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February 8, 2023

Via E-mail (craig_nobili@yahoo.com)
Craig M. Nobili, Trustee
The Nobili Trust, Dated May 24, 1995
44 Alta Cascata Place
Henderson, Nevada 89011

Re: The Administration of The Nobili Trust, Dated May 24, 1995

Dear Craig:

The following is a trust administration memorandum that may explain some of the duties and responsibilities that you, as trustee, may have when administering The Nobili Trust, Dated May 24, 1995. If you should have any questions or concerns about an item that is either addressed in this letter or not, please call or e-mail me.

MEMORANDUM REGARDING TRUST ADMINISTRATION

I. INTRODUCTION

The purpose of this memo is to try to anticipate your questions by providing a general overview of how trusts work and your duties and responsibilities as trustee.

II. TRUSTS IN GENERAL

A. What is a Trust?

A trust is a legal relationship, usually evidenced by a written document called a "Declaration of Trust" or "Trust Agreement," whereby one person, called the "Trustor" or “Settlor” transfers property to another person, called the "Trustee," who holds the property for the benefit of another person, called the "Beneficiary." The same person may occupy more than one position at a time. For example, in the typical revocable trust, as long as the Trustor is alive, he or she is also the Trustee and Beneficiary. On the death or incapacity of the Trustor, a "Successor Trustee" (e.g., child, friend, bank) takes over as Trustee and follows the Trustor's instructions, which are set forth in the Trust instrument, concerning the distribution of property and the payment of taxes and expenses.

B. Living Trusts and Probate Avoidance

Living trusts help to avoid probate. Probate is a court-supervised procedure for collecting a deceased person's assets, paying debts and taxes, and distributing the property to the person's beneficiaries (either according to the instructions the person set forth in his or her will or as determined by state law if the person died without a will). The probate process usually takes 9 to 12 months to complete, although it may take longer in complicated cases.

Probate is not a tax. In California, probate fees (those due to the attorney and to the personal representative) are calculated as a percentage of the gross (not net) value of the assets in the estate. These rates are set out in Probate Code §§10800 and 10810 (4 percent on the first $100,000, 3 percent on the next $100,000, 2 percent on the next $800,000, and so on). For example, let's say that Decedent, who was not married at time of death, died owning one asset, a house worth $800,000 with a mortgage of $400,000. Decedent has a will that leaves the house to Decedent's two children, A and B. C is named as executor. The probate fees for this case would be as follows: $19,000 to C's attorney (plus any "extraordinary fees," which are billed hourly but subject to court approval) and $19,000 to C (if C decides to take a fee), for a minimum total fee of $38,000. These fees are calculated without regard to the $400,000 mortgage, because the fees are charged on the gross (not net) value of the estate. Additionally there are court costs, which include filing fees, appraisal fees, publication costs and miscellaneous costs, which tend to be around $2,000 - $3,000, regardless of the size of the estate. Therefore a probate of the above example may cost the family around $40,000.00.

Living trusts avoid probate with respect to those assets that are transferred into the living trust before death. In other words, living trusts avoid the court supervised administration otherwise required to transfer assets to a person's beneficiaries at death. However, as explained below, even though no court procedure is involved, that does not mean there is nothing to do. The living trust makes administration easier, but it does not do away with administration altogether. For example, assets still have to be collected and managed pending distribution to the beneficiaries, appraisals of assets have to be made, debts and taxes have to be paid, tax returns may be required (living trusts do not avoid estate taxes, as some people have been led to believe), and legal documents must be prepared in connection with the distribution of the trust property to the beneficiaries. These activities are very similar to a probate. The major difference is that, with a living trust, everything is handled privately, without court supervision, which makes for (in most cases) a faster, less expensive administration process.

There is an expense to the administration of a trust, which may include legal fees, accounting fees, asset transfer fees, and your own Trustee fees if you decide to accept any. The other beneficiaries of the Trust, if any, need to understand that the process may take longer than they anticipated. However, in comparison to probate, these delays and costs are substantially reduced, often resulting in time savings of months and costs savings of 50 to 90 percent.

C. Court Involvement

There is also a misconception that the existence of a living trust avoids all possibility of court involvement. This is true (in part) only if all of the Trustor's assets were properly funded into the living trust. For example, if assets held outside the trust exceed $184,500[1] in gross value, a probate will be required to transfer those assets to you, as Trustee, where you will add them to the trust.

Moreover, if at any time a beneficiary of the Trust believes that the Trustee has acted improperly or without regard for the beneficiary's interests, the beneficiary may file a petition with the court to force the Trustee to make a full report and accounting or to redress an alleged breach of trust, including removal of the Trustee or surcharge against the Trustee.

Finally, circumstances may arise in which there are questions about whether the Trustee should or should not take certain actions (e.g., selling a business interest or real property, commencing litigation). In such cases, it may be advisable for the Trustee to petition the court for instructions whether to proceed in a certain way. The beneficiaries will be given notice of the hearing and will be given a copy of the petition that describes the proposed action. The matter will then be addressed in open court, and the beneficiaries will have an opportunity to appear in court and be heard. By obtaining an order from the court in this manner, the Trustee may be able to cut off the beneficiary's

[1] California Probate Code section 13100 provides that the amount $184,500, may adjust in accordance with Section Probate Code section 890.

right to complain about the particular action if he or she fails to appear in court. Such a petition protects the Trustee if there is a fear that the Trustee's decision will be second-guessed by a beneficiary. Also, if relations between the Trustee and the beneficiaries are hostile, it may be advisable for the Trustee to seek court approval of the Trustee's accountings to minimize potential arguments with the beneficiaries.

III. ADMINISTRATION OF THE TRUST

After the Trustor's death, the administration Trust continues as a management and distribution vehicle that will exist only as long as is necessary to identify and collect trust assets, pay debts and taxes, and distribute the trust assets to the beneficiaries (or in further trust, depending on the terms of the Trust). You might visualize this trust as a funnel through which all of the trust assets will pass to the beneficiaries (with the exceptions of tangible personal property, life insurance proceeds, and other non-trust assets that may pass directly to the beneficiaries outside the Trust). As successor Trustee, it is your job to collect and manage the trust's assets, appraise trust property, pay all taxes and expenses relating to the administration of the Trust, and distribute the trust property according to the Trustor's instructions.

IV. POUROVER WILLS

In addition to the Trust, the Trustor signed what we call a "pourover" will. The purpose of the pourover will is to provide for the distribution of assets that were omitted from the Trust, either intentionally or inadvertently. One of your first tasks will be to determine what assets, if any, were omitted from the Trust. If any such assets exceed $184,500 in gross value, a probate may be required to transfer these assets to the Trust. If these assets do not exceed $184,500 in value, you can collect such assets under a declaration procedure authorized by the Probate Code. At least 40 days must elapse after the date of death before you can use this declaration procedure. Whether or not a probate is required, the original will must be deposited for safe keeping with the County Clerk within 30 days of the date of death.

When locating asset information, the following are examples of documents to look for:

1. Deeds to real property;
2. Leases;
3. Private annuities and Life Insurance policies on the decedent's life;
4. Documents showing any life insurance or retirement benefits provided by the decedent's employer;
5. Statements for any IRA, Pension, or 401K accounts;
6. Statements from any bank accounts;
7. Statements from any brokerage accounts;

8. Partnership Agreements for partnerships of which the decedent is a partner; and

9. Information regarding any other assets owned by the decedent.

V. DISTRIBUTIONS OF PROPERTY

A. Tangible Personal Property

Provided the beneficiaries are in agreement, the distribution of tangible personal property may be handled informally and the attorney does not need to get involved. If any disagreement develops, however, the division of personal property should be handled in a more formal manner. We recommend that you carefully document and inventory the items of property available for distribution and the disposition of each.

Before allowing the distribution of any items of personal property, however, please note that you are responsible for reporting such items on a federal estate tax return, if required (see below). Furthermore, if any items of property (or group of items that constitutes a single collection) have a fair market value of $3,000 or more, these items must be separately appraised for federal estate tax purposes. You should therefore keep careful records of what assets are distributed and to whom, and you should obtain any required appraisals before distributing particularly valuable items.

B. Other Distributions From the Trust

One of the first questions the Trustee and other beneficiaries usually ask us is, "When will the trust property be distributed?"

In answer to the question of when distribution will take place, we anticipate that distribution will take place in several stages. Depending on how quickly assets and liability information can be assembled, you may be able to make preliminary distributions of a portion of the trust estate within a few weeks. After we have obtained all appraisals and can project the expected tax liabilities and expenses with more accuracy, you may distribute more of the trust estate, making certain to reserve sufficient funds for payment of estate taxes, income taxes, administrative expenses, attorney and trustee fees, debts and liabilities, etc. However, if any litigation arises concerning the Trust (e.g., a "contest" of the Trust), you may have to withhold distribution until such problems have been completely resolved. (Our office has had cases in which a living trust that provided for distribution "at death" was not actually distributed until more than a year after death because of disagreements among the beneficiaries and the ensuing court procedures.)

Moreover, as noted above, living trusts do not avoid estate taxes. If it is determined that estate taxes or fiduciary income taxes are payable in this case, we will recommend that you retain a further reserve in the Trust after payment of such taxes until all audits are completed or until the period for assessment of a tax deficiency passes (3 years). This reserve is for your own protection. Any legal fees, accounting fees, and your own Trustee fees incurred in connection with the audit process, and any tax deficiencies that might be assessed by the IRS, are chargeable to the Trust. If you have already distributed all of the trust assets, you, as Trustee, may have to bear these expenses and taxes yourself if the beneficiaries are unwilling or unable to contribute their fair share. If this situation applies in your case, we will assist you in determining an appropriate amount to hold as a reserve.

VI. TRUSTEE DUTIES, POWERS, AND COMPENSATION

A. Standard of Trust Management

As Trustee, you will act in a fiduciary capacity. As such, you owe certain legal duties to the beneficiaries, as explained in more detail below. In managing the trust property, you must use at least ordinary business ability. However, if you have special skills, under California law you will be held to a higher standard of care. In any event, your management will be judged in light of the circumstances existing at the time transactions occur, rather than with the benefit of hindsight. If you exceed your trustee powers, you may be held liable for loss or damage to the trust estate.

B. Source of Trustee Powers

It is important that you understand the rules under which you must operate. These rules are derived from three sources: (1) the Trust itself, (2) statutory law (the "Trust Law" found in the California Probate Code), and (3) decisional law created by the courts.

The principal source of your Trustee powers is the Trust itself. You should therefore read the Trust carefully. In doing so, you will see that the Trust contains two types of provisions: (1) "dispositive provisions" that govern the distribution of property and (2) "administrative provisions" that govern the powers of the Trustee, payment of taxes and expenses, rules for interpreting the trust instrument, and other procedural issues. The bulk of the Trust is made up of these administrative provisions.

In creating a trust, the Trustor may include any lawful provisions that he or she wishes to govern the trust relationship. Because tax considerations are often important in creating a trust, the Trustee's rights and duties are often limited by the tax results desired by the Trustor. The provisions of a trust may override general provisions of the Trust Law, except when the law expresses a paramount public policy. Whenever the trust instrument does not provide for a given situation, the Trust Law applies.

C. General Duties of Trustee

Your basic duties as Trustees involve the collection, management, and investment of trust assets and the accumulation and distribution of income and principal under the Trust. Another important set of duties relates to tax matters, which are explained in detail elsewhere in this memo.

It is a fundamental principle of trust law that you must be faithful to the interests of the Trust and its beneficiaries. You occupy a position of trust and confidence and owe a duty of care to the beneficiaries. You have a duty to administer the Trust solely in the interest of the beneficiaries and to deal impartially with them. You cannot use trust property for your own profit or for any non-trust purpose. You must not engage in any transaction that will result in a conflict of interest between you and the Trust or a beneficiary.

You have a duty to take reasonable steps to take and keep control of trust property and to preserve the trust property and make it productive. You must not commingle trust property with your own property under any circumstances. You also have a duty to take reasonable steps to enforce claims of the Trust and to defend lawsuits brought against the Trust.

You must carry out all Trustee activities personally. In other words, you may not delegate your responsibilities to others. However, you may hire attorneys, accountants, investment advisors, and others to consult with you concerning your administration of the Trust. Nevertheless, you will ultimately be held responsible for your acts or omissions.

D. Uniform Principal and Income Act

The Uniform Principal and Income Act (Probate Code §§16320–16375) went into effect January 1, 2000, and significantly changed the way in which a trustee should think about principal and income.

For trust accounting purposes, all trust receipts and disbursements need to be allocated between "income" and "principal" in accordance with the terms of the trust and the rules set forth in the Act. Please keep in mind that "trust accounting income" and "tax accounting income" are not the same. For example, capital gain is "income" for tax purposes however, for trust accounting purposes, capital gain is allocated to principal and will not be distributed out to you as "net income" from the trust. The rules relating to allocation between principal and income are sometimes complicated. Your CPA or tax preparer must exercise care in making these allocations in order to properly track trust transactions.

If you have questions about the allocation of receipts between principal and income, please let us know, as we can provide you with instructions on how to divide principal and income.

E. Trust Investments

The Uniform Prudent Investor Act (the "Act") (Probate Code §§16002(a), 16003, 16045–16054) was added to the California Probate Code in 1996. Under the Act, a trustee, who invests and manages trust assets, must comply with the "prudent investor rule." The Act sets forth a framework which describes the prudent investor rule with regard to standard of care, portfolio strategy, risk, diversification, delegation, costs, and compliance standards. The law is of considerable advantage to trustees because it provides common sense investment guidelines. Furthermore, it provides a favorable procedure for reviewing the trustee's actions that examines the investments made by the trustee in the context of the entire trust portfolio instead of viewing each asset in isolation. The basic reasons for establishing the Act were:

(1) Portfolio rather than individual investments;

(2) Trade off in investing between risk and return;

(3) No categoric restrictions on types of investments;

(4) Requirement to diversify investments; and

(5) Delegation of investment and management functions by trustee permitted.

The Act sets forth a laundry list of circumstances that are appropriate for a trustee to consider with regard to investments decisions: (1) general economic conditions; (2) inflation and deflation; (3) tax consequences; (4) the role each investment or course of action plays within the overall trust portfolio; (5) the expected return from income and the appreciation of capital; (6) information provided to the trustee from the beneficiaries; (7) needs for liquidity, regular income and preservation of capital; and (8) an asset's special relationship to the trust or to a beneficiary. (Probate Code §16047(c).)

Under the Act, as trustee, you are now provided with statutory protection when treating one asset differently from the norm if that particular asset has a special relationship to the trust or a beneficiary. More significantly, your course of action is now evaluated in the context of the "trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably suited to the trust." (Probate Code §16047(b).) No longer are the trustee's individual asset investment decisions viewed in isolation. For example, if a trustee's investment of a specific asset were to generate a loss, this loss would be viewed in light of the entire trust portfolio. The trustee could have accepted the loss in order to offset other income of the trust or to allocate trust resources to less risky assets. The Act does not, however, shield you from liability in making unsound investments or failing to exercise your power of investment in the best interests to the trust.

Under the Act, a trustee is charged with the duty to diversify the investments when making and implementing the investment decisions. (Probate Code §16048.) In addition, the Act sanctions the trustee's ability to delegate investment and management functions. (Probate Code §16052.) However, the trustee is required to exercise prudence in the selection of an agent, to establish the terms/scope of the agent's duties and to periodically review the agent's overall performance and compliance with the terms of the delegation. This delegation does not permit you to avoid all responsibility. You must continue to take an active role in evaluating the agent. If you have any questions about the propriety of any investment, you should seek legal advice before making or continuing the investment.

F. Providing Information to Beneficiaries

Under the Trust Law, you owe a duty to the beneficiaries to make them aware of the existence of the Trust and to keep them reasonably informed of the Trust and its administration (see Probate Code §16060). You also have a duty to provide the terms of the Trust to beneficiaries upon request (see Probate Code §16061.5). We will discuss with you what specific actions you and we will take to fulfill these duties.

State law also requires that you provide the beneficiaries with certain information upon reasonable request (see Probate Code §16061) even if the Trust Instrument waives this requirement (see Probate Code §16068) and that you give a full accounting and report of all trust transactions not less often than annually or at the termination of the Trust or upon a change of trustee (see Probate Code §16062), unless the Trust instrument or a beneficiary waives this requirement in writing. The subject Trust does not waive this requirement.

In addition to the duty to provide an accounting, you have a duty to provide a report to beneficiaries upon request. In practice, depending on the judge, the information contained in such a report may be the same as the information provided in an accounting. Although a beneficiary may waive the right to an accounting, a beneficiary cannot waive either the right to be kept informed or the right to request a report. Therefore, even if a formal accounting was not required, we would strongly recommend that such accountings be prepared and presented to the beneficiaries.

In any event, internal accountings will be needed to provide a permanent record of trust transactions, to distinguish between principal and income transactions, and to provide a single source of data for preparation of income tax returns. Because this information must be recorded and assembled anyway, it makes sense to give this information to the beneficiaries for a number of reasons. First, it will give the beneficiaries a better understanding and appreciation for the complexity of your job as Trustee and the amount of work involved. Second, it will help to avoid misunderstandings by disclosing all relevant transactions. Third, it will start the running of a 3-year statute of limitations for all matters you disclose in the accounting. If no accounting is made, there is no statute of limitations and your liability exposure continues indefinitely.

Please note that a trust accounting is a legal document that should be prepared by a lawyer or a CPA familiar with the trust accounting rules to make certain that it meets the format required by the Trust Law. Only in this way can you be assured that the 3-year statute of limitations begins to run. CPAs are not always experienced in fiduciary accounting standards and you should not rely on financial statements prepared by an accountant to satisfy the fiduciary accounting requirements of the Probate Code.

Although making formal accountings will add to the expense of administration, bear in mind that the cost is payable from the Trust (not from your own pocket, except to the extent of your pro-rata share if you are also a beneficiary) and is tax deductible. Because the cost is payable from the Trust, it is spread among all the beneficiaries. In other words, all of the beneficiaries will share the cost of protecting you from subsequent liability. You should give serious consideration to taking advantage of this benefit even if the Trust does not require accountings or the beneficiaries are willing to waive this requirement. Although we recommend that formal trust accountings be prepared, if you would prefer to request that the beneficiaries waive the requirement of a formal trust accounting, please let us know and we will prepare the appropriate waiver forms.

G. Recordkeeping

Regardless of whether you intend to make a formal accounting to beneficiaries, you must keep careful records of all trust transactions. In fact, if you do not prepare a formal accounting, you should probably keep these records forever, because there is no statute of limitations and your liability exposure will continue indefinitely.

In particular, you must keep an accurate bookkeeping ledger, with descriptive notations of all income and receipts, noting for each entry the date, the person to or from whom payment was made or received, the nature of the payment, and the amount. All disbursements for trust expenses should be made by check. You should never pay cash for any trust expenditure. You should keep a file or set of files in which you keep a copy of the trust instrument and your financial records for the Trust, including bank statements, statements of income received, bills for expenses, bank deposit receipts, canceled checks, copies of tax returns, and copies of correspondence relating to the Trust.

If you have not already done so, you should immediately open a checking account with a financial institution of your choice in your name as Trustee of the Trust. To do this, you will need to take an original Certification of Trust to the bank. We have prepared or will prepare several such documents for your use. Do not use your own Social Security number or that of decedent on this account. You should instead use the employer identification number for the Trust. Either our office or your CPA should obtain the employer identification number for you. All trust expenses should be paid from, and all trust income should be deposited to, this trust checking account. Do not continue to write checks against or use any account standing in the name of Trustor for any trust transactions.

H. Trustee Compensation

Under the terms of the Trust and the Trust Law, you are entitled to reasonable compensation for your services as Trustee. In determining reasonableness, factors such as the amount of time spent in trust administration and the size of the trust estate may be considered. You do not have to accept a trustee's fee. If you do, you should know that it is reportable as taxable income. Generally in most counties in California, the court will approve without a supporting declaration, annual fees of one percent (1%) of the present fair market value of all estate property, real or personal, at the beginning of the accounting period, but not including income received during the accounting period nor net gains and/or losses. Good faith estimates of fair market value of real property by the fiduciary are sufficient for this purpose.

The court also allow reasonable expenses to be reimbursed by the trustee.

If you decide the tax a fee, other than a percentage, you can also take an hourly fee. The Local Rules of the Superior Court of California, County of Contra Costa provides some guidelines on reasonable Trustee fees. For the non-professional trustee, the standard maximum hourly rate is $75.00 per hour (*2023 Local Rules*). If higher rates are paid and a court petition is filed, the approval of the higher rates will be based on all relevant factors presented, including special expertise applicable to the services provided, circumstances of the service, and relationship to the decedent, or other parties.

Whether or not you accept a fee, we strongly recommend that you keep a log or diary of the time you spend on trust matters, including the date, amount of time expended, what you did, and the decisions you made and the basis for the decisions. If you incur miscellaneous expenses for which you expect reimbursement from the Trust, you should carefully record these expenses. This log or diary will not only support your request for trustee's fees (if you decide to accept a fee), but will also serve as a written record of the actions and your thoughts surrounding those actions in the event your activities are ever questioned by a beneficiary of the Trust.

VII. TAX MATTERS

A. Taxpayer Identification Number (Employer Identification Number - EIN)

You will need to obtain a separate taxpayer identification number (EIN) for the administration trust. You should transfer the title on all bank and brokerage accounts standing in the name of the Trustor to your name as Trustee. Use only the new taxpayer identification number on such accounts and not the Trustor's or your own social security number.

B. Notice Concerning Fiduciary Relationship

Federal and state laws require that the respective taxing authorities be notified of the existence of a new trust or a change in fiduciary relationship. Because the Trust is now irrevocable and has in essence become a separate taxable entity, we must notify the taxing authorities of its existence. This is done by way of a "Notice Concerning Fiduciary Relationship" (IRS Form 56). Either your tax preparer or our office should prepare this form.

C. Estate and Gift Taxes

Depending on the size of the estate, estate tax returns may be required and estate taxes may be payable. Under current law, an estate tax return is required in any case in which a for deaths occurring in 2023 if the decedent's gross estate exceeds $12,940,000 in value. The "gross estate" includes any property interests of the decedent at the time of death, including but not limited to property in a probate estate, property in a living trust, and joint tenancy property. In other words, the gross estate for tax purposes is not the same thing as the "probate estate." In fact, someone could avoid probate altogether by having a fully funded living trust, but that does not mean that no estate taxes will be payable.

Our preliminary analysis of assets indicates that a federal estate tax return will **NOT** be required. Also, we have **NOT** agreed to prepare a IRS Form 706, but we can assist with the preparation of such a return if it is necessary by providing documentation and answering questions as requested by you. You will need to engage the services of a CPA to determine if a return is required and to prepare such a return.

As successor Trustee, it is your responsibility to file the federal estate tax return (IRS Form 706) and any required state tax returns for property situated in another state (California does not currently require a state tax return). If, on the other hand, a probate is required, it is the executor's responsibility to file such returns. The estate tax returns, if required, and any tax due, must be filed within nine (9) months following the date of death, unless an extension is obtained.

As part of the process for collecting asset values, you will need to obtain appraisals for values of trust assets. It is helpful for us to know the fair market value of all assets in the Trust or owned by Trustor outside the Trust at the time of death. For real property, closely held business interests, and tangible personal property, qualified appraisals will be required.

In addition, if Trustor made any gifts during the year of death (or any prior year for which no gift tax return was filed) that exceeded $10,000 per donee per year, plus inflation adjustments for years after 2001 ($11,000 per donee in 2002–2005, $12,000 per donee in 2006–2008, $13,000 in 2009–2012, $14,000 in 2013–2017, $15,000 in 2018-2021, $16,000 in 2022 and $17,000 in 2023), you (or the executor of the estate if there is a probate) will also be required to file a gift tax return to report such gifts. If you know of any such gifts, please let us and the CPA know.

D. Alternate Valuation Date (*if a Federal Estate Tax Return is filed*)

For federal estate tax purposes if you file such a return, you may elect to use the values of the assets at either the date of death or at the "alternate valuation date," which is either 6 months after the date of death or, for assets sold or distributed before that date, the date of sale or distribution. Whichever valuation date you choose, that date must be used for valuations of all trust assets. In addition, you can use alternate-valuation-date values only if the effect would be to reduce the estate tax liability. (For example, if there is no estate tax payable, you cannot use alternate valuation simply to get a higher income tax basis.) If you wish to use the alternate valuation date, each asset will have to be appraised not once but twice: once at the date of death and again at the date that is either 6 months later or the date of distribution.

E. Income Taxes

1. Income Tax Basis

For federal and state income tax purposes, generally of the property in the Trust (other than assets which are "income in respect of decedent" or IRD) will receive a new income tax basis equal to the fair market value at the date of death (or the alternate valuation date, as explained above). Internal Revenue Code § 1014 provides in part (a) the following, "…the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be—(1) the fair market value of the property at the date of the decedent's death, (2) in the case of an election under section 2032, its value at the applicable valuation date prescribed by such section, (3) in the case of an election under section 2032A, its value determined under such section, or (4) to the extent of the applicability of the exclusion described in section 2031(c), the basis in the hands of the decedent.

This new basis is the measuring point for any capital gains in the event you sell any property of the Trust or for any depreciation deductions pending administration. IRD refers to income which was earned by the decedent during his or her lifetime, but the tax was not yet paid on the funds at the time of death. This income is subject to be being taxed as income for the beneficiary. IRD assets typically include a 401k account.

2. Income Tax Consequences to Beneficiaries

All property received by inheritance, including property distributed from a living trust, is received free of income tax. However, some income tax consequences to the beneficiaries should be noted. One such consequence is that the basis of assets received on distribution will be the date-of-death value (or alternate-valuation-date value), as explained above. The income tax basis of assets received will determine the capital gain a beneficiary will realize if and when the beneficiary sells an inherited asset.

In addition, the beneficiaries of any residuary gift must be aware that the distribution of trust assets will carry out to the beneficiaries income earned by the Trust during the period of trust administration to the extent of basis, which income will be reportable on the beneficiaries' own individual tax returns. The Trust will supply the beneficiaries with K-1s reporting the amount of income passed through to the beneficiaries. Alternatively, before this distribution of income to a residuary beneficiary, the Trustee may make an election under Internal Revenue Code §643(e) to recognize the gain at the trust level, in which case the distribution and basis to the beneficiary are increased to fair market value. If the beneficiaries have already filed their returns for a taxable year before obtaining K-1s, they will be required to file amended returns.

Finally, some assets, such as IRAs, retirement plans, and certain annuities will be partly or fully taxed as income to the beneficiary of any such asset. Life insurance, IRAs, 401(k) plans and other retirement type plans pass under beneficiary designations filed with the respective institutions rather than under your will or trust. If the Decedent was over age 70.5, if born before July 1, 1940, were required to take a minimum distribution from their IRA or 401(k) account. This is commonly referred to as a Required Minimum Distributions (RMD). RMD is a set of rules that dictate when benefits must be distributed from retirement plans, placing outer limits on income tax deferral. There may have been an RMD in the year of the Decedent's death that was not withdrawn. You should consult with the Decedent's financial advisor. There might be significant consequence for failing to take the RMD. If the Decedent did not take any distributions, or if the distributions are not large enough, you may have to pay a 50% excise tax on the amount not distributed as required. You will need to consult with the financial advisor to determine if the RMD was taken for the year of death or for any other year.

Also, you may need to establish inherited individual retirement accounts. The Setting Every Community Up for Retirement Enhancement (SECURE) Act, eliminated the Stretch Out Inherited IRA, and replaced it with a "10-Year Rule." Under the 10-Year Rule, the entire inherited IRA must be withdrawn by the end of the 10th year following the year of inheritance. Within those ten years, there are no distribution requirements. In other words, a person can withdraw the IRA evenly throughout the decade or wait until the very last year and withdraw the entire amount. As long as the entire balance is out by the end of the 10th year after the death of the original account owner, the beneficiary is free to withdraw the funds as they see fit.

There exceptions to the 10 Year Rule. The 10 Year Rule does not apply to IRAs inherited prior to 2020. For those beneficiaries, the rules do not change. The SECURE Act also identifies four groups of beneficiaries who are not subject to the new 10-Year Rule. This includes beneficiaries who are:

- Spouses
- Disabled
- Chronically ill
- Not more than 10 years younger than the original account owner

For these beneficiaries, they are eligible to stretch their inherited IRA just as they would have been able to do prior to the SECURE Act.

In addition, certain minor children of the account holder will be allowed to take age-based required minimum distributions until they reach age 18. At that time, they are then subject to the 10-Year Rule.

3. Decedent's Final Returns

Final state and federal personal income tax returns will be required for the period of January 1 through the date of the Trustor's death. Such returns will include income generated by the assets of the Trust before the date of death. Income generated by the assets in the Trust after the date of death is reportable on the fiduciary returns (see below).

4. Fiduciary Returns

All trusts that meet certain minimum income limits are required to file fiduciary tax returns (state FTB Form 541 and IRS Form 1041) either on a calendar-year (tax year ending December 31) or fiscal-year basis. In the event that you elect to use a calendar year end, the Trust's first taxable year will be a short taxable year commencing with the date of Trustor's death and ending on December 31, or earlier date if trust administration is completed before that date. The returns for this period will be due on April 15 of the year following the year of death. If you use a fiscal year end, the returns will be due on the 15th day of the fourth month following the end of the fiscal year end. You will need to determine as to which year end to use in coordination with your tax professional or tax preparer.

VIII. ATTORNEYS' ROLE

As your attorneys, our job is to assist you in carrying out your duties as Trustee as described in this memo. We will help you collect and value assets, pay debts and taxes, and prepare the necessary transfer documents in connection with the eventual distribution of trust property to the appropriate beneficiaries. We will give you advice concerning tax matters and accounting to beneficiaries. If any court action is necessary, we will represent you in that action. The exact nature and scope of our services is set forth in the separate engagement letter that you have signed.

Please keep in mind that we represent you and do not represent any other beneficiaries of the trust. Any communication between you and our firm is subject to the attorney-client privilege and will be kept confidential. With your permission, we may provide information to other beneficiaries and answer some of their questions. However, it is inappropriate for us to give them legal advice. Furthermore, because you are a beneficiary as well as the Trustee, we cannot render any advice to you in your capacity as a beneficiary if it would conflict with your duties as Trustee. Doing so might constitute a conflict of interest and a violation of our ethical requirements under the State Bar Rules.

IX. CONCLUSION

This memo is intended to serve as an overview of the trust administration process and your duties as Trustee. It is not intended to anticipate every possible question or problem that may arise during the course of administration of the Trust. If any questions or problems arise that are not adequately explained by this memo or by reference to the Trust itself, please contact our office first, before taking any action.

Very truly yours;

Gagen McCoy
A Professional Corporation

C. Joseph Doherty, III

C. Joseph Doherty, III