

Chapter 1

Functioning in a Fiduciary World

In This Chapter

- ▶ Becoming comfortable with the terminology surrounding estates and trusts
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You may have known for a while that someone close to you has named you as the executor of his or her will, as the trustee of a trust he or she's created, or even as both. That knowledge may make you feel extremely honored while that person's alive and kicking and still able to look after his or her assets.

Those warm and fuzzy feelings may come crashing to a halt, though, the day you hear your friend has passed away, and you're now in charge of the show. All eyes will be on you as you pick up the reins and try to keep this buggy called an estate or trust moving along at a steady clip, while keeping all the promises written down during your friend's lifetime. The responsibility is huge, but so is your potential satisfaction, as you honor his wishes after he is no longer around to appreciate your actions.

This chapter is a jumping-off point for understanding what an estate administrator or trustee actually does: assume control of someone else's affairs in a way that's both sensitive to family dynamics and responsive to family needs. Mishandled, estate and/or trust administration can cause permanent family rifts; on the other hand, competent and careful management helps to keep family memories happy and purpose intact.

Getting a Handle on Who's Involved

Administering a trust or estate isn't rocket science, but it does have its own language. One of the biggest stumbling blocks you run across, especially as you're beginning in your new role, is figuring out who all the players are and what roles they all play. This section points out some important basic lingo you need to know as you start your journey. Refer to the other chapters in Part I for more on your responsibilities as an administrator or trustee.

Identifying an estate's fiduciaries

Several kinds of *fiduciaries* (people or corporations who hold and administer assets of one person, either living or deceased, for the benefit of another) may be involved in estate administration, depending upon whether a will exists and who the heirs are. You may not even be the only fiduciary; in that case, you and the other(s) must act in unison. And one person or group can fulfill multiple fiduciary roles, such as when one person is named both executor and trustee. The following are types of fiduciaries you may be named:

- ✓ **Executor:** The *executor* is the person named in the will to “execute” the will — to carry out the wishes of the person making the will, including disposing of the property according to the will. A female executor is sometimes referred to as an *executrix*, though we don’t make this distinction in this book. A named executor may decline to act, although we hope this book gives you the confidence to embrace the role.
- ✓ **Administrator:** The *administrator* is a person appointed by the probate court to administer the decedent’s estate when the decedent left no valid will. A female administrator may be referred to as an *administratrix*.
- ✓ **Personal representative:** The *personal representative* is a general term for both the executor and the administrator. In some states, this term is used in place of executor or administrator.
- ✓ **Guardian:** A *guardian* is the person appointed by the probate court to take care of the person and the property of another person who is considered incapable of taking care of his or her own affairs because of his or her age (usually a minor) or for other reasons such as mental illness, mental retardation, physical incapacity, or illness.
- ✓ **Conservator:** Similar to a guardian, but with less restrictive rules than those for a guardian. For example, the probate court may appoint a conservator for someone who can’t properly care for his or her property due to mental weakness or physical incapacity, for a person missing in action or a prisoner of war, or for a mentally retarded person.

A probate court rarely appoints a conservator for an estate, especially if you’ve already been appointed as executor or administrator; however, you may find yourself dealing with an already-appointed conservator of an estate beneficiary. Remember, just because you’re all working with the same set of assets doesn’t mean you belong to the same team. As executor or administrator, you’re only responsible for the property owned by the decedent; a beneficiary’s conservator is responsible for the that beneficiary’s interest.



Knowing who the trustees are

A trust, just like an estate, must have a fiduciary heading up its team: in this case, a *trustee*. The trustee of a trust is charged with the task of investing the trust's assets, and balancing the desires of the trust's creator (the *grantor*, also referred to as the *settlor*) with the needs of the *beneficiary* (the person or organization entitled to receive the income earned by the trust's assets) and the wants of the *remainderman* (the person or organization who receive what's left of the trust's assets after the trust period ends). It may sound daunting, but when done properly, everyone should go home happy.



Because balancing these competing interests can be complicated, many grantors choose two or more individuals and/or corporations to act together as co-trustees, jointly filling these roles, assigning general powers to all and sometimes specific additional powers to certain trustees. In order to differentiate between the trustees, trustees often are designated as either *independent* or *family*. This section discusses these two types of trustees. Chapter 3 goes into more depth about the different types of trusts and how they operate.

All by themselves: Independent trustees

Independent trustees, or fiduciaries who aren't named in the trust as either grantor, beneficiary, or remaindermen, can be an important cog in keeping the wheels of a trust running smoothly. Whether they're trusted friends of the grantor or are banks, trust companies, lawyers (or law firms), or accountants (or accounting firms), independent trustees owe their primary allegiance to the grantor, who is relying on them to make decisions that best serve the interest of the trust, rather than that of any beneficiary or remainderman.

Frequently, grantors direct an independent trustee to make all decisions regarding discretionary distributions to beneficiaries, especially if one of the trust beneficiaries is also a trustee. And, in the case of testamentary trusts, the probate court often delegates the power to make discretionary distributions to the independent trustee alone so as to remove any semblance of self-serving from a trustee who also has a beneficial or remainder interest in the trust.

For example, one of us acts as trustee for a testamentary trust where the decedent's widow (who is the income beneficiary) and two children (the remaindermen) are also trustees. Only the independent trustee may make decisions regarding distributions of principal to the widow or the children. Distributions to the children prior to their mother's death require either the consent of the independent trustee or the probate judge.



No independent trustee assumes the responsibilities lightly. As a result, expect to pay for their services, unless the independent trustee is a close friend of the grantor, who may be willing to perform this service out of long friendship and the goodness of her heart. Banks and trust companies most likely have pamphlets that list how they calculate their fees; because they probably have active custody of the trust assets, they usually collect their fees automatically from the trust. Non-institutional professional trustees such as attorneys and accountants bill you for their services. They may charge based on their normal hourly rates, but they're more likely to calculate their fees based on a percentage of the market value of the assets of the trust as well as a percentage of income collected.

Trusts that mandate an independent trustee typically also include a *line of succession* so that if one trustee is no longer able to act, another is in line to take his or her place. If the trust requires an independent trustee, make sure that any vacancies are filled promptly, because it's next to impossible for the trust to function efficiently without one in place.

All in the family: Family trustees

Trust grantors often feel that using only professional trustees (as efficient as they may be) may not account for special family circumstances. In these cases, the grantor may choose to also have a *family trustee*, or a trusted member of his or her family, who knows the players (the beneficiaries and the remaindermen) well and has no difficulty making decisions based on the grantor's wishes.

Family trustees usually have most of the same powers as independent trustees (such as investment powers and the authority to prepare and sign income tax returns and to make scheduled distributions to income beneficiaries), except that their powers over discretionary distributions are often limited if they have any vested interest in the trust as a beneficiary or remainderman.



It's possible for trusts to exist with only a family trustee, although the results are sometimes messy. Somehow, wherever money is concerned, perceptions of appropriate behavior on all sides tend to skew; in our opinion, you're far better off to limit opportunities for self-serving during trust administration by never allowing a family trustee to serve alone. With the addition of an independent trustee, everyone concerned — from the grantor to the trust beneficiary to the trust remaindermen — can be confident that all the competing interests were considered throughout administration and that the trustees made appropriate and fair decisions.



Another bad idea: having family members be sole trustees of a trust established for their benefit. Unless the trustee/beneficiary is only entitled to mandatory distributions of all the income annually (and principal distributions made under very limited circumstances), the assets of the trust can be included in the trustee/beneficiary's taxable estate at the time of his or her

death, even though the trust property would never be included in the probate estate. If there's also an independent trustee, the grantor can give far more flexibility to that trustee to make distributions of income and principal to the beneficiary, and the trust assets still won't be included in that beneficiary's taxable estate upon his or her death.

And, even though the surviving spouse may be the sole trustee of a marital trust for his or her benefit (after all, the property in the marital trust at the time of the surviving spouse's death will be included in his or her taxable estate anyway), in practice, we've seen few trusts where there isn't also an independent trustee, if only for ease of administration. If the surviving spouse is the beneficiary of a trust other than the marital trust, an independent trustee can provide more flexibility in distributions to the surviving spouse without having the trust assets included in his or her estate.

Lining up your team

No matter whether you've just been named as the fiduciary, or you're the fiduciary's trusted advisor, you'll probably have times when you really want someone else to explain your options to you or set out the potential pros and cons of a decision you must make. Creating a team of professional advisors before you need the advice is the best way to ensure that, when the time comes to make those decisions, you're able to ask the advice and move forward in a clear and measured manner. Chapter 4 lists the types of advisors you may want to employ and explains how they can help you administer a trust or estate without your surrendering all the fun to them.

Estate of Change: Delving into Estates

The day a person dies, you're sure to have more on your mind than the fact that you've just assumed a new role — that of the person designated to wrap up the decedent's affairs. And yet even while you're wrestling with your personal feelings about the loss, you're somehow supposed (and expected) to start tossing all the various balls in the air. You may find yourself planning a funeral at the same time that you're creating the estate's calendar, collecting keys to the residence (if the decedent has no surviving spouse), buying the food for the after-funeral *collation* (light meal), and figuring out what the decedent owned and owed.

In this section, we walk you through all the steps of administering an estate. Just remember, when all the advice begins to leave you breathless, prioritizing can mean the difference between keeping your sanity and running screaming into the sunset. (Check out Part II for more info.)

Changing the status quo

Although losing a friend or loved one may be difficult, you need to realize that the person's status is static. Your loved one is dead; your status, as administrator or executor has also been altered, but that alteration will continue to morph through the process. You're now responsible for the estate and the decedent's assets and liabilities.

Chapter 5 walks you through the first steps in your legal role. We help you to dive into the decedent's affairs, as you try to gain a sense of what the decedent owned, who he or she owed money to, and who inherits what's left. You create a calendar with all the estate's important deadlines listed prominently, and you discover the documents, both ones that were created before the decedent's death and others that you obtain after death, that you need in order to start moving this estate forward.

Probating an estate

Probate, a word that strikes terror in many hearts, is a fairly straightforward process of providing court supervision to your administration of an estate. Probate exists for your protection as executor as much as to protect the interests of the estate's heirs and legatees. With the probate court judge standing between you and the heirs, you have the opportunity to do your job unmolested. And, as you do that job, the judge and the court staff check your steps and help you when you need it, making sure that you're doing everything you should. As the executor of the estate, you'll start the process by filing the decedent's last will, if there is one, and applying for administration. You can't finish until the court tells you that you can, when you file the final account, and it's allowed.

In Chapter 6, you work your way through the probate process, including getting appointed as executor, administrator or personal representative; filing the last will, if one exists; notifying heirs and creditors; and completing the legal documents you're required to file with the court.

Collecting the estate's assets

Most of the fun in administering an estate (at least, we think so), is digging for buried treasure. As the executor, you need to accurately assess all the estate's assets so you can make a plan for the estate. Without knowing what's there, you won't know if you'll be required to file an estate tax return, or what kind of probate administration you'll need to do.

Chapter 7 tells you where and how to dig, including in some fairly unexpected places, and what to do with those assets after you find them. You also

discover how to value property, including when you can do it yourself and when you're better served to have an expert help you.

Paying expenses and making distributions

Just because the decedent isn't living doesn't mean he or she doesn't still have expenses. After all, the electricity in the house wasn't turned off at the moment of death, and any mortgage on the residence still needs paid. In addition, the new entity, the estate, begins accumulating its fair share of costs, whether for accounting and investment services, or lawn mowing. In fact, the estate expenses may end up looking similar to the decedent's before his or her death. As the executor, you're responsible for making sure that all the decedent's and estate's bills are paid. Chapter 8 takes you through the expenses you may run across, including the funeral arrangements, the first expense most people think about in relation to death.

After you pay all the estate's bills, you're free to pay off everyone the decedent listed in his or her last will (or the heirs-at-law if he or she died without a valid last will). In Chapter 8, you also discover how to slice up what remains of the pie, in what order you make payments, how to transfer property other than cash, and how to mathematically make divisions of property when the dividing line isn't entirely clear.

Tying up the estate's loose ends

Even after you've paid everyone who needs to be paid, you still need to tidy some odds and ends before you can close the estate and move on. Chapter 9 walks you step by step through all the final actions that will bring the estate to a close. You find out what you need to file with the probate court, the IRS, and the decedent's resident state tax authority to obtain the letters releasing you from further responsibility. You also discover all the final flourishes that will bring the estate you've administered so well to its natural conclusion.

Managing a Trust

Unlike an estate, which only exists for a relatively short period of time (we hope), trusts can continue on for decades, or even longer, depending on the terms of the trust and the ages of all the participants. And because you're involved for the long haul, the lists of what you need to do, in the short term and on an ongoing basis are different. This section highlights some of the main tasks you have to do as a trustee. Whether you've just been appointed as trustee or you've been one for a while but still have questions, you can check out Part III for complete answers.

Comprehending your duties as trustee

When you agree to act for someone as a trustee, more is involved than just signing on the dotted line, and then walking away. You're now obligated to do your best for the grantor in carrying out his or her wishes, as set forth in the trust instrument. The trust instrument clarifies and specifies your duties. Chapter 10 discusses these types of duties. You grapple with the limits of fiduciary responsibility and discover what it means to honor the grantor's intent. And you explore how to invest the trust assets so that you not only protect the trust principal but also produce the income that the income beneficiary has a right to expect.

Putting assets into trust

If you've finally reached the stage where it's time to transfer assets into a trust, either your own or someone else's, you need to know and follow certain rules in order to make a smooth transition from individual ownership to trust ownership. Chapter 11 explains how to smoothly make those transfers, whether during the grantor's lifetime or after his or her death.

Putting the trust to work

After you transfer the assets into the trust, you as trustee have to create an investment plan that balances income production and growth against risk. Remember, the money in the trust isn't yours to play with, so you can't make any ridiculous gambles with it. Still, taking a keep-it-safe-and-in-the-bank approach isn't smart either because the income beneficiary has a right to (and will) expect income from the trust.

Chapter 12 gives you the pros and cons of a variety of investment options, as well as clueing you in to some current investment theories. It also shows you how to factor in beneficiary needs when determining how best to invest trust assets. Finally, it gives you a heads-up as to what sorts of fees the trust will incur — fees that you have to factor into your calculations when you determine how much, if anything, you can pay to the beneficiaries.

Discovering the point of the trust

A trust's purpose, and your mission, is to balance income generation for the benefit of the current income beneficiary (and principal distributions, when permitted) with principal protection for the remainder interest. Chapter 13 is where you unearth the extra information you may want to consider as you handle this balancing act, such as the beneficiary's health, education, or

other extraordinary circumstances. Figuring out which life events warrant additional distributions may be the trickiest part of trust administration. In Chapter 13, you also discover why many trustees are likened to kindly relatives, as you attempt to uncover all that you can about the income, or current beneficiary (without being accused of stalking).

Compiling and organizing trust records

You've done all the tricky stuff, but you still must track the activity correctly. Keeping records, though not difficult, isn't particularly fun or exciting, so many people get sloppy about it. Our advice to you: Keep 'em neat! Staying on top of your recordkeeping means never finding yourself buried in an avalanche of paper you're not quite sure what to do with. Chapter 14 tells you how to maintain the trust's records with a minimum of fuss and bother.

Bringing the trust to its conclusion

Trusts sometimes seem to go on forever, but the day (usually) eventually comes when all trusts must come to an end. When that day comes for the trust you're administering, you need to know how to tie up all the loose ends neatly, like preparing and filing the final tax returns and accounts and making the final distributions of the remaining income and assets. You've done a great job up until now — it would be a shame to ruin your track record at this late date.

Chapter 15 explains how to terminate a trust with a minimum of fuss and bother. And call us crazy, but for us, life doesn't get much better than when we've received the last assent to that final trust account, the one on which the ending balance is zero!

Paying Uncle Sam

Taxes in estates and trusts can be pretty involved. Why? Because you're not only dealing with income taxes (and we know how much everyone loves to deal with income taxes), but you may also be responsible for preparing and filing **Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return**. This section gives an overview on Form 706 and the estate and trust income tax return (Form 1041), as well as the decedent's final Form 1040. Check out Part IV for everything you ever wanted to know about estate and trust tax forms.

Compiling the estate tax return

Not every estate is required to file Form 706, but if you're responsible for one that is, dive right into Chapter 16, which takes you on a stroll through the lengthy estate tax return. Although the blank return may seem formidable, you may find that with the help of this chapter and the Form 706 instructions you're able to prepare all, or at least large chunks, of the return yourself. Chapter 17 goes into more depth and walks you through the many schedules associated with Form 706. Give yourself some credit and take a stab at Form 706; you'll probably be surprised by how far you get. Even if you do end up taking this return to a professional, you gain a much better handle on all the assets and expenses of the estate by first attempting it yourself.

Figuring out the income taxes

Whether you are administering a trust or are involved in an estate, you have to file annual income tax returns as long as either entity owns assets that are producing income. If you're the executor of an estate, you may also be responsible for filing the decedent's final income tax return (or maybe even his or her final two tax returns, depending on when he or she died). We have you covered.

Discover how fiduciary income taxes differ from personal income taxes in Chapter 18, and find out what quirks exist for the decedent's final return(s). Armed with a **Form 1041, U.S. Income Tax Return for Estates and Trusts**, in one hand, and this chapter in the other, you can work your way through trust or estate return preparation on a line-by-line basis.

Whipping together Schedule K-1

Tax forms can be intimidating, especially unfamiliar ones. And **Schedule K-1, Beneficiary's Share of Income, Deductions, Credits, etc.**, may seem overwhelming. But it's really not. In Chapter 19, see how the information from Form 1041 translates to Schedule K-1 when you've made distributions to a beneficiary from either a trust or estate. After you figure out how to make the calculations, it almost becomes fun (well, at least for us, but then we're an accountant and an attorney.)