GUIDELINES FOR SETTLING AN ESTATE

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Settling an estate can be an emotional event for all parties involved. Even if many problems and costs are avoided through proper trust planning, the emotional issues will always remain. Most parents like to think that when their time comes, their children (and/or other beneficiaries) will all act in a loving, sharing way. While many estate settlements have been smooth, my experience has not always been that positive. When a death occurs, especially when there are non-spousal beneficiaries, unfortunately there are often only two questions after the funeral: (1) How much do I get, and (2) when do I get it? Even if this situation is avoided, if the estate settlement process is not handled properly, family disputes often arise that can result in hard feelings that last for years, and even result in litigation between family members.

This document has therefore been prepared to help the surviving spouse and/or children, successor trustee, personal representative and others involved in the estate settlement process resolve all issues as quickly and as fairly as possible, and to avoid or at least minimize disputes between family members. And while oriented toward decedents with living trusts, many of the issues mentioned in this checklist also apply to settling estates of individuals who used a will rather than a living trust.

It is also important to understand that this document is not intended to serve as legal or tax advice. Settling an estate is a complicated process that requires the assistance of an attorney and an accountant, as well as a financial advisor when investment portfolios are involved.

1. <u>Location and Verification of Documents.</u> The successor trustee should contact the decedent's estate planning attorney, accountant and financial advisor, and coordinate all activities with those advisors. The trustee and the attorney must first obtain the decedent's original living trust and will, and determine if there have been any amendments. These basic estate planning documents will identify the people who will have the control and responsibility for all postmortem actions, and will specify the disposition of assets. In addition to the living trust and will, it must be determined if there are any other trusts or insurance policies where the decedent was a beneficiary, trustee or grantor, and if the decedent had ownership interests in any businesses, partnerships, or other arrangements. All documents should be held by the successor trustee or their attorney so that a post-death inventory and checklist can be completed.

   The trustee and personal representative must work together, if they are different persons, throughout the settlement process. In almost every estate non-trust assets or actions will require the participation of a personal representative (PR), in addition to the trustee. The trustee or PR may have to post a bond, and will need to order the appropriate number of death certificates to assist in the reregistration of assets and collection of benefits. The trustee should also notify all potential beneficiaries that no distributions will take place until an accounting and appraisal have been completed, all debts of the estate are paid, and provisions have been made for the filing of tax returns and payment of taxes.

   Many individuals also assume that they will receive something from an estate simply because they were related to the decedent. However, just because they are family members doesn't mean they will inherit anything. In order to receive anything, they must be specifically named as a beneficiary or heir. These issues may have to be addressed soon after the death, so open communication with the family and all beneficiaries is extremely important throughout the settlement period.

2. Inventory and Valuation of Assets. All assets must be located, valued and preserved. Any questions involving the valuation of assets in the estate must be resolved within 9 months after the death. If the decedent worked closely with a financial advisor, that advisor may already have a comprehensive list of assets that will serve as a starting point. A complete and accurate inventory should then be prepared by the attorney or accountant to:
   - Determine if a probate is required for non-trust assets,
   - Determine whether any federal estate tax or state inheritance tax is due,
   - Identify possible sources of cash, if needed, to pay taxes or debts of the decedent or estate,
   - Identify potential life insurance death benefits,
   - Split assets into a marital trust, a credit shelter trust, and other irrevocable trusts if required by the trust,
   - Make charitable gifts if required by the trust,
   - Document the stepped-up basis for capital assets where appropriate,
   - Provide a starting point for the estate appraisal,
   - Determine if any assets have debts against them,
   - Identify any pledges or donations that may have been promised in writing, outside the will or trust, especially to churches or non-profit organizations,
   - Determine if immediate action must be taken to preserve assets or claims due to the decedent or to the decedent's estate, and
   - Assist the surviving spouse, heirs and successor trustee.

3. Differences Between Federal and State Estate Taxes
   In 2001 Congress passed a tax law (EGTRRA) that dramatically increased the exclusion amounts that individuals can keep or give away at death, before federal estate taxes are imposed. For example, the federal exclusion amount for estate tax purposes increased to $1.5 million in 2004, and is scheduled to increase to $3.5 million by 2009. As a result, many individuals are under the mistaken impression that if their estate value is less than these amounts, they don't have to worry about paying estate taxes.

   Unfortunately, that is not true. That same legislation also "disconnected" the state and federal estate laws in many ways. One result was abolishing the state death-tax credit, a system where the federal government shared with state governments a portion of the estate taxes it collected. Most states are having their own budget problems, and the last thing they need is to lose a large source of tax revenue. As a result, most states have now passed laws imposing their own estate or inheritance taxes, and most of them have exemption limits that are much less than the federal exclusion amounts. In fact, several states retained the old federal limit of $675,000.

   For example, if someone dies with a $1.5 million estate in 2004, there would not be any federal estate tax due. The decedent's family may therefore be planning on distributing all of the estate. But if that person's state of residence has an exclusion amount of $675,000, then $825,000 of the estate will be taxable under that state's inheritance tax. To make matters even worse, if the decedent owned property in another state other than the state of residence, that other state can also impose a death tax on the value of that property. In some cases, the combined effective tax liability (state and federal) could be even higher in 2004 than it was in 2001! This is another reason for making sure that you use qualified legal and tax professionals that have a good understanding of the estate tax laws to help you through the estate settlement process.

4. Protecting Assets. When a death occurs, lasting damage often results from family arguments over photos, artwork, silverware, vases and other personal property with more emotional value than financial value. It is not unusual, unfortunately, to see family members taking items and saying "Mom said I could have this," as the house is essentially stripped even before the funeral service. Personal property should be videotaped if there are multiple heirs. Since keys may have also been given to repairmen or neighbors, locks to the house and garage should be changed immediately after the death, even if there is a surviving spouse. Cash should be deposited into a new bank account in the name of the trust. Coin collections, jewelry and other valuables should be inventoried by at least two persons, and then held by the attorney until the estate is settled. The decedent's bank(s) should be notified to cancel any power of attorney, and the decedent's broker or financial advisor should be notified to cancel any discretionary authority over securities accounts.

5. Probate/Legal/Accounting. Only those assets actually titled in the trust are legally part of the trust estate. Unfortunately, many people buy living trusts at seminars or do their own trust, and then fail to change the title to assets into their trust. This defeats the purpose of having the trust, since all assets titled in the name of the decedent at the time of death are then governed by the decedent's will, not the trust. As a result, those assets must go through probate unless held in joint title, or passed by contract or beneficiary instructions (e.g. life insurance, annuities, IRAs or qualified plans). If non-trust assets are valued low enough, a "small estate" probate process may be available.

   And if the decedent owned real estate in another state, an ancillary probate will also be required in that other state unless title is held in the decedent's living trust, held in joint tenancy with the right of survivorship, or held in the name of an entity such as a partnership or a corporation.

   The trustee and personal representative can be held personally liable for any errors, so they should work closely with an attorney and an accountant who are experienced in post-mortem planning. They must ensure that all assets are identified and valued, titles are properly changed, tax elections are made as required, disclaimer powers are exercised as needed, the state of domicile is determined, tax returns and other documents are filed, and all other actions properly taken. The decedent should have had a "pour-over" will that coordinates with the living trust and transfers all non-trust assets into the trust prior to distribution.

   To provide a clear record of all estate settlement activity, a new checking account is usually opened by the trustee to receive all estate receipts and income, and to pay all estate distributions, expenses and taxes.

   The comments made in this document also assume that married couples had a single joint living trust. If each spouse had their own living trust, the instructions in each trust must be followed since the assets are held in separate titles.

6. Collection of Decedent's Benefits. The surviving spouse, successor trustee and/or PR should take action to identify and collect benefits for the decedent and the decedent's survivors. These benefits may include final wages, accrued vacation or sick pay; worker's compensation payments; retirement or disability income, either from Social Security or as a fringe benefit from an employer; funeral and death benefits from Social Security, Veteran's Administration, or employment agreements; medical expenses from health or Medicare supplemental insurance; group or association life and disability income benefits; workers compensation claims; and retirement plan benefits. If the decedent had multiple employers or belonged to a union, be sure to check with each entity. A surviving spouse may also be able to receive "survivor's benefits" for the rest of his or her life.

7. Notes Receivable. The decedent may have been owed money on a note or account receivable from a direct loan, or from the sale of property or other assets. They may also have made loans to friends or family members without obtaining proper notes or security, especially if they have been ill or confused in recent years. When individuals become ill, debtors (including family members) often stop making payments. Be sure to review bank records for at least the last two years, and carefully review past tax returns and other records for evidence of payments received by the decedent. When notes or contracts are secured by real property, confirm that the property taxes are paid current, and instruct the insurance agent for that property to change the additional insured party to the new lienholder (successor trustee, new trust or heirs). If the note is collected through a collection escrow, contact the escrow company to change their instructions and record the required documents to change the named payee.

8. Life Insurance. Death benefits are often overlooked, so take special care in this area. In addition to normal group and personal life insurance on the decedent, be sure to look for the following: Paid up policies for which premiums have not recently been paid; veteran's life insurance; fraternal, business association or financial institution policies; credit life policies on the home, autos and credit cards; term riders on regular policies; accidental death riders on regular life or disability policies; and accidental death policies like travel insurance, or those provided when travel tickets are purchased with credit cards.

   Homeowners often have mortgage insurance that will pay off the mortgage in the event of their death. Premiums may have been included in the loan payments and not paid as separate premiums, so be sure to check for this coverage as well if the decedent owned real property with liens against it.

The trustee should also determine if there are any death benefits due from policies owned by irrevocable trusts, or from business insurance such as buy-sell agreements. Do not assume that partners or business co-owners will always tell the surviving spouse when life insurance existed on the decedent. If the decedent leaves a surviving spouse or minor children, they are also eligible for a small death benefit from Social Security.

Be sure to check life insurance policies owned by the surviving spouse as well, including the spouse's employer's group life coverage, since the decedent may have been covered under a term rider on the spouse's policy. Some group life insurance is not in the decedent's taxable estate, so be sure to discuss with your accountant and keep it out of the estate if the estate is taxable.

Insurance companies or agents often try to convince a beneficiary to convert a life insurance death benefit into an immediate or deferred annuity, or into a new life insurance policy on a survivor. Be sure to ask another qualified, independent advisor to review any such proposals before taking final action.

If life insurance policies cannot be found, but the trustee or family has reason to believe they exist, review bank records for the last few years to see if premiums have been paid to any life insurance companies. In addition, the trustee should contact the Unclaimed Properties department in any state the decedent lived in to see if they have any record of unclaimed insurance. The trustee should also check on the web site **www.unclaimed.org** to see if any insurance is listed there for the decedent (also see my section on "Detective Work.")

9. IRAs and Retirement Plans. There are many complicated rules to consider when making decisions involving the distribution of a decedent's IRAs and retirement plans. Since total taxes due (income & estate) can exceed 70% of the value of an inherited IRA or retirement plan, getting competent tax and financial advice is very important. For example, if multiple beneficiaries are named, the amount going to charities or other entity beneficiaries must be separated from the rest of the account to avoid a forced early payout of the share going to the otherwise "designated beneficiaries." Talk to your advisors to make sure you understand the difference between a beneficiary and a "designated beneficiary."

   Even if all beneficiaries are individuals, it is usually best to divide the IRA into separate IRAs in case one beneficiary wants his paid in cash immediately, and another wants hers paid out over her lifetime in a "stretch out IRA." Leaving the IRA in a beneficiary trust may also be advisable if one or more of the individual beneficiaries has special needs or financial problems. Many IRA custodians are unwilling to participate in any distribution process involving trusts or stretch-out IRAs, so it may be necessary to change the custodian of the IRA or retirement plan to meet the goals of the decedent or the beneficiaries.

   Certain issues require special attention. If an IRA is to be divided, the final "designated beneficiaries" must be determined by September 30 of the year following the death of the owner, and changes in the account must be completed by December 31. In addition, certain decisions such as qualified disclaimers must be made within nine months of the death.

   Another area of concern involves employer-sponsored qualified plans and life insurance benefits that are governed by ERISA. Unless a participant's current spouse signs a consent form waiving all rights as the primary beneficiary, the current spouse will receive all benefits payable under ERISA, even if others are named as the beneficiaries. This could be very important, since ERISA overrides even divorce decrees and other legal agreements, and has led to many very serious legal disputes.

   The trustee should also consider the tax liability of assets when making distributions to heirs. While IRAs and retirement plans are fully taxable when distributed, capital assets normally receive a "step-up in basis" to the value at the date of death, so they can be received by the beneficiary with no tax liability. In one example I saw, one child received an IRA valued at about $500,000. The decedent's will said that the second child was to receive real estate with a value equal to the IRA, and then the balance of the estate (all cash and capital assets) was to be divided between the two children.

The second child sold the real estate and kept all $500,000, since the real estate was a capital asset and was sold with no tax liability. However, the first child owed almost $250,000 in state and federal income taxes on the inherited IRA, so received only half as much cash <u>after-tax</u> as the other child. The father undoubtedly thought he was treating them equally when he signed the will and beneficiary instructions, but because the tax consequences were ignored the results were very inequitable to his children.

10. <u>Detective Work.</u> Decedents often have assets or insurance that they forgot about, or even intentionally hid from family members, so the family may not be aware that those assets or insurance even exist. As part of the inventory and appraisal process the trustee should review at least two years' bank records, looking for names of payors, payees or deposits that may lead to these assets or benefits. Be sure to look for checks to insurance companies. This search could not only lead to life insurance benefits, but could also identify insurance that should be cancelled, such as long term care or health insurance on the decedent, or insurance on assets like cars or property that have been sold.

    Tax returns for the last two years should be reviewed for 1099's, K-1's and other indications of assets and income sources. The decedent's mail should also be closely reviewed for at least one year after the death for information on possible assets or insurance.

    Personal desks and file cabinets should be inspected, including those in the decedent's business office if one exists, and safe deposit boxes should be located and inventoried. The decedent's residence and business office should also be closely inspected for hidden floor, closet or wall safes. And be careful when cleaning out the house, since many people hide cash or gold coins in soup cans or food boxes designed as a "safe," hide valuables in shoe boxes in closets, or keep cash in envelopes or even magazines. While reviewing records, look for any references to a post office box. Close family members may also be aware of hidden assets, or of testamentary letters giving instructions on how to find them.

    Check the web site **www.unclaimed.org**, which is maintained by the National Association of Unclaimed Property Administrators (NAUPA). NAUPA is an association of state officials charged with the responsibility of collecting unclaimed property, and reuniting lost owners or beneficiaries with that property. This site is *not* associated with those companies who locate unclaimed property, and then claim a percentage of the asset value for matching the property with the rightful owner or beneficiary. You should also look on **www.unclaimedassets.com**, for links to government agencies, banks and other holders of unclaimed assets.

11. <u>Estate Appraisal.</u> After a death an estate appraisal may be necessary for the following reasons:
    - For the accounting/appraisal of the decedent's estate,
    - To value assets for estate tax purposes and to determine whether estate taxes are due,
    - To determine if a credit shelter trust or other trust should be funded, and if so, with which assets,
    - To determine the original cost basis and stepped-up basis values of assets in the estate, and
    - For choosing which assets go to the surviving spouse and/or to other beneficiaries or trusts.

12. <u>Appraisal Problems and Opportunities.</u> IRS regulations contain detailed instructions for appraising many types of assets. Personal property is included in virtually every estate, and may be covered under special rules. For example, the IRS requires a professional appraisal for "Items with intrinsic value such as jewelry, silverware, art or collections when valued at more than $3,000." Professional appraisals should always be obtained for real estate if there is any possibility that the valuation will be challenged by the IRS, beneficiaries, or other interested parties.

    To avoid potential disputes with beneficiaries when non-cash assets or marketable securities are distributed, the trustee should obtain and retain outside appraisals on any asset of value that will be distributed "in-kind." Appraisals should always be obtained when dividing assets into multiple trusts or distributing to multiple beneficiaries, or when the estate valuation is near or exceeds the unified credit amount. County real estate tax appraisals are often a poor indication of value for estate or distribution purposes. This is especially true if any property is under a farm or timber tax deferral program, since they usually show a tax appraised value that is a fraction (as little as 10%) of the fair market value. Using the wrong value could therefore not only cause tax problems, but could also result in huge disputes between family members (and even claims against the trustee). And do not assume that old furniture or other old items are worthless. What may look like junk to you could be valuable antiques to others, so always seek expert advice in this area.

If publicly traded stocks, bonds or mutual funds are in the estate, keep a copy of a newspaper or other documents showing share values on the date of death. Special IRS rules apply to closely held (non-public traded) stock, partnerships and other non-incorporated business interests, and a formal appraisal may be required. Review the entire list of assets with your accountant and attorney to determine if formal appraisals or other special actions are required.

Professional advisors should always be used when capital assets are involved, since you will usually want to maximize the new basis values. Depending on the assets owned and what happens to the value of those assets after the date of death, you may want to use an "alternate valuation" date (6 months after the date of death) to establish the value of the estate. By maximizing the date-of-death values, you will minimize the taxable gains on those assets when the property is ultimately sold by the estate or the beneficiaries.

If the decedent owned an interest in a Limited Liability Company, a Family Partnership, a Private Corporation or other non-public entity, special valuation procedures may be available that could reduce estate tax liability, so work with a lawyer and accountant who are familiar with these discounted valuation procedures. A detailed valuation of the entire estate should be completed even if no estate tax is due, since the trustee and/or PR can be held personally liable for errors or omissions. If any assets were not titled in the trust, probate will be required for those assets and additional requirements must be met before the estate can be closed.

13. <u>Safe Deposit Box.</u> Inventory the contents and then distribute the contents as directed by the trust document or will. If large amounts of cash or other valuables are found, the estate's attorney should be notified. Be sure to ask family members which banks the decedent used, even several years ago, since they may have had more than one safe deposit box.

14. <u>Business or Partnership Interests.</u> If the decedent was an owner of a business, family farm or other non-public entity, steps must be taken to preserve and protect the enterprise. Continuation or liquidation is an issue that must be addressed immediately, since banks and creditors may call loans once they learn of the death. Suppliers and creditors may also be hesitant to provide new material or credit to the business until they know who is going to run the company and who will be responsible for debts.

    In some states, a surviving partner automatically becomes a "liquidating trustee" under the law, unless a binding buy-sell agreement is in place. Review corporate or partnership documents, and interview the other partners/shareholders to determine the existence of any agreements and any buy-sell or other business insurance.

    Family owned businesses may also be able to take advantage of certain estate tax provisions to reduce the estate tax liability, if family members will continue to own and run the business. Competent legal and tax advice should be obtained immediately to review all of these issues, especially if the business or partnership interests represent a large part of the estate. These continuation and liquidation issues are closely tied to the valuation issues mentioned earlier.

    Business operations should also be closely monitored after the death until ownership and management issues are resolved. In some cases the remaining partners or co-owners have taken cash or assets from the business, or have incurred additional debt and left the decedent's estate responsible for their percentage share of that debt. And if the decedent was ill or absent from the business for some time prior to death, it would also be prudent to audit the books for the time the decedent was not monitoring the books carefully.

15. <u>Stepped-up Basis.</u> Basis is the purchase price of a capital asset, plus capital improvements, minus depreciation. Whenever property is sold, any amount received over the basis is taxed at capital gain tax rates. The stepped-up basis is the value of the property or capital asset owned by the decedent on the date of death, as shown on the inventory and appraisal. Since heirs normally receive capital assets at the stepped-up basis, they can often avoid capital gains tax on the difference in value between the decedent's original cost basis and the new stepped-up tax basis. Do not assume that county tax appraisals for real or personal property are valid, because they often show amounts that are substantially under or over fair market values.

The inventory and appraisal should be safeguarded, because these will document the new tax basis for each asset pursuant to IRC Section 1014. Date of death basis values should also be provided to heirs who receive assets from the decedent through the estate, since that will establish their tax basis when they eventually sell those assets.

One opportunity that is often overlooked is the ability to own real estate as community property in a non-community property state. For example, if retirees sell property in California and use the proceeds to buy property in Oregon, that Oregon property can be treated as community property for estate tax purposes even though Oregon is not a community property state. However, to take advantage of this law, the deeded title to the property in Oregon must have been held as Community Property. Why is this important? As community property, at the first death the survivor can take a 100% step-up in basis on that property, rather than the normal 50% received in a non-community property state. This strategy can therefore be very important in reducing tax liability.

16. Creditors. As the trustee/PR you must not only identify the assets, but you must also determine the debts and liabilities of the decedent, and pay those debts. Be sure to request documentation if a debt is questionable, since some claims may not be legitimate. If a probate estate is opened, the probate estate is primarily liable for the decedent's debts. If it does not have enough assets, then the trust must pay the creditors since the trust document should require that the trustee pay all outstanding debts and liabilities of the decedent. Many post-death expenditures such as travel, funeral expenses, and estate administration are tax-deductible expenses to the estate, so be sure to discuss this issue with your accountant and keep detailed receipts.

    Ensure that all legitimate creditors are paid in full before making any distributions to beneficiaries, since the trustee and PR can be held personally responsible for unpaid debts once an estate is distributed. Proper creditor notices must also be published to limit possible claims against the estate and the trustee/PR. In some states known creditors must personally receive written notice of the death; published notices only are not considered adequate legal notice in those states.

    In some states the trustee can also file a court action to cut off the claims of creditors after a statutory procedure is completed, if the trustee and beneficiaries are concerned about possible unknown liabilities of the decedent.

    Pay all credit cards off in full. If there is a surviving spouse, ask for a new credit card and account issued in the spouse's name only, and then close the old accounts.

    One trap to be aware of involves the State Department of Human Resources or Senior and Disabled Services. If the decedent or the decedent's spouse received certain benefits (such as nursing home care) during their lifetime, contact the State to see whether the decedent's estate owes for services rendered. Many states also allow older citizens to defer paying property taxes on their home once they reach a certain age, but those taxes are still due at their death or when the home is sold. The state will usually have a recorded lien against the decedent's residence for these unpaid taxes.

17. Changing Title. The title to property of a decedent should be changed following the death. Property going to heirs or trusts should be reregistered into the new owner's name. Title to property retained in the same trust (e.g. a martial trust) should also be changed to reflect that the decedent is no longer a trustee. Prior to making a change in title, the custodian or county recorder will require documentation such as a death certificate and a letter of instruction or deed.

    If real estate is retained in the same trust, a death certificate is often recorded in each county where the real estate is located to avoid problems in the future.

    When securities are involved, custodians will have different requirements, so be sure to contact each custodian before preparing documents to change titles.

    There are often serious misunderstandings when non-qualified annuities are owned by the decedent. Even if there is a co-owner (such as the spouse), the annuity value may have to be paid out at the owner's death, depending on the contract structure, the named annuitant, etc. In fact, under certain contracts the spousal co-owner may be responsible for paying tax on the distribution, even if the money goes to somebody else (such as a child) as the named beneficiary! Make sure you get expert help if annuities were owned by the decedent, before notifying the insurance company that the owner has died.

The trust's distribution provisions must be followed. For real estate, this will require the preparation and recording of a deed to the beneficiary. The trustee should confirm that all non real-property assets are reregistered into the beneficiaries' name(s) as instructed by the trust. The estate's attorney should assist in all real property reregistrations.

18. Certification of Trust or Copies of Trust. Title insurance companies, financial institutions, life insurance companies, securities firms and other asset holders normally request a copy of the trust, a certified copy of the death certificate, and their own documents before changing title or paying death benefits. While some companies will require only certain pages of the trust (e.g. trustor's names, trustee designations, powers, beneficiaries, and signatures), other companies will require a copy of the entire trust before they will pay the death benefit or change the title.

    In many states a "Certification of Trust" can be prepared and used in lieu of providing a copy of the full or partial trust document itself. In those states, the law usually provides that a copy of the full trust document does not have to be provided if a properly drafted Certification of Trust is signed by the successor trustee and given to those parties.

    The successor trustee will have to prove they have the power to act on behalf of the trust before any action is taken, even opening a new bank account to handle the trust's cash receipts and disbursements. Therefore one of the first steps a successor trustee should take following a death is to have the attorney prepare a new Certification of Trust naming the successor trustee(s) for the trust.

19. New Titles. Non-trust assets held in the decedent's name must be changed to the new owners as instructed by the will. For trust assets retained by the surviving spouse/trustee, asset titles may remain unchanged. For emotional reasons the surviving spouse may even want to leave the decedent's name on the registration as a co-owner or co-trustee, but this can cause legal problems. As soon as possible, the decedent's name should be removed, leaving the survivor as sole trustee. A new Certification of Trust should then be prepared, stating that one of the trustors is deceased, and naming the new trustee or trustees for the trust.

    In any event, the surviving spouse's social security number must be used on all personal accounts after the death. If the trust provides, the assets may be split into two or more trusts at death, either for tax or family planning. A surviving spouse may retain one trust as a revocable living trust, but all other trusts will normally be irrevocable trusts. Assets owned outright by the decedent to be retained in the spouse's name should be reregistered into the living trust by the surviving spouse or the PR for the estate.

20. A & B Trusts. Living trusts and wills often require a division of assets upon the first spouse's death to minimize the estate tax due on the total estate. The surviving spouse will retain certain assets in a revocable trust (also known as a Marital trust, or "A" trust), and the remaining assets are usually retitled into a new irrevocable trust (also known as a Family trust, a Credit Shelter trust, or "B" trust). Unless separate living trusts were used, the Family trust is normally funded with no more than the effective exclusion amount ($1,500,000 in 2004 and 2005).

    However, assets must be reregistered in accordance with the formula stated in the decedent's trust. For example, spouses who were previously married and have separate children often have separate living trusts that clearly identify "his" and "hers" assets, and these trusts often become irrevocable at their death. These trusts often provide that the surviving spouse may receive income from the trust for the remainder of his or her life, but the principal usually eventually goes to the decedent's own children, not to the spouse or the spouse's children.

    But when assets are held in joint trusts, at the first death assets with growth potential are usually placed in the B Trust. The residence is normally retained in the surviving spouse's trust to preserve the residence tax exemption, but the decedent's will or trust often governs the disposition of the residence. In addition, there may be income or estate tax reasons for not leaving the residence in the surviving spouse's trust.

Be sure to seek competent tax advice before transferring any assets to the Family trust or any other irrevocable trust. For example, if certain assets (such as an annuity or a note receivable on a property sale) are transferred to an irrevocable trust, the entire deferred taxable gain can be triggered even if no cash is received, resulting in a large tax liability without any cash receipts available to pay the taxes.

Special care must also be taken whenever the decedent owned a large IRA or retirement plan, since the entire amount can be taxable income to the beneficiary if not rolled over to a spousal IRA or a special beneficiary trust. With proper planning and the use of disclaimers, trusts, and stretch-out IRAs, taxable income can be deferred and spread out over many years even if it is not rolled over to a spousal IRA.

21. Surviving Spouse's Estate Planning Documents. The surviving spouse's revocable trust, will, healthcare power of attorney/advance directive, power of attorney, IRA and retirement plan beneficiary instructions, investment accounts, life insurance policies and annuities, and other documents should be reviewed and amended as necessary to reflect the death, changes in the law, or changes in family goals or situations.

    Other family members should also be encouraged to review their estate planning documents and investments to make sure the decedent is no longer named as a beneficiary, trustee or other party in their documents.

22. Irrevocable Trusts. Legal and tax counsel must be consulted whenever an irrevocable trust is established, including a Family trust. A federal tax ID number must be obtained, and the appropriate assets must be reregistered into the new trust. Unless the decedent's will or trust provides otherwise, the new trust(s) are governed by the terms of the original will or trust, and a new trust does not have to be drafted. However, a Certification of Trust should be prepared for each new trust, naming the trustee(s) and providing other essential information. This will allow the trustee to transact business on behalf of the trust. A Fiduciary Income Tax Return (Form 1041) will have to be filed each year for every irrevocable trust.

    Once established, an irrevocable trust must be treated properly. If the appropriate tax reporting is not done, or if assets inside or income from the trust are not handled properly, the assets and income can be brought back into the surviving spouse's taxable estate, with significant negative tax consequences.

    The trustee of any irrevocable trust should also work with the financial advisor to draft and sign a Fiduciary Investment Policy Statement to establish the goals and guidelines for managing the assets in the trust.

23. Life Insurance Trusts. Life insurance is often owned by an irrevocable trust to keep the death proceeds out of the decedent's taxable estate. In that event, it will be essential to make sure the death benefits are paid into and retained by this life insurance trust, until distributions are made in accordance with the trust's provisions. The trustee should obtain legal and tax counsel before making any distributions or loans from this trust, to make sure the proceeds are not brought back into the decedent's or the survivor's taxable estate. A special area of concern is using cash from an irrevocable trust to directly pay the decedent's estate taxes, since this can result in the entire trust being added back into the taxable estate.

24. Disclaimers. If a named beneficiary already has a large, taxable estate, they may want to "disclaim" their inheritance to the next heir in line. For example, a son may be able to disclaim his father's inheritance (all or part) directly to his own children. Be sure to discuss disclaimers with the attorney and accountant, since a generation skipping tax could be imposed on disclaimed amounts greater than $1.5 million. All qualified disclaimers must be completed within nine months of the death. Disclaimers can be especially valuable if the decedent had a large IRA or retirement plan, and named the spouse as the primary beneficiary and a Plan Benefits Trust as the contingent beneficiary. If disclaimed by the spouse, a Plan Benefits Trust can be used to fund a Credit Shelter Trust without triggering income tax on the inherited IRA.

25. Estate and Inheritance Taxes. A Federal Estate Tax Return (Form 706) may be required upon the death of an individual if the value of the estate is greater than the effective exemption amount, even if most of the assets were held in a living trust. And as mentioned earlier, a state inheritance tax return and tax may be due on even smaller amounts, depending on the state of residence. Inheritance taxes may also be claimed by more than one state if the decedent

owned real estate in other states. Some states are very aggressive in collecting this tax, so when large estates are involved more than one state may claim that the decedent was a resident of their state in order to claim higher taxes from the estate.

Assets placed and held inside an irrevocable trust will not be subject to estate taxation upon the death of the surviving spouse, no matter how large it grows after the first spouse dies, as long as the trust was properly established and maintained. At the survivor's death, if the survivor's taxable estate is greater than the then-current effective exclusion amount, another Federal Estate Tax Return must be filed. Work with your accountant to ensure all returns are filed properly and on time.

No federal estate taxes are due, no matter how large the estate, if both spouses were U.S. citizens, all assets are left to the surviving spouse or to a "qualified trust," and the unlimited marital deduction is chosen. However, leaving everything to the spouse could result in paying unnecessary taxes at the second death if the joint estate exceeds the effective exemption amount at the first death. With proper planning, no estate tax will be due when the first spouse dies, unless more than the effective exemption amount was transferred to an irrevocable trust or was distributed to someone other than their spouse. However, if special valuation strategies are used in settling the estate, it may be advisable to file an estate tax return and pay a small amount of tax to "start the clock" on potential audits, even if all current tax liability could otherwise be avoided by maximizing the marital deduction.

26. <u>Tax Matters.</u> Work with your tax and legal advisors to make sure each of the following items are properly addressed in a timely manner.
    - Ensure that past income tax returns were properly filed, especially if the decedent lived alone or was ill or confused in recent years.
    - Prepare the decedent's final personal income tax return. This tax return is due by April 15 of the year after the death.
    - Determine whether the decedent was making estimated income tax payments. If so, make the estimated payments when due.
    - If the decedent owned real property, make sure that real property taxes are paid before the due dates, and that appropriate fire and liability insurance coverage is in force.
    - Apply for a tax identification number for any irrevocable trust, including a Family trust.
    - With the help of your accountant, determine the amount of cash that will be needed to pay all tax liabilities, including income and estate taxes. If adequate cash or life insurance proceeds will not be available, begin discussions on which assets will be sold or if loans will be needed. Families often confuse "wealth" with cash, so be sure this area is carefully analyzed. This issue is very important where the majority of the estate is an illiquid business or real estate.
    - Make any necessary tax elections available to the trustee.
    - Determine if the decedent had established any charitable or other trusts that could reduce the tax liability of the decedent or the estate.
    - If the decedent had a large IRA or retirement plan, significant tax savings may be possible if certain action is taken following the death. Discuss your options with the decedent's financial advisor or your financial advisor, whoever is the most qualified in this area. Then ensure that your accountant reviews and approves the strategy before making any changes. If trusts are part of the distribution strategy, make sure the trust's attorney is also involved.
    - Determine if the decedent had any unused capital losses, bankruptcy losses, or other issues that could reduce income or estate taxes.
    - Ensure that final expenses and bills, including fees due the trustee and PR, are paid from the probate or trust estate and not by survivors or heirs. This will reduce settlement fees, as well as income taxes and estate taxes.
    - Prepare any required tax returns for the decedent, for the estate and for any trusts that have become irrevocable. Following the death, the decedent's estate and all irrevocable trusts become separate income tax payors. Some planning opportunities may arise since a fiscal year can be chosen for the estate.
    - Pay all federal estate taxes and state inheritance taxes due.
    - Set up a separate checking account for each irrevocable trust, and run all income, expenses and distributions through that account. This will be important to provide a single source for future trust accounting and tax filings.

27. Forwarding Mail. To ensure that all of the decedent's mail is received, if there is no surviving spouse, the trustee should instruct the post office to forward all mail to the trustee's address.

28. Telephone. To improve security, surviving widows may want to change their listing in the phone book to show only their initials and last name, and to have a male relative or friend record the greeting message on her phone's answering machine or voice mail.

29. Insurance. The trustee is responsible for the maintenance and protection of all trust assets. Therefore:
    - Review the decedent's automobile, homeowner, rental, liability, business and other insurance to ensure that coverage is adequate and continues until assets are distributed.
    - Ensure that health insurance premiums are adjusted and continued if there are survivors under the policy.
    - Cancel all unneeded policies, such as health or long term care policies on the decedent, or on cars or property that are sold, and ask for refunds of unused premiums.
    - Notify the insurance companies and escrow companies involved with notes or mortgages receivable if titles of the payer or payee are to be changed to another person or entity.
    - If the decedent was a professional, consider purchasing a malpractice insurance trail policy.

30. Cash Needs. Estimate future cash needs for the estate and for any trusts. Take action to obtain the cash needed to pay any obligations of the decedent and the trusts which may arise in the near future. Some common obligations include unpaid debts, medical bills, funeral expenses, reimbursement to state agencies, estate and income taxes, and a reserve for miscellaneous and general expenses. If debts exist, be sure to determine if any lump sum or balloon payments are due in the future so they can be planned for as well.

31. Lawsuits. Determine if there are any actions pending on behalf of or against the decedent, or any businesses or properties owned by the decedent. Also, determine if the estate has an action for the wrongful death of the decedent. Be especially careful if the decedent was a professional with malpractice exposure. Be sure to seek competent legal help in this area since proper public notices must be published to limit liability by the estate, even if there are no known debts or claims at the time of death. If all assets are held in a living trust but the decedent has potential liability exposure, in some states it may be prudent to run some assets through a probate just to trigger creditor protection against later claims.

32. Reports to Beneficiaries. If required by the trust agreement, the trustee must provide all beneficiaries with interim reports during the settlement period, and a final report once assets are distributed and the trust is terminated. The trust agreement may also require regular reports to the trust's beneficiaries by the trustee for any irrevocable trusts established after the death. Even if reports are not required, periodic written communication with family members and beneficiaries during the settlement period can help avoid misunderstandings, disputes, and even litigation.

33. Distribution of Assets. The last step in the postmortem process is distributing assets to the heirs and beneficiaries. This process requires a careful analysis to make sure that the best allocation is made to serve both tax and non-tax purposes. Bequests can be of three basic types – specific, pecuniary and fractional. Since each of these can result in significant tax consequences, it is important to obtain proper legal and tax advice prior to making any distributions. For example, if a note receivable is transferred through a pecuniary or specific bequest, taxable income can be triggered even if no cash is received by the heir. Tax advice on the selection of assets is also critical when charitable bequests are made or S-corporation stock was owned by the decedent.

34. Since trustees or personal representatives are often under significant pressure from heirs and beneficiaries to make distributions before an estate is settled, this might be a good time to remember that trustees can be held personally responsible for any errors in distributions or valuations done during an estate settlement or during the administration of a trust.

35. Be sure to consider tax consequences when balancing assets distributed to heirs and beneficiaries. For example, IRAs or annuities will result in taxable income to the beneficiaries, but stocks and real estate are usually received at the stepped-up value without tax liability by the beneficiary. And beneficiaries of life insurance also usually receive all

benefits without any tax liability. A person in a lower tax bracket could therefore retain more after-tax dollars from the same asset with taxable income, than would another beneficiary who is in a higher bracket.

36. Receipts should be obtained from all beneficiaries and heirs who receive assets from the trust or estate.

37. A surviving spouse can easily be overwhelmed with all of the financial matters involved in settling an estate when added to the emotional issues involved in the loss of the spouse. I have found that providing a detailed net worth statement and retirement income projections can provide tremendous comfort to the surviving spouse and his or her family members, even prior to closing the estate. Final net worth statements should then be prepared for the surviving spouse and for any irrevocable trusts established once the estate is settled.

38. I have also learned that having one or more family meetings can be very important prior to closing an estate. The surviving spouse and/or all heirs and beneficiaries should be present at these meetings. During these meetings the financial advisor, attorney and accountant can discuss the settlement process and answer any questions. Often it is best to have one meeting early in the estate settlement process to let everyone know what is involved, and to establish reasonable expectations. Do not make estimates of the amounts to be paid to heirs and beneficiaries at this time, because many unknown situations can come up during the estate settlement process that can change these amounts.

    A second meeting should then be held near the end of the process, once final amounts are known. Since reality is often significantly different than expectations of heirs and beneficiaries, it is very important for trustees to work with the professional advisors while preparing for and conducting these meetings.

    Good luck!