35th Annual

Tax Symposium

FOUNDATIONS OF FIDUCIARY ACCOUNTING:

A BEGINNER'S GUIDE FOR CPAS

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THE ATTORNEY-CPA PARTNERSHIP IN ADMINISTRATION

The Division of Labor:



Attorneys interpret the intent of the document and legal statutes; CPAs track the math and tax implications.

The Shared Goal:



Protecting the fiduciary (Trustee/ Executor) from personal liability and avoiding costly beneficiary litigation.

The Roadmap:



1. Fiduciary Duty to Account (The Legal Shield)
2. Trust Accounting Concepts (Interpreting Document vs. Statute)
3. Accounting Forms/Reports (Evidentiary Defense)

FIDUCIARY DUTY TO ACCOUNT

THE SOURCE OF THE DUTY: COMMON LAW & STATUTES

Mandatory Disclosure
A fiduciary cannot manage assets in secrecy.

The Legal Standard
Fiduciaries must provide enough information for beneficiaries to protect their interests.

Default vs. Mandatory Rules
State laws allow grantors to waive some reporting requirements, but not the core duty to keep beneficiaries reasonably informed.



TRIGGERING THE STATUTE OF LIMITATIONS

- **Limiting Liability:** An attorney's primary reason for insisting on a formal accounting is to start the clock on beneficiary objections.
- **The Window:** In many jurisdictions, providing a legally compliant accounting shrinks the time a beneficiary has to sue from 3–5 years down to 1 year (or less).

No Accounting = Open-Ended Liability

THE LITIGATOR'S TARGET: CONSEQUENCES OF BREACH



Surcharge Actions



Removal and Fee Denial



Shifted Attorney Fees

TRUSTEE COMPENSATION – RULES, CALCULATION, AND SCRUTINY

- **The Legal Standard:** Fiduciary compensation must be authorized by the **governing document**, **state statute**, or **court order**.
- **The Litigation Risk:** If a fiduciary cannot justify their hours, courts can order a partial or full refund of the fees.



The CPA's Reporting Mandate:

Compensation *must* be explicitly disclosed as a distinct line item on the accounting.

TRUST ACCOUNTING CONCEPTS

GOVERNING DOCUMENT VS. STATE LAW

The Hierarchy of Authority:

- **The Trust or Will Instrument:** The absolute ruler. If the document says capital gains are income, they are income.
- **State Statute:** Applies *only* if the document is silent.



The Attorney's Warning

CPAs must read the specific trust instrument first. Blindly applying state default law can result in an accidental breach of trust.

THE EQUITABLE APPORTIONMENT DILEMMA

The Inherent Structural Conflict:

- **Income Beneficiaries** demand high-yield, income-producing assets like bonds or real estate.
- **Remainder Beneficiaries** demand long-term capital growth and principal preservation.



THE EQUITABLE APPORTIONMENT DILEMMA

The Legal Trap – The Duty of Impartiality:
Under common law and the Uniform Trust Code,
a trustee *cannot* favor one class of beneficiary over another

Fiduciary Accounting Adjustments:
How the accountant mathematically balances the equities when statutory classification fails to reflect economic reality:

- Principal-to-Income Adjustments
- Income-to-Principal Adjustments
- Underproductive Property Adjustments

THE "TAX VS. FIDUCIARY" DISCONNECT (FORM 1041 TRAP)

The Tax vs. Accounting Disconnect:

Bridging the gap for clients when the IRS taxes trust transactions differently than how they are allocated on the fiduciary ledger.



THE "TAX VS. FIDUCIARY" DISCONNECT (FORM 1041 TRAP)

DNI vs. FAI Core Mechanics:

- **Distributable Net Income (DNI):**
  The statutory ceiling on taxable income shifted from the trust to a beneficiary via Schedule K-1.
- **Fiduciary Accounting Income (FAI):**
  Cash receipts legally classified as distributable income under the trust agreement or state law.
- **The Structural Clash:**
  Capital gains are often included in trust taxable income but rarely classified as FAI available for distribution to current beneficiaries.



Key Takeaway:

A tax return is *not* an accounting. Filing Form 1041 does **not** satisfy a trustee's legal duty to account to beneficiaries.

NAVIGATING DISCRETIONARY DISTRIBUTIONS & THE HEMS STANDARD

- **The Power to Distribute:** Wills and trusts frequently grant the fiduciary the power to distribute principal or income based on a specific legal standard.
- **The HEMS Standard:** distributions limited to a beneficiary's **Health, Education, Maintenance, and Support**.
- **The Discretionary Paradox:** Even “sole discretion” requires good faith and compliance with the HEMS standard.
- **The Accounting Trail as a Shield:** CPAs must document that HEMS distributions were used for permitted purposes, protecting the trustee against claims of favoritism or waste.

ACCOUNTING FORMS / REPORTS

THE ACCOUNTING AS LEGAL EVIDENCE

- **The Legal Burden:**
  In legal disputes, the burden of proof is on the fiduciary to justify all expenditures.

- **The Accounting's Defense Purpose:**
  It demonstrates mathematical perfection to a probate judge:

  Inventory + Income = Expenses + Distributions + Remaining Assets.

- **Judicial Reception:**
  A clean, properly balanced account instantly establishes a presumption of competence in the eyes of the court.

DRAFTING THE MULTI-SCHEDULE DEFENSE

- **Starting Values (The Line in the Sand):** Establishing date-of-death or funding valuations. This locks in the fiduciary's starting baseline liability.
- **Schedules A, B & C (The Operational Trail):** Meticulous tracking of every receipt and disbursement, proving no commingling of personal assets occurred.
- **Schedule D (The Proof of Compliance):** Verifying that distributions exactly match the terms of the trust document, and proving what assets remain under trustee control.

CORE TAKEAWAYS

Accountability Is the Shield:
Timely, properly prepared accountings fulfill a mandatory legal duty and provide the trustee's best defense against personal liability and beneficiary lawsuits.

The Ledger Outranks the Return:
The trust document and state statutes govern trust accounting. Form 1041 does not fulfill the duty to report to beneficiaries.

Strict Classifications Are Required:
Accountants must document principal/income allocations, trustee compensation, and discretionary HEMS distributions to demonstrate the trustee's impartiality.

The Partnership Protects the Client:
Accurate CPA schedules allow estate attorneys to secure legally binding release and indemnity agreements, helping keep administration out of court.

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QUESTIONS

Submit questions for presenters

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THANK YOU



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