



Estate Tax (Form 706)

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Estate Tax (Form 706)

At death, all property of the decedent is included in the gross estate for estate tax. Taxable gifts made after 1976 are added to the total. The estate is allowed deductions for funeral expenses, administrative expenses, decedent's debts, and state death taxes. Most property passing to a surviving spouse or charity is also fully deductible.

States with Estate or Inheritance Tax

| | | | |
|----------------------|---------------|---------------|--------------|
| Connecticut | Kentucky* | Nebraska* | Rhode Island |
| District of Columbia | Maine | New Jersey* | Vermont |
| Hawaii | Maryland** | New York | Washington |
| Illinois | Massachusetts | Oregon | |
| Iowa* | Minnesota | Pennsylvania* | |

* Inheritance tax only. **Has both an estate and an inheritance tax.

Estate tax is due if the net estate is more than the estate tax exclusion for the year of death (\$12,920,000 in 2023). The estate receives a credit for gift tax payable by the donor during life.

Example: Henry died in 2023. He had the following assets:

| | |
|---------------------------------------|---------------------|
| House | \$2,675,000 |
| Cabin | 950,000 |
| Bank accounts..... | 1,100,000 |
| Brokerage account..... | 4,250,000 |
| Household and personal property | 560,000 |
| Vehicles..... | 145,000 |
| IRA rollover account..... | 1,200,000 |
| Total..... | \$10,880,000 |

Henry gave each of his four children \$750,000 when his wife died in 2011. He reported taxable gifts of \$2,948,000 (\$750,000 minus \$13,000 annual exclusion per gift). Henry made no other taxable gifts during his lifetime and paid no gift tax in 2011.

Henry's estate paid funeral and other expenses of \$150,000 and state death tax of \$300,000. Tax on Henry's estate is calculated as follows:

| | |
|---|-------------------|
| Total gross estate | \$10,880,000 |
| Less allowable expense deductions | (150,000) |
| Tentative taxable estate..... | 10,730,000 |
| State death tax deduction..... | (300,000) |
| Taxable estate | 10,430,000 |
| Adjusted taxable gifts made after 1976..... | 2,948,000 |
| Total..... | 13,378,000 |
| Tentative tax..... | 5,297,000 |
| Gift tax payable on gifts after 1976..... | (0) |
| Gross estate tax..... | 5,297,000 |
| Allowable credit..... | (5,113,800) |
| Estate tax | \$183,200 |

Marital Deduction

An unlimited deduction is allowed for transfers to a spouse during life and for assets passing to a surviving spouse at death. **Exceptions:**

- Assets passing to a spouse who is not a U.S. citizen.
- Certain terminable interests.

The marital deduction does not exclude assets from tax but rather postpones tax until the death of the second spouse. Assets that pass to a surviving spouse are included in the surviving spouse's estate and taxed at his or her death. Transfers that could allow taxable assets to pass to someone other than the spouse without estate tax generally do not qualify for the marital deduction.

Noncitizen Spouses

Gifts to a spouse who is not a U.S. citizen do not qualify for the marital deduction. A taxpayer is allowed a higher annual exclusion for gifts to a noncitizen spouse (\$175,000 in 2023).



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Exceptions: Assets passing at death to a noncitizen spouse qualify for the marital deduction if:

- The assets pass to the spouse in a qualified domestic trust, or
- The spouse is a U.S. resident who becomes a U.S. citizen before the due date for the estate tax return.

If a marital deduction is not allowed, and the surviving spouse's estate is later subject to U.S. estate tax, the surviving spouse's estate receives a credit for tax paid on the first spouse's death.

Terminable Interests

A terminable interest is one that will end after a period of time or when some contingency occurs or fails to occur (e.g., life estates, annuities, estates for a term of years, or patents). Terminable interests are not deductible if:

- The donor retained or gave an interest in the same property to anyone other than the spouse, and
- Someone other than the spouse may possess or enjoy any part of the property after the spouse's interest ends.

Marital Estate Tax Planning

Since every taxpayer is allowed an estate tax exclusion, a married couple can potentially shield twice the exclusion amount from estate tax. If the exclusion of the first spouse to die is unused, the couple may pay more in estate tax overall. To maximize the full estate tax exclusion for both, a married couple can elect portability of the estate tax exclusion of the first spouse to die.

Exclusion Unused

If a couple does not elect portability, all of a couple's assets pass to the surviving spouse and the couple loses the chance to use the exclusion of the first spouse to die.

Portability of the Estate Tax Exclusion

A predeceased spouse's unused estate tax exclusion may be transferred to his or her surviving spouse if an election is made on Form 706 (even if there is no filing requirement) within nine months of the decedent's date of death, or before the 6-month extension period ends. The surviving spouse can use the unused exclusion for lifetime gifts or transfers at death.

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The unused exclusion is the lesser of:

- The unused exclusion of the last deceased spouse of the surviving spouse, or
- The basic exclusion amount that applies at the time of the surviving spouse's death. If the estate tax exclusion decreases between the first spouse's death and the surviving spouse's death, the lower amount applies.

Example: Wanda died in January 2023. All her assets passed to her husband, Ralph, except a \$300,000 IRA that named Wanda's sister as beneficiary. Wanda's executor filed an estate tax return electing to transfer her unused exclusion of \$12.62 million (\$12.92 million minus \$300,000) to her surviving spouse. Ralph died in December 2023 with assets of \$20 million. His exclusion of \$12.92 million plus Wanda's unused exclusion of \$12.62 million eliminates his estate tax.

Charitable Deduction

An unlimited deduction is allowed for most transfers to charity during life and for assets passing to charity at death. Deductible contributions are similar to those allowed for income tax. Contributions to non-governmental organizations outside the U.S. are generally deductible. Only certain gifts of partial interests in property, such as remainders and trust shares, are deductible.

Valuation

The value of assets reported on Form 706 is generally the fair market value on the date of death. Assets may be valued using special-use valuation or alternate valuation.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 73.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of \$5,000.