Wealth Planning **Update**

Running an irrevocable trust like a business

Irrevocable trusts are helpful tools for individuals and families to meet their wealth planning objectives. If you've already made the decision to establish an irrevocable trust, you're quite aware of the benefits trusts can provide. Where many people get tripped up, though, is understanding the tasks that must be completed on an ongoing basis once the trust agreement is signed.

You might assume that the attorney who prepared the trust agreement will guide you through everything you need to do, but that may not be the case. If you tell your CPA you have established the trust, they can advise you on some, but not all, of the tasks required to run the trust.

However, pulling together a full team of professionals—including your attorney, CPA and private banker will increase the likelihood that your trust will be properly managed. In fact, approaching the trust as if you are running a small business with a team of advisors can be a helpful way to look at the process.

The importance of selecting the right trustee

Once you establish an irrevocable trust, it can be very difficult to change it without a court order or the consent of all of your beneficiaries. As a result, it's important to choose a trustee who can responsibly handle the role. The trustee will function very much like the CEO or owner of a small business.

If you name a family member or other individual as a trustee, they need to clearly understand their obligations and required tasks. An individual (as opposed to a professional corporate trustee) may have other jobs and responsibilities of their own. In addition, they probably haven't served as a trustee before. In that case, they might want to work with an attorney—most likely the one who drafted the trust—to make sure they fully comprehend their trustee duties and obligations.

Trustees should also know that taking on this role is a significant legal responsibility. Trustees are bound by a fiduciary duty to the trust and its beneficiaries. The fiduciary standard is a high legal standard of conduct which requires the trustee to act in the best interests of the trust and its beneficiaries. In fact, the trustee is potentially personally liable for breaches of that duty and can be sued for mistakes or deliberate misdoings related to the trust.

In addition, your trustee must both avoid conflicts of interest related to the trust and disclose any possible conflicts to the beneficiaries. The trustee must also keep trust assets separate from their personal or business assets. This requirement is the same financial advice that responsible business owners follow: never co-mingle assets.

Once you've chosen the trustee for your irrevocable trust, you and your trustee have a number of important tasks to complete.

Pulling together a full team of professionals—including your attorney, CPA and private banker will increase the likelihood that your trust will be properly managed.

Establishing the trust: Key tasks

When you initially set up the irrevocable trust, you or your trustee will need to:

- **Consult a CPA**

Just as a smart business owner surrounds himself with qualified professional advisors, your trustee should do the same. One of the first experts the trustee should hire is a CPA. It may make sense to use your CPA, if you already have one.

The CPA needs to know that you've set up an irrevocable trust and to identify its type. There are intentionally defective grantor trusts (IDGTs), grantor-retained annuity trusts (GRATs), spousal lifetime access trusts (SLATs), qualified personal residence trusts (QPRTs) and many more. The CPA will prepare to file federal and state income tax returns for the trust and determine who pays the income taxes on trust earnings. Depending on the type of trust, the CPA may arrange paperwork so you (the grantor), the trust or your beneficiaries can make estimated tax payments.

IDGT: intentionally defective grantor trust
GRAT: grantor-retained annuity trust
SLAT: spousal lifetime access trust
QPRT: qualified personal residence trust

- **Obtain a tax identification number**

Either your attorney or the CPA will file the necessary forms to establish federal and state tax IDs for the trust.

- **Open bank accounts**

At bare minimum, the trust needs its own checking account. If the trust will hold significant amounts of cash, the trustee will want to learn about FDIC insurance coverage. FDIC insurance can be complex for irrevocable trusts, so be sure your trustee understands the applicable guidelines.

The trustee may want to consider holding some cash and other assets in an investment account. The trustee should work with an investment advisor to develop an asset management strategy appropriate for the trust.

- **Notify the successor trustee**

Smart business owners create a succession plan so it's clear who will take over their business if anything happens to the owner or key officers. When you run your trust like a business, it's similarly important for you, the grantor, to name a successor trustee when you create the trust agreement. This is an individual or professional who will take over as trustee if the original trustee dies, becomes incapacitated or resigns. While doing so is not legally required, it is a smart idea to notify the successor trustee in advance of their potential role.

Ideally, the successor trustee will be able to review a copy of the trust agreement. They may also ask for the trust's income tax returns and accountings. You aren't required to give those to the successor until they officially take over as trustee, but doing so may help the successor prepare for their future role.

- **Notify trust beneficiaries**

The governing laws for your trust and the trust agreement may require that the trustee notify the trust beneficiaries that the trust has been established. Most states distinguish what information the trustee must give current beneficiaries versus remainder beneficiaries. Generally, the trustee will provide current beneficiaries with a copy of the trust plus ongoing accounting statements (see "handle trust accounting" below). The trustee should seek guidance from an attorney to confirm whether the trust agreement or state law requires additional information be provided to beneficiaries.

- **Obtain liability and other insurance**

If your trust includes property, such as houses, vehicles and antiques—anything other than investment accounts and cash—the trustee will need to obtain property and casualty insurance for these assets. The trust and trustee may need additional coverage for potential liability issues.

- **Write a letter of intent (optional)**

Your trust agreement creates the trust, but it often doesn't explain why you set up the trust the way you did, and what your intentions are regarding distributions to beneficiaries. Consider writing a letter, which you can leave alongside the agreement, to outline your goals and wishes. This letter won't include legally binding information, but it can help your trustee make better decisions. This letter is similar to a small company's mission statement.

Running the trust: Ongoing tasks

Once the irrevocable trust is established, the trustee and their selected team of professionals will need to regularly monitor it. This task is similar to a business reviewing its monthly or quarterly profit and loss statements, as well as providing ongoing updates to investors and employees. The trustee's primary ongoing responsibilities are to:

• Manage trust assets

This is probably the most time-intensive task related to running a trust. If trust assets are primarily cash and investment accounts, the trustee may need to first set up those investment accounts. The trustee should also perform due diligence on the advisor or company they work with to purchase and manage investments. Other types of assets may require significantly more hands-on management. Examples include investment real estate, businesses, ranches and farms.

• Handle trust accounting

The trustee needs to keep track on a regular basis of all money coming in and out of the trust, plus keep an inventory of trust assets. Accounting reports are usually shared with beneficiaries on a monthly or quarterly basis. An annual accounting report may be required by state law or by the trust agreement. Accounting responsibilities can be extremely complex. It's again important that you choose a trustee who is trustworthy and understands trust accounting. Professional corporate trustees are well versed in trust accounting. Similarly, corporate CEOs don't do all of their company's accounting work. They delegate these tasks to experts.

• Make distributions to beneficiaries

The trustee will make decisions about how and when to make distributions (give money) to the beneficiaries, as governed by the trust agreement. In addition, the trustee may wish to set up some practical rules for when a beneficiary can make a distribution request and what process the trustee will use to respond to requests.

If the trust requires the trustee to consider a beneficiary's financial situation when making distributions, the beneficiary should know in advance that the trustee may ask for annual personal financial statements and income tax returns. In addition, the trustee should check to see whether they need to make distributions to pay taxes or repay beneficiaries for taxes on their trust income.

Finally, the trustee should plan how they will handle turning down potential distribution requests, and how they'll deal with potential conflicts from disgruntled beneficiaries.

• Regularly monitor the trust

The trustee of an irrevocable trust needs to keep a close eye on many details. For instance, they should:

- Determine annually whether the trust is in the best jurisdiction (state) for income tax purposes
- Check that the trust has enough cash to make anticipated distributions
- Monitor trust investments for their performance and safety
- Review trust-related insurance policies at least once a year to be sure that they provide adequate coverage

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A successful trust meets all of its goals

As you can see, managing an irrevocable trust well is very similar to running a successful small business. Creating the trust agreement is only the first step. An effective trust also requires naming a trustworthy, competent trustee as your trust's "CEO." The trust's continued effectiveness requires bringing in specialists like an attorney, CPA and other advisors.

Finally, ongoing monitoring and reporting will help ensure that the trust meets its financial and other goals. The ultimate payoff: A well-run trust that helps you share your wealth with the people and organizations that are most important to you.

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