

Choosing a Trustee: Navigating the Complexities and Key Considerations

Herb Fineburg: Welcome Danielle and Max to this episode of Trust Us.

One of the more important questions asked by clients is, how do I pick a trustee and what is involved in choosing a trustee? Max what are the major issues that clients ask about in selecting a trustee?

Max McCauley: Well, there are many issues, but the most common question is who should be the trustee? Second we'll encourage discussion about how many trustees should be selected, what their roles are going to be, the pros and cons of using a corporate trustee versus an individual trustee including costs, fees, formalities, and tax considerations.

Danielle Friedman: I think as you said, Max the most common question we get from clients is, who should I name as my trustee? And this is primarily, after the death of a client or when a client funds and sets up an irrevocable trust, the client cannot be their own trustee in the case of an irrevocable trust.

And of course, after a client is deceased, they need someone to serve as trustee of any trust that they've set up as part of their estate plan. So a lot of times the client just wants to name a family member and they may even want to name the beneficiary of the trust as the trustee. And that can be okay sometimes, but Herb, what have you found and what advice do you give to clients when they want to serve as a trustee or when they want a beneficiary to serve as their own trustee?

Herb Fineburg: Well, I think the first thing that we review with them is the restrictions on a beneficiary who is also a trustee. The main purpose of trusts is to provide asset protection for the beneficiary, and in order for the beneficiary to have asset protection, the beneficiary as trustee can only make distributions to himself or herself for specific purposes. Danielle, what are those limited purposes that the beneficiary trustee can make distributions to him or herself?

Danielle Friedman: So in our industry, we refer to those as the ascertainable standard. And commonly that standard is health, education, maintenance, and support. And that is not something that we have developed on our own.

That is something that has been blessed by the IRS and it's the maximum amount of leeway that you can give a beneficiary trustee in terms of the amount of distributions that they can make, or the types of distributions that they can make without causing the trust assets to be treated as being owned by the beneficiary, whether it's for creditor purposes or estate tax purposes.

So again, health, education, maintenance, and support. We also abbreviate that as HEMS, and so the HEMS standard is what a beneficiary trustee, that's the maximum amount that a beneficiary, a trustee can distribute to himself or herself.

Herb Fineburg: So Max, what do we do if we have a situation where there's a trust and the individual needs a special distribution that is not for health education and possibly not covered by maintenance or support?

How do we get around that when there's a single trust beneficiary.

Max McCauley: I think you're talking about the situation where you'd have a beneficiary trustee versus an independent trustee.

Herb Fineburg: Yes. Right.

So you'd appoint an independent trustee, either alone or with, as a co-trustee, with the beneficiary trustee.

Max McCauley: Absolutely. And I'll flip that back to you, herb. How often do you see folks wanna have a beneficiary as a trustee versus an independent trustee?

Herb Fineburg: Most of the time that I see it is when a trust is set up for a spouse and the surviving spouse wants to be the sole trustee of his or her trust.

After that, we usually try to encourage people to appoint an independent trustee along with the trustee beneficiary. An independent trustee could even be as simple as having a sibling as a co-trustee. What is the niceties of having what we'll call an independent trustee Danielle? How does that change the appearance of the trust?

Danielle Friedman: Well, there's a couple benefits to it. Primarily if I'm the beneficiary and there's an independent trustee, then the independent trustee is not constrained by the HEMS standard. They can make distributions to me for any reason. At their discretion, assuming it's the type of trust that we recommend, which is all distributions, whether it's income or principal, are always discretionary.

There's never any mandatory distribution. So I'll preface it with that. But, the independent trustee can make distributions for any purpose. The other thing I like about having two trustees with one being independent, is that it bolsters the asset protection of the trust. Whether you're dealing with a third party creditor or divorce. When you have two trustees, they have to agree unanimously on any distribution decisions. So if you have a creditor who is pressuring the debtor beneficiary slash trustee, that party can't just make distributions to the creditor nor would they want to, but it adds extra protection by having an independent co-trustee, because that independent co-trustee would never agree to making a distribution to satisfy a creditor, nor could a court compel a independent co-trustee to make a distribution to a creditor.

The same is true in the divorce context. So if you have a beneficiary slash trustee who is getting divorced and they have an independent co-trustee, the court has jurisdiction over the beneficiary trustee, but they don't have jurisdiction over the independent trustee. So even if a judge is acting outside of the terms of the trust and is compelling a distribution, which they shouldn't be able to do anyway, they certainly can't compel a trustee who's outside of their jurisdiction to make a distribution, to satisfy division of assets in the event of a divorce.

The last example I'll give is sort of an informal context, is if you have a beneficiary who is a trustee of his or her own trust. And they're the sole trustee and the assets are in the trust for the benefit of the beneficiary. But the beneficiary knows that, it was the set lawyer's intent not to waste the trust assets and not to spend them frivolously, but that beneficiaries married and maybe they're getting pressure from their spouse to dip into the trust.

Honey, let's buy a beach house. Use your trust funds. Well, while the spouse, the married beneficiary may feel some pressure from their spouse. If you have an independent co-trustee or just co-trustee in general, that can be the bad guy. That can be the guy that the spouse is feeling the pressure can say listen, I would love to spend the trust money to buy a beach house, but I have to get the consent of this other guy, and this other guy is saying no. So the co-trustee can serve as the out for an otherwise pressured trustee slash beneficiary.

Max McCauley: So if you had two trustees, wouldn't that be difficult to administer? Have to have two signatures on everything. Get the paperwork from, trustee A to trustee B to sign everything?

Danielle Friedman: Yeah, that, that can pose a headache for for a lot of clients. So oftentimes what we'll do is write in our trust documents that while all decisions have to be unanimous, paperwork does not have to be signed by both trustees. The signature of one trustee is sufficient to indicate that there has been agreement by both trustees for whatever action needs to be taken. Whether it's making an investment decision, opening an account, selling property, the third parties can rely on the signature of one trustee.

Max McCauley: The main question that I see a lot is who should be the trustee, the sibling, the parent, the spouse, the, accountant, a lawyer, corporate fiduciary. How do you walk through that question on who should be the trustee?

Herb Fineburg: Really, it's a matter of who the client feels most comfortable with. In essence who the client trusts the most to be the trustee.

Corporate trustees as a general matter, are typically the trustee of last resort because one, their fees are often cost prohibitive, at least in the mind of the person setting up the trust. And two, they are structured so that they have a very stringent review process for fiduciary responsibility.

So they're the most conservative as far as whether you get a distribution. If you're able to pick a trusted friend, I find people are most comfortable with that. And a trusted friend is in fact, oftentimes the accountant who knows everything about the family. Sometimes it's the lawyer. Many times I see people pick their children where if they have two children, both children are the trustee of one children's trust, and the same two are the trustee of the other child's trust.

The main point of the trustee is to create asset protection, but to allow reasonable access to the assets so that the children can enjoy the assets without wasting them. You want the, for example, the children who are the beneficiaries of the trust to be stewards of the inheritance for themselves and for their children.

So that's typically what I find are the most usual characters to be a trustee of a trust and anything that you want to add to that.

Danielle Friedman: Family members, are oftentimes the first pool of individuals that clients look to when naming trustees. And I just tell them, make sure that you don't cause unnecessary tension.

When you select a trustee, you wanna make sure that whoever you're naming can say no comfortably to a beneficiary if that is what the circumstances provide. You don't wanna, put siblings against each other, which is often why if you have a family where there's two children, parents will name both children as co-trustees of one another's trust.

That way there's a little bit more even footed. You don't, you certainly, may not want to name one sibling out of multiple siblings as the trustee for everyone, because that may put that person in a very uncomfortable position. The other thing I would say is when you are naming trustees, you can name multiple trustees to wear different hats, and fortunately, trust law has evolved to the point where you can bifurcate trustee responsibilities. So if you think someone is going to make great investment decisions but may not have the backbone to say no to someone when it comes to a distribution decision, you can name one person to be an investment trustee and they're responsible for investing the trust assets and another person to make distribution decisions, and they have no say into investment decisions, but when it comes time to deciding whether to make a distribution to a beneficiary, that's the person who makes the distribution decision.

So it's really nice to be able to select different individuals to serve in different capacities.

Max McCauley: And if the trust owned a business, could you have a third trustee that's responsible for the business decisions?

Danielle Friedman: Yeah, I think you can carve up the role of trustee really into as many individuals as you want to serve as specifically or as broadly as the circumstances require.

Herb Fineburg: What do you do if the trustee is someone who the beneficiaries really cannot work with? Do you have authority of the beneficiary or methodology for removing a trustee?

Danielle Friedman: Yeah, so this really the terms of what govern this power really get fleshed out when you're drafting the trust and you have to have a sense of what the client prefers, the set lore of the trust, and whether they want the trustee that they want to serve, regardless of how they feel about the beneficiary's relationship with the trustee, then maybe you just say that the only time the trustee can be removed is for cause, for wrongdoing and if a beneficiary wanted to remove the trustee, they would have to go to court and prove that the trustee did something improper and had to be removed by the court.

That's the far end of the spectrum in terms of, giving the beneficiary the least amount of power to remove and replace the trustee. The most flexible terms allow a beneficiary to remove a trustee for any reason or for no reason at all. If they don't like this person or they're unhappy with the way the trust is being managed, they can remove the trustee without court involvement and the trust agreement can say that that beneficiary also has the power to then replace the

trustee. We always limit that replacement language by saying that the replacement trustee has to be independent, can't be, their spouse, their sibling, someone like that. It has to be someone who is independent as that term is defined in the Internal Revenue Code.

I won't go down that rabbit hole, but they have to be independent. That way the beneficiary isn't just naming, their husband or wife as the trustee who's gonna say yes to them whenever they want money, but they could name a friend. And so that is the other end of the spectrum where trusting the beneficiary with a lot of responsibility and you are looking to that beneficiary to make good decisions in the future. A lot of families do that. They wanna give flexibility. These trusts are gonna be in place for a really long time, and so they wanna give the beneficiary the maximum amount of flexibility to remove and replace trustees because nobody knows what the future can hold.

Max McCauley: Do you typically name a successor trustee if a trustee dies or is disabled or unable to serve or unwilling to serve for some reason?

Danielle Friedman: Yes. So oftentimes we will tell a client to name as many successors as they can. Oftentimes they hit a wall after they name one or two people.

But we encourage a long list of successors. That way the set lore can maintain as much control as they want in terms of who's going to be the trustee in the event someone ceases to serve in that role.

Max McCauley: What if all of the trustees are unable and the successors have died? What happens then?

Danielle Friedman: Trusts, again, you see a number of different provisions as to what happens if there's a vacancy in the role of trustee. So the most conservative being that the beneficiaries have to petition the court to name someone to fill the vacancy. The loosest standard being that the beneficiary can name someone to fill the vacancy, and of course, that person should be independent.

And the reason for that has a lot of tax consequences. State tax inclusion reasons, creditor protection reasons. So if a beneficiary does have the power to name a replacement trustee or fill a vacancy, that they should be limited to naming someone who's independent.

Herb Fineburg: Danielle, one of the questions I often get is, how does a trustee get compensated? And can we provide a methodology in the trust document for compensating the trustee?

Danielle Friedman: Sure. So again, this runs the gamut and ultimately it depends on what the set lore of the trust wants. You can specify that a trustee can only serve if they're not going to accept compensation. Which good luck finding a trustee that's going to serve in that role, unless they're a close family member or unless it's the beneficiary serving as his or her own trustee.

Typically you wanna compensate your trustee because it's a lot of work, and they're also taking on some risk in this role. So you wanna make sure that they're adequately compensated. You

can rely on state law, and every state has a different standard as to what a trustee should be compensated.

In certain states, it's based on the value of the trust assets. In states like Pennsylvania, where we primarily practice, it's fair and reasonable compensation, and that's an extremely broad standard and it's really, there's nothing black and white about that. It really depends on what the trust assets are, what the responsibilities of the trustee is and what they're doing on a day-to-day basis.

The other thing about trustee compensation is, if you're going to name a corporate trustee, they're going to be compensated and there's no corporate trustee that's going to serve without taking the fee. Usually they have a fee schedule, and it's based on the assets and the value of the trust and what they're managing.

There are different types of roles for corporate trustees. So if you have a corporate trustee that's not really managing the trust assets, but it's really just serving in an administrative capacity, it's gonna be a different fee than if you have a trustee that's handling soup to nuts everything that has to do with the trust.

Long story short, it varies but it really is up to the set lore what they wanna provide in terms of compensation. They can set an hourly rate for individual trustees really whatever they want. But again, the trustee has to accept the role. So if they don't like the compensation structure, they don't have to serve.

Herb Fineburg: I find that if you name a corporate trustee, that they also require that you allow them to invest the assets, so then they also get a management fee on top of it.

Danielle Friedman: That is very common that if you're naming a bank or a trust company, not only are they taking a trustee fee, but then they're taking a percentage of assets under management, which is common of any professional that's managing funds and investments. They're taking an investment advisor fee if you will.

Herb Fineburg: So the fair and reasonable compensation standard, which sounds like it's hard to put your hands around, is that something the judge will decide?

Danielle Friedman: Yeah, so the way I explain to clients what fair and reasonable means, it's if the beneficiary is going to complain, then maybe the fee is not fair and reasonable. If it's something that the beneficiary can live with, then it's fair and reasonable. But certainly if a trustee takes the fee that the beneficiary is unhappy with, then the ultimate arbiter of what's fair and reasonable is the judge, at least in Pennsylvania. You're gonna go to court and you're gonna suss out what the trustee did, how complicated was it, how much work was there to do? And that's going to determine what is fair and reasonable.

Herb Fineburg: And they're pretty conservative judges on how much people get paid.

Danielle Friedman: Yeah, for the most part it's not something that you're gonna make a living off of.

Max McCauley: It sounds like it could be very expensive if you used a corporate trustee.

Danielle Friedman: Can be. It depends. Sometimes I do recommend corporate trustees if I know that there's gonna be a lot of family tension, or if the trust assets are particularly complicated. If it's not just, a brokerage account, but you have a real estate portfolio or a lot of other assets and you know that the beneficiaries are going to not be as easygoing as you would like, then maybe a corporate trustee is the right move because you want someone who can deal with the pressures that come with that role, which are facing pressure from the beneficiary making important

Max McCauley: Sophisticated business decisions.

Danielle Friedman: Yeah, making decision. Exactly. So sometimes, a corporate trustee can be well worth the fee in certain circumstances.

Herb Fineburg: Okay.

That sounds like a good description of all the options available for naming a trustee and who to pick. Until we meet again, thanks Max. Thanks Danielle. And we'll get together soon on another topic of interest to our listeners.

Max McCauley: Thanks, Herb.

Danielle Friedman: Thank you.