



An Independent Delaware Trust Company



Choosing a Fiduciary

It's well known that a directed trust offers a number of benefits over the traditional model of one fiduciary making all decisions involving the trust. With a directed trust, the fiduciary duties are bifurcated, thus allowing the settlor to delegate each fiduciary role to the best person or entity to handle that role. However, utilizing a directed trust presents some challenges due to the inherent problems of coordinating multiple fiduciaries. For this reason, settlors and their advisors should dedicate a great deal of time and effort selecting an experienced directed trustee who possesses the skills needed to keep all of the "moving parts" working in harmony. Unfortunately, settlors and their advisors sometimes fail to dedicate the same amount of time in selecting the trust's other fiduciaries. This oversight can derail an otherwise well thought-out estate plan, potentially costing the settlor or trust both time and money.

Advisors sometimes fail to realize that the persons who are selected to serve as fiduciaries can cause tax results that differ dramatically from those that they anticipate. Imagine if you will Joe, a US settlor, who wants to establish a directed US "sprinkle" trust for his descendants using a directed Delaware trustee. Believing that he should not pay income taxes on assets of which he has divested himself, Joe has decided that the trust should be a non-grantor trust. Seeking someone that he trusts to serve as the distribution fiduciary for his trust, Joe appoints his brother, who is a Canadian resident and citizen. Unfortunately for Joe, because his brother is both a related or subordinate party (as defined in I.R.C.

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Prior to joining CTC, Peter worked as an associate at several law firms in the Philadelphia area, concentrating on estate and tax planning, estate and trust administration, fiduciary litigation, personal and fiduciary tax matters, and business transactions.

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§672) and a foreign person who will be making “substantial decisions,” Joe’s trust is not a US trust taxed as a complex trust; instead, it is a foreign grantor trust. Shocking as it sounds, this type of scenario happens all too frequently.

The above demonstrates how a seemingly innocuous choice of a fiduciary is actually an important one that can dramatically change the landscape of how both the trust and the settlor are taxed. In the above example, because Joe’s brother is a “related or subordinate party” Joe now is responsible for paying some, if not all, of the trust’s income taxes. Because Joe’s brother is foreign, the trust is not a US trust and, depending on the situation, may result in additional costs to the trust, the beneficiaries or Joe due to additional reporting requirements, a deemed sale under §684 (if it were not a grantor trust), and the “throwback rules.” In an alternative scenario, if Joe’s brother was a US person but lived in one of the many states that impose trust income taxes based upon the residency of the trustee, the trust would now be responsible for unanticipated state taxes that would not have otherwise occurred. These are just a small sampling of some of the unfortunate issues that may arise if care is not taken in selecting a fiduciary; issues that are all the more unfortunate given the fact that they are easily avoided with a little time and thought. When a settlor establishes a trust they are investing their time and money with the expectation that they will achieve a particular result. Notifying them that, due to a careless oversight, they not only “did not get what they paid for,” but may also incur additional costs, is a conversation that no adviser wants, or should need, to have.

Commonwealth Trust Company is well known for its skill at serving as a directed trustee. What many people may not realize is that Commonwealth’s employees are also highly skilled at identifying problems like the ones set forth above, and often do so before they become actual problems. There have been numerous occasions where our employees have provided guidance to our clients and their advisors about the ramifications of selecting a certain fiduciary, guidance that resulted in a thankful advisor and a happy client. Our employees are skilled and knowledgeable in all aspects of trust administration and their ability to put these attributes to use when working with clients and their advisors is just one of the countless reasons [why Commonwealth Trust Company](#) should be your first, and only, choice to serve as your directed trustee.

Commonwealth Trust Company is pleased to provide this article as a guide. Commonwealth Trust Company is not engaged in the practice of law and is not providing legal advice by the provision of these materials. Commonwealth Trust Company recommends that clients seek the opinion of their attorney regarding the specific legal and tax issues addressed in this article.