

# Estate Tax





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## Estimating Estate Tax Liability

As the old saying goes, you can't cheat death or taxes. In fact, you might still owe taxes after you die! One of these taxes is the federal estate tax. Generally, this is a tax that may be imposed on property you own at your death.

Any U.S. citizen who leaves an estate (plus adjusted taxable gifts) in excess of the estate and gift tax exemption equivalent amount (\$5,450,000 in 2016, \$5,430,000 in 2015) may be subject to estate tax.

Estimating and planning for the estate tax may be important to you because this could be one of the largest expenses your estate may have to pay. It also means that a significant part of your estate may go to the government and not to your beneficiaries.

**Caution:** *Transfers of property you make to persons who are more than one generation below you (e.g., a grandchild or great-nephew) may also be subject to generation-skipping transfer (GST) tax, a separate and additional type of federal transfer tax. Some states also impose their own gift tax, estate tax, and GST tax. These taxes are not discussed here, but you should take them into account when planning your estate. See your financial professional for more information.*

### The federal unified tax system

Under federal law, all property transfers are taxed under a unified gift and estate tax system. This means that lifetime gifts are reported and gift tax owed is paid annually. Upon your death, gifts are added back to your estate for estate tax calculation purposes, even though gift tax may have already been paid on them. Any gift tax paid is subtracted from estate tax owed. The result of this system is that you pay tax on the cumulative amount of wealth you give away, which effectively pushes your estate into a higher tax bracket.

### Calculating estate tax

Estate tax is imposed on your taxable estate, which is the value of your gross estate reduced by the qualified conservation easement exclusion and various deductions.

Your cumulative taxable transfers are calculated by adding adjustable taxable gifts you made during life to your gross estate. A tentative tax is calculated on your cumulative taxable transfers, as well as on your adjusted

taxable gifts. The tax is calculated under the Unified Tax Rate Schedule, which is graduated; the larger the value of your cumulative transfers, the greater the tax rate (much like your income tax). A tentative estate tax is calculated by subtracting the gift tax on adjustable taxable gifts from the estate tax on cumulative taxable transfers.

Credits are subtracted from the tentative estate tax, resulting in the estate tax that is owed.

The estate tax calculation looks like this:

<b>Gross Estate</b>
- Deductions
<b>Taxable Estate</b>
+ Adjusted Taxable Gifts
<b>Cumulative Taxable Transfers</b>
Tax on Cumulative Taxable Transfers
- Tax on Adjusted Taxable Gifts
<b>Tentative Estate Tax</b>
- Credits
<b>Estate Tax Owed</b>

**Tip:** *If you have not made taxable gifts during your lifetime, there is a shortcut that can be used to estimate what your estate tax would be if you were to die in 2016. Simply subtract the applicable exclusion amount from the taxable estate, and multiply this amount by 40 percent. For example, estate tax on a \$6,450,000 taxable estate for a decedent dying in 2016 would be \$400,000 [\$6,450,000 taxable estate minus \$5,450,000 applicable exclusion amount equals \$1,000,000; multiplied by the 40 percent top tax rate equals \$400,000].*

### Determining what is taxable

The first step in estimating estate tax is to determine what is taxable. This includes property owned by you (or deemed to be owned by you) at the time of your death (the gross estate).

The gross estate includes all property and property interests--of any description, wherever located--at the time of your death. This includes property that passes through probate and property inherited directly by joint owners or designated beneficiaries. Generally, your property includes:

- Real estate
- Personal property (e.g., cash, insurance proceeds, cars, furniture, jewelry, art objects)



**Under the federal unified tax system, estate tax is calculated by taking into account both your taxable estate and the adjusted taxable gifts you make during your lifetime. The result of this system is that you pay tax on the cumulative amount of wealth you give away, which effectively pushes your estate into a higher tax bracket.**

- Intangible property (e.g., copyrights, patents)

Generally, the value assigned to each property item is the fair market value (FMV) on the valuation date, though other valuation methods may apply. Simply stated, FMV means the price at which property would sell for on the open market.

**Tip:** *The valuation date is generally the date of death, but can be six months after the date of death if the executor makes a special election for this. This may be beneficial if property decreases in value during the six-month period. This may happen, for instance, if you own a small business that suffers because of your death.*

## Determining what isn't taxed

The second step in the estate tax calculation is to determine what isn't taxed. Certain amounts are excluded from, and deductions are subtracted from, your gross estate. The result is your taxable estate.

The following exclusions are allowed:

- Qualified conservation easement exclusion: A limited amount of the value of land subject to a qualified conservation easement can be excluded from your gross estate.
- Social Security benefits: Any benefits payable to your heirs under the Social Security system are excluded from your gross estate (unlike some life insurance or retirement plan benefits).
- Workers' compensation death benefits: Any benefits payable to your heirs under your state's workers' compensation law are excluded from your gross estate.

**Technical note:** *While the applicable exclusion amount (or basic exclusion amount; sometimes referred to as an exemption) indicates the amount of property that can be sheltered from federal gift or estate tax by the unified credit, the applicable exclusion amount is not actually an exclusion (or exemption). So do not reduce the gross estate by the applicable exclusion amount. Instead, the unified credit is subtracted below as a credit against tax.*

The following deductions are allowed:

- Estate expenses: Certain expenses incurred by your estate can be deducted from your gross estate. These expenses include funeral expenses, administration expenses (e.g., executor's or administrator's fees, court costs, attorney's

fees, and appraiser's fees), certain debts of the decedent, certain taxes, certain claims against your estate, and casualty losses suffered during the administration of your estate.

- Unlimited marital deduction: The unlimited marital deduction lets you deduct the value of property you leave to your spouse from your gross estate. Although this deduction is unlimited, only certain property interests qualify, and certain conditions and requirements must be satisfied.

**Tip:** *If your spouse is not a U.S. citizen, the marital deduction is generally not available unless you use a qualified domestic trust (QDOT).*

- Charitable deduction: The entire value of property you leave to charity is deductible from your gross estate. The gift must be to a qualifying organization and must be for a public purpose. Gifts to individuals, no matter how needy, do not qualify. Certain conditions must be met to qualify for this deduction, but the amount is not limited as it is with the income tax deduction.
- State death tax deduction: State inheritance or estate taxes (collectively referred to as state death taxes) paid are deductible from the gross estate.

This is what your calculation should look like at this point:

<b>Gross Estate</b>
- Deductions
<hr/>
<b>Taxable Estate</b>

## Calculating the tentative estate tax

As noted earlier, deductions are subtracted from the gross estate, resulting in the taxable estate. The taxable estate is then added to your adjusted taxable gifts, resulting in your cumulative transfers.

Generally, adjusted taxable gifts are gifts made after 1976 that are not "qualified transfers" for educational or medical purposes or transfers that qualify for the annual gift tax exclusion, marital deduction, or charitable deduction. Generally, the value of a gift is the FMV of the property on the date the gift is made.

A tentative tax is calculated on your cumulative taxable transfers, as well as on your adjusted taxable gifts. The tax is calculated under the Unified Tax Rate Schedule (see below) for gift tax and estate tax, which is graduated. A tentative estate tax



is calculated by subtracting the gift tax on adjustable taxable gifts from the estate tax on cumulative taxable transfers. [The gift tax on adjustable taxable gifts is calculated as reduced by the unified credit available in the year of any gift.]

As a result of calculating tax this way, the larger the value of your cumulative transfers, the greater is the tax rate on your taxable estate.

This is what your calculation should look like at this point:

<b>Gross Estate</b>
- Deductions
<b>Taxable Estate</b>
+ Adjusted Taxable Gifts
<b>Cumulative Taxable Transfers</b>
Tax on Cumulative Taxable Transfers
- Tax on Adjusted Taxable Gifts
<b>Tentative Estate Tax</b>

## Deducting credits

Once your tentative estate tax has been calculated, there are credits available to apply against the tax.

- The unified credit: This credit (\$2,125,800 in 2016, \$2,117,800 in 2015) allows you to pass an amount referred to as the basic exclusion amount (formerly known as the applicable exclusion amount) free from gift and estate tax. This lifetime exclusion (which is sometimes referred to as an exemption) effectively exempts \$5,450,000 (in 2016, \$5,430,000 in 2015) from gift tax and estate tax. For 2011 and later years, the exclusion amount is portable, that is, any exemption that is unused by the first spouse to die may be used by the surviving spouse for gift tax and estate tax.

[Technically, the Internal Revenue Code refers to the portable unused exemption as the deceased spousal unused exclusion amount (DSUEA).]

- Credit for gift taxes paid: You are allowed to deduct the gift tax paid on taxable gifts included in your gross estate if the gift was made before 1977.
- Foreign death tax credit: This credit is allowed for death taxes paid to a foreign country or U.S. possession on property included in your gross estate and situated in that country or possession.
- Credit for federal estate tax on prior transfers: If your gross estate includes property that was transferred to you by will, gift, or inheritance, and on which estate tax has already been paid, you may be entitled to a credit.

This is what your calculation should finally look like:

<b>Gross Estate</b>
- Deductions
<b>Taxable Estate</b>
+ Adjusted Taxable Gifts
<b>Cumulative Taxable Transfers</b>
Tax on Cumulative Taxable Transfers
- Tax on Adjusted Taxable Gifts
<b>Tentative Estate Tax</b>
- Credits
<b>Estate Tax Owed</b>

## Achieving peace of mind

Although estimating estate tax can be complicated, you can do it if you proceed step by step. Estimating estate tax is an important step in formulating and implementing a successful estate plan, and the peace of mind that comes with that should be worth your time and trouble.

#### **A word about state death taxes**

The individual states also impose their own "death taxes," in the form of an estate tax or an inheritance tax, or both. Whether your estate will be subject to state death taxes depends on the size of your estate and the tax laws in effect in the state in which you are domiciled.

Some states also impose a separate gift tax.

#### **A word about generation-skipping transfer (GST) tax**

GST tax is an additional tax imposed on property you transfer to an individual who is two or more generations below you (e.g., a grandchild or great-nephew). A flat tax rate equal to the highest estate tax rate then in effect is imposed on every generation-skipping transfer you make over the GST tax exemption, which is \$5,450,000 (in 2016, \$5,430,000 in 2015).

Some states also impose their own GST tax.

## **Federal Gift and Estate Exemption Limits and Tax**

For 2016, there is a \$5,450,000 gift and estate tax basic exclusion amount, the estate of a deceased spouse can transfer any unused applicable exclusion amount to the surviving spouse, and the top gift and estate tax rate is 40%.

<b>Year</b>	<b>Amount effectively exempted from federal gift and estate tax</b>	<b>Highest federal gift and estate tax rates</b>
<b>2015</b>	\$5,430,000 plus DSUEA*	40%
<b>2016</b>	\$5,450,000 plus DSUEA*	40%

\*Basic exclusion amount plus deceased spousal unused exclusion amount (exclusion is portable for 2011 and later)

## **Gift and Estate Tax Rate Schedules**

For 2011 and later years, the credit shelter amount is portable, that is, any exemption that is unused by the first spouse to die may be used by the surviving spouse for gift and estate tax purposes.

### **2015 and 2016 Gift and Estate Tax Rate Schedule**

<b>Taxable Gift/Estate</b>	<b>Tentative Tax Equals</b>	<b>Plus</b>	<b>Of Amount Over</b>
0 - \$10,000	\$0	18%	\$0
\$10,000 - \$20,000	\$1,800	20%	\$10,000
\$20,000 - \$40,000	\$3,800	22%	\$20,000
\$40,000 - \$60,000	\$8,200	24%	\$40,000
\$60,000 - \$80,000	\$13,000	26%	\$60,000
\$80,000 - \$100,000	\$18,200	28%	\$80,000
\$100,000 - \$150,000	\$23,800	30%	\$100,000
\$150,000 - \$250,000	\$38,800	32%	\$150,000
\$250,000 - \$500,000	\$70,800	34%	\$250,000
\$500,000 - \$750,000	\$155,800	37%	\$500,000
\$750,000 - \$1,000,000	\$248,300	39%	\$750,000
\$1,000,000 -----	\$345,800	40%	\$1,000,000
<b>Credit shelter amount</b>	<b>Credit amount</b>		
\$5,430,000 in 2015	\$2,117,800 in 2015		
\$5,450,000 in 2016	\$2,125,800 in 2016		

## IMPORTANT DISCLOSURES

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American Private Wealth  
781-300-7777  
[www.AmericanPrivateWealth.com](http://www.AmericanPrivateWealth.com)

