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Elder Law Guys: Death and taxes — and taxes and taxes

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As we begin our 10th year of writing this column, we recognize that most people know the old saying, “Nothing is certain but death and taxes.”

We have found that many people just don’t know how extensive these taxes can be.

Death causes a host of federal and state tax issues, especially if the decedent lived in Pennsylvania. Let’s identify the major ones that normally need to be dealt with as well as what should be done to either plan ahead or plan shortly after a death occurs.

Federal estate tax — Right now, this is a big non-event for the majority of people. The federal estate tax is paid based on the value of the assets owned, or controlled, by the decedent at the time of death. While tax rates can be as high as 40 percent, the great news is that currently the first $11.4 million (we should be so lucky) of value is not subject to tax.

Prior to the implementation of the Tax Cuts and Jobs Act of 2017, this exemption was less than half of that amount, or roughly $5 million.

Keep in mind that the tax is scheduled to revert back to the pre-2018 amount at the end of 2025.

Most of us will not need to worry about this tax. But it is out there and it does change when sweeping tax bills are passed. Remember, this tax is in addition to any state death tax or income tax returns.

Pennsylvania inheritance tax — As with state liquor stores and beer distributors, Pennsylvania continues to be in the minority of states (six) across the country that have a state tax triggered by death, while 12 states have an estate tax.

Like the federal estate tax, this “inheritance” tax is charged on the value of the assets owned or controlled by the decedent and is relatively independent of the obligations to still file income tax returns.

Pennsylvania charges anywhere from 0 to 15 percent inheritance tax depending on the relationship between the decedent and the beneficiary.

A commonly asked question is whether this is due when the beneficiary lives outside of Pennsylvania.

Unfortunately, the tax is based upon the domicile of the decedent, not the beneficiary.

Final income tax returns — The decedent's representative must still file all state, local and federal income tax returns for the portion of the year in which the decedent was alive.

Fiduciary income tax returns — When a person dies and his last will and testament is admitted to probate, his executor will obtain an employer identification number for the estate from the Internal Revenue Service.

Likewise, if the decedent died owning a trust, the trustee will obtain an EIN. You know what happens when you obtain an employer identification number? You guessed it! You get a letter from the IRS notifying you of the due date for the income tax return for the estate or trust -– known as fiduciary income tax returns.

These returns must be filed annually for each year that the estate or trust is in existence or conducts business.

A very important subset of these tax returns involves federal capital gains tax and how assets purchased prior to death will be treated for tax purposes when sold after death. This typically includes real estate and investments.

Those are a lot of taxes to consider, not to mention the fact that each has a unique due date and paying certain taxes in certain ways may be more favorable as to other tax liabilities based on the overall situation.

The key is to develop a plan that takes all taxes into consideration and then plan accordingly to mitigate the overall tax exposure. As you can imagine, this is more effective when done prior to death with the collaboration of your attorney, accountant and financial planner.

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