
Estate Planning Insights

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HELP YOUR EXECUTOR (OR LIVING TRUST TRUSTEE) BEFORE YOU DIE

We discussed the American Taxpayer Relief Act of 2012 in our last two newsletters. We also discussed the 3.8% Medicare surtax that became effective this year. While there are some important recent developments that are worthy of discussion, including the US Supreme Court's decision in US v Windsor and numerous statutory law changes made by the Texas Legislature, we want to "switch gears" this time and move away from recent developments to discuss some "classic" matters. One of those classic matters involves what the Executor of your Estate (or the successor Trustee of your Living Trust) must do as a result of your death. There are things you can do, now, to help streamline that process later.

The Three (or, Four) Parts of the Post-Death Process.

When a person dies (the "decedent"), various legal (and other) activities are triggered. We refer to these activities, collectively, as the "post-death process." In a series of newsletters dated July 31, 2004, October 31, 2004, and January 31, 2005 (all on the firm's website), we discussed the three parts of the post-death process. We want to revise that breakdown and say that there are three *or four* parts to the post-death process, depending on whether the decedent owned any probate assets at death.

Most people do not recognize that there are separate and distinct parts of the post-death process. Some of the confusion may be due to the fact that these separate and distinct parts often overlap in terms of when the activities are performed. In addition, some attorneys only handle one (or two) parts of the post-death process, which may lead lay persons to believe that everything has been done when, in fact, some work remains unfinished (we know this because we periodically have to complete what other attorneys start but don't finish). What we hear most often are people referring to the post-death process as "probate." That is incorrect and also misleading. Probate is merely one part of the post-death process, applicable in most (but not all) cases. Even if there is no probate proceeding, the other parts of the post-death process must still be handled.

We also find that people who use a Living Trust (rather than a Will) as their primary estate planning document do not understand that, just because the probate process might be avoided does not mean that there are no legal activities required when the Living Trust grantor dies. Some "Living Trust promoters" actually lead people to believe that *nothing* has to be done when the Living Trust grantor dies, which is totally false. The only part of the post-death process that might be avoided is probate.

Here is how we break down the separate "parts" of the post-death process:

1. Probate: applicable if the decedent owned any probate assets at death (see below). Even if a Living Trust is the primary estate planning document, a probate process is still needed to place the probate assets into the Trust.
2. Administration: applicable in ALL cases.
3. Federal tax "due diligence": applicable in ALL cases.
4. Closing and distribution (and re-titling of the decedent's assets): applicable in ALL cases. In some cases, this final part includes setting up and funding new trusts created as a result of the decedent's death.

Probate. A probate process is necessary in any case in which the decedent owns any "probate assets." Probate assets are assets that are distributed pursuant to a Will (if there is one), otherwise according to the default distribution rules in the Texas Probate Code (basically, the state of Texas has written a "Will" for persons who die without one). Even persons who use a Living Trust as their primary estate planning document must still have a Will--called a "pour-over Will"--to place their probate assets *into* their Living Trust when they die. To convert probate assets to non-probate assets, the grantor of the Living Trust must re-title each probate asset into the name of his Living Trust *before* he dies. Otherwise, the only way his probate assets will "make it into" his Living Trust is through probating his pour-over Will upon his death.

If a grantor is able to re-title every single one of his probate assets into the name of his Living Trust before he dies, then he will have a "fully funded Living Trust" at death, meaning that he will not own any probate assets. In that particular case (which used to be *extremely* rare and is now just rare), the Living Trust grantor's pour-over Will will *not* have to be probated when he dies. Thus,

probate is the one part of the post-death process that can be avoided by using a fully funded Living Trust (or by not owning any probate assets at death).

The probate process itself is fairly simple if the decedent's Will (i) was executed properly, (ii) does not contain any ambiguities or errors, and (iii) appoints an "Independent Executor to serve without bond." In most cases, probate consists of one court hearing (and the documents related to that hearing), the providing of some legal notices (and proof of satisfaction of that requirement), and the preparation of an Inventory, Appraisal and List of Claims (the "Inventory"). The Inventory is a list of the probate assets in which the decedent owned an interest at death, with each asset being valued at its fair market value as of the decedent's date of death. The Will and the Inventory basically function together as a "deed." A living person transfers title to property through the execution and recording of a deed. The deed specifically describes the property being transferred. Legal title to the decedent's probate assets is transferred via his Will. Just like a deed, the decedent's Will must be filed in the public records (initially, in the probate records, and, sometimes later, in the real property records). To be given effect, however, the Court must first "admit the Will to probate," which means that the Court declares the Will to be valid. Unlike a deed, the Will does not specifically describe each and every probate asset being transferred by it on the decedent's death. Thus, the Inventory completes the Will as a "deed"—it itemizes the assets being transferred by the Will to the new owners as a result of the decedent's death.

People who do not distinguish between the separate parts of the post-death process refer to all of the parts, together, as "probate." Again, this is incorrect and gives probate a "bad rap." In our experience, the part that people like the least (and find to be the most complicated) is what we call, "federal tax due diligence." Viewed as a whole, the probate part of the post-death process is fairly simple in Texas. Thus, while it is possible to avoid the probate process completely, note that the other parts of the post-death process (including the more complicated parts) cannot be avoided merely by avoiding probate. Even if there is no probate process because the decedent's Living Trust was fully funded prior to his death, the successor Trustee of the Living Trust must still perform the other parts of the post-death process. Thus, except for the probate portion of the post-death process, there is really no difference between what an Executor must do and what a post-death Living Trust Trustee must do (hereafter, we will refer to these post-death "fiduciaries" as the "Executor/Trustee" so that it is clear that *both* must handle the other three parts of the post-death process).

Post-Death Administration Matters. What do we mean by the term "administration"? Actually, this is something that occurs throughout the entire post-death process and

overlaps with the other parts. Examples of activities that exemplify *administration* include the following:

- (i) Manage the Assets. This includes, but is not limited to, the following: identify the assets and take control of them; value the assets according to IRS rules to satisfy federal tax "due diligence" (see below); obtain/maintain appropriate insurance for the assets; store them (if applicable); decide whether any of the assets should be sold for investment or liquidity reasons (i.e., to raise cash to pay debts, taxes and expenses--see next item); distribute the assets when it's time to do that; resolve title problems and other disputes, if any; run the business or oversee the manager of the business, as applicable; handle litigation and tax audits involving the estate/trust/decedent, etc.
- (ii) Pay Debts, Taxes and Expenses. Pay the decedent's debts, funeral expenses, and final income taxes; pay federal estate taxes owed by the decedent's estate and pay any state death taxes owed to states where the decedent owned real property or minerals; pay other taxes owed by the decedent (such as employment taxes and business taxes); pay the post-death administration expenses, such as attorneys' fees, accounting fees, appraisal fees, storage fees; file fiduciary income tax returns during the pendency of the post-death process and pay fiduciary income taxes; pay property taxes on real property; evaluate and pay legitimate creditors' claims, etc.
- (iii) Provide Support for the Spouse/Minor Children. Make distributions to or for the benefit of the surviving spouse and minor children for their health, support, maintenance and education throughout the post-death period.

Federal Tax "Due Diligence." A very important part of the post-death process is what we call federal tax "due diligence." This does not just refer to federal *estate* tax matters, but also includes federal income tax matters (and, to the extent applicable, Generation-Skipping Transfer Tax matters, unresolved federal gift tax matters, and other pending tax matters, such as accrued but unpaid employment taxes). The Executor/Trustee has personal liability for all taxes owed by the decedent or his "estate" (which includes his Living Trust). Note that whether there is a probate process or not has no effect on the value of the decedent's estate for federal estate tax purposes. The IRS doesn't care whether the decedent's assets pass upon death by Will, by beneficiary designation, by right of survivorship, by transfer on death, or by the terms of a Living Trust Agreement. All assets in which the decedent owned an interest at death are part of his estate for federal estate tax purposes. Thus, the Executor/Trustee must prepare a comprehensive spreadsheet showing all assets in which the decedent owned an interest at death and must value each asset according to IRS regulations. Preparing

the spreadsheet is part of the Executor/Trustee's federal tax due diligence. It will show whether the decedent's estate had a value that is large enough to require the Executor/Trustee to prepare and file a federal estate tax return (Form 706). It will also show the new income tax basis for all "capital assets" in which the decedent owned an interest at death. Capital assets achieve a new income tax basis as a result of the decedent's death and, thus, the spreadsheet satisfies the Executor/Trustee's federal estate tax AND federal income tax due diligence (assuming each asset has been valued according to IRS regulations). Thus, even if the decedent does not have a "taxable" estate for federal estate tax purposes, the Executor/Trustee is still responsible for handling ALL applicable tax matters, which includes the income tax basis matters (applicable in every case). There could also be state tax matters that the Executor/Trustee must handle. The Executor/Trustee should be sure that all tax matters have been fully handled before distributing the decedent's assets to the beneficiaries (because of the personal liability of the Executor/Trustee for those taxes).

Closing, Distribution and Trust Funding. The final part of the post-death process has to do with closing the post-death entity, whether that is a decedent's estate or a post-death Living Trust, and distributing the decedent's assets according to the Will or Living Trust Agreement. Distributing the decedent's assets will involve *re-titling* the assets into the name(s) of the new owner(s) (the beneficiary/beneficiaries under the Will or Living Trust Agreement) because the decedent's assets cannot remain titled in his name or under his Social Security Number. Re-titling assets may require the execution and recording of Deeds and Assignments, the completion of new account forms, the writing of checks, the supplying of various documents and instructions to a transfer agent, etc. In some cases, the decedent's estate plan may call for the establishment of one or more *new* trusts as a result of his death. In that case, as part of the final phase of the post-death process, the Executor/Trustee must "set up" each new trust and re-title the assets that are supposed to be placed into the new trust into the name of that new trust (this is referred to as "funding" the trust).

When all three (or four) parts of the post-death process have been completed, the Executor/Trustee must file a final federal income tax return for the decedent's estate or post-death Living Trust, showing the income being distributed to the beneficiaries in the final year.

Dealing with Your Body. You should be sure that your family members know what you want done with your body upon your death. Most people do not need to appoint an "official" agent to deal with their body, although some people, mostly those with partners who are not recognized as legal family members, should execute

an "Appointment of Agent to Control Disposition of Remains" so that their partner, and not family members with priority under the law, can handle the disposition of their body when they die. Do you want to be buried or cremated? Do you want to have a funeral or memorial service (or neither)? Where will your remains (or cremains) be kept? Have you already made arrangements for any of these items? Note that, technically, your Executor/Trustee is *not* the person who deals with your body when you die. Thus, you will want your family members to know what your wishes are in regard to these matters. You can even write out your instructions—just be sure your family members know where they are kept.

How You can Help Your Executor/Successor Trustee.

As discussed above, the Executor/Trustee has significant post-death responsibilities. Be sure you have named someone as Executor/Trustee who is responsible, trustworthy, prudent, detail-oriented, and a good communicator. Never name a person as Executor/Trustee who cannot handle a large volume of work or who cannot make important decisions in a timely manner.

Financial Statement. As noted above, one of the duties of the Executor/Trustee will be to prepare a comprehensive spreadsheet showing *all* assets in which you owned an interest at the time of your death. You can give your Executor/Trustee a "head start" by preparing a financial statement showing all of your assets and liabilities and updating it on a regular basis (at least once a year). Let your Executor/Trustee know where that document is kept (whether "on paper" or in electronic form). Show as much information as possible for each asset. For example, for accounts, show the name of the financial institution, the account number, the type of account, the title of the account, the current value, etc.

Other Information. In addition to maintaining a current financial statement, make sure that you have all of the following in a "safe place" and that your Executor/Trustee knows where it is (and will have access to it):

1. List of all of your family members and beneficiaries, with current contact information (addresses, phone numbers, email addresses, etc.).
2. List of all of your professional advisors, along with their current contact information.
3. Your birth certificate, marriage license(s), divorce papers (if applicable), military discharge papers (if applicable), and information regarding where your original estate planning documents are located.
4. Information regarding your "digital assets" and other "digital accounts"—a list of all such assets/accounts and your user name/login name, password/PIN, and other relevant information.
5. Original life insurance policies and annuity contracts.

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6. Copies of the most current beneficiary designation forms for your life insurance policies, annuity contracts, qualified and non-qualified retirement plans, and IRAs.

7. Copies of the signature cards and account agreements that originally established each bank, savings and loan, credit union, brokerage and investment account (so that the precise legal title or registration can be determined), and also copies of any documents that modified the original title or registration of the account. This is VERY important and most people fail to do this. As discussed in our newsletters dated July 31, 2005, April 30, 2008, July 31, 2009 and January 31, 2012 (all are on the firm's website), the legal title of an account means MORE than just the names on the account. The way an account is legally titled determines who inherits that account on your death.

8. Other important papers, such as original deeds for real property and minerals, original car titles, and original stock and bond certificates, and copies of other important items, such as gift tax returns, recently filed income tax returns, leases, mortgages, promissory notes, business entity documents (formation documents, ownership certificates, buy-sell agreements), asset appraisals, homeowner's and other insurance policies, etc.

9. If you received any assets by gift or inheritance, copies of the documents relating to that, such as the Will or Trust Agreement, Gift Deed or Assignment, Inventory (and

federal estate tax return) filed for that person's estate.

10. If you are the beneficiary of a trust created by someone else, a copy of that Trust Agreement, a list of the assets held in that trust, and recent K-1s provided to you.

Your Final "Love Letter." Some people like to write a final "love letter" to their loved ones. This type of document can also be called an "ethical Will." Karen Gerstner wrote a newsletter discussing Ethical Wills when she was with her prior law firm. That newsletter, dated August 15, 2001, is on the firm's website: www.gerstnerlaw.com.

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 above. You can also reach us by email addressed to:

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