



## FINANCIAL PLANNING

*The decision to name a trustee is a complex process that includes weighing and balancing the various factors according to personal preferences and circumstances.*

# What to Look for When Selecting a Trustee For Your Estate Plan

By Michael E. Leonetti

Selecting the people to carry out the provisions of an estate plan is one of the most important and difficult tasks involved in the estate planning process. It is impossible to make a proper selection of any member of the estate planning team without understanding, in general terms, what it is the individual should be doing and how that person interacts with others who have important roles to fulfill.

A trustee is the person or institution named in a trust agreement to carry out the objectives and follow the terms of the trust. A trustee can be a non-professional individual, a professional individual (such as an attorney, an accountant or an investment adviser), or a corporate fiduciary (such as a bank or corporate advisory firm). They need not be related, and in some circumstances it is inadvisable to select a close relative.

The selection process and decision criterion for selecting a trustee is similar to choosing an executor, but there

are several significant distinctions. First, 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 beyond. This fact should have a significant impact on the choice of trustee or on the decision to name co-trustees and successor trustees, or to provide a mechanism for their appointment. In addition, unlike the selection of the executor, the selection of a trustee is tax-sensitive. In other words, in some situations tax consequences will vary widely depending on whether the grantor, the grantor's spouse, the beneficiaries, the grantor's business associates, the grantor's professional advisers, or a totally independent third party is named as trustee.

The decision to name a trustee is further complicated by a multiplicity of personal, family, business, investment, and also non-tax considerations. All must be weighed and balanced by the grantor and attorney drafting the trust.

When selecting a trustee, there are 17 major attributes to consider, although they are not equally important. Certain attributes—integrity, for instance—are always extremely important; the importance of certain other attributes will depend on individual circumstances.

### Overall Abilities

#### ***Integrity***

Honesty and loyalty are the watchwords of trust. 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. This is perhaps the most critical factor.

#### ***Decision-Making Ability***

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

There are four types of decisions:

- Investment decisions: To purchase, retain, and sell securities. This is critical since the amount of income will depend on the decisions made.
- Management of assets and personnel of a closely held business, if this is part of the trust.
- Ability to interface effectively with other advisers.
- Discretion and judgment regarding conflicting interests.

### Managing the Trust and Its Assets

#### ***Investment Performance and Track Record***

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 non-professional individuals have proven more astute or competent than their bank trust counterparts, although performance among all entities varies widely.

But the highly computerized and experienced investment departments of banks and professional individual fi-

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duciaries give them an advantage over anyone who is not a professional investor. A further advantage of the bank trustee is that trust assets may be invested in the bank's common trust funds, which increases the safety of investments through diversification.

The ultimate decision in this category should not be made until the various track records are compared.

### ***Business Sophistication***

When one or more businesses are held in the trust, it is extremely important that the trustee have expertise in running that type of business. If the business is large, or large relative to other trust assets, or if it is a specialized or personal service business, this may mean a family member, business associate, or professional adviser. 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 proceeds are reinvested. If sold precipitously, a business may not realize its full potential value. A closely held business is hard to sell, so knowing when and how best to dispose of it is a crucial skill.

### ***Accounting and Tax Planning Expertise***

Corporate fiduciaries generally have an advantage over non-professional individual trustees when considering the myriad accounting procedures, compliance requirements, and tax planning opportunities that must be handled by a trustee. Most family members will simply be incapable of fully understanding all 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 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 the planning policy and

decisions must be made by the trustee—these are among the duties that are not delegable.

### ***Recordkeeping and Reporting***

A trust is a long-term arrangement under which accountings must be made periodically over many years to a number of parties, including the grantor, beneficiaries, appropriate federal and state taxing authorities, and the supervising court. This requires statements of receipts, disbursements, and trust assets in an intelligible form and using careful storage of long-term records. If a trustee does not have this skill, then services must be obtained from professional advisers.

### ***Financial Security***

This refers to the security of the funds entrusted to the trustee and to the "depth of the trustee's pockets" in the event of a successful malfeasance or misfeasance suit by beneficiaries.

A non-professional 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 using an individual non-professional trustee. Conversely, banks and trust companies are both internally and externally (by state and/or federal regulators) audited. In addition, all investments made by a corporate fiduciary must be approved by a trust investment committee.

If sued, will the fiduciary be available to answer for a wrongful act and be able to pay damages? 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 an 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 asset sizes.

### **Interacting With Beneficiaries**

#### ***Knowledge of and Sensitivity to Beneficiaries***

In some cases, an understanding of

the family involved, their special needs or desires and how they relate to the grantor's objectives should take priority over many of the other considerations. For example, if the financial encouragement of a handicapped child 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 the letter of the trust itself.

### ***Impartiality & Lack of Conflicts of Interest***

How will the trustee react when faced with a choice that favors him or her at the expense of other beneficiaries, or favors others at his or her expense? For instance, will he or she alienate one family member by (properly) denying a distribution or ingratiate himself or herself to another by being liberal in the policy of making distributions? 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.

The remarriage of a spouse or child named as trustee may result in less than impartial decisions, especially when the trustee has been given discretionary powers over the trust income or principal, even if the new spouse is not included in the class of possible recipients.

An independent professional trustee is not subject to these problems. Since the choice between "no" and "yes" may be one of the most important duties of a trustee, the ability of a professional trustee to be objective and impartial should be given some preference in the decision-making process.

### ***Flexibility***

Changes in tax laws 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 these changes, the trustee must be willing and able to change as well.

### ***Availability***

This criterion has two aspects: permanency and proximity.

Corporate trustees are often consid-

ered because they possess one attribute not possessed by individuals, or even professionals—perpetual existence. A bank or its successor is likely to be in business during the entire term of the trust even if it lasts for generations, while individuals die, become disabled, retire, or make career changes. On the other hand, corporate trustees can have changes in personnel at the senior management, professional, and clerical levels. Even though the same legal entity is involved, changes of both the personalities and the principles upon which money is managed and invested could be drastic enough to constitute a new entity for all practical purposes.

Proximity should also be considered. An individual trustee is likely, over a long period of time, to move away from the city in which the trust or its beneficiary is located. Of course, banks can present a similar problem—although banks don't tend to move, beneficiaries do, and dealing with the bank selected by the grantor may no longer be convenient.

One option to consider is to make provisions that give beneficiaries the power to change from one corporate fiduciary to another.

### ***Willingness to Serve***

An individual trustee could easily lose interest throughout the long years and even generations that a trust may last. Corporate fiduciaries are more likely to continue for the full term than individuals.

You may feel your primary trustee nominee will serve admirably, but no one can guarantee the future for either individuals or institutions. It would be wise to select a successor trustee or make provisions to permit beneficiaries to do so.

### **Legal Requirements & Tax Effects**

#### ***Competence***

A trustee must have the legal capacity to contract. This precludes the appointment of a minor or incompetent adult. In many states, a non-resident individual may act as a trustee, although

as a practical matter, geographical considerations often argue against selection of an individual who lives a considerable distance from the beneficiaries of the trust.

#### ***Tax Neutrality***

A recoverable trust has a neutral impact upon taxes at both the federal and state levels.

But if one of the major reasons for establishing an irrevocable trust is to save federal and state income, estate, or generation-skipping transfer taxes, the identity of the trustee is a very tax-sensitive decision. If the wrong party is selected as trustee, the result may be inclusion of the trust assets in income (or in the gross estate or the generation-skipping tax base).

The potential for adverse tax results increases significantly when the trustee is given discretionary powers over the income or principal of the trust. Adverse tax results may also occur when the grantor, his or her spouse, a family member, or some combination of them is selected as a trustee, co-trustee, or one or more of these people becomes a trustee under a successor provision in the trust.

#### ***State Law Compliance***

State trust laws must be considered in selecting a trustee. If state law trust requirements are not met, the trust will become invalid and will not provide any intended tax benefits. This occurs because federal law recognition of a trust as a separate tax entity presupposes validity of the trust under state law.

### **Fees and Standards**

#### ***Fees***

It is customary for bank trustees to 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. Although this fee is typically based on 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 agreed-upon amount or a flat hourly charge.

Many individuals name as trustees spouses, 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 the trust assets is small and payment of minimum fees to a corporate fiduciary would significantly reduce the income and principal of the trust.

In larger trusts, when a relative or friend is trustee, it may be a good idea to provide for fees, even at a reduced schedule, in order to ensure prompt performance and avoid building a resentment toward onerous duties.

#### ***Standards***

A trustee will be held to a high degree of skill and care. Under the "prudent man" rule, a trustee must use the same degree of care and skill that a person of ordinary prudence would exercise in dealing with his or her 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 or she is under a duty to exercise such skill.

### **Summary**

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 with all of the advantages and none of the disadvantages. Many grantors, therefore, attempt to obtain the strengths of both the professional and the non-professional trustee by naming "co-trustees." Often, one or more family members and a corporate fiduciary are selected.

If you are evaluating which institution, firm, professional, or non-professional to select as a trustee, you may find the accompanying checklist helpful.



## Trustee Evaluation Checklist

Rank each factor on a scale of 1 through 10. If you feel certain factors are more important, double the score for that factor. Then compare the totals for each nominee.

Nominee: \_\_\_\_\_

Score

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

### Overall Abilities

Integrity

Decision-Making: Ability to make investment decisions, closely held business decisions, interface effectively with other advisers, and judge and deal with conflicts of interest.

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### Managing the Trust and Its Assets

Investment Performance and Track Record

Business Sophistication

Accounting and Tax-Planning Expertise

Recordkeeping and Reporting Ability

Financial Security: Ability to ensure security of trust funds and cover damages should a malfeasance or misfeasance occur.

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### Interacting With Beneficiaries

Knowledge of and Sensitivity to Beneficiaries

Impartiality and Lack of Conflicts of Interest

Flexibility: Ability to cope with tax law changes and changing circumstances of beneficiaries.

Availability: Likelihood that nominee will remain in existence in its present form throughout the existence of the trust, and likelihood that it will remain geographically close to the beneficiaries throughout the trust's existence.

Willingness to serve throughout the term of the trust.

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### Legal Requirements and Tax Consequences

Competence: Ability to enter into legal contracts.

Tax Neutrality: Will naming of nominee as trustee result in adverse tax consequences?

State Law Compliance: Does naming of nominee as trustee meet state trust laws?

\_\_\_\_\_  
\_\_\_\_\_

### Fees and Standards

Fees: Reasonableness of fees relative to size of trust.

Standards: Which trustee standard will nominee be held to legally?

\_\_\_\_\_

### TOTAL SCORE