

LESSON 15

ESTATE TAX
Estate Filing Requirements -
Form 706
Study Guide

Federal estate tax applies to the **transfer of property at death**. The estate of a person who died (the decedent) is **liable for the tax** on the entire taxable estate. However, the beneficiaries of the estate may have to pay the tax if the estate does not pay it when it is due. Each beneficiary's liability is **limited** to the value of the part of the estate he or she received.

Generally, the value of the estate is determined on one of two dates:

- **the date of death or,**
- **if the alternate valuation method is used, 6 months after the date of death.**

The date at the location of a person's domicile (legal residence) at the time of death determines the date of death. A person's domicile also determines where the estate tax return must be filed.

Form 706

The executor of a decedent's estate uses Form 706 to figure the estate tax imposed by Chapter 11 of the Internal Revenue Code. This tax is levied on the entire taxable estate, not just on the share received by a particular beneficiary.

If a return must be filed, you should use Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, that applies for the year of the decedent's death.

Citizens or residents

For decedents dying in 2009 Form 706 must be filed by the executor for the estate of every U.S. citizen or resident whose **gross estate, plus adjusted taxable gifts** and specific exemption is **more than**.

<u>Year of death</u>	<u>Gross Estate More Than</u>	<u>Amount of Credit</u>
2009	\$3,500,000	\$1,455,800

To determine whether you must file a return for the estate, **add**:

1. The **adjusted taxable gifts** made by the decedent **after** December 31, 1976
2. The total specific exemption allowed under section 2521 for gifts made by the decedent **after** September 8, 1976; and
3. The decedent's **gross estate** valued at the date of death.

Nonresident noncitizen

If the decedent was **neither a resident nor a citizen** of the United States, file Form 706NA, United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States, if the value of the gross estate located in the United States is **more than \$60,000**. This amount is reduced in the same manner as for a citizen of the United States.

Due date of return

Form 706 to report estate and/or generation-skipping transfer tax within **9 months after the date of death** unless an extension of time for filing has been granted.

Tax rate

The tax rate for the estates of decedents dying in **2009 is 18% to 45%**.

Where to file returns

The executor must now file Form 706 at the **Cincinnati Service Center**, at the following address.

Department of the Treasury
 Internal Revenue Service
 Cincinnati, OH 45999

Extension of time for filing

Use Form 4768, *Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes* to apply for an **automatic 6-month extension** of time to file. File Form by the original due date of the return.

Paying the Tax

The estate and GST taxes are **due within 9 months** after the date of the decedent's death **unless** an extension of time for payment has been granted, or unless you have properly elected to pay in installments, or to postpone the part of the tax attributable to a reversionary or remainder interest.

Extension of time for paying

There are provisions that allow additional time for paying the estate tax. The usual extension of time to pay is **up to 12 months** from the date the payment is due.

A discretionary extension of time to pay a deficiency for reasonable cause may be granted, for 1 year at a time, for up to a maximum of **4 or 10 years**.

The application **must** establish why it is impossible or impractical for the executor to pay the **full amount** of the estate tax by the estate tax return due date.

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Hardship payment extension

The Internal Revenue Service, however, may extend the time for payment for **up to 10 years**. These extensions will be allowed if you can show reasonable cause. When you apply show why it is impossible or impractical for you to pay the full amount of the tax on the due date.

Estate tax lien

Generally, no tax may be assessed later than **3 years** after the estate tax return is filed or is due, whichever is later. The period of assessment **is 6 years if 25%** or more of the value of the gross estate is not reported on the return. The period of assessment of taxes is **4 years** for recipients of **property** included in the gross estate.

A tax lien attaches to all property included in the gross estate (except property used to pay certain administration expenses and claims) to cover the assessment. The lien is considered to attach at the decedent's date of death. It will not lapse **until 10 years after that date** unless the tax is fully paid or becomes unenforceable because of lapse of time. If the estate tax is not paid when due, all persons receiving this property are personally liable for the tax to the extent of the value of the property on the date of the decedent's death.

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Estate Filing Requirements -
Form 706
Questions & Answers

Due date of return

04-19. You must file Form 706, United States Estate Tax Return, within 6 months after the date of the decedent's death, unless an extension of time to file is received.

⊗

04-19. *False.*

ANALYSIS:

The Form 706 is due 9 months (not 6 months) after the date of death unless an extension of time for filing has been granted.

05-40. If an extension is not granted, when must Form 706 be filed to report estate and/or generation-skipping transfer tax?

- A. By the 15th day of the fourth month following the date of death.
- B. Within 6 months after the date of death.
- C. Within 9 months after the date of death.
- D. Within 1 year of the date of death.

⊗

05-40. *C. Within 9 months after the date of death.*

ANALYSIS:

Form 706 is used to report estate and/or generation-skipping transfer tax within 9 months after the date of death unless an extension of time for filing has been granted.

Extension of time for paying

00-13. There is no provision for an extension of time to pay the tax liability associated with Form 706, United States Estate Tax Return.

⊗

00-13. *False.*

ANALYSIS:

The usual extension of time to pay the estate tax is up to 12 months from the date the payment is due. However, the IRS may extend the time for payment for up to 10 years.

The return is due 9 months after the date of death. The maximum extension of time for filing the return is a period of 6 months.

**ESTATE TAX
Gross Estate
Study Guide**

Federal estate tax applies to the **transfer of property at death**. The estate of a person who died (the decedent) is liable for the tax on the entire taxable estate. However, the beneficiaries of the estate may have to pay the tax if the estate does not pay it when it is due. Each beneficiary's liability is limited to the value of the part of the estate he or she received.

Gross estate

The gross estate **includes** the value of **all** property to the extent of the decedent's interest in the property at the time of death.

Property owned by the decedent

The gross estate **includes all property** in which the decedent had an interest (including real property outside the United States). **It also includes:**

- Certain transfers made during the decedent's life **without an adequate and full consideration** in money or money's worth.
- Annuities,
- The includable portion of joint estates with right of survivorship,
- The includible portion of tenancies by the entirety
- **Certain life insurance proceeds** (even though payable to beneficiaries other than the estate).
- Property over which the decedent **possessed a general power of appointment**
- **Dower or curtesy** of the surviving spouse
- Community property to the extent of the decedent's interest as defined by applicable law.

Transfers with retained life interest

The gross estate **includes** the value of property transferred after March 3, 1931, but before the death of the transferor, if that person kept possession or enjoyment of the property, or reserved certain rights or interests in it. This includes the right to income from the property for life (or for a period that does not in fact **end before death**, or that cannot be determined without reference to the decedent's death). However, if the transfer of property was made for its **full worth in money** (or other equal value), it is **not included** in the gross estate.

Rights or interests

The rights or interests that may be reserved for life **include** the use, possession, income, or other enjoyment of the transferred property, or the right to name persons who will possess or enjoy the transferred property or its income.

Powers of appointment

Include in the gross estate:

- The value of property for which the decedent possessed a **general power of appointment** (defined below) on the date of his or her death and
- The value of property for which the decedent possessed a general power of appointment that he or she exercised or released **before death** by disposing of it in such a way that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's gross estate a transfer with a retained life estate, a transfer taking effect at death, or a revocable transfer.

With the above exceptions, property subject to a power of appointment is **not includible** in the gross estate if the decedent **released the power completely** and the decedent held no interest in or control over the property.

If failure to exercise a general power of appointment results in a lapse of the power, the lapse is treated as a release only to the extent that the value of the property that could have been appointed by the exercise of the lapsed power is more than the **greater of \$5,000 or 5%** of the total value, at the time of the lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed power could have been satisfied.

Power of appointment

A power of appointment **determines who will own or enjoy the property** subject to the power and when they will own or enjoy it. The power must be created **by someone other than the decedent**. It does not include a power created or held on property transferred by the decedent.

A power of appointment **includes** all powers which are, in substance and effect, powers of appointment regardless of how they are identified and regardless of local property laws. For example, if a settlor transfers property in trust for the life of his wife, with a **power in the wife** to appropriate or consume the principal of the trust, the wife **has a power of appointment**.

It does not matter whether a power is actually called a power of appointment in a legal document. It also does not matter if the term is used in local property law. What matters is **that the power exists in substance and effect**. Thus, if the property laws of a state give the wife a power of testamentary disposition over property to which she does not have a vested title, she is considered to have a power of appointment for federal estate tax purposes.

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Some powers do not in themselves constitute a power of appointment. For example, a power to amend only administrative provisions of a trust that cannot substantially affect the beneficial enjoyment of the trust property or income is **not a power of appointment**. A power to manage, invest, or control assets, or to allocate receipts and disbursements, when exercised only in a fiduciary capacity is not a power of appointment.

Example

Michael Elm, the decedent, was given the power to appoint the corpus of a trust. He could appoint to any of six persons not including himself, and he could also invade the corpus for his own reasonable support, education, and medical expenses. He would not be considered to have a general power of appointment.

General Power of appointment

A general power of appointment is a power that is **exercisable in favor** of the **decedent**, the **decedent's estate**, the **decedent's creditors**, or the **creditors of the decedent's estate, except**:

1. A power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to health, education, support, or maintenance of the decedent.
2. A power exercisable by the decedent **only** in conjunction with:
 - a. the creator of the power or
 - b. a person who has a substantial interest in the property subject to the power, which is adverse to the exercise of the power in favor of the decedent.

A part of a power is **considered** a general power of appointment if the power:

1. May only be **exercised by the decedent** in conjunction with **another person** and
2. Is also exercisable in favor of the other person (in addition to being exercisable in favor of the decedent, the decedent's creditors, the decedent's estate, or the creditors of the decedent's estate).

The part to **include** in the gross estate is a general power of appointment is figured by **dividing the value of the property by the number of persons** (including the decedent) in favor of **whom the power is exercisable**.

Date power was created

Generally, a power of appointment **created by will** is considered created on the **date of the testator's death**.

A power of appointment created by an *inter vivos* instrument is considered **created on the date the instrument takes effect**. If the holder of a power exercises it by

creating a second power, the second power is considered as created at the time of the exercise of the first.

Dividends

Outstanding dividends declared to stockholders of record **on or before** the date are included in the gross estate. Those declared **after the date** of death are not.

Interest

Unpaid interest that has accrued on savings certificates (redeemable after death without forfeiture of interest) from the date of the last interest payment to the date of death, plus the face amount of the certificates, is **includible** in the gross estate.

U.S. Government bonds and other U.S. Government indebtedness **are included in the gross estate** even if, by law, they are generally **exempt** from all federal taxes. The estate tax is a tax on the transfer of property and not a tax on the property itself. This also includes bonds issued by a state government agency and secured by a pledge of a loan by the federal government.

Income tax refund

If the estate is entitled to a refund because of an overpayment of income tax, the overpayment is an asset **includible** in the gross estate. If the estate and a surviving spouse are entitled to a refund because of an overpayment of income tax on a joint return, part of the overpayment is includible in the gross estate. The includible amount is the amount by which the decedent's payment of the joint income tax exceeds his or her income tax liability.

Medical insurance reimbursements

Medical insurance reimbursements are **included** in the gross estate if the decedent had a right to the amount at death.

Dower and curtesy interests

The gross estate **includes** the value of a surviving spouse's dower or curtesy interest in the decedent's estate, including a statutory interest in place of the dower or curtesy interest.

A **dower interest** is a widow's interest in her deceased husband's property.

A **curtesy interest** is a widower's interest in his deceased wife's property.

Annuities

In general, you **must include** in the gross estate all or part of the value of any annuity that meets the following requirements:

- It is **receivable** by a beneficiary following the death of the decedent and by reason of surviving the decedent
- The annuity is under a contract or agreement entered into after March 3, 1931;

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- The annuity was payable to the decedent (or the decedent possessed the right to receive the annuity) either alone or in conjunction with another, for the decedent's life or for any period not ascertainable without reference to the decedent's death or for any period that did not in fact end before the decedent's death; and
- The contract or agreement is **not** a policy of insurance on the life of the decedent.

These rules apply to **all types of annuities, including** pension plans, individual retirement arrangements, and purchased commercial annuities.

An annuity contract that provides periodic payments to a person for life and **ceases** at the person's death is **not included** in the gross estate. Social Security benefits **are not includible** in the gross estate even if the surviving spouse receives benefits.

Part includible

If the decedent contributed **only part** of the purchase price of the contract or agreement, include in the gross estate **only** that part of the value of the annuity receivable by the surviving beneficiary that the decedent's contribution to the purchase price of the annuity or agreement bears to the total purchase price.

Example

If the value of the survivor's annuity was \$20,000 and the decedent had contributed three-fourths of the purchase price of the contract, the amount includible is \$15,000 ($3/4 \times \$20,000$).

The gross estate **includes** the value of an annuity or other payment under a contract or agreement that a beneficiary will receive because he or she survives the decedent. The value included is based on contributions made by the decedent or the decedent's employer.

A pure annuity contract that provides periodic payments to a person for life and **ceases** at the person's death is **not included** in the gross estate.

Joint interests

The gross estate **includes** the value of property held jointly at the time of death by the decedent and anyone who has the right of survivorship. However, that part of the property acquired by a person other than the decedent for adequate and full consideration in money or money's worth, or by bequest or gift from a third party, is **not included** in the decedent's gross estate.

Proceeds of life insurance

The gross estate **includes** the proceeds of life insurance on the decedent's life **if**:

1. The proceeds are receivable by the estate, or

2. The proceeds are receivable by another for the benefit of the estate, or
3. The proceeds are not receivable by or for the benefit of the estate and the decedent possessed incidents of ownership in the policy.

Transfers within 3 years before death

These transfers **include** only the following:

- Any transfer by the decedent with respect to a life insurance policy within 3 years before death.
- Any transfer within 3 years before death of a retained life estate, reversionary interest, or power to revoke.

Report these transfers **regardless** of whether a gift tax return was required to be filed for them when they were made.

Certain gift taxes paid on property transferred within 3 years

Property gifted within 3 years before death is **not included** in the decedent's gross estate. However, the total value of the **gift taxes that were paid** on the gift by the decedent is **included** in the gross estate.

Qualified terminable interest property (QTIP)

QTIP is property

- Which pass from the decedent,
- In which the surviving spouse has a qualifying **income interest for life**, and
- To which an election applies

The surviving spouse has a qualifying income interest for life **if**:

- The surviving spouse is entitled to **all** the income from the property payable annually or at more frequent intervals, and
- **No** person has a power to appoint any part of the property to any person other than the surviving spouse.

The decedent is allowed a marital deduction for QTIP transfers. The property is then taxed in the surviving spouse's estate.

ESTATE TAX

Gross Estate

Questions & Answers

Gross estate

02-14. If an individual transfers title to property to one or more other individuals, but retains the right to the use of the property during his or her lifetime, the property will be included in his or her estate.

⊗

02-14. True.

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ANALYSIS:

Transfers with a retained life estate are transfers by the decedent in which the decedent retained an interest in the transferred property. The amount includible in the gross estate is the value of the transferred property at the time of the decedent's death.

02-38. Which of the following items are included in a decedent's gross estate?

- The decedent's IRA, where the decedent's spouse is the named beneficiary.
 - A checking account with the decedent's daughter as joint tenants. The daughter's funds were used to set up the account.
 - Assets held in the decedent's revocable grantor trust.
- A. All of the assets are included in the decedent's estate.
 B. The IRA and checking account are included in the decedent's estate.
 C. The IRA and the assets in the revocable grantor trust are included in the decedent's estate.
 D. None of the assets are included in the decedent's estate.

⊗

02-38. C. The IRA and the assets in the revocable grantor trust are included in the decedent's estate.

ANALYSIS:

The gross estate includes all property in which the decedent had an interest (including real property outside the United States). It also includes:

- Certain transfers made during the decedent's life without an adequate and full consideration in money or money's worth.
- Annuities,
- The includable portion of joint estates with right of survivorship,
- The includible portion of tenancies by the entirety,
- Certain life insurance proceeds (even though payable to beneficiaries other than the estate),
- Property over which the decedent possessed a general power of appointment,
- Dower or curtesy of the surviving spouse,
- Community property to the extent of the decedent's interest as defined by applicable law.

The gross estate includes the IRA (annuity) and the assets held in the decedent's revocable grantor trust.

The checking account owned by the decedent and his daughter is not included in the decedent's estate because the daughter provided the funds to set up the account.

05-66. Harry, a single person, died in 2009. The executor does not elect the alternate valuation date. Given the following information, determine the value of Harry's gross estate.

	FMV at date of death
Certificates of deposit	\$ 100,000
Mortgage receivable on sale of property	\$2,000,000
Paintings & collectibles	\$ 500,000
Income tax refund due from 2008 individual tax return	\$ 30,000
Household goods & personal effects	\$ 20,000

- A. \$2,600,000.
 B. \$2,650,000.
 C. \$2,620,000.
 D. \$2,120,000.

⊗

05-66. B. \$2,650,000.

ANALYSIS:

The gross estate includes the value of all property to the extent of the decedent's interest in the property at the time of death. All items listed are included in the gross estate.

04-71. Given the following information, determine the value of Sam's gross estate. Sam is single:

	FMV at date of death
Cash	\$ 15,000
Life Insurance on Sam's Life (payable to his estate)	\$200,000
Jointly owned Property (Percentage includible-100%)	\$100,000

A. \$315,000.
 B. \$115,000.
 C. \$265,000.
 D. \$ 65,000.

⊗

04-71. A. \$315,000.

ANALYSIS:

The gross estate includes the value of all property to the extent of the decedent's interest in the property at the time of death.

Because the life insurance was payable to Sam's estate it is included in the gross estate. Likewise, the jointly owned property is included in Sam's estate because his ownership percentage is 100%. Computed as follows:

Cash	\$ 15,000
Life insurance policy	200,000
Jointly owned property - his ownership is 100%.	100,000
Gross value of estate	\$ 315,000

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04-72. Given the following information, determine the value of Sara's gross estate:

	FMV at date of death
Beneficiary for life of a QTIP trust (Qualified terminal interest property)	\$2,000,000
Irrevocable trust (Sara was the grantor, but retained no interest in the trust)	\$1,000,000
Revocable grantor type trust (Sara was the grantor)	\$ 500,000
A. \$2,500,000.	
B. \$3,500,000.	
C. \$ 500,000.	
D. \$3,000,000.	

04-72. A. \$2,500,000.

ANALYSIS:

The gross estate includes the value of all property to the extent of the decedent's interest in the property at the time of death.

Qualified terminable interest property (QTIP) is property that the decedent's spouse was allowed a marital deduction for QTIP transfers. The property is included in the surviving spouse's gross estate (Sara's estate).

The irrevocable trust is not included in her gross estate because she retained no ownership position.

The revocable grantor trust is included in her gross estate because she did not relinquish complete dominion or control.

Sara's gross estate is \$2,500,000 which includes the FMV of \$2,000,000 of the QTIP trust and \$500,000 FMV of the revocable trust.

03-71. John, a single taxpayer, died on March 3, 2009. Based on the following information, determine the value of John's gross estate

	FMV on date of death
Life insurance on John's life (payable to John's estate)	\$250,000
John's revocable grantor trust	\$800,000
Stock given to John's son in 2007 (no gift tax was paid)	\$ 50,000

- A. \$ 250,000.
B. \$ 700,000.
C. \$1,050,000.
D. \$1,100,000.

03-71. C. \$1,050,000.

ANALYSIS:

Because John is the grantor (owner) of the revocable trust it is included in his gross estate. The life insurance is also included in his gross estate because it was payable to the estate. John's gross estate is \$1,050,000 (\$800,000 + \$250,000). The stock he gave to his son in 2006 is not included in his gross estate because it is excepted under the transfer rules of section 2035 explained below.

Some transfers within 3 years before death include only the following:

- Any transfer by the decedent with respect to a life insurance policy within 3 years before death.
- Any transfer within 3 years before death of a retained life estate, reversionary interest, or power to revoke.

Report these transfers regardless of whether a gift tax return was required to be filed for them when they were made.

Certain property gifted within 3 years before death is not included in the decedent's gross estate. However, the total value of the gift taxes that were paid on the gift by the decedent is included in the gross estate.

Since no gift tax was paid on the stock gifted, there is no gift tax to include in the gross estate.

03-72. When Lisa's husband died in 1999, he set up a qualified terminable interest property (QTIP) trust, naming Lisa as the beneficiary for her life. Lisa died in 2009. Given the following information, determine the value of Lisa's gross estate.

	FMV on date of death
Lisa's revocable grantor trust	\$ 750,000
QTIP trust	\$1,000,000

- A. \$ -0-.
B. \$ 750,000.
C. \$1,000,000.
D. \$1,750,000.

03-72 D. \$1,750,000.

ANALYSIS:

Lisa's gross estate is \$1,750,000. It consists of her revocable grantor trust because she is the owner (\$750,000) and the QTIP trust (\$1,000,000.)

QTIP is property:

- Which passed from the decedent (husband),
- In which the surviving spouse (Lisa) has a qualifying income interest for life, and
- To which an election applies

Since the husband was allowed a marital deduction for the QTIP transfer, the property is taxed in the surviving spouse's (Lisa's) estate.

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**ESTATE TAX
Alternate Valuation
Study Guide**

Valuation

Generally, the **value** of the decedent's property interest for estate tax purposes is its:

- **fair market value at the date of death or**
- **at the alternate valuation date.**

Real property used in farming or other closely held businesses may be eligible for a reduced valuation for estate tax purposes if the executor **elects** it.

Valuation understatement penalty

A **20% penalty** applies for the underpayment of estate tax that **exceeds \$5,000** when the underpayment is attributable to valuation understatements. A valuation understatement occurs when the value of property reported on Form 706 is **65% or less** of the actual value of the property.

The penalty **increases to 40%** of the underpayment attributable to a gross valuation misstatement. There is a gross valuation misstatement if the value of any property claimed on an estate tax return is **40% or less** of the amount determined to be correct.

Alternate valuation

As executor, you may **elect** to use the alternate valuation method. Under this method, property included in the decedent's gross estate is valued as of a date **other than that of death**.

This election does not change the rule that the gross estate **includes** property that the decedent owned or had an interest in on the date of death.

Unless you elect at the time you file the return to adopt alternate valuation, you must value all property included in the gross estate **on the date of the decedent's death**. Alternate valuation **cannot** be applied to **only part of the property**

You may elect special-use valuation for certain farm property and closely held business real property in addition to alternate valuation.

You **may not elect** alternate valuation **unless** the election will **decrease both** the **value** of the gross estate and the **sum** (reduced by allowable credits) of the estate and GST taxes payable by reason of the decedent's death with respect to the property includible in the decedent's gross estate.

You elect alternate valuation by checking "Yes" on line 1 and filing form 706. You may make a protective alternate valuation election by checking "Yes" on line 1, writing the word "protective," and filing form 706 using regular values.

Once made, **the election may not be revoked**. The election may be made on a late filed Form 706 provided it is not filed **later than 1 year after the due date** (including extensions actually granted). Relief under sections 301.9100-1 and 301.9100-3 may be available to make an alternate valuation election or a protective alternate valuation election, provided a Form 706 is filed no later than 1 year after the due date of the return (including extensions actually granted).

The election is effective **only** if a return is required to be filed.

Alternate valuation rules

If you elect the alternate valuation method, property in the estate is valued according to the following rules:

1. Any property distributed, sold, exchanged, or otherwise disposed of **within 6 months** after the decedent's death **is valued** on the **date** of distribution, sale, exchange, or other disposition, whichever occurs first. Value this property on the date it ceases to form a part of the gross estate; i.e., on the date the title passes as the result of its sale, exchange, or other disposition.
2. Any property not disposed of **within 6 months** after the decedent's death **is valued as of 6 months after the date of the decedent's death**.
3. Any property, interest, or estate that is affected by **mere lapse of time is valued as of the date of the decedent's death** or on the date of its distribution, sale, exchange, or other disposition, whichever occurs first. However, you may change the date of death value to account for any change in value that is not due to a mere lapse of time on the date of its distribution, sale, exchange, or other disposition.

The property included in the alternate valuation and valued as of 6 months after the date of the decedent's death, or as of some intermediate date (as described above) is the property **included in the gross estate** on the date of the decedent's death. Therefore, you **must first determine** what property **constituted the gross estate** at the decedent's death.

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ESTATE TAX
Alternate Valuation
Questions & Answers

Alternate valuation

05-16. If the executor of an estate elects the use of an alternate valuation date and then changes his/her mind, he/she can use the date of death as the valuation date by amending the estate tax return (Form 706) within 1 year of the date of death.

⊗

05-16. *False.***ANALYSIS:**

Once the alternate valuation is selected it cannot be changed. The election can be made within 1 year of the due date (including extension) for filing the return.

02-40. Which of the following statements concerning the alternate valuation election is correct?

- A. The alternate valuation election may be made even if no estate tax will be paid if the election is not made.
- B. If the alternate valuation election is made, it is possible for some but not all of the assets to be included in the decedent's estate at a higher FMV than on the date of death.
- C. If the alternate valuation election is made, assets that are disposed of within 6 months of the decedent's death are generally valued on the date of death.
- D. None of the statements are correct.

⊗

02-40. *B. If the alternate valuation election is made, it is possible for some but not all of the assets to be included in the decedent's estate at a higher FMV than on the date of death.*

ANALYSIS:

The alternate valuation applies only if it will decrease the value of the gross estate and the sum of the estate tax and the generation-skipping transfer tax (reduced by any allowable credits).

If you elect the alternate valuation method, property in the estate is valued according to the following rules:

1. *Any property distributed, sold, exchanged, or otherwise disposed of within 6 months after the decedent's death is valued as of the date on which it is first distributed, sold, exchanged, or otherwise disposed of.*
2. *Any property not disposed of within 6 months after the decedent's death is valued as of 6 months after the date of the decedent's death.*

If the alternate valuation is selected, it is very likely that some assets will be given a higher value than the FMV at date of death. But, remember the overall value of the gross estate must be lower than the FMV at date of death to elect the alternate valuation method.

02-67. John, who was not married, died on October 12, 2009. He did not leave any of his assets to charity. Given the following information, may the executor of the estate make the alternate valuation election, and if so, what is the value of the gross estate on the alternate valuation date?

	FMV Date of Death	FMV Alternate Valuation
Residence	\$2,000,000	\$2,010,000
Stock	\$1,900,000	\$1,600,000
Expenses	(\$ 450,000)	(\$ 300,000)

- A. No, the election cannot be made.
- B. Yes, the election can be made. The alternate value of the gross estate is \$3,610,000
- C. Yes, the election can be made. The alternate value of the gross estate is \$3,900,000
- D. Yes, the election can be made. The alternate value of the gross estate is \$3,310,000.

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02-67. *B. Yes, the election can be made. The alternate value of the gross estate is \$3,610,000.*

ANALYSIS:

The alternate valuation values the gross estate before expenses. The alternate valuation may be elected if it will decrease the value of the gross estate. Computed as follows:

	FMV at Date of Death	FMV Alternate Valuation Date
<i>Residence</i>	<i>\$2,000,000</i>	<i>\$2,010,000</i>
<i>Stock</i>	<i>1,900,000</i>	<i>1,600,000</i>
<i>Total</i>	<i>\$3,900,000</i>	<i>\$3,610,000</i>

The FMV at date of death is \$3,900,000 and the FMV at the alternate valuation date is \$3,610,000. Therefore, the alternate valuation can be elected.

LESSON 15

ESTATE TAX
Taxable Estate
Study Guide

Taxable estate

The taxable estate is the total gross estate minus:

1. Administration and funeral expenses,
2. Claims against the estate,
3. Any outstanding obligation to which the property is subject, if the value of the property is included in the gross estate and is undiminished by the outstanding indebtedness,
4. Casualty and theft losses,
5. Marital deduction, and
6. Charitable deduction
7. State death taxes

Administrative expenses

These expenses **include** commissions as the executor, fees of attorneys for the estate, and miscellaneous expenses.

Expenses for executor commissions and attorney fees may be deducted for amounts **paid** or amounts which at the time of filing the estate tax return may **reasonably be expected to be paid**.

Funeral expenses

Funeral expenses **are allowable** as a deduction from the gross estate if they are actually paid, are allowable out of property subject to claims under local law, and are paid within the time allowed for the filing of the estate tax return.

Funeral expenses are allowable only as deductions in **computing** the estate tax.

Claims against the estate**Medical expenses**

If medical expenses are deducted **only** on the estate tax return, they are fully deductible as claims against the estate.

If expenses for the decedent's medical care are paid **within one year** after date of death, they are treated as being paid in the tax year in which they were incurred. In this case, if a **waiver is filed**, the expenses may be deducted on the **decedent's income tax return** for the year incurred. The deduction may be claimed only to the extent that the decedent's total medical deduction **exceeds** the percentage limitation for the year incurred.

If part of the medical expenses are deducted on the decedent's income tax return and part deducted on the estate tax return, the part deducted on the estate tax return **may not include** the amount that is not deductible for income tax purposes because of the **percentage limitation**.

Example

The decedent incurred \$20,000 in medical expenses in 2008. These were the only medical expenses incurred during the year. The decedent's income tax return for 2008 showed an adjusted gross income of \$100,000.

The decedent died in 2009. You, as the executor of the decedent's estate, paid the \$20,000 in medical expenses within one year of the decedent's death. You elected to deduct \$5,000 as a claim against the estate.

You file an amended income tax return for 2008 and attach the necessary waiver indicating that \$15,000 had not been and would not be deducted for estate tax purposes.

Only \$7,500 (\$15,000 - \$7,500 (7.5% x \$100,000)) is deductible on the decedent's income tax return for 2008.

If you had deducted all the medical expenses as claims against the estate, \$20,000 would be deductible for estate tax purposes.

Taxes

Taxes that **are deductible** as claims against the estate include property taxes accrued before the decedent's death, unpaid income taxes on income received by the decedent during life and unpaid gift taxes on gifts made by the decedent during life.

Taxes that are **not deductible include** income taxes on income received after the decedent's death, property taxes not enforceable before death, or any estate, succession, legacy, or inheritance taxes.

State death taxes

The state death tax credit has been **repealed** for estates of decedents dying after December 31, 2004. Beginning in 2005, the credit will be **replaced with a state death tax deduction** against the value of the gross federal estate. Deduct the state death tax on Form 706, line 3b.

Other indebtedness

This **includes** any **unpaid mortgages** and other indebtedness against property included in the estate. If the estate is liable for the payment of the obligation, you must include the full value of the property in the gross estate and **deduct** the amount of the outstanding indebtedness. If the estate is not liable for the obligation, include only the value of the property minus the obligation in the gross estate.

Casualty and theft losses

Casualty and theft losses **can be deducted** from the gross estate if the following conditions are met:

1. Losses occurred during the settlement of the estate,
2. The casualty is from fires, storms, shipwrecks, other casualties and thefts, and
3. The losses are not compensated by insurance or otherwise.

LESSON 15

Marital deduction

The marital deduction is a deduction from the gross estate of the value of property that is **included** in the gross estate **but that passes, or has passed**, to the surviving spouse.

Interests passing to the surviving spouse include:

- dower (or curtesy) interests or the statutory interest in place of dower or curtesy, if elected.
- They also include an interest that, under community property laws, the surviving spouse had merely an expectant interest in before the decedent's death.

For estates of decedents dying after 1981 the marital deduction is **unlimited**.

Mortgaged property

If a property interest that passes to a surviving spouse is subject to a mortgage or other encumbrance, or if an obligation is imposed upon the surviving spouse in connection with the passing of a property interest, the value of the interest **must be reduced by the amount of the mortgage or other encumbrance**. However, if the will or local law requires the executor to discharge the mortgage or other encumbrance out of other assets of the estate, or to reimburse the surviving spouse, the payment or reimbursement constitutes an additional interest passing to the surviving spouse.

Bequests

A bequest is the act of giving or leaving property to another through the last will and testament. Generally, any distribution of income (or property in kind) to a beneficiary is an allowable deduction to the estate and is includible in the beneficiary's gross income to the extent of the estate's distributable net income. **However**, a distribution will **not be an allowable deduction** to the estate and will not be includible in the beneficiary's gross income if the distribution meets the following requirements.

- It is required by the terms of the will.
- It is a gift or bequest of a specific sum of money or property.
- It is paid out in three or fewer installments under the terms of the will.

Qualified terminable interest property (QTIP)

QTIP is property

- Which passes from the decedent,
- In which the surviving spouse has a qualifying **income interest for life**, and
- To which an election applies

The surviving spouse has a qualifying income interest for life **if**:

- The surviving spouse is entitled to **all** the income from the property payable annually or at more frequent intervals, and

- **No** person has a power to appoint any part of the property to any person other than the surviving spouse.

The decedent is **allowed** a **marital deduction** for QTIP transfers. The property is then taxed in the surviving spouse's estate.

Charitable Deduction

A deduction is allowed for the value of property in the decedent's gross estate that the decedent transferred during life or by will to or for the use of **any** qualifying charity.

Gross estate tax

The gross estate tax before the allowance of any credit is an amount equal to:

1. A tentative tax on the sum of -
 - a) The amount of the taxable estate, and
 - b) The amount of the adjusted taxable gifts;

Minus

2. The total amount of tax payable for gifts made after 1976.

The adjusted taxable gifts include only the value of the taxable gifts that were made by the decedent after 1976 and that are not includible in the decedent's gross estate.

Credits against the tax

The following credits are **deducted** from the gross estate tax to determine the net estate tax payable:

1. Unified credit,
2. Credit for gift taxes,
3. Credit for tax on prior transfers, and
4. Credit for foreign death taxes.

Unified credit

The 2009 unified credit amount is **\$1,455,800**. The credit effectively exempts the first **\$3,500,000** of transfers.

Credit for state death taxes

The state death tax credit has been **repealed** for estates of decedents dying after December 31, 2004. Beginning in 2005, the credit will be **replaced with a state death tax deduction** against the value of the gross federal estate.

Credit for tax on prior transfers

If the transferee (the decedent for whose this return is filed) received property from a transferor who died within **10 years before, or 2 years after**, the transferee, a **credit** is allowed on this return for all or part of the estate tax paid on the Federal estate tax paid by the transferor's estate with respect to the transfer.

LESSON 15

If the transferee was the transferor's surviving spouse, **no credit is allowed** for property received from the transferor to the extent that a marital deduction was allowed to the transferor's estate for the property. There is no credit for tax on prior transfers for federal gift taxes paid in connection with the transfer of the property to the transferee.

Credit for foreign death taxes

If property located in a foreign country is included in the gross estate, the estate may take a credit for **all or part** of the death taxes paid to a foreign country. The maximum credit is the smaller of the foreign death taxes imposed by the foreign country or the federal estate tax attributable to the property located in the foreign country.

**ESTATE TAX
Taxable Estate
Questions & Answers**

Taxable estate

02-15. A decedent's funeral expenses may be taken as a deduction on Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.

02-15. True.

ANALYSIS:

Funeral expenses are allowable only as deductions in computing the estate tax on Form 706.

03-39. All of the following items can be claimed as deductions against a decedent's estate except:

- A. Specific bequest to son.
- B. Executor's fees.
- C. Legal fees to settle estate.
- D. Charitable bequests.

03-39. A. Specific bequest to son.

ANALYSIS:

Executor's fees, legal fees to settle estate and charitable bequests can all be claimed as deductions against the decedent's estate.

A specific distribution to the son will not be an allowable deduction to the estate and will not be includible in the beneficiary's gross income if the distribution meets the following requirements.

- It is required by the terms of the will.
- It is a gift or bequest of a specific sum of money or property.
- It is paid out in three or fewer installments under the terms of the will.

04-40. In general, which of the following items are allowable deductions against a decedent's estate (Form 706)?

- A. Funeral Expenses.
- B. Mortgages (decedent's liability).
- C. Charitable Bequests.
- D. All of the above.

04-40. D. All of the above.

ANALYSIS:

All the above items are allowable deductions against the estate state in addition to the following:

- Administration expenses,
- Claims against the estate,
- Casualty and theft losses,
- Marital deduction.
- Charitable deduction

05-41. Which of the following statements is true regarding allowable deductions on Form 706, United States Estate Tax Return?

- A. Penalties incurred as the result of a federal estate tax deficiency are deductible administrative expenses.
- B. Attorney fees paid incidental to litigation incurred by the beneficiaries are a deductible administrative expense.
- C. Executor's commissions may be deducted if they have actually been paid or if it is expected that they will be paid.
- D. Funeral expenses are not an allowable expense.

05-41. The true statement is C. Executor's commissions may be deducted if they have actually been paid or if it is expected that they will be paid.

ANALYSIS:

Expenses for executor commissions and attorney fees may be deducted for amounts paid or amounts which at the time of filing the estate tax return may reasonably be expected to be paid.

In regard to item A, penalties resulting from an estate tax deficiency are not deductible expenses.

In regard to item B, attorney fees paid incidental to litigation incurred by the beneficiaries are not deductible expenses of the estate.

In regard to item C, funeral expenses are allowable deductions of the estate.

04-73. Based on the following information, what is the total allowable deduction against the decedent's estate?

- | | |
|------------------------------------|----------|
| • Mortgages and notes (receivable) | \$10,000 |
| • income in respect of a decedent | \$ 5,000 |
| • Funeral expenses | \$12,000 |
| • Attorney fees | \$20,000 |
- A. \$47,000.
 - B. \$32,000.
 - C. \$42,000.
 - D. \$10,000.

LESSON 15

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04-73. B. \$32,000.

ANALYSIS:

Allowable deductions against the decedent's estate are the funeral expenses of \$12,000 and the \$20,000 of attorney fees for a total of \$32,000. Mortgage and notes receivable and income in respect of a decedent are additions to the decedent's estate.

03-73. Laura's gross estate equals \$2,500,000. Given the following information, determine Laura's taxable estate:

Charitable contributions specified in	
Laura's will	\$100,000
Funeral expenses	\$ 10,000
Medical expenses claimed on Laura's	
Form 1040	\$ 20,000

- A. \$1,870,000.
 B. \$1,880,000.
 C. \$2,390,000.
 D. \$2,500,000.

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03-73. C. \$2,390,000.

ANALYSIS:

The taxable estate is the total gross estate minus:

- Administration and funeral expenses,
- Claims against the estate,
- Any outstanding obligation to which the property is subject, if the value of the property is included in the gross estate and is undiminished by the outstanding indebtedness,
- Casualty and theft losses,
- Marital deduction, and
- Charitable deduction.

Medical expenses were deducted on Laura's 1040 return, therefore they may not be claimed on the estate tax return (Form 706). Computed as follows:

Gross estate	\$2,500,000
Less: Charitable contribution specified in Laura's will	(100,000)
Funeral expenses	(10,000)
Total deductions	\$ 110,000
Taxable estate	\$2,390,000

Credits against the tax

03-16. If a decedent's estate includes property that was received from a person who died within 10 years before, or 2 years after the decedent received the gift, the decedent's estate may be allowed a credit for estate taxes previously paid on the property.

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03-16. True.

ANALYSIS:

If the decedent received property from a transferor who died within 10 years before, or 2 years after the transferee, a credit is allowable on this return for all or part of the Federal estate tax paid by the transferor's estate with respect to the transfer.

04-41. Which of the following tax credits are allowed on an Estate Tax return (Form 706)?

- A. Credit for foreign death taxes.
 B. Credit for Federal gift taxes (pre-1977).
 C. Credit for tax on prior transfers.
 D. All of the above.

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04-41. D. All of the above.

ANALYSIS:

The following credits are deducted from the gross estate tax to determine the net estate tax payable:

- Unified credit,
- Credit for gift taxes,
- Credit for tax on prior transfers, and
- Credit for foreign death taxes.

03-40. Which of the following amounts paid may be claimed as a credit on the estate tax return:

- A. State death taxes paid
 B. Generation-skipping transfer tax.
 C. Allowable unified credit.
 D. Earned income credit.

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03-40. C.. Allowable unified credit.

ANALYSIS:

The following credits are deducted from the gross estate tax to determine the net estate tax payable:

- Unified credit,
- Credit for gift taxes,
- Credit for tax on prior transfers, and
- Credit for foreign death taxes.

In regard to item A, beginning in 2005 the state death taxes paid is a deduction against the value of gross federal estate and not a credit.

In regard to item B, the generation-skipping transfer tax is an additional tax.

In regard to item D, the EIC applies to 1040 returns.

LESSON 15

ESTATE TAX
Estate Tax Deduction
Study Guide

Estate tax deduction

Income that a decedent had a right to receive is **included** in the decedent's gross estate and is subject to estate tax. This income in respect of a decedent is **also taxed** when received by the recipient (estate or beneficiary). However, an income tax deduction is allowed to the recipient for the estate tax (Form 706) paid on the income.

The deduction for estate tax can be claimed only for the **same tax year** in which the income in respect of the decedent must be included in the recipient's income. (This also is true for income in respect of a prior decedent.)

Individuals can claim this deduction only as an **itemized deduction**, on line 28 of Schedule A (Form 1040). This deduction is **not** subject to the 2% limit on miscellaneous itemized deductions. Estates can claim the deduction on the line provided for the deduction on Form 1041. For the alternative minimum tax computation, the deduction is not included in the itemized deductions that are an adjustment to taxable income.

If the income in respect of the decedent is capital gain income, you **must reduce** the gain, but not below zero, by any deduction for estate tax paid on such gain. This applies in figuring the following.

- The **maximum tax** on net capital gain.
- The **50% exclusion** for gain on small business stock.
- The **limitation** on capital losses.

Computation

To figure a recipient's estate tax deduction, **determine**:

- The estate tax that qualifies for the deduction, and
- The recipient's part of the deductible tax.

Deductible estate tax

The estate tax is the tax on the taxable estate, **reduced** by any credits allowed. The estate tax qualifying for the deduction is the part of the net value of all the items in the estate that represents income in respect of the decedent. **Net value** is the excess of the items of income in respect of the decedent **over** the items of expenses in respect of the decedent. The deductible estate tax is the difference between the actual estate tax and the estate tax determined without including net value.

Example 1

Jack Sage used the cash method of accounting. At the time of his death, he was entitled to receive \$12,000 from clients for his services and he had accrued bond interest of \$8,000, for a total income in respect of the decedent of \$20,000. He also owed \$5,000 for business expenses for which his estate is liable. The income and expenses are reported on Jack's estate tax return.

The tax on Jack's estate is \$9,460 after credits. The net value of the items included as income in respect of the decedent is \$15,000 (\$20,000 - \$5,000). The estate tax determined without including the \$15,000 in the taxable estate is \$4,840, after credits. The estate tax that qualifies for the deduction is \$4,620 (\$9,460 - \$4,840).

Recipient's deductible part

Figure the recipient's part of the deductible estate tax by **dividing** the estate tax value of the items of income in respect of the decedent included in the recipient's income (the numerator) by the **total value** of all items included in the estate that represents income in respect of the decedent (the denominator). If the amount included in the recipient's income is **less** than the estate tax value of the item, use the lesser amount in the numerator.

Example 2

As the beneficiary of Jack's estate (*Example 1*), you collect the \$12,000 accounts receivable from his clients. You will include the \$12,000 in your income in the tax year you receive it. If you itemize your deductions in that tax year, you can claim an estate tax deduction of \$2,772 figured as follows:

<u>Value included in your income</u>		Estate tax
Total value of income in respect of decedent	×	qualifying for deduction
<u>\$12,000</u> \$20,000	×	\$4,620 = \$2,772

If the amount you collected for the accounts receivable was more than \$12,000, you would still claim \$2,772 as an estate tax deduction because only the \$12,000 actually reported on the estate tax return can be used in the above computation. However, if you collected less than the \$12,000 reported on the estate tax return, use the smaller amount to figure the estate tax deduction.

LESSON 15

Estates

The estate tax deduction allowed an estate is figured in the same manner as just discussed. However, any income in respect of a decedent received by the estate during the tax year is **reduced** by any such income that is properly paid, credited, or required to be distributed by the estate to a beneficiary. The beneficiary would include such distributed income in respect of a decedent for figuring the beneficiary's deduction.

ESTATE TAX
Estate Tax Deduction
Questions & Answers

Estate tax deduction

05-42. Which of the following statements concerning the deduction for estate taxes by individuals is true?

- A. The deduction for estate tax can be claimed only for the same tax year in which the income in respect of a decedent must be included in the recipient's income.
- B. Individuals may claim the deduction for estate tax whether or not they itemize deductions.
- C. The estate tax deduction is a miscellaneous itemized deduction subject to the 2% limitation.
- D. None of the above.

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05-42. *The true statement is A. The deduction for estate tax can be claimed only for the same tax year in which the income in respect of a decedent must be included in the recipient's income.*

ANALYSIS:

The deduction for estate tax can be claimed only for the same tax year in which the income in respect of the decedent must be included in the recipient's income.

In regard to item B, individuals must itemize deductions to claim the deduction for estate tax.

In regard to item C, this deduction is not subject to the 2% limit on miscellaneous itemized deductions.

02-68. Joseph died on November 2, 2009. Joseph left all of his assets, including an IRA, to his two sons equally. From the information below, determine if Joseph's sons qualify to claim an estate tax deduction on their returns when they report the taxable IRA distributions.

Assets and deductions

- House (no mortgage) \$2,500,000
- Cash in bank \$ 500,000
- IRA-distributed \$ 600,000
- Administrative expenses \$ 30,000

- A. No, because the amount of the taxable estate is less than \$3,500,000.
- B. Yes, because the amount of the income in respect of a decedent (the IRA) exceeds the estate's deductions.
- C. Yes, because the gross estate exceeds \$3,500,000.
- D. No, because the amount of the income in respect of a decedent (the IRA) is less than \$2,000,000.

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02-68. *C. Yes, because the gross estate exceeds \$3,500,000.*

ANALYSIS:

For decedents dying in 2009 Form 706 must be filed by the executor for the estate of every U.S. citizen or resident whose gross estate, plus adjusted taxable gifts and specific exemption is more than \$3,500,000. The 2009 unified credit is \$1,455,800 which effectively exempts the first \$3,500,000 of transfers.

Joseph's gross estate is \$3,600,000, so Form 706 is required. In all likelihood some tax would have to be paid and part of the tax paid would be attributable to the IRA which is considered income in respect of the decedent. Therefore, the correct answer is C.

END OF SECTION 15