

SETTLING AN ESTATE A PRIMER FOR PROBATE AND ESTATE ADMINISTRATION

Settling an Estate: Understanding Probate and Estate Administration

This paper provides a simple, concise overview of what is required to manage the affairs of a deceased person. Most important, the paper covers the potentially dangerous areas where an executor can become personally liable because of mistakes in judgment or failure to take actions that are timely or in the best interests of the estate and beneficiaries. Questions can arise in areas that involve very complicated technical issues and the assistance of professional advisers is suggested.

Introduction

The distribution of property of a person who dies is regulated by state laws and court interpretation of those laws. Probate is the process of proving that the will in question is valid, that it was in fact the decedent's will, his or her scheme of distribution of assets at death, and that the document was the decedent's last will. In a broader sense probate is the procedure by which the law assures that creditors (including tax authorities) will be paid and that beneficiaries will receive their intended shares of the decedent's property. It is an essential link in the transfer of property and the proof of title. Essentially, probate assets consist of property owned by a decedent in his or her own name at death. All other assets are non-probatable assets. Probate can be avoided by holding property jointly between spouses. On the death of the first spouse, the property goes directly to the surviving spouse outside of probate. Other techniques for avoiding probate and planning your estate will be discussed later. Probate begins shortly after a death, when the family or someone else familiar with the decedent's affairs locates the will or determines that no will exists.

Intestacy

Everyone has a will, either the one you write or the one the State of California writes for you. If you did not write a valid will, California, through its intestacy laws, decides:

1. Who receives your assets;
2. When they receive your assets;
3. What they receive; and
4. How they receive your assets.

Intestacy is a one-size-fits-all law administered by the probate court. In an intestacy, California provides that the largest share of the estate will go to the surviving spouse and the remaining share is divided equally among the children regardless of their individual needs or financial or emotional ability to invest or manage the assets.

A will is a key vehicle for transferring property at death, and it often is the first step taken by people in planning the distribution of their estates. Everyone needs to have a properly executed will that is stored in a safe place, preferably a safe-deposit box. The will is used to designate heirs, identify the property they are to receive, indicate the person or persons (and/or institution) who will act as the personal representative of the estate, and clarify related details. The personal representative acts for the estate to assemble, safeguard and distribute the decedent's property. If you own a business, your will should mention something about the operation of the business because, in most states, the executor cannot safely operate the business without specific authorization.

Personal Representative

What Is An Executor?

When a person dies owning property of more than minimal value, someone will almost always be required to administer the estate, that is, assemble assets, pay debts and taxes, and distribute the remaining assets according to the terms of the decedent's will. That person (it could be just one or several parties and/or an institution), who acts for the decedent, is called the estate's personal representative. A person can name one or more persons (and/or an institution) to act on the decedent's behalf in the will; that person or institution is called an executor (male) or executrix (female). But if there is no valid will in existence at the decedent's death, the appropriate court will appoint an administrator or administratrix to take jurisdiction over the estate.

As mentioned above, the executor or administrator has three basic functions- all of which are subject to court oversight designed to protect the interests of the beneficiaries. The following discussion applies to you if you have been appointed to be the executor or administrator of a will. These functions are to:

1. Assemble and safeguard the property.
2. Pay debts, taxes, and expenses out of the available funds (or liquidate assets, if necessary, to create sufficient funds).
3. Distribute any remaining assets to the beneficiaries according to the terms of the will or if there was no valid will according to the intestacy laws of the state.

As a personal representative, you must account for all probate assets in an inventory filed with the court. Usually, this requires an appraisal of the estate assets. Then you must pay all the estate's debts and collect all sums due to the estate, pay all state death taxes, and federal estate taxes (typically within nine months of the decedent's death).

How Are The Executor's Fees Set?

Although an executor may decline to take a fee or the will itself may require the executor to serve without a fee, absent such circumstances, executor is entitled to reasonable fees for the work done on behalf of the estate. The size of the fee is monitored and sometimes limited by a court or by a statutory schedule of fees. Although fees of professional executors (such as trust companies) are generally fixed, there is often negotiation in the case of very large estates. The fee ultimately charged should be based on the following:

1. Size of the estate
2. Nature of the work required
3. Time needed to perform the services
4. Complexity of the estate
5. Personal representative's professional background and competence

6. Results and benefits to the heirs

Judicial oversight is one of the advantages of the probate process. Since fees are paid out of the estate's assets, the executor will be required by the court to provide detailed records of the time spent, services performed, and expenses incurred. Because executors' or administrators' fee are subject to income tax, waiving them often makes sense if the executor is also the sole or primary beneficiary of the estate.

Selecting An Executor

The selection of an executor can be a difficult problem that is often fraught with emotion. It is necessary to determine whether the person under consideration possesses the following:

- * Trustworthiness
- * Financial acumen
- * Objectivity (and lack of conflict of interest)
- * Knowledge of the beneficiaries' needs and circumstances
- * An understanding of your intentions and goals
- * Knowledge of the subject matter of the estate
- * Experience (business and investment)
- * Ability and willingness to serve
- * Physical proximity to the estate's heirs
- * Competence
- * An orderly mind

Always consider naming one or more backups in case the primary nominee named cannot or will not serve. No one has to serve as an executor and, in many cases, the person named should not accept.

Who Should Not Serve as an Executor?

You should consider declining to serve as an executor if:

1. One or more family members is belligerent and is likely to refuse to cooperate with you or with other beneficiaries.
2. You are not willing to monitor the progress of the estate's attorney, CPA, appraiser(s), and other members of the probate team.
3. Are not willing to maintain constant communication with both the beneficiaries and other advisers.
4. Hate to keep detailed records.

As a practical matter, in many cases, the selection of an executor should be relatively easy. Select a

person who has the most to lose from a sloppy job and the most to gain from an efficient estate settlement. Usually, that person should be the sole or major beneficiary of the estate. Try to avoid naming someone who doesn't get along with one or more of your beneficiaries, who may have a conflict of interest, or who may be placed in an uncomfortable position by accepting this sometimes burdensome responsibility.

You can, of course, name more than one executor; sometimes the executor is a close family friend who is selected so that there will be no conflict of interest or jealousy among family members. In such a case a bank may be named as coexecutor. If minors are involved and there are no relatives or close friends, a bank may be the appropriate choice as sole executor or coexecutor.

What Is The First Thing The Executor Must Do?

Assume a property owner has died and immediate matters such as the funeral, burial, and anatomical gifts, if any, have been resolved. (The arrangements for these are usually the responsibility of the immediate family, although the executor will receive the bills and pay the costs from the estate's assets.) The first task is to search for the decedent's last will and any codicils (addenda to a will).

Generally, the will should be in the possession of the decedent-not the attorney who drew it. Why? The named executor should be free to use an attorney other than the one who drew the will and should feel neither psychologically bound to that attorney nor tied to that attorney's fee structure. Typically, the attorney who drew the will is the appropriate choice, but the executor that you select should have control over that choice.

Once the Will is Found, What is the Executor's Next Job?

The next step is to choose the estate's attorney and other professional advisers and work with them to analyze the will and attempt to capture the decedent's thinking. It is at this point that the probate process begins.

How Does an Executor Locate Professionals to help?

The executor can easily locate professionals who will provide assistance by contacting the local estate planning council. Estate planning councils are listed in the telephone book and are usually willing to provide a directory of their membership free of charge. The professionals who belong to the councils are invariably professionals such as CPAs (who may also be Personal Financial Specialists), attorneys, trust officers, and CLU's & ChFC's (Chartered Life Underwriters and Chartered Financial Consultants).

What If There Is A Closely Held Business?

When an estate contains a closely held business, the executor must ask-and find the answers to-many difficult questions. Among them are the following:

- A. Is management able to continue a sound business operation?
- B. Can the business produce enough income to provide the survivors with a level of dividends sufficient to meet their needs?
- C. Is it possible for the business to profitably employ family members?

- D. Is there sufficient cash outside the business to pay death taxes and other costs?
- E. Will family members cooperate and work effectively under the executor's control?

As a general rule, an executor must liquidate a business as quickly as reasonable or continue to run the business at the executor's own risk. That is, the family keeps any profits if the business prospers but can sue the executor if the business fails. However, the executor can be specifically allowed or directed to continue the business by (a) the decedent's will, (b) the probate court, (c) state law, or (d) the consent of all the beneficiaries and other interested parties (such as creditors).

If the executor decides to continue a business-even under the protection described above- dangers abound. An executor must personally run the business, an onerous task that cannot be delegated. Funds to run the business must come from the business. If the business is used, operated, or its funds distributed improperly, the other shareholders, partners, or beneficiaries may sue.

If an estate contains a family business and there is no up-to-date, fully funded buy-sell agreement, there is a multiplicity of problems to face. To begin with, the business has probably just lost its key management person. And most closely held businesses are the biggest part of the decedent's estate, so there is a dangerous lack of investment diversification.

The executor must beware of letting emotional ties to the business-as well as personal associations that may transcend the usual company-employee relationships-subvert rational thinking. Another danger rests in the business itself, a classic non-liquid, non-marketable asset. Forced sales at pennies on the dollar often result from the need to quickly raise large amounts of cash to pay debts ,death taxes, and administration expenses.

Six Steps To Avoid Liability

Being an executor is like walking in quicksand on a dark, moonless night. Executor has to be totally loyal to the estate's beneficiaries and their interests, avoid conflicts-of-interest even at his or her own expense, and exercise care and prudence in managing the estate's property. Among the obligations of the executor are the duty to:

1. Protect and preserve capital.
2. Make property productive. This means to retain non-income-producing property only if such action is specifically authorized by the will or by the court or by express permission from the beneficiaries.
3. Consider the risks of both inflation and speculation. Assets cannot be allowed to sit, on the other hand, they cannot be risked on a high flyer.
4. Maintain records and account to the beneficiaries. The capital and income that came into the estate, what was paid out, to whom, and for what purpose, must be specified often in a court accounting.
5. Make decisions. Some of them will be difficult, such as: Should Pop's business be sold? Should the family home be sold? Others can be hired to perform ministerial tasks, but the executor alone is responsible for making the decisions. Actions must be decisive,

organized, and timely.

6. Hire and Fire advisers. No matter what the attorney or accountant advises or even if the attorney or accountant is late in filing a federal or state death tax return, the beneficiaries (and perhaps the courts) may hold the executor responsible for the selection of advisers who do not act competently or timely.

Surcharge

The executor usually signs documents, collects fees, and keeps an eye out that all is being done correctly and promptly. In performing these and dozens of other difficult and time-consuming duties, the executor must act as a reasonable and prudent individual. If he or she does not act reasonably and in the best interest of the beneficiaries, the court may surcharge the executor, which amounts to imposing personal financial liability for mistakes.

Selling An Asset Without Authority

If the executor sells an asset without authority by will or by court or by all of the beneficiaries, he or she may be held liable. If the estate suffers unnecessary expenses because of an undue delay, the executor may be personally surcharged. If there is any conflict of interest and the executor benefits, he or she will be called upon to make up the beneficiary's loss.

What is Probate?

It was noted above, that probate in its most narrow sense is the legal process of proving that the will in question (a) is valid, (b) is the will of the decedent, and (c) is the decedent's last will. In addition, probate is the appropriate forum through which to assure creditors that debts will be paid and assure beneficiaries that the terms of the will be carried out.

Mechanically, the steps in probate are the following:

1. The executor or personal representative named in a will goes to the local county office responsible for the probate of wills and presents evidence of the testator's death (usually by bringing the death certificate).
2. The executor then presents the will (an executed original) to the official for probate. When accepted, the executor is then appointed.
3. Typically, the witnesses to the will execute affidavits stating that the document presented is, in fact, the decedent's last will and that it was signed in their presence.
4. The executor signs a statement, either prepared at the probate court or, beforehand, by the executor and the estate's attorney petitioning the court to officially name the executor to act on behalf of the estate.
5. In cases when the will does not provide for the waiving of a bond or the executor is from out of state, a bond must be obtained by the executor to protect the heirs.

In some cases, the entire process takes less than fifteen minutes. If the official is satisfied that the state law requirements have been met, an official statement of your authority to act as the executor on behalf

of the estate, usually in the form of short certificates or letters testamentary stating the date of your appointment by the court, is issued.

If anyone believes the will is invalid or that there was a later will, probate is the place to raise the challenge. Likewise, if a surviving spouse wants to elect against the will, probate is the proper arena. This election allows a surviving spouse to claim and obtain a statutorily determined share of an estate (typically about one-third rather than the share provided in the will) even if the will is perfectly valid.

Contesting a Will

Probate is also the arena in which to contest a will no matter how few assets pass under it or how small the value of those assets. Although a will may not be set aside merely because an individual is unhappy with its provisions, it can be contested by that person. But to be successful (and few will contests are), in most states the potential heir (the person who would benefit if the will were invalidated) must prove that the:

- ↯ Decedent lacked testamentary capacity (legal ability to make a will) or
- ↯ Decedent was the victim of fraud; for example, the document signed was thought to be a paving contract, or the decedent was deceived into thinking the desired beneficiary was already dead, but he or she was still living or
- ↯ Decedent made the will under undue influence (persuasion strong enough to overcome any freedom of choice) or
- ↯ Signature on the will is not that of the decedent or was not made at the direction of the decedent or
- ↯ The document does not meet state law requirements for a valid will (e.g. it was not properly signed or witnessed)

Avoiding Probate

There are a number of legitimate advantages to avoiding the probate process. Worse burdens are unnecessary taxes, which probate avoidance schemes do not prevent, or unreasonable transfer costs, which can be cut considerably by (1) organizing the estate using some of the suggestions made later in this paper and (2) strong and careful arm's-length negotiation of legal fees before work begins. (This is one reason that the attorney who drew the will should seldom be named executor or trustee unless there is no other competent individual or bank that could or would serve.)

Given the delays inherent in probate, a number of people try to avoid the process by arranging their affairs so they own nothing in their own names at the time of their death. There is nothing wrong with avoiding probate, which can be accomplished by purchasing life insurance or annuities, using qualified and non qualified retirement plans, placing property in joint tenancy with rights of survivorship, or by placing property into a revocable trust for the benefit of survivors (a living trust). Furthermore, California has a small-estate exemption of \$100,000 probate to free small estates from the process.

The revocable trust is an important estate planning tool. It is a useful and, generally, cost effective device for transferring property from one generation to the next, but it may not be for everyone. It is

not necessarily the size of the estate that determines the need for probate; it is how the property is owned at death. For example, if Mr. Smith's estate had only one asset, a \$10-million life insurance policy payable to his surviving spouse, there would be no need for probate because no assets would pass under Mr. Smith's will or through intestacy. It will pass directly under the life insurance contract to the named beneficiaries. On the other hand, if Mr. Smith had a \$10,000 bank account and a \$150,000 condominium in his own name, probate would be required.

The Solution: Preparing For Death

There are many estate planning techniques that can simplify the estate settlement procedures, reducing the slippage that erodes an estate as well as alleviating or even eliminating death taxes. Although action is particularly important if death is imminent, you should consider a number of these techniques even if you are in good health. Taking the following steps is important because they can simplify the job of the executor and increase the financial security of the beneficiaries.

Prepare and Update Your Will

A will is essential. It is the key legal document in estate planning because it serves as a vehicle of property transfer at death. A will provides for an efficient and financially beneficial distribution of one's assets. People outgrow their initial wills; events such as marriage, divorce, a birth, the death of a spouse or child, and a move to a new state are reasons to update the will. New laws also necessitate will revisions.

Establish Your Domicile

To avoid having to settle an estate and pay death taxes in more than one state, determine with your attorney which state is most advantageous to your heirs and then establish that state as your domicile. To establish domicile, consider taking the following steps:

- ↯ Register to vote in the desired state.
- ↯ Apply for a certificate of domicile if the state issues one.
- ↯ File all tax returns from the desired state.
- ↯ Purchase securities and open a bank account in the desired state.
- ↯ Apply for a driver's license in the desired state.

Inventory and Centralize Your Documents

Create a list locating all important documents. This list should include your will; all bank accounts; life and health insurance policies; real estate deeds; trust documents; stocks, bonds, and other securities; birth and marriage certificates and marital agreements; military discharge records; tax records; and social security information, together with any employee benefit brochures and business agreements. If any documents are kept in a safe-deposit box, find out from the bank whether the safe-deposit box will be sealed at your death. Laws vary from state to state, but California allows a surviving spouse or relative (in the presence of a bank representative) almost immediate access to the box in order to obtain the will. To avoid confusion, only your property should be kept in your safe-

deposit box. Keep an up-to-date list of the names, addresses, and phone numbers of trusted advisers in that box.

By creating an inventory and centralizing your documents now, you will be assured that your affairs will be in order. Keep in mind that an inventory of your assets taken after your death will be much costlier because you will not be around to assist. This inventory of your assets can be used to prepare a letter of instructions, which can serve other purposes as well.

Write a Letter of Instructions

The letter of instructions does not have the legal force of a will, but can specify your funeral arrangements, organ and body donations, and your personal messages to survivors. There is no set form for a letter of instructions. It should contain information that the executor or your survivors will need to know to settle your estate, such as the location of the key to the safe-deposit box. The letter of instructions should be in a place known and immediately accessible to your survivors. By updating it regularly, you not only protect your assets, but also prevent added stress on your survivors.

Prepare a Durable Power of Attorney

This legal document gives someone else the authority to act on your behalf if you become physically incapacitated or mentally or emotionally incompetent. This attorney-in-fact does not have to be a lawyer and can be a family member. The durable power of attorney gives that person the power to conduct the basic financial activities of your life—such as depositing money in the bank and paying bills. This person can be authorized to make gifts on your behalf to specified beneficiaries. By making lifetime gifts, both federal and state death and income taxes can be saved and creditors may be barred from reaching the gifts. Without a power of attorney, your family must seek a court-appointed guardian to carry out your personal and financial decisions. It is important that your power of attorney be durable; this means that the powers you grant will continue in the event of your disability. It could also include the designation of your health care representative, who will make important medical decisions if you are not able to do so.

List Your Advisers

You should record the names, addresses, and telephone numbers of your accountant, insurance agent, attorney, bank officer, stockbrokers, and other advisers. Put a copy in your safe-deposit box and give the original to the person you have named as executor. It is also important to include this information in your letter of instructions.

Check and Update Key Documents

Be sure your will, life insurance policies, and employee benefit beneficiary designations are the way that you want them to be. Confirm that life and disability insurance premiums have been paid and that receipts or checks indicating payment have been retained. Be sure that your estate is not named as the beneficiary of your life insurance or retirement plan because this could result in needless death taxes and subject your assets to the claims of creditors.

Arrange for Successor Management and/or Sale of Your Business

If you are in business or have a professional practice, it is easier and far more profitable for you—rather than your estate's executor—to arrange for its sale. A life insurance funded buy-sell agreement with

your co-owners can create cash for your family at your death and eliminate the financial risk inherent in a business which loses a vet employee. If you own a business interest and it meets certain statutory tests, your business assets may help pay death taxes and your estate may be eligible to defer payment of a portion its federal estate tax liability for many years.

Consider a Revocable Trust

Placing property into a revocable trust can reduce and perhaps even eliminate some of the cost, delay, and uncertainty involved in the probate process.

Consider a Living Will

If you do not want heroic and extraordinary measures to be taken to prolong your life, you should express your wishes either in a living will or in a broader document known as a health care proxy.

Consider Anatomical Gifts

If you do or do not want to make a gift of your eyes, heart, or other organs at death, your specific intentions should be stated in writing.

Consider Extended-Term Insurance

If death is imminent, by electing extended-term insurance, you will be relieved of the burden of paying premiums on your cash value life insurance, while keeping your coverage in force for a limited time until your death.

Consider Repaying Life Insurance Policy Loans

Since life insurance proceeds are treated by most states far more favorably than the same amount of almost any other asset, it may make sense for you to convert cash or property purchased with life insurance policy loans back into life insurance.

Use Waiver of Premium

If you are disabled for the stated period of time, you may be eligible to receive a refund of the last six months' premiums (which can then be spent or given away to remove that cash from your estate), while keeping your policy in full force.

Consider Immediate Charitable Gifts

If you intend to make charitable gifts in your will, you should consider making lifetime gifts now rather than waiting. The immediate income tax deductions will often outweigh the death tax savings, particularly if you are married or if your estate is modest.

Use The Federal Gift Tax Exclusion

Each gift you make during lifetime can save both federal and state death taxes (in many states). Once a gift is made, it is removed from the estate and from probate and thus not subject to a will contest or the claims of creditors.

Easing the Probate Process: Pick the Right Estate Administration Team

If a personal representative selects the right people to assist, then the estate settlement process can be relatively smooth and trouble free. But the responsibility for major decisions and the actions taken by the individuals hired remains with the personal representative because the personal representative must answer to the estate's beneficiaries (and to the courts) if things go wrong! This is one reason a personal representative should be able to hire and fire any member of the estate administration team.

Many professional skills are useful in estate administration, just as they are in estate planning. Usually, a team effort works best. The CPA, the attorney, and the life insurance agent (preferably a CLU or ChFC) are the professionals most often associated with the team.

The Estate's Attorney

The estate's attorney will provide advice on the duties and responsibilities, property law, and taxes. The attorney can help to avoid costly mistakes; advise about hidden assets, such as insurance coverage or governmental benefits; pursue rights, such as lawsuits on behalf of the estate; and inform about tax elections and options.

Generally speaking, the estate's attorney does not have to be the same attorney who drew the will (although he or she usually will be the most knowledgeable and, therefore, the proper choice). Additionally, in smaller estates it may not be necessary to retain the services of an attorney, if the executor can handle the responsibilities without difficulty. In most cases, the executor should hire the attorney as soon as possible. You may want to interview several attorneys. Talk about fees immediately. Insist on an hourly rate or a flat overall fee. Ask the attorney to state a cap (maximum) on the total fee to be charged. Moreover, do not let the attorney do anything until the entire fee agreement is satisfactory to you and in writing. Remember, the lowest fee is not necessarily the best choice. You would not settle for cut-rate medical care if your life was at stake. Inexperience, at any price, is no bargain in legal services, especially when many thousands of dollars are at stake. Examine the criteria discussed above for executor's fees and apply those factors to the attorney as well. And do not be embarrassed to ask, "what if..." questions.

The Role of the CPA

The CPA is an essential adviser, especially if the decedent had an interest in a business. The CPA is also a key person to assist with the many federal and state tax returns that will have to be filled whether or not the bulk of the estate goes through probate. The CPA is an important member of the team because he or she is usually the most intimately acquainted with the financial affairs of the decedent and is knowledgeable about income and estate tax laws. In addition, the CPA can advise on valuation issues and, in the case of a family business, help ascertain its existing and potential earning power. Questions about federal taxes or how to calculate the tax basis on the sale of appreciated property can often be answered by the CPA. Also, since the CPA knew the decedent's affairs, it is often the CPA who recognized the decedent's need for estate planning services and initiated the estate planning process, and thus can provide excellent advice about the decedent's intentions. If the CPA regularly provides estate planning or financial planning services, there is a good chance that the CPA is skilled in estate administration.

The Life Insurance Agent

The life insurance agent is an important member of the estate administration team and one of the first

to be contacted after someone dies. The obvious reason is to discover how much insurance will be paid and how quickly the beneficiaries will receive it. The insurance agent, can provide invaluable information on governmental and veterans' benefits as well as policy settlement options. This is important to assure that federal estate tax liquidity needs are met promptly. Although in most estates the major need for cash occurs at the death of a surviving spouse, in many estates there will be significant taxes, debts, and other expenses at the first death. The agent will need a certified copy of the death certificate and the policy itself. Photocopy the whole contract, including the application and any riders, before providing the policy to the agent. Be sure to obtain a receipt for the original policy. In addition, a claim form from the insurance company signed by the executor, and, in some cases, the short certificate or letters testamentary evidencing authority to act on the estate's behalf, will also be needed. A casualty and liability agent should also review existing casualty and property insurance, covering the assets of the estate as well as revised insurance needs.

Other Advisers

It may be necessary to call in real estate agents, stockbrokers, trust officers, appraisers, and other specialists to play their specific roles in the estate settlement process.

A Final Word

Understanding the probate process will help you protect your heirs from needless taxes and expenses. Your CPA is a key adviser, who can assist you, not only in the accumulation of wealth, but also, in assuring the efficient conservation and distribution of your estate or in the settling of another person's estate.

Disclaimer

This paper is intended to give you the information and background you need to be able to talk with your professional advisers about your estate. This booklet is not intended to be used as a substitute for professional advice. The publisher is not rendering legal, accounting, tax, or other advice. The services of competent professionals should be sought before applying the information.