INFORMATION FOR SUCCESSOR TRUSTEE

Many people becoming trustees for the first time have asked questions such as "What is a trust?" or "What taxes must I pay as a trustee?" or "Am I required to file annual reports with a court?" Most people have had little experience with trusts. The purpose of this memorandum is to provide a general description of the bundle of legal relationships which is called a revocable trust. A revocable trust differs from an irrevocable trust in two major respects: (1) it can be amended or revoked by the grantor; and (2) it does not have a separate taxpayer; income is taxed to the grantor, not to the Trust (and possibly to its beneficiaries). I also have set out some of the general rules governing the administration of revocable trusts. While you are administering the trust, you may find it helpful from time to time to refer to this memorandum.

1. TRUSTS & TRUSTEES, DEFINED

A trust is a legal relationship in which one or more persons (the trustee or trustees) hold legal title to property and manages it for the benefit of one or more people (the beneficiary or beneficiaries). In managing the trust property (the trust estate), you, as trustee, must use at least ordinary business ability. Your management of the trust estate will be judged only in the light of circumstances existing at the time transactions occur. You may be held personally liable for trust losses if you exceed the powers granted in the trust instrument or by the law.

The first source of your powers, rights, and duties is the instrument by which the trust was created. The trust instrument may be a trust agreement, a will, or judgment of a court. On creating a trust, the grantor has the power to include any lawful provisions he or she wishes to govern the trust relationship. Since tax considerations are usually important in the creation and management of a trust, the powers, rights, and duties of a trustee are often limited by the tax results desired by the grantor.

The provisions of a trust instrument may override general provisions of trust law, except where a rule of trust law expresses a paramount public policy. Wherever a trust instrument does not provide for a given situation, the general trust law governs.

It is important that you, as a trustee, know the rules under which you must operate, whether they are found in the trust instrument or in the general law, or partly in both.

Trust instruments contain provisions called "dispositive provisions" which determine who is to receive benefits and what benefits they are to receive.

In addition, many trust instruments contain lengthy administrative provisions, some of which are restatements of the general trust law and some of which supersede otherwise applicable rules of trust law; the administrative provisions are usually designed to give the trustees broader powers and greater freedom to administer their trusts.

In the usual situation where a question regarding a trust cannot be answered by referring to the trust instrument or to the general trust law, the trustees may ask a court for instructions; the petition for instructions should described the proposed course of action.

2. GENERAL DUTIES OF TRUSTEES

Your basic duties as a trustee involve the collection, management, and investment of trust assets and the accumulation and distribution of income and principal pursuant to the trust instrument. Another important set of duties relates to tax matters, some of which are discussed elsewhere in this memorandum.

It is a fundamental rule of trust law that you must be faithful to the interests of the trust and its beneficiaries. You must also keep, or cause to be kept, proper accounts and records. You must not engage in any transaction which will result in a conflict of interest between you and the trust.

A trustee is generally required to keep trust property separate from the trustee's own property, and the property of each separate trust usually must be identified as the property of the individual trust; however, these requirements may be modified by the trust instrument under which you are acting. Even if you are allowed to hold trust property in your own name or commingle it with other property, separate records and separate tax returns are needed for every trust.

3. TRUST INVESTMENTS

Modern trust instruments often contain provisions allowing trustees to make whatever types of investments are deemed to be in the best interest of the trust and the beneficiaries. Even though broad powers are granted to you, these powers must always be exercised for the best interest of the trust and the beneficiaries. A Settlor may expressly provide that the trustee's investment cannot be questioned (in the absence of bad faith or willful misconduct). If you are at all uncertain about the propriety of any proposed investment, you should seek competent legal advice.

4. BOOKS AND RECORDS

The trustee must keep accurate accounting records for the trust. The trustee has responsibilities to both the income beneficiaries (usually the Settlor or Settlors) and the remainder beneficiaries (those who will receive the property on termination of the trusts). Therefore, careful records must be kept of all trust transactions.

The records must distinguish between income and principal receipts and income and principal disbursements. For example, if a trust holds a note received on the sale of an asset and the note is being paid on an installment basis, each payment most likely will include both a repayment of the principal portion of the note and an interest portion. These items must be broken down as each payment is received: the interest is allocable to the income account while the note repayment portion is allocable to the principal account. (This treatment may or may not be the same for income tax purposes, as fiduciary accounting and fiduciary income taxation are not always parallel.)

Similar careful treatment must be accorded expenses allocable to principal and expenses allocable to income. In some instances, the trustee has the discretion to determine the manner of allocation as between principal and income. In other instances, the allocation procedure is not clear. When any question of allocation arises, the accountants or attorneys should be consulted.

Fiduciary record keeping differs substantially from normal bookkeeping or even from corporate or personal income tax record keeping. A fiduciary is responsible for every penny which passes through her or his fingers and must therefore account to the penny. Thus, the trustee is required to keep a precise record of every receipt and disbursement, every gain and loss, every distribution to a beneficiary, and every change in the nature of an asset of the trust. This is not difficult if good records are kept from the inception of the trust. However, failure to keep good records will require time-consuming and costly reconstruction of trust records for both tax and accounting purposes, and will raise adverse inferences against the Trustee should a dispute arise at a later date. If you need assistance, we can provide assistance. If you have any other questions on this subject, you may wish to call us or your accountant.

5. DISBURSEMENTS

I recommend that all disbursements made on behalf of the trust be made by check. Record each disbursement; show the date, amount, name of payee, the purpose of the payment, and whether the payment is from principal or from income. Such a record could be kept on a copy of each check, on a voucher, or in a list of cash disbursements.

6. NOTICES CONCERNING FIDUCIARY RELATIONSHIP

Federal and state tax laws require you to notify the respective taxing authorities of your appointment as a trustee. The purpose of the notification is to establish the place to which the taxing authorities must send communications to be effective. For example, the filing of notices concerning fiduciary relationship will require the taxing authorities to send any notice of a proposed deficiency in trust income tax to you as trustee rather than to a trust beneficiary.

7. INCOME TAXES, TAX RETURNS AND ACCOUNTING PERIODS

Trustees are responsible for the filing of trust income tax returns. A federal fiduciary income tax return (Form 1041) must be filed for any tax year in which a trust earns any taxable income, or gross income of $600, regardless of the amount of taxable income, or when any beneficiary is a nonresident alien. A Florida income tax return may have to be filed as well. A CPA trained in fiduciary accounting will be able to advise you.

Fiduciary income taxation is a highly specialized field; many accountants are not familiar with its intricacies. Therefore, it is extremely important that an accountant familiar with fiduciary income taxation be employed to prepare the subtrust fiduciary income tax returns.

We hope that this memorandum has provided useful information. However, no general memorandum can substitute for careful reading of the trust instrument you are to administer and for specific advice and guidance. Please call us for answers to questions concerning any trust matter.