

TRUSTS & ESTATES



WEALTH PLANNING > ESTATE PLANNING

Ensure Grantor Understands Trust Roles

Here's a sample letter to a client explaining the responsibilities of different parties in administering a trust

Martin M. Shenkman | Feb 02, 2015

Often, as estate-planning attorneys, we create irrevocable trusts for our clients. But our job shouldn't end there. We need to make sure our clients understand what's in the trust, what their responsibilities are regarding the trust and what the responsibilities are of other individuals who have roles in administering the trust.

Here's a sample letter you can adapt and send to your clients, which explains the responsibilities of different parties in administering the trust. The catalyst for this letter was a combination of: two presentations at the 2015 Heckerling Institute of Estate Planning about trust protectors, John Porter's discussion of IRS audits, and Skip Fox's ethics presentation.

*DATE

Via Regular Mail

*CLIENTNAME

*CLIENTADDRESS

Re: Trust Positions and Named Individuals

Dear: *CLIENTNAME:

You created a sophisticated, grantor, irrevocable trust (or trusts). That trust may provide for one or more fiduciary positions and other power holders for which you

named friends, family and/or institutions. It is important that all these individuals, perhaps with the exception of institutions, be reminded of their roles and responsibilities to be certain that they understand them. Too often, once a trust is signed, people holding these positions have no involvement or even forget the important role they may play. This could adversely affect their role and perhaps the status of your trust.

You should take a number of proactive steps to assure that these individuals:

- Are aware of the title and purpose of the role they serve.
- Have a copy of the signed trust agreement appointing them (this is particularly important if they did not sign the trust document).
- Have read and understood the provisions of the trust pertaining to their role.
- Understand that our firm and your other advisors do not represent them. It is important that they understand this so that if they do have any concerns, they will know to hire their own advisors to assist them.

Assuring that each fiduciary and power holder is aware of the above might itself help support the reality of those positions if that is ever challenged by the Internal Revenue Service or a claimant. **Example:** Assume that grantor trust status was achieved by giving an individual the power to loan funds to the grantor without adequate consideration. Further assume that person did not sign the trust instrument. If the IRS ever questioned the power holder, if he or she had no idea that the power was held, what the power meant, or how to exercise it, could the reality of that power be sustained? Assuring that the power holder has a copy of the trust instrument, and acknowledges understanding the role, might be vital to the success of the trust.

In addition to the general matters above, following are illustrations of some of the positions that may be provided for in your trust and some of the possible roles or powers the individual serving in each of those capacities might have. You should be certain that all individuals are aware of their actual powers as provided under your trust document. I can assist you with providing this information and help you

corroborate these duties with each individual at the annual trust review meeting I have recommended as essential to your trust plan.

Power to Substitute (swap) Property

This is a power that might have been included in your trust to characterize it as a grantor trust (a trust for which all income is reported on your personal return).

While this is usually you, as the settlor or grantor of the trust, in some occasions it might be another individual. For example, if your trust holds voting stock, a different individual may be named to hold that power. You should also consider who might exercise this power for you if you are incapacitated. The trust instrument might not have been addressed this question. It might be advisable to update your durable power of attorney to expressly address this.

1. The exercise of this power may be used to swap assets back into your estate to potentially qualify for a basis step-up on your death and for other purposes.
2. The exercise of this power must be done with all appropriate formalities required under the trust, and the equivalent value of assets transferred into the trust must be corroborated. This might require an independent appraisal. In the case of hard-to-value assets, consider a defined value mechanism before consummating a swap of assets.
3. Review periodically the assets of the trust to determine when a swap might be advisable. You should also consider the cash position and lines of credit you have available, as that might affect the feasibility of your actually exercising the power to substitute.

Power to Loan Trust Assets Without Adequate Security

This is a power that you might have included in your trust to characterize it as a grantor trust. You might include it as a sole power, or you might include it in combination with other powers. You should:

1. Review periodically the status of the trust to determine the feasibility and advisability of exercising the power to loan.

2. Recognize that loaning funds of the trust to the grantor without adequate security could raise claims by beneficiaries of the trust. If the loan is made at the minimum interest rate required under the tax laws, that rate may be less than market, and that too might give rise to a claim by beneficiaries that the loan is to their disadvantage.
3. The individual holding this power should not be a fiduciary so that he or she should not also serve in another capacity that creates a fiduciary relationship. Therefore, if this individual is appointed to another fiduciary capacity (e.g., your trust named this individual as a successor trust protector, and the prior trust protector resigned) he or she must address this matter before accepting or serving in such fiduciary capacity.

Power to Add a Charitable Beneficiary

This is a power that might have been included in your trust to characterize it as a grantor trust. You might include it as the sole power, or you might include it in a combination with other powers. You should:

1. Review periodically the status of the trust to determine the feasibility and advisability of exercising the power to add a charitable beneficiary.
2. Recognize that adding a charitable beneficiary to the trust could raise claims by beneficiaries of the trust that the individual is effectively diverting assets to the charity that could have been available to them. This is why the individual serving in this role cannot also have a fiduciary relationship to the trust, as that might preclude such an action.
3. Since this power is held in a non-fiduciary capacity, if the power holder becomes appointed in a fiduciary capacity under another provision of the trust (e.g., your trust named this individual as a successor trust protector, and the prior trust protector resigned) he or she must address with counsel this matter before accepting or serving in such fiduciary capacity.

Trust Protector

Because the title “trust protector” can mean many different things depending on the terms of the particular trust document, it is extremely important that the individual

serving in this capacity understands precisely what responsibilities are involved.

Because of the paucity of law on this topic and how new the concept is, there is significant variation in how different lawyers might use this role. No assumptions should be made. In many trusts, the trust protector serves as a fiduciary and, as such, is held to a high standard of care and has a duty of loyalty and other duties to the trust and beneficiaries. Many trusts give the trust protector the right to change trustees. If this is the case, then the role is of critical importance and should not be taken lightly. The trust protector should:

1. Review periodically the status of the trust to determine the feasibility and advisability of exercising any one or more of the powers granted to him or her.
2. Recognize that carrying out the responsibilities of trust protector may require periodic review of the trustee's performance and other activities of the trust. The law is quite unclear concerning this review. But if the trust protector has the authority to replace the trustee, and especially if the trust protector is designated as serving in a fiduciary capacity in the trust document, some monitoring might be advisable.
3. Investigate liability, errors, omissions and other insurance coverage for serving as a trust protector.
4. Recognize that he or she may be entitled to compensation for serving as trust protector. If the trust instrument provides for this compensation, it should be addressed. If the trust instrument is silent and the trust protector is a fiduciary, then state law that governs fiduciary compensation might provide guidance as to what should be done. If the trust protector is expressly indicated not to be acting as a fiduciary and the trust instrument is silent, then it may be unclear whether compensation can or should be provided. Nonetheless, addressing this in writing to avoid misunderstandings and potential future claims might be advisable.

Investment Trustee

Many trusts provide for an individual, perhaps called investment trustee," "investment advisor" or by another name, who is designated and empowered to make investment decisions for the trust. If the trust is formed in a state that permits what is referred to as a "directed" trust, then this individual can eliminate liability to the general trustee for investment decisions within this individual's purview. This

elimination of liability has important ramifications for both the general trustee and the investment trustee. If the general trustee has no liability for investment decisions, he or she should act accordingly. This might mean merely confirming that the investment trustee directs each investment action that the general trustee has to implement. However, if the trust instrument or state law does not permit directed trusts, the investment trustee's role may reduce the liability of the general trustee but may not eliminate it. In the latter cases, the general trustee might be best served by taking some actions to monitor investment performance of decisions made by the investment trustee. The investment trustee should:

1. Review the status of trust investments to determine the appropriateness of exercising the powers granted to him, her or it. Maintain a current investment policy statement establishing trust investment standards that consider the terms of the trust, applicable governing law, trust objectives, tax considerations and other relevant factors.
2. Recognize that carrying out the responsibilities of the investment trustee requires periodic review of the trust investment performance and possibly other activities of the trust. If trust assets are marketable securities managed by a professional wealth manager, periodic meetings with that wealth manager might suffice. If some or all of the assets are private equity interests, such as stock in a closely held business, the determination of what steps might be appropriate is unclear. However, taking no action does not seem prudent. Perhaps an annual meeting with the officers of the entity and the independent certified public accountant to review entity performance and operations might be prudent.
3. Understand that this power is held in a fiduciary capacity and serving in such a fiduciary capacity carries with it responsibility and liability, a duty of loyalty and other duties to the trust and to the trust beneficiaries.
4. Investigate liability, errors, omissions and other insurance coverage with respect to serving as investment trustee.
5. Recognize that he or she may be entitled to compensation for serving as investment trustee. If the trust instrument provides for this compensation, it should be addressed. If the trust instrument is silent, then state law that governs fiduciary compensation might provide guidance as to what should be done. Nonetheless, addressing this compensation issue in writing to avoid misunderstandings and potential future claims might be advisable.

Insurance Trustee

Some trusts provide for a separate investment trustee charged with solely making decisions concerning life insurance held by the trust. This might be used for a host of reasons. You, as the settlor of the trust, might opt to serve as the investment trustee but it might be advisable that you should not hold investment powers over life insurance so a separate function might have been created. Many trusts designated institutional fiduciaries to serve, but you might have opted to hold certain life insurance (e.g., existing policies that were given or sold to the trust) and did not wish to have the institutional trustee have the responsibility for those policies. The role of an insurance trustee is new, and the law uncertain, so it may be advisable to take some actions to corroborate what steps this individual has taken.

For example, if no insurance is held in the trust, is this role irrelevant? While that might seem a reasonable conclusion, it is not certain. Perhaps if no life insurance is held in a trust that provides for such a position, the individual serving as insurance trustee might periodically document why no insurance is held. An insurance trustee should:

1. Review the status of any insurance held by the trust, as well as the trust activities generally, to determine the appropriateness of exercising the powers granted to him or her as insurance trustee. Unless the individual serving is an insurance professional, consider having an independent insurance consultant review the policies and issue a report.
2. Maintain a current insurance investment policy statement establishing trust investment standards as it relates to insurance that consider the terms of the trust, applicable governing law, trust objectives, tax considerations, insurance needs for the beneficiaries, insurance needs to fund tax obligations and other relevant factors.
3. Recognize that carrying out the responsibilities of the insurance trustee may require periodic review of the trust liquidity or sources of cash flow to pay future premiums and, if there are potential shortfalls, endeavor to address them.
4. Review and monitor any split-dollar arrangements.
5. Recognize that he or she holds this power in a fiduciary capacity, and serving in such a fiduciary capacity carries with it responsibility and liability, a duty of

loyalty and other duties to the trust and its beneficiaries.

6. Recognize that he or she should investigate liability, errors, omissions and other insurance coverage with respect to serving as insurance trustee.

7. Understand that he or she may be entitled to compensation for serving as insurance trustee. If the trust instrument provides for this compensation, it should be addressed. If the trust instrument is silent, then state law that governs fiduciary compensation might provide guidance as to what should be done.

Nonetheless, addressing this compensation issue in writing to avoid misunderstandings and potential future claims might be advisable.

I urge you to review these responsibilities with the individuals you have named in your trust(s) and ensure that they understand the requirements those positions entail. I would be pleased to help you do so. I can customize the general information above to your specific trust(s) and guide you as to steps that should be taken by you and each other individual. Given the uncertainty in the law on many of these points, the significant dollars involved and the importance of respecting trust formalities to the success of your planning, it is important that you address these matters.

An annual review meeting with the participation of all relevant fiduciaries, power holders and advisers, is essential to the success of your trust(s). Please contact my office to schedule a meeting to review your trust administration, as well as your overall estate planning.

Sincerely yours,

*LAWFIRM NAME

By: _____

*ATTORNEYNAME

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