

DEATH TAXES

I. Federal (U.S.) Taxes

A. Estate Tax

The federal estate tax applies to all assets owned by a decedent. It includes probate and non-probate property of all kinds. Most decedents' estates do not have to file a federal estate tax return because there is a "unified credit" available to every U.S. citizen. Sometimes it is referred to as a credit shelter amount or an exemption equivalent. Only if a decedent's estate is up to the threshold amount must a return be filed. If a return is due, it is due nine months from the date of death, if there is a tax, it is also due at that time.

The threshold amount for federal estate tax is changing over the years. According to current law, it is:

<u>Year</u>	<u>Amount Sheltered</u>
2007	\$2,000,000.00
2008	\$2,000,000.00
2009	\$3,500,000.00
2010	tax is repealed!
2011	\$1,000,000.00

Note that in 2010 the tax is repealed completely, but in 2011 it comes back with only a \$1 Million cutoff.

Once the tax kicks in, the tax bracket is stiff:

<u>Year</u>	<u>Top Tax Bracket</u>
2007	45%
2008	45%
2009	45%
2010	no tax
2011	55%

In addition to the unified credit, a second major tax savings is the "marital deduction." The marital deduction is a deduction from the gross estate and provides that a husband or wife can leave any portion or all of his or her estate to the surviving spouse without tax at the first death. To qualify for the marital deduction, the property must be left in one of several ways:

1. Outright. (as by a simple Will).
2. In trust for the spouse's life with all of the income paid to the spouse during life but with no right of the spouse to withdraw or appoint principal during life or at death. To come under this provision, the executor must elect for the trust to qualify as a marital deduction trust. "Qualified Terminal Interest Property or QTIP."
3. In trust with all of the income paid to the spouse for life and, in addition, the spouse having either or both the right to withdraw the principal and the right to direct by Will where the principal will go at death.
4. In trust with the Trustee having discretion to pay income to the spouse for life and with all accumulated income and principal at the spouse's death paid to his or her estate. This option was used when the income tax rates were much higher and varied. ("estate trust")

Of course, IF THE LAW REMAINS AS IT NOW IS and if you should die in 2010, there is no U.S. estate tax.

B. Generation Skipping Transfer Tax

There is a generation skipping transfer tax which provides a flat tax at the top rate of U.S. estate taxation on all non-exempt transfers which skip a generation.

A gift directly to a grandchild skips tax at the child's generation. A gift to a husband or wife for life, then to a child for life and then to the grandchildren, or to the child for life and then to the grandchild is a generation skipping transfer which can trigger the tax upon the death of the child.

Each U.S. citizen has an exemption which is increasing – at least for a while. It looks like this:

<u>Year</u>	<u>Exemption Amount</u>
2007	\$2,000,000
2008	\$2,000,000
2009	\$3,500,000

2010
2011

tax repealed
start over again

The purpose of a trust for a child's life can be:

1. Management of investments if the child needs someone else to do the managing.
2. Save estate taxes, as just described.
3. Protect assets against a potential creditor of the child.
4. Make sure grandchildren receive the funds after the child's death.

C. IRA Taxation

Everything that comes out of a retirement plan or a traditional; (nonRoth) IRA is taxable income. For income tax purposes, if W survives and is the beneficiary of H's IRA, she can "roll over" the IRA into her own IRA and defer the income taxation on the asset until and as payments are made to her. This has the benefit of deferring income tax and also permitting further investment within the IRA on a tax deferred basis. Tax deferred because so long as the income and/or capital gains are received within the IRA, there is no income tax to be paid. The income tax must be paid as ordinary income when the IRA pays out to the beneficiary.

As with all other assets owned by a decedent, the interest in the retirement plan is an asset which is eligible to be taxed for federal estate tax purposes. It is also eligible to qualify for the marital deduction. But if a marital deduction trust is to be used, there are more requirements than for other "regular" kinds of assets.

The difficulty comes when trying to put together the income tax concepts and the estate tax concepts. For estate tax purposes you will remember that the marital deduction trusts (except in the estate trust, D., which is seldom used) all require that the current income be paid to the surviving spouse. The IRA income tax requirement is that once the beneficiary obtains her required beginning date, which is April 1 following the year she is 70-1/2, the IRA must pay out over her lifetime so that according to the mortality tables the entire IRA will be paid out at the conclusion of her expected life. Usually, what this means is that when the required beginning date occurs, the trust must take from the retirement account all the income and some principal in accordance with these concepts.

The purpose of having the IRA paid to a trust is to facilitate splitting the retirement plan benefit into pieces - one to fill up the credit shelter trust (\$2,000,000 and up depending on the year of death) and the other to the marital deduction trust. Also, the

owner of the IRA can make sure that the IRA goes from the surviving spouse to the children because it stays under the control of the Trust, rather than the surviving spouse. The disadvantage is that the ability to “roll over” is lost.

D. Cost Basis

Effective for property acquired from decedents dying after December 31, 2009, the stepped-up basis at death rules are repealed and replaced with modified carryover basis at death rules. The recipient of property will receive a basis equal to the lesser of the adjusted basis of the property in the hands of the decedent or the fair market value of the property on the date of the decedent’s death. However, executors will be able to increase the basis of estate property by up to \$1,300,000, or \$3,000,000 in the case of property passing to a surviving spouse.

II. Ohio Estate Tax

The Ohio estate tax is levied on an Ohio resident’s property over \$338,333.33. Most nonprobate property is taxed along with probate property. However, life insurance is not taxed so as long as the beneficiary is not the decedent’s probate estate. There is also an exception for the portion of a retirement plan which was contributed by an employer. It does not matter whether the property passes by the person’s Will or is in a trust or in a retirement plan (IRA’s are fully taxable). The basic tax is at the rate of 7% over \$500,000.

Ohio has marital deduction provisions which parallel the federal estate tax law.