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5 Things Everyone Should Know About Death and Taxes

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Halloween is right around the corner, meaning so is the busiest time of year: Thanksgiving, the winter holidays, Valentine's Day, and my all-time favorite season finale – tax day. With visions of the Grim Reaper in my head, I am reminded of the two inevitabilities that we all (begrudgingly) accept: death and taxes. Having recently been involved in the settling of an estate for a family member, one notices the parallels; we spend our lives trying to avoid each and in the end want both to be as painless as possible. Here are five things everyone should be aware of when it comes to estate planning, beneficiaries, and taxes.

1. A little organization goes a long way.

I cannot exaggerate this point enough. Anyone who has been involved in the loss of a family member can attest to this: there are a lot of things that must be done when a person dies. Having a single secure location for any account-related or asset-related documents is critical to allowing those you leave behind to quickly identify the location of assets and prioritize how to go about starting the process of notifying banks, insurance companies, etc. The location is up to you, but it should be just one place.

Documents you may wish to include are the most recent copies of life insurance policy documents, bank statements, last will and testament, any medical directive you may have, car insurance and mortgage or lease documents. In addition to keeping these documents in one secure centralized location, put dates on them so that your loved ones can identify any that may have been replaced or updated. While this may seem like it doesn't have anything explicitly to do with taxes, it is the starting point of knowing the contents of the estate and determining what will be subject to tax, as well as who will be responsible for any taxes.

2. Know your limits and exemptions.

Every few years updates are made to the tax code related to estate taxes. In December 2012, Congress permanently enacted legislation to allow each person the ability to leave or give away up to $5.25 million without owing any estate tax. This number is indexed for inflation each year. In addition, the ability of spouses to combine exemptions was extended permanently. This exemption is commonly referred to as "portability" and allows married couples to combine their exemptions for a total of $10.5 million that the couple may leave or give away without triggering estate taxes. For those with larger estates, the maximum estate tax rate is 40 percent, an increase in 2013 over the 35 percent cap that was previously in place.

One thing to keep in mind is that large gifts distributed over your lifetime can reduce the amount of estate tax exemption when you die. While the amounts vary for married couples and individuals, there are annual limits of gift giving that will not reduce the amount of your estate tax exemptions. For 2013, a single person's gift exemption limit is $14,000 and is $28,000 for a married couple. In 2014 and beyond you just need to adjust for inflation.

As a reminder, while these schedules were extended permanently, Congress has the ability to pass new legislation overriding these limits. Keeping yourself informed of any changes can save your estate and your loved ones from a prolonged settling or probate process.

3. Not all assets are created equal.

A colleague of mine, Ann Schnorrenberg, wrote a great post on this topic, which I encourage you to read at. The bottom line here is that different assets are better sources of spending during retirement, such as market-value assets, because others are more tax efficient to transfer on death, like Roth IRAs.

4. Who is responsible for taxes?

Just because we die, it doesn't mean we avoid the tax man. When an individual taxpayer dies, a new taxpayer, the estate, is born. Federal income tax is assessed on the deceased's final return, the return of a beneficiary of the income, or, if the estate receives more than a certain amount of income, on the estate's income tax return. State taxes are specific to each state and may or may not have the same exemptions as the federal level. As mentioned above, inheritance may or may not be taxable to the beneficiary, based on the type of account and the amount. For example, cash inherited from a bank account, or a payout from a life insurance policy is typically not taxable to the beneficiary, but 401(k)s, traditional IRAs, and some annuities, may be. Assets such as some investments, property, or real estate each have different tax treatment that could involve a step-up provision for the beneficiary. Surviving spouses often receive the assets of the deceased with minimal income tax implications.

5. When in doubt, ask a professional.

One of the greatest gifts you can leave to your loved ones is the gift of preparation. In the age of the internet, it is too easy to fall into a false sense of security that we can determine all of the ins and outs of estate planning and keep up with the almost annual tax code changes. Lawyers, accountants and financial planners exist for a reason, and are there to understand your family's unique circumstances, be it supporting a loved one's healthcare, providing for a family member's education, or ensuring the continued well-being of a spouse. This team can also help you create any documents that will assist in avoiding probate and quickly settling the estate with minimal tax implications for your heirs.

We may not be able to chose when it happens, how it happens, or who we leave behind, but we all know that inevitably, our time will come. Grieving over the loss of a loved one can be complicated and difficult enough that a little preparation while we are here can make a world of difference for those we leave behind.