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RETAINING A BUSINESS INTEREST AND THE TRUSTEE'S DUTY TO DIVERSIFY INVESTMENTS by Randy Spiro

A Trust instrument can waive the Trustee's duty to diversify investments. This duty is highlighted when an owner of a closely held business which is owned by a Trust dies and the Trust becomes irrevocable.

Some Trusts contain very specific waivers. Other Trusts do not contain any waivers. Still other Trusts have boilerplate language buried in the Trust purporting to waive the Trustee's duty to diversify Trust investments.

A Successor Trustee may be inclined to sell the business after the owner's death in order to protect himself or herself against later claims by Trust Beneficiaries should the value of the business decline. The more specific the waiver of the Trustee's duty to diversify investments, the more comfortable the Successor Trustee may be in continuing to retain and manage the business as an asset of the Trust.

But even when the Trustee's duty to diversify investments has been clearly waived in the Trust instrument, a Trustee still needs to prudently manage that business. This means that the Trustee could be held liable for failing to sell the business if retaining it later becomes inconsistent with the purposes of the Trust or if it later is deemed imprudent for the Trustee to have continued to retain it.

Whenever a Trustee is concerned about whether or not to sell the business, he or she can petition the Court, with notice to the Beneficiaries, asking to be instructed as to whether to sell or retain the business.

A business owner needs to do more than consider whether or not to waive the Successor Trustee's duty to diversify in his or her Trust documents. He or she needs to consider who will be an appropriate Successor Trustee, who will be in charge of day-to-day business operations, what roles the spouse and children will play in the business, whether children who are active in the business should get more than an equal share, what assets to leave the children who are not active in the business, and how the Federal Estate Tax on the business will be paid.