

## Estate Tax Update

*Gina M. Barry, Esq.*



When a Massachusetts resident passes away, every asset that he or she owns is subject to estate tax. Estate tax is imposed by both the

Commonwealth of Massachusetts (state estate tax) and by the United States' government (federal estate tax). While this may seem to create a fairly large burden, both the state and federal estate tax systems provide a credit that allows the deceased individual to pass a certain amount of assets without paying any estate tax.

The value of your estate for estate tax purposes includes everything you own at the time of your death. Thus, you need to add up the value of all of your assets, including but not limited to, real estate, life insurance proceeds, retirement accounts, investment accounts, bank accounts and tangible personal property to determine the gross value of your estate. Many people are surprised to learn the true value of their taxable estate.

In Massachusetts, the estate tax credit allows a decedent to pass \$1 million in assets without owing any Massachusetts estate tax. This tax is a cliff tax, meaning that once your estate exceeds \$1 million, tax is paid on the entire estate and not just the amount over the \$1 million. There is no ability to pass this credit between spouses. You must use your credit, or

your credit will be lost. There has been no change in the state estate tax system for several years, and there is no anticipated change forthcoming. The maximum tax rate is 16%.

With respect to federal estate tax, on January 1, 2013, the American Taxpayer Relief Act of 2012 was passed, making permanent the \$5 million lifetime exemption set forth in the 2010 Tax Relief Act, but with inflation adjustments. In 2013, this exemption allows you to pass \$5.25 million without paying estate tax. The highest tax rate is currently 40%. Unfortunately, the federal estate tax threshold and rates are not set in stone as the fiscal year 2014 budget called for lowering the estate tax exclusion back to the 2009 level as of the year 2018.

An important distinction between the state and federal estate tax systems is the availability of "portability" of the exemptions between spouses, which began on January 1, 2011. In 2013, this means that if a spouse does not use all of his or her \$5.25 million federal exemption, it may be used by the estate of the surviving spouse, which essentially allows a married couple to pass \$10.5 million without paying any federal estate tax.

Both the federal and state estate tax systems also provide for a Marital Deduction. The Marital Deduction allows for a deduction on a dollar for dollar basis of all property left by the decedent to his or her surviving spouse. For example, if a husband

owned \$20 million and left it all to his surviving wife at his death, his estate would be entitled to a federal and a state Marital Deduction of \$20 million. Using the marital deduction would mean that he would not use his credit, but his taxable estate would still be zero, and no state or federal estate tax would be due. At first, this seems to be an excellent technique; however, it is upon the second death, when the surviving spouse is holding the entire estate, that the government takes a large percentage of the estate. This is especially problematic at the state level, where portability of the credit still does not exist, and thus only one estate tax credit would be available to offset taxes.

As a previously deceased spouse's unused credit can not be used at the state level, married couples with a taxable estate often establish sophisticated trusts designed to capture their respective credits. A single person does not have this option available and will need to consider alternative planning, which may include charitable giving. Non-charitable gifting is also an option whether married or single. Massachusetts does not impose any gift tax. Under the federal system, in 2013, you can gift \$14,000 per person without having to report the gift to the Internal Revenue Service. Federal gift tax is only payable when you have gifted more than your lifetime exemption (\$5.25 million in 2013). Note well that for each

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gift you report, you use some of your federal estate tax credit to avoid paying tax at that time, and your lifetime exemption will be reduced proportionately upon your passing.

If you are a Massachusetts resident and your estate is greater than \$1 million dollars, you can take steps now to reduce, or possibly eliminate, any estate tax that would be due upon your passing. As the estate tax system is exceptionally compli-

cated, it is highly recommended that you seek the advice of a qualified advisor, who is well versed in the updated estate tax systems, to assist you.

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