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Complex Distributions, Final Accounting, and Estate Closing

Personal Representatives and trustees are faced with numerous potential complexities and risk throughout the course of an estate administration. Fiduciaries must particularly be mindful of the breach of fiduciary duty risk inherent in distributing assets, and be aware of the process of and potential protections afforded by the final accounting and the estate closing. Some of the more noteworthy issues are discussed below.

A. NON PRO RATA DISTRIBUTIONS.

A "pro rata" distribution of estate assets generally means that each beneficiary receives a portion of each asset of the estate equal to their portion of the overall estate (e.g., a beneficiary of 10% of the residue of an estate receives 10% of each estate residue asset). A non-pro rata distribution, on the other hand, generally means that each beneficiary's share of an estate can be fulfilled with portions of individual assets greater or smaller than their percentage share of the entire estate.

Absent a provision in the governing instrument prohibiting non-pro rata distributions of the decedent's assets, RCW 11.68.090 and RCW 11.98.070(15) authorize a Personal Representative acting under nonintervention powers to select any part of the probate estate or trust in satisfaction of any partition or distribution, in kind, in money or both, to make non-pro rata distributions of property in kind, and to allocate particular assets or portions of them or undivided interests in them

to any one or more of the beneficiaries without regard to the income tax basis of specific property allocated to any beneficiary and without any obligation to make an equitable adjustment. *Estate of Ehlers*, 80 Wn. App. 751 (Div. III, 1996).

For example, if an estate passing in two equal shares consists of a $1 million cash account and a $1 million parcel of real estate, the Personal Representative with non-pro rata allocation powers is not required to distribute 50% of each asset to each beneficiary. Rather, the Personal Representative[1] may distribute 100% of the cash to one beneficiary and 100% of the real estate to the other. This procedure may be used, for example, to accomplish the distribution to the surviving spouse of the entire former community interest in the personal residence to preserve the ability of the surviving spouse to exclude post-death gain resulting from future sale under IRC §121, or to allocate the decedent's interest in closely held corporation stock to the survivor to preserve the S election.

Most Wills do not contain a prohibition against the non-pro rata distribution of the decedent's assets among the shares established under the Will, since such a prohibition would make the division of assets too inflexible. Rather, the customary approach is for a Will to contain an express discretionary power to make non-pro rata distributions among the shares. The result is that Washington State Personal Representatives and trustees have great flexibility in allocating the assets in the estate or trust amongst the beneficiaries, so long as the beneficiaries receive their full share(s) in term of value.

Despite the broad flexibility afforded to estate and trust fiduciaries, non-pro rata allocations also present greater risk. Fiduciaries should be wary of making a

[1] RCW 11.02.005(14) defines "Personal Representative" to include any executor of a testate estate or administrator of an intestate estate.

non-pro rata allocation if beneficiary objections have been raised, since allegations of favoritism and/or breach of fiduciary loyalty duties may result. This is a particularly substantial risk when the estate contain family "legacy" assets (e.g., multi-generation real estate), operating business interests, or other income producing property. Additionally, assets that are difficult to value, or that may have a broad range of value depending on the subjective opinions of the appraiser or valuation expert, or are subject to significant volatility (e.g., crypto currency) can subject the fiduciary to challenge. For example, if one or more beneficiaries is allocated a greater portion of the estate's non-cash assets (and other beneficiaries elect a greater portion of more stable assets, e.g. cash), a volatile asset's sudden drop in value of can result in claims against the Personal Representative for breaching fiduciary duties. An estate fiduciary should always consider obtaining the consent of all beneficiaries to a plan of distribution. If consent cannot be obtained, a fiduciary should consider a petition to the court under RCW 11.96 (the Trust and Estate Dispute Resolution Act, or "TEDRA") to request court direction.

B. NON-PRO RATA SPOUSAL ROLLOVER ALLOCATIONS.

It is common for a significant portion of a decedent's total date of death estate to consist of non-probate retirement accounts. The interplay between Washington's non-pro rata allocation and community property statutes provide a unique estate funding technique for individual retirement accounts.[2] Use of this technique can prevent wasting a decedent's estate tax exemption, while preserving

[2] So long as the participant spouse dies first, the technique described in this section should apply generally to all retirement accounts, including those subject to ERISA. The Private Letter Rulings analyzing and approving the technique, however, specifically deal with IRAs, so there is less assurance that the method will be respected if it involves an ERISA covered plan. As a result, caution is advised with non-IRA qualified accounts. If the nonparticipant spouse dies first, the analysis is more complex, involves federal preemption statutes, and is outside the scope of these materials. Generally, see *Boggs v. Boggs*, 520 U.S. 833, 840, 117 S. Ct. 1754, 117 L. Ed. 2d 45 (1997), and *Ablamis v. Roper*, 937 F.2d 1450 (9th Cir. 1991).

the continued tax-free growth and deferral benefits of a traditional spousal rollover.

In addition to the general non-pro rata allocation powers, RCW 11.02.070 grants the Personal Representative the power to administer the whole of the community property during the administration of the estate. RCW 11.28.030 grants the surviving spouse the right to administer the community property, even if the Will provides to the contrary. RCW 6.15.020 confirms that the non-participant spouse's interest in an IRA is subject to disposition by Will, and therefore is subject to administration under the statutes referenced in the prior section of these materials in the same manner as other assets that pass by Will. As a result, the surviving spouse serving as sole Personal Representative with nonintervention powers has the specific, exclusive fiduciary authority under Washington law to make non-pro rata distributions of the community assets, including an interest in an IRA that is subject to administration (whether as part of an equal partition of the entire community estate, or a division of property between different shares of the decedent's estate). This exclusive authority of the surviving spouse is, according to the IRS letter rulings below, all that is necessary to qualify an IRA for the spousal rollover when the estate or revocable living trust (instead of the spouse) is the named beneficiary.

Consider the following hypothetical scenario:

1. A $4,386,000 exclusively community property estate consists exclusively of $2,193,000 cash and a $2,193,000 IRA.

2. Both spouses are 60 years old when the first death occurs. The surviving spouse is named the IRA beneficiary by the deceased participant spouse,

and the estate is the contingent IRA beneficiary in the event of disclaimer by the surviving spouse. The full $2,193,000 Washington State and $12.92 million federal exemptions are available to the decedent's estate, at least $1,096,500 of which will be wasted if the decedent's $1,096,500 community interest in the IRA passes directly to the survivor as provided in the beneficiary designation, and is consequently unavailable for distribution to the bypass trust established under the Will.

3. The surviving spouse (who is also the sole Personal Representative of the decedent's estate) disclaims the decedent's interest in the IRA in order to ensure that $2,193,000 of total assets will be subject to administration in the decedent's half of the community estate and available for distribution to the bypass trust established under the Will. The decedent's estate is thereafter comprised of a $1,096,500 half interest in the cash account, and a $1,096,500 half interest in the IRA. The written disclaimer document is unconditional and does not contain any direction by the surviving spouse as to the disposition of the disclaimed property. However, the surviving spouse does not resign as Personal Representative, nor disclaim any of the normal powers of the Personal Representative.

4. In a later equal, non-pro rata partition of the community property estate, the decedent's $1,096,500 half interest in the community IRA is allocated by the surviving spouse/Personal Representative to the survivor's 50% share of the community estate, and the survivor's $1,096,500 half interest in the community cash is allocated to the decedent's 50% share of the community estate. This leaves the decedent's estate with $2,193,000 cash, and the survivor with the entire $2,193,000 IRA as his/her separate property.

5. The decedent's entire estate ($2,193,000 cash) is then distributed to the bypass trust established under the Will.

6. The Surviving Spouse may then accept the IRA as an inherited IRA, or (more commonly) roll the account over into his or her name. Either way, the surviving spouse may defer any required minimum distributions to his or her applicable required beginning date, and thereafter take the required minimum distributions (RMD's) according to his or her remaining actuarial lifespan.[3]

The IRS has issued private letter rulings consistent with the results described above regarding the income-tax impact of making non-pro rata distributions of community property IRA interests from estates and trusts. See, for example, Private Letter Ruling 199925033 (obtained by attorneys at the Montgomery Purdue law firm), which ruled that the IRS does not consider the equal non-pro rata partition of the former community property estate (in this case held in a revocable living trust) following the death of one spouse to be an income-taxable event under either IRC Sec. 1001 or Sec. 691(a)(2). The IRS so ruled even though 100% of a community property IRA was allocated fully to the share of the surviving spouse (the "Survivor's Trust" under the revocable living trust agreement), and other community assets of equivalent value were allocated to the decedent's share for further non-pro rata distribution to additional trusts. The IRS cited Rev. Rul. 76-83, 1976-1 C.B. 213 as the governing authority. See also, 199912040.

C. PRELIMINARY DISTRIBUTIONS.

[3] Although The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 limited non-spousal beneficiaries to a ten-year period for continued deferral, surviving spouses may still use their life expectancies for calculating RMD's. "Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019," Pub.L. 116–94.

Ideally, a Personal Representative will not need to make any distributions until all taxes and expenses have been identified and paid. This is rarely the case. In many, if not most, administrations, one of more beneficiaries will request that an advance distribution be made prior to the time the Personal Representative is ready to make a final distribution. This can present numerous issues and challenges.

A fundamental duty of a fiduciary of a trust or estate is the duty of loyalty, also referred to as the duty to act in the best interests of the beneficiaries. A Personal Representative is required to administer an estate solely in the best interests of the beneficiaries, and is prohibited from considering his or her own personal interests or the interests of third parties.[4] RCW 11.98.078(8) provides that if the trust has two or more beneficiaries, the trustee "must act impartially in administering the trust ..., giving due regard to the beneficiaries' respective interests." "The ethical standards for personal representatives [are] the same, regardless of whether the representative performs his or her duties under court supervision. All personal representatives act in identical fiduciary capacities and must refrain from self-dealing, administer the estate solely in the interest of the beneficiaries, and uphold their duty of loyalty to the beneficiaries." *In re Estate of Jones,* 152 Wash.2d 1, 24, 93 P.3d 147 (2004).[5]

Making preliminary distributions to one or more, but not all, beneficiaries risks claims that the Personal Representative has breached the duty of loyalty.

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[44] See RCW 11.98.078(1).

[5] The Personal Representative stands in a fiduciary relationship to those beneficially interested in the estate, and is obligated to exercise the utmost good faith and diligence in administering the estate in the best interests of the heirs. *In re Estate of Larson*, 103 Wn.2d 517, 521, 694 P.2d 1051 (1985).

Unless there is a significant justification for doing otherwise, preliminary distributions should be made simultaneously to all beneficiaries, and each beneficiary should receive their proportionate share of the distribution. Doing otherwise risks allegations that the Personal Representative is favoring the interests of one beneficiary over the others, and can create additional accounting complexities.[6]

For example, assume a Will names five equal 20% beneficiaries of a $500,000 estate. Due to great need, the Personal Representative elects to distribute $100,000 to one beneficiary. Following the distribution until closing, the remaining estate appreciates to a gross value of $525,000, reduced to $500,000 after $25,000 of estate administration expenses. Are the four remaining beneficiaries entitled to $125,000 each and the $100,000 beneficiary nothing further? Or must the Personal Representative hypothetically add the $100,000 back into the estate and use a gross $625,000/net $600,000 estate to divide in five shares? On the other hand, assume the same facts, but following the preliminary distribution, the net value of the remaining estate drops to $345,000. After paying the $25,000 in expenses, the remaining four beneficiaries have $80,000 each to split, leaving them $20,000 each worse off than the preliminary distributee. Is the Personal Representative required to recover 4/5ths of the excess distribution from the preliminary distributee? Is the Personal Representative liable if he can't?

These and similar accounting issues are avoided by making proportionate distributions to all beneficiaries. If doing so to accommodate a beneficiary in great need is impractical (for example, it would not leave enough in the estate to cover

[6] See *Matter of Estate of Rohatsch*, 23 Wn. App.2d 1015 (2022) for a recent example of how preliminary distributions resulted in removal of a Personal Representative.

ongoing expenses and potential risks), a loan arrangement is typically preferable to a large preliminary distribution. It is also prudent for the fiduciary to discuss any requests for preliminary distributions with the beneficiaries in advance in order to identify any objections. Personal Representatives should consider whether the preliminary distribution should be memorialized in a writing under RCW 11.96A.220 (a "TEDRA Agreement") to further insulate him or herself from later claims that may arise, and to specifically address the potential need for re-contribution of estate assets if unexpected costs or expenses arise. If a preliminary distribution is made to one, but not all beneficiaries, the estate could later suffer an unexpected value loss that results in the preliminary distribution being an overpayment of the recipient beneficiary's share. If the recipient beneficiary is no longer in possession of the distributed property and is otherwise judgment proof, the Personal Representative will be faced with risk of personal liability.[7]

D. DATE OF DEATH AND DATE OF DISTRIBUTION VALUES.

For estate tax purposes, the date of death is typically used to value trust or estate assets. See IRC 2031.[8] Very generally speaking, estate plans often divide the decedent's estate in terms of pecuniary amounts or fractional shares, or some combination thereof. A common example of a pecuniary share definition is to define a portion of the estate in terms of the specific estate tax exemption amount

[7] See, for example, *In re Estate of Jones*, 152 Wash.2d 1, 21–22, 93 P.3d 147 (2004) (excess distributions to beneficiary was a breach of fiduciary duty, leading to Personal Representative's removal and subsequent disbarment); See also RCW 11.98.110 for general discussion of when Personal Representatives are personally liable for torts ("Breach of a fiduciary duty imposes liability in tort." *Micro Enhancement Intern., Inc., v. Coopers & Lybrand, LLP*, 110 Wn.App. 412, 433–34, 40 P.3d 1206 (2002)).

[8] Although estate tax returns generally require assets valued as of the date of death, IRC 2032 allows an alternate valuation date of six-months following the date of death if doing so would reduce the amount of tax due. In these materials, the term "date of death" generally encompasses the alternate valuation date where necessary.

that remains available to the decedent at the date of death.[9] In many cases, particularly those without specific and/or pecuniary shares, the difference between the date of death and the date of distribution values is immaterial. For instance, if an estate is to be distributed between four children in four equal shares, the Personal Representative can simply divide every estate asset into separate 25% shares without determining each asset's respective date of distribution value. But in many other cases, including when non-pro rata allocations are made, or where martial-deduction funding language is present, the difference between date of death and date of distribution values can be critical.

As described in the non-pro rata allocation discussion above, unless the governing instrument provides otherwise, a beneficiary entitled to a fractional share of an estate is entitled to the fair market value of that share, not to that specific fraction of each estate asset. If a Personal Representative chooses to make a non-pro rata allocation of non-cash property, the date of distribution is generally controlling.[10] Failure to take into account the changed values of an estate can result in later claims, for example, if the values of the non-cash assets have changed significantly from the date of death.

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[9] A "pecuniary" gift is one that can be expressed in terms of a fixed dollar amount or is determined under a formula or other method by which a fixed dollar amount can be computed. Rev. Proc. 64-19, 1964-1 C.B. 682, § 2.01. RCW 11.108.010(1) defines pecuniary bequest as "a gift in a governing instrument which either is expressly stated as a fixed dollar amount or is a gift of a dollar amount determinable by the governing instrument, and a gift expressed in terms of a "sum" or an "amount," unless the context dictates otherwise." For example, "I give $100,000 to my surviving spouse" and "I give to my surviving spouse the minimum amount necessary to reduce the combined Washington State and federal estate taxes to zero" are pecuniary gifts.

[10] For example, in the pecuniary bequest context, see RCW 11.108.030 which provides that when a trustee satisfies a pecuniary bequest by distribution of property other than money, the property must be valued at the fair market value on the date of distribution.

Changed values for particular assets do not merely impact the funding of the particular recipient beneficiary's share. Rather, the shares for all beneficiaries are impacted by their respective proportionate share of the change. For example, assume an estate leaves its assets in two shares. The first share is defined as the fraction of the estate equal to the decedent's date of death exemption from the Washington state estate tax. The second share is all other assets to a non-spouse beneficiary. Assume at the decedent's date of death, the Washington state estate tax exemption is $2.193 million, the decedent's total estate equals $5.193 million, and the decedent's Will allocates all taxes and expenses proportionately between the shares of the estate residue. Further assume two additional scenarios: One-year later, after paying all taxes and expenses of the administration, and after taking into consideration post-death asset appreciation, the estate now totals $5.5 million in the first scenario, and the estate totals $5 million in the second. How are the shares funded in each of the two scenarios?

The answer depends on the language that the governing instrument uses to define the shares of the estate, and the applicable governing document or statutory language allocating taxes and expenses between the shares. The Personal Representative must understand how these two issues work in tandem to ensure that each share of the estate is accurately funded. If not, the Personal Representative may be removed and potentially found personally liable for the funding error.[11]

In the examples above, the share for each beneficiary is defined, not as a specific dollar amount (regardless of date of distribution) but as a fraction or

[11] See fn. 7 above.

portion of the estate. As a result, the Personal Representative is required by the terms of the governing document (in this example) to determine that exact fraction as of date of death. Based upon the date of death values in the example, that fraction is 42.23% ($2.193M/$5.193M). The Bypass Trust is therefore entitled to 42.3% of the date of distribution value of the estate ($2,322,645.87 of $5.5 M, or $2,111,496.24 of $5 million). If the Personal Representative in this example simply funds the Bypass Trust with the $2.193 million exemption amount in place at death, they will either underfund or overfund the trust at the date of distribution. If the Bypass Trust beneficiaries are different from the beneficiaries of the other estate share, the Personal Representative has created risk of claims from the shortchanged beneficiaries.[12]

However, if the governing document defines the shares differently, for example "I give $2.193 million to …," the resulting allocation of estate assets could be different. Depending on the exact wording of the bequest and the language of the Will allocating the expenses, it could be that the $2.193 million bequest is a specific bequest that is not a portion of the residue, meaning that share is funded by that specific dollar amount and 100% of the taxes and expenses are allocated to the other share.

Even if the ultimate beneficiaries of all shares are the same (as is often the case with shares created to segregate a decedent's estate up to his or her tax exemption from a non-exempt share passing to the same person or persons who are the beneficiaries of the first share), underfunding a bypass trust can result in increased (and otherwise avoidable) estate taxes at the second death, and overfunding can result in expensive and burdensome tax audits and adjustments.

[12] See fn. 7.

Personal Representatives must have a clear understanding of how the funding language and the expense and tax allocations in the governing instruments operate in tandem, and would be prudent to seek the advice of counsel before making any distributions based on potentially mistaken assumptions.

The difference between date of death and date of distribution values of estate assets is even more complex when the marital deduction is involved. In a great many estates, the decedent's assets will be divided into two shares, a marital share and an estate tax exempt share. The marital share passes to the surviving spouse or to a qualifying trust (e.g., a "QTIP Trust") eligible for the marital deduction. The other share will typically be defined in terms of the value of the remaining exemption and is intended to shelter assets equal to that value so as to bypass estate taxes (hence the typical names for this type of trust are "Exemption Use Trusts," "Credit Shelter Trusts," and/or "Bypass Trusts").[13] The complexities and risks of marital deduction funding options (and expense and tax allocations to or away from a marital share) requires an in-depth examination outside the scope of these materials. However, Personal Representatives and practitioners must be aware that errors in properly allocating post-death appreciation or depreciation between marital and non-marital shares can result in a disallowance of the marital deduction for the marital share, potentially resulting in catastrophic damage to the estate.[14]

[13] These materials refer to these types of trusts as "bypass trusts."

[14] For example, IRS Revenue Procedure 64-19, 1964-1 C.B. 682, provides that if a pecuniary marital gift may be satisfied with non-cash assets valued as finally determined for estate tax purposes, then the estate-tax marital deduction may be entirely disallowed for that gift unless the assets used to satisfy the gift are required to: (i) have an aggregate fair market value at the date, or dates, of distribution amounting to no less than the amount of the pecuniary gift, or (ii) be "fairly representative" of the appreciation or depreciation in the estate. This requirement prevents abuses involving the allocation of assets to the marital gift that have depreciated since the estate tax return

E. EXPENSE AND TAX ALLOCATION ISSUES – WHEN DO NONPROBATE ASSETS SHARE?

1. General Rules. Prior to making final distributions and closing the estate, the Personal Representative must not only ensure all taxes and estate administration expenses are paid, but also properly allocate those charges to the distributive shares. Most estate planning instruments include express allocation provisions that specify which bequests and shares are subject to taxes and expenses. For example, a typical provision may read as follows:

> Payment of Taxes and Expenses. Estate, inheritance, succession, or generation-skipping transfer taxes imposed upon my estate by any jurisdiction, including related interest or penalties ("Taxes") shall be apportioned as provided in RCW Title 83, except that no Taxes shall be apportioned to gifts of tangible personal property or specific pecuniary cash gifts. As provided in RCW Title 83, I intend that no Taxes shall be allocated to the recipient of any gift of property under this Will or otherwise that qualifies for estate tax marital or charitable deductions. Expenses of administration shall be paid from the residue of my estate, except no expenses of administration shall be allocated to any recipient of any residuary gift that qualifies for estate tax marital or charitable deductions.

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valuation date, which results in underfunding the overfunding the estate tax exempt Bypass Trust share and impermissible reduces estate tax liability at the surviving spouse's death. The IRS may also assert that pursuant to Rev. Rul. 84-105, the surviving spouse makes a taxable gift to other family members for failing to object to an alleged underfunding of the marital shares (and overfunding of the non-marital shares) in the year of the deceased spouse's estate distribution. As a result, practitioners funding bequests between a marital and non-marital share should consider filing "zero-gift" gift tax returns to begin the running of the statute of limitations.

In the absence of an express provision indicating otherwise, the allocation of estate taxes is governed by RCW 83.110A. RCW 83.100A.030 generally provides that the estate tax not apportioned by the governing instrument is apportioned ratably to each person that has an interest in the apportionable estate.

Expenses of administering the estate generally fall upon the estate assets as directed by Will, or in the absence of a statement in the Will, as directed by Title 11 RCW. RCW 11.76.110 sets forth an order of payment priority for estate debts, with costs of administration having highest priority. Costs of administration are distinguished from lower priority "claims" against the estate, since the costs arise after the decedent's death.[15] As a result, the Personal Representative has the legal authority and direction to satisfy the costs of administering the estate prior to satisfying claims against the estate that existed at the time of the decedent's death.

The costs of administering the estate generally apply first against the residue of the estate, then against general gifts (e.g., "all of my vehicles"), then against the specific bequests. See RCW 11.10.010. An expense of administration is charged against the separate property and the decedent's half of the community property in proportion to the relative value of the property, unless a different charging of expenses is shown to be appropriate under the circumstances, including against the surviving spouse's or surviving domestic partner's share of the community property. RCW 11.10.030.

[15] It is well established that claims arising after the death of the decedent are not considered creditor's claims. See *Olsen v. Roberts*, 42 Wn.2d 862, 865, 259 P.2d 418 (1953) (explaining that to qualify as a claim against the estate, an obligation must arise as a debt incurred during the decedent's lifetime); *Witt v. Young*, 168 Wn. App. 211, 218, 275 P.3d 1218 (2012) (same). Instead, claims that arose after the death of the decedent are "treated differently." *Judson v. Associated Meats & Seafoods*, 32 Wn. App. 794, 797, 651 P.2d 222 (1982). Claims that accrue after the decedent's death are claims for costs of administration. *In re Est. of Wilson*, 8 Wn. App. 519, 525, 507 P.2d 902 (1973).

2. Nonprobate Assets: The term "nonprobate assets" generally refers to those that pass outside of the probate process and the terms of a decedent's Will. While nonprobate assets generally are not within the power of the Personal Representative to possess, administer, and distribute, the nonprobate assets may still be liable and chargeable with their share of expenses and taxes.

The liability of a beneficiary of a nonprobate asset is generally governed by RCW 11.18.200. This statute provides that, unless expressly exempted by statute or the terms of the decedent's estate planning documents, nonprobate assets subject to the decedent's general creditors immediately before the decedent's death are subject to estate taxes and their "fair share of expenses of administration reasonably incurred by the Personal Representative in the transfer of or administration upon the asset." The statute does not define "transfer of" or "administration upon," so their ordinary meanings apply."[16] As a result, the proper allocation of expenses necessary to "transfer" or "administer upon" a non-probate asset will be a question of fact, and a potential source of dispute.

RCW 11.020.005(13) defines nonprobate asset expansively, except it specifically excludes the pay-on-death proceeds of a life insurance policy, annuity, or other similar contract, or those of an employee benefit plan (including individual retirement plans). See also RCW 6.15.020(4). Accordingly, these excluded assets, which are generally considered nonprobate assets for most all other purposes, are not "nonprobate assets" for purposes RCW's 11.020.200's liability for claims and expenses statute. The result is that life insurance, annuities and similar contracts,

[16] I*n re Estate of Wegner v. Tesche*, 157 Wn. App. 554, 564, 237 P.3d 387 (2010), citing *Nationwide Ins. v. Williams*, 71 Wn. App. 336, 342, 858 P.2d 516 (1993) (undefined statutory terms must be given their usual meaning and courts may not read into a statute meanings that are not there).

and qualified retirement plans are not subject to any of the estate's claims or costs of administration.

However, RCW 11.18.200(2)(j) indicates that "[n]othing in this section derogates from the rights of a person interested in the estate to recover any applicable estate tax under chapter 83.110A RCW or from the liability of any beneficiary for estate tax under chapter 83.110A RCW." Retirement account and life insurance beneficiaries remain liable for the apportioned estate tax, and the Personal Representative may pay the estate tax out of the probate residue and then seek reimbursement from the retirement and life insurance beneficiaries. See generally, RCW 83.110A.050, .060, and .090. Also, IRC Sec. 2206 provides generally that if any part of the gross estate on which the tax has been paid consists of life insurance proceeds receivable by a beneficiary other than the estate, the Personal Representative is entitled to recover from that beneficiary the portion of the tax liability attributable the proceeds (if the proceeds are payable to the surviving spouse, and the proceeds qualify for the marital deduction, there is no right to recovery). Practitioners should carefully consider the practical difficulties that may arise when expressly allocating estate taxes to or away from life insurance and/or retirement plans.

Due to the general imposition of a proportionate share of taxes and the "fair share" of administration expenses, Personal Representatives should keep clear record of estate charges that relate specifically to nonprobate assets (for example, attorney or accountant fees regarding the asset). If the Personal Representative is taking a fee, the specific hours worked on matters relating to the administration of the particular asset must be clearly documented. Personal Representatives who cannot obtain consent of the nonprobate asset beneficiaries to the allocated share,

or the waiver of the probate beneficiaries to contribution from the non-probate assets, should consider a petition to the court under RCW 11.96A for instructions.

F. RESERVE FOR FINAL EXPENSES.

After the final expenses of the decedent have been paid, all creditor claims have been handled, and all taxes paid, the estate will likely be in position to make a major distribution of assets to the estate beneficiaries. However, in addition to the projected expenses necessary to close the estate (e.g., attorney and CPA fees), prudent fiduciaries will consider the risk of unexpected additional costs, and retain a sufficient holdback up to the very moment the estate is ready to close. Where estate taxes have been paid and closing letters not yet obtained, the estate also remains subject to IRS and/or Department of Revenue assessment for additional taxes, interest, and possible penalties. As a result, a Personal Representative should calculate the probable worst-case scenario estate tax audit result, and also retain enough assets to satisfy the additional possible liability.[17] Particular attention should be paid to hard to value assets (e.g., non-cash, and non-marketable security assets) and assets to which valuation discounts have been applied, and perform a hypothetical value mark up to calculate potential additional tax.

Once the Personal Representative receives closing letters from the tax agencies (see discussion below) and is ready to close the estate, the paperwork necessary to close the estate should be prepared, final professional fees should be submitted to the Personal Representative and paid, the remaining holdback distributed, and the estate closed. Note, however, that RCW 11.68.114 allows the

[17] If assets are distributed without paying the additional tax due resulting from an audit, the IRS can recover from the personal assets of the Personal Representative. See, e.g., *Estate of Lee v. Commissioner*, TC Memo 2021-92 (estate's Personal Representative was personally liable for the unpaid estate taxes because he made distributions of estate assets with knowledge of the estate tax owed).

Personal Representative to retain up to $3,000 following closing for the determination and payment of any additional taxes, interest, and penalties.

G. Final Accounting and Estate Closing.

Requirements regarding a final accounting and estate closing depend greatly on whether the Personal Representative has or has not been appointed with nonintervention powers. If the Personal Representation was appointed with nonintervention powers, the Personal Representative may close the estate without order of the court, and without filing a final accounting. If the Personal Representative is serving without nonintervention powers, the requirements are more burdensome.

1. **Request for estate tax closing letters or account transcript (Form 4506-T).** To confirm that the IRS examination of an estate tax return is completed and closed, estates or representatives should either request an estate tax closing letter (IRS Letter 627), or request an account transcript (on Form 4506-T).[18] Receipt of an account transcript with a transaction code of "421," similar to receipt of a closing letter, confirms the IRS has completed its examination of the estate tax return. For all estate tax returns filed on or after June 1, 2015, estate tax closing letters are issued only upon request. Once obtained, the Personal Representative should send the IRS closing document to the Department of Revenue (DOR) via secure message, using the My DOR services, or by mail or fax. The DOR will then customarily provide a letter confirming the estate tax return review is complete.

2. **Nonintervention Powers –The RCW 11.68.110 Declaration of Closing.** To close the estate with the least amount of effort, paperwork, and

[18] Account transcripts are available online through the Transcript Delivery Service (TDS).

expense, a Personal Representative appointed with nonintervention powers may file an RCW 11.68.110 Declaration of Completion of Probate (the "closing declaration"). The closing declaration generally describes the actions taken by the Personal Representative, describes fees paid (and/or will be paid) to accountants, attorneys, appraisers, and to the Personal Representative (if any), describes any tax liability that the estate incurred and confirms it has been settled and paid, and states that the estate is ready to be closed. The beneficiaries may waive notice of filing the closing declaration and/or of any hearing on the closing declaration, and if all do so, the estate is closed five days from the declaration filing date and the Personal Representative is discharged from all liability other than any liability relating to the actual distribution of the reserve. RCW 11.68.112.[19]

If the nonintervention Personal Representative cannot obtain waivers from all beneficiaries, the Personal Representative must mail notice to such parties within five days of filing the closing declaration. RCW 11.68.110(3). The notice recipients then have thirty days to come forward to request an accounting of the estate, or for a review of the fees paid, or both. If no party comes forward before the end of the thirty days, the estate closes automatically, and the Personal Representative is discharged from all liability other than any liability relating to the actual distribution of the reserve. RCW 11.68.112.

3. Nonintervention Powers – The RCW 11.68.100 Hearing: Closing with the RCW 11.68.110 declaration of completion can be particularly

[19] Although the closing of the estate and the Personal Representative's discharge is provided by statute, the closing and discharge is not absolute. Washington state "cases have historically ... allowed an estate to be reopened upon a showing of extrinsic fraud. It has been repeatedly held by this court that a decree of distribution by the superior court in probate ...., is entitled to the same weight as a judgment in any court or proceeding, is of equal solemnity, and cannot be attacked ... except for fraud." *Pitzer v. Union Bank of California*, 141 Wash.2d 539, 551-552, 9 P.3d 805 (2000), citing *Meeker v. Waddle*, 83 Wash. 628, 635, 145 P. 967 (1915); see also *Farley v. Davis*, 10 Wash.2d 62, 70–71, 116 P.2d 263, 155 A.L.R. 1302 (1941).

beneficial in estates with a small number of (and cooperative) beneficiaries. Though far simpler (and less costly to the estate), not all beneficiaries will be comfortable with that closing option. In both methods described above, the Personal Representative attempts to close the estate without providing any kind of final accounting to the beneficiaries. This may cause some or all beneficiaries to not only refuse to sign a waiver to close the estate within five day of filing the closing declaration, but may also result in a response petition to the declaration within the thirty day period demanding an RCW 11.68.100 accounting. Beneficiaries may also be more inclined in this scenario to oppose the payment of fees and/or allege misconduct. In cases where these concerns are present, the Personal Representative should particularly consider the alternate approach of petitioning the court under RCW 11.68.100 to close the estate and distribute any remaining property. The Personal Representative commences this alternate closing process by giving notice to all parties interested in the estate and noting a hearing.

The petition must include the fees paid, or to be paid, to the Personal Representative, attorneys, accountants, appraisers or other professionals involved with the administration of the estate, and the court can review and determine the reasonableness of these fees at the hearing. RCW 11.68.100(2). Following the hearing, the court will enter an order which will either:

(a) Find and adjudge that (I) all approved claims of the decedent have been paid, (II) the heirs of the decedent or those persons entitled to take under his or her will, and (iii) distributes the property of the decedent to the persons entitled to the estate property or

(b) Approves the accounting of the Personal Representative and settles the estate of the decedent in the same manner as in the administration of estates in which the Personal Representative does not have nonintervention powers. RCW 11.68.100(1)(a)-(b).

Because the hearing process is more burdensome and expensive, Personal Representatives dealing with difficult beneficiaries should consider whether a midway point between the two is appropriate. This can be accomplished, for example, by preparing an informal final accounting to be provided to the beneficiaries along with the Declaration of Completion and/or requests for waiver discussed above. The additional information may make beneficiaries comfortable with the less involved option for closing the estate, and the possible costs savings that result, without preparation of a full formal accounting.

Finally, a nonintervention Personal Representative should always remember that he or she may at any time present a matter, defined in RCW 11.96A.030, to the court for resolution or for instructions under TEDRA (chapter 11.96A RCW). A Personal Representative shall not be deemed to have waived the Personal Representative's nonintervention powers by seeking or obtaining any order or decree during the course of the administration of the estate. RCW 11.68.120. Personal Representatives faced with contentious issues should not hesitate to submit such matters to the court to obtain the protections of a court order.

4. Intervention Estates – RCW 11.76. RCW 11.76 governs the administration of estates when Personal Representatives are appointed without nonintervention power. The Personal Representative of an intervention estate must begin the closing process by preparing the court a final report, which

generally must demonstrate that the estate is ready to be closed, describes any estate property not previously disclosed to the court, debts paid, the recipients of estate property, and any property left to distribute.[20] See RCW 11.76.030. The Personal Representative's final report asks the court for a settlement of the estate and distribution of property and the Personal Representative's discharge.

Once the final report and/or petition for distribution has been filed, a hearing date is set, and the Personal Representative must publish notice of the hearing in a legal news publication no less than twenty days prior to the date of the hearing. The Personal Representative must mail a notice of the hearing to each known heir, legatee, devisee and distributee. RCW 11.76.040. Prior to the hearing date, parties interested in the estate may file objections to the final report or distribution petition, or may appear at the hearing and present their objections to the court. The court has broad discretion to determine if the estate was properly administered, and can enter an order approving the report or petition. Once receipts from each heir have been provided to the court, the court will issue an order closing the estate, approving the final distribution of assets, and discharging the Personal Representative. RCW 11.76.050.

5. IRS Forms 56, 4810 and 5495. Finally, the Personal Representative and advisors should be aware of three IRS Forms that may serve to manage risk of ongoing exposure for estate tax liabilities:

[20] The final report should set forth that "the estate is ready to be settled and shall show any moneys collected since the previous report, and any property which may have come into the hands of the personal representative since his or her previous report, and debts paid, and generally the condition of the estate at that time. It shall likewise set out the names and addresses, as nearly as may be, of all the legatees and devisees in the event there shall have been a will, and the names and addresses, as nearly as may be, of all the heirs who may be entitled to share in such estate, and shall give a particular description of all the property of the estate remaining undisposed of, and shall set out such other matters as may tend to inform the court of the condition of the estate, and it may ask the court for a settlement of the estate and distribution of property and the discharge of the personal representative." RCW 11.76.030.

(a) IRS Form 56 (Notice Concerning Fiduciary Relationship);

(b) IRS Form 4810 (Request for Prompt Assessment Under Internal Revenue Code Section 6501(d)); and

(c) IRS Form 5495 (Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905).

A Form 56 is generally filed twice, first when the Personal Representative is appointed, and a second time when the Personal Representative is discharged. The closing Form 56 at discharge will "relieve [the Personal Representative] of any further duty or liability as a fiduciary." See Form 56 instructions. A typical defense raised in transferee liability proceedings against a fiduciary is that the fiduciary is no longer serving in that capacity and is thus not a proper party. However, this defense requires that (1) under local law the discharge is final and complete, and (2) the fiduciary has notified IRS of the termination of the fiduciary relationship. Failure to provide notice of termination allows a deficiency to be properly asserted against the fiduciary even though the fiduciary has been discharged under state law. Treas. Reg § 301.6903 -1(b).

The Personal Representative can also ensure there are no unpaid back taxes of the decedent by filing a Form 4810 (Request for Prompt Assessment for Income and Gift Taxes). A very cautious Personal Representative may even wait for the IRS to respond to this request before making any distributions to the beneficiaries.

Finally, the Personal Representative should consider whether to file a Form 5495 (Request for Discharge from Personal Liability for Decedent's Income and Gift Taxes). If so, the IRS has nine months in which to notify the Personal Representative

of any deficiency for the decedent's applicable income or gift tax returns. If no notice is received from the IRS within nine months from the date of filing Form 5495, the Personal Representative is then discharged from personal liability. Some believe that requests for discharge of income and gift tax should not be routinely made, as they can trigger an audit, though that has not been the author's experience.

H. CONCLUSION

The many issues, complexities, and risks inherent in administering an estate cannot be addressed comprehensively in materials of this length (if at all). However, the discussions above highlight some of the advanced concepts that can assist a Personal Representative in fulfilling his or her duties according to law, and without incurring undue risk.