SETTLING THE ESTATE

The term "settling the estate" refers to the period immediately after the death of one or both spouses. Settling an estate in a Living Trust is generally very easy. If all of the assets are in the Living Trust and if the estate has been organized, settling the estate typically takes less than an hour.

Upon Death

1. Make important telephone calls;
2. Make funeral arrangements, including memorial or flowers and funeral notice;
3. Notify other people;
4. Check the safe-deposit box, safe and checking account;
5. Make an appointment to meet with your primary adviser, financial planner, attorney, accountant, etc and apply for a Tax Identification Number, if necessary.

Military Papers

Copies of military discharge papers should be obtained. If an individual who served in the armed forces dies, the Veterans Administration will provide $150.00 toward funeral expenses, a headstone marker, and an American flag, if desired.

In the process of making funeral arrangements, you will need to take the military separation papers to the funeral home. These papers are needed to show proof that the deceased person was a veteran of military service.

Order Death Certificate

Order at least ten (10) death certificates. A separate death certificate will be needed for each insurance policy and each real asset (real estate, stocks, bonds, and so on) that you desire to ultimately sell or transfer. A simple copy of the death certificate is not sufficient; it must be a certified copy, obtained from the county recorder's office. Unfortunately, certified copies of the death certificate are seldom available until about ten days after the death of an individual. However, you can usually obtain one or two copies of the death certificate for immediate use directly from the funeral home. With a copy of the Living Trust and a certified copy of the death certificate, the surviving Trustee or successor Trustee then has exactly the same power to manage the estate as the deceased individual had while living.

Check Safe-Deposit Box, Home Safes and Checking Accounts

You should look in the safe-deposit box for two reasons. First, the deceased may have left a message or statement of posthumous desires that should be carried out by the survivors. The second, and more important, reason to look in the safe-deposit box is to inventory the contents to be sure that all of the valuable assets (such as real estate deeds and stocks and bonds) are in the name of the Trust.

As a good business practice, it is worthwhile to put your safe-deposit box in the name of your Living Trust. With the Trust document and a death certificate in hand, the bank should readily give the successor Trustee access to the safe-deposit box. In your estate-planning process, do not forget to let your successor Trustee know where your safe-deposit box is located as well as the location of the key to the safe-deposit box.

Make Appointment with Your Primary Adviser

The next step is to make an appointment to meet with your primary adviser. The actual settlement process, involving the estate and financial affairs, will begin at the meeting with this person or persons.

The Settlement Process

If you have done your estate planning properly, if you have all of your assets in the Living Trust, your survivors have nothing to do from a legal standpoint. They do not have to change your Trust or change title to any of your assets. The one exception would be, upon the death of a single individual or the second spouse (if married), when the estate is large enough to be subject to federal or state taxation.

The surviving spouse or adult children should be able to settle the estate without difficulty, so long as it has been organized. The surviving Trustee or successor Trustee needs only a copy of the death certificate and a copy of the Living Trust to allow him or her to take whatever action is necessary on behalf of the Trust.

Further Instruction for your Primary Adviser

The following steps should be followed by your primary adviser to settle an estate in a Living Trust:

1. Review the Trust instructions.
2. Notify life insurance companies.
3. Ensure that all assets are inside the Trust.
4. Review the size of the estate.
5. File an income tax return. Obtain a written valuation of assets.
6. Review business agreement.
7. Review credit cards.
8. Distribute personal effects.
9. Review allocation and distribution of assets.

1) Review the Trust Instructions

The importance of organizing your estate is especially apparent during the process of estate settlement. By organizing the estate, it prevents a guessing game upon the death of a Settlor. Having an organizing estate allows the survivor the privilege of settling the estate in minutes (or possibly an hour), rather than trying to piece together the assets in the estate over several months.

You and your primary adviser should specifically look at the following sections of the Living Trust document:

1. The actual Trust, specifically the section covering the "successor Trustee' for authority in administering the Trust. Also, the section covering "Division of Shares" to find out the desires of the deceased person.

2. The Family Trust section.

3. The Payment of Debt, Expense, and Taxes section.

If the successor Trustee is the surviving spouse, the Trust provides that he or she have exactly the same power to administer the Trust as before the death of the spouse. Now that only one of the original Trustees is still living or neither is still living, it is most important to be sure that the Trust names competent successor Trustees to assume responsibility for the Trust upon the eventual death of the second spouse or other successor Trustee.

2) Notify the Life Insurance Companies

Your adviser should check to be sure that each of the life insurance companies has been notified of the death of the insured. Each insurance company will require a certified copy of the death certificate.

3) Ensure Assets Are Within the Trust

Your adviser should help you ensure that all of the asses are within the Trust. If any assets are not in the Trust and the value of all assets outside the Trust exceeds the value established by the state the assets are located in, then those assets outside the Trust must go through probate. If everything is in the Trust, the surviving Trustee steps in immediately and, with the Trust and a death certificate, has identically the same power to buy, sell, or transfer any of the assets, as did the individual who placed those assets into the Trust.

4) Revise Size of Estate

The adviser should check the information to determine whether the estate is subject to federal estate taxes the state inheritance taxes. If so, the adviser should ascertain which forms need to be filed and how much tax needs to be paid.

With proper estate planning, there need not be any estate taxes to pay upon the death of the first spouse, regardless of the size of the estate. However, if estate taxes are due, a Form 706 (Federal Estate Tax Form) must be filed, and any taxes due must be paid within nine (9) months of death.

There are options available under the tax code for extending estate tax payments over a ten (10) year period, but most estates do not qualify for the extension.

5) File Income Tax Return

Upon the death of a spouse, the adviser should explain that the surviving spouse has a right to file a joint income tax return (Form 1040, as had been done while the spouse was alive) for the year in which his or her spouse died. The surviving spouse should keep an accurate record of the decedent’s last medical and funeral expenses, because the medical expenses can be deducted from the survivor’s taxable income, and the funeral expenses can be deducted for estate tax purposes.

The surviving spouse should use his or her social security number to identify all of the assets in the Trust. The reason for reporting the assets in this manner is that it enables the Trustee to transfer back and forth between the A Trust and the B Trust as easily as possible. The I.R.S. Trust Identification Number is used to identify the assets upon the death of a single Settlor and upon the death of the second spouse.

A surviving spouse acting as the surviving Trustee will typically pay out all the income from the Trust to himself or herself and continue to report the Trust income on his or her personal Form 1040 income tax return.

a) Upon Death of First Spouse

If a couple has an A-B Trust, upon the death of a spouse, one-half of the Trust becomes irrevocable. A Form 1041S (S for simple) tax return should then be filed, but only for the irrevocable Trust. This form must be filed each year until no assets remain in the Trust.

The I.R.S. Trust Identification Number will be used on the Form 1041S tax return. The Form 1041S and the accompanying Schedule K-1 are the only places where the special Trust ID number will be used during the life of the surviving spouse.

All of the income in the irrevocable Trust usually paid to the surviving spouse. However, since the surviving spouse is still a Settlor of the Trust, the net effect is paying all of the income to oneself. Therefore, on Form 1041S, the surviving spouse would subtract from the income of the irrevocable Trust an income distribution deduction in the same amount.

The Form 1041S tax return on the irrevocable Trust is simply an information return. The surviving Trustee would continue to report any income received from the irrevocable Trust on his or her regular Form 1040 tax return.

b) Upon Death of Both Spouse or a Single Person

Upon the death of both spouses or a single person, the entire Living Trust becomes irrevocable. Depending upon the distribution instructions, income may or may not be retained in the Trust. In either case, however, the successor Trustees of the Trust must then file a Form 1041S income tax return. For example, if the Trust were providing for minor children, possibly only a portion of the Trust income would be distributed to the children. The children would be responsible for reporting the income they received from the Trust on their own individual income tax returns, and the Trust would be responsible for paying taxes on any income that was retained in the Trust.

Any assets retained in Trust must use the special I.R.S. Trust Identification Number. The practice of using this number after the death of the Settlors is logical, because the social security numbers belonging to the Settlors cease upon their deaths.

c) Payment of Taxes

If the Trust has retained income, it may be required to pay federal income taxes. On the other hand, if all of the income is paid out from the Trust, then the recipients of the income will report such income on their own Form 1040 tax returns and pay any taxes due. The Trust must still file a Form 1041S Trust tax return. However, as previously mentioned, if all of the income of the Trust is paid out, the Trust has no taxable income to report on Form 1041S.

d) Income Retained in the Trust

It may be to your tax advantage to retain some income in the Trust even though the 1986 tax code eliminated the income tax advantages of retaining income in the irrevocable Trust and having it act as a separate tax entity. Congress continues to change the tax laws. Therefore, your tax attorney or CPA should review the pros and cons of whether to use the irrevocable Trust as a separate tax entity.

e) Obtain Written Valuation of Assets

The adviser should explain that one of the most important functions that must be completed upon the death of an individual who has a Living Trust is to establish written valuation of all of the assets in the Trust. It is absolutely necessary to obtain written valuation of all real estate and securities in order to determine a new cost basis for these assets and to take advantage of stepped-up valuation, thus minimizing the taxable gain when the assets are eventually sold.

The adviser should describe why and how to get stepped-up valuation. It is essential to establish a written valuation of each asset upon the death of a Settlor. The written valuation provides a valid and documented justification of the asset's current market value for determining stepped-up valuation.

f) Real Estate

The simplest method of establishing current market value for real estate is to telephone two real estate agents from separate firms. Tell the agents that you are always interest in the possibility of selling your real estate and that you would appreciate it if they would estimate the value for which you should be able to sell your property (preferably on the high side when no estate taxes are due). Ask the agents to give these figures to you in writing, as well as to back up their valuations with "comparable" (recent sales of comparable real estate within the neighborhood).

On the death of the last Settlor, if the estate is going to be subject to estate taxes, you may desire to seek an evaluation on the low side. In general, however, you should never ask for either overvaluation or undervaluation of the real estate.

If the valuations from the two real estate agents are fairly close together, take the average of the two estimates for the value of your real estate. If the two estimates are far apart, ask a third real estate agent for another valuation of your real estate.

It is most important to place these written valuations in your Living Trust portfolio (or somewhere else safe and accessible), so that you may use the valuations to substantiate your new stepped-up cost basis to the Internal Revenue Service, possibly years later when you decide to sell your real estate. You must be able to prove your cost basis in writing.

The same principle of establishing written proof of current market valuation at the date of death applies to any real estate and to any survivor, whether a surviving spouse or children. Note that your children also get stepped-up valuation as their cost basis upon the death of the surviving spouse.

g) Securities

Establishing the current market value of stocks and bonds is very simple, just look in the newspaper. The stock and bond quotations in the newspaper on or near the date of death are sufficient.

Simply put, the stock quotation page from the newspaper in your Living Trust portfolio, but be sure that the entire page with the newspaper's dateline is included, so that the date of the quotation is recorded for future use.

Alternatively, your stockbroker can give you the actual stock and bond prices on the date of death. Most brokers will provide these figures to you in writing if you ask them to do so. In many cases, a monthly statement of account form a brokerage firm will include the value as of the date of the statement. Remember, the market value of the stocks and bonds at date of death becomes the new cost basis, which will be used to compute any taxable gain when the asses are eventually sold.

6) Review Business Agreements

Your adviser should review business agreements for action, dispositions, and benefits. Any businesses must be valued very carefully and wisely. You should hire at least two, possibly three, certified public accounting firms to value your business. Since most privately held businesses have a minimal cost basis, stepped-up valuation can become extremely important. However, you must establish a sound and justifiable basis to satisfy the Internal Revenue Service.

When you have an interest in a business of substantial value, you should be aware that a number of estate planning tools can be used to freeze or establish the value of the business and, if desirable, to shift the gain to your children. The various alternatives should be pursued with a knowledgeable estate-planning attorney.

The I.R.S. has some fourteen (14) different methods by which to compute corporate valuation, and upon your death, the I.R.S. will always strive to come up with the highest valuation for your business For your valuation purposes, the I.R.S. looks at a business the day before an individual dies, not the day after. Thus, where there is an interest in a privately held business, a proper estate plan is essential. While you are living, being the most knowledgeable about your business, you are in the best position to do something toward determining a proper valuation. Failure to do so, however, may have a tragic result.

7) Review Credit Cards

The next step to take in settling an estate is to review the credit cards that were issued to the deceased individual and to determine whether they should be destroyed. Cards that should definitely be destroyed are those issued in the name of the deceased or for business use only.

8) Distribute Personal Effects

At this time, it is appropriate to distribute personal effects as specified in any special directive. Any special estate distribution should also be made, if specified. Your adviser should help you begin this step by checking the section titled "Divisions and Shares" in your Revocable Living Trust.

9) Review Allocation and Distribution

If assets are to be distributed or retained in Trust for the heirs, your adviser should help you determine which assets, and real estate should be distributed, sold, or converted to income. Remember, though, to first determine any outstanding debts or taxes that must be paid before the estate is distributed.

The importance of the allocation and distribution aspects of settling an estate cannot be overemphasized. The "Division of Shares" section of the Trust should be reviewed carefully. Even if only one spouse has died, the decedent may have left specific instructions as to certain assets that are to be distributed outright upon his or her death. Since the Trustee should be given the choice of distributing in cash or in kind (by the language in the Trust), the Trustee preferably should distribute the assets outright, rather than selling them and then distributing the cash.

If the decedent is single or the surviving spouse, then the allocation and distribution of the assets in the estate must conform to the "Division of Shares" section of the Trust. Again, it is always preferable to distribute the assets, where appropriate, rather than simply selling the assets and then distributing cash. On the other hand, to be perfectly fair to all heirs, it is often difficult to divide assets equally, so it may be necessary to sell some assets and then distribute equal dollar amounts in cash to each heir.

Final Issues

After the survivor has met with the primary adviser, he or she still has several months within which to take care of some important issues: a) Making sure assets are most advantageously placed in the various Trusts; b) reviewing the way these assets are invested; and c) filing Form 706 for estate taxes, if required.

Assets Place into "A" Trust or "B" Trust

People who have an "AB" Trust need to be concerned about allocating assets among the "A" Trust or the "B" Trust.

The surviving spouse's share of community and separate property should be identified and placed in the "A" Trust with any excess amount of the federal estate tax The decedent's share of the community and separate property limit and should be placed in the "B" Trust.

The decedent's assets consist of the decedent's separate property and the value of the decedent's share of the community or common property. One-half of the assets value of the community or common property must flow into Trust B.

Most people think that, if they own a home, the decedents owns half of the house and the surviving spouse owns the other half of the house and, therefore, they need to put one-half of the house into Trust A and the other half into Trust B. However, this belief is not true. You may put the entire house into either Trust A or Trust B, as long as you put an equal value of assets into the other Trust. If you think of the dollar value of the house instead of the house itself, as what is being placed in the Decedent's Trust B, then apportionment of assets into the A and B Trusts is much easier to understand.

The procedure for placing assets in the A and B Trust is really very simple. To place an asset in an A or B Trust, the Trustee merely needs to describe the assets, the valuation amount, the date on which the valuation was made, and the source of valuation. This description can be made on the form, which lists the assets placed in the A Trust. The form for Trust B are the same except for its title. The Trustee should date and sign these forms.

Thereafter, the Trustee may totally ignore this distribution of assets among the A and B Trusts, other than to annually report the income on the Form 1041S Trust tax return, as mentioned before.

The Trustee must also abide by rules for use of those assets and described in the Trust under the provisions of the B Trust.

Growth assets should be placed in the B Trust, since these assets will henceforth be insulated from further estate taxes. Nevertheless, each surviving spouse has his or her own set of objectives. Once of the most important features of to Living Trust is the right of the Trustee to transfer assets between the survivor's portion of the Trust and the decedent's part of the Trust (that is from the A Trust to the B Trust or from the B Trust to the A Trust). This process is actually quit easy. You need only to describe the assets, the amount of valuation, the date of valuation, and the source of valuation. Then you show from which Trust the asset is being taken and to which Trust the asset is being transferred. The transfers would then be signed and dated by the Trustee.

Review Investments and Investment Objectives

Review the investments in the Trust to see whether they meet the objectives of income, growth, and security. Determine whether some assets should be reinvested to provide adequate income as well as appropriate growth for a hedge against inflation. The assets should be reviewed at least annually to determine whether they should be reinvested for the best balance between growth and income and whether assets should be shifted among the A and B Trusts to preserve anticipated appreciation.

Upon the death of an individual, it makes sense to review the types of investments in the estate to see whether they still correspond with the objectives of the survivors. This review is particularly necessary when the survivor is a spouse, a minor child, or a handicapped individual of any age.

Typically, upon the death of a spouse or a parent, the family income is reduced substantially. It may be far more appropriate to sell assets that were invested for growth and to replace them with income-producing assets.

On the other hand, if both parents are deceased, the beneficiaries of the Trust are the children, and the children are to receive the assets with an outright distribution, then the simplest way to distribute the assets is just to change title to the assets. However, if the assets are to be retained in Trust for a period of time, it may be more appropriate to leave the assets invested for growth.

It also may be appropriate to change the identification number on you Trust assets. The surviving spouse's social security number should be used. If there is no surviving spouse, then the I.R.S. Trust ID Number (Employee Identification Number) should be used. This number should have been recorded in the Living Trust portfolio. I.R.S. Form W-9, or its appropriate alternate form as specified by I.R.S regulations, should be used to change the tax number for each asset. This form may be obtained from any financial institution.

As mentioned earlier, if part or all of the Living Trust becomes irrevocable and assets are retained in the Trust, it will be necessary to annually file a Form 1041S Trust tax return for the irrevocable part of the Trust.