



**Protecting You, the Trustee, and  
the Beneficiaries  
with Fiduciary Accounting**

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# Objective

**Use the state statutes as your protection.**



# Why are the definitions so important?

- Defines what we are doing. Different from normal tax terminology and concepts.
- Defines how to account and record transactions. Our road map.
- They protect you when challenged.



## What is Income?

Section 738.102 (5) - Money or property received by a fiduciary as a current return from the Principal (i.e. Interest, Dividends, Royalty)

- **Question** - *What about mutual funds and receipt of 1099's how do you record?*
- **Question** – *What about 1099's that reflect dividends in ex-date but not received?*



## **What is Income?**

Section 738.502 – Rental Income - Rent deemed income except for refundable deposits, or deposit deemed advance payments. Become income when service provided or deposit is nonrefundable.



## What is Income?

Section 738.401 – Entities – (2) General Rule - receipt from entity is income.

➤ **Exceptions –**

- Property other than money,
- One or more of a series of distributions for interest in entity
- Total or partial liquidation receipt.
- Reg. Investment Company or REIT classified as STCG or LTCG

➤ **Question – *What about the income on the Schedule K-1 we receive?***



# What is Income?

## Section 738.602 Deferred Comp, Annuities etc....

- Payments are income if:
  - (2) Deemed to be interest or dividend. Principal otherwise.
  - (3) May also use a unitrust calculation approach to allocate to income and or principal.



# What is Income?

## Section 738.403 Business Activity in a trust

- (1) Trustee can account for business activity separate from all other aspects of trust.
- (2) Trustee determines working capital needs.
  - Sale of assets except for inventory is principal transaction.
- **Question – *Can Trustee change their opinion later (more than 1 year)?***
- **Question – *Will an accounting for a separate business activity qualify for fiduciary accounting purposes***



# What is Income?

## Section 738.701 – Disbursements from Income

- (1) ½ of trustee fees, investment fees
- (2) ½ of accounting fees and professional fees
- (3) Payment of ordinary expenses connected with administration, management preservation etc...
- (4) Recurring premium payments for insurance coverage.



# What is Income?

## Section 738.503 Obligation to pay money

- (1) In general allocated to income
- (2) Allocate to principal if from sale redemption or other disposition



## What is Principal?

Section 738.102 (11) - Property held in trust for distribution to a remainder beneficiary when the trust terminates



# What is Principal?

## Section 738.501 – Principal Receipts are

- (1) Assets received
- (2) Sale, liquidation, or exchange of an asset
- (3) Receipts due to previous disbursements due to environmental cleanup or reclamation of property
- (4) Proceeds from involuntary conversion



# What is Principal?

## Section 738.702 Principal Disbursements

- ½ of trustee fees, investment fees, accounting fees, professional fees
- Trustee compensation for acceptance, termination distribution or disbursement of property for sale.
- Payments of principal
- Expenses of a proceeding that concern the principal asset
- Premium payments on life insurance
- Estate Taxes including penalties apportioned to the trust.
- Environmental matters
- Extraordinary repairs and capital improvements
- Special Assessments



## What is Principal?

Section 738.504 Insurance policies - Insurance payments allocate to principal. If dividend payment, allocate to income.



# What is Principal?

## Section 738.603 – Liquidating Assets

- (1) Diminishing asset ex. Leasehold, patents, copyrights, royalties
- (2) Allocate 5% to income, balance to principal.



## What is Principal?

### Section 738.703 Transfers from Income to Principal for Depreciation

- (2) Trustee may transfer from income to principal for depreciation

Exceptions are personal residence, personal tangible property used by beneficiary and administration of estate

- (3) Tax depreciation is deemed reasonable



## What about Income Taxes?

Section 738.705 - Source of income for income taxes determines source of payment.

- **Question** – *What about paying beneficiary's income taxes?*



# Fiduciary Duties and the Power to Adjust

## Section 738.103

- (1) Allocating between Income and Principal within the scope of 738.201,202 and 301-303.
- (2) Exercising the Power to adjust under 738.104(1)



# Fiduciary Duties and the Power to Adjust

## Section 738.104

- (1) Trustee has the power to adjust to the extent the trustee deems it is necessary, if prudent investor investment management used, and trustee follows the trust document.



## Fiduciary Duties and the Power to Adjust

### Section 738.104 (continued)

- (2) Factors to be considered before utilizing the power to adjust.
  - nature purpose and duration of trust
  - intent of grantor
  - identity and circumstances of beneficiaries
  - liquidity needs, preservation and appreciation of capital
  - types of assets,
  - trustee's ability to invade principal
  - anticipated tax consequences



## Fiduciary Duties and the Power to Adjust

### Section 738.104 (continued)

- (3) Trustee may not adjust
  - (a) QTIP
  - (b) Reduces actuarial value
  - (c) Fixed Annuity or Fixed Percentage of Assets (GRIT, CRUT, CLUT, GRAT, CRAT, CLAT)
  - (d) Permanently set aside for charitable purposes, unless both income and principal are set aside.
  - (e) & (f) Exercise power to adjust treats beneficiary as owner of trust.
  - (g) Trustee beneficiary of trust
  - (h) Adjustment would benefit trustee



## **Fiduciary Duties and the Power to Adjust**

### Section 738.104 (continued)

- (4) e,f,g and h do not apply if there is a co-trustee who has the authority to adjust and is not a beneficiary of the trust.



## **Fiduciary Duties and the Power to Adjust**

### Section 738.104 (continued)

- (5) Release of Power Trustee may release power if trustee is converting trust to unitrust.
  - Release complete power to adjust or from one direction to the other if uncertain about result of having specific power or deprive trust of tax benefit or impose on the trust a tax burden.
  - Release may be permanent or for a specific period of time.



## **Fiduciary Duties and the Power to Adjust**

### Section 738.104 (continued)

- (7) Nothing in this chapter is intended to create or imply a duty to make an adjustment. No inference of impropriety shall be made as a result of a trustee not exercising the power to adjust.



## Fiduciary Duties and the Power to Adjust

### Section 738.104 (continued)

- (8) Trust existing prior to 1-1-2003. Cannot adjust without providing written approval and no objection is filed. Super majority of beneficiaries must approve. Review objections proceedings. Objection is valid for one year.
- A supermajority of beneficiaries (66 2/3%) can request and force a trustee not to make the adjustment. Court action not necessary.
- Receive approval from beneficiaries prior to making adjustment
- Nothing in this chapter is intended to create or imply a duty to make an adjustment. No inference of impropriety shall be made as a result of a trustee not exercising the power to adjust.



## Fiduciary Duties and the Power to Adjust

### Section 738.104 (continued)

- (9) Statement Required to exercise power.
- (10) Trust exists on January 1, 2003 if it is not revocable on that date.
- **Question – *What about distributions using ascertainable standards?***



# Total Return Trust

## Section 738.1041 Total Return Trust

- (2) Trustee may convert from total return to income and vice versa without court approval.
  - Must define FMV when valued and manner of calculation.
  - Cannot be greater than 5% or less than 3%.
  - May exclude assets from FMV
- **Questions – *Why and are we subjecting ourselves to a potential litigation by excluding? What assets are we excluding?***



# Total Return Trust

## Section 738.1041 Total Return Trust

- (4) Upon conversion treat unitrust amount as income per document.

### Pecking order of distribution from total return trust

- Ordinary income
  - Taxable Income
  - Tax Exempt Income
- Short Term Capital Gains
- Long Term Capital Gains



# Total Return Trust

## Section 738.1041 Total Return Trust

- (6) Conversion shall not affect any other provisions of the document (QTIP).



# Residual and Remainder Distribution

## Section 738.202 Distribution of Residuary and Remainder Interest

- (1) Pro-rata based on FMV at distribution date.
  - Income is distributed pro-rata based on assets received.



# Residual and Remainder Distribution

## Section 738.202 Distribution of Residuary and Remainder Interest

- (2) Each beneficiary is entitled to income whether they have received their residual distribution or not.
- **Question** – *Does this mean the beneficiary has income even if they do not receive any distribution until the following year?*
- **Question** – *Does the Trust pay the taxes for the beneficiary who did not receive their income in that year?*



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*Certified Public Accountants and Business Consultants*

*Right Answers. Right Now.®*

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