Trustee Selection

CHAPTER OVERVIEW
This chapter examines factors that a grantor should consider in selecting a trustee for the ILIT, including trustee attributes, duties and liabilities. The chapter also contains a discussion of the non-insured surviving spouse serving as a trustee of the ILIT.

§9.1 SELECTION OF TRUSTEE
In selecting a trustee to administer the ILIT and its subsequent resulting trusts, such as a marital deduction trust and a family (i.e., credit shelter) trust, the grantor needs to consider a myriad of tax and non-tax factors. Because a trust may be in existence for years, if not decades, flexibility concerning successor trustees and co-trustees also needs to be

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considered. In this regard, the trust instrument should permit an individual trustee to appoint a substitute trustee or co-trustee for property or matters that the individual trustee is unable to handle. See, Paragraphs 6.5 and 6.6 of Sample ILIT. Additional flexibility can be achieved by permitting current individual trustees to name their own successors, subject to certain limitations. See, Paragraph 6.7 of Sample ILIT. The most significant form of flexibility regarding trustee matters is the ability of the grantor or a beneficiary to remove a trustee and appoint a successor trustee. See, Paragraph 6.21 of Sample ILIT.

§9.1(a) Power To Remove And Replace Trustee

If a beneficiary has the unrestricted right to remove a trustee and can appoint himself or herself or a related or subordinate person (within the meaning of IRC section 672(c)) as successor trustee, that beneficiary will be deemed to possess the powers of the trustee, which may result in the beneficiary having a general power of appointment over the trust estate under IRC section 2041. Treas. Reg. §20.2041-1(b). If, however, the beneficiary's power to remove and replace the trustee is limited to appointing someone who is not related or subordinate to the beneficiary, such as an independent trustee or corporate trustee, then the beneficiary is not considered as having a general power of appointment over the trust estate. Rev. Rul. 95-58, 1995-2 C.B. 191; Priv. Letter Rul. 9607008. See, Paragraph 8.3(I) of Sample ILIT for a comprehensive definition of an independent trustee. A beneficiary can also be given the power to remove a trustee for reasonable cause, in which case the beneficiary is not bound by the requirements of Rev. Rul. 95-58, and can appoint anyone as the successor trustee. See, Paragraph 6.21(A) of Sample ILIT permitting the appointment of a disinterested trustee (as defined in Paragraph 8.3(K) of Sample ILIT). See Chapter 8, above, for a discussion of the tax consequences of a beneficiary who serves as trustee.

§9.2 TRUSTEE DUTIES

In selecting a trustee to administer the ILIT and its subsequent resulting trusts, the grantor should be mindful of a trustee's duties. Duties

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may be imposed by statute, common law, and the trust instrument. Many, but not all, of the duties imposed by law can be modified by the trust instrument. The paramount duty of a trustee, which underlies all other duties, is his or her fiduciary duty. The trustee stands in a fiduciary relationship with the trust and its beneficiaries. This relationship involves a duty on the part of the trustee to act for the benefit of the trust beneficiaries, and to administer the trust solely in the interest of the trust beneficiaries (and not for the trustee’s own benefit).

A corporate fiduciary is familiar and experienced in trust matters; however, few individuals, especially family members, have sufficient experience and expertise to administer a trust on their own. Consequently, the individual trustee will need legal, accounting, investment and tax assistance in fulfilling his or her duties. Thus, there will be additional expenses when an individual serves as the sole trustee. If the individual trustee desires the assistance of a co-trustee, the trust instrument can permit the appointment of a co-trustee, including a corporate trustee, by the individual trustee. See Paragraph 6.5 of Sample ILIT.

The typical duties of a trustee include:

§9.2(a) Duty To Administer The Trust

Once a person has accepted the appointment as a trustee, that person must administer the trust according to its terms as long as that person serves as a trustee—even if that person receives no compensation for serving as a trustee. When the trust contains ambiguous or uncertain terms, the trustee will need professional assistance, and possible judicial interpretation of the trust instrument. A trustee may not


§9.2(b) Duty Of Loyalty To The Trust And Its Beneficiaries

The trustee has the duty to administer the trust solely in the interests of the beneficiaries, to be honest, to avoid conflicts of interest and self dealing, and to act in good faith. This is the fundamental fiduciary duty of a trustee.

Common examples of potential self dealing include:

• Sale or lease of property to the trust by the trustee (including the trustee’s own securities);
• Purchase of trust property by the trustee at public sale or auction;
• Lease of trust property to the trustee;
• Loan by the trustee to the trust;
• Loan by the trust to the trustee;
• Investment of the trust’s assets in the trustee’s own securities;
• Employment of agents related to the trustee;
• Personal use of the trust property by the trustee;
• Use of the trust property by the trustee for personal profit; and
• Trustee’s engagement in a business that competes with the trust.

These impermissible forms of self dealing and conflict of interest can be waived by the express terms of the trust, by statute, with the consent of the beneficiaries (after full disclosure by the trustee), or by court approval (after full disclosure by the trustee). See, Paragraphs 6.19, 7.1(A)(2), 7.1(A)(5), and 7.1(A)(10) of Sample ILIT.

§9.2(c) Duty To Administer The Trust With Reasonable Skill And Care

A trustee must administer the trust with same care, skill, and caution as a prudent person would in dealing with his own property. If the trustee has special skills or is named trustee on the basis of representation of special skills or expertise, the trustee is under a duty to use those skills. See, Paragraph 6.18 of Sample ILIT.