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SO YOU WANT TO BE A TRUSTEE: IS IT THE STAIRWAY TO HEAVEN OR A WALK ON THE WILD SIDE?

By Alexander A. Bove Jr. and Melissa Langa

Historically, it is not at all unusual for clients to name their attorneys executors of their estates and trustees of their trusts. And it typically follows that most attorneys would welcome the appointment. But while the two positions have a number of characteristics in common in terms of their respective duties and responsibilities, the fact is that acting as trustee can be far more daunting and time-consuming, and can bring about far more exposure to liability, than the role of executor. With that in mind, we offer our guideline/checklist/stay-out-of-trouble regimen for the trustee-to-be:

Document and Jurisdiction Due Diligence:

- ☐ Review the trust (including amendments and any letter of wishes). For example: Is your successor named, or is there a mechanism to appoint one? Do you have the authority to resign? In some states, without that authority stated in the trust, a trustee may not resign without court permission. That can be a costly and public exercise. The Uniform Trust Code, soon to be the law in Massachusetts, will allow a trustee to resign with consent of the beneficiaries, but permission in the trust to resign is always better.

- ☐ And never underestimate your exposure to liability. Some trusts contain broad trustee exculpation clauses (better for the trustee), so that, short of outright stealing or driving the trust off a cliff, you shouldn't have to worry so long as you use "reasonableness" as your guide. If there is no exculpation clause, check your malpractice coverage.

- ☐ Determine what state law governs the trust and understand how the law might change or how it supplements the trust. If you are a Massachusetts lawyer and the trust is governed by New York or Missouri law, engage counsel from the relevant jurisdiction (the trust will pay for it) and ascertain any peculiarities existing in that state. Add them to the guidelines.

- ☐ Review the previous trustee's accounts for the past three years. Depending on the state law governing the trust, you could be liable for the negligence or other breaches of duty committed by the previous trustees, if you don't take action (Massachusetts is one of those states), so this could be serious stuff. You should also review the provisions requiring you to account to the beneficiaries. It is important to meet your obligations in that regard.

- ☐ Review the relevant estate tax return (Form 706) if funded as result of a death. This is to confirm that the trust received all it was entitled to, or whether more might be coming. It will also provide you with important tax basis information for trust property received from the estate.

- ☐ Review the relevant gift tax return (Form 709) if funded by a lifetime taxable gift. For the same reason as the foregoing comment regarding tax basis.

Previous Administration Due Diligence:

- ☐ Discuss with the prior trustee whether there have been any past problems, audits, lawsuits and such. Reread the comment above on the previous trustee, but in addition, some of these may be continuing issues for which you will be personally responsible to properly follow up and oversee. (Aren't you glad you took this job?)

- ☐ Receive and review the prior trustee's notes and minutes, relevant correspondence with beneficiaries, advisors, and other third parties. These should give you insight on the activities, beneficiaries' complaints, etc., that took place before you came on the job.

- ☐ Meet with the trust's advisors, such as the accountant and financial advisor, and plan for regular follow-up reviews with them. Be sure you choose experienced and "trustworthy" people, as you ultimately will be responsible for implementing their recommendations.

Beneficiary Due Diligence:

- ☐ Identify beneficiaries (current and future) and make a preliminary assessment of the overall family situation, keeping in mind the dispositive provisions of the trust. As noted below, you will be meeting with all or some of them, and you don't want it to appear that you have no idea what's going on.

- ☐ Confirm the citizenship of beneficiaries. If any of the beneficiaries is a non-resident alien, there may be different tax consequences in a distribution, or in some cases, in the choice of investments.

- ☐ Meet with the beneficiaries or representatives (e.g., parents of minors, guardians, conservators). Be prepared to explain in detail how the trust operates. This will be an important meeting. Since you'll be viewed as holding the purse strings, everyone will want to know if you're going to be generous or onerous, reasonable or disagreeable. And be prepared to listen to all their special needs and convincing reasons that funds should be distributed to them.

- ☐ Discuss discretions held by the trustee and consideration for exercise. Don't promise too much, but show that you are and will continue to be concerned with their needs and well-being. And be sure to explain what a "remainderman" is and why you need to keep it in mind.

- ☐ Determine an ongoing beneficiary meeting schedule. Once a year? More often? It will depend on the terms of the trust and the circumstances of the beneficiaries. At the very least, keep a line of correspondence with them.

- ☐ Determine distribution needs (this year and five-year projection). And when meeting with your investment person as noted below, consider the projected distributions in structuring the trust investments.

Asset Due Diligence:

- ☐ <u>Review all current trust assets</u>. Some may be illiquid, such as privately held stock, but that doesn't reduce your responsibility to manage and look after them. You may have to engage outside specialists to advise you.

- ☐ <u>Identify the tax basis of each asset</u>. As noted above, much of this will be gleaned from the estate and the gift tax return(s), as applicable, and perhaps some from the settlor's accountant. The information will be very important in decisions on selling assets.

- ☐ <u>Identify any legacy assets with special retention requirements</u>. Occasionally, a settlor will direct that the trustee may never sell a certain piece of real estate or a position in stock held by the trust (and this could be publicly, as well as privately held shares). What do you do, for example, if it is publicly traded stock that is rapidly declining before your very eyes, and the beneficiaries are insisting you sell **it** before their inheritance disappears? Will you be personally liable for its loss, or should you petition the court for instructions? (The latter would probably be your recommended course of action.)

- ☐ <u>Review the status of any real estate held in the trust</u>. Remember, again, if it is held in the trust, it is *your* responsibility — that is, maintenance, repairs and especially adequate insurance. If it is rental property, you could engage a manager, but the responsibility is still there and perhaps greater, as you now have to keep track of what the manager is doing. This includes leases, the management agreement itself, improvements, etc.

- ☐ Review current insurance policies on trust assets for adequacy. In some cases, you may be able to make a reasonable assessment, but never hesitate to confirm with a specialist. If something happens, and the coverage is inadequate to make the trust whole, guess who will be responsible?

- ☐ Review (or prepare) an investment policy and review trust investments with a financial advisor. Establish a quarterly meeting schedule for reviewing the investment policy and strategy, having in mind the cash flow needs for distributions and the mid- to long-term objectives of the trust.

- ☐ If insurance is held in trust, consider a review of the policy by the insurance advisor. This is important, because the suitability of policies can change materially over a period of years, and, typically, it is one of the trust's assets seldom re-examined. Failure to restructure, exchange, replace, or convert a policy when it can be shown that one of those options would have preserved or substantially increased coverage or reduced costs could render the trustee personally liable for the loss. And here we are usually talking about serious money. Thus, it is wise to engage an expert to render an opinion on the policy.

Tax Due Diligence:

- ☐ With a tax advisor's input, determine the tax status of the trust (TIN and grantor vs. non-grantor complex vs. simple). See comment below on tax issues.

- ☐ If the trust is a grantor trust, determine whether the trust gives the trustee (or someone else) the "toggle power" to turn off the grantor trust status. Calendar annual consideration of whether to exercise the power**,** but unless you're an experienced tax attorney (or accountant) don't try this at home. Consult with a tax specialist (one who knows fiduciary tax law) and let him be your guide. Tax mistakes and oversights can expose you to personal liability, and usually you don't know of the problem until it's too late.

- ☐ Determine whether the trust is a GSTT trust. If yes, or if you have no idea, engage a tax accountant to advise you, and confirm the proper allocation of GSTT exemption and filing of GSTT tax returns. They include Form 706-GS (D) and Form 706-GS (D-1) (filed when a tax year includes a distribution from the GSTT trust) and Form 706-GS (T) (filed when a GSTT trust is terminated). (See comment immediately above.)

- ☐ Get copies of the past three years' tax returns from the trust's accountant. If necessary, obtain an independent review by a different accountant.

- ☐ File Form 56 with the IRS (Notice of Fiduciary Relationship). This form tells the IRS that you are in charge and all notices regarding the trust should be sent to you.

- ☐ File Form 8821 with the IRS. This form will grant the IRS authority to speak to your professional representative regarding the trust.

- ☐ Schedule annual February meeting with the trust accountant to discuss "65-day distributions." This is a tax strategy that allows a distribution made this year to be treated as if it were made last year. Again, check with a tax specialist.

- ☐ Keep track of the grantor trust status. If the trust is taxed as a grantor (income tax pass-through) trust, establish a relationship with the grantor and discuss having an annual meeting to discuss trust business that will impact the grantor's tax liability.

Compensation Due Diligence:

- ☐ Discuss trustee compensation and confirm in writing with the beneficiaries and co-trustee, if any. The last thing you want is for the beneficiaries to be unaware of your fees and to learn after the fact. Be upfront and clear about this. It may also help to advise them of comparable fees charged by corporate trustees.

- ☐ Legal fees. If your firm will be providing legal advice and services to the trust, discuss this with the beneficiaries and, where applicable, the grantor. Make it clear how the trust will be billed and that the firm's legal fees will be in addition to your trustee fees.

Acceptance Due Diligence:

- ☐ Release of the previous trustee. Before your acceptance or during its process, the previous trustee may want to obtain releases from the beneficiaries for prior trustee actions. Although not every trustee requests this, it is reasonable to request and you may be involved in the process.

- ☐ Sign acceptance of your trusteeship.

- ☐ Administrative details. Add this trust to your Trust Administration List, if you have one. That is, you should calendar all your required services, distributions to beneficiaries, etc. If you have a paralegal, that person can handle the administration much more efficiently. You must attend to things such as opening billing accounts (trustee and legal fees) for the trust, bank and investment accounts, and determine a minimum balance for the trust "operating account".

Conclusion:

As we suggested, it's definitely not all fun and games, and definitely not "easy money." It is the serious business of not only looking after someone else's money, but administering it long term for the benefit of a family that will look to you for help with their support, perhaps subsistence, education, health care, careers, and even retirement, all the while feeling free to complain that you charge too much and/or you're too slow in responding to their requests. And while it may often seem like a lot of responsibility for not enough compensation, it may also be viewed as a testimony to your judgment and expertise, and an honor that you have been selected for the position.