



# YOUR DUTIES AS TRUSTEE FOR A LIVING SETTLOR

*Guidelines for Trust Administration*

*by Layne T. Rushforth*

1. **INTRODUCTION:** This memo is for the trustee of a trust<sup>1</sup> whose settlor has resigned or has become incapacitated and who is the trust's primary (if not only) beneficiary. Perhaps some of these tasks have been done by a predecessor trustee, but we recommend that you review this entire memo. Your task is to administer and distribute the trust estate<sup>2</sup> as directed in the trust document. This memo outlines your duties as trustee, and gives a simplified overview of the trust administration process. "We" refers to THE RUSHFORTH FIRM, LTD., a professional law corporation<sup>3</sup>, and "you" refers to the trustee designated in the trust or appointed under its terms. If you ever have a question about this memo or about what you should and should not do, please call us.
  - 1.1 **Title:** An "trustee" is one who owns assets under a trust. Persons acting jointly as trustees are called co-trustees, and sometimes the duties of each co-trustee are different, depending on the trust document. For the purposes of this memo, we will assume that there is one trustee, and if there are co-trustees, you should confer with us regarding the division of duties and responsibilities among all of the trustees.
  - 1.2 **Trust Instrument:** Because a trustee is legally bound by the trust instrument, you must read the entire trust document carefully. Do not sign any document indicating that you are willing to abide by the trust document until you have read and understood all of its provisions.
  - 1.3 **Official Appointment:** You have authority to act as trustee as soon as you have complied with the terms of the documents regarding your appointment. Because different trusts have different requirements, it is impossible to outline all specific requirements in this memo.
    - (a) As a general rule however, to become trustee, you must:
      - (1) Sign a "certificate of incumbency"<sup>4</sup> indicating that you are the incumbent (i.e., acting) trustee and declaring that you are willing to follow the terms of the trust instrument.

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<sup>1</sup>A "trust" is the legally recognized arrangement under which a trustee owns and manages trust assets for designated beneficiaries. Sometimes, we also use the word "trust" to refer to the document that creates the trust arrangement, but usually we will refer to the document as the "trust instrument", "trust document", "trust agreement", or "declaration of trust". For the purpose of this memo, those terms include any pertinent trust amendments.

<sup>2</sup>The "trust estate" consists of all assets belonging to the trust, whether they were originally owned by the trustee, received under a contractual beneficiary designation (such as under a life insurance policy or other contract providing death benefits), or received as a distribution from the settlor's probate estate.

<sup>3</sup>The Rushforth Firm, Ltd. is a California professional corporation. In Nevada, legal work is done in association with The Rushforth Firm, a Nevada professional corporation.

<sup>4</sup>The "Certificate of Incumbency" may also be called by other names, such as an "Affidavit of Successor Trustee".



(2) Attach to the certificate of incumbency a copy of: (a) your predecessor's resignation or (b) declarations from one or more physicians (as required in the trust) stating that your predecessor is incapacitated to the point that he or she can no longer act as trustee.

(3) Have the certificate of incumbency recorded in the county in which the trust is considered located (often referred to in the documents as the "situs" of the trust) and in each county in which real property owned by the trust is located.

(b) You can choose, if you wish, to have your appointment confirmed by the court [NRS 164.010], but this is usually unnecessary. On the other hand, if there is a dispute as to your appointment or qualifications or if you anticipate that some of your decisions may be challenged by beneficiaries, court confirmation may be appropriate and even advisable.

## 2. TRUST ADMINISTRATION:

2.1 **General Duties:** Generally, your task, as trustee, is to:

- (a) Collect all assets<sup>5</sup> belonging to the trust;
- (b) Manage and invest trust assets;
- (c) Pay debts and taxes as required in the trust document; and
- (d) Distribute the remaining trust assets to the designated beneficiaries, as provided in the trust instrument.

2.2 **Powers:** Under Nevada law, a trustee can convey good title except as restricted by the document that transferred title to the trustee. [NRS 164.067] Of course, you are liable to the beneficiaries if you breach your duty as a trustee by failing to act prudently [NRS 164.050] or by failing to follow the trust instrument. Most trusts have specific and detailed provisions relating to the powers of the trustee, which you must read carefully.

## 3. PROHIBITED ACTS: You must NEVER:

- (a) Act without the consent of your co-trustee (or a majority of all co-trustees, if there are more than two) except as pre-arranged by the co-trustees or as provided in the trust instrument;
- (b) Deposit estate funds into a personal account;
- (c) Make loans without adequate documentation and proper security under the circumstances;

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<sup>5</sup>In legal terminology, the words "property" and "assets" are used interchangeably.



- (d) Invest in speculative investments or in any investment which is not adequately documented;
- (e) Place trust assets into an individual's personal safe deposit box;
- (f) Make cash disbursements to a beneficiary or any other person without getting a signed receipt;
- (g) Co-mingle the assets of the trust estate with those of any other entity or person;  
or
- (h) Take title to assets in your own name without reflecting your capacity as trustee.

4. **COLLECTION AND MANAGEMENT OF ASSETS:** Your primary duties are: to take possession of the trust's assets; to see that debts, claims, taxes, and other expenses are provided for; to see that assets are properly invested; and to see that distributions are made to beneficiaries as directed in the trust instrument.

4.1 **Inventory:** Your first responsibility as a trustee is to ascertain the trust's asset and make an inventory of them. The inventory must include a value for each item. Bank accounts, publicly-traded securities, and vehicles listed in the "blue book" can be listed without a formal appraisal. Real estate, valuable jewelry, and other special collections should be appraised by an independent appraiser, whom you may select. We can help you select appraisers if you do not know any who are qualified and whose fees are reasonable. The value shown on the inventory should reflect the net value of each asset.<sup>6</sup>

4.2 **Protecting Assets; Limiting Liability:** It is your duty to see that assets are preserved and protected.

- (a) Securities (especially bearer bonds), jewelry, and other items of substantial value should be kept in a safe deposit box. Please let us know if there are any items you think should remain, or be placed, in the possession of another person.
- (b) Accounts at financial institutions<sup>7</sup> belonging to the trust should be given early attention. The balance of each account should be transferred into a federally-insured trust account, registered something like this: "JAMES DOUGH, Trustee of the DOUGH 1990 TRUST dated 1-2-90". The trust should have its own tax identification number, which we can apply for at your request. Outstanding checks made by the deceased settlor should be itemized and, in most situations, honored. Accounts owned by the deceased settlor as a joint tenant with another named person do not necessarily belong to the trust; and the surviving joint tenant

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<sup>6</sup>The "net value" is the gross value of the asset less the value of any known liens or encumbrances, including mortgages and other liabilities. The inventory should reflect the net value and how it was calculated.

<sup>7</sup>Such as banks, savings and loan associations, credit unions, thrift companies, etc.



may have the legal right to collect the account. If there are joint accounts, call us so that we can discuss the details.

- (c) The proceeds from life insurance and other death benefits are payable to the designated beneficiary or beneficiaries. Unless the trust is the beneficiary, such benefits are not assets of the trust estate. If there are no surviving beneficiaries, the probate estate may be the beneficiary, and the trust will receive its entitlement, if any, through the probate proceeding. If the trust is the designated beneficiary, the appropriate benefit claim form should be obtained, completed, and submitted as soon as reasonably possible.
- (d) All credit cards issued solely in the deceased settlor's name should be cut, and the pieces should be returned to the issuer promptly with a request to cancel the account. If there is a joint account holder, advise each credit card company of the date of the deceased settlor's death and let it know that the surviving account holder will be solely responsible for any charges made thereafter. Please advise us of any action you take.
- (e) Trust assets should be adequately insured against damage, theft, loss, and personal injury claims. Make sure existing policies continue in force after the deceased settlor's death. You may need to replace existing policies, or the trustee — or you as trustee — may need to be added as an insured on a rider to existing policies.

- 4.3 **Disbursements:** Keep meticulous records of all disbursements from trust accounts and assets. We strongly recommend that money be disbursed in the form of a check so that there is a written audit trail for all transactions. Document any cash transactions with written receipts.
- 4.4 **Investments:** Unless restricted by the trust instrument, you can generally invest in any type of asset, but keep in mind that Nevada law does not permit "speculative" investments by trustees and "safety" must always be a key factor in your selection of investments. [NRS 164.050]
- 4.5 **Record Keeping:** You *must* keep an exact record of all receipts and disbursements. Your records should reflect the source of each receipt, and should indicate whether it represents principal or income<sup>8</sup>.
- 4.6 **Sale of Trust Assets:** It may be necessary to sell trust assets to avoid depreciation or other loss, to raise cash needed for expenses, or to comply with the terms of the trust document. Unless the trust document states otherwise, you can proceed with the sale of trust assets without prior notice to the trust's beneficiaries or to the public.

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<sup>8</sup>"Principal" refers to all assets, such as a bank account, stock, car, home, and the like. "Income" refers to revenues generated from the principal includes interest, dividends, rent, royalties, and the like. Income also includes compensation for the deceased settlor's personal services, such as salary and bonuses. Some payments may include income and principal, such as a mortgage payment.



4.7 **Advisors:** You may retain accountants and other advisors to help you make wise tax-planning and investment decisions. We are prepared to give you legal advice upon your request; however, if the trustee (you) or the trust becomes a party to a lawsuit, it may be necessary to retain another law firm to act in behalf of you and/or the trust.

5. **FEDERAL AND STATE TAXES:** You are responsible to see that all applicable tax laws are followed.

5.1 **Income Taxes:** The income tax returns that are required will depend on the various entities that exist and the amount of income each has. You should make arrangements with your accountant or other qualified return-preparer to have the necessary returns prepared. If there is a court-appointed guardian or conservator, you must coordinate the preparation of tax returns with him or her.

(a) *Trusts* — You need to file a fiduciary income tax return (IRS Form 1041) for each calendar year. It is your responsibility to see that this is done. There may be several irrevocable trusts created under one document that require separate tax returns.<sup>9</sup> As to each revocable trust, the income will be reported on the settlor's individual income tax return (IRS Form 1040), and the taxes will be paid at the settlor's own rates. As to any irrevocable trust, the income that is retained in the trust will be taxed to the trust, and the income that is distributed will be taxed to the beneficiary.

(b) *Individual* — If the settlor of the trust is legally competent, the settlor can sign his or her own individual income tax return (IRS Form 1040). If the settlor has been declared legally incompetent, this is normally done by the court-appointed guardian or conservator. Although the guardian or conservator may sign the form, it is likely that the trust may be the source of the funds to pay any tax due. This is just one of the reasons why you and any court-appointed guardian or conservator need to work together. If you are serving in both capacities, it is important to keep trust and guardianship/conservatorship matters separate, even if things are coordinated together.

5.2 **Gift and Generation-Skipping Taxes:** Each person who makes lifetime gifts having a cumulative value equal to or less than the "applicable exclusion"<sup>10</sup> does not incur a federal gift tax. Even though a tax is not due until cumulative lifetime gifts exceed the applicable exclusion, a federal gift tax return is due for all gifts made in a calendar year in excess of the annual gift-tax exclusion of \$13,000 per recipient. If gifts exceed the annual exclusion

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<sup>9</sup>If you have become a trustee of a two-settlor trust after one settlor has died, it is possible that you will be managing one or more irrevocable trusts (such as the Marital Trust and/or the Credit-Shelter Trust), as well as a revocable trust (the Survivor's Trust).

<sup>10</sup>The applicable exclusion for gift tax was \$625,000 in 1998; \$650,000 in 1999; \$675,000 in 2000; \$1 million in 2002 and 2003. In 2004 the applicable gift-tax exclusion for was frozen at \$1,000,000, which continued until 2011 when the gift tax exclusion and estate tax exclusion were re-unified at \$5 million (for at least 2011 and 2012).



and the applicable exclusion for lifetime gifts, a gift tax will be due that is 35% of the value of the gift.<sup>11</sup>

- (a) If gifts are made to a trust for grandchildren or lower generations (“skip persons”), a gift tax return may be required to properly allocate the exemption for the generation-skipping transfer tax (which exemption is referred to as the “GST exemption”. Because the generation-skipping transfer tax (“GST tax”)<sup>12</sup> applies in addition to any applicable gift tax, it is to be avoided. For this reason, it is unlikely that any gift-giving strategy would involve making gifts to skip persons in excess of the GST exemption.
- (b) Because one’s estate plan may include a gift-giving strategy, such as annual gifts to one or more irrevocable trusts, it is common for revocable trusts to contain a provision authorizing the trustee to continue making gifts in accordance with an established pattern. You need to become familiar with any established gift-giving plan and to coordinate with any gift-giving strategy that may also be approved for the guardian through the Family Court.

**5.3 State Taxes:** In Nevada, there is no income tax, but Nevada is entitled to a portion of the federal gift and generation-skipping tax. Other states may have additional taxes that apply, depending on where the trustee is domiciled, where beneficiaries reside, and where assets are located. The rules are complicated, so be sure to consult with your accountant to determine if other states’ taxes may be due.

**6. ACCOUNTINGS; DISTRIBUTION:** You should prepare an annual accounting for everything you receive and everything you disburse. If the settlor is competent, it should be given to the settlor. If the settlor would not understand the accounting it should be given to any court-appointed guardian of the estate or conservator, as well as anyone else that is designated in the trust to receive a copy.

**6.1 Accountings:** The annual accounting must distinguish between expenditures of income and principal, and must reflect all receipts and disbursements since the prior accounting (or since the original inventory in the case of the first accounting). If you pay yourself compensation (discussed in subsection 6.3, below), this should be clearly identified in the accounting.

**6.2 Distributions:** Most trusts give the trustee the authority and discretion to make

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<sup>11</sup>The maximum rate imposed for federal gift tax purposes was, is, and will be: 50% in 2002; 49% in 2003; 48% in 2004; 47% in 2005; 46% in 2006; 45% in 2007, 2008, and 2009; 35% in 2010, 2011, and 2012; and 55% in 2013 and beyond.

<sup>12</sup>The GST tax is imposed at the highest rate imposed for federal estate tax purposes, but the GST tax rate in 2010 is zero. The GST exemption was \$1,100,000 in 2002 and \$1,120,000 in 1993. Since 2004, the GST exemption has been the same as the applicable exclusion for the estate tax, which has been, is, and will be: \$625,000 in 1998; \$650,000 in 1999; \$675,000 in 2000; \$1 million in 2002 and 2003; \$1.5 million in 2004 and 2005; \$2 million in 2006, 2007, and 2008, \$3.5 million in 2009; \$5 million in 2010, 2011, and 2012, and \$1 million (plus inflation adjustments) in 2013 and beyond.



distributions “to or for the benefit of” the settlor. The trust may also provide for distributions to or for the settlor’s dependents, as well as for the payment of the settlor’s obligations. Following the terms of the trust is your highest priority.

- (a) Distributions may be either mandatory or discretionary.
  - (1) Mandatory distributions are those payments required in the document. They should be paid as directed in the trust instrument. If the trust requires payments to begin at a certain date, and such payments cannot be made on time for one reason or another, be sure to make up the payments as soon as possible.
  - (2) Discretionary distributions are those payments which the trust instrument permits but does not require. Discretionary distributions also include distributions that are mandated by the trust document where the time and/or the amount of the distribution is left to your discretion.
    - (A) We recommend that you consider all relevant factors in making distribution decisions and that you keep a written record of the factors you weigh. It would be almost impossible to properly make discretionary distributions without conferring with the settlor (if competent) and each other beneficiary.
    - (B) If the trust authorizes payments to a beneficiary for a specific purpose or need, it is appropriate to ask the beneficiary to provide documents and information relevant to his or her financial condition, such as copies of paycheck stubs, tax returns, and an explanation of what funds are needed.
    - (C) Some trust documents will allow payments "for" as well as "to" a beneficiary. This means that you can pay bills directly, buy assets for a beneficiary's use, and provide services to a beneficiary without having to make direct payments to the beneficiary.
- (b) Keep meticulous records, and obtain receipts or cancelled checks from each recipient.

**6.3 Compensation:** Unless the trust instrument provides otherwise, you are entitled to "reasonable compensation" for your services, which is taxable income to you.

- (a) “Reasonable compensation” can be based on an hourly fee or a percentage fee. Bank trust departments customarily charge an annual fee equal to approximately one percent (1%) of the current value of the trust's assets. Sometimes a lower fee is quoted, but transaction charges often make up for the difference. In addition to the regular management fee, there is frequently also a distribution fee when assets are distributed out of the trust to one or more beneficiaries.



- (b) If there are two or more trustees, the compensation should be allocated among the co-trustees according to their services, as they agree.
- (c) If the trust instrument provides for more specific compensation, you should follow the trust instrument. If you feel that the compensation provided for in the trust is unreasonable, you can either resign or petition the court for additional compensation.
- (d) A trustee's fee is usually paid quarterly, and is normally paid one half from trust income and one half from trust principal [NRS 164.330(1)(e) and 164.340(1)].
- (e) Compensation (but not expense reimbursements) is taxable to you, usually as self-employment income. If you intend to waive your compensation, consult us or your accountant about how to document this to avoid having taxable income imputed to you even though you do not receive it.

**6.4 Anticipating Disputes:** It may be wise to have your appointment as Trustee confirmed by the Court and to otherwise seek judicial guidance, especially if you are about to make a decisions that is controversial. This gives the beneficiaries an opportunity to express their concerns to the court, but once the court has made a decision, your compliance with the court order cannot be subsequently challenged. Seeking judicial guidance is particularly important:

- (a) If you anticipate that some of your decisions may be challenged by beneficiaries (including future beneficiaries who will receive distributions after the settlor's death);
- (b) If you know that there will be some decisions that will favor one beneficiary (or group of beneficiaries) over another; or
- (c) If some of the trust provisions are ambiguous requiring court interpretation.

**7. CONCLUSION:** The trust administration process will take your time and effort. We hope you will call upon us when legal questions are involved and whenever you feel we can help simplify the trust administration process.

**7.1 Beneficiaries:** Unless you are the only beneficiary, we recommend that you communicate frequently with all the trust's current beneficiaries (including any court-appointed guardian of the estate or conservator for the settlor and for each other beneficiary who is a minor or otherwise incompetent), keeping them apprised of your activities, particularly those that affect them. It may also be wise to confer with the beneficiaries who will receive distributions from the trust after the settlor's death. If you have concerns about trust investments or discretionary distributions, conferring with the trust's present and future beneficiaries may avert misunderstandings later. Timely written correspondence to interested persons regarding your actions and decisions is your best defense against potential litigation later.



- 7.2 **Effort:** From the day you assume the duties of a trustee until the beneficiaries have signed receipts indicating that they have received all they are entitled to, the primary responsibility for the trust rests on your shoulders. Our task is to help ease your burden in every way possible, so if you need help, please let us know

*NOTE: This memo provides general information only and does not contain legal, accounting, or tax advice. For brevity, this memo is oversimplified and should not be relied on for any particular situation. Although this memo may discuss tax issues, this is not a "covered opinion" as defined in Circular 230 issued by the U. S. Treasury Department, and nothing in this memo can be relied upon to avoid any tax penalties.*

[END: Version of January 27, 2011]

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