

ESTATE ADMINISTRATION 101

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What is estate administration?

An estate administration is the process of winding up a decedent's affairs. On a basic level, that entails gathering the decedent's assets, satisfying the decedent's debts and obligations, filing tax returns (final individual income tax returns, fiduciary income tax returns, state death tax returns, and a federal estate tax return), and ultimately distributing the decedent's assets in accordance with the decedent's estate plan.

What is probate?

Probate commonly refers to the process of getting a personal representative (also known as an executor or administrator) sworn in at the local courthouse in which the decedent was a resident. This allows the personal representative to have the power to administer a decedent's estate.

What assets are governed by probate?

Assets that are in an individual's sole name, (i.e. not jointly owned) that do not have a beneficiary designation, or are not set up as transfer on death assets.

What does a personal representative do?

The personal representative of an estate is the individual legally tasked with fulfilling the duties inherent in an estate administration.

Does serving as a personal representative expose the individual to liability?

Short answer, Yes. A personal representative is generally NOT liable for the debts and obligations of the decedent in an ordinary estate administration. However, a personal representative is liable to the beneficiaries (and potentially creditors) for the proper and prudent administration of the estate. Additionally, a personal representative could also be subject to transferee liability in the case where the decedent or the decedent's estate owes taxes, but the personal representative does not satisfy those taxes out of the decedent's assets.

How long does an estate administration take?

An estate administration can range from a few months to a few years or longer depending on the circumstances. In Pennsylvania, a typical estate administration will usually take 6 months at the minimum.

Pennsylvania, unlike many other states, has a death tax, known as the "Inheritance Tax." Pennsylvania essentially takes a snapshot of a decedent's balance sheet as of the date of death. The decedent's net assets are subject to tax at varying rates (0% to 15%), depending on the relationship between the decedent and the beneficiaries of the decedent's estate. For property passing to a spouse, the tax rate is 0%. For property passing to the decedent's children the rate is 4.5%. Once a decedent's Inheritance Tax return is filed, it typically takes the PA Department of Revenue 4 to 6 months to issue an "Appraisalment." The Appraisalment will either be the Department of Revenue's acknowledgement that the Inheritance Tax Return has been accepted as filed or will set forth adjustments to that return. The estate administration cannot begin to wind down until the Inheritance Tax Return has been accepted. Thus, for most Pennsylvania residents the process is likely to take 6 months at a minimum.

For estates that are subject to federal estate tax, the administration process is usually significantly longer. The federal estate tax return ("706") also essentially takes a snapshot of a decedent's balance sheet as of the date of death. However, the 706 does require substantially more investigative work and disclosure. PA only taxes gifts made within 1 year of the decedent's death. The 706, on the other hand, requires that all of the decedent's gift tax returns be filed and reconciled along with the 706. Furthermore, an executor of an estate has a duty to determine whether the decedent made any unreported gifts during his or her lifetime that would have required a gift tax return being filed. The executor can be held personally liable for any federal estate taxes that would have been due on the unreported gifts. Finally, the IRS will issue a "Closing Letter" after the 706 is filed, which is the only way of ensuring there is no additional estate tax liability.

The good news is that, under the current law, the federal estate tax exemption is \$11,400,000 per person, alleviating the need to file a 706 for many estates.

Do I need a lawyer to do an estate administration?

The technical answer is No, but the cost of a skilled lawyer is worth his or her weight in gold as there are many traps for the unwary. A skilled lawyer will guide the personal representative through the process, and avoid problems with taxing authorities, creditors of the estate, and beneficiaries.

The language of most estate planning documents is complex, which makes it inherently difficult for the average reader to identify planning opportunities available after the decedent's death. A few of these post mortem tax planning opportunities include:

1. Funding a credit shelter type trust to preserve a decedent's unused estate and generation skipping tax exemption and keep the appreciation of those assets outside of the reach of federal estate tax and generation skipping tax.
2. Maximizing potential income tax deductions through the estate administration process, which is especially important now that the Tax Cuts and Jobs Act has eliminated many of the miscellaneous itemized deductions for individuals.

3. Making an election under Section 454 of the Internal Revenue Code (the "Code") to tax accrued interest on savings bonds in the decedent's final income tax return.
4. Making an election under Section 754 of the Code for partnerships in which the decedent held an interest to get a step up in basis on the assets inside the partnership.
5. Making a QTIP Election (only for married couples) to potentially get a step up in basis in the assets in a trust not only at the first spouse's death, but also the second spouse's death.

How is an estate administration closed?

By now you have at least a general sense that estate administrations are not always the quickest and easiest tasks to complete. Most states have two ways of terminating an estate administration and releasing the personal representative from liability for his or her role.

Option one is the more streamlined approach and is referred to as an "Informal Settlement" and typically involves providing each beneficiary of the estate a summary of the main transactions and an agreement releasing the personal representative from liability in connection with the estate administration.

Option two is more time consuming and expensive and is referred to as a "Formal Settlement" which involves preparing an Account of the estate administration. The Account sets forth every transaction, no matter how small, and must be filed with the local court in which the decedent resided at the time of his or her passing. Preparing an Account can be very time consuming, burdensome and expensive. Generally, we try to avoid filing an Account, unless there is a compelling reason to do so.

If I set up my assets so they automatically transfer on death, I will avoid probate and my estate administration will be simple, right?

Not necessarily. "Avoiding probate" does not eliminate the requirement to file the tax returns mentioned above. While it is true that using transfer on death accounts or titling assets jointly with the right of survivorship (hereinafter referred to as "automatic transfers") will place the decedent's assets in the beneficiaries' hands much faster, that is not necessarily a good thing, for the following reasons:

1. Automatic transfers can greatly reduce post mortem tax planning opportunities. There are often opportunities to reduce income and estate taxes during an estate administration. However, most of the opportunities require action before a beneficiary receives assets from the decedent. Thus, automatic transfers may eliminate these opportunities.
2. Final expenses, debts and taxes always need to be paid. When all of a decedent's assets are set up as automatic transfers, the personal representative would be in the tough spot of asking each beneficiary for some of the transferred funds to pay those expenses. When assets are not set up as automatic transfers, typically all expenses, debts, and taxes are paid before, then funds are distributed to the beneficiaries.

3. A Will/Revocable Trust is NOT going to change how automatic transfers occur. Often times a plan structured around setting up all or most of an individual's assets as automatic transfers results in unintended distributions. For example, different assets may be initially set up with different owners to achieve a balanced distribution among the beneficiaries. However, account values and the inherent tax consequences of the accounts can change over time, leaving the beneficiaries in an unequal footing.

How does an estate plan impact an estate administration?

A good estate plan will lay the groundwork for an efficient and effective estate administration. It should be clear that many of the potential traps in an estate administration can be greatly reduced by a good estate plan. From a tax planning opportunity standpoint, a good estate plan will allow for more post mortem opportunities. Usually, even a basic estate plan provides for some tax planning opportunities, but generally a more complex plan will provide more opportunities.

Anything else I should know about estate administration?

The level of expertise, services provided, and fees charged by law firms will vary. In selecting an attorney, it is important to find one with sufficient expertise who will consider all the potential issues and opportunities inherent in an estate administration, or who will work with a qualified tax advisor for any issues outside of his or her role. Finally, it is important to understand how the attorney charges for his or her work. Most law firms will either do work on an hourly basis, or charge a percentage based on the size of the estate. Both methods can be good from a client perspective, depending on circumstances. However, in either case a client should have a sense of what method is being used and what to expect.

Should you have questions, comments or thoughts, please do not hesitate to contact myself or a member of the Metz Lewis Tax, Trusts, and Estates team! <https://www.metzlewis.com/practices/private-client-group/>



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