DO I PAY NORTH DAKOTA TAXES WHEN SOMEONE LEAVES ME MONEY?

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There are taxes that can enter the picture when money is changing hands. This can be true if the asset transfers are taking place while both parties are living, and there are also death taxes.

In this paper, we will look at these taxes in an effort to provide some clarity, because there are some misconceptions out there.

FEDERAL ESTATE TAX

First off, we should explain some things about the federal estate tax. This tax would not be levied on transfers to each individual inheritor. The federal estate tax would be applicable on the entire taxable portion of the estate in question before it is transferred to each individual heir.

Fortunately, most people do not pay the federal estate tax, because there is a relatively high exclusion or credit. In 2015, the amount of this exclusion is $5.43 million. It is increased annually to account for inflation, so each year you may see a slightly higher figure.

Using the figure that is in place this year, the portion of an estate that exceeds $5.43 million would potentially be subject to the federal estate tax.

However, there is an unlimited marital estate tax deduction. The estate tax is not applicable on asset transfers between spouses, regardless of the amount of the transfers.

We should point out the fact that there is also a federal gift tax that is unified with the estate tax. This tax is in place to prevent people from giving tax-free gifts while they are living to avoid the estate tax.

The exclusion is a unified exclusion that applies to lifetime gifts coupled with the value of an estate.

State-Level Estate Tax

There are a number of states in the union that impose state-level estate taxes. In most of these states, it would be possible to be exempt from the federal estate tax but exposed to a state-level estate tax, because the state level exclusions are typically lower than the federal exclusion.

We practice law in the state of North Dakota. In effect, there is no state-level estate tax to contend with in our state, but you could be exposed to a state-level estate tax if you own valuable property in a state that has such a tax.

Inheritance Tax

Some people are under the impression that an inheritance tax and an estate tax are one and the same thing. In reality, they are two different forms of taxation.

As we have stated previously, an estate tax is levied on the entire taxable portion of an estate. An inheritance tax would be applicable on asset transfers to each nonexempt inheritor.

There is no federal inheritance tax, but there are six states in the union that impose state-level inheritance taxes. North Dakota is not among them. For your information, the six states are Pennsylvania, New Jersey, Maryland, Iowa, Kentucky, and Nebraska.

INCOME TAX

You are required to report income that you receive on your annual tax return. This can lead to the belief that you should report an inheritance as taxable income. In fact, an inheritance would not be looked upon as taxable income by the Internal Revenue Service. You do not have to include an inheritance when you file your return.

CAPITAL GAINS TAX

If you are in possession of assets that have appreciated, that appreciation is potentially subject to the capital gains tax. The tax would kick in if you were to liquidate the asset and take direct personal possession of the appreciation. This is called realizing a gain.

There is a step-up in basis when it comes to inherited assets. This means that you would not be responsible for the gains that took place during the life of the decedent if you inherited appreciated assets.

You would however be responsible for subsequent gains if you held on to the assets and they continued to appreciate.

SUMMARY

When you are planning your estate, or when you are in line for an inheritance, you are naturally going to be concerned about taxation.

In North Dakota there is no state-level estate tax, and there is no state-level inheritance tax. Everyone in all 50 states must be concerned about the federal estate tax, but it is only applicable on estates that exceed $5.43 million in value (this is the 2015 figure).

An inheritance would not be looked upon as taxable income. Plus, if you inherit appreciated assets, you would not be required to pay a capital gains tax on the appreciation that took place while the decedent was living.

If you would like to learn more about taxes on asset transfers, set up a consultation with a licensed estate planning attorney.

REFERENCES

IRS
http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estate-and-Gift-Taxes

North Dakota Tax Commissioner
http://www.nd.gov/tax/

About the Author

Raymond J. German

As an attorney in Minnesota and North Dakota, Raymond J. German provides a wide range of estate planning services to his clients, with a primary focus on helping them provide for the security of their loved ones, reduce estate taxes and avoid or at least minimize the costs and delays of probate, all with a well-crafted estate plan. Mr. German defines the mission statement for German Law Group, PC, as "Helping one family at a time pass on values, beliefs and finances, which can be shared for generations to come." Mr. German is well aware of the growing importance of estate planning and dedicates himself to informing the public of the need for careful attention to their specific situations. He is a frequent speaker on a variety of estate planning topics, regularly presenting educational seminars for the public as well as private groups.

Raymond J. German approaches each challenge with not just solid expertise, but also remarkable enthusiasm and vigor. By constantly seeking simpler, better, and more effective ways of doing things, he continues to make a real difference in the lives of families and on the way estate planning is practiced by attorneys around the country.

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