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TRUSTEES BEWARE: Understanding Your Trustee Duties and How to Stay Out of Trouble

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I. Introduction

Trustees have numerous responsibilities in the administration of a trust. There are many situations where a trustee can trip up and unknowingly expose itself to liability. This outline will discuss common issues that arise in the administration of a trust and the proper way a trustee can address these problems while limiting its potential liability.

The Top Issues that Get Trustees in Trouble:

1. Investment Issues
   a. Trust owns non-income producing property or underperforming assets.
   b. Trust assets are not diversified.
   c. Inappropriate investments for purpose of trust.
   d. Too risky / Too safe.
2. Irrevocable Life Insurance Trusts
3. Payment of Fees
   a. Trustee fees.
   b. Excessive professional fees.
4. Conflicts of Interest
   a. Trustee is also an owner of an entity in which the trust also owns an interest.

b. Trustee is also a beneficiary of the trust.

5. Discretionary Distribution Standards

Exercise of a trustee's discretion in making distributions to beneficiaries is always a potential liability. Distributing too much or too little, showing preference to one beneficiary over another, let us count the ways to get into trouble here!

6. Keeping the Beneficiaries Informed

Trustees have specific requirements for informing the trust beneficiaries during the administration. Properly doing so greatly limits a trustee's potential liability.

7. Tax Issues

Trusts may have certain assets or tax attributes which require special care by the trustee. If the trustee does not properly address these issues, or worse yet, does not even know the issues exist, the trustee could harm the trust and the beneficiaries, leaving itself exposed to liability. Trustees can inadvertently cause a corporation to lose a subchapter S election, incur generation skipping transfer tax, fail to make a I.R.C. §754 election, or accelerate income tax to the income beneficiary to name a few ways.

8. Ending the Trust Administration

Trustees need to exit as trustee without incurring further liability, especially considering that the trustee will no longer have the trust funds to look to for the payment of litigation expenses.

9. Trust Litigation

Knowing the standards that a court will hold the trustee to can help trustees make better decisions in administering the trust.

II. Investment Issues

A. Examples of Investment Issues

The following are classic examples of problems that occur regarding investments of trust assets:

1. Surviving Spouse is income beneficiary and children of a prior marriage are remainder beneficiaries of a trust. Spouse wants the trust invested to produce maximum income and children want the trust to concentrate on growth investments. Does it matter if the trustee has the power to invade principal for the spouse's benefit? Consider electing the trust to be treated as a unitrust.

2. Decedent died owning a large percentage of his assets in real estate, some income producing but others are a large cash drain. The market value has decreased. What does the trustee do?

3. Decedent's spouse and/or child want the family's longtime investment manager to make the investment decisions but you don't really feel comfortable with the manager's investment policies or plans.

4. Decedent died owning a closely held business which is now in a trust for the benefit of children who can't agree about how the business should be run or sold.

5. The assets in the trust portfolio have declined in value and there is a very uncertain economic climate. Does the trustee sell assets, hold cash and wait? What if the market rebounds and the trustee doesn't get to participate in any of the profits while the trustee is "sitting out"?

6. See the case of *Parker v. Shullman*, 983 So.2d 643, (Fla. 4th DCA 2008). Beneficiaries complained of decline in value of trust assets due to the trustee's investment decisions. The trustee was not held liable because the trustee's actions were reasonable at the time and the trustee relied on professional investment advice.

   How does the trustee deal with these issues?

B. Avoiding Liability by Following the Appropriate Standard of Care

1. A trustee has a duty to invest the trust assets as a prudent investor would. The prudent investor rule is a test of conduct and not of performance. The standard is applied not to investments in isolation, but in the context of the investment portfolio as a whole and as a part of an overall investment strategy incorporating risk and return objectives reasonably suitable for the trust. F.S. §518.11(1)(a).

   a. No single investment decision is viewed in isolation. The court will look at all circumstances surrounding the investment decisions at the time the investment was made. F.S. §518.11(1)(b).

   b. Duty to diversify. F.S. §518.11(1)(c). Can be a problem with real estate or closely held business assets.

   c. Duty to review existing investments of the trust within a reasonable time after acceptance of the trust. F.S. §518.11(1)(d).

C. Investment Plan

1. In implementing the investment plan, the trustee should document the factors considered in determining a reasonable investment portfolio.

    a. General economic conditions.

    b. Possible effect of inflation.

    c. Expected tax consequences of decisions or strategies.

    d. Role of each investment within the portfolio.

    e. Expected total returns.

    f. Costs.

    g. Purposes, terms, distribution requirements and other circumstances of the trust.

2. In carrying out the investment plan, the trustee should review the investment portfolio at least annually, or more frequently in times of market fluctuations, and document the reasons for maintaining or changing the portfolio.

3. The duty of a trustee to diversify investments is routinely modified, or even waived, under the terms of many trusts. Trusts often provide that a trustee may retain assets contributed to the trust, regardless of the risk of the contributed asset or the resulting lack of diversification.

D. Reliance on the Terms of the Trust

1. If the trust document specifically authorizes certain investments, the trustee can reasonably rely on the terms of the trust. F.S. §518.11(2); F.S. §736.1009.

2. If the terms of the trust regarding the trust investments no longer seem reasonable, the trustee can obtain a court order to deviate from the terms of the trust. F.S. §518.11(3)(a).

E. Court Approval

F.S. §518.11(3)(b) specifically authorizes a trustee to obtain court approval for any action regarding trust investments.

F. Beneficiary’s Consent

A trustee is not liable to a beneficiary for a breach of trust if the trustee has fully disclosed his proposed actions and beneficiary has willingly consented to them. F.S. §736.1012. The consent must not be improperly induced and the beneficiary must know of the beneficiary's rights. If a trustee is concerned about the trust investment or an underperforming asset held by the trust, he can obtain consents from the beneficiaries to relieve him from personal liability. In order for a consent to be valid, however, the trustee must fully disclose all of the facts surrounding the transaction.

G. Reliance on Investment Advice

The court in *Parker v. Shullman* held that the trustee was not liable for a decline in the trust assets because the trustee took careful steps to interview investment advisors, schedule meetings with the advisors on his duties as trustee, and followed the advice of the advisors.

H. Delegating Investment Decisions

A trustee may delegate duties and powers, including investment decisions, that a prudent trustee of comparable skill could delegate under the circumstances, provided the trustee exercises reasonable care in selecting the agent, defining the scope of the delegation and monitoring the agent's performance. F.S. §736.0807. If the investment functions are properly delegated to an agent, the trustee will not be held liable for any investment decisions by the agent. F.S. §518.112(4). To properly delegate the trustees investment functions, the trustee must:

1. exercise reasonable care in selecting the agent, establishing the scope and terms of the delegation and periodically reviewing the agent's actions. F.S. §518.112(1); and

2. give notice of the intent to delegate the investment functions to all beneficiaries who are entitled to receive distributions from the trust. F.S. §518.112(3).

In performing the delegated functions, the agent is subject to the same fiduciary standards for the trust investments. F.S. §518.112(6).

I. Statute of Limitations

The statute of limitations is discussed in Section VII, below.

III. Irrevocable Life Insurance Trusts ("ILITs")

A. ILITs Present Unique Issues for Trustees

1. Continued suitability of policy.

a. Financial viability of insurer.

b. Comparative cost of newer policies.

2. Additional notice requirements.

a. Crummey withdrawal notices.

b. Actions in respect to policies.

3. Payment of premiums when the trust has no, or few, other assets.

B. Prudent Investor Rule

1. Trustee has a duty to invest and manage investment assets as a prudent investor would considering the purposes, terms, distribution requirements, and other circumstances of the trust. See Section II, above. The trustee must consider:

a. Whether an insurance policy is or remains a proper investment.

b. Whether to exercise a policy option.

c. Whether to diversify insurance policies relative to one another or to other assets, if any.

d. Changes in the health or financial condition of the insured(s).

2. The trustee must monitor the continued economic viability of the company that issues the policy.

3. The trustee must monitor whether the policy is still economically competitive with other policies available.

4. The trustee should consider periodically retaining a consultant who is an expert in life insurance to review all aspects of the policy.

5. Subject to the requirements discussed in Section II, H above concerning notice of delegation of the investment functions, the trustee may delegate the investment functions in respect to a life insurance policy to certain persons, without any continuing obligation to review the agent’s actions and without obligation to diversify until the policy proceeds are received. Those persons include -

a. Beneficiaries of the trust.

b. The spouse, ancestor or descendant of a beneficiary.

c. Any person or entity nominated by a majority of the beneficiaries entitled to receive notice of delegation of investment functions to an investment agent.

d. An investment agent, if the trustee exercises reasonable care, judgment, and caution in selecting the investment agent and in establishing the scope and specific terms of the delegation.

F.S. §518.112(2)

6. The trustee should also consider and review the possibility of selling an insurance policy on the secondary market.

C. Additional Notice Requirements

1. In order for transfers to the trust (to allow the trustee to pay premiums on the life insurance) to qualify for the annual gift exclusion (currently $13,000), the transfer must be a gift of a present interest. The beneficiary must have the unrestricted right to the immediate use, possession or enjoyment of the transferred property or the income therefrom. Treas. Reg. §25.2503-3(b). Generally, transfers to a trust are future interests, because the enjoyment of the beneficiary is limited and/or deferred. If the beneficiary has the right to withdraw property as a result of a transfer to the trust, what would otherwise be a gift of a future interest will be a gift of a present interest. Crummey v. Comm'r., 397 F.2d 82 (9th Cir. 1968).

a. In order to document that the beneficiary had knowledge of the right of withdrawal, the trustee should give written notice to the beneficiary or his or her legal representative of each transfer made to an ILIT.

b. The trustee should require the beneficiary (or legal representative) sign the notice and return it to the trustee. The beneficiary (or legal representative) should not waive the right to withdraw, because this would be treated as a release of a general power of appointment, rather than a lapse, with potentially adverse transfer tax consequences.

c. The trustee should retain copies of the signed notices to document that the transfers constituted present interest gifts that qualify for the annual gift exclusion.

2. The trustee should inform the qualified beneficiaries of other important matters involving the administration of the trust. For example, if the trustee did not have sufficient funds to continue to pay the premiums necessary to keep the life insurance currently owned by the trust in force, the trustee should inform the qualified beneficiaries before –

   a. Borrowing to pay the premiums.

   b. Reducing the face amount of an insurance policy.

   c. Exchanging a policy for another policy.

   d. Selling a policy to a life settlement company.

   e. Surrendering a policy for its cash surrender value.

   f. Allowing a policy to lapse.

D. <u>In re Matter of Stuart Cochran Irrevocable Trust</u>, 901 N.E. 2d 1128 (Ind. Ct. App. 2009). Court considered whether it was prudent for the trustee to exchange insurance policies with significant risk and likelihood of lapse for an insurance policy with a smaller but guaranteed death benefit. The court found that although the trustee's process in investigating alternatives and communicating with the beneficiaries was not perfect, its actions were sufficient and the decision to replace the old policies was prudent under the circumstances.

   1. The insured died unexpectedly. If the insured had been in poor health, the trustee might have been held liable for failing to take reasonable steps to ascertain the health of the insured before exchanging the policies.

   2. The trustee relied on guidance from an outside, independent advisor with no financial stake in the outcome of the decision.

   3. The trustee provided some information to the beneficiaries about its decision to exchange the policies. The lawsuit may have been avoided or the issue may not have been so close if the trustee had provided notice at each step along the way and given the beneficiaries the opportunity to object.

IV. Trustee Compensation and Professional Fees

A. Trustee Compensation

   1. Statutory Authority

If the compensation of the trustee is not specified in the trust document, the trustee is entitled to reasonable compensation. F.S. §736.0708(1).

a. What is reasonable compensation?

(i) In *West Coast Hospital Ass'n v. Florida National Bank of Jacksonville*, 100 So.2d 807 (Fla. 1958), the Florida Supreme Court listed several factors to consider in determining reasonable compensation of the trustee:

A. The amount of capital and income of the trust;

B. The compensation of agents for performing similar work in the community;

C. The success or failure of the administration;

D. The trustee's skill;

E. The amount of risk assumed by the trustee;

F. The time involved in the administration;

G. The character of the work of the trustee.

2. Terms of the Trust

If the terms of the trust specify the trustee's compensation, the trustee is entitled to such compensation, but it may be adjusted by the court. F.S. §736.0708(2).

3. Agreement with the Beneficiaries

The trustee should consider entering into an agreement with the beneficiaries as to his compensation. Doing so would prevent a beneficiary from later claiming the trustee's compensation was unreasonable.

4. Judicial Determination

If the trustee is concerned about the payment of his fees and the beneficiaries will not agree to a reasonable fee, the trustee may seek a judicial determination of the validity of his or her fees. F.S. §736.0201(4)(c).

5. Statute of Limitation

If the trustee has already been paid from the trust, or the trustee does not wish to (or cannot) obtain the consents of the beneficiaries or judicial approval, the trustee can disclose the payment in a trust disclosure document so as to begin the statute of limitations as discussed in Section VII, below.

B. Payment of Professional Fees

1. Statutory Authority

a. The trustee has the power to hire professionals to advise the trustee and to pay a reasonable compensation for such services. F.S. §736.0816(20). This statute governs all professionals including, investment advisors, accountants, etc. The amount of "reasonable compensation" will depend on the facts and circumstances.

b. F.S. §736.1007 specifically governs the compensation of attorneys for the trustee.

(i) For ordinary services in the initial administration of the trust, 75% of the rate specified in F.S. §733.6171 is presumed reasonable, i.e.:

A. $1,125 for a trust valued at $40,000 or less;
B. an additional $562.50 for trusts valued between $40,000 and $70,000;
C. an additional $562.5 for trusts valued between $70,000 and $100,000;
D. an additional 2.25% on the excess of a trust's value over $100,000 and less than $1,000,000;
E. an additional 1.875% on the excess of a trust's value over $1,000,000 and less than $3,000,000;
F. an additional 1.5% on the excess of a trust's value over $3,000,000 and less than $5,000,000;
G. an additional 1.125% on the excess of a trust's value over $5,000,000 and less than $10,000,000; and
H. an additional .75% on the excess of a trust's value over $10,000,000.

(ii) An attorney is entitled to reasonable compensation for extraordinary services provided. F.S. §736.1007(5).

(iii) The court may increase or decrease the compensation paid to an attorney. F.S. §736.1007(6).

c. For attorney’s fees for trust litigation, see Section XI, below.

3. Court Authorization

If in doubt about the reasonableness of the compensation, the trustee can get a court order authorizing the payment of professional fees from the trust. F.S. §736.0201.

4. Beneficiary Consent

The trustee may also obtain consents from the beneficiaries for the payment of any expenses of the trust, including professional fees. F.S. §736.1012

5. Statute of Limitations

If the trustee has already paid the fees, the trustee should disclose the payment in a trust accounting or other trust disclosure document to begin the statute of limitations as discussed in Section VII, below.

V. Conflicts of Interest

A. Generally

The trustee has a duty to administer the trust solely in the interest of the beneficiaries. Any sale, encumbrance, or other transaction entered into by the trustee which involves the trust property and benefits the trustee or in which there is another conflict of interest is a breach of fiduciary duty and is voidable per se. If a beneficiary wants to void the transaction, the only defense the trustee will have are those enumerated in F.S. §736.0802(2):

1. the transaction was authorized by the terms of the trust;
2. the transaction was approved by the court;
3. the statute of limitations has run;
4. the beneficiary consented to the transaction;
5. the transaction was entered into before the trustee contemplated becoming the trustee; or
6. the transaction was consented to by the settlor.

If the transaction does not fall within one of the above exceptions, then the transaction will be voided.

B. Presumed Conflict

Pursuant to F.S. §736.0802(3), a conflict of interest is presumed when a transaction is entered into by the trustee with:

1. the trustee's spouse;

2. trustee's relatives;

3. an agent, employee, officer or director of the trustee; or

4. an entity in which the trustee has a significant interest in.

Unlike transactions which directly involve the trustee, a transaction in which there is a presumed conflict of interest is not void per se. The trustee may rebut the presumption by showing evidence that no conflict existed.

C. Affiliated Investments - Corporate Trustee Exceptions to Presumed Conflict Rule

Notwithstanding the above, a conflict of interest is not presumed to exist with respect to a corporate trustee where:

1. The corporate trustee invests in mutual funds in which the trustee or its affiliate provides services in a capacity other than as trustee. The trustee, or associate or affiliate of the trustee may receive reasonable compensation for its services from such mutual fund provided such compensation is fully disclosed in writing to all qualified beneficiaries. F.S. §736.0816(3); and

2. The corporate trustee invests in "investment instruments" (e.g. securities, private investment funds, REITs, etc.) that are controlled or owned by the trustee or its affiliate, or from which the trustee or its affiliate receives compensation. Certain notices and disclosures must be provided to the beneficiaries AND a majority of qualified beneficiaries must provide written consent within 90 days after delivery of the written request by the trustee. See F.S. §736.0802(5).

D. Remedies Available to the Beneficiaries

1. The transaction is voidable by any beneficiary who was affected by it. F.S. §736.0802(2).

2. In addition to voiding the transaction, F.S. §736.1001(2) provides a non-exclusive list of remedies a court may order for any breach of trust. The court can:

   a. compel performance by the trustee;

   b. enjoin the trustee from committing the breach;

   c. order the trustee to return the trust property or pay monetary damages;

      (i). the monetary damages against the trustee are the greater of the amount required to restore the value of the trust property or the amount of profit realized by the trustee. F.S. §736.1002(1).

   d. compel the trustee to provide an accounting;

   e. remove the trustee and appoint a successor trustee; or

   f. reduce or deny the compensation of the trustee.

E. Examples of Trustee's Conflicts

1. *Estate of Rothko v. Reis*, 43 N.Y.2d 305 (1977)

   An estate consisted mostly of almost 800 valuable paintings. The decedent had a contract with an arts dealer to sell his paintings at a commission of 10%. The executor of the estate entered into a contract with the same company to sell the paintings at a commission of 50%, without exploring whether the original contract survived the death of the decedent. Additionally, the executor was also a director and treasurer of the company. The court held that the executor had an inherent conflict of interest and that the contract entered into with the company lacked fairness to the estate. Thus, the court voided the contract and awarded damages to the beneficiaries of the estate.

2. *Aiello v. Hyland*, 793 So.2d 1150 (Fla. 4th DCA 2001).

   A trust owned land on which a business was located. The trustee was a shareholder of the business located on the property. The trustee attempted to sell the property to a trust beneficiary who was also a shareholder of the business for less than full market value. The court concluded that the trustee had a conflict of interest and voided the sale.

3. *Barnhart, III v. Hovde*, 490 So.2d 1271 (Fla. 5th DCA 1986).

The trustee sold the sole asset of the trust and the sale benefited the trustee's son and resulted in a detriment to the beneficiaries of the trust. The court voided the transaction.

F. Preventing a Claim Before the Transaction Occurs

1. Obtain Court Approval. F.S. §736.0802(2)(b).

2. Obtain Beneficiary Consents. F.S. §736.0802(2)(d).

3. Transaction Authorized by the Trust Document. F.S. §736.0802(2)(a).

G. Limiting Liability After the Transaction Occurs

1. The trustee can shorten the statute of limitations by disclosing the transaction in a trust accounting or other disclosure document as discussed in Section VII, below.

2. Even if the trustee does not obtain the beneficiaries' consents before the transaction, if the beneficiaries consent to, or ratify the transaction, the trustee will be free from liability. So the trustee can obtain the beneficiaries' consents after the transaction has occurred. F.S. §736.0802(2)(d).

VI. Discretionary Distributions

The trustee owes a duty to administer the trust impartially among the beneficiaries. F.S. §736.0803. This can become difficult when a trustee has authority to make discretionary distributions to a beneficiary which would reduce the amount available for other beneficiaries.

A. Review the terms of the trust document for guidance concerning exercise of discretion

1. Certain beneficiaries may receive priority in distributions under the terms of the trust document.

B. Obtain Court Approval

C. Obtain Consents of the Affected Beneficiaries

D. Considerations

1. Is the distribution subject to an ascertainable standard (e.g., health, education, maintenance and support) or totally within the discretion of the trustee?

2. Do the terms of the trust give some beneficiaries priority over others for distributions?

3. May a trustee consider other financial resources available to beneficiary?

4. Are non-pro rata distributions allowed?

5. Are "interested trustees" prohibited from participating in decisions to make certain types of distributions or distributions to certain beneficiaries?

6. What will the income tax (and GST tax, if applicable) effect of the distribution be on the trust, beneficiaries who receive distributions and beneficiaries who do not receive distributions?

E. Document Discretionary Distributions and the Reason for Making Them

F. Examples of Judicial Review of a Trustee's Discretion

1. *NCNB National Bank of Florida v. Shanaberger*, 616 So.2d 96 (Fla. 2d DCA 1993)

The dispositive provisions in the trust allowed the trustee to make discretionary distributions to the beneficiary for his health, education, maintenance and support. The trust also allowed the trustee to make additional distributions to the beneficiary, in the trustee's sole discretion for any purpose. The beneficiary required nursing home care and requested that the trustee pay for this expense. The trustee realized that the continued payment of the beneficiaries nursing home expenses would exhaust the trust, leaving nothing for the other beneficiaries. The trustee requested the beneficiary to provide information regarding the beneficiary's other sources of income. The beneficiary brought suit alleging that the trustee had abused its discretion by asking for this information. The court held:

(i) A trustee's exercise of its discretion is not subject to control by the court except to prevent an abuse of discretion.

(ii) The trustee's request for additional information was reasonable because there was no evidence that the trustee acted dishonestly, arbitrarily, or from an improper motive.

2. *Sarasota Bank & Trust Company v. Reitz*, 297 So.2d 91 (Fla. 2d DCA 1974)

A trust gave the trustee the discretion to make principal distributions to the beneficiary "in the standard of living to which she was accustomed during my lifetime, and to provide for her such luxuries, pleasures and recreation as she should desire." The trustee obtained a judicial construction of the discretionary distribution standard and a court order was entered fixing the annual distribution. The annual distribution took into consideration reasonable expenses for repairs to the beneficiaries property, including the residence.

Sometime after the court order was entered, the beneficiary requested an additional distribution to pay for the new air conditioning equipment, but the trustee refused because the annual distributions already included an amount for reasonable repairs. The court held:

> "The questions is not whether the trial judge or the judges on this panel would construe repairs to include the replacement of air conditioning equipment. The question is whether the trustee acted improperly in so construing the instrument, and we find no evidence that it did. The view that the allowance for repairs should, over the years, permit replacement of this equipment is not untenable."

3. *Mesler v. Holly*, 318 So.2d 530 (Fla. 2d DCA 1975)

A trust gave the co-trustees the power to invade the corpus for the income beneficiary as the co-trustees deemed necessary to maintain the beneficiary's accustomed standard of living. The co-trustees of the trust were the income beneficiary and a third party. However, the third party was not involved in the administration of the trust, so in essence, the income beneficiary/co-trustee was the only acting trustee. The remainder beneficiaries brought an action against the trustee alleging that she had abused her discretion in making distributions of the trust corpus. The court noted that:

(i) even though the trustee's discretion is broad, this does not relieve the trustee from the duty to exercise good faith in the trust administration;

(ii) a trustee is always subject to accountability to the remainderman where discretion is improperly, arbitrarily or capriciously exercised; and

(iii) a trustee's discretion is vulnerable when making a determination for the trustee's own benefit.

The court ultimately remanded the case to the trial court to determine whether the trustee abused her discretion.

VII. Informing Trust Beneficiaries; Statute of Limitations; Representation

A. Informing the Qualified Beneficiaries of Existence and Acceptance of Trust

1. Within 60 days of accepting as trustee, the trustee must give notice to qualified beneficiaries of the acceptance of the trust and the trustee's name and address. F.S. §736.0813(1)(a).

2. Within 60 days after the trustee acquires knowledge of an irrevocable trust, the trustee must give notice to the qualified beneficiaries of the trust's existence, the identity of the settlor, the right to request a copy of the trust, and the right to receive accountings. F.S. §736.0813(1)(b).

    a. Who is a qualified beneficiary?

        Pursuant to F.S. §736.0103(14), a "qualified beneficiary" is a beneficiary who:

        (i) is a distributee or permissible distributee of trust income or principal;

        (ii) would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in A, above, terminated on that date without causing the trust to terminate; or

        (iii) would be a distributee or permissible distributee of trust income principal if the trust terminated in accordance with its terms on that date.

3. Things to consider when initially notifying beneficiaries:

    a. Waiver of future trust accountings. F.S. §736.0813(2).

    b. Limiting action for contesting the validity of a revocable trust. F.S. §736.0604(2).

    c. Getting release from duty to institute proceeding against prior trustee. F.S. §736.08125(1)(c).

    d. Determining representation of qualified beneficiaries. See, VII, D below.

B. Trust Accountings

1. A trustee has a duty to provide accountings to the qualified beneficiaries annually, on change of trustee, and on termination of the trust pursuant to F.S. §736.0813(1)(d). The accountings must include:

a. statement identifying the trust, the trustee, and the time period covered by the accounting;

b. all cash and property transactions and all significant transactions;

c. receipts and disbursements during the accounting period;

d. gains and losses realized during the accounting period;

e. to the extent possible, the identity and value (both acquisition or carrying value and estimate of current value) of the assets at the close of the accounting period;

f. all non-contingent liabilities;

g. allocation of receipts and disbursements between income and principal; and

h. for final accountings, a plan of distribution.

2. Waiver of Accountings

a. Qualified Beneficiaries can waive the right to receive accountings. F.S. §736.0813(2).

b. If the beneficiaries waive the right to accountings, then the trustee should consider providing "informal accountings" to the beneficiaries along with a limitation notice so as to reduce the statute of limitations. An "informal accounting" can be anything that provides the beneficiary with enough information so that the beneficiary could know of a claim or reasonably should have inquired into the existence of a claim. F.S. §736.1008(4)(a).

(i) Bank account statements

(ii) Investment account statements

(iii) A letter from the trustee to the beneficiary describing transactions of the trust.

3. Court Approval of Accountings

The trustee may ask the court to review and settle an interim or final accounting. F.S. §736.0201.

C. Statute of Limitations

The failure to provide an accounting may not give rise to a liability, although a qualified beneficiary can compel the trustee to provide an accounting pursuant to §736.1001(2)(d). The benefit for providing trust accountings frequently is the statute of limitations for bringing an action against a trustee is reduced for actions adequately disclosed in the accounting.

1. Without providing an accounting, a beneficiary may have up to forty years after a trust terminates or the trustee resigns to bring an action against a trustee. F.S. §736.1008(6).

2. The statute of limitations is reduced to four years for matters adequately disclosed in an accounting or other trust disclosure document. F.S. §736.1008(1)(a).

3. The statute of limitations is further reduced to six months if a limitation notice is given to the beneficiary along with the accounting or trust disclosure document. F.S. §736.1008(2).

   a. F.S. §736.1008(4)(c) provides sample language for a limitation notice:

      "An action for breach of trust based on matters disclosed in a trust accounting or other written report of the trustee may be subject to a 6-month statute of limitations from the receipt of the trust accounting or other written report. If you have questions, please consult your attorney."

   b. *Harris Trust Co. of Florida v. Davis*, 668 So.2d 689 (Fla. 4th DCA 1996).

      The trustee made trust distributions on behalf of the Beneficiary. These distributions were shown on the accounting provided by the trustee along with a limitation notice. The Beneficiary brought a complaint that the distributions made on her behalf were not really distributions to her. The court held that because the Beneficiary did not bring the action within six months of receiving the accounting, the Beneficiary's claim was barred.

4. If trustee actively conceals facts supporting a cause of action, the applicable statute of limitations is extended an additional thirty years. F.S. §736.1008(6)(b).

D. Representation

1. Under F.S. §736.0301, certain individuals can represent and bind beneficiaries, provided that there is no conflict of interest.

   a. A holder of a power of appointment can represent permissible appointees and takers in default who are subject to the power, unless the holder of the power is the sole trustee. F.S. § 736.0302(1).

   b. A taker in default of a power of appointment can represent permissible appointees. F.S. §736.0302(2).

      * Representations under (i) and (ii), above, do not apply to any matter determined by the court to involve fraud or bad faith by the trustee.

   c. A guardian of the property may represent and bind the estate of the ward he represents. F.S. §736.0303(1).

   d. An agent can represent a beneficiary with regard to a specific issue. F.S. §736.0303(2).

   e. A trustee can represent and bind the beneficiaries of a trust. F.S. §736.0303(3).

   f. A personal representative may bind interested persons in an estate. F.S. §736.0303(4).

   g. A parent can represent and bind minor or unborn children. F.S. §736.0303(5).

   h. A minor, incapacitated person, unborn individual, or a person who cannot be located can be represented by another individual with a substantially identical interest, to the extent there is no conflict of interest. F.S. §736.0304

   i. The court can appoint a representative of a minor, incapacitated or unborn individual, or a person who cannot be located. F.S. §736.0305(1).

   j. The trust can specify a designated representative or the trust can appoint someone, other than the trustee, to designate a representative in the future. F.S. §736.0306.

      * A designated representative is not liable for any actions or omissions made on behalf of the beneficiary, if the

designated representative acted in good faith. F.S. §736.0306(4).

VIII. Tax Issues

A. Consider whether trust is a grantor or non-grantor trust. If the trust is a non-grantor trust or recently became irrevocable, the trustee should file a Form SS-4 to obtain an EIN for the trust.

B. If the trust was a revocable trust, the trustee should consider if it is beneficial to make a I.R.C. §645 election so that the trust and estate can file a joint tax return. Making a §645 election can provide the opportunity to use a fiscal year for income tax purposes rather than a standard calendar year.

C. If the trust owns interests in partnerships, the trustee should consider whether an I.R.C. §754 election would be appropriate.

D. S Corporation Stock

An irrevocable, non-grantor trust is not an eligible holder of S Corporation stock unless the beneficiary makes a Qualified Subchapter S Trust ("QSST") election or the trustee makes an Electing Small Business Trust ("ESBT") election. If a trust holding S Corp stock does not make a QSST or ESBT election within the appropriate time, the S Corporation status of the corporation will terminate.

1. QSST Election

a. Qualifications to make the QSST election:

(i) Only one income beneficiary;
(ii) All of the income of the trust is required to be distributed to the income beneficiary;
(iii) Beneficiary must be U.S. citizen;
(iv) Principal distributions can only be made to the income beneficiary;
(v) The beneficiaries income interest must terminate on the earlier of the termination of the trust or the death of the beneficiary; and
(vi) If the trust terminates during the life of the income beneficiary, all of the assets must be distributed to the income beneficiary.

I.R.C. §1361(d)(3).

b. A QSST election must be made within two months and fifteen days from the time the trust receives the S Corporation stock. I.R.C. §1361(d)(2)(D). Late elections are subject to IRS approval.

c. The beneficiary, not the trustee, makes the election. I.R.C. §1361(d)(2)(A).

d. The effect of the election is that the S Corporation stock is treated as owned by a separate trust, wholly owned by the income beneficiary. The income and deductions from the S Corporation stock pass through directly to the beneficiary. I.R.C. §1361(d)(1).

2. ESBT Election

a. Qualifications for ESBT election:

(i) The beneficiaries of the trust must not be any person other than an individual, an estate, or a charitable organization;

(ii) No interest in the trust was acquired by purchase;

(iii) The trust must not be a CRUT or CRAT;

I.R.C. §1361(e)(1)(A).

b. The trustee, not the beneficiaries, of a trust holding S Corporation stock makes an ESBT election. I.R.C. §1361(e)(3).

c. The election must be made within two months and fifteen days from the time the trust receives the S Corporation stock. Late elections are subject to IRS approval.

3. Time Limitations

a. A wholly owned grantor trust (i.e. revocable trust) retains permitted shareholder status for 2 years after the death of the grantor. I.R.C. §1361(c)(2)(A)(ii). If a §645 election is made for a revocable trust, such trust may own S corporation stock for the duration of the §645 election period.

(i) The election period runs from the date of death until the earlier of:

(1) the date that all assets are distributed from the electing trust and related estate, or

(2) (i) if no estate tax return is required, 2 years after the date of decedent's death, or (ii) if an estate tax return is required, the later of 2 years after the date of the decedent's death or 6 months after final determination. Final determination is generally 6 months after the estate tax closing letter is received, unless a claim for refund is filed or estate tax liability is contested.

Treas. Reg. §1.645-1(f).

b. A testamentary trust is a permitted shareholder for 2 years from the day the S corporation stock is transferred to it. I.R.C. §1361(c)(2)(A)(iii).

c. An estate is a permitted shareholder for a reasonable period of administration.

E. Generation Skipping Transfer ("GST") Tax Issues

Distributions from a trust which is GST exempt can be made to any generation of beneficiaries without GST tax consequences. If a trust is either not exempt or only partially exempt from GST tax, distributions from the trust may have serious GST tax consequences.

1. Definitions

a. Skip-Person

A person who is at least two generations below the transferor of the property. This would include grandchildren, great grandchildren, and any non-family member who is more than 37.5 years younger than the transferor. Additionally, the "predeceased ancestor rule" permits a step-up in the generation assignment of certain family members whose parent is deceased at the time of the transfer. I.R.C. §2651(e).

b. Applicable Rate

The applicable rate for GST transfers is the product of the inclusion ratio and the maximum federal estate tax rate.

c. Applicable Fraction

The applicable fraction is the amount of GST exemption allocated to the transfer divided by the value of the property transferred to the trust. For instance, if a settlor transferred $1,000,000 to a trust and allocated $400,000 of GST exemption to the transfer, the applicable fraction would be 4/10 or 0.4.

d. Inclusion Ratio

The inclusion ratio is 1 minus the applicable fraction. So in the example above, the inclusion ratio would be .6

2. EXAMPLE: Grantor establishes a trust the income of which is distributed to child and the trustee can make discretionary distributions of principal to child or the settlor's grandchild. What are the GST tax consequences of a $100,000 distribution made to the grandchild assuming a inclusion ratio of 1, .5, and 0?

a. 1 Inclusion Ratio

If a trust has an inclusion ratio of 1, then any distributions made from the trust to skip persons will be subject to the GST tax. The amount of the GST tax is equal to the value of the distribution multiplied by the applicable rate. In this case, the applicable rate would be 45% (the maximum federal estate tax).

The transfer of $100,000 to a grandchild would, therefore, result in a GST tax of $45,000. The payment of the GST tax on a taxable distribution is the liability of the person receiving the property, in this case, the grandchild.

b. .5 inclusion ratio

The applicable rate in this case would be 22.5% and the grandchild would owe $22,500 in GST tax on this distribution.

c. 0 inclusion ratio

Because the trust has a 0 inclusion ratio, the applicable rate would be 0% and no GST tax would be owed on the distribution to the grandchild.

3. Dealing with GST trusts

a. Determine the Inclusion Ratio

b. Division of Trusts

If there would be an inclusion ratio greater than 0 for a trust, before funding the trust, the trustee can divide the trusts into two separate trusts as permitted under F.S. §736.0417 so that one trust would have an inclusion ratio of 1 and the other trust would have an inclusion ratio of 0. Any distributions to a skip-person could be made from the 0 inclusion ratio trust, thereby avoiding the GST tax.

4. “Grandfathered” GST trusts

a. Transfers under a trust that was irrevocable on September 25, 1985 are generally exempt from the application of the GST tax, unless actual or constructive additions are made to the trust subsequent to September 25, 1985.

IX. End of the Trust Administration

A. Resignation of Trustee

1. A trustee may resign upon

a. 30 days notice to the qualified beneficiaries, the settlor (if living) and all co-trustees; or

b. court approval.

2. A trustee is still liable for acts taken during the trusteeship unless he is otherwise discharged from liability. F.S. §736.0705(3).

3. A trust may authorize the trustee or another named individual to appoint a successor. The trustee should make certain a successor is appointed and willing to serve before resigning.

B. Removal of Trustee

1. The trust may give certain persons the ability to remove a trustee. The removal may be either for cause or for any reason.

2. The settlor, co-trustee or beneficiary may petition the court to remove the trustee. A court may remove the trustee for the following reasons:

a. if the trustee has committed a breach of trust;

b. there is a lack of cooperation among the co-trustees which impairs the trust administration;

c. due to the unfitness, unwillingness, or persistent failure of the trustee, the court determines that the removal would be in the beneficiaries' best interests; or

d. if there has been a substantial change in circumstances or all of the qualified beneficiaries request the trustees removal and the court finds that removal is in the best interest of the beneficiaries and does not impair a material purpose of the trust.

F.S. §736.0706.

C. Delivery of Property by Trustee who has Resigned or been Removed

A trustee who has resigned or has been removed has a duty to deliver the trust property to a successor trustee. Until the property has been delivered, the trustee still has an obligation to protect the trust property. F.S. §736.0707.

D. Termination of Trust

1. Distribution of Property

The trustee has a duty to proceed expeditiously to distribute the trust property to the beneficiaries once a trust has terminated. F.S. §736.0817.

2. Final Accounting

Unless waived by the beneficiaries, the trustee has a duty to provide a final trust accounting upon the termination of the trust or the trustee's resignation. F.S. §736.0817.

E. Receipts and Releases from Beneficiaries

1. The trustee should obtain receipts and releases from all of the beneficiaries before making the final distribution from the trust. Otherwise, a beneficiary may bring a claim against the trustee and the trustee would have no source of funds with which to defend the claim.

2. A beneficiary may even consent to a breach of trust, release the trustee from liability for the breach, or ratify the transaction constituting the breach, unless either:

a. The consent, release or ratification was induced by improper conduct by the trustee or

b. the beneficiary did not know of his or her rights or of the material facts relating to the breach.

F.S. §736.1012

TRUST LITIGATION

X. Standard of Review

A. Generally

When a trustee's judgment or discretion is involved, courts will not interfere with the trustee's actions except to prevent abuse. Restatement (Third) of Trusts, §50.

B. Burden to Prove Breach

The initial burden of proof is on the beneficiaries to prove that a breach occurred which proximately caused an injury. If that is established, the burden shifts to the trustee to demonstrate that the loss or injury would have occurred absent the breach. *Fort Myers Memorial Gardens, Inc. v. Barnett Banks Trust Company, N.A.*, 474 so.2d 1215 (Fla. 2nd DCA 1985).

C. Failure to Keep Accurate Records

The trustee has a duty to keep clear, distinct, and accurate records. If the trustee fails to keep accurate records and accounts, all presumptions are against the trustee. *Traub v. Traub*, 135 So.2d 243 (Fla. 2nd DCA 1961).

D. Reliance on the Terms of the Trust

A trustee who acts in reasonable reliance on the terms of the trust is not liable to a beneficiary for a breach of trust to the extent the breach was based on the reliance. F.S. §736.1009.

E. Exculpatory Clauses

A clause in a trust relieving a trustee of liability for breach of trust is valid in Florida, but it does not relieve the trustee from acts of bad faith or reckless indifference. If, however, the trustee caused the exculpatory clause to be drafted, the exculpatory clause is invalid unless:

1. the trustee proves that the clause is fair under the circumstances, and

2. the term's existence and contents were adequately communicated directly to the settlor or the independent attorney of the settlor.

F.S. §736.1011

XI. Payment of Attorney's Fees

A. Generally

The trustee can pay reasonable attorney's fees and costs in any trust proceeding from the trust without court authorization, subject to the qualifications below. F.S. §736.0802(10)

B. Payment of Trustee's Attorney Fees When Breach of Trust Claim is Made

1. Notice to Qualified Beneficiaries

If a breach of trust claim is made against the trustee in a judicial proceeding, the trustee must provide written notice of the trustee's intention to pay attorney's fees and costs incurred in the proceeding from the trust **prior** to making any payments. The notice must be given to all qualified beneficiaries whose share would be affected by the payment of the fees. F.S. §736.0802(10)(a)

2. Court Order to Prevent Payment

A beneficiary may obtain a court order to prohibit the trustee from paying the attorney's fees and costs from the trust. To obtain the order, the beneficiary must make a reasonable showing by evidence in the record or by proffering evidence for the court to conclude that a breach of trust has occurred. The trustee can offer additional evidence to rebut the evidence of the beneficiary. F.S. §736.0802(10)(b).

a. If the court determines there is a reasonable basis to conclude there has been a breach of trust, the court will prohibit the payment of attorney's fees and costs in the proceeding, and order the refund of any fees and costs paid before the court order.

b. If the court determines there is not a reasonable basis to conclude there has been a breach of trust, the trustee can continue to pay the attorney's fees and costs in the proceeding from the trust.

3. Conclusion of the Claim

If the case for breach is withdrawn, dismissed, or resolved without a determination by the court that the trustee committed a breach, the trustee can be refunded any out of pocket attorney's fees and costs from the trust. F.S. §736.0802(10)(b).

C. Award of Attorney's Fees

In all actions for breach of fiduciary duty or challenging the exercise or failure to exercise the trustee's powers and in all actions challenging the validity or modification of a trust, the court may award attorney's fees and costs in its discretion. F.S. §736.1004. So a trustee who has been wrongly accused of breach of trust should consider requesting the court to order the beneficiary to repay the trust for the costs incurred in the litigation.
