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BEING A TRUSTEE: WHAT YOU NEED TO KNOW

What is a trustee?

A trustee is a fiduciary named in an agreement or a Will who takes legal title to property and holds that property in trust for the benefit of the trust beneficiaries.

Who are the beneficiaries?

The beneficiaries of the trust may be particular persons named in the agreement or the Will or may be a class of individuals, such as the descendants of the person who created the trust (the “grantor”). Because the trust will generally exist for a considerable length of time, the trust will likely have current beneficiaries, who possess immediate interests in the trust (whether in trust income or principal or both), and “remainder” beneficiaries, who will only receive trust benefits in the future.

What are the trustee’s primary fiduciary duties to the beneficiaries?

Generally, the trustee has a duty to make trust property productive of income for current income beneficiaries and an equally important duty to preserve trust principal for remainder beneficiaries. But the general duties to all beneficiaries are the same: act honestly and in good faith in the administration of the trust and exercise reasonable care and prudence in all actions as trustee, including avoiding any sort of self-dealing. In addition, the trustee needs to keep the beneficiaries informed about the trust when appropriate and keep all trust information confidential with respect to third parties. Appropriate communication with the beneficiaries can prevent many potential problems.

How is the trustee to administer the trust?

The grantor of the trust provides the trust terms either in an agreement during life or in a Will at death. The trustee must know exactly what the particular provisions of the trust require the trustee to do and not to do. The guidelines for trustee conduct discussed here are general; only the actual terms of the trust agreement or Will control, and those terms may expand or restrict the trustee’s powers. In the event of uncertainty about what the trust requires or permits, the trustee may consult legal counsel for advice (to be paid for from the trust) and, if necessary, apply to a court for advice and instructions.

How should trust funds be invested?

A trustee must invest trust funds as a “prudent investor”, using reasonable skill and caution when making decisions about trust property. The trustee should seek a reasonable rate of return on trust assets but without incurring significant risk – all based on the facts and circumstances applicable to the particular trust under the then-prevailing economic conditions, including the inflation rate, applicable taxes, total return, need for liquidity, etc.

How must a “prudent investor” invest?

A prudent trustee/investor must:

- Use an overall investment strategy that allows for appropriate distributions to the beneficiaries in accordance with return and risk objectives reasonably suited to the trust portfolio
- Consider the portfolio size, nature and projected duration of the trust, liquidity requirements, overall economic conditions, effects of inflation or deflation, projected tax consequences of investments and distributions, the effect of each investment decision in the overall strategy, the expected total return and the needs of the beneficiaries for distributions over time
- Diversify assets, taking into account the specific trust purposes (except in limited circumstances when lack of diversification might be appropriate)

A prudent trustee/investor may (unless the trust instrument provides otherwise):

- Invest in any type of asset: no particular investment is, by nature, prudent or imprudent
- Consider related trusts (if any), any other sources of income of, or resources available to, the beneficiaries and any special relationship of a particular asset to the beneficiaries
- Delegate investment and management functions (to a bank or other investment advisor), which can mitigate some risks involved in serving as trustee. For example, an investment firm could be hired to manage trust assets – but the trustee must still exercise care, skill and caution in choosing any such firm and in overseeing its investment or management functions

What distributions should a trustee make?

Certain distributions may be required by the terms of the trust instrument. Other discretionary distributions that are permitted but not required should only be made after taking into account the needs and desires of the beneficiaries, the specific trust terms, the value of the trust property, the intent of the grantor and the tax consequences, including income tax, estate tax and generation-skipping transfer tax.

What kind of records should a trustee keep?

The trustee will set up separate bank and brokerage accounts for the trust, using the trust’s own taxpayer identification number. NO assets that are not trust assets can be co-mingled in such accounts. The trustee will keep accurate records about trust transactions, such as distributions made, expenses paid and purchases and sales of assets. A trustee may need to render a detailed accounting of all trust transactions, which requires accurate and complete records. The accounting may also provide the basis for the beneficiaries or a court to release the trustee from liability for actions as trustee, whether during the trust term, upon leaving office or on termination of the trust.

What about tax returns?

Unless the trust is a “grantor” trust, it will be a separate tax-paying entity. The trustee is responsible for preparing and filing any required federal and state income tax returns and for making required tax payments on a timely basis. But the trustee can hire accounting and legal help to provide appropriate tax advice and to prepare the needed returns (again to be paid from trust funds).

How is a trustee compensated?

In New Jersey, a trustee is entitled to a fee for services based on rates set by statute. The fee might be reduced if trustee duties are delegated or (less likely) increased owing to special services provided.

This White Paper provides only general information about trustees and their duties. In case of doubt about any particular trustee action (or inaction), please consult your tax or legal advisor and document any advice you receive in the trust records.

This White Paper was prepared by the Tax and Trusts & Estates Practice Group at Sherman Wells Sylvester & Stamelman LLP. If you have questions, you may contact any of the attorneys in our Group. Nothing in this White Paper should be relied upon as legal advice in any particular matter. © Sherman Wells Sylvester & Stamelman LLP.

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