

Estate Tax Return Preparation: A Guide for Paralegals



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Estate Tax Return Preparation: A Guide for Paralegals

Though recent changes to the tax code have sought to reduce the overall estate tax burden endured by non-spouses in the event of a loved one's death, the tax remains a crucial part of federal revenue even today. In order to ensure that Americans are paying this tax appropriately, and in line with federal requirements, the Internal Revenue Service requires that Form 706 be filed with the agency for the tax year that ends most immediately after an individual has passed away and their estate has been executed according to the guidelines and instructions set forth in a last will and testament. This form is extensive, with a combined sixteen different parts and schedules. For those new to the estate tax, or those new to Form 706 itself, this extensive listing of assets, income, and an estate's overall value can be somewhat confusing.

The good news for today's paralegals is that the sixteen various parts of Form 706 are actually easy to break down. Each of these different forms and schedules covers a different component of an estate's total worth, the tax due to the federal government by any named beneficiaries, and any other considerations that might expose income to federal taxation after the death of a client's loved one. Understanding each of these sixteen components will make it far easier for paralegals to navigate the estate tax and to sufficiently prepare an accurate, favorable Form 706 that will benefit their client and safeguard them from either underpaying their taxes or overpaying the federal government.

Getting Started: Naming the Decedent, the Estate's Executor, and Any Trustees

The first part of Form 706 is dedicated entirely to naming and identifying the parties who passed away, those who stand to inherit any amount of money from that individual's estate, and the executor of the estate who is responsible for enacting the will. This section of the tax form will also be dedicated to attaching the will and other documents prepared in advance by the decedent. For reference, a brief list of terms is as follows:

- "Decedent" is simply the term applied to the individual whose estate is being distributed due to their recent passing.
- "Trustee" or "Fiduciary" applies to each individual who stands to gain monetarily from the decedent's death by inheriting any part of their estate. When there are multiple trustees, each will need to provide identifying information for the purpose of filing Form 706 and each will need to sign the first page of the completed tax document, along with the paralegal, before it is submitted to the Internal Revenue Service for review and processing.
- "Executor" typically applies to the individual named in the decedent's will whose job it is to manage the sale and distribution of the individual's assets to the trustees or fiduciaries. If no executor of the estate is appointed prior to the decedent's passing, then any individual with any possession of the executor's property could be considered an executor of the estate for the purpose of filing the Form 706 documentation with the IRS.

Necessary Documentation for the Completion of Part 1

Part 1 of Form 706 can only be considered complete when a few key documents are attached. All documents attached for IRS review within Part 1 must be certified and notarized prior to submission, or they will not be considered valid by the agency. In this case, the IRS would require an amended Form 706 to be submitted with the proper certification and notarization signatures. Required for inclusion with Part 1:

- A death certificate listing the date of the decedent's passing, certified and notarized prior to inclusion.
- A copy of the decedent's last will and testament, also certified and notarized prior to inclusion with Part 1 documentation.
- A signed copy of Form 4768 if an extension was granted concerning the deadline for submitting Form 706 to the IRS for review. While a signature is required, certification and notarization of this form is not mandated by current IRS guidelines.

Submitting Part 2, Known as the Tax Computation Document

Part 2 of IRS Form 706 concerns the computation of the tax to be paid by any fiduciaries inheriting some part of the decedent's estate. This is prepared by the paralegal simply by filling in a few key numbers from the decedent's will, and it is fully explained using line-by-line documentation paired with Form 706 when it is obtained from the IRS via its website, or via a paper form sent directly from the agency.

Part 2 of the tax document is typically filled in as the rest of the corresponding parts of Form 706 are completed. This section of the document should be kept on hand, side-by-side, while the other schedules and documentation are being prepared by the paralegal.

Part 3: Elections Made by the Decedent's Executor

A key part of IRS Form 706 can be found in Part 3, which is titled "Elections by Executor." This part of the form is used to list the fair market value of any assets held by the decedent at the time of their death. For the purpose of IRS reporting and a fair assessment of the estate tax due by the fiduciaries, the fair market value of the decedent's assets is defined as the price of an asset if it were to change hands, between a buyer and a seller, without any compulsion to complete the transaction.

While executors can typically make an election of the fair market value of each asset on this part of Form 706, the paralegal will often offer some amount of assistance when identifying the fair market value and making an accurate report of each asset's value. Paralegals should be prepared to research asset prices including homes, vehicles, and other property, and this information should be verified with executors prior to their electing an overall asset price.

The fair market value price is calculated based on the date of the decedent's death, though there are at least two exceptions to this requirement that can be filed prior to electing a fair market value price of any asset. They include the following:

- An alternate valuation date, which can extend up to six months after the decedent's death. This alternate valuation date must be filed for as an exception, and the exception must be granted in order for a later date to be used. A request to use this alternate valuation date is made within Part 3 by checking the box on page 2, line 1. Alternate value information must then be documented and recorded on Schedule A through Schedule I of Form 706 prior to it being submitted to the IRS for review.

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- A "timely sale" valuation date, if the asset is sold prior to the six-month extended window for calculating its fair market value. In this case, the fair market value of the asset would be calculated not as the decedent's date of death, but as the date of the sale itself.

It is important to note that the IRS always rounds dollar amounts during tax form submissions, whether it's a personal income tax form or estate tax documentation. Any amount 50 cents or greater is rounded up, while any amount less than 50 cents is rounded down to the nearest full dollar amount.

Part 4: General Information about Beneficiaries and the Preparer

Part 4 of Form 706 is labeled "General Information," and it requests the signature of the tax preparer a second time. This section will generally be completed by the paralegal on behalf of the beneficiaries or fiduciaries, though their information will be reported alongside the preparer's own information throughout Part 4. The preparer will fill in key information pertaining to their identity on this form for use by IRS officials.

Information requested of beneficiaries within Part 4 includes documentation of generation-skipping transfers, tax information pertaining to each beneficiary, power of appointments, interest in closely held corporations, non-probate assets that include trusts, and any gift tax returns that are necessary for filing to calculate a fair estate tax.

Part 5: Recapitulation of Assets and Necessary Estate Taxes

The final official part of Form 706 is labeled "Recapitulation," and it is easily the most extensive part of the process. There are a combined sixteen schedules to be completed within Part 5, dealing with everything from the value of the gross estate to the deductions and benefits that can be claimed by fiduciaries as part of calculating their financial obligations. All of these schedules must be filled out, including those that are not applicable to the estate. In the event that a schedule does not apply to the decedent's estate and assets, paralegals are encouraged to simply enter "0" in each line of the schedule and continue until they have reached the last of these schedules. This is the best practice encouraged by the IRS and it makes final calculation of burdens, obligations, and deductions, a great deal easier for the paralegal or other tax preparer.

Schedule A: Real Estate Interest(s)

The decedent's real estate holding and interests are listed and documented within Schedule A, and this includes not only any homes or personal property, but also any rental properties or income, condominiums, extra cemetery plots, mineral interests, easements on any land, or any tenancy sharing that occurred prior to the decedent's passing. This is only a statement of current holdings, interests, and values. Information on applicable tax is calculated in several other sections, including Schedule B and Schedule F.

Schedule A is also concerned with the executor's election of real estate values, which should have been discussed and disclosed in Part 2. Most real estate holdings are eligible for a discount of between 10 percent and 25 percent, though paralegals should reference the latest IRS documentation and discussion on these discounts, their applicability, and how acceptable they are for given types of real estate or other interests in this area.

Schedule B: Stocks, Bonds, and Investments

All of the decedent's investments held at the time of their death are documented using Schedule B. This includes stocks, bonds, mutual funds, and any other investment mechanisms that were held at the time of the decedent's passing. Any investments held in tenancy with another party must also be declared and evaluated by using Schedule B. This includes interest earned, as well as any dividends distributed, as part of the decedent's investment portfolio.

The fair market value of these investments is calculated as being the mean price of the investment's highest and lowest value on the date of the decedent's death. If that death occurred on a federal holiday or a weekend when no trading was being done, then the fair market value uses the mean of high and low valuations of the last trading date before, and the first trading date after, the individual passed away.

Schedule C: Mortgages, Notes, Cash Holdings

The information on schedule C is rather basic, but concerns any mortgages or bank notes held by the decedent at the time of their death, as well as the amount of money held in the individual's checking and savings accounts. Any holdings currently placed in a money market account must also be reported using the Schedule C documentation paired with Form 706.

It's important to remember that below-market interest rates applied to mortgages and bank notes will be considered financial gains made by the estate. For this reason, they may affect the valuation of mortgages and bank notes for the purposes of asset reporting and estate tax assignment.

Schedule D: Life Insurance and Other Liability Policies

Any life insurance policy that contributes to the value of a decedent's overall estate must be documented using Schedule D. This schedule is also used to report the financial benefits or gains that arise from other, smaller liability products. This can include mortgage insurance, any other term life insurance products, vehicle insurance, credit card insurance packages, or any other policies that cover active financing undertaken prior to the decedent's death, where the financed item or product has not yet been paid off in full.

Schedule E: Property Owned Jointly with Another Party

This schedule covers any real property or investment notes held jointly with another individual, including the decedent's spouse or a non-spousal joint party. Because this section covers both spousal and non-spousal interests, it is split into two parts. Part I of Schedule E covers all spousal joint properties and investments. Part II of this schedule covers holdings held jointly with a non-spouse.

For the purposes of Schedule E, jointly held property includes both real assets, like houses, boats, vehicles, mobile homes, and even airplanes. It further covers jointly held investment assets, including stocks, bonds, bank notes, mortgages, and virtually any other investment tool held and actively trading at the time of the decedent's death.

Schedule F: Miscellaneous Property and Investments

Anything not covered by Schedule A through Schedule E must be reported using the Schedule F form for miscellaneous property or other assets. This is typically a gray area for many paralegals, but a recommended starting point can often come from the decedent's homeowner's insurance policy. There, a large list of assets and other notable items will be listed as covered and protected. These items, if they were not reported or eligible in earlier schedules, should then be reported.

Paralegals should also take time to confer with the executor or any of the fiduciaries to discuss potential missed assets or investments that are eligible for inclusion as part of Schedule F.

Schedule G: Gifts and Transfers During Decedent's Life

Though it's common for many people to transfer small, incremental pieces of their estate as gifts in order to dodge estate taxes, many of these transfers do need to be documented as part of IRS Form 706. That's where Schedule G comes in. The form is broken up into five parts, covering transfers made from the decedents to others within three years of their death. The three parts are as follows:

- Section A: Gift transfers of the estate's value and assets three years prior to the decedent's death.

- Section B: Non-gift transfers, including life insurance benefits and other financial mechanisms, within three years of the decedent's passing.
- Section C: Transfers with retained life estate, the full value of which needs to be reported using Schedule G and Form 706 when calculating the estate tax.
- Section D: Transfers that take effect after the decedent's passing, the full value of which must be included for consideration as part of Schedule G.
- Section E: Revocable transfers made as part of a revocable trust, the value of which must be fully reported as part of the gross value of the estate on Schedule G.

Schedule H: Appointments

Schedule H involves the power of appointments or, in more basic terms, the person to whom each asset will be given and the date on which that transfer will occur. It's worth noting that the decedent often does not have power of appointment at the time of their death, and this responsibility may fall to their executor, their spouse, or someone else as named in the will or recommended by federal best practices.

If the decedent did indeed relinquish their power of appointment prior to their death, documentation to this effect must be attached along with Schedule H. It must be certified and notarized prior to submission, however, or it will be rejected by the Internal Revenue Service.

Schedule I: Annuities

Any annuities held by the decedent, which were still benefitting from ongoing payments at the time of their death, must be reported by this schedule. The value of any annuity will be considered part of the gross estate if the decedent was receiving annuity payments at the time of their death without any way of having those payments continued thereafter.

Schedule J: Expenses

A full listing of the decedent's funeral expenses is required for Schedule J, though this is not the only expense that must be reported and documented. The Schedule J requirements also include all administrative expenses required to administer and execute the estate, as well as any expenses incurred by the estate when using a paralegal or other tax preparer to assist with the filing of the estate tax return.

Schedule K: Decedent's Debts

All outstanding financial obligations held by the decedent at the time of their death must be reported using this schedule. This includes credit card debt, remaining mortgage payments, any liens on vehicles or other personal property, and any other debts that will likely count against the final, settled value of the estate. Schedule K is split into two parts. Part 1 covers income tax liability held by the decedent, as well as any obligations to a former spouse. The second part of Schedule K documents mortgages and other liens.

Schedule L: Net Losses During Administration

Losses due to things like vandalism and weather that occur during the administration of the estate, are considered net losses that should be reported using Schedule L.

Schedule M: Transfers to a Surviving Spouse

As is well known, spouses do not pay an estate tax on the assets that they inherit directly from their deceased husband or wife. Schedule M covers the transfer of all assets to a spouse and documents their ineligibility for the estate tax.

Schedule O: Charitable Deduction

If any part of the estate is donated to charity, Schedule O is used to document the date, amount, and nature of that transfer. This deduction then counts against the amount of estate tax to be paid.

Schedule P: Foreign Death Tax

This schedule applies to both overseas property and assets, as well as to the death of non-resident citizens of the United States who were living abroad at the time of their death. Paralegals will need to consult and work with overseas taxation authorities if Schedule P is relevant and required.

Schedule Q: Prior Transfer Credit

Any taxes paid on prior transfers of the estate to beneficiaries can receive a credit, if eligible, via Schedule Q. This is designed to prevent double taxation of assets.

Schedule U: Conservation Land Easement

Tax credits for a qualified conservation land easement are available to a small number of surviving families and beneficiaries, though requirements are strict and tough to meet by most of these groups. To learn more about Schedule U, consult IRS documentation covering qualifying conservation efforts and easements among surviving family members and fiduciaries.

A Logical Process for Full Documentation of the Estate

With dozens of schedules and the use of five distinct parts within Form 706, paralegals preparing this key form for the first time will be able to proceed in a logical manner that will help them complete the form within a reasonable amount of time. Thanks to extensive IRS documentation and the help of side-by-side tax calculation formulas, the estate tax preparation process is arguably one of the easiest things to do after a decedent has passed away and left their family to handle the rest.

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