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IN THIS ISSUE

SERVING AS A TRUSTEE: PART V
By Mary J. Peshel, J.D.

This article has been published in five parts. Part I dealt with the initial duties of a Trustee and Part II discussed dealing with trust assets and expenses; these appeared in our December 2018 Newsletter. Part III dealt with filing and paying taxes as well as subtrust funding and Part IV addressed Trustee liability; these appeared in our January 2019 Newsletter. This issue, the final installment, Part V, addresses distributions to beneficiaries.

Complimentary copies of previous parts of this article, or the full article, can be obtained on our website at www.mmpph.com.

SERVING AS TRUSTEE: PART V DISTRIBUTIONS TO BENEFICIARIES

Making distributions to beneficiaries is a significant responsibility for a Trustee. Most beneficiaries will have little involvement with a Trustee other than when distributions are made. In most circumstances the Trustee will look only to the trust instrument, including all amendments, for guidance in making distributions. In some cases a Court Order or Distribution Agreement may be relevant and must be reviewed.

The Trustee has a duty to act impartially among the beneficiaries in all actions, including when making distributions. For example, the distribution of all stock to one beneficiary and all real property to another beneficiary may not be considered fair. The best approach is usually to distribute proportionate shares of each asset to each beneficiary, but distributing one asset to one beneficiary and a different asset to another beneficiary can be appropriate. If the distribution is other than proportionate shares, it is advisable to document this in a written Distribution Agreement executed by all parties.

MANDATORY VS. DISCRETIONARY DISTRIBUTIONS

When trusts continue over time, the instrument may provide for mandatory and discretionary distributions. The mandatory distributions are fairly easy to administer. For example, trusts often provide for all net income to be distributed to one or more beneficiaries.

Discretionary distributions are more complicated and often allow for distributions for "needs," typically defined as the "health, education, maintenance and support" of the beneficiary. In order to determine the beneficiary's needs, the Trustee should obtain financial information from the individual. Decisions about discretionary distributions can be difficult; this is an area where professional advice may be helpful.

Some trusts provide for withdrawal rights when the beneficiary reaches certain ages (i.e., 25 years, 30 years and 35 years). The Trustee should be aware of the ages of the various beneficiaries so these distributions can be made in a timely manner.

SUBTRUSTS

If the trust divides the assets into subtrusts (for example Trusts A, B and Q for the surviving spouse, or Trusts for children or grandchildren), each of these subtrusts will likely be a separate entity for income tax purposes. Typically, a taxpayer identification number is obtained for each irrevocable subtrust. This can be done using IRS Form SS-4, which is filed online.

Ownership records must be changed to show that the Trustee of the appropriate trust owns certain assets (i.e., real property, insurance policies, securities, etc.). The listed owner should read something like: “Bill Smith, as Trustee for the Jones Family Trust dated October 6, 1991, as amended, Trust ‘Q’.” Generally, bank accounts should be established in the name of each subtrust; this will help prevent the commingling of funds among the different trusts. Separate accounts will also be helpful in preparing accurate and complete accountings.

With respect to assets such as securities and insurance, a phone call or email to the company will usually reveal the proper method for changing title. Changing ownership of real property will require more inquiry and paper-work, including deeds and, in California, preliminary change of ownership reports.

In California, changing ownership of real prop-erty can trigger a reassessment of property taxes. Certain transfers, such as between spouses, and between parents and children, are exempt from property tax reassessment, though documents must be filed with the appropriate Assessor’s Office, in a timely manner, in order to obtain the parent-child exclusion. Also, there are special rules which must be complied with when a trust owns contaminated property, such as gas stations and mills.

INCOME vs. PRINCIPAL?

Items coming into and going out of the trust should be categorized either as “income” or “principal”. These distinctions are made in the trust accounting records and are important as the beneficiaries may be entitled to distributions of income only.

The trust instrument normally identifies what types of items are allocated to income and what are allocated to principal. To the extent the trust does not so provide, California has adopted the Uniform Principal and Income Act (“UPIA”), which also makes these distinctions. The following is a list of how certain items are generally characterized. However, you should still review the terms of each trust and the UPIA (Probate Code Sections 16320-16375) for rules applicable to your situation.

<u>Income:</u>

* Rent
* Interest
* Dividends

<u>Principal:</u>

* Capital gains, unless trust provides otherwise
* Portion of note payment towards principal repayment
* Assets set aside for remainder beneficiaries

NOTIFYING THE BENEFICIARIES

In some circumstances, the Trustee must notify beneficiaries when they have a right to withdraw assets from the trust. This usually arises when the trust is a “Crummey” trust, which grants the beneficiary a certain period of time in which to withdraw gifts made to the trust. The trust may also require the Trustee to notify beneficiaries when making adjustments between principal and income under the UPIA.

TAXATION OF DISTRIBUTIONS

Distributions of principal are generally not taxable when received by the beneficiary. Distributions of income are taxed as income to the recipient. In 2019, trusts are taxed at a 37% tax rate when the income reaches $12,751, while an individual is not taxed at that rate until his/her income reaches $510,301 (or $612,351 for married couples). As it is likely that the beneficiaries have lower tax rates than the trust, distributing income from the trust to the beneficiaries is usually desirable as it may produce greater overall tax savings.

KEEP GOOD RECORDS

One of the best ways to avoid pitfalls is to maintain current and accurate records of all trust business. You should keep these records in a safe place and keep them for at least four or five years after the trust has terminated (keep tax returns for seven years). Your attorney or accountant can provide you with a sample trust accounting format to help guide you as to what information is pertinent.

OPTION TO RESIGN

If you come to a point where you believe that you are unable to serve as Trustee, most trusts provide that a Trustee may resign for any reason. If the trust does not so provide, you may seek the Probate Court's approval to resign.

GETTING PAID

Many trusts provide for the Trustee to be paid for their services. However, the document may provide only a vague reference to "reasonable compensation." Trustees can be compensated based on an hourly rate, or as a percentage of trust assets, or on some combination of the two methods. When agents are hired to assist with matters such as property management, the Trustee's fees are typically reduced accordingly.

Some of the criteria used by courts to determine a reasonable fee are: value of trust assets; types of assets under management; gross income of the trust; success of administration; special skills or expertise; fidelity of the Trustee; risk or responsibility taken on; time involved; local custom; character of work performed; and the value of the Trustee's time. In some instances, extraordinary compensation is also warranted, such as for the sale of real property. A Trustee should also be reimbursed for reasonable expenses paid out-of-pocket with respect to administering the trust, such as recording fees and postage. Trustees can hire experts such as attorneys and accountants; their fees are paid directly from the trust.

TERMINATING THE TRUST

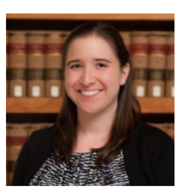
Eventually the Trustee will be required to terminate the trust. Some trusts terminate shortly after the death of the Trustor; in such event all assets can be distributed after the Trustee pays all debts, expenses, and taxes. Sometimes the trust is terminated upon a certain event, as provided for in the trust instrument itself, such as when the beneficiary reaches a certain age. In order to protect the Trustee, it is recommended distributions occur after the beneficiaries consent, in writing, to the accountings and to the Trustee's actions.

A FEW FINAL WORDS

The role of Trustee is a very important one, involving a wide range of skills and requiring difficult decisions that will affect the lives of the trust beneficiaries. The preceding guidelines should help you through most of your duties and obligations. The three most important things to remember are:

. Read the estate planning documents;
. Keep good records; and
. Seek help when you need it.

Remembering these three things will help make your role as Trustee a satisfying and rewarding experience. We hope this information has been helpful to you. If you have any questions regarding trust administration that have not been addressed, we would be happy to assist you.



FEDERAL TAX UPDATE

By Katie Lepore, CPA, J.D., LL.M., Taxation

Bill to Fix Technical Tax Issues. On January 2, 2019, Rep. Kevin Brady (R-TX), the outgoing Chairman of the House Ways and Means

Committee, released the "Tax Technical and Clerical Corrections Act," which discusses several changes for technical errors to the Tax Cuts and Jobs Act (TCJA). It is unlikely that legislation will follow.

Bill Funding IRS Passes House. On January 9, 2019, the House passed H.R. 264, the Financial Services and General Appropriations Act, which would fund the IRS through September 2019. It is unlikely that the Senate will pass the bill, especially since the White House has issued a Statement of Administration Policy of its opposition to H.R. 264.

Access to Tax Court Protected. On December 19, 2018, President Trump signed into law H.R. 3996, the Protecting Access to the Courts for Taxpayers Act. The law expands the authority for federal judges to transfer misfiled cases to the U.S. Tax Court so that taxpayers do not need to pay two filing fees or miss the opportunity for their tax case to be heard.

IRS Will Waive Penalties for Some Taxpayers. On January 16, 2019, the IRS announced in Notice 2019-11 that it will waive penalties for many taxpayers whose withholding or estimated payments in 2018 fell short of the tax due. The Tax Cuts and Jobs Act of 2017 lowered tax rates for many taxpayers, but also reduced or eliminated deductions which offset income. In early 2018, the IRS released new withholding tables for taxpayers, but these new tables did not take into consideration the effect of lost deductions. Updated tables were not released until November. As of August 2018, an estimated 30 million taxpayers were under-withholding. Normally, taxpayers can avoid penalties only if the amount due is less than $1,000, or by either (i) paying at least 90 percent of the tax liability due, or (ii) paying at least 100 percent of the tax due for the previous year (i.e., for 2017). Under the Notice, a payment of 85 percent of the tax due will be sufficient to avoid penalties.

House Can Help Defend ACA. A federal court in Texas recently ruled the Affordable Care Act (ACA) unconstitutional after the TCJA reduced the individual mandate penalty for shared responsibility under the ACA down to zero. Since the ACA was upheld by the U.S. Supreme Court under Congress's taxing authority, the constitutionality of the ACA is now in question. The House voted to adopt Title III of the Rules of the 116th Congress to authorize the House to intervene, appear, or take steps it deems necessary in the case to work toward upholding the ACA as constitutional.

Employer Provided Parking May Be Taxable. On December 10, 2018, the IRS issued Notice 2018-99 explaining in further detail to employers which expenses for parking are no longer deductible under TCJA. All employers who own or lease parking spaces, lots, or garages that employees use, or employers who reimburse employees for parking, are subject to the new rules. The rules are complex and may apply on a case by case basis. You should consult your CPA for proper deductions.

Partnership Audits Developments. In December 2018, there were several developments with regard to the new Centralized Partnership Audit Regime enacted under the Bipartisan Budget Act of 2015, which we previously detailed in our March 2018 newsletter. The IRS has announced its intention to issue proposed regulations: a) allowing the IRS to directly audit a partner without applying the Centralized Partnership Audit Regime, and b) disallowing a partnership with a qualified subchapter S subsidiary (QSub) from electing out of the new audit rules. In addition to these forthcoming proposed regulations, final regulations were issued on December 21, 2018 regarding partnership audits. Furthermore, the IRS has been releasing partnership-related forms and instructions to comply with the audit rules, including Form 8979, Partnership Representative Revocation, Designation, and Resignation, and Schedule B-2 to elect out of the audit rules.

STATE TAX NEWS

By Katie Lepore, CPA, J.D., LL.M., Taxation

California State Disability Insurance Increases. California State Disability Insurance (CASDI) benefits will increase in 2019. The withholding rate remains at 1.0%, but the taxable wage limit will increase from $114,967 to $118,371. For new CASDI claims, the maximum weekly benefit will increase from $1,216 to $1,252.

Tax Appeals Assistance Program. Starting January 1, 2019, the Taxpayers' Rights Advocate Office began administering the franchise and income tax portion of the Tax Appeals Assistance Program (TAAP). TAAP offers free legal assistance to eligible taxpayers with lower income who have filed an appeal to the Office of Tax Appeals, based on a decision made by the Franchise Tax Board. The amount in dispute must be under $30,000 before taxpayers may use the assistance of TAAP.

Trust Decanting. Beginning January 1, 2019, California has adopted a modified version of the Uniform Trust Decanting Act. Under the new law, the fiduciary (Trustee) of an irrevocable trust may distribute the assets from one trust to a second trust under certain circumstances without the consent of the beneficiaries or court. The Act is not identical to laws adopted in other states. The new Act is codified in California Probate Code Sections 19501-19530.

California Tax Filing Season Begins. The Franchise Tax Board has begun its tax filing season and is accepting 2019 state tax returns. Taxpayers are reminded that several new federal laws may not apply to their California state returns.

AREAS OF PRACTICE

ESTATE PLANNING
& ADMINISTRATION
WILLS & TRUSTS
ESTATE & GIFT TAX PLANNING
INSURANCE TRUSTS
FAMILY LIMITED PARTNERSHIPS
GENERATION SKIPPING/DYNASTY TRUSTS
ESTATE/GIFT TAX DISCOUNT PLANNING
CHARITABLE GIFT PLANNING
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ESTATE & GIFT TAX RETURNS
PRE-MARITAL AGREEMENTS

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BUSINESS APPRAISAL SERVICES/DISCOUNT OPINIONS
VALUATIONS FOR ESTATE AND GIFT TAX PURPOSES

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TAX REPRESENTATION

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REAL PROPERTY TRANSACTIONS &
REORGANIZATIONS
BUSINESS ACQUISITIONS/SALES
EMPLOYEE COMPENSATION

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LIMITED LIABILITY COMPANIES
BUY/SELL AGREEMENTS
EMPLOYMENT MATTERS
REORGANIZATIONS
ASSET PROTECTION

REAL ESTATE
SALES & LEASES
FINANCING
SHARED EQUITY AGREEMENTS
CO-OWNERSHIP ARRANGEMENTS

LITIGATION
ERISA LITIGATION
FIDUCIARY LITIGATION
PROBATE & TRUST LITIGATION
WILL CONTESTS
REAL PROPERTY MATTERS
BUSINESS & COMMERCIAL DISPUTES
LABOR LAW LITIGATION

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