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5 BIG MISTAKES EXECUTORS MAKE—AND HOW TO AVOID THEM

Being named the executor of a family member's (or other loved one's) estate is, in many ways, an honor. The decision shows that the person saw you as a highly trustworthy, capable person of integrity.

But it's also a major responsibility that can quickly become a burden if you aren't set up to do your job properly. The fact is, administering an estate comes with plenty of potential pitfalls that can threaten your loved one's wealth and your peace of mind. That goes double if the death is unexpected and leaves you reeling emotionally as you try to take on the legally required duties of an executor.

The good news: You can take steps to avoid some of the biggest mistakes that executors often make and to ensure that the process goes as smoothly as possible.

What You Need to Know First

At death, everything a person owns becomes part of their taxable estate. Estate administration is the process of managing the estate. This includes paying off debts and any taxes due, and distributing the property to heirs in accordance with the deceased person's wishes (or by state law if the deceased did not leave a will).

The executor is the person responsible for estate administration. If you have been named the executor of an estate, you are legally required to wrap up its affairs, arrange for the payment of any income and estate taxes, and distribute the assets of the estate.

All too often, executors without quality legal guidance make mistakes during the process of carrying out these responsibilities—mistakes that expose the estate to litigation, increased tax liability, and other potentially serious consequences.

The five most common, and avoidable, mistakes executors make are:

Mistake #1: Making Distributions Too Early

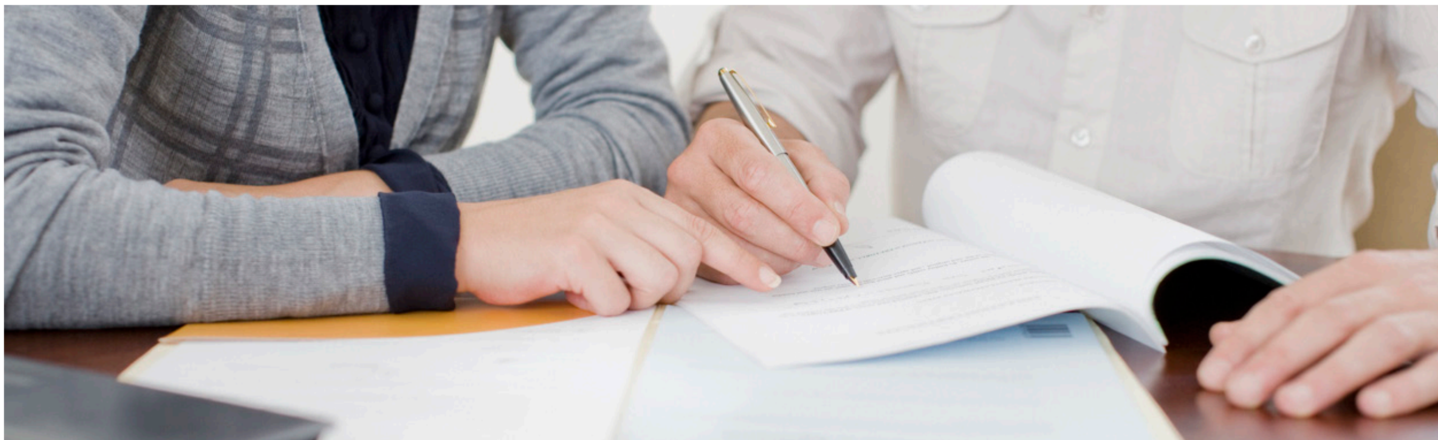
As executor, you are liable for the estate and its distributions. If you make distributions from the estate—handing out money to family members, for example—before taxes and other liabilities are paid, you are personally responsible. The same is true if you make disproportionate payments to family members.

Such distributions, known as "at risk" distributions, should be avoided. That's not to say you can't make these distributions. But a miscalculation or unexpected claim puts you at risk—if, say, you need to get money back from a family member to pay a tax bill, but that person has already spent it all.

Solution: One way to protect against this liability is to have any beneficiary sign a document (generally called a "refunding bond") saying that the distribution they receive may be recalled to settle estate liabilities.

Mistake #2: Failing to Make the "Portability Election"

The concept of portability means a surviving spouse can make use of both their individual federal estate tax exemption and the unused exemption of the first-to-die spouse. Because every decedent is allowed a



federal exemption of $12.06 million in 2022, this allows a married couple to shelter a combined $24.12 million from any federal estate tax liability.

However, this estate tax exemption can often cause a problem for surviving spouses when the entire estate of the first-to-die spouse is sheltered from estate tax. This key requirement is commonly overlooked because you have to ask for it. Even if no estate tax is due upon the death of a first-to-die spouse, the executor of the estate must elect portability by filing an estate tax return on Form 706 within the allowed time frame following the death, with the filing of a proper extension. And if you don't use it, you lose it.

Mistake #3: Failing to Properly Advertise the Estate

The appointment of an executor and the existence of the estate may need to be advertised in a local newspaper. If debts are owed, creditors need to be notified so they can make claims against the estate if necessary.

Each state has different laws that govern the advertisement of an estate, so you will want to make sure you understand your state's rules.

Failure to satisfy a notice requirement may expose you personally to the estate's creditors.

Mistake #4: Failing to Liquidate Securities Through a Market Downturn

As executor, you would be responsible for managing the estate's assets, including any stock portfolios. While you don't necessarily need to have the financial and business acumen of Warren Buffett, failing to monitor the markets and estate investments could seriously damage the estate's value.

As an executor, you're also a fiduciary. That means you are legally required to act in the best interests of the heirs and other beneficiaries of the deceased person. You also must follow the instructions that the deceased spelled out for you.

It falls on your shoulders to ensure the estate's financial health. That job may involve buying and selling stocks or other securities in response to bull and bear markets. An executor's primary goal is to preserve assets, not to pursue hedge-fund-like returns.

Mistake #5: Failing to Properly Conclude the Estate

Executors who have properly distributed most of the estate's assets often fail to properly close the estate. Common ways an estate is closed include:

- Filing a family settlement agreement with the court, showing that all beneficiaries agree that they received their share of the estate
- Going through a court accounting process where a judge ultimately approves of the distributions

If you don't close the estate properly, you can attract unwanted and bothersome IRS attention and potentially be sued.

It is also recommended to work with an accountant (or estate administration lawyer in more complicated cases) to help ensure all tax matters are concluded before the estate is finished with administration.

3 Reasons to Use a Professional in Estate Administration

To avoid these issues, you may want to consult with a professional during estate administration. Here are three reasons why:

1. **To file the proper forms to protect the estate.** Consulting with a professional can give you access to a wealth of knowledge. Estate administration requires familiarity with the complex—and not entirely riveting—process, statutes, and tax forms. To protect an estate against costly mistakes, such as failing to file a state or federal estate tax return or the portability election, you might engage a professional to help navigate the administration process.
2. **To be protected.** There are many actions you can take as an executor that can put you at personal risk. Example: As executor, you are responsible for making distributions to beneficiaries. However, you become personally liable for any improper distributions made before taxes and creditors are paid. To avoid these at-risk distributions, you can work with a professional to ensure state probate and tax formalities and federal tax law are fulfilled.
3. **To protect the estate's value.** If you don't properly protect the estate assets' value, you could be in breach of your fiduciary duty. Consulting with a professional will help you to properly react to market conditions as they change. These actions can include selling a home, performing an estate sale, or engaging a financial professional to manage the investment portfolio.

The upshot: When you're serving as an executor, a professional can counsel you throughout the process. Having access to trustworthy advice can help ensure that the estate administration is a smooth and stress-free process.

You can explore the topic further with your legal or financial professional to help you consider the right next step for you. We are always here to help answer our clients' questions about estate administration.

—Northstar Financial Planners

SELLING REAL ESTATE IN THIS MARKET? HERE'S HOW THE CAPITAL GAINS WORK

If you sold your home after the pandemic began, you may have brought in a sizable profit. According to Redfin, home prices in Florida are up 20.4% compared to last year, with the median days on the market being 23 days. In addition, 39.1% of homes in Florida sold above list price.[1]

Sometimes such profit can throw taxpayers for a loop when it comes time to give Uncle Sam his piece of the pie.

"Capital gains" is the term used when you sell an asset for more than you paid. In the financial world, we typically discuss this in relation to stocks, bonds, and mutual funds. For example, if you buy a share of stock for $100 and later sell it for $150, you have a capital gain of $50.

The capital gains tax can be either long term (asset held for one year or more) or short term (asset held less than one year). The long-term capital gains tax rate is usually more favorable to the taxpayer and typically do not exceed 15% for most individuals.[2]

Short-term gains are taxed the same as ordinary income, which is usually people's highest individual income rate.

So how does this all work in real estate? For the most part, the same as other assets. If you own a home for less than one full year and sell for a profit, get ready to pay the higher short-term capital gains rate. Hold and sell after the one-year mark, and you pay the long-term capital gains rate. The exact amount depends on your tax bracket, marital status, and other factors.

Like stocks, the price you paid for real estate is considered your basis, but you can also add in closing costs, agent fees, capital improvements, and repairs. Instead of being reported on your 1099, the sale of real estate will be on Form 8949 and Schedule D. It is best to work with a tax advisor to complete and review your tax return due to the complexity of reporting.

Can you alleviate some of this tax bill? Yes! One of the easiest ways is taking advantage of the primary residence exclusion, also known as Section 121. To qualify, you must pass the "ownership" and "use" tests. According to IRS.gov, you are generally eligible for the exclusion if "you have owned and used your home as your main home for a period aggregating at least two years out of the five years prior to its date of sale. You can meet the ownership and use tests during different 2-year periods. However, you must meet both tests during the 5-year period ending on the date of the sale."

What this means is that a home seller can move into an investment or rental property for two years before the sale so that they can take advantage of the exclusion. For individuals, the exclusion can include up to $250,000 in capital gains, and married couples may exclude up to $500,000.[3]

Another way to reduce gains on an investment property sale is by looking into a 1031 exchange. When selling

[1] https://www.redfin.com/state/Florida/housing-market
[2] https://www.irs.gov/taxtopics/tc409
[3] https://www.irs.gov/taxtopics/tc701

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an investment property, you may effectively trade one property for another. This means you can profit and flip your investment into a like-kind exchange while deferring taxation until you sell the new investment many years later.

If done properly, there is no limit on the number of 1031 exchanges you do. While you may have a profit on each exchange, you might only have to pay the tax one time at a more favorable long-term capital gains rate in your lower-income years. Working with a professional advisor can help you in taking the appropriate steps for a proper exchange.[4]

Finally, your capital gains bill may also be reduced by using the losses from the sale of other assets to offset the gains of your real estate sale. Just like in our hypothetical stock sale, if you buy a stock for $100 and later sell it at a loss for $50, you now have a capital loss of $50. You can use that loss to subtract from the gain on your real estate transaction. While the goal of stock investing isn't to sell at a loss, well-timed trades to "harvest" losses can help you lower taxable gains either in the same year or even future years.[5]

With the right professional network team—your tax professional, financial advisor, real estate agent, and even an attorney—all on the same page, you can enhance your wealth and optimize your tax mitigation strategies. Proper planning should take place before, during, and after the transaction is complete to ensure that you are not paying any more in taxes than you have to.

You can explore the topic further with your legal or financial professional to help you consider the right next step. Our Plantation, FL wealth management firm is always here to help answer our clients' questions about real estate.

—Felipe Mejia, CFP®

[4] https://www.investopedia.com/financial-edge/0110/10-things-to-know-about-1031-exchanges.aspx
[5] https://www.investopedia.com/articles/taxes/08/tax-loss-harvesting.asp

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