

# Sitting duck

*Approach a request to serve as a trustee very carefully*

by Charles A. Lowenhaupt

What are friends and family for? The answers are limitless and the opportunities abundant, but when we talk about trusts, we think in terms of friends and family serving as trustees. Don't agree to be a trustee for a friend or relative without an understanding of just what the position entails.

Let's address whether you should serve as trustee for your brother, sister, other relative or friend. Let's also assume we are not discussing a trust of which you are the beneficiary, such as one set up by your parent, your spouse or yourself; trusteeship of those trusts has its own problems and rewards.

So what is the trustee, what are the responsibilities of the trustee, and what are the liabilities of the trustee, all with respect to a private trust?

The trustee is a fiduciary—a protector of trust assets, the interpreter of trust purposes, the alter ego of the creator of the trust and a sitting duck for any number of lawsuits, primarily by beneficiaries but also by government entities.

What should be known by anyone who agrees to serve as trustee is that this requires diligence, expertise and time. The trustee's responsibilities are investing the trust's assets, considering the needs of the trust's beneficiaries, understanding the trust instrument and the creator's desires and record keeping. The trustee's job is to run the trust efficiently to accomplish the creator's purposes.

Investment is an activity in which many engage for themselves, and many readers will be professional investors in one way or another. Yet the trustee investor must invest as a prudent investor (once called a prudent man), and this requires following a process (and maintaining a record of the process) to allocate assets among classes, selecting assets within each class and monitoring investment return.

The trustee must recognize that investment performance has two components, return and appropriateness. The return on the trustee's personal investments may be extraordinary but the investments may not be

appropriate for the trust. Often the trustee will wander down the path to lawsuit by investing the trust as the trustee would invest personal assets and not as the prudent investor set out in state rules.

Most trusts will have a beneficiary—the current beneficiary, now entitled to trust assets (sometimes income and sometimes principal upon certain terms) and another, the “remainderman,” (whose identity is often unknown), entitled to trust assets at a later date. If the trustee does not invest for future benefit, the trustee may be failing in his responsibilities to the remainderman; but if the portfolio is so volatile it may be low when the needs of the current beneficiary arise, the trustee may be failing in responsibilities there. The trustee is expected to look for adequate income and adequate capital appreciation and is free to use any number of asset classes.

Often the trust will provide for distributions to meet the needs of one or more beneficiaries. The trustee must be prepared to learn of and evaluate those needs by means of process and communication with the beneficiary or his or her parents.

The trustee must understand the trust instrument to ensure he or she is administering it properly. The trustee must know when distributions are to be made, such as, for example, when the beneficiary reaches a certain age. If the trust provides for distribution only of income, the trustee cannot distribute principal to the beneficiary no matter how needy or worthy the beneficiary may be. A trust providing that it can be used only for health and maintenance is likely not available to help a beneficiary start a business. The trustee distributing trust assets without authority in the trust agreement may well owe funds to restore the trust.

Finally, the trustee is responsible for filing tax returns, for providing reports and statements to the beneficiaries and for seeing that the trust assets are secure and correctly accounted for.

The trustee may hire experts such

as investment professionals, custodians, lawyers and accountants, but the trustee is responsible for due diligence in the selection and proper monitoring of those experts. If trust assets are lost or stolen, the trustee should be capable of showing that reliance on those experts was reasonable and prudent.

Operative words for the trustee are “prudence” and “process.” Following process is prudent and may be as important as the result in defending a lawsuit brought by a beneficiary or government official. Various statutes give rules and regulations for the trustee and generally set out as the trustee's primary duty the management of a prudent investment process reflecting the purposes of the trust and the interests of the beneficiary. Without that process, performance and good intentions may be merely paving the way to litigation.

A road map to follow to avoid the pitfalls and hazards of a trusteeship is a handbook recently written by the Foundation for Fiduciary Studies and edited by the American Institute of Certified Public Accountants. “Prudent Investment Practices: A Handbook for Investment Fiduciaries” (available at [www.ffstudies.org](http://www.ffstudies.org)) sets out 27 practices for discharging trustee duties, all in clear English with few of the layers of detail normally encountered in statutes.

If you are willing to serve as trustee, what should you ask for? Compensation is not unreasonable, especially since you are likely to spend time and to incur potential liabilities. Amounts can be set based on state rules, on trust size, on the number of trustees and on your relationship to the creator of the trust. For example, you may decide not to charge to serve as trustee of your mother's trust.

As trustee, you should have resources to help you understand the trust instrument and your responsibilities under it. You should be able to hire a lawyer when you are trustee (or if you are given the opportunity to review the trust even before you serve) to advise with respect to language and

your role. Remember that as trustee you are bound by the language in the trust; if you can help write that language before the trust is signed, you may be more comfortable serving.

Insist that if the creator wants you to be trustee, he or she should give you the flexibility to run the trust in a manner comfortable and natural to you. For example, if you are a real estate junkie, insist that the trust allow real estate investments. Be certain you are comfortable with whatever “incentives” the creator wants to build into the trust; you should not serve as the trustee of a trust rewarding sobriety, for example, if you are a liquor distributor.

You should want the ability to resign as trustee, and this may require some understanding with the creator of the trust that you will leave when you think it appropriate. In fact, there are many trustees chained to their trusts not by the trust instruments but by their feelings of duty to the trust's creator. You may desire a retirement in Florida playing golf rather than a sunset of fireworks dealing with impatient beneficiaries.

Should you serve as trustee? There are worse favors you can perform for a friend or family member. But the role is never a sinecure.

You must be prepared for hard work and some frustration and anguish. Regardless of the size of the trust, regardless of your sense of closeness to the creator or the beneficiaries, regardless of your competence as trustee, you assume substantial duties and responsibilities as a trustee and you expose yourself to liabilities.

Considering those liabilities and understanding your responsibilities before you become a trustee will make your serving as one more effective and more constructive. n

*Charles Lowenhaupt is an attorney concentrating in wealth counseling and estate planning. He is managing partner of Lowenhaupt & Chasoff LLC, the U.S.' first tax law firm, established in 1908.*