

New Dimensions in Estate & Trust Planning

*An Article to Benefit Clients & Friends
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TRUST ADMINISTRATION At the Death of a Trustmaker

After-death Administration falls into two categories: Probate Administration and Trust Administration. Probate Administration is triggered where the decedent's assets are solely owned. Those assets pass to beneficiaries through a will, which must comply with Virginia law. Probate is also triggered where the decedent's assets are solely owned and there is no will or trust to provide direction as to who gets what. In this case the decedent is deemed "intestate", meaning he or she died without a will. Who will receive, and how much each will receive, is determined by Virginia State Law.

Trust Administration is triggered where the decedent's assets are owned by the trust and are governed by the instructions in the trust agreement, not the probate court. Trust Administration usually occurs at the death of a Trustmaker. The purpose of this article is to explain the necessary Trust Administration that must occur after the **FIRST** Trustmaker's death for a married couple. Sometimes, this is

referred to as the period for the surviving spouse.

For the surviving spouse, this, at best, is a very difficult time to move ahead with business matters. Of course, there are numerous legal, tax and investment issues to be evaluated and decisions to be made. These issues do not have to be addressed in the weeks immediately following the death. However, it is extremely important that the successor trustee (usually, spouse) NOT change names on any assets, file claim forms or exercise any rights to rollover IRAs, etc., until they meet with their estate administration attorney on the work that needs to be and the legal options available to them. Prior to such a meeting, any changes often destroy the legal options and flexibility afforded to a surviving spouse and children. In addition, any estate tax planning is often destroyed, or undermined, creating estate tax exposure at the second death. The surviving spouse should move ahead only after being well advised by counsel.

The administration process at death is a very methodical process. The very first step with any Administration (tax or non-tax) is to locate and itemize all of the assets of the deceased.

The second step is discovering how each asset is titled (who is the owner of each asset) and who has been designated as the beneficiary of the life insurance policy, the IRA, annuity or 401(k) plan. Owners may be the deceased spouse or the surviving spouse solely. Assets may also be held as Tenants by the Entirety or as Joint Tenants with Rights of Survivorship, or some other form of joint ownership.

The ease of Trust Administration is in direct relation to how well the assets were titled in the Revocable Living Trust prior to death. In general, the trust should be the titleholder of the real estate, bank and investment accounts, tangible personal property, and should be named as a primary or contingent beneficiary of the life insurance policies, the qualified plans and IRAs, depending on the specific facts of the individual's estate planning situation.

Once ownership of all the decedent's assets has been determined, the assets must be valued as of the decedent's date of death, (including accrued interest). These are the values that will be used to fund the tax or non-tax sub-trusts triggered at a death.

Non-Estate Tax Trusts

When the surviving spouse does not need the protection from Estate Taxes, the RLT basically continues as a marital sub trust. The surviving spouse may have complete control of and access to the assets, just as they did in the RLT prior to the death of the first Trustmaker. Or, there may be more limited control and access, as is often the case in a blended family, (in order to protect the interests of the surviving spouse as well as children of the deceased). The surviving spouse may serve as the sole Trustee or serve with a co-trustee as determined earlier at the planning stage. Usually, the main estate administration issues are to determine

ownership and valuation of all assets, move them into the Marital Trust and prepare a new Affidavit of Trust evidencing the new trustee. This is also a good opportunity to review the survivor's assets in an effort to avoid future probate or estate tax. The surviving spouse may also want to review their choice of backup trustees for disability and for death. Usually the taxpayer identification number will be the surviving spouse's Social Security number. The major advantages of the non-estate tax trust are personal issues such as: providing for the surviving spouse without court intervention (probate), protecting family privacy, protecting the Trustmaker against disability guardianship proceedings, and distributing assets to children at the second spouse's death (often protecting inheritances from divorcing spouses, predators and creditors).

Estate Tax Trusts

In Trust Administration cases with tax provisions, the Marital and Family Trust must be created and funded (assets moved) in order to provide the expected estate tax protection at the death of the first spouse. The ownership of the deceased's assets must be determined and valued as in the non-tax trusts but, in addition, now must be allocated between the Marital Trust and the Family Trust according to a numerical formula contained in the Trust. Those assets allocated to the Family Trust are the assets that will be protected from Federal Estate Tax using the decedent's Federal Estate Tax Exemption. These values will also establish the step up in cost basis received by the Family Trust for income tax purposes.

In the allocation process, the question arises as to which assets are the best assets to put in the Marital Trust and which are best to put in the Family Trust. To make this determination, there are estate tax considerations, income tax considerations, the character of the investment holdings, income needs of the surviving spouse, the likelihood of sale in the near future and a host of other issues to address. In a very real way, this allocation

process serves as a planning opportunity for the surviving spouse as assets are structured based on the survivor's goals and objectives.

A decedent's social security number cannot continue to be used to report income activity after death. Therefore, the Trustee will be applying for and obtaining the tax identification numbers for the Family Trust (and the estate of the decedent if probate is required.) Also, new Affidavits naming the Successor Trustee for the Marital Trust and the Family Trust will be prepared. These new Affidavits, similar to the Affidavits of Trust used to initially fund the RLT, will now be used to move (or fund) assets into the survivor's Marital Trust and to the decedent's Family Trust after the allocation of the assets has been determined and approved.

As with all tax planning, there are always IRS rules to be followed. The IRS requires that both the Marital Trust and the Family Trust fairly reflect the future anticipated appreciation and depreciation of the allocated assets in each of the trusts. In other words, there is a prohibition from placing all of the highly appreciated assets in the Family Trust to take advantage of the step up in cost basis and thereby reducing the potential capital gains to be paid if the Family Trust sells these assets.

The IRS also requires the filing of the Federal Estate Tax return on estates exceeding the Federal Estate Tax Exemption. This return is due within nine (9) months of the decedent's date of death. The Revocable Living Trust (RLT) is normally structured in such a way that there will be no estate tax payable at the death of the first Trustmaker. This means that Form 706 becomes an informational return, establishing the new step up in cost basis for assets, which by the filing date, have been allocated to the Family Trust.

During the allocation process, it is very helpful for us, as legal advisors, to work side by side with the Trustee's team of advisors, namely the investment advisor and CPA. By utilizing all of the members of the estate

planning team, we can be assured of an appropriate allocation of assets that will successfully meet the expectations of the surviving spouse.

After the allocation of assets has been approved by the surviving spouse and his or her team of advisors, the final step is to complete the funding of the Marital Trust and Family Trust. The appropriate Affidavits have already been prepared, and with the help of the Trustee and the other team members, the final transfer of assets into their respective trusts will be completed. The estate administration attorney will have discussed all legal options available to the surviving spouse as well as their fiduciary duties as Trustee. The investment advisor will manage the assets, consistent with the terms of the trust, to meet the income needs of the surviving spouse. The CPA will be responsible for all of the reporting requirements on the income generated by both sub-trusts under their respective taxpayer identification numbers.

IS LEGAL OR TAX COUNSEL NEEDED IN TRUST ADMINISTRATION?

In every instance, it is wise for the surviving spouse and children to meet with an experienced estate administration attorney who is knowledgeable in Trust Administration to review the status of the decedent's estate plan and assets and advise the survivor as to their options and the work to be done. Estate plans are based on the family, financial and tax situations envisioned at the time the trust was prepared. The plan now will need to be analyzed in light of current conditions, as there may be opportunities to reduce taxes or optimize other personal planning strategies on an after-death basis. Often there has been a change of Trustee, a change of taxpayer identification number, a change in the structure of investments as well as the tax reporting requirements. As a result, these situations should be carefully reviewed with legal counsel and family members who will be affected by the decisions.

SUMMARY

There are two major goals in Trust Administration at the first death. The first is ensuring the financial security of the surviving spouse. This is a paramount concern in both the tax and nontax trusts. The second is estate tax driven – ensuring the decedent's Federal Estate Tax Exemption has been preserved by the creation and funding of the Family Trust.

As an added benefit, it is important to note that the value of the assets placed in the decedent's Family Trust, plus all future appreciation on these assets, will always be ESTATE TAX FREE to the beneficiaries (usually, children) of the trust.

In closing, it is important to keep in mind that upon the death of a loved one, the most important thing to understand is that there are usually no emergencies. There will be plenty of time in the days ahead to handle the necessary business and tax matters. Initially, it is most important to take care of yourself and to satisfy the needs of the family as together you grieve your loss.

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