

## Successor Trustee Handbook

*The purpose of this handbook is to assist you, as successor trustee, in carrying out your duties. This handbook is updated from time to time; please contact us if you are not sure you have the latest version. Also, please remember that this handbook is a guide; it is not intended to answer every question that could come up in the administration of a trust, and it is not intended to give you legal advice.*

### INTRODUCTION

A trustee is what the law calls a *fiduciary*: a person who is responsible for taking care of something that belongs to someone else. Under the law, fiduciaries owe legally enforceable duties to the people on whose behalf they handle property. Any time you act in your capacity as trustee, your fiduciary duties come first.

**What Is “Property”?** We use the term *property* here in its broadest possible sense. Property includes land and buildings, which are called *real property*; physical objects such as household goods and personal effects, which are called *tangible personal property*; and things that you cannot really see or touch but nevertheless have value (such as contract rights), as well as things that represent something else that has value (such as stock certificates or cash or bank accounts), which are called *intangible personal property*.

**What Is a Trust?** In order for you to have a good feel for your duties, you first need to understand what a trust is and how it works.

A *trust* is a legal relationship that results when a person (often called a *trustmaker*, *settlor*, *trustor* or *grantor*) makes an agreement with a *trustee* to handle property for the benefit of the *beneficiaries*. (A common form of trust used in estate planning is a “revocable” or “living” trust.) The agreement is normally set out in a written document which is called the *trust instrument* or the *trust agreement*. Your first and foremost duty as a trustee is to read, understand and faithfully follow the terms of the trust instrument, which are in essence the “rules” laid out by the trustmaker.

Once the trust agreement is made, the trustmaker transfers property to the trustee. The trustee actually becomes the legal owner of the property. However, the “real” owners of the property are the beneficiaries, who are said to be the equitable or beneficial owners; they are the ones who are

supposed to benefit from the property.

**Co-Trustees.** A trust can have more than one trustee at a time. Each *co-trustee* must decide for himself or herself how best to carry out his or her fiduciary duties. Beware that a *co-trustee can be held responsible for another co-trustee’s breach of a fiduciary duty*. Thus, it is important that all co-trustees pay close attention to everything that is done in the administration of the trust. If there is any question or problem, that issue should be communicated to the other co-trustee(s) immediately.

As a general rule, where there are two co-trustees, both have to agree on all matters of trust administration, and where there are three or more co-trustees, the majority rules. In order to minimize the chances of being held responsible for someone else’s poor judgment or breach of duty, a co-trustee should be sure to make a written record of any points of disagreement about trust business. In extreme cases, a co-trustee may be required to “blow the whistle” on another co-trustee’s activities, either by notifying the trustmaker about the issue or by filing a complaint with a Court in the jurisdiction the trust is being administered.

If you ever have questions about what to do as trustee, you should seek appropriate advice immediately. You should not hesitate to consult your lawyer, CPA or other advisors.

**What Is a “Successor Trustee”?** A *successor trustee* is the institution or person who takes over the management of trust property when the original trustee has died or become incapacitated.

The fact that you have been named as a successor trustee in someone’s trust instrument does not obligate you to accept that position. You should consider very carefully your decision to accept the job of trustee. Once you accept the position, you accept all that goes with it. It is a position of great honor and great responsibility.

### TRUSTEE INSTRUCTIONS

#### Some Guidelines for You as Trustee

The law does not demand absolute perfection from you. However, it does demand absolute loyalty, absolute honesty, and complete and accurate disclosure, even if that

disclosure could cast you in an uncomfortably negative light. In the classic words of Judge Benjamin Cardozo (who went on to become a U.S. Supreme Court justice):

“Many forms of conduct permissible in a workaday world for those acting at arm’s length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the “disintegrating erosion” of particular exceptions. [...] Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd[.] — *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

## Section 1. Some Basic Rules

**How to Sign Documents.** Arizona law (properly known as “Arizona Revised Statutes” or “A.R.S.”) states that “[u]nless otherwise provided in the contract, a trustee is personally liable on contracts entered into in the trustee’s fiduciary capacity in the course of the administration of the trust estate.” In other words, unless you take pains to document that you are signing a contract as a trustee and not as an individual, you will be inviting personal liability for whatever the contract requires. Accordingly, whenever you sign any document on behalf of the trust, always sign as “*Your Name, Trustee.*” It must be absolutely clear that you are obligating the trust and not yourself. If you do this (assuming you were acting within the scope of your authority as trustee when you signed a document), you will not be personally liable for any obligation under that document.

**Sources of Your Authority as Trustee.** Your authority comes first and foremost from the trust instrument, and your duties and powers as described there are your primary instructions. You should read the trust instrument with care, and from time to time read it again. The trust instrument may contain specific provisions that take precedence over the general rules that apply to trusts, including those mentioned in this handbook. However, note that there are certain basic rules relating to trusts that will apply no matter what the trust instrument says. (For example, a trust instrument cannot allow or encourage illegal activity on the part of the trustee or the beneficiaries.)

The second source of your authority comes from the Arizona Revised Statutes. Various provisions of the A.R.S. cover things that are not specifically spelled out in the trust instrument. The Arizona Trust Code, The Uniform Trustees Powers Act, the Uniform Prudent Investor Act, the Uniform Principal and Income Act, and the Uniform Probate Code hold particular relevance to your role as a trustee.

The third source of your authority is found in the court decisions relating to trusts. This is known as *common law* or

*case law*. The common law of Arizona is found primarily in the opinions of the state Supreme Court and Court of Appeals; those courts may follow decisions from other jurisdictions as well.

You need to keep all three of these sources of authority in mind as you carry out your duties as trustee. You also need to remember that Treasury Regulations, the Internal Revenue Code, and court decisions that interpret the Code will dictate what you can or should do in many circumstances. This should convince you that you will need to rely on the advice and guidance of your legal counsel, accountant and other advisors throughout your tenure as trustee.

## Section 2. Your Fundamental Duties as Trustee

Trustees are subject to a variety of duties, some of which are summarized below. Please bear in mind that the penalty for your breaching any of these duties is that you will have to pay for any resulting damage to the trust, out of your own pocket. Personal liability – even if you are not paid for your efforts – is one of the things that go along with being a fiduciary.

**Duty of General Prudence.** You, as trustee, are duty bound to deal with the trust property as a “prudent person” would deal with the property of another. Note that this is a standard of *conduct* rather than of *performance*. Your actions (or times of inaction) will be judged against what a reasonable person would have done in the same circumstances, given the same limitations to which you were subject, and armed with the same information that was at your disposal. If you conduct yourself properly, you will not be faulted if something bad happens, such as a decline in the value of trust assets. Acting reasonably in the circumstances is your basic job description; if you do that, you generally need not worry about being judged in the light of hindsight. Note that if you have or claim to have special expertise in connection with any facet of trust administration, you will be duty-bound to exercise that expertise. Thus, the standard for judging your job performance will take into account your special abilities (whether actual or claimed).

**Duty to Carry Out the Terms of the Trust.** One noted authority states that “the first and most important duty of the trustee is to study and become thoroughly familiar with the provisions of the trust instrument, and thereafter to follow them out implicitly.” (Loring, *A Trustee’s Handbook* [Rounds 2002 ed.] at 12.) It will be difficult for anyone to find fault with your performance of your fiduciary duties if everything you do is in accordance with the terms of the trust instrument. If at any time you are reasonably in doubt as to the correct interpretation of the trust instrument, you can always petition a court for instructions.

**Duty of Loyalty.** As a trustee, you must always act to further the interests of the trust and the beneficiaries. You are serving as trustee for the benefit of someone other than

yourself. You should not enter a transaction that gives you an opportunity to benefit yourself at all, much less at the expense of the trust. If any situation should arise in which there is a conflict between your personal interests and the trust or between the trust and the interests of third parties, you as trustee should put the interests of the trust first. For example, you should not sell trust property to yourself or sell your property to the trust because this creates the appearance that you may have taken advantage of the trust. Similarly, you should never loan trust funds to yourself. The rules set forth in this paragraph are strictly applied not only to transactions in which you deal directly with yourself, but also to transactions in which you deal with entities (such as partnerships or corporations) in which you are personally interested. These rules apply even though a particular transaction may be scrupulously fair, and even if it is advantageous to the trust.

Note that Arizona law allows you to obtain a court's permission to enter into a transaction between yourself and the trust. This will require notifying all of the beneficiaries of the proposed transaction and giving them the opportunity to take positions before the court as to why the transaction should or should not be allowed to go forward. The fact that the law gives you this opportunity means that you will be judged very harshly if you ever do enter into a transaction involving a conflict of interest without prior court permission.

***Duty Not to Delegate.*** Once you have accepted the position of trustee, you are responsible for the administration of the trust, and you should not turn over the complete administration of the trust to others. This does not mean that you must actually perform all of the administrative work yourself. You can delegate certain administrative details to persons qualified to handle them. For example, you can employ an agent to collect rents. However, the responsibility for the administration of the trust always remains with you as trustee.

If you are one of two or more trustees, you cannot rely on the other trustees to administer the trust. You must participate in the administration. If another trustee acts improperly with respect to trust matters, you have the obligation to correct the situation. You have an obligation to be aware of what other trustees are doing on behalf of the trust. Each trustee is responsible to the beneficiaries for the misconduct and breaches of duty of the other trustees. Consider an important part of your job as being the watchman for the beneficiaries. If something goes wrong, don't let it go wrong on your watch!

***Duty to Report.*** Under the Arizona Trust Code, adopted in Arizona in 2009, the trustee of an irrevocable trust (a trust that cannot be modified or amended, which most all living or revocable trusts become upon the death of the trustmak-

er), now has several important, affirmative notification and reporting requirements.

Unless the trust expressly states otherwise, a trustee of an irrevocable trust must keep all "qualified beneficiaries" reasonable informed about the administration of the trust and of material facts necessary for such qualified beneficiaries to protect their interests in the trust. A trustee also has an affirmative obligation to respond to a beneficiary's request for information related to that administration. A "qualified beneficiary" is a person to whom distributions of income or principal may be made from the trust *and* a person who would receive distributions of income and principal from the trust if the primary beneficiary or beneficiaries die(s), i.e., a remainder beneficiary or beneficiaries.

Moreover, a trustee of an irrevocable trust must:

- promptly furnish a beneficiary with a copy of the portions of the trust relevant to that beneficiary upon request;
- within 60 days of acceptance of the position, notify all qualified beneficiaries of a trustee's name, address and telephone number; and
- within 60 days of learning of an irrevocable trust's existence, notify each qualified beneficiary of the identity of the trustee, of the identity of the trustmaker and of the beneficiary's right to request a copy of the portions of the trust relevant to that beneficiary and of the right to receive a trustee's report.

Finally, a trustee must, upon request at least annually, provide to each beneficiary a report containing a description of the trust's assets, liabilities, income and expenses, including the source and amount of a trustee's compensation. This report must also, if feasible, provide an estimate of the fair market value of the trust's assets.

***Duty to Account.*** As mentioned above, one of your basic duties, which will be discussed more fully below, is your duty to account or provide "reports" to the beneficiaries. Beneficiaries are entitled to be kept reasonably informed about their interests in the trust. Note that different beneficiaries may have different interests in the trust, and you are duty-bound to account to each beneficiary only with respect to that beneficiary's interest.

***Duty to Segregate Trust Assets.*** You must keep the trust property separate and distinct from your own property. In other words, you should have a separate bank account or accounts for the trust, and you must not put either trust principal or income into your personal accounts. Trust assets must always be readily identifiable as such and must be segregated from your other property.

***Duty to Get Help If You Need It.*** Should any questions arise as to the proper interpretation of the terms of the trust, you should consult the lawyer for the trust. "Flying by the

seat of your pants” is dangerous because it can expose you to personal liability if something goes wrong. On the other hand, your reliance on the advice of a competent and qualified professional can be a defense to a claim that you breached a fiduciary duty.

***Duty to Protect and Preserve Trust Assets.*** You have the duty to protect and preserve the trust assets, and to insure them whenever practicable. Be sure to consult a competent insurance agent regarding proper coverage for the trust assets. Few things are worse than having a trust asset destroyed through no fault of yours and then discovering that the asset was not insured. In that case, your own personal bank account becomes the insurance company.

***Avoiding the Appearance of Impropriety.*** You will find very little sympathy with a judge or jury if you do something that looks like it may be improper, whether or not it really is. If someone questions your activities as trustee, you may find yourself having the burden of proving that you acted properly. You do not have the advantage of being presumed innocent until you are proven guilty. Most of the time, you will find the contrary presumption working against you. Wise trustees do their best to be completely above reproach.

### Section 3. Accounting and Reporting

You must set up and keep an accurate set of books. You do not need to be a CPA to do this, but you might want to engage a CPA or a professional bookkeeper to assist you. Your records should show all assets you receive, hold and disburse, with the date, amount and explanation of each. Arizona Revised Statutes require you to keep the beneficiaries reasonably informed about the trust and its administration, although no beneficiary of a revocable living trust, other than the trustmaker, has the right to information about the trust during trustmaker’s lifetime.

If the persons who receive trust income (also known as *current income beneficiaries*) are different from those who will receive the principal when the trust terminates (also known as *remaindermen*), your records should classify all receipts and disbursements as income or principal. In most cases, there will be no difficulty about this. Things like rent, interest and ordinary dividends are clearly income. However, although proceeds from the sale of an asset (i.e., a house or stocks and bonds) may cause taxable income, the sale proceeds are generally principal.

Many trust instruments contain instructions to guide the trustee in resolving these and other accounting problems, and you may find all of the guidance you need from this source. If you do not, you (with the assistance of your lawyer or CPA) will need to consult the Uniform Principal and Income Act.

If you keep your accounts carefully, it will be a simple matter for your CPA to find all of the information necessary to prepare trust tax returns, reports to the beneficiaries or reports to the court, if that becomes necessary.

Remember that the trust you are administering is a separate “person” in the eyes of the law, and, although it has no physical body, a clear set of books creates a record of its healthy and independent life.

You are entitled to reimbursement of your reasonable expenses incurred in the administration of the trust. You are also entitled to a reasonable fee for services rendered, but you are not required to take a fee. If you do, it should be added to your other income and reported on your personal income tax return.

As mentioned above, you must be prepared to render a trustee’s report or an accounting at least once a year. Any beneficiary may demand such an accounting, and, even if none does, your annual accounting or report should be a permanent part of your records of your administration of the trust.

The trust beneficiaries are generally entitled to copies of the trust instrument (at least the portions of the trust instrument that relate to their specific beneficial interests), and they may also be entitled to examine the books and records of the trust. This is another good reason for you to maintain your books in a scrupulous manner.

Your annual accounting should include the following elements:

- an inventory of all trust assets, any changes in the status of the assets, and the approximate fair market value of each asset;
- detailed information regarding all trust bank accounts, including bank statements; and
- the nature of all investments, together with proper backup information;
- any and all insurance, of all types, in force for the trust assets or for a beneficiary, and the dates and amounts of all premium payments;
- all debts of the trust and pertinent information about each debt, including the nature of the debt and the identity of the creditor;
- a list of all known claims presented to the trustee and pertinent information about each claim, such as the identity of the claimant, the nature of the claim, and what action the trustee took regarding that claim;
- all receipts that have come into the trust and how those receipts were derived;
- all disbursements made from the trust, to whom each disbursement was made, the purpose of the disbursement, and whether the disbursement came out of principal or income;

- a statement that all tax returns have been filed;
- a statement that all taxes and bond premiums (if any) have been paid; and
- a statement specifying the trustee's compensation and how that compensation was calculated.

You would be wise to have the beneficiaries sign (a) written receipts for all distributions and (b) written approvals of your annual accountings as they are rendered. If any beneficiary does not approve them, you have the option of asking a court to review and approve your accountings.

#### Section 4. Investments

You must keep the trust assets invested appropriately. It is important for you to remember that if you are serving as a trustee for someone other than yourself, you will be held to a higher standard of care than you would be if you were simply investing your own funds.

Arizona has adopted the Uniform Prudent Investor Act (UPIA). A summary of your responsibilities under the UPIA follows.

A trust instrument may limit or permit deviations from the following rules, and, to the extent the trustee acts in reasonable reliance on the terms of the trust instrument, the trustee cannot be faulted by the beneficiaries. However, where the trust instrument is silent, or where it specifically adopts the UPIA, the following rules apply.

Standard of care; portfolio strategy; risk and return objectives:

- (a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.
- (b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.
- (c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:
  - (1) General economic conditions;
  - (2) The possible effect of inflation or deflation;
  - (3) The expected tax consequences of investment decisions or strategies;
  - (4) The role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;
  - (5) The expected total return from income and the appreciation of capital;
  - (6) Other resources of the beneficiaries;

(7) Needs for liquidity, regularity of income, and preservation or appreciation of capital; and

(8) An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

(d) A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.

(e) A trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.

(f) A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.

You, as trustee, have the duty to diversify the trust assets. This means that you should not place all of the trust's eggs in one basket. If all of the trust assets were invested in an airline stock, for example, and if there were a terrorist attack that resulted in huge losses for the airline industry, the value of the trust assets would take a tremendous hit. Thus, you need to diversify the trust assets and thereby minimize the risk that the trust could be impoverished by a downturn in any one stock or any one market segment. Bear in mind, however, that your duty to diversify is also driven by other circumstances. If, for example, you had the duty to pay a large trust obligation or to distribute trust assets to beneficiaries, it might be appropriate for all or a substantial portion of the trust assets to be in cash and not invested in other kinds of assets.

Within a "reasonable time" after accepting a trusteeship or receiving trust assets, you are required to review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust. What constitutes a "reasonable time" depends on the circumstances, but it certainly does not pay to dawdle. If the value of the trust assets declines significantly, and if you could have avoided the loss through diversification, you may very well have some unhappy beneficiaries on your hands.

You have the duty to be absolutely loyal to the trust and to be impartial toward the beneficiaries. Your duty of impartiality is driven by the kinds of interests held by the various beneficiaries. For example, some beneficiaries may have current rights to receive trust income, whereas others may have the right to receive trust property at some point in the future. You need to treat the beneficiaries in each class the same way, and you must not favor the current beneficiaries over the future beneficiaries unless the trust instrument allows you to do that.

Although the general rule is that trustees cannot delegate any of their responsibilities to others, the Arizona Trust Code (ATC) acknowledges that delegating some of your responsibilities may very well be in the best interest of the trust. Thus, you are allowed to delegate investment functions and management functions to others, if that would be prudent in the circumstances. If, for example, you are not a Wall Street wiz, it is probably your duty to consult someone

who is when you develop the investment strategy for the trust. You can even delegate investment decision-making authority to expert asset managers if that would be appropriate, given the value and kind of trust assets for which you are responsible. Similarly, if the trust assets include real estate and you are not an ace real estate manager, there is nothing wrong with your engaging someone who is. You nevertheless have the duty to monitor the experts to whom you delegate responsibilities and to make sure that they are faithfully serving the best interests of the trust.

The above summary is fairly comprehensive, but it is not exhaustive. Always remember that if ever you have questions about trust administration, you can and should call on the expertise of your legal counsel and other advisors.

### Section 5. Income Taxes

The Internal Revenue Code considers a revocable or living trust to be a “grantor trust” during the lifetime of the trustmaker. As a general rule, such a trust is not required to file income tax returns [per Treas. Reg. §1.671-4(b)]. Moreover, the trustmaker’s Social Security number is the initial taxpayer identification number for the trust, at least for as long as the trustmaker is alive.

The trustees of all other types of trusts may be required to obtain taxpayer identification numbers (by filing Form SS-4 with the IRS) and file fiduciary income tax returns (Form 1041) with the IRS and analogous forms with the states in which the trusts derive income. The obligation to file a Form 1041 arises if the trust had any *taxable income* or had *gross income* of \$600 or more, regardless of the amount of taxable income in any taxable year.

You are advised, particularly if you are a layperson, to seek professional assistance in the preparation of tax returns, since they do differ substantially from personal income tax returns. We recommend that you consult, if not retain, a CPA.

### Section 6. Interim Distributions

Of great interest to the beneficiaries is when and under what circumstances they receive distributions.

The trust instrument should tell you who is to receive benefits from the trust and when those benefits are to be paid. It may also give you certain discretionary powers with regard to distributions.

Some of the problems that can arise in exercising your discretionary powers are illustrated by the following example.

The trust instrument gives you the power, in your sole discretion, to distribute income or principal or both among your sister’s three children – Sandy, Henry and Ralph – to provide for their maintenance, support and education. All of them have a legal guardian. Sandy is a sophomore in college and doing very well. Henry is “doing his thing” in

San Francisco, while Ralph is doing average work in high school and is something of a sports car nut.

You receive a request from the children’s guardian for \$3,000 for Sandy’s tuition for the coming year (to be spent at a university in Europe); \$1,000 for medical expenses for Henry, who is undernourished and high on drugs; and \$2,000 for a car for Ralph. Which of these requests can you honor under the standards given?

*For Sandy:* Education is a proper purpose of the trust, but does it have to be in Europe? Perhaps Sandy will get just as good an education in the U.S. for half the cost. If you enable Sandy to go to Europe, Henry and Ralph could later claim that you abused your discretion or even breached your fiduciary duty to the trust to the extent that \$3,000 exceeds the cost of Sandy’s education at a comparable stateside institution. If you do decide to allow Sandy to go to Europe for her education, you should make certain to document some very good reasons for her going there instead of staying here.

*For Henry:* Support and maintenance are proper purposes, but does this term include medical expenses or is it intended to be limited to ordinary living expenses such as room and board? The trust instrument may or may not tell you. You may also be stuck in the quandary of trying to decide whether spending money for Henry’s medical care, without also requiring him to undergo some kind of drug treatment, is prudent.

*For Ralph:* Do support and maintenance include a car if Ralph has access to a reliable car now? What if Ralph has a part-time job and needs transportation?

In all three cases, the trust instrument may give you adequate guidance. However, if it does not, you have your work cut out for you. Your primary objective should be to carry out the intent of the person who created the trust, if that can be determined from the trust instrument. You should also consider the size of the trust, the amount of income the trust generates, the needs and convenience of the beneficiaries, and various other demands that the trust might be called upon to meet.

Remember that when your permissible sphere of action is limited by a standard, you must observe that standard or risk a lawsuit for breach of trust or breach of a fiduciary duty. You are personally liable (meaning that your own assets are at risk) if you lose a lawsuit in which you are accused of violating your fiduciary duties.

Also remember that, if you are presented with an issue that cannot easily be resolved, you always have the option of petitioning a court for instructions. If you pass up the opportunity to petition the court and end up making a wrong decision, you can be sure that if a beneficiary sues you, the court will not regard you with great favor.

This short handbook cannot outline all of the problems you may face in connection with the exercise of your discretionary powers, but the above example should encourage you to analyze every distribution for possible problems before taking action. There is never any harm in consulting

your legal counsel and other advisors if issues come up, and doing so can help you stay out of hot water.

### Section 7. Final Distribution

If you are administering a trust at the time it terminates, you should give the beneficiaries a final accounting. Your final accounting should include the following:

- the property, rents, revenues, and profits received since your last accounting that was approved all of the beneficiaries or by the court;
- the disposition of the property, rents, revenues, and profits;
- the debts and expenses of the trust that remain unpaid;
- the property that remains in the hands of the trustee;
- a statement that the trustee has paid all required bond premiums, insurance premiums, and any other payments that the trustee is required to keep current;
- a description of the tax returns filed by the trustee during the term of the trust;
- a complete accounting of the taxes that the trustee paid during the term of the trust;
- a description of all current delinquencies in the filing of tax returns or the payment of taxes, and the reasons for each delinquency; and
- other facts that should be disclosed to convey a full, complete, and definite understanding of the condition of the trust.

You should ask the beneficiaries to sign a document in which they approve your accounting, waive any claims against you, and promise to pay any trust expenses that crop up after they have received the trust assets. Remember that the beneficiaries' promise to pay those obligations is only as good as their ability to hold on to the assets you distribute to them, and it would behoove you to be very sure that all trust obligations have been paid before you make final distributions. If any of the beneficiaries declines to approve your final account, you can petition a court to review and approve your account and discharge you from all further liability.

### Section 8. Title to Trust Assets

Whenever you take title to an asset as trustee, you should pay close attention to how that title is vested. Generally, title should be vested in:

*Trustee's Name*, Trustee, or his/her successors in trust, under the *Name of Trust*, dated *Trust Date*, as amended.

or

*Trustee 1's Name* and *Trustee 2's Name*, Trustees, or their successors in trust, under the *Name of Trust*, dated *Trust Date*, as amended.

When you sign documents, including checks, you should sign your name "*Your Name*, Trustee." By signing as "Trustee" you will not be held personally liable as long as the action you are taking is within the scope of your authority as trustee. This rule does not apply to a trustee who is also the trust creator—it only applies to successor trustees.

### Section 9. Avoiding Potential Liability

A trustee is subject to a variety of duties. The penalties for breaching a duty include having to pay for any resulting damage to the trust (or estate), out of your own pocket. Personal liability – even if you are not paid for your efforts – is one of the things that go along with being a fiduciary.

While you may perceive that there is a low risk of getting sued, you must not ignore the possibility. When you are acting as a fiduciary and are essentially in control of someone else's property or inheritance, you can easily become the focus of others' suspicion, frustration or anger.

Two things can help you avoid personal liability in connection with serving in a fiduciary capacity.

- First, keep good, well-organized records and thoroughly document all transactions, including any reasons for making or not making distributions.
- Second, understand the instructions contained in the trust, and obey them.

In doing those things, keep beneficiaries well informed of trust business and be friendly and cooperative. People are relatively unlikely to take legal action against someone who is considerate and communicates well, and with whom they have a good relationship.

THE VALUE OF PROPER RECORD-KEEPING. If you are sued, having a carefully documented file is going to look far better to a judge and jury than having a file that is in disarray. Similarly, a trustee who seeks advice from experts is going to look better than one who "wings it." In other words, from day one you must prepare for a lawsuit. It has been said that "if one wants peace, one should prepare for war." A trustee who is fully prepared for war, but not deliberately doing anything to start it, is far more likely to avoid becoming a casualty.

Consider the dynamics of a lawsuit against a trustee. Judges and juries alike tend to have more sympathy for the party that appears to be "right." If you have sloppy records (or have none), or if you have not sought help when you came up against something beyond your expertise, or if you have not provided beneficiaries with information that you should have, you will not be given the benefit of any doubt.

CARRYING OUT THE INTENT OF THE TRUST. Your second line of defense is your ability to show how you carried out the intent of the trust. The better you do that, the more

difficult it will be for a beneficiary (or anyone else) to show that you did something wrong.

It may be tempting to take a shortcut to fix a problem or correct a poorly worded document. That is not your job. Only a court of proper jurisdiction can change a trust document, and even a court's authority to do that is limited. Do not take it upon yourself to deviate from what is written. The trust instrument is the best expression of the trustmaker's intent. That expressed intent may be your best defense. You may not add to or subtract from the words of the document. You cannot be selective in carrying out various parts of the document. Consult your legal counsel if there is ever any question as to the correct interpretation of the trust instrument.

Remember that, once you accept the job of Trustee, you cannot get out of a lawsuit merely by resigning. If you ever wish to stop serving as trustee, you can resign, but your job (and the attendant duties and potential liability) does not end until a replacement trustee steps into your shoes and all of the trust assets are transferred to your replacement.

**CONCLUSION.** In discussing matters of personal liability, it is not this article's purpose to scare you out of acting in a fiduciary capacity. You have been named to serve because someone close to you has a great deal of respect for you and trusts your judgment and integrity.

We offer this discussion to help you anticipate problems before they occur and to give you a few important but relatively simple pointers on how to make the process go smoothly.

## Section 10. Final Thoughts

The following pointers will help make your job easier, and they will help you avoid conflict with beneficiaries.

**Try to understand why the trust was created.** Understanding the intent behind the trust will help you fulfill your role as trustee. There are many reasons for creating trusts, and there was probably more than one reason for creating this trust. Getting the drafting attorney to provide you with this information, even if you must pay for his or her time, can be invaluable to you later.

**Examine your motives.** You should be extremely careful that everything you do or refrain from doing as trustee is motivated by your desire to execute your duties faithfully and to the best of your ability. You cannot allow yourself to be influenced by your personal feelings about individual beneficiaries or your own self-interest.

**What if you are a beneficiary of the trust?** As a beneficiary, you are entitled to benefit from the trust. However, it is critical that you remain impartial and faithfully carry out your duties to the other beneficiaries. If anything you do as trustee smacks of greed or self-interest, you will have a very difficult time convincing a judge or a jury that you satisfied

your obligations as trustee. If you are ever in doubt as to whether a conflict exists between your personal interests and those of other beneficiaries, it is better to abstain from acting until you have consulted your legal and other counsel, or, in appropriate cases, have received instructions from the court.

**Keep well-documented files.** What should be in your trust files? In addition to your accountings, and the back-up information upon which your accountings are based, your files should include:

**Keep notes of meetings with beneficiaries.** For each meeting, keep a record of the date, the length of the meeting, and a summary of what was discussed. You should also keep records of all other communications between you and the beneficiaries, including such things as copies of all correspondence.

**Request beneficiaries' income tax returns.** If the trust instrument grants you discretion in making distributions to beneficiaries, their income tax returns can provide you a great deal of helpful information. Those returns are, after all, signed under penalty for perjury. Beneficiaries may be reluctant to share their income tax returns with you, but your request for that kind of information is not unduly intrusive—no more so than a bank asking for the same documentation before deciding whether to loan money.

**Prepare beneficiaries' annual budgets.** If you have discretionary authority with respect to distributions, you may even want to help prepare budgets for the beneficiaries. This shows that you have carefully considered their needs relative to discretionary distributions.

**Verify out-of-pocket expenditures.** Since you are entitled to reimbursement of all reasonable amounts you advance on behalf of the trust, keep copies of proof of payment, such as canceled checks or receipts.

**Preserve communications with advisors.** Keep all copies of all correspondence between yourself and your advisors, and always ask them to at least summarize any advice they give you in writing.

**Preserve information upon which any exercise of discretion is based.** That might include such things as beneficiaries' bank statements, credit card statements, pay stubs or other employment information, invoices, proposals, and any other information they give you to justify a request for a distribution.

**Understand your options in using an attorney.** It is common for the lawyer who drafted the trust instrument to represent successor trustees, but there is no rule that says the successor trustees are stuck with the drafting attorney. You have a duty to seek competent legal counsel, and you will need to assess whether that is a role that the drafting attorney can fill. Even if the drafting attorney is competent and highly regarded, you may not feel at ease communi-

cating with him or her. When you choose your legal counsel, you should give some consideration to how comfortable you feel with that person. Your attorney should inspire trust and confidence and should be someone with whom you can be completely frank and honest.

### **Conclusion**

Please keep in mind that the guidelines laid out in this handbook are far from exhaustive. The guidelines are intended to alert you to your duties and to impress upon you the significance of your responsibilities.

Never shrink from asking for legal or other advice. That advice may cost something in the short run, but the cost can be far less than it takes to fix a mistake later on. Remember that the trust will pay the reasonable costs associated with your obtaining advice, but you could end up paying out of your own pocket for your failure to secure advice when you needed it.