

Estate Accounting and Taxation

Many individuals accumulate substantial amounts of wealth over their lifetimes. When they die, a large part of their assets is passed on to heirs through estates and trusts. It follows then that accurate, timely accounting information for trusts and estates is more important than ever. And, the Economic Growth and Tax Relief Reconciliation Act of 2001 (Tax Act 2001) placed broader demands on accounting records. In the hands of an experienced user, Financial Navigator (FN) is an effective software tool for performing the required tasks.

This presentation is for users experienced with FN, especially in tracking investments and recording receipts and disbursements. Further, while a background in partnership accounting is not required, it is helpful in understanding the advanced aspects of trust accounting.

This document consists of three parts:

- Trusts & Estates: Introduction
- Estate Accounting and Taxation (this document)
- Trust Accounting and Taxation

Financial Navigator and Trust and Estate Accounting

Although accounting for trust and estates requires considerable professional judgment, FN makes the tracking and reporting process much easier. Accordingly, the purpose of this presentation is to acquaint you with:

- Setting up data files and the Chart of Accounts,
- Recording financial activity during period of estate or trust administration,
- Reporting for trusts and estates,
- Tax planning and preparation, and
- Managing cash flow.

Beginning and Ending of an Estate

The instructions and descriptions in this section assume that the financial affairs of the individual have been tracked on Financial Navigator prior to the death and creation of the estate entity. If that is not the case, you should use FN to start tracking the assets of the deceased individual from the first day of the year in which the person died.

Estate Tax Year

IRS regulations state that the moment of death determines the end of the decedent's tax year and the beginning of the estate's tax year. Estates can elect a fiscal year beginning with the date of death and ending not more than twelve months thereafter. Setting the estate's fiscal year can have important tax consequences for the estate and its beneficiaries. Yearend selection should be established as part of an overall tax planning strategy and should include the election to file one tax return for both the estate and related revocable inter vivos trust.

Creating the Estate Entity

If the assets and liabilities of the deceased are already set up on FN, beginning the estate is a matter of copying the data files and making changes to that copy so it becomes the ongoing data for the estate. The two main changes required to the estate data files are:

- Removing all previous transactions from the data files. This is similar to Beginning a New Year in FN, but you do not want to advance the date to the next year. You want the year to remain the same as the current year for the decedent.
- Updating the cost basis of the assets to the market value on the date of death. This cost basis may subsequently be changed to values based on the alternative valuation date.

Note that an estate entity often includes both probate (see definitions above) and non-probate assets. Generally, non-probate assets would include those assets, the title to which passes from the decedent by operation of law. Examples might include homestead property and property held in a revocable inters vivos trust during the decedent's life. Separating probate and non-probate assets is required for reports to the probate court and accurate completion of the estate tax return, Form 706. Tracking of these groups of estate entity assets is easily accomplished by creative use of account qualifiers.

Estate's Data Files

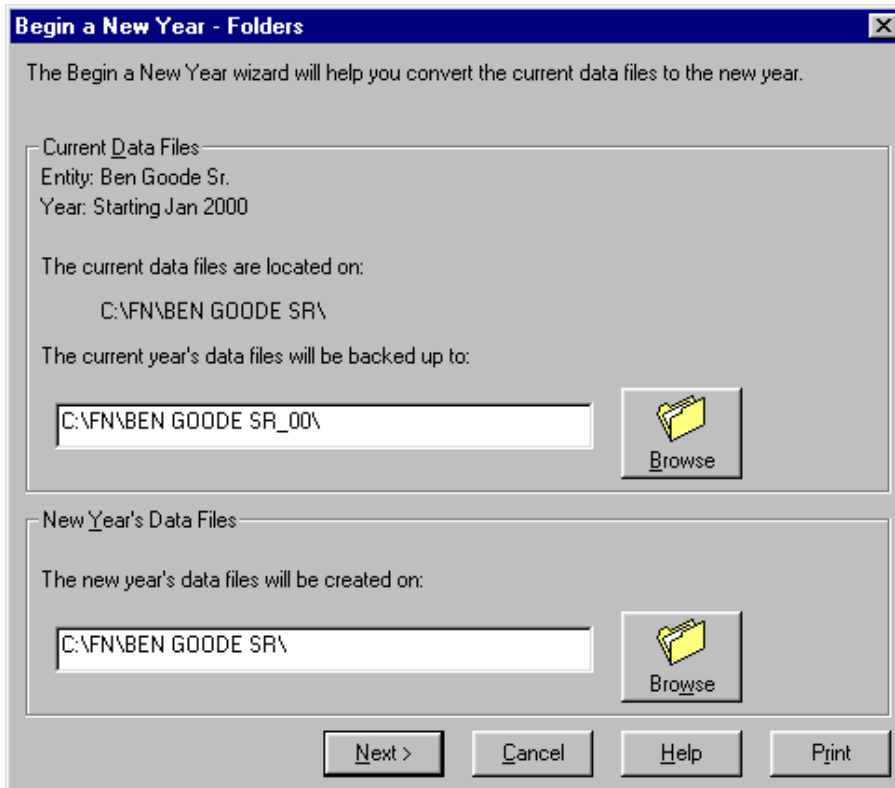
To create data files for an estate:

1. Start FN and load the FN data files for the individual.
2. Update the data files for all the transactions that have occurred prior to the date of death.
3. Select **File | Save As** and enter a new folder name for the estate. FN creates a new data files folder and opens the new files.

4. Select **File | Change Entity Name**. The Select Type of Finances screen appears.
5. Select the **Individual, Trust, or Estate** option button if it is not already selected. Select **OK** to continue. The Individual, Trust, or Estate screen appears.
6. Change any information if necessary. Select **OK** to continue. The Change Entity Name screen appears.
7. Enter the name of the estate for the entity name. Select **OK** to continue. Select **OK** to the prompts that appear and return to the FN desktop. This creates a new entity and uses one of your available entity names.

Estate's Assets *To set up the estate's accounts:*

1. Select **Investments | Enter Prices to Update Securities** to update the account balances for all marketable securities to the current market values. Enter the date of death as the valuation date and enter market prices as of that date. Skip this step if it was already done in the files for the decedent.
2. Select **Utilities | Begin a New Year**. The Begin a New Year - Folders screen appears.



3. Accept the default locations or enter the appropriate drive and folders for the backup and New Year's data folders. Select **Next** to continue and display the Options screen.

4. In the Tax Year frame, enter the current year (not the next year) in the Year Ending field.
5. Select the appropriate month to start the fiscal year from the Beginning Month list box. As described previously in this section, the beginning of the estate's tax year is normally the date of death of the person whose estate you are tracking.
6. Select **OK** to continue. Complete the questions and select **OK** to update the data files.
7. Change the starting balances on all assets that are not marketable securities to equal the market value of the asset on the date of death.
8. Make an extra backup copy of these files to be used for alternative dates for valuing the estate. See the section below for a further explanation.
9. Select **Utilities | System Reconfiguration | Update Tax Basis with Beginning Balance**. This updates the tax basis on all assets to be equal to the market value at the date of death.

You now have a set of data files for the estate that have:

- No transactions for the year,
- Beginning balances equal to the balances of the assets at the date of death,
- The tax basis for the assets revalued to the value on the date of death, and
- The tax year set to the date of death, if necessary.

Note: *that the Tax Act 2001, when fully implemented in 2010, will require maintaining the decedent's original tax basis in the assets held at the date of death.*

Entering Transactions for an Estate

Use the data files created in the previous section and begin entering transactions for the first month the estate became operational. This is the first month after the death of the individual. To do this, simply set the active month to be this month. This means all of the months prior to this active month will remain blank with no transactions.

When dealing with estates, there are specific rules with respect to valuation of the decedent's assets such as publicly traded securities, closely held securities, and income accrued but not paid prior to the date of death. In addition, the personal representative is not required to account for certain assets, although these assets *are* included in the estate tax return of the decedent, for example, jointly owned property and property held in a trust of the decedent.

Tax Planning and Reporting for an Estate

An estate is subject to two forms of taxes. It must file an annual income tax return similar to an individual. If the market value of the assets exceeds a given amount, it must also file an estate tax return and be subject to estate taxes.

The estate tax is calculated on the value of the assets shown on the estate tax return. Tax law allows you to pick the valuation date to be the date of death or any date six months after the date of death.

Stock Web, a Financial Navigator companion product, can be used to estimate prices for both dates to determine the date on which the portfolio has the value which best suits your situation. If you are concerned with estate taxes, use the date that yields the lower valuation. However, if the alternative valuation date does not yield a reduction in estate taxes, it cannot be used to value the estate.

Note: *Again, when dealing with estates, there are specific rules with respect to valuation of the decedent's assets. See the previous section for details.*

Samples of Reports

Here are examples of two of the main reports required for estate reporting:

- Summary of Account
- Subsidiary Schedule

These were prepared in Excel with data taken from FN.

Summary of Account

September 30, 1996 ACCOUNTING OF PERSONAL REPRESENTATIVE

Estate of: Mr. Ben Goode Sr.

From: April 4, 1993 Through September 30, 1996

Summary

I.	Starting Balance	Assets per Inventory on Hand at Close of Last Accounting Period		\$0.00
II.	Receipts			
	Schedule A –	Income	\$141,988.52	
		Principal	\$6,424,817.15	
		Subtotal		\$6,566,805.67
III.	Disbursements			
	Schedule B –	Income	(\$6,719.53)	
		Principal	(\$5,124,326.28)	
		Subtotal		(\$5,131,045.81)
IV.	Distributions			
	Schedule C –	Income	(\$171,136.68)	
		Principal	(\$878,882.00)	
		Subtotal		(\$1,050,018.68)
V.	Capital Transactions and Adjustments			
	Schedule D –	Net Gain or (Loss)		\$229,799.88
VI.	Assets on Hand at Close of Accounting Period			
	Schedule E –	Cash and Other Assets		\$0.00

Subsidiary Schedule

September 30, 1996 ACCOUNTING OF PERSONAL REPRESENTATIVE

Estate of: Mr. Ben Goode Sr.

From: April 4, 1993 Through September 30, 1996

SCHEDULE A Receipts During Period

Date	Brief Description	Income	Principal
04/04/93	Bal in NationsBank		13,766.41
04/04/93	Bal in Merrill L CMA		280,642.04
04/04/93	Two Mercedes Benz autos		4,500.00
04/04/93	Personal property to be distributed in kind		35,845.00
04/04/93	Personal property to be sold		51,917.50
04/04/93	Artwork valued at sales price		124,900.00
04/04/93	Residence \$605,000 less expenses of sale. See closing statement.		555,598.75
04/09/93	Div 199 shs Dominion Resources paid 3/20 to holders 3/2 @ 0.615		122.39
4/09/93	Merrill Lynch Defined Asset Funds		337.00
04/15/93	Interest on Balances	18.19	
04/16/93	Div 1,000 shs National Westminster Bank Non Cum Pfd Ser A ADRs 10.64		665.00

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