

## **Deceased Taxpayer Tax Returns**

We often prepare tax returns where there is a deceased taxpayer (decedent). This document discusses a variety of topics associated with a deceased taxpayer's tax return. The intent is to provide background information and details that should assist in properly completing the tax return as well as providing advice and counseling to the surviving spouse or family.

### **Topics Discussed**

- I. General Information
- II. Cost Basis, Sale of Main Home, and Homeowner Exclusion
- III. First Time Homebuyer Credit (FTHBC)
- IV. Remaining Basis in a Pension or Annuity
- V. Background on Probate
- VI. Completing the Tax Return

### **I. General Information**

**Filing Status:** If your spouse died during the year, you are considered married for the whole year for filing status purposes. If you didn't remarry before the end of the year, you can file a joint return for yourself and your deceased spouse. If you remarried before the end of the tax year, you can file a joint return with your new spouse. In that case, your deceased spouse's filing status is married filing separately for that year.

A Financial Power of Attorney (POA) does not survive death and is not valid for a deceased individual.

### **II. Cost Basis, Sale of Main Home, and Homeowner Exclusion**

**Sale of Main Home – Adjusted Cost Basis: Community Property (Idaho)** adds the following rules to the Adjusted Basis: Each spouse is considered to own half of the community property. When either spouse dies, the total fair market value of the community property at that time becomes the basis of the entire property, including the part belonging to the surviving spouse. At the death of the surviving spouse (2<sup>nd</sup> to die), the fair market value at that time becomes the inherited basis for the beneficiaries. PUB 523, Selling Your Home

The step-up in cost basis may also apply to other community property assets with a cost basis, such as stock and investment accounts. PUB 551, Basis of Assets and PUB 555, Community Property

**Sale of Main Home – Homeowner Exclusion Amount:** If the taxpayer sells their home within 2 years after their spouse dies and has not remarried as of the sale date, they can count any time their spouse owned the home as time they owned it and any time when the home was their spouse's residence as time when it was their residence. In addition, the taxpayer may be able to increase their exclusion amount from \$250,000 to \$500,000 if the taxpayer or their deceased spouse meet the requirements for Test 1 (2-year

ownership) and both the taxpayer and their deceased spouse meet the requirement for Test 2 (2-year residence). PUB 523, Selling Your Home.

A couple of common mistakes for home ownership and account registration in a community property state:

1. Holding the title of a home in joint tenancy with a spouse, is a step-up in basis mistake in a community property state. If you do this, when one spouse dies the other one must keep the original cost basis on one half of the house. In other words, you will only get a step-up in basis on half the house.
2. There are certain pitfalls associated with owning a home with your children. If you intend to allow your heirs to avoid probate on your real property after your passing, you don't want to own the real property with your children. Use a trust instead. If not, your children will recognize a full capital gain on the home, as the step-up in basis rule will not apply.

### **III. First Time Homebuyer Credit (FTHBC)**

The FTHBC was for certain home purchases in 2008. The FTHBC was based on the purchase price and the max was \$7500 to be paid back over 15 years starting in 2010. The FTHBC of a deceased taxpayer is forgiven and does not have to be repaid.

### **IV. Remaining Basis in a Pension or Annuity**

Any unrecovered basis at the last annuitant's death is allowed as an itemized deduction on the final return of the decedent. The Bogart Annuity/Pension Exclusion Calculator can be used to determine any unrecovered basis.

### **V. Background on Probate**

This is not intended to be a detailed discussion on estate planning and estate tax law, but some basic concepts should be understood to properly complete a deceased tax return and understand the entries on the Form 1310.

When a person dies, any real estate (house) that is titled in a person's name no longer has a legal owner. This can also apply to other titled property such as a vehicle. In order to establish an individual with the legal authority to sell or transfer the property, a Probate is necessary. Probate is a court supervised legal procedure. During probate, the court will do the following:

- ✓ authenticate the Last Will and Testament and if there is no Last Will and Testament, then the State Intestate Laws will be applied by the court
- ✓ approve and authorize the Executor/Personal Representative to pay all debts and taxes and distribute remaining property per the applicable instructions to the authorized beneficiaries
- ✓ close the Probate after all property is properly and legally distributed as certified by the Executor/Personal Representative

In this context, the Executor/Personal Representative is a court-appointed position and requires a court issued certificate of appointment and is typically a Letters Testamentary. Idaho uses the term Personal Representative (PR). A power of attorney or a copy of the decedent's Will is not acceptable evidence of the appointment.

The PR is required to: inventory and account for all assets and property; pay debts and taxes; and distribute assets and property. For tax purposes, these responsibilities are detailed in IRS PUB 559, Survivors, Executors, and Administrators. Consider advising the family member/PR of PUB 559 requirements.

Probate is normally not required when there is a small estate (< \$100,000) and there is no real estate ownership, regardless of the value of the real estate. This is true regardless of whether there is a written Last Will and Testament or not. Whenever there is a small estate and no real estate ownership, the property can generally be transferred through an Affidavit by the person who is legally entitled to inherit that property. The person simply presents an Affidavit representing that they are entitled to receive the property. No other steps are required. This is typical for Tax-Aide clients.

Additionally, probate can be avoided through the proper use of: 1) Trusts; 2) named beneficiaries for certain accounts (IRA, Life Insurance and Annuities); 3) pay/transfer on death account registrations; 4) or through some combination of these methods.

Probate may be necessary upon the death of the first spouse. There is a common misconception that a surviving spouse is not required to go through the probate process. Most people assume that the surviving spouse is somehow automatically entitled to receive and own all of the decedent's property. Property does not automatically transfer to the surviving spouse. The decedent is entitled to give their property away in a Last Will and Testament to whomever they want which could include the surviving spouse, children, siblings, charities or even strangers. Depending upon how the property is owned, registered, and the beneficiaries, a Probate and court appointed PR may be necessary.

## **VI. Completing the Tax Return**

Two Situations we will discuss for tax preparation:

1. Surviving Spouse
2. No Surviving Spouse (Single or 2<sup>nd</sup> to die)

In either situation, there may be raw emotions and this is often a difficult time for the Surviving Spouse and family members. Be compassionate and understanding. Knowledge of the material in this document could help in preparing the tax return and for counseling and advising the clients.

Many of our clients are not familiar with Probate and tax laws and this can be confusing and complex. Occasionally, family members have not taken the necessary steps to initiate Probate when it is required. For the no surviving spouse situation where Probate is required and a refund is due, a paper return will be necessary. The return can be completed and paper copies provided. The family member should be advised of the need

for Probate. The paper return will need to be signed by the PR and mailed along with a copy of the court issued certificate of appointment (Letters Testamentary) in order to claim the refund.

### **1. Surviving Spouse**

Complete the tax return with attention to the following;

- ✓ Basic Information – check the deceased box and enter the date of death. The date must match the date reported to Social Security Administration. TaxSlayer will make the necessary “deceased” entries on the forms.
- ✓ Filing Status – should be MFJ in the year of death
- ✓ Adjust TaxSlayer entries as necessary: If there is carry-forward, make the surviving spouse the primary taxpayer and you may have to adjust taxpayer and spouse designations on individual entries (W-2, 1099-R, Social Security, etc.)
- ✓ Sale of Main Home – Adjusted Cost Basis and Homeowner Exclusion Amount
- ✓ First Time Homebuyer Credit
- ✓ Remaining basis in a pension or annuity
- ✓ Adjusted Cost Basis on other types of appreciated assets – tax documents and account records (brokerage accounts) should be updated for the step-up
- ✓ Surviving spouse will be the only signature required

### **Extra Credit**

Depending upon the circumstances, consider advising the surviving spouse of the following.

- ✓ Filing status and standard deduction will change to Single next year
- ✓ What is the effect on next year’s tax return for the surviving spouse? Consider completing a rough estimate for next year and adjust withholding if necessary.
- ✓ Income source changes:
  - Social Security and surviving spouse rules
  - Pension – is there a survivor benefit
- ✓ IRA and Roth IRA beneficiary rules for Spousal IRA and Inherited IRA and the 2019 SECURE Act
- ✓ Update beneficiaries on all accounts
- ✓ Update account registrations (Single, Joint, WROS, POD/TOD). Pay particular attention to Titled property (house, real estate and vehicles) – this may require Probate depending on how the assets are registered and the decedent’s Will.
- ✓ Update other Estate Plans and documents (Will, Trust, Financial POA, Living Will and Medical POA)
- ✓ Life Insurance and annuity death benefits

## **2. No Surviving Spouse (Single or 2<sup>nd</sup> to die)**

Complete the tax return with attention to the following:

- ✓ Basic Information – check the deceased box and enter the date of death. The date must match the date reported to Social Security Administration. Enter the name of the person filing the return on behalf of the Taxpayer. TaxSlayer will make the necessary “deceased” entries on the forms.
- ✓ Sale of Main Home – Adjusted Cost Basis and Homeowner Exclusion Amount
- ✓ First Time Homebuyer Credit
- ✓ Remaining basis in a pension or annuity
- ✓ Adjusted Cost Basis on other types of appreciated assets – tax documents and account records (brokerage accounts) should be corrected for the step-up

### Extra Credit

Depending upon the circumstances, consider advising the family member/beneficiary of the following:

- ✓ IRA and Roth IRA beneficiary rules for Inherited IRA and the 2019 SECURE Act
- ✓ Step-up in basis rules for inherited property and assets
- ✓ Life Insurance and annuity death benefits

When you enter the e-file section, you may receive an error message and advise you need to complete the Form 1310, if not already completed.

Additional requirements for the tax return will be determined by the following:

- Is a refund due?
- Is Probate required and is there (or needs to be) a court-appointed PR?

In all cases where a refund is not due (a payment is due) the return can be signed for by the PR or responsible family member and can be e-filed. That person then assumes responsibility for paying the amount due.

### Refund is Due and Probate is not required and there is no court-appointed PR:

- ✓ A Form 1310 needs to be completed, the responsible family member can sign for the return, and the return can be e-filed along with the Form 1310. This is a fairly common situation for our clients where there is a small estate and no real estate ownership.
  - ✓ Form 1310 Part I Box C would be checked in Tax Slayer and Part II needs to be completed. In order to e-file and use the Form 1310 to claim the refund, Part II questions 2a and 2b have to be answered NO and question 3 has to be answered YES. See the TaxSlayer entry screen below: Part II will be NEITHER
- The Form 1310 is essentially serving as the Affidavit discussed earlier.

Refund is Due and Probate is required:

- ✓ A paper return will be necessary. The return can be completed and paper copies provided. If Probate has not been initiated and there is no court appointed PR, the family member should be advised of the need for Probate. The paper return will need to be signed by the PR and mailed along with the court issued certificate of appointment (Letters Testamentary) in order to claim the refund.
- ✓ Form 1310 Part I Box B would be checked in TaxSlayer and Part II should not need to be answered. Uncheck the TaxSlayer box for electronically filing. A Form 1310 is not required since the PR is signing the actual return. It would not hurt to print the Form 1310 and have the PR also sign it.
- ✓ The Form 1310 Box B instructions are confusing and refer to an amended return on Form 1040X. For original returns or amended returns where a refund is due and Probate is required, Box B is checked and a paper return is necessary.

You may get hung-up in TaxSlayer and not be able to enter the E-file section such that bank direct deposit info cannot be entered. You may have to manipulate the Form 1310 entries in order to get to the E-file section for bank info and then correct the Form 1310 entries for the printed copies.

If you check Box B, then you are indicating that a Probate is required. This tells the IRS that there is a court supervised Probate in-process and the IRS requires the court designated PR to file the return and to provide evidence of appointment (Letters Testamentary). In this case, an e-file is not allowed since there is no way to attach the document.

In any case, a copy of the Death Certificate is not required to be sent to the IRS, but a copy should be kept with the Estate records.

Form 1310 Entries in TaxSlayer

Enter the person claiming the refund including an SSN, address and phone number. Make the necessary entries as outlined above for the situation.

The Form 1310 and TaxSlayer entry screen are shown below – note that the TaxSlayer entries are not identical to Form 1310.

**Form 1310**

**Part I** Check the one box that applies to you. You must also complete Part III below. See instructions.

- A  Surviving spouse requesting reissuance of a refund check received in the name of both the decedent and the surviving spouse.
- B  Court-appointed or certified personal representative (defined below). Attach a court certificate showing your appointment, unless previously filed.
- C  Person, **other** than A or B, claiming refund for the decedent's estate. Also, complete Part II.

**Part II** Complete this part only if you checked the box on line C above.

	Yes	No
1 Did the decedent leave a will? . . . . .	<input type="checkbox"/>	<input type="checkbox"/>
2a Has a court appointed a personal representative for the estate of the decedent? . . . . .	<input type="checkbox"/>	<input type="checkbox"/>
b If you answered "No" to 2a, will one be appointed? . . . . .	<input type="checkbox"/>	<input type="checkbox"/>
If you answered "Yes" to 2a or 2b, the personal representative must file for the refund.		
3 As the person claiming the refund for the decedent's estate, will you pay out the refund according to the laws of the state where the decedent was a legal resident? . . . . .	<input type="checkbox"/>	<input type="checkbox"/>
If you answered "No" to 3, a refund cannot be made until you submit a court certificate showing your appointment as personal representative or other evidence that you are entitled under state law to receive the refund.		

**Part III** Signature and verification. All filers must complete this part.

I request a refund of taxes overpaid by or on behalf of the decedent. Under penalties of perjury, I declare that I have examined this claim, and to the best of my knowledge and belief, it is true, correct, and complete.

TaxSlayer Entry

Check here if you plan on sending this form electronically.

**Part I - Check the box that applies to you**

- A - Surviving spouse requesting reissuance of a refund check.
- B - Court-appointed or certified personal representative. Attach a court certificate showing your appointment, unless previously filed.
- C - Person, other than A or B, claiming refund for the decedent's estate (complete Part II if checked)

**Part II - Complete ONLY if you checked 'C' in Part I**

- Check here if you have a valid proof of death.
- Check here if the decedent left a will.

**Personal Representative.**

- a. A court HAS ALREADY appointed a personal representative for the estate of the decedent.
- b. A court WILL provide a personal representative for the estate of the decedent.
- Neither
- Check here if, as the person claiming the refund for the decedent's estate, you will pay out the refund according to the laws of the state where the decedent was a legal resident.

CANCEL

CONTINUE