



Selecting the Right Trustee and Role of Trust Protectors within the Trust World

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Jason Kohout is a partner practicing with Foley & Lardner LLP. He is the chair of the firm's Family Offices Team and assists families and business owners in tax planning, business succession, and philanthropy. In addition, he works extensively with nonprofit organizations in the areas of governance, fundraising and tax exemption matters. Jason's broad experience, in conjunction with his in-depth knowledge of tax, corporate and trust law, allows him to provide creative and practical solutions for his clients, especially for clients that own businesses or have philanthropic interests or nonprofit organizations focused on governance or fundraising.

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INDUSTRY TEAMS

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Taxation
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Stephanie Derks concentrates her practice on estate planning for high-net-worth individuals, family business succession planning, family office formation, trust and estate administration, tax compliance, and other wealth planning matters. Stephanie understands the unique dynamics involved when working with families and individuals. She strives to provide creative and comprehensive solutions to achieve clients' estate, business, and tax planning goals. She is a member of the firm's Estates and Trusts Practice.

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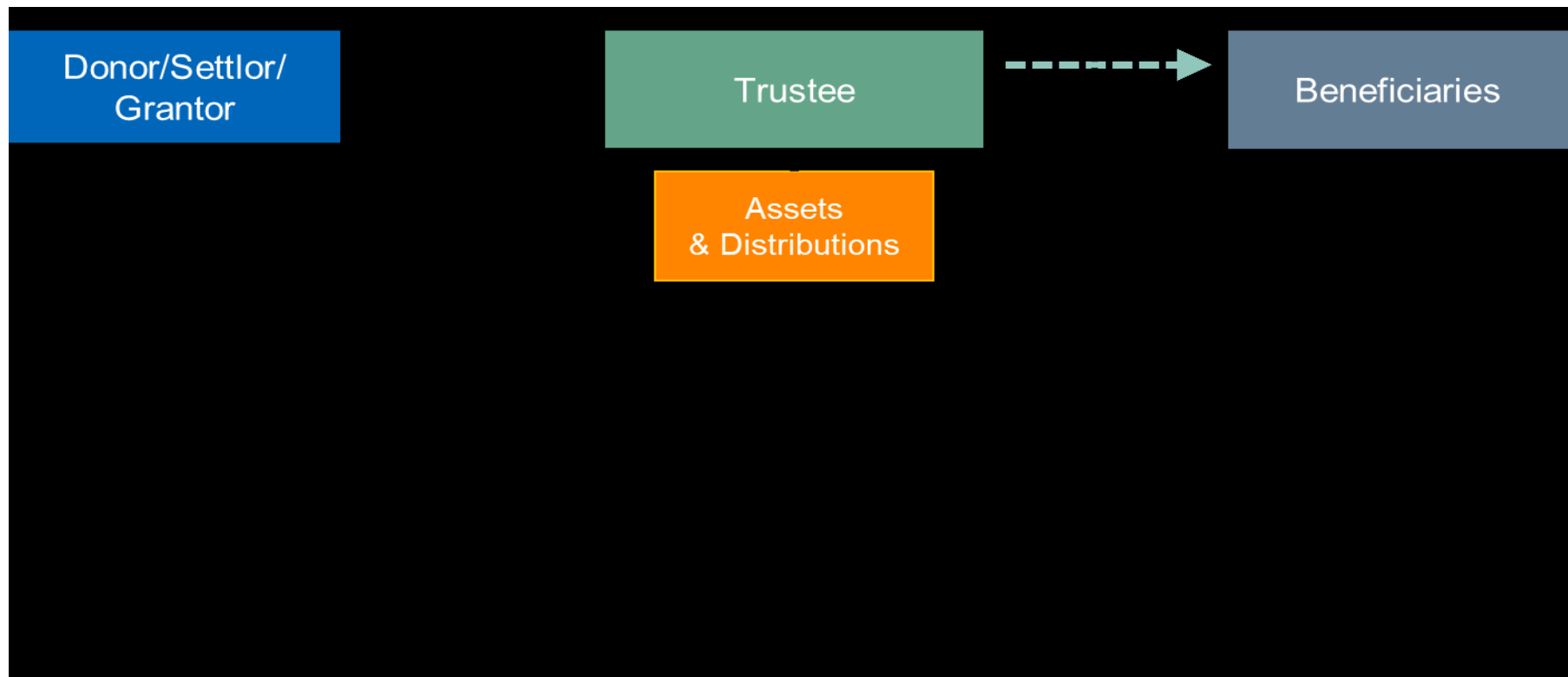
PRACTICE AREAS

Estate Planning
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Who is the Trustee

Trustee

- Has control over assets and makes distributions to beneficiaries.
- Has fiduciary duties to beneficiaries and must follow the rules under the trust document created by the Settlor.



Trustee's Responsibilities

Distributions / Uses of the Funds

- Determining decisions regarding distributions or using the funds from the trust.
- Distributions: following the terms of the trust, exercising discretion, duty of loyalty.

Investments

- Making decisions about investing trust funds.
- Conflicts of interest with other family members/family entities.

Administration

- Filing state and federal income tax returns.
- Segregating trust assets, providing for custodian accounting for the property.
- Accounts: May be required under state law or trust document to provide trust information and accounts to some or all beneficiaries.

Dividing and Delegating Trustee Powers

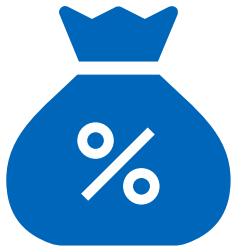
Delegating Responsibilities

- If there are multiple Trustees, the Trustees may delegate various tasks to one another.
- The Trustees can also delegate tasks to professional advisors, such as delegating investment management to investment advisors.
- Example: Trustees delegate trust administration and investments to the family office.
 - Wis. Stat. Sec. 701.0807
- Trustees with Different Roles
 - It may make sense to name different trustees with different roles and powers.
 - Example: “Independent Trustee” with tax sensitive distribution powers.
 - Example: “Business Trustee” who has family business powers (for consolidation purposes).

Directed Trustees / Directing Parties

- Trustees must take direction from a “directing party” regarding investment or distribution decisions (sometimes these are limited or broad decisions).
- Although not a trustee, a fiduciary who must act in good faith and may be liable for their actions/directions to Trustees.
 - Wis. Stat. Sec. 701.0808

Multiple Trustees with Different Roles



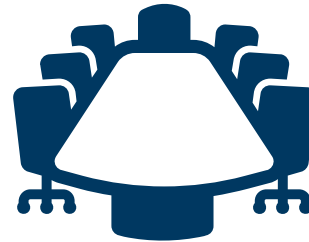
Managing Trustee

Makes investment decisions and distribution decisions (unless required to be made by Independent Trustee because of tax issues)



Administrative Trustee

Responsible for administrative tasks, such as preparing trust accounts and filing tax returns. May hold title to assets, but is directed by Managing Trustee



Business Trustee

Votes family business interests held in trust; makes decisions whether to sell or continue holding special investments owned by trust.



Independent Trustee

May make unlimited distributions, terminate trust, and other tax sensitive issues. Is someone other than a “related or subordinate party.”

Private Trust Companies—A Way to Divide Trustees' Role (and to provide for succession)

Board of Directors

- Responsible for general day-to-day administration.
- May be composed of family members.
- Board may delegate authority to various committees.

Committees

- Investment Committee: investment management decisions.
 - Distribution Committee: decisions regarding distributions and personal use of trust assets by beneficiaries.
 - Amendment Committee: ability to amend the trust document.
 - Participation on the Distribution Committee and Amendment Committee should be subject to tax sensitive limitations (can't vote on distributions to yourself and a committee person cannot be removed and replaced with a related/subordinate party).
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- IRS Notice 2008-63

Succession / Removal Provisions are another way to Divide

Options:

- Appoint own successor.
- Beneficiary or beneficiaries is appointed co-trustee or has power of appointment.
- Different Trustee / third party appoints.
- Or party nominates and the other party approves (trustee nominates and must receive beneficiary approval).

Remove and Replacement:

- Other Trustee.
- Beneficiaries.
- Third party.
- Usually limited to other than “related and subordinate” party.
- Default: Wis. Stat. Sec. 701.0704:
 - Terms of the trust; then appointed by unanimous agreement of the beneficiaries; then by court.

Choosing Trustees depends on the Settlor's Goals

Taxes:

- Use GST exemption / long-term dynasty estate planning.
- Grantor Trust / Installment Sale Estate Planning.
- State Income Tax Planning.

Creditor & Divorce Protection

- Protect assets from beneficiaries' creditors or divorcing spouse.

Administrative Convenience

- Prepare trust accounts and file taxes.
- Segregate trust assets.

Choice of Law/Jurisdiction

- Leverage advantageous state law for either tax or administrative purposes.

Distributions:

- Protect against "over distribution" or use of the trust assets.
- Settle disputes among family members.

Investments:

- Maintain control for a business or collective investment scheme.
- Mitigate conflicts of interest.

Beneficiary Stewardship and Engagement

- Beneficiaries taking active role in managing trust assets.

Prototype: Beneficiary as Trustee (with power to add Independent Trustee)

Prototype:

- Beneficiary as trustee.
- Generally, Beneficiary has an ability to appoint an Independent Trustee to exercise certain tax sensitive powers (distributions beyond HEMS, trust termination, trust decanting).
- Beneficiary may remove and replace the Independent Trustee.

Key Advantage: Beneficiary will work for free and (presumably) has the best insight as to the Beneficiary's preferences.

Beneficiary as trustee may be used for ***most*** advantages of trusts:

- Tax advantages, creditor and divorce protection, administrative convenience, and jurisdictional choice.
- If cannot obtain advantage, can appoint administrative co-trustee or delegate to another trustee to obtain many of these advantages, but still retain most control.

Why can't the Settlor serve as trustee?

Settlors can have administrative and (most) investment powers over the trust.

- If Settlers retain the ability to determine beneficial enjoyment (outside of exceptions), then trust property is subject to estate tax at death.
- Settlor can retain power to remove and replace with an Independent Trustee.
- Section 2036; Rev. Rul. 95-58

But ... limitations of “Beneficiary as Trustee” presents key limitations

Beneficiary is a fiduciary to other beneficiaries.

- State law usually allows for the trust instrument to use a lower standard, but results may vary.

Distributions: Beneficiary is self-interested in overdistribution / over-usage.

- Beneficiary situations: Age/maturity/new spouse.
- Beneficiary may not follow settlor’s intent.

Distribution Fairness: balancing between generations/beneficiaries presents conflict

- Split interest trusts (marital trusts).
- Maybe easier for non-beneficiary to settle disputes.

Investments:

- Beneficiary makes choices on investments, may not necessarily go with overall family vision (or just make bad decisions).
- Conflict of interest between a beneficiary who is involved in business versus other beneficiaries.
- Desire for consolidated control of business.

Administration / Taxes / Jurisdiction Issues:

- May be solved by directed trustee / remove and replace powers.

Loss of creditor protection?

Stuck with place of administration

Possible Advantages of Non-Beneficiary Trustees

- Fidelity to Settlor's intent (what would Settlor have done).
- Better positioned to say "no" to a distribution or investment to protect trust assets and beneficiaries' interests.
- Avoids a self-interested conflict of interest (is neither a current or remainder beneficiary) and can balance between beneficiaries.
 - Conflict of interest is a very difficult argument to overcome in a dispute. The participation of an independent party can be a significant asset in executing on the settlor's objectives.
- Avoids or alleviates conflicts of interest with closely-held business (if non-beneficiary is also not involved in business).

Potential Non-Beneficiary Trustees

- Non-beneficiary family member.
- Advisors (accountants, attorneys, business executives at company).
- Trust companies.
- Family Private Trust Companies.

Balance between availability of a trustee who can address the issue versus perceived “loss of control.”



Considerations in Choosing Non-Beneficiary Trustees

- Judgment.
- Fees/Costs.
- Flexibility for administering closely-held business interests.
 - Possibility of litigation/fights.
- Trust investments.
 - Special assets: real estate, etc.
 - Relationship with current investment manager.
 - Investment approach in general.
- Relationship with beneficiaries.
- Permanence – choosing successors.
 - Individuals – should start building relationships.
 - Entities—remain but people and policies change.
 - Family Trust Companies – family trust company must select successor directors and committee members.
- Appetite for working through trust disputes.
- Jurisdiction (next slide).

Issues for Governing Law / Situs

Governing Law:

- Rule against perpetuities.
- Grantor trust distribution power.
- Allowance of appointment back to Settlor (for SLATs).
- Requirements to report to beneficiaries—silent trust.
 - Wis. Stat. Secs. 701.0105(2) and 701.0813.
- Trust protector statute.
 - Wis. Stat. Sec. 701.0818.
- Directing party statute.
 - Wis. Stat. Sec. 701.0808.
- Domestic Asset Protection Trust.
- Court system.
- Attorney General involvement (for charitable trusts).

State income tax situs:

- Cal. Rev. & Tax Code Section 17742-43: a portion of trust income is allocated to California and subject to California tax based on the number of fiduciaries resident in the state.
- Utah, Iowa, and Arizona

Conflict of Law issue

- Dispositive provisions are governed under the state law designated in the trust instrument.
 - Wis. Stat. Sec. 701.0107
- Law of the state where the trust is administered governs administrative provisions.
- Wis. Stat. Sec. 701.0108: Place of administration.
 - (1) The principal place of administration of a trust is determined by any of the following:
 - (a) The designation in the trust instrument if any of the following applies:
 1. A trustee's usual place of business is located in the jurisdiction designated in the trust instrument.
 2. A trustee is a resident of the jurisdiction designated in the trust instrument.
 3. All or part of the administration of the trust occurs in the jurisdiction designated in the trust instrument.
 4. The trust instrument designates the jurisdiction where the settlor is domiciled at the time the trust instrument is executed.
 - (b) If the principal place of administration is not validly designated in the trust instrument under par. (a), the jurisdiction where the trustee's usual place of business is located or, if the trustee has no place of business, the jurisdiction where the trustee's residence is located.

Questions

- **Governing law / Administration provision**
 - Attempt to designate the place of administration.
 - Does provision contemplate how place of administration is changed?
 - Silver v. Honeck, 216 N.E. 3d 970 (Ill. App. Ct. 2021).
 - Not specified—place of administration moved when trustees moved.
 - Wis. Stat. Sec. 701.0108(4): must provide notice to beneficiaries of transferring place of administration.
- Conflict of laws – other state conflict of law provision may be different.
- Possible ways for another state to gain jurisdiction.
 - Personal jurisdiction (presence of trustee).
 - Specific jurisdiction based on the actions of trustee.
 - But not the presence of the beneficiary.
 - Facts and circumstances test can general personal jurisdiction even when trustee moved to new state.
 - Buskirk, 267 Cal. Rptr. 3d 655 (Cal. Ct. App. 2020).
- And what about trust protectors, directing parties, and designated representatives?

Checks and Balances

Consider mechanism for removal and replacement of trustee (balance against need for beneficiaries not to dominate the trustee).

- Removed if approved by entire family.
- 3rd Party Trustee Remover/Trust Protector.
- If removed, then replaced by trust company that meets certain criteria.

Trustee Succession

Building relationships

- Determine who will be appointed as successor trustee.

On-boarding

- Ensure successor trustees understand family dynamics and Settlor's intent.

A Senior Law Firm Partner's List of Characteristics and Attributes for Successful Trustees

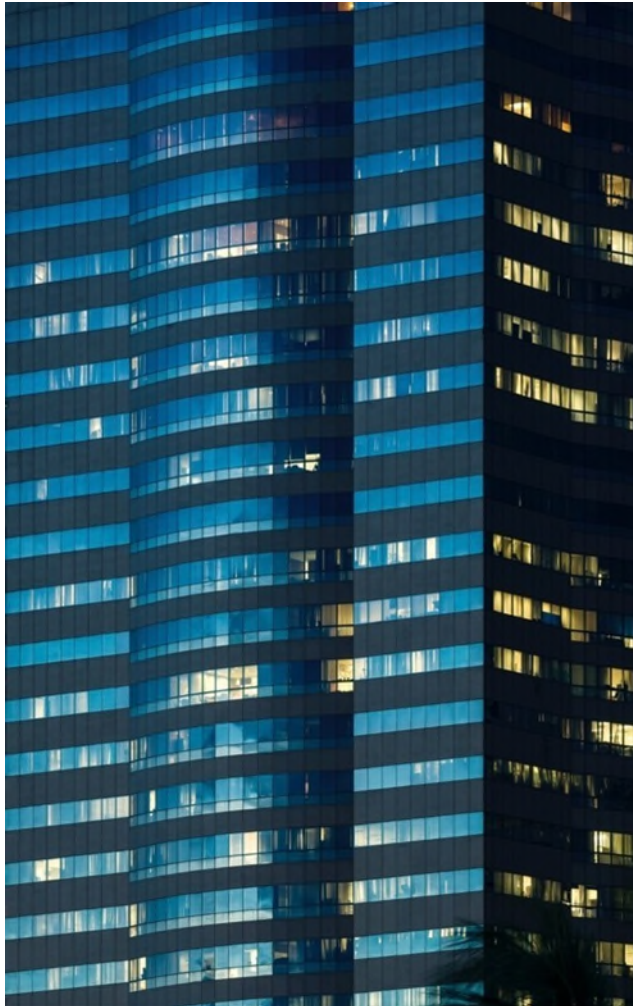
- 1. Exercise sound judgment.**
- 2. Team oriented – compatible in group decision setting.**
- 3. Experienced in all facets of trust administration (but consider willingness to delegate to others in a supervisory role)**
- 4. Thick skin – willingness to say no and withstand pressure.**
- 5. Cultural fit with family.**
- 6. Strong interpersonal and advisory skills.**
- 7. Subordinating personal interests to fiduciary responsibilities and Settlor intent.**
- 8. Availability and personal commitment.**

Trust Protectors Wis. Stat. Sec. 701.0818

The role of the Trust Protector varies greatly based on:

- State Law:
 - Most states that have adopted the Uniform Trust Code specifically allow for Trust Protectors.
 - Other states may permit based on case law.
- Powers given to the Trust Protector.
- Who is the Trust Protector and how are they appointed?

Trust Protector



Fiduciary versus Non-Fiduciary

Should the Trust Protector owe fiduciary duties to the beneficiaries?

This may be dependent on state law.

Even if non-fiduciary, if acting in a fiduciary capacity, could still be considered a fiduciary by a court.

Qualifications:

For tax purposes, typically a Trust Protector must be a person that is not a related or subordinate party as defined under Section 672(c) of the Internal Revenue Code.

A trusted advisor often fills this role.

Possible Trust Protector Powers

- Removing and replacing the Trustee.
- Representing Beneficiaries.
- Certain tax sensitive powers.
- Powers to amend.

Possible Roles for the Trust Protector

Trust Protector as a “Checks and Balance” against Trustee:

- Trust Protector has ability to remove and replace Trustee.
- Either alone or acting with approval of the beneficiaries.

Trust Protector as a Work Around for Difficult Beneficiaries:

- Allow Trust Protector to represent / bind unborn and minor beneficiaries (“Designated Representative”).
- Ability to review trust accounts on behalf of beneficiaries and bind beneficiaries in court actions or to release a trustee.

Trust Protector with Amendment Powers:

- Trust Protector could have powers to amend trust, move situs, etc.
- Consider giving a party without fiduciary duties ability to exercise certain powers to avoid a gift by beneficiaries (PLR 202352018).

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