Price & Farrington's Estate and Tax Planning *Fast*Facts February, 2007

Estate, Tax and Wealth Planning for Advisors and Clients

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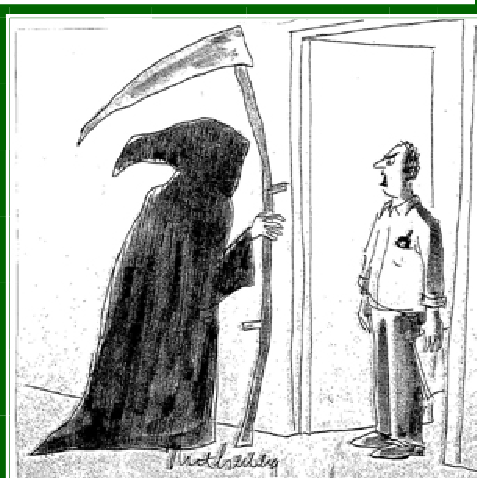
How to Be A Trustee, Part 2:
A Primer for the First-Time Fiduciary



"Are you nuts? Just yesterday, I signed up for a year's unlimited calling plan!"

As we saw in Part 1 (Jan., '07 *Fast*Facts) a trustee serves as a ***fiduciary***, managing trust assets in the best interests of the trust beneficiaries.

Accounting. You must set up and keep an accurate set of books. You might want to engage a CPA or professional bookkeeper to assist you. Your records should show all assets you receive, hold and disburse, with the date, amount and explanation of each.

If the persons who receive trust income (the ***current income beneficiaries***) are different than those who will receive the principal when the trust terminates (known as ***remaindermen***) your records should classify all receipts and disbursements as ***income*** or ***principal***. In most cases there won't be any difficulty with this. Things like rent, ordinary dividends and interest are clearly income; and generally, proceeds from the sale of an asset are principal.

Most trust instruments contain instructions to guide the trustee in resolving these and other accounting issues. If not, the *Washington Principal and Income Act* of 2002 (RCW 11.104A) and the *Washington Trustees' Accounting Act* (RCW 11.106) provide guidance. Remember that the trust you are administering is a separate "person" in the eyes of the law; a clear set of books creates a record of its healthy and independent life. You should be prepared to provide an accounting at least once a year, regardless of whether or not a beneficiary has demanded one. The trust beneficiaries are generally entitled to copies of the ***trust instrument*** and they may also be entitled to examine the books and records of the trust. This is another good reason for you to maintain your books in a scrupulous manner.

You're entitled to ***reimbursement*** of reasonable expenses incurred in the administration of the trust. You are also entitled to a ***reasonable fee*** for services rendered, but you don't have to take a fee.

Investments. You must keep the trust assets invested appropriately. To the extent you, as trustee, act in reasonable reliance on the terms of the trust instrument, you cannot be faulted by the beneficiaries. Where the trust instrument is silent, most states, including Washington, have adopted the *Uniform Prudent Investor Act (UPIA)*. The act allows fiduciaries to adopt ***modern portfolio theory*** to guide investment decisions reducing portfolio volatility and losses. A fiduciary's performance is measured on the entire portfolio, not on the performance of each investment singly. As trustee, you generally have the duty to diversify the trust assets, unless circumstances or the trust instrument dictate otherwise.

You have the duty to be absolutely loyal to the trust and to be impartial toward the beneficiaries. Your duty of impartiality is driven by the kinds of interests held by the various beneficiaries. For example, one may have current rights to receive trust income while another may have the right to receive trust property at some point in the future. You must not favor the current beneficiaries over the future beneficiaries unless the trust instrument allows you to do that.

The UPIA allows a trustee to delegate investment and/or management functions to appropriate persons where it is prudent under the circumstances. Still, you have the duty to monitor the experts to whom you delegate responsibilities to make sure they are faithfully serving the best interests of the trust.

Income taxes. A revocable living trust is a ***grantor trust*** during the lifetime of its maker and isn't required to file income tax returns if you are *both* the grantor (i.e., the trustmaker) *and* the trustee or co–trustee. The trustees of all other types of trusts may be required to obtain taxpayer i.d. numbers (by filing Form SS-4 with the IRS) and file fiduciary income tax returns (Form 1041) with the IRS. Since trust income tax returns are substantially different from personal income tax returns, we recommend you seek help from a CPA or other profes-

ON TRUTH & LIES

- ***Truth is generally seen, rarely heard.***
- ***The cruelest lies are often told in silence.***
- ***A man had rather have a hundred lies told of him, than one truth which he does not wish should be told.***
- ***A lie can make it half way around he world before the truth gets its boots on.***
- ***Who lies for you will lie against you.***
- ***In quarreling, the truth is always lost***

(...and THAT'S the truth!)

sional in preparing trust tax returns.

Interim Distributions. Let's now turn to the subject of primary interest to the beneficiaries: when and under what circumstances they receive distributions. The trust instrument should tell you who is to receive benefits from the trust and when those benefits are to be paid. It may also give you discretionary powers over distributions.

Example. The trust instrument gives you power, in your sole discretion, to distribute income or principal to your sister's three children to provide for their ***maintenance, support and education.*** *Jennifer* is a college sophomore and doing very well. *Jason* is "doing his thing" in San Francisco, while *Jonathan* is doing average work in high school and is a sports car nut. You receive a request from the children's guardian for $3,000 for Jennifer's tuition for the coming year (to be spent at a university in Europe), $1,000 for medical expenses for Jason, who is undernourished and high on drugs, and $2,000 for a car for Jonathan. Which of these requests can you honor under the standards given?

For Jennifer: Education is a proper purpose of the trust, but does it have to be in Europe? Can she get just as good an education in the U.S. at half the cost? Could Jason and Jonathan later claim that you abused your discretion or even breached your fiduciary duty to the trust in paying for an exorbitant European education? You should make certain to document very good reasons for allowing Jennifer to study in Europe instead of staying here.

For Jason: Support and maintenance are proper purposes, but does this term include medical expenses, or is it intended to be limited to ordinary living expenses such as room and board? The trust instrument may or may not tell you. You may also be stuck in the quandary of deciding whether spending money for Jason's medical care, without also requiring him to undergo some kind of drug treatment, is prudent.

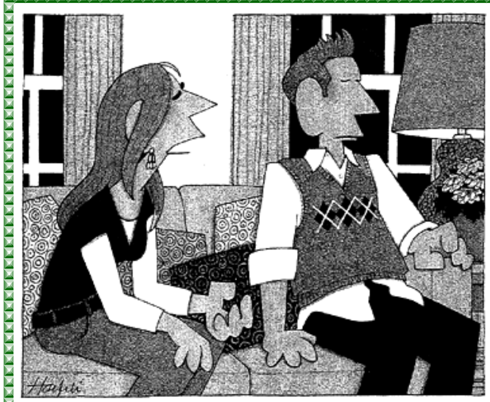
For Jonathan: Does support and maintenance include a car if Jonathan has access to a reliable car or some other means of transportation now? What if he has a part time job and needs transportation?

In all three cases, the trust may—or may not— provide you adequate guidance. Your primary objective is to carry out the intent of the trust creator if that can be determined from the trust instrument. You should also consider the size of the trust, the amount of income it generates, the needs and convenience of the beneficiaries, the various other demands the trust might be called upon to meet and the overall range of discretion you are permitted as trustee.

When your permissible sphere of action is limited by a ***standard***, you must observe that standard or risk a lawsuit for breach of trust. You are ***personally liable*** (meaning that your own assets are at risk) if you lose a lawsuit in which you are accused of violating your fiduciary duties. Remember that if you are presented with an issue that cannot easily be resolved, you always have the option of petitioning a court for instructions. And there is never any harm in consulting your legal counsel and other advisors if issues arise that could put you in hot water.**

*** Contact our office for more information on how a trustee can avoid potential liability.*

Titling trust assets. Whenever

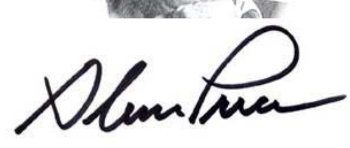


"I wish you'd open up to me. I need some ammunition."

you take title to an asset as trustee, it should generally be as: *[Trustee's name], Trustee, or [his/her] successors in trust, under the [Trust Name] Trust, dated [trust date], as amended.* When you sign documents, including checks, you should sign: *[Your Name], Trustee*. You won't be held personally liable if your actions are within the scope of your authority as trustee. This rule doesn't apply to a trustee who is also the trust creator; it only applies to successor trustees.

Final thoughts. Try to understand *why the trust was created*. Examine *your motives*. Keep *well-documented files*. Be alert to your *duties and responsibilities*. Never shrink from *asking for legal or other advice*. That advice might cost something in the short run, but the cost can be far less than the cost to fix a mistake later on. Remember that the trust will pay the reasonable costs of obtaining advice, but you could end up paying out of your own pocket for your failure to secure advice when you most need it.

We wish you good planning. GDP



So, What About a Corporate Trustee?

What does a corporate/professional trustee offer as a substitute for Uncle Joe or Aunt Lucy? Plenty, says Michael Vranizan, Trust Officer for The Whittier Trust Company in Seattle (206.332.0836)...

☑ Objectivity ☑ Impartiality.
☑ Continuity. ☑ Longevity.
☑ Professionalism. ☑ Expertise.
☑ Accountability.

In our *March '07 FastFacts* we'll flesh out what these words mean and how the use of a corporate trustee could dramatically improve your family's trust planning. GDP