

Web: www.aldavlaw.com

Blog: www.californiitrustestateandprobatelitigation.com

TRUST ADMINISTRATION AND DUTIES OF TRUSTEES

What is Trust Administration?

A Trustee is responsible for: collecting and securing trust assets; paying trust expenses; investing trust assets; collecting trust income; keeping accurate records of all transactions; and distributing income and principal to beneficiaries in accordance with the provisions of the trust document. Sometimes the person who created the trust (known as the “settlor” or the “grantor”) may direct that the trust pay all of the debts, taxes, funeral expenses and administration expenses of the grantor’s estate. If the trust instrument so directs, the Trustee will have those responsibilities as well.

A Trustee should keep in mind the following three key concepts as he or she performs his or her duties as Trustee:

- Accurate record-keeping is crucial to the proper administration of a trust. A Trustee is required to keep detailed records of all transactions, and the Trustee must make certain that the trust assets are not commingled with his or her assets or with the assets of any other individual, entity, estate or trust.
- The law imposes duties of loyalty and fairness on all Trustees. A Trustee must administer the trust solely for the benefit of the beneficiaries and display the utmost fairness in any dealings with the beneficiaries.
- The trust document and applicable law dictate the Trustee’s duties. A Trustee must exercise all “mandatory powers” granted in the trust document or the Trustee may be held liable for resulting damages and possibly removed as Trustee.

If the provisions of the trust instrument and applicable law allow, the Trustee may delegate various powers and discretions granted to the Trustee to any appropriate person, firm or corporation. The Trustee may delegate these tasks for any period, and the Trustee has the power to revoke any such delegation. For example, the power to delegate may permit the Trustee to hire an investment manager for the trust’s assets, who would have the authority to buy and sell assets without first consulting the Trustee. This delegation, however, will not exonerate the Trustee from liability for improper performance or lack of performance of the delegated tasks.

Trustee’s Duties and Responsibilities

A Trustee has the duty to:

- Secure possession of trust assets.
- Make trust property productive.
- Exercise powers granted in trust instrument.
- Make payments to beneficiaries.
- Keep accurate records.
- Not commingle property.
- Be loyal and fair to beneficiaries.
- File tax returns.
- Defend trust against attack.
- Reimburse fees and expenses.
- Terminate trust and wind up trust affairs.
- Seek professional advice when necessary.

Duty to Secure Possession of Trust Assets. As soon as reasonably possible after becoming Trustee, the Trustee must secure possession of the trust's tangible assets (e.g., jewelry and artwork) and the documents representing the trust's intangible assets (e.g., stock certificates and certificates of deposit). The Trustee has a duty to use reasonable skill and diligence to enforce any rights or claims that the trust may have to recover property from others, such as a predecessor Trustee. If the Trustee is a successor Trustee taking over from a prior Trustee, he or she should be diligent in securing all trust assets from the prior Trustee.

Certain other duties flow from the "duty of possession," or the duty to take possession of trust property and keep it safe. A Trustee has a duty to act as business manager and to protect and preserve the trust property. For example, the Trustee should deposit documents representing negotiable securities with a bank or broker with appropriate insurance or in a safety deposit box, record deeds and mortgages to secure the trust's interests in real estate, and obtain insurance (fire and liability, for example) to the extent that customary good business practice would dictate. If the property of the trust is described in the trust instrument or in the records of a preceding Trustee as having a certain value, the Trustee must verify that the property has the same value when the Trustee accepts it. If the value of the property has declined, the Trustee has a duty to inquire as to the reason for the decline.

Certain trust property may require special attention. For example, the law imposes substantial penalties on owners and operators of property containing toxic waste. The Trustee will therefore want to carefully examine the history of any real property held by the trust before agreeing to act as Trustee or to accept the property, as the case may be. Once the Trustee accepts the real property, the Trustee may become liable under the law for the cost of an environmental clean up of the property.

Duty to Make Trust Property Productive. The Trustee has a duty to invest the trust property in income-producing assets as soon as reasonably possible. After the Trustee has set aside cash for expenses and distributions to beneficiaries in the immediate future, the Trustee should consider what funds are available for investment. Income earned by the trust property that is not necessary to pay trust expenses and will not be paid to beneficiaries should be reinvested.

The Trustee must select and implement appropriate investments within a reasonable time. The Trustee may be held liable for any loss resulting from an unreasonable delay in investing funds. The investments the Trustee selects must meet the requirements of the trust and be permissible trust investments. The terms of the trust document, any applicable court orders, and the law of the governing jurisdiction will determine what investments are appropriate.

Until the Trustee has selected investments, the Trustee should hold the investment funds in an interest-bearing account in an appropriate bank, a money market fund, treasury bills, etc. If the Trustee is careless in selecting the bank, or if the Trustee leaves the funds on deposit after the Trustee should have known that the bank was in bad financial condition, the Trustee may be liable for any resulting loss.

The Trustee's responsibilities for investing trust assets are governed by the "prudent investor rule." This rule requires the Trustee to use the care and skill of a reasonably prudent investor in retaining, buying and selling trust investments. The Trustee's selection of investments may be affected by a court order or a specific instruction in the trust document. If the Trustee follows the directions in the trust instrument concerning investment, the Trustee is protected unless there is clear evidence that such action would be harmful. A court may order the Trustee to ignore the trust instrument's instructions regarding investments when it appears that following these directions is impossible or is detrimental to the beneficiaries. If the Trustee invests according to a court decree, the Trustee will be protected from any liability.

If the Trustee is given discretion in making investment decisions, the Trustee should keep in mind the factors that a court would consider if an investment decision were challenged. A court would make the following inquiries: How much did the Trustee investigate the investment beforehand? What were the ratings and opinions of experts about the investment? Was the investment suited to the needs of the trust and its beneficiaries? Did the Trustee diversify funds into a variety of investments? Did the Trustee's investments provide protection against inflation? What were the tax effects on the trust and its beneficiaries?

When making investment decisions, the Trustee does not have to follow the requests or instructions of a beneficiary. Communication with the beneficiaries about investment decisions and results is important to proper trust administration, however, and the Trustee should make such communication on a regular basis.

Should the Trustee choose to delegate investment authority to an investment advisor, the Trustee remains responsible for supervising the investment advisor's activities. As such, the Trustee should review the trust's account statements on a regular basis and meet with the investment advisor periodically to review the investments and discuss investment strategy.

Exercise Powers Granted in Trust Instrument. A Trustee has both "express" and "implied" powers. Express powers are those granted in clear, direct language by the trust instrument, by court decree, or by statute. Implied powers are not expressly given but are necessary to the proper administration of the trust. For example, the power to sell trust property may be implied when the trust instrument directs the Trustee to distribute principal to many beneficiaries, but a significant part of the trust's assets is comprised of real estate.

An express power granted in the trust instrument may be either mandatory or discretionary. If the trust instrument directs the Trustee to perform a certain act of trust administration, the Trustee has been granted a mandatory power. The Trustee has the duty to exercise a mandatory power. On the other hand, if the trust instrument merely authorizes the Trustee to do or to refrain from doing a certain act or to use the Trustee's judgment, the power granted is discretionary. The court does not closely scrutinize the use of discretionary powers. The Trustee should exercise a discretionary power in good faith after considering the purposes of the trust and the circumstances of the beneficiaries. If the Trustee does so, a court will not direct the Trustee to act in a particular way or set aside any decision the Trustee has made. Nevertheless, in some situations, if the Trustee fails to exercise a discretionary power, the Trustee may be ordered by a court, at the request of a beneficiary, to exercise the power.

Make Payments to Beneficiaries. It is the Trustee's responsibility to make payments of income and distributions of trust principal as required or permitted by the trust document. The terms of the trust will determine the timing of payments, the persons to whom payments should be made, and the form of the payments. The Trustee's duties in this regard are absolute - using reasonable care and prudence is no excuse for failing to follow the trust document.

Keep Accurate Records. The Trustee has a duty to retain all legal documents involving the trust, to secure and file receipts for all payments, and to keep accurate records. Keeping records will allow the Trustee to show beneficiaries that the trust is being administered properly. Accurate record keeping also is vital in preparing tax returns and accountings for beneficiaries. In maintaining records for the trust, it is important that the Trustee allocate receipts and payments between income and principal for eventual use in preparing accountings.

If an investment advisor is acting as the investment manager for the trust, the account statements that the Trustee receives from the investment manager should provide the Trustee with an accurate record and may satisfy the Trustee's record keeping duties, including the allocation of receipts and disbursements between income and principal. Therefore, it is important that the Trustee review and retain the account statements on a permanent basis.

Do Not Commingle Property. The Trustee has a duty to keep trust property separate from his or her individual property and from other property that the Trustee may hold for other trusts, except to the extent expressly permitted by applicable law. Consequently, the Trustee should earmark or label the trust property as that of the trust in whatever way is practicable. There are a few exceptions to this requirement. Bearer bonds, for example, need not have any label of trust ownership on their face. The Trustee also may hold stocks, bonds, and other trust property in the name of a nominee without mentioning the trust in any instrument. The Trustee will still be responsible, however, for the acts of the nominee affecting any investment so registered.

Duty of Loyalty and Fairness. A Trustee has a duty to administer the trust solely in the interests of the beneficiaries, and the Trustee must exclude from consideration his or her own advantages and the welfare of non-beneficiaries in making decisions regarding the trust. Even if the Trustee acts in good faith or with good intentions, the Trustee could be considered disloyal if a transaction benefits the Trustee or third persons. The Trustee need not have made a profit for a transaction to be considered disloyal. Examples of such a transaction might include: dealing

with a person who is in collusion with the Trustee; dealing with a third party with the same economic interests that the Trustee has (the Trustee's spouse, for example); and dealing with a corporation in which the Trustee owns much of the stock.

A Trustee's duty is to display the utmost fairness to each beneficiary and treat the beneficiaries impartially, not favoring one over another. This requires disclosing to each beneficiary all relevant facts and explaining the legal rights of each beneficiary and the effect of any proposed dealing. The Trustee also may have a duty either to advise the beneficiary to secure independent counsel regarding the wisdom of a proposed transaction or to secure such counsel for the beneficiary.

File Tax Returns. A Trustee is responsible for filing federal and state income tax returns for the trust and paying applicable taxes from the trust property. Generally, estimated state and federal income taxes will need to be paid quarterly, and annual income tax returns must be filed and income taxes paid by each April 15th. If the Trustee fails to file a return on time or if the Trustee files an inaccurate return, the Trustee may be held personally responsible for the resulting penalties and interest. I

Defend Trust Against Attack. Occasionally a person will attempt to destroy the trust in whole or in part, or have it set aside or declared invalid. The Trustee then has a duty to investigate and to form an opinion on the merits of the claim of the person attacking the trust. If there are reasonable grounds for believing the claim to be unfounded, the Trustee has a duty to use reasonable skill and prudence in opposing the claim. If, however, the Trustee's examination of the claim suggests that the attack is well-founded and that a defense would be meritless and would involve unjustified expense, the Trustee has no duty to defend against the claim.

Fees and Expenses. Unless the trust document provides otherwise, the Trustee is entitled to reasonable payment for services as Trustee. Any such fees are taxable income to the Trustee and may be income tax deductible expenses for the trust. The Trustee is also entitled to be reimbursed for certain appropriate expenses the Trustee incurs in fulfilling his or her duties as Trustee. In some states, the amount the Trustee is paid is set by law (absent a contrary provision in the document that created the trust); in other states, the Trustee should keep accurate records of his or her expenses and the time spent on trust matters to support these payments.

Trust Termination. The Trustee's powers and duties as Trustee do not immediately cease when a trust terminates. The Trustee continues to have the power and duty to retain possession of the trust assets, safeguard and manage the trust property, and perform all other acts reasonably necessary to wind up the trust affairs. These powers and duties exist only while the Trustee is required to prepare the accounting, if any, distribute the trust assets, and secure the Trustee's discharge as Trustee. Once the trust is terminated, the Trustee's final duty is to deliver the trust assets and any income earned promptly, in its then existing form, to the beneficiaries. If the Trustee unreasonably delays transfer and the assets depreciate or are lost during the delay, the Trustee may be held liable.

Seek Professional Advice. The Trustee should confer with a professional advisor if he or she is an inexperienced Trustee or has little knowledge of his or her responsibilities under the trust document. Early and frequent consultation with a professional advisor will facilitate efficient trust administration. Professional advice as to investments and in complex areas such as

tax planning and accounting can reduce potential problems with beneficiaries and help to insure that serving as Trustee does not leave the Trustee personally liable for his or her actions or inactions.

* * * * *

Please contact Albertson & Davidson, LLP at (951) 686-5296 for further information regarding trust administration and the duties of trustees or any other estate planning options.

© 2011, Albertson & Davidson, LLP