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Post-Mortem Administration Checklist for the CPA Financial Planner

by Andrew L. Whitehair

In a letter Benjamin Franklin wrote to Jean-Baptiste Leroy in 1789, Franklin quipped, “In this world, nothing can be said to be certain, except death and taxes.” Though we can debate who first coined this iconic phrase, mortality, both ours and our clients’, is not debatable. As the American population ages, dealing with the complex tax issues surrounding client deaths will inevitably become more prevalent for CPA financial planners.

Given the low frequency of deaths in any particular client base, many CPAs have not yet gained much experience with death-related issues. As a result, many of those unfamiliar with post-mortem administration may miss several important opportunities or fail to avoid major pitfalls. Conversely, those familiar with the intricacies can provide some well-thought-out strategies for future generations’ success.

The following post-death checklist provides some key areas to consider when handling your client’s estate.

IRC Section 645 Election. Many of the planning opportunities described below hinge on making this strategic election. If the decedent has the power to revoke the trust on the date of the decedent’s death, then the trust is deemed a qualified revocable trust (QRT) and eligible to make an IRC Section 645 election. This election effectively treats the QRT as part of the estate and provides numerous benefits, including selecting a fiscal year-end and combined tax reporting. The election is made on Form 8855 and generally must be filed on or before the due date, including extensions of the estate’s initial income tax return. Late-filed Section 645 elections are not allowed, so pay careful attention to the filing deadline.

Fiscal Year Ends. While trusts typically must adopt a calendar year end, estates are free to choose a fiscal year end. Since QRTs that make a Section 645 election are considered estates for tax purposes, QRTs can adopt the fiscal year end most beneficial to them. For example, if your client dies in March 2013 and a Section 645 election is subsequently made, the trust can adopt a fiscal year end as late as February 2014. Distributions made from the estate, trust or both during 2013 are reported on the Feb. 28, 2014 fiscal year end return, passing through any taxable income to the beneficiaries’ 2014 tax returns. This provides an additional year of income tax deferral. Be mindful to work closely with other advisers to ensure optimal timing of (1) income receipts, and (2) asset sales to ensure tax minimization and maximum tax deferral.

S Corporation Status. A Section 645 election can also help a client avoid tax pitfalls, particularly if a client’s estate owns S corporation stock. Trusts are eligible S corporation shareholders only in limited circumstances, and generally only if an election is made. However, an estate is an eligible shareholder during the period of estate administration. A Section 645 election can extend the time by which a trust is an eligible shareholder, potentially avoiding the disastrous result of an inadvertent S corporation termination. Pay special attention to the expiration of the Section 645 period (the longer of two years from date of death or six months from receipt of an IRS closing letter), because S corporation shares that continue in trust may require a special election.

Charitable Set-aside Deduction. Trusts are generally able to take a charitable deduction only for amounts authorized by the trust agreement and actually paid to charity. However, an estate or Section 645 trust is eligible to claim a charitable deduction for amounts permanently “set-aside” for charitable purposes. Taking advantage of this deduction can provide income tax savings for estates of which a portion of the residual estate goes to charity.

IRA Planning. If the beneficiary of an inherited IRA is a surviving spouse, that spouse can roll the IRA into his or her own name, possibly deferring distributions until age 70½. Non-spouse beneficiaries must understand that distributions can be spread over their life expectancies, allowing for greater deferral and stretching the tax impact over several years. Furthermore, if a decedent dies after the required beginning date for required minimum distributions (RMDs), then the IRA beneficiaries must take the remaining RMD by the end of the year of the decedent’s death. Failure to do so can result in a 50% excise tax penalty.

IRD Deduction. An important but often overlooked deduction is the one allowed for income in respect of decedent (IRD) items, such as IRAs, qualified plans and wages. The deduction can help partially offset taxable IRD income for beneficiaries of larger estates subject to the estate tax. Calculate this deduction for the estate and create carry-forward schedules to ensure the deduction is claimed in future years when the related income is recognized.

Estate/Trust Distribution Planning. Given the top marginal rate of 39.6%, plus the fact that the 3.8% net investment income tax applies to estates and trusts with taxable income in excess of only $12,150 in 2014, it is important for clients to consider making interim distributions from the estate, trust or both during the administrative period to avoid paying unnecessary tax. To simplify reporting and avoid unfair tax treatment, pro-rata distributions are generally best.

Final Individual Tax Return. If the decedent has a surviving spouse who did not remarry, married filing joint status is available in the year of death. Therefore, consider which filing status will best maximize tax savings and do not overlook the deduction for medical expenses. Care should also be taken in allocating the income correctly between the 1040 and 1041, ensuring inclusion on the proper tax return. Also, while most carryovers are eliminated at death, pay special attention to both Section 469(g)(2), which allows passive activity losses in the year of death, if the loss exceeds the value of the step up in basis, and Section 196(b), which allows a deduction for unused qualified business credits.

Verify Basis "Step-Ups." IRC Section 1014 provides that property acquired from a decedent receives a new tax basis equal to the fair market value (FMV) at the date of the decedent's death or alternate valuation date if elected. While many investment firms have processes in place to ensure the basis is correctly adjusted upon death, mistakes frequently happen. Add value by working closely with your client's investment advisers to ensure assets are correctly stepped up to their FMV and coded as long-term property.

Section 754 Election. In addition to step-ups on brokerage accounts, clients with interests in partnerships should also consider making a Section 754 election. There are three points to keep in mind:

1. In many cases, another tax preparer may handle the partnership's tax returns, so coordinate with that preparer to ensure a Section 754 basis adjustment is made to accelerate deductions into earlier years.
2. For clients with real estate partnerships, consider suggesting a cost segregation study to ensure any basis adjustment is allocated into the correct asset classes. This will shift basis to assets with shorter depreciable lives.
3. The popularity of publicly traded partnership investments provides another area to add value for deceased clients. Contact the tax support hotlines of these investment partnerships to inform them of the death, and ensure future K-1s accurately report capital and ordinary gains on the eventual sale of the partnership.

Excess Deductions on Termination. Under Section 642(h)(2), non-business deductions in the year of the estate's or trust's termination pass through to the beneficiaries as miscellaneous 2% expenses. If the estate/trust will receive no benefit in a prior year, consider deferring those deductions or accelerating payment to avoid the 2% limitation.

Administrative Expenses. The attorney preparing the estate tax return may be focused primarily on minimizing the estate tax, hence maximizing estate tax deductions. However, administrative expenses may generally only be deducted on either Form 706 or Form 1041, but the same expense cannot be claimed on both forms. Because an election waiving the right to claim administrative expenses is generally needed on Form 706, it is important to communicate with the estate attorney so that expenses are taken where they generate the most value. With top marginal income tax rates now higher than top estate tax rates, the choice of where to claim administrative expenses is not always apparent and requires careful planning and coordination.

A Way to Build More Business

Though every estate presents its own unique challenges, these planning ideas may help you add value and avoid mistakes. Knowledge of post-mortem administration can build business among your existing clients and referral sources because they view you as a valuable member of the estate planning team. No one likes to think about death, but CPA financial planners prepared to have the necessary difficult discussions and equipped with post-mortem administration skills can bring substantial value for their clients and survivors for the long term.

About the Author

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AICPA PFP Resources

The AICPA's PFP section has a number of resources with more information to help CPA financial planners educate themselves, and their clients, on end-of-life matters.

- The *CPA's Guide to Financial and Estate Planning*—This guide is designed for professionals who structure, tailor and administer financial and estate plans. In the clearest of language, the guide explains all the important planning concepts, and examines the most important techniques used to set and meet the financial goals of clients and their families. The guide, available as a free download to PFP section members, inclusive of CPA/PFS credential holders, includes four separate volumes, with content in each one applicable to post-mortem administration.
- *A Guide to Financial Decisions: Implementing an End-of-Life Plan*—Although the content in this publication is designed to educate the public on these issues and encourage them to seek professional assistance, the guide is available as a PDF at no charge for CPAs to use as they interact directly with their clients and prospects as well as other professionals who might be involved. The guide can also be customized with your logo on the front cover and your name and contact information on the back cover.
- Elder Planning Websites—This comprehensive list includes organization websites related to aging and eldercare.
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