

WHAT IS A TRUST PROTECTOR AND WHAT DOES A TRUST PROTECTOR DO?

Everyone knows that a Trust has a trustee, but did you also know that it could have a trust protector? In the past a trust protector was mostly used for foreign asset trusts since these trusts had foreign trustees and a domestic trust protector would be appointed to monitor the trustee's activity. With the increase in long term generation skipping (dynasty) type trusts, trust protectors are now more frequently appearing in domestic trusts.

Duties and Role of a Trust Protector

The trust protector's main job is to monitor the actions of the trustee and to represent the settlor's interest during the many years a trust may be in existence. The terms of the trust should be very clearly defined in the trust document. Some powers given to a trust protector may also be defined from state law (currently there are eight states that have statutes regarding the duties of a trust protector).

A trust protector's responsibilities generally fall into one of the following categories:

- ▲ Direction (trust administration, investment of trust assets, trust distributions, settle disputes between trustee(s) and beneficiaries).
- ▲ Power to consent (investment of trust assets, approve distributions, terms of power of appointment).
- ▲ Power to change (amend trust, change trust situs, delete or add beneficiaries, remove or add trustees).
- ▲ Power to veto trustee actions.

Who Should be Appointed a Trust Protector?

Since the trust protector's main job is to represent the settlor's interest in the trust, the trust protector should be someone (or entity) who is very familiar with the intent of the settlor. A corporate trustee is generally not chosen as a trust protector as they tend to be too conservative to properly represent the settlor. Options to consider include a settlor's sibling, relative, friend, or advisor who has business experience and the time needed to properly perform the required duties.

Fiduciary and Liability Issues

The determination of whether the trust protector is subject to the same fiduciary standards as a trustee may be dependent on the state statutes and/or the trust document. Under the statutes of Idaho, Wyoming and Michigan, the trust protector is considered a fiduciary and may be liable for losses resulting from a breach of fiduciary duties. In Arizona and Alaska, a trust protector is not considered a fiduciary and is not liable for its actions.

- ▲ In addition, some state statutes (Idaho, Nevada and South Dakota) protect a trustee from liability for following the direction of a trust protector. The trust document may also include provisions that the trustee will not be subject to liability for following the direction of a trust protector; however, it should be noted that this may not provide full protection.

It is recommended that the trust document clearly define when the trust protector should have greater protection and when they would be liable. However in all cases, the trust protector would be liable in the event of gross negligence and/or willful misconduct.

Potential Tax Consequences

To avoid any adverse tax consequences, care should be taken in granting certain powers to the trust protector:

- ▲ Income Tax: Be careful powers are not included that would cause the trust to be considered a "grantor trust" with respect to the trust protector, thus causing the protector to be responsible for all income taxes.
- ▲ Estate Tax: No power should be granted to the trust protector that would be deemed a general power of appointment over the trust principal to avoid inclusion of principal in the estate of the trust protector.

If you have any questions regarding the above, please give us a call. As always, it is important to consult with a financial and legal advisor before taking any specific action.

This publication is designed to present information on business, tax and estate planning matters in general terms and is not intended to be used as a basis for specific action without obtaining professional advice.

610.722.3300

866.250.5413

www.ktadv.com