



SENIOR CONNECTION

October 2, 2018

TRUST ADMINISTRATION

APPOINTMENT OF SUCCESSOR TRUSTEE

1. Review the trust document to determine who is appointed as successor trustee(s) upon the death or incapacity of the settlor (i.e. the person who created the trust). If the settlor is alive, but incapacitated, review the trust terms to ensure you have acceptable evidence of incapacity.
2. The trustee's acceptance of the appointment does not have to be formal to be effective. If the trust document does not provide a method or the method provided in the terms is not expressly made exclusive, a trustee accepts the appointment by accepting delivery of the trust property, exercising powers or performing duties as trustee or otherwise indicating acceptance of the trusteeship. A.R.S. § 14-10701.
3. If the trust requires the successor trustee to obtain a fiduciary bond, make sure the successor trustee is bondable before proceeding.
4. Prepare affidavit of appointment of successor trustee(s). If there is real property titled to the trust, the affidavit will need to be recorded. Some attorneys record the certificate of trust existence instead of an affidavit, but the certificate does not show the events leading to the appointment of the successor as the affidavit does. The affidavit should also be provided to financial institutions when retitling assets to the new trustee's name.
5. If the trust became irrevocable upon the death or incapacity of the settlor, the successor trustee will need to obtain an employer identification number (EIN) for the trust using IRS Form SS-4. The successor trustee will also need to complete IRS Form 56 and Arizona Department of Revenue Form 210 to notify the taxing authorities of the appointment. The successor trustee will need to file annual tax returns for the trust as well.

NOTICE TO QUALIFIED BENEFICIARIES

1. Qualified beneficiary (A.R.S. § 14-10103(14)): a beneficiary who, on the date the beneficiary's qualification is determined:
 - (a) Is a distributee or permissible distributee of trust income or principal.

- (b) Would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subdivision (a) of this paragraph terminated on that date.
 - (c) Would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.
- 2. Within 60 days from the acceptance of the appointment by the successor trustee, the successor trustee must notify the qualified beneficiaries of the trust's existence, of the identity of the settlor or settlors, of the trustee's name, address and telephone number, of the right to request a copy of the relevant portions of the trust instrument and of the right to a trustee's report. A.R.S. § 14-10813.
- 3. Within 90 days from the date of the appointment, an inventory and appraisal of the trust assets showing the date of death values (or the values at the time of the successor trustee's appointment, if the successor was appointed due to the incapacity of the previous trustee) should be provided to the qualified beneficiaries. This is not required under the Arizona Trust Code, but is recommended.
- 4. If the trust document does not provide accounting requirements, the successor trustee must provide an accounting to the qualified beneficiaries at least annually and at the termination of the trust. A.R.S. § 14-10813. Because the timeframe for accounting under the Arizona Trust Code is ambiguous, this author follows Rule 30 of the Arizona Rules of Probate Procedure to determine the accounting period: first accounting period starts with the date of death or appointment and ends at the end of the ninth month following, with the accounting to be provided within 90 days after the end of the accounting period, and subsequent accountings beginning from the ending date of the previous accounting through the next year, with the accounting to be provided within 90 days after the end of the accounting period.

MARSHALLING TRUST ASSETS

- 1. Determine which assets are already titled in the name of the trust.
- 2. Determine which assets have beneficiary designations payable to the trust, such as pay on death or transfer on death or if the trust is named beneficiary on life insurance, annuities, or retirement plans.
- 3. Determine which of the deceased settlor's assets are titled in the decedent's name and don't have co-title owners with right of survivorship, beneficiary designations (other than a beneficiary that is the estate) and are not titled into the name of a trust. Divide those assets into two categories: real property and personal property. Everything except real property is considered personal property.
 - (a) Did the deceased settlor have a "pour over will"? The pour over will ensures that any assets that remain a part of the probate estate (i.e. assets not already titled to the trust and assets without designated beneficiaries) will be directed to the trust

upon the settlor's death. The pour over will, like a regular will, also designates who the decedent wants to handle their probate estate upon their death (i.e. the personal representative) The personal representative is responsible for gathering the probate assets and distributing them to the trustee. Depending on the value of these assets, the pour over will may need to be probated in court.

- (b) Did the decedent assign their tangible personal property to the trust? Did the decedent have a tangible personal property list with their last will and testament? The trust document may instruct the trustee to distribute the personal property pursuant to the tangible personal property list prior to distributions to trust beneficiaries. The trustee should secure the personal property owned by the trust in a safe or storage unit.

5. Retitle the assets: "Successor Trustee Name, as trustee of the Trust Name dated..."

A-B TRUSTS: TO SPLIT OR NOT TO SPLIT

1. A-B trust: A marital trust that splits into two trusts, a Decedent's Trust and a Survivor's Trust, upon the death of the first spouse to die. A-B trusts are generally used when one or both spouses has/have children from previous marriages, and/or to minimize estate taxes. The Decedent's Trust contains the separate property of the first spouse to die and the decedent's half of the community property or the amount of those assets in excess of the estate tax exclusion amount. The Survivor's Trust contains the separate property of the surviving spouse and the surviving spouse's half of the community property.
 - (a) Separate property: real and personal property that is owned by a spouse before marriage or is acquired by that spouse during the marriage by gift or inheritance, and any income or increase in value on such property.
 - (b) Community property: all property acquired by either spouse during the marriage, except property acquired by gift or inheritance.
2. Disclaimer Trust: The surviving spouse has the option after the first spouse's death of either having the trust split or just having it continue as a single trust. If the surviving spouse takes no action, then the trust continues for the benefit of the surviving spouse just as if the trust had been a single trust structure from the beginning. However, the trust has language which allows the surviving spouse to disclaim her inheritance from the decedent (decedent's half of the community property trust estate and his or her separate property), at which point the trust would split and the decedent's share would go to the decedent's bypass trust. Two problems: (1) the disclaimer has to be executed within nine months of the first spouse's death (many times the surviving spouse forgets that s/he needs to make this decision within nine months of the death of his or her spouse) and (2) the survivor needs to be careful not to exercise any dominion or control over the decedent's share until the disclaimer is exercised. Once IRS thinks there is evidence that the survivor has

taken ownership of the surviving spouse's assets, the surviving spouse cannot exercise the disclaimer.

3. Benefits of the split:
 - (a) Protects the testamentary intentions of the decedent;
 - (b) Provides some creditor protection to the surviving spouse;
 - (c) Growth on the Decedent's Trust is sheltered from estate tax;
 - (d) Decedent's generation skipping tax exemption can be applied to the Decedent's Trust assets.
6. Downside to the split:
 - (a) Split trust requires more administration. Community real property that is owned by the trust will need to be distributed to the Decedent's Trust and the Survivor's Trust in equal shares using a deed of distribution.
 - (b) Decedent's Trust assets do not get a step-up in tax basis at the surviving spouse's death;
 - (c) Undistributed income is taxed at the compressed trust tax rates.
7. The court can modify the trust to remove the split, if warranted by the circumstances.

NOTICE TO CREDITORS

1. Under A.R.S. § 14-6103, the trustee of a nontestamentary trust (i.e. a trust not created under the decedent's last will and testament) may notify known creditors upon the death of the settlor using the probate procedures for creditor notification under A.R.S. § 14-3801, but is not required to do so.
2. Publish notice to creditors once a week for three successive weeks in a newspaper of general circulation in the county that includes the address to mail claims and notifies creditors of the settlor to present their claims to the trustee within four months after the date of the first publication of the notice or be forever barred.
3. Mail notice to any known creditors informing them that they must present the creditor's claim within four months after the published notice, or within sixty days after the mailing or other delivery of the notice, whichever is later, or be forever barred.
4. Consider duty of care, which includes exercising reasonable care, skill and caution.
5. After expiration of the creditor's claim period, pay the valid debts and any taxes owed, and prepare a distribution plan and accounting.
6. Remember, if the probate estate is insufficient, trust assets may be subject to liability for the deficiency.

DISTRIBUTION STANDARDS

1. If the assets will remain in trust rather than being distributed outright to the beneficiaries, either upon the settlor's death, when the settlor is alive but incapacitated, or when there is surviving settlor entitled to distributions, the trustee must pay close attention to the distribution standards provided in the trust document.
2. The distribution standard may require the trustee to consider the other assets available to the beneficiary before making a distribution.
3. Health, education, maintenance, and support (HEMS) standard: the trustee cannot pay off the beneficiary's mortgage, but may pay the mortgage and other expenses on a regular basis or buy property in the name of the trust for the beneficiary to live in.
 - (a) Reasonable comfort
 - (b) Accustomed standard of living
4. Education and extraordinary health expenses.
5. Decedent's Trust may provide for mandatory income distributions to the surviving spouse and for invasion of principal with certain limitations.
6. Sub-trusts may provide different distribution standards and different trustees than the administrative trust:
 - (a) Minor's trust: A sub-trust for beneficiaries who are minor children at the time of the settlor's death.
 - (b) Special needs trust: A sub-trust for a beneficiary with disabilities who may need or be receiving needs-based public benefits.
 - (c) Trust for addicted beneficiary: A sub-trust for beneficiaries with substance abuse issues.
 - (d) Trust for spendthrift beneficiary: A sub-trust for someone who is not good at handling money and might spend all of their inheritance irresponsibly.
 - (e) Trust for creditor and divorce protection: A sub-trust will provide protection from the beneficiary's creditors even if the beneficiary is also the trustee of the sub-trust, clearly delineate the assets as separate property in the event the beneficiary gets a divorce, ensures that the spouse will not have control over the funds, and may have a positive psychological effect on the beneficiary in the sense that he or she might be more likely to view the funds in the sub-trust as their retirement or emergency funds or funds to use as a last resort.
 - (f) Special purpose sub-trust: For example, a sub-trust for a home owned by the trust that is to be maintained for use by a specified beneficiary. The trustee should pay careful attention to what expenses the trust is allowed to pay and what the beneficiary must pay.

ACCOUNTING

1. Prior to making final distributions, the trustee must prepare a final accounting, and should provide it to the beneficiaries with a request for them to sign a waiver of liability form for the trustee. If court approval of the accounting is sought, then a petition for approval of the accounting must be filed with the court.
2. Not required by statute but our firm recommends:
 - (a) That the accounting provided to the beneficiaries be accompanied by a proposal for distributions before final distributions are made.
 - (b) That the trustee hold back an amount to cover final fees and costs when making distributions, and that the proposal for distributions indicate the amount being held back. Our firm normally will hold the funds for distribution in our trust account and notify the beneficiaries that the distribution funds are being held there.
 - (c) That once signed waivers are received from all of the beneficiaries that distribution checks be sent out with receipt forms to be signed.
 - (d) That the trustee then prepare a “final final” informal accounting and provide it with distribution of any remaining funds from the hold-back to the beneficiaries.

FINAL DISTRIBUTIONS

1. Prior to making final distributions, all administrative expenses, taxes, and valid creditors' claims should be paid.
2. If a beneficiary dies after the decedent, but before distribution:
 - (a) The survival statute (A.R.S. § 14-2702) says that a beneficiary is treated as if they predeceased the decedent unless there is clear and convincing evidence that they survived for at least 120 hours (5 days) after the decedent's death, unless the trust provides for a longer survival time frame.
 - (b) If the beneficiary is deemed to have survived the decedent, the distribution would be made to the death beneficiaries named in the trust or if none, the personal representative of the beneficiary's estate or the affiant if the beneficiary's estate can be collected by small estate affidavit.
3. Note that the law favors distributions in kind so the trustee should always contact the beneficiaries regarding whether they want particular personal or real property before s/he disposes of it, unless the trust gives specific instructions to the trustee regarding the disposition of such property. This includes the family home. In cases where the beneficiaries don't agree with the trustee's decisions regarding sale of the home, a court order may be sought.

4. Specific bequests laid out in the trust are paid out of the trust before any other bequests can be made, so if there are no assets left after the specific bequests, the general bequests abate (i.e. become void). A.R.S. § 14-3902.

COMMON GROUNDS FOR REMOVAL OF TRUSTEE

1. Under A.R.S. § 14-10706, a trustee may be removed by the court if:
 - (a) The trustee has committed a material breach of trust.
 - (b) Lack of cooperation among co-trustees substantially impairs the administration of the trust.
 - (c) Because of unfitness, unwillingness or persistent failure of the trustee to administer the trust for the benefit of the beneficiaries, the court determines that removal of the trustee best serves the interests of the beneficiaries.
 - (d) There has been a substantial change of circumstances or removal is requested by all of the qualified beneficiaries, the court finds that removal of the trustee best serves the interests of all of the beneficiaries and is not inconsistent with a material purpose of the trust and a suitable co-trustee or successor trustee is available.
5. Material breach of trust: “A violation by a trustee of a duty the trustee owes to a beneficiary is a breach of trust.” § 14-11001(A). The statutes do not specifically delineate what breaches are considered “material,” but the trust may provide guidance and the court will likely look to the actual harm caused by the breach to determine materiality. In addition to removal, the court may reduce or deny compensation to the trustee as a remedy for breach of trust. § 14-11001(B)(8).
6. Trustee liability for breach of trust: A trustee who commits a breach of trust is liable to the beneficiaries affected for the greater of either: (1) the amount required to restore the value of the trust property and trust distributions to what they would have been had the breach not occurred, or (2) the profit the trustee made by reason of the breach. A.R.S. § 14-11002(A); Restatement (Second) of Trusts §§ 201, 205, 206.
7. Restatement (Third) of Trusts § 37, cmt. e. provides examples of grounds for the removal of the trustee, including:
 - (a) lack of capacity to administer the trust;
 - (b) unfitness, whether due to insolvency, diminution of physical vigor or mental acuity, substance abuse, want of skill, or the inability to understand fiduciary standards and duties;
 - (c) acquisition of a conflicting interest;

- (d) refusal or inability to give bond, if bond is required;
 - (e) repeated or flagrant failure or delay in providing proper information or accountings to beneficiaries;
 - (f) the commission of a crime, particularly one involving dishonesty;
 - (g) gross or continued inadequacies in matters of investment;
 - (h) changes in the place of trust administration, location of beneficiaries, or other developments causing serious geographic inconvenience to the beneficiaries or to the administration of the trust;
 - (i) unwarranted preference to the interests of one or more beneficiaries;
 - (j) a pattern of indifference toward some or all of the beneficiaries; or unreasonable or corrupt failure to cooperate with a co-trustee.
8. The trust document may state specific grounds for removal and instructions to disregard certain actions that may otherwise be grounds for removal.
9. Any objections regarding the accounting or breach of trust actions associated with the accounting must be presented within one year after the date the beneficiary or a representative of the beneficiary was sent a report that adequately disclosed the existence of a potential claim for breach of trust and informed the beneficiary of the time allowed for commencing a proceeding. A report adequately discloses the existence of a potential claim for breach of trust if it provides sufficient information so that the beneficiary or representative knows of the potential claim or should have inquired into its existence. A.R.S. § 14-11005(A) and (B).
10. For a breach of trust that arises from conduct unrelated to or not disclosed in the accounting, a judicial proceeding by a beneficiary against a trustee for breach of trust must be commenced within two years after the first to occur of: (1) the removal, resignation or death of the trustee, (2) the termination of the beneficiary's interest in the trust, or (3) the termination of the trust. A.R.S. § 14-11005.

CLOSING THE TRUST

1. Termination of uneconomic trusts, A.R.S. § 14-10414: After notice to the qualified beneficiaries, the trustee of a trust that consists of trust property having a total value of less than one hundred thousand dollars or that is uneconomic to administer may terminate the trust if the trustee concludes that the value of the trust property is insufficient to justify the cost of administration. This does not apply to an interested trustee under A.R.S. § 14-11014(N)(4). The court may also modify or terminate a trust or remove the trustee and appoint a different trustee if it determines that the value of the trust property is insufficient to justify the cost of administration.

2. Termination of noncharitable irrevocable trust by consent, A.R.S. § 14-10411: A noncharitable irrevocable trust may be terminated on consent of all of the beneficiaries if the court concludes that continuance of the trust is not necessary to achieve any material purpose of the trust. A noncharitable irrevocable trust may be modified on consent of all of the beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust.