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**YOU HAVE JUST BEEN APPOINTED
TO SERVE AS THE TRUSTEE OF A
TRUST, NOW WHAT?**

You've just discovered that you've been named trustee of a trust. Not only are you unsure of whether you should accept the role and responsibility, but you have no idea what the role entails, the types of problems you might face, and whether you'll receive compensation.

What Is a Trust?

A "trust" is a legal relationship through which a person (the settlor) gives property to another (the trustee) who holds it for the benefit of another person or group of people (the beneficiaries). The terms of the trust are contained in the "trust instrument." An individual also may create a trust through his or her will.

The "current beneficiaries" are those who are presently entitled or eligible to receive distributions from the trust. The "remainder beneficiaries" are those who will become entitled or eligible to receive distributions once the interests of the current beneficiaries terminate.

Although you, as trustee, have title to the property, it is not yours; it belongs to the beneficiaries. You are the steward of the property for the settlor's loved ones, and you must administer it for their benefit in accordance with state law and the settlor's directions and objectives as set forth in the trust instrument. Your obligations to the trust and its beneficiaries are called "fiduciary duties."

Should You Accept the Role of Trustee?

Once you discover that you've been named trustee of a trust, you must decide whether or not to accept the position. Chances are, you were named as trustee because of your relationship to the settlor and/or the beneficiaries. You may have asset management or investment experience or you may be familiar with the business the settlor has placed in the trust. You may lack such experience but are a friend or relative that the settlor trusts will manage and distribute the trust property in accordance with his or her

wishes. Accepting the position of trustee allows you to do so, however, it comes with significant responsibility, demands on your time and potential liability.

Of course, there are situations in which it may be advisable to decline the position of trustee. Litigious beneficiaries, a difficult co-trustee or complicated trust assets may dissuade you from acting, or you may not have enough time to devote to the trusteeship. Keep in mind that it is easier to decline than to resign from a trusteeship, so taking the time to consider all potential issues before accepting is well worth it.

How Do You Know What to Do?

A trustee's instructions are found in the trust instrument and state law, which specify your duties to the beneficiaries and the powers you have to fulfill those duties, what taxes must be paid, and who must pay them. If you are a trustee of a trust governed by a will, you may have additional duties imposed by the probate court supervising the administration of the decedent's estate.

Read the Trust Instrument.

If you have accepted your appointment to serve as the trustee your first step should be to carefully read the entire trust instrument. It should tell you:

- Why the settlor created the trust
- Who should or may receive distributions
- What those people should receive
- When and how often they should receive it
- Any conditions on distributions
- How to manage and invest the trust assets, possibly including specific instructions for certain assets
- What information the settlor would like the beneficiaries to receive
- How long the trust lasts

You generally are required to follow the terms of the trust instrument, unless those terms are illegal or contrary to public policy. If you need assistance interpreting or implementing the terms of the trust instrument, it may be appropriate to retain a lawyer to help you. Generally, payments made to an attorney providing advice on the administration of a trust are proper expenses of such trust.

Carry Out Fiduciary Duties.

All of your conduct as trustee is governed by fiduciary duties. These are rules that stem from the fact that the trustee/beneficiary relationship is one of trust. These duties are:

- **Duty of care.** You must manage the trust assets competently, prudently and diligently.

- **Duty of loyalty.** You must act only in the best interests of the beneficiaries, and you cannot seek or realize personal gain from your trustee position or the trust assets.
- **Duty of impartiality.** You must treat the interests of all beneficiaries evenhandedly, with respect to the assets held in the trust as well as investment and distribution decisions.
- **Duty to inform.** You must provide the beneficiaries with information necessary to protect their interests in the trust.

These duties should guide every task you undertake as trustee.

What Do You Need to Do?

Invest the Trust Assets

You must invest the trust assets in a manner appropriate for the beneficiaries of the trust, considering the purposes of the trust, specific investment directions in the trust instrument, the nature of the trust assets, the beneficiaries' financial needs and risk tolerance, and potential tax consequences. You cannot favor the interest of any beneficiary or class of beneficiaries, and you must invest to produce income for the current beneficiaries and preserve principal for the remainder beneficiaries. Most states also have a *prudent investor rule*, which requires you to manage the trust portfolio with an overall investment strategy having risk and return objectives reasonably suited to the trust and to diversify trust assets.

Once you accept a trusteeship, you should take the following steps:

- Determine what is or should be in the trust
- Collect and secure all trust assets and make sure they are titled in the name of the trust
- Check the trust instrument for any specific directions regarding trust assets or investment
- Understand the trust assets (including types of assets, basis, concentration in any business, stock, or industry, potential for income production and principal growth, maintenance or other associated costs, debts, etc.)
- Analyze the beneficiaries' respective rights and needs and determine the trust's investment objectives
- Determine what asset mix will best achieve those objectives
- Make sure that the trust assets are properly diversified, taking into account capital gain or other tax consequences

You should continue these actions throughout the life of the trust. Following a logical and sound decision making process when making trust investment decisions can help protect you from future challenges. As you invest the trust assets, be careful not to commingle trust property with your personal funds. You also must not combine trust funds with the funds of any other trust you administer, unless the trust instrument allows you to pool trust funds for investment purposes. In addition, you generally may

not take part in any transaction in which your interest is adverse to the interest of the beneficiaries; however, there is an exception to this rule when the trust instrument authorizes the conflict of interest. For example, a trust instrument could authorize a trustee to work for (and receive a salary from) a business owned by the trust or provide a means for a named trustee who also is a beneficiary to purchase certain assets from the trust.

Determine and Make Distributions to Beneficiaries

You must make distributions to the beneficiaries as required by the trust instrument. Before making any distribution, you must determine the level of discretion you have to make distribution decisions. For example, you could be directed to distribute all trust income to a beneficiary, to only make distributions to the beneficiary for health, education, maintenance and support (often referred to as an “ascertainable standard”), or to make whatever distributions to the beneficiary that you in your absolute discretion deem to be necessary or advisable.

Determining what distributions to make under these standards is not always simple. For example, if you are required to distribute all of the income, you must first select suitable investments and then properly allocate receipts and disbursements between income and principal according to the trust instrument and state law. The broadest standard of absolute discretion imposes no limits on your authority as trustee, but also provides you with no guidelines for determining how much to distribute.

Unless the trust agreement authorizes the trustee to favor one beneficiary over others, you must treat beneficiaries equitably in making discretionary distribution decisions. This may not mean distributing equally; a trust instrument that requires the trustee to make distributions to beneficiaries for their education may require larger distributions to a beneficiary that goes to an out-of-state private college than to a beneficiary that attends a local public college. If tangible assets (such as a vacation home, an RV, etc.) are not distributable outright but instead are to be held in trust for multiple beneficiaries, make sure that you grant them equal opportunities to use those assets. For example, you may not let one beneficiary use a residence to the exclusion of others.

You should continue these actions throughout the life of the trust, as both the beneficiaries and their respective needs are likely to change over time. As with investment decisions, following a logical and sound decision making process when making trust distribution decisions can help protect you from future challenges.

Pay Taxes

You must be aware of what taxes are due and who must pay them — the settlor, you as trustee or the beneficiaries. Different types of trusts and fiduciary income tax accounting rules can make this a complicated question and can influence other areas of trust administration. For example, trusts are taxed at the highest federal income tax rate, so a trustee with discretionary distribution authority may wish to distribute funds to a beneficiary in a lower income tax bracket (assuming such a distribution is

consistent with the terms of the trust), thus reducing the total tax paid. You also should be aware of potential gift or generation-skipping transfer tax issues that could affect the trust. Finally, be aware that in certain circumstances, you may have personal liability for failing to pay a trust's tax obligations.

Assert and Defend Against Claims

As the trustee, you may need to litigate on behalf of the trust, whether by asserting a claim or defending against the claim of a beneficiary or third party. This often entails doing a cost/benefit analysis of enforcing or defending against a claim versus abandoning or settling that claim in addition to working toward your chosen goal.

Inform the Beneficiaries (Accountings)

You generally are required to provide the beneficiaries with information necessary to protect their interests. (Certain states have exceptions to this requirement due to concerns from settlors fearing that disclosure of a trust could adversely affect a beneficiary's behavior.)

This means letting them know what is in the trust and what has been done with it. At least annually, you should provide current beneficiaries with a written accounting of the assets, liabilities, receipts and disbursements of the trust. In some cases, you also may be required to provide this information to remainder beneficiaries, or it may be advisable to do so. In addition, you should provide any additional information that a beneficiary reasonably requests from you.

Keep Information Confidential

Although you are required to ensure that the beneficiaries have adequate information about the trust, you must make sure to keep trust information, including trust terms, trust assets, beneficiary names and other beneficiary information confidential from everyone else (other than your agents and advisors). Sometimes beneficiary information must even be kept from other beneficiaries.

Seek Assistance

You were chosen because the settlor wanted you to exercise your personal discretion in deciding what distributions to make and how to invest the trust assets. As a general rule, you are not permitted to delegate those discretionary decisions.

This does not mean that you cannot seek help, however, and prudent administration of the trust may actually require you to do so. For trusts with significant or complicated assets, you may need to engage an investment advisor to manage the trust property; however, you still would need to determine the investment objectives of the trust and monitor the advisor's work. It also may be advisable to engage an accountant with fiduciary expertise to assist you with tax matters or an attorney to advise you regarding trust interpretation, compliance with your fiduciary duties, or potential or existing

litigation. Again, if you do retain an advisor or agent, you still must supervise the advisor's or agent's conduct to comply with your fiduciary duties.

Think Outside the Box

This final recommendation is the most nebulous, but it is one through which you can provide great value to the beneficiaries. You may find yourself in a situation where investment performance or beneficiary needs have changed in an unpredictable way. Or perhaps a trust isn't working in the way that the settlor intended. You may also face a change in tax or other law that jeopardizes the purpose of the trust.

Estate planners have a variety of creative techniques to address these issues. For example, an attorney can help you convert a trust to a total return trust or a unitrust (allowing you to invest for the overall benefit of the trust by automatically allocating a certain percentage of the assets to income each year).

In addition, trust law (including tax law that applies to trusts) is constantly evolving, and these changes may create opportunities for an informed trustee to improve the efficiency of trust administration or to fix previously unsolvable problems. For example, many states now have statutes authorizing nonjudicial settlement agreements and the relatively new technique of trust decanting, both of which can be used to modify unworkable or undesirable trust terms.

How Do You Protect Yourself From Liability?

Trustees often find themselves in the center of family fights. Some beneficiaries view the trust as a piggy bank and become angry when the trustee refuses to make huge distributions. Some trustees carelessly invest trust property or seek to benefit inappropriately from the trust assets. More often, however, small misunderstandings or perceived slights build up until one person finally files a lawsuit.

Often, a beneficiary has an issue (e.g., does not feel that he or she understands what is in the trust or what the trustee is doing, believes the trust investments are not making enough money or are invested in assets that are too risky, feels that the trustee is not distributing enough to him or her, or feels that the trustee is favoring another beneficiary or family line), and feels that the trustee's responses to his or her concerns are inadequate.

Whether their complaints are reasonable or not, beneficiaries may sue the trustee. At that point, tensions are so high and positions are so entrenched that it can take years and hundreds of thousands of dollars before the dispute is resolved.

If a trust matter is litigated and a court finds in favor of a beneficiary, it may require the trustee to take a certain action, remove the trustee, force the trustee to pay back compensation, or even require the trustee to pay damages from the trustee's personal assets for a breach of trust.

Even if a trust instrument contains language exculpating trustees from all liability, the law prohibits it from protecting you absolutely. It generally cannot absolve you from liability for actions taken in bad faith or gross negligence.

The best way to protect yourself from potential liability is to do what you can to avoid litigation in the first place. This does not mean caving to beneficiary demands, but rather administering the trust in a manner that is thoughtful, deliberate and transparent. Taking the following steps can go a long way toward ensuring beneficiary harmony and reducing your potential liability:

- **Follow a process.** Make sure that you follow a logical procedure for making distribution and investment decisions. Even if your decisions appear unwise in hindsight, being able to show that they were reasonable at the time they were made will provide you with significant protection.
- **Seek help.** Engage assistance when a reasonable person would do so. For example, hire an investment advisor if the trust holds large or complex assets, an accountant to prepare tax returns, and an attorney to advise you regarding your obligations and to answer questions you have about the trust administration.
- **Keep clear records.** A failure to do so will make it difficult for you to defend your administration of the trust in a court proceeding. Records include the trust instrument and any amendments, bank statements, other documents evidencing transactions, tax returns, real estate deeds, communications with advisors you've engaged and beneficiaries, and your notes regarding your process and decisions.
- **Be transparent.** Provide the beneficiaries with information regarding the trust on a regular basis. Respond to beneficiary questions courteously, completely and in a timely manner. If a trust instrument purports to be a "secret trust" and you are directed to keep the assets and terms of the trust confidential, check applicable law to determine what information you still must provide to beneficiaries or if you have other disclosure obligations. Keeping beneficiaries informed builds a relationship of trust, allows them to complain and you to address their concerns before a potential problem grows too large, and helps foreclose claims of beneficiaries that are not made in a timely manner.
- **Obtain releases.** If you intend to take action that may be challenged in the future (e.g., making a large discretionary distribution, retaining an investment in the family business instead of diversifying, etc.), you may want to obtain releases from the beneficiaries so that they cannot later sue you for your conduct.
- **Go to court.** If the trust instrument is unclear or beneficiaries disagree about an action you intend to take, you may seek instructions from the court. You also may request that a court approve your accountings or actions, thus forcing any potential challenges into the open and foreclosing future lawsuits.

Do I Get Compensated for Being a Trustee?

Trustees are generally entitled to reasonable compensation for their services. Compensation is based on the level of risk and responsibility of the trustee, the time

the trustee spent, the value of the trust, the number and complexity of the issues the trustee had to address, and customary trustee fees in the community. If a trustee has delegated certain tasks to agents who charge a fee (e.g., investment managers), those fees may reduce the compensation to which the trustee is entitled.

We hope this document has helped you understand the role of a trustee as well as potential pitfalls and best practices. This is the first in a series designed to provide practical information on the implementation of estate plans and to highlight legal developments that may affect current plans or create future planning opportunities to better achieve personal, financial and tax objectives.