

# Taxes

## Income Taxes

Individual income tax returns may still need to be filed even for someone who has died. Federal and state income taxes, if any, are due on the income received by the deceased from the beginning of the year until the date of death. This income is reported on a federal income tax return, Form 1040. Any tax due on such income is a liability of the estate and is due the April 15 following the year of death. If you are a surviving spouse, you can file a joint return with the deceased spouse even if he or she lived only one day of the year, as long as you have not remarried during the year.

If the deceased had been making quarterly estimated tax payments prior to death, future estimated tax payments are not required. The surviving spouse, however, is not relieved of making the future quarterly estimated tax payments on his or her income.

After death, a federal fiduciary income tax return, Form 1041, may have to be filed for each year the estate is open. This return reports the income received during the estate's taxable year on probate assets. The estate is entitled to deductions against the income for administrative expenses not deducted on the estate tax return, Form 706 (see below). The estate does not need to make quarterly estimated income tax payments for its first two years.

If the deceased was entitled to income but had not received it prior to death, it is called "income in respect of a decedent (IRD)." This includes items such as the interest income portion of annuities, retirement plan distributions, and interest accrued on bonds. The persons inheriting that property (which may be you) should include the income on their personal income tax return in the year they receive the property and pay income tax

on that income amount. However, they may be able to take an itemized deduction for any federal estate tax (see below) which was paid on that income.

*The sections immediately following, which discuss Federal and Washington State Estate Taxes, have not been updated for the 1998 and 2001 changes in Federal Law. Please refer to the Estate Planning Guide – Fifth Edition, also available at this website*

## **Federal Estate Tax**

The federal government assesses a tax based on the value of the deceased's estate. For tax purposes, the estate includes any property in which the deceased had an interest at death, including IRD items. The proceeds of a life insurance policy are also included in the estate, unless ownership of the policy was transferred more than three years prior to death or was owned by someone other than the deceased. For inclusion in the taxable estate it makes no difference if the property passes by will, without a will (intestacy), by community property agreement or by joint tenancy.

In most cases, a federal estate tax return will have to be filed only if the total return may be required and tax may be due in certain other instances, such as if substantial gifts of property were made prior to death. In determining the amount of the estate for purposes of federal estate tax, only one-half of the community property is taxable, while all of the deceased's separate property is taxable. For example, no return is required and no tax is due, in most cases, if there is no separate property and the total community property is valued under \$1,200,000. This is because one-half of the value of the community property does not exceed the exempt amount \$600,000 and there is no separate property. If federal estate tax is due, it must be paid within nine months of the date of death. The filing of the estate tax return, but not the payment, can be extended six months from the nine-month filing date.

Deductions are taken against the value of the property for liabilities, such as mortgages, and for expenses, such as administration, funeral, attorneys, and accountants.

The estate tax rates vary from 37% on the first dollar of net value over \$600,000, to a maximum of 55% on estates with a net value of \$3,000,000 or more. Certain large estates are also subject to an additional 5% rate on top of the 55% rate. If all the deceased's property is left to the surviving spouse, no estate tax is due because property passing to the surviving spouse passes estate tax free (but only if the surviving spouse is a U.S. citizen). See the Estate Planning Council of Seattle's book "Estate Planning" for more detailed information concerning estate taxes and planning ideas.

Even if no taxes are payable, most assets owned by the deceased get a new income tax cost basis for capital gains tax purposes, which is usually fair market value on the date of death. This can reduce, or even eliminate, capital gains on assets sold after death.

### **Washington State Estate Tax**

Washington levies an estate tax only on estates which are required to pay federal estate tax. For example, if a person dies in 1994 leaving an estate of less than \$600,000 no federal or state estate taxes will be due. If taxes are due to Washington, it is the amount calculated in the federal estate tax return, Form 706.

The Washington estate tax applies to the estates of Washington residents, and to non-residents with property located in Washington. A tax lien on the deceased's property in favor of the State is automatically created on the date of death. If no federal tax return is required to be filed, the personal representative of the estate should apply to the Washington State Department of Revenue for release of the lien. If a federal tax return is to be filed, the state tax must be paid at the same time as the federal tax, generally within nine months of the date of death. After the personal representative of the estate forwards a copy of the federal estate tax closing letter or I.R.S. audit report to Washington State, the State will release its lien and the property may then be distributed to the heirs.

## **Other States' Taxes**

The deceased may have owned property located in other states or countries (such as a vacation home in Palm Springs, California). The states or countries may have estate or inheritance taxes, so you may face filing requirements and taxes due for those states or countries. Contact the estate's attorney or C.P.A. for assistance.

## **Property Taxes**

Property taxes are due at the same time and in the same manner as if the deceased were still alive. After the transfer of property, the taxes are then paid by the person who receives the property, and the deceased's estate has no further obligation.