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Trust UPDATE

Stillman BANK

Perils of the amateur executor or trustee

Should there really be a first time for everything?

Trust-based wealth management programs continue to grow in popularity among affluent families. One key consideration for any trust plan will be the choice of trustee. In some cases, a family member may be selected for the job. That person may be presumed to be familiar with the family dynamics, and there could be a desire to keep the fees for trusteeship "within the family."

Deborah Jacobs, a lawyer and financial journalist, poured some lukewarm water on that choice in "6 Tips for Family Trustees," published online in July by Morningstar. She raised the concern that the family member may not be fully prepared for what the job of trusteeship entails—it is not a purely honorary position. Here are her six tips, together with our observations. Most of these observations also apply to the job of an executor in settling an estate.

"1. You may need professional help in managing the trust."

A trustee must safeguard and invest trust assets, prepare tax returns, and keep meticulous records of distributions of trust income and principal. Jacobs warns that the amateur trustee can hire experts for assistance, and notes that the fees for the experts generally can be charged to the trust.

A corporate fiduciary, such as us, has substantial expertise in-house, which may reduce the costs for outside experts. More importantly, we already have trust accounting systems in place. We keep meticulous records as a matter of routine. We are also supervised by banking regulators in the discharge of our duties.

"2. You must be impartial."

The duty of impartiality is the essence of "fiduciary duty," a legal standard of performance that all trustees must meet. That may not sound difficult, but it can be a source of conflict, Jacobs notes. Some trusts have very general guidelines for distributions, such as to "maintain reasonable comfort" or provide for an "accustomed manner of living." That standard can be tricky to interpret, and beneficiaries may not always see eye-to-eye with the trustee. More specificity isn't always helpful. If a trust is to provide for education expenses of a beneficiary, what should be done about a perpetual student who seems to have no plans for ever completing studies and getting a job? What was

the trust creator's intent in that situation?

Sometimes the best way to avoid family disputes is to vest a neutral third party, such as us, with the decision-making authority. When a young adult beneficiary tells us that "Grandpa would have wanted me to have a Mercedes," we have the ability to discern the truth of the assertion. We have the ability to say, "No."

"3. Choosing investments can be tricky."

Trusts normally are invested in a diversified portfolio of securities. However, that doesn't tell us much. What will be more important, current income for current beneficiaries, or asset growth for future beneficiaries? Should value stocks be preferred to growth stocks? How important is preservation of trust principal and risk minimization?

Jacobs focuses on the issues associated with concentrated assets; for example, when a trust holds shares of a family business. The trust needs to be clear on whether diversification is required, or certain large holdings will be acceptable. As important as this issue is, managing an ordinary securities portfolio can be very challenging in today's financial markets. We are prepared for that challenge, as we meet it every day. A family member trustee may need to turn to outside experts for this task as well.

"4. You could get sued."

Jacobs recommends that every potential trustee first read the trust instrument carefully, then hire a lawyer to explain anything that is unclear. The risk of a lawsuit from a disgruntled beneficiary is very real. To minimize conflicts, all decisions need to be thoroughly documented, with the explanation and reasoning provided.

One of the little-known benefits of using a corporate fiduciary is that if a mistake should be made in trust administration, the fiduciary has the resources to make good. Although trust departments do not care to advertise this fact, it is often mentioned by estate planning attorneys when they consult on the question of choosing a trustee.

"5. Don't expect to enjoy it."

The family trustee is entitled to compensation, just as we are. Jacobs notes that some family members do not ask for pay, even though the work may go on for years. As a result, it may seem like a thankless job.

"6. Make sure there's an escape hatch."

You may decline an appointment as trustee, but once you have accepted the responsibility, it may not be so easy to surrender. Again, the terms of the trust document will be key. In many cases your fiduciary obligations will continue until your successor has agreed to take over.

Whom will *you* choose?

Have you nominated a family member to serve as executor of your estate, or as your trustee? Are you confident that he or she has the ability to handle the job?

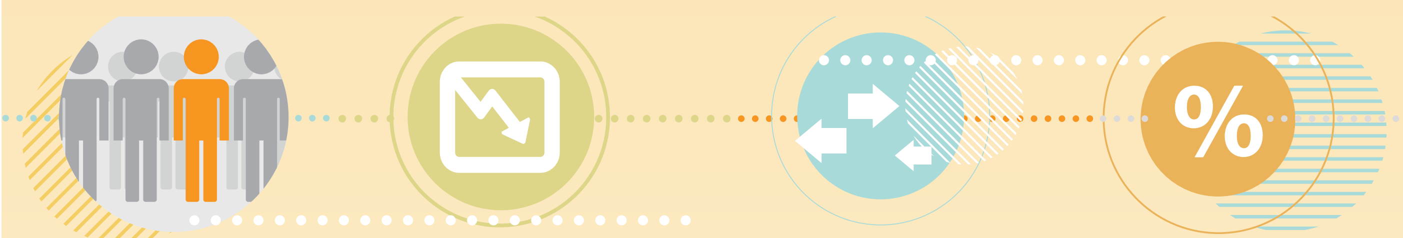
We have the skills, the experience and the knowledge to handle properly the job of estate settlement. Trusteeship is our everyday business. We are available, and we are impartial. We understand the nature of fiduciary responsibilities, and we know how to discharge them.

And for all this, our fees are generally comparable to what an inexperienced individual would receive. In some cases our experience will help to reduce estate shrinkage, increasing the amount available for beneficiaries.

Would you like to learn more? Please call on us for more details about our estate settlement service. ☐

Where executors can go wrong

According to the website http://erassure.com/i-am-an-executor/the-risks-associated-with-being-an-executor, the most common reasons for a lawsuit against an executor are:



Favoritism: Preferential or prejudicial treatment of certain beneficiaries resulting in a loss of entitlement by another beneficiary.

Loss of money or value: Timing issues related to the sale of real property or various types of financial instruments that result in diminished value of the asset.

Conflict of interest: Allegation of conflict of interest on the part of the executor whether the executor is also a beneficiary or not.

Error in value: Failure to valuate or improper valuation of assets.

The website includes several examples taken from actual cases. Even when a lawsuit is unsuccessful, the costs to the estate and its beneficiaries may be considerable.

We all age differently

A recent study by researchers in New Zealand attempted to quantify something that we all know intuitively: People age at different rates. They were able to explore data from a longitudinal study of 1,000 individuals in the South Island city of Dunedin, who have been studied since their births in 1972-73. At age 26, eighteen different biomarkers were measured for these individuals, including blood pressure, white blood cell count, blood vessel integrity, cholesterol, dental health, kidney and liver functions, and measurements of metabolism and immunity.

Next, the individuals were tested on their balance, strength and motor coordination, tests that are usually reserved for older adults. Finally, researchers asked a group of college students to review photographs of the study participants and to guess their ages.

All three tests were consistent. Among the findings:

- Although most individuals were aging normally, some were aging less than one year per calendar year, and appeared to still be in their 20s.
- A few individuals were aging as much as three years per year, and had biological indicators consistent with being in their 60s.
- Closer examination of the data revealed that indications of accelerated aging were evident as early as age 26.

The goal of the research is to find ways to slow the aging process. To some extent, the pace of aging is genetic. To the extent aging is influenced by environment, such as living with high levels of stress, a lifestyle change could be warranted. For diseases that are age related, earlier intervention may be appropriate for those who are aging rapidly. ☐

Doctors die differently

A recent item on CNN followed up on a 2011 essay by Dr. Ken Murray, "How Doctors Die" [http://www.zocalopublicsquare.org/2011/11/30/how-doctors-die/ideas/nexus/]. Given their medical knowledge, doctors have greater familiarity with the inevitability of death and the potential for "futile care" at the end of life. They generally avoid for themselves treatments that they would recommend for their patients. A 2013 survey at Stanford revealed that 88.3% of doctors said they would choose "no-code" or do-not-resuscitate orders for themselves.

Dr. Murray identified several forces that seem to conspire to maximize medical treatment at the end of life. These include the failure of the patient to clearly communicate his or her wishes, a reluctance of family members to "let go," the bias of physicians toward extending life whenever possible, and the institutional and economic forces that reward medical services. Given their unique position, doctors can resist these forces should they choose to do so.

Dr. Murray's essay caused a sensation in 2011, and CNN's revisiting of the topic of how doctors die differently may revive interest in the benefits of avoiding heroic measures at the end of life. ☐

How to convert an inheritance to a debt for tax purposes?

The terms of Warren Billhartz' 1978 divorce decree required him to leave half of his estate to the four children from his first marriage (one son, three daughters), divided equally. He remarried a year later. Most of Billhartz' assets were owned jointly with Marcia, his second wife, or were held in a living trust. Marcia and Ward, the son from the first marriage, were co-trustees of the trust.

Warren died in 2006, leaving a substantial estate. In accordance with the divorce decree, the trust obtained a lifetime annuity for the first wife. Ward received 16% of the balance of the trust, and each of the daughters 6%—in other words, the divorce decree requirement that the children be treated equally was ignored, and they received only 34% of the net trust assets instead of 50% of the estate.

The distribution to the children totaled $14 million. The executor characterized that payment as a claim against the estate and took a deduction for the full amount. The IRS disallowed the entire deduction, creating a tax deficiency of $6.6 million. The estate took the case to the Tax Court. However, after a series of negotiations, the estate and the IRS reached a settlement in which the Service agreed to allow 52.5% of the deduction. No rationale for that partial deduction is provided in the court opinion, but evidently each side was concerned about losing.

Next, it appears that the daughters were not aware that, under the terms of the divorce decree, they were entitled to the same share of their father's estate as their brother, and that the siblings should have had 50% of the estate. They first learned of the terms of the decree when the Tax Court litigation was filed. The sisters filed a state lawsuit alleging fraud. Curiously, the brother resigned his trusteeship and joined their lawsuit, alleging Marcia had concealed key documents from them.

With the possibility that additional payouts would be due to the children, the estate moved to void its settlement agreement with the IRS. Litigation with the children was settled with an additional distribution to each of the girls of $1.45 million. Perhaps the estate hoped to apply the 52.5% deduction to the additional payouts.

The Tax Court refused to set aside the settlement, and it entered a decision for the IRS. On appeal, the Seventh Circuit Court of Appeals agreed. The estate contended that the settlement was based upon a mistake of fact, that the distributions to the children already had been finalized. The Circuit Court notes that "mistake of fact" does not extend to a failure to anticipate future developments.

In a footnote the Court notes that no opinion has been expressed on the appropriateness of the deduction for the bequests to the children. ☐