SELECTING THE RIGHT PEOPLE

SELECTING A TRUSTEE

A trust is essentially an agreement where the Grantor (the person who creates the trust) asks another person (the trustee) to hold or administer assets on behalf of a beneficiary (the person who gets the assets). As such, the trustee is the person (and/or institution) named in a trust agreement to carry out the objectives and follow the terms of the trust. A trustee can be an individual (professional or nonprofessional) or a corporate fiduciary, or, in some limited circumstances, a tax-exempt charitable organization. It is also possible and common to appoint both individual and corporate trustees for reasons that will be discussed below.

Duties of the Trustee

It is useful in enumerating the duties and listing the attributes of a good trustee to consider the typical objectives that a trust is designed to accomplish. These goals include the following actions:

- Reduce or eliminate income, estate or generation-skipping transfer taxes at the federal or state level.
- Reduce or eliminate probate and administration costs.
- Provide a vehicle that will serve as a receptacle for both probate and nonprobate assets and facilitate attainment of other estate planning objectives through unified administration.
- Provide for minor children in a manner more flexible and custom-tailored to the grantor’s desires than the Uniform Transfers to Minors Acts allow.
- Provide for recipients who are legally of majority age but who lack the emotional or intellectual maturity or physical capacity or technical training to handle large sums of money or an investment portfolio or a family business.
- Provide for individuals who have the capacity to handle large sums of money or an investment portfolio or a family business but choose not to make the necessary investment decisions or deal with the constant problems or devote the degree of attention required.
- Postpone full ownership of trust assets until the beneficiaries of the trust have attained ages specified by the grantor or until events specified by the grantor have occurred.
- Enable the investment of an asset that does not lend itself to fragmentation. This often occurs where the grantor desires to spread the beneficial ownership among a number of individuals. Life insurance policies and real estate are just two examples of assets that are difficult to split up or are worth substantially more if held together.
- Limit the parties who can obtain the assets and achieve particular dispositive objectives. For instance, where family control of a business or a specific asset is important, the grantor will want to limit the class of beneficiaries and prevent recipients from disposing of property to persons outside the family. A common example is the desire to protect assets from the consequence of an unsuccessful marriage or other creditor issues.

The duties of the trustee may therefore include the satisfaction of a number of tax and nontax objectives that include, but are not limited to, the investment, management, and protection of trust assets and compliance with the dispositive intentions of the grantor.

To a great extent, the selection process and decision criteria for selecting a trustee will follow the same pattern as in choosing an executor; premium will be placed on many of the same attributes. But there are several significant distinctions.

Unlike the role of the executor, which is typically concluded within a year or two, the trustee's responsibilities commonly last for at least one generation and often last beyond two or three generations. This fact should have a significant effect on the choice of trustee or on the decision to name both co-trustees and successor trustees (or to provide a mechanism for their appointment by a resigning trustee or by the beneficiaries). Usually, the trust will provide either that the last serving trustee may name his or her replacement or that a majority of the adult beneficiaries or the surviving spouse may name the replacement.

A second distinguishing factor is that the choice of trustee, unlike the selection of the executor, is tax sensitive. In other words, there will be situations in which tax consequences will vary widely (results ranging from success to tax disaster) according to whether the grantor, the grantor's spouse, the beneficiaries, the grantor's business associates, the grantor's professional advisors, or a totally independent third party is named as trustee.

The decision is further complicated by a multiplicity of personal, family, business, investment, and nontax considerations-which must all be weighed by the grantor and the attorney drafting the trust. Quite often, a trade-off between flexibility and tax-saving objectives will be required. And even with the aid of skilled counsel, some compromise may be necessary.

Attributes of a Good Trustee

When selecting a trustee, the major attributes to consider are:

1. Availability.
2. Impartiality and lack of conflict of interest.
3. Financial security.
4. Investment acumen.
5. Business sophistication.
6. Accounting and tax-planning expertise.
7. Recordkeeping and reporting ability.
8. Knowledge of and sensitivity to beneficiaries and their circumstances.
9. Fees.
10. Decision-making abilities.
11. Competence.
12. Standard to which trustee will be held.
13. Integrity.
14. Flexibility to meet changing circumstances.
15. Willingness to serve throughout the term of the trust.
16. Experience as a trustee.
17. Tax-neutral impact.
18. Neutral or positive state law impact.

Availability

This criterion has two aspects, permanency and proximity. Corporate trustees are often considered because they possess one attribute that individuals (even individuals who are professional trustees) do not possess-perpetual existence, at least in the sense that a bank (or its successor) is likely to be in business during the entire term of the trust even if it lasts for generations, whereas individuals, even professional trustees, may with unpredictable frequency retire or make a career change or die or become disabled. Although banks may take holidays, they never take vacations. So to some extent it can be said that corporate fiduciaries have the availability advantage over individuals.

This perpetual-existence theory must be considered in perspective; only change lasts forever. The real issue is whether the trustee will be able to serve effectively long enough. The briefly considered answer to this question would still seem to give unparalleled advantage to a bank, especially when the possible senility or emotional instability or physical disability of an individual trustee is considered. It is particularly difficult to protect beneficiaries against these human frailties, since there is generally no automatic retirement mechanism for superannuated or mildly incompetent trustees within the trust instrument.

However, with corporate trustees, a different type of problem can arise. If the personnel at the senior management, professional or clerical levels change over time, the beneficiaries may experience a dramatic change in the beneficiary's relationship with the institution have changed so drastically as to constitute a new entity for all practical purposes. Surely, in the time span of a trust running for two or more generations, turnover in most banks will effect a drastic, if not revolutionary, change in people dealing with and policies affecting trust beneficiaries. The bank that was so friendly and competent (perhaps because its senior management gave great priority to trust business in the years in which the trust was established) may be cold and less than satisfactory to a second generation of beneficiaries. The consolidation of the financial services industry has led to widespread mergers that can change the fiduciary landscape very rapidly.

Availability must also be considered in geographic terms. An individual trustee is likely-over a long period of time-to move from the city in which the trust or its beneficiary is located. Of course, although banks generally remain, and in fact are becoming, regional in scope, since beneficiaries often move (or perhaps did not live in the same city or state or country as the grantor to begin with), dealing with the bank selected by the grantor may no longer be convenient. Consider provisions giving beneficiaries or a trust protector the power to change from one corporate fiduciary to another. (See discussion below of removal and replacement of trustees.)

Impartiality and Absence of Conflicts of Interest

How will the trustee react when faced with a choice that favors him at the expense of other beneficiaries-or favors others at his expense? What are the intrafamily implications of those choices? For instance, will he alienate one family member by (even properly) denying a distribution, or ingratiate himself to another by being liberal in his policy of making distributions? Can he say "no" to one child and "yes" to another without causing a never-ending family feud? A trustee who is also a family member may be forced by conscience or by duty to make choices injurious to the harmony of family relationships. Can the trustee do that?

Will the trustee (such as the grantor's spouse) be subject to the influence of one or more children (or a second spouse or lover) to make distributions that may not be in the best interest of other beneficiaries? Is the family member/trustee easily persuaded or likely to show favoritism? The remarriage of a spouse or child who is named as trustee may result in less than impartial decisions-especially where the trustee has been given discretionary powers over trust income or principal-even if the new spouse is not included in the class of possible recipients.

A child/trustee may take on the role of a parent to his or her remaining parent or siblings. This may be positive, but is also may result in an attempt to control the lives of family members through the family finances as if that person were a parent rather than a child.

An independent professional trustee is not subject to such problems. Since the choice between "no" and "yes" may be one of the most important duties of a trustee, this ability of a professional trustee to be objective and impartial should be given high preference in the decision-making process. While an independent professional trustee is a good choice for this position, the combination of the professional trustee acting together with a family member can work well. On this basis the family member can help ensure that the professional trustee is aware of the personal dynamics of a situation.

Conflicts of interest can occur even where there is no issue of impartiality. For example, assume that grantor names his attorney as trustee. The attorney/trustee would most likely be objective and impartial as between the conflicting interests of family members. But consider these questions:

- Once the grantor has died, who will negotiate with the attorney to ensure that fees are reasonable?
- Who could fire the attorney (or trustee) if services were not performed properly or in a timely manner?
- Can the attorney remain impartial as a trustee if he represents the business of one of the beneficiaries?
- Is it appropriate for an accountant serving as trustee to continue in the dual capacity if he also represents a business owned by the trust?
- What if there is an argument between the attorney/trustee and the grantor (or the trust's beneficiaries) that is entirely personal or is on the attorney/client level and has nothing to do with the relationship he has as a trustee?
- Is it possible for an attorney/trustee to fairly represent the beneficiaries, the grantor, or co-trustees in a trust-related situation?
- Will the attorney or accountant be willing to allocate appropriate time to the trust or will at the same time that the person is concentrating on obtaining and servicing professional clients (especially if the fees for serving as trustee are substantially lower than that charged in the professional's practice)?

Conflict of interest problems would plague a business associate or partner who was named trustee. For instance, if the trust held stock in one or more businesses in which the trustee was an officer or shareholder, his salary, or his stock interest would be affected by his actions taken as a trustee. What if the trustee was the art dealer for the trust of an artist who trusted him and had the highest degree of respect for the dealer's integrity, judgment, and marketing expertise? Assume the trust's assets consisted mainly of the artist's paintings. The dealer/trustee would be bound to obtain the highest price possible when selling trust assets. But as a dealer, he would want to pay the lowest possible price. Would it be appropriate to continue as trustee under those circumstances? It is risky to name anyone who is likely to buy or lease assets from or sell or lease assets to the trust or have any other dealings with trust property. Typically, we recommend either a blanket prohibition of self-dealing or limit such activity in a significant way, such as giving the beneficiaries or a trust protector an approval or a veto right over self-dealing transactions.

Some of these impartiality and conflict-of-interest problems can be overcome or minimized if anticipated in advance. But in most cases, if it is foreseeable that these problems will occur, they will. Often, the problem is not that an unethical transaction has occurred or an improper decision has been made. Rather, it is that the parties are uncomfortable merely because the beneficiaries know it could happen, assume it will, and the trustee knows the beneficiaries may distrust, second-guess, or sue him/them/it merely because they suspect a conflict of interest could have occurred or might occur.

Financial Security

This refers to the security of the funds entrusted to the trustee and the "depth of the trustee's pockets" in the event of a successful malfeasance or misfeasance suit by beneficiaries. A nonprofessional trustee will not have an internal audit staff to review the acts of the person administering the trust. This lack of a system of checks and balances is one of the major shortcomings of an individual nonprofessional trustee. Conversely, banks and trust companies are audited both internally and (usually by the state or by the Office of the Comptroller of the Currency) externally. All investments made by a corporate fiduciary must be approved by a trust investment committee, and the portfolio, which is typically diversified, is reviewed frequently.

If sued, will the fiduciary be available to answer for and be able to pay damages for a wrongful act? The answer is likely to be “no” with respect to an individual trustee but “yes” with respect to a corporate fiduciary. For example, in the event of embezzlement or some other impropriety or breach of trust, the odds of a recovery from a bank or trust company are significantly higher than from an individual trustee merely because of the relative sizes of the fiduciary’s own assets. Banks serving as trustees are required to meet minimum amounts of capitalization requirements, whereas individual trustees have no required minimum capitalization requirements.

An individual trustee can acquire physical security for trust assets by hiring safe deposit and other facilities. Banks and trust companies have such protection on site but of course build charges for their use into their fees.

Investment Acumen

The trustee’s ability to successfully invest and reinvest trust funds is one of the more important attributes to consider in the selection process. In this regard, many professional and even nonprofessional individuals have proved more astute or competent than their corporate counterparts. In some cases, the grantor’s opinion of a spouse or child as “financially inept” has proven to be an incorrect perception.

But the highly computerized and experienced investment departments of banks and professional individual fiduciaries do have an advantage over anyone who is not a professional investor. A further advantage of the professional trustee is that trust assets can be invested in a bank’s common trust funds, which increases the safety of trust investments through diversity, although investing in a corporate fiduciary’s proprietary funds usually represents a big conflict of interest for that fiduciary.

The ultimate decision in this category should not be made until the various track records are compared. The performance of commercial trust departments has varied considerably from bank to bank and from the investments returns of other investment managers.

Investment policy is an important consideration in the selection process. Corporate fiduciaries tend to be conservative. This may be either attractive or a drawback depending on how aggressive the grantor’s own style or personal objectives are or were. However, the trustee should generally manage the trust assets in a more conservative fashion then they would manage their own assets. So it is entirely appropriate for the trust assets to be managed in a more conservative fashion.

The investment decisions of an ultraconservative trustee may not be suited to the beneficiaries’ risk-taking propensities or their growth and income objectives. But this in turn may be more in keeping with the grantor’s long-range goals of restraining the lifestyle of income and principal recipients. A conservative approach is also more consistent with the trustee’s responsibilities.

So the ultimate decision is not between professional and nonprofessional or between individual and corporate fiduciary; it must be made on the basis of the type of investment policy the grantor of the trust desires and the particular trustee that will come closest to matching that policy. Keep in mind that in many situations, the appropriate solution is to name both individual and corporate fiduciaries.

Business Sophistication

Where one or more businesses are held in the trust, it is extremely important that the trustee have expertise in running that type of business. Even if the trustee should or intends to sell it, knowing when and how best to dispose of it is a very important skill. If the business is large or large relative to other trust assets, or if it is a specialized or personal service type of business, this may mean that a family member, business associate, professional advisor, or even a former competitor may have to be considered in spite of impartiality issues or potential conflicts of interest.

Typically, corporate fiduciaries do not continue businesses left in trust. The business is quickly sold and the proceeds are reinvested. In most cases that will be the appropriate course of action, since few banks have enough of the right type of personnel to continue the success of a growing business, and a failing business should usually be liquidated as quickly as possible. Nonprofessional individual fiduciaries rarely have the time to run a business even if they have the expertise and experience.

Accounting and Tax Planning Expertise

Corporate fiduciaries have a definite advantage over nonprofessional individual trustees when considering the myriad accounting procedures, tax compliance, and tax planning opportunities that must be handled by a trustee. The level of sophistication, expertise, and experience that should be applied over the lifetime of any trust is one that few nonprofessionals can provide. This means that most family members are incapable of fully understanding all of the problems that must be avoided and the availability and implications of the tax and property law elections that must be weighed. Even knowledgeable attorneys and accountants do not have the requisite practical day-to-day experience unless they practice solely in this field.

It is possible and in many cases appropriate for a trustee to hire agents for advice and assistance. Most trustees will communicate regularly with outside attorneys and accountants. But planning policy and decisions must be made by the trustee; these are among the duties that cannot be delegated. Thus, the trustee must have a working knowledge of the accounting laws and both federal and state tax laws (income, estate, gift, and generation-skipping). Will an untrained trustee know whom to call or if the advice received is both legally correct and practical or when that advice is wrong? Will a nonprofessional understand the interplay between tax, trust, and property law well enough to interpret provisions in the trust and adequately inform beneficiaries about the tax and other legal effects of various choices?

Recordkeeping and Reporting Ability

A trust is a long-term arrangement under which accountings must be made periodically over many years to a number of parties that may include the grantor, the beneficiaries, the appropriate federal and state taxing authorities, and the supervising court. This requires regular statements of the receipts, disbursements, and assets of the trust in an intelligible form, and careful long-term record storage. Also, some states which have adopted the Uniform Trust Code may require certain notices to be provided to the beneficiaries of a Trust including notice of changes of trustee.

Knowledge of Beneficiaries

In some cases an understanding of the family involved and their special needs or desires and how they relate to the grantor's objectives should properly take priority over many of the other objectives on this list. If the financial encouragement of a handicapped child, for example, is not provided through the trust, the trust may fail in its purpose regardless of how much tax it saves or how closely the trustee meets both the letter of the law and the terms of the trust itself. *Sensitivity* here is therefore used interchangeably with *flexibility*. If flexibility in dealings with trust beneficiaries and a high degree of personal sensitivity are primary considerations, a nonprofessional trustee is indicated, even as a co-trustee.

Fees

Corporate and other professional fiduciaries charge a fee for their services. Usually, this fee is based on a percentage of the income and principal of the trust. A distribution fee equal to a percentage of the principal disbursed from the trust is also often charged (upon termination or otherwise). Although this fee is typically set according to a standard schedule of fees, it may be possible to negotiate the fee in the case of a trust with a large amount of assets. This may be an amount agreed on or may be a flat hourly charge. Where trust assets consist solely of unfunded life insurance trusts, unimproved real estate, or closely held stock, the nonprofessional may be the best choice for a trustee, even if only over those assets. Likewise, trusts with assets of less than $500,000 in value are often discouraged from using corporate fiduciaries because of the fees. In fact, many trust companies will accept trusts only with a minimum level of assets. Depending upon the institution, these minimums can be at $1,000,000 or higher. If you are considering a corporate trustee, it will be important to find out if your situation meets the institution's minimum requirements. Many times, the institution will aggregate family members' accounts for purposes of determining if the minimum account value was attained. Also, many corporate trustees will insist on reviewing the terms of the trust prior to execution and will oftentimes request or require additional provisions to the trustees' powers.

Many individuals name their spouses or relatives, close friends or even trust beneficiaries because they will serve as a personal favor or as an accommodation and will not charge a fee to act as a trustee. This may be an economic necessity where the value of trust assets is small and payment of the minimum fees to the corporate fiduciary would significantly reduce the income and principal of the trust. However, in most cases, the fees saved by using a nonprofessional amounts to a false economy. A family member or friend who invests the time, effort, and takes the liability risk required by a trustee *should* be appropriately compensated.

There is a further aspect with respect to fees and the selection of a trustee; in selecting a relative who is also a beneficiary: Will the fees charged be understood by and acceptable to other beneficiaries, or will such fees-even if reasonable for the services performed-be resented and cause conflict? And, conversely, will the time and aggravation and liability risk assumed by an individual family member or friend trustee warrant a sizeable fee that is well deserved? Is it fair to expect that anyone – even a close family member – should put in what may be countless hours over years or decades – for no or less than a reasonable fee?

Decision-Making Ability

The trustee selected must be able to make many decisions, some of great significance, over an extended period of time. This entails the need for emotional maturity and wisdom as well as knowledge.

Competence

A trustee must have the legal capacity to contract. This precludes the appointment of a minor or an incompetent adult. In many states a nonresident individual can act as a trustee (although as a practical matter, geographical considerations often contraindicate selecting a person who lives a considerable distance from the beneficiaries of the trust). Some states bar nonresident corporations from serving as trustees.

Skill

A trustee will be held to a high degree of skill and care. Under the "prudent person" rule, a trustee must use the same degree of care and skill that a person of ordinary prudence would exercise in dealing with his own property.

The Uniform Probate Code, adopted by many states, places a higher standard on professional trustees by providing that if the trustee has greater skill than that of a person of ordinary prudence, he is under a duty to exercise such skill.

Integrity

Honesty and loyalty are the watchwords of trusts. Vast sums of money and other assets are entrusted to fiduciaries who must exercise a high degree of care over trust property and act consistently on behalf of trust beneficiaries.

Flexibility

Change in tax law and in the circumstances and goals of each of the beneficiaries is the only certainty. Since a trust is a mechanism specifically designed to meet that change, the trustee must be willing and able to change as well.

Willingness and Ability to Serve Throughout the Term of the Trust

An individual trustee could easily lose interest through the long years and even generations a trust may last. An individual could become physically, mentally, or emotionally unable to complete the many tasks of trustee. Corporate fiduciaries are more likely than individuals to continue serving for the full term.

Experience as a Trustee

This is the rarest of all characteristics. Obviously, past experience in administering a trust is invaluable. Through experience, the fiduciary is more likely to appreciate the broad and complex multiplicity of laws involved, know whom to call on for assistance, avoid many mistakes, and more efficiently administer and execute the terms of the trust.

Tax Impact of Various Types of Trustees

A revocable trust has a neutral impact on taxes at both federal and state levels. As long as the grantor has reserved the right to revoke the trust at any time, in most situations he will be treated for all federal and state tax purposes as if he had not established a trust and had remained as the outright owner of the property in the trust. So, with respect to a revocable trust, it does not matter for tax purposes who is selected as trustee. For example, the grantor will be taxed on the income of a revocable trust whether he names himself, his spouse, a beneficiary, a friend, a business associate, a professional whom he employs, or an independent corporate or other professional fiduciary. However, the choice of trustee may have an impact on whether the revocable trust has to file a separate income tax return. So long as either the grantor or the grantor's spouse are at least one of the trustees, a separate return is not required for the trust, and everything will be reported on the grantor's personal income tax return.

But if one of the major reasons for establishing an irrevocable trust is to save taxes (federal and state income, estate, or GST), the identity of the trustee is a very tax-sensitive decision: Inclusion of the trust's assets in income (or in the gross estate or in the GST tax base) will result if the wrong party is selected as trustee. The potential for adverse tax results increases significantly when the trustee is given discretionary powers over the income or principal of the trust if the trustee or a co-trustee is the grantor, his or her spouse, a family member (or some combination of them), or if one or more of these people becomes a trustee under a successor provision in the trust.

Consequently, the adverse tax consequences can be avoided very simply by providing that these individuals may not become a trustee or by specifying that if such a person is a trustee, he or she may not participate in a decision that will result in the to-be-avoided tax result. For example, a surviving spouse/trustee would be prohibited from exercising a broad discretionary power over principal in her own favor if the objective of the trust was to prevent inclusion of assets in her estate. However, it is obvious that favorable tax results are obtained at the cost of a loss of flexibility.

Figure 14.1 summarizes the major income and estate tax consequences of using various types of parties as trustees in irrevocable trusts. When considering the tax plication of the choice of trustee, there are four important categories:

1. Grantor
2. Adverse party
3. Nonadverse party
4. Independent party

The *grantor* is a person who provides the corpus of the trust. The Code also defines a category of parties who are "related or subordinate" to the grantor. Depending on the nature and circumstances of that person's relationship with the grantor, that definition will often encompass:

- the grantor's spouse;
- close relatives;
- a corporation in which the grantor or trust has significant holdings; or
- an employee of a corporation in which the grantor or trust has significant holdings, or in which the grantor is an executive.[19]
  A *nonadverse party* is, simply, a party that does not meet the definition of an "adverse party" An *independent trustee* is a party who is not a grantor, adverse party, or a "related or subordinate" party. Essentially, an independent trustee is unrelated to the grantor and can in no way gain any benefit from the trust (aside from the payment of reasonable fees for their services as trustee). They are often corporate trustees, such as a financial institution.

Before naming the grantor or anyone with an interest in the trust as trustee, consideration must be given to these implications. In addition, while consideration is given to having the grantor be trustee of his own irrevocable trust, the potential tax consequences make it advisable to do so only as a last resort.

Through experience, the fiduciary is more likely to appreciate the broad and complex multiplicity of laws involved, know who to call on for assistance, recognize and avoid many mistakes and more efficiently administer and execute the terms of the trust.

Neutral State Law impact

State trust laws must be considered in selecting a trustee. If state law trust requirements are not met, the trust will be invalid and provide none of any intended tax benefits. This is because federal laws' recognition of a trust as a separate tax entity presupposes validity of the trust under state law.

When a beneficiary is named as trustee, the Doctrine of Merger must be considered. This doctrine holds that the trust as a separate entity ceases to exist when the legal title to the property held by the trustee is identical to the beneficial interest held by the beneficiary. For instance, if the grantor's son is both the sole trustee and sole beneficiary, the trust will cease to exist. It is important to check applicable state law on this point.

COTRUSTEES

After considering each of the desirable characteristics of a good trustee, it will become obvious to most grantors that it is impossible to select a trustee that has all of the advantages and none of the disadvantages. Many grantors therefore attempt to obtain the strengths of both the corporate and the nonprofessional trustee by naming co-trustees. Often, one or more family members and a corporate fiduciary are selected.

Note, however, that combining the positive aspects of more than one trustee has a cost; certain drawbacks or issues must be considered. For instance, if two trustees are selected, what is the procedure if they do not agree on a given issue? If three or more are selected, will the majority rule? What responsibility does a dissenting trustee have for an action (or nonaction) taken by the majority? It usually is a bad idea to take members from both sides of a blended family and make them co-trustees because they often do not have any experience working together, and each side has their own interests that they will protect.

Resignation, Removal and Succession of Trustees

As part of the selection process itself, a grantor should think long and hard about the removal of current trustees and the appointment of successor trustees (typically, at least two should be named). The trust instrument itself should provide for where a vacancy in the office of trustee opens up. In fact, the trust instrument should provide for the procedure for a trustee to resign and for what happens in that event. The trust instrument itself must consider issues such as the following:

- Who, if anyone, should be given the power to remove trustees?
- What is the procedure for removing a trustee? What trustees can be removed by which beneficiaries? What constitutes a "beneficiary" for this purpose?
- Should such a power be given to the grantor, the beneficiaries, the trustee(s), or an outside party such as a trust protector?
- How narrow or broad should a removal power be (i.e., under what circumstances should someone be able to remove a trustee)? Removal for cause? What constitutes "cause?" Who has the power to invoke it?
- How often may a removal power be exercised?
- How will succession be determined?
- What restrictions, if any, will be placed on the successor trustee? Does it have to be an independent trustee? Does the replacement have to be a corporate trustee? Who is eligible for appointment to the office of trustee?
- What are the various tax consequences of allowing the grantor or the beneficiaries to remove a trustee and without restriction appoint a new one?
- Should the document provide that certain persons will not be subject to the removal provisions in the document such as a spouse or other beneficiary?

In trusts that are expected to last for generations, the provision in the trust instrument that provides for removal and replacement of trustees is very important and should not simply be left to default boilerplate. In long-term trusts, where the ranks of beneficiaries could grow to be large over time, it probably is prudent for a trustee who is resigning without cause to appoint a successor trustee, rather than have to get the beneficiaries or a court involved to appoint a successor trustee to avoid an expensive and often internecine squabble over the identity of the replacement.

Summary

The selection of a trustee is a most difficult one because of the longevity of most trusts, the complexity of the tax and other laws with which the trustee must comply, and the sensitivity a trustee must have to both the grantor's objectives and the beneficiary's needs and desires. For these reasons, one or more co-trustees (almost always professionals) is indicated where the terms of the trust are complex or the estate is large or where problems between the beneficiaries can reasonably be expected, which often occurs in blended families.

TRUST PROTECTOR

In this day and age of virtually perpetual trusts that are possible in many jurisdictions and the need to build in as much flexibility into the estate plan as possible and the need to build in as much accountability for the trustee as possible without necessarily giving the beneficiaries the power to remove a trustee, the trust protector can be a very worthwhile thing to use in all trusts that are expected to last for a while. The job duties of a trust protector can be as limited or as limitless as the imagination of the estate planner will allow. There is very little statutory guidance on trust protectors in the United States, but that is gradually changing as usage of the trust protector concept increases.

Many states have addressed the trust protector concept. Trust protectors can have the following tasks, without limitation:

1. To remove any trustee, without cause, to appoint a different trustee or additional cotrustees, and to appoint successor trustees;
2. To amend the terms of the trust instrument to achieve favorable tax status, or to take account of changes in the Internal Revenue Code, state law, or any cases, rulings and/or regulations thereunder;
3. To exercise any voting rights of closely held business interests;
4. To amend the provisions of the trust instrument with regard to how the beneficiaries will benefit from the trust, and to amend the trust administrative provisions;
5. To revoke any and all powers of the grantor and/or grantor's spouse that cause the trust to be a grantor trust for income tax purposes;
6. To appoint and remove distribution committee members and investment committee members, if any:
    - To appoint successor trust protectors;
    - To terminate any trust;
    - To veto or direct trust distributions;
    - To interpret terms of the trust instrument at the request of the trustee;
    - To advise the trustee on matters concerning a beneficiary;
    - To provide direction regarding notification of qualified beneficiaries;
7. To remove all or any part of the property, or the situs of administration, of this trust or any trust established hereunder, and elect, by instrument in writing filed with the trust records, that thereafter such trust shall be construed, regulated, and governed as to its administration by the laws of such other jurisdiction; and
8. To use trust assets to hire legal counsel or other advisors to advise and defend the trust protector in connection with any matter concerning the trust.

The biggest issue in determining the scope of the trust protector role often is in deciding whether the trust protector is to be treated as a fiduciary. As a general rule, trust protectors who have no investment control responsibility are not considered as fiduciaries. However, the trust instrument should expressly provide relative to that issue, as well as to the extent, if any, of the trust protector's responsibility to monitor the trustee. The trust instrument also should specify how a trust protector can resign or be removed as well as the method and sources of compensation and reimbursement of the trust protector.

There are two schools of thought on the use and role of trust protectors. The first school takes a minimalist view and gives the trust protector usually only the power to remove the trustee. The second school takes a broader view of the trust protector's role and endows the trust protector with overarching powers such as the ones that we laid out earlier. Some trust protector positions take effect immediately upon trust creation, while others "spring" into effect at some point in the future, i.e., on the occurrence of some problem or controversy. We tend to prefer the latter school, although we underscore that it is important to build in accountability for the trust protector too.

The trust instrument should expressly require the trustee to provide financing, at the trust's expense, of the trust protector's defense for any claim arising out of the trust except for claims arising out of bad faith, fraud or willful misconduct by the trust protector. The trust instrument also should permit the trust protector to release, renounce, suspend or modify to a lesser extent any or all powers and discretions conferred under this instrument by a written instrument delivered to the trustee.

The position of “Trust Protector” has evolved from its use solely for offshore asset protection trusts to common inclusion in revocable and irrevocable trusts. Many trusts are now drafted as dynasty trusts which can last for hundreds of years depending upon the rule against perpetuities in the particular jurisdiction governing the trust. The naming of a trust protector can introduce flexibility into a document which may be needed over such a long period of time.

The powers conferred on the trust protector can include the power to name a successor trustee, the power to amend the trust provisions to respond to changes in the tax law, the power to terminate the trust, the power to amend administrative provisions, or the power to change the trust situs.

One question which arises is whether the trust protector is a “fiduciary.” Many states provide by statute a presumption that the trust protector is acting in a fiduciary position; however, such presumption can be overcome by language in the document which provides that he is not acting in a fiduciary position. This may be preferable to a particular client because the trust protector’s duties can be greatly expanded if he or she is acting in a fiduciary position.

McLean Revocable Trust v. Patrick Davis PC, is a relatively recent case dealing with trust protectors. In the document at issue in that case, the trust protector had the power to remove the trustee and appoint a successor. The trust explicitly provided that the trust protector was acting in a fiduciary capacity and the court held that “(o)ne who acts as a fiduciary assumes at least the basic duties of undivided loyalty and confidentiality.” Therefore, the trust protector had a duty of care to supervise the trustees’ actions. The issue in the case was whether the lower court properly granted summary judgment, and the appellate court did not rule on whether the fiduciary had violated his duty of care. However, if the trust had provided that the trust protector was acting in a non-fiduciary capacity, then the trust protector would not have owed a duty of care. The *McLean* case was later cited as providing that “[u]nder Missouri law, the existence of a fiduciary relationship between the parties is an essential element of any claim for breach of fiduciary duty.”