

So Now You Are a Trustee

You have just agreed to be a trustee. You are now in charge of safeguarding the trust's valuable assets, administering the assets and investing them if appropriate, and distributing income and principal from the trust according to the trust instrument.

- What does this mean?
- What are your responsibilities?
- What are your potential liabilities?
- What do I do now?

"Living" (or inter vivos) trusts are contracts between the creator of the trust (often called the Trustmaker, the Grantor or the Settlor) and the trustee. A "testamentary trust" is a trust created in somebody's will. In either case, you must agree to be the trustee. If you do agree, you are bound by both the specific terms of the instrument and the general laws governing trusts and trustees.

Trusts have thousands of uses, ranging from preserving a child's inheritance until they're an adult, to managing the financial affairs of an elderly person, to running a large business. This memorandum is intended to give you a general idea of what is involved. When you have questions beyond the scope of this brief explanation, please feel free to call us.

Your Authority

Your authority to act as trustee comes first from the trust document. The duties and powers described in the trust are your basic instructions. Read the trust instrument with care and, from time to time, read it again. It may contain specific provisions which take precedence over the general rules discussed here.

Generally speaking you, as trustee, have three kinds of duties to the trust and its beneficiaries:

1. A duty of impartiality (You cannot favor the interest of one party over another)
2. A duty of undivided loyalty (You cannot put your own interest in conflict with those of the trust)
3. A duty to administer the trust with care and prudence.

First Steps

One of the first steps is to register the trust with the Probate Court in the county where the trust is being administered. Registration must occur within 30 days after the trust is created (or 30 days after a revocable trust becomes irrevocable, often when the Trustmaker dies). There are penalties for failing to register a trust. Also, the trust registration statement must be amended or updated whenever there is a change in trustee or in the place of administration of the trust. There are court-approved forms for trust registration and amendment.

You don't have to provide a copy of the trust or disclose the terms of the trust when you register it. Registering the trust just ensures that the beneficiaries are advised of their interests in the trust and provides the trustee and beneficiaries information regarding the particular court having jurisdiction in case questions arise about administering and distributing the trust.

The court generally does not have ongoing jurisdiction over the administration of the trust (unless provisions of the trust require it) and the trustee does not have to file copies of its accountings with the court.

Colorado law gives beneficiaries the right (under certain circumstances) to move the place of trust administration to a place more convenient for them. Should this occur and the place of administration is still in Colorado, a new trust registration will have to be filed in the new county of administration. Whether the new place of administration is in or out of Colorado, the trust registration in the foreign place of administration will have to be amended to show the change.

More on Your Duties

You must always act to further the interests of the trust and the beneficiaries. You should not enter into a transaction where you might personally benefit at the expense of the trust. If a situation arises where there is a conflict between your personal interests and the trust or between the trust and the interest of third parties, you should always put the interests of the trust first. For example, you should not sell trust property to yourself or sell your property to the trust because this might induce you to take advantage of the trust. You should not loan trust funds to yourself for personal or business purposes. The legal rules in this paragraph are strict and apply not only to transactions in which you would deal directly with yourself, but also prohibit transactions in which you as trustee would deal with organizations, such as partnerships or corporations in which you are personally interested. These rules apply even though the transaction may be scrupulously fair and even if the transaction benefits the trust.

You must keep trust assets separate and distinct from your own property. In other words, you should have a separate bank account or accounts for the trust and should not put either trust principal or income into your personal accounts. Trust assets must be readily identifiable as such and must be segregated from your other property.

Once you have accepted the duty to administer the trust, you should not turn over the complete administration of the trust to others. This doesn't mean you must actually perform all the administrative work yourself. You can delegate certain details to persons qualified to handle them. For example, you can employ an agent to collect rents. However, the ultimate responsibility for administration always remains with you as trustee.

If you are one of two or more trustees, you cannot rely on the others to administer the trust. You must participate in the administration. If another trustee is acting improperly with respect to trust matters, you have the obligation of acting to correct the situation.

If questions arise regarding the proper interpretation of the terms of the trust, you should not guess. Call us! If the trust wording is ambiguous, it will likely be necessary to petition the court to get a ruling on the matter.

Title to Trust Assets

We can help you decide how to hold title to trust assets. This includes questions regarding in whose name should real estate be held, and how should securities be registered and bank accounts maintained. There are many options, varying circumstances and different opinions on the right way to handle this.

Accounting

As trustee, you must set up and keep a set of books for the trust. You don't need to be a CPA, but your records must at least make a clear distinction between property you handle as trustee and your own property. Any mixing of the two is strictly prohibited.

One essential trustee's duty is to account to the beneficiaries of the trust. How often you must account may be in the trust instrument; if not, you must account periodically, but at least annually. At a minimum, your accounting should reflect in detail all items of cash receipts and disbursements, proceeds from the sale of assets and distributions to beneficiaries. It should show opening and closing cash balances and must contain a list of the trust assets at the close of the accounting period.

What Should The Records Include?

List all assets received, held and disposed of, and all receipts and disbursements, giving the date, amount and explanation of each.

If the persons who receive income under the trust instrument are different from those who will receive the principal when the trust terminates, your records should classify all receipts and disbursements as income or principal. In most cases, this will not be difficult – ordinary dividends and interest are clearly income, proceeds from a sale of stock are principal.

Many trust instruments contain instructions to guide the trustee in resolving these and other accounting problems, and you may find all the guidance you need from this source. If not, we can advise you by applying the Colorado law called the "Uniform Principal and Income Act."

From records kept in the above manner, you or your accountant can draw information necessary to prepare trust tax returns, reports to your beneficiaries and reports to the court if your trust is under court supervision.

As a trustee, you are entitled to reimbursement of your reasonable expenses in the administration of the trust. You are also entitled to a reasonable fee for services performed, but you're not required to take one. If you do, add this to your other income on your personal income tax return.

Investments

Perhaps your most important duty, besides keeping accurate and detailed books, is keeping trust assets invested. Remember that you will be held to a higher standard of care when investing as a trustee than you would be when investing your own funds.

The Colorado legislature has adopted a standard of trust investments called the "Prudent Investor Rule." Since this rule is the heart of all investment judgments, the statute is quoted here at length.

The Prudent Investor Rule

In acquiring, investing, reinvesting, exchanging, retaining, selling and managing property for the benefit of others, fiduciaries shall be required to have in mind the responsibilities which are attached to such offices and the size, nature and needs of the estates entrusted to their care, and shall exercise the judgment and care under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of the property of another not in regard to speculation but in regard to the permanent disposition of funds, considering the probable income as well as the probable safety of capital.

What Does This Mean To You?

Clearly this rule gives you the power to invest trust assets in ways a prudent, cautious person would invest money. It imposes on you the standard of investment which a prudent investor would follow considering all the circumstances involved.

As a general rule, you should give due consideration to the value of the trust assets and the purpose of the trust and to the extent practical:

- a. diversify the assets of the trust among many types of investments
- b. diversify among various industries with your stock holdings
- c. balance the need for current income versus long-term capital appreciation since the persons who take current income and those who eventually receive the capital have conflicting interests
- d. if you are at all in doubt, seek professional guidance both for initial investments and for continuing review of investments.

YOU SHOULD NOT:

- a. Speculate with trust assets in the hope of making big profits
- b. lend trust money to yourself, no matter how good your security, buy trust assets for your own account or engage in other forms of self-dealing
- c. continue to hold an investment which no longer meets the “prudent man” standards
- d. continue to hold assets transferred to you as trustee without an independent investigation of their quality as trust investments
- e. delegate investment decisions to others

Powers of Trustee

To find out exactly what powers you have to carry out your job as trustee, we can help you determine if the trust is governed by the Colorado Fiduciaries’ Powers Act, CR.S. 15-1-801.

If this act does not apply you are governed in your powers only by the terms of the trust. In addition to the terms enumerated in the trust, you also have all powers “necessary and appropriate” to carry out the terms of the trust.

If the Colorado Fiduciaries’ Powers Act is applicable, you have the powers under the Act to the extent reasonably necessary to administer the trust except as limited by the trust instrument. Should any conflict arise between the powers in the trust instrument and those under the Act, you should favor those in the trust instrument.

If you are acting as a co-trustee, keep in mind that all co-trustees must be in agreement in the exercising of trust powers unless the instrument itself directs otherwise. More importantly, remember that you can’t delegate those acts which you personally should perform as trustee.

Courts are very strict with trustees. Sometimes the trust instrument grants you broad powers or purports to relieve you of responsibilities which you would otherwise have, but you still have a duty to exercise the powers fairly and prudently.

Income Taxes

You may have an obligation to file fiduciary income tax returns with both the Internal Revenue Service (Form 1041) and the Colorado Department of Revenue (Form 104:1). The obligation arises if the trust is not a grantor trust and had “any taxable income” or “gross income” of \$600 or more, regardless of the amount of taxable income in any taxable year.

You may want to ask us or your accountant for help in determining the need for and in preparation of these returns as they do differ substantially from personal income tax returns. Quarterly tax deposits are often required of trusts.

As with an individual taxpayer, a trustee must file returns on a calendar year basis and the return must be filed, and all taxes paid, by April 15.

As an individual, you have your Social Security number which you use as an identification number on your personal tax returns. With a trust, it is necessary to get a “taxpayer identification number” from the Internal Revenue Service. This number is used on your fiduciary income tax returns, when reregistering securities in your name as trustee and when setting up bank accounts for the trust. We can help you obtain the TIN.

Distributions

When and how do the beneficiaries of the trust receive money?

Your trust instrument will tell you who is to receive benefits and when they are to be paid. It may also give you certain discretionary power over distribution.

Consider this example of discretionary distribution to see what problems can arise:

You, as trustee, have sole power to distribute income or principal or both among your sister’s three children to provide for their maintenance, support and education. Alice is doing well as a college sophomore. Bob is borderline vagrant, living in San Francisco. Charlie is doing average work in high school and loves sports cars. The children’s guardian asks for \$15,000 for Alice’s tuition for a junior year studying abroad, \$5,000 in medical expenses to check Bob into a drug clinic and \$10,000 for a new car for Charlie.

Which requests can you honor? Education is a proper purpose of the trust, but perhaps Alice could get as good an education here at half the cost. If you give her the \$15,000, can Bob or Charlie later claim you abused your discretion or even breached the trust?

Does support and maintenance include a new car? Medical expenses? You should attempt to carry out the intent of the person who created the trust if that can be determined from the trust instrument. You must also consider the assets of the trust, the amount of income, the needs of the beneficiaries and the various other demands the trust might be called upon to meet.

No booklet can outline all of the possibilities, but know that you should analyze every distribution for possible problems before making the distribution.

Your Liability

As trustee, you are personally liable to the beneficiaries for any loss to the trust estate and for any gain the trust estate should have realized but didn't, if:

- You failed, for any reason, to exercise the care and skill of a person of ordinary prudence in managing the property of another, or
- You negligently or intentionally did something you should not have done, or
- You negligently or intentionally failed to do something you should have done.

In certain matters, you may be liable even though your improper action was not intentional or negligent. Many trustees find errors and omissions insurance worthwhile.

Word of Caution

These guidelines cannot tell you everything you need to know about administering a trust. They are intended to alert you to your duties and to impress you with your responsibilities. When you're uncertain about something, calling us may avoid personal liability and the need for more costly legal services later.

