

10-1957

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Recommended Citation

Kitchen, Gertrude H. (1957) "Estate Administration," *Woman C.P.A.*: Vol. 19 : Iss. 6 , Article 5.
Available at: <https://egrove.olemiss.edu/wcpa/vol19/iss6/5>

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ESTATE ADMINISTRATION

By GERTRUDE H. KITCHEN, C.P.A., Baltimore Chapter

The subject of estates is, of course, a very broad one. Volumes have been written on a number of subdivisions of the subject such as estate taxation, administration of estates, estate planning, accounting for estates, the relationship of trusts to estates, the role of insurance in estates and so on. My idea, however, in choosing the topic of Estate Administration was to bring to the attention of those who have not had experience with estates, the practical effect of what happens when someone dies. The accountant's role in estate confines itself to preparation of administration accounts, preparation of income and federal tax returns, maintaining books, preparation of profit and loss or net worth statements, valuing of assets, particularly goodwill and capital stock of a close corporation, and, in estate planning, the tax effects of various plans.

I will touch very lightly on ESTATE PLANNING, concentrate the ADMINISTRATION OF AN ESTATE. There is no estate plan which suits any two or any group of people. Instead, each person's plan should be based on many facts including his worth, health, age, who are his next of kin, whether he owns his business, whether he is a member of a partnership, whether he has any dependent heirs, etc. Some of the devices used in an estate plan are:

1. Gifts during life time
2. Life insurance
3. Business insurance and stock purchase agreements
4. Marital deduction
5. Revocable and irrevocable trusts
6. Will

The purpose of an estate plan is to have outlined before one dies what he desires to be done with his property after his death, and to save as much taxes as possible. However, it should be realized that the saving of taxes is not always of primary importance. As a general rule an estate is most advantageously planned by a team of people consisting of a lawyer, a certified public accountant, a trust company and a life insurance man.

In discussing the ADMINISTRATION OF AN ESTATE I will enumerate the various steps usually involved.

1. Almost immediately upon one's death (often even before there is time to shed tears) it must be determined if the decedent

has left a will. If so, it must be located. The reason for the urgency is to find out if the decedent has left any instructions as to his burial and to see if he has named an executor so that such person can assume authority and take responsibility for making decisions regarding burial, etc. Usually before a person dies he will inform the executor that he has been so named. Upon locating the original copy of the will and ascertaining that the decedent did not change his mind, the executor will immediately take over. However, there are a number of cases where the fact that a person was named as an executor came as a complete surprise to him. After the will is located and a search made to make sure there is no later will or a codicil to the will, it should be taken to the register of wills or clerk of the orphans court, in the county or city in which the decedent maintained his last domicile, with the request that it be admitted to probate. If the executor is not a lawyer or a trust company, a lawyer is usually called in to advise the executor what procedure to follow from then on.

If a will cannot be located, the lawyer will advise the next of kin to either have himself appointed to act in lieu of an executor (in which case he is known as an administrator instead of an executor) or to renounce his right to be named administrator in favor of whomever he wishes to act. If there is more than one next of kin, each one has a right to act as administrator. Those who do not want to act can renounce in favor of anyone they choose.

In the case of a will having been left, the register of wills will notify the witnesses to appear at the register of wills office. The witnesses will be asked to swear under oath that they saw the decedent sign the will, etc.

The register of wills then gives the executor or administrator a certificate stating that the will has been admitted to probate.

2. The second step is for the executor to make an appointment with an appraiser from the orphans court to take an inventory of the estate's assets. This is usually done within the first week after the death. The values placed on all the items listed are supposed to be fair market values. Such inventory is filed with the register of wills as promptly as possible. Included in this inventory are the assets which pass by law into the jurisdiction of the executor. This

does not include life insurance wherein the beneficiary is someone other than the estate, and jointly owned property which passes on death to a named survivor other than the estate, and real estate which is not administered under the will. If property is owned as tenants in common by two (or more) people, it is considered that each owns an absolute interest in one-half of the property. If one of such persons dies, his one-half interest would be included in the administration of his estate. If property is owned as joint tenants with right of survivorship or as tenants by entireties, on the death of one the property passes direct to the survivor and is not administered through the estate. However, the survivor should pay voluntarily to the register of wills the inheritance tax on the portion of such property which had been acquired with funds supplied by the decedent or had been previously inherited by the decedent. The executor will sometimes file a list of decedent's debts as it is determined what they are. However, it appears to be a more common practice not to file such a list, but merely to account for them in the first administration account.

3. A checking account is opened in the name of the estate. To it is transferred all the cash in any bank accounts of the decedent as well as all cash on hand at date of death. This account is maintained for the receipt and disbursement of all cash coming into the estate by way of sale of assets, dividends on securities, etc. and payment of all bills.

4. A notice to creditors is then published in some local newspaper for a specific number of times. This gives any creditor of the decedent the opportunity to file a claim against the estate. If a creditor does not do this within the time prescribed in the notice, he forfeits his right to the claim.

5. Within thirty days after decedent's death a "preliminary notice" must be filed with the District Director of Internal Revenue if the gross estate exceeds \$60,000.00 This is the first contact the estate has with the federal government. On this form is listed the approximate value as of date of death of all assets. The assets to be included in this form are not only the ones in the inventory filed in the probate court but also life insurance regardless of who the beneficiary is, jointly owned property, real estate, annuities, etc.

6. The next step is usually the filing of a petition for payment of funeral expenses.

7. At the end of the calendar year (assuming the decedent's taxable year was a

calendar year) the executor must file federal (and sometimes local) income tax return for the decedent. This is known as the "decedent's final return" and is prepared on a form 1040. It should include all income tax items up to the date of the decedent's death. If from the date of death to the last day of the calendar year, the estate had income in excess of \$600.00 a federal fiduciary income tax return (form 1041) must be filed unless the estate elects a fiscal year. This form is very similar to an individual income tax return. For each calendar year thereafter a fiduciary return must be filed if the income exceeds \$600.00 in any year.

8. Probably the next thing to do is prepare the federal estate tax return. It is due 15 months after date of death, on form number 706. From time to time the treasury department revises this form, so if you are ever called on to use one, make sure you have the latest form. The instructions with this form are as a rule quite complete, and state that there is a choice of using either (1) the value at date of death or (2) an alternate value. The method elected must be used for all items. Values at date of death are intended to be fair market values and the method of obtaining them is particularly prescribed for certain items. Special attention is called to the method required for valuing securities listed on a stock exchange and for valuing the net worth of a sole proprietorship or stock in a closely held corporation. Generally the alternate value is (1) for assets still owned by the estate one year after death — their fair market value on such date and (2) for assets sold prior to one year after death — the sale price of such assets. The assets included on the federal estate tax return are not only the ones included in the administration of the estate in the local courts but also real estate, jointly owned property (regardless of who the joint owner is), life insurance and certain other items. In connection with jointly owned property, the full value of the property must be included in the gross estate unless it can be proven that a part of the property originally belonged to the surviving joint tenant. Federal estate taxes are a graduated tax and range from 3% on the first \$5,000.00 of the taxable estate to 77% on the portion in excess of \$10,000,000.00 Often in trying to save federal estate taxes the executor strives to keep the value of each asset as low as possible. This sometimes proves to be a fallacy. If that asset is subsequently sold by the person who inherits it, his basis

for reporting the sale on his income tax return is the value used on the federal estate tax return. The result may be that it costs 25% in income taxes to save 18% in federal estate taxes. Another item on the federal estate tax return to which I wish to refer is the marital deduction. Generally the significance of this is that when a man or woman dies the value of the estate which passes to the surviving spouse may be deducted. This deduction is known as the marital deduction. However, such deduction may not exceed 50% of the taxable estate. When the estate tax return is filed, the executor usually writes a letter requesting the treasury to examine it and discharge the executor from any personal liability in connection with it. If such a letter is written, the treasury department cannot hold the executor liable for any additional tax unless it so assesses it within a year after the letter is filed. However, the treasury department has three years within which to assess an additional tax on the heirs.

9. After it is determined what the federal estate tax will be, the executor is in a position to know whether certain of the estate assets must be sold to pay the tax. The executor makes this decision and determines which assets to sell, if any. If he is sure there will be enough left to make a distribution of all the specific legacies per the will as well as part of the rest and residue, he then prepares his first administration account and files it with the register of wills. This account consists of charging the executor with all assets on hand at date of death plus all assets received from the date of death to the date of the filing of the administration account plus gains on all property sold since date of death; and crediting the executor with all items paid since date of death including funeral expenses, decedent's debts, administration expenses, federal estate taxes, executors commission and the tax thereon, and distributions to the legatees as well as the inheritance tax withheld from such distribution. Even in preparing this first account the executor makes sure he retains enough in the estate to pay additional federal estate taxes if they are assessed upon examination of the return. Otherwise, the executor can be held liable for such tax. The executor's commissions are based on the gross estate and are usually, as prescribed by the Maryland law, for an estate involving no unusual problems:

10% of the first \$20,000 and
2% of the balance.

Inheritance taxes in Maryland are a tax,

not on the estate, but on the person receiving the inheritance and are based on the inventory value of the property depending on the heir's relation to the decedent as follows:

Lineal tax (parents, children,
grandchildren, wife) 1%

Collateral tax (any other person) 7½%
This tax is deducted by the executor from each legatee's share before he gets his distribution. Incidentally, the distribution one receives from an estate is, of course, not subject to income taxes.

10. Once the estate tax return has been examined and the treasury department sends the executor a letter releasing him from liability, the executor files his final administration account and distributes the entire balance of the estate.

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to build and supervise as varied a list of securities as that owned by most investment trusts. These funds offer an ideal investment medium for the person without the time, temperament, talent or training to do their own investing. There are many kinds of funds. Some stress income, some growth, some special fields such as electronics, natural gas, chemicals, and some stress geographical locations of special interest such as Canada, Texas, etc. Here again a close look at your particular requirements is a *must*. Mutual funds are an excellent medium for pension funds, schools, hospital groups, private trustees, and gift giving. Many states now permit children to own securities (managed by a custodian until 21) without the necessity of a trust instrument. This facilitates gift giving to minors.

An interesting way to learn more about the stock market, if you are willing to invest a little money and some of your time monthly, is by joining one of the popular investment clubs. There are thousands in the United States and Canada. If there isn't one in your area, start one—perhaps among your bridge club members, your bowling team, your friends at work. Any interested group can form the nucleus of an investment club. You will have fun—you usually meet once a month—you will invest a little money each time, \$10 or \$15, and you will learn to analyze corporations (usually clubs confine their purchases to stock of growth companies). Then a little later, when you may have much larger sums to invest, you will have a better idea about how it should be done.

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