So You Want to Be Your Own Trustee: Or Nobody Told Me This Before

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Some years ago while I was still active in my financial planning business I had a client share with my other clients what it had been like to act as the trustee of his own trust after the death of his wife. He had lost his wife a couple of years earlier. It was an eye-opening discussion for most in attendance. It was that experience that first led me to write up this series of articles about the realities of living with the results of your estate planning documents.

Every trust has at least three parties to the trust. The first party is the trustor or grantor. This is the party who sets up the trust and grants property or assets to the trust. The second party is the trustee or the party who is responsible for the management and operation of the trust. The third party is the beneficiary who receives the benefits of the trust. With a Family Living (Intervivos) Trust that you set up during your lifetime typically the Trustor/Grantor, Trustee and Beneficiary are all the same party; usually the husband and wife. With that as background let me clarify the situation we are dealing in this section.

You and your spouse are both alive and have created a Family Trust. The trust is revocable, amendable and changeable. Everything you own (except maybe a bank account or two) is owned by this trust. Yes, even your automobiles and country club membership should be titled in the trust; at least in most states. You have rights to deal with everything owned by this trust just as you did before you formed this trust. Nothing much has changed, except that you now own everything as “John and Mary Doe, Trustees”, not “John and Mary Doe, Joint Tenants” as was probably the case before you set-up the trust. The purpose of the trust is to avoid probate and some estate taxes, if your estate is large enough. This latter reason is much less significant since 2010. Everything (except maybe setting it up) is very simple. The first death changes the simplicity of things dramatically. Two trusts are formed at the first death – maybe even three. Although, since 2010 the need for two trusts (or even three) is less dramatic and probably will be less freguent than before 2011. If there are two trusts, one of them is now irrevocable; it can’t be amended or changed. The other trust can be operated much in the same way as you did the original trust, although it is not exactly the same. It is still revocable, amendable and changeable. Finally, there is one other big difference. You have lost your spouse; your confidant; your support team and your confidence builder. You are on your own to deal with a brand new and confusing situation. The following outline of what you need to do as trustee following the death of your spouse is divided into two time periods: At Death and Life Thereafter.

At Death

1. Notify all of your family advisors of the death of your spouse: Attorney, CPA and Financial Planner.

2. Meet with your attorney to get a description of what must be done immediately and what can be postponed. There is a whole myriad of things that could fall into the “must be done immediately” category, but here are just a few:

> a) Apply for any and all insurance benefits: life, health, disability and, maybe, long term care.
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> b) Make decisions about any “disclaimers” that are available to you. The term “disclaimer” probably is not familiar to you. It gives you a right to refuse an inheritance. There are many good reasons why you might want to disclaim an inheritance. Your attorney can guide you in making this decision. BUT it must be made early, because if you so much as touch, use or receive distributions from any of the assets (bank account, stock, bond, investment account, IRA, etc.) you will not be able to disclaim your right to inherit these assets later. You may find yourself trapped into funding the Decedent’s Trust whether you need to or not. Because you will probably need or want to have access to these assets soon after the death of your spouse, you should make this decision early on.
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> c) Order death certificates. Order two or three times as many than you are told you need. There is always a need for more even years later. Much of what needs to be done right away, such as applying for insurance benefits, can not be done without a death certificate.

3. Meet with your Attorney, CPA and Financial Planner to discuss “funding” the trusts that will be set up as a result of your spouse’s death. Again, two trusts maybe set up, but it is possible for a third to be established. The following is a brief description of each and some broad issues confronting you when drafting these trusts.

> a) The Decedent’s Trust (or the By-Pass or Trust B): This trust is set up to help you avoid estate taxes when the second spouse dies. So it is much less likely that this trust will be set up in the future although the original document may still allow one to be set up just in case it is needed. There is a limit on how much can be put in this trust. Also, it may

not be necessary to fund this trust at all, if your estate is small enough, as it much more likely since 2010. This is where the issue of disclaimers becomes important. You need to decide whether you should or should not fund the trust and then decide what assets to put in the trust. It would be best to put assets in this trust that will grow in value rather than produce income. The purpose of this trust is to pass as much as you can to final beneficiaries at your death free from estate taxes.

However, you need to be aware of your income needs, and whether or not there will be enough income producing assets outside of this trust to meet your needs. Your Financial Planner can help you evaluate this situation.

This trust is the one that creates the vast majority of the administrative and bookkeeping complications for the trustee. Because as trustee, you can only distribute income to the income beneficiary (again, you), you have to know what is income and what is not plus properly account for it. Therefore, it would be best if you could fund this trust with only easy-to-deal-with assets such as stocks, bonds and mutual funds that are invested in stocks and bonds. Even then, it is not all straight forward. Interest and dividends are income, but long-term capital gains are not. Short-term capital gains are. Also, there can be a difference between income tax accounting rules and the rules for trust accounting. Trust accounting rules determine what is available for distribution to the income beneficiaries of the trust. Tax accounting rules determine what is reportable for income tax purposes. Your trust document should clarify how this accounting is to be done. If the dividends are not taxable, they may be considered to be return of principal rather than income. Often you don't know what the distribution is (income or principal) until you receive the tax notice after the end of the year in which the distribution was received. Your CPA can be helpful in selecting the assets that have the least bookkeeping and tax complications associated with them.

b) The Survivor's Trust (or A Trust): Everything that does not go in the Decedent's Trust typically goes into this trust. This one is a piece of cake to manage as compared with the Decedent's Trust. It operates much like, but not completely like, the one you had during your joint lifetimes. It is still revocable, amendable and changeable. There are bookkeeping, accounting and tax reporting complications, but they are not as burdensome as with the Decedent's Trust. Everything that happens in this trust gets reported on your personal income tax return, although there can be some surprises when the time comes to file your tax return. You do not have to account to anyone else for what did or did not happen to the assets in this trust from day to day and year to year.

c) The QTIP Trust (Qualified Terminable Interest Property or C Trust): This trust may or may not be set up after the first death. First of all, the trust that was in existence during your joint lifetimes must permit its creation, but generally, it is only created under certain limited circumstances. Those circumstances may involve the existence of children from a prior marriage, very large estates or smaller estates where it is decided to exercise a disclaimer and not fund the Decedent's Trust. For this latter reason, this is one of those issues that needs to be settled early on. This trust has all the same accounting, bookkeeping and tax reporting complexities as the Decedent's Trust, so you should seek guidance from your CPA as to the best assets to put in this trust. However, unlike the Decedent's Trust, the assets in this trust do not avoid estate tax at the second death. Therefore, you do not need to emphasize growth with the investments in this trust. You can emphasize income if your Financial Planner feels that is what you need the most.

In summary, in this first stage of your life as a trustee, you have met with your advisory team: Attorney, CPA and Financial Planner. You have decided which trusts need to be or should be set up. As a result, you have directed your attorney to take care of all that needs to be done in this regard. You may have decided to exercise some Disclaimers to facilitate this process, and have instructed your attorney to take care of what needs to be done there, as well. With the advice from your team of advisors, you have decided which assets need to go into which trusts. You have instructed your Financial Planner to set up the accounts that need to be set up and transferred assets into those accounts. You will be doing some of this yourself with banks and such. Your CPA should be filing for tax identification numbers for each of the trusts that have to report to the IRS each year. Your CPA will later instruct you how to keep the books and records for each trust, so you can report to the IRS each year and comply with the laws that affect your actions as trustee. Your attorney will also participate in this instruction by telling you what you can and can not do with the financial management of the trusts, and its' funds under the terms of the trust document that authorizes you to be trustee.

Life Thereafter About now, you are probably asking yourself whether or not you really want to be the trustee after your spouse's death. We will discuss your options in more detail in another section. However, even if you have a professional trustee appointed, you will still have to participate in most, if not all, of what has been described above. However, your advisory team will have been expanded to include someone other than yourself to be trustee.

Now you are in position to get on with your life as trustee. The trusts we discussed above, the Decedent's, Survivor's and maybe the QTIP have all been set up and funded. Tax identification numbers have been requested from the IRS for each trust. There are bank accounts, checking and maybe savings or money market accounts, for each trust. In addition, there are investment accounts established for each trust. Other assets such as real estate, limited partnerships, plus your home have been re-titled in the name of the appropriate trust. Now the income starts to flow and the bookkeeping responsibilities kick in. What are some of the responsibilities that you have as trustee?

1) Keep the income from the assets in each trust segregated from the income generated by the assets in the other trusts.

a) The income generated by the assets in the Decedent's Trust, the QTIP Trust, and the Survivor's Trust must be kept separate from each other, even though you are the income beneficiary of each trust. There should be one account for each trust into which all of the income flows from all sources. Then out of this account you, as trustee, pay the expenses of the trust. Now, you can pay yourself, as beneficiary, the net income after the expenses of the trust. Still, it is important to note as we have above, that not all of the distributions received by each trust are distributable to the income beneficiary. If the monies received are from the sale of an asset, they are not distributable. If for some reason, they are, the distribution may be income taxable. If the monies received are from a capital gains distribution made by a mutual fund, they may be distributable if they are a short-term capital gains but not if they are long-term capital gains. If the monies received are from a real estate investment of any sort, they may not all be distributable because some of the distribution might be tax-free due to depreciation deductions available to rental real estate. The point of all this is, you have to know what the source of the monies are that have been received and only pay out to yourself and any other income beneficiaries, what is permitted by the trust document; usually just the income. Often you don't know until sometime later what the source of the monies received might have been. When in doubt, it is best to ask. Ask your Financial Planner, ask your CPA or ask the source that sent you the monies. It is important to keep the monies segregated until you know what they are and how much you can distribute and to whom. Finally, write yourself a check.

b) The income generated by the Survivor's Trust may also have some of these complications associated with it. You should again have a separate bank account to receive, hold and make distributions. However, whatever you get, you can keep, spend or give away as you see fit. Usually everything that happens in this trust is reported on your personal income tax return.

2) Comply with the terms of the trust(s).

a) Don't distribute monies that are not considered income to the income beneficiary. Again, you are probably the income beneficiary as well as the trustee. Even so, you still have to be careful that you are only distributing to yourself what you are supposed to get from the trust.

b) Distribute principal in compliance with the trust document. Most Decedent's Trusts allow the income beneficiary to take up to 5% of the value of the trust each year in addition to the income. This is not difficult to determine. Determine the value of the trust on December 31st and multiply by 5%. If it is likely that the Decedent's Trust is going to be quite large, you may want to limit the dollar amount of this 5% distribution. (This limitation has to be in the original trust document; it can't be added once the trust or one part of it become irrevocable at the first death.) You can take out this amount in the following year, in addition to any income. However, if you do not take it, you can not make up for it in subsequent years. You need to keep a record of how much you took and when and how the amount was calculated. Most Decedent's Trusts also allow the income beneficiary to take additional principal if their other income is not sufficient to support their health and living needs. There is precise language in the trust that can be interpreted liberally, but as trustee, you need to document the need and why the distribution was made.

c) Report to the residual or remainder beneficiaries of the trust. Many trusts require that the trustee report to the ultimate beneficiaries of the trust; those who will receive the assets of the trust upon the income beneficiaries death. Typically, this is overlooked and not done and it never causes a problem. However, if there are children of more than one marriage who stand to inherit the trust assets or if there is conflict among siblings or between in-laws, this could cause problems once the trust is distributed. This is especially true if the ones who are most likely to be "out of sorts" with the others, or with you, are expecting more than they end up getting. Thus, it is a good idea to send everyone an annual report of the financial results of the trust showing its beginning and ending values, the income distributed and the amount of any principal distributions. As trustee, you have to prepare the report, or have it prepared, then deliver it.

3) Account for and manage the expenses of the trusts. There will be all sorts of expenses, as you can imagine, from all that we have covered in this section. Some of these expenses must be taken out of income and some out of the principal of the trust and some split 50/50 between income and principal. The Uniform Principal and Income Act stipulates how

expenses are to be allocated if the trust document does not, and most don't. You need to seek guidance from your attorney and CPA as to how to allocate the expenses. This has to be done in order to determine how much income you have left over to distribute.

4) File Income Tax Returns for the Decedent's Trust, Survivor's Trust and QTIP Trust and send K-1s to anyone who received any of the income from the trusts – probably you. Again, you probably won't do this yourself but will have your CPA do it. Nevertheless, you have to capture all of the data and information necessary for your CPA to file the return.

All of these responsibilities are in addition to the other responsibilities that you have as a widow or widower. One of things you will have to do AT DEATH is to file an estate tax return if your estate is close to the exemption amount. Again you will need to work with your Attorney and CPA to get this job done.

Another responsibility we all have is to manage and care for our financial resources in a prudent manner. To an even greater extent, this is true of trustees. You come under the Uniform Prudent Investor Act as well as the Uniform Income and Principal Act mentioned above plus the terms of the trust document that you and your spouse set up. First of all, it needs to be determined whether or not there is anything in the trust document that overrides the guidelines of the Act. If not, the guidelines of the Act dictate that you must establish and maintain a well-diversified portfolio that conforms to the investment objectives of the trust. Unless the trust document spells out those objectives you, as trustee, must establish them and periodically review, and if necessary, revise them. This requires that you establish an Investment Policy Statement and Model Portfolio to guide your investment decisions. Your Financial Planner can help you in the development and implementation of the policy statement and model portfolio. You could also have your Financial Planner take over active management of the trust assets for you in compliance with the policy statement and model portfolio. Please note, the active management of the trust assets by your Financial Planner will not only help you comply with the Uniform Prudent Investor Act, but the reports provided by the manager will help immeasurably with the reporting you have to do as trustee.

SO YOU WANT TO BE YOUR OWN TRUSTEE: Ninety-nine times out of hundred people chose to appoint themselves as trustee when they set up their Family Trust. There is no reason not to because the role is no different than they had as owners of their assets before they set up their trust. But at the first death everything changes as you have seen from the above discussion. So why do we find ourselves taking on this role? Because they are so many things wrong with corporate trust companies.

- They only want BIG trusts. If you have less than 5 to 10 million dollars under their control as trustee, they relegate you to an 800 number or to the continuous turnover of low-level employees. This is true of the major trust companies almost uniformly.

- They want to not only be your trustee, but they also want to be your investment manager, which means putting you into their own mutual funds. You do not get any personal investment guidance and management.
- Most trust companies are owned by large publicly held financial services firms that have “cross-marketing” needs. This creates a privacy concern.
- They will not hold all of your assets as trustee, so you still have to be the trustee for some of your assets or find someone who will. Assets such as real estate, private businesses and limited partnerships or other esoteric assets are not usually held by corporate trust companies.
- They are often out of state and out of touch with your personal needs and concerns.

These are just some of the reasons most people do not want a corporate trustee involved in their personal affairs and with their trust. There are alternatives between appointing a corporate trustee or being one yourself.