

A group of business professionals are seated around a glass conference table in a modern office setting. A man with glasses and a blue blazer is the central focus, looking intently at someone off-camera. Other participants, including a woman with brown hair and another man with glasses, are visible in the background and foreground, some with their backs to the camera. The scene is brightly lit with natural light from large windows in the background.

# The nuts and bolts of fiduciary accounting

2024 Nevada Trust Conference  
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# Your speaker

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Francine is a frequent speaker at industry conferences and a published author on topics impacting fiduciaries, including fiduciary leading practices, fiduciary accountings, the role of fiduciary accountings in litigation and the calculation of fiduciary accounting income.

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# Agenda



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# 01

## Fiduciary duties and responsibilities



# Acting as a fiduciary is not easy

The duties of the trustee or executor will vary depending on the type of assets, the instructions in the trust document and the needs of the beneficiary:

- ▶ Type of trust
- ▶ Value of the assets
- ▶ Type of assets
- ▶ Common law and state statutes impose certain duties on trustees; the breach of a duty can result in a liability



# Challenges to consider when agreeing to act as a trustee

- ▶ Risk assessment
- ▶ The time and expertise needed
- ▶ Pending lawsuits
- ▶ Pending tax issues
- ▶ Why the prior trustee resigned/was terminated
- ▶ Whether any of the beneficiaries have special issues and whether elderly settlor(s) are still alive
- ▶ Family dynamics
- ▶ Understanding the scope of the obligations under the trust and any agreements
- ▶ Whether there are unique trust terms that may hamper or enhance the trustee's ability to accomplish needed tasks during administration
- ▶ Whether there are special assets
- ▶ Whether there are liquidity concerns
- ▶ Whether there are multiple trustees and whether there is a trust protector



# Key fiduciary duties

## Loyalty

- ▶ Administer the trust solely in the interests of the beneficiary

## Good faith

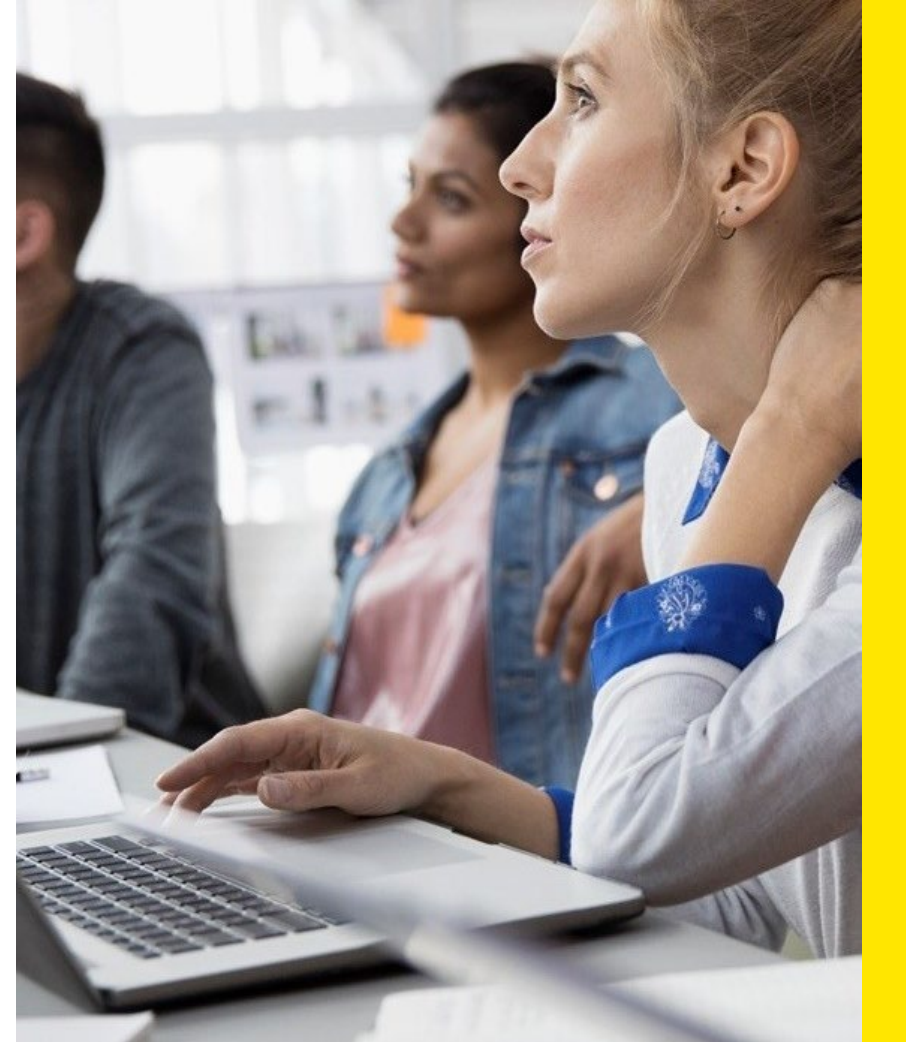
- ▶ Administer the trust in accordance with its terms and the provisions of the applicable probate code and law

## Inform and account

- ▶ Keep the beneficiaries apprised of the status of the assets entrusted to them

## Prudence

- ▶ Administer the trust as a prudent person by considering the purposes, term, distribution requirements and other circumstances of the trust





# Key fiduciary duties

## Care

- ▶ Exercise reasonable care, skill and caution in the performance of duties and the delegation of responsibilities (e.g., choosing an agent)
- ▶ Uniform Prudent Investor Act

## Frugality

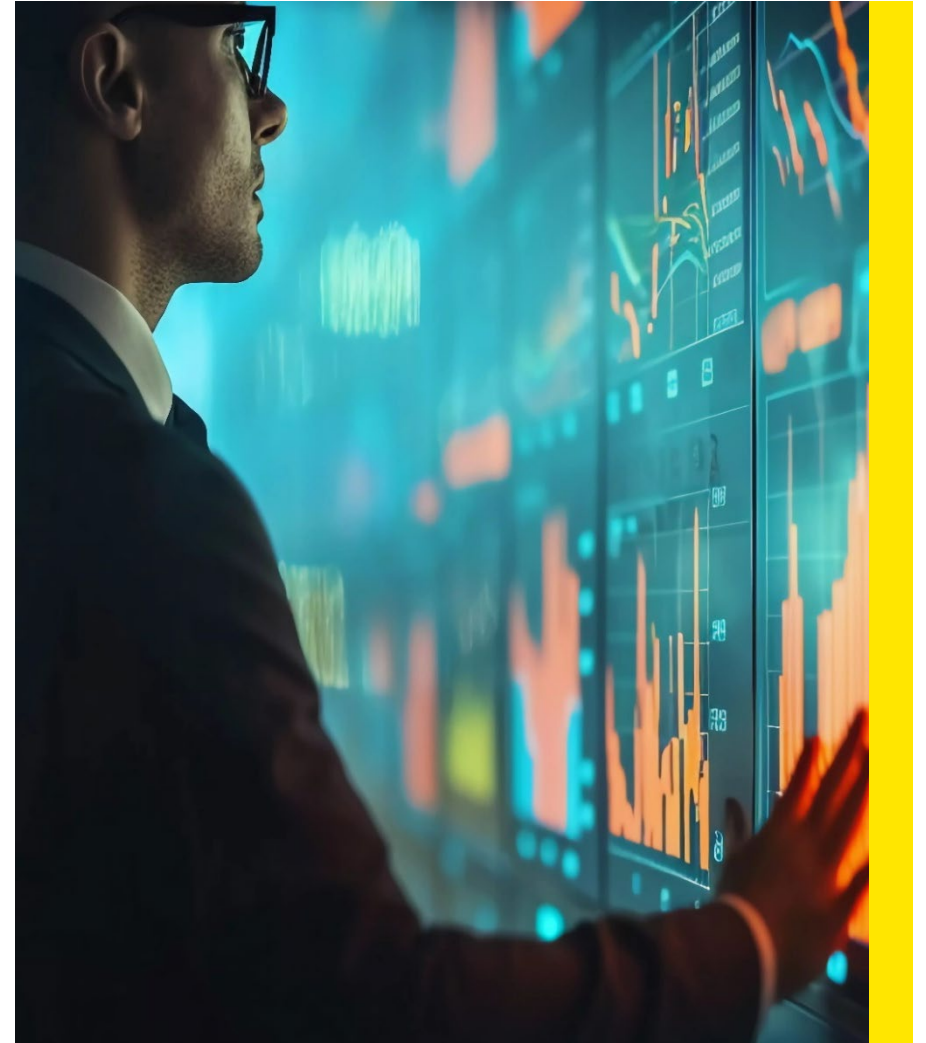
- ▶ Incur only costs and expenses that are reasonable in relation to the trust property, trust purpose and skills of the fiduciary
- ▶ Follow settlor's intent, unless it results in a breach
- ▶ Religion and race restrictions vs. changing last name

## Impartiality

Absent special instructions, cannot prefer one class of beneficiaries over another

## Control

- ▶ Control, keep track of and preserve trust property





## Fiduciary accounting basics

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# What is a fiduciary accounting?

- ▶ A statement of the receipts and disbursements managed by the fiduciary during a specific period, allocating all transactions between principal and income
- ▶ Cash-based accounting, like balancing a checkbook; not according to GAAP
- ▶ Accountings are governed by:
  - ▶ Trust/will, then
  - ▶ Nevada Uniform Principal and Income Act (or other applicable state's law)





# When?

## Events that may trigger the need for an accounting

- ▶ State law or the governing instruments
- ▶ Request by a beneficiary
- ▶ Death of a beneficiary or trustee
- ▶ Termination of trust due to term or end of a measuring life (e.g., beneficiary comes of age)
- ▶ Resignation of a trustee or executor
- ▶ Acceptance of appointment by a successor trustee or executor (to protect against a breach by the predecessor trustee or executor)
- ▶ Court-ordered
- ▶ Special needs trusts/conservatorships
- ▶ Charitable trusts on termination



# Duty to account – Nevada

- ▶ Testamentary trusts – Except otherwise provided by the will or court order, the trustee shall account for the income and principal of a testamentary trust **until the termination of the trust** in the same manner as a trustee of a non-testamentary trust. Nev. Rev. Stat. Ann. § 165.1201
- ▶ Non-testamentary trusts – Has a duty to account by delivery of an account in the form, manner and to the person as required by the trust instrument. Nev. Rev. Stat. Ann. § 165.1204



# Delivery of account, frequency and when deem final

## Nev. Rev. Stat. Ann. § 165.1214

- ▶ Except as otherwise required in the trust instrument, the **trustee shall deliver an account within 90 days after the end of the period of account**, which may be extended by the beneficiaries or court order.
- ▶ The account can be delivered by mail or electronically.
- ▶ An account is deemed approved and final:
  - ▶ By the beneficiary who received a copy **if no written objection is received within 90 days** after the date on which the trustee provided the account
  - ▶ By all beneficiaries who are not required to receive an account, such as nonvested and contingent beneficiaries, remote beneficiaries, minor beneficiaries, and unborn or unknown beneficiaries if the account is deemed approved and final by a beneficiary who has a similar, but preceding interest, in the trust estate or as to any beneficiary who has waived an account pursuant to NRS 165.121
  - ▶ By court





# Duty to account and who is entitled to receive it

## Nev. Rev. Stat. Ann. § 165.1207

- ▶ Unless otherwise provided in the trust instrument, the trustee of a non-testamentary trust shall deliver an account upon demand to each current beneficiary and to each remainder beneficiary. A remote beneficiary or a beneficiary whose only interest is a discretionary interest.
- ▶ Under limited circumstances the trustee of a revocable trust is only required to deliver an accounting to the settlor.
- ▶ For an irrevocable trust subject to a broad power of appointment, the trustee is only required to deliver the account to the power holder.
- ▶ Does not have to deliver an account to a beneficiary who waived the right to receive an account.



# Form and contents of account

## Nev. Rev. Stat. Ann. § 165.135

- ▶ 1. An account must include:
  - ▶ (a) A statement indicating the accounting period;
  - ▶ (b) With respect to the trust principal:
    - ▶ (1) The trust principal held at the beginning of the accounting period, and in what form held, and the approximate market value thereof at the beginning of the accounting period;
    - ▶ (2) Additions to the trust principal during the accounting period, with the dates and sources of acquisition;
    - ▶ (3) Investments collected, sold or charged off during the accounting period;
    - ▶ (4) Investments made during the accounting period, with the date, source and cost of each investment;
    - ▶ (5) Any deductions from the trust principal during the accounting period, with the date and purpose of each deduction; and
  - ▶ (6) The trust principal, invested or uninvested, on hand at the end of the accounting period, reflecting the approximate market value thereof at that time;
  - ▶ (c) With respect to trust income, the trust income:
    - ▶ (1) On hand at the beginning of the accounting period, and in what form held;
    - ▶ (2) Received during the accounting period, when and from what source;
    - ▶ (3) Paid out during the accounting period, when, to whom and for what purpose; and
    - ▶ (4) On hand at the end of the accounting period and how invested;
  - ▶ (d) A statement of unpaid claims with the reason for failure to pay them; and

# Form and contents of account

## Nev. Rev. Stat. Ann. § 165.135 (continued)

- ▶ (e) A brief summary of the account, which must include:
  - ▶ (1) The beginning value of the trust estate:
    - ▶ (I) For the first accounting, the beginning value of the trust estate shall consist of the total of all original assets contained in the beginning inventory.
    - ▶ (II) For accountings other than the first account, the beginning value of the trust estate for the applicable accounting period must be the ending value of the prior accounting.
  - ▶ (2) The total of all receipts received during the accounting period, excluding capital items.
  - ▶ (3) The total of all gains on sales or other disposition of assets, if any, during the accounting period.
  - ▶ (4) The total of disbursements and distributions during the accounting period.
  - ▶ (5) The total of all losses on sales or other disposition of assets, if any, during the accounting period.
- ▶ 4. *Notwithstanding the provisions of subsections 1, 2 and 3, an account may instead consist of:*
  - ▶ (a) A statement indicating the accounting period and a financial report, which must consist of a compilation or financial statement of the trust prepared by a certified public accountant and include summaries of the information required by subsection 1; or
  - ▶ (b) A statement prepared by the trustee, the contents of which are agreed to by the trustee and the person receiving such report as sufficient to serve as an account.
- ▶ An account prepared pursuant to this subsection must be in a writing, signed by the person receiving the information and documentation, delivered to the trustee, and may include a waiver of account.



# Why?

## Accountings protect both the beneficiaries and the fiduciary

- ▶ Protects beneficiaries:
  - ▶ Since an accounting requires the fiduciary to disclose all activity in the trust or estate that the beneficiary can review, if there is any disagreement, the beneficiary can challenge.
- ▶ Protects fiduciaries:
  - ▶ Except in instances of fraud, fiduciaries are protected from future liability for the period covered in the accounting.
- ▶ If the trustee doesn't account, then the statute of limitations for surcharge doesn't start. There is no reason to delay.
- ▶ Accountings can be beneficial in tax audits.



# How to settle an accounting

- ▶ Judicial – filed in court
  - ▶ Pros:
    - ▶ It has the most protection.
    - ▶ Once approved, no beneficiary who is given notice of the accounting can ever again object to any act and/or transaction disclosed in that court-approved account.
    - ▶ Without such approval, the statute of limitations is typically three years (in some states, the time period can be shorter).
    - ▶ The trustee may remain liable for any act/transaction that is not disclosed in the accounting.
  - ▶ Cons:
    - ▶ It is more expensive.
    - ▶ It takes a longer time to resolve.
    - ▶ The beneficiary may object, causing protracted litigation.
- ▶ Settled outside of court – informal
- ▶ Nevada: By the beneficiary who received a copy **if no written objection is received within 90 days** after the date on which the trustee provided the account



## How to account

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# Step 1. Review the trust instrument

- ▶ Are there special principal and income allocations?
- ▶ Does the trustee have discretion to allocate between principal and income?
- ▶ Does the trustee have discretion to distribute principal?
- ▶ Who are the beneficiaries?
- ▶ Are there any conditions that must be satisfied for a distribution to be made (e.g., beneficiary must be a certain age, have attained a certain level of education)?



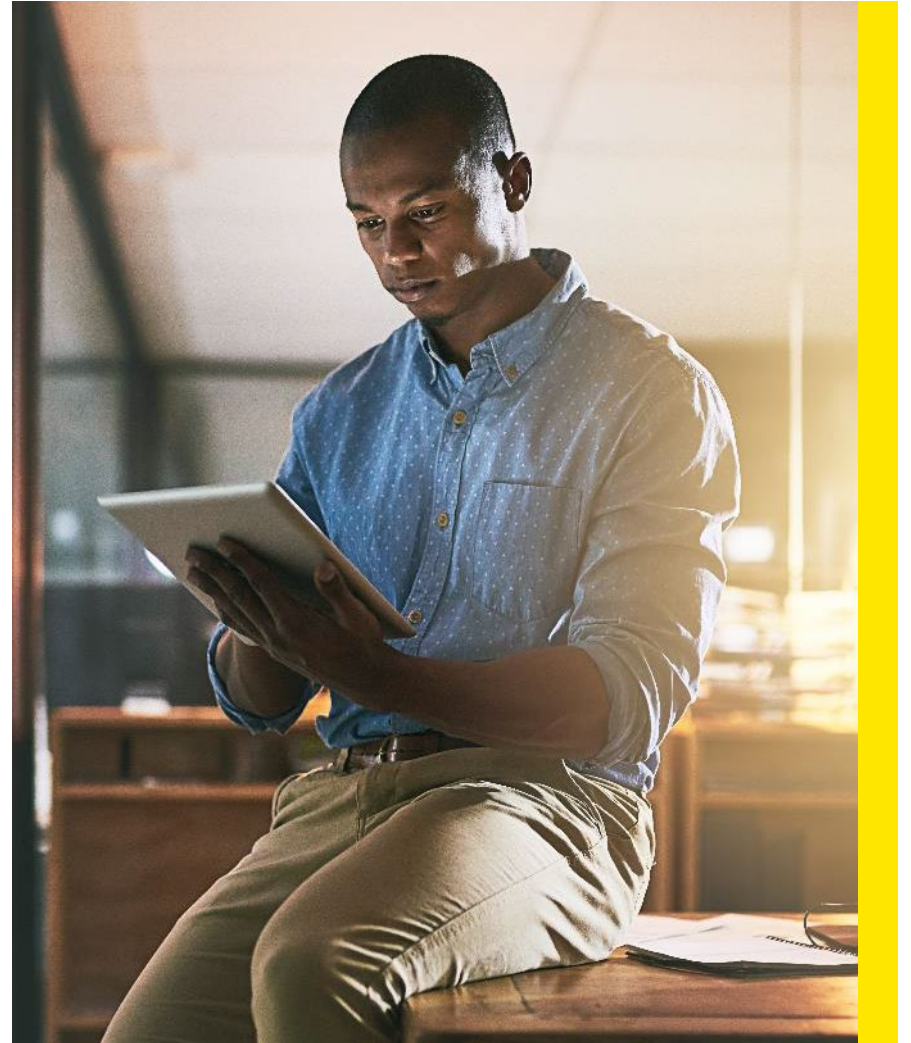
## Step 2. Determine what state's rules apply

- ▶ Sometimes stated in the governing instrument
- ▶ Can become more complex with long-dated trusts
- ▶ Not all states have adopted the Uniform Principal and Income Act (UPIA):
  - ▶ Even for states that have adopted the UPIA, some have made modifications.
- ▶ Seven states have adopted the Uniform Fiduciary Income and Principal Act (UFIPA) – Arkansas, California, Colorado, Kansas, Utah, Virginia and Washington.
  - ▶ Legislation introduced: Florida and Missouri



# Step 3. Gather the data

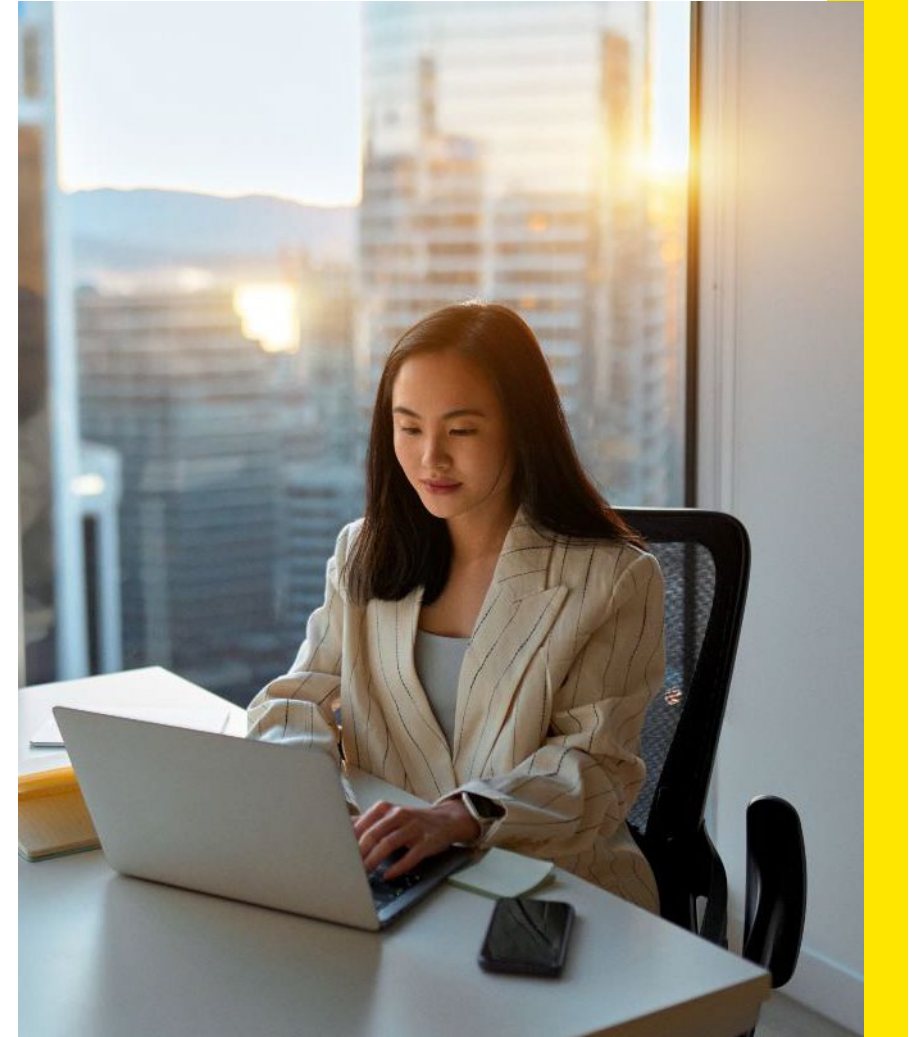
- ▶ The will (if applicable) and trust instruments
- ▶ IRS Form 706, if applicable
- ▶ Documentation supporting inception values (e.g., valuation reports, inventory, opening brokerage statements)
- ▶ Copy of prior accounting
- ▶ Statements covering the accounting period (e.g., brokerage, checking accounts with ledger, subaccounts)
- ▶ Loan agreements and amortization schedules
- ▶ Current list of assets held in the trust
- ▶ Dividend reinvestment accounts
- ▶ Closing statements for real estate sales
- ▶ Settlement agreements
- ▶ Any petitions or other court filings





# Determining opening inventory (aka carry value)

- ▶ Opening inventory is needed for the first accounting.
- ▶ It is the beginning value of an asset for which the fiduciary is accountable:
  - ▶ If the asset was acquired by the trust or the estate – the acquisition cost or fair market value (FMV) (e.g., a gift)
  - ▶ For estates of decedents and revocable trusts after the grantor's death and assets becoming subject to a trust by reason of a will – typically, the final value determined for estate tax purposes
  - ▶ In other cases, the FMV of the asset at the beginning of a fiduciary's administration:
    - ▶ Note: If a trust distributes an asset to another trust, the carry value in the new trust is the FMV on the date of transfer, not the carry value of the distributing trust.
- ▶ Accrued interest and accrued dividends are not shown on the opening value – include in income (only applicable for trusts).
- ▶ Typically, the positions are principal; however, there are exceptions.



# Determining opening inventory (aka carry value)

- ▶ For subsequent accountings, the opening inventory should exactly match the ending inventory values listed on the prior accounting.
- ▶ When there is a change in the fiduciary, the new fiduciary can change the carry value to the FMV at time of change:
  - ▶ If there is a substantial unrealized loss, the new fiduciary's performance can be measured based on the FMV at the time the person took over and by the poor performance of the prior trustee.
  - ▶ If there is a substantial unrealized gain, the new fiduciary's performance should not benefit by the good performance of the prior trustee.





# Accountings should rely on good source data

The accounting should reflect all the information contained in the source data:

- ▶ Checking, savings and brokerage account statements
- ▶ Trust statements
- ▶ Estate settlement documents
- ▶ Brokerage houses generally maintain records for a shorter period.
- ▶ Reconstruction may be required to reconcile missing documentation.





# Detailed documentation

**Each transaction must be listed on the appropriate schedule and should be itemized with a detailed description:**

- ▶ Checks written, cash withdrawals and deposits, and wire transfers
- ▶ Each dividend and interest payment should be described by source and date.
- ▶ Each disbursement should be listed separately by payee and date, not grouped together in a broad category:
  - ▶ Tax payments, separated by type of tax payment
  - ▶ Expenses paid on behalf of a beneficiary



# Wire transfers/checks and deposits

**Many banks do not provide substantive descriptions for wire transfers on statements or as part of transaction details. It is important to know the source of the funds and what they were used for:**

- ▶ If a distribution from a partnership is received via a wire transfer, what partnership wired the money and why?
- ▶ When the trust sends a wire, who is the money going to and why (e.g., to pay a bill, make a capital contribution on a partnership or LLC)?
- ▶ Statements typically only show check numbers:
  - ▶ The preparer should request copies of checks or get details from the fiduciary.
- ▶ Some deposits only show account numbers with no name.
- ▶ You need to request details.

**Don't settle; ask questions!**

# Asset reconciliation

- ▶ The accounting should identify all assets held in the trust or estate.
- ▶ Assets that have been removed, transferred or disbursed should be shown.
- ▶ All assets that belong to the trust or estate should be disclosed, regardless of where the assets are held.
- ▶ For a first accounting, the opening balance will consist of the list of assets funding the account.
- ▶ For subsequent accountings, the opening balance should exactly match the ending inventory values listed on the prior accounting.
- ▶ Use carry value vs. market value on the list of assets.

**If the closing balance of the subsequent accounting  
doesn't match the opening balance of the prior accounting,  
something was missed.**



# Income collection verification

The income received on investments should be compared with the principal and income investment schedules.



All dividends, interest and other income should be verified to have been properly collected.



For loans, have payments been received?



For partnerships and mutual funds, unless provided with correspondence from the funds, it is difficult to determine whether all moneys due have been collected.

# Capital changes are identified and properly reported

- ▶ **Stock split:** This is a division of corporate stock by the company to existing shareholders of a specified number of new shares with a corresponding lowering of value for each outstanding stock; for example:
  - ▶ A 2-for-1 stock: For 100 shares of a company that has a 2-for-1 split, you'll end up with 200 shares after the split.
- ▶ **Reverse stock split:** A corporation merges its existing shares of stock into a smaller number of shares, which raises their price; for example:
  - ▶ A 1:10 reverse stock split: For 1,000 shares each worth \$1, one would have 100 shares worth \$10 each after the split.
- ▶ **Spin-off:** This occurs when a company creates a new independent company by selling or distributing new shares of its existing business. It is a type of divestiture.
- ▶ **Mergers and acquisitions:** Two or more companies agree to merge themselves to form a new company.



# Capital changes

- ▶ Statements should show if a capital change has occurred.
- ▶ Client statements are unique and report capital changes in different ways and with different details.
- ▶ Capital changes should be carefully reviewed to confirm that the inventory values are properly applied, along with details of the assets spun off or exchanged.
- ▶ Additional research may be necessary utilizing a capital change subscription service.

**The accounting may not reconcile if a capital change is reported incorrectly or missed.**



# Accounting must balance

- ▶ The total charges should equal the total credits.
- ▶ Cash and assets should be reconciled separately so that they are reconciled properly.

Cash reconciliation	
Cash on hand (beginning assets on hand)	Cash disbursements (disbursements or distributions)
Cash receipts (additions or receipts)	Purchases/reinvestments
Sales proceeds (gain or loss)	Cash on hand (end assets on hand)
Total =	Total
Asset reconciliation	
Assets on hand (beginning assets on hand)	Assets sold carry value (gain or loss)
Asset purchases	Return of principal
Asset reinvestments	Assets on hand (end assets on hand)
Total =	Total

# Common mistakes we've seen

- ▶ **Principal and income incorrectly allocated**
- ▶ Distributions not made in accordance with the trust:
  - ▶ Distributions made from principal when not permitted
- ▶ Incorrect calculation of final distributions upon trust termination (e.g., 10% to charity A, 20% to charity B)
- ▶ Incorrect calculation of unitrust or annuity payments
- ▶ **Expenses incorrectly allocated:**
  - ▶ Example: For trustee commissions in New York State, it is one-third income, two-thirds principal, and accounting fees are 100% to the principal.
- ▶ **Expenses/distributions miscategorized:**
  - ▶ Trust pays expenses of beneficiary that should be treated as beneficiary distributions (e.g., expenses on property not owned by the trust, medical).
- ▶ Missing assets or including assets that are not trust property



**Incorrect allocations could result in the income beneficiary getting too much or too little.**

# Common mistakes we've seen

## **Not following the trust or the will:**

- ▶ Who is entitled to distributions?
- ▶ Special rules for allocating principal and income.
- ▶ Is there discretion in allocating expenses?
- ▶ What state laws apply?
- ▶ If the trust or will does not provide specific rules, look to the applicable state's principal and income act.
- ▶ Relying on the UPIA:
  - ▶ Not all states adopted the UPIA (e.g., Illinois).
  - ▶ Even when adopted, many states have made modifications.
  - ▶ Seven states have adopted the UFIPA.
- ▶ Tax situs and the rules governing the administration of the trust can sometimes differ.





# Common mistakes we've seen

- ▶ “Data dump” vs. an accounting
- ▶ Not knowing the principal and income rules
  - ▶ Income tax payments are allocated between principal and income.
  - ▶ How to treat payments from IRA, annuities and pension plans.
  - ▶ Absent special instructions, discretionary HEMS payments are distributions to the beneficiary out of principal, not disbursements from trust income (i.e., not a trust expense).
  - ▶ Default rule is principal.
  - ▶ Special rules for determining if a payment from an entity is principal or income.
- ▶ Identifying if there is a death or termination of an income interest to know which rules apply
- ▶ Not many people understand the rules!



# Disbursements vs. distributions

## What is a trust expense?

- ▶ Any payments related to the trust or asset owned by the trust
- ▶ Real estate taxes on trust-owned property
- ▶ Estate taxes
- ▶ Funeral expenses, decedent's debts, etc.
- ▶ Legal fees
- ▶ Commissions
- ▶ Investment advisory fees
- ▶ Accounting/tax prep fees
- ▶ Filing fees
- ▶ Fees to maintain trust property

# Disbursements vs. distributions

## What is a distribution?

- ▶ Payments to or on behalf of a beneficiary (e.g., school tuition)
- ▶ Real estate expenses (including mortgage payments) paid on property not held by trust (e.g., beneficiary's house)
- ▶ Beneficiary's personal income taxes – Form 1040 and personal state taxes
- ▶ Beneficiary's medical expenses (e.g., doctors, medical insurance, pharmaceutical expenses)
  - ▶ Some financial institutions and fiduciaries treat certain beneficiary expenses (e.g., medical expenses) for SNTs as a disbursement from income instead of a distribution to the beneficiary from principal.
- ▶ Expenses on items for beneficiary's own use (e.g., car payments, vacations, education expenses)



# Challenges we've seen working with nonprofessional fiduciaries

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- ▶ Commingling funds
- ▶ Treating the trust as a personal “piggy bank”
- ▶ Lack of record-keeping and missing documents (the classic “receipts in a grocery bag”)
- ▶ Missing descriptions (e.g., checks, ATM withdrawals/deposits, wire transfers)
- ▶ Missing charge card receipts
- ▶ Running up fees:
  - ▶ Legal and accounting bills
  - ▶ Bounced checks and late-payment fees
- ▶ Finding more “stuff after the fact” (e.g., additional banking accounts, transactions)
- ▶ Reliance on memory
- ▶ Opening too many banking and brokerage accounts
- ▶ Failure to identify all the trust property (e.g., the apartment in Palm Desert)
- ▶ Bad family dynamics
- ▶ Inexperience
- ▶ Inconsistent and/or unequal preliminary distributions



## Calculating fiduciary accounting income

# Why fiduciary accounting income (FAI) is important

- ▶ Income available for payment trust income beneficiaries:
  - ▶ Dividends, income and ordinary income
- ▶ Principal available for remainder beneficiaries and discretionary distributions:
  - ▶ Capital gains and other receipts that are principal
- ▶  $FAI = \text{Income} - \text{all expenses attributable to income}$
- ▶ Look to the trust instrument for guidance; if unclear or silent, look to state law
- ▶ If FAI is not calculated correctly:
  - ▶ Some beneficiaries can receive less than they are entitled to.
  - ▶ Some beneficiaries receive overpayments.
  - ▶ This can lead to litigation.





# Nevada Uniform Principal and Income Act

## Receipts

- ▶ 164.825. **Allocation of money received from entity to income;** allocation of receipts from entity to principal; determination of money as return of capital; reliance upon financial statements and other information about character of distribution or source of funds from which distribution is made.
- ▶ 164.830. Allocation of amount received as distribution of income to income; allocation of distribution of principal to principal; purchase of interest in trust that is investment entity.
- ▶ 164.835. Accounting separately for business or other activity.
- ▶ 164.840. **Allocation of assets, money, property and other receipts to principal.**
- ▶ 164.845. **Allocation of receipts from rental property to income;** treatment of refundable deposit.
- ▶ 164.850. **Allocation of interest on obligation to pay money to trustee to income;** allocation of amount received from disposition of certain obligations to principal; applicability of provisions.
- ▶ 164.855. **Allocation of proceeds of life insurance policy** and certain contracts to principal; allocation of dividends on insurance policy to income or principal.
- ▶ 164.860. Allocation of entire amount to principal if allocation between principal and income under certain circumstances is insubstantial.
- ▶ 164.865. Allocation of certain payments received because of services rendered or property transferred to payor in exchange for future payments to income or principal, or both; certain exceptions for trusts that qualify for marital deduction under federal law.
- ▶ 164.870. **Allocation of receipts from liquidating assets to income and principal.**
- ▶ 164.875. **Allocation of receipts from interest in minerals to income or to income and principal;** allocation of receipts from interest in water to income or to income and principal; applicability.

# Nevada Uniform Principal and Income Act

## Receipts (continued)

- ▶ 64.880. **Allocation of net receipts from sale of timber** and related products to income or principal, or both; applicability.
- ▶ 164.885. Request of spouse if marital deduction is allowed and amounts transferred from principal to income and distributed are insufficient to obtain marital deduction; proceeds from sale or disposition of assets generally principal.
- ▶ 164.890. Allocation of receipts from and disbursements made in connection with transactions in derivatives to principal; allocation of amount received for granting certain options to principal.
- ▶ 164.895. Allocation from proceeds of collateral financial assets to income and principal; allocation of payments in exchange for interest in asset-backed security to principal or to principal and income.

# Nevada Uniform Principal and Income Act

## Disbursements

- ▶ 164.900. Disbursements required to be made from income; reduction of amount charged against income.
- ▶ 164.905. Disbursements required to be made from principal.
- ▶ 164.910. Transfer of net cash receipts from principal asset subject to depreciation to principal.
- ▶ 164.915. Transfer of amount from income to principal to make certain principal disbursements.
- ▶ 164.920. Payment of taxes required to be paid by trustee.
- ▶ 164.925. Adjustments between principal and income to offset shifting economic interests or tax benefits between income beneficiaries and remainder beneficiaries; reimbursement of principal if estate taxes are increased and income taxes are decreased under certain circumstances.



# Disbursements from income

## Nev. Rev. Stat. Ann. § 164.900

- ▶ 1. A trustee shall make the following disbursements from income to the extent that they are not disbursements to which paragraph (b) or (c) of subsection 2 of NRS 164.800 applies:
  - ▶ (a) Except as otherwise provided in subsection 2 or otherwise ordered by the court, **one-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee;**
  - ▶ (b) Except as otherwise ordered by the court, **one-half of all expenses for accountings, judicial proceedings, or other matters that involve both the income and remainder interests;**
  - ▶ (c) **All the other ordinary expenses incurred in connection with the administration, management or preservation of trust property and the distribution of income, including interest, ordinary repairs, regularly recurring taxes assessed against principal, and expenses of a proceeding or other matter that concerns primarily the income interest; and**
  - ▶ (d) All recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.
- ▶ 2. If the amount charged to the income of an irrevocable trust pursuant to paragraph (a) of subsection 1 exceeds 15 percent of the income of the trust in the accounting period, the trustee shall exercise the authority in NRS 164.795 to equitably reduce the amount charged against income for that accounting period unless:
  - ▶ (a) The trustee, after taking into consideration the terms of the trust instrument, reasonably concludes that the reduction is not in the best interest of the beneficiaries of the trust;
  - ▶ (b) The reduction of the amount charged to income would violate the express terms of the trust instrument other than a general directive to comply with the Uniform Principal and Income Act (1997) or with a general provision that contains language similar to that found in paragraph (a) of subsection 1;
  - ▶ (c) The trustee is authorized under the terms of the trust instrument to distribute trust principal to each income beneficiary; or
  - ▶ (d) The trustee gives notice in compliance with NRS 164.725 of the intent not to make the adjustment and no current income beneficiary objects.

# Disbursements from principal

## Nev. Rev. Stat. Ann. § 164.905

- ▶ 1. A trustee shall make the following disbursements from principal:
  - ▶ (a) **The remaining portion of the disbursements described in paragraph (a) of subsection 1 of NRS 164.900;**
  - ▶ (b) All the trustee's compensation calculated on principal as a fee for acceptance, distribution or termination, and disbursements made to prepare property for sale;
  - ▶ (c) **Payments on the principal of a trust debt;**
  - ▶ (d) Expenses of a proceeding that concerns primarily principal, including a proceeding to construe the trust or to protect the trust or its property;
  - ▶ (e) Premiums paid on a policy of insurance not described in paragraph (d) of subsection 1 of NRS 164.900 of which the trust is the owner and beneficiary;
  - ▶ (f) **Estate, inheritance and other transfer taxes, including penalties, apportioned to the trust;** and
  - ▶ (g) Disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties, and defending claims based on environmental matters.
- ▶ 2. If a principal asset is encumbered with an obligation that requires income from that asset to be paid directly to the creditor, the trustee shall transfer from principal to income an amount equal to the income paid to the creditor in reduction of the principal balance of the obligation.

# Rules after death of decedent or end of income interest in trust

## [Nev. Rev. Stat. Ann. § 164.800](#)

- ▶ After a decedent dies, in the case of an estate, or after an income interest in a trust ends, the following rules apply:
- ▶ 1. A fiduciary of an estate or of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically given to a beneficiary ... The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.
- ▶ 2. A fiduciary shall determine the remaining net income of a decedent's estate or a terminating income interest under the rules in NRS 164.810 to 164.925, inclusive, which apply to trustees and by:
  - ▶ (a) Including in net income all income from property used to discharge liabilities;
  - ▶ (b) **Paying from income or principal, in his or her discretion**, fees of attorneys, accountants and fiduciaries, court costs and other expenses of administration, and interest on death taxes, but the fiduciary may pay those expenses from income of property passing to a trust for which the fiduciary claims an estate tax marital or charitable deduction only to the extent that the payment of those expenses from income will not cause the reduction or loss of the deduction; and
  - ▶ (c) **Paying from principal all other disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, including debts, funeral expenses, disposition of remains, family allowances, and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust, or applicable law.**
- ▶ Note: There are additional provisions relating to distributions.



## Differences between tax and accounting



# Differences between tax and fiduciary accounting

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- ▶ Activities within pass-through entities are ignored for fiduciary accounting purposes.
- ▶ If a trust holds an interest in a partnership, LLC, S corporation or other pass-through entity, the trust only reports transfers, distributions and receipts between the two entities when the receipt is paid or a distribution is made.
  - ▶ A trust could own an interest in a partnership, LLC or S corporation with a large investment portfolio or a successful business, but until the entity makes a distribution to the trust, the trust doesn't have fiduciary accounting income.
- ▶ There are special rules to determine if a payment from the LLC to the trust is income or principal. Liquidating and partial liquidating distributions are a receipt of principal. The rules are complex.

# Differences between tax and accounting

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Method for allocating inventory on sales of securities:

- ▶ **Accounting:** weighted average
- ▶ **Tax:** first in, first out (FIFO); average basis (only for stock in mutual funds or dividend reinvestment plans) or specific identification

Estate valuation date:

- ▶ **Accounting:** date of death (some folks take the position that the alternative valuation date can be used)
- ▶ **Tax:** date of death or alternative valuation date

Partnerships:

- ▶ **Accounting:** generally treated as accounting income if distributions are made from an entity; state law varies if treated as a return of principal or income
- ▶ **Tax:** taxable income as reported on Schedule K-1

Allocation of expenses:

- ▶ **Accounting:** varies by state and maybe the governing instrument; typically split between income and principal
- ▶ **Tax:** distinction between income and principal generally not relevant in determining whether an expense is deductible for tax purposes

# Differences between tax and accounting

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Timing differences for mutual funds, common trust funds, etc.:

- ▶ **Accounting:** cash basis
- ▶ **Tax:** Form 1099

Bond amortization:

- ▶ **Accounting:** generally, not done unless specified in the instrument
- ▶ **Tax:** required for tax-exempt bonds

Federal and state tax payments:

- ▶ Allocations between principal and income generally not determined until tax returns filed
- ▶ Paid out of trust principal and true-up for income allocation when tax returns are finalized
- ▶ Trend for large trusts/estates: To align the accounting, where possible with tax reporting



# Fiduciary litigation



# Trend: increase in fiduciary litigation

Baby boomers are retiring with more wealth.

People are living longer.

Families are blended/complex.

It is more common when a family member is acting as a trustee.

People lack experience.

There are more family disputes.

Charities are beneficiaries.

There is a breach of loyalty or self-dealing.

There is a breach of the prudent investor rule.

There are more divorces.

There is negative press about professional fiduciaries.

# If you don't already have one, get an accounting

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# Common red flags

- ▶ Unusual transactions
- ▶ Account that does not balance
- ▶ Unsupported and unexplained reductions in assets
- ▶ Large expenses
- ▶ Missing income (e.g., Social Security, pensions)
- ▶ Loans to/from the trustee
- ▶ Cash expenses/missing receipts
- ▶ Cash withdrawals by debit card from the trust account
- ▶ Use of decedent's credit card after date of death
- ▶ Consolidated deposits without backup documentation to track income sources
- ▶ Hiring family members
- ▶ Commingling of assets
- ▶ Excessive compensation or irregular/off amount paid to trustees, including mileage
- ▶ The transfer of assets to non-trust accounts
- ▶ Use of trust residence without compensation to the trust
- ▶ Determining whether the trust property was made productive
- ▶ Duplicated expenses
- ▶ Hidden transaction fees in investment accounts when a quarterly fee is also being charged
- ▶ Deposits exceeding Federal Deposit Insurance Corporation (FDIC) limits
- ▶ Failure to diversify trust portfolio of financial and real property assets
- ▶ Failure to properly invest the trust assets or investing in high-yield or volatile investments
- ▶ Joint signature deposit or brokerage accounts that were created without the understanding or intention that the survivor will inherit the balance of the account at time of death
- ▶ Questionable liabilities listed

# Accountings provide a roadmap for litigation

## Review the schedules

- ▶ Prudent vs. imprudent investments
- ▶ Fraudulent payments
- ▶ Bargain sales
- ▶ Misappropriation of funds
- ▶ Whether disbursements were made pursuant to a trust or will
- ▶ Whether sibling got more than me
- ▶ Whether spending by the beneficiary was excessive
- ▶ Whether approvals of spending requests by the fiduciary were prudent or negligent (e.g., the luxury sports car)
- ▶ Elder abuse and undue influence
- ▶ Excessive fees
- ▶ Commingled funds
- ▶ Failure to allocate between subtrusts, and beneficiaries of each subtrust are different







## Accounting review – a case study

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# Case study: accounting review

There are three generations: Mary, mother of Maria; Maria; and George, Maria's son.

Mary dies on 31 October 2016.

Upon Mary's death, the trust is to terminate and distribute 80% to Maria and 20% to George.

The largest asset is Mary's home, which sells on 30 October 2020.



Property on hand at the beginning of the accounting period totals \$1,666,059.93.

Property on hand at the close of the accounting period totals \$365,410.99.

George hires counsel and demands an accounting.



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