

# 31st Annual Tax Symposium

## **TRUST ADMINISTRATION:** **THE GRANTOR HAS DIED, AND YOU ARE THE SUCCESSOR TRUSTEE** **NOW WHAT? (HINT: CALL YOUR LAWYER)**

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### I. OVERVIEW

- A. Individuals often create and fund a revocable trust as part of their estate plan.
  - 1. The trust will dictate and govern who gets what, when, and under which circumstances as a result of the grantor's/settlor's/trustor's death (at least with respect to assets owned by the trust or payable to the trust).
  - 2. The trust will also appoint a successor trustee to carry out those directions.
    - a. Trusts often provide for subsequent, successor trustee(s) in case one or more successor trustees decline to serve, resign, or die while serving.
    - b. Trusts often provide for two or more co-trustees to serve together.
      - i. If, for example, three co-trustees are appointed, do they have to act by unanimous or majority vote or can each of them act independently?
  - 3. A trust generally becomes irrevocable on the death of the grantor, although the trust agreement may give someone (e.g., a surviving spouse) a power of appointment to change the distribution of assets.

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- B. What should you do if you or one of your clients is appointed as successor trustee or co-trustee?
  - 1. Accept?
  - 2. Run and hide?
- C. Conduct reconnaissance.
  - 1. Obtain a copy of the trust agreement.
    - a. Read it.
    - b. Read it again.
  - 2. Review Michigan law.
    - a. Michigan Trust Code – MCL 700.7101 et seq.
    - b. Michigan law generally provides “default” rules, meaning if there are trust provisions that are contrary to Michigan law, the terms of the trust will control (with certain exceptions).
  - 3. Who are beneficiaries of the trust?
    - a. Is there a surviving spouse? If so, was this a first or subsequent marriage?
    - b. Are there children? Are they adults? Are they going to be problematic?
    - c. Do any beneficiaries have special needs?
    - d. One or more charities?

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4. What are the assets of the trust?
  - a. Residence or other real property?
  - b. Cash and marketable securities?
  - c. Business interests?
  - d. Retirement assets?
5. What are the debts and expenses likely to be?
  - a. Are there final expenses for the decedent (e.g., medical)?
  - b. Is there a mortgage on a residence or other real property?
  - c. Is an estate tax return needed?
  - d. Is an estate tax return advisable (e.g., portability)?
- D. It is really important to know that although a trustee is entitled to receive “reasonable” compensation, serving as trustee is no day at the beach. There are a lot of responsibilities and potential pitfalls.
- E. Trust administration is generally unsupervised, although the trustee or a beneficiary can always petition the probate court to review or supervise matters.

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## II. PROVIDE NOTICES

- A. MCL 700.7814(1)(c) provides that within 63 days after the date the trustee acquires knowledge that a formerly revocable trust has become irrevocable, whether by the death of the grantor or otherwise, the trustee shall notify the qualified trust beneficiaries of the following:
  - 1. The trust's existence.
  - 2. The identity of the grantor or grantors.
  - 3. The court in which the trust is registered, if it is registered.
  - 4. The right of the beneficiary to request a copy of the terms of the trust that describe or affect the trust beneficiary's interests.
- B. MCL 700.7103(g) provides that a "qualified trust beneficiary" means a trust beneficiary to whom 1 or more of the following apply on the date the trust beneficiary's qualification is determined:
  - 1. The trust beneficiary is a distributee or permissible distributee of trust income or principal.
  - 2. The trust beneficiary would be a distributee or permissible distributee of trust income or principal if the interests of the distributees under the trust described above terminated on that date without causing the trust to terminate.
  - 3. The trust beneficiary would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.
- C. Review the trust agreement to see if any additional notices to the beneficiaries are required.

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- D. Consider providing notice under MCL 700.7604.
1. A person must commence a judicial proceeding to contest the validity of a trust within two years after the grantor's death.
  2. That period is shortened to six months if a beneficiary is provided a notice that contains the following:
    - a. The trust's existence.
    - b. The date of the trust instrument.
    - c. The date of any amendments known to the trustee.
    - d. A copy of relevant portions of the terms of the trust that describe or affect the person's interest in the trust, if any.
    - e. The grantor's name.
    - f. The trustee's name and address.
    - g. The time allowed for commencing a proceeding.
  3. Should the trustee provide this notice to a person who is not a trust beneficiary (e.g., a disinherited child or other family member) to get the clock started? Or could that notice trigger/encourage the person to bring a challenge?
- E. Should the trustee simply provide a copy of the trust agreement rather than excerpts?
1. Beneficiaries who are similarly situated but who are treated differently may be upset to learn about what others are receiving.
  2. The provisions for shares of other beneficiaries can be redacted.

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## F. Notify creditors.

1. If there is no probate estate, MCL 700.7608 requires the trustee to provide notice to creditors under rules similar to those applicable to the personal representative of a decedent's probate estate.
2. In general, creditors will have four months thereafter to present claims to the trustee or be barred.
3. Failure to comply with these statutory requirements extends the four-month period to three years.

## III. IDENTIFY AND PROTECT TRUST ASSETS

### A. The trustee must identify all assets that are subject to distribution under the trust.

1. Persons close to the grantor can be of vital assistance in identifying trust assets.
  - a. Family members.
  - b. CPA/Accountant.
  - c. Financial Advisor.
  - d. Attorney.
  - e. Insurance agent.
2. Review income tax returns.
3. Review the grantor's checkbook.
4. Go through the grantor's residence.
5. Determine if the grantor had a safe deposit box.

What happens if the trustee cannot access it?

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- B. The trustee must ensure that all trust assets are adequately protected against fire, theft, destruction, and other causes.
  - 1. Change the locks on residential real estate.
  - 2. Secure tangible personal property.
  - 3. Insure real estate.
  - 4. Insure valuable tangible personal property (e.g., jewelry and artwork).
- C. The trustee must invest the trust assets prudently.

## IV. OBTAIN FEDERAL TAXPAYER IDENTIFICATION NUMBER

- A. The trustee must obtain a federal taxpayer/employer identification number for the Trust.
  - 1. Form SS-4.
  - 2. Can be obtained online at [irs.gov](https://irs.gov).

## V. RETITLE TRUST ASSETS

- A. All trust assets should be retitled in the name of the trustee as trustee of the trust.
  - 1. E.g., Donald Duck, Trustee of the Mickey Mouse Trust dated November 18, 1928.
  - 2. Third parties often abbreviate and use different designations when titling trust accounts.
    - i. E.g., Donald Duck, Ttee of the Mickey Mouse Trust u/a/d 11/18/1928.

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## VI. INCOME TAX BASIS

- A. The trustee must determine the fair market value of the trust assets as of the grantor's date of death to properly report gain or loss on any disposition of trust assets.
- B. In general, the basis of the trust assets will be adjusted to fair market value as of the grantor's date of death (or as of the "alternate valuation date," if applicable) under Internal Revenue Code Section 1014.
  - 1. This adjustment does not apply to "income in respect of a decedent" (e.g., traditional IRA).
  - 2. Appraisals may be needed for assets that are difficult to value (real estate or a closely-held business interest).

## VII. OPEN AND MAINTAIN CHECKING ACCOUNT

- A. The trustee should open a checking account in the name of the trustee.
- B. All receipts/income for the trust should be deposited into this account and all disbursements should be paid out of this account.
- C. Use of trust assets to pay unrelated expenses is forbidden.
- D. However, if someone has paid trust expenses from personal funds (e.g., funeral expenses), the trustee can reimburse that person provided the payments are properly documented with receipts.



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## VIII. DIVIDE AND DISTRIBUTE TRUST ASSETS

### A. Tangible personal property.

1. Tangible personal property is often transferred into the name of the trust by a form of assignment.
2. This includes vehicles, furniture, furnishings, clothing, jewelry, artwork, and collectibles. This excludes real property, bank and brokerage accounts, and business interests.
3. Trust agreements frequently allow the grantor to dispose of specific items of tangible personal property via a separate statement or list with any remaining items to be distributed to family members or other beneficiaries.
  - a. What if the grantor gave the item away during lifetime?
  - b. What if the grantor sold the item during lifetime?
  - What if the grantor replaced any item with a similar item?
4. Trust agreements frequently provide for any remaining items to be distributed to a group of beneficiaries (e.g., children).
  - a. The trustee should seek consensus among the beneficiaries as to the timing and manner of selection and distribution.

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5. Disagreement, conflict, and in some cases, litigation, can easily arise.
  - a. “Dad told me I was getting his smoking jacket.” “Oh yeah, well mom gave me the knitted toaster cover last year; she was just using it until she passed.”
  - b. What happens if the beneficiaries cannot agree?
  - c. Are appraisals needed? Are appraisals advisable?
6. Be warned, tangible personal property can “disappear.”
7. What can the trustee do with tangible personal property that no one wants?
  - a. Sell?
  - b. Donate?
  - c. Throw away?
- B. Satisfy specific bequests, for example:
  1. “\$50,000 to each of my grandchildren.”  
“10% of the remaining trust assets to the Salvation Army.”
- C. Make division and distribution of the remaining trust assets as provided in the trust agreement, for example:
  1. Allocate assets between a marital and family trust pursuant to a funding formula.
  2. Distribute assets among children equally or pursuant to specified percentages.
  3. Hold a beneficiary’s share in continuing trust until the beneficiary reaches age 30 and prior to that time use assets of the beneficiary’s share for the beneficiary’s health, education, maintenance, and support.

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D. The trustee usually has the discretion to distribute assets in cash or “in kind” (i.e., in using noncash property).

1. However, the distribution of appreciated assets in satisfaction of a pecuniary (i.e., fixed dollar) bequest is a deemed sale by the trust.

If the trustee will make in kind distributions to multiple beneficiaries, the trustee should allocate the assets in a manner that is fairly representative of any built-in gain or loss.

## IX. ACCOUNT

A. A quintessential trustee duty is keeping beneficiaries informed about the assets and administration of a trust.

1. The trustee must maintain accurate books and records of the trust assets and its administration.
2. The trustee must provide the trust beneficiaries with periodic accountings (also referred to as “reports”).
3. Accountings allow trust beneficiaries to stay informed about the administration of the trust and to protect their beneficial interests in the trust.

B. MCL 700.7814.

1. MCL 700.7814(1) provides a trustee must keep the qualified trust beneficiaries reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests.

Unless unreasonable under the circumstances, a trustee must promptly respond to a trust beneficiary's request for information related to the administration of the trust.

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2. Absent a contrary provision of the trust agreement, MCL 700.7814(3) requires a trustee to send to the distributees or permissible distributees of trust income or principal, and to other qualified or nonqualified trust beneficiaries who request it, at least annually and at the termination of the trust, a report of the following:
    - a. Assets and their market values.
    - b. Liabilities.
    - c. Receipts.
    - d. Disbursements.
    - e. Source and amount of trustee's compensation.
  3. MCL 700.7814(4), which cannot be modified or overridden by the terms of the trust agreement, empowers the probate court to compel the trustee to account.
  4. Under MCL 700.7814(5), a trust beneficiary may waive the right to a trustee's report or other information otherwise required to be furnished.
    - a. The trustee should require any such waiver to be in a writing signed by the beneficiary.
    - b. A trust beneficiary, with respect to future reports and other information, may withdraw a waiver previously given.
- C. The trustee should review the trust agreement to determine whether it modifies (to the extent it can) or adds to the requirements under MCL 700.7814.

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- D. The trust agreement may provide the trustee is not required to account to some or all of the trust beneficiaries.
  - a. However, a beneficiary is always entitled to receive relevant information about the trust property and to petition the probate court to order the trustee to provide statements of account and other information. See MCL 700.7105(2).
  - b. Also, as noted above, a beneficiary can always petition the court to require preparation and provision of an accounting.
  - c. A trustee should expect that a judge will order an accounting.
  - d. Therefore, at a minimum, the trustee should maintain adequate records to be able to report if required to do so.
  - e. Trying to obtain and recreate records after years have passed can be an extremely time-consuming and expensive endeavor.
- E. The preparation and provision of an account can protect the trustee from breach of trust claims. See, e.g., MCL 700.7905(1)(a).
  - 1. Default statute of limitations.
    - a. A judicial proceeding by a trust beneficiary against a trustee for breach of trust must be commenced within five years after the first of the following to occur:
      - i. The removal, resignation, or death of the trustee.
      - ii. The termination of the trust beneficiary's interest in the trust.
      - iii. The termination of the trust.
    - b. This is a long period for the trustee to be concerned about potential claims of beneficiaries.

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2. Shortened statute of limitations if report is provided.
  - a. A trust beneficiary cannot commence a proceeding against a trustee for breach of trust more than one year after the date the trust beneficiary was sent a report if that report:
    - i. Adequately disclosed the existence of a potential claim for breach of trust.
    - ii. Informed the trust beneficiary of the time allowed for commencing a proceeding.
  - b. A trustee report adequately discloses the existence of a potential claim for breach of trust if the report provides sufficient information so that the trust beneficiary knows of the potential claim or should have inquired into its existence.
- F. Although similar concepts are involved, trust accounting is not the same as financial or tax accounting.

## X. TAX REPORTING

- A. A final income tax return may be required for the grantor for the year of death.
- B. A trust is a separate taxpayer and normally must file an income tax return on Form 1041. Trusts are also generally required to file a state income tax return.
- C. An income tax return is required if:
  1. The trust has taxable income;
  2. The trust has gross income of \$600 or more; or
  3. A trust beneficiary is a non-resident alien.

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- D. A trust generally must select a calendar tax year.
  - 1. However, if eligible, a trust may make an election under Internal Revenue Code Section 645 to be taxed as part of the estate.
  - 2. In this case, the trust may have a fiscal tax year.
  - 3. This treatment is permitted for a period of two years after the date of the decedent's death, or if a federal estate tax return is filed, the date that is six months after the final determination of the estate tax liability.
- E. In general, trusts are taxed like individuals.
- F. The party liable for taxes on trust income typically depends on the terms of the trust agreement and on who receives the income (i.e., the trust itself or a trust beneficiary).
  - 1. Trust income retained by the trust is taxed to the trust, while distributed income is taxed to the beneficiary who receives it.
  - 2. Thus, trust income is taxable to the trust or to the beneficiary, but not to both.
- G. Under Internal Revenue Code Section 663(b), a trust may elect to treat amounts properly distributed in the first 65 days of the next tax year as though they were made in the current year (the "65-day rule").
- H. The trustee or an authorized representative must sign Form 1041. If there are joint fiduciaries, only one is required to sign the return.

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- I. A federal estate tax return is required if the value of the grantor's estate exceeds the exemption from federal estate tax (currently \$12,060,000), taking into account any lifetime taxable gifts made by the grantor.
  1. For this purpose, all of the grantor's assets (and not just assets held in or payable to the trust) are included.
  2. Filing an estate tax return may also be advisable for "portability" purposes.

## XI. TRUST TERMINATION

- A. The trustee should make final distributions (or allocations to continuing trusts) only after the trustee is certain all taxes and other liabilities have been satisfied or provided for adequately.
  1. Failure to do so may subject the trustee to personal liability.
  2. If an estate tax return is filed, it is prudent to wait until tax clearances are obtained or, at a minimum, a closing letter is received.
- B. The trustee should prepare a proposed plan of distribution pursuant to MCL 700.7821 and provide it to the beneficiaries.
  1. The right of any trust beneficiary to object to the proposed distribution terminates if the trust beneficiary does not notify the trustee of an objection within 28 days after the proposal was sent, but only if the proposal informed the trust beneficiary of the right to object and of the time allowed for objection.
  2. The trustee should follow this procedure in connection with any partial termination of the trust, including with respect to the distribution of tangible personal property as noted above.
  3. The trustee has the right to retain a reasonable reserve for the payment of debts, taxes, and expenses, including attorney fees and other expenses incidental to the allowance of the trustee's accounts.



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- C. Can the trustee and the beneficiaries agree to alter the provisions of the trust?
  - 1. The parties can enter into a nonjudicial settlement agreement under MCL 700.7111. This avoids court involvement and can be used to (i) interpret the terms of the trust, (ii) approve a trustee's accounting, and (iii) fill a trustee vacancy. It cannot be used to (i) violate a material purpose of the trust, (ii) modify the trust, or (iii) terminate the trust. Its application is therefore fairly limited.
  - 2. The parties pursue a judicial modification under MCL 700.7411. This requires petitioning the probate court. Will the court “rubber stamp” a modification if the trustee and all trust beneficiaries agree? What if less than all beneficiaries agree? Note that the statute requires the court to conclude that the modification is consistent with the material purposes of the trust.
- D. Whenever possible, the trustee should obtain signed receipts from beneficiaries when distributions are made.
- E. Whenever possible, the trustee should ask for a release from beneficiaries. However, under MCL 700.7821(3), a release is invalid to the extent either of the following applies:
  - 1. The release was induced by improper conduct of the trustee.
  - 2. The trust beneficiary, at the time of the release, did not know of the material facts relating to the breach (this is where accounting to the beneficiaries can provide significant protection to the trustee).