



A CPA's Guide to Trusts

Edward K. Zollars, CPA
Phoenix, Arizona

ed@tzlcpas.com

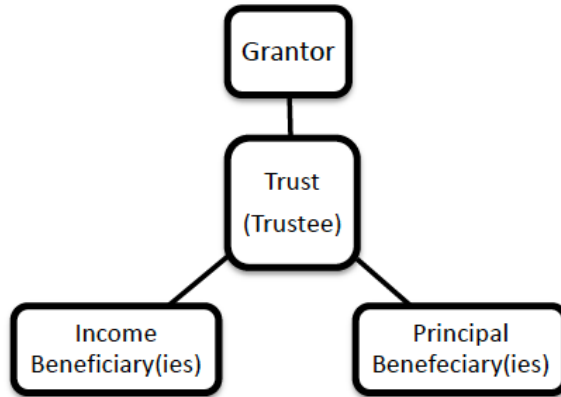
www.cperesources.com



CPA's Guide to Trusts

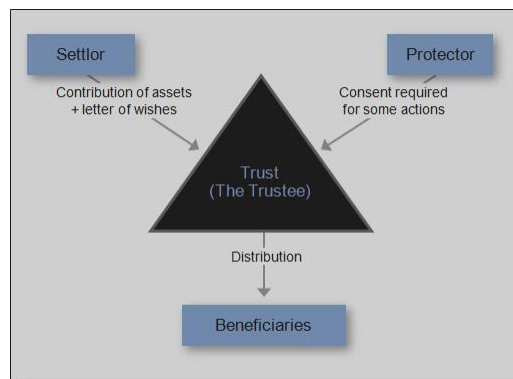
KEY PLAYERS IN A TRUST

Purposes of Trusts



NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Parties Involved in a Trust



NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Advisers Involved With a Trust



- Attorney
- Insurance Agent
- Financial Adviser

Nichols Patrick
CPE, INCORPORATED
Experts in Tax Training

Nichols Patrick
CPE, INCORPORATED
Experts in Tax Training

CPA's Guide to Trusts

USES OF TRUSTS

Trust Documents

- Trustor's Purpose for the Trust
- Trust Property
- Power to Change
- Distributions
 - Trust Income
 - Trust Principal (Corpus)
- Trustee Issues
- Administrative Issues



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Types of Trusts



- Estate Planning Trusts
 - Revocable Living Trusts
 - Bypass Trusts
 - QTIP Trusts
 - Irrevocable Life Insurance Trusts
 - GST Trusts
- Asset Protection Trusts
- Special Needs Trusts

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Operating the Trust



Nichols Patrick
CPE, INCORPORATED
Experts in Tax Training

Nichols Patrick
CPE, INCORPORATED
Experts in Tax Training

CPA's Guide to Trusts

TRUST ACCOUNTING

Trust Accounting Concepts



- Where do standards come from?
- Income
- Principal
- Depreciation
- Importance of Proper Categorization

NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Sources of Trust Accounting Rules

- State Principal and Income Acts
- Trust Document



NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Preparing Trust Accountings



- National Fiduciary Accounting Standards
- Charge and Discharge Statement Format
- Primacy of Governing Court

NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

National Fiduciary Accounting Standards Statement

- Example for:
 - Estate Executors
 - Trust Administrators
- Relatively complex document – “design by committee”
- Most jurisdictions will accept
 - Some will not
 - Others will prefer an alternative

NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Executors Report

Purpose of Account: William C. Doe, Executor, offers this account to acquaint interested parties with the transactions that have occurred during his administration.

*The account also indicates the proposed distribution of the estate.

It is important that the account be carefully examined. Requests for additional information or questions or objections can be discussed with:

[Name of Executor, Counsel or other appropriate person]
[address and telephone number]

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Summary of Account

	<i>Page</i>	<i>Current Value</i>	<i>Fiduciary Acquisition Value</i>
*Proposed Distribution to Beneficiaries	12	<u>\$102,974.56</u>	<u>\$ 90,813.96</u>
Principal			
Receipts	3-4		\$160,488.76
Net Gain (or Loss) on Sales or Other Disposition	5		<u>2,662.00</u>
			\$163,150.76
Less Disbursements:			
Debts of Decedent	6	\$ 485.82	
Funeral Expenses	6	1,375.00	
Administration Expenses	6	194.25	
Federal and State Taxes	6	5,962.09	
Fees and Commissions	6	<u>11,689.64</u>	<u>19,706.80</u>
Balance before Distributions			\$143,443.96
Distributions to Beneficiaries	7		<u>52,630.00</u>
Principal Balance on Hand	8		\$ 90,813.96

* - Optional if applicable

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Summary of Account

Principal Balance on Hand	8	\$ 90,813.96
For Information:		
Investments Made	9	
Changes in Investment Holdings	9	
Income		
Receipts	10	\$ 2,513.40
Less Disbursements	11	178.67
Balance before Distributions		\$ 2,334.73
Distributions to Beneficiaries	11	2,334.73
Income Balance on Hand		-0-
Combined Balance on Hand		<u>\$ 90,813.96</u>

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Receipts of Principal

<i>Assets Listed in Inventory (Valued as of Date of Death)</i>	<i>Fiduciary Acquisition Value</i>
Cash:	
First National Bank — checking account	\$ 516.93
Prudent Saving Fund Society — savings account	2,518.16
Cash in possession of decedent	<u>42.54</u>
	\$ 3,077.63
Tangible Personal Property:	
Jewelry —	
1 pearl necklace	515.00
Furniture —	
1 antique highboy	\$ 2,000.00
1 antique side table	60.00
1 antique chair	<u>55.00</u>
	2,115.00
Stocks:	
200 shs. Home Telephone & Telegraph Co., common	\$ 25,000.00
50 shs. Best Oil Co., common	5,000.00
1,000 shs. Central Trust Co., capital	50,850.00
151 shs. Electric Data Corp., common	1,887.50
50 shs. Fabulous Mutual Fund	1,833.33
200 shs. XYZ Corporation, common	<u>6,000.00</u>
	90,570.83
Realty:	
Resident --- 86 Norwood Road West Hartford, CT	50,000.00
Total Inventory	<u>\$146,278.46</u>

Nic
Expert

Receipts of Principal

Note: To facilitate preparation, the accountant may prefer to detail the starting balance by attaching a copy of the inventory as an exhibit. (This would be inappropriate if the inventory is prepared in a form that includes substantial extraneous material or does not list assets in an orderly manner.) The opening entry would then read:

"Assets Listed in Inventory per copy attached \$146,278.46"

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Receipts of Principal

*Receipts Subsequent to Inventory
(Valued When Received)*

2/22/79	Proceeds of Sale — Best Oil Co., rights to subscribe received 2/15/79	\$	50.00*	
3/12/79	Fabulous Mutual Fund, capital gains dividend received in cash		32.50	
5/11/79	Refund of overpayment of 1978 U.S. individual income tax		127.80	
9/25/79	From Richard Roe, Ancillary Administrator net proceeds on sale of oil and gas leases in Jefferson Parish, Louisiana		<u>10,000.00</u>	\$ 10,210.30

Adjustment to Carrying Values

Increased value of 200 shs. XYZ Corporation,
common stock upon audit of Federal Estate Tax Return:

Adjusted value upon audit	\$	10,000.00	
Value per Inventory		<u>6,000.00</u>	\$ 4,000.00
Total Receipts of Principal			<u><u>\$160,488.76</u></u>

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Receipts of Principal

*Proceeds of sale of rights may be treated as an additional receipt, as illustrated here, or may be applied in reduction of carrying value as illustrated on page T-8 of the Model Trustee's Account. Either method, consistently applied, is acceptable.

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Gains and Losses on Sales and Other Dispositions

			<i>Gain</i>	<i>Loss</i>
2/7/79	100 shs. Home Telephone and Telegraph Co., common			
	Net Proceeds	\$ 14,025.00		
	Fiduciary Acquisition Value	<u>12,500.00</u>	\$ 1,525.00	
3/15/79	1,000 shs. Central Trust Co., capital			
	Net Proceeds	27,467.00		
	Fiduciary Acquisition Value	<u>25,425.00</u>	2,042.00	
3/15/79	200 shs. XYZ Corporation, common			
	Fiduciary Acquisition Value	10,000.00		
	Net Proceeds	<u>9,000.00</u>		\$ 1,000.00
5/21/79	35 shs. Electric Data Corp., common			
	Net Proceeds	530.00		
	Fiduciary Acquisition Value	<u>437.50</u>	92.50	
7/20/79	\$10,000 U.S. Treasury Bonds, 3%, due 7/1/82			
	Net Proceeds	10,000.00		
	Fiduciary Acquisition Value	<u>9,997.50</u>	2.50	
	Total Gains and Losses		<u>\$ 3,662.00</u>	\$ 1,000.00
	Less Loss		<u>1,000.00</u>	
	Net Gain		<u>\$ 2,662.00</u>	

Disbursements of Principal

Debts of Decedent			
1/25/79	John T. Hill, M.D., professional services	\$ 250.00	
4/12/79	State Tax Commissioner, 1978 state capital gains tax	156.00	
1/25/79	Thomas Pharmacy, prescriptions	23.82	
2/1/79	Sanders Hardware, purchases per bill dated 12/15/78	<u>56.00</u>	\$ 485.82
Funeral Expenses			
1/10/79	Smith Funeral Home, services	1,200.00	
2/15/79	Jones Memorials, grave marker	<u>175.00</u>	1,375.00
Administration Expenses			
11/14/78	Clerk of Court, probate costs	72.00	
2/22/79	Henry Smith, appraisal of jewelry and antiques	50.00	
11/16/79	Arden, Miles and Solomon, disbursements	56.00	
	Various miscellaneous affidavits, registered mail, toll telephone charges and other costs	16.25	194.25

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Disbursements of Principal

Federal and State Taxes			
8/13/79	State Tax Commissioner, state death tax	2,501.33	
8/13/79	Internal Revenue Service, federal estate tax	2,663.29	
11/15/79	Internal Revenue Service, U.S. fiduciary income tax for fiscal year ending 7/31/78 (attributable to capital gains)	283.84	
11/23/79	Internal Revenue Service, deficiency in Federal Estate Tax interest 8/14/79 to 11/24/79	\$ 505.24 <u>8.39</u>	5,962.09
Fees and Commissions			
11/16/79	Albert Schryver, Esq., fee as Guardian <i>ad litem</i>	375.00	
11/16/79	William C. Doe, Executor's principal commission 5% on \$50,000 4% on \$50,000 3% on \$60,488	6,314.64	
11/16/79	Arden, Miles & Solomon, attorney's fees	<u>5,000.00</u>	<u>11,689.64</u>
			<u>\$ 19,706.80</u>

C.P.E., INCORPORATED
Experts in Tax Training

Distributions of Principal to Beneficiaries

TO: Janet Doe, in satisfaction of gift under Article FIRST of Will			
12/1/78	1 pearl necklace	\$ 515.00	
	1 antique highboy	2,000.00	
	1 antique side table	60.00	
	1 antique side chair	<u>55.00</u>	\$ 2,630.00
TO: Janet Doe, in satisfaction of gift under Article SECOND of Will			
12/1/78	Residence — 86 Norwood Road West Hartford, CT		<u>50,000.00</u>
	Total Distributions of Principal to Beneficiaries		<u><u>\$ 52,630.00</u></u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Principal Balance on Hand

	<i>Current Value 12/10/79 or as noted</i>	<i>Fiduciary Acquisition Value</i>
Cash	\$ 5,305.63	\$ 5,305.63
Stocks:		
50 shs. Best Oil Co., common	4,500.00	5,000.00
1,000 shs. Central Trust Co., capital — value at most recent sale, 9/18/79	32,168.76	25,425.00
116 shs. Electric Data Corp., common — not traded, value per company books, 12/29/78	1,684.00	1,450.00
50 shs. Fabulous Mutual Fund	4,016.17	1,833.33
200 shs. Home Telephone & Telegraph Co., common	16,000.00	12,500.00
\$40,000 U.S. Treasury Bills due 12/14/79	<u>39,300.00</u>	<u>39,300.00</u>
	<u>\$102,974.56</u>	<u>\$90,813.96</u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Information Schedule - Principal

			<i>Cost</i>
Investments Made			
2/1/79	\$10,000 U.S. Treasury Bonds, 3%	\$ 10,022.50	
	Less accrued interest collected 6/29/79	<u>25.00</u>	\$ 9,997.50
9/14/79	\$40,000 U.S. Treasury Bills due 12/14/79		39,300.00
Changes in Investment Holdings			
Central Trust Co.			
11/14/78	1,000 shs. capital stock, par \$5 inventoried		\$ 50,850.00
1/15/79	1,000 shs. additional received in 2-1 split, par reduced to \$2.50		
	2,000 shs. par \$2.50 carried at	<u>50,850.00</u>	
3/15/78	<u>1,000</u> shs. sold, carried at	<u>25,425.00</u>	
	<u>1,000</u> shs. remaining, carried at	<u>\$ 25,425.00</u>	
Home Telephone & Telegraph Co.			
11/14/78	200 shs. common par \$10, inventoried		\$ 25,000.00
2/7/79	<u>100</u> shs. sold, carried at	<u>12,500.00</u>	
	100 shs. remaining, carried at	12,500.00	
3/30/79	100 shs. additional received in 2-1 split par reduced to \$5		
	<u>200</u> shs. par \$5 carried at	<u>\$ 12,500.00</u>	

N

Experts in Tax Training

Receipts of Income

Dividends

Best Oil Co., common			
1/2/79 to 10/2/79 — 50 shs.		\$ 20.00	
Central Trust Co., common			
1/15/79 — 2,000 shs.	\$ 600.00		
4/13/79 to 10/15/79 — 1,000 shs.	<u>900.00</u>	1,500.00	
Electric Data Corp., common			
12/29/78 to 3/30/79 — 151 shs.	30.20		
6/29/79 to 9/28/79 — 116 shs.	<u>23.20</u>	53.40	
Fabulous Mutual Fund			
3/12/79 to 9/12/79 — 50 shs.		140.00	
Home Telephone & Telegraph Co., common			
2/1/79 — 200 shs.	225.00		
5/1/79 to 11/1/79 — 200 shs. (after stock split)	<u>450.00</u>	<u>675.00</u>	\$ 2,388.40

Interest

U.S. Treasury Bonds, 3%, due 7/1/82			
6/29/79 — \$10,000	150.00		
Less: accrued interest paid on purchase 2/1/79	<u>(25.00)</u>	125.00	125.00
	Total		<u>\$ 2,513.40</u>

Disbursements of Income

11/15/79	U.S. Fiduciary Income Tax for fiscal year ended 7/31/79 (allocable to income)	\$ 53.00
	To be paid:	
	William C. Doe — Executor's income commission 5% on \$2,513.40	<u>125.67</u>
		<u>\$ 178.67</u>

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Distributions of Income to Beneficiaries

	TO: William C. Doe, Trustee under Article FOURTH (A) for Walter Doe	
11/16/79	Cash	\$ 1,167.37
	TO: Sharon Doe	
11/16/79	Cash	<u>1,167.36</u>
	Total	<u>\$ 2,334.73</u>

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Proposed Distribution to Beneficiaries

	<i>Current Value 12/10/79 or as noted</i>	<i>Fiduciary Acquisition Value</i>
Per Article FOURTH (A) of Will:		
TO: William C. Doe, Trustee for Walter Doe		
25 shs. Best Oil Co., common	\$ 2,250.00	\$ 2,500.00
500 shs. Central Trust Co., capital	16,084.38*	12,712.50
58 shs. Electric Data Corp., common	842.00**	725.00
25 shs. Fabulous Mutual Fund	2,008.09	916.67
100 shs. Home Telephone & Telegraph Co., common	8,000.00	6,250.00
\$20,000 U.S. Treasury Bills, due 12/14/79	19,650.00	19,650.00
Cash	<u>2,652.81</u>	<u>2,652.81</u>
	\$ 51,487.28	\$ 45,406.98
Per Article FOURTH (B) of Will:		
TO: Sharon Doe		
25 shs. Best Oil Co., common	\$ 2,250.00	\$ 2,500.00
500 shs. Central Trust Co., capital	16,084.38*	12,712.50
58 shs. Electric Data Corp., common	842.00**	725.00
25 shs. Fabulous Mutual Fund	2,008.09	916.67
100 shs. Home Telephone & Telegraph Co., common	8,000.00	6,250.00
\$20,000 U.S. Treasury Bills, due 12/14/79	19,650.00	19,650.00
Cash	<u>2,652.81</u>	<u>2,652.81</u>
	\$ 51,487.28	\$ 45,406.98
Total	<u>\$102,974.56</u>	<u>\$ 90,813.96</u>

Nic
Experts

Statement of Executor

WILLIAM C. DOE, Executor under the Last Will and Testament of JOHN DOE, deceased, hereby declares under (oath)* (penalties of perjury) that he has fully and faithfully discharged the duties of his office; that the foregoing First and Final Account is true and correct and fully discloses all significant transactions occurring during the accounting period; that all known claims against the Estate have been paid in full; that, to his knowledge, there are no claims now outstanding against the Estate; and that all taxes presently due from the Estate have been paid.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Model Trust Accounting

FIRST AND FINAL ACCOUNT
For the "Marital Trust" Established under the Will of John H. Doe, Deceased

Stated by UPSTANDING TRUST COMPANY, Surviving Trustee and
Mary W. Doe (Deceased Trustee, Died December 30, 1977)
presented on her behalf by UPSTANDING TRUST COMPANY,
as Executor of her Will

John H. Doe, Died	January 30, 1965
Date of Trustees' first receipt of funds	February 11, 1967
Account Stated for the Period	February 11, 1967 to June 15, 1979

Purpose of Account: The Trustees offer this account to acquaint interested parties with the transactions that have occurred during their administration of the trust.
It is important that the account be carefully examined. Requests for additional information or questions or objections can be discussed with:

[Name of Trustee, Counsel or other appropriate person]

[address and telephone number]

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Summary of Account

	Page	Current Value	Fiduciary Acquisition Value
*Proposed Distributions to Beneficiaries	13	<u>\$293,572.79</u>	<u>\$261,006.44</u>
Principal			
Receipts	3		\$158,259.02
Net Gain (or Loss) on Sales or Other Disposition	4		<u>113,549.47</u>
			\$271,808.49
General Disbursements	5	77.36	
Fees	5	<u>4,300.00</u>	<u>4,377.36</u>
Balance before Distribution			\$267,431.13
Distributions to Beneficiaries	6		<u>10,703.79</u>
Principal Balance on Hand	7		\$256,727.34
For Information:			
Investments Made	8-11		
Changes in Investment Holdings	8		
	8-11		

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Summary of Account

Income		
Receipts (see note on Page 12 about waiver)	12	\$ 5,907.25
Less Disbursements	12	<u>227.96</u>
Balance before Distributions		\$ 5,679.29
Distribution to Beneficiaries	12	<u>1,400.19</u>
Income Balance on Hand	12	\$ 4,279.10
Combined Balance on Hand		<u>\$261,006.44</u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Receipts of Principal

Assets awarded trustees by adjudication dated January 30, 1967,
of Smith, J., Upon the First Account of the executors and the
schedule of distribution pursuant thereto:

1. Premises 789 Main Street, Media, PA	\$ 10,000.00	
2. \$7,000 face value, Bethlehem, PA General Bonds 1.75%, due 4/1/1968	6,965.00	
3. \$20,000 face value, Ohio Turnpike Commission Project One bonds 3.25%, due 6/1/2000	18,025.00	
4. 352 shs. American Telephone & Telegraph Co., capital	54,340.00	
5. 703 shs. XYZ & Co., common	67,663.75	
6. 5 shs. Southwest Rodeo Oil Co., common	1.00	
7. Checking account, Upstanding Trust Company	<u>264.27</u>	\$157,259.02

Other Receipts:		
3/15/67 Federal Estate Tax Refund	<u>1,000.00</u>	<u>\$158,259.02</u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Receipts of Principal

Note: To facilitate preparation the accountant may prefer to detail the starting balance by attaching as an exhibit a copy of the closing balance from the last account, schedule of assets in the deed, etc., as appropriate. The opening entry would then read:

"Assets awarded by adjudication dated January 30, 1967, of Smith, J ., upon the First Account of the executors per schedule of distribution pursuant thereto, copy attached \$157,259.02."

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Gains and Losses on Sales and Other Dispositions

			<i>Gain</i>	<i>Loss</i>
7/2/67	103 shs. XYZ & Co., common			
	Net Proceeds	\$ 25,614.54		
	Fiduciary Acquisition Value	<u>9,913.75</u>	\$ 15,700.79	
7/11/67	5 shs. Southwest Rodeo Oil Co., common			
	Company declared bankrupt	0.00		
	Fiduciary Acquisition Value	<u>1.00</u>		\$ 1.00
4/6/68	100 shs. XYZ & Co., common			
	Net Proceeds	22,226.25		
	Fiduciary Acquisition Value	<u>9,625.00</u>	12,601.25	
12/29/74	\$20,000 face value, Ohio Turnpike Commission Project One bonds due 6/1/1980			
	Net Proceeds	18,450.00		
	Fiduciary Acquisition Value	<u>18,025.00</u>	425.00	
6/19/78	500 shs. XYZ & Co., common			
	Net Proceeds	56,337.21		
	Fiduciary Acquisition Value	<u>1.00</u>	56,336.21	
8/9/78	\$50,000 Commercial Credit Co., demand note			
	Repaid	50,000.00		
	Fiduciary Acquisition Value	<u>50,000.00</u>		
9/22/78	852 shs. American Telephone & Telegraph Co., capital			
	Net Proceeds	39,503.92		
	Fiduciary Acquisition Value	<u>19,816.70</u>	19,687.22	

Nich
Experts in Tax Training

Gains and Losses on Sales and Other Dispositions

11/17/78	\$70,000 U.S. Treasury Bills			
	Matured		70,000.00	
	Fiduciary Acquisition Value		70,000.00	
11/17/78	Premises 789 Main Street, Media, PA			
	Sold receiving Purchase Money			
	Mortgage		15,000.00	
	Cash		5,000.00	
	Total		20,000.00	
	Less expense of Sale			
	Broker's Commission	1,000.00		
	Transfer Tax	200.00	1,200.00	
	Balance		18,800.00	
	Fiduciary Acquisition Value		10,000.00	8,800.00
	Total Gains and Losses			\$ 113,550.47
	Less Loss			1.00
	Net Gain			\$ 113,549.47

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Disbursements of Principal

General Disbursements

5/15/78	Fire Insurance, 789 Main Street, Media, PA		\$ 50.00
6/15/79	Reimbursement to Smith, Jones and Brown, Esquires, for Miscellaneous Expenses, 2/11/67 to date:		
	Postage and Insurance	\$ 26.21	
	Telephone	1.15	27.36
	Total		\$ 77.36

Fees

6/15/79	Smith, Jones and Brown, Esquires, Attorneys' Fees		\$ 4,300.00
			\$ 4,377.36

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Distributions of Principal to Beneficiaries

	TO: Mary W. Doe		
7/1/67	\$7,000 face value Bethlehem, Pa. General bonds 1.75%, due 4/1/75	\$ 6,965.00	
7/2/67	Cash	<u>238.79</u>	\$ 7,203.79
	TO: XYZ Charity		
5/4/79	Advance distribution, cash		<u>3,500.00</u>
	Total Distribution of Principal to Beneficiaries		<u>\$ 10,703.79</u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Principal Balance on Hand

	<i>Current Value</i>	<i>Fiduciary Acquisition Value</i>
\$20,000 face value, Indiana Toll Road Commission East/West Revenue Bonds, 3.5%, due 1/1/2002	\$ 13,600.00	\$ 17,275.00
1,260 shs. American Telephone & Telegraph Company, capital	57,015.00	29,306.40
680 shs. ABC Corp., common	56,355.00	48,124.00
Mortgage, 789 Main Street, Media, PA face amount \$15,000 reduced to	14,750.00	14,750.00
\$120,000 face value, ABC Corp., demand note	120,000.00	120,000.00
Checking account, Upstanding Trust Company	<u>27,271.94</u>	<u>27,271.94</u>
Total	<u>\$288,991.94</u>	<u>\$256,727.34</u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Information Schedules - Principal

		<i>Cost</i>
	Investment Made	
12/28/74	\$20,000 Indiana Toll Road Comm. East/West Revenue Bonds, 3.5%, due 1/1/2002 Bought at face value	\$ 17,275.00
6/29/78	\$50,000 Commercial Credit Co., demand note	50,000.00
8/18/78	\$70,000 U.S. Treasury Bills due 11/19/78	68,000.00
9/28/78	\$120,000 ABC Corp., demand note	120,000.00

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Information Schedules - Principal

Changes in Investment Holdings		
2/11/67	American Telephone & Telegraph Company, common	
2/11/67	352 shs. awarded	\$ 54,340.00
4/24/67	704 shs. received in 3-1 split	<u>0.00</u>
	1,056 shs. carried at	54,340.00
3/22/67	1,056 rights to subscribe to additional stock sold for	<u>1,484.41*</u>
		52,855.59
3/12/72	1,056 rights to subscribe to additional stock sold for	<u>2,507.00</u>
		50,348.59
6/22/72	1,056 shs. received in 2-1 split	<u>0.00</u>
	2,112 shs. carried at	50,348.59
5/5/78	2,112 rights to subscribe to additional stock sold for	<u>1,225.49*</u>
		49,123.10
9/22/78	852 shs. sold for	\$ 39,503.92
	Less Gain on Sale	19,687.22
		<u>19,816.70</u>
	1,260 shs. carried at	<u><u>\$ 29,306.40</u></u>

Nichols
Experts in Tax Training

Information Schedule - Principal

	XYZ & Co., common		
2/11/67	703 shs. awarded		\$ 67,663.75
7/2/67	103 shs. sold for	\$ 25,614.54	
	Less Gain on Sale	<u>15,700.79</u>	<u>9,913.75</u>
	600 shs. carried at		\$ 57,750.00
4/6/68	100 shs. sold for	\$ 22,226.25	
	Less Gain on Sale	<u>12,601.25</u>	<u>9,625.00</u>
	500 shs. carried at		\$ 48,125.00
7/9/70	250 shs. ABC Corp., common received @ 47.6875 in one-half for one divestment distribution		<u>11,921.88</u>
			<u>\$ 36,203.12</u>
1/6/72	180 shs. ABC Corp., common received @ 79 in a 0.36 share for one divestment distribution		<u>14,220.00</u>
			<u>\$ 21,983.12</u>
1/4/73	*250 shs. ABC Corp., common received @ 96.0625 in a one-half for one divestment distribution normally \$24,015.62, of which the following was applied to account value		<u>\$ 21,982.12</u>
			<u>1.00</u>
6/19/78	500 shs. sold for	\$ 56,337.21	
	Less Gain on Sale	<u>\$6,336.21</u>	<u>1.00</u>
	0 No Longer Held		<u>\$ 0.00</u>

Nichols Pa
C.P.E., INC. CO
Experts in Tax Training

Information Schedule - Principal

I-10

	ABC Corp., common		
7/9/70	250 shs. received in distribution on 500 shs. XYZ & Co., common		\$ 11,921.88
1/6/72	180 shs. received in similar distribution		<u>14,220.00</u>
	430 shs. carried at		26,141.88
1/4/73	250 shs. received in similar distribution		<u>21,982.12</u>
6/15/79	34 shs. received as 5% stock dividend, transferred to income 680 shs. carried at		<u>\$ 48,124.00</u>
	789 Main Street, Media, PA		
2/11/67	Awarded		\$10,000.00
11/17/78	Sold for purchase money mortgage of \$15,000 and cash of \$3,000	20,000.00	
	Less settlement costs itemized in principal account	<u>1,200.00</u>	
	Balance	18,800.00	
	Less Gain on Sale	<u>8,800.00</u>	<u>10,000.00</u>
	No Longer Held		<u>\$ 0.00</u>
	Mortgage on 789 Main Street, Media, PA		
11/17/78	\$15,000 mortgage received on sale of said premises		\$ 15,000.00
6/15/79	250 principal received on account		<u>250.00</u>
	\$14,750 balance remaining		<u>\$ 14,750.00</u>

Nich
Experts in Tax Training

Information Schedule - Principal

		Southwest Rodeo Oil Co., common	
12/11/67	5 shs. Awarded		\$ 1.00
7/11/67	_____ Company Declared Bankrupt		<u>1.00</u>
	<u>0</u>		<u><u>0.00</u></u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Receipts of Income

Waiver of Income Accounting

An income accounting having been waived for the period February 11, 1967 to May 30, 1979, a limited schedule of receipts of income follows:

6/1/79	Balance per last income statement rendered	\$ 1,773.25
	Dividend	
6/8/79	ABC Corp. on 680 shs.	578.00
6/15/79	34 shs. ABC Corp. — 5% stock dividend @ \$79.00	2,686.00
	Interest	
6/1/79	Indiana Toll Road Commission	350.00
6/15/79	ABC Corp., demand note	<u>520.00</u>
	Total Income Receipts	<u><u>\$ 5,907.25</u></u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Disbursements of Income

6/1/79	Patrick Green, tax collector, 1979 personal property tax	\$ 155.56	
6/15/79	Upstanding Trust Co., — 5% commission on income collected 3/30/79-5/31/79	<u>72.40</u>	<u>\$ 227.96</u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Distribution of Income to Beneficiares

6/1/79	TO: Upstanding Trust Co., executor under the Will of Mary W. Doe, deceased, on income arising before 1/1/1978 Cash	\$ 650.19	
6/15/79	TO: XYZ Charity Cash	<u>750.00</u>	<u>\$ 1,400.19</u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Balance of Income on Hand

		<i>Current Value</i>	<i>Fiduciary Acquisition Value</i>
6/15/79	Cash	\$ 1,593.10	\$ 1,593.10
6/15/79	34 shs. ABC Corp., common	<u>2,987.75</u>	<u>2,686.00</u>
		<u>\$ 4,580.85</u>	<u>\$ 4,279.10</u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Proposed Distribution to Beneficiaries

Per Article FIFTH of Will:

Mary W. Doe not having exercised her general power of appointment granted to her over the assets of the Marital Trust, the entire fund on hand is to be distributed pursuant to the terms of Article FIFTH of the Will to XYZ Charity.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Proposed Distribution to Beneficiaries

PRINCIPAL

	<i>Current Value</i>	<i>Fiduciary Acquisition Value</i>
\$20,000 face value, Indiana Toll Road Commission East/West Revenue Bonds, 3.5%, due 1/1/2002	\$ 13,600.00	\$ 17,275.00
1,260 shs. American Telephone & Telegraph Company, capital	57,015.00	29,306.40
680 shs. ABC Corp., common	56,355.00	48,124.00
Mortgage, 789 Main Street, Media, PA, face amount \$15,000 reduced to	14,750.00	14,750.00
\$120,000 face value, ABC Corporation, demand note	120,000.00	120,000.00
Checking account, Upstanding Trust Company	<u>27,271.94</u>	<u>27,271.94</u>
Total Principal	\$288,991.94	\$256,727.34

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Proposed Distribution to Beneficiaries

INCOME

6/15/79	Cash	\$ 1,593.10	\$ 1,593.10
6/15/79	34 shs. ABC Corp.	<u>2,987.75</u>	<u>2,686.00</u>
	Total Income	\$ 4,580.85	\$ 4,279.10
	Combined Total	<u>\$293,572.79</u>	<u>\$261,006.44</u>

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Trustee's Statement

WALTER TRUST, Vice President of Upstanding Trust Company, Surviving Trustee under the Will of JOHN H. DOE and Executor under the Will of Mary C. Doe, Deceased, Trustee under the Will of John H. Doe, hereby declares under (oath)* (penalties of perjury) that said Trustees have fully and faithfully discharged the duties of their office; that the foregoing First and Final Account is true and correct, and fully discloses all significant transactions occurring during the accounting period; that all known claims against the Trust have been paid in full; that, to his knowledge, there are no claims now outstanding against the Trust; and that all taxes presently due from the Trust have been paid.

WALTER TRUST

Subscribed and sworn to
by WALTER TRUST before
me this _____ day of _____, 1980.

Notary Public

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Charge and Discharge Statement

- Alternative approach used in some states
- Also used sometimes for accountings to beneficiaries between formal court accountings
- Arguably less intimidating than the full statement

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Doe Decedent's Trust
Charge and Discharge Statement - Income Tax Basis

PRINCIPAL

The Trustee charges himself with:

Beginning Principal	\$ 1,000,000.00
Gain/(loss) on sale of securities (Schedule A)	14,000.00

The Trustee credits himself with:

Administrative fees	\$ (13,000.00)
Accounting fees	(3,500.00)
Income tax expense	(3,500.00)
Total	<u>(20,000.00)</u>

Balance of principal before distributions	994,000.00
---	------------

Distributions to Karen Doe	(200,000.00)
----------------------------	--------------

Leaving a principal balance of	<u>\$ 794,000.00</u>
--------------------------------	----------------------

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

INCOME

The Trustee charges himself with:

Interest Income (Schedule B)	\$ 60,000.00
Dividend Income (Schedule C)	12,000.00
Total	\$ 72,000.00

The Trustee credits himself with:

Accounting fees	(3,500.00)
Administrative fees	(13,000.00)
Total	<u>(16,500.00)</u>

Balance of income before distributions	55,500.00
--	-----------

Distributions to Karen Doe	<u>(55,500.00)</u>
----------------------------	--------------------

Leaving an income balance of	<u>\$ -</u>
------------------------------	-------------

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Doe Decedent's Trust
Balance Sheet - Income Tax Basis

ASSETS

Bank of America, Checking	\$ 12,400.00
Bank of America, Certificates of Deposit	97,100.00
Marketable Securities - Charles Schwab	<u>700,000.00</u>

Total Assets	<u>809,500.00</u>
--------------	-------------------

LIABILITIES AND TRUST PRINCIPAL AND INCOME

Due to Karen Doe	\$ 15,500.00
Trust Principal	794,000.00
Trust Income	<u>-</u>

Total Liabilities and Trust Principal and Income	<u>\$ 809,500.00</u>
--	----------------------

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Accounting Issues

- Know requirements for accounting
 - Jurisdiction over estate/trust
 - Determine format of accounting and rules
- Reporting issues
 - Litigation support exception may apply in some cases
 - Otherwise standard financial reporting rules apply
- And, as always, “GAAP is GAAP” regardless of reporting

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training



CPA's Guide to Trusts

UNIFORM PRINCIPAL AND INCOME ACT

Uniform Principal and Income Act

- Lays out general terms to deal with traditional concepts of:
 - Corpus (principal)
 - Income
- “Fills in” the blanks where trust document is silent



Definitions

- Beneficiary
- Fiduciary
- Income (and related definitions that depend on this)
- Principal and remainder beneficiary
- Trustee

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Duties of the Trustee

- Trust document may override UPIA
- Next looks to discretionary override of UPIA if provided (but will have to look at fiduciary duty)
- Finally look to UPIA

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

- Requires prudent investor standard to be used
- Can work around straight-jacket of UPIA
- Problems
 - Fiduciary duty to beneficiaries must be considered
 - Prohibited in certain circumstances

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

Example (1) B T is the successor trustee of a trust that provides income to A for life, remainder to B. T has received from the prior trustee a portfolio of financial assets invested 20% in stocks and 80% in bonds. Following the prudent investor rule, T determines that a strategy of investing the portfolio 50% in stocks and 50% in bonds has risk and return objectives that are reasonably suited to the trust, but T also determines that adopting this approach will cause the trust to receive a smaller amount of dividend and interest income. After considering the factors in Section 104(b), T may transfer cash from principal to income to the extent T considers it necessary to increase the amount distributed to the income beneficiary.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

Example (2) B T is the trustee of a trust that requires the income to be paid to the settlor's son C for life, remainder to C's daughter D. In a period of very high inflation, T purchases bonds that pay double-digit interest and determines that a portion of the interest, which is allocated to income under Section 406 of this Act, is a return of capital. In consideration of the loss of value of principal due to inflation and other factors that T considers relevant, T may transfer part of the interest to principal.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

Example (3) B T is the trustee of a trust that requires the income to be paid to the settlor's sister E for life, remainder to charity F. E is a retired schoolteacher who is single and has no children. E's income from her social security, pension, and savings exceeds the amount required to provide for her accustomed standard of living. The terms of the trust permit T to invade principal to provide for E's health and to support her in her accustomed manner of living, but do not otherwise indicate that T should favor E or F. Applying the prudent investor rule, T determines that the trust assets should be invested entirely in growth stocks that produce very little dividend income. Even though it is not necessary to invade principal to maintain E's accustomed standard of living, she is entitled to receive from the trust the degree of beneficial enjoyment normally accorded a person who is the sole income beneficiary of a trust, and T may transfer cash from principal to income to provide her with that degree of enjoyment.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

Example (4) B T is the trustee of a trust that is governed by the law of State X. The trust became irrevocable before State X adopted the prudent investor rule. The terms of the trust require all of the income to be paid to G for life, remainder to H, and also give T the power to invade principal for the benefit of G for "dire emergencies only." The terms of the trust limit the aggregate amount that T can distribute to G from principal during G's life to 6% of the trust's value at its inception. The trust's portfolio is invested initially 50% in stocks and 50% in bonds, but after State X adopts the prudent investor rule T determines that, to achieve suitable risk and return objectives for the trust, the assets should be invested 90% in stocks and 10% in bonds. This change increases the total return from the portfolio and decreases the dividend and interest income.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

Thereafter, even though G does not experience a dire emergency, T may exercise the power to adjust under Section 104(a) to the extent that T determines that the adjustment is from only the capital appreciation resulting from the change in the portfolio's asset allocation. If T is unable to determine the extent to which capital appreciation resulted from the change in asset allocation or is unable to maintain adequate records to determine the extent to which principal distributions to G for dire emergencies do not exceed the 6% limitation, T may not exercise the power to adjust. See Joel C. Dobris, Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax Planning, 66 Iowa L. Rev. 273 (1981).

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

Example (5) B T is the trustee of a trust for the settlor's child. The trust owns a diversified portfolio of marketable financial assets with a value of \$600,000, and is also the sole beneficiary of the settlor's IRA, which holds a diversified portfolio of marketable financial assets with a value of \$900,000. The trust receives a distribution from the IRA that is the minimum amount required to be distributed under the Internal Revenue Code, and T allocates 10% of the distribution to income under Section 409(c) of this Act. The total return on the IRA's assets exceeds the amount distributed to the trust, and the value of the IRA at the end of the year is more than its value at the beginning of the year.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

Relevant factors that T may consider in determining whether to exercise the power to adjust and the extent to which an adjustment should be made to comply with Section 103(b) include the total return from all of the trust's assets, those owned directly as well as its interest in the IRA, the extent to which the trust will be subject to income tax on the portion of the IRA distribution that is allocated to principal, and the extent to which the income beneficiary will be subject to income tax on the amount that T distributes to the income beneficiary.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

Example (6) B T is the trustee of a trust whose portfolio includes a large parcel of undeveloped real estate. T pays real property taxes on the undeveloped parcel from income each year pursuant to Section 501(3). After considering the return from the trust's portfolio as a whole and other relevant factors described in Section 104(b), T may exercise the power to adjust under Section 104(a) to transfer cash from principal to income in order to distribute to the income beneficiary an amount that T considers necessary to comply with Section 103(b).

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Power to Adjust

Example (7) B T is the trustee of a trust whose portfolio includes an interest in a mutual fund that is sponsored by T. As the manager of the mutual fund, T charges the fund a management fee that reduces the amount available to distribute to the trust by \$2,000. If the fee had been paid directly by the trust, one-half of the fee would have been paid from income under Section 501(1) and the other one-half would have been paid from principal under Section 502(a)(1). After considering the total return from the portfolio as a whole and other relevant factors described in Section 104(b), T may exercise its power to adjust under Section 104(a) by transferring \$1,000, or half of the trust's proportionate share of the fee, from principal to income.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Judicial Control of Power to Adjust

- Officially acts limits court's power to modify
- Must find abuse of fiduciary duty – not merely that court would have done it differently
- However, still means can be second-guessed

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

End of Income Interest

- Ties income and principal receipts to property
- Pecuniary amounts distributed first from income
- Issues when you have successive income interests to get the cut-offs right

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Remainder and Pecuniary Beneficiaries

- Income balance for those not receiving current distribution
- Requirement to maintain records of unpaid income interests
- Options for gain/loss on principal assets

When Right to Income Begins/Ends

- Right starts on
 - Date stated in trust *or*
 - Date asset becomes subject to trust
- Rules for determining such dates

Death/End of Interest

- Allocate “income” items before DOD to principal
- Day to day required if:
 - No due date *or*
 - Not periodic

Apportionment at End of Interest

- Undistributed income
 - Received before end of interest
 - Does not include accrued
- Also describes how to deal with the end of a unitrust or annuity interest

Accrued Periodic Payments

Example B accrued periodic payments. The rules in Section 302 and Section 303 work in the following manner: Assume that a periodic payment of rent that is due on July 20 has not been paid when an income interest ends on July 30; the successive income interest begins on July 31, and the rent payment that was due on July 20 is paid on August 3. Under Section 302(a), the July 20 payment is added to the principal of the successive income interest when received. Under Section 302(b), the entire periodic payment of rent that is due on August 20 is income when received by the successive income interest. Under Section 303, neither the income beneficiary of the terminated income interest nor the beneficiary's estate is entitled to any part of either the July 20 or the August 20 payments because neither one was received before the income interest ended on July 30. The same principles apply to expenses of the trust.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Character of Receipts

- Receipts from an entity
 - Does not generally follow traditional GAAP or income tax rules
 - Rather cash = income (subject to certain exceptions)
 - Other than cash = principal
- Liquidation/partial liquidation issue

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Mutual Funds

- “Capital gain” dividends
 - Long term capital gain dividends are principal
 - Short term capital gain dividends are income
- Reinvested dividends
 - By default is a reclassification under Section 104 (Power to Adjust)
 - However, may justify moving back to income if done to avoid costs

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Distributions from Trust or Estate

- If did not purchase it, retains nature from distributing trust or estate
- If purchased, then treat as entity under entity distribution rules
- Commentary notes that distributing trust may require an allocation to one type or the other regardless of where it came from in the distributing trust

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Business Activity

- Option to maintain separate accounting records
- Determines need to retain cash (basically keep it in principal)
- List of specific activities that qualify for this option

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Principal Receipts

- Assets transferred into the trust
- Proceeds from sale of asset
- Payments from 3rd parties to reimburse trust for
 - Environmental matters
 - Other reasons not based on loss of income
- Eminent domain proceeds (though some may be allocated to income).

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Principal Receipts

- Net income in a period without an income beneficiary
- Other specified receipts in the UPIA

Rental Property

- Payments of rent go to income (commentary discusses issues where power to adjust may be appropriate)
- Deposits
 - Added to principal
 - May not be distributed until obligation ends

Obligation to Pay Money

- Interest must be allocated to income without regard to any amortization of premium
- Sale of obligation is allocated to principal (unless maturity < 1 year)
- Rules do not apply to
 - Deferred compensation
 - Liquidating assets
 - Mineral, water, natural resources
 - Timber
 - Derivatives and options
 - Asset based securities

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Insurance Policies

- Principal
 - Life insurance
 - Other insurance contract where named beneficiary
- Dividends on Policies
 - Income if premium paid from income
 - Principal if premium paid from principal
- Does not apply to deferred compensation

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Insubstantial Allocations

- Can ignore insubstantial allocations required for
 - Deferred compensation
 - Liquidating assets
 - Mineral, water and other natural resources
 - Timber
 - Asset backed securities

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Example

For example, assume that a trust's assets, which include a working interest in an oil well, have a value of \$1,000,000; the net income from the assets other than the working interest is \$40,000; and the net receipts from the working interest are \$400. The trustee may allocate all of the net receipts from the working interest to principal instead of allocating 10%, or \$40, to income under Section 411. If the net receipts from the working interest are \$35,000, so that the amount allocated to income under Section 411 would be \$3,500, the trustee may decide that this amount is sufficiently significant to the income beneficiary that the allocation provided for by Section 411 should be made, even though the trustee is still permitted under Section 408 to allocate all of the net receipts to principal because the \$3,500 would increase the net income of \$40,000, as determined before making an allocation under Section 411, by less than 10%. Section 408 will also relieve a trustee from having to allocate net receipts from the sale of trees in a small woodlot between principal and income.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Deferred Compensation

- Portion of payment categorized as interest, dividends or payments in lieu go to income
- Otherwise
 - 10% to income
 - 90% to principal

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Example of Designation of Interest/Dividend

For example, some deferred compensation plans that hold debt obligations or stock of the plan's sponsor in an account for future delivery to the person rendering the services provide for the annual payment to that person of dividends received on the stock or interest received on the debt obligations. Other plans provide that the account of the person rendering the services shall be credited with "phantom" shares of stock and require an annual payment that is equivalent to the dividends that would be received on that number of shares if they were actually issued; or a plan may entitle the person rendering the services to receive a fixed dollar amount in the future and provide for the annual payment of interest on the deferred amount during the period prior to its payment. Under Section 409(b), payments of dividends, interest or payments in lieu of dividends or interest under plans of this type are allocated to income; all other payments received under these plans are allocated to principal

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

IRA Issues

Thus, if an IRA holds a portfolio of marketable stocks and bonds, the amount received by the IRA as dividends and interest is not taken into account in determining the principal and income allocation except to the extent that the Internal Revenue Service may require them to be taken into account when the payment is received by a trust that qualifies for the estate tax marital deduction (a situation that is provided for in Section 409(d)).

Liquidating Assets

- Expected to decrease in value
 - Leasehold
 - Patent
 - Copyright
 - Royalty right
 - Payments over > 1 year without stated interest (such as lottery winnings)
- Allocate
 - 10% income
 - 90% principal

Minerals, Water Rights, Natural Resources

- If received as rental right, to income
- If received as production payment
 - Amount treated as interest to income
 - Remainder to principal
- Royalty, shut-in-well payment, take-or-pay payment, bonus, delay rental
 - 10% income
 - 90% principal

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Minerals, Water Rights, Natural Resources

- Working interest or other interest
 - 90% principal
 - 10% income
- Water
 - Renewable – allocate to income
 - Not renewable
 - 10% income
 - 90% principal

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Timber

- Income to extent amount removed does not exceed growth rate
- Principal to the extent exceeds growth rate
- Between the two based on above principals for
 - Lease of timberland
 - Contract to cut timber
- Other payments to principal

NicholsPatrick
C.P.E. INCORPORATED
Experts in Tax Training

Timber

- Must allocate reasonable amount to principal for depletion

NicholsPatrick
C.P.E. INCORPORATED
Experts in Tax Training

Property Not Productive of Income

- Marital deduction trust issue
- Trustee makes (or doesn't make) use of right to adjust but income not sufficient, spouse can force the issue

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Derivatives and Options

A "derivative" means a contract or financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates, or other market indicator for an asset or a group of assets.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Derivatives

- If don't account under business rule, receipts and disbursements are allocated to principal from transactions related to derivatives

Options

- Amounts received when granting an option are allocated to principal
- Amounts paid when receiving an option are allocated to principal
- Gain/loss is also a principal item

Asset Backed Security

In this section, "asset-backed security" means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Asset Backed Security

- Payments
 - From interest or other current return to income
 - All other to principal
- Disposal of interest
 - If all paid in one accounting period, all to principal
 - If paid over more than one accounting period
 - 10% to income
 - 90% to principal

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Disbursements from Income

- From income
 - ½ of regular compensation
 - Trustee
 - Investment adviser or custodian
 - ½ of expenses for
 - Accountings
 - Judicial proceedings
 - Other matters that involve both interests

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Disbursements from Income

- From income
 - All other ordinary expenses incurred for
 - Administration,
 - Management and
 - Preservation of property
 - Includes
 - Repairs
 - Taxes assessed against principal
 - Expenses of proceeding involving the income interest
 - Recurring insurance premiums covering loss of income

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Disbursements from Principal

- Remaining $\frac{1}{2}$ of fees that were half charged to income
- Trustee's compensation calculated on principal fee for acceptance, distribution, or termination, and disbursements made to prepare property for sale
- Payment on principal of a trust debt
- Proceedings primarily concerning principal

NicholsPatrick
C.P.E. INCORPORATED
Experts in Tax Training

Disbursements from Principal

- Other insurance premiums
- Estate, inheritance or transfer taxes
- Environmental matter payments
- Reimburse income if required to make payment on encumbered asset from income

NicholsPatrick
C.P.E. INCORPORATED
Experts in Tax Training

Depreciation

- Reduction in value due to wear, etc (not the GAAP idea)
- Trustee may transfer amount of cash receipts to principal but not
 - Used by beneficiary as residence
 - During administration of decedent's estate
 - If accounting for as business

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Transfers to Reimburse Principal

- Large repairs, etc.
- Capital improvement
- Prepare property for rental
- Periodic payments on obligations secured by principal asset to extent depreciation transfer inadequate
- Environmental matters

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Income Taxes

- Tax imposed on receipts charged to income paid from income
- Tax imposed on receipts charged to principal paid from principal
- Allocated appropriately if based on both

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Income Taxes

Example (1) – Trust T receives a Schedule K-1 from Partnership P reflecting taxable income of \$1 million. Partnership P distributes \$100,000 to T, which allocates the receipts to income. Both Trust T and income Beneficiary B are in the 35 percent tax bracket.

Trust T's tax on \$1 million of taxable income is \$350,000. Under Subsection (c) T's tax must be paid from income receipts because receipts from the entity are allocated only to income. Therefore, T must apply the entire \$100,000 of income receipts to pay its tax. In this case, Beneficiary B receives nothing.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Income Taxes

Example (2) - Trust T receives a Schedule K-1 from Partnership P reflecting taxable income of \$1 million. Partnership P distributes \$500,000 to T, which allocates the receipts to income. Both Trust T and income Beneficiary B are in the 35 percent tax bracket.

Trust T's tax on \$1 million of taxable income is \$350,000. Under Subsection (c), T's tax must be paid from income receipts because receipts from P are allocated only to income. Therefore, T uses \$350,000 of the \$500,000 to pay its taxes and distributes the remaining \$150,000 to B. The \$150,000 payment to B reduces T's taxes by \$52,500, which it must pay to B. But the \$52,500 further reduces T's taxes by \$18,375, which it also must pay to B. In fact, each time T makes a distribution to B, its taxes are further reduced, causing another payment to be due B.

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Income Taxes

Alternatively, T can apply the following algebraic formula to determine the amount payable to B:

$$D = (C - R * K) / (1 - R)$$

D = Distribution to income beneficiary
C = Cash paid by the entity to the trust
R = tax rate on income

K = entity's K-1 taxable income

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Income Taxes

Applying the formula to Example (2) above, Trust T must pay \$230,769 to B so that after deducting the payment, T has exactly enough to pay its tax on the remaining taxable income from P.

<u>Taxable Income per K-1</u>	<u>1,000,000</u>
<u>Payment to beneficiary</u>	<u>230,769¹</u>
<u>Trust Taxable Income</u>	<u>\$ 769,231</u>
<u>35 percent tax</u>	<u>269,231</u>

<u>Partnership Distribution</u>	<u>\$ 500,000</u>
<u>Fiduciary's Tax Liability</u>	<u>(269,231)</u>
<u>Payable to the Beneficiary</u>	<u>\$ 230,769</u>

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Income Taxes

In addition, B will report \$230,769 on his or her own personal income tax return, paying taxes of \$80,769. Because Trust T withheld \$269,231 to pay its taxes and B paid \$80,769 taxes of its own, B bore the entire \$350,000 tax burden on the \$1 million of entity taxable income, including the \$500,000 that the entity retained that presumably increased the value of the trust's investment entity.

Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Adjustments for Taxes

- Another adjustment clause
- Due to
 - Elections and decisions
 - Distribution triggered taxes
 - Passthrough entities

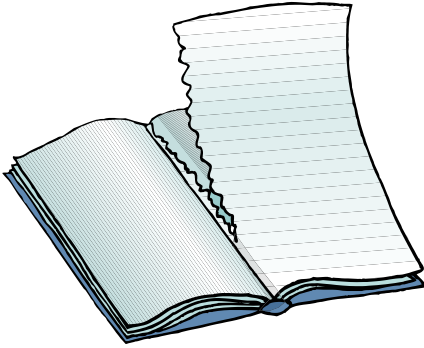
Nichols Patrick
CPE, INCORPORATED
Experts in Tax Training

Nichols Patrick
CPE, INCORPORATED
Experts in Tax Training

CPA's Guide to Trusts

INCOME TAXATION OF TRUSTS

Revocable vs. Irrevocable Trust



- Revocable Trust
- Irrevocable Trust
 - Simple Trust
 - Complex Trust

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Unique Characteristics



- Taxable Income
- 2% Floor on Itemized Deductions
- Distribution Deduction
- Income Reported by Beneficiaries

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Unique Characteristics of Form 1041

A Check all that apply:

- Decedent's estate
- Simple trust
- Complex trust
- Qualified disability trust
- ESBT (S portion only)
- Grantor type trust
- Bankruptcy estate-Ch. 7
- Bankruptcy estate-Ch. 11
- Pooled income fund

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Filing Requirements

- Electronic Filing
- Filing Requirements
- When to File
- What to File



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Estimated Payments of Income Tax Liability



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Distributable Net Income

Schedule B		Income Distribution Deduction	
1	Adjusted total income (see instructions)	1	
2	Adjusted tax-exempt interest	2	
3	Total net gain from Schedule D (Form 1041), line 19, column (1) (see instructions)	3	
4	Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)	4	
5	Capital gains for the tax year included on Schedule A, line 1 (see instructions)	5	
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6	
7	Distributable net income. Combine lines 1 through 6. If zero or less, enter -0-	7	
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law	8	
9	Income required to be distributed currently	9	
10	Other amounts paid, credited, or otherwise required to be distributed	10	
11	Total distributions. Add lines 9 and 10. If greater than line 8, see instructions	11	
12	Enter the amount of tax-exempt income included on line 11	12	
13	Tentative income distribution deduction. Subtract line 12 from line 11	13	
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14	
15	Income distribution deduction. Enter the smaller of line 13 or line 14 here and on page 1, line 18	15	

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Effect of Losses



NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Fiduciary Accounting Rules

- Taxable Items Generally Allocable to Corpus
- Expenses Allocable to Corpus



NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Depreciation



Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Allocation Between Principal and Income

- Effect of Capital Transactions
- Marital Claims



Nichols Patrick
C.P.E., INCORPORATED
Experts in Tax Training

Marital Trusts



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Income Distribution Deduction

Schedule B Income Distribution Deduction			
1	Adjusted total income (see instructions)	1	
2	Adjusted tax-exempt interest	2	
3	Total net gain from Schedule D (Form 1041), line 19, column (1) (see instructions)	3	
4	Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)	4	
5	Capital gains for the tax year included on Schedule A, line 1 (see instructions)	5	
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6	
7	Distributable net income. Combine lines 1 through 6. If zero or less, enter -0-	7	
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law	8	
9	Income required to be distributed currently	9	
10	Other amounts paid, credited, or otherwise required to be distributed	10	
11	Total distributions. Add lines 9 and 10. If greater than line 8, see instructions	11	
12	Enter the amount of tax-exempt income included on line 11	12	
13	Tentative income distribution deduction. Subtract line 12 from line 11	13	
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14	
15	Income distribution deduction. Enter the smaller of line 13 or line 14 here and on page 1, line 18	15	

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Tiered Distribution Structure



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Allocation of Classes of Income to DNI



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Allocation to Beneficiaries

- Nature of Income
- Allocation of Deductions to Classes of Income
- Year of Income Inclusion



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Gains/Losses on Transfers of Property to Beneficiaries

- When Recognition of Gain is Required
- When Recognition of Gain is Elective
- Nonrecognition of Loss



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Reporting and Tax Compliance

NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Termination of Trusts and Estates



- Trust Termination
- Estate Termination
 - Termination Event
 - Unduly Prolonged Administration
 - Planning
- Taxation

NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training



CPA's Guide to Trusts

GRANTOR TRUSTS

Grantor Trust Triggers



- Power to Revoke/Return Corpus
- Distribute for Benefit of Grantor
- Reversionary Interest Rules
- Power Over Beneficial Interests
- Administrative Powers



Grantor Trust Triggers



- Power to Take Principal or Income
 - Note – does not need to be the grantor
 - Any person holding right has an issue

NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Income Tax Treatment of Grantor Trusts

- Income Treated as That of Grantor
- Gain on Sale of Residence
- Tax Planning Logic Behind IDGTs



NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Income Tax Filing Requirements



- Standard Method
- Trusts Treated as Wholly Owned by One Person
 - Grantor's TIN Option
 - Trust TIN/1099s
- Trusts With More than One Grantor or Owner

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Income Tax Filing Requirements



- Changing Reporting Methods
- Trusts that May Not Use Alternative Methods

NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

CPA's Guide to Trusts

NET INVESTMENT INCOME TAX

Trusts and Estates Subject to Tax

- General Rules
- Exempted Trusts and Estates



Computing the Tax



- Adjusted Gross Income Limitation
- Undistributed Net Investment Income
- Capital Gain Issues

NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training

Special Issues Facing Trusts and Estates

- Passive Activities
- Bankruptcy Estates
- Charitable Remainder Trusts
- “Simplified” CRT Method
- Impact on ESBTs



NicholsPatrick
CPE, INCORPORATED
Experts in Tax Training



CPA's Guide to Trusts

STATE COMPLICATIONS OF TRUSTS

State Law Governing Trusts

- State Principal and Income Act
- Prudent Investor Act
- Other State Trust Laws



State Income Taxation Issues

- Tests in Determining Tax Status
- Dealing with State Income Tax Issues



Nichols Patrick
CPE, INCORPORATED
Experts in Tax Training

Nichols Patrick
CPE, INCORPORATED
Experts in Tax Training

CPA's Guide to Trusts

CPA'S DUTIES AND EXPOSURES

Professional Obligations

- Conflict of Interest Issues
 - AICPA Code of Professional Conduct
 - Circular 230 §10.29
- Due Diligence
- Financial Reporting Issues



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Expectations of the Parties

- Surviving Spouse
- Offspring
- Other Interested Parties
- Other Professionals



NicholsPatrick
C.P.E., INCORPORATED
Experts in Tax Training

Who is the Client?



- Key Issue for Communication
- Fiduciary Responsibility Issues