

An Overview of Trust Administration



The First and Most Important Step

Trust administration is a necessary process that occurs after the death of either one or both settlors. To protect the successor trustees, there are many things that must be done to ensure proper administration. Fortunately, working with an attorney for trust administration is a straightforward process that will give the successor trustees a great peace of mind throughout the administration.

HOW TRUST ADMINISTRATION BEGINS

Trust administration begins with a required probate code notice to all trust beneficiaries and heirs of the settlors. California Probate Code Section 16061.7 states that such notice must be sent within 60 days of the death of a settlor and allows the recipient of the notice to request a copy of the trust. After receiving the mailed notice, the recipient has 120 days from the date of mailing to file a trust contest. If no contest is filed within a 120 days, then the notice recipient may forfeit their right to file a contest. But if no notice is mailed, the statute of limitations in which a trust contest could be filed is much greater, and could be up to at least four years.

Beware: Many successor trustees who handle trust administration without the advice of an attorney often skip this very important step.

Requirements

The notice required under California Probate Code Section 16061.7 has several requirements, each one of which must be met in order for the notice to be effective. These requirements include the following:

The notification by the trustee is usually required to be served on each beneficiary and each heir of the deceased settlor.

The notification by trustee shall be served by mail to the last known address or by personal delivery.

The notification by trustee shall contain the following information:

The identity of the settlor or settlors of the trust and the date of execution of the trust instrument.

The name, mailing address and telephone number of each trustee.

The address of the physical location where the principal place of administration of the trust is located.

Any additional information that may be expressly required by the terms of the trust instrument.

A notification that the recipient is entitled, upon reasonable request to the trustee, to receive from the trustee a true and complete copy of the terms of the trust.

There's much more to the notice requirement than meets the eye at first glance. If you are concerned or want to ensure that the administration of the trust is properly handled, please consult with an attorney for legal advice concerning your situation.

As part of the initial trust administration process, your attorney will also ask you to provide him or her with the decedent's original will so it may be lodged with the court. California law requires that a decedent's will be lodged with the court for safekeeping, even if no probate is going to be opened.





SECOND STEP - DEALING WITH REAL PROPERTY

In those cases where the trust holds real property, a number of steps must be followed to vest title in the successor trustee so that the property can be managed, sold, or distributed as part of the trust administration.

An Affidavit of Death of Trustee and Consent of Successor Trustee should be recorded against each real property held in the Living Trust. This Affidavit is recorded with a certified

copy of the death certificate. When it is recorded, it changes the title of the property from the trustee (usually the settlor) who has died and into the names of the new trustee (s).

Along with this Affidavit, a Preliminary Change of Ownership Form must be completed and recorded at the same time. This form informs the county recorder why the Affidavit is being recorded.

If the Living Trust will transfer the ownership of the real property from parents to children or in any other manner exempt from property tax reassessment, then the appropriate exemption form must be filled out and mailed to the county assessor's office. A grandparent/grandchild exclusion is also available for the portion of the property passing to a grandchild if their parents are deceased.

Your attorney will prepare these documents for you to sign.

THIRD STEP - COLLECTING THE OTHER ASSETS

Once you have dealt with the real property, you will need to identify all of the other trust assets, e.g. bank accounts and investment accounts, and have the title to those assets transferred into your name as successor trustee. In order to accomplish this, you will first need to obtain a federal tax identification number for the trust. It is essential that you obtain a federal tax ID number for the accounts that are in the name of the trust so that any income earned from those assets is reported correctly to the IRS.

Beware: Do not use your own social security number as an identification number when administering someone else's trust, or you will find yourself liable for tax on income earned by the trust, and not by you.

How to Obtain a Federal Tax ID Number for Your Trusts

Obtaining a federal tax identification number (also called an employer identification number) is very easy. With the right information, you can obtain one online from the Internal Revenue Service. If you are working with an attorney on the trust administration, your attorney can obtain the number for you.

Transference of Trust Accounts

Once you have obtained a federal tax identification number, you should have all trust accounts transferred to your name as successor trustee, using the new identification number. If you are administering a trust that is splitting into multiple share trusts as part of a distribution plan, be sure to get a separate federal tax identification number for each separate share trust. Don't use one federal tax identification number for multiple trusts.

What to Do If Not All the Assets Are Placed Into the Trust

During the process of collecting all of the decedent's assets, you may discover that the decedent failed to place all the intended assets into his or her trust prior to death. The result is that these assets remain part of the decedent's estate and are subject to the probate process. The most common way this situation can be dealt with during Trust Administration is through the use of a Will with a "pour-over" provision. This provision directs that any assets 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. If the proper documents are in place, a simple petition can be filed and a probate can be avoided.



To assist you in collecting the assets and transferring them to your name as successor trustee, your attorney will prepare a document known as a Certification of Trust, which will identify you as successor trustee and set forth the scope and extent of your powers. The Certification will also set forth how title to the assets should now be held and will recite the new tax identification number to be used for all trust accounts. You will want to present this Certification to any financial institution holding trust assets in order to have the assets transferred to your name.

Once you have all of the assets identified and under your control, be sure to prepare an inventory of all trust assets and obtain appraisals for trust assets that do not have a readily ascertained value. Assets such as real property should be appraised immediately from the date of death.

FOURTH STEP - ASCERTAINING AND PAYING DEBTS & TAXES

As successor trustee, it is your obligation to pay the settlor (s) valid debts and to satisfy any tax liabilities owed. Taxes can be especially tricky, as there may be estate taxes owed in addition to income taxes, if the estate is large enough. To determine whether a federal estate tax return must be filed for the deceased settlor, you will need to add up the total value of the decedent's estate, including both trust assets and no-trust assets. If the total value of the estate is more than the exemption amount – currently \$5,000,000 – then it will be necessary to file Form 706 federal estate tax return. However, if the decedent made gifts during his lifetime, the decedent may have already used up a portion of his or her exemption amount and thus even if the estate is less than the exemption amount, a federal estate tax return may still be required. You will want to work closely with an attorney and an accountant to evaluate whether a federal estate tax return is required. If a return is required, it is highly recommended that you engage a competent professional to prepare the return as the return can be quite complicated.



Filing Tax Form 706

The IRS requires that the federal estate tax Form 706 be filed within nine months of death. (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 every year of its existence after the death of the original trustor.) Once your attorney or tax professional 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. For a married couple, after the first death, there is generally no estate tax payable, due to the unlimited marital deduction.

However, at the death of the surviving spouse or that of a single individual, estate tax becomes a very important issue. Your attorney will work with you to determine which assets are in the trust, which assets are outside of the trust, which assets may need to go through probate and which assets are subject to estate tax. Often, estate assets may need to be sold in order to pay the estate tax liability. Since this may take time, it is essential that you consult with an attorney early on in the administration process regarding any potential estate tax liability, to ensure there is sufficient time to liquidate estate assets in order to pay the estate taxes by the nine month post-death deadline.

Filing Income Tax Returns

As successor trustee, you will be responsible for filing the last income tax returns for the decedent. You may also have to file fiduciary tax returns.

A note on 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 asset tax perspective, the income tax consequences may make the higher estate tax valuation a better deal for the beneficiary.





Because a successor trustee may be held personally liable for unpaid taxes, you will want to work with your attorney and accountant to make sure that all tax liabilities are satisfied prior to distributing the trust assets to the beneficiaries of the trust.

FIFTH STEP - THE ACCOUNTING

A Living Trust is only revocable while the settlor (s), the person (s) who created the Living Trust, are alive and well. Once the settlors lose capacity or pass away, their Living Trust becomes irrevocable. The California Probate Code requires that a successor trustee who is administering an irrevocable trust prepare and render an accounting of their actions and administration of the trust. To satisfy that legal requirement, you must keep detailed accounting records of the trust.

You will need to:

Keep track of all the trust money you are spending to wind up the decedent's final affairs

Keep track of all deposits and disbursements from the trust

Review the trust document to see what method of accounting is required

Some trust documents expressly require an accounting while others have waived accountings. However, even where a trust document waives an accounting, the law may still require it. So, it is recommended that you consult with an attorney early in the administration process to determine the scope of your accounting obligation. And even where the trust waives the requirement of a formal accounting, you will still want to keep detailed accounting in case the trust administration goes into litigation.

SIXTH STEP - DISTRIBUTION

After all of the assets have been collected, the debts paid, the tax returns filed and the tax liabilities satisfied, the accounting prepared and rendered (if required), you will be in a position to distribute the remaining trust assets. As with all other aspects of trust administration, the terms of the trust document will dictate how the trust assets are to be distributed among the trust beneficiaries.

Before Anything Else – Determine Who the Beneficiaries Are

A trust will often simply direct that the assets be distributed outright to the various beneficiaries. However, it is quite common that the trust will dictate that assets for certain beneficiaries be held in trust for those beneficiaries. This requires that you establish sub-trusts for those beneficiaries. Examples of common sub-trusts are a separate share trust for a minor, a bypass trust and survivor's trust (for a married couple) or even a pet trust so that a beloved pet can be cared for. As successor trustee, you will need to identify any sub-trusts that are required under the trust document and ensure that those sub-trusts are properly funded.

Sub trusts

Sub-trusts are especially common in administrations of trusts established by married couples. Married couples who have done proper tax planning through a living trust have what is known as an AB or ABC 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.



The Importance of Proper Funding

It is crucial that the A, B and C trusts are properly funded because an improper funding of the sub-trusts can endanger the tax protection afforded to these sub-trusts—plus can result in an equitable distribution to the sub-trust beneficiaries. It is highly recommended that you consult with an attorney regarding the funding of any sub-trusts prior to making any allocations of assets to the sub-trusts or distributions to any of the trust beneficiaries.

Debts or claims on the estate

Cash bequests specified by the will

If there isn't enough cash in the estate to cover these expenses, the assets to sell must be decided. If sufficient cash is available, then a decision has to be made if any assets such as a home should be sold anyway.

After a decision is reached on which assets, if any, should be sold, the executor or administrator can proceed with the sale. If a home is going to be put on the market for sale, it often makes more sense to market it within thirty days of the appointment rather than to let it remain vacant for months.

ALLOCATION & DISTRIBUTION OF TRUST ASSETS

Once you have determined whether there are any sub-trusts that need to be funded and you have identified who the beneficiaries are, you can proceed with allocating and distributing the trust assets. If you have not already retained an attorney to help you with trust administration, you might consider retaining an attorney for the purpose of preparing a Trust Distribution and Termination Agreement.

This agreement, when properly prepared, recites key components of the trust administration, including, but not limited to:

Identifying the successor trustees

Outlining the distribution provisions

Reciting distributions of personal property already made

Describing the funding and the values used for determining the distributions to sub-trusts and to the beneficiaries

Proposing a final distribution plan

Obtaining consent from beneficiaries for final distribution and waivers of accounting, if appropriate

The purpose of the Agreement is to protect the successor trustee while obtaining an agreement among the beneficiaries for the final distribution of trust assets. Such agreements can be quite helpful in avoiding the threat of future litigation by trust beneficiaries.

What to Do When There Are Issues Between Beneficiaries

In situations where there is acrimony among the beneficiaries or towards the successor trustee, your attorney is likely to suggest you prepare a formal accounting of your actions as successor trustee and seek court approval of those actions and of your proposed distribution scheme. By petitioning the court for such approval, you minimize the risk of future litigation, since a beneficiary who does not object in the court proceedings is typically barred from later complaining about your administration of the trust, if you have properly disclosed your actions. If you do not choose to obtain court approval, a beneficiary generally has three years to object to your administration of the trust after close of your administration.

The trust administration process is often complicated and confusing, and can seem overwhelming at times. Many times the process is hampered even further due to the emotions and conflicts that arise among the trust beneficiaries as a result of family dynamics and the grieving process. If not properly dealt with, these emotions and conflicts often play out in court in protracted and expensive trust litigation. Contact an experienced attorney to help you avoid such a result. If you need a referral to attorneys I know and trust .

