KAREN S. GERSTNER & ASSOCIATES, P.C.
5615 Kirby Drive, Suite 306
Houston, Texas 77005-2448
Telephone (713) 520-5205
Fax (713) 520-5235
www.gerstnerlaw.com

BASICS*

What Every Executor Ought to Know

Synopsis

The estate administration process can be daunting, especially to someone who has no prior experience with probate or estate matters. The process is much less intimidating, however, once you have a basic understanding of the steps involved in the estate administration process, including the executor's responsibilities to gather estate information; pay debts, expenses, and taxes; file necessary tax returns; and distribute the assets of the estate in accordance with the wishes of the deceased person ("decedent").

I. Introduction.

A good friend or a member of your family is having a Will drawn up, and asks you whether you would be willing to act as the executor. You feel honored by this request, and you give your consent. Or, perhaps someone close to you has passed away, and the time has come to assume your executorial function. You may be wondering exactly what the extent of your obligations will be, how much time your duties may demand, and where to go for help in fulfilling this important role.

This outline is intended to give you an overview of the estate administration process, focusing on the executor's responsibilities to gather estate information; pay debts, expenses, and taxes; and distribute the assets of the estate in accordance with the wishes of the decedent. The outline is not intended as a do-it-yourself manual or as a substitute for legal or tax advice, but it may give you some idea of the duties that you can perform on your own, and it can help you to be an informed client when you hire professionals to help you perform these tasks.

II. Don't Be Intimidated by "Probate".

Many people are aware that estates may be required to "go through probate," but they may not know what this process entails. As a result, many people are intimidated by the idea of becoming involved in probate. "Probate" refers to the series of legal procedures by which a court assures itself that a Will is valid, that the debts, taxes, and expenses of a decedent will be paid, and that the remaining assets will be distributed to the rightful heirs or beneficiaries. These procedures are to some extent overseen by a court in the county in which the decedent lived.

The Texas Probate Code establishes several different probate procedures for transferring property to beneficiaries. If the decedent left a Will prepared by a Texas attorney, the Will is likely to provide for "independent" administration. This language authorizes the use of a streamlined, efficient, low-cost probate

*Karen S. Gerstner & Associates, P.C. has compiled the *Basics* series to provide plain-English, summary explanations of fundamental estate planning and estate administration techniques and concepts. As a result, our discussions may gloss over some of the more complex topics and even ignore a few issues. The Basics memoranda are *not* legal advice. Instead, they are generalized, educational tools designed to help our clients and potential clients develop an understanding of the estate planning and administration process. Before engaging in any estate planning, you should consult a qualified estate planning attorney. Portions of this outline were adapted from a pamphlet entitled "What Every Executor Ought to Know" (Commerce Clearing House, Inc., 1991).

system. If no Will is found, or if the Will does not provide for independent administration, other estate administration procedures may be utilized.

As the executor, you may need to hire experts to help you go through the probate process and complete your other duties. You are entitled to charge their reasonable fees to the estate. The size and complexity of the estate, as well as your own level of expertise in handling financial and tax matters, will determine the extent to which you will need the assistance of an attorney, accountant, or other professional.

In addition to reimbursement for your out-of-pocket expenses, you may be entitled to receive a fee for your own services as executor. In Texas, unless the Will provides otherwise, the executor's commission is set at five percent of the receipts and disbursements of the estate, not to exceed five percent of the estate's assets. Of course, you may choose to waive this fee if you so desire.

III. Steps to Take Before Death.

Once you learn that you are named executor in a living person's Will, it may be a good idea to make a tactful attempt to gather some general information about the Will writer (known as the "Testator"). Although most people are understandably concerned that their private affairs, including the contents of their Will, remain private, there is a certain amount of information that an executor should have. Because the Testator's trust in you has been shown by the fact that you were chosen to perform this important role, you should not feel uncomfortable asking certain limited questions.

A. Know How to Locate the Will.

Although some Testators may voluntarily share information with you regarding their wishes for disposition of their property, it is not necessary for you to know the particular property or percentage of the estate that will be passed to the beneficiaries. You should, however, know the location of the original Will, and have some idea of how to retrieve it when the proper time comes. Under the best of circumstances, the Testator may give you a copy of the Will. Occasionally, the Will is given in a sealed envelope to be opened only upon the Testator's death, with the understanding that you will not violate his or her confidence by opening it prematurely.

If you are not given a copy of the Will, the Testator may tell you that it is held in a Will vault at an attorney's office (and give you the name and address of the attorney), that it is stored in a safe deposit box (and tell you the name of the bank or savings institution, and possibly the location of the key stamped with the box number), or that it is among his or her personal papers at home.

In addition to the location of the Will, it is wise to know the whereabouts of close family members who are the likely beneficiaries under the Will. If you are a member of the family yourself, you probably already have the information you need. Otherwise, you might ask the Testator for names, addresses, and phone numbers of close family and friends.

B. Letters of Instruction.

One of your major duties as executor will be to locate and gather together the assets of the estate. Although you may have some idea of the general nature of the estate through your relationship with the Testator, the best way for a Testator to be sure that none of his or her assets are overlooked is to prepare a detailed Letter of Instruction. Such a letter should be kept in an accessible place so it can be updated on a regular basis, and its existence and location should be made known to the executor and perhaps to other close family members.

A letter of instruction might include the names, addresses and phone numbers of the Testator's:

- family and friends
- attorney
- accountant
- banker
- stockbroker
- insurance agent, business associates, and other individuals whose assistance may prove helpful

The letter of instruction might also let you know the whereabouts of important papers, such as:

- the original Will
- birth, adoption, or baptismal certificates
- marriage certificate
- divorce decree or separation agreement
- safe deposit box and keys
- bank passbooks
- brokerage statements
- income tax returns
- gift tax returns
- cemetery site deed

Sometimes, the letter of instruction will also contain a detailed inventory of assets and liabilities, including items such as:

- bank names, addresses, and account numbers
- savings bond denominations, numbers and location
- stock, bond and mutual fund names, location of certificates, and number of shares
- real estate descriptions
- pension/profit sharing account information
- insurance policy information and the location of policies
- motor vehicle descriptions and the location of titles
- mortgage amounts and information about other loans

The letter may also contain instructions as to funeral arrangements and instructions as to disposition of particular personal effects. Written instructions disposing of personal effects may or may not be legally binding, depending upon a number of factors. Many people use this method of describing their wishes, however, since a letter is much more easily revised than a Will. In addition, during probate, a Will becomes a public record and its contents may be viewed by curious persons, while a letter would remain private.

If the Testator does not have such a letter, and does not respond to your suggestion that he or she may want to create one, you should still try to get some idea of the Testator's record-keeping habits and the location of important documents. The more information that you have available to you prior to the Testator's death, the easier your job as executor will be.

IV. First Days and Weeks After Death.

A. See that Funeral Arrangements are Made.

Funeral arrangements are generally made by the surviving spouse, children, or other family members rather than by the executor as such. The decedent's wishes should be respected if they are known, but do not have to be carried out if they are unreasonable or financially burdensome. Unfortunately, often the decedent's wishes are expressed only in the Will, which might not be discovered or located before disposition of the body must occur. Obviously, such instructions cannot be binding.

In making final arrangements, the question of anatomical gifts should be considered. Under the Uniform Anatomical Gift Act, organ donations or gifts of the entire body for medical research made by the decedent must be honored by the survivors. However, if the gift was made by means of the Will rather than through an Organ Donor Card, it may be impossible to respect since organ donations must take place within a few hours of death.

Although the executor does not necessarily make the funeral arrangements, he or she is responsible for keeping track of the expenses and paying the bills from the estate's assets. All reasonable funeral expenses are payable from the estate. If a relative or friend pays the funeral director, he or she will be entitled to reimbursement from the estate. Generally, funeral expenses include all costs for preparation, transport and burial of the body; costs of conducting memorial and burial services, including any traditional meal for family and friends; and costs of travel, meals, and lodging for the person who is in charge of making arrangements.

Funeral expenses and expenses of the deceased person's last illness are given priority when an estate has limited assets. Under the Texas Probate Code, the first $15,000 in funeral expenses and expenses of last illness must be paid before any other claims. Such expenses in excess of $15,000 are to be paid before any other obligations, except any allowance paid to the surviving spouse or children, and expenses of administration such as court costs, attorney fees, and executor fees.

At the time funeral arrangements are being made, it is a good idea to order a number of certified copies of the death certificate from the funeral director. Most people start with ten or twenty. These certificates may also be obtained from the county health department. You will generally need a separate certified copy in order to effect a transfer of each piece of real estate, motor vehicle, stock certificate, bank account, etc.; to obtain insurance proceeds and death benefits; to gain access to safe deposit boxes; to complete tax returns; and for numerous other reasons.

B. Locate and Read the Will.

Even if you were given a copy of the Will before the Testator died, you have an obligation to locate and retrieve the original. In most cases, the Testator will have told you of its location. If not, you will have to thoroughly check all logical places before you can conclude that no Will exists.

Original Wills are often retained by the attorney who prepared them. If you do not know the name of the decedent's attorney, it may be listed in the decedent's address book or collection of business cards, or you might find a canceled check or a notation in the decedent's checkbook. You may, but are under no obligation to, hire the attorney who prepared the Will to assist in settling the decedent's estate.

Under Texas law, upon receiving notice of the Testator's death, any person having custody of the decedent's Will must deliver it to the county clerk. Because of this statute, an attorney who has the original

Will may resist handing it over to a nonlawyer. If you hire an attorney other than the one who has custody of the original Will, the two attorneys will make arrangements to have the Will filed. At that time, you should be given a copy of the original Will if you don't already have one. Of course, once the Will is filed with the probate court, anyone, including the executor, may obtain a certified copy from the county probate clerk upon payment of a nominal copying fee.

If the Will was stored in a safe deposit box, you are permitted to open the box if you have obtained the key and if you were a joint signatory on the box, or if another person who is a surviving joint tenant of the box accompanies you. Under Texas law, there is no requirement for the box to be sealed upon death. If you cannot locate the key or if no authorized signatory on the box is living, the bank should still permit you to examine the contents of the decedent's safe deposit box, in the presence of a bank officer, if you are the spouse, parent or adult child of the decedent, or if you are named as executor in a photocopy of the Will.

Another common place to find a Will is among the decedent's personal papers at home. Of course, some people are more organized than others in maintaining personal papers. A thorough search may be required before the original Will is located.

Once the Will is located, no legal formalities are required for its reading. You may read it in the presence of close family members, or you may read it privately. Although novels and movies suggest otherwise, the lawyer and family members do not have to gather together for a formal "reading of the Will." You may, if you choose, send a photocopy or a summary of relevant provisions to the beneficiaries named in the Will. Since the original Will will be delivered to the probate court, you may want to make one or more copies for ready reference. If the Will is stapled or bound together, copy it without removing any staples or binders. If a question later arises regarding the integrity of the Will, you can testify that no pages were disturbed while the Will was in your possession.

If the original Will cannot be located and only a photocopy can be found, Texas law creates a presumption that the decedent destroyed the original Will, intending to revoke it. This presumption can be overcome by evidence to the contrary. Your lawyer can advise you about the procedures required if the original Will cannot be found.

C. Obtain Guardian for Minor Children.

If there are minor children (under age 18) who are left orphaned by the decedent's death, a guardian must be appointed for them by the probate court as soon as possible. The appointment of an individual as the "guardian of the person" of a minor gives the individual parental authority over the child. Minors cannot receive medical treatment or enroll in school without the consent of a parent or guardian. For this procedure, you will probably need an attorney's assistance. Where both parents are deceased, the court will almost always respect the nomination of guardian(s) made in the Will or in a separate Guardian Designation, if the nominee is able and willing to serve. If the decedent did not name a guardian in a Will or Guardian Designation, the court will appoint a grandparent or other close relative to serve as guardian. A minor who has reached age 14 may, with the consent of the court, select his or her own guardian or replace a court-appointed guardian.

If the decedent is a divorced parent, and the other natural parent is still living, custody will almost invariably be awarded to the surviving parent, regardless of the nomination made in the Will or Guardian Designation of the first parent to die. An exception would occur where the surviving natural parent is shown to be unfit or declines to act.

If the minor child owns assets outright (not in trust or in a custodial account), the court will also appoint a "guardian of the estate" to manage the assets until the child reaches the age of majority. The guardian of the estate may be the same person as the guardian of the child's person.

D. Application for Probate of Will and for Issuance of Letters Testamentary.

Your duties as executor are important, and therefore, you should not unduly delay getting started with the probate process. Before filing the Will for probate, however, you may want to make a quick, preliminary inventory of the estate's assets and obligations to see whether formal probate procedures are actually necessary. The various types of probate procedures are discussed beginning at page 8.

If it is evident that the decedent held substantial assets solely in his or her own name, thus making formal probate a foregone conclusion, you will probably need the assistance of an attorney in petitioning the Court to probate the Will (i.e., declaring it to be valid), to be appointed the decedent's executor, and to receive Letters Testamentary. These "Letters" are certified court orders proving that you have the legal power to represent the decedent's estate and handle the estate assets. You will need copies of the Letters to show to persons holding assets of the decedent, debtors, creditors, and others so that they will comply with your requests.

In most cases, obtaining such Letters takes two to three weeks after the Will is filed with the probate court. The procedure for initiating probate and obtaining Letters Testamentary involves filing an Application for Probate with the court. The original Will is attached to the application. Court personnel post notice at the courthouse that an instrument purporting to be the decedent's Will has been offered for probate. This is the only notice required before a probate hearing is held. After legal notice has been posted for ten days, a brief hearing is held. At the hearing, the court will require testimony that the decedent has passed away while residing in the county in which the Will is being offered for probate. The testimony will also have to show that the writing offered for probate is the decedent's Will, and that so far as is known, the Will has not been revoked. Finally, the testimony must show that you are eligible to serve as executor of the estate (i.e., you are not a minor, mentally incapacitated or a convicted felon). After the hearing, you must file an oath with the court stating that the writing offered for probate is the decedent's last Will as far as you know and believe, and that you will faithfully perform all of the duties of executor. Upon the filing of this oath, the court issues Letters Testamentary in your name.

Generally, the Will waives the posting of any bond or other security. If the Will did not specify otherwise, however, you will probably be required to be bonded, to protect disinterested parties against possible negligence, fraud, or embezzlement. The bonding premium is based on the total value of the probatable assets, and is an administration expense chargeable to the estate. Your lawyer or an insurance agent can help you to arrange this coverage. The bond must be filed with the court before Letters Testamentary can be issued.

E. Personal Representative's Duty of Care.

After the hearing, if all procedures have been properly completed and if no one contests the Will, you will receive the Letters Testamentary. You now have the legal authority and the responsibility to handle all necessary and required matters involving the decedent's estate.

However, there are a few restrictions on your powers. You have a duty to use the care and skill that an ordinarily prudent person would use with respect to his or her own affairs. As executor your basic function is to gather the decedent's assets together, and to liquidate and distribute them as speedily as

possible. The total period of administration, from time of death to final closing, typically ranges from 3 to 18 months, depending on whether full probate and/or a federal estate tax return is required. If you retain an asset beyond a reasonable time and the estate suffers a loss, you can be held liable. You also run a risk of liability if you retain cash too long without putting it in an interest-bearing account.

Furthermore, as executor, you will be asked to make a variety of decisions and elections about investments, distribution of assets, payment of taxes, and the like. When these choices and elections are to be made, you must not seek to maximize your own advantage at the expense of the estate as a whole, particularly if you are also a beneficiary. At a minimum, this means you may not deal with estate assets in a manner that will give you a financial gain, or buy an estate's asset at an unreasonably low price. If in doubt as to the propriety of a particular action, you should seek advice from your attorney.

You will also be responsible for filing and paying applicable federal and state taxes on a timely basis. In some cases, you may be held personally liable for failure to fulfill these duties, under both federal and state law. There are also numerous criminal penalties that can be imposed on an executor for willful and deliberate violations of the tax laws.

F. Notify the Internal Revenue Service.

Whether or not formal probate is required, certain tax forms will need to be filed on behalf of the decedent. Upon assuming the role of executor, you should notify the IRS of your appointment to act for the estate on Form 56, Notice Concerning Fiduciary Relationship. Filing this form is not mandatory, but is suggested if you live at an address that is different from that of the decedent. Until this form is received, the IRS will continue to send the decedent's mail, including any important tax notices, to his or her former address.

You will also need to obtain a federal taxpayer identification number ("EIN") for the estate. You can apply for an EIN online, by telephone, by fax, or by mail, depending on how soon you need to use the EIN. *See* www.irs.gov for further information. To obtain this number, you should file IRS Form SS-4, Application for Employer Identification Number. Within 15 to 30 days, you should receive a number from the IRS. This number is required on the estate income tax form just as an individual income tax form would require a Social Security number. If you want to obtain this number quickly, you can complete the Form SS-4 and then call the IRS at (512) 462-7843. They will ask you to read to them certain information from the form, and will assign a number over the phone. The form must then be signed and mailed or faxed to the IRS. As an alternative, the attorney you have hired may be able to obtain the number for you right away, from an assigned block of numbers received from the IRS.

V. Is Probate Required?

One of your duties as executor is to create a list of assets, including all assets that could potentially be subject to the federal estate tax. If the total value of the taxable estate amounts to $2,000,000 or more, a federal estate tax return must be filed. However, the size of the taxable estate does not in itself determine whether probate is necessary. You will have to classify these assets as "probate" or "non-probate" property before you can determine whether and what kind of probate proceedings are required. In addition, you must undertake a careful review of the terms of the decedent's Will.

A. Separate Probate from Non-Probate Assets.

Not all of the decedent's assets will pass under the Will. Those that do, such as real estate and tangible property, are referred to as "probate assets." "Non-probate" assets are those that pass to survivors independently of the Will. They are not subject to claims for the decedent's debts and expenses, though they may be subject to certain death taxes. Furthermore, they need not be reported to the probate court, and you are generally not responsible for administering them. If the entire estate consists of non-probate assets, and if there are no minor orphans to consider, no probate procedures are required and the assets may simply be distributed.

The most common types of non-probate assets are joint tenancy property; life insurance benefits; other contractual benefits such as annuities, pensions, or similar retirement plans; IRA and Keogh accounts with named beneficiaries; Totten (bank account) trusts; and assets placed in revocable living trusts before death. The ownership of joint tenancy property automatically passes to the surviving joint tenant(s) upon the death of one of the joint tenants, regardless of the provisions in the Will. Trust property is governed by the trust document rather than by the Will. Life insurance proceeds and other contractual benefits normally pass directly to the beneficiaries, but may become probate property in two situations: (1) where the beneficiary is the decedent's estate or a trust created by the Will, or (2) where all the named beneficiaries predeceased the decedent.

Once you have determined which of the decedent's assets are probate assets, you can add up their value. The total value of these assets, the nature of any debts owed by the decedent, the language in the decedent's Will, and the relationships of the surviving beneficiaries to the decedent often determine the kind of probate procedures that are available to the estate.

B. Types of Probate Procedures.

Probate procedures vary considerably from state to state. Texas has more than one kind of procedure, although not all probate procedures are available to all estates. To find out the details about procedures available for the estate, you will probably need to consult a local attorney who practices probate law.

For most probate procedures, some level of court involvement will be required. In urban areas, the Texas legislature has established specialized "probate courts" to undertaken this task. In counties without large urban centers, probate is handled by county courts, which also handle other types of cases.

1. Small Estate or Affidavit Procedure.

This type of procedure typically may be used where the "probate" estate is made up of property not exceeding a maximum value set by state law. This maximum under Texas law is currently $50,000, excluding the value of the decedent's homestead and certain personal property. The small estate affidavit will not work to transfer title to real estate other than the decedent's home.

Under the affidavit procedure, no Will is filed for probate, and no executor is appointed. The person settling the estate, usually the surviving next of kin, signs a legal form known as an affidavit stating such things as (i) the statutory waiting period following the death (30 days) has elapsed, (ii) the estate does not exceed the legal limits, and (iii) the person signing the form is legally entitled to receive the decedent's assets. These forms are available from the county clerk or probate court. The affidavit must be sworn to by two disinterested witnesses and by all adult distributees.

Because the probate court is not involved in overseeing the process of administration, the costs of using the affidavit procedure are low, even if some assistance from a lawyer is required. The lack of court involvement may result in faster settlement. Parties receiving the affidavit are required to transfer the decedent's property to the designated person or persons. As indicated above, however, the affidavit procedure is not effective to transfer title to real property other than the decedent's homestead. If the decedent owned real property other than his or her homestead, or owned assets with a value in excess of $50,000, another probate procedure must be used.

2. Independent Administration.

Texas law provides for a simple probate procedure in which an executor is appointed but can act much more independently than in formal "dependent" probate administration, described below. As indicated earlier, an independent administration is available if the decedent's Will so specifies. No particular language is required. Any indication that the estate is to be administered without court supervision, including simply using the phrase "independent executor" is generally sufficient. Often, the Will will provide "no action shall be had in relation to the settlement of my estate other than the probating and recording of my Will, and the return of an inventory, appraisement, and list of claims of my estate."

If the Will does not provide for independent administration, an independent administration may still be obtained if all of the distributees of the estate agree in writing to designate a person to serve as independent administrator. Under those circumstances, a court can appoint an independent executor of the estate unless the court finds that it would not be in the best interests of the estate to do so. Unfortunately, some probate courts in Texas seem reluctant to appoint an independent executor at the request of the distributees if the Will does not expressly appoint one.

If an independent executor is appointed, the probate process is fairly simple. The Will is filed at the courthouse following the decedent's death. After a statutory waiting period of ten days, a short probate hearing is held. Upon hearing a brief testimony, the court admits the Will to probate and officially confirms the appointment of the executor. This is the only hearing required before the court.

After the executor is appointed, notice of the appointment is published in a local newspaper, and notice of the appointment is given to creditors. The executor is also required to give notice to all beneficiaries named in the Will. The executor is then required to file an inventory of the probate assets in the court records, but this is a rather informal filing which requires no hearing.

3. Filing the Will to Transfer Title Only.

If the decedent died owing no debts, and if no action by an executor is otherwise required to distribute property under the Will, the Will may be placed on file without the appointment of an executor. This process, described as filing the Will as a "muniment of title," is often utilized if no independent executor is appointed and no administration is required.

When the Will is filed as a muniment of title, a hearing must still be held to insure that the Will is valid. In addition, the court must be satisfied that all debts of the decedent have been paid. Under those circumstances, the Will is placed on file to evidence the persons entitled to receive the decedent's property, but no Letters Testamentary are issued. Instead, a certified copy of the court's order identifying the recipients of the estate serves as evidence to transfer title of the decedent's assets to the recipients per the Will. In most counties in Texas, the court requires the person filing the Will to prepare and file a probate inventory. In addition, the applicant must file, within 180 days after the hearing admitting the Will to

probate, an affidavit stating which assets have been transferred to the estate's beneficiaries, and which assets remain to be transferred.

The muniment-of-title procedure is somewhat unusual. It is not widely recognized in other states. Accordingly, if the Will appoints an independent executor, it may be simpler to obtain Letters Testamentary, even if no debts are owed. Stock transfer agents in New York, and title companies in other states, are generally familiar with transferring assets through the use of Letters Testamentary. They may be less familiar with the muniment-of-title procedure. Because independent administration is such a simple process, it is generally preferred over the muniment-of-title procedure, if available.

4. Dependent Probate Administration.

If none of the simplified procedures are applicable, you may be required to undergo formal "dependent" probate proceedings. This necessitates more extensive involvement by the probate court, which usually results in higher legal fees, and considerably more time to complete. The following is a brief summary of the kinds of steps you, with your attorney's assistance, will probably be required to take.

To initiate probate proceedings, you must petition the court to be appointed the decedent's "administrator." Again, a hearing is held to validate the decedent's Will or confirm that no Will has been left. Testimony must be given ensuring that you are qualified to serve as executor. After the hearing, you must file an Oath of Office, and post a bond (at the estate's expense) to ensure that probate assets are properly handled. After receiving Letters Testamentary, you will be required to submit a detailed inventory of assets, together with any necessary appraisals, within ninety days. The court may appoint one or more disinterested appraisers to evaluate the property of the estate, again, at the estate's expense.

As part of the process of initiating probate, you must notify any known creditors of the decedent's death, and such creditors have six months within which to submit their claims to you. You will be required to pay the legitimate claims, debts, and expenses of the estate, following the priority sequence established by the Texas Probate Code. No claims are payable, however, until expiration of the six-month period. Early payment may subject you to personal liability if the estate does not have sufficient assets to pay all claims.

During this six-month period, you may need to liquidate the estate's probate assets to pay such claims. Unless the Will expressly authorizes sales of assets, you will be required to obtain court approval before selling assets (such as real estate or securities) to raise cash. Court approval may also be required before taking many other types of actions. In each case, a hearing may be required so that the court can ensure that the sale is necessary and that a fair price is obtained.

After the statutory claims period expires, you are no longer required to wait for later-filed claims before debts are paid. Claims filed late must be paid, however, if funds remain after all claims filed on time are paid in full. When all properly filed claims and taxes are paid, you must compile and submit for court approval a complete accounting of all your activities. This final accounting also shows the current value and the proposed distribution of the remaining assets according to the Will. Another hearing may be held, to give beneficiaries and others an opportunity to contest your actions. If a single asset is to be distributed to more than one beneficiary, any beneficiary may bring an action to have the court require a sale of the asset, so that the sales proceeds can be divided. After these hearings, assuming the court approves the final disposition and you carry it out, you will prepare a closing statement verifying that you have fulfilled all your duties, discharged all debts, and paid all taxes. Copies of this statement must be sent to the court and

to all interested parties. Upon acceptance of this statement, the court officially discharges you from duties, and the estate is closed.

Remember that the procedure just described is required only if one of the more simplified procedures outlined above is not available. Most individuals who have Wills drawn by a Texas attorney will utilize the "independent administration" process, which eliminates nearly all court involvement. As you can see, a properly drawn Will can save the family substantial time and expense.

VI. Identifying and Evaluating the Assets.

One of the most time-consuming, but also one of the most important, duties you have as an executor is to find the decedent's assets, list them in an organized fashion, and assign them their proper values. This process involves systematically going through virtually everything that belonged to the decedent at the time of death, and creating an itemized inventory.

If estate tax or state death taxes apply, you will need an inventory for tax purposes. In addition, even if the Will provides for an independent administration, you will need to file an inventory of assets with the probate court. Finally, the estate's assets cannot be properly distributed according to the Will until their nature and value are known.

A. Locate the Assets.

The estate's attorney will be available to assist you in preparing the inventory. To ensure that all material assets are identified, you will probably be asked to locate and provide records including the following:

- Bank records.
- Canceled checks.
- Checkbooks.
- Income tax returns for the last three years.
- All prior gift tax returns.
- Insurance policies and appraisals.
- Medicare information.
- Salary records for any employees.
- Business records.
- Credit card statements.
- Securities and brokers' statements.
- Deeds, mortgages, etc.
- Information as to jewelry, art, and other valuables.

In the majority of cases, it is likely that you will be doing much of the inventory work yourself. This task may involve a thorough search of the decedent's records, files, and personal effects. If the Will named a corporate co-executor (such as a bank or trust company), the professionals from that entity will probably undertake most of this work.

1. Sources of Information.

If the decedent left an updated Letter of Instruction, your task will be simplified, although you should still check carefully to be sure nothing was overlooked. Otherwise, a good place to start is with the prior year's income tax return. The income listed on the return should tell you where to look to find most

income-producing assets. The return can also provide a wealth of other information about the decedent's financial affairs. Other substantiating records are often kept in the vicinity of the tax forms.

Another excellent source of information is the decedent's checkbook and file of canceled checks for the previous year. Look for payments made for investments, insurance, debts, mortgages, medical expenses, tax payments, vehicle registration fees, and safe deposit box rental fees. Identifying the source of deposits can also give you needed information.

It is a good idea to monitor the decedent's incoming mail for at least six months, and possibly a full year. Look for dividends, pensions, and payments of various types owed to the decedent; bank or brokerage statements; insurance premium notices; and charge account bills, etc. All of these items provide clues as to the decedent's assets and liabilities, and some of these are sent out only on a quarterly, semi-annual, or annual basis. You can have the decedent's address changed to your own address if you provide the local postmaster with identification and a copy of your Letters Testamentary.

2. Safe Deposit Box.

You will need to locate and inventory the contents of the decedent's safe deposit box(es), if any. You may find a small flat key with a number imprinted on it among the decedent's personal belongings, or you may also find a statement or a canceled check for the yearly rental fee from the depositary institution. If not, you may have to check all banks at which the decedent maintained an account.

Once you have determined the institution at which the box is located, you may contact it for further instructions as to how to obtain access to the box. If the key cannot be found, the bank may impose a charge since the lock may have to be replaced.

As indicated earlier, until Letters Testamentary are issued to you, ordinarily, the box will be opened only for the surviving joint tenant. Once you have received Letters Testamentary, you should have no difficulty obtaining access to the decedent's safe deposit box. In Texas, unlike some states, you are <u>not</u> required to have a representative of the state treasury department present to inventory the contents. If you are concerned that a question might arise as to what was in the box, either from the taxing authorities or the beneficiaries, it is a good idea to have someone with you (such as the estate's attorney) when you first open the box. In fact, any time you anticipate that cash, coins, jewelry, or other valuable property may be found, whether in a safe deposit box or secreted somewhere among the decedent's belongings, you would be well advised to have at least one witness to watch you open the receptacle and to sign a statement as to the amount that was found.

Safe deposit boxes are the usual receptacle for important papers such as deeds, insurance policies, stocks and bonds, and promissory notes. They may also contain actual assets such as jewelry, coin collections, and cash.

B. Distinguishing Between Probate and Non-Probate Assets.

As indicated earlier, an executor is typically responsible for administering only "probate" assets. Not all of the decedent's property will pass through probate. Some types of property pass automatically to someone, regardless of whether they are named in a Will, by contract or operation of law. Remember, however, that both probate and non-probate assets must be valued for purposes of computing the federal estate tax liability. The following types of property will pass to designated beneficiaries without going through probate:

- Property owned in joint tenancy with right of survivorship (if property is so owned, those words should appear on the title to the property or in the financial institution's forms establishing the account). The property will pass to the survivor.

- Funds on deposit in a financial institution in the decedent's name, marked "payable on death" or "P.O.D." to a named beneficiary. The account balance will be paid to whoever is named as a beneficiary.

- Life insurance proceeds (unless the proceeds are payable to the insured's estate or all named beneficiaries have died). The proceeds will be paid to whoever was named as a beneficiary.

- Property held by a trust established during the decedent's lifetime (including a "living" or "inter vivos" trust). Trust property is distributed according to the provisions of the trust agreement.

- IRA and other retirement plan benefits (unless the decedent's estate was named as the beneficiary or all named beneficiaries have died). The benefits will be paid to whoever is named as a beneficiary.

- U.S. savings bonds that are co-owned or payable to a beneficiary. The bonds can be redeemed by the co-owner or the beneficiary.

C. Preserve the Assets.

As you go through the decedent's papers and effects, your first concern must necessarily be to prevent the destruction or deterioration of any assets you discover. If there is a residence that will be unoccupied, you must make certain it is kept locked and take appropriate precautions to avoid burglary or vandalism. If there are motor vehicles, they should also be secured and kept in running condition. Valuables such as jewelry or securities that were not jointly owned but are part of the estate should be kept in a safe place, such as a safe deposit box rented in your name, as executor. If the decedent maintained an ongoing business, you will need to decide whether to make arrangements to continue the business (at least temporarily), to sell it, or to close it down.

During the period of administration you will be taking other precautions to preserve the assets. Some actions you may need to take include:

- Making sure that insurance policies on vehicles and real estate are kept up.
- Making sure mortgage payments are made.
- Making utility payments if required to keep property from deteriorating.
- Filing claims for Medicare, private medical insurance, or casualty insurance benefits.
- Returning to the issuer any charge cards that are not jointly owned, for possible refunds of annual fees.
- Cashing in unused airline tickets.
- Canceling club membership and magazine subscriptions if refunds are available.
- Canceling any margin accounts or standing orders to buy or sell stocks or commodities with brokerage houses.

D. Community Property Rules.

If the decedent was married at the time of death, Texas community property rules must be examined to characterize the property of the decedent and the surviving spouse. The Texas system of property ownership is derived from Spanish civil law. Essentially, the concept is one of marriage as a partnership. All "community property" assets are co-owned equally by the spouses. Conversely, an asset that is the "separate property" of one spouse is subject to that spouse's sole management, control and disposition. Under our state Constitution, virtually all property acquired during marriage is community property. Separate property consists of: (1) property acquired before marriage, (2) property acquired while living outside a community property jurisdiction, (3) property acquired after marriage by gift or inheritance, and (4) recoveries for personal injuries. In addition, spouses (or persons about to marry) may agree in writing that property owned or acquired by them is the separate property of one spouse.

In determining whether property is separate or community, Texas law looks to both the acquisition date and the source of funds used to acquire property. Property acquired before marriage, acquired by gift or inheritance, or acquired while living outside of a community property state is separate property, unless any community property has been commingled with it (which can happen if interest, dividends and other earnings are added by the financial institution to an account originally holding separate property). Under our "inception of title" doctrine, separate property does not become community by virtue of subsequent marriage or relocation to Texas. If community funds are used to make payments on a separate property debt (such as a mortgage), or to make improvements on separate property, the community does not acquire an interest in the property. However, the community may be entitled to reimbursement for any such payments. If separate property is sold, assets acquired with the sale proceeds generally remain separate property. For this purpose, it is essential that the source of funds can be specifically traced to a separate property origin.

In order to solve title problems when accounting information is unavailable, Texas law includes a presumption that all property owned by a husband and wife is community property. This presumption can be overcome by "tracing" the property acquisition to a separate property source. If separate and community assets have become so commingled that it is impossible to trace accurately, then the presumption operates to make assets community property. Accordingly, the separate property character of assets can be lost due to a lack of accurate accounting information.

The rules regarding capital appreciation and income deserve special mention. If a separate property asset increases in value, this enhancement remains separate property. For example, if one spouse owns real estate before marriage, the entire property remains separate even if there is a substantial increase in value after marriage. The community is entitled at most to reimbursement for mortgage payments or the cost of improvements made with community funds. Unlike the rules regarding capital appreciation, the income derived from separate property assets is generally community property (absent contrary agreement between the spouses). Accordingly, community property would include such items as cash dividends from separate property stock, rent from separate property land, and interest from separate property accounts.

Until recently, the Texas Constitution limited the ability of spouses to alter marital property characterization rules. However, a fairly recent amendment allows spouses to agree that assets are the separate property of one spouse, or that the income derived from separate property will remain separate. This agreement would take the form of a formal written document. Due to additional recent changes in the law, Texas spouses can now "create" community property out of one spouse's separate property by signing a special agreement to that effect. Both types of agreement should be prepared by a competent attorney and, in many cases, each spouse must have his or her own attorney.

Classification of property as community or separate is essential. The decedent's Will controls only his or her separate property and his or her one-half of the community property. The balance of the community property belongs to the surviving spouse (as does all of the surviving spouse's separate property). Nevertheless, under Texas law, the executor generally has the duty to collect, safeguard and administer both halves of the community property while the estate is being administered.

E. Value the Assets.

As you discover assets, you will have to compile an inventory and assign a value to each item. The method of valuation to be used is generally dictated by the Internal Revenue Code under rules applicable to the federal estate tax, whether or not estate tax is eventually determined to be due. This method is used because the value of the estate must be determined before you can be sure whether it is large enough to require the filing of an estate tax form. Generally speaking, for persons dying in 2009, if the estate amounts to $3,500,000 or more (before subtracting debts and expenses) an estate tax return must be filed even if no tax is actually owed. For this purpose, both probate and non-probate assets must be valued. It is therefore essential that you identify and evaluate non-probate assets, even if you are not required to administer them. The estate tax return is due nine months after the date of death. Under Texas law, a probate inventory is due within 90 days after Letters Testamentary are issued (unless the court grants additional time). Therefore, you should aim to complete your valuation within a few months after Letters are issued, and in no event more than six or seven months after the date of death.

Whether or not an estate tax return is required, the value placed upon the estate's assets serves another very important function. Under the Internal Revenue Code, when an inherited asset is sold, whether by the estate, or later by a beneficiary, any gain (or loss) on the sale of the asset is measured by comparing the sales price received to the value of the asset at the date of death. The purchase price paid by the decedent when the asset was originally acquired is irrelevant. Since date-of-death values thus establish the "cost basis" of assets, care must be exercised in ensuring that accurate values are obtained. This new cost basis applies to all of the decedent's separate property, and *both halves* of the community property. Thus, the surviving spouse also acquires a new cost basis in his or her community assets.

1. Time and Method of Valuation.

Under federal tax law, all of the property owned by the decedent anywhere in the world, even property in which he or she owned only a fractional share, must be counted. If a fractional interest is owned, only the portion owned by the decedent is included in valuing the estate. Thus, for example, if a piece of real property is community property, only one-half of its total value will be included in the estate. The value must be determined as of the date of death, although for estate tax purposes an alternative valuation date may be used if it proves to be more advantageous in reducing estate taxes. The alternative date is the date six months after the date of death, or the date of sale or distribution for property sold or distributed within six months. If the alternative date is elected, it must be used for every asset in the estate.

The value of property is its "fair market value." IRS regulations define fair market value as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."

2. Joint Tenancy Property.

As you make your inventory of assets, you may come upon some property held in joint tenancy with a surviving spouse, an adult child, or one or more other living persons. Most types of assets can be owned

jointly, although the most common are probably joint bank accounts and brokerage accounts. These assets are typically marked with language such as "Jt. Ten", "JTWROS", "payable on death to", "POD", or the like.

As noted earlier, such property is not included in the decedent's probate estate. It is not governed by the terms of the decedent's Will. It must, however, be listed on the estate tax return. As a general rule, the value of the entire property will be included in the taxable estate of the first joint tenant to die, unless it can be proven that the other joint tenant(s) contributed to the cost of acquiring the property. If this can be shown, then the percentage of the decedent's contribution to the total acquisition costs is the percentage of the property's fair market value at death included in the decedent's taxable estate.

Where the only other joint tenant is the decedent's spouse, a special rule applies. One-half of the property's value at death is considered part of the taxable estate of the first spouse to die, regardless of how much each spouse contributed to the acquisition costs.

Keep in mind that even where a safe deposit box was rented in joint tenancy, the property inside the box will not be considered to be joint tenancy property without additional evidence. For estate tax purposes, such property is considered the sole property of the first renter to die, unless you can prove otherwise.

3. Specific Types of Assets.

The following paragraphs present the general rule-of-thumb methods used in valuing different types of assets. The IRS regulations contain detailed instructions for virtually every type of asset, and these regulations, or the estate's attorney or qualified tax accountant, should be consulted whenever you run into an unusual or difficult situation.

Real Estate: Where the decedent owned real estate, such as a personal residence, commercial buildings, a summer or winter home, farmland, etc., a professional appraisal may be necessary, since under the law each parcel of real estate is unique. Under certain conditions, real property that consists of a family farm or a closely-held business can be valued for estate tax purposes on the basis of actual use, when such a value is less than the value of its "highest and best" (most lucrative) use. Your lawyer or tax accountant can advise you about whether this "special use valuation" is available.

Texas law requires that real property be appraised unless the requirement for an appraisal is waived by the court. Most courts in Texas routinely waive the requirement of a formal appraisal unless estate and inheritance taxes are due. If no estate tax is due, many people forego the cost of a professional appraisal, particularly for residential real property. Instead, they obtain a letter from a realtor familiar with property values in the neighborhood which sets forth the realtor's opinion of value. This letter serves as evidence of value.

The property's complete legal description and location should be listed, as well as the appraised value and the basis for the appraisal. Pay particular attention to any real estate that is located outside of Texas. You may be required to employ an attorney in that state and undergo ancillary (supplementary) probate proceedings there as well as in the home state.

Stocks and Bonds: The value of publicly traded stocks, bonds, and mutual funds can be determined by reference to a newspaper such as *The Wall Street Journal* or *New York Times* published the day after the date of death. Many brokers, attorneys, and accountants have access to computerized data bases that can also provide this information. The Internal Revenue Service seems to prefer the use of these computerized

programs and having a print out of the report attached to the federal estate tax return. The value is based upon the average between the high and low selling price on the date of death. Where the decedent was enrolled in a dividend reinvestment program, you may have to contact the administrator of the program to find out the exact number of shares and fractional shares owned at the date of death. Interest and dividends accrued up to the date of death must also be included in the estate inventory. If the decedent owned a very large block of stock in a single company, or shares of privately traded or closely held stock, special rules apply, and an expert appraisal may be needed to determine the value.

The inventory description of each stock should show the number of shares, whether the stock is common or preferred, the issuer, the par value, and the price per share. If available, you should also note the exchange on which the stock is traded, and the "CUSIP" number of the shares. Bond descriptions should include quantity, denomination, name of the obligor, kind of bond, date of maturity, rate of interest payable, and interest due dates. The name, account number, number of shares, and price per share on the date of death should be listed for each mutual fund.

Business Interests and Partnerships: The valuation of closely held business interests is often an especially difficult proposition. If the decedent's personal efforts were a major factor in the successful operation of the business, a willing buyer may pay significantly less for the business after the decedent's death than could be obtained for it while the decedent was still alive. If the decedent owned less than a controlling interest in the business, a willing buyer is likely to pay much less than would be realized upon liquidation of the business due to this lack of control. The decedent's interest may be subject to an agreement imposing an obligation to sell the interest at a set or formula price.

The valuation of unincorporated business interests held by the deceased requires appraisal of all the assets of the business, including goodwill. The portion of the business owned by the decedent should be given a net value equal to the amount that a willing purchaser would pay to a willing seller in view of asset value and earning capacity. An accountant's or appraiser's examination of the business will usually be necessary. Where the decedent was a member of a partnership, the surviving partner(s) should be able to provide you with a statement of the decedent's ownership interest and capital worth. For estate tax purposes, you may need to obtain a statement of partnership or business assets and liabilities for the valuation date and for the five years immediately preceding the valuation date.

Cash and Bank Accounts: Cash in possession of the decedent as well as money deposited in savings, checking, and money market accounts or invested in certificates of deposit is accorded its face value at the time of death. Interest accrued up to the date of death is generally included in these amounts. Checks outstanding at the time of death (other than gifts) may be subtracted from the total if they are later honored and charged against the decedent's account. If the cash includes foreign bank accounts, the value should be stated in terms of the official rate of exchange on the date of death. List the name and address of each savings institution, the account numbers, the name in which the account is held, and the dollar amount for each account.

Loans, Notes and Mortgages: Amounts owed to the decedent in the form of loans, promissory notes, and mortgages held by the decedent (as well as contracts to sell land) are generally valued at the amount of unpaid principal, together with the accrued interest, unless you can establish a lower value or prove them to be worthless. If a note is forgiven in a decedent's Will, it is nevertheless included in the gross estate. The following information should be listed: face value and unpaid balance, date of mortgage or

note, date of maturity, name of maker, description of any property securing the loan, interest dates, and rate of interest.

Life Insurance: As the executor, you should be aware of every life insurance policy on the decedent's life, whether or not it is subject to estate tax or is part of the probate estate. If an estate tax return is filed, every policy must be listed regardless of whether it is subject to tax. If you suspect the decedent had life insurance but cannot find any information about the policy, go to the American Council of Life Insurance website, www.acli.com, for hints regarding life insurance policy searches.

Your description of the insurance must include the name of the insurance company, the name of the beneficiary, the face amount of the policy, the policy number, the amount of any outstanding loans against the policy, the interest on any loans, and the amount of any accumulated dividends on the policy. Accident insurance is treated as life insurance for estate tax purposes.

The value of life insurance is the net proceeds received, if paid in a lump sum. If the proceeds are not paid in a lump sum (if, for example, they are payable to the beneficiary as an annuity), the value is the value of the future proceeds as of the date of death. To obtain this value, you will need to contact the life insurance company. For each policy, a company representative must complete an IRS Form 712 and return the form to you. Although some companies provide these forms as a matter of course, many companies send them only if you specifically request them.

Generally speaking, the proceeds of life insurance policies are taxable for estate tax purposes if (1) the proceeds are payable to the estate, or (2) the proceeds are payable to a named beneficiary but the insured held one or more of the "incidents of ownership" in the policy. "Incidents of ownership" include the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to borrow against the surrender value of the policy. Even where the decedent transferred all the incidents of ownership to another person, if he or she did so within three years of death, the policy proceeds are still included in the decedent's estate. Accordingly, most life insurance proceeds will be part of the taxable estate, despite the fact that they are usually not part of the probate estate.

Insurance that a decedent may have taken out on the life of another individual is taxable for estate tax purposes to the extent of the replacement value of the policy. This value can be obtained from the insurance company by requesting an IRS Form 712, Part II, which is used to value an insurance policy on the life of a living insured.

Tangible Personal Property: One type of asset included in virtually every estate, no matter how small, is tangible personal property. This category includes everything from simple furniture, clothing, and memorabilia, to major appliances, motor vehicles, and farm machinery, to art collections, expensive jewelry, and antiques. The value of personal property is the price that a willing buyer would pay to a willing seller. Accordingly, if an item or group of items is not marketable, such as well-worn clothing, there is no need to list it in your inventory.

You will need to visit the location(s) of the property. The IRS regulations provide that you should make a room-by-room survey, looking for the kinds of items that could be sold for more than a minimal, "rummage sale" price. All items that could realistically be sold should be listed, although items of a similar nature with individual values of less than $100 can be grouped. For example, dining room furniture could

ordinarily be listed as a single item. If no estate tax return is required, a less detailed inventory of personal property is usually prepared. If the estate is very small and you find virtually nothing that could be sold, it may be a good idea to make an inventory entry such as "Personal effects–$200" or some other nominal amount. This practice will show any interested parties that you did not forget to consider this category.

Whenever you encounter articles with artistic or "intrinsic" value such as jewelry, furs, silverware, works of art, or stamp collections, it may be a good idea to have an expert appraise the item(s). The IRS requires a professional appraisal if any one article is valued at more than $3,000, or any collection of articles is valued at more than $10,000.

Annuities: Information about annuities is required because they are generally taxable for estate tax purposes, although they are not usually part of the probate estate. The amount includable is all or a portion of the lump-sum, annuity, or other payment received by a survivor by reason of the death of the decedent, depending on whether and how much the decedent contributed to the plan. The term "annuity" covers a very broad range of contracts or agreements, and includes private annuities purchased by the decedent, as well as many types of employer-provided deferred compensation plans. Complex rules apply to the valuation of annuities, and you will probably need to contact the organization making the payments as well as an experienced tax professional if the decedent owned this type of asset.

Gifts, Transfers and Powers of Appointment: You must also attempt to reconstruct all taxable gifts, transfers of property for less than fair market value, and powers of appointment held by the decedent during his lifetime. This can be a very complicated matter requiring more than a little detective work. If the decedent filed any federal gift tax returns during his or her lifetime, you must attempt to obtain a copy of each form. If you cannot locate copies of these returns, you should do your best to elicit information from the decedent's family and friends.

Every individual is permitted to make a tax-free gift of up to $13,000 per year (2009 amount) to each of an unlimited number of people. If the individual's spouse consents to the gift, or if a couple makes a gift of community property, the annual amount is $26,000 per recipient from that couple. There are additional exclusions for gifts to pay medical expenses or tuition, but generally speaking, gifts to any one recipient over the $13,000 annual exclusion are subject to federal gift tax unless made to one's spouse.

The gift tax applies to indirect transfers as well as outright gifts. Thus, if the decedent paid rent or expenses for someone he or she was not legally obligated to support, a gift will be deemed to occur. Gifts of cars, jewelry and other tangible property must also be considered, based upon the fair market value of the gifted property. If a gift is made to a trust, the gift is treated as though it had been made to the trust's beneficiaries. Some gifts to trusts do not qualify for the $13,000 per year exclusion, however; in those cases, each dollar given to the trust is a taxable gift. Your attorney or other tax professional can assist you in evaluating such gifts.

Transfers between spouses are tax-free, as are transfers of property incident to divorce, but transfers prior to marriage under prenuptial agreements may well be taxable. In addition, if the decedent's spouse is not a U.S. citizen, transfers by gift are tax-free only to the extent of $133,000 per year (2009 amount), with this figure being indexed annually for inflation.

In effect, the law operates to add all "taxable gifts" (that is, gifts in excess of the annual exclusion) made after 1976 to the value of the estate before computing estate taxes. Gifts are normally valued at their

fair market value at the time the gift was completed, unless the donor retained the income from or control over the gifted property.

A "general power of appointment" may be described as the ability to use up, invade, or take over property of another person or entity for the benefit of the power holder, his or her estate, his or her creditors, or the creditors of the estate. In most cases, a general power of appointment arises because a trust was created of which the decedent was a beneficiary or trustee. If the decedent held any such powers at his or her death (for example, in connection with a trust created by someone else), the value of the property subject to the power may be included in the decedent's estate, whether or not the power was ever used. Powers of appointment are governed by a multitude of technical rules. If you believe the decedent may have possessed such a power, or if the decedent was the trustee or beneficiary of a trust, you will almost certainly require professional advice in this regard.

Miscellaneous Assets: Decedents' estates may contain other types of assets such as rights to receive royalties on patents or trademarks, judgments in lawsuits, and reversionary or remainder interests. Professional assistance in identifying and appraising these kinds of assets will probably be necessary.

Unclaimed Property: There are at least two websites every Texas Executor ought to check to see whether the decedent has any unclaimed property: www.unclaimed.org and www.window.state.tx.us/up. If any unclaimed property shows up for the decedent, the Executor should file a claim to recover it.

VII. Paying Claims, Expenses and Taxes.

While you are in the process of identifying the estate's assets and creating a detailed inventory, you should also be creating a list of the estate's liabilities. Your list may include bills such as insurance and mortgage payments, charge account payments, utility bills, payments on other outstanding loans, and bills for medical expenses, as well as expenses incurred after death for funeral expenses, attorney fees, court costs, appraiser's fees, and your own executor's fee, if any. In addition, you will eventually need to compute and pay any federal or state individual income taxes, and any death or income taxes applicable to the decedent's estate.

A. Establish an Estate Checking Account.

After Letters Testamentary are issued, but before you pay any of the decedent's bills, you should establish an estate checking account. Choose a bank or savings and loan association that is convenient to you, but be sure that it is federally insured.

You will probably want to choose the type of account that requires a low minimum balance and charges low fees, rather than the type that pays the highest interest, because this account is only a temporary "parking place" for funds during the period of administration. If it later turns out that there is much more money in the checking account than is needed to pay the estate liabilities, you will probably want to transfer some of the money to a safe, interest-bearing account such as a savings account, a money market fund, or a mutual fund that invests solely in government securities.

The account should be opened under a name such as "Estate of Mary Catherine Blake, Deceased; John Quincy Doe, Executor." The savings institution will tell you the exact format of names that it requires. To avoid delay, you can, if you so desire, open the account using your personal funds, which you can later recover from the estate.

Once the account is opened, you can deposit all checks payable solely to the decedent, endorsing them in your name as executor for the estate of the decedent. Whenever you liquidate any of the estate assets, you will deposit the proceeds to this account. Whenever you pay an estate debt, you should use a check from this account rather than your personal check.

You will be required to keep careful records regarding the source of every item that goes into the account, as well as every check you write. The size and complexity of the estate will determine the extent of the records you need to keep.

B. Decide Which Bills to Pay and When.

Ideally, you would pay the decedent's bills, debts and expenses as soon as it was apparent they were legitimate, thus avoiding any late payment charges. However, from a practical standpoint, you may want to postpone payment until you are sure that the estate will have sufficient probate assets to cover all expenses. Furthermore, some debts might be covered by insurance. You will want to investigate whether the decedent had credit life insurance that will cancel the unpaid balance on credit cards or credit union loans, whether mortgage life insurance will cancel the unpaid balance on a mortgage, and whether health insurance will cover medical expenses. Although not required to do so, many credit card companies and department stores stop charging interest from the date of death, as long as no additional charges are made to the account, and the full balance outstanding at the time of death is paid within a reasonable time.

Although you might feel a moral obligation to pay the debts of a deceased relative or friend, you are not legally required to take on another person's debts no matter how close your relationship. If the estate's assets are insufficient, some creditors will not be entitled to be paid in full. Furthermore, if the estate is small, state law might not require you to deplete it by paying all creditors even if the estate is not insolvent. Where a spouse and/or dependent children survive, under some circumstances, Texas law provides for a "family allowance" of a specific amount that is exempt from creditors' claims.

Nevertheless, you will want to make timely payments for items needed to preserve the probate assets, such as continued insurance coverage and possibly mortgage and utility payments. Thus, many factors must be considered before making any payments, and you may need to consult an attorney to help you decide which creditors to pay and when to pay them.

If you are undergoing "dependent" probate proceedings, you will generally be permitted to pay only those claims that are properly submitted according to the procedure the court requires. Claims that arrive after the legal claim period may not be paid until all claims filed on time are paid in full.

Keep in mind that only probate assets are used to pay the estate's expenses and claims. Conversely, when you receive bills pertaining to assets that were held in joint tenancy, or claims against the community property and the surviving spouse, you will have to allocate the expenses between those owed by the decedent, for which the decedent's estate is responsible, and those owed by the surviving spouse or the surviving joint tenant(s).

State laws provide for a priority sequence that is used when an estate's assets are insufficient to pay all claims. Liabilities are divided into classes, and all claims in the first class must be paid before any in the second, all those in the second class must be paid before any in the third, and so on. The Texas class system is as follows: (1) funeral expenses and expense of last illness up to $15,000; (2) family allowance, if any; (3) costs of administering the estate; (4) claims secured by a mortgage or lien (including tax liens);

(5) claims for certain taxes owed to the State of Texas; (6) all other claims filed within six months after Letters Testamentary are issued; and (7) all claimed filed more than six months after Letters Testamentary are issued. If the assets are insufficient to pay all claims in a particular class, each creditor in the class will receive a uniform percentage of his or her claim.

Federal law also sets forth certain rules for paying amounts (including taxes) owed to the federal government. If any executor knows or should know that amounts are due to the IRS or other agency of the federal government, and pays or distributes assets to anyone else instead, the executor may be held personally liable for any amount that is not paid to the federal government. Under the U.S. Constitution, in case of a conflict between federal and state law, federal law controls.

Mortgages and other long-term obligations need not be paid in full during administration of the estate. In most cases, so long as regular installments are made, the creditor will accept payment in due course. Frequently, assets encumbered by mortgages or liens are distributed to the estate's beneficiaries "subject to" the indebtedness. The recipient then continues paying the installments as they come due. Under Texas law, if a Will makes a specific bequest of an asset that is encumbered by a debt, the beneficiary is entitled to receive the asset free and clear of the debt unless the Will otherwise so provides. Under these circumstances, the debt may need to be paid by the estate or assumed by other beneficiaries.

C. Liquidate Assets as Needed.

If the estate does not have enough cash, where do you get the funds with which to pay the estate's claims, expenses, and taxes? You may have to liquidate the probate assets as needed, and deposit the proceeds into the estate checking account. Usually, your primary source of funds would be those that are already in the form of cash: savings and checking accounts, and insurance proceeds that are paid to the estate rather than a named beneficiary. If these assets are insufficient to pay all claims, you will have to sell other assets such as securities, real estate, promissory notes, vehicles, and other personal property.

The decision as to which assets to sell and which to distribute to the beneficiaries "as is" will rest on many factors, including tax considerations and beneficiaries' preferences. You may well need the advice of an attorney in making this decision if the estate has insufficient liquid assets. Where dependent probate administration is being undertaken, approval of the probate court may be required before certain assets can be sold.

Your primary source in deciding which assets to sell is the decedent's Will. If the Will does not provide otherwise, state laws provide an order of priority in reducing gifts (bequests) made in the Will, when necessary to pay claims. The gifts out of the residue of the estate are usually the first to be cut. If there is still a deficiency, the general money bequests (bequests of a specific amount but not from any particular source) are reduced, followed by the money bequests payable out of specific sources (i.e., from the sale of named assets). Property that has been specifically bequeathed to a beneficiary may be sold only as a last resort.

Even when it is not necessary to sell assets to pay claims, in some instances it may be more convenient to sell them in order to carry out the distribution made in the Will. For example, an unmarried decedent may have left her home to her six nieces and nephews, and the most practical way to effect this bequest may be to sell the property and distribute the proceeds. As another example, a decedent may have left shares of a number of different stocks to be divided among his four children, and distributing the shares themselves might mean that some heirs would get stocks that are appreciating in value more rapidly than

others. Where the Will does not contain specific instructions, the executor usually has a very broad range of discretion in deciding how to handle these situations.

Make sure that you keep careful records of any sales you make. It may well happen that some items will have to be sold for less than their inventory value, and the estate's beneficiaries may expect you to explain why.

D. Compute, File and Pay Taxes.

As the executor, you are responsible for filing the final federal income tax returns the decedent would have been required to file if he or she had lived. You are also required to file any necessary federal or state tax returns applicable to the estate itself.

After death, there are three potential taxpayers: the estate, which may have to pay federal income tax, estate tax, and generation-skipping tax; the decedent, who is subject to income tax for the portion of the year before he or she died; and the beneficiaries, who may have to pay income tax when income from the estate assets is distributed to them.

Careful consideration must be given to the rules and the different tax rates that apply to each taxpayer and each type of tax, so that proper elections to minimize taxes may be made. For example, some deductions can be reported on one of several different tax forms, depending on what is more advantageous under the circumstances. The tax preparer may need to make several calculations using different alternatives before deciding which form should get the deduction.

Clearly, the job of filing tax forms is a complicated one. These returns are not the sort that most accountants or professional tax preparers undertake on a routine basis. Therefore, you may well need the assistance of an accountant or an attorney familiar with probate and estate tax matters, particularly where a federal estate tax return is required. Some of the major requirements and considerations are described below, but space does not permit a full treatment of tax issues in this booklet.

1. Final Income Tax Return.

You must file a final federal individual income tax return (Form 1040) for the decedent, unless he or she did not earn enough income in the final calendar year to be required to file. The due date is April 15th of the year after the year of death, although extensions may be available.

On the final income tax return, you report only income that the decedent actually received (for cash-basis taxpayers) or accrued (for accrual-basis taxpayers) up to the date of death. Any income received or accrued after that date is ordinarily reportable on the estate's income tax return (discussed below). If the decedent receives any year-end 1099 forms from banks, savings and loans, or other financial institutions reporting interest or dividends earned for the entire calendar year (i.e., both before and after death), the institutions should be notified of the death so they can correct their records, and special care should be taken to correctly allocate the amounts between the final individual income tax return and the estate's income tax return.

If the decedent was married at the time of death, and the surviving spouse does not remarry before the end of the year, the decedent's final return can be in the form of a joint return with the surviving spouse. The income reported is that of the decedent for the portion of the year he or she was alive, and that of the spouse for the entire calendar year. A full personal exemption can be claimed for the decedent even if his

or her income was less than the minimum filing amount. Filing a joint return usually results in significantly lower overall taxes, but this election must be agreed to by both the surviving spouse and the executor. Otherwise, both the survivor and the decedent will have to file as "married filing separately."

2. Estate Income Tax Returns.

The estate of a decedent is a taxable entity separate from the decedent. It comes into being upon the decedent's death, and generally continues to exist until the final distribution of the estate's assets to the heirs and other beneficiaries. The income earned by estate assets during the period of administration is subject to income tax.

Filing Requirements: Like other taxpayers, the estate is required to report its income annually. If the estate has gross income of $600 or more in a taxable year, the executor must file a federal Fiduciary Income Tax Return (Form 1041) for that year. The executor may choose to report estate income on a calendar or a fiscal year basis. The tax year selected begins on the date of death. The executor can select a fiscal year ending on the last day of any month, so long as the fiscal year-end selected is not more than 12 months after the date of death. Thus, the executor might, for example, spread the estate income over several tax periods and reduce taxes by choosing a fiscal year end that results in a very short first tax year, a 12-month second tax year, and possibly a third tax year that is also short. If the estate is not closed within two years of the death, the executor will have to make quarterly estimated tax payments for the estate.

Taxable Income and Deductions: In determining what income is taxable to the estate and what is taxable to the beneficiaries, the general rule is that income that is retained by the estate during the tax year is taxed to the estate, but if assets are distributed to the beneficiaries of an estate, they will be treated as carrying out the estate's income, causing that income to be taxed to the beneficiary. Thus, where the estate would pay a higher marginal tax rate than a beneficiary, it may be advantageous to distribute the income to the beneficiary as soon as possible. The beneficiary will then be required to report the income in his or her individual income tax return. The beneficiary is taxed as though he or she received the estate's income on the last day of the estate's fiscal year end, regardless of when the income was actually distributed.

When estate assets must be sold to pay taxes or claims or to effect a distribution, any gain or loss on the property must be reported on the estate income tax form. As mentioned earlier, the basis or starting point for computing gain or loss is the asset's value at the time of death, not the price the decedent originally paid for the asset.

Estate income is not the only item that can "pass through" to the beneficiaries. If, in the final year of its existence, the estate has deductible expenses that exceed its income, the "excess deductions" may be claimed by the beneficiaries on their individual income tax returns. Expenses of administration, such as the executor's commission, attorney fees, and appraisal expenses, generally will be the most significant type of excess deductions. Because of the availability of these deductions to beneficiaries, an estate with income of less than $600 may file an estate income tax form to permit beneficiaries to claim these expenses, even though the tax return would not otherwise be required by law.

3. Federal Estate Tax Return.

As mentioned earlier, a federal estate tax return (Form 706) must be filed if the decedent's total estate (before deductions) exceeds the filing threshold (unless Congress enacts further legislation, $3,5000,000 in 2009, not subject to tax in 2010, and back to $1,000,000 in 2011 and thereafter), even if it is ultimately determined that no estate tax is due. The return is due within nine months of the date of death, although

extensions for up to six additional months might be available. At 36 pages (plus attachments), this form is extremely lengthy and complex, and traditionally the IRS has manually examined each and every Form 706 filed. Therefore, it is almost inevitable that you will need the advice of an experienced tax professional if your listing of the assets of the estate shows that its value, including both probate and non-probate assets, exceeds $3,500,000, or even approaches that amount.

By completing the detailed inventory and valuation process described on pages 11-20, you already have much of the information needed to fill in the estate tax form. The next step is to determine and claim all available deductions and credits. Only then can the amount of any tax due be computed.

Deductions: Available deductions against the gross estate are: (1) administration and funeral expenses; (2) claims against the estate; (3) outstanding mortgages and debts; (4) casualty and theft losses; (5) the charitable deduction; and (6) the marital deduction.

Deductible funeral expenses ordinarily include all amounts actually expended, provided the amounts were billed within nine months of death and are payable from the estate under state law.

Administration expenses consist of attorneys' fees; the executor's fee; accountants' fees; and any other expenses incurred in the collection of assets, payment of debts, and distribution to beneficiaries, such as court costs, appraiser's fees, secretarial help, cost of maintaining, storing, or preserving estate property, and costs of selling property if necessary to pay debts, expenses, or taxes, or to carry out the Will.

Legally enforceable debts and mortgages that date from before death are deductible, even if they were not billed before the death (e.g., medical expenses for a final illness or charge card purchases made by the decedent shortly before death). Mortgages on specific property are deductible to the extent that the value of the property was included in the gross estate. For example, if the decedent's home was a community property asset, 50% of the value of the home will be included in the estate, and 50% of the outstanding balance of the mortgage on the home will be deductible.

Losses incurred during the administration of the estate resulting from theft, fire, storm, shipwreck, and war are deductible to the extent they are not compensated for by insurance. Remember that one of your duties as executor is to protect and safeguard the assets of the estate, including the maintenance of adequate insurance. One would hope that such losses would be limited to your reasonable insurance deductible.

An unlimited deduction is allowed for the amount of property transferred to any organization operated exclusively for charitable, religious, educational, scientific, or literary purposes, as well as to veterans organizations, or to the United States or any political subdivision for exclusively public purposes. Gifts to needy individuals or to organizations that participate or intervene in political campaigns are not deductible.

Finally, if the decedent was married at the time of death, an unlimited marital deduction applies to any property transferred to his or her surviving spouse. With certain exceptions, the deduction does not apply when the gift is made to a trust, to the spouse in the form of a "life estate" or in the form of any other interest that is classified as "terminable." The rationale for this rule is that the marital deduction property must eventually be includable in the surviving spouse's estate. If the decedent's spouse is not a U.S. citizen, no deduction is allowed unless a special trust is established to hold the inherited property. Marital deduction

rules can be technical, especially if property passes to a spouse in trust. As a result, you will want to consult with your tax advisor to make sure that this important deduction is properly claimed.

Credits: Once all available deductions are computed and subtracted from the gross estate, a tentative estate tax can be computed using the tax tables pertaining to Form 706. Then, a second set of subtractions is made, for any available tax credits that apply. The most important of these is the unified credit of $1,455,800 that is allowed to every decedent. This credit has the effect of exempting the first $3,500,000 in the estate from tax; as a result, decedents actually end up paying federal estate tax only on amounts in excess of $3,500,000.

A credit for tax on prior transfers is allowed when the decedent inherited property from someone else who died less than ten years earlier, if the property was taxed in the first decedent's estate. The credit is equal to 100% of the prior tax if the decedents died within two years of each other, 80% if the second decedent died within four years of the first, 60% if within six years, 40% if within eight years, and 20% if within ten years.

Other credits exist for foreign death taxes paid on property located in foreign countries and for prior federal gift taxes paid.

Additional Federal Taxes: After all credits have been taken, one special type of additional tax may have to be computed and added to the federal estate tax due. This is the 45% generation-skipping tax, which applies when the decedent has made transfers exceeding $3.5 million to grandchildren whose parents are still living.

4. State Death and Inheritance Taxes.

Until recently, all 50 states, the District of Columbia, and Puerto Rico imposed one of three types of inheritance or death tax (which is in addition to the federal estate tax). In the majority of states, the state death tax was based on the federal state death credit mentioned above. In other words, money that would otherwise be paid as federal estate tax was instead paid to the state, with some adjustments. A smaller group of states imposes inheritance taxes on the persons receiving the decedent's property, and an additional tax to absorb the federal death tax credit. A minority of states imposes estate taxes that are similar to the federal estate tax. Texas followed the first of these three approaches. As a result, for estates of decedents dying in years prior to and including 2004, no inheritance tax was due to the State of Texas unless federal estate taxes were due. In addition, any death tax paid to the State of Texas was subtracted from the estate tax otherwise payable to the IRS. However, recent changes in federal tax law, completely phasing out the credit for state death taxes, has eliminated the "sponge tax" that formerly applied in Texas and other states and has resulted in many states enacting new state inheritance tax laws. Texas has not yet changed its laws and probably will not do so anytime soon. Therefore, *Texas no longer imposes any death taxes at all*. Remember, however, that the estate of a Texas decedent may owe inheritance tax to other states if the decedent owned real estate or oil and gas interests in those other states.

VIII. Distributing the Remaining Assets.

A. Non-Probate Assets.

Although we have saved the discussion of distribution of assets for the end, in reality you may begin to distribute certain assets in the first few days after the decedent's death (be careful, however, that significant probate assets are not distributed before the "survivorship" period specified in the Will has ended). At the

time of death, non-probate assets (see page 14) pass to survivors by operation of law, independently of the Will or any action by the probate court. They are generally not subject to claims against the estate, so they may be immediately available for use by survivors.

Accordingly, when you come upon a non-probate asset, your main responsibility is to ascertain its value for estate tax purposes and then notify the joint owner or beneficiary of its existence. Although not strictly necessary, many executors also consider it a part of their duty to help the beneficiary transfer the asset into his or her own name. Retitling the property in the survivor's name must be done before the property can be sold, and usually involves presenting a certified copy of the death certificate to the custodian of the asset or the transfer agent.

For example, a joint bank account that provides for rights of survivorship may be retitled in the survivor's name by filing a new signature card. Stock brokers or transfer agents can help the surviving joint tenant transfer stocks and bonds owned as joint tenants with rights of survivorship. In each case, a copy of the death certificate may be needed to accomplish this transfer.

B. Life Insurance and Survivor's Benefits.

Life insurance policy proceeds are often an important source of cash for survivors. These proceeds are non-probate assets if the designated beneficiary is anyone other than the estate of the deceased. Recovering the proceeds generally involves filing a claim form, which is obtained from the insurance company, together with a certified copy of the death certificate. Sometimes the company will also require you to surrender the original insurance policy, or submit an affidavit stating that the original policy has been lost. It may be a good idea to make a copy of the completed claim form and supporting documents, and to submit the claim via registered or certified mail.

The surviving family may also need assistance in filing for the social security death benefit and survivors' benefits, veterans' burial benefits, or any employee, union, or workers' compensation benefits available.

C. Personal Effects and Motor Vehicles.

The furniture and personal effects in the residence are not necessarily joint property. In practice, however, they are often specifically bequeathed to the surviving spouse or surviving children under the Will. Once you have made your inventory for tax and probate purposes, and once it is apparent that the estate's expenses can be paid without selling these items, the personal effects can be divided among family members according to a letter of instruction left by the decedent, or according to the Will's instructions.

Occasionally, family members may get into disagreements about how best to divide personal effects. Unfortunately, hard feelings can develop among family members over the manner in which assets are allocated. The sentimental value of these items, more often than their monetary value, is of primary importance to the family. Absent specific instructions from the decedent, you, as the executor of the estate, must decide how best to divide these items. Often, if the family is unable to agree, the items can be apportioned by a drawing or other similar means.

D. Other Probate Assets.

Once all expenses, claims, debts and taxes are paid or provided for, you will be ready to distribute the probate assets that remain and settle the estate. Of course, the instructions in the Will govern this process. In addition, if the estate is being administered subject to court supervision, you must follow

whatever procedures are required by the probate court in your situation. For example, if a dependent administration is required, you may be required to file a final accounting or statement with the court showing how assets have been distributed. A court order closing an independent administration is optional, although the probate judges in a few rural counties apparently require an order closing the independent administration.

When the estate is large or complex, the process of planning distributions should begin very early in the administration period, with the aid of your attorney. Many considerations must be taken into account. Most important are the immediate needs and legitimate demands of the beneficiaries, along with directions and limitations imposed by the Will and local law. Within these boundaries, careful planning can do much to minimize taxes that would otherwise be paid by the estate and/or beneficiaries.

In certain cases, the distribution scheme provided in the Will may be altered. Texas law permits a surviving spouse to occupy the homestead, even if it is bequeathed to someone else. In some cases, the decedent's family may be entitled to a "family allowance" from the estate during administration. Some beneficiaries may decide to renounce or "disclaim" part or all of their share; in such a case, they can avoid adverse gift tax consequences if their disclaimer is made in writing no more than nine months after death, and is made before they accept the benefits of the disclaimed property. The disclaimed property passes as though the person disclaiming the property failed to survive the decedent.

During the period of administration, some of the noncash assets may have gone up in value, while others may have declined. Gifts measured by dollar values (e.g., "I give $100,000 worth of property to my son") are generally based upon the value of the property at the date it is distributed from the estate. Therefore, you may need to obtain final appraisals before you can determine how to divide and distribute the assets under the Will.

Generally speaking, once you have specifically determined which assets are to be distributed to each beneficiary, you will write a letter to each distributee explaining that the final settlement is being made and describing in detail the property being distributed to him or her. You can include with the letter a check for the amount of cash being distributed. You may also include a deed to any real property, stock certificates, copies of appraisals, etc. The letter should be delivered personally or sent by registered or certified mail, and you should obtain a signed, written receipt from the distributee. Except in a dependent administration, where a final accounting will be required by the court, the estate can then be considered closed. Remember that a final income tax return for the estate (Form 1041) will also need to be filed to complete the process.

IX. Summary.

As you can see, the role of executor is an important one, involving a wide variety of skills and requiring you to make decisions that can affect the lives of survivors for many years to come. Nevertheless, the job is manageable, if you follow the steps outlined above and consult with experienced professionals as needed. You should be able to proceed with confidence, knowing that when your tasks are completed and the estate is closed, you will have honored the memory of the decedent in a very tangible way.