Estate Planning

Trustee selection considerations.

By Eva Stark, JD, LL.M.

Many estate plans incorporate a revocable trust, an irrevocable trust, or both. Revocable trusts are typically set up to facilitate asset management during lifetime as well as to avoid probate and maintain privacy after death. Irrevocable trusts are generally created to help reduce estate taxes, protect assets from creditors or for special purposes such as providing for a special-needs child.

When a trust is contemplated or drafted, the issue of trustee selection necessarily arises. Who should serve as trustee? Should a family member (or friend) serve, or should a corporate trustee be selected? What should a grantor consider when selecting a trustee?

THE TRUSTEE'S ROLE. To understand what qualities are important in a trustee, it is important to understand the role of a trustee. The trustee is the person or entity who holds legal title to all trust assets and has a fiduciary duty to hold and manage the assets for the benefit of the trust beneficiaries. The most common roles of the trustee are record keeping, handling accounting matters, filing any required tax returns, tax planning, managing investments, making distributions to beneficiaries, exercising discretion in making distributions, and keeping beneficiaries informed; all as required by the trust instrument and applicable law.

TECHNICAL KNOWLEDGE. In order to carry out the myriad of duties required of a trustee, he, she, or it must have a broad range of technical knowledge and great organizational skills. As a result, corporate trustees generally employ professionals with substantial accounting, tax, trust administration, and legal experience and have sophisticated systems and software in place. In contrast, an individual trustee will often lack the knowledge and skills to carry out all of these duties. He or she will typically need to engage professionals such as accountants, attorneys, and financial advisors or risk breaching his or her fiduciary duties.

If a trust holds an interest in a closely-held family business, it is also important to ensure that the trustee understands the business. It is unlikely that a surviving spouse or a corporate trustee will have the requisite knowledge. A “special business trustee” can be considered to make decisions and take actions with respect to business interests held by the trust. Potential candidates for a special business trustee may be a family member who is actively involved in the business or a senior manager or executive working for the business.

UNDERSTANDING THE NEEDS OF INDIVIDUAL BENEFICIARIES. A family member serving as trustee is likely to have a deeper understanding of beneficiaries’ circumstances and needs as well as family values and may be more effective at fulfilling the grantor’s intent with respect to trust distributions. A corporate trustee will generally lack such depth of understanding and will likely use a more “one-size-fits-all” approach.

Familiarity with the beneficiary’s needs can be especially important for special needs trusts, as an example. A special needs trust is a trust typically established for disabled children with the goal of enriching their lives without disqualifying them from government benefits. An individual trustee close to the beneficiary will be better able to direct resources toward expenditures that most improve the beneficiary's quality of life; however, familiarity with the law for these trusts is paramount.

CONFLICTS OF INTEREST. Although all trustees must act in the beneficiaries' best interests, conflicts of interest can arise for both corporate and individual trustees. An institution may offer a multitude of products and services in addition to fiduciary services (such as investment products, banking services, etc.) which creates an incentive to steer assets in the direction of its own products and services without investigating better or less costly alternatives. Similarly, an individual trustee who is also a beneficiary, for example, may favor distributions to himself or herself or his or her descendants instead of other trust beneficiaries such as a step-parent or sibling. It is important for both individual and corporate trustees to recognize such potential conflicts and manage them accordingly.

RELIABILITY. Corporate trustees will typically be banks or trust companies, many of which have been in business for generations and are likely remain in place for many more. Individual trustees, on the other hand may die, become disabled, or refuse to serve as trustee when the time comes.

COST. Individual trustees typically serve for free but may expend trust resources for professional advice. Corporate trustees on the other hand can charge high fees which may render smaller trusts uneconomical. Individuals considering a corporate trustee should comparison-shop and evaluate the fees and services offered by various institutions. Avoiding a corporate trustee solely because of the potentially high upfront costs may be "penny wise and pound foolish" in the long run. Also, if a costly error does occur, a corporate trustee has the financial ability to reimburse the trust for the mistake; an individual trustee is unlikely to have the wherewithal to do so.

INDIVIDUALS TO BE AVOIDED. It is important to note that depending on the goals of the grantor and the trust's provisions, certain persons should never serve as trustee. For example, the grantor of an irrevocable trust created for estate tax reduction purposes generally should not serve as trustee of his or her trust as it could result in the inclusion of trust assets in the grantor's estate. Similarly, a spouse who is an insured on a policy owned by an irrevocable life insurance trust should also generally not serve as trustee since the life insurance policy could arguably become includible in his or her taxable estate. There are many situations where certain individuals should be avoided. It is important for clients to discuss with their attorney any limitations with respect to whom may be appointed trustee.

THE BEST OF BOTH WORLDS?
Choosing an individual trustee or a corporate trustee is not a binary decision. In many circumstances it may make sense to appoint an individual and a corporate trustee as co-trustees. The individual trustee may make decisions regarding distributions while the corporate trustee may handle other duties such as record keeping, accounting, tax questions or discretionary distributions.

MAINTAINING FLEXIBILITY. When creating a trust, it is important to name successor trustees or have a mechanism for the appointment of successor trustees. Where a corporate trustee is contemplated, grantors might also consider incorporating language for the removal of the corporate trustee, with or without cause, in case the trustee's handling of trust assets becomes unpalatable to trust beneficiaries or if the corporate trustee is acquired by a less favorable company.

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