NEBRASKA INHERITANCE TAX

DISCLAIMER

This article is intended for informational purposes, only. It does not constitute legal advice. Nor is it a substitute for legal advice.

Nebraska has an inheritance tax. Not all states do. In fact, most states choose not to impose a tax on time-of-death transfers. Of Nebraska's neighbors, Colorado, Wyoming, South Dakota and Kansas do not have an inheritance tax. Iowa, which has an inheritance tax, exempts transfers to lineal descendants (children, grandchildren, etc.) and lineal ascendants (parents, grandparents, etc.) from inheritance tax.

What is the Nebraska Inheritance tax and how does it work?

What Is Taxed?

For residents of the state of Nebraska, most of what you own at the time of death is going to be subject to the inheritance tax. This includes property, and interests in property, that transfer to your heirs at the time of death through a will, in a trust, by deed, by title, by gift or, in some cases, by sale. It may include personal property outside of the state of Nebraska which a Nebraska resident owns. It does not include real estate owned by a Nebraska resident in another state. It does include Nebraska real estate owned by a resident of another state.[1] It also includes property that the deceased person either gave away or transferred for less than fair market value within the three years preceding the date of death.[2]

At What Rate?

There are three levels, or rates, of inheritance tax:

- 1% with a $40,000 exemption
- 13% with a $15,000 exemption
- 18% with a $10,000 exemption

The exemptions are for recipients, meaning that each person who receives property from the deceased is entitled to the applicable exemption. For example, if a deceased person were to leave $100,000 to each of three children, the first $40,000 that each receives

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[1] Nebraska inheritance tax may also apply to tangible personal property located in Nebraska even though it was owned at the time of death by a resident of another state. If a nonresident dies owning intangible personal property, such as accounts, located in Nebraska, that property will be subject to Nebraska inheritance tax only if the laws of the state of the decedent's residence impose a similar tax on property owned by a Nebraska resident in that state. See Neb. Rev. Stat. § 77-2007.01, Uniform Reciprocal Transfer Tax Act.

[2] Property that was given away more than three years before death is not subject to inheritance tax. "Given away" in this context means completely given away – no strings attached. Property given away within the three years before death under the federal gift tax annual exclusion amount (currently $14,000) is also not included for calculating the inheritance tax. (See article on *Transfer Taxes* for discussion of the federal annual exclusion.)

would be exempt, and tax would be payable on the remaining $60,000, at 1%, or $600 each.

Who falls into this 1% tax bracket? Property which passes at the time of death to children, grandchildren, etc., on down the line, or to brothers and sisters, or to parents and grandparents (that sometimes happens), is subject to the 1% tax. You can include the spouses of any of these relatives in this group as well, even if the relative has already died. In addition, relatives of a deceased person's former spouse are included in this group if the deceased person was married to the former spouse at the time of the former spouse's death. A spouse's relatives are also included if the deceased person at the time of his or her death was married to the spouse. The group also extends to legally adopted children. Finally, this 1% category includes "any person to whom the deceased for not less than ten years prior to death stood in the acknowledged relation of a parent."[3]

Inclusion in the first category of persons is important because the tax jumps significantly in the next category. If you leave property to aunts, uncles, nieces, nephews, or any of their lineal descendants, or to their spouses, the tax rises to 13%, with a $15,000 exemption.

There is only one more category, and that is for everyone else. The tax for these transfers is equal to 18% and the exemption is only $10,000.

The inheritance tax must be paid within 12 months of the date of death, otherwise interest accrues at 14%, with penalties of 5% per month up to 25% of the tax due. An estimate of the tax amount can (and usually should) be paid by that 12-month date if there is a delay in determining the final amount of the tax.

The inheritance tax, in some respects like the real estate tax, is a lien against any real estate which is subject to the tax. It can therefore, if unpaid, create title problems. A title commitment, for example, in the context of a sale or of financing, may not be available where an inheritance tax determination was not made (and paid) at the time of death of a previous owner.

The person who receives property from the deceased is finally ultimately liable for payment of the inheritance tax.

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[3] A couple of points here. First, an adult (in Nebraska, someone 19 years of age or older) cannot be legally adopted. Second, the "acknowledged relation of parent" qualification, in the law sometimes called *in loco parentis*, is not restricted to an adult-child relationship. In other words, a person might come to act as a parent for the requisite 10 year period of time even when both parties are adults. The decision as to whether or not this parental relationship exists can sometimes require a court decision. It is interesting to consider the significance of a statement by the deceased in his or her Will that he or she treated someone as if that person were a child. These issues might arise in a number of contexts. For example, where a bachelor rancher or farmer felt that he or she had established a parent-child relationship with an adult hired hand (whether unrelated, or distantly related) and desired to leave property to that person. The difference between a 1% tax and a 13%, or even 18%, tax could make this issue significant.

The lien for taxes is not endless. Of course, it expires when the tax is paid. Even if the tax is not paid, the lien expires 10 years after death, unless, within those 10 years, a court makes a determination of the amount of the tax, in which case the lien expires five years after the court determination. It is important to note that it is the *lien* for the tax which expires, not the liability for payment of the tax. There is no limitation on the liability of the personal representative or the person who received the property subject to the tax. They remain liable for payment.

<u>Are There Other Exemptions?</u>

Some property is not subject to the inheritance tax. For example, an employee benefit plan may be exempt under certain conditions, as are gifts made within three years of the date of death under the federal gift tax annual exclusion. (See article on *Transfer Taxes* for discussion of annual exclusion.) Life insurance death benefits, if not paid to an executor of the estate, are not subject to the inheritance tax. In addition, any transfer of property between spouses is exempt from the tax. Transfers of property for religious, charitable, public, scientific, or educational purposes are also exempt, as are transfers in general to governmental bodies.

There are certain other <u>exemptions</u> and <u>allowances</u> applicable to the inheritance tax calculation. A $20,000 homestead allowance is available for a surviving spouse or, if there is no surviving spouse, for minor or dependent children. There is a $12,500 exemption for personal property to the surviving spouse and to children, whether or not the latter are minors. And a "family allowance" (up to $20,000, payable in a lump sum or as monthly installments) is available to the surviving spouse and minor children for up to one-year; it is exempt not only from inheritance tax but from claims against the estate, other than claims for costs and expenses of administration.

There are also <u>deductions</u> against the inheritance tax: funeral costs; expenses of last illness within six months of death; debts which the deceased person was liable for at the time of death and which are in fact paid; any federal estate tax that is paid; and the costs of administration, including court costs and expenses, such as the costs of sale of property, personal representative fees, attorney fees, and other expenses and costs incurred in the preservation, management, and protection of the estate.

In addition, there is a <u>credit</u> for inheritance taxes that have been paid within five years of death on the same property. If the deceased person received property from someone who died within the five year period before the decedent's death, and if inheritance tax was paid on that property, there is a credit allowed for those previously paid taxes. For example, suppose a child receives an inheritance upon a parent's death and pays a tax on that inheritance. Assume that the child then dies within five years of the death of his or her parent, leaving property to siblings or to his or her own children. There would be a credit available in the child's taxable estate for the tax paid on property that the child inherited from his deceased parent.

<u>Tax is Paid to the County</u>

The tax is a state of Nebraska inheritance tax but the county receives the money. The tax is paid to the county of the deceased person's residence or, in the case of real estate, to the county in which the real estate is located. If real estate is owned in more than one county, the inheritance tax is apportioned among the counties according to the percentage of real estate in each county. Interestingly, the county judge and the county clerk are to inform the county attorney each year as to any inheritance taxes that they believe are owing but have not been paid.

<u>How Are the Taxes Determined and Paid</u>

The determination of the tax – how much is to be paid – occurs as part of a probate proceeding in the county court. If there is no probate – if, for example, the deceased's property is transferring through a trust or through beneficiary designation – then a separate county court proceeding specifically for determining the inheritance tax is to take place. How does this separate proceeding work? In general, a petition is filed in the county court; it is called a petition for determination of inheritance tax. An inventory is prepared – what did the deceased own at death and what was the fair market value of the property at the date of death. In some estates this may require appraisals. An inheritance tax worksheet must be completed (essentially an inheritance tax return) and an effort made to reach agreement with the county attorney as to the value of the taxable estate. Assuming such agreement is reached, the tax is paid once the court approves the amount. Such a proceeding can occur without the need for actual hearings in court. However, it is also possible that disputes might arise as to property valuation, exemptions, etc., which could then lead to litigation within the inheritance tax proceeding.

It is worth noting that agricultural real estate may sometimes be valued for inheritance tax purposes at the county assessed value, marked back up to fair market value. (This is after all the county assessor's determination of the fair market value of the real estate.) In general this can be determined by taking the value from real estate tax statements and dividing that value by .75 in order to remove the statutory discount for agricultural land. Of course, there may be reasons for obtaining an appraisal or using a value other than marked-up tax assessed value. For example, if the heirs are going to sell real estate, it might be best to value the property at the known or estimated sale price. Even if that value results in a higher inheritance tax, it could very well result in lower capital gain tax on the sale of the real estate.

Let's look at an example. Assume that the children of a deceased mother are inheriting land from their mother. Assume their mother paid $1000 per acre for that land. In tax language, their mother had a $1000 *basis* in the land. If she had sold it before her death for $5000 per acre, she would have paid capital gain tax on the $4000 appreciation, or gain, in the land. The fact that she left the land to her children in a time-of-death transfer (as in a Will, or revocable trust, or beneficiary deed) entitles the children to an automatic basis adjustment, or, in this case, a step-up in basis. Essentially, this means that the children have a basis in the land equal to its value at the time of their mother's death. Assume that the children intend to sell the land and will be able to sell it for $5000 per acre. If the marked-up tax assessed value at the time of the mother's death were $3500 per acre, the inheritance tax based on that value would be approximately $35 per acre –

1% of $3500. If the children instead used the full fair market value of $5000 per acre as the taxable value, the inheritance tax would equal $50 per acre, an increase in tax of $15 per acre. However, the $15 per acre increase in inheritance tax might seem like a good idea when we look at the capital gain consequence. If the children's new basis in the land is $3500 per acre and they sell it for $5000, they will likely have to pay capital gain tax on the $1500 difference, at a possible combined federal and state rate of 27%. This translates to $405 per acre in capital gain tax, significantly more than the $15 per acre difference in inheritance tax. In other words, it may be penny wise and pound foolish not to take full advantage of the basis adjustment in order to reduce the inheritance tax. Now, you may ask, is it possible to use one value for inheritance tax and another for basis adjustment? You will need to speak with your advisor about that one.

Conclusion

A couple of final points. People are sometimes urged to plan their estates in order to avoid probate. It is often the costs that are associated with probate which people are being warned against in such advice. In many, if not most, informal probate proceedings, much of the work that is done is the same work that is required in an inheritance tax determination. Therefore, so long as Nebraska has an inheritance tax, avoiding probate as a means of savings costs may be an oversold idea, or, at any rate, taken with a grain of salt. There may be numerous other compelling reasons to avoid probate, or positive reasons to use a trust or beneficiary designations, just as there may be good reasons for relying on a will and anticipating a probate. The point is that the avoidance of the administrative costs of probate alone may be an inadequate reason for determining the structure your estate plan, in particular in light of Nebraska's inheritance tax.

It is worth pointing out that where spouses own property jointly with right of survivorship there is likely not to be a need for an inheritance tax determination upon the first death. Rather, only one inheritance tax determination will need to be undertaken, and that at the time of death of the surviving spouse.

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