

## CHOOSING A TRUSTEE: A PRACTICAL APPROACH

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*The parent who leaves his son enormous wealth generally deadens the talents and energies of the son.*  
Andrew Carnegie.

According to the IRS there are more trust income tax returns being filed than corporate returns. This statistic points to the massive growth in trusts over the last two decades. Perhaps one of the greatest struggles for clients is finding the right trustee and providing a framework for the appointment of successors. With an estimated \$41-136 trillion passing in the next 50 years, the concerns surrounding trustee selection will only grow.

Choosing a Trustee. We find that the most common struggle for clients is the choice of who will provide long term management of the family assets. In many cases the choice of who will handle the children is easier than choosing the manager of the family assets. There are a number of criteria that we typically recommend that the client use in choosing a trustee. These include the following:

- Protect the Family. In many cases a traditional trustee will view his or her primary role as protecting the trust assets. Instead, we believe the primary role of a trustee is to **protect and preserve the family**, even if that means the depletion of family assets over time. The goal should not be to preserve assets for remote remainderman, but to assure that a family is properly taken care of as the first priority. Such proper care may involve the depletion of assets or to the contrary, could involve not making distributions to spendthrift beneficiaries.

- a. Discretionary Judgment. A direct result of the first criteria is that the client must trust the judgment of the trustee. Typically, we recommend that the trustees be given broad discretionary authority in making decisions on distributions (to the extent permitted by law - such as the limits in a marital trust). Such a broad discretionary authority typically involves value-based judgment decisions and a client has to be comfortable that the trustee is up to the task.

To minimize this need for discretionary judgment, some advisors have told their clients to use an "ascertainable standard" such as to "*provide for the health, education, maintenance and support of the beneficiary in her accustomed manner of living*". We do not believe that ascertainable standards are typically in the best interest of the client or his family. First, the language is so ambiguous that value judgments are still necessary on the part of the trustees (e.g., what is the "accustomed manner of living?"). Second, how do you know when the standard has been exceeded? What happens when a remainderman beneficiary sues the estate of a deceased stepmother/trustee because the marital trust provided her a Jaguar rather than a Volvo? The ambiguity of the standard asks for conflict. Last, what if a genuine need exists outside of the ascertainable standard such as supporting an athlete/beneficiary who is training for the Olympics?

- b. Financial Ability. Although the trustees do not have to have professional financial skills, it is wise to use someone who has shown financial responsibility in the past and who has shown the ability to make correct decisions on financial issues. A brother-in-law who has been in bankruptcy twice is probably not a good choice. A trustee needs to be able to differentiate good investment proposals from sham transactions.
- c. Conflicts. The trustees who are chosen (both originally appointed and successors) should be appointed with an eye on the potential conflicts of interest which may exist or could be perceived by the beneficiaries. For example, appointing as a trustee of a marital trust a child who resents his stepmother is probably not a good idea.

- d. Guardians. We typically recommend that the trustees not be the guardians of any minor beneficiaries. This removes an inherent conflict of interest of the guardian/trustee being accused by a dissatisfied heir of mismanagement of the family assets by making distributions that indirectly benefitted the trustee/guardian.
- e. History. Particularly where the trustees will hold funds for the benefit of minors, we recommend that the client think through how they have seen this potential trustee deal with their own children because that treatment will probably parallel how the trustee will treat the client's children. When my wife and I were looking for trustees, we had three close friends we thought about using. One would have provided whatever money a child wanted if they had wanted to sail the Caribbean for the rest of his or her life. Another would have told the child to wait tables if they were going to Harvard Law School because they were not getting any trust funds. We picked someone more in line with our own approaches.

Finding a Trustee. Even with the above criteria many clients have a difficult time trying to determine who to choose as trustee. When looking for a trustee we typically tell clients to start with family, then review friends, then look at professional advisors, and finally look at institutional trustees. The trustees may also be given the authority to hire a third party or trust department to handle certain administrative functions.

In many cases, we have recommended that co-trustees be used so that persons with some, but not all the above characteristics can be blended with a trustee who has other characteristics. For example, it often makes sense to use a family member as co-trustee to mentor the children in financial responsibility, while also having an institutional co-trustee to manage the investment and administration of the trust.

Institutional trustees are often of concern to clients because of rumored horror stories they have heard from friends. To minimize this concern, we always provide that either co-trustees or adult beneficiaries can remove an institutional trustee at any time without cause and appoint a replacement institutional trustee. Particularly when the primary beneficiaries may be minor children, it may be important to provide that the non-institutional co-trustee and/or guardians of the minor children have the ability to replace an institutional trustee with another institutional trustee.

Trustee Removal. The IRS has acknowledged that both the grantor and beneficiaries can be given the right to remove and substitute trustees without adverse tax consequences. Revenue Ruling 95-58, 1995-2 CB 91 provides that such a power is not considered a power of appointment which would pull the assets into the grantor's or beneficiary's estate. The substitute trustee cannot be related or subordinate to the party having such a power.

In many cases it makes sense to permit the grantor or a spouse who is beneficiary of the trust to remove any trustee (e.g., a child becomes a problem). Moreover, after the death of the grantor and the grantor's spouse, giving a majority of the adult beneficiaries the ability to remove and substitute a trustee can avoid a legal fight if the trustee does not perform properly. However, to protect against arbitrary action, it may be appropriate to require approval from the remaining trustees, and/or a super-majority (e.g., 66-80% percent) of the adult beneficiaries. Finally, it may be important to permit family trustees to appoint, remove and substitute an institutional Co-Trustee. An institutional Co-Trustee can provide investment and administrative services if the family trustees do not want to perform these function. In some cases it may make sense to have the institutional perform the functions without being a Co-Trustee, reducing the fees to the institution.

Successor Trustees. Particularly where the trust is expected to have a long term existence (e.g., a Dynasty Trust), the trust agreement needs to document how successor trustees are chosen. Many potential future Co-Trustees may not even be born when the trust is created. A selection process that contains one or more of the following approaches may make sense:

- f. Allowing a surviving spouse to choose the successor trustee.
- g. Allowing a majority or a super-majority of the adult beneficiaries to appoint a successor trustee.
- h. Allowing the last named Trustees to choose their successors.
- i. Allowing the last named Trustees to choose their successors, with the approval of a majority of the beneficiaries.

- j. Allowing the remaining Co-Trustees to choose the successor.
- k. Allowing the remaining Co-Trustees to choose the successor, with the approval of a majority of the beneficiaries.
- l. Giving a third party (e.g., local probate court) the authority to select a successor trustee.

Choosing a trustee to manage family assets can never be done cavalierly. Hopefully, this column can provide you and your clients some useful perspectives in making the selections.

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