Fiduciary/Trust Tax Services

Helping organizations manage fiduciary tax compliance obligations

Fiduciary responsibility

Can a financial services organization serving as trustee outsource trust tax preparation while sufficiently upholding its fiduciary responsibility?

A financial services organization has a multitude of operational responsibilities when it serves as trustee. Among other things, it custodies assets, manages investments, oversees beneficiaries' needs, safeguards financial assets, maintains accounts, facilitates tax payments and files tax returns, all while preserving the intentions of the trust's grantor. Understandably, financial services organizations outsource some of these duties, including the preparation of tax returns. Using a professional services firm for the preparation of required tax filings, such as the Fiduciary/Trust Tax Services group of Ernst & Young LLP, benefits both the trustee and the beneficiaries. Taking advantage of Ernst & Young LLP's breadth of experience preparing fiduciary tax filings, as well as Ernst & Young LLP's robust understanding of complicated trust tax regulations, results in substantial time and cost savings, and facilitates efficient and accurate tax return preparation. The inherent risk a trustee faces in tax return preparation can be mitigated by leveraging the deep experience of an outside provider like Ernst & Young LLP, which complies with strict professional standards.

Considering the sheer volume and increasing complexity of the trust accounts it oversees, an institutional trustee is uniquely burdened with the difficulty of spending sufficient time on and giving sufficient attention to each trust account, and thus risks violating its responsibilities as trustee. Every state imposes a strict set of rules in order to hold trustees accountable for their fiduciary responsibilities. For example, every trustee has a duty to administer the trust efficiently, effectively and prudently, including complying with state regulations, being accountable to beneficiaries, producing a reasonable return on investments and ensuring overall cost savings. A trustee is obligated to make key decisions on how to comply with these fiduciary duties, including whether to perform all of the functions itself or whether to outsource some of them.

Confusion about whether the fiduciary duty precludes a trustee from outsourcing any of its roles can prevent some financial services organizations from achieving greater competitive success in the market. If delegating certain tasks would reduce costs and verify the job is done well, and does not violate a trustee's fiduciary duty, wouldn't delegating tasks be the prudent decision? In fact, most state trust rules and the national banking rules not only authorize outsourcing of certain functions, but recommend or even require it.

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First, the Uniform Trust Code, adopted in some form by most states, grants very broad general powers upon trustees: a trustee is given "all powers over the trust property which an unmarried competent owner has over individually owned property."[1] In addition, the Code gives a trustee the discretion whether to delegate some of its duties:

> (1) A trustee has a duty to perform the responsibilities of the trusteeship personally, except as *a prudent person of comparable skill might delegate those responsibilities to others*.
> (2) In deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising or monitoring agents, the trustee has a duty to exercise fiduciary discretion and to act as a prudent person of comparable skill would act in similar circumstances.[2] (Emphasis added)

A trustee must concern itself with not only an imprudent decision to delegate, but also with a *failure* to delegate when a delegation may be the prudent course.[3] A trustee whose strengths do not include an expertise in fiduciary income tax, but who decides nevertheless to prepare its own returns could actually cause harm to the trust by incurring inappropriate expenses and could even expose the trust to liability for failure to prepare a form accurately or for failure to timely file the correct form.

Only a court can review a trustee's exercise of its discretionary power to delegate, and there must be some abuse alleged. In those cases, some considerations a court will take into account are: "the burdens and complexity of the decisions or activities involved," "considerations of efficiency, convenience, and cost in light of the situs of the property or activities involved," and the "fairness and appropriateness of the responsibilities in question to the trustee's compensation and the overall burdens of the trusteeship."[4] It is therefore critical that a trustee consider all of its options in light of the cost, efficiency, convenience and effectiveness, while considering all of its other obligations. Further, most trust instruments specifically authorize the trustee to hire professional advisors, as necessary, including accountants, attorneys, consultants and investment advisors to support the trustee in managing its many fiduciary duties.

In addition to state law, the Office of the Comptroller of the Currency (OCC) has set forth the standards that apply to the fiduciary activities of national banks, and provides authority for a bank's power to outsource some of its services.[5]

Outsourcing trust tax preparation to a firm like Ernst & Young LLP adds an additional layer of review and security. Focusing in this area, Ernst & Young LLP is well equipped to handle the volume of returns, and has the proficiency to operate with a high level of sophistication to address more complex trusts matters. In addition, for the issues outside the normal scope of trust tax preparation, Ernst & Young LLP is home to a variety of experienced professionals in other practices, such as exempt organizations, information reporting, partnerships and valuation, who are able to address many of the complex tax matters faced by financial institutions today. Having a team dedicated to accurately and efficiently completing trust tax returns, as well as having access to high quality consulting services for sophisticated issues, creates an overall cost savings, efficiency and risk management that is consistent with a trustee's fiduciary responsibility.

To further solidify a commitment to its fiduciary responsibility, a trustee may want transparency and oversight within the third-party relationship. For example, the tools embedded in the Ernst & Young LLP process will allow the trustee to track the status of required tax filings and responses to tax notices. Proprietary resources such as EY Share Trust coupled with commercial software products, enable the free flowing exchange of information providing for integration and oversight, so the trustee is fully involved and engaged in the return preparation process. The trustee has visibility into the status of work on a day-by-day basis and can track and respond to questions. Furthermore, a trustee may want to conduct a review of a sample population of returns in order to validate that returns are complete and accurate, in addition to establishing regularly scheduled conferences with preparers to check on progress and outstanding issues. Therefore, a trustee can satisfy its fiduciary duty while delegating the actual return preparation.

In summary, taking advantage of a third-party trust tax preparer, especially a well-respected, experienced firm such as Ernst & Young LLP, can assist the trustee in upholding its fiduciary duty, lift the burden of tax preparation and allow the trustee to focus on other vital obligations of trusteeship. Using Ernst & Young LLP's Fiduciary/Trust Tax Services practice provides an additional layer of security for the trustee, giving the trustee confidence that the trust is paying the least amount of tax while maintaining federal and state compliance. In addition, the trustee has access to other subject-matter professionals for unusual or complex matters who are working alongside a group that is already familiar with the financial institution's accounts and needs.

SCORE No. 00640-181US
1705-2327084
ED None

1 Unif. Trust Code § 815(a)(1) (2010).
2 Restatement 3d of Trusts § 80.
3 Restatement 3d of Trusts § 80, comment d(1).
4 Restatement 3d of Trusts § 80, comment e.
5 "Pursuant to a written agreement, a national bank exercising fiduciary powers… may purchase services related to the exercise of fiduciary powers from another bank or other entity." 12 CFR 9.4(c).