

death. Automatic retitling mechanisms reduce the risk of challenges from blood relatives of the decedent and increase the probability that the decedent's assets will be left as desired.

Financial planners should focus not just on the appropriate transfer devices for nontraditional partners, but also the tax consequences of each device, including the income, gift, estate and generation-skipping transfer taxes involved. It is important to realize that nonmarried nontraditional partners will not be able to make use of the unlimited marital deduction, nor the portability of exemptions, and that substantial age gaps may trigger a generation skipping transfer tax. Some states do have domestic partnership acts that offer some protection for nontraditional relationships. As various transfer devices are discussed throughout this book, keep in mind how they may apply to nontraditional relationships.

## THE PROBATE PROCESS

### STATE PROBATE LAWS

The probate process varies among states. The discussion below focuses on the more general aspects of the probate process in order to explain how the process works.

### BEGINNING THE PROBATE PROCESS - PRODUCING THE WILL

Once a person dies, the first step in the probate process is producing a will, if one can be found. Any person can begin the probate process by presenting the will to the probate court. Generally, clients should be advised to let a trusted individual, usually the executor, know where the will is located. If the will is in a safe deposit box, banks will generally open the safe deposit box for the sole purpose of removing the will after receiving proof of death. If individuals plan to keep the will in a safe deposit box, it is wise to make a copy of the will and give this to the executor with a note stating the actual will's location. This will expedite the retrieval of the will. At this point, it is also advisable for the family to obtain multiple certified copies of the death certificate for insurance, Social Security, probate, and other purposes.

### THE PROBATE COURT

Once the will has been found or it is determined that the decedent did not have a will, then the interested parties must go to the probate court to open the **estate administration** or **succession** (a term for passing property) process. The appropriate probate court in which to bring a petition will depend on the type and location of assets owned by the decedent. For a majority of individuals, the appropriate probate court will be the court where the person was domiciled at death. A person's **domicile** is the place where the person has made their home, is registered to



Key  
Concepts

**Underline/highlight the answers to these questions as you read:**

1. Distinguish between an executor and an administrator.
2. Identify how the probate process begins.
3. Determine which individuals must post a surety bond.
4. Distinguish between letters testamentary and letters of administration.

vote, has a drivers license, filed a resident state income tax return, etc. In the event that a person holds real property located outside the city or state of their domicile, then an additional probate court must be consulted. This process is called ancillary probate. In most cases, a majority of the process is completed with the initial probate court, with only a few documents being filed in the ancillary probate court to change title for the real property situated in that jurisdiction.

To begin the probate process, the petitioner (generally the executor) must provide the court with certain information, including a certified copy of the death certificate, the last will (if available), a list of the names and addresses of the decedent's heirs, and a list of the known creditors. Depending on the state, this can be rather easy. Generally the state will have a short document that can be filled out and submitted to the probate court with the necessary documents attached. A hearing will then be scheduled for interested parties to appear. The known creditors of the estate should be notified of the date of the hearing. In addition, the date of the hearing should be publicized in the appropriate legal and community newspapers. Assuming all paperwork is in order and there are no disputes among the heirs, the hearing will be rather short. The court will accept the will, it will be filed in the public records and the court will officially open the probate process. The court will then appoint a personal representative, as is discussed below.

As mentioned in Chapter 2, if the will is a statutory will and has a self proving affidavit, the will is considered valid on its face without the need for witnesses to testify that the decedent did indeed sign the will and was mentally competent. If the will does not have a self proving clause, then witnesses will be needed at the initial hearing to validate the will.

#### **PERSONAL REPRESENTATIVE - EXECUTORS AND ADMINISTRATORS**

When the probate process begins, a personal representative will be appointed to administer the estate. Depending on whether the decedent had a will or not, the personal representative is called the **executor** or **administrator**. When females were appointed they were historically referred to as the executrix or administratrix, but today many people use the generic terms: executor/administrator. In addition, some states now use the generic all encompassing title of personal representative and do not distinguish between an executor or administrator.

In the case of a valid will in which an executor is named, the probate court usually accepts the appointed individual as executor and provides that person with powers called letters testamentary. A grant of **letters testamentary** empowers the executor to act as the agent of the court. In the event of intestacy, or where an executor cannot be appointed by the probate court, the court will appoint an administrator (generally a family member of the decedent who has the largest interest in the estate). The court provides individuals appointed as administrator with powers called **letters of administration**. The primary difference between an executor and an administrator is that the decedent chooses the executor, and the probate court names the administrator. In some states, administrators may have to formally close the estate before the probate court while an executor may be able to close informally. Letters testamentary or letters of administration are essentially equal in power and provide the holder with the legal authority to perform the functions of executor or administrator. Exhibit 4.3 identifies the primary duties of an executor or administrator in the probate process.

**EXHIBIT 4.3 COMMON DUTIES OF EXECUTOR AND ADMINISTRATOR**

When the Decedent Dies Testate (with a will)	When the Decedent Dies Intestate (without a will)
<p>The Executor:</p> <ul style="list-style-type: none"> <li>• Locates and proves the will.</li> <li>• Locates witnesses to the will.</li> <li>• Receives letters testamentary from court.</li> </ul>	<p>The Administrator:</p> <ul style="list-style-type: none"> <li>• Petitions court for his or her own appointment.</li> <li>• Receives letters of administration.</li> <li>• Posts the required bond.</li> </ul>
<b>Duties of the Executor or Administrator</b>	
<ul style="list-style-type: none"> <li>• Locates and assembles all of the decedent's property.</li> <li>• Safeguards, manages, and invests property.</li> <li>• Advertises in legal newspapers that the person has died and that creditors and other interested parties are on notice of the death and opening of probate.</li> <li>• Locates and communicates with potential beneficiaries of the decedent.</li> <li>• Pays the expenses of the decedent.</li> <li>• Pays the debts of the decedent.</li> <li>• Files both federal and state income, fiduciary, gift tax, and estate tax returns (such as Forms 1040, 1041, 709, and 706 for federal tax purposes) and makes any required tax payments.</li> <li>• Distributes remaining assets to beneficiaries according to the will or to the laws of intestacy.</li> <li>• Closes the estate formally or informally.</li> <li>• TRA 2010 permits executors or administrators of estates of decedents who died in 2010 to opt-in to the new regime and get a step-up basis or keep carryover basis and not be subject to the estate tax regime that was created in TRA 2010. (Explained more fully in Chapters 5, 6, 10, and 12)</li> <li>• TRA 2010 also permits executors or administrators to elect to donate the decedent's unused exemption amounts to his or her surviving spouse, thereby making the exemption portable. Note that this requires the executor/administrator to file a timely estate tax return, even if the estate is otherwise not required to file a Form 706. (Explained more fully in Chapters 5, 6, 10, and 12)</li> </ul>	

***Surety Bonds***

If an administrator is appointed by the court, then the administrator must generally post a bond called a **surety bond**. Some states also require a bond to be posted if the will names an individual as executor, unless a provision of the will waives the bond requirement. Although the surety bond requirement can be waived by the will or by the heirs and legatees, states generally will not allow the bond to be waived if an executor is named that is not a resident of the state in which the probate process is occurring. The purpose of the surety bond is to protect the creditors, heirs, and legatees of the estate from financial loss in the event that the administrator or executor engages in a wrongful act. In the event that the administrator or executor misappropriates assets of the estate or is negligent and causes a loss to the estate, the surety bond company will reimburse the estate for the loss. An administrator will need a formal discharge of the surety bond before closing the estate.

## MANAGING AND DISTRIBUTING THE ESTATE

Once appointed, the executor or administrator identifies and takes control of the decedent's assets. This is referred to as "marshalling the assets." After the assets have been marshalled, the personal representative compiles an inventory list of the decedent's property. The property is then valued by a valuation specialist or appraiser. Depending on the type of assets, the valuation may be relatively inexpensive or substantial in both cost and time.

The personal representative must then identify and list all debts owed by the decedent. This includes notifying potential creditors regarding the death and requesting final payoff balances. Most importantly, the personal representative must file the necessary federal and state tax returns and pay any taxes due. Remember that the personal representative must be paid (unless compensation is waived) and the court-approved advisors to the executor or administrator must also be paid. Once the debts and taxes have been paid, the probate court will generally allow the assets to be distributed to the heirs or legatees. At this point, if ancillary probate is required, then the court order allowing disposition of property is filed in the ancillary probate court to allow title to change in that jurisdiction as well.

The personal representative will first distribute the specific personal property bequests to specific legatees (e.g., a particular piece of jewelry is left to the decedent's daughter) and then the specific real property bequests to specific legatees. Only after all debts, taxes, and costs have been paid and all specific legatees have been satisfied will the residuary heir or legatee take the remaining property. After all of the assets have been distributed, the court will officially close the probate proceedings.

### POTENTIAL PROBLEMS IN DISTRIBUTION

Probate is not simple. One common problem is that assets specifically bequeathed to legatees may have been disposed of prior to the decedent's death. In these cases, unless the testator has provided some alternative asset, the legatee is not entitled to any replacement asset. This extinction of the legacy is called **ademption**.



Quick

Quiz 45

#### Highlight the answer to these questions:

1. The probate court provides an appointed administrator with certain powers represented by letters testamentary.
  - a. True
  - b. False
2. All executors are chosen by the probate court.
  - a. True
  - b. False
3. Court-appointed administrators must generally post a bond.
  - a. True
  - b. False
4. Letters testamentary provide the holder with the legal authority to perform the functions of executor.
  - a. True
  - b. False
5. In the event a decedent dies without a valid will, the probate court appoints an administrator.
  - a. True
  - b. False

False, False, True, True, True.

#### EXAMPLE 4.8

In Mike's will, he leaves a 1986 convertible to Joe. When Mike dies, he has a 1999 convertible, which he acquired when he traded in his 1986 convertible. Joe receives nothing under the will, and his gift is said to *adeem*.

Another frequently encountered problem during the probate process occurs when there are not enough assets in the estate to satisfy all of the decedent's specific bequests. If the estate is too small to satisfy all bequests, the court will generally reduce the amounts given to the legatees. This reduction is called **abatement**.

#### EXAMPLE 4.9

Len leaves \$100,000 to each of his four brothers, but when he dies, Len only has \$250,000. If Len has not decided who takes what and in what priority, the probate court will ascertain the likely wishes of the decedent. In this case, since all four brothers have equal standing, the court would likely award each 25% of the total.

Even if there are sufficient assets to satisfy all specific legatees and create a residuary estate, there remains a question as to who will bear the cost of debts and federal estate taxes and state inheritance taxes of the estate. Should each specific legatee pay his own taxes pro rata or should the residuary legatee bear the entire burden of state and federal taxes? Most states have a default presumption if the testator fails to specify, but any presumption may or may not be consistent with the testator's wishes.

#### EXAMPLE 4.10

Karen and Teddy were married and had two children, Josh and Kerstin. Teddy died with an estate valued at \$400,000. Teddy's will left \$100,000 to each child and the remainder of his estate to his wife Karen. His will did not specify how taxes should be paid, so assume the state law dictates that the estate taxes should be paid out of each bequest based on the percentage the assets bear to the estate. Also, assume the taxes were \$10,000. In this instance each person will pay based on the pro rata share they received. Since Karen received \$200,000 of the \$400,000 estate, one half of the estate taxes will be paid from her proceeds ( $(\$200,000 / \$400,000) \times \$10,000 = \$5,000$ ). Each child's net proceeds are reduced by one fourth of the tax due because they are each receiving one-fourth of the estate ( $(\$100,000 / \$400,000) \times \$10,000 = \$2,500$  per child). Thus Karen will receive a net amount of \$195,000 and each child will receive a net amount of \$97,500.

Now assume that the will stated that the state estate taxes are paid from the residuary portion. Since Karen is receiving the residuary, her portion will be reduced by the full amount of all taxes paid. Therefore, she will receive a net amount of \$190,000 and each child will receive \$100,000. The point is

that the will should be written in a clear way so as to avoid any possible ambiguity. The will is the voice of the decedent and the decedent's desires should be clearly expressed

## PROPERTY PASSING THROUGH PROBATE

Property passing through probate includes property that can be disposed of by a will, such as fee simple property, the decedent's share of property held as tenancy in common, the decedent's share of community property (as discussed in Chapter 3).

Recall that fee simple is outright ownership and does not provide for automatic retitling. Therefore, this type of property must pass through the probate process to be retitled. Similarly, there are no provisions for property held as tenancy in common or community property to automatically transfer title once the owner dies and therefore the property must be retitled through the probate process at the time of death.

In addition to real property, other tangible and intangible property also passes through probate for retitling. For example, automobiles and household goods are often disposed of through a will and must pass through probate for retitling. Finally, the probate process also retitles property owned at the time of death, but not disposed of through the will, such as intestate property resulting from the failure of the decedent to include a residuary clause in his will.



### Key Concepts

**Underline/highlight the answers to these questions as you read:**

1. Determine which types of assets go through probate.
2. Determine which types of assets do not go through probate.

## PROPERTY PASSING OUTSIDE OF THE PROBATE PROCESS

Property that passes outside of the probate process includes property that passes by state contract law, state property titling law, and state trust law. All of these transfers reduce the probate estate and therefore reduce probate transaction costs and may improve liquidity for the named heirs and legatees.

### STATE CONTRACT LAW

Transfers that avoid probate by contract allow the client to select a designated beneficiary to whom the property will be transferred. The selected beneficiary will directly receive title to the property at the death of the owner. However, before the death of the owner, the selected beneficiary does not have any rights to the property; since the owner of the property can, at any time, change, amend, or revoke any revocable beneficiary selection. In all situations, if a named beneficiary is not chosen, the property is included in the decedent's probate estate. If a beneficiary or successor beneficiary that was named predeceased the testator, and there is not a

living contingent beneficiary, then the property will transfer through the probate process to be retitled. In addition, if the decedent had named his estate as the beneficiary of a contract, then the proceeds would also transfer through the probate process.

**EXAMPLE 4.11**

Jaime owns a life insurance policy on his life with his wife Barbara named as the beneficiary. At Jamie's death, the death benefit will be paid directly to Barbara, thus avoiding the probate process.

**EXAMPLE 4.12**

Jamie owns a life insurance policy on his life. He does not have a named beneficiary. At Jamie's death, the death benefit will be paid to his estate and thus will be transferred through the probate process to his heirs.

**EXAMPLE 4.13**

Jamie owns a life insurance policy on his life. The named beneficiary is his wife Barbara, who died last year. At Jamie's death the proceeds will be paid to Jamie's estate because Barbara is deceased. Thus, the death benefit will transfer through Jamie's probate estate.

**EXAMPLE 4.14**

Jamie owns a life insurance policy on his life with his estate as the named beneficiary. When Jamie dies the assets will be paid directly to the estate and thus will transfer through the probate process.

Naming a beneficiary does not trigger any gift tax consequences. These contractual beneficiary designators are easy and efficient mechanisms to avoid the probate process, as there is no need for the asset to be retitled, since title is transferred automatically to the named beneficiary. The following are typical devices that use beneficiary designations to transfer property at the death of the owner under state contract law.

### ***Life Insurance***

Life insurance is a contract that allows the owner of the policy to name a beneficiary. The life insurance company contracts with the owner of the policy and agrees to pay the death benefit to the named beneficiary upon the death of the insured. The insurance company is thus acting as agent of the owner. For the beneficiary to collect the proceeds of life insurance, he simply has to provide a certified copy of the death certificate obtained from the local coroner's office to the insurer. Life insurance thus offers a fairly quick solution to help meet the many immediate liquidity needs that arise when someone dies.

### ***Annuities***

Annuities are contracts, similar to life insurance, where a named beneficiary can be selected by the owner of the annuity. At the death of the owner of the annuity, the named beneficiary will receive the annuity death benefit, which may come in the form of an annuity for life, annuity for term, or a cash payment. In some cases, the death benefit settlement option has been pre-selected by the owner, or if not pre-selected the beneficiary may choose any one of the settlement options allowed under the contract.

### *IRAs, SEPs, SIMPLEs, and Qualified Retirement Plans*

Retirement plans also allow the owner to name a beneficiary. At the death of the account owner, the named beneficiary receives the assets from the retirement account. The custodian of the plan or account has a contract with the owner of the account and is directed upon the owner's death to pay the beneficiary upon receipt of a certified death certificate.

### *Totten Trusts, Pay-on-Death (POD) Accounts, and Transfer-on-Death (TOD) Accounts*

**Totten Trusts**, named after the legendary 1904 Totten case (*In re Totten*, 179 N.Y. 112, 71 N.E. 748), are not really trusts at all, but are instead accounts designated as "held in trust for another." Totten Trusts are not joint accounts, and the named beneficiary does not have any rights to the account while the owner was alive. Instead, they are merely bank accounts with beneficiary designations. At the death of the account owner, the bank transfers the assets in the account to the named beneficiary. Most states have now codified the historical Totten Trust into what is now called **Pay-on-Death (POD) Bank Accounts** or **In Trust For (ITF) Accounts**. In addition, many states have statutorily created **Transfer-on-Death (TOD) Accounts** for investment accounts with named beneficiaries.

Most states have adopted PODs/ITFs for bank accounts and/or TODs for investment accounts to allow these types of accounts the same advantages as other beneficiary-designated accounts. The beneficiary designation is similar to naming a beneficiary for a retirement account or IRA and generally completed in a similar fashion. All but two states now have a similar transfer device for either bank accounts or investment accounts, with over half of the states having transfer devices for both types of accounts. State laws vary and a full understanding of applicable state law is needed when selecting such designations.

### **STATE TITLING LAW**

Property held as a joint tenancy with rights of survivorship (JTWROS), or as a tenancy by the entirety (TE) pass outside of the probate process because of the automatic retitling mechanism of the survivorship feature. At the death of a joint tenant, his or her interest passes automatically to



### Quick Quiz 4.6

**Highlight the answer to these questions:**

1. A decedent's interest in property owned "joint tenancy with rights of survivorship" with his surviving brother will not pass through probate.
  - a. True
  - b. False
2. A revocable living trust is a device that may be used to avoid the probate process.
  - a. True
  - b. False
3. Life insurance proceeds payable to the decedent pass through the probate process.
  - a. True
  - b. False
4. Property held "tenancy by the entirety" will pass through probate for retitling.
  - a. True
  - b. False
5. A bank savings account with a listed pay-on-death beneficiary avoids the probate process.
  - a. True
  - b. False

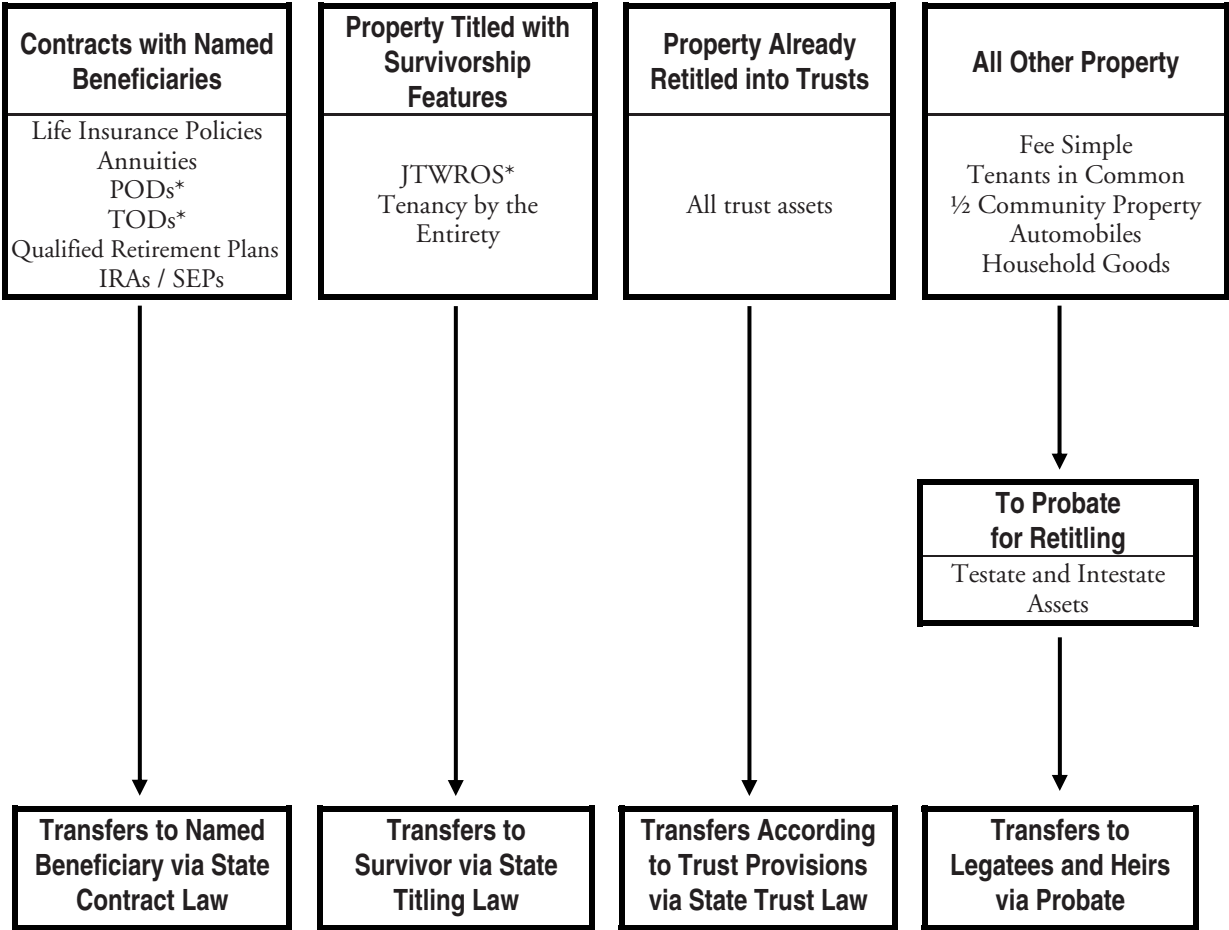
True, True, True, False, True.

the surviving tenant, or in the case of TE, to the surviving spouse. The surviving joint tenant must produce a certified death certificate of the decedent in order to transfer title.

**STATE TRUST LAW**

As discussed in Chapter 8, all trust property will pass outside of the probate process per state trust law. Property in trust has already been retitled because when the grantor of the trust transferred the property into the trust, it had to be retitled as trust property. Even in the case of a revocable trust, the trust becomes irrevocable upon the grantor’s death. Property in trust is managed and distributed according to the specific provisions of the particular trust and has no further need to be retitled. Exhibit 4.4 illustrates various assets and how they pass through and around probate.

**EXHIBIT 4.4 ASSETS PASSING THROUGH AND AROUND THE PROBATE PROCESS**



\*PODs - Pay-on-death bank account with named beneficiaries.  
 \*TODs - Transfer-on-death investment accounts with named beneficiaries.  
 \*JTWROS - Joint tenancy with right of survivorship.