

Staff Paper

Estate Transfer Summary

by

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Abstract

Brief description of estate transfer tools and a discussion of the Federal estate and gift tax.
(Note: information updated from Staff Paper #00-03.)

[4 pages]

ESTATE TRANSFER SUMMARY

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Property Ownership

Fee Simple - Ownership by one person who can buy, sell, give, or mortgage as he or she sees fit. When the owner is married, real estate is subject to a spouse's dower rights and, therefore, any transactions require their signature. At death, property becomes part of the probate estate.

Tenancy in Common - Ownership by two or more individuals who own an undivided share of ownership. At death, each tenant's share of ownership becomes part of the probate estate of the deceased.

Joint Tenancy With Rights of Survivorship - Ownership by two or more individuals, in which all owners must agree to any transactions involving sale, gift or use for borrowing purposes. At death, the surviving joint tenants take the property without probate proceedings.

Tenancy by the Entirety - Joint ownership with rights of survivorship between husband and wife.

Property Distribution Without a Will

Married With Children - Property distribution for a married person with child, children, or descendants is divided between the surviving spouse (who is also the mother of all the children) who receives the first \$60,000 plus one-half the remaining balance of the property, and the children who receive one-half the property divided equally. If there is a child or children of a prior marriage, spouse and such children's share equally.

Married Without Children and Without Parents - All property to the surviving spouse.

Married Without Children, but With at Least One Parent Surviving - The surviving spouse receives the first \$60,000 plus one-half the remaining balance of the property and the parent or parents receive one-half the property.

Widow or Widower With Children - All property to children divided equally. Grandchildren take their deceased parent's share.

Unmarried - In cases of an unmarried person, or widow or widower without children or descendants, the distribution is as follows: If the parents survive, all to the parents or survivor. If no parents survive, all property goes to brothers and sisters, divided equally. Nieces and nephews take their deceased parents' share. If no parents, brothers, or sisters survive, the property is divided ½ to the nearest kin of maternal grandparents and ½ to the nearest kin of paternal grandparents. If no kin, all to the state.

Federal Estate and Gift Tax

The Federal estate and gift tax law has a single tax schedule. While living, a person may make a gift of \$11,000 per year per person to any number of individuals without filing a return or paying a tax. The value of property given is its fair market value. Husband and wife can combine their exemption and therefore give \$22,000 per person per year. Any gifts in excess of the annual exemption are taxed according to the following rate schedule.

Taxable Estate and Lifetime Gifts		Tax =	
From:	To:	(\$)	(%)
\$ 0	\$ 10,000	\$ 0	18
10,000	20,000	1,800	20
20,000	40,000	3,800	22
40,000	60,000	8,200	24
60,000	80,000	13,000	26
80,000	100,000	18,200	28
100,000	150,000	23,800	30
150,000	250,000	38,800	32
250,000	500,000	70,800	34
500,000	750,000	155,800	37
750,000	1,000,000	248,300	39
1,000,000	1,250,000	345,800	41
1,250,000	1,500,000	448,300	43
1,500,000	1,500,000	555,800	45
2,000,000		780,800	49

The gift tax is calculated on the accumulated gifts above the annual exemption over a person's lifetime, but no tax is paid until the unified credit is used up. The amount of the credit is equal to the tax on the exemption equivalent. The gift tax exemption is \$1 million until 2010 when a special table introduces a top tax rate of 35%. The exemption equivalent for the estate tax is \$1 million in 2002 and 2003; \$1.5 million in 2004 and 2005; \$2 million in 2006, 2007 and 2008; and \$3.5 million in 2009. The maximum estate tax rate gradually decreases from 49% in 2003 to 45% in 2009. The estate tax is eliminated in 2010, but returns in 2011 with a \$1 million exemption. There is a 100% marital deduction for gift and estate transfers between spouses.

At death the taxable estate includes all property owned by the decedent including life insurance and jointly owned property except to the degree the surviving joint tenant can prove monetary contribution towards acquisition. Any unified credit which has not been used for gifts during life is available to use against the tax at death.

Cost Basis for Income Tax

The cost basis in the hands of the heirs is the fair market value at date of death or alternative value if chosen on the Federal estate tax return. In the case of joint tenancy property, the survivor receives a step-up-in-basis for the portion included in the taxable estate of the deceased. A surviving spouse, however, gets a full date of death value basis in joint tenancy property that was acquired by the decedent spouse before 1977. In 2010 there will be no step-up-in-basis, except for estates where the executor will be able to partially increase the basis by up to \$1.3 million or \$3 million for a surviving spouse.

Alternate Valuation of Certain Real Property (Code Section 2032A)

A special valuation rule applies to real property in a closely held business on the basis of the property's value as a closely held business. This special valuation cannot reduce the decedent's gross estate by more than \$750,000. To qualify for this valuation:

- (1) The business real and personal property must be at least 50% of the adjusted gross estate.
- (2) The real property must be at least 25% of the adjusted gross estate.
- (3) The property must pass to a qualifying heir.
- (4) The real property must have been owned and managed by the deceased or his heir for 5 of the last 8 years prior to death.
- (5) The property must continue to be actively used by a qualified heir for at least 10 years after death or the foregone taxes will be recaptured.
- (6) The cost basis of the property will receive a step-up in basis to the alternative valuation, not the fair market value.

Qualified Family-owned Business (Code Section 2057)

The qualifications for this exclusion are essentially the same as the valuation of certain real property rules, except business personal property is also included and real property, if any, does not have to be 25% of the adjusted gross estate.

The maximum exclusion is the difference between \$1,300,000 and the unified credit exemption. (\$1,300,000 less \$1,000,000 = \$300,000 in the year 2002 and 2003.)

Unlike item (6) under the "Alternative Valuation of Real Property," property under the small business exclusion will receive a full step-up in basis to fair market value.

Special Payment Alternative

Code Section 6166 allows a 14-year period for payment of estate tax attributable to an interest in a farm or other closely held business if the value of the business exceeds 35% of the adjusted gross estate. You can defer paying estate tax for four years and then pay the tax (with interest) in 10 annual installments. The rate is 2% on the first \$1,000,000 of taxable value above the exclusion amount and 45% of the "underpayment of tax" rate on the excess.

Michigan Inheritance Tax (now the Estate Tax)

For deaths after 9/30/93 the Michigan Inheritance tax will be the credit for State death taxes under the Federal estate and gift tax. This amount is paid to the Michigan Department of Treasury and is subtracted from the amount of the Federal estate tax calculation sent to the Internal Revenue Service.

Estate Planning Tools

Property Ownership - The individual or individuals who own the property.

Estate Splitting - Dividing property ownership between individuals in separate ownership such as fee simple or tenancy in common rather than joint ownership.

Will - A document which gives an individual an opportunity to give the Probate Court instructions on how his or her probate estate is to be handled and divided. Can name the personal representative and guardian for minor children.

Gift - A transfer of property from one owner to another for no consideration or a consideration at less than fair market value.

Sale - A transfer of property from one owner to another for a consideration at fair market value.

Trust - Ownership and control of property by a third party (trustee) who manages the property and pays the income to a named beneficiary according to instructions given by the person setting up the trust and who transfers the property to it.

Life Insurance - A contract between an owner of a policy and the insurance company which states that for a consideration (premium) the company will pay a given sum (face value of the policy) to a named beneficiary in case of death of the named insured. Different degrees of savings may also be a part of the policy.

Annuity - A contract in which a given sum of money is paid on a periodic basis to a beneficiary for life.

Marital Deduction - Under the Federal estate and gift tax the exemption for the surviving spouse is equal to whatever the spouse received.

Life Estate - A transfer of ownership from an owner to a second party with a reservation of some rights, such as life use of the residence. Property does not go through probate, but usually is still taxable in the estate of the deceased owner.

Deed in Escrow - Papers are prepared to transfer real estate to another owner and given to a third party for delivery at a later date or when specified conditions are met. There is no transfer until delivery is made.