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## INSIGHT: Trust Protector Planning—Key Considerations



BY JEFFREY S. LEVIN

Today, many high-net-worth families use discretionary trusts to hold their family's assets for centralization of management and administration; asset protection planning; confidentiality; income and transfer tax planning; and multigenerational transfer planning purposes. Often, family leaders are reluctant to relinquish direct control over the family's assets to an independent corporate fiduciary because of a concern that the trustee may not act in accordance with the family's goals and ownership considerations. The concept of a "trust protector" has developed and is now often used to provide the family leader(s) a degree of control over the administration of the family's trust without losing many of the advantages provided by the trust ownership structure.

The following discussion addresses several of the issues that a family leader should consider in the selection of a trust protector and a determination of the responsibilities and authority of the designated trust protector. A trust protector could either be an individual or a separate legal entity.

### ***Separation of business and investment decision making from family-related decision making***

The trust protector, unless the protector's relationship originated from the family business, should not be involved in the business decision making and management of the family business or family investments. The family business and family investments should be the responsibility of professionals hired for these services. The trust protector as a family representative could have a role in the overall supervision of the business and investment professionals and their hiring and fir-

ing, but the operating decisions should be made by those professionals.

### ***Compensation of the trust protector***

The trust protector (unless the protector is a family member or already has a position with the family business), investment company or family office should be appropriately compensated for services as the protector. Compensation alternatives could be either or a combination of a fixed annual amount, an hourly or daily *per diem* rate, or a stated or graduated percentage of an objectively determined value of the family business or family investments. Alternatively, if the protector provides professional services to the family, such as acting as its lawyer or the family's accountant, the professional could receive the professional's hourly rate payable to the protector's professional firm in lieu of a separate protector fee. In addition, if the protector would be assisted by other professionals, affiliated either with the protector's firm or by independent third-party advisors, there should be an understanding of how those professionals are to charge for their services or otherwise be compensated.

For example, for lawyers affiliated with the family's current law firm, that firm's normal or previously agreed upon hourly rates would be appropriate. For third-party advisors, an appropriate fee should be set. The protector should be reimbursed for reasonable expenses and disbursements incurred in connection with its performance of the protector's services or responsibilities, or such expenses could be paid directly by the family business or family office. Such expenses should include travel and related expenses to attend family—or business-related meetings and appropriate legal and administrative fees incurred by the protector. If these expenses would not be paid or reimbursed, the protec-

tor's compensation should include a provision for projected expenses.

### ***Fiduciary considerations***

A trust protector could be or not be considered a fiduciary. It is important that the protector's status is clearly defined. If the protector is not a fiduciary, then the protector's powers would be considered as personal powers of the protector. As a fiduciary, the protector must act in the best interests of the family members/trust beneficiaries and may not take any action or make a decision that would be in the best interests of the protector. If the fiduciary fails to act appropriately, the protector could be liable for a breach of fiduciary duty.

In the case of a protector who does not have any interest in the family business or trust, this is generally not an issue. It is probably preferable for this protector to be considered a fiduciary so there is a recognized standard for appropriate conduct and decision making. In the case of a protector who is a member of the family or might have family members who are trust beneficiaries, this is a more significant consideration. In that case, if the protector is a fiduciary, the protector should not make a decision that could favor the protector or the protector's family to the disadvantage of or adverse to other interested persons.

### ***Indemnification***

A protector could be indemnified for personal liability or a breach of fiduciary claims by the terms of the operative instrument, such as the trust agreement or family office formation documents. In addition, the family office or the trust could maintain appropriate insurance to cover such claims, including legal fees to defend the protector against such claims. On the other hand, there probably should be some limit on the extent of the indemnification. For example, in some cases, gross negligence, willful misconduct or illegal or criminal conduct should not be covered by an indemnification provision.

Also, if the protector decides to obtain the protector's own personal liability coverage, the premiums should be paid or reimbursed by the family office or trust. If not, the protector's compensation should include the projected cost of this policy. If the protector is a lawyer or an accountant, the protector should also determine to what extent, if any, the lawyer's or accountant's professional malpractice insurance coverage would cover the lawyer's or accountant's activities as trust protector, while also serving as a partner of the firm providing legal services.

### ***Responsibilities***

The trust protector's responsibilities could cover a broad range of issues and decision making or be extremely limited in scope. As a practical matter, the family and business reasons for the consideration of a trust protector should serve as a guide for the identification of the protector's responsibilities. The protector's responsibilities could include one or more of the following:

- Power to remove and replace the trustee
- Power to amend the trust

- Power to add or delete beneficiaries
- Power to decant the trust
- Power to change the situs and governing law of the trust
- Power to terminate the trust
- Power to consent to or veto trust income and/or principal distributions
- Power to appoint successor protector
- Power to direct the vote with respect to certain business or investment decisions
- Power to approve the hiring and/or firing of senior business or investment officers

In the event that more than one person serves as protector, procedures should be established that identify if any particular power could be exercised by one of the protectors, by a majority of the protectors or by the unanimous vote of the protectors. If there is a dispute among the protectors, there should be some guidance as to how to resolve the dispute—mediation, arbitration or court action.

In addition, the operative documents should clearly establish that the protector has an unrestricted right to confidential and proprietary family and business information, so the protector has the necessary and appropriate information to make its decisions.

### ***Appointment and removal***

The operative documents should identify how the initial protector or protectors are to be selected, or simply state who will be the initial protector. Once the protector is identified, the operative documents should also identify how and when a protector could be removed from that position. For example, could the majority of adult trust beneficiaries vote to change protectors? Also, there should be criteria to determine if an individual protector no longer has the mental capacity or physical ability to continue to perform the role and responsibilities of protector. The operative documents should also address what happens upon the resignation or death of a protector.

### ***Successor***

In connection with the appointment and removal of a protector, there should be an appropriate procedure for the appointment or designation of a successor protector and an alternative procedure if the designated person refuses to accept the appointment or is otherwise unavailable. Frequently, a protector is responsible to designate that person's successor. Query whether the operative documents should provide appropriate selection criteria or whether the decision should rely solely on the good judgment of the current protector. In addition, there should be a provision to address the consequences if the current protector for some reason fails or refuses to designate a successor.

### ***Personal tax considerations of the protector***

The operative documents could provide an individual protector with significant powers and control over the family/trust assets. The degree of control could present personal tax issues for the protector if the protector could be deemed the beneficial owner of these assets. A

protector should review the proposed powers and confirm that the protector would not have any adverse personal tax consequences or adverse tax consequences in the jurisdiction where the assets are located.

### **Conclusion**

The selection and the extent of the authority of a trust protector could have significant future consequences for family trust beneficiaries. Professional guidance is recommended to address and resolve the above issues that best protects the family's interests, as well as pro-

vides the appropriate procedures for the selection of current and successor trust protectors.

*This column doesn't necessarily reflect the opinion of The Bureau of National Affairs Inc. or its owners.*

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