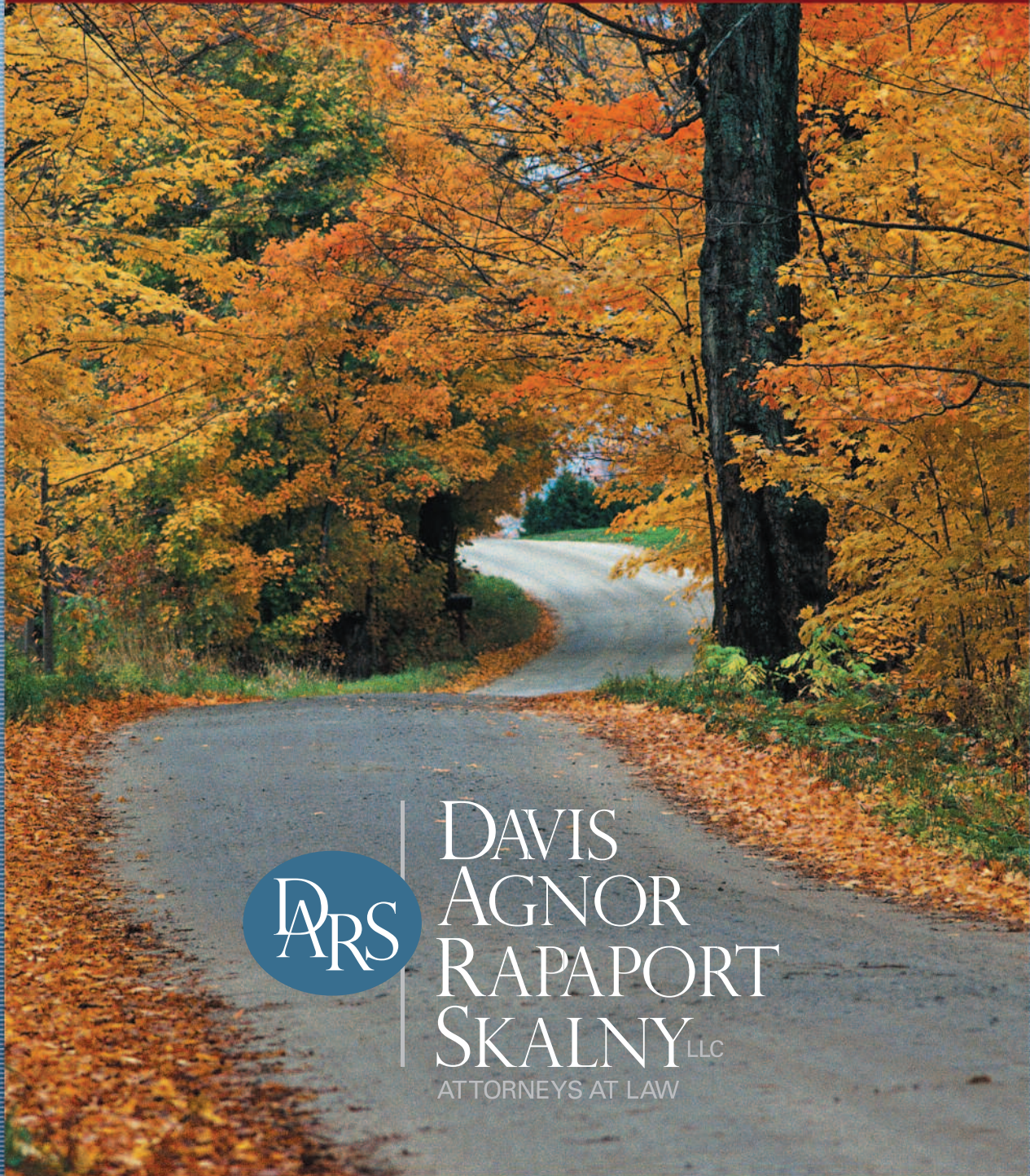


Some “Plain English” on Probate



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Some “Plain English” on Probate

During a time when families are dealing with the emotional trauma of losing a loved one, facing the prospect of understanding how to wind up the worldly affairs of that loved one can be overwhelming. The purpose of this pamphlet is to outline, in “plain English,” the procedures that should be followed when dealing with probate.

It has been our experience that the nature and issues involved in each probate estate are as unique as each individual. Therefore, the understanding of the general concepts contained in this brochure is just the beginning.

Probate Defined

Simply put, probate is the process by which the government both insures that the creditors of the decedent are paid and authorizes the personal representative to take whatever action is necessary to transfer property from the decedent to the decedent’s beneficiaries in accordance with the decedent’s directives. The Orphans’ Court, in conjunction with the Register of Wills, in each county oversees these functions.

When a person (the “decedent”) dies, someone must take responsibility for winding up the de-

cedent’s worldly affairs. That person is the personal representative. This person is also known as the executor or the executrix. The total of all of the decedent’s property is called the decedent’s estate, and this property must be identified and appraised. From the estate, debts of the decedent (including taxes) are paid and distributions are made to the decedent’s beneficiaries. Probate provides an orderly, court-supervised process for achieving these goals.

Please note that even if there is no probate property, there is a legal requirement to file the original of a Will and certified copy of the death certificate with the Register of Wills in the decedent’s county of residence in a timely manner. In addition, the Register’s Office will require that an Information Report be completed concerning non-probate property. The Information Report is discussed under the Probate vs. Non-Probate section of this pamphlet.

The Probate Process

The probate process begins when an estate is opened with the Register of Wills. This is done by filing a Petition for Probate with the Register of Wills in the county where the decedent resided. The original copy of the decedent’s Will (together with any Codicils, which are amendments to the Will) and the death certificate are filed along with the Petition. The Petition includes what is called a “Schedule A,” which is a rough approximation of the value of the estate. The Register of Wills then appoints the person nominated in the decedent’s Will as the personal representative, and issues Letters of Administration, which authorize the personal representative to act in the decedent’s place in all matters. If a person dies without a Will, the Register of Wills will still appoint a personal representative on a priority basis established by law.

A bond must also be filed. A bond provides a guarantee that the personal representative will perform his duties faithfully, in accordance

with the Will and the law. If the Will states that the requirement of a bond has been waived, it will still be necessary to file what is called a “nominal bond,” which is a guarantee to the State that inheritance or estate taxes will be paid when due. In all other cases, including estates where there is no Will, a bond in the amount established by the Register of Wills will have to be filed by the personal representative. Any expenses related to procuring a bond is paid from the estate’s assets.

In addition, a List of Interested Persons must be filed that identifies all of the legal heirs of the estate, including their addresses. Finally, a Notice to Creditors must be filed with the Petition for Probate. This Notice will be sent by the Register of Wills to a local newspaper to be run once a week for three consecutive weeks.

Within 90 days after the estate has been opened, the personal representative is required to file an Inventory with the Register of Wills. This is a detailed listing of all of the probate property that was owned solely by the decedent at the time of the decedent’s death. (Probate property will be further described later.)

Not only does all of the probate property have to be identified, but the value of that property will have to be stated. Usually this is done by having the property appraised by a qualified appraiser, although there are some types of property that can be appraised by the personal representative (e.g., publicly traded stocks and bank accounts).



Also within 90 days of opening the estate, the personal representative must file an Information Report with the Register of Wills. Specific types of non-probate property, which are discussed in a later section, must be identified and valued in the Information Report. For example, if property of the decedent was transferred within two years before the date of death, it is normally presumed that the transfer was made in contemplation of death, and the value of that transferred property must be taxed.

There is a common misperception that while an estate is being probated, there can be no distributions to the beneficiaries, even in cases of need. That is not the case, even though, in most cases, distributions are kept to a minimum for administration purposes. A personal representative may not make a distribution if by doing so, legitimate expenses and taxes cannot be paid. In addition, a personal representative must follow the provisions of the Will (or, if there is no Will, the distribution provisions contained in the law) in making any distributions. If there is any doubt about whether a distribution should be made

prior to the closing of the estate, the personal representative may ask the Orphans’ Court for the authority to make any such distribution.

Once nine months have passed from the time the estate is opened, an accounting must be filed that shows all of the

income and expenses of the estate from the time the estate was opened. In most cases, the estate can be closed at this time, which means



that 20 days after the accounting is approved by the Orphans' Court, distributions can be made to the beneficiaries. Where there may be outstanding matters that preclude the closing of the estate at the time that the first accounting is filed, the personal representative continues to administer the estate until all those outstanding issues are resolved, providing periodic accountings as required by law. Typically, however, it takes approximately 9 to 12 months to take an estate completely through probate.

Maintaining Records

The successful completion of the probate process in a timely manner is contingent upon keeping complete and accurate records during this process. In order to insure that everything is properly reported to the Register of Wills or to the Internal Revenue Service, the following suggestions should be followed:

1. Establish an Estate Checking Account.

After the death of the decedent, the personal representative will receive checks from the decedent's employer, from investments that were owned by the decedent, from tax refunds, and from a host of other sources. These checks should be deposited into a checking account that is opened in the name of the estate. Before any check is deposited, however, a photocopy of that check should be made so that if there is ever a question about the deposit, it can be answered easily and quickly. Note that before a checking account can be opened, the personal representative must obtain a taxpayer identification number from the IRS by filing a form SS-4.

2. Keep All Receipts. Whenever a bill is paid by the personal representative, a copy of that bill should be kept with the estate's records. It should be noted on the copy when the bill was paid and the check number from the estate checking account that was used to pay the bill. If a person is reimbursed from the estate checking account for expenses paid on

behalf of the estate, a detailed record of that reimbursement should be made at the time of the reimbursement, including copies of any bills paid by that person.

3. Convert Accounts to Estate Accounts.

The decedent's bank accounts and investment accounts should be changed from the decedent's name to the estate's name. If the decedent maintained numerous accounts, the personal representative may combine these accounts into one or more accounts.

4. Funeral Expenses. Because funeral expenses are a priority item to be paid by the estate, and because these expenses are often scrutinized by the Register of Wills, the receipts associated with the decedent's funeral should be maintained in a separate file.

Small Estates

If the probate estate is valued at \$30,000 or less (\$50,000 if the sole beneficiary of the estate is the surviving spouse), the much simpler small estate probate process may be used.

The administration of a small estate, like a regular estate, is initiated by filing with the Register of Wills a Petition for Probate, the original Will (and Codicils, if any), a List of Interested Persons, and a death certificate. In addition, an inventory (with appraisals, if appropriate) is filed as part of the Petition, as is a list of all of the decedent's known creditors. Finally, copies of any funeral bills are submitted to the Register of Wills. Although this sounds like a lot, once these papers are filed, there is very little more to do to wind up the estate.

With a small estate, a bond may not be required and no commissions are paid to the personal representative. The maximum probate fee is \$150, but may be less, depending on the value of the estate.

One potential complication with a small estate arises when the small estate is larger than the

sum of the probate administration costs, allowable funeral expenses, and statutory family allowances. If the estate exceeds these amounts, a Notice to Creditors has to be filed, in which case the estate cannot be closed until after the six-month notice period has elapsed. This situation may also require that a bond be posted.

After all of the required information and forms are submitted to the Register of Wills, the personal representative is appointed and the creditors are paid so that the estate can be closed and distributions can be made. No final accounting needs to be submitted to the Register of Wills, although the personal representative will have to file a certificate stating that all that needed to be done was done.



cannot be met, then the estate must continue under regular administration.

Under modified administration, the formal inventory and final accounting are combined into a final report that must be filed within 10 months of opening the estate. Although this seems simpler than what is required in a regular probate administration, essentially the same information is required.

Because there can be no extensions for filing the final report or for making distributions, and because of the potential for being required to convert a modified administration to a regular administration, this form of probate administration is reserved for very limited situations where there is no possible dispute among the beneficiaries and where there is no likelihood that administration will be delayed because of the inability to sell asset of the estate, such as a home.

Modified Administration

The concept of “modified administration” was created to respond to concerns that the probate process was just too complicated when only spouses and children were involved as beneficiaries. A streamlined set of procedures was formulated to make the probate process simpler in these limited situations. Unfortunately, this response has not been as useful as was once hoped.

In solvent probate estates where the beneficiaries are limited to spouses, children, or trusts established for spouses or children where the spouse is the trustee, modified administration of the probate estate can be elected. If modified administration is elected, all of the paperwork required for administering the probate estate must be completed within 10 months of opening the estate, and all distributions must be made within 12 months of opening the estate. If either of these time limitations

Miscellaneous Probate Considerations

- **Funeral Expenses.** It is the personal representative’s responsibility to pay for any funeral expenses from the assets of the estate. If the decedent’s Will specifically authorizes the personal representative to pay funeral expenses without court supervision, and if the estate is solvent, no court order is required. Otherwise, such expenses will be limited to \$5000, without express prior authority from the Orphans’ Court.
- **Out-of-State Property.** If the decedent owned real property in another state, that property will have to go through the probate process in that state by what is called an “ancillary probate proceeding.” It is an ancillary probate proceeding because the

primary probate of the decedent's estate is performed in the state of the decedent's residence at the time of his death. Each state has its own probate process, so it may be necessary to retain an attorney in that state to handle the probate on behalf of the personal representative. This is why many people are using revocable living trusts, at least in part, to hold title to real property owned in other states. Real property held in trust eliminates the need for an ancillary probate proceeding for that property. Of course, applicable state inheritance taxes still have to be paid.

Will Contest

What happens if a beneficiary believes that a Will was signed under duress or through undue influence, or if the beneficiary believes that the signer of the Will was not competent when the Will was signed? Or, what happens when a disgruntled family member wants to contest the terms of a Will? Or, what happens if a Will was not properly executed or does not meet all of the formal legal requirements? The answer is that a beneficiary may initiate a caveat proceeding before the Orphans' Court. In this proceeding, the Orphans' Court is asked to determine the validity of a Will, or to interpret the terms of the Will.

Caveat proceedings are meant to protect the rights of the decedent. For example, there was a case before Maryland's Court of Appeals involving an elderly gentleman who, in the last days of his life, executed a Will naming a live-in helper as his sole beneficiary, totally excluding his family. The gentleman needed a helper because he was partially blind and paralyzed, and was unable to read, write, or manage his financial affairs. After working with the gentleman for only one month, the helper retained an attorney to draft a Will, and did not allow the gentleman to meet with the attorney. The Orphans' Court, after reviewing

the circumstances, set aside the Will on the basis that the helper exercised undue influence over the decedent. The system worked in this case.

Just like any other case before a court, caveat proceedings are lawsuits where the person questioning the validity of a Will brings a petition against the estate. Sometimes, these lawsuits can take many years to resolve, at great expense. This is why it is so important to have sound legal advice when a person is contemplating making a significant change in beneficiaries in a new Will or Codicil.

Probate vs. Non-Probate Property

Generally, any property owned in the decedent's name at death is probate property. This includes bank accounts, stock certificates, investment accounts, real estate, personal property, and any other property that was solely owned by the decedent at the time of death.

Non-probate property is property that passes by virtue of a beneficiary clause or by operation of law. Some examples of non-probate property include:

- **Jointly-Owned Property.** Property, such as property owned as tenants by the entireties with a spouse, or as joint tenants with rights of survivorship ("JTWRROS") with a non-spouse, becomes the property of the surviving owner automatically upon the other owner's death.
- **Beneficial Interest Property.** Property in which one has a beneficial interest is property that passes as the result of a beneficiary clause to a named beneficiary other than the estate. This generally includes life insurance proceeds, annuities, and pension and retirement funds. It would also include bank accounts that employ a "payable on death" provision or an investment account that employs a "transfer on death" provi-

sion. Of course, if the estate is named as beneficiary or if no beneficiary is named, then the property passes to the estate and is subject to the probate process.

- **Trust Property.** Property held in trust for the decedent's benefit is trust property. This property, because it is not in the decedent's name, is not included in the decedent's estate. There are many types of trusts being employed today, such as bypass (or credit shelter) trusts, revocable living trusts, life insurance trusts, and irrevocable trusts established to benefit children or grandchildren.
- **Life Estates.** Real property can be transferred by one person to another but still allow the original owner to retain the use of the real property for the rest of his or her life. The original owner may retain the right to sell or mortgage the property. This retained interest is called a life estate. Upon death, the life estate terminates, and the person to whom the property was transferred has full ownership and use of the real property. This is a very useful probate avoidance technique depending on the intent of the owner of the property and the nature of the property.

Dying Without a Will

What happens if someone dies without a Will? If a person dies without a Will, that person is said to have died intestate, leaving an intestate estate. This creates three immediate implications. First, since the decedent did not identify a personal representative, the Orphans' Court will have to do so. Usually this will be a surviving family member. Second, a bond is posted for the amount of the intestate estate or for such amount as established by the



Register of Wills. Finally, the estate must be distributed in accordance with the intestate laws of Maryland.

Dying without a Will does not mean that the estate will pass to the State, for it almost certainly will not; but it does mean that the estate will most likely not be distributed in accordance with the true wishes of the decedent. For example, if a decedent leaves a surviving spouse and adult children, the spouse will receive, in addition to any family allowance, one-half of the estate, and the adult children

will split the other half of the estate. The intestate laws provide numerous other distribution options that depend on the make-up of the surviving family.

By the way, the only time that an estate would pass to the State is when the personal representative cannot identify any surviving members of the decedent's family, no matter how remote the relationship may be. In those cases, the estate is transferred to the Board of Education in the county in which the decedent was a resident.

The Taxable Estate

One of the most confusing aspects associated with administering an estate is sorting out all of the various taxes that may need to be paid. In recent years, there have been some dramatic improvements to the tax laws; however, these taxes still must be considered during the probate process, especially since the penalties associated with non-compliance or non-payment are often severe.

There are five different types of taxes that must be considered:

I. Maryland Inheritance Tax. The Maryland Inheritance Tax generally applies to

all probate property. However, it also applies to retirement accounts, to jointly-owned property (other than property held by husband and wife), to property held in certain trusts for the decedent's benefit, and to certain life estates. Fortunately, this tax has been limited so that distributions to spouses, children, spouses of children, stepchildren, grandchildren, spouses of grandchildren, parents, brothers and sisters, and grandparents are no longer taxed. Distributions to all others, such as nieces, nephews, aunts, uncles, cousins and friends, are taxed at the rate of 10%.

2. Federal Estate Tax. The Federal Estate Tax is imposed on the same property as the Maryland Inheritance Tax, which includes both probate and non-probate property; however, there are no exemptions from the tax, other than the decedent's spouse, that are based on the relationship of the beneficiary to the decedent. In other words, all of the decedent's property may be subject to the tax.



In addition, the Federal Estate Tax extends to property such as life insurance proceeds from policies owned by the decedent or in which the decedent had ownership rights or powers. Annuities are treated in much the same way as life insurance, except for establishing the value to be included.

The Federal Estate Tax was overhauled in 2001 by Congress so that by 2010, the tax should be eliminated. In the meantime, however, the tax remains and can have a significant impact on the estate. Estates that were valued over \$1 million were subject to the Federal Estate Tax in 2002 and 2003. In 2004, the tax started on taxable estates that were in excess of \$1.5 million. In 2006, the amount that can be protected is \$2

million. In 2009, this number goes up to \$3.5 million. Assuming that Congress does not change the tax laws in the meantime, in 2010, the estate tax is eliminated altogether, only to come back in 2011 at the \$1 million dollar level. Undoubtedly, Congress will change this arrangement before 2010, but the extent of those changes is currently impossible to predict.

The Federal Estate Tax is based on the fair market value of decedent's estate as of the date of death. The personal representative has the option of using a date that is six months after the date of the decedent's death as an alternate valuation date. If using the alternate valuation date provides a tax benefit to the estate, it must be applied to the entire estate, not just certain assets that have gone down in value.

The Federal Estate Tax can be a very harsh tax. In most cases, the tax will be between 41% and 48% of the taxable estate that exceeds the amount of the estate that is protected from the tax. Any Federal Estate Tax that is due must be paid within nine months of the decedent's death, even if an extension for filing the tax return is requested.

3. Maryland Estate Tax. In essence, the Maryland Estate Tax is imposed upon a decedent's estate that is also subject to the Federal Estate Tax (e.g. \$1.5 million in 2004 and 2005). Any Maryland Estate Tax that is paid by the estate is treated as a tax credit against the Federal Estate Tax, which means that the impact of this tax on the estate is usually minimal. Nevertheless, it is another tax return that must be timely filed.

4. Individual Income Tax. The income earned by a decedent prior to his or her death

must be included in the decedent's federal and state income tax returns, and any income taxes that may be due must be paid.

5. Fiduciary (Estate) Income Tax. While an estate is being probated or being administered, the property in the estate continues to earn interest, dividends, or other types of income. In addition, there may be capital gains or losses on property that is sold during the administration of the estate. This income must be reported and any tax paid before the estate can be closed.

A common misconception is that property that escapes probate is not subject to estate and inheritance taxes. This is not the case. This confusion comes from the assumption that the probate process triggers the payment of taxes. The only tax actually triggered by the probate process is the Maryland Inheritance Tax, and even this tax is payable on non-probate assets whether an estate is opened or not.

Costs of Probate

Minimally, the costs would include up to \$1,000 as a probate fee for most estates (for probate estates of \$1 million or less), and several hundred dollars for advertising and bond costs. Note that bond costs can be much higher if the requirement for a bond is not waived in the decedent's Will. Appraisal fees may also be incurred, and they can range from \$200 to several thousand dollars or more, depending on the nature of the property that is included in the probate estate.

The largest expenses associated with probate, however, involve the personal representative's commission and attorneys' fees. By statute, absent extraordinary circumstances, the total of both these expenses is limited to 9% of the first \$20,000, and 3.6% of the balance of the probate estate. These expenses are monitored by the Orphans' Court, and can only be paid after approval is received by that Court,

unless all of the beneficiaries and creditors have signed a consent. These fees can be less than the statutory rate, although this would require working out the fee arrangements with the attorney at the time an attorney is engaged to handle the probate process. Also, if a personal representative is a beneficiary, the commission paid to the personal representative is often waived since any commission paid is taxable income to the personal representative.

Conclusion

As stated above, probate is a process that is used to wind up, in an orderly manner, the worldly affairs of a decedent. Although the process can seem cumbersome (which it most definitely is!), it does provide a mechanism for making sure that the decedent's wishes are followed, that all creditors be paid, and for giving a beneficiary a means to question any aspect of the administration of the estate. Considering how complicated each of our lives can be, it is no wonder that the mechanism used to accomplish these purposes is likewise a bit complicated. However, by following the guidelines in this brochure, and by understanding the process, the pains associated with probate can be eased considerably.



About Our Firm

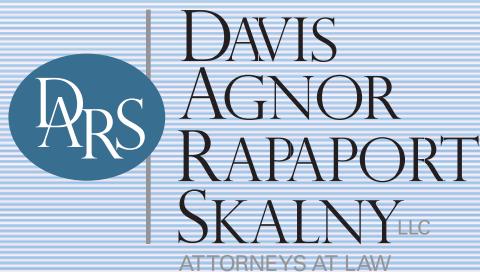
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We are conveniently located beside the Mall in downtown Columbia, convenient to both Baltimore and Washington, D.C. If you have any questions about your estate planning needs, please feel free to call us at 410-995-5800 or at 301-621-4152.

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