strategies

Should My Spouse Be A Trustee?

The choice of naming a successor trustee is one of the most important decisions confronting an estate planning client. Many clients hastily name their spouses as the first successor trustee without considering the ramifications of that decision. Who is the best or most ideal trustee may change during one's lifetime and flexibility needs to be built into their estate plan in order to accommodate any change in circumstances.

Should one trustee, or two or more co-trustees, be designated to serve if you are not able to act in that capacity? Should you name an individual, or a bank or trust company, or both? Other clients fail to consider their spouse's ability and preference to serve as trustee, as well as the uncomfortable situation of having to ask someone else to be able to access or spend what the spouse considers to be their own money. The type of trust, the lack of creditor protection, the tax consequences and limitations on the spouse when serving as a trustee all need to be carefully considered when naming a trustee.

Spouse Can Hire Expertise

When considering naming one's spouse as trustee, many clients have doubts about their spouse's ability to make proper investment decisions. When you consider that the spouse can continue to use the same trust or investment advisor who had been serving during one's lifetime or can select different or additional advisors if the need arises, this may not be as big of a concern as first feared. Of course, if your spouse is not financially responsible or has Alzheimer's, dementia or has a gambling, drug or alcohol dependency, you should refrain from naming them as successor trustee. In the majority of cases, the reluctance is the fear that the spouse has little financial experience and may be burdened by having to make investment decisions. Keep in mind that investment advice can be hired at a very reasonable price and that the advisor's compensation can be set based upon performance. The spouse trustee can hire a myriad of legal, tax and financial advisors who can advise on both trust and investment matters.

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Family managed trusts frequently under-perform professionally managed trusts, so one needs to make sure that the spouse understands the importance of selecting a qualified advisor versus an inexperienced child or sibling who does not have the experience and knowledge to make proper decisions concerning investments, payment of expenses, as well as the handling of beneficiaries' requests for money. In addition to selecting proper trustees, one should also include guidelines to help the trustee determine who they should be consulting with or how they should be administering the trust. The lack of guidelines will increase the likelihood that a beneficiary may claim that the trust has been improperly managed and seek to recover losses from the trustee. This tends to arise most often with second marriages, when the children are from a prior marriage or when a trustee continually ignores either the current income beneficiary (spouse) or the remainder beneficiaries (children).

Tax Concerns

Many advisors fail to even consider the spouse as a trustee due to the tax complications which may result in trust assets being taxed twice, once in the first spouse's estate and a second time at the death of the spouse-trustee due to the spouse's retention of too much control. This is seldom a necessary concern because tax issues with a spouse-trustee can normally be avoided with careful drafting of the trust agreement, even when the spouse is named as a beneficiary. Properly drafted, the trust assets will not be included in the spouse's taxable estate as long as ascertainable standards are used to limit the spouse's ability to distribute trust income or principal to themselves. The ascertainable standard "safe harbor"

limitations of health, education, maintenance and support (HEMS) were established by the IRS. The trustee spouse should also not have the power to satisfy their legal obligations with trust assets. This can be avoided when the trust is drafted by precluding this type of distribution or by using co-trustees so that the other trustee will be in charge of distributions made to the first trustee.

Every trust agreement should contain language to protect the spouse, if he or she may at some time serve as a trustee, in order to avoid any estate tax inclusion problems. If a family has minor children, the trust should also prohibit the surviving spouse from making distributions to the children which may discharge that spouse's support obligations.

Certain types of trusts require more careful planning and dictate that perhaps the spouse should not serve as a trustee of tax-sensitive trusts. This concern will arise whenever a trust owns life insurance on the spouse's life or on the lives of both spouses. In this situation, if the spouse is serving as the trustee, they will be deemed to have certain incidents of ownership over the life insurance policies held by the trust which could result in the inclusion of the life insurance in the trustee's estate for estate tax purposes. The spouse should even refrain from serving as a co-trustee unless the trust agreement clearly and unequivocally provides that the spouse has no authority or power relating to the life insurance policy. Most of the time the risk of having to pay thousands of dollars of taxes on otherwise estate-tax-free life insurance owned by the trust is not worth naming the spouse as a trustee for these type of trusts.

Another concern with naming a spouse as trustee of an irrevocable trust is what happens in the event of a divorce. Do you really want an ex-spouse to be the trustee of your irrevocable trust?

Estate Planning Trusts

For the garden-variety estate planning trust, naming a spouse as trustee will certainly permit spousal control over all trust assets and will provide the maximum flexibility for any spouse who is comfortable undertaking such a responsibility; however, you may still want to name a bank, trust company or corporate fiduciary as a co-trustee or backup trustee.

For Further Information on Estate Planning or Asset Protection Strategies, Please Contact:

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