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## Selecting a Trustee

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## Selecting a Trustee

### What is it?

#### *In general*

A trustee is a person (or institution) selected to administer a trust. A trustee's role is to adhere to the terms of the trust document and fulfill its objectives. A trustee can be an individual (professional or nonprofessional) or a corporate trustee, such as a bank or trust company. You, as the grantor, should choose a trustee carefully because an inappropriate choice could invalidate the trust and have serious tax consequences. You must also weigh many other personal, family, business, investment, and nontax concerns. For a large or complicated trust, a combination of individual and corporate trustees may best provide the expertise needed to manage the trust with the flexibility to respond to beneficiaries' changing needs.

#### *Trust administration*

Trust administration is the area of law that defines a trustee's duties, powers, and liabilities in relation to the beneficiaries. A trustee has specific duties. The scope of a trustee's powers depends on the extent of those duties. Because the trustee is personally liable for breaches of duty, the extent of a trustee's duties also determines his or her liability.

### Selecting a trustee

#### *Eligibility and tax considerations*

As the trust's grantor (the person establishing the trust), you can name any of the following as a trustee: yourself, your spouse, family, friends, the beneficiaries, business associates, professional advisors, a bank, or a trust company.

**Caution:** However, you must investigate carefully before appointing a trustee because the tax consequences can vary widely, depending on whom you name. If the trustee you appoint doesn't meet state trust law requirements, the trust will be invalid and provide none of the intended tax benefits.

There are a number of situations in which it's inadvisable to appoint yourself or a beneficiary as trustee:

- A sole beneficiary cannot be sole trustee--According to state trust law requirements, if the sole beneficiary is the sole trustee, the trust is invalid. A beneficiary can be a trustee only if there are other beneficiaries and/or other trustees.

**Example(s):** If Sue sets up a trust with herself as the sole beneficiary, her trust is invalid if she is also the sole trustee. This is not because she can't be both grantor and trustee. It's because she can't be both sole beneficiary and sole trustee. However, if she appoints Dan, her tax attorney, as cotrustee, or she if adds her niece, Jessie, as another beneficiary, her trust may be valid.

- Testamentary trusts --It's inadvisable to name a beneficiary as the trustee of a testamentary trust. If the trust document is drafted with the sole beneficiary as the sole trustee, the trust could be invalidated and the IRS could include the assets in the beneficiaries' gross estates for estate tax purposes.

**Example(s):** Glenn appoints his spouse, Anna, as the sole trustee of a trust intended to avoid estate taxes at her death. If the trust is not properly drafted, the IRS could include the trust in Anna's gross estate because she cannot be both sole trustee and sole beneficiary.



- Irrevocable trusts --If your primary purpose in setting up an irrevocable trust is to avoid federal and state income, estate, or generation-skipping transfer taxes, you should select an independent trustee. You could appoint yourself, but only in certain restricted circumstances and with severely diminished powers. Otherwise, you face the risk that the IRS could include the trust assets in your gross estate.

**Example(s):** Mrs. Dickinson, a widow, sets up an irrevocable trust for her child, and names herself as trustee. If she dies, the IRS could include the trust assets in her gross estate, even though the trust was irrevocable.

- Revocable trusts --For tax purposes, it doesn't matter who you name as trustee. You'll be taxed on the income regardless of whether the trustee is you, your spouse, your family member, your friend, a beneficiary, a business associate, a professional, or a bank or trust company.

### **Other considerations**

A trustee's responsibilities often span at least one generation and may extend beyond two or three. This should have a significant impact on your choice of trustee or on your decision to appoint cotrustees or successor trustees. You must also weigh and consider many other personal, family, business, investment, and nontax factors. For example, does your candidate possess the necessary investment, accounting, and tax planning expertise? On the other hand, does he or she know the beneficiaries and will he or she be sensitive to their changing needs?

### **Combining professionals and nonprofessionals as cotrustees**

Combining a professional and a nonprofessional as cotrustees can provide the longevity the role requires, protect against possible adverse tax consequences, and balance the specialized knowledge of a professional trustee with the personal touch of a family member or trusted friend. If your estate is large or the trust provisions complex, you should consider selecting one or more professional trustees.

### **Laws and trust provisions govern trustee's conduct**

State laws govern a trustee's conduct. However, you can modify the effect of these laws to some extent through appropriate provisions in the trust document.

## **What are the duties of a trustee?**

### **In general**

A trustee has many specific duties to fulfill, including the duty to preserve, protect, and invest the trust assets. Some of the more important duties follow. However, keep in mind that as a grantor you may modify the trustee's duties to some extent through appropriate provisions in the trust document.

### **Duty of loyalty**

The most basic duty of a trustee is that of loyalty to the beneficiaries. This duty needn't be specified in the trust document. It arises out of the fiduciary relationship between the trustee and the beneficiaries. This requires the trustee to administer the trust solely in the interests of the beneficiaries. In case of conflict of interest between the trustee and the beneficiaries, the trustee must resolve the conflict in favor of the beneficiaries, since this is the purpose of the trust.

### **Duty to keep and render accounts**

A trustee must keep clear and accurate records of income, expenses, and investment gains and losses. These records are necessary for filing the annual fiduciary income tax return. Additionally, the trustee has a personal stake in maintaining accurate records. First, he or she is personally liable for costs that arise due to incomplete or



inaccurate records. Second, the court can deny or decrease the trustee's pay or remove him or her from office. Third, beneficiaries may, within reason, compel a financial accounting.

### ***Duty not to delegate***

A trustee may not delegate the administration of the trust or the performance of his or her duties to others, unless the terms of the trust allow it. On the other hand, in areas where the trustee does not possess specialized knowledge or skill, it would be prudent for the trustee to employ professionals, such as accountants, appraisers, attorneys, bankers, and brokers. No hard and fast rules exist about this. Individual circumstances must dictate the appropriate actions.

### ***Duty to keep trust property separate***

A trustee commits a breach of trust if he or she commingles trust assets with his or her personal assets, even if the commingling provides him or her with no benefit. This rule makes trust assets easier to trace, prevents them from being seized by the trustee's personal creditors, and makes them less subject to waste. Even if the trustee doesn't commingle trust assets, he or she commits a breach of trust if he or she takes title to the assets. Trust assets must belong to the trust. Otherwise, the trustee could claim that profitable investments were his or her property, while unprofitable investments belonged to the trust.

### ***Duty to exercise reasonable care and skill***

A trustee must exercise reasonable skill and care in administering the trust. The trustee's actions must meet the prudent person standard, meaning he or she must administer trust assets with the same degree of skill and care that a person of ordinary prudence would use in managing his or her own personal assets. Thus, a trustee can be liable for mismanaging trust assets if his or her actions fail to measure up to the prudent person standard.

### ***Duty regarding investment***

A trustee must satisfy the prudent person standard when investing trust assets. He or she must consider both the safety of the capital as well as the likelihood of income. The trustee is not required to invest the funds for capital appreciation. Rather, his or her main responsibility is to conserve the original trust assets and invest them to yield a reasonable income. On the other hand, the trustee is not required to invest in the most conservative investments, such as government bonds. If another investment prudently yields a higher return, the trustee may purchase it. The trustee's goal should be to preserve the assets to carry out the objectives of the trust.

## **What are the powers of a trustee?**

### ***In general***

Since a trustee's duties and powers are interrelated, the scope of a trustee's powers depends on the extent of his or her duties. A trustee's privileged powers are those he or she can exercise without violating a duty to the beneficiaries. A combination of state law and trust provisions grant powers to the trustee. Although a power may not be specifically granted, it may be implied from the trust terms. As the grantor, you can expressly confer a power through a provision in the trust agreement. Likewise, you can prohibit a trustee from exercising a specific power.

### ***Power to incur expenses***

A trustee may incur expenses that are reasonable, necessary, and appropriate to preserve trust assets.

### ***Power of sale***

A trustee may sell trust assets to pay debts, administration expenses, and taxes. The terms of the trust dictate the scope of this power. For example, salable assets may include real estate unless the trust agreement prevents it. If the terms of the trust were unclear, or if a required sale of assets would defeat or hamper the trust's objectives, the trustee must obtain court approval to deviate from the terms of the trust.



### ***Power to mortgage or lease***

A trustee may mortgage trust property or pledge it as collateral for a loan if a statute or the terms of the trust specifically allows it. Otherwise, the trustee may not mortgage or pledge the property since this could result in its loss.

A trustee, however, usually may lease trust property unless the trust agreement specifically forbids it. This is because the trustee has a duty to make the property productive. If the trust contains land, the principal way of making land productive is by leasing it.

### ***Power to continue a business***

A court may allow a trustee to operate a business if its sale would cause a loss to the trust. Under some circumstances, a trustee may continue business operations for a brief period of time without court approval in order to sell the business as a going concern.

Otherwise, a trustee may not carry on the operations of an active business unless the trust agreement specifically allows it. In fact, the trustee has a duty to dispose of the business and invest the proceeds in appropriate investments.

## **What are the liabilities of a trustee?**

### ***In general***

If a trustee intentionally or negligently violates a duty to the beneficiaries or misuses a power, he or she commits a breach of trust. The extent of a trustee's liability depends on the scope of his or her duties and powers. If a breach of trust causes a loss or depreciation in the value of the trust assets, the trustee is personally liable for the amount of the loss. Likewise, if a breach of trust results in a gain, the trustee must return any profit to the trust.

## **What is a trust protector?**

A trust protector is an individual, committee, or entity named in a trust document that is given power over the trustee and authority to make major changes to the trust document. A trust protector does not manage the day-to-day administration of the trust; that is the job of the trustee. The purpose of a trust protector is to give flexibility to an irrevocable trust, and to have a check and balance against trustee failures and abuse. Typically, a trust protector can amend provisions in the trust document in order to address legal and tax law changes, changes in the circumstances of the beneficiaries, or any other possible future circumstance. A trust protector can also act as a liaison between the trustee and the beneficiaries, helping to resolve any disputes that may arise.

There is no set list of powers that can be given to a trust protector. The grantor must anticipate which powers might be necessary in order to carry out his or her intentions and the objectives of the trust. Those powers (and limitations) should be carefully defined in the trust document (or separate letter, if a trust protector is named after the trust has been created). Additionally, the grantor should provide some guidance to the trust protector regarding what is expected of him or her.

The powers given to a trust protector can be limited or broad. For example, a trust protector can be given the authority to oversee, direct, remove, add, or replace the trustee, or expand or limit the trustee's powers. A trust protector can also be given the power to add or delete beneficiaries, increase or decrease the interests of any beneficiaries, veto or direct trust distributions, regulate trust investments, change the trust situs or governing law, or even terminate the trust. The grantor, however, should list only those powers that will further the trust's purpose, and resist an all-inclusive listing, which may cause friction between the trust protector and the trustee, or result in undesirable legal or tax consequences.

As the name implies, a trust protector is meant to be a safety measure, giving the grantor peace of mind. A grantor may want to name a trust protector if he or she:



- Is concerned that the trustee will fail to exercise his or her duties in a satisfactory manner
- Would like to withhold certain powers from the trustee
- Would like a neutral third party to act as moderator between the trustee and the beneficiaries





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