

# To Be Or Not To Be? ... A *Fiduciary*

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*Often there is an inherent conflict of interest between the fiduciary's interests and the beneficiaries' interests.*

To be or not to be a fiduciary—that is the question. Should you, as an attorney, serve as a fiduciary for your clients? If not, whom will you advise your client to name as the fiduciary?

Determining who should serve as a fiduciary is complex. Legally, any “natural person” can serve as a trustee, personal representative (i.e. executor or administrator), guardian or conservator, or in any other fiduciary capacity.<sup>1</sup> Banks or trust companies authorized to do business under Virginia law can serve as fiduciaries, as well as professional law corporations.<sup>2</sup> However, the more critical issue is not who *can* serve as fiduciary but who *should* serve as fiduciary. *Black's Law Dictionary* provides insight into the characteristics and duties of a fiduciary. It defines a fiduciary as “a person having duties involving good faith, trust, special confidence and candor towards another.”<sup>3</sup> Moreover, fiduciary duty is defined as “the highest standard of duty implied by law.”<sup>4</sup> It is a duty that demands subordination of

“one's personal interests to that of the other person.”<sup>5</sup>

A competent fiduciary must have the temperament, skills and accounting support needed to put the interests of the beneficiaries first and to deal with the myriad details involved in performing his or her fiduciary duties. This article will examine the temperament, skills and accounting support a competent fiduciary needs so that you as an attorney can assess who should fill this role on behalf of your client.

## Temperament

Why is temperament important to consider in appointing a fiduciary? Not everyone has the right temperament and nature required of a fiduciary. It is important that the client appoint a fiduciary who is capable of putting the beneficiaries' interests before his or her own interests and has the commitment to carry out the many responsibilities demanded of a fiduciary.

### **Conflicts of Interest and Family Relationship.**

Often there is an inherent conflict of interest between the fiduciary's interests and the beneficiaries' interests. The fiduciary must make sure that decisions made on behalf of the beneficiaries are in the best interests of the beneficiaries, not in the best interests of the fiduciary. Personal circumstances, self-centeredness, greed or the bottom-line, profit-driven corporate world we live in often make it difficult to put the beneficiaries' interests first. The person or organization must make a conscious decision that personal or corporate goals will not interfere with the beneficiaries' best interests. Therefore, your client must consider whether the potential fiduciary is capable of this kind of behavior.

Because of the profit-driven realities of corporate life, it is often very difficult to find a corporate fiduciary that can overcome some of the inherent conflict of interest issues. For example, a bank or trust company serving as fiduciary might have a difficult time firing its own investment department for poor investment performance, even if the trust officer is absolutely convinced that it is in the best interest of the beneficiaries to change investment advisors. There are many individuals who work for banks or trust companies that have the basic nature required of a fiduciary, but the corporate environment may stifle the individual's ability to act in accordance with what he or she believes to be in the best interest of the beneficiaries.

If the client is considering naming an attorney or law firm as fiduciary, the attorney must deal with the ethical issues involved when the attorney drafts the document that names the attorney or law firm as the client's fiduciary. Did the attorney act in the best interest of the client when naming the attorney or law firm as the fiduciary, or did the attorney exert undue influence over the client in order to secure the appointment as the fiduciary? The primary legal ethics opinion regarding this issue concludes that an attorney can draft a document naming the attorney or the law firm as the client's fiduciary even in cases

where there was no pre-existing attorney/client relationship.<sup>6</sup> The attorney, however, must take care in considering the client's mental and physical health before soliciting or accepting future employment as a fiduciary.<sup>7</sup> The attorney must also fully disclose to the client the potential fees the attorney or law firm will charge when serving as the fiduciary and suggest that the client investigate and compare the potential fees of others who serve as fiduciaries.<sup>8</sup> The best interest of the client can only be served when the client is fully informed of the responsibilities and duties of the fiduciary in his or her particular circumstances and of all the options available in choosing a person or organization to fulfill those responsibilities and duties. Perhaps most important, the attorney or law firm must carefully consider whether it is competent to serve as a fiduciary before allowing a client to name the attorney or law firm as fiduciary.

Appointing a family member or friend has unique conflict considerations. The client needs to consider whether appointing a family member or friend will create tension or antagonism among family members and other beneficiaries. Appointing a family member or friend sometimes intensifies destructive family relationships and creates distrust and animosity among the family members. This happens when a client is in a second marriage, has children from a prior marriage and names the new spouse or children as fiduciary of the estate or trust. It can also be true in families who have more than one child of the same marriage.

### **Subordination of Personal Interest to Best Interest of Beneficiaries.**

Whether the fiduciary is a family member, a friend, an attorney or an organization, subordinating the fiduciary's interest to that of the beneficiary's requires a special kind of person or organization. A fiduciary must have the heart of a servant who enjoys dealing with people and a willingness to get involved in unfamiliar situations. All of this takes a person with a special confidence in his or her own abil-

ity to solve problems and work with different people. Serving as a fiduciary often requires interacting with professionals in many different fields (i.e., financial, medical, spiritual, etc.) and coordinating their efforts to solve problems that may arise. Unfortunately, many fiduciaries lack this confidence and are often more inclined to assume the role of a "boss" with an agenda to fulfill rather than a "servant" willing to fulfill the wishes and solve the problems of the "master."

In subordinating personal interest, the fiduciary must be able to "step in the shoes" of the person who appointed him or her and to carry out the wishes and intentions of that person regardless of his or her own circumstances. When you step in the shoes of another person as fiduciary, you must be prepared to deal with the problems and opportunities confronted by that person in his or her daily life. A fiduciary may need to attend to various personal needs, such as shopping or going through years of accumulated personal effects and financial papers to decide what should be kept or discarded. On the other hand, a fiduciary may need to manage the investments for unsophisticated or inexperienced beneficiaries and assist them in managing their financial or business affairs. Though family members or close friends are most likely to understand the personal intentions and preferences of the client, they may have a difficult time separating the personal or family relationships from their fiduciary responsibilities. Also, family members or friends may not have the skills or time to manage the financial and business affairs of the client.

In addition to having the heart of a servant and the ability to step in the shoes of another person, a fiduciary must have the strength of character to do what is in the best interest of the ward in a guardianship or conservatorship, or beneficiaries of a trust or estate, regardless of the pressure applied to do otherwise from the ward, the beneficiaries or the fiduciary's loved ones. The fiduciary is constrained to act in accordance with the terms of the document or the court order under which he or she was appointed, except where it is

deemed impossible or illegal. This can be difficult when a ward or beneficiary is unhappy with the terms of the document or court order or is just an unhappy person, generally. Nevertheless, the temperament of a fiduciary cannot be shaped by the temperament of the beneficiary. It

### **Experience is the finest teacher.**

Having access to an experienced fiduciary is important when naming an individual—whether family member, friend or attorney—who has never or only occasionally served as a fiduciary. If probate is required,

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does not matter if the beneficiary is rude, inconsiderate or demanding. The fiduciary is required to act in good faith, with patience and understanding. That may require “tough love” or gentle persuasion depending on the particular circumstances.

Though the client may be fortunate enough to have someone with the right temperament to serve as fiduciary, that person or organization must also have the skills and accounting support necessary to carry out the fiduciary responsibilities. Finding the right person or organization with all three attributes is much more challenging.

### **Skills**

What skills are necessary to be a competent fiduciary in Virginia? A competent fiduciary must understand and apply the necessary federal and Virginia statutes regarding fiduciary responsibilities and duties; must understand fiduciary investment and accounting responsibilities; must understand fiduciary income tax and estate tax issues; and must be able to organize and keep track of a myriad details.

being familiar with the various people and offices involved in the probate process will enable the fiduciary to be more efficient in fulfilling his responsibilities.

A fiduciary requiring court appointment (i.e., executor, trustee under the will, guardian, etc.) must deal with the various court officials and meet filing and reporting deadlines. It helps if the fiduciary knows the probate clerk and the Commissioner of Accounts and has experience in complying with their particular requirements. The personal relationships developed over time—not only with officials but also with other experienced fiduciaries—can be relied upon to help solve unusual problems. An experienced fiduciary is more likely to know what is required to solve problems and whether approval of the court or some court-appointed official is necessary. When a person or organization has had the opportunity to serve in many different fiduciary capacities, that person or organization is more likely to be able to address the unique circumstances that inevitably arise. Experience is the finest teacher in becoming a skilled fiduciary.

### **Understanding and Applying the Necessary Federal and Virginia Statutes**

No matter how many years of experience the fiduciary may have, there will always be something new to consider and address, either because a statute has changed or the circumstances of the particular situation are different. Therefore, the fiduciary must not only understand and apply the current Virginia statutes regarding fiduciary responsibilities and duties, but must be skilled in interpreting and learning new laws and applying them to the particular circumstances under which the fiduciary serves. A prime example of this can be found in the statutes regarding fiduciary investing and accounting.

### **Virginia’s Uniform Prudent Investor Act and Uniform Principal and Income Act**

When Virginia enacted the Uniform Prudent Investor Act (UPIA)<sup>9</sup> and the Uniform Principal and Income Act (UPAIA),<sup>10</sup> the investment and accounting duties of the fiduciary were more precisely defined and codified. The prudent investor rule, however, is a default rule and the provisions of the trust may expand, restrict, eliminate, or otherwise alter the investment powers and responsibilities of the fiduciary. Nevertheless, waiver of the prudent investor rule must be expressly manifest in the trust. This can be done by making reference to the prudent investor rule, or by granting the trustee powers to make speculative investments or to hold or acquire a specific asset.<sup>11</sup>

The UPIA was written under the auspices of modern portfolio theory that sets forth the view that investments should be balanced between the risk tolerance of the individual trust and the potential return. It promotes a total return approach to investing that allows the fiduciary to balance the often conflicting needs of the different beneficiaries. Under the UPIA, no investments are *per se* imprudent as long as the assets meet the objectives of the particular trust. In fact, true to Virginia’s reluctance to

dispose of outdated statutes, the investments specifically authorized by the Virginia legal list are still included under the UPIA as prudent investments.<sup>12</sup> Most financial experts would agree, however, that using this list of investments as a guideline would not be in the best interests of the beneficiaries. Diversity, not only in the type of investments (i.e., equities, bonds, cash equivalents, real estate, etc.), but also in the different subclasses of any particular type of investment, is a key component in reducing risk and achieving the highest overall portfolio performance.

The UPIA requires the fiduciary to exercise reasonable care, skill and caution in investing the assets of the trust in a way that conforms to the terms and purposes of the individual trust. The good news under the UPIA is that the fiduciary is no longer held responsible for the performance of individual investments but for the overall performance of the portfolio. The bad news is that the fiduciary can no longer blame poor investment performance on prior investment restrictions.

The duty of loyalty and impartiality under the UPIA demands that the fiduciary invest and manage the assets under the fiduciary's control solely in the interest of the beneficiaries.<sup>13</sup> Once again, this skill requires the ability to subordinate personal interests to the best interests of all the beneficiaries. Unless otherwise directed in the document, the fiduciary must balance the investment needs of the current income beneficiaries and those of the remainder beneficiaries. The income beneficiaries' demand for income and the remainder beneficiaries' demand for growth can often put the fiduciary in a "no win" situation. The power to make an equitable adjustment between income and principal, given to the fiduciary in certain circumstances as defined under the UPAIA,<sup>14</sup> enables the fiduciary to invest for total return and still comply with the duty of impartiality when there are beneficiaries with conflicting investment needs. Nevertheless, there are prerequisites the fiduciary must meet under the UPAIA before making adjustments between income and principal, and there are

numerous exceptions where a fiduciary cannot make adjustments.

Because fiduciary investing usually requires highly specialized knowledge that is beyond the capability of most fiduciaries, the UPIA allows for the delegation of investment and management functions to an agent.<sup>15</sup> This is particularly important for individual fiduciaries and law firms who are not professional investment advisors. The right to delegate this responsibility is new in Virginia, and in most cases individuals and law firms serving as fiduciaries should exercise this right to delegate investment management to a professional investment advisor. The right to delegate, however, cannot be construed to allow the fiduciary to simply walk away from the investment oversight responsibility. The fiduciary must exercise care in selecting an agent and must periodically review the agent's performance to assure that it is consistent with the purposes and terms of the trust.

The competent fiduciary must also understand concepts of fiduciary accounting that allocate assets into categories of either income or principal. The UPAIA defines what is considered income and what is considered principal and directs what expenses are chargeable to income and what expenses are chargeable to principal. Understanding the difference between income and principal and what is charged to each category is important to the fiduciary when he or she has different beneficiaries entitled to income and to principal. Mistakes in properly allocating receipts and expenses to income or principal can be very costly and can subject a fiduciary to potential liability.

### **Fiduciary Income Taxes and Estate Taxes**

A competent fiduciary must also understand federal and Virginia fiduciary income tax and estate tax issues. This often involves highly technical knowledge that can have a dramatic impact on the administration of an estate or a trust. Proper tax planning—during a client's lifetime and

after a client's death—provides financial benefits to the client and to his or her beneficiaries.

The federal and state laws regarding income taxes and estate taxes are often complex and subject to change. Keeping current on these taxes and their impact on fiduciary responsibilities can be daunting. Most individuals, including attorneys who do not specialize in fiduciary income tax and estate tax matters, must seek expert help. It is vital that this assistance is sought in a timely manner. The penalties for late filing and late payment of taxes can be substantial.

Moreover, it is important to find experienced professionals who prepare fiduciary income tax returns and estate tax returns as a routine part of their practice. Most estates and trusts (except grantor trusts during the grantor's lifetime) are required to file fiduciary income tax returns. A separate tax identification number must be applied for by the estate or trust. The knowledge necessary to prepare fiduciary income tax returns is entirely different than that required to prepare other income tax returns. Costly mistakes are often made in filing fiduciary income tax returns because the individual or firm preparing the returns is not experienced in the area of fiduciary income tax law. A fiduciary is personally responsible for the filing of these returns and payment of taxes and, therefore, should exercise extreme diligence in assuring the proper preparation of these returns and payment of taxes.

Preparation of estate tax returns also requires very specialized knowledge and skill. Simply identifying whether an estate tax return, federal or state, is required to be filed requires a comprehensive understanding of the decedent's assets and how they are titled, as well as knowledge of the current federal and state estate tax laws. Assembling the information required to file the returns and computing the tax can be a time consuming and complex process. Because the executor, administrator or any person in actual or constructive possession of the decedent's assets, is personally liable for the payment of estate

taxes, it is very important that whoever prepares the returns is experienced and knowledgeable in this very specialized area of tax law.

### Organizational Skills

In order for the fiduciary to fulfill all of these various and complex responsibilities, the fiduciary must have the ability to organize and keep track of a myriad details. Organization is not a skill that all individuals or organizations naturally possess. As with most skills demanded of a fiduciary, organization requires a certain mind set and temperament. The fiduciary must be able to assemble information in a manner that is useful and efficient, and avoid procrastination in gathering information, solving problems and tracking and meeting deadlines. If a fiduciary does not have a natural ability to organize and track the details required for accurate preparation of fiduciary accountings and fiduciary income and estate tax returns, the fiduciary will become frustrated and may not be able to fulfill his or her responsibilities.

This is the reason that many attorneys and law firms do not practice in the area of estate or trust administration. Fiduciary work is very labor intensive and requires time and attention to administrative details that many find tedious and frustrating. Because of this, it is important to confirm whether the potential fiduciary has not only the proper temperament and skills, but the accounting support necessary to track all the information required to fulfill the responsibilities of a fiduciary.

### Accounting Support

Having the proper accounting support is the last piece of this rather complex puzzle. This is particularly true if the individual or organization serves as fiduciary for multiple clients, or for complex estates or trusts. If a family member or friend serves as fiduciary in a single, uncomplicated case and possesses the necessary traits to be a competent fiduciary, he or she may be able to fulfill his or her fiduciary duties without much accounting support.

If an individual or organization serves as fiduciary for multiple cases, or for complex estates or trusts, the fiduciary will be required to accumulate and track a significant amount of information and produce accountings and income and estate tax returns. This task is very difficult without the assistance of sufficient well-trained staff and appropriate computer software programs. The fiduciary should research the various computer software programs available to assist in the preparation of accountings, estate tax returns, gift tax returns and fiduciary income tax returns.<sup>16</sup> Preparation of fiduciary income tax returns is very different from the preparation of other income tax returns. There is software specifically designed for fiduciary income tax returns, estate tax returns and gift tax returns. Utilizing the appropriate software programs will enhance the efficiency and accuracy of the fiduciary and maintaining an experienced, well-trained staff will add to the overall level of competency of the fiduciary.

### Fiduciary Compensation

Virginia law authorizes "reasonable compensation" for fiduciaries. This "reasonableness" standard can be difficult to interpret because the meaning of "reasonable" can vary depending on the circumstances. There is no particular fee schedule a fiduciary can depend on to meet this standard. Executor's fees and attorney's fees charged in a probate estate are subject to the approval of the commissioner of accounts, as are the trustee's fees and attorney's fees charged to trusts under wills. Furthermore, what the various commissioner of accounts in Virginia consider reasonable varies from region to region. Most commissioners start with a five percent one-time fee for executors and administrators. Usually the percentage decreases as the total value of the estate assets increases. In addition, most commissioners will allow trustees under a will, as well as guardians or conservators, an annual fee that starts at one percent of the market value of the assets with the percentage decreasing as the total value of the assets increases, plus five percent of receipts collected during the accounting

period (usually excluding capital gains). This can also vary from region to region. Therefore, it is always wise to check with the local commissioner of accounts' office.

Banks and trust companies usually have published fee schedules. However, if the bank or trust company is serving as a fiduciary subject to court appointment (i.e., executor or trustee under the will), the will must include language that allows the bank or trust company to be compensated in accordance with its published fee schedule. If the proper language is not included in the will, the bank or trust company will be subject to whatever fees the commissioner of accounts considers reasonable. The same would be true for attorneys and law firms serving as fiduciaries subject to court appointment. Your client should be encouraged to investigate and compare the fees of the fiduciary he or she is considering naming with those fees of other professional fiduciaries performing similar services in the local area. However, the cheapest or the most expensive is not necessarily a good indicator of the best choice. Consideration must also be given to the quality of the fiduciary services rendered.

### Conclusion

Determining whether "to be or not to be a fiduciary," or advising a client on whom to appoint as a fiduciary, can be a complex undertaking. Whether the potential fiduciary is a family member or friend, attorney or law firm, or bank or trust company, it is a significant responsibility. The ability to put another's interest before one's own requires the heart of a servant and great strength of character. Attention to details is critical and procrastination can be costly. The skills necessary to be a competent fiduciary are technical and specialized. Much of what is required cannot be learned from a book. It comes from the experience of dealing with different people in a fiduciary capacity over many years. Serving as a fiduciary in multiple situations requires much accounting support to produce the necessary fiduciary accountings and fiduciary income tax and estate tax returns.

To be a fiduciary is to assume the highest standard of duty implied by law and to carry out those duties in good faith and with trust, special confidence and candor.<sup>17</sup> It is an exciting and challenging experience that is always evolving and never stagnant. Changes in the responsibilities of the fiduciary are inevitable and should be seen as opportunities, not as problems. All of this demands careful consideration in order to choose the person or organization that can truly be a competent fiduciary. Any person or organization that considers serving as a fiduciary needs to make a thorough inventory of his or her or its own abilities and characteristics to make sure that person or organization has what it takes to be a competent fiduciary.

To be or not to be a fiduciary is an important question. How will you advise your client? 🍷



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Endnotes:

- 1 *Va. Code* § 6.1-5.
- 2 *Va. Code* § 13.1-546.1.
- 3 *Black's Law Dictionary* 625 (6th ed. 1990).
- 4 *Id.*
- 5 *Id.*
- 6 *Va. L.E.O.* 1515.
- 7 *Id.*
- 8 *Id.*
- 9 *Va. Code* § 26-45.3, et seq.
- 10 *Va. Code* § 55.277.1, et seq.
- 11 *Va. Code* § 26-45.3 B.
- 12 *Va. Code* § 26-45.3 A.
- 13 *Va. Code* § 26-45.7.
- 14 *Va. Code* § 55-277.4.
- 15 *Va. Code* § 26-45.10
- 16 Fiduciary accounting and tax preparation packages currently on the market include: West Group Estate Practice Systems for Windows by Thomson West ([www.west.thomson.com](http://www.west.thomson.com)); Fiduciary Practice System (formerly Zane Software) by Thomson Fast-Tax ([www.fasttaxtrust.com](http://www.fasttaxtrust.com)); Selden Integrated Systems, Inc. (formerly Probate Software) ([www.probate-software.com](http://www.probate-software.com)); and ACTEC Trust and Estate Accounting Package for Quicken ([www.actec.org](http://www.actec.org)).
- 17 *Black's Law Dictionary* 625 (6th ed. 1990).