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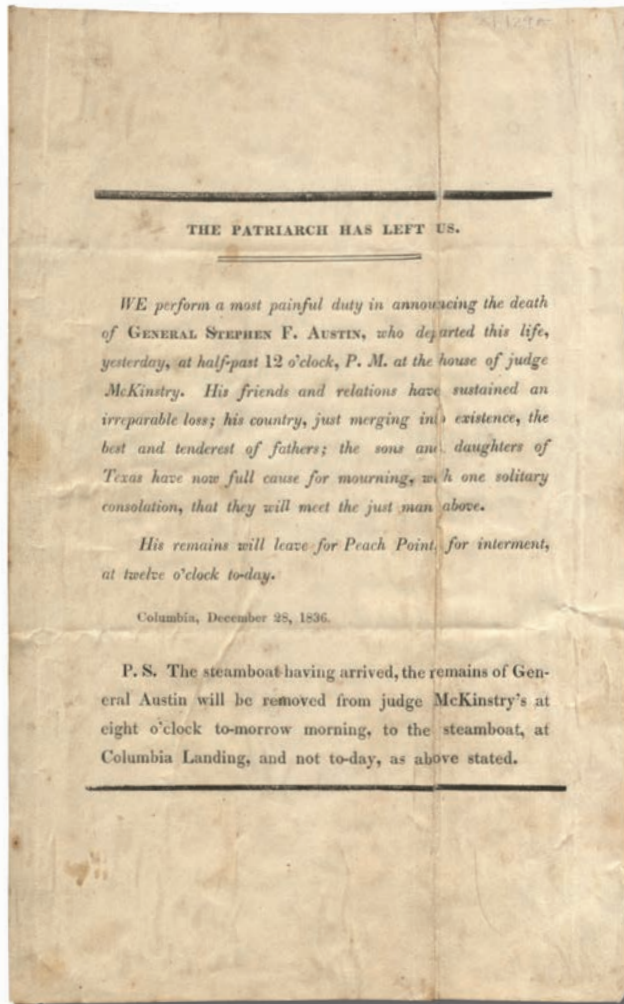
Estate Administration

Estates are separate legal entities which operate, and should be administered, in accordance with their governing documents—as well as an extensive array of legal and tax rules and regulations. Estates fall under the jurisdiction of the probate court system. In our experience at Houston Trust Company, we often find that individuals have been placed in the role of executor of an estate. These individuals often are unaware of the nature of these entities and are inexperienced in their administration and settlement. We attempt to outline below the general steps to be followed in administering and settling an estate, along with some important considerations of executorship.

Overview

Estate administration can be described as a temporary, transitory process, the existence of which is driven by the defining event—someone has died. Estates can and sometimes do take years to finally settle, depending on a number of variables, including but not limited to (1) the size of the estate,

(2) the nature and extent of the estate's assets and liabilities, (3) the dynamics of the beneficiaries (which may include family members and friends, longtime employees, and/or charities), (4) pending or threatened litigation, and (5) IRS audit.



Broadside announcing the death of Stephen F. Austin.
December 28, 1836. Special Collections, University of Houston Libraries.
University of Houston Digital Library. Web. August 23, 2017. <http://digital.lib.uh.edu/collection/earlytex/item/1098>.

The death of a loved one is perhaps the most stressful and emotionally painful experience an individual will ever endure. The pain felt due to the loss is often compounded by the very real and immediate loss of security associated with a loved one who also provided financial support. While powers of attorney, medical directives, and guardianships are helpful management tools during life, these arrangements are of no use once an individual dies. In an instant, a living, breathing individual exists only in our memories, and at that same instant, from a legal point of view, his or her affairs suddenly change and enter into the world of “estate administration”. More specifically, from the moment of an individual’s passing, they cease to exist

as a legal entity, resulting in many possible ramifications: new trusts may be formed or existing ones terminated, community property will be divided, and bank accounts could be frozen. Despite this new state of affairs, initially, no one has the authority to administer the estate, such as it exists. Therefore, the immediate days and weeks following death are not only the most painful and confusing for the family, but they can also be critical from an administration perspective.

Initial Administration and Probate Process

After final arrangements, the initial task most families face after the death of a loved one is maintaining continuity of the individual’s affairs. Government agencies must be notified, claims for life insurance need to be filed, arrangements for feeding and housing for pets must be made, and utility bills must be paid. These duties—and many others—are the responsibility of the executor of the estate, who can only begin taking the necessary formal actions when he, she, or it (in the case of a corporate executor) is duly appointed by the appropriate court.

Careful planning with revocable trusts can solve many transitional challenges, but people often fail to fully implement such plans, thereby limiting their value. Even in cases where a trust is present and properly implemented, the prospective executor must still find the decedent’s original will—assuming, that is, that the decedent left one. Often the decedent will have chosen to keep their will, storing it in a not-so-obvious or unpublished location. For this reason, the drafting attorney may sometimes keep the original document for safekeeping, or it may be deposited with a trust company. Regardless of the circumstances surrounding the will and any trusts that might be present, the executor must retain competent legal and tax counsel—often the drafting attorney and the family accountant—to facilitate the formal legal proceedings and ensure proper reporting and payment of all taxes. An investment advisor may also be added to the professional team.

Texas probate proceedings need not be complicated, lengthy, or expensive. Generally, (1) the application to

serve as executor and the will are filed with the appropriate court; (2) notices are issued; (3) a brief hearing is held and the will is admitted to probate; (4) letters testamentary are issued; (5) an inventory, appraisal, and list of claims is filed and, once the court approves; (6) the formal proceedings are closed. However, as simple as all of this may appear, much happens during this period and challenges can and do arise. Oftentimes, an individual executor can be overwhelmed by the volume of work that must be done in a relatively short period.

Administering the Estate

Once an executor has been appointed, the real work of administration truly begins. The executor must immediately locate and secure all property owned by the estate, which may entail completing a variety of tasks, including (but not limited to) securing the decedent's residence and vacation homes; ensuring that any pets are properly cared for; collection, validation and payment of immediate bills such as utilities, credit cards, casualty insurance premiums, and the like—all while managing the expectations of anxious beneficiaries.

A major responsibility of the executor is to determine what is includible in the estate. Certain property, such as retirement accounts, pay-on-death accounts, survivorship property, and life insurance proceeds (unless the estate is the beneficiary) may pass directly to beneficiaries and thereby not be subject to probate.

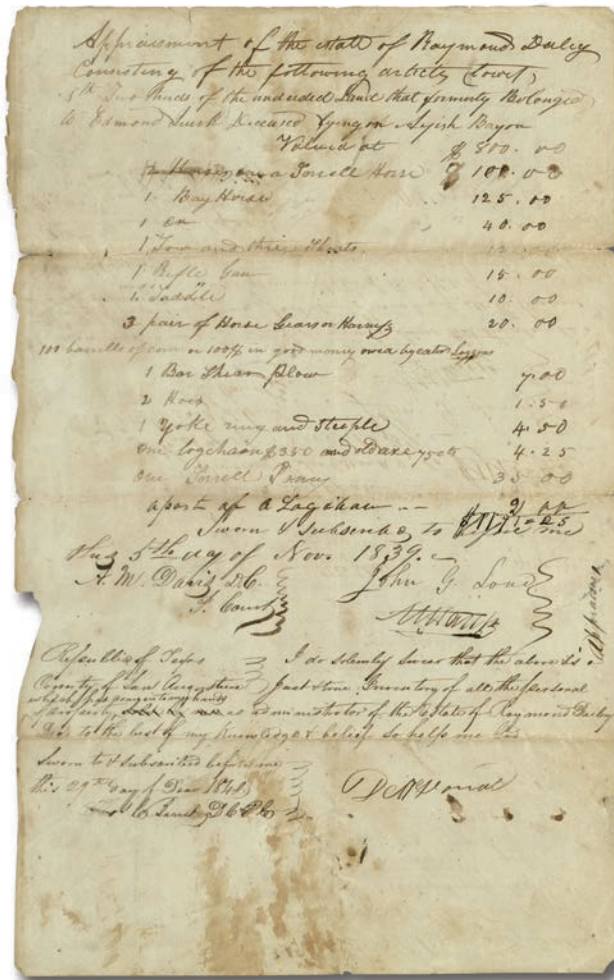
However, some of these items are includible in the overall estate for federal estate tax purposes. In addition, if the decedent was married, the executor must determine what property is community property

or separate property of the surviving spouse, as the surviving spouse's property is not includible in the estate. This process may require division and segregation of community-owned interests via deeds, assignments, or even partition. The executor must also determine whether property held in trust is includible in the estate, at least for tax purposes.

Ultimately, a complete inventory (or affidavit in lieu thereof, as allowed in certain circumstances) of the decedent's probate assets and liabilities will need to be filed with the court and included in the federal Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. Although Texas does not, certain states also impose an inheritance tax and have their own applicable state estate tax forms which must be prepared. Thus,

all financial accounts need to be located, their assets valued as of the date of death, and statements evidencing those values should be obtained. The estate's professional service provider will have specialized software that generates these valuations in a fraction of the time it would take an inexperienced individual to calculate.

Appraisals should be ordered for residential and commercial properties, business interests, and personal property. Personal collections of fine art,



Love, John Gilbert (ca. 1789–1866). *Appraisal of the estate of Raymond Daley - Front*. November 5, 1839 - December 29, 1840. Special Collections, University of Houston Libraries. University of Houston Digital Library. Web. September 10, 2017. <http://digital.lib.uh.edu/collection/earlytex/item/1630/show/1628>.

antique furniture, stamps, coins, baseball cards, or consumables (such as wine) require appraisals from specialists in these fields. The recent rise of the internet and social media make it more likely that the decedent owned some form of digital property, some of which may have commercial value. Written appraisals can provide valuable evidence in case of an audit or challenge and may also serve to facilitate division of specific personal property items among family members. The executor should communicate regularly with beneficiaries, providing periodic reports on the progress of the administration, including anticipated distribution dates. It is essential that the executor maintain a good written record of all of these activities.

The executor should determine whether the decedent established and funded a trust, as doing so may simplify the probate process, even if the trust assets are includible for federal estate tax purposes. The trust instrument may even contain a majority—if not all—of the tax planning and dispositive provisions, reducing the will itself to a simple “pour-over” instrument that serves only to direct the executor to place all property into the hands of the trustee for administration and disposition. This planning technique has recently increased in popularity, as the formalities of amending a trust are less stringent than those for a will. However, we would note that trusts also present an additional set of rules governing the conduct of the trustee and, thus, a different set of challenges for one acting in the dual capacity of executor and trustee.

The executor is also tasked with continued management of all of the estate’s assets until they can be distributed. Although tangible personal property is typically the first asset class distributed from the estate, it must be safeguarded in the short term, which may entail maintaining safe deposit boxes, storage units, or additional security measures at the residence. The executor’s role assumes additional importance if the decedent left personal property to be divided among multiple beneficiaries and no specific instructions as to who should receive particular personal property items (as is often the case). Likely there will be an overlap in personal items chosen or preferred. As such, it is then up to the executor to determine a fair and equitable division of this property, and not all of the beneficiaries may be fully pleased with the results—

particularly if the executor is a family member who will also receive a share.

Real property interests may require additional administration, such as continued utilities payments and maintenance of insurance, and may be subject to liquidation to raise cash needed for estate taxes or to satisfy obligations of the estate. Business interests often require additional time, effort, and expertise to ensure continued operational status—particularly if the death triggered a management transition or stock appraisal and transfer procedure embedded in the entity’s governing documents. Financial assets, often thought of as the “easiest” to manage, can be the most challenging, as such assets are subject to daily market fluctuations and may be the sole source of liquidity to satisfy specific cash gifts or the estate tax liability. As such, the executor should immediately review the investment portfolio to determine what, if anything, should be done to protect it from a market swoon and preserve liquidity. An income tax return must be filed for the year of death, and if applicable, the estate tax return must be filed within nine months of death (unless extended). In most cases, the income and/or estate taxes are due to be paid by the initial filing deadline without regard to extensions. In addition, the executor must deliver cost basis information to the beneficiaries, as the cost basis of the property they receive will have been adjusted from the decedent’s acquisition cost to its date-of-death value (commonly referred to as the “step-up”).

The estate is a taxpayer and must continue to file Form 1041 (U.S. Income Estate Tax Return for Estates and Trust) annually while it remains under administration, culminating in a final return at closure. If a Form 706 must also be filed, the executor should also take care not to make distributions to heirs that would cause the estate to become illiquid in the event of an audit or court proceedings. Depending on how the estate plan was designed, the estate tax burden may be apportioned among the heirs’ respective shares, or it may be borne solely by the residuary estate—that part of the estate that is left over after specific gifts are made, and often the largest component of the estate. As such, the executor must be careful in making distributions and calculate and retain an appropriate reserve to account for the anticipated expenses of administration, payment of

any estate liabilities, a possible audit defense, and any adverse adjustments as a result of the audit. Additional amounts may need to be held back if litigation is anticipated or underway.

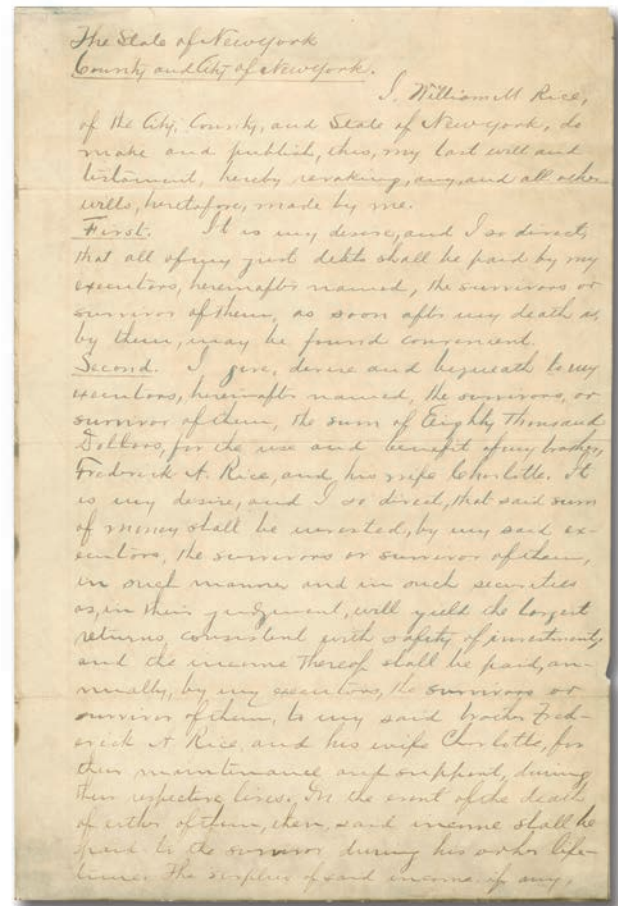
Closing the Estate

As time passes and the administration process lengthens, particularly after the estate tax return has been filed, the patience of beneficiaries will be tested. The executor should be mindful of this fact and act diligently to process and complete distributions as soon as possible, but with prudence as outlined above. It is also imperative for the executor to maintain an open line of communication with beneficiaries, managing expectations according to the circumstances.

Finally, after completion of the probate process and upon completion of the estate's administration (which may also entail completion of any IRS audits, payment of additional tax, and procurement of appropriate closing letters), the executor must wind down the estate for final distribution. At this juncture, the executor must complete funding of any trusts or deliver all undistributed property to the beneficiaries according to the governing documents. This final exercise may demand the executor perform tedious and detailed calculations to divide the remaining property. It may also require completing the sale of illiquid property to raise cash, issuance of deeds or assignments of interests, and/or corporate filings. At the end of the process, the executor should have and retain detailed records and accountings of all of these activities.

As one can tell from the above and from Appendix A, estate administration is a somewhat unique and often a time-consuming exercise—one which most individuals only learn through experience and usually only do once in a lifetime. In our experience, if these matters are handled solely by family members, hasty decisions, and possibly costly mistakes, are more likely to be made. Failure to follow the rules within the timeframes prescribed by law can give rise to problems, both with legal authorities and with the family. Fiduciary litigation—be it a will contest, a challenge to the executor's actions, or otherwise—lengthens the administration process and adds

significant expenses that erode the estate, in some cases consuming it completely. Placing a corporate executor in the role of executor (or agent for executor) can provide a steady and experienced hand to coordinate with the legal and tax team members, ensuring efficient and timely administration.



"Last will and testament of William M. Rice, dated Sept. 26, 1896 (handwritten)." (1896) Rice University: <http://hdl.handle.net/1911/63456>.

Although a corporate executor must be compensated for its services, the value, professionalism, and expedience that a professional executor adds to the process may well outweigh the perceived expense.

Who Should Serve as Executor

It is common for an individual to name the spouse or one or more of their children—typically the oldest—to serve as executor. Although these arrangements can work for some families, we have also observed how they can turn ugly, destroying families and their wealth.

Courthouse case records are brimming with stories of family fiduciary appointments gone wrong, resulting in diminishment (or even total loss) of the estate. Sometimes these losses are caused by the family-member executor's inexperience, while in other cases outright fraud or theft of estate assets have occurred. As for naming the children, the individual's difficult task of "choosing the right executor" may be complicated by the fact that the children will hide intra-family hostilities until the individual dies. However, once the individual has passed, long-simmering rivalries among siblings and other family members re-surface, causing family strife. Often, family members learn for the first time that their parent chose one of them as the executor only after the parent has passed, resulting in surprise and leaving siblings to wonder the reasons for the choice. We have observed in practice and read in court cases numerous instances where a family-member executor has failed in various respects, allowing personal interests and biases to cloud their objectivity and judgment, resulting in communication breakdowns, hurt feelings, and poor administration. In some cases, these actions—or omissions—lead to claims of negligence or malfeasance, and may result in costly court proceedings for damages or removal of the executor, thus prolonging administration and depleting the estate's resources.

Conclusion

The end goal of estate administration is the final settlement of all debts and the expedient and proper disposition of all assets owned by the decedent to the appropriate beneficiaries. The estate administration and settlement process is but one of several specialized processes for transferring assets from one entity or generation to another. Proper estate administration entails careful adherence to the governing documents, as well as application of a myriad of statutes, rules, regulations, and common law principles developed over centuries. It also requires detailed recordkeeping. The conscientious fiduciary must execute all of these tasks while injecting a healthy dose of common sense and business experience, while also balancing the requirements and rigors of administration with the expectations and needs of the beneficiaries.

We have observed that individuals often find themselves frustrated by the complexity of these issues, and often are not in a position to devote the time or expertise required to handle the technical requirements—much less manage the human elements of the job. As such, a corporate fiduciary (whether serving alone, as a co-fiduciary or as an agent for the appointed individual), can provide the desired objectivity, continuity, professionalism, organizational structure and experience to the process, easing the burden for all interested parties.

APPENDIX A

A “To-Do” List for Texas Executors

The following is a basic checklist of tasks facing a prospective executor. Although listed to approximate the chronological order in which they are normally completed, the order of completion and the extent to which the executor completes them may be affected by the presence of a trustee (often the same person(s) or entity as the named executor) of a previously created and funded revocable trust. In addition, a non-Texas executor may be faced with issues that do not currently apply in Texas, such as state income tax or inheritance tax. Finally, items associated with court proceedings or tax filings will be handled by counsel or the accountant, as the case may be.

- Secure residence and assets
- Locate last will and testament
- Obtain death certificate (should obtain multiple original copies)
- Obtain legal representation (often the drafter of the will/estate plan)
- Hire accountant (often the decedent’s accountant)
- Apply to Probate Court for admission of will and appointment of executor
- Obtain Letters Testamentary (should obtain multiple original copies)
- Issue required Public Notices
- Notify all beneficiaries of estate
- Notify Social Security Administration (if not done already)
- Process and pay outstanding bills—mortgages, utilities, credit card accounts, insurance premiums, loans
- Cancel/close unneeded credit accounts
- Locate all financial assets and accounts (consider consolidation of financial assets for administrative ease)
- Access safety deposit boxes—collect, inventory and safeguard contents
- Ascertain, administer, and collect on accounts, loans receivable, or other claims
- Collect life insurance payable to the estate
- Collect and preserve financial statements and records
- Assemble inventory of all assets of the estate
- Determine non-probate assets and excluded assets (spouse’s community/separate property)
- Obtain appraisals for real property, business interests, personal property, automobiles
- Divide/distribute personal property items in accordance with will (clothing, personal effects, jewelry, collectibles, furniture, art, automobiles, club memberships, etc.)
- Prepare and file inventory, appraisal & list of claims (or affidavit in lieu thereof, as applicable) with Probate Court (the attorney will do this, but executor must provide the data – due 90 days from appointment, unless extended)
- Prepare and file decedent’s final Income Tax Return (accountant will do this, but the executor must collect and provide relevant information)
- File Form 706, Estate Tax Return (attorney or accountant will prepare, but executor must collect and provide data—due 9 months from death, unless extended)
- Complete funding of trusts/distribution of remaining assets (deeds, assignments, etc.)
- Prepare and file Estate Income Tax Returns