Tax Lives Even After Death- Efficiently Administering an Estate

by Andrew J. Powers

It is not uncommon for a family member to be asked to witness a will and be named Executor (or Executrix) of the estate upon death and ensure that person's wishes are respected following their demise, nor is it uncommon for a family member to be notified that a relative has passed and that they are the next of kin but the decedent passed without a will, a/k/a *intestate*. Administering the estate could be challenging enough, but did you know that income tax lives on even after death? Most think that because inheritance estate tax threshold is now as high as it is, that taxes are not something to be concerned about. In fact, many attorneys who are not knowledgeable regarding income tax, may tell you the same thing. Nothing could be further from the truth.

Allow me to walk you through this, first a summary and later the detail. When someone passes away, immediately, a Decedent's Estate is created, and once the backs and financial institutions are notified from third party sources, collecting dividends and interest and liquidating security accounts becomes a problem as the Decedent's social security number is virtually inactivated and a new federal tax ID number is required. The application form for a federal tax ID number is SS-4 and this can be done online and the number issued immediately. From this point on, all dealings are with the Decedent's Estate. Now, if there are no investment accounts (including no bank interest), this substantially mitigates the problem, however if taxable income is $600 or more, or if one of the beneficiaries is a nonresident alien, all income and deductible expenses need to be reported to IRS on Form 1041. Most states have their respective forms. The due date is the 15th day of the fourth month following the end of the estates taxable ear. By default, unless the year end is specified otherwise on the application, IRS will designate the estate as a calendar year with the tax return due date being April 15. Now if the estate will be settled before December 31 of the year of death, this is fine, but if the person passed during the later part of the year and if a few months more are required you may want to apply and file as a fiscal year end. I strongly advise taking these steps, beginning with the tax ID number application, with a qualified income tax specialist who has done this before and knowledgeable regarding the laws and potential pitfalls, and I advise against going this alone as you will face issues such as who will be responsible for paying the tax (the estate or the beneficiaries), are the assets (including the earned income of the estate) deemed distributed (even if they are not), and may other issues

Now we need to switch gears and look to the final tax return of the decedent. As a calendar year taxpayer, a final tax return is due by April 15. The estate administrator will need to ensure that if the decent owes income tax on their final return, that the tax is timely paid. In the event that all the assets are distributed to beneficiaries and there is no money remaining, the estate administrator is responsible for any unpaid tax liabilities. If there is a refund, the money is combined with distributable assets and distributed to the beneficiaries. If there is a refund,

Form 1310 is required to be filed with the tax return, providing the decedent's court designated administrator or other representative's name and social security number and that person is required to sign the tax return.

Basic Legal Requirements and Estate Administrator Requirements

When someone passes away it is necessary to consider many issues, such as is there a surviving spouse who has joint ownership and survivor entitlement to the assets, who are named beneficiaries of the decedent's insurance policies or other financial accounts, including employment assets and benefits, final wages and other Income in Respect of a Decedent (IRD) that is reported on the final tax return of the decedent. Are there pension or other retirement accounts where no beneficiary is stated. Sometimes (and as a tax professional, I have seen this instance) a the decedent had named a beneficiary to a retirement account prior to getting married and never changed the named beneficiary to the new spouse. Although under the Employee Retirement Act of 1974 (ERISA), retirement benefits are required bylaw to be paid to the surviving spouse, often confusion arises due to the named beneficiary other than the spouse, and benefit payments are delayed and sometimes come to a halt. In one instance that I witnessed, the surviving spouse hired an attorney to resolve the issue. Although knowledgeable with Elder Care Law, this attorney took a substantial fee to file a petition with Surrogate Court requesting a Court Order to be issued to the decedent's employer to pay the benefits to the surviving spouse, when in fact, all that was necessary was to site for the employer's benefit administrator the statutory ERISA provision that mandated that the surviving spouse was the legal beneficiary, which would have quickly resolved the matter. Unfortunately, the Court Order further complicated the matter and benefits that would otherwise be exempt or subject to different tax reporting if paid to the surviving spouse, were incorrectly reported as the would be to a non surviving spouse. Her legal and tax advisory fees were substantially greater than they should have been merely because she failed to consult with an experienced tax advisor first.

Estate planning usually involves drafting a Last Will and Testament. However if there is no will, the person is known as having passed "intestate". Depending on facts and circumstances including whether or not there is a surviving spouse and/or the size of the estate and the nature of the assets, this may-or may not-be a issue as different laws and rules may apply. Note that every state has its own laws regarding surrogate matters, so there is no "one size fits all". A small estate (which is often simplified) in one jurisdiction may not qualify for small estate rules in another. My suggestion (and this is not "legal advice") is that you first check the Surrogate Court internet website and other information that is applicable to the state jurisdiction of the decedent's legal residence which is available on the internet. After you have updated yourself, then choose a qualified attorney to guide you through the process and if necessary handle legal matters for the estate. Keep in mind that not only are the fees of the accountant and the attorney to be paid from the assets of the estate, they should be determined or estimated early on so hat these expenses can be budgeted when it is time to distribute assets to the

beneficiaries. Also, most states (if not all) have a designated maximum fee that can, and should be, paid to the estate administrator. This amount is often determined by the size of the estate. The fee can be waived by the administrator, but if it is, this should be in writing and duly witnessed or notarized to avoid later unpleasantries.

As previously stated, estate planning usually involves drafting a Will. When a will designates a person who agrees to administer the last wishes of the decedent, as stated in their will, that person is known as the Estate's Executor (or Executrix). The executor is responsible for ensuring that the debts of the decedent are paid and that assets are distributed to the beneficiaries in accordance with the terms of the will.

After death occurs, the executor should file the will, along with a death certificate, with the Surrogate Court (also known as Probate Court). This is a legal requirement. This begins the probate process, including the time that the Court appoints a person as executor or administrator of the estate. Keep in mind that even if someone is named as executor within a will, even of that person previously agreed to serve as executor, they are under no legal obligation to do so, although they do have the obligation to file the will with the court, after which the court will appoint a different executor, or administrator. When there is no executor or administrator appointed, assets may remain in estate indefinitely, causing problems.

Penalty for Failing to File a Will with Probate Court

Failing by an executor, administrator, or other legal representative to file a will with the court can open a world of nasty penalties. Although most states don't make it a crime (criminal act) not to file the will with the court, not filing the will could create legal and monetary exposure to the person if sued by a beneficiary who was financially harmed by the fact that the will was not filed. This is actually stipulated by statute in some states. Also, if the failure to file is coupled by evidence that the act was intentional for the purpose of personal financial gain, the act becomes criminal.

Debts of the Estate and Creditors

Although family members and beneficiaries to an estate are under n legal obligation to pay the debts of a decedent, that may not be true regarding the executor in the event that the estate was determined to be mismanaged with funds distributed to beneficiaries prior to paying creditors that which they have legal claim and standing. However, by filing a will in Probate Court, the time in which creditors have to make legal claim against the estate is reduced from one year to four months from the date that the executor or administrator is appointed.

Probate is not always required but often suggested-Small Estates

Probate is the process of legally transferring the assets of the decedent's estate to the beneficiaries. Most states have a streamlined process, usually determined by the value of the estate (between $10,000 and $100,000 depending on the state jurisdiction) and/or the nature of the assets, whereby state law refers to this as a "small estate" and exempts formal probate

(and often the filing of the will) and instead provides a simplified process that is often referred to as “transfer by affidavit” or “voluntary administration”. For example, NYS provides that, regardless of whether or not a will exists, if the personal property of a decedent’s estate is less than $50,000, then it is a Small Estate and permitted voluntary administration. However, if the decedent owned real property in their name alone, the estate is no longer deemed to be considered small. If the real property is jointly owned, and personal property is less than $50,000, it is a “small” estate. In cases where there is real property and a will exists, a probate proceeding should be filed. If real property exists but there is no will, administrative proceedings are required. It is also suggested that even if the assets at the time of death were less than $50,000, in the event that a wrongful death or other lawsuit may be field in the future, a probate or administrative proceeding should be filed in order to preserve such future claim.

In cases of a Small Estate, NYS has a So It Yourself (DIY) program and form. NYS provide a step by step guide. For more information regarding NYS probate law and guidelines, visit NYS.Gov.

Some other points to consider when determining whether probate is or is not required to affect the transfer of property are as follows:

- In cases where property is held in joint tenancy with right of survivorship, property transfers automatically to the co-owner without the need of probate. However, in cases of “co-ownership via joint tenants in common, the property must be transferred by probate.
- In community property states, joint property will transfer to the spouse.
- Some assets, such as “transfer on death (TOD)” financial accounts such as life insurance contracts, IRAs and other retirement accounts, will transfer automatically to the named beneficiary.
- Assets held in trust, are not deemed to be held by the decedent’s estate, and therefore transfer to their heirs without the need of probate.
    - It should be noted that revocable trusts automatically become irrevocable at the time of the death of the trust grantor.

In conclusion, if a loved one has passed and you need to learn what you need to do in order to claim inheritance, or of you wish to be a voluntary administrator of an estate, it is advised that you consult with a probate attorney in the jurisdiction of the decedent’s last known place of domicile. However, it cannot be overly stressed that anyone faced with being appointed as or acting in the capacity of an executor or administrator should contact a tax specialist who is qualified and competent regarding matters of estate income taxation. Whereas law offices of probate attorneys will only handle preparing and filing the federal and state Estate Tax Returns (death taxes), many, if not most, do not handle or even advise or go near income taxes, as that is not their area of expertise unless they are qualified Tax Attorneys as well. A qualified estate income tax specialist (who also understands ERISA laws dealing with the decedent’s retirement

and death benefits) can work closely with the estate attorney and make the process to much smoother and avoid unwelcomed complications including those regarding an administrator's personal liability for unpaid taxes and claims.