TIMELY ISSUES OF IMPORTANCE TO PROBATE COUNSEL

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A NOTE CONCERNING THE PROGRAM MATERIALS

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KELLI E. BROWN is a partner in the firm English, Lucas, Priest & Owsley, LLP, where she practices in estate planning and litigation, as well as probate law. Ms. Brown received her B.A. from the University of Dayton in 1993 and her J.D. from Salmon P. Chase College of Law in 1996. In 1997, she received her L.L.M. in Estate Tax from the University of Miami. Ms. Brown is a member of the Ohio, Tennessee, Kentucky and American Bar Associations. She is also a member of the National Academy of Elder Law Attorneys and serves on the Kentucky Bar Association Elder Law Committee. She is on the Probate and Trust Legislative Committee. She is an executive committee member and former Chair (2010-11) of the Kentucky Bar Association Probate and Trust Law Section. Ms. Brown also serves on the board of the Bowling Green Community Foundation and on the University of Kentucky Estate Planning Institute. Ms. Brown is a fellow with the American College of Trusts and Estates Council (ACTEC).

EDWARD J. BUECHEL is a partner in the firm Raines, Buechel, Conley & Dusing, PLLC, where he concentrates his practice in the areas of estate planning and probate. Mr. Buechel received his A.B., summa cum laude, from Xavier University and his J.D. from the University of Kentucky College of Law. He is a member of the Cincinnati, Northern Kentucky, Ohio, Kentucky and American Bar Associations. Mr. Buechel is a Fellow of the American College of Trust and Estate Counsel and serves as Chair of the Board for St. Charles Care Center and as a Member of the Board of the Community Foundation of Northern Kentucky. In addition, he is a member of the Legislative Committee of the Kentucky Bar Association’s Probate and Trust Law Section.
JOHN T. HAMILTON is a member/partner in the firm Gess, Mattingly & Atchison, PSC, where he practices in the areas of commercial litigation, bankruptcy and probate. Mr. Hamilton received his Bachelor of General Studies and J.D. from the University of Kentucky. He is a member of the Fayette County, Kentucky and American Bar Associations as well as the American Bankruptcy Institute and the Kentucky Justice Association.
Most attorneys with probate experience shun the insolvent estate on the theory that estates with more debt than assets cannot possibly result in full payment to the attorney. This is not always true, and an attorney can sometimes overlook a diamond in the rough if they know what to look for. The truth is that some insolvent estates can be profitable with the expertise of a qualified, experienced estate attorney to unwind what can be very complicated issues.

Every insolvent estate is different and comes with its own set of circumstances which can challenge the estate attorney to explore legal areas he or she had not previously dared to dwell including real estate (selling assets), divorce (interpretation of divorce agreements), collections (liens and creditors), IRS issues/taxes, and litigation. This article reviews some general key elements of insolvent estate administration and offers practical tactical advice for issues likely to be encountered.

I. CONDUCTING THE INITIAL INVESTIGATION

You never truly know the whole picture of an estate administration until an estate is opened and the KRS 395.190 six month period has run; even then there can be surprises. That said, a thorough initial investigation can allow you to make educated decisions about how to proceed and your ability to assist in the administration of an insolvent estate. Important initial evaluation may involve analysis of the following:

✓ Will your representation be of the fiduciary?
✓ Assessment of the “known” situation.
✓ Review of all documentation available concerning all known assets.
✓ Review last three years’ tax returns.
✓ Check PeopleMap on Westlaw or the Lexis equivalent on the decedent.
✓ Confirm title to real estate.
✓ Confirm ownership of assets.
✓ Check the courthouse for mortgages and secured creditor liens.
✓ Investigate possible claims and liabilities.
✓ Was the decedent on Medicaid?
✓ Check CourtNet for existing litigation.
✓ Check unclaimed property for assets.
✓ Assess how helpful the fiduciary will be in resolving known issues.

Paramount to the investigation process is whether your representation will extend to the fiduciary in his or her fiduciary capacity. In other words, is the potential client the executor or administrator of the estate?

If you represent the fiduciary, this will allow the attorney: (1) to be paid out of estate funds in the priority established under KRS 396.095; and (2) to legally
administer the estate (prepare probate documentation, negotiate with creditors, prepare tax returns, etc.).

An heir-at-law or beneficiary who will not serve as the fiduciary will not have the ability to pay his or her attorney from estate funds. Heirs/beneficiaries who will not receive anything from an estate are generally not willing to spend their own money to resolve legal issues. Further, an attorney for the non-fiduciary will not possess the capacity to legally resolve the issues of the estate. Therefore, in most insolvent situations, representation of the personal representative is essential.

Assuming the person who is your potential client is in fact the person who will have the authority to legally administer the estate, the next step is to conduct a general discussion with the personal representative and a thorough review of the known situation. This is not specific to insolvent estates; however, all of these topics are important and can allow an evaluation of the time and effort needed to administer the estate, your ability to handle the issues at hand, and whether there will be adequate funds to compensate you.

After the face-to-face meeting with the potential client, it is important to verify as best as you can all known assets and all known liabilities. For example, if a decedent purportedly owned real property, obtain the deed and review it. Did the decedent own the property individually or does he/she have a fractional interest? Did the decedent have a life estate? Does it pass by virtue of survivorship? Ownership dictates to what degree the real estate will be available to you as you administer the estate.

Check the title on all real estate and confirm mortgages and liens. Secured interests in real property will be “secured creditors,” meaning that they have a priority security interest in the asset they secure and get paid ahead of everyone else, even the attorney.

If the amounts of the secured creditors are in excess of the value of decedent’s assets, this estate will likely not be worth your time. However, this is not always true. Not long ago a potential personal representative came to see me, telling me the decedent had a $144,000 IRS tax lien against the only asset, which was real property. The real property had a PVA value (the value the taxing authorities place on the property) of $150,000. With only a $6,000 gap between the IRS lien and the estimated value, there was not a lot of room to compensate the professionals needed to resolve the many issues. Yet, the client also told me that the decedent was declared incompetent many years prior to death, lived in a nursing home, and there had been no tax reporting. I suspected that the IRS lien was based upon an assessment made without a filed taxed return and therefore would be a highly inflated amount. I completed the necessary documents to investigate the tax status (See Taxes below), and verified that the decedent’s tax returns for many years had not been filed and that the decedent’s income could not have been such that it would justify the high IRS assessment and/or that the cost of care would offset the tax. I then agreed to represent the client, and after corrected 1040 tax returns were prepared and filed for the missing years, the IRS tax lien was reduced to less than $20,000. Thus, the $6,000 gap was replaced.
with a $124,000 gap. Although the estate was still insolvent, there were no fur-
ther secured creditors and thus ample funds to resolve the issues by and through
administration.

An important consideration is also whether the potential problems of the case
can be resolved by you. In other words, is your knowledge sufficient to administer
the specific problems in the estate? For example, if the estate is about to be
embroiled in protracted litigation with the IRS or any other party for that matter,
you must determine whether you have the necessary skills for this job.

Another factor is the client. Let’s face it, some clients demand more attention
than others and have unreasonable expectations on your ability to make an ugly
situation vanish. This is certainly a consideration. Controlling the expectations
of the client and providing them with an understanding of what will be expected
(and what is unknown) is key and should always be in writing.

It is also important to determine what possible non-secured claims may exist and
their viability. The claims that are made after someone dies never cease to
amaze me. Girlfriends make claims for services, “friends” claim they left $50,000
in cash in the decedent’s mobile home, and the most frequent, the old “he told
me that I could have [insert valuable item here].”

All of the above should be used to paint a broad picture of what the challenges of
the estate administration could be should you determine to proceed forward.

II. REPRESENTING A FIDUCIARY OF AN INSOLVENT ESTATE: THE
ENGAGEMENT OF THE ATTORNEY

Potentially important initial documents will likely be:

✓ Engagement letter signed by the fiduciary.
✓ Engagement letter filed of record with the District Court having juris-
diction.
✓ A “duties” letter summarizing the obligations of the client.
✓ Signed authorization to receive information.
✓ Authorization permitting you to review all documentation concerning
assets.
✓ IRS Form 56.
✓ IRS Form SS-4.
✓ Authorization to receive Tax ID number via Internet.
✓ Power of Attorneys for specific issues (especially if the client is out of
state).

A. The Engagement Letter

Assuming you want to proceed with the representation of a client in the
administration of an insolvent estate and have made an assessment that
there will be sufficient non-secured funds in which to be compensated
and can resolve the issues, it is important to have a well written
engagement letter in place.
The engagement letter should specify: (1) The normal provisions such as your hourly rate and the rate for any staff such as paralegals; (2) It should also give you an “out” clause in the event the estate evolves into something that the attorney is unable to handle; and (3) It should limit the scope of representation to the area with which you will be assisting and excluding the areas you will not be assisting. Our rules of ethics permit us to limit our representation (See SCR 3.130(1.2)), and it is a good idea to do so. For example, it may be appropriate to define the boundaries of the representation as follows:

**Scope of representation services do not include:**

i. Non-estate related litigation.

ii. Appeals of any circuit court decisions.

iii. Anything not directly related to the Estate of John Doe.

iv. Preparation of state and federal income, gift, or estate tax returns (although we will work together to engage a qualified CPA).

Some attorneys file their fee agreements of record in the district court having jurisdiction over matter as a method of providing notice for any creditor. This is optional and in no way guarantees that the district court will approve the payment as required under KRS 395.617 (proposed settlement).

B. The “Duties” Letter

A written explanation of the issues at hand and the client’s responsibilities is essential in any probate. A well drafted “duties” letter may include important probate dates such as inventory deadlines and the expiration of the creditor period. It will also include the dates and obligations for tax reporting. For insolvent estates an understanding of what will be required by the client will be helpful to all parties. Make it clear and as simple as possible. For example, if the decedent owned a home that is now vacant or vehicles that will have to be sold, the fiduciary should maintain insurance pending sale. Your client, the fiduciary, will have a responsibility to protect the assets that come through his or her hands. And, it is imperative to note that the scrutiny of many creditors will be upon your client as he or she handles assets.
III. TAX ISSUES

Taxes and tax issues of issue may include:

✓ Income tax.
✓ Inheritance tax.
✓ Estate tax.
✓ Form 56.
✓ Form 2848.
✓ Form SS-4.
✓ CAF number.
✓ Authorization for securing online taxpayer identification number.

All of the above taxes and forms are standard in the so-called normal estate. When an estate is insolvent, greater care should be used in investigating what the decedent’s tax status was while living and whether liens exist.

A. IRS Issues

It is common to find that a decedent with an insolvent estate had tax issues during life that now must be resolved in the administration of the estate. When an estate has IRS issues, my experience is that every aspect of resolution becomes more complicated.

You’ll notice that in calling the IRS, the operator does not answer with “It’s a great day at the IRS! How can I assist you today?” No. First, you call and are put through a series of “options.” Second, assuming you picked the correct options, you are put through to a hold line to wait for an agent. You may be there for fifteen minutes or over an hour. Assuming you speak to an actual person, you will be asked for your CAF number and then asked if you have completed and filed a Form 2848 Power of Attorney and a Form 56 Notice Concerning Fiduciary Relationship. You will not be provided with any information about the estate or the decedent if these have not been filed. Both of these forms (the Form 2848 and the Form 56) are available online although they are mailed or faxed to different locations. The “processing” time of these documents varies and can be days or even weeks. Form 56 cannot be faxed, so do not expect any immediate answers. Assuming you go through all of the above, and speak to an actual IRS representative, you will have to explain your situation from the beginning each time.

If an agent has not been assigned to your case, you are among thousands of people that call the IRS everyday concerning their tax issue. Although attorneys have a special help line (1-866-860-4259), you are still speaking to someone who is states away from you and is not familiar with you or your case. In regard to contacting the IRS by phone, let me state this up front, I do not think that the individual IRS agents are people that intentionally stand in the way of your progress. Rather, my opinion is that the system in place stands in the way and probably makes for unhappy overworked agents who are not thrilled to take another call, especially
from an attorney who has been on hold for an hour and then told her Form 2848 and Form 56 which she knows have been sent in properly are not “on file.”

In any event, the current IRS system is what it is, and there are various methods you can employ to receive information. Sometimes it pays to wait on hold. Sometimes it is best to call the Taxpayer Advocate (1-877-7774748) in order to assist you. Other times may require a face-to-face visit at your local service center. No matter which method you choose to speak to the IRS, it is always best to send communication to the IRS via a mechanism which verifies receipt. They may still claim it was lost or they do not have it, but you protect yourself and the client from limitations periods.

Get all of your IRS documents in place at the outset of representation (the Form 56, Form 2848). This should be done when the client is signing the fee agreement. If you ask, they may fax you a tax transcript for the decedent. Once you have the ability to ask questions and receive information, you can evaluate the decedent’s tax circumstances. Any number of things could have occurred from a failure to file, to a lien, to identity theft. These issues are complicated and resolving them is even more so. A terrific source of information for dealing with the IRS for just about any possible issue of controversy is Effectively Representing Your Client before the IRS, 4th Edition 2009 published by the ABA. This two-volume series is fantastic and has literally assisted me in facilitating tens of thousands of dollars for these estates.

As is evident from the above, patience, proof, and knowledge are necessary when dealing with the IRS.

B. Other Tax Related Issues

If you are not a CPA or a tax attorney who regularly prepares tax documents, the client should engage a qualified CPA with estate tax experience to assist with the necessary tax reporting documents. The cost of the CPA will be a cost of administration under the priority statute KRS 396.095.

IV. SELLING ASSETS

A. Personal Property

Unless the Last Will and Testament of the decedent makes some other provision, all of the personal property must be exhausted first before any of the real property is used to pay debts. KRS 395.220. When dealing with personal property, the following may be helpful:

- Inventory all personal property.
- Do not forget the KRS 391.030 exemption of $15,000.
✓ Investigate reasonable sales methods such as tag sales and auctions.
✓ Keep careful records.

With creditors having an interest in all aspects of the fiduciary’s actions, it is best to complete a detailed inventory of personal property for submission under KRS 395.250. I am not suggesting you list every fork, but it is a good idea to have a comprehensive list of the items of real value.

It will be incumbent upon the fiduciary to place a value on the assets on the inventory. Since the value of some assets cannot be known without a sale to an objective party, consider including language that allows the viewers of the inventory (like creditors) to know that the values are either estimates or based upon a source (such as PVA value). You can always submit an amended inventory after sale.

Of course, if the decedent is survived by a spouse or children, consider making a petition for exemption of the first $15,000 in personal property under KRS 391.030. Generally, spouses and children claim the household items for themselves as these items are generally not much of an interest to creditors. For example, I have never once had a creditor request that a decedent’s photos or everyday dishes be sold to determine value.

Assuming the KRS 391.030 exemption has been made and there are excess items of personal property which the fiduciary must sell, this is often a difficult task. Some personal property is just easier to sell then others. A car, for example, can be taken to a dealer and sold with the fiduciary executing the necessary title documents. An exercise bike from 1984 is not so easily sold. Think of what is in the average person’s garage and then evaluate how much of that “stuff” has any value. Many times, not much. Yet, it is the fiduciary’s job to work this out. Some solutions are auctions, garage sales, consignment shops, etc.

B. Real Estate

Real estate is potentially the decedent’s most lucrative asset. Assuming the personal property has been exhausted, a fiduciary may sell real property under certain circumstances; however, to do so, the statutory process must be closely followed. An administration involving real estate has a lot of issues some of which could be:

✓ Is there specific authority to sell real estate in the last will and testament?
✓ How is title to the real estate held?
✓ Written declaration of the amount owed to secured creditors.
✓ Under what authority may I sell the real estate (last will, statute)?
✓ Options under KRS 389A.010.
✓ Waivers from creditors allowing the sale.
✓ Foreclosure.
Options under KRS 389A.030.
Determine what liens are on the property.
Call the lienholders and explore expectations.
Sale with reserve.

The issues to resolve may be as follows:

1. Does the fiduciary have the power and authority to sell the real estate?

Real and personal property are two separate types of property that pass by different methods. Upon death of an owner of real property, the title to said property passes directly to the heirs at law or to the beneficiaries under a Last Will; it does not pass through the estate. Slone v. Casey, 194 S.W.3d 336 (Ky.App 2004). This principle of Kentucky law is one of the most confusing aspects of Kentucky probate to attorneys, judges, and just about every person and entity with an interest in an estate. The attorney representing the personal representative of the insolvent estate must be familiar with the law and the rules and proceed accordingly.

Basically, the fiduciary cannot simply sell real estate without participating in the requirements under the relevant statutory provisions unless the power to sell so is unambiguously stated in testamentary document. KRS 395.220. However, even when there is authority to sell real property in a last will and testament, a cautious fiduciary would seek court approval for the method so as to provide notice to all interested parties including the creditors.

2. Should the fiduciary sell the property or wait for foreclosure?

When the decedent owned real estate, the issue will become whether the interest of the secured creditors (often a bank with a mortgage) is greater than value of the property itself. In other words, if the property is sold, will there be funds which can be distributed in the estate? To make this determination, you will need: (1) the secured creditor to provide you with an updated debt obligation amount; and (2) a knowledgeable person to give you an estimate of the value of the property for sale purposes.

Assuming you have the proper authorization to receive information, the creditor should be more than willing to provide you with the current amount of the debt.

Getting a value for sale may be more difficult since it is subjective. However, when there are creditors involved and the estate is insolvent, securing this information will be necessary to show due diligence to the court when seeking permission for sale.
It may also be necessary for the purposes of setting a reserve. An appraiser may agree to complete a basic appraisal and may wait until closing to be paid. Other parties such as experienced auctioneers may submit a written estimate of sales value if they suspect that they may be retained to perform the auction of the property.

If the amount of the secured creditors is in excess of the potential sale value of the property, then most of the time, the personal representative should not sell the property and should allow foreclosure to occur. The reason is that foreclosure will strip the liens whereas a private sale by the estate will not. This is very important. If your fiduciary sells land in his or her capacity as fiduciary likely they have entered into a contract with an auctioneer or realtor. That contract says they will pass good title. If the secured creditors to real property are not paid in full upon the sale, the lien will not be released and the seller (the fiduciary) will not pass good title since the secured creditors will not release their liens.

Therefore, if it appears that the amount of the secured creditors to the property will be in excess of the sales value, your personal representative should advise the secured creditors to foreclose. This will do several important things: it will strip off the liens, allow good title to pass, and it will relieve your fiduciary of the responsibility for sale of the property. Of course, foreclosure sales are not known for bringing in large sale funds so likely your secured creditors will be not be paid in full for their secured interest. If a secured creditor is not paid in full under the foreclosure, then they may join the unsecured creditors of the estate by filing a claim and waiting for priority payment under KRS 396.095.

3. Negotiation.

As will be stated below (See Creditors), never underestimate your ability to negotiate with creditors or a creditor's willingness to compromise a claim. This is true even for secured creditors.

4. Statutory procedures for sale by the fiduciary.

a. KRS 389A.010.

The statute allows “any trustee, guardian, conservator, or personal representative” to bring a motion in district court for the sale of real property. Follow the provisions of the statute closely as there are many requirements for notice to all interested parties under the rules of civil procedure and time deadlines. Here, you can request that the court allow the fiduciary to sell the property by a certain method like auction or private sale.
b. KRS 389A.030.

Any joint owner or a “fiduciary possessing a power of sale” may bring a circuit court action for sale of real property by master commissioner. Basically, this is a sale at the courthouse steps, so to speak. This statute, like KRS 389A.010, has many very specific requirements which must be closely followed.

VI. CREDITORS

✓ Prioritize creditors – secured vs. unsecured.
✓ Know the priority of all creditors.
✓ Give notice to all known creditors.
✓ Disallow claims without merit.
✓ Ask for waivers of sale to expedite court sales.
✓ Negotiate!
✓ Abatement rules.
✓ Secure releases when appropriate.

Not all creditors are equal. Kentucky law has recognized that certain classes of claims are so meritorious as to deserve payment before others. It is essential to know these rules and to prioritize creditor claims and determine which must be addressed right away, which come first, and which, if any, are contestable.

A. Notice

KRS 424.340 requires notification to creditors of the appointment of a personal representative by the district clerk in the local newspaper. In addition to this statutory requirement, the fiduciary must adhere to the U.S. Supreme Court’s decision in Tulsa Professional Collection Services, Inc. v. Pope, which held that the notice which is the type discussed above (the clerk to circulate a general notice by newspaper) does not satisfy the requirements of due process in situations where the creditor is “known or reasonably ascertainable.” Tulsa Professional Collection Services, Inc. v. Pope, 485 U.S. 478 (1988).

After Pope, many state courts evaluated just what “known or reasonably ascertainable” means. Kentucky courts have not espoused a standard on this. Good practice may be a common sense approach that if the fiduciary is aware that the decedent owed money to a person or entity, present them with a letter advising them of the decedent’s death, the court, and the case number of the probate. Retain a copy on the file in the event the claimant does not file a claim within the six month time period of KRS 395.190.
B. Claims

1. Delivery/filing.

Claims in an estate must be presented in one of two ways: (1) delivery (by mail or otherwise) of a written claim statement to the personal representative; or (2) filing a written claim statement with the district clerk in the probate action. KRS 396.015.

2. Content.

A claim must be written and include the basis and amount of the claim, the name and address of the claimant, the date the claim will be due if not already due, and a description of the security if secured. KRS 396.015.

3. Disallowance.

A personal representative may give notice to a claimant of disallowance in writing and must state that the claimant has sixty days from the date of the notice to file an action in circuit court on the claim. KRS 396.055.

Note that if the personal representative fails to mail notice to claimants within sixty days after the six month deadline for filing the claim, the claim is deemed allowed and cannot thereafter be disallowed without a showing of cause. KRS 396.055

C. Who Gets Paid and When: Priority

1. Secured creditors.

Since secured creditors have priority in the asset in which they are secured, your costs associated with the administration of the estate do not come before them. In other words, while the secured creditor may appreciate your legal efforts in effectuating payment for their secured interests, they get paid before you for the asset in which they are secured.

For example, if the decedent’s only asset is a home which has a value of $150,000 and there is a $160,000 mortgage secured to the property, this is not an asset in which the fiduciary will likely recover funds for the estate or from which you will be paid to provide legal services. Therefore, the estate in this example is not one in which the attorney would have an interest if he or she would like to be compensated. In the alternative, if the decedent had funds in the decedent’s name alone in excess of secured interests (for example, a $150,000 mortgage on a property valued at $300,000), then the case may be worth a closer look.
The six-month limitation on claims against the decedent’s estate does not impact proceedings for enforcement of a mortgage, pledge, lien or other surety interest upon property of the estate to the extent of the security. KRS 396.011. In other words, even if a secured creditor does not file a claim, they still have a secured interest in the property in which they are secured.

It is possible to negotiate with secured creditors. In fact, creditors represented by law firms often “get” that if they provide a discount of the amount owed, an estate administration can provide an efficient mechanism for payment. When this has occurred in my practice, I submit a polite request in writing with back-up documentation as to why I am requesting a discount as well as the timeframe I propose for payment of the debt assuming the discount is granted. I have had considerable success using this method.

2. Priority of payment after secured creditors.

After secured creditors, KRS 396.095 provides the order of payment of claims when the assets of an estate are insufficient which is as follows:

a. Cost of administration.

b. Funeral.

c. Taxes.

d. Unsecured creditors and all other claims.

Cost of administration is a broad term which covers everything from attorneys to the fiduciary fee to CPAs to locksmiths -- basically anything reasonably necessary to effectuate the administration. Of course, all of these costs are subject to court approval during settlement of the estate unless waived.

3. Unsecured creditors.

This may be your most interesting (and aggressive) group of creditors.

Negotiation with an unsecured creditor: Never underestimate your ability to negotiate. Many times creditors with attorneys are just as anxious as you are to get the issues resolved. If you can reasonably assure them that property will be fairly sold in an efficient manner, they are willing to come to the table and discuss dis-
counting. Of course, all such communication should be verified in writing.

4. Abatement.

Often the estate is not insolvent, but there are not enough liquid assets to cover the creditors. The issue then becomes determining the order in which the property should be used to pay the claims. These questions are usually referred to as problems of "abatement."

At common law, the provisions which the testator has made for the payment of his or her debts in the last will shall be followed. Often the testator has no specific provisions for debt payment within his last will. The general rule was that when there is no detailed instructions in the testamentary instrument, debt payment must first come from the undevised estate. When this is the case, KRS 394.420 states that each devisee shall contribute his proportion of the debt, interest and costs according to the value of the estate received by him. KRS 394.430 when read in connection with KRS 394.420 explains that when this occurs, residuary legatees and legatees to an estate shall not, after paying such debts, be entitled to contribution. The result of reading the two statutes together is that if the undevised property is insufficient to pay all the debts, the residuary estate should be used in order to satisfy the debts and with regard to the debts remaining after the application of the residuary estate, then the other devisees share ratably and the residuary do not receive a distribution.

Basically, there are a number of statutes in Kentucky that impact abatement. How it applies to an estate depends upon what kind of issues are at hand such as creditor type (secured vs. non-secured), the 391.030 exemption, and the election of the surviving spouse. The statutes should be read in the context of the issues of the particular estate.

VII. SEEKING HELP FROM THE COURT

If there are complicated issues, I like to submit my cases to the jurisdiction of the relevant court even beyond what may be required. This has several implications that can protect the fiduciary and the attorney. First, it gives notice and an opportunity to be heard for all motions brought before the court with an opportunity to appeal. Second, the parties can rely upon the orders of the court for proceeding forward as protection.

VIII. ADVERSARY PROCEEDINGS

When issues before the district court become adversarial, then the personal representative can file an action to settle an estate under KRS 395.510. If such
an action is filed, all known creditors and representatives of the decedent must be made a party.

IX. SETTLEMENT

The definition of an insolvent estate is an estate where there is not enough assets to satisfy the existing obligations. While there are various settlement mechanisms, it is incumbent upon the personal representative to utilize the statutory provisions to finalize the estate while giving all interested parties an opportunity to contest or forever be silent. KRS 395.617 allows a personal representative to do this by seeing court approval of a periodic or final settlement prior to distribution of assets.

It works like this: the personal representative files a proposed settlement describing what assets came into the hands of the personal representative, what liabilities exist, and what the personal representative proposes to be distributed. A minimum of twenty (20) days' notice of a hearing must be given to all parties by certified mail, return receipt requested. Those with an interest in the estate may file exceptions or appear at the hearing to protest. If exceptions to the proposed settlement are filed, evidence may be heard and the court shall render a ruling concerning the proposed settlement. If no exceptions have been filed then the proposed settlement “shall” be approved; however, the order may be appealed to district court within thirty days so it is prudent for the personal representative not to make distributions until the appeals time has expired.

X. RESOURCES

A. IRS Resources


2. IRS Practitioner Hotline 1-866-860-4259.

3. Taxpayer Advocate 1-877-777-4778.

4. IRS Louisville Taxpayer Advocate 502-582-6030.

B. Kentucky Estate Administration Resources


C. Medicaid and Elder Law Resources

- Kentucky Practice Vol. 23 Elder Law.
The Issue: When a person dies as a result of an injury or medical negligence, what are the interests and claims that survive to be pursued by the estate and against the estate?

I. GENERAL BACKGROUND

A. Testate Succession
   1. Locate final will and file petition for probate.
   2. Identify claim as “potential claim for personal injury and/or wrongful death” (don’t yet know true nature).

B. Intestate Succession
   1. KRS 391.010 Descent of Real Estate.
   2. KRS 391.030 Descent of Personal Property.

C. Wrongful Death Beneficiaries
   1. KRS 411.130 sets out order of distribution.
   2. Practice note – beneficiary must be living at time of death. Compare to inheritance via will or intestate succession.
      a. Will may distribute to an individual or to a class (such as children or living children).
      b. Intestate succession under KRS 391.010 and KRS 391.030 allows *per stirpes* distribution to heir “and their descendants” (*i.e.* children can take deceased parents’ share).
   3. Practice note – Conflict between will or intestate succession beneficiaries and wrongful death beneficiaries can become a real issue in the event of a large personal injury/wrongful death recovery.
D. Potential Conflict for Counsel – Who Is Client?

1. Generally, the client is the person who hires you. In the probate context, if the “personal representative” hires you, your client was generally viewed to be that person, not the estate or the estate’s beneficiaries. See KBA Ethics Opinion E-401 (issued September 1997) (“We reject the view that a lawyer who represents a fiduciary also owes fiduciary obligations to the beneficiaries that in some circumstances will override obligations otherwise owed by the lawyer to the fiduciary, such as the obligation of confidentiality.”)

2. However, the above rule was substantially altered in the recent case of Anderson v. Pete, 2011 WL 4633096 (Ky. App. 2011) (not final, motion for discretionary review pending). In Pete, the Court of Appeals held that a personal representative’s attorney owed duties to an estate’s beneficiaries (both estate and wrongful death) under the theory that they are intended third-party beneficiaries of the legal contract entered into with the personal representative.

3. When representing a personal representative, it is presumed that you are representing them in their fiduciary capacity (not individual capacity), KRS 395.145, Hamilton v. Nunn, 57 S.W.2d 655, 657 (Ky. 1933).

II. NATURE OF CLAIM FOR ESTATE

A. Lifetime Personal Injury

Per KRS 413.180, an injury occurring as a result of negligent conduct during life of an individual “survives” and may be pursued by the estate representative.

B. Wrongful Death Claim

Per KRS 411.130, when a death occurs as a result of negligence or gross negligence, damages may be recovered for the death from the person who caused it, or whose agent or servant caused it. This claim is also brought by the personal representative for the benefit of wrongful death beneficiaries who are the real parties in interest. Vaughn’s Adm’r v. Louisville & N.R. Co., 179 S.W.2d 441, 445 (Ky. 1944); Robertson v. Vinson, 58 S.W.3d 432 (Ky. 2001).

C. Measure of Damages

1. For lifetime injury.
   a. Medical expenses.
   b. Lost wages.
c. Pain and suffering.
d. Loss of consortium.
   i. Spousal (Martin v. Ohio Co. Hosp. Corp., 295 S.W.3d 104 (Ky. 2009)).
   ii. Child (KRS 411.135).
   iii. Parent (Guiliani v. Guiler, 951 S.W.2d 318 (Ky. 1997)).
e. Punitive damages.
   ii. Punitive damages are defined in KRS 411.184 (declared unconstitutional in part) and Williams v. Wilson, 972 S.W.2d 260 (Ky. 1998) – must involve grossly negligent or intentional conduct.

2. For wrongful death claim.
   a. KRS 411.130 – statutory measure of damages includes punitive damage “If the act was willful or the negligence gross.”
   b. Otherwise wrongful death damages are generally defined as “loss of power to labor and earn money.” Smith v. McCurdy, 269 S.W.3d 876 (Ky.App. 2008).

III. ALLOCATION OF DAMAGES BETWEEN LIFETIME PERSONAL INJURY CLAIM AND WRONGFUL DEATH CLAIM

A. Case Study -- Com Air Flight 5191 Crash (August 27, 2006)
   1. Claims based upon negligence of pilots and air traffic control.
   2. Damages.
      a. Medical expenses.
      b. Pain and suffering.
c. Monetary loss.

d. Wrongful death.

These cases created substantial difficulty in distribution of settlement proceeds under the estates when death was almost instantaneous.

B. Various Claims of Beneficiaries of Estate vs. Wrongful Death Beneficiaries

1. Will beneficiary claims.

2. Intestate beneficiary claims.

3. Wrongful death beneficiary claims.

4. Survivors claim.
   a. Spousal loss of consortium.
   b. Child loss of consortium.
   c. Parental loss of consortium.

C. Duty of Probate Counsel

1. Identify various claims under will or intestacy.

2. Identify living survivors having interest in wrongful death claim.

D. Handling Recovery through Settlement

1. Most personal injury/wrongful death litigation is resolved through settlement rather than actual trial.

2. Settlement documents rarely admit any liability and more often disclaim liability for all nature of claims. Also, settlement documents rarely allocate damages amongst various damage categories (i.e. don’t specify any amount for punitive damages).

3. Smith v. McCurdy, supra – Attempts to judicially allocate recovery between estate and wrongful death beneficiaries. Opinion says where no loss of earning capacity then none of recovery is included in wrongful death category and all goes into estate.

   a. Problems with decision:

   Older or retired persons or nursing home residents who die as a result of sudden negligent occurrence may have no damage claim if had no power to earn.
b. Point:

Decision totally disregards “punitive damage” element in wrongful death statute.

E. Key for Probate Counsel

1. Reach a consensus among groups having an interest in the recovery.

2. Avoid litigation.
   a. Under KRS Chapter 396 claims against estate are filed in Circuit Court. This means your personal representative will be sued.
   b. Proof problems – how does either side prove where money would have gone without having jury allocate between various damage elements?
   c. Means parties will essentially have to try the underlying personal injury/wrongful death claim to determine allocation of damage.
      i. If conduct was grossly negligent, jury should allow for punitive damages.
      ii. How much of the recovery is for lifetime medical expenses, pain and suffering? How much for punitive? Was punitive for lifetime injury? Was punitive for wrongful death?

(a) Point:

Lifetime damages that are pursued by an estate representative go into estate for distribution.

(b) Wrongful death damages pursued by a personal representative don’t go into the estate, but are paid by personal representative directly to statutory wrongful death beneficiaries.

IV. HANDLING CLAIMS AGAINST ESTATE

A. KRS 396.011 says anyone having a lifetime claim must file within six months of appointment of Personal Representative. Claims are filed by filing in probate action or written notice to personal representative.
B. Claims by Government Unit – KRS 396.011 and KRS 396.205 provide that a governmental unit has up to two years after discharge of personal representative to bring an action against a personal representative or any distributee.

C. Administrative Expense Claims

1. Funeral/burial expenses.

2. Personal representative commission KRS 395.150 (not to exceed 5 percent of the value of the personal estate) KRS 411.130 (allows payment for “costs of administration and costs of recovery”).

   See Sturges v. Sturges, 102 S.W. 884 (Ky. 1907) (setting forth that “costs of administration” shall be paid prior to disbursing funds to beneficiaries).

D. Claims against estate do not go against any recovery of damages allocated to wrongful death. Emmerke’s Adm’r v. Denunzio, 196 S.W.2d 599 (Ky. 1946). This is because the wrongful death recovery flows directly to the statutory beneficiaries and not through the estate where it would be subject to claims.

E. Decision of Personal Representative on Allocation of Damages

1. KRS 411.130 and KRS 411.133 directs that a personal representative is to prosecute both wrongful death and personal injury claims – therefore, there is the implication that part of this duty to prosecute is to allocate damages between several claims.

2. Analysis of makeup of damages based upon facts of particular case.

3. Reaching decision with eye toward position of estate vs. wrongful death beneficiaries.

V. MEDICAID SERVICES CLAIMS

A. Arise from Daily Rates Paid by Medicaid for Room and Board in Nursing Home

Statute and regulations giving rise to claims:

1. 42 U.S.C. §1396p – requires states to seek recovery from certain estates.

2. KRS 194A.050 – requires state Medicaid office to comply with federal statute.
B. Exemptions -- See KAR 1:585 Sec. 3

1. Surviving spouse.
2. Child under twenty-one or blind or disabled.
3. Estate under $10,000.
4. Asset subject to recovery is sole income-producing asset of family farm or business conveyed to survivor.

C. Claims from Medicaid Services

1. Filed through a Verified Statement of Claim; or
2. Filed by letter setting forth claim to the personal representative.

D. Elicit Claim to Start Medicaid Clock Running by Taking Affirmative Action to Notify Medicaid When Estate Is Created

Open question as to whether Medicaid claims are “lifetime” claims or not. If yes, then there is potential benefit from getting Medicaid to file within six months of estate initiation in order to trigger claims objection and litigation procedures set forth in KRS 396.055.

E. Medicaid Services Reliance on Smith v. McCurdy

Standard argument is that entire recovery for nursing home wrongful death claim is to go into estate, because of no ability to prove loss of earning capacity.

F. Resolving Medicaid Claims

1. Reduce gross settlement by all recovery expenses.
   a. Attorney fees (Tort and Estate).
   b. Funeral/burial expenses.
   c. Other estate claims (based upon claims filed).
   d. Personal representative expenses (commissions).
2. Argue punitive award would have been allocated to the wrongful death claim where death occurred shortly following injury.
3. Argue inability to fairly allocate to prove lifetime vs. wrongful death damages.
VI. LITIGATION BETWEEN BENEFICIARY GROUPS (SHOULD BE AVOIDED)

A. Wrongful Death Beneficiary vs. Testate Beneficiary

B. Wrongful Death Beneficiary vs. Intestate Beneficiary
TITLE XVII. Economic Security and Public Welfare
Chapter 194A. Cabinet for Health and Family Services (Refs & Annos)
194A.050 Execution of policies, plans, and programs -- Administrative regulations -- Fees.

(1) The secretary shall formulate, promote, establish, and execute policies, plans, and programs and shall adopt, administer, and enforce throughout the Commonwealth all applicable state laws and all administrative regulations necessary under applicable state laws to protect, develop, and maintain the health, personal dignity, integrity, and sufficiency of the individual citizens of the Commonwealth and necessary to operate the programs and fulfill the responsibilities vested in the cabinet. The secretary shall promulgate, administer, and enforce those administrative regulations necessary to implement programs mandated by federal law, or to qualify for the receipt of federal funds and necessary to cooperate with other state and federal agencies for the proper administration of the cabinet and its programs.

(2) The secretary may utilize the Public Health Services Advisory Council to review and make recommendations on contemplated administrative regulations relating to initiatives of the Department for Public Health. No administrative regulations issued under the authority of the cabinet shall be filed with the Legislative Research Commission unless they are issued under the authority of the secretary, and the secretary shall not delegate that authority.

(3) The secretary may utilize the Council for Families and Children to review and make recommendations on contemplated administrative regulations relating to initiatives of the Department for Community Based Services. No administrative regulations issued under the authority of the cabinet shall be filed with the Legislative Research Commission unless issued under the authority of the secretary, and the secretary shall not delegate this authority.

(4) Except as otherwise provided by law, the secretary shall have authority to establish by administrative regulation a schedule of reasonable fees, none of which shall exceed one hundred dollars ($100), to cover the costs of annual inspections of efforts regarding compliance with program standards administered by the cabinet. All fees collected for inspections shall be deposited in the State Treasury and credited to a revolving fund account to be used for administration of those programs of the cabinet. The balance of the account shall lapse to the general fund at the end of each biennium. Fees shall not be charged for investigation of complaints.

Effective: June 20, 2005
391.010 Descent of real estate.

When a person having right or title to any real estate or inheritance dies intestate as to such estate, it shall descend in common to his kindred, male and female, in the following order, except as otherwise provided in this chapter:

(1) To his children and their descendants; if there are none, then

(2) To his father and mother, if both are living, one (1) moiety each; but if the father is dead, the mother, if living, shall take the whole estate; if the mother is dead, the whole estate shall pass to the father; if there is no father or mother, then

(3) To his brothers and sisters and their descendants; if there are none, then

(4) To the husband or wife of the intestate; if there are none surviving, then

(5) One (1) moiety of the estate shall pass to the paternal and the other to the maternal kindred, in the following order:

   (a) The grandfather and grandmother equally, if both are living; but if one is dead, the entire moiety shall go to the survivor; if there is no grandfather or grandmother, then

   (b) To the uncles and aunts and their descendants; if there are none, then

   (c) To the great-grandfathers and great-grandmothers, in the same manner prescribed for grandfather and grandmother by subsection (a); if there are none, then

   (d) To the brothers and sisters of the grandfathers and grandmothers and their descendants; and so on in other cases without end, passing to the nearest lineal ancestors and their descendants.

(6) If there is no such kindred to one of the parents as is described in subsection (5), the whole to go to the kindred of the other. If there is neither paternal nor maternal kindred, the whole shall go to the kindred of the husband or wife, as if he or she had survived the intestate and died entitled to the estate.

expenses, charges of administration, and debts, shall pass and be distributed among the same persons, and in the proportions, to whom and in which real estate is directed to descend, except as follows:

(a) The personal estate of an infant shall be distributed as if he or she had died after full age;

(b) An alien may be distributed as though he or she were a citizen; and

(c) Personal property or money on hand or in a bank or other depository to the amount of fifteen thousand dollars ($15,000) shall be exempt from distribution and sale and shall be set apart by the District Court having jurisdiction over the estate on application to the surviving spouse, or, if there is no surviving spouse, to the surviving children.

(2) The surviving spouse may, at any time before the property or money is set apart by the court, procure on petition from the Judge of the District Court having jurisdiction over the estate, an order authorizing the surviving spouse to withdraw from any bank or other depository not exceeding two thousand five hundred dollars ($2,500) belonging to the estate. Upon presentation of the order, the bank or depository shall permit the surviving spouse to withdraw the sum and shall lodge the order, endorsing thereon the amount withdrawn, with the circuit clerk who shall retain it in the clerk's files to be considered in connection with further proceedings in the estate and the withdrawal shall be treated as a charge against the property of the estate exempt from distribution.

(3) In the application for the setting apart of property or money under subsection (1) of this section, the surviving spouse or, if there is no surviving spouse, the surviving children may make their selection out of the personal property of the estate to the extent that the value of the property selected does not exceed the amount of fifteen thousand dollars ($15,000).

(4) Where any person dies testate:

(a) Personal property or money on hand or in a bank or other depository to the amount of fifteen thousand dollars ($15,000) shall be exempt from distribution and sale and shall be set apart by the District Court having jurisdiction over the estate on application of the surviving spouse;

(b) If there is no surviving spouse, personal property or money on hand or in a bank or other depository bequeathed to surviving children to the amount of fifteen thousand dollars ($15,000) shall be exempt from distribution and sale and shall be set apart by the District Court having jurisdiction over the estate on application by the surviving children;

(c) The exemption of the surviving spouse under paragraph (a) of this subsection is not conditioned upon the surviving spouse renouncing the will, and, in the event of renunciation, the surviving spouse shall be entitled to the exemption in addition and prior to determining the statutory share of the surviving spouse under KRS 392.080; and
(d) Subsection (3) of this section shall apply with respect to the surviving spouse provided that the surviving spouse shall first select from among the personal property of the residuary estate, then to the extent necessary from among the money on hand or on deposit specifically bequeathed under the will, and then to the extent necessary from among any other personal property specifically bequeathed under the will. Where the selection of the surviving spouse is made up, in whole or in part, from personal property or money on hand or on deposit specifically bequeathed to a beneficiary, such beneficiary shall have a right of contribution on the principles of KRS 394.420 to 394.490 unless the will otherwise directs, or it is necessarily to be inferred therefrom that the testator intended the same to fall on such beneficiary except that there shall be no right of contribution from the surviving spouse.

Effective: July 15, 2010

TITLE XXXIV. Descent, Wills, and Administration of Decedents’ Estates
Chapter 395. Personal Representatives (Refs & Annos)
395.150 Compensation of representatives.

(1) The compensation of an executor, administrator or curator, for services as such, shall not exceed five percent (5%) of the value of the personal estate of the decedent, plus five percent (5%) of the income collected by the executor, administrator or curator for the estate.

(2) Upon proof submitted showing that an executor, administrator or curator has performed additional services in the administration of the decedent's estate, the court may allow to the executor, administrator or curator such additional compensation as would be fair and reasonable for the additional services rendered, if the additional services were:

(a) Unusual or extraordinary and not normally incident to the administration of a decedent's estate; or

(b) Performed in connection with real estate or with estate and inheritance taxes claimed against property that is not a part of the decedent's estate but is included in the decedent's estate for the purpose of asserting such taxes.

Effective: October 1, 1942
(1) All claims against a decedent's estate which arose before the death of the decedent, excluding claims of the United States, the State of Kentucky and any subdivision thereof, whether due or to become due, absolute or contingent, liquidated or unliquidated, founded on contract, tort, or other legal basis, if not barred earlier by other statute of limitations, are barred against the estate, the personal representative, and the heirs and devisees of the decedent, unless presented within six (6) months after the appointment of the personal representative, or where no personal representative has been appointed, within two (2) years after the decedent's death.

(2) Nothing in this section shall affect or prevent:

   (a) To the extent of the security only, any proceeding to enforce any mortgage, pledge, lien or other security interest securing an obligation of the decedent or upon property of the estate; or

   (b) To the limits of the insurance protection only, any proceeding to establish liability of the decedent or the personal representative for which he is protected by liability insurance.

Effective: July 15, 1988

(1) As to claims presented in the manner described in KRS 396.015 within the time limit prescribed in KRS 396.011, the personal representative may mail a notice to any claimant stating that the claim has been allowed or disallowed. If, after allowing or disallowing a claim, the personal representative changes his decision concerning the claim, he shall notify the claimant. The personal representative may not change a disallowance of a claim after the time for the claimant to commence an action on the claim has run and the claim has been barred. Every claim which is disallowed in whole or in part by the personal representative is barred so far as not allowed unless the claimant commences an action against the personal representative not later than sixty (60) days after the mailing of the notice of disallowance or partial allowance if the notice warns the claimant of the impending bar. Failure of the personal representative to mail notice to a claimant of action on his claim for sixty (60) days after the time for original presentation of the claim has expired has the effect of a notice of allowance, except that upon petition of the personal representative and upon notice to the claimant, the court at any time before payment of such claim may for cause shown permit the personal representative to disallow such claim.

(2) A judgment against a personal representative to enforce a claim against a decedent's estate is an allowance of the claim.
(3) In the case of a disallowance of a claim which has not matured or which is contingent or unliquidated, the personal representative may consent to an extension of the sixty (60) day period imposed by subsection (1) of this section for the commencement of an action on a disallowed claim, or to avoid injustice, the court, on petition, may order an extension of the sixty (60) day period, but in no event shall the extension run beyond the applicable statute of limitations.

Effective: July 15, 1988  

TITLE XXXIV. Descent, Wills and Administration of Decedents’ Estates  
Chapter 396. Claims against Decedents’ Estates  
396.205 Limitation on actions not otherwise barred.

Notwithstanding any other statute to the contrary, no cause of action on any claim not otherwise barred by the provisions of KRS 396.011 and KRS 396.055(1), or any other applicable statute of limitations, shall be brought against the personal representative or against any distributee after the expiration of two (2) years from the date of the order of discharge of the personal representative. The foregoing limitation shall not preclude an action by any claimant against the personal representative or any distributee for fraud.

Effective: July 15, 1998  

TITLE XXXVI. Statutory Actions and Limitations  
Chapter 411. Rights of Action and Survival of Actions (Refs & Annos)  
411.130 Action for wrongful death -- Personal representative to prosecute -- Distribution of amount recovered.

(1) Whenever the death of a person results from an injury inflicted by the negligence or wrongful act of another, damages may be recovered for the death from the person who caused it, or whose agent or servant caused it. If the act was willful or the negligence gross, punitive damages may be recovered. The action shall be prosecuted by the personal representative of the deceased.

(2) The amount recovered, less funeral expenses and the cost of administration and costs of recovery including attorney fees, not included in the recovery from the defendant, shall be for the benefit of and go to the kindred of the deceased in the following order:

(a) If the deceased leaves a widow or husband, and no children or their descendants, then the whole to the widow or husband.

(b) If the deceased leaves a widow and children or a husband and children, then one-half (1/2) to the widow or husband and the other one-half (1/2) to the children of the deceased.

(c) If the deceased leaves a child or children, but no widow or husband, then the whole to the child or children.
(d) If the deceased leaves no widow, husband or child, then the recovery shall pass to the mother and father of the deceased, one (1) moiety each, if both are living; if the mother is dead and the father is living, the whole thereof shall pass to the father; and if the father is dead and the mother living, the whole thereof shall go to the mother. In the event the deceased was an adopted person, “mother” and “father” shall mean the adoptive parents of the deceased.

(e) If the deceased leaves no widow, husband or child, and if both father and mother are dead, then the whole of the recovery shall become a part of the personal estate of the deceased, and after the payment of his debts the remainder, if any, shall pass to his kindred more remote than those above named, according to the law of descent and distribution.


TITLE XXXVI. Statutory Actions and Limitations
Chapter 411. Rights of Action and Survival of Actions (Refs & Annos)
411.133 Joinder of wrongful death and personal injury actions.

It shall be lawful for the personal representative of a decedent who was injured by reason of the tortious acts of another, and later dies from such injuries, to recover in the same action for both the wrongful death of the decedent and for the personal injuries from which the decedent suffered prior to death, including a recovery for all elements of damages in both a wrongful death action and a personal injury action.


TITLE XXXVI. Statutory Actions and Limitations
Chapter 411. Rights of Action and Survival of Actions (Refs & Annos)
411.135 Damages in action for wrongful death of minor.

In a wrongful death action in which the decedent was a minor child, the surviving parent, or parents, may recover for loss of affection and companionship that would have been derived from such child during its minority, in addition to all other elements of the damage usually recoverable in a wrongful death action.


TITLE XXXVI. Statutory Actions and Limitations
Chapter 411. Rights of Action and Survival of Actions (Refs & Annos)
411.184 Definitions -- Punitive damages -- Proof of punitive damages.

(1) As used in this section and KRS 411.186, unless the context requires otherwise:

(a) "Oppression" means conduct which is specifically intended by the defendant to subject the plaintiff to cruel and unjust hardship.

(b) "Fraud" means an intentional misrepresentation, deceit, or concealment of material fact known to the defendant and made with the intention of causing injury to the plaintiff.
(c) "Malice" means either conduct which is specifically intended by the defendant to cause tangible or intangible injury to the plaintiff or conduct that is carried out by the defendant both with a flagrant indifference to the rights of the plaintiff and with a subjective awareness that such conduct will result in human death or bodily harm.

(d) "Plaintiff" means any party claiming punitive damages.

(e) "Defendant" means any party against whom punitive damages are sought.

(f) "Punitive damages" includes exemplary damages and means damages, other than compensatory and nominal damages, awarded against a person to punish and to discourage him and others from similar conduct in the future.

(2) A plaintiff shall recover punitive damages only upon proving, by clear and convincing evidence, that the defendant from whom such damages are sought acted toward the plaintiff with oppression, fraud or malice.

(3) In no case shall punitive damages be assessed against a principal or employer for the act of an agent or employee unless such principal or employer authorized or ratified or should have anticipated the conduct in question.

(4) In no case shall punitive damages be awarded for breach of contract.

(5) This statute is applicable to all cases in which punitive damages are sought and supersedes any and all existing statutory or judicial law insofar as such law is inconsistent with the provisions of this statute.

Effective: July 15, 1988
History: Created 1988 Ky. Acts ch. 224, sec. 2, effective July 15, 1988. Validity: This section has been held unconstitutional in the case of Williams v. Wilson, 972 S.W.2d 260 (Ky. 1998).

Title XXXVI. Statutory Actions and Limitations
Chapter 413. Limitation of Actions (Refs & Annos)
413.180 Action by or against personal representative under KRS 413.090 to 413.160.

(1) If a person entitled to bring any action mentioned in KRS 413.090 to 413.160 dies before the expiration of the time limited for its commencement and the cause of action survives, the action may be brought by his personal representative after the expiration of that time, if commenced within one (1) year after the qualification of the representative.

(2) If a person dies before the time at which the right to bring any action mentioned in KRS 413.090 to 413.160 would have accrued to him if he had continued alive, and there is an interval of more than one (1) year between his death and the qualification of his personal representative, that representative, for purposes of this chapter, shall be deemed to have qualified on the last day of the one-year period.

Effective: July 15, 1988

STATUTORY AUTHORITY: KRS 194A.030(2), 194A.050(1), 205.520(3), EO 2004-726

NECESSITY, FUNCTION, AND CONFORMITY: The Cabinet for Health and Family Services, Department for Medicaid Services has responsibility to administer the Medicaid Program. KRS 205.520(3) empowers the cabinet, by administrative regulation, to comply with any requirement that may be imposed or opportunity presented by federal law for the provision of medical assistance to Kentucky's indigent citizenry. 42 U.S.C. 1396p(b)(1)-(4) establishes minimum requirements for state plans for estate recovery actions. This administrative regulation establishes provisions relating to estate recovery.

Section 1. Definitions.

(1) "Aged institutionalized individual" means a recipient age fifty-five (55) or older who received nursing facility (NF) services, intermediate care facility for individuals with mental retardation or a developmental disability (ICF/MR/DD) services, home and community based (HCB) waiver services, supports for community living (SCL) services, acquired brain injury (ABI) waiver services, ABI long-term care waiver services, or Michelle P. waiver services with payment for these services made, wholly or in part, by the Medicaid Program.

(2) "Department" means the Department for Medicaid Services or its designee.

(3) "Estate" means:

(a) All real and personal property or other assets owned by the deceased recipient that would be included as probate property under Kentucky law; and

(b) All real and personal property or other assets in which the deceased recipient had legal title or interest at the time of death, to the extent of the recipient’s interest, whether the asset was conveyed to a survivor, heir or assign of the deceased recipient through joint tenancy, tenancy in common survivorship, life estate, living trust or other arrangement.

(4) "Estate representative" means the court appointed fiduciary or the fiduciary’s attorney, the recipient family member or other interested party who represents to the department in writing that he or she is the representative for the estate.

(5) "Long-term care partnership insurance" is defined by KRS 304.14-640(4).

(6) "Long-term care partnership insurance policy" means a policy meeting the requirements established in KRS 304.14-642(2).

(7) "Period of institutionalization" means the period of time an aged institutionalized or permanently institutionalized individual received Medicaid services.
(8) "Permanently institutionalized" means residing in a nursing facility or intermediate care facility for individuals with mental retardation or a developmental disability for six (6) months or more.

(9) "Recipient family member" means the surviving spouse, child or sibling of a deceased recipient.

(10) "State plan" is defined by 42 C.F.R. 400.203.

(11) "Surviving child" means a living child under age twenty-one (21) or a child who is blind or disabled as defined in 42 U.S.C. 1382c.

Section 2. Recovery.

(1) The department shall seek recovery from the estate of a deceased recipient for a period of institutionalization.

(2) The amount recovered shall not exceed the amount paid by the Medicaid Program on behalf of the deceased recipient for services received during a period of institutionalization.

(3) The amount subject to recovery shall include:

   (a) The expenditures for:

      1. NF services pursuant to 907 KAR 1:022;
      2. ICF/MR/DD services pursuant to 907 KAR 1:022;
      3. Home and community based (HBC) waiver services pursuant to 907 KAR 1:160;
      4. Supports for community living (SCL) services pursuant to 907 KAR 1:145;
      5. Acquired brain injury (ABI) waiver services pursuant to 907 KAR 3:090;
      6. ABI long-term care waiver services pursuant to 907 KAR 3:210; or
      7. Michelle P. waiver services pursuant to 907 KAR 1:835; or

   (b) Other costs for:

      1. Related prescription drugs, hospital services, and related physician services; or
      2. Medicare cost sharing or Medicare premiums.

(4) The amount subject to recovery shall include a capitation payment made by the Medicaid Program to a managed care organization on behalf of the deceased recipient.
Section 3. Exemptions and Limitations.

(1) Recovery shall not be made from the estate if the estate representative can verify to the department's satisfaction that there is a:

   (a) Surviving spouse; or

   (b) Surviving child.

(2) Recovery shall not be made from the estate on any resources protected from consideration during the eligibility determination process based on payment issued by a long-term care partnership insurance policy.

(3) The department shall waive estate recovery to the extent the recovery would work an undue hardship.

   (a) Undue hardship shall exist if an asset subject to recovery is the sole income-producing asset, for example a family farm or business, conveyed to the surviving recipient family member. A sole income-producing asset shall not include residential real property producing income through a lease or rental arrangement.

   (b) The estate representative shall apply for an undue hardship exemption by:

      1. Making a written request to the department within thirty (30) days of receipt of the notice provided in accordance with Section 7(3)(a) of this administrative regulation; and

      2. Verifying to the department's satisfaction that the criteria specified in paragraph (a) of this subsection exists for an undue hardship.

   (c) The department shall issue a decision on an undue hardship exemption request within thirty (30) days of receipt of the request and supporting documentation.

   (d) 1. If the department denies the estate representative’s request for an undue hardship exemption, the estate representative may request an appeal.

      2. If an appeal is requested, an administrative hearing shall be conducted in accordance with 907 KAR 1:563, Section 4, and KRS Chapter 13B.

   (e) The department shall not conclude that an undue hardship exists if the deceased recipient created the hardship by resorting to estate planning methods under which the recipient illegally divested assets to avoid estate recovery.

(4) (a) The department may waive recovery if it is not cost effective to recover from the estate.

   (b) The department shall not consider it to be cost effective to recover from an estate if the total date-of-death value of the estate subject to recovery is:
1. Less than the administrative cost of recovering from the estate; or

2. $10,000 or less.

(5) (a) The department may grant an exemption of the recovery provisions on a case-by-case basis to the extent of the anticipated cost of continuing education or health care needs of an estate heir.

(b) The estate representative shall submit to the department a written request for an exemption and provide verification to the satisfaction of the department.

(6) (a) A deceased recipient’s estate shall be subject to recovery of Medicaid Program expenditures to the extent it is adjudicated through a final administrative appeal process or court action that the recipient qualified for Medicaid fraudulently.

(b) If the recipient qualified for Medicaid fraudulently, the exemptions or limitations established in this section shall not apply.

Section 4. Notification.

(1) A general written notice regarding estate recovery shall be provided by the department to an aged institutionalized or permanently institutionalized individual, or an authorized representative acting on his or her behalf, at the time the individual requests coverage of NF services, ICF/MR/DD services, HCB waiver services, SCL services, ABI waiver services, ABI long-term care waiver services, or Michelle P. waiver services under the Medicaid Program.

(2) When an aged institutionalized or permanently institutionalized individual who is receiving NF services, ICF/MR/DD services, HCB waiver services, SCL services, ABI waiver services, ABI long-term care waiver services, or Michelle P. waiver services under the Medicaid Program dies, the Medicaid provider from which the recipient was receiving institutionalized services at the time of death shall be responsible for reporting the death to the local Department for Community Based Services office within ten (10) days of the date of death.

(3) (a) Upon receipt of the notice of death specified in subsection (2) of this section, the department shall prepare and serve written notice of its intent to recover upon the estate representative.

(b) The estate representative shall be responsible for notifying individuals who are affected by the proposed recovery.

(c) If no estate representative exists, notice shall be provided to the family members or heirs if the recipient has provided the department with this information through the eligibility application process.

(4) The notice of intent to recover shall include:

(a) The action the department intends to initiate;
(b) The reason for the action;

(c) Exemptions and limitations to estate recovery as specified in Section 3 of this administrative regulation;

(d) Conditions that are considered an undue hardship exemption as specified in Section 3(3) of this administrative regulation;

(e) Procedures for applying for an undue hardship exemption as specified in Section 3(3) of this administrative regulation;

(f) The total amount subject to recovery; and

(g) The procedure for appealing a denial of an undue hardship exemption request.

(20 Ky.R. 1741; Am. 2348; eff. 2-2-1994; 22 Ky.R. 632; eff. 10-19-1995; 1114; 1531; eff. 1-5-2004; 35 Ky.R. 1637; 1802; 2747; eff. 7-6-2009.)
Michael Anderson was driving a van owned by his employer when he hit a retaining wall on October 17, 2001. He was partially ejected from the van and died from his injuries. The van’s seat had a locking mechanism that was not functioning properly, a fact that Anderson had previously brought to the attention of his employer. Anderson’s estate retained Mickiel Pete, an attorney, to sue the company responsible for maintaining the van. Pete filed a complaint making claims for wrongful death on behalf of the estate and for loss of consortium for Anderson’s widow. However, he did not name Anderson’s two minor children as plaintiffs nor did he include claims of loss of consortium/parental love and affection for them. The suit was later dismissed. Anderson’s two children (one now an adult, the other as a minor by and through his mother) filed a professional negligence action against Pete. Pete moved for summary judgment, arguing that he did not have an attorney-client relationship with the children and therefore lacked standing, and the circuit court agreed. The Court of Appeals reversed, noting that it appeared reasonable for the children and their mother to believe the children were among Pete’s clients, but also that as beneficiaries of the estate, and therefore of the proceeds of any wrongful death recovery, Pete owed them a duty regardless of any attorney-client relationship. “[T]he result is inescapable that Pete owed a duty to Michael and Malik -- whether as attorney to client or as attorney to intended beneficiary.” (Emphasis in original). The case was remanded.

Thelma Nanney, a woman in her eighties with myriad health issues, died in 2001. She left behind two daughters, Diana Smith and Denica McCurdy. After Thelma’s death, Diana filed a petition with the court seeking to be named administratrix of her mother’s estate as she believed her mother died intestate. Diana believed a wrongful death suit was warranted based on the circumstances surrounding her mother’s death. However, it was discovered that Thelma did have a will leaving everything to Denica. The probate court appointed Denica as executrix of Thelma’s estate. Denica filed suit under theories including but not limited to wrongful death against the nursing home and others in state court, and the defendants removed it to federal court. The suit later settled, but the findings of fact in the case said the proceeds were not attributable to wrongful death but to personal injury; a recovery for wrongful death would go to Thelma’s heirs at law, while a recovery for personal injury would go to and through the estate. The amount of the settlement remained confidential, and all claims were released. Diana intervened in the probate court matter seeking a share of the settlement proceeds, and both sisters subsequently sought summary judgment. The trial court granted summary judgment to Denica, reasoning that because the federal court determined the damages were not attributable to wrongful death, they would flow through the estate as a matter of law. Diana appealed, arguing the state law, which allowed the personal representative to bring both causes of action in the same suit, was silent as to how any resulting proceeds should be divided, and that such a split should be governed by the explicit rules of KRS 411.130(2). The court rejected this argument on two grounds: first, that the federal court had explicitly allocated the damages to personal injury, rather than wrongful death; and
second, that the measure of damages for wrongful death was lost earning capacity, and the parties had stipulated Thelma had none. The trial court’s grant of summary judgment was affirmed.
I. INTRODUCTION

A. Because of the law's exemptions, Kentucky's current inheritance tax does not apply to many estates.

B. Because of the law's tax rates, when it applies, it is likely to be significant and cannot be forgotten in the process of creating a client's estate plan.

C. This presentation briefly discusses the recent history of Kentucky's inheritance and estate tax, significant provisions of the laws, filing requirements, some planning techniques and helpful resources.

D. It is impossible to discuss all of the features and intricacies of the Kentucky inheritance tax in the time provided for this presentation. As a result, only select topics of particular interest will be presented.

II. INHERITANCE VS. ESTATE TAXES

A. Inheritance Taxes

1. The overall size of the estate does not matter.

2. Tax depends on the relationship of the recipient of property to the decedent.
   a. The amount of the tax is based on who receives property as a result of the decedent's death.
   b. The closer the recipient is related to the decedent the higher the exemption and the lower the tax rate.

B. Estate Tax

1. Generally, the size of the estate determines the tax.

2. With a few exceptions (surviving spouse and charities) the relationship of the recipient of property to the decedent does not affect the calculation of tax.
III. KENTUCKY ESTATE TAX

A. Although beyond the scope of this presentation, Kentucky has an estate tax.

B. KRS 140.130 imposes an estate tax "on all estates equal to the amount by which the credits for state death taxes allowable under the federal tax law exceeds the tax levied under KRS 140.010, less the discount allowed under KRS 140.210, if taken by the taxpayer."

C. Because the state death tax credit currently does not exist under the federal estate tax law, the Kentucky estate tax is no longer relevant but if the state death tax credit comes back as scheduled, the Kentucky estate tax will automatically apply.

D. When applicable, the Kentucky estate tax imposes a "sponge" or "pick-up" tax. Except for the loss of the 5 percent discount, if taken, this tax doesn't cost the estate anything. It simply shifts the receipt of funds from the Federal government to the state. If Kentucky did not impose the tax, the federal estate tax payable would be increased because the benefit of the state death tax credit would be lost.

IV. KENTUCKY INHERITANCE TAX

A. Imposed by KRS 140.010, et seq. See Appendix for an electronic site to this chapter.

B. History

1. Initially enacted in 1906.

2. In 1995 significant changes were made to the statute. These changes eventually eliminated the applicability of the inheritance tax to most estates.
   a. Brothers, sisters, half-brothers and half-sisters were moved from Class B Beneficiaries to Class A Beneficiaries.
   b. An exemption from tax equal to the total inheritable interest received by a Class A Beneficiary was phased in over a three-year period.
   c. As a result of this legislation, for decedents dying after June 30, 1998, Kentucky imposes no inheritance tax on amounts received by a Class A Beneficiary.
3. In earlier years, Kentucky's inheritance tax was very significant, even for amounts passing to a surviving spouse.

4. For example, with respect to decedents dying in the late 1970s and the 1980s, the applicable exemptions and rates were:

<table>
<thead>
<tr>
<th>Beneficiaries</th>
<th>Exemption</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>CLASS A – Including, for example</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Surviving spouse</td>
<td>$50,000</td>
<td>5-10 percent</td>
</tr>
<tr>
<td>Infant child</td>
<td>$20,000</td>
<td>3-10 percent</td>
</tr>
<tr>
<td>Parent, adult child, step-child, grandchild</td>
<td>$5,000</td>
<td>2-10 percent</td>
</tr>
<tr>
<td>CLASS B – Including, for example, brother, sister, niece and nephew</td>
<td>$1,000</td>
<td>4-16 percent</td>
</tr>
<tr>
<td>CLASS C – Educational, religious or other institutions, societies or associations not exempted by KRS 140.060 and all persons not included in Classes A or B</td>
<td>$500</td>
<td>6-16 percent</td>
</tr>
</tbody>
</table>

C. Current Classification of Beneficiaries

1. KRS 140.070.

2. Class A Beneficiaries are: parents, surviving spouse, children by blood, stepchildren, children adopted during infancy, children adopted during adulthood who were reared by the decedent during infancy, grandchildren who are the issue of a child by blood, the issue of stepchildren, the issue of children adopted during adulthood who were reared by the decedent during infancy, the issue of children adopted during infancy, brothers, sisters, and brothers and sisters of the half blood.

   a. Once a step-child always a step-child? If husband and wife divorce, are the children of the wife still the step-children of the husband? Informally, the Revenue Cabinet said yes.

   b. Planning opportunity: If a client, an aunt for example, raises an individual while that individual is a minor, and desires to leave assets to that individual at the client's death, consider an adult adoption. That would convert the individual (in this case the niece or nephew) into a Class A Beneficiary and could save significant inheritance taxes.
For example, $22,960 of inheritance taxes are payable in connection with a $200,000 bequest to a niece or nephew (a Class B Beneficiary) but no inheritance tax is payable in connection with a $200,000 bequest to a Class A Beneficiary.

3. Class B Beneficiaries are: nephews, nieces, nephews and nieces of the half blood, daughters-in-law, sons-in-law, aunts, uncles, and great-grandchildren who are the grandchildren of a child by blood, of a stepchild or of a child adopted during infancy.

- The niece or nephew of one spouse is not the niece or nephew of the other spouse. Estate of Mary L. Connolly, Kentucky Board of Tax Appeals, File No. K89-R-1090, 1990 Ky. Tax LEXIS 67 (1990).

4. Class C Beneficiaries are: organizations and entities not exempted by KRS 140.060 and individuals not included in the definition of either Class A or Class B Beneficiaries.

D. Current Rates and Exemptions

<table>
<thead>
<tr>
<th>Beneficiaries</th>
<th>Exemption</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>CLASS A</td>
<td>Total Inheritable Interest</td>
<td></td>
</tr>
<tr>
<td>CLASS B</td>
<td>$1,000</td>
<td>4%-16%</td>
</tr>
<tr>
<td>CLASS C</td>
<td>$500</td>
<td>6%-16%</td>
</tr>
</tbody>
</table>

E. Examples of Tax

1. A $200,000 bequest to a Class B Beneficiary, a daughter-in-law or son-in-law for example, would result in an inheritance tax of $22,960 and bequests in excess of $200,000 would be taxed at a marginal rate of 16 percent.

2. A $200,000 bequest to a Class C Beneficiary, a friend or unmarried domestic partner for example, would result in an inheritance tax of $28,670 and bequests in excess of $200,000 would be taxed at the marginal rate of 16 percent. In fact, a bequest in excess of $60,000 would be taxed at a marginal rate of 16 percent.
F. Property Subject to Tax

1. In general, all property which a resident decedent owned or had an interest in at the time of death is included in the decedent's gross estate and reportable on the decedent's inheritance tax return.

2. Special assets.

   a. Real estate which is owned by a resident decedent but not located within the state of Kentucky is not subject to the provisions of the Kentucky inheritance tax. KRS 140.010.

   b. Certain military benefits are not taxable. KRS 140.015.

   c. Transfers in contemplation of death must be included on the decedent's inheritance tax return and are treated as transferred to the transferee at the death of the transferor.

      i. KRS 140.020(2) provides: that "[e]very transfer made within three (3) years prior to the death of the grantor, vendor or donor of a material part of his estate, or in the nature of a final disposition or distribution thereof, and without an adequate valuable consideration, shall be construed *prima facie* to have been made in contemplation of death within the meaning of this chapter. If a transfer was made more than three (3) years prior to the death of the decedent it shall be a question of fact, to be determined by the proper tribunal, whether the transfer was made in contemplation of death." (Emphasis added)

      ii. **Beware:** The instructions to the Kentucky inheritance tax return quotes the statute "in part" but leaves out the words "*prima facie.*" The instructions read as if all gifts made within three (3) years of death are included in the decedent's gross estate and taxable to the transferee. Although the form requires that all transfers made within three (3) years of death be disclosed, that does not make all of the transfers taxable. It simply raises a rebuttable presumption.

      iii. Although the statute implies that transfers made more than three (3) years prior to death can be
"made in contemplation of death," there is no requirement that these transfers be disclosed. As a result, it is doubtful that they would become known to the Revenue Cabinet.

iv. KRS 140.020(3) provides that "[t]here shall be no presumption of contemplation of death as to certificates of deposit jointly owned and all such certificates of deposit shall be taxed pursuant to KRS 140.050." This provides a unique planning opportunity which will be discussed later.

d. Life insurance proceeds are not taxable unless they are payable to the insured or the estate of the insured. KRS 140.030(2).

i. Insurance proceeds payable to a designated beneficiary pass tax-free.

   (a) This includes the trustee of a testamentary or inter vivos trust.

   (b) **Planning opportunity:** Be sure all life insurance proceeds are payable to a designated beneficiary.

ii. Proceeds payable under certain government provided life insurance policies also pass tax free even if they are payable to the insured or the insured's estate.

e. Property owned jointly with right of survivorship is included in the decedent's gross estate but only to the extent of the decedent's fractional ownership of the property. KRS 140.050. This is the case regardless of who contributed to the purchase of the property or deposited funds into the account.

i. For example, if the decedent and one other person own a joint and survivor bank account, only 50 percent of the account is included in the gross estate of the decedent, even if the decedent made all of the deposits into the account. If the decedent and two (2) other people own the account, only one-third is included.
ii. This appears to be the case even if the survivor provided all of the consideration. As a result, care should be taken in putting accounts in joint names with right of survivorship. If all of the funds are provided by one owner and that owner survives, he or she could be required to pay inheritance tax in connection with the receipt of funds which he or she deposited. On the other hand, if the contributing owner dies, all of the funds will be received by the survivor but he or she will be required to pay inheritance tax on only one-half of the proceeds.

iii. If the asset is put into joint names with right of survivorship or is acquired within three (3) years of the decedent's death, the portion excluded from the decedent's gross estate under KRS 140.050 (the joint and survivorship statute) might be included under KRS 140.020 (the transfers in contemplation of death statute).

f. Qualified plans and IRAs.

i. Annuities or other payments receivable by a beneficiary, other than an executor, from a qualified plan are excluded from taxation to the extent attributable to employer's contributions. KRS 140.063.

- It is unclear whether contributions to a 401(k) plan pursuant to an employee's election would be treated as employer or employee contributions but according to the Revenue Cabinet, these contributions are treated as employee and not employer contributions. This would result in a portion of the distribution being subject to inheritance tax.

ii. Amounts receivable by a beneficiary (other than the executor) as an annuity under an IRA are excluded from taxation. KRS 140.063(3).

(a) This exclusion only applies to the extent the amounts in the IRA are attributable to tax deductible or rollover contributions. KRS 140.063(4).
For these purposes an annuity is defined as "an annuity contract or other arrangement providing for a series of substantially equal periodic payments to be made to a beneficiary (other than the executor) for his life or over a period extending for at least thirty-six (36) months after the date of the decedent's death." KRS 140.063(4).

- According to the Revenue Cabinet, the beneficiary could make an arrangement with the IRA custodian (after the decedent's death) to receive the IRA proceeds in a series of substantially equal periodic payments for his life or over a period extending for at least thirty-six (36) months and this would allow the proceeds to be excluded from the decedent's gross estate.

iii. Because all amounts attributable to employer contributions which are received pursuant to the terms of a qualified plan are excluded from taxation and only "annuities" receivable from an IRA are excluded, consideration should be given to leaving benefits in the qualified plan rather than rolling them over into an IRA.

g. Property subject to a power of appointment.

i. KRS 140.040 provides that property subject to a power of appointment held by a decedent is included in the gross estate of the decedent as if he or she owned the property itself.

ii. This applies to property subject to a special power of appointment as well as property subject to a general power.

iii. This statute applies whether or not the power is exercised by the holder of the power.

iv. The taxation of property subject to a power of appointment is discussed below in connection with
a planning opportunity which uses powers of appointment to save inheritance tax.

G. Valuation of Assets and Calculation of Inheritable Interests

1. Assets are valued as of the date of the decedent's death. Kentucky does not have an alternate valuation date.

2. Life estates are valued using the appropriate mortality tables and an assumed interest rate of 4 percent. KRS 140.100.

3. 103 KAR 2:005 sets forth the life expectancy table to be used in valuing assets included in the decedent's gross estate and the value of transfers made as a result of a decedent's death. See Appendix for an electronic site to this regulation.

4. A table to be used to value life estates is included in the instructions to the inheritance tax forms. See Appendix for an electronic site to these forms and instructions.

5. KRS 140.110(1) provides in part that "[i]n the case of estates in expectancy which are contingent or defeasible, a tax shall be levied at the rate which, on the happening of the most probable contingencies or conditions named in the will, deed, trust agreement, contract, insurance policy, or other instrument, would be applicable under the provisions of this chapter."

   • This provision could be very helpful in establishing a lower tax at the decedent's death.

6. If a decedent's Will provides that the inheritance tax is payable from the residuary estate, the Revenue Cabinet takes the position that there is an additional bequest to a non-residuary beneficiary. This additional bequest is the amount of the tax paid from the residuary estate as a result of bequest, etc., to the non-residuary beneficiary. This would include tax on the tax, etc.

   a. Calculation of the total tax due (including all of the tax on the tax) requires an algebraic calculation:

   i. \[ A = (B + A - C) \times D + E \]

   (a) "A" is the total tax due.
(b) "B" is the amount of the specific bequest or other amount to which the beneficiary is entitled.

(c) "C" is the breakpoint in the tax calculation (the amount above which the marginal tax rate will apply).

(d) "D" is the marginal tax rate.

(e) "E" is the tax from the table attributable to the amount of the bequest, etc. below the breakpoint.

ii. For example, under Betty's will, Tom (an unrelated neighbor – a Class C Beneficiary) receives a specific bequest of $150,000. Betty's will provides that all inheritance taxes are to be paid from Betty's residuary estate and directs Betty's Executor not to seek payment or reimbursement from Tom. There is no Federal estate tax.

(a) The tax table provides that for distributive shares to a Class C Beneficiary above $60,000, the tax would be $6,270 plus 16 percent of the excess over $60,000.

(b) As a result, the tax, under the above formula, would be calculated as follows:

i) Step 1: \[ A = (150,000 + A - 60,000) \times 16\% + 6,270. \]

ii) Step 2: \[ A = (90,000 + A) \times 16\% + 6,270. \]

iii) Step 3: \[ A = 14,400 + .16A + 6,270. \]

iv) Step 4: \[ A = 20,670 + .16A. \]

v) Step 5: \[ .84A = 20,670. \]

vi) Step 6: \[ A = \frac{20,370}{.84} \text{ or } 24,607.14. \]
vii) The total tax is $24,607.14 and the total bequest is considered to be $174,607.14 or $150,000 + $24,607.14.

(c) To prove this is correct, calculate the tax on a bequest of $174,607.14.

i) Under the table the tax is: 
($174,607.14-$60,000) x 16% + $6,270.

ii) The tax is $24,607.14.

b. The Revenue Cabinet’s position is being challenged in Estate of Mildred L. McVey, Kentucky Board of Tax Appeals, File No. K10-R-22, 2011 Ky. Tax LEXIS 139 (2011). This case is discussed below. See Appendix for an electronic site to this case.

H. Calculation of Inheritance Tax

1. The exemption applicable to Class B and C Beneficiaries is applied against the lowest tax bracket or brackets. KRS 140.080(1).

2. Use the tax tables provided in the instructions to calculate the tax. This will assure that the exemption is properly taken.

3. Under current Federal estate tax law, Kentucky estate and inheritance taxes paid as a result of a decedent’s death are deductible in calculating the Federal estate tax payable. In addition, Federal estate taxes paid (or estimated) in connection with a decedent’s death are deductible in calculating the Kentucky inheritance due.

a. The amount of each tax depends on the amount of the other tax.

b. These inter-related calculations require the development of algebraic formulas and the use of simultaneous equations. This probably requires a computer program which can quickly make a series of calculations. This can be done using Excel’s iterative calculation feature.
I. Liability for Tax and Payment

1. Unless the decedent's will provides otherwise, the ultimate liability for inheritance tax falls on the recipient of the assets which account for the tax.

2. Even though the recipient of the property is ultimately responsible for the tax, KRS 140.190 provides that "[a]ll personal representatives, trustees, and beneficiaries shall be personally liable for the taxes until they are paid, but only to the extent that property from the estate come into their hands, and in no case shall the personal representative or trustee be liable for a greater sum than passes through his administration."

3. As a result, the personal representative is required to pay the full amount of the inheritance tax due, even taxes with respect to assets which do not pass through the decedent's estate (for example amounts received by surviving joint tenants, beneficiaries of IRAs and transfer on death beneficiaries). The personal representative would then have to collect the taxes from the individual liable for the tax in order to satisfy his or her obligations to the beneficiaries of the estate.

4. Taxes are due eighteen (18) months after the date of the decedent's death. KRS 140.210.

5. If the taxes are paid within nine (9) months of the decedent's death, a five percent (5%) discount is allowed. KRS 140.210.

   - Even if the tax return is not filed within nine (9) months of the decedent's death, the five percent (5%) discount can be taken with respect to taxes paid to the Revenue Cabinet within the nine (9) month period.

6. Under KRS 140.222, a beneficiary who owes more than $5,000 in inheritance taxes can elect to pay the tax in ten (10) equal annual installments.

   a. The first installment is due at the time the return is filed.

   b. Interest is charged on the deferred tax at the interest rate defined in KRS 131.010(6). Interest begins to accrue eighteen (18) months after the date of the decedent's death.
c. This election is made on a form prescribed by the Revenue Cabinet.

d. A bond or other security may be required. KRS 140.224.

e. When this election is filed and the first installment paid, the personal representative is relieved from further liability with respect to the deferred taxes.

J. Required Forms and Related Documents

1. Applicable forms and instructions can be found on the Revenue Cabinet's website. See Appendix for an electronic link to these forms.

2. Form 92A200 is required in most instances where an inheritance tax return must be filed.

3. In certain uncomplicated situations, Form 92A205 may be filed.

4. If all assets pass to Class A Beneficiaries and exempt organizations and no Federal estate tax return is filed, no inheritance tax return is required. In this case, an affidavit is required to be filed with the District Court when the estate is closed. See Appendix for an electronic site to a form affidavit.

5. If real estate is included on the return, Form 92A204, Real Estate Valuation Information Form, is required to be filed with the return.

6. If a beneficiary elects to pay his or her inheritance tax in installments, Form 92A928 is required to be filed with the return.

K. A Case to Watch and Planning Opportunities

1. Estate of Mildred L. McVey (cited above and in the Appendix).

   a. Mildred McVey's Will contained the following provision:

   "Any death or inheritance taxes payable at my death on my estate whether on property passing under this Will or otherwise shall be paid out of my residuary estate as a cost of administration and shall not be charged in any way to any beneficiary or recipient of my estate."

   53
b. Because of the language in Ms. McVey's Will, the Estate deducted the inheritance tax liability as a debt of the Estate. The Revenue Cabinet disallowed this deduction. The taxpayer appealed this disallowance. The Board of Tax Appeals found for the taxpayer and reversed the decision of the Revenue Cabinet.

c. The Revenue Cabinet also adjusted the distributive share of certain beneficiaries to reflect the "bequest of tax" provided for in Ms. McVey's Will. The taxpayer also appealed these adjustments. Again, the Board of Tax Appeals found for the taxpayer and reversed the decision of the Revenue Cabinet.

d. The Revenue Cabinet has appealed this decision to the Franklin Circuit Court. Although briefs have been filed, as of the time this outline was prepared (March 13, 2012), no decision on the appeal has been rendered.

e. The Revenue Cabinet has informally indicated it will not follow this decision until the appellate court rules. Apparently some taxpayers are filing protective refund claims in the event the decision of the Board of Tax Appeals is ultimately upheld.

2. Gifts in contemplation of death and KRS 140.020(3).

a. As described above, accounts placed in joint names with right of survivorship within three (3) years of the decedent's death could result in the entire account being taxed to the surviving joint tenant, one-half (½) because it is treated as received from the decedent and taxable under 140.050, and one-half (½) because the account was placed in joint names in contemplation of death and is, therefore, taxable under KRS 140.020(2).

b. But, KRS 140.020(3) provides that there is "no presumption of contemplation of death as to certificates of deposit jointly owned and all such certificates of deposit shall be taxed pursuant to KRS 140.050."

c. Therefore, if a certificate of deposit is acquired in joint names with right of survivorship, even on the day before death and in contemplation of death, only one-half (½) of the value of the certificate of deposit will be taxable and it will be taxable under KRS 140.050. No part of the
certificate of deposit will be taxed under KRS 140.020 as a transfer in contemplation of death.

3. Using powers of appointment to reduce taxes.

   a. KRS 140.040(2) provides as follows:

   In the case of a power of appointment which passes to the donee thereof at the death of the donor, under any instrument, and if the donor dies on or after April 24, 1936, the transfer shall be deemed to take place, for the purpose of taxation, at the time of the death of the donor and the assessment be made at that time against the life interest of the donee and the remainder against the corpus. The value of the property to which the power of appointment relates shall be determined as of the date of the death of the donor and shall be taxed at the rates and be subject to the exemptions in effect at the death of the donor. The determination of the applicable rates and exemptions (in effect at the death of the donor) shall be governed by the relationship of the beneficiary to the donee of the power of appointment. In the event the payment of the tax at the death of the donor should operate to provide an exemption for any beneficiary of a donee not authorized by KRS 140.080, then such exemption shall be retrospectively disallowed at the time of the death of the donee. It is further provided that the remainder interest passing under the donee's power of appointment, whether exercised or not, shall be added to and made a part of the distributable share of the donee's estate for the purpose of determining the exemption and rates applicable thereto. (Emphasis added)

   b. This statute provides that powers of appointment are taxed in the estate of the creator of the power.

   c. Assume a client with a $1 million net estate wants to leave the estate to her niece. If an outright bequest of
$1,000,000 is made to the niece, the inheritance tax would be $150,960 (disregarding the discount for early payment).

i. If the estate were left in a trust which provided income to the niece for life and gave niece a broad special power of appointment, significant tax savings could result.

   (a) If niece was fifty years of age at the death of client (niece's aunt), the value of niece's life estate would be $690,228 and the tax on the income interest would be $101,396.48.

   (b) What is the tax on the remainder interest? The underlined sentence in the above quotation states that the tax is computed based on the rates and exemptions in effect at the death of the donor (the aunt) and shall be "governed by the relationship of the beneficiary to the donee of the power of appointment." (Emphasis added). The identity of beneficiary of the power of appointment is unknown at the time of the donor's death. The policy of the Revenue Cabinet is to compute the tax based on the most likely person to whom the donee will appoint the property. If the donee of the power (the niece in this example) is married or has children when her aunt dies, the most likely beneficiary will be assumed to be either her spouse or her children, both Class A Beneficiaries. Computing the tax based on the relationship between the donee and the beneficiary means that the tax on the remainder will be zero if the spouse or children of the donee are assumed to be the applicable beneficiaries: gifts to Class A Beneficiaries are exempt from tax.

   (c) If the donee (niece) ultimately appoints the property to someone other than a Class A Beneficiary, the tax would be retroactively imposed at the time of the donee's death. However, in virtually all cases, that is unlikely to occur.
ii. Assuming the donee of the power of appointment (the person who receives the property subject to the power of appointment) is a Class A Beneficiary with respect to the life tenant (the niece), leaving the estate to the niece in trust would, in this example, save $49,563.52 in tax. If the niece was age sixty at the time of her aunt's death, the savings would be $68,741.76.

V. COMMON MISTAKES REPORTED BY THE REVENUE CABINET

A. In preparing for this presentation, I asked a representative of the Revenue Cabinet for a list of common mistakes made in connection with inheritance tax returns.

B. The Cabinet's List Included:

1. Will not attached;
2. Real Estate Valuation Information Form not included;
3. County assessed value not provided on Real Estate Valuation Information Form;
4. Omitted assets – There is a difference between taxable assets and probate assets. Probate assets are assets that pass per terms of the will or intestate law. Taxable assets are survivorship property, gifted property, trust property, etc., and include probate assets;
5. Omission of the date items are placed in joint names. These dates must be included on the Jointly Owned Assets Schedule;
6. Assets not identified properly;
7. Errors made in determining whether there is a bequest of tax based on the wording in the will and/or trust agreement;
8. Incomplete schedules or schedules not attached;
9. Incorrect calculation of distributions;
10. Incorrect tax computations;
11. Incorrect classification of beneficiaries;
12. Survivorship property not properly distributed;

13. Return not signed by executor/administrator/beneficiary and preparer (Note: If more than one executor/administrator, only one signature is required).

C. Care Must Be Used in Filing These Returns

VI. CONCLUSION
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<tr>
<th>DESCRIPTION</th>
<th>ELECTRONIC CITE</th>
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<td>KRS Chapter 140, Kentucky Inheritance Tax Statutes</td>
<td><a href="http://www.lrc.ky.gov/KRS/140-00/CHAPTER.HTM">http://www.lrc.ky.gov/KRS/140-00/CHAPTER.HTM</a></td>
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<tr>
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<tr>
<td>Kentucky Revenue Cabinet's Inheritance and Estate Tax Cite</td>
<td><a href="http://revenue.ky.gov/individual/inherittax.htm">http://revenue.ky.gov/individual/inherittax.htm</a></td>
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