WHAT EVERY BENEFICIARY SHOULD KNOW

8/30/17

FOR THE SURVIVING SPOUSE & NON-SPOUSE BENEFICIARY

As investment executives who specialize in helping our clients meet their financial goals, we understand that you may have questions about the areas you need to focus on during this phase in your life. This special report presents a list of the areas that need to be addressed from the perspective of both a surviving spouse and non-spouse beneficiary.

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It is not easy to lose someone you love. Amid the pain and suffering of losing your loved one, you will soon be faced with important financial decisions ahead of you. Take comfort in the fact that there are very few financial decisions that need to be addressed right away. Most of these decisions can wait. My goal with this paper is to put together a list of the areas that need to be addressed from the perspective of both a surviving spouse and a non-spouse beneficiary (including a section if they are also the estate representative). Simply go to your section that applies, and read over the list of potential areas that need to be considered.

Let's begin.

1. SURVIVING SPOUSE

AREAS TO ADDRESS SHORTLY AFTER THEIR PASSING:

1. Apply for death certificates. Typically, the funeral home or an attorney will help you with this process. Usually 5-10 copies should suffice.
2. If your spouse was collecting social security benefits, then you will need to contact the Social Security Administration to inform them that your spouse passed away. You can reach them at: 1 (800) 772-1213.
3. You (and your young children) may be entitled to widow(er) social security benefits.
4. If your spouse was collecting a monthly pension, contact the provider to inform them that he/she passed away and ask if there are survivor benefits.
5. If there are any life insurance policies, reach out to them.
6. Identify any memberships (gym), subscriptions (magazine), or policies (disability, long term care, health) in your spouse's name that need to be cancelled. Old bank or credit card statements might help you locate these more quickly.
7. Notify all three credit bureaus by mail to notify them of the decedent's passing and request that a **"Deceased – Do Not Issue Credit"** flag be placed on their credit file.
8. Notify any open credit card companies that the decedent maintained an account with.
9. Notify your estate attorney, financial planner, and accountant.
10. Avoid any major financial decisions during this emotional time.

AREAS TO ADDRESS AFTER THE DUST SETTLES:

If the decedent owned any real estate (even if owned jointly with you, for example, your primary residence), you should get the home appraised. This is important for tax purposes because if/when that piece of real estate is sold, the cost basis needs to be "stepped-up" using the valuation obtained as of their date of death.

GEEK NOTES: What is step-up in cost basis?

First we need to know what cost basis means. Cost basis is the purchase price of the property (plus improvements) that is used when calculating your profit/loss for tax purposes when a property is sold. For example, if I paid $300K for a home and I added a garage for $30K, then my cost basis for the property is $330K. When someone passes away, their share of the property is included as part of their estate using the value of the property as of their date of death. This is why an appraisal is important.

If the decedent owned 50% of the property and the house was valued at $500K as of their date of death, then their 50% ownership needs to be "stepped-up" to $250K (half of $500K). The surviving joint owner's cost basis remains the same as a 50% owner at $165K (half of the original $330K). This gives you a total cost basis now of $415K ($250K + $165K), an improvement of $85K.

When you sell the property you have to pay taxes on the profit which is the difference between your cost basis and your sale price. The higher the cost basis, the lower your profit and tax liability. This can result in a *HUGE* benefit for heirs. Please note that community property states can handle their step-up rules differently than described above, however, their treatment is usually *more* beneficial, not less.

NON-RETIREMENT INVESTMENT ACCOUNTS:

1. If your spouse owned non-retirement investment accounts, then these too should be entitled to a step-up in cost basis for tax purposes. Not all account types qualify. Check with the attorney.
    - Death bed gifts are not allowed. If you gift an asset to someone who passes away within one year of the gift and you receive the asset back as an inheritance, then the step-up in basis is disallowed.
2. If the account was owned solely by the decedent without any beneficiaries, then this account will have to flow through their will and the listed heirs in the will become the beneficiaries.
3. If the account was owned jointly (with rights of survivorship) with you, then you automatically take ownership of this account.
4. If the assets were owned by a trust, then the trust document needs to be reviewed to identify who the beneficiaries are and what the next steps are.

ESTATE TAX RETURN:

It may be necessary for you to file an estate tax return for your spouse. This must be done within nine months of their passing (a six month extension may be requested). This is more common for larger estates or when estate tax sensitive trusts are being utilized. It is suggested that you speak with your estate attorney to determine if you need to file an estate tax return.

INCOME TAX RETURN:

1. An income tax return must be filed on behalf of the decedent for the year of death.
2. Depending upon the circumstances, an estate income tax return may need to be filed for each year the estate remains open.
3. Filing Status:

- If you were married to the decedent when they passed, then you can use "Married Filing Jointly" for the year of death filing.
- If you have a dependent child at home, you are allowed to file "Qualifying Widow with Dependent Child" for the following two years (if you qualify). It is worth checking with an accountant to verify your filing status.

4. Remember to make sure that the cost basis for non-retirement assets have been stepped-up. Check with your financial advisor, the custodian, or your accountant if you are unsure.

RETIREMENT ACCOUNTS:

1. Retirement accounts do **NOT** get a step-up in cost basis
2. In most cases, all of the funds held within a retirement account are pre-tax funds, which means these funds have never been taxed before. The exception to this rule is if you have Roth or after-tax funds held within the account.

> *GEEK NOTES:* If after-tax funds are held within the account you should find a tax form in your most recent tax filing, Form 8606, which tracks these after-tax funds. You don't want to lose track of this because otherwise you could potentially end up paying taxes twice on the same after-tax funds.

3. If your spouse who passed away was 70.5 or older, then you need to make sure they took their required minimum distribution (RMD) before year-end, otherwise, take it ASAP. If there is more than one retirement account, then I suggest you seek help from a professional because there are certain requirements that must be met.

> *GEEK NOTES:* The RMD is calculated each year using a factor that coincides with an individual's age, plus the prior year-ending account value of their retirement account. For most people it results in the need to distribute about 4%-5% of the account value each year, growing as the individual gets older.

4. An exclusive benefit that surviving spouses maintain is the ability to move their decedent spouse's retirement account directly into their own retirement plan, tax free. Another option that is less common but still available, is to move the decedent's account into an "inherited retirement account." This would appeal to a surviving spouse who is under the age of 59.5 and plans to take funds from the retirement account. This would allow him/her to do so without paying the 10% early withdrawal penalty. There are a couple other scenarios where it can make sense to consider the inherited retirement account option, but most often times we find that rolling the funds directly into the surviving spouse's retirement plan is the most beneficial.

YOUR ESTATE PLAN:

1. Chances are, your spouse was included within your estate plan as maybe your estate representative, trustee, agent, etc. It is time to revisit those documents to determine whether or not they need to be updated.
2. You probably also named your spouse as your primary beneficiary of your retirement accounts or life insurance contracts. It is time to revisit these documents to ensure that they match your wishes.

REVIEW YOUR FINANCIAL PLAN AND DESIRED RISK TOLERANCE:

1. Your financial plan needs to reflect your current situation. Schedule an appointment with your financial planner to focus on your plan.
2. You may have inherited large sums of money that you need to put together a game plan for regarding what your next steps should be. Part of this may include investing, and you should use this opportunity to revisit your desired risk profile before investing these new sums.

2. NON-SPOUSE BENEFICIARY AND THE ESTATE REPRESENTATIVE

AREAS TO ADDRESS SHORTLY AFTER THEIR PASSING:

1. Apply for death certificates. Typically, the funeral home or an attorney will help you with this process. Usually 5-10 copies should suffice.
2. If the decedent was collecting social security benefits, then you will need to contact the Social Security Administration (SSA) to inform them of their passing. You can reach them at: 1 (800) 772-1213.
3. If the decedent was collecting a pension, then you should reach out to the pension provider to inform them of their passing.
4. If there are any life insurance policies, reach out to them.
5. Identify any memberships (gym), subscriptions (magazine) or policies (disability, long term care, health) that the decedent obtained and reach out to each group to cancel them. Old bank or credit card statements might help you locate these more quickly.
6. Notify all three credit bureaus by mail of the decedent's passing and request that a **"Deceased – Do Not Issue Credit"** flag be placed on their credit file.
7. Notify any open credit card companies that the decedent maintained an account with.
8. Notify the decedent's estate attorney, financial planner, and accountant.

AREAS TO ADDRESS SHORTLY AFTER THE DUST SETTLES:

If the decedent owned any real estate, you should get the home appraised. This is important for tax purposes because if/when that piece of real estate is sold, the cost basis needs to be "stepped-up" reflecting the decedent's share of the property using the appraisal obtained as of their date of death.

GEEK NOTES: What is step-up in cost basis?

First we need to know what cost basis means. Cost basis is the purchase price of the property, (plus improvements), that is used when calculating your profit/loss for tax purposes when a property is sold. For example, if I paid $300K for a home and I added a garage for $30K, then my cost basis for the property is $330K. When someone passes away, their share of the property is included as part of their estate using the value of the property as of their date of death. This becomes the new cost basis for the property. If the house appraises for $500K, then this is the new stepped-up cost basis. This is why an appraisal is important.

When the property is sold, you have to pay taxes on the profit which is the difference between your new cost basis and your sale price. The higher the cost basis, the lower your profit and tax liability. This can result in a *HUGE* benefit for heirs. Please note that community property states can handle their step-up rules differently than described above, however, their treatment is usually *more* beneficial, not less.

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1. If the decedent owned non-retirement investment accounts, then these too should be entitled to a step-up in cost basis for tax purposes. Not all account types qualify. Check with the attorney.
   - Death bed gifts are not allowed. If you gift an asset to someone who passes away within one year of the gift and you receive the asset back as an inheritance, then the step-up in basis is disallowed.
2. If the account was owned solely without any beneficiaries, then this account will have to flow through the decedent's will (aka probate) and the listed heirs in the will become the beneficiaries.
3. If the account was owned jointly (with rights of survivorship) with someone else, then the surviving joint owner automatically takes full ownership of the account.
4. If the assets were owned by a trust, then the trust document needs to be reviewed to identify who the beneficiaries are and what the next steps are.

ESTATE TAX RETURN:

1. It may be necessary for you to file an estate tax return for the decedent. This must be done within nine months of their passing (a six month extension may be requested). This is more common for larger estates or when estate tax sensitive trusts are being utilized. It is suggested that you speak with your estate attorney to determine if you need to file an estate tax return.
2. If federal estate taxes (larger estates) are paid on behalf of the decedent's estate, then the beneficiaries may be entitled to an income tax deduction. The technical term for this is "income in respect of a decedent" (IRD). Check with the estate attorney to see if this applies and if so notify all beneficiaries.

INCOME TAX RETURN:

1. The estate representative needs to file an income tax return on behalf of the decedent for the year of death.
2. Depending upon the circumstances, an estate income tax return may need to be filed for each year the estate remains open.
3. Remember to make sure that the cost basis for non-retirement assets have been stepped-up. Check with your financial advisor, the custodian, or your accountant if you are unsure.

RETIREMENT ACCOUNTS:

1. Retirement accounts do not get a step-up in cost basis.
2. In most cases, all of the funds held within a retirement account are pre-tax funds, which means these funds have never been taxed before. The exception to this rule is if you have Roth or after-tax funds held within the account.
3. If the decedent is 70.5 years of age, or older, they are required to take a required minimum distribution (RMD). You should check with the custodian to see if they met their RMD already. If they did *NOT*, then the beneficiaries need to take the RMD as soon as possible. If there is more than one retirement account, then I suggest you seek help from a professional because there are certain requirements that must be met.
4. Non-spouse beneficiaries are not allowed to move the inherited retirement account directly into their own retirement account(s). Non-spouse beneficiaries are required to move these funds into an "inherited retirement account." It is important that it maintains this title so the IRS knows that any withdrawals that come from an account with this title avoids the 10% early withdrawal penalty.

> *GEEK NOTES:* If after-tax funds are held within the account, you should find a tax form in the decedent's most recent tax filing, Form 8606, which tracks these after-tax funds. You don't want to lose track of this because otherwise you could potentially end up paying taxes twice on the same after-tax funds.

5. Non-spouse beneficiaries are required to begin taking the RMDs using their own life expectancy in the year following the decedent's death and each year going forward. Even Roth IRA accounts are required to take RMDs when a non-spouse beneficiary inherits a Roth IRA account.

> *GEEK NOTES:* The RMD is calculated each year using a factor that coincides with an individual's age plus the prior year-ending account value of their retirement account. For most people, it results in the need to distribute about 4%-5% of the account value each year, growing as the individual gets older.

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3. NON-SPOUSE BENEFICIARY

AREAS TO ADDRESS SHORTLY AFTER THEIR PASSING:

The estate representative should be providing you, or the financial institution, with a copy of the death certificate if you are listed as the beneficiary of any accounts (including life insurance).

AREAS TO ADDRESS SHORTLY AFTER THE DUST SETTLES:

If you are inheriting real estate you should check with the estate representative to find out what the appraised value of the property was as of the decedent's date of death for cost basis purposes.

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SUMMARY

We hope that you found this whitepaper on What Every Beneficiary Should Know to be helpful and informative. Please remember that nothing referenced in this paper should be construed as legal or accounting advice. Legal or accounting advice should only come from a qualified attorney or accountant.

If you would like to discuss your personal financial situation, please do not hesitate to give our office a call at (978) 624-3000. We would be happy to talk to you.

Sincerely,

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