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Chapter **1**

Operating in a Fiduciary World

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 that 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: assumes 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 keep family memories happy and purpose intact.

Identifying the Players

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. The following sections point out some important basic lingo you need to know as you start your journey. Refer to the other chapters in Part 1 for more on your responsibilities as an administrator or trustee.

Determining an estate's fiduciaries

Several kinds of *fiduciaries* (people or organizations who hold and administer assets of one person, either living or deceased, for the benefit of that person or 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*, although we don't make that 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 (often a minor) or for other reasons such as mental disability, physical incapacity, or illness.
- » **Conservator:** A *conservator* is 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 disability or physical incapacity, or for a person missing in action or a prisoner of war.



REMEMBER

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 that 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 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 of the present interest* (the person or organization entitled to receive the income earned by the trust's assets. Depending on the terms of the trust, perhaps some or all of the trust assets themselves) and the wants of the *remainderman* or *remainder beneficiary* (the person or organization who receives 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.



REMEMBER

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.

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 accountants, 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 present interest 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.



REMEMBER

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 his 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 present interest 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 present interest beneficiaries), but their powers over discretionary distributions are often limited if they have a vested interest in the trust as a present interest beneficiary or remainderman.



WARNING

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 present interest 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.



WARNING

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 of advisors

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 for 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 the next sections, 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 2 for more info.)

Altering 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 evolve 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 dive into the decedent's affairs. You gain a sense of what the decedent owned and how he held title to it (and thus whether it flows through the probate estate), 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, 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 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. Without accurately 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 unusual 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 that 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 to be paid. In addition, the estate begins accumulating its fair share of costs, whether for accounting and investment services, or for lawn mowing. In fact, the estate expenses may look similar to the decedent's before death. As the executor, you're responsible for making sure that the decedent's and estate's bills are paid. Chapter 8 takes you through the expenses you may run across, including the funeral; 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, you still need to tidy some odds and ends before you can close the estate. Chapter 9 guides you through all the necessary final steps. You find out what you need to file with the probate court, the IRS, and the decedent's state tax authority to obtain the letters releasing you from further responsibility. You also discover all the final flourishes that will bring the estate to its natural conclusion.

Operating a Trust

Unlike an estate, which only exists for a relatively short period of time (we hope), trusts can continue on for decades, depending on the terms of the trust and the ages of all the participants. 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. The following sections highlight some of your main tasks as trustee. Whether you've just been appointed or you've been a trustee for a while but still have questions, you can check out Part 3 for complete answers.

Understanding your duties as trustee

When you agree to act 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, which clarifies and specifies your duties. Chapter 10 discusses these 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 purpose 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 the 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, although 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 eventually comes when all trusts must come to an end. When that day comes, 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 income taxes), but you may also be responsible for preparing **Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return**. Part 4 gives an overview of **Form 706**, the estate and trust income tax return (**Form 1041**), as well as the decedent's final **Form 1040**.

Compiling the estate tax return

Not every estate is required to file **Form 706**, but if you must file, 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 many of the 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.



REMEMBER

If your decedent held title to property, whether in his name alone, as a joint tenant, or in the name of his revocable trust, all the decedent's property is subject to the federal estate tax. But of course, that's after the whopping exclusion amount of \$5.25 million in 2013, indexed annually for inflation.

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 years of income 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 Chapter 18 in the other, you can work your way through trust or estate return preparation on a line-by-line basis.

Planning an income tax strategy

There is rarely just one way to skin a cat, and the same can be said of preparing tax returns. With a little forethought and scheming, you can minimize the amount of income taxes paid by both the trust or estate and the income beneficiary. In Chapter 19, we discuss how to legally reduce the amount of income tax you pay to the IRS.

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 20, 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.)