Ep. 210: What You Need To Know About Estates - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management podcast, I'm your host, Tom Mullooly and this is episode 210. In this episode we want to cover some questions that we've received recently regarding estates, not necessarily estate planning, but some questions regarding the mechanics of what happens when we are involved in an estate. This isn't necessarily going to answer every question regarding estate. Estates in general are not really straightforward because, primarily because there's people involved and sometimes the instructions that are on hand are messy, they're cloudy, sometimes there's no instructions at all because the decedent, the person who passed away did not leave a will.

We'll try and go through a few mechanical basics that you need to know. One of the things that I try and stress to folks when we're talking about the mechanics of how an estate gets broken down is that this may be something that a client goes through once in their life, maybe two times, hopefully not too often, but this is something that we come upon all the time at Mullooly Asset Management podcast. You'll find your CFP will usually be pretty well-versed in what happens when it's time to go through the estate process.

Again, you may get some good ideas about how estates work through this podcast, this isn't necessarily about estate planning, but you may get some ideas about how to plan once we go through some of these topics. First, a word from our compliance team.

Speaker 2: Tom Mullooly is an investment advisor representative with Mullooly Asset Management. All opinions expressed by Tom and his podcast guests are solely their own opinions and do not necessarily reflect the opinions of Mullooly Asset Management. This podcast is for informational purposes only and should not be relied upon as a basis for investment decisions. Clients of Mullooly Asset Management may maintain positions and securities discussed in this podcast.

Tom Mullooly: Welcome back to the podcast. One of the things that we get asked a lot when it comes to estates is people will reach out to us and they'll say, "Hey, I'm the executor for this estate. Um, I understand I might be entitled to a fee, what's involved and what's a usual and customary fee?" That's a really good question. Understand that your executor fee is going to be taxable income. So if you are in a situation where you're going to be inheriting a chunk of the estate or a portion of the estate, or all of the estate, you may not want to take an executor fee because that can be considered taxable income, whereas what you inherit is not going to be considered taxable income.

You may be subject to an inheritance tax especially if you're in New Jersey or other states where they apply an inheritance tax. Be very careful on claiming the executor fee because this is going to be taxable income as if you earned it in a salary. What's a typical executor fee? In assets where the estate is from zero up to 200,000, the normal and customary fee allowed in New Jersey is 5%, that would make it $10,000 maximum. Anywhere between 200,000 and $1 million, the customary fee is 3.5%. Anything from $1 million and up, the customary and usual executor fee is 2%. Again, this is going to show up as taxable income.

How flexible is this number? It's completely flexible. This is just usual and customary. Understand that if the executor takes a large fee and the estate doesn't go smoothly, or people get their nose out of joint because so and so got more than they did, you might wind up in court. One of the things that may get questioned is the unusually large executor fee that you took. So stay within the guidelines of what's normal and customary and you should be okay.

It also should be gauged upon how much work and how much time you're going to be putting in to this estate. We've seen situations where executors have to literally take over someone's business and begin dismantling the business or find a suitable buyer and negotiate a good price for the business. Some of these things can get really, really complicated. There's got be situations where executors are going to need to spend a lot of time, and then there's other situations where you're an executor for a family member and we fill out a couple of papers, we do a little math and everything gets split up. That's really pretty simple.

Keep in mind that this can be a flexible number but you also need to also know what is usual and customary. 5% up to 200,000, that's pretty normal. Anything between 200,000 and a million is about 3.5%, over $1 million usually 2%. Those numbers can be flexible based on how involved you want to get. Again, if there's mismanagement of an estate, the court has the authority to surcharge the executor for an excessive fee.

A moment ago I mentioned the phrase inheritance tax. In New Jersey there is inheritance taxes and you need to know about this. The tax rates in New Jersey for an inheritance range anywhere from 11% up to 16%. This tax doesn't apply to money or assets that are left to a direct family member. What does the state deem to be a direct family member? Any money that's left to a parent, a spouse, a child, a grandparent, the inheritance tax in those cases does not apply. It applies to transfers of $25,000 or more that go to the decedents siblings, or to children's spouses, or to transfers of $500 or more to friends of the decedent.

You have to be aware of these things as you are either getting ready to receive an inheritance or you're distributing part of an estate. It's also part of the job of the executor to make the family members aware of what kind of taxes they may be susceptible too. It's also the job of the executor to make sure that everybody who's receiving a distribution from the estate know what kind of tax ramifications are involved.

Regarding taxes, one of the questions that we get a lot is what the difference between inheritance taxes and estate taxes? The main thing is who pays. An estate tax is paid by the estate, through the decedents assets and before any assets are distributed to those people to receive an inheritance. An inheritance tax is paid by the folks who actually inherit it. Regarding estate taxes in New Jersey, it was somewhat onerous if you passed away in recent years as a resident of the state of New Jersey because the New Jersey estate tax was calculated on assets that exceeded $675,000.

If you own a home in New Jersey and maybe have a few bank accounts, it's a pretty safe bet that if you passed prior to 2017 you were going to be paying New Jersey estate taxes. Keep in mind, there are federal estate tax brackets and there are state estate tax brackets. A lot of people forget about the state. Back here in New Jersey, everything over $675,000 was included in your taxable state estate tax calculation.

In the year 2017, they raised a threshold in New Jersey from 675 to $2 million, a nice break, but that break got even better in 2018. In 2018, there is no state estate tax in New Jersey. There is no state estate taxes if someone passes away 2018 and beyond. Of course, these number can be tinkered by your local state government so stay tuned. Right now there are no state estate taxes, but we'll see what the future brings with that.

Then the question becomes what do we do with these brokerage accounts or these investment accounts when someone passes away? If the decedent has a brokerage account that's titled joint with rights of survivorship, all of the money that's in that account, all of the assets will go automatically to the other party named on that account whether it's joint tenant by entirety or joint with rights of survivorship. If you have a joint account, it's going to the other person, and it bypasses the probate process.

What do you do when an individual sets up a transfer on death account? This is really a good question. Transfer on death accounts are, in the big picture, a fairly new concepts, they've been around for about 20 years. There's a similar type of account at a bank where it would be called a POD or a payable on death account. In the 90s I had clients asking me, "Can we set up a payable on death account for our brokerage account?" You can't really do a payable on death account with a brokerage firm because payable implies that we would have to sell everything and then pay it out.

What the brokerage world has come up with is something called transfer on death where everything just gets transferred to the parties that you name on the account. So if you have a transfer on death account and there are two children involved, and they're going to be split 50/50, what happens is all of the assets in the account get a stepped up cost basis, stepped up to the value on the date of death of the decedent. It's the same thing that happens with a joint account.

The assets in the account on a transfer on death get a stepped up cost basis and the parties who were named in the transfer on death account will receive this asset. They don't have any kind of tax ramifications, they don't have capital gains to worry about because they're inheriting this at the cost basis on the date of death. There's very little gain or loss because this is a recent transaction. There will be new accounts set up for the parties who were named on the TOD or transfer on death account, and all the assets simply get moved where they belong.

With rights of survivorship account, remember there are two people who own an account like this, one of them passes away. Their half of their account gets stepped up in cost basis, not the entire account, not all of the assets in the account. The 50% that the party who passed away, their half gets the stepped up cost basis. It's not very straightforward, there is a little bit of math involved, but it's something that you need to know about.

What do we do with IRAs? IRAs go completely on the beneficiary form. We have seen this a lot where clients passed away and they did not name a beneficiary. What do we do in a case like that? The first thing we'll tell you is, "Name a beneficiary", because the money goes outside of probate and goes directly to the party named as the beneficiary. It stays out of someone's estate, not a big deal if you don't have a large estate, but still it simplifies the process.

Now, the person who's named as the beneficiary has a couple of choices. You can elect to receive the proceeds of the IRA if you take as a distribution. It's a distribution so it's a taxable event. You will get a 1099 R because it's a distribution from a retirement account, you'll get that the following year for your taxes. That money will be subject to state and federal taxes, it's important to know that and to make set asides, or at least be prepared for that happening in the coming year.

You're also entitled to set up what's called an inherited IRA if you're the beneficiary. This money cannot be merged with your existing IRA, it has to be a separate account, here's the reason why. When you inherit an IRA you still have to take a required minimum distribution even if you are under 70 and a half. You inherit an IRA from mom or dad and you are in your 40s, you're still going to have some small required minimum distribution that you need to take every year.

Some folks refer to this as a stretch IRA which you're certainly entitled to, it's a way to stretch out the tax deferred compounding of the account. That's a good tip, it's a good tool to have in your back pocket. Sometimes the IRA may be really small, it may be $10,000 or $20,000, you may just want to take the money and be prepared to pay some taxes with that, but you do have that option of an inherited IRA, or some people refer to it as a stretch IRA.

I appreciate you listening to our podcast today, these are just some of the questions that we've received regarding estates that clearly didn't answer even a fraction of them. Sometimes we have to referee family fights, sometimes we get involved in some real drama, others are really straightforward and pretty easy to do. If you've got questions regarding estates and planning your estate, by all means, speak with your financial planner. If you don't have someone and you'd like to get some questions answered feel free to get in touch with us here at Mullooly.net.

That wraps up episode 210, thanks for listening, I'll talk to you again soon.