object once the report is filed with the court, so it's important to review it carefully. Many referee's will send a pre-report to the attorney so as to give the attorney a little more time to review it before it's filed with the court.

Since every estate is potentially an income producing entity, it is generally necessary for the estate to obtain a federal tax identification number. This can be obtained over the phone by calling the IRS (locally in Fresno). However, prior to making the call, it is necessary to fill out form SS-4 and have it ready to read the information to the agent. A number will be provided at that time, and the form can be faxed or mailed to the IRS. It is also necessary to pick a fiscal year for the estate (no later than eleven months from the month in which the decedent died), and the estate's income taxes (form 1041 for federal and 541 for state) are due three and a half months after the end of the fiscal year. In addition, it will probably be necessary to file the decedent's final income tax return for the year in which he or she died (along with the state return).

If a return can't be prepared in time for any particular deadline, it is wise (read "malpractice") to pay the anticipated tax so as to stop any interest and penalties. If a late return is to be filed, apply for an extension. Even if no tax is paid, at least the penalties will be avoided. However, the executor may be opening himself up for a surcharge if interest is added on.

Estate taxes are due nine months from the date of death. Since this can come up rather quickly, it's important for the estate attorney to keep the executor aware of this fact. Unless the estate attorney is a tax expert, hire a CPA knowledgeable in estate taxes to prepare the returns. If the CPA is not familiar with estate tax returns, it may be necessary to advise him/her of that an alternative valuation date is available in some situations. This alternative means that the executor can choose to have the estate property (ALL, that is) valued at either the date of death or six months later. It cannot be used if the executor disposed of some property during the six months prior to the request. This can be useful if the property has depreciated following the decedent's death from other than natural causes. For example, if the stock market crashed or there was a fire, the alternate valuation may be quite useful.

Valuation and basis can be important when dealing with assets that have appreciated over the years. Property held in joint tenancy form by spouses can be troublesome when determining basis because the IRS will allow a stepped up basis as to only one-half of the value when the first spouse dies. On the death of the surviving spouse, the other half is stepped up to the value at that time. This gives the property two different bases. If the heirs then sell the property, there may be a capital gains tax on the half that was attributed to the first spouse. On the other hand, if property is held as "community property", the asset is stepped up in basis twice: once on the death of the first spouse, and then again when the survivor dies.

Reduction of one's estate prior to death (in order to avoid estate taxes) is an important part of estate planning. One frequently used technique is to give part of your estate away during your lifetime (usually to children, but also to charity). Under federal law, a person can give up to \$13,000 per year to an individual without paying any gift tax or filing a return. The gift tax is the flip side of the estate tax, and its purpose is to keep people from giving their property away just prior to death (in order to avoid estate taxes). However, the annual gift tax exclusion allows a married couple to give their married children up to \$52,000 **each** per year! Over a ten year period, this can add up to quite a bit of money.

Additional estate deductions have been enacted recently, but anyone desiring to reduce or eliminate their estate taxes should seek competent estate planning advice on a regular basis.

**TABLE OF UNIFIED CREDITS UNDER THE ECONOMIC GROWTH AND TAX
RELIEF RECONCILIATION ACT OF 2001 (signed into law on June 7, 2001)
AND MORE RECENT LAWS ENACTED IN JANUARY, 2011**

<u>Year of Death or Gift</u>	<u>Applicable Credit Amount</u>	<u>Applicable Exclusion Amount</u>
2001	\$220,550	\$675,000
2002	\$345,800	\$1,000,000
2003	\$345,800	\$1,000,000
2004	\$555,800	\$1,500,000
2005	\$555,800	\$1,500,000
2006	\$780,800	\$2,000,000
2007	\$780,800	\$2,000,000
2008	\$780,800	\$2,000,000
2009	\$1,455,800	\$3,500,000
2010	\$0	\$0
2011		\$5,000,000
2012		\$5,000,000