

Trustee Selection

The appointment of a trustee is critically important because trustees make decisions regarding distributions of property. The issues surrounding the appointment of a trustee depend on the period during which the trustee serves. If the trustee will only serve while the creator of the trust (called the “donor”) is alive, the appointment issues are minimized as the donor can replace the trustee at any time. However, most trustees serve long after the death of the donor and may have broad discretion to make distribution decisions; thus, the appointment raises many more issues.

All trustees are responsible for managing the trust property, understanding the legal landscape (knowing what can and can not be done and knowing what should and should not be done) and understanding the (usually, income and estate) tax implications of actions and inactions. In considering whether to appoint a family member trustee or a professional trustee, one must consider the abilities of the proposed family member trustee. Most family member trustees are unable to personally address these issues and hire one or more professionals. The alternative to this is to appoint a professional trustee who may bring one or more of these abilities to the table.

Family Member Trustees

A difficult issue to consider when appointing a family member trustee is how the other family members will react. For example, if a child is appointed as the trustee of a trust for the benefit of the other children and grandchildren, will the other family members feel slighted by not being appointed? Will the other family members be able to deal with a sibling holding the purse strings? In cases where trustees have the authority to make distribution decisions, the trustees must not only know what to do, they must be dedicated to the objectives of the donor and make difficult decisions to distribute or withhold funds to/from family members in the face of emotional and conflict of interest issues.

A tax issue arises when one appoints a family member trustee to serve over a share for his/her benefit. If the trustee has the discretion to make distributions to him/herself, the trustee will be said to have a general power of appointment over the trust property. The property will be subject to all the claims of the trustee’s creditors, all of the income will be taxable to the trustee and the trust property will be included in the trustee’s estate for estate tax purposes. One means by which to avoid these harsh consequences is to limit the reasons for which the trustee can make distributions to the standards of health, education, maintenance and support, but these standards can severely limit distributions.

Professional Trustees

An alternative is to appoint a professional trustee to serve with the family member trustee and permit broad discretionary distributions, but prohibit the family member trustee from making distribution decisions to or for his/her benefit. The family member trustee can then participate in distribution decisions to or for other family members without consequence.

If you determine that the appointment of a professional trustee is appropriate, one must consider who or what entity to appoint. Banks, trust companies, attorneys and other professionals (CPAs, CFPs,) serve as professional trustees. Each brings to the table a slightly different skill set and few cover all three general responsibilities of trustees, investment, legal and tax. Skills not covered by the professional will require additional assistance.

Investments can be handled by a competent investment manager who should first gain an understanding of the objectives of the trust. The legal responsibilities can be handled by an attorney who practices in this area. Finally, the tax implications can be addressed by a competent CPA or tax attorney.

Another important issue to consider in naming a professional trustee is fees. There are a number of ways a professional trustee can be compensated. The most common is as a percentage of the property under management. The fee as a percentage of the assets decreases as the assets under management increases. When comparing trustee fee schedules be careful to consider what the fee covers. Does this cover only investment management? What about legal advice? What about tax planning and tax compliance? If these services are not included, how much in additional fees will the trustees incur to meet their responsibilities?

There are a number of other relatively minor issues that should also be considered. The location of the trustee while relevant is not too important in our computer driven society. The age of the trustee is also relevant if the same age or older than the donor. This issue should be addressed by a carefully drafted trustee replacement paragraph.

Following the Donor's Objectives

When selecting a trustee, the overriding concern should not be the three general issues which, as discussed above, can all be handled with competent assistance. The overriding concern should be; who or what entity will carry out the wishes of the creator of the trust when that person is no longer able to communicate them? The trustee must make difficult decisions based on what the donor wanted. Consequently, the trustee should be an integral part of the estate planning process that gives rise to the trust. Moreover, the objectives and desires of the donor with respect to distributions should be communicated to the professional.

Given that it is not possible for one to discuss all of the possible reasons for distributions with a trustee at the time of the drafting of the instrument, how does the trustee gain the necessary understanding to make the "right" decisions? A method I have used for years to document a client's objectives is for the client to complete a memorandum to me which defines what distributions are appropriate under a variety of circumstances. As indicated above, it is impossible to cover every possible distribution issue; however, the memorandum is broad enough to reflect the donor's desires.

Not only does the trustee need to understand these issues, the replacement for the initial trustee must have a method by which to gain such an understanding. This is a common problem when banks are named as trustee. The original trust officer may know the donor's objectives, but the new trust officer does not. In my practice, the memorandum from the donor stays with the trust administration file; therefore, if I am replaced as trustee, future trustees will learn the donor's desires.

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