

In You They Trust

by **Steven T. Goldberg - March 2007** Kiplinger's Personal Finance, March 2007

Being named a trustee by a friend or family member is an honor—but it may be one you could do without.

The likelihood that you'll be asked to serve as a trustee is growing exponentially as trusts become ever more popular. Some people with sizable estates create trusts to avoid estate taxes; others set them up to prevent irresponsible heirs from frittering away an inheritance. Most trusts are created in conjunction with wills and other estate-planning tools. "We almost never prepare a will without a trust," says Martin Shenkman, a tax and estate lawyer in Teaneck, N.J.

Ted Siegler manages a trust that was created as part of a legal settlement of a malpractice case after Siegler's sister-in-law suffered brain damage during surgery. Siegler, 56, is the chief financial officer of a start-up firm in Silicon Valley. But even with his background, he finds that managing a trust "is not an easy or pleasant task." Says Siegler, "It's only something you would do out of loyalty to your family or a close friend."

Even then, many people "should just say no," says David Reagan, a financial planner in Modesto, Calif., who formerly managed a bank trust office. Serving as a trustee involves a lot of time and work, requires some specialized knowledge and could make you susceptible to emotional and legal donnybrooks. "One of the biggest problems is that people get in over their heads," cautions Kyle Krull, a lawyer in Overland Park, Kan., who specializes in trusts and estates. "And problems often come with a lawyer attached." Finding insurance for a nonprofessional trustee may be difficult. A few firms offer liability coverage, but your premiums will likely run \$1,500 a year or higher.

Learn your duties. If you find yourself in Siegler's position, start by carefully reading—and understanding—the trust document. If anything seems unclear, consult the lawyer who drew up the trust or hire another lawyer who specializes in trusts and estates. Pay special attention to provisions regarding distributions, advises Patricia Barrett, a Houston mediator who also serves as a trustee for two of her family members. "Does the document say, for example, that money should be used for both health and education expenses, or exclusively for education?"

Next, learn a little trust law. One good source is "How to Settle an Estate," by Charles Plotnick and Stephan Leimberg (Plume, \$16). A trustee is a fiduciary—someone who must act "prudently" on behalf of the trust's beneficiaries. That means not only that you act with good intentions, but also that you know what you're doing. It also means turning down unreasonable requests for money from a beneficiary, even if he happens to be your favorite nephew. "Trustees are always being asked for stuff," says Doris Hawks, an elder-law attorney in Los Altos, Calif. "You often hear, 'I want a new car now,' or 'I need this to happen now.' "

Prepare an investment strategy. Disagreements over how a trust's assets should be invested cause the most headaches. Start by drawing up an investment-policy statement that spells out the trust's investment strategy, and get the beneficiaries to agree in writing. If they balk, you may want to find a lawyer to mediate the disagreement.

Regardless of how you invest your own money, as a trustee you must usually develop a diversified mix of stocks or stock funds and bonds or bond funds, as well as cash. Just because Uncle Ned worked for IBM and invested 25% of his money in company stock doesn't mean it's okay for you to keep it there.

You'll be fine as long as you follow the trust's instructions, invest sensibly and exercise a little more caution than you might ordinarily use with your own investments. A mix of two-thirds stocks and one-third bonds and cash will almost always pass legal muster in a long-term trust—such as the one that Siegler is managing for his sister-in-law, who can't care for herself and will need the money for as long as she lives. On the other hand, if you're managing a short-term trust for a 13-year-old nephew's college education, you'll want to be more conservative, with one-third of the assets in stocks and the remainder in bonds and cash to protect the trust from big losses.

The trust document may give instructions on how to distribute assets. Otherwise, use common sense. A long-term trust might distribute about 4% or 5% of its value the first year, then increase the payout annually by the inflation rate. Many trusts require you to pay out dividends and interest to beneficiaries every year.

One of the most common trusts—and one of the trickiest for a trustee to manage—is a bypass trust. Often set up by affluent couples to avoid estate taxes, a bypass trust typically benefits the surviving spouse after the first spouse dies. After the death of the second spouse, the remainder of the trust goes to the couple's children.

As a result, there's a built-in conflict of interest: How much should you disburse to the spouse, and how much should you preserve to benefit the children? Often the trust guides the trustee to favor the spouse over the kids. You may have some leeway to increase distributions to the spouse or preserve more assets for a disabled child. In all cases, your payments must meet the test of reasonableness.

Hire outside help. If you don't feel comfortable writing an investment-policy statement or investing on your own, hire an investment adviser. The trust will almost always pay for this, plus any other professional help you need. Just remember that hiring a pro doesn't let you off the hook. You must retain someone who will prudently diversify the trust's assets at a reasonable price. So simply retaining Aunt Julia's broker isn't usually the answer. A fee-only adviser who charges 1% or less annually to manage a \$1-million portfolio will almost always pass the test (start your search with the National Association of Personal Financial Advisors at <http://www.napfa.com/>).

You should also hire an accountant to prepare Form 1041, the annual tax return that trusts must file with the IRS, as well as the K-1 form beneficiaries must file to report income from the trust. In addition, you may want to send the beneficiaries an annual report (a short letter should do) showing the annual gain or loss on the trust's assets, the trust's expenses and how much was distributed.

If all this sounds like a small nightmare, consider delegating the whole task to a bank trust department. Few banks will handle a trust worth less than \$500,000, and annual fees will generally be 1% or more of assets. But a trust department can take over the financial end of the job and handle the paperwork, while you take care of personal matters. "You're better at seeing what the beneficiary might require, such as private school for a minor," says Suzanne Snedegar, an estate lawyer in Bethesda, Md.

Then there's the question of compensation. You're entitled to be paid—the amount you may receive is usually set by state law—and experts say you should take the money. But Siegler didn't want to accept compensation from a family member.

One compromise is to reimburse yourself for expenses only.

- » Keep things simple. Use just one checking account and one brokerage account per trust.
- » Keep canceled checks, monthly bank statements and brokerage statements—as well as bills—for the life of the trust.
- » Talk to a trust lawyer if you're uncertain about the trust's terms. Use an accountant or investment adviser when necessary.
- » Keep trust assets separate. Commingling them with your own could lead to criminal charges.
- » Keep beneficiaries informed. The trust is for their benefit; you're merely its steward.

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