The Duties of a Successor Trustee

As a trustee you have many responsibilities. If you have any questions about the nature of your responsibilities, please consult with The Karp Law Firm and we will advise you of the appropriate course of action.

**Show loyalty to all trust beneficiaries.** Even though you are a beneficiary, as trustee you owe the duty of loyalty to the other trust beneficiaries, including the remaindersmen.

**Deal impartiality with beneficiaries.** You cannot favor the income beneficiary (yourself) over the interests of the remainder beneficiaries. For example, you might be able to substantially increase your disposable income by investing trust assets solely in tax-free bonds or certificates of deposit. However, by their very nature these assets will not have any growth.

**Make the trust property productive of income.** You violate this duty if you keep large amounts in a checking account that does not pay interest (and does not grow in value like a stock would). There may be other trust assets which do not produce income, such as vacant land. If the trust has or acquires unproductive assets, consult with our firm as to your options.

**Invest only in prudent investments.** As the trustee, you have both the authority and the obligation to invest the assets of the trust. You can sell any stock, bond or property and you must reinvest the proceeds from that sale. When a bond is called or matures, you must reinvest the proceeds. Investment duties are a very important part of what a trustee must do. Florida has adopted the prudent investor rule. Florida Statute Sec. 518.11. This rule requires:

- Consideration by the trustee of the purposes, terms, and other circumstances of the trust;
- Exercise of reasonable care and caution as a part of an overall investment strategy which incorporates risk and return objectives reasonably suitable to the trust;
- Diversity of investments unless specific reasons are present not to diversify;
- Review at investment and implementation of a formal investment plan;
- An investment strategy that considers both the reasonable production of income and safety of principal, consistent with the fiduciary’s duty of impartiality and the purposes of the trust.

**Account to beneficiaries and keep beneficiaries informed.** Upon commencement of the trust administration you are required to inform all income and remainder beneficiaries of your acceptance of the trust. If a beneficiary requests it, you are required to provide that beneficiary with a complete copy of the trust document, including any amendments as well as relevant information about the assets of the trust and the particulars relating to administration. In addition, even without request, you must provide all beneficiaries with a statement of the accounts of the trust annually.

**Do not commingle assets.** You must keep the assets of each trust separate and you must keep your personal assets separate from the trust assets. This requires separate bank accounts, brokerage accounts, and safe deposit boxes for trust assets. It is particularly important that you keep the assets of the bypass trust (also known as the Credit Shelter Trust) separate from all other assets since these assets will pass tax free at the death of the income beneficiary. If you mix any other assets in with these assets (or simply take the assets out of the trust and mix them with your personal assets), in addition to breaching your fiduciary obligations, you will have subjected these assets to taxation when you die, where they would not have been subject to tax otherwise.
Avoid conflicts of interest and self dealing. You cannot buy assets from the trust or sell your personal assets to the trust. You cannot favor yourself as a beneficiary at the expense of any remainder or potential remainder beneficiary. You certainly cannot make any distribution to anyone or withdrawals from the trust unless specifically authorized in the trust. Conflicts of interest and self-dealing is a very broad and ill-defined area. If you have any concern as to any specific action or situation, you may consult with us.

Preserve the trust assets and uphold the trust. You will be liable if trust assets are lost, misplaced or destroyed because of your inattention or negligence. You should always be certain that all trusts assets are appropriately insured.

File tax returns and pay any tax due. Each trust has a tax year, which, like your personal tax year, ends annually on December 31st. Like you, the trust must have a taxpayer identification number and file a tax return no later than April 15th of the year following. The income tax return for the trust is a Form 1041 and is called a Fiduciary Income Tax Return. If this is not filed annually and timely, penalties and interest may be assessed. There may be other tax returns and taxes which the trust may be required to file, and you as trustee are therefore responsible. We recommend you consult a qualified and experienced CPA. You should not assume that your long-time CPA is either experienced or qualified, since fiduciary taxation differs significantly from taxation of individuals and corporations, which most CPA's are used to handling. Before deciding on a CPA for the trust, you should determine that CPA's specific experience and qualifications in this specialized area. Please remember we have a qualified and experienced CPA on staff.

Distribute income. The current income beneficiaries are entitled to all of the income annually. The beneficiaries cannot choose to take less than all of the income and the trustee is under an obligation to distribute it. This can be accomplished, for brokerage and mutual fund accounts, either by providing for automatic payment of dividends and interest (but not stock splits, sales or bond maturities or redemption) to be sent to you periodically by check, or alternatively, if you have a personal account with that broker or mutual fund, the income and interest can be swept automatically into your personal account.

What is income? Generally, income includes interest earned on bank accounts, CDs, bonds or mortgages, and dividends on stocks or mutual funds. Some stocks and mutual funds issue "stock dividends" or "dividend shares." These shares are not income, but are actually principal of the trust. Also, if there is an amortizing asset, such as a mortgage being paid off to the trust or a FNMA or similar amortizing bond investment, a part of the payment is principal and a part is income. You must distribute the part which is income and retain the part which is principal, even though the dollars appear to be of a single character. If you have specific questions whether a particular receipt is income or principal, we suggest you consult the trust's CPA since he or she will have to make that same determination for the annual accounting. If you don't get a satisfactory answer there, you should consult us on the question.

Expenses of the trust. The trust in its operation will necessarily have ongoing expenses. An example is the fee charged by the CPA for preparing the various tax returns each year. If you consult with us on a matter about the trust, our fee is an expense to be paid from the trust. Costs for insurance and real estate taxes (on real estate owned by the trust) are further examples. In fact, each check you write (except to pay yourself income) and each direct charge to the trust's bank or brokerage account is a trust expense. Like receipts, expenses must be also apportioned and charged between the income side and the principal side. For example, we told you previously that interest on a bond is totally income, which is fully payable to you. There are also expenses which are fully chargeable against income (against your interest in the trust). Examples are the intangible tax, real estate taxes and insurance expense. Certain expenses are fully chargeable against the principal (and not against your income account). Examples are income tax on capital gains, broker's commissions and improvements to trust real estate. Finally, there are some charges that are split between the income and the principal account. The most
common example of this are recurring trustees fees. In some unusual instances these allocations may be specified differently in the trust document.

Delegate investment functions if necessary. In many instances, individual trustees are not equipped to comply with their investment responsibilities as described above. Florida Statute Sec. 518.112 allows you to delegate investment functions to an investment agent. If you wish to do this, you must exercise reasonable care, judgment and caution in selecting the agent, in establishing the scope and specific terms of any delegation, and in reviewing periodically the agent’s actions in order to monitor overall performance and compliance with the scope and specific terms of the delegation. This “delegation” differs from merely obtaining investment advice. It contemplates turning over the investment functions to an investment advisor as opposed to simply seeking investment advice and then acting or not acting on that advice. However, you are still required to monitor the performance of the investment agent.

Investment agents are available. For example, most banks have what is called an “investment advisory account.” This is different from a custodial account. Fees for this service may run around one and one-half percent (1.5%), plus the cost of the brokers commissions incurred in securities transactions. Also, most of the major brokerage houses have a special investment management service. This is NOT just a regular brokerage account where a broker is assigned to your account and charges you fees when a trade is made. Also, you may not designate your account executive (broker) as an investment advisor, regardless of the confidence you have in him or her. Rather it is where you deposit funds or securities with the investment manager and for a fee of perhaps 2% (depending on the size of the trust) that manager buys and sells securities as he or she deems appropriate. The fee includes all commissions on transactions.

You may not assume you have satisfied your investment responsibilities just because you consult regularly or occasionally with your stock broker. Be forewarned that most stock brokers understand less about the prudent investor rule and fiduciary duties than you do.

Good record keeping. Keeping accurate records is one of the difficult jobs you will have to undertake as trustee. You may keep your own personal records as informally as you wish, but you may not do so with trust records. Upon your death or incapacity, another person will be stepping into your shoes as trustee in an ongoing operation, and must be able to understand immediately exactly what is happening and what the current status of various trust matters. Also, if you are ever called upon by the IRS or a remainder beneficiary to explain any portion of the trust business, assets or transactions, good records are an absolute requirement. In many aspects, operation of a trust is similar to operation of a business, and as you know, a business must have good records to be successful. The CPA you have selected to do the trust work should be very helpful in helping to set up the accounting and record keeping system for the trust.

For some trustees, setting up or later maintaining the trust records is just too great a burden and the person may retain a trust department of a bank on a fee basis to do much of this work. Also, see the references above concerning hiring an investment advisor. However you decide to manage this important duty, it must be efficiently managed. If you need further advice on this matter, we would be pleased to meet with you, with your CPA, and with your investment advisor, if you decide to retain one.