
**PRACTICE DEVELOPMENT/ESTATE
SERVICES**



CPAs as Trust Protectors

Helping clients build flexibility and additional oversight into their trusts is a manageable, meaningful new niche.

by Michael B. Allmon

EXECUTIVE SUMMARY

- **Clients who want their** beneficiaries to avoid probate often place assets in trust. Many CPAs are reluctant to take on being a trustee, which is a time-consuming responsibility. An alternative is to be a third-party "trust protector" alongside a professional trustee. CPAs are highly qualified for the trust protector role because they have the client's confidence, the right skill sets, a tax background and an understanding of the client's family dynamics.
- **A trust protector has** contractual powers (described in the trust document) to assist in guiding both corporate trustees and trust beneficiaries through legal and tax complexities to realize the trustor's original intent. Using a trust protector provides an added safeguard over the actions of an appointed corporate trustee. The concept is common in offshore asset protection planning.
- **A trust protector can** generally remove and replace a trustee; terminate the trust; change the situs of administration; resolve co-trustee deadlocks or beneficiary-trustee disputes; veto investment decisions; and redirect trust distributions or amend administrative provisions and trust terms based on unforeseen circumstances in the beneficiaries' lives or changes in law.
- **Few statutes define** and regulate the role of trust protector, and only a few domestic jurisdictions recognize it (Alaska, Delaware, Idaho, South Dakota and Wyoming). There is little domestic case law to address issues such as who is checking the trust protector's powers, the trustee's role if those powers are broad, or terms of succession for the role.

■ **Because the role is not defined** in most states, there is potential legal liability. Contentious beneficiaries could argue that a protector acted imprudently or improperly. Other drawbacks to be managed include an uncertain fee structure and the always-present issue of uncertain timing.

Michael B. Allmon, CPA, a partner at Michael B. Allmon & Assoc. LLP CPAs, is the founding chair of the California Society of CPAs Estate Planning Committee. His e-mail address is mike@mbacpas.com.

Clients who want their beneficiaries to avoid the stress, expense and delay of probate often place assets in trust. Increasingly they are asking their CPAs in both public practice and industry to act as trustees. However, many CPAs are reluctant to take on the fiduciary responsibility of being a trustee for several reasons: They lack adequate infrastructure and staff for trust administration; they are inexperienced in trustee work, especially for real estate and other nonliquid assets; and they are uncertain about how to bill appropriately.

An alternative to acting as trustee is to be a “trust protector” alongside a professional trustee. This article will examine the basic definition and duties of a trust protector, offer reasons CPAs are an excellent fit for the trust protector role, describe potential pitfalls of the arrangement and their solutions, and suggest why CPAs should want to act in this capacity.

Quite a Bit of Money Out There

U.S. trust institutions held \$1.1 trillion in personal trust and agency account assets in 2005, representing 1.1 million accounts.

Source: 2005 FDIC Trust Report.

FROM PLANNING TO PROTECTION

A trust protector is a third party (neither trustor nor trustee) who has been granted contractual powers to protect the terms of a trust. The concept—relatively new for onshore trusts—is common in offshore asset protection planning. A trust protector can assist in guiding both corporate trustees and trust beneficiaries through legal and tax complexities to carry out the client’s original intent. The idea has grown in popularity in reaction to the increasingly unpredictable nature of changing law and tax policy.

A trust protector’s authority lies in the powers and duties spelled out in the trust document (the contract). When the client uses a trust protector, the main trustee becomes an excluded fiduciary in those areas in which the trust protector is empowered. Generally, trust protector powers include some or all of the following:

■ ***The ability to remove and replace a trustee.*** The most common—often the only—power of trust protectors is the ability to replace a trustee who is unresponsive to the needs of the beneficiaries or who is not performing to the standard required by the trust’s investment policy statement (IPS). The IPS outlines how the trustee is to manage the trust’s investment portfolio and addresses risk tolerance, goals and asset allocations. It should be reviewed periodically.

■ ***The power to change situs of administration.*** The situs—the trust’s legal “home,” which determines which state’s laws will apply—is an important factor in its administration. Sometimes estate planning attorneys will recommend that a trust have a situs in a state other than the one in which the trustor lives. For instance, trusts sited in California having non-California beneficiaries are subject to a complex tax formula; using another state for the situs could reduce the trust’s state income taxes. Consult the trust’s attorney when a trust situs differs from the trustor’s home state. Changes in law occurring after the trust document has been prepared also can make it advisable to move the trust situs.

■ ***The power to resolve deadlocks between co-trustees.*** This is sometimes referred to as “tie-break” power.

■ ***Discretion to veto investment decisions, redirect trust distributions or amend administrative provisions and trust terms based on unforeseen circumstances such as divorce, irresponsibility or changes in law.*** For instance, a trust protector might decide that distributions to a beneficiary who is in a temporary situation such as a divorce or credit action, or who has become drug addicted, should be modified. Changes in estate tax laws also might provide reasonable grounds for the protector to act to amend the trust document.

■ ***Ability to terminate the trust.*** This might apply when the trust is no longer large enough to warrant ongoing administrative costs and continuing it is not in the beneficiaries’ best interests. For example, I am trustee of a trust (formerly a protector of this trust) that had six beneficiaries. As each beneficiary turned 21, his or her portion of the trust was distributed. The last beneficiary is much younger than the others, so the trust might not have enough assets to cover its management costs until that beneficiary turns 21. Based on cost considerations, it would make sense to distribute the remaining funds early.

■ ***Dispute resolution between beneficiaries and the trustee.*** A trust protector who arbitrates disputes can reduce the trust’s litigation costs.

As this list shows, using a trust protector lets a trustor extend control and build flexibility into an otherwise rigid document long past the time when he or she is deceased. Such capacity makes it more likely that the spirit of the trust ultimately will be carried out, even in a changing legal, tax and economic environment.

Another benefit for the trustor is the trust’s ability to adapt terms to the changing circumstances of beneficiaries. Finally, a trust protector provides an added safeguard over the actions of an appointed corporate trustee, who may not know or understand the client’s family dynamics.

NOT A CURE-ALL

Many issues that arise with the choice of a trustee also are present in choosing a trust protector. For instance, the inherent conflict of interest between current beneficiaries and remaindermen (inheritors whose estate vests after a prior estate terminates) is not eliminated by the addition of a trust protector, no matter how sagacious the chosen party. (This is particularly true if the trust protector is also a beneficiary of the trust.) Nor is there much domestic case law to address other unresolved issues such as:

- Who is checking the powers wielded by the trust protector?
- What is the trustee's ultimate role if the trust protector's powers are broad?
- What are the terms of succession for the role?

Few statutes define and regulate the role of trust protector, and only a few domestic jurisdictions recognize the concept (including Alaska, Delaware, Idaho, South Dakota and Wyoming). To limit potential liability, research the laws of your state to ensure you fully understand the applicable laws.

WHY CPAs ARE A GOOD FIT

CPAs are highly qualified for the trust protector role because they:

- ***Have the client's confidence.*** A trust protector should be unassailably objective, especially given unresolved issues in the law and the inherent conflict of interest between beneficiary and remaindermen and between beneficiary and trustee. Clients see their CPA as a reliable, trusted adviser.
- ***Have the knowledge.*** CPAs have the education, training and experience to handle the role. Their working knowledge of a range of financial instruments can help them judge how well the trust's investment policy is being executed.
- ***Understand the clients.*** Clients want someone who is intimately familiar with the family's financial situation and long-term goals for passing wealth to the next generation. For many families that person is their accountant. Sometimes a family's CPA knows their financial situation as well or better than they do.
- ***Have a tax background.*** CPAs' knowledge of tax law puts them in a good position to determine whether changes in the law will necessitate changes to a client's trust.

Case Study

It Works Well for Me

Clients sometimes ask me to act as trustee of their estates, but based on my executor and trustee experiences, I think CPAs can best serve clients by monitoring the actions of the primary fiduciary rather than being the primary fiduciary.

In 1995, I became an acting co-trustee and executor for a client who died and left a large and complex estate, primarily in trust. My duties included everything from

ensuring two steel companies were managed efficiently (they were responsible for the section 6166 estate tax payment plan that I negotiated with the IRS), handling potential toxic contamination claims, settling document disputes, dealing with numerous tax matters (income, estate and excise taxes) and beneficiary issues (such as a claim not authorized in the documents) to the more usual activities of a fiduciary—investing and communicating to all beneficiaries.

Once the complex issues were settled, my co-trustees resigned. I remained as sole trustee. I then found a national trust company to accept all liability for any actions, to handle all matters in a trustee role, and to share the trustee's compensation with me. By our agreement I voluntarily created a trust protector role for myself and gave up all authority to act—except for the power to replace that trustee with anyone I chose, including myself. My CPA firm continued to provide tax services to the trust.

So far, I have had to replace the acting trustee twice. The first time I changed trustees because of a change due to a merger of the trust company. The second time was due to an unresponsive and difficult trustee (they were not providing timely accounting information that we needed to prepare income tax returns, nor were they meeting our investment objectives, as spelled out in the trust's investment policy statement).

I now ask my clients to have their trust documents name me as either trustee or protector. When I am named as trustee, I usually have the ability to replace myself and limit my responsibilities to the role of a trust protector.

PROTECTORS' RISKS

A trust is a contract that offers tremendous potential flexibility. Limited only by state law, the role of trust protector can take on almost any characteristic clients and their estate planning advisers can imagine. But as with nearly all new areas of practice, there are some risks for pioneers. A CPA who chooses to act as a trust protector will have to manage:

- **Potential legal liability.** Because the functions of a protector are not defined in most states, contentious beneficiaries could argue that a protector acted imprudently or improperly. Before agreeing to act as your client's trust protector, consult an estate planning attorney, research how your state views trust protectors, and find out whether your malpractice carrier will cover you in that capacity.

- ***Uncertain fee structure.*** Still-developing laws in your state may not address the issue of fees for trust protectors. A protector's fees might possibly be covered by total trustee fees where such fees are defined as "fair and reasonable." To be safe, obtain your client's agreement to add language to the trust document to ensure payment of your fees for both fiduciary and accounting services for the estate. Clients who ask you to serve will want you to be motivated to act on their behalf and to be properly paid for doing so. Weigh the potential for earnings against potential liabilities in accepting the trust protector role.

- ***Uncertain timing.*** Neither trustee nor trust protector can know when his or her service to the client will begin. During busy season a CPA would find it almost impossible to do the job of trustee; because being a trust protector is the less

time-consuming role, the CPA can still satisfy the client's wish to obtain his or her continued judgment in the disposition of the estate even in the face of uncertain timing.

» Practical Tips

To limit potential liability:

- ▶ Research how your state views trust protectors, and make sure you fully understand the applicable laws in your jurisdiction.
- ▶ Consult an estate planning attorney with knowledge of your present and potential area of practice.
- ▶ Find out whether your malpractice carrier will cover you for trust protector services.

MANAGEABLE AND MEANINGFUL

CPAs are uniquely qualified to serve as trust protectors, an engagement that offers an attractive alternative to the nearly full-time job of trustee. Performing the service in conjunction with a corporate trustee will let you serve your client's best interests and solidify the relationship. It shifts responsibility for day-to-day trust administration to another entity, yet gives you a degree of oversight.

When properly drafted within the trust document, the balance of power between the two roles can serve to best reflect the trustor's original intent well beyond his or her lifetime. The oversight of a trust protector in domestic trusts is likely to become a more common feature in years to come. CPAs are well positioned to take on the role.

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AICPA RESOURCES

Code

- AICPA Professional Standards, Code of Professional Conduct, www.aicpa.org/about/code/index.html.

Conferences

- AICPA Conference on Tax Strategies for the High Income Individual
April 30–May 1
Bellagio, Las Vegas
- Practitioners Symposium
June 4–6
Sheraton Wild Horse Pass Resort and Spa, Chandler (Phoenix), Ariz.

CPE

- CPEexpress: Estates & Taxes: Income Tax Fundamentals; Grantor Trusts (# HAP).
- Income Taxation of Estates and Trusts (# 736943JA).

Web Sites

- AICPA Personal Financial Planning Center, <http://pfp.aicpa.org>.
- AICPA Professional Ethics Division, www.aicpa.org/members/div/ethics/index.htm.

For more information or to make a purchase, go to www.cpa2biz.com or call the Institute at 888-777-7077.

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