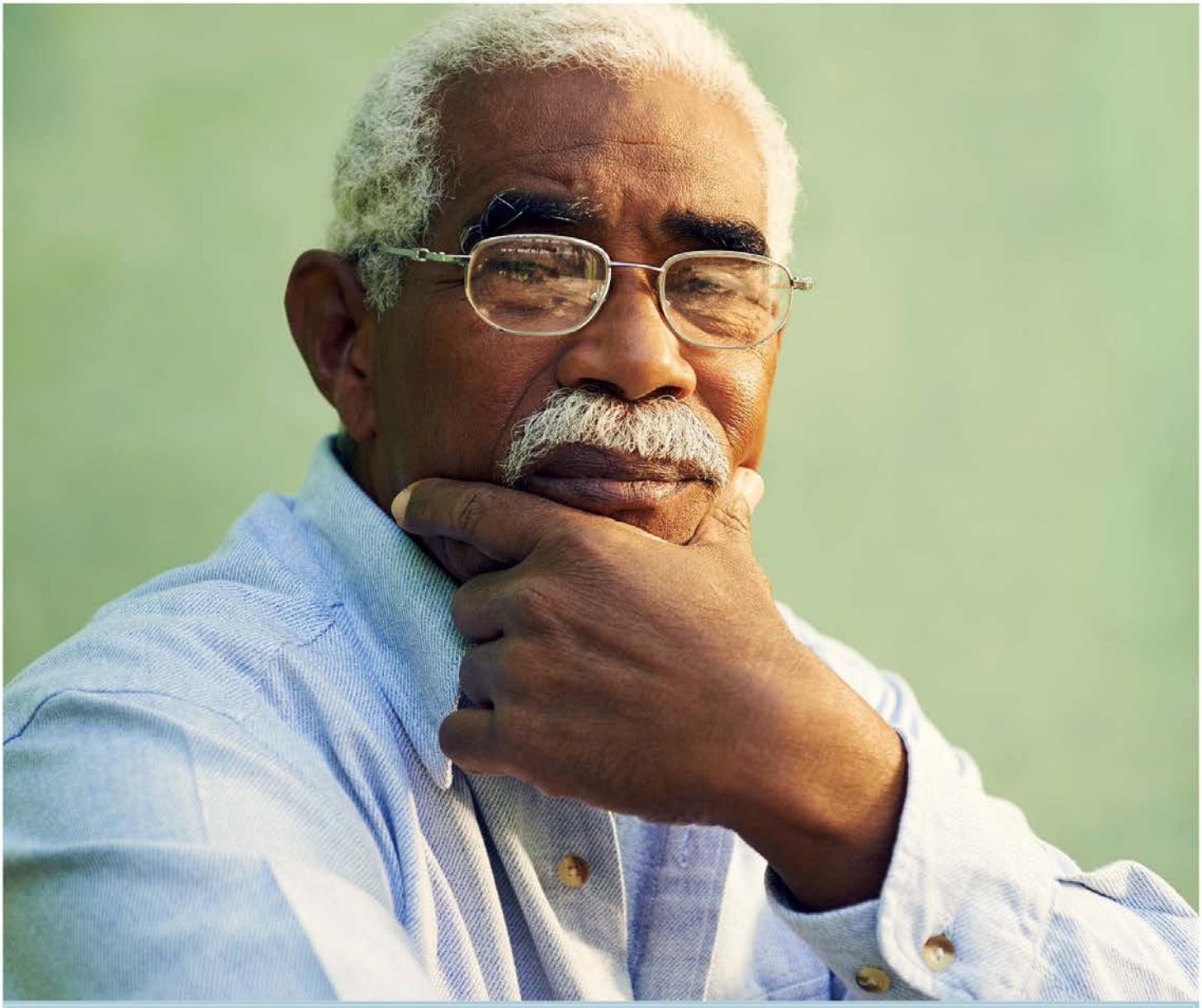

TRUST ADMINISTRATION

Prior Planning Prevents Problems

AMERICAN ACADEMY | OF ESTATE PLANNING ATTORNEYS

TRUST ADMINISTRATION—WHAT YOU NEED TO KNOW

Trust Administration is the process people often find themselves in unexpectedly, after the death of a spouse or parent who created the trust prior to passing on. It comes during a very emotional time, and often brings with it difficult and complex financial and family issues. The task of reviewing the trust and finding and valuing the assets of a recently deceased family member can be daunting, as can be the complexities of estate tax law. What is important to remember for anyone administering a trust is that there is a definite process to follow, and resources to assist you as you assume this new role.

A TALE OF TWO ESTATES

Mrs. Smith lost her spouse several years before falling ill herself and passing away. She left an estate valued at approximately $400,000. Her daughter, whom she named successor trustee, arrives at Mrs. Smith's attorney's office with a neat stack of papers outlining her Living Trust and detailing the assets of her estate. All of her assets are owned by the trust or become payable to the trust upon her death. Administration of the Smith Trust could take as little as six to eight weeks, at a cost of around $4,000-$6,000.

Contrast this with the estate of Mr. Jones. In a similar situation, he lost his spouse a few years prior, and also had an estate of about $400,000 at the time of his death. His son was named successor trustee, but when his son arrived at the attorney's office following his father's death, the story takes a different turn. Instead of a neat stack detailing assets and asset ownership, his son had only a mess of crumpled, unlabeled papers. The attorney waded through the pile to determine the assets of the estate and of the trust. He discovers that three bank accounts were not put into the trust. The result? Trouble. Trust Administration cannot be complete until all three bank accounts have passed through probate. With the attendant legal fees and procedures, administration of the trust could take as many as nine months or more, plus additional probate fees with a total cost thousands of dollars more than Mrs. Smith's Trust Administration.

TAKE ACTION

Upon the death of a loved one, great emotional sadness sets in as family and friends support each other during the bereavement period. After finding a firm emotional foundation, it is time to address the task of administering the trust set up by the deceased.

- After funeral arrangements are made, the first step is to call an *experienced* estate planning attorney. This person holds the keys to a successful, painless Trust Administration.

- Find the Trust documents. This may entail a frustrating search from basement to attic. If the attorney is a member of the American Academy of Estate Planning Attorneys your deceased loved one will have an organized binder with all applicable documents and personal papers.
- Schedule a meeting with your estate planning attorney to take place within the first two to three weeks after death. At this meeting, the attorney will outline the legal and tax requirements affecting the estate and lay out the terms of the trust, which the trustee is to follow.
- Prior to the meeting, collect all financial information available about the assets of the deceased: deeds, bank statements, brokerage statements, tax returns for the three years prior to death, titles and any other records of ownership. DO NOT CHANGE THE TITLE OF ANY ASSETS! This can create unnecessary problems for you.

STAGES OF TRUST ADMINISTRATION

Inventory Assets

Trust Administration has a clearly defined path for the administrator. The first task is to inventory the assets of the estate. This involves determining the title, or ownership of all assets in the estate. The attorney will then obtain a date-of-death valuation of these assets. Proper determination of asset ownership is important to help ensure that all assets that are supposed to be in the trust are owned by or payable to the trust, while proper valuation of the assets can have important income and estate tax implications. The attorney in charge of the Trust Administration should recommend experts in property and asset valuation; there are firms that specialize in this field.

Determine Estate Tax

An individual can pass $5 million (adjusted for inflation) without federal estate tax (this amount is temporarily doubled in years 2018 through 2025). However, many states have state estate or inheritance taxes at much lower levels. The survivor of a married couple might be able to use the exclusion of the predeceasing spouse, as well as their own. However, in order to be able to get “portability” of the deceased spouse’s exclusion, a federal estate tax return must be timely-filed, even if it would not otherwise be necessary to do so. There are many reasons that a couple might plan to have the first spouse leave their assets in a “Family” or “B” Trust for the benefit of the survivor and children, rather than relying on portability. A Family Trust not only locks in the deceased spouse’s exclusion amount, even growth of the trust would be excluded from the survivor’s estate. Further, the trust could be exempt from tax even in the estate of the children. Portability does not allow for this.

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A separate Family Trust allows for many protections that portability does not provide. The trust can provide creditor protection, both in the event of a remarriage and divorce, from other creditors. Also, a Family Trust can lock in the ultimate beneficiaries of the assets. This can be important in blended families.

Your attorney will work with you to determine which assets are in the trust, which assets are outside the trust, which assets may need to go through probate and which assets are subject to estate tax. The estate tax is payable within nine months of the date of death, and accompanies the estate tax return, using IRS Form 706.

Division of Trust Assets

Married couples who have incorporated tax and protection planning into a Living Trust have what is known as an A-B or A-B-C Trust. This ensures that when the first spouse dies, the deceased spouse's assets remain available for use by the surviving spouse, but in trust. By keeping the assets in trust, the assets remain out of the surviving spouse's estate, sheltered from future estate taxes. While the couple is alive, their assets are held in a "Joint Trust," owned equally by both parties (except for IRA and Retirement funds, which must be in the owner's name). After the first death, the trust is split into two or three parts, the Survivor's Trust, the Family Trust, and potentially the Marital Trust.

The Survivor's Trust is generally designed to hold the surviving spouse's assets. The deceased spouse's assets are generally split between the Family and Marital Trust. The Family Trust, a separate entity, is not counted as part of the surviving spouse's estate upon death. This trust can pay income to the survivor, and the survivor can also have access to the principal under certain circumstances. It is crucial that the A, B and C Trusts be properly funded. At the time of death, many assets that have not been transferred into the trust are considered part of the estate, subject to the probate process.

File the 706 Tax Form

It is required that the federal estate tax IRS Form 706 be filed within nine months of death. If portability is to be elected, the estate tax return must be filed even if it would not otherwise be required. This is in addition to income tax return 1040 for the deceased for the year of his or her death, and a 1041 tax return for the trust in every year of its existence after the death of the original trustor. Once your attorney has calculated any estate taxes owed, it is essential to file the 706 tax form and pay the taxes within the allotted nine months to avoid any penalties and interest.

Distributions to Beneficiaries

The job of the trustee is not to make his or her own decisions regarding the disposition of assets, but to carry out the terms of the trust. Once the bills and taxes are paid, and all assets

are received, the trustee's next step is to follow the terms of the trust and pay out any assets due to the beneficiaries.

COMMON FUNDING PITFALL

One of the most common pitfalls facing trustees is improperly or inadequately funded trusts. Often, the deceased has failed to place all the intended assets into the deceased's trust prior to death. The result is that these assets remain part of the decedent's estate, subject to the probate process.

The most common way that this situation can be dealt with during Trust Administration is through use of a will with a "pour-over" provision. This provision directs that any asset not placed into the trust during the deceased's lifetime will be put into the trust at death and distributed according to the terms and conditions of the trust. However, the assets will likely have to go through probate before they are placed in the trust.

TRUSTEE RESPONSIBILITY & LIABILITY

The duties of the trustee are as follows:

- Collect the assets of the estate.
- Pay any remaining bills left by the decedent, incurred by reason of the decedent's death, or during the Trust Administration.
- Pay any death tax owed.
- Make the distributions dictated by the trust.

This may sound simple, but there is a myriad of laws and procedures that must be followed to shield the trustee from liability.

Trustees have the responsibility to carry out the trust *exactly as it was written*. However, in carrying out the terms of the trust, trustees can open themselves up to legal penalties and even litigation. In many states, the management of trust assets must be carried out in accordance with the Prudent Investor Rule, a series of guidelines governing the way that assets must be invested. For those who say that a conservative strategy is the best way to go when investing the assets of a decedent, watch out! The Prudent Investor Rule states that trustees and other money managers have a duty to maximize returns while considering risk and keeping investments diversified in accordance with the modern portfolio theory of investing.

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Carefully document all transactions related to the estate and the trust. This can eliminate future difficulty if questions arise as to the management of the estate and trust. Your estate planning attorney can advise you more carefully on these requirements.

INCOME TAX CONSEQUENCES

All assets owned by the deceased must be valued as of the date of death. No matter what the value at the time of purchase, most assets (some assets like IRAs, annuities and retirement plans are excluded) receive a "step-up" in basis for tax purposes. For example, a stock is purchased at a price of $10, but has reached $100 at the time of death. If this stock is sold before death, there will be a capital gains tax on the $90 profit. At death, the stock is revalued so that the beneficiary can sell the stock at $100 without incurring any capital gains tax. While it often appears that this higher value may be detrimental from an estate tax perspective, the income tax consequences may make the higher estate tax valuation a better deal for the beneficiary.

ADDITIONAL PITFALLS

The major pitfall facing trustees is improper funding of trusts prior to death, as discussed above.

Another common mistake is one of inaction. Slow or no action by the trustee gives others the chance to get to the estate first and take possessions from the deceased's home, or take actions that may prove detrimental to properly carrying out the terms of the trust.

The trustee has a duty to act swiftly to protect the assets of the trust.

Lastly, many trustees try to do everything independently. Seeing the terms of the trust spelled out in the documents is not a substitute for the advice of competent estate planning counsel. The laws governing estate and trust management are complicated and can subject trustees to penalties if not followed precisely. Ask yourself this question: Do I fully understand the legal requirements and tax consequences of Trust Administration?

ROLE OF THE ATTORNEY

Trustees should seek the advice of the deceased's estate planning attorney to assist in navigating the pitfalls and complex legal and tax issues of Trust Administration. If the deceased did not specify an attorney, organizations like the American Academy of Estate Planning Attorneys (AAEPA) can help you find an estate planning attorney in your area who is experienced in dealing with your particular situation.

The estate planning attorney acts as the leader of the estate planning team, working with the deceased's CPA, financial planner, and other trusted advisors to value the assets of the deceased.

The financial planner can help determine ownership of any investments and assist with the transfer of these assets into or out of the trust, as well as help identify and make claims for death benefits from life insurance, annuities, IRAs, or retirement plans which have become payable.

So, what should this cost? The American Academy of Estate Planning Attorneys conducted a nationwide survey of estate planning attorneys pertaining to the average cost of trust Administration. Typical fees charged by attorneys administering trusts ranged from 1 to 1.5% of the total value of the deceased's trust assets. The costs can be more or less, based on the size of the estate, and the time necessary to carry out the steps outlined above. This compares very favorably with the cost of a probate, which the same American Academy of Estate Planning Attorneys' survey determined to be slightly more than 2% of the total value of the estate.

DON'T DELAY

The passing of a loved one is an incredibly trying time. However, it is necessary to take the time to properly administer the trust they have left behind. Follow the simple steps in the Trust Administration checklist, and work with an experienced estate planning attorney to best carry out the terms of the trust, and to protect the beneficiaries and yourself from any legal liabilities that may arise.

DEFINITIONS

Trustee: The person who manages assets owned by a trust under the terms of the trust.

Successor Trustee: Any person appointed to handle a trust after the death or disability of the trustor.

Trustor: The creator of a trust.

Decedent: The deceased person.

Funding a Trust: Transferring ownership of property to a trust.

CHECKLIST

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There are three groups of items essential to sailing across the troubled seas of Trust Administration. The following list of documents to gather, people to contact, and actions to perform should help you navigate a successful course through the Trust Administration process.

Documents

- Original will
- Records of ownership (titles, deeds)
- Trust documents
- Bank statements
- Brokerage statements
- Stock or bond certificates
- Safe deposit box title and inventory Tax returns
- Inventory of personal assets
- Itemization of liabilities
- Vehicle registrations

People

- Estate Planning Attorney
- CPA
- Other Financial Planners / Brokers
- Life Insurance Agent

Actions

- Pay all bills
- Inventory assets
- Check need for probate
- Investigate postmortem estate planning strategies
- Fund Trust
    - Retitle assets
- File tax returns
    - 706 federal

    - State
    - Last income tax return for decedent
- 1041 tax return for trusts
- Pay out distributions

FREQUENTLY ASKED QUESTIONS

Q: Why does the Trust Administration process take so long?

A: Although the Trust Administration process seems relatively straightforward, there are several reasons it can be drawn out over several months or even years. The first step, the inventory of assets, must be completed before the Trust Administration can begin, and this can be difficult to complete depending upon the prior organization and the size and complexity of the decedent's assets. Next, the 706 estate tax return must be filed within nine months, or fifteen months if an extension is filed. Often, it is prudent to wait until the last minute to file this form. If the spouse of the decedent is in failing health and may pass away before the deadline, then both 706 forms can be used to maximize tax advantages to the estate. The final step, asset distribution, cannot take place until the 706 has been filed, and even then should not take place until the "Closing Letter" is received from the IRS certifying acceptance of the 706 return. This closing letter will take a minimum of six to eight months, and as long as three years, to arrive after the 706 is filed.

Q: I thought that a Living Trust avoids probate and attorney fees. Why do I have to pay more fees?

A: While having a Living Trust can significantly reduce costs compared to probate, there is still a considerable amount of work to be done in properly administering even a simple Living Trust. The services of an attorney are required, and that person or firm should be compensated fairly for their services. It is important to remember that the fees allowed for Trust Administration are usually much lower than those for probate, and there is generally less work involved, as there is less involvement of the courts and state bureaucracy.

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Q: Can I pick and choose what assets go into the "B" Trust?

A: The answer depends upon the language of the trust document. Certain trusts include "pick and choose" language that allows trustees to selectively place assets into the "B" Trust.

Q: How do I transfer the car(s) into my name?

A: If you are a relative of the deceased, this is simple. To transfer the title of vehicles owned by the deceased, simply take the death certificate to the DMV, and perform the transfer, paying whatever fees they require. If not a relative, bringing along the will and or any trust documents indicating your status should be sufficient.

Q: What do I do about Social Security?

A: Social Security will continue to send out benefit checks until they are notified of an individual's death. The executor/spouse/ee should contact the local Social Security Administration office and notify them of the death, or if a benefit check is received, send it back with a letter notifying them. This is important. If checks continue to be deposited, the recipient can incur liability later when Social Security learns of the recipient's death.

ABOUT THE ACADEMY

This report reflects the opinion of the American Academy of Estate Planning Attorneys. It is based on our understanding of national trends and procedures, and is intended only as a simple overview of the basic estate planning issues. We recommend you do not base your own estate planning on the contents of this Academy Report alone. Review your estate planning goals with a qualified estate planning attorney.

The Academy is a national organization dedicated to promoting excellence in estate planning by providing its exclusive Membership of attorneys with up-to-date research on estate and tax planning, educational materials, and other important resources to empower them to provide superior estate planning services.

The Academy expects Members to have at least 36 hours of legal education each year specifically in estate, tax, probate and/or elder law subjects. To ensure this goal is met, the Academy provides over 40 hours of continuing legal education each year. The Academy has also been recognized as a consumer legal source by *Money Magazine*, *Consumer Reports Money Adviser* and Suze Orman in her book, *9 Steps to Financial Freedom*.

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