Tax Considerations After a Family Member Death
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Several kinds of taxes may be due shortly after a family member's death. During this emotional time, it's often worthwhile to employ a tax professional to alert you and the family to important deadlines. You can help the tax professional—and potentially save time and money—if you understand what needs to be done.

Income Tax
The deceased's tax year ends on the day of death. For single taxpayers whose income is large enough, the executor or appointed personal representative must file a final income tax return by April 15 following the year of death. The final return includes any income actually received and deductible expenses actually paid prior to death. As a surviving spouse, you can claim a married filing jointly status in the year of your spouse's death and treat their tax obligations as your own. In addition, if you remain unmarried and care for a dependent child, you may be able to claim widow or widower status for two years following the year in which your spouse died. In both cases, this tends to result in lower taxes than if you file as single or head of household. Be sure to review the signature requirements for the returns in the instructions for IRS Form 1040.

An heir doesn't generally incur federal income tax on an inheritance, but there are exceptions. Retirement assets such as 401(k) plans, IRAs, and annuities are tax-deferred while the owner is living; once they pass to beneficiaries, taxation will continue to be deferred until distributions begin. You can usually arrange distributions, so the taxes are stretched over time. It's a good idea to talk to the retirement plan administrator or insurance company about your options.

Fiduciary Income Tax
Estates and trusts are treated as taxpayers and file IRS Form 1041 annually if their gross income exceeds $600. It is prudent to obtain taxpayer identification numbers for each entity as soon as possible and provide the numbers to financial institutions holding the estate or trust assets. This will help you avoid corrected 1099s, which could delay filing of returns. Taxable income earned on assets held in an estate or trust should be reported to each entity. If taxable income is retained in the trust or estate, the entity must make estimated tax payments quarterly like any other taxpayer not subject to withholding.

The trust's or estate's tax liability may be shifted to the beneficiaries if distributions are paid to the heirs. The heirs will almost always pay less in taxes than a trust or estate would.

Estate and Inheritance Taxes
Larger estates may be subject to additional taxes. At the federal level, estates with more than $12.92 million in assets may be exposed to estate taxes unless certain deductions apply. For most married couples, an estate transferred to the surviving spouse who is a U.S. citizen is completely sheltered. Others will need to pay any federal estate taxes, which are due within nine months of the death. Most states also apply an estate tax, an inheritance tax, or both. Keep in mind that tax liabilities are not limited to the state of residency. Potentially, the executor may have to file and pay taxes in several states.

Larger estates can incur total taxes as high as 40 percent. This may result in selling assets to raise cash. If the deceased had arranged for a life insurance trust, it may be possible to sell assets to the trust or borrow from the trust to pay the tax bill.

Beneficiaries' tax basis in most inherited property is equal to its fair market value at the date of death. Consequently, a sale soon after death triggers little or no additional income tax. The heirs owe taxes only on the appreciation between the date of death and the date of sale. Because it is important to establish each asset's fair market value for both estate and income tax purposes, an appraisal is often advisable.

Certain documents will be filed with the estate tax return, including the decedent's will, relevant trust documents, business balance sheets and profit and loss statements, brokerage and bank statements, property appraisals, and Form 712 from insurance policies. Note that some expenses incurred by the deceased are deductible on the final income tax return or on the estate tax return.

Your accountant should compare the relative tax advantages of both options. In addition, the trustee and executor may make postmortem tax elections to minimize the future taxation of the estate and its heirs. A knowledgeable estate planning attorney or accountant can review the situation to determine if such opportunities exist.

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