Estate Planning Insights

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HANDLING AN ESTATE: THE FINAL PHASE

In our July 31, 2004 newsletter we discussed the first phase of the post-death process: Probate. In our October 31, 2004 newsletter we discussed the second phase of the post-death process: tax and administration matters. In this last newsletter in this series, we will discuss the steps that are involved in closing an Estate and distributing all of the assets to the beneficiaries. While it is tempting to rush through the final phase of the post-death process, these concluding matters must be handled correctly or else the estate plan may fail to achieve all of the benefits that were intended.

Completing the First Two Phases of the Post-Death Process. As Executor of the Estate, you have seen to it that the Will of the deceased person ("decedent") was "admitted to probate"–declared to be valid. Further, as Executor you have identified, collected and secured all Estate assets (or as the successor Trustee of a funded Living Trust, you have taken control of all Trust assets). As Executor you have filed the Probate Inventory (list of assets passing by the Will) with the Court and obtained approval of the Inventory. Further, as Executor or as successor Trustee of a funded Living Trust (hereafter referred to jointly as the "Fiduciary") you have listed and valued all assets in which the decedent owned an interest and, if required based on the total value of the assets, you have prepared and timely filed a United States Estate Tax Return and a Texas Inheritance Tax Return, and paid any federal estate taxes and Texas inheritance taxes due. As the Fiduciary, you have paid all known debts and expenses, made sure that a final individual income tax return was filed for the decedent and paid any income taxes due, and otherwise handled any necessary or required estate administration matters (such as determining and settling the amount due doctors and hospitals [or due back to the estate as a refund] with respect to the decedent's expenses of last illness). Most importantly, you have received a "Closing Letter" from the Internal Revenue Service ("IRS") with respect to the federal estate tax return that you filed, indicating that the "Estate" may now be closed (or, if the estate tax return was audited by the IRS, you have settled those tax matters and entered into a settlement agreement with the IRS). You are now ready to close the Estate and distribute the assets to the decedent's beneficiaries (who might be individuals, charities, trusts or other entities).

Also In This Publication...

Distributions of Assets Outside the Decedent's Will or Living Trust. Long before the Fiduciary is ready to distribute the decedent's assets pursuant to the estate plan in the Will or Living Trust Agreement, certain "non probate" assets may already have passed to the beneficiaries designated to receive them pursuant to a transfer mechanism not controlled or overseen by the Fiduciary. Examples of these "non probate" transfers would include (i) assets that pass directly to beneficiaries by beneficiary designation (this applies to life insurance policies, retirement plans, IRAs, and annuities), and (ii) assets that pass directly to beneficiaries due to the form of titling used or other contractual arrangement established by the decedent prior to death (this applies to bank and other accounts set up as "joint tenants with right of survivorship", bank accounts titled in the name of a "Trustee" for the benefit of a beneficiary (a "Totten trust account"), and Pay On Death ("POD") and Transfer on Death ("TOD") arrangements). While these forms of transfer may be convenient, since they occur outside the Will or Living Trust Agreement, they are not part of the decedent's estate plan created in the Will or Living Trust, which can sometimes cause very serious tax and other problems. For example, in the case of a married couple, these non probate transfers can cause under-funding of the Bypass Trust created in the Will or Living Trust (because these assets pass outside the estate plan in the document), resulting in potentially hundreds of thousands of dollars in *unnecessary* estate taxes being paid on the second spouse's death. Other problems include unequal treatment of beneficiaries who were supposed to end up with equal shares. This happens frequently, such as when one child is placed on a parent's bank accounts "for convenience", but the wrong account title – "Joint Tenants With Right of Survivorship" – is chosen (usually by the person at the bank, who doesn't explain the legal effect of that form of titling). Instead of the parent's estate passing equally to all of the children on the parent's death, that one child will own 100% of the JTWROS bank accounts, to the exclusion of the other children, when the parent dies. Fixing the problem after death can involve negative gift tax consequences for the named child (i.e., if the child decides to split the accounts with his or her siblings, the child will be making a taxable gift if the amount is greater than $11,000 per sibling). Just as often, that child decides that he or she is fully entitled to keep those bank accounts, and is also entitled to receive a share of the parent's other assets passing under the Will (a position that is legally correct in this example).

Early Distribution of Assets. Certain small gifts made in the Will or Living Trust Agreement ("specific bequests") may already have been given to the beneficiaries entitled to receive them long before the third post-death phase is reached. There is often no reason to hold up the distribution of small bequests once the "survivorship period" has passed, as long as the bulk of the assets remain until all tax matters are resolved (bequests should not usually be distributed prior to the stated survivorship period in the Will or Living Trust because if the recipient dies before the end of the stated time period, then the gift would "fail" and that asset would belong to someone else). Frequently, the beneficiaries of an Estate become frustrated by the length of time between the decedent's death and final distribution of the assets. They may believe that the Fiduciary (or the Fiduciary's attorney) is procrastinating or performing his/her duties in a dilatory manner. In fact, it is *extremely risky* for a Fiduciary to make a final (or major) distribution of the decedent's assets prior to obtaining a clearance on all tax matters from the IRS. This is because the Fiduciary has **personal liability** for taxes due by the decedent and his estate. Thus, if the Fiduciary has already distributed most or all of the decedent's assets to the beneficiaries and it is discovered that additional taxes must be paid, if the Fiduciary cannot get the money back from the beneficiaries, the Fiduciary will have to pay those taxes out of his/her own, personal pocket. This may well be the reason for the Fiduciary's "delay" in making the final distribution.

Making the Final Distribution. With respect to the bulk of the assets passing by the terms of the decedent's Will or Living Trust, once the first two phases of the post-death process have been completed, the Fiduciary is now in a position to transfer these assets to the intended recipients. Distributing assets from the decedent's estate or Living Trust primarily involves changing the title of the assets into the name(s) of the new owner(s) (i.e., placing the assets in the name(s) of the beneficiary/ies). Depending on the type of asset, changing the title can be simple or complicated.

• **Real Estate and Minerals.** With respect to real estate, title is usually changed by means of a deed. The Fiduciary can sign a "distribution deed" conveying the particular piece of real estate to the beneficiary and then file the deed for record in the real property records in the county where the property is located. If the property is in a different county from the one in which the decedent resided at date of death, it is technically best to file a certified copy of the decedent's probated Will and Order Admitting the Will to Probate (if applicable) in the county records first, before filing any distribution deeds. This creates a clear chain of title. Mineral interests can also be transferred by means of a (mineral) deed, handled the same way as surface estates. If minerals are under lease and being produced, new division orders will need to be prepared and executed. Usually, most of this documentation is prepared by the mineral production company.

• **Stocks and Bonds.** If the decedent held actual stock or bond certificates, the title transfer process can be quite complex. The stock or bond transfer agent for that particular security will advise the Fiduciary of the documents that need to be prepared and completed (sometimes as many as seven different forms) and the steps that need to be taken. If the decedent owned securities through a brokerage firm or investment company, or in direct registration with the issuing company, the title transfer process is usually simpler. Often the account that belonged to the decedent is closed by the account executive upon instructions from the Fiduciary, and the assets are then transferred into new accounts in the names of the beneficiaries.

• **Bank Accounts and Certificates of Deposit.** Of course, with bank accounts, since the only asset in the account is cash, the Fiduciary can merely write a check to each beneficiary for his or her appropriate share. With respect to certificates of deposit ("CDs"), the law allows the Fiduciary to cash in CDs early, without penalty, due to the death of the decedent. Funds in the CD can then be placed in an account held in the name of the Estate or Living Trust (as applicable), on which the Fiduciary can write checks to the beneficiaries.

• **Motor Vehicles.** Title to motor vehicles is transferred by going to the County Tax Assessor-Collector's office and taking the vehicle's certificate of title, current registration receipt, proof of insurance, and either a death certificate (for vehicles that were titled as joint tenants with right of survivorship titles) or Letters Testamentary (for vehicles not titled in right of survivorship form).

• **Household Furnishings and Personal Effects.** These assets do not usually have a "title" that needs to be changed. In addition, these assets are usually distributed long before the final phase.

Transferring title into the names of individual beneficiaries can be relatively simple, as discussed above. As part of the asset distribution and re-titling process, the assets placed in the name of each individual beneficiary should also reflect that beneficiary's social security number. It is also a good idea for the Fiduciary to obtain a receipt for the distributions made to each beneficiary.

Distributing Assets to Trusts. The decedent's estate plan may create one or more trusts as beneficiaries upon his death. Many of these trusts are designed to avoid or defer estate taxes. Some are designed to provide creditor protection (including divorce protection) for the trust beneficiaries. Therefore, it is vitally important that assets passing into new trusts as a result of the decedent's death be properly re-titled, so that the tax and other benefits sought by the decedent can be achieved.

Most tax planning included in a Will or Living Trust Agreement is based on "formulas", which are usually quite technical and complex. Thus, if the decedent created any trusts to take effect upon his death, the Fiduciary will need to obtain advice from a qualified attorney regarding the computation of the proper amount passing into each trust and the composition of the assets to be used to fund each trust (it is usually best for the Fiduciary to hire, from the beginning, an attorney who specializes in *both* probate and estate tax matters, so that the entire three-part process will be efficient, coordinated and geared toward implementation of the entire estate plan, including the more complex tax planning portion of the plan). Further, the wording used to title assets that are held in a trust must be very precise, otherwise the trust might be ignored and not achieve the tax benefits, creditor protection benefits or other benefits for which it was designed. In addition, each trust must obtain its own taxpayer identification number, to be reflected on all trust assets.

Final Income Tax Return for the "Estate". Once the Fiduciary has distributed all of the decedent's assets, the Fiduciary must file a final "fiduciary" income tax return (Form 1041) for the decedent's "Estate" (this applies whether the decedent's estate plan was in the Will or in the Living Trust). All income, expenses and other deductions, etc., in the final year will flow through the Estate and out to the beneficiaries. Each beneficiary will receive a K-1 showing how much of the income and other tax items has to be reported in the beneficiary's own income tax return. Assuming that the Fiduciary saved just enough in the Estate account to pay the CPA who prepares the final fiduciary income tax return, after writing that last check, the Fiduciary is done.

Thank You from the Beneficiaries. Hopefully, the beneficiaries appreciate all of the time and effort the Fiduciary has put into handling all three phases of the post-death process for the decedent's estate. It would be a nice touch for the beneficiaries to send a thank you note to the Fiduciary. Serving as a Fiduciary is a lot of work and a position of serious responsibility. Most people who have a good attorney to advise them along the way and help them through the process meet the challenge beautifully.

For additional information on serving as a Fiduciary, you may go to our website and review the Basics memos entitled, "What Every Executor Ought to Know" and "What Every Trustee Ought to Know".

A HELPING OF HIPAA

Congress recently passed a law entitled the Health Insurance Portability and Accountability Act ("HIPAA") that limits disclosure of "Individually Identifiable Health Information". A HIPAA Authorization authorizes your health care providers to give your personal, protected medical information to any person(s) designated by you in the Authorization. The person(s) you have designated in a HIPAA authorization can obtain your private medical information from health care providers, thus enabling them to discuss and provide advice to you about your health care matters and also to assist you in taking care of your health matters and in taking care of your health-related business matters. The Authorization becomes effective at the time you sign it and is not affected by your subsequent disability or incapacity.

Why Would You Want to Sign a HIPAA Authorization? It appears clear that *once you have become mentally incapacitated*, your agents named in your Medical Power of Attorney can obtain your private medical information from health care providers using the authority given to them in that document. The problem is that you may want or need those persons to obtain such information while you are still competent, in order to help you with your medical affairs (including helping you with matters that are related, such as obtaining medical bills and paying them). Prior to you actually becoming mentally incapacitated, neither the agents named in your

Medical Power of Attorney nor the agents named in a "springing" Statutory Durable (financial) Power of Attorney are in a position, under HIPAA rules, to obtain your private health information. Thus, if you want someone you trust to be able to obtain your private medical information, even during a time when you are still mentally competent, you must sign a written document meeting HIPAA requirements, specifically authorizing those persons to obtain such information. Because both your agents in your Medical Power of Attorney and the persons you name in your HIPAA Authorization will have access to your private health information if you become mentally incapacitated, it would be wise to name the same people in both documents.

We have created a HIPAA Authorization form that is available to all of our existing clients at a nominal charge (just contact Nan at 713-520-5205 or nan@gerstnerlaw.com). For new estate planning clients, we are offering the HIPAA Authorization form as part of our standard estate planning "package". Prospective estate planning clients can contact our office to schedule a no obligation initial conference.

IN OUR NEXT NEWSLETTER we are going to re-visit the advantages and disadvantages of using a Living Trust Agreement as your primary estate planning document versus using a Will.

Contact Us:

If you have any questions about the material in this publication, or if we can be of assistance to you or someone you know regarding estate planning or probate matters, feel free to contact us by phone, fax or traditional mail at the address and phone number shown below. Feel free also to submit proposed topics for future newsletters.

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