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Tax Tidbits : Timely Information for the Newly Widowed

Filing Status

MFJ, HOH, QW, S.....pretty confusing, right? Actually, your filing status is the starting point for your tax return, it is determined as of the last day of the year, and determines your income tax rate and standard deduction. Let's decode the code!

You can still use **Married Filing Jointly (MFJ)** with your deceased spouse for the year of death (unless you remarry during the year). You will sign the return (or efile form) as surviving spouse.

If you qualify, you can file as a **Qualifying Widower (QW)** for the next 2 tax years. The main qualifyer is that you maintain a home for a child that you claim as a dependent. The home must be the main home of the child for the entire year, except for temporary absences such as college.

After 2 years, if you are still maintaining a home for your dependent child, you will use filing status **Head of Household (HOH).** The rates for this status are not quite as low as MFJ and QW, and not quite as high as S.

If you don't have a child at home, you will file **Single (S)** in the years following the death of your spouse. Because the rates for Single filing status are higher than for MFJ, QW and HOH, you may need to plan ahead for a bigger tax "bite". Your tax professional can help you plan.

Taxable Income

In general, income received by the decedent prior to death is reported on the decedent's final tax return. Income received after the date of death, is reported on the return of the recipient.

Examples of inherited income that is taxable include annuities, interest and dividends, wages, traditional IRA's and other qualified plans. Inherited income that is not taxable include life insurance proceeds, cash, stocks, bonds, cars and personal belongings.

Note: IRA's inherited from the deceased have special rules when it comes to distributions. If you have a specific situation please consult your advisor.

Selling the Family Home

There's a special rule for widows and widowers who sell the family home within 2 years of the day their spouse died. In general, you can exclude up to $500,000 of gain on the sale of a primary residence (married). You must have lived in the home for at least 2 of the last 5 years to qualify. As a surviving spouse, you will qualify for the full $500,000 exclusion if you sell within 2 years of the date of death. There is no need to rush to sell to protect the profit!

In addition, community property stepped-up basis rules would apply and also limit the possible taxes on primary home sale.

Stepped-Up Basis

The tax basis of most assets that you inherit from your spouse is stepped up to fair market value on the date of death (except for retirement accounts). In the state of Texas, or any other community property state, 100% of the value may be stepped up. Basis is the amount from which gain or loss is figured when you sell the asset. The higher the basis, the lower the gain, if any.

For example: Let's say that you and your spouse owned some stock that was held in a brokerage account. Assume that you originally paid $10,000 but on the date of his death, it was worth $50,000. Because of community property laws, your basis is stepped up on the entire amount, to $50,000. Further growth in value would result in capital gain, decline would result in capital loss.

Holding Period of Assets

Inherited property is always considered to have been have been held long-term.

Estate Tax vs Estate Income Tax

There are some common misconceptions about "estate tax". The federal estate tax is a tax on transfers of property at death. And estate tax return (Form 706) must be filed if the decedent's gross estate at the time of death plus taxable lifetime gifts exceeds the exclusion for the year of death. The exclusion for 2015 is a unified amount of $5,430,000 and for 2016 increases to $5,450,000.

An estate income tax return (Form 1041) is used to report income earned on assets that remain undistributed in the decedent's estate. If the gross income generated (interest , dividends, royalties, rent, etc) exceeds $600, regardless of taxable income, a return must be filed. However, most of you, as surviving spouse will not need to file a 1041.

When you are grieving the loss of your spouse, the last thing you may want to think about is filing your tax return. But let me assure you that you do have options! An extension of time to file is available (good until Oct. 17 this year) and will give you time to gather your thoughts and your documents. Remember though, the extension is for filing the tax return only, there is no extension of time to pay. Do your best to get an accurate estimate so you don't wind up paying penalties.