MARGOLIS
BLOOM &
D'AGOSTINO

Your future. Handled with care.

A Primer on the Massachusetts Estate Tax

By Harry. S Margolis

While very few estates are subject to a federal estate tax, which only applies to those exceeding $13.6 million (in 2024), many more are subject to the Massachusetts estate tax for which the threshold was raised from $1 million to $2 million in 2023. While the Massachusetts estate tax rate is not nearly as high as the federal rate, which is 40%, many clients still prefer to take steps to reduce or eliminate the estate tax their heirs will have to pay.

The Massachusetts estate tax rate starts at .8% of assets over $40,000 and goes up to 16% on assets over $10 million. The reader may well wonder why there's any tax on estates of $40,000 and above when estates of less than $2 million are not taxed. The answer is that it doesn't matter anymore, but did before the 2023 change in the estate tax law. Before then, once the tax is triggered, Massachusetts estates taxes were calculated based on the full value on the estate. This is still true, but all estates under $2 million are exempt from taxation.

The Amount

A few examples of Massachusetts estate taxes:

Size of Taxable Estate	Approximate Tax $10,000	Effective Rate
$2,000,000	$0	0%
$3,000,000	$82,400	2.75%
$5,000,000	$292,000	5.8%
$10,000,000	$969,000	9.7%

The Structure

To understand the Massachusetts estate tax, it helps to understand its structure. Like many other states, before the phase out of the federal estate tax enacted under President George W. Bush, Massachusetts pegged its tax to the amount permitted as a credit for state estate taxes under the federal estate tax. This way, estates did not owe more due to the state tax; it just diverted some of the taxes from the federal government to the state coffers.

When Congress voted to phase out the estate tax it also phased out the state estate tax credit. The result for many states was a significant loss of revenue, even though the states had made no change in their own tax laws. Massachusetts chose to prevent this loss of revenue by freezing its estate tax as it was in 2001. As a result, in order to determine the federal tax credit available then, executors today must complete a 2001 federal estate tax return. (This gets a bit more odd with every passing year.)

In 2023, the legislature raised the threshold to $2 million simply by creating a $99,600 credit which wipes out the tax for smaller estates. It also reduces the tax on larger estates by this amount. The new law applies to the estates of anyone dying on or after January 1, 2023.

Out-of-State Property and Non-Resident Decedents

The treatment of out-of-state or out-of-country property was completely changed by the new law. Formerly, it was not taxable in Massachusetts. On the other hand, property owned in state by non-Massachusetts residents was taxed if their entire estate exceeded $1 million, in the proportion of the Massachusetts property to the entire estate. For non-resident decedents, there's no change in the law other than the threshold for taxation being raised to $2 million.

Here's how this works in practice:

Let's assume that the decedent owned property in Florida valued at $600,000 and that his entire estate totaled $2.5 miolliom. The tax on a $2.5 million estate would be about $39,000. Since the non-Massachusetts property consisted of 24 percent of the estate, the tax due would be reduced by this percentage to $29,600 ($39,000 x .76 = $29,600).

The calculation for non-Massachusetts decedents dying owning property in Massachusetts is similar. Using the same numbers, but with real estate valued at $600,000 being in Massachusetts, the estate would pay approximately $9,360 in taxes ($39,000 x .24 =$9,360). (In this case, the accounting and legal fees to prepare the tax return might approach the tax due to the Commonwealth, but at least they're deductible.)

Reducing the Tax

For those Massachusetts resident individuals or couples with estates totaling more than $2 million, there are essentially three ways to reduce or eliminate estate taxes: reducing one's assets through gifts and spending, planning for couples to both give away up to $2 million tax free, and making large taxable gifts.

20 William Street, Suite 320, Wellesley, MA 02481 t 781-705-6400 f 781-446-6995 www.margolisbloom.com

1. Gifting and Spending

One way to lower or eliminate one's estate tax is to reduce one's taxable estate, hopefully below $2 million. This can be done by spending or by making gifts either to charity or to individuals in amounts of up to $18,000 each per year (in 2024).

A taxpayer with an estate of $2.2 million may be reluctant to make gifts or to overspend, especially if a significant part of the estate consists of a home. For instance, a taxpayer, who we will call "Jane," may have a home worth $900,000, $600,000 in savings and investments and $700,000 in an IRA. Jane may be comfortable living off of her Social Security, investment income and annual IRA withdrawals, and be legitimately fearful of the effect on her financial security of transferring out $200,000 of her savings.

Several alternatives are available to Jane. One would be to make $18,000 annual gifts to her children, grandchildren and their spouses, if any, until the value of her assets fell below $2 million. Or, she could give her children a one-third interest in her home (in $18,000 annual increments). This would have the advantage of eliminating the estate tax. But if she has owned the home for a long time and it has a low basis (the amount she paid for it plus the cost of improvements), the lifetime gift to her children would cause a higher tax on capital gains on the sale of the house after Jane's death. Such a capital gains consequence could significantly undercut the estate tax benefit of the gifts, or even cost more.

Jane also has the option of accelerating her IRA distributions in order to make the annual gifts. All withdrawals from IRAs constitute taxable income. To the extent Jane does not completely use up her IRA funds during her life, they will pass to her children who will have ten years to withdraw. They may well be in a higher tax bracket than Jane, meaning that it would be cheaper for Jane to withdraw the funds than for them to do so. In addition, to the extent that Jane reduces her estate by paying the taxes on the IRA withdrawals, that saves an additional 7% in estate taxes. (This analysis does not factor in the lost earnings on the funds Jane uses to pay taxes early, but they might be ameliorated to some extent if she converts from a standard IRA to a Roth IRA.)

Another option for Jane would be to take a home equity loan on her home and make gifts from those funds, in effect transferring equity in her home without any adverse capital gain consequences. Of course, there's the cost of interest payments on the loan.

If an estate cannot be lowered below $2 million through gifts and spending, reducing its size stills saves heirs some estate taxes. Every $100 of spending or gifting for estates between $2 million and $3 million in size reduces estate taxes by $8 or $9.

20 William Street, Suite 320, Wellesley, MA 02481 t 781-705-6400 f 781-446-6995 www.margolisbloom.com

2. Planning for Couples

The first fact to know about planning for couples is that there is no tax on funds passing to the surviving spouse, no matter how much. However, if the surviving spouse does not need the funds and they remain in their estate when they die, the excess over $2 million.

There are a few planning techniques that can reduce or eliminate estate taxes when the second spouse passes away. First, each spouse can set up his or her assets so that enough passes directly to the next generation instead of to the surviving spouse so that the surviving spouse's estate is below $1 million. This only makes sense if the couple determines that the surviving spouse doesn't need those funds. Also, don't go overboard. If the first spouse who dies gives away more than $2 million to people other than his spouse, his estate will have to pay a tax at that point.

Second, the surviving spouse can disclaim some or all of the funds coming to her from the deceased spouse. This causes her be treated as having predeceased her spouse and the property will pass as if that were the case, usually directly to children. This allows for what is called "post mortem" estate planning, to make adjustments based on the situation after the death of the first spouse to pass away, but the result can be the same as in disinheriting the surviving spouse – leaving her at financial risk.

The third option, which most clients prefer, is for the estate to be structured so that the assets of the first spouse to die pass into a trust for the benefit of the surviving spouse. The trust can be structured so that it can be used for the surviving spouse's benefit, without it being taxed at her death.

By way of example, assume a couple has a total estate of $2.8 million. If everything passes to the surviving spouse, at her death the estate will owe a tax of approximately $65,000. If instead, upon the death of the first spouse to pass away $900,000 passed into a trust for the benefit of the surviving spouse, she would be left with $1.9 million in her own name, less than the $2 million threshold for Massachusetts estate taxes. This means that there would be no estate tax on the surviving spouse's estate, saving $65,000 (assuming her estate does not grow beyond $2 million). And this is true even if the value of the trust left by the first spouse to die grows above $2 million.

20 William Street, Suite 320, Wellesley, MA 02481 t 781-705-6400 f 781-446-6995 www.margolisbloom.com

Making Large Gifts

A third method of reducing estate taxes is less effective than those described above, but may be used in certain circumstances. Above, we discussed taxpayers making gifts of up to $18,000 per recipient per year. This amount is excluded from gift tax reporting.

Contrary to popular belief, there is no legal bar to giving away more. There is just a requirement that the taxpayer report larger gifts on a gift tax return to be filed with their annual income tax return. Under current law, they to pay a gift tax only when his accumulated taxable gifts exceed $11.2 million. (Only once have we had a case in which someone actually paid a gift tax. Our client was receiving a gift from a movie star friend who had to pay a gift tax because he had exceeded the much lower gift tax limit in place at that time.)

While few taxpayers ever pay gift taxes, the filing of the return affects their estate taxes when they die. For federal estate tax purposes, in effect, the amount of taxable gifts made during a decedent's life gets added to their taxable estate when they die. This is not the case for Massachusetts, which has no gift tax. If a Massachusetts taxpayer gives property to someone else before he dies, it's out of their estate immediately.

However, until the 2023 change in the Massachusetts estate tax law, the gift came back into the Massachusetts estate just for the purpose of determining whether it exceeded the $1 million threshold and had to pay an estate tax. This does not appear to be the case under the new law, but it could trigger the requirement to file an estate tax return if no tax is due.

Here is an example of how the tax used to work: Let's assume the taxpayer had an estate of $1.2 million which would have been subject to a tax of approximately $50,000. This tax could be completely eliminated by lowering her estate by $200,001 to $999,999. The taxpayer could also reduce the size of her estate below $1 million by giving away $200,001 all at once. However, this would not have eliminated the estate tax, since the larger gift would be included back in her estate for purposes of determining whether it is subject to tax. The large gift, however, would have saved the estate about $15,000, reducing the tax to about $35,000 from the $50,000 it would otherwise have had to pay.

Under the new law, it appears that such large gifts, perhaps reducing the size of an estate from $2.2 million to $1.9 million, completely eliminates the estate tax due to a provision in the law that specifically states that estates under $2 million are not subject to a tax. However, the utility of such "deathbed" planning could undermine its utility. First, it does not eliminate the trouble and expense of preparing an estate tax return. Second, the tax savings in our example would only be about $16,000, about the same as the savings under the old tax regime, but on a significantly larger estate. Third, the gifted assets would not receive a step-up in basis, meaning that depending on the property transferred the consequent taxes on capital gain could exceed the estate tax savings.

As the reader can see, this is complicated material and there is considerable interplay between estate, income and capital gains tax rules. Tax planning should always be carried out with the guidance of a qualified professional.

20 William Street, Suite 320, Wellesley, MA 02481 t 781-705-6400 f 781-446-6995 www.margolisbloom.com