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NEWSLETTER

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June 2013

EVENTS:

Presentations and Continuing Education:

Oddities and Challenges in Probate Law: Handling Assets of the Estate and Filing Taxes. June 10, 2013 at 9:00 a.m. - 4:30 p.m., Doubletree Hotel, San Diego. Presented in part by DeEtte L. Loeffler through the *National Business Institute*. For more information call (800) 930-6182 or visit our website at www.mmpph.com.

Estate Planning Issues and the Role of Portability. June 13, 2103 at noon, Foothills Bar Association, Estate Planning Section, 8166 La Mesa, Blvd, La Mesa, CA 91942. Presented by Bradford N. Dewan.

In this Issue:

COMMON TRUSTEE MISTAKES: FAILURE TO PREPARE REGULAR TRUST ACCOUNTINGS

DeEtte L. Loeffler, JD, LL.M Taxation

Trust accountings are not like anything else a trustee is likely to do in life (unless the trustee is an accountant who handles trusts regularly). When trust accountings are required, to whom they are due, and how they differ from other financial reports, is important for the surviving spouse, and your successor trustees, to know.

What Is A Trust Accounting?

A trust accounting is a report that sets forth the assets, income and expenses, gains and losses, and distributions of a trust incurred during a set period of time. Accountings generally cover a 12 month period, from January 1 to December 31 of a given year, although a fiscal year may be used by the trust. For example, if the Trustor dies in May, the accounting may cover the period from June to June.

This report must be prepared by the Trustee (i.e., the person named to manage the trust assets) or by an accountant or other professional with the Trustee's oversight, and must be presented to the correct beneficiaries in a timely manner. Failure to do accountings may give rise to suspicion by the beneficiaries, and may even result in litigation against the Trustee personally.

When Are Trust Accountings Required?

Under California law, trusts are divided into two broad categories: revocable trusts and irrevocable trusts. Revocable trusts are ones that can be revoked (i.e., terminated), usually by the person who established the trust (the "Trustor").

Irrevocable trusts cannot be revoked by the Trustor, either because the Trustor intentionally released that right, or because the Trustor is deceased or no longer has the legal capacity to make changes.

Accountings are generally not required for revocable trusts. This is because the trust beneficiary (who is usually also the Trustor) can waive the trust accounting requirement in writing. (See Probate Code Section 16064). Most trusts have a provision stating under what circumstances an accounting will be due. Generally, the accounting is waived if one or both of the Trustors is also serving as a trustee. However, upon the resignation of the Trustors, even if they are not incapacitated, the trust will generally require the Trustee to provide an accounting unless the Trustors waive that requirement in writing.

In contrast, accountings are always required for irrevocable trusts created after July 1, 1987. (See Probate Code Section 16062). Any provision in the trust that purports to waive all accountings is not enforceable as against public policy. However, the beneficiaries can still agree, in writing, to waive the accounting. Gift trusts for adult beneficiaries should provide regular accountings to the beneficiaries at least annually. (Trusts for minors need not provide a written accounting to the beneficiaries if the trustee is also the guardian of the child.)

<u>Who Is Entitled To An Accounting?</u>

The Trustee should look in two places to determine who is entitled to an accounting. First, under California law, all beneficiaries who are "permissive" income or principal beneficiaries of the trust are entitled to receive an accounting. For example, if after the death of the husband the wife is the sole income beneficiary of a trust and upon her death the remainder is distributable to the children, only the wife is entitled to receive an accounting during her lifetime.

Second, the trust may require the accounting be given to more individuals than would otherwise be required. For example, the trustee may require the trustee to provide an accounting of the credit shelter trust (or "bypass trust") to the remainder beneficiaries to ensure that they are kept informed and can monitor the use of the assets in the trust. This is often included in trusts when each spouse has children from a prior marriage and the assets of each spouse are to pass to different beneficiaries after the death of both Trustors.

Finally, to the extent a beneficiary is not currently a permissive beneficiary and the trust does not require an accounting be made, the Trustee <u>cannot</u> provide an accounting unless the current beneficiaries allow the disclosure.

<u>What Should The Accounting Include</u>?

While a financial statement ("balance sheet") shows the assets and debts, a trust accounting does much more. In addition to a balance sheet (the "Summary") showing the total "charges," (assets, receipts and gains) and total "credits," (disbursements, distributions and losses), the accounting should consist of a series of "schedules", each addressing different aspects of the trust. Generally the accounting should include at least seven (7) schedules, as follows:

<u>Beginning Assets</u>: Schedule "A" should list all the assets existing at the beginning of the accounting period with their fair market value. A first accounting would begin on the date the trust was established (for a trust that is irrevocable from the start, such as a gift trust), or on the date the trust became irrevocable (i.e., the date of the Trustor's incapacity or death).

<u>Receipts</u>: Schedule "B" should list all of the receipts, including income and principal received by the Trust. Receipts must be kept track of chronologically and separately. For example, the accounting should list income from a rental property by date of receipt, and should not combine it with income received from a bond. In addition, the return of principal should be listed separately from income. For example, the trust may receive loan repayments from a promissory note, and should list the return of principal separately from the income (i.e., in different columns).

<u>Gains on Sale/Changes in Form of Assets</u>: Schedule "C" should list gains on sale of assets. For example, if the sale price of an trust asset was greater than the appraisal value ("carry value"), the difference or 'gain' would be recorded on this schedule. Changes in form of assets can also be listed here (such as when a bank account is closed and the funds are transferred to a new account).

<u>Disbursements</u>: Schedule "D" lists in detail all disbursements that were made from the Trust during the accounting period. It must include not only how much was disbursed, but also if the disbursement was of income or principal, the date of payment, the payee, the check number, and the purpose of the disbursement (i.e., "electric bill"). As with income, these entries must be accounted for chronologically and separately. Disbursements also include costs incurred upon on the sale of real or other property.

Some expenses must be paid one-half from principal and one-half from income (such as trustee, accounting, attorney and investment fees). One common mistake is to pay all of these fees from income alone, which improperly reduces the income distributable to the income beneficiary.

Distributions: Schedule "E" should list all distributions of trust assets made to the current permissible trust beneficiaries. Distributions are generally treated as income to the extent of the available income, and as principal thereafter. For example, if during January the trust received income of $1,000 but distributed $1,500 to the beneficiary, only $1,000 would be income taxable to the beneficiary and deductible by the trust, and the remaining $500 would be accounted for as distribution of principal.

Losses on Sale/Changes in Form of Assets: Schedule "F" should list any losses on the sale or disposition of assets. Like Schedule "C", it will also list changes in form.

Assets on Hand: Schedule "G" will list all the assets on hand at the end of the accounting period, and their carry values.

What To Do If Accountings Were Not Done Or Were Done Wrong.

If you are a Trustee, you should immediately seek the assistance of an attorney or accountant who has experience dealing with trusts to determine if an accounting is in fact required, or needs to be corrected. If required, you should gather the necessary information and, with assistance, prepare the accounting. In some cases, the beneficiaries may be willing to waive prior accountings so long as they have been kept generally informed about the trust.

If you have questions about your trust, the accounting format, or trust accountings in general, we would be happy to assist you.

ARE YOU FINANCIALLY PREPARED FOR FIRE SEASON?

DeEtte L. Loeffler, JD, LL.M Taxation

Fire season has started early this year. Chances are if you own a home in San Diego County, this is a concern for you. Since the wildfires in 2007, you may have taken steps to reduce the risk of loss, such as adding a fire retardant roof, and/or clearing back foliage from the house, but have you taken all the steps you should to protect yourself financially?

Update Your Homeowner or Renter's Insurance

If it has been a long time since you looked at your homeowner's (or renter's) insurance policy, now would be a good time to look. If you have added assets, or improved your home, you might not be carrying enough coverage to rebuild/refurnish in the event of a loss. In addition, you should consider whether some of your assets are worth insuring using a "rider". Riders, which provide additional insurance for high value items, can often be obtained for electronic equipment (computers, TV's, sound systems), jewelry, art, and silver. You may need to obtain an appraisal to support the addition of such riders to your policy.

Trustees should also review policies for any real properties held in trust. The trustee is responsible for safeguarding assets, which includes ensuring the assets are adequately insured against loss by fire.

Secure Important Papers and Information.

You should store your important documents in a place unlikely to burn. While a "fire proof" safe is good to have, safes will actually melt in a fire hot enough to destroy a house. It is better to store these documents in a bank safe deposit box, or in an office or other place which has a reduced chance burning.

You should also make copies of these important documents to be stored elsewhere, such as with a trusted friend or relative who lives in place less likely to burn. In the event of a fire, the copies may be accepted by a court in lieu of originals that can be shown to have been in the house when it burned.

It is also a very good idea to back up the information on your computer to a disk periodically, so that this information can be stored elsewhere, or taken with you in a hurry. Family photographs and other irreplaceable documents can also be scanned and stored, preventing their loss.

The internet may also provide a good place to store photographs, inventories and/or important documents. There are a number of "cloud based" storage companies now offering such services. It is important to research them thoroughly, however, before storing financially sensitive documents such as tax returns, password lists, financial data, and/or estate planning documents.

Inventory Your Assets.

Do you remember what you have in the third drawer down in the kitchen cabinet? You might have to list those assets on an insurance claim. One way to simplify this process is to prepare an inventory now to keep with your important papers. If you lack time to do a thorough inventory of your home, taking a video of your property, to include the contents of your closets, cupboards and drawers, could provide useful information if it is ever needed - helping to prepare a list of the assets lost and also to prove their existence and condition. Another option is to hire a company that is willing to do the inventory for you. Several such inventory companies came into existence after the 2007 fires, and still provide these services.

You may also want to consider having your home reappraised on a regular basis. With home values on the rise again, you may want to discuss the value with your insurance company now, rather than argue its proper replacement value after a loss.

Have An Exit Strategy.

In addition to the emergency survival kit you should keep by the door or in your car, you should keep a binder, or box, ready to go with your important assets and information. Be sure to include the disk of the data from your computer.

While we hope this year will not be a bad one for fires, it is better to be prepared. Taking these steps now can prevent heartache and extra work in the future.

STATE TAX NEWS: NEW TAXES OR FISCAL RESTRAINT?

With the passage of Proposition 30 in November of 2012, California voters imposed a tax hike on themselves. At the same time, Democrats obtained a supermajority in the state legislature, paving the way for them to pass future legislation without a single Republican vote. However, despite revenue in excess of the proposed budget, Governor Brown (Dem) is urging fiscal restraint and has argued imposing additional new taxes at this time would be unwise. He argues that increased revenues in 2013 were the result of taxpayers accelerating income in 2012 before new higher federal tax rates went into effect, not evidence that California's economy has fully recovered.

The governor's cautious tone has not discouraged state legislators from proposing several new taxes, from a 12 cent tax on sugary soft-drinks (to address obesity issues) to a 9.9% "oil severance" tax on oil and gas harvesting (to fund higher education). It has yet to be seen whether these bills will gain sufficient support to pass the legislature, and if so, whether Governor Brown will agree to sign them into law.

LEGISLATIVE UPDATE: A BUSY YEAR

There are a significant number of tax related bills in discussion in Congress this year, many of which, if adopted, will affect our clients.

In the income tax arena, one tax proposal would limit itemized deductions for taxpayers in the top three federal income tax brackets (33%, 35% and 39.6%). This proposal is significant because it would **tax state and local bond interest that is currently tax exempt,** as well as **taxing employer provided health insurance.** It would also deny deductions for health insurance premiums paid by the self-employed, **contributions to IRA and 401K plans**, health savings accounts, and Archer MSA, interest on education loans, and certain higher education expenses.

Another bill, the "Fair Share Tax", would impose a minimum tax rate of 30% on higher income taxpayers, phasing in at $1 million of AGI.

In the transfer tax arena, President Obama has proposed a return to the estate and gift tax rules of 2009, but this proposal would not go into effect until 2018. More important are proposals to restrict the terms of Grantor Retained Annuity Trusts and Generation Skipping Trusts.

We will continue to monitor these and other tax proposals as they make their way through the legislative process and will keep you informed of any significant developments.

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