

THE UNEXAMINED TRUST IS NOT WORTH DRAFTING

DC Bar: Estates, Trusts and Probate Community

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Overview

- Issues which present drafting challenges
 - Boilerplate such as simultaneous death, situs/governing law, and tangible personal property
 - Disability of settlor or trustee
 - Liability of directed trustees and advisors
- Default provisions and case law
- Consequences when trust is silent
- Sample language
- Examples and take-aways

Simultaneous Death and Survivorship

- Basic survivorship requirement:
 - “For purposes of this Agreement, a beneficiary is deemed to survive the Grantor only if he or she is living on the sixtieth (60th) day following the Grantor’s death.”
- If survivorship requirement applies to all beneficiaries, including spouse, no simultaneous death provision is necessary
- Tax and non-tax reasons for including a survivorship requirement

Non-Tax Reasons for Survivorship Requirement

- Avoid double probate
- Ensure the Grantor's contingent beneficiaries take
 - *See Janus v. Tarasewicz*, 482 N.E.2d 418 (1985)
 - Newlyweds died in a common disaster
 - Dispute over life insurance proceeds
 - Illinois' simultaneous death act provided as follows: “[i]f the title to property or its devolution depends upon priority of death and there is no sufficient evidence that the persons have died otherwise than simultaneously and there is no other provision in the will, trust agreement, deed, contract of insurance or other governing instrument for distribution of the property different from the provisions of this Section: (a) The property of each person shall be disposed of as if he had survived.”

Default State Law

- Virginia¹ and DC²
 - 5 day survivorship requirement
 - Applies to Wills, trusts and other instruments
- Maryland
 - Survivorship requirement³
 - 30 day survivorship requirement
 - Only applies to Wills, not trusts
 - Does not apply to spouses
 - Simultaneous death provision⁴

Length of Survivorship Requirement

- Too short = concerns about double probate and not allowing your contingent beneficiaries to take
- Too long = delays administration and could jeopardize the marital deduction
 - Up to 6 month survivorship requirement permissible under IRC § 2056(b)(3)
- 30 to 90 days is typical

Specific Bequests

- Survivorship requirement could unintentionally eliminate or duplicate specific bequests in couple's coordinated estate plan
- Example:
 - H & W have mirror image trusts
 - On first death, everything to surviving spouse
 - On second death, \$100,000 to charity, residue to children
 - If spouses die in quick succession, survivorship requirement could result in \$200,000 passing to charity, contrary to the couple's intent
- For possible drafting solutions, see separate handout titled "Sample Provisions for Trusts"

Tax Reasons for Survivorship Requirement

- Including a survivorship requirement can prevent the same property from being subject to state estate tax twice
- Not a concern with spouses because of the marital deduction
- Not a concern for Federal estate tax purposes because of the previously taxed property credit (IRC § 2013)
- Neither Maryland nor DC offers a similar credit

Eliminating the Survivorship Requirement

- Might include a survivorship requirement in one spouse's documents, but in the other spouse's documents say:
 - “For purposes of this Agreement, a beneficiary, other than the Grantor's spouse, is deemed to survive the Grantor only if he or she is living on the sixtieth (60th) day following the Grantor's death. The Grantor's spouse shall be deemed to survive her if he actually survives her by any length of time, no matter how short. Further, if Grantor and her spouse die simultaneously or under such circumstances that the order of their deaths cannot be determined, Grantor's spouse shall be deemed to survive her.”
- Why?
 - Portability concerns
 - Equalization

Simultaneous Death & Portability

- Treasury regulations do not address how portability works in the event of simultaneous death
- Treas. Reg. § 20.2056(c)-2(e) provides that, if the order of deaths of the decedent and his spouse cannot be established, a presumption supplied by the Will will be respected for marital deduction purposes
- Seems logical the IRS would respect a presumption supplied by the Will for purposes of portability as well
- However, what if the presumption is that neither spouse survived?
- Because of this uncertainty, cautious estate planners might choose to designate one spouse as the survivor in both spouses' documents

Simultaneous Death & Equalization

- When federal estate tax exemption was lower, and prior to portability, equalization was important to minimize federal estate tax
- Now, equalization is important to minimize *state* estate tax
 - Allows both spouses to use their full state estate tax exemption
 - Allow both spouses to have a full run up in state estate tax brackets
- If credit shelter/marital trust disposition or if everything passes to surviving spouse in a trust that qualifies for the QTIP election, name the less wealthy spouse as survivor to equalize in the event of simultaneous death
- If outright bequest to surviving spouse, need a formula provision in the simultaneous death clause in order to equalize

Situs and Governing Law

- Basic provision:
 - “The situs of this trust is State X and it shall be governed by the laws of such state.”
- How much flexibility does the drafter have to choose situs?
- How much flexibility does the drafter have to choose governing law?
- Should the drafter include a more detailed situs/governing law provision?

What Is Situs?

- Administrative situs
- Tax situs
- Jurisdictional situs
- Locational situs

Administrative Situs' Impact on Tax Situs

- The following 14 states will tax a trust if it is administered in state: (1) Colorado; (2) Indiana; (3) Kansas; (4) Louisiana (unless trust designates law of another state); (5) Maryland; (6) Minnesota (trust created or first administered in state before 1996); (7) Mississippi; (8) Montana; (9) New Mexico; (10) North Dakota; (11) Oregon; (12) South Carolina; (13) Virginia; and (14) Wisconsin (*inter vivos* trusts created or first administered in state before October 29, 1999)
- Governing law does not typically impact tax situs
 - But see Louisiana, Idaho and North Dakota

Administrative Situs' Impact on Jurisdictional Situs

- Trustee and beneficiaries deemed to have consented to the jurisdiction of the court at the principal place of administration as to matters involving the trust¹
- Most states will defer to the courts of the state that is the principal place of administration
- *Lavery v. Gorman*, 2013 Ariz. App. Unpub. LEXIS 1353 (2013)
 - Trust had many ties to CA: (1) trust agreement executed in CA; (2) grantors domiciled in CA; (3) one co-trustee domiciled in CA (other in AZ); (4) one beneficiary domiciled in CA (other in PA); (4) trust agreement said CA law applied but did not designate trust situs
 - Trustee filed petition for approval of accounting in AZ; beneficiary filed motion to dismiss
 - Probate court dismissed, but appellate court reversed because the beneficiary did not present evidence that CA was the principal place of administration

Designating Situs in Trust Agreement

- Situs has to have a certain connection to the trust
- In UTC jurisdictions, the state designated as the trust's situs must be either:
 - The residence of a trustee;
 - The principal place of business of a trustee; or
 - The state where all or part of the administration occurs.²

If Trust Is Silent

- Generally, principal place of administration is where the Trustee is located
- Gets tricky if there are co-Trustees in different states or a corporate Trustee with operations in multiple states
- In that case, facts and circumstances analysis
 - Where are the trust records kept?
 - Where are the trust assets held?
 - Where is the trust officer located?

Governing Law: Validity

- Examples of matters of validity:
 - Capacity of grantor
 - Rule against perpetuities
- In UTC jurisdictions, law governing validity of an *inter vivos* trust must be either:
 - The state in which the trust agreement was executed;
 - The state where, at the time of creation, the grantor was domiciled, had a place of abode or was a national;
 - The state where, at the time of creation, a Trustee was domiciled or had a place of business; or
 - The state where, at the time of creation, any trust property was located³

Governing Law: Construction

- Examples of matters of construction:
 - Rights of adopted children
 - *Per stirpes vs. per capita*
- What law can you designate to govern construction?
 - In UTC jurisdictions, any law, but designation will not be effective if it is “contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue”⁴
 - Maryland did not enact UTC § 107, which deals with governing law
- What if the trust agreement is silent?
 - Usually the law of the place having the most significant relationship to the trust’s creation will govern the dispositive provisions

Governing Law: Administration

- Examples of matters of administration:
 - Trustee powers
 - Trustee compensation
 - Removal and replacement of Trustees
- What law can you designate to govern administration?
 - In UTC jurisdictions, any law, but designation will not be effective if it is “contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue”⁵
- What if the trust agreement is silent?
 - Usually the law of the principal place of administration will govern administrative matters

Why Address Situs Change in the Trust Agreement?

- Without addressing situs change explicitly, a court could say Grantor's intent was not to permit a change in the place of administration
 - See, e.g., *In re Hudson's Trust*, 29 A.D.2d 145 (1968)
 - But see *In re Peierls Family Inter Vivos Trusts*, 77 A.3d 249, 259 (2013)
- Provide a simpler procedure for changing situs
 - Absent a contrary provision in the trust document, some states require judicial approval
- Remove ambiguity regarding the law that applies after situs change
 - Transferring the principal place of administration will normally change the governing law with respect to administrative matters (but not normally with respect to validity and construction)
 - When dealing with a GST-grandfathered or GST-exempt trust, might not want certain aspects of the law to change (e.g., RAP)

Tangible Personal Property

- Trustee duty to take reasonable steps to take control of property
 - TPP Exemption in MD Trust Act to avoid probate
- Deed of assignment to establish trustee control of TPP
 - Include all TPP “acquired or received by Donor subsequent to the execution of this Deed of Transfer”
- Consequences of trust’s instructions
 - Duty of impartiality for trustee not to favor beneficiary
 - Duty of loyalty for trustee who is also beneficiary
 - Implementation of client wishes
 - Sale or donation of TPP item unsuitable for distribution

If Trust is Silent

- Risk of violating Trustee duties
- Intervention of court
 - Cup and saucer provision: “The court may determine questions of title to personal property not exceeding \$50,000 in value for purposes of determining what personal property is properly includable in an estate that is the subject of a proceeding before the court.”
- Expenses if no separate clause and TPP passes to residue
 - Payment of debts and expenses leading to Trustee’s sale
 - DNI carried out to beneficiaries in year of distribution

Representatives, Writings, Specific Bequests

- Designation of Trustee or other representative to select TPP for beneficiaries
- Preparation of separate writing or schedule
- Use of specific bequest clauses
 - By category, such as heirloom furniture, Victorian china, dessert spoons
 - “My Elaine de Kooning painting, *The Burghers of Amsterdam Avenue*”
 - Ademption issue when property subject to specific bequest is sold or destroyed during period of disability

Resolution of Conflicts or Clarity

- Conflicting or unclear clauses
 - Maryland estate with two TPP dispositions to widow and private foundation
 - *Ejusdem generis* – presumption that general description following particular items limits it to same or similar kind
 - Jewelry, personal adornments, children’s toys not part of clause bequeathing “household contents” simply because found on premises

Capacity to Create Trust

- Required capacity to create revocable trust same as for Will
 - Age 18, sound and disposing mind, able to execute deed or contract
 - Cannot be unsound mind or unemancipated minor
 - Age 18 and “legally competent to make will”
- Incapacity nullifies settlor’s powers under revocable trust
 - Revocation or amendment, directing trustee, suit for breach
 - Withholding of information from beneficiary (DC, MD)
 - Removal/replacement of trustee or advisors

Third Parties Exercising Settlor Powers

- Powers to revoke, amend, direct distributions by others
 - By agent when expressly stated in trust or DPA
 - By guardian
 - Court approval in DC
 - Court approval and no trust prohibition in MD
 - Without court approval when trust permits or with court approval if trust silent in VA
 - By beneficiary
 - To enforce settlor's intent to benefit beneficiary in DC
 - To “which distributions may be made” during settlor’s lifetime as if trust irrevocable in MD

Third Parties Exercising Settlor Powers (cont.)

- Power to remedy breach
 - UTC recognizes right of agent, conservator/guardian or beneficiary
 - Comment to Section UTC 603 distinguishes possession of right to remedy based on whether breach occurred during settlor's capacity or incapacity
- Removal of trustee by co-trustee or beneficiary petition to court
 - UTC recognizes conservator/guardian rights as well

Capacity to Serve as Trustee

- Required capacity of natural person to serve as Trustee
 - Capacity to hold title to property in same manner as beneficial owner
 - Capacity to administer property in same manner as beneficial owner
- Consequences of incapacity
 - Temporary incapacity gives Co-Trustee authority to act on Trustee's behalf
 - Trustee's duty to seek court removal of incompetent Co-Trustee

If Trust is Silent

- Trustee cannot be forced resign
- Court proceeding will be necessary to remove trustee
- Loss or damage to trust must be proven
- Courts recognize incompetent Trustee still capable of sound judgement

Addressing Disability of Settlor or Trustee

- Define Incapacity
 - Physical and mental illness, intellectual disability, substance abuse, other causes
 - Insufficient understanding or capacity to make or communicate responsible decisions
- Address standard for determination
 - Request for medical exam or information (VMIA)
 - Process involving agreement by other trustees or spouse and settlor not object
 - Mandatory trustee resignation on occurrence of events
- Determine who gets powers in event of incapacity
 - Settlor names spouse, sibling, child, protector
 - Automatic co-trustee appointment

Example in Action: The Donald Sterling Case

- Background
 - LA Clippers in revocable trust with co-trustees Donald & Shelly Sterling
- Facts
 - Donald's racial comments led to NBA fine and threats to force team sale
 - Shelly had Donald evaluated by 2 doctors; diminished cognitive capacity
 - Donald disqualified as trustee & Shelly negotiated \$2 billion sale
 - Donald argued no mental incapacity & Shelly's failure to follow proper protocol. He attempted to revoke the trust and then went to court
- Question Raised
 - Was Donald properly removed as trustee for incapacity, giving Shelly authority to sell Clippers?
- Answer
 - Court ruled in favor of Shelly. She followed proper trust protocol

Directed Trust Standard of Conduct

- Directed Trustees and Advisors under UTC § 808
 - Advisor/fiduciary with powers to invest, distribute, modify trust
 - Trustee's role to follow Advisor's direction and trust terms
- Advisor's standard of conduct
 - Good faith, reasonable, in beneficiary's interest
 - Liable for loss resulting from breach of fiduciary duty
- Trustee's standard of conduct
 - Compliance excused if contrary to trust terms or serious breach of Advisor duty
 - No duty to monitor, advise or warn beneficiary (MD, VA)
 - Liable if loss and willful misconduct by following Advisor (MD,VA)

Directed Trustee's Failure to Warn

- *Rollins v. Branch Banking Trust Company of Virginia*
 - Beneficiaries' claim against trustee for loss of corpus
 - No Trustee liability for investment
 - Imposition of common law duty to warn
 - Subsequent statutory relief from monitoring, warning
- Trustee duty to keep qualified beneficiaries apprised (DC, VA)
 - "Reasonably informed" about administration of trust and "material facts necessary" to protect interests
 - Same as UTC § 813 duty to inform and report; not mandatory

Conflicts Over Trustee Duty and Solutions

- Risk of conflict over trustee duty created by general obligations
 - Annual report sufficient in normal circumstances
 - Trustee obligation to “provide full and accurate information to the trust beneficiaries regarding the administration of the trust”
 - Advance disclosure if conflict of interest
- Draft trust terms to specify that:
 - directed trustee or advisor liable only for own willful misconduct
 - directed trustee or advisor no duty to warn beneficiary or monitor each other
 - keeping beneficiary reasonably informed not applicable to other’s conduct

Example in Action: Investment Advisor

- Client's irrevocable trust for adult son
- Directed trust with client's personal financial advisor serving as investment advisor
- Corporate trustee objection to investment power
 - Margin Trading. To purchase securities or other assets on margin; to buy, sell, or otherwise deal in calls (covered or uncovered), puts or other options
- Wanted to require advance notice to beneficiary

Citations

Simultaneous Death

1. VA Code § 64.2-2202
2. DC Code § 19-503
3. MD Code, Est. & Trusts § 4-401
4. MD Code, Courts & Jud. Proc. § 10-801

Situs

1. UTC § 202; DC Code § 19-1302.02; VA Code § 64.2-711; MD Code, Est. & Trusts § 14.5-202
2. UTC § 108; DC Code § 19-1301.08; VA Code § 64.2-706; MD Code, Est. & Trusts § 14.5-108
3. UTC § 403; DC Code § 19-1304.03; VA Code § 64.2-721; MD Code, Est. & Trusts § 14.5-403 (doesn't mention place of abode)
4. UTC § 107; DC Code § 19-1301.07; VA Code § 64.2-705
5. UTC § 107; DC Code § 19-1301.07; VA Code § 64.2-705

Tangible Personal Property

1. DC Code § 19-1308.09
2. MD Code, Est. & Trusts § 14.5-809
3. VA Code § 64.2-751(E)
4. DC Code § 19-1308.03
5. MD Code, Est. & Trusts § 14.5-803
6. VA Code § 64.2-765
7. DC Code § 19-1308.02

Citations

(cont.)

Tangible Personal Property (cont.)

8. MD Code, Est. & Trusts § 14.5-802
9. VA Code § 64.2-764(A)
10. MD Code, Est. & Trusts § 1-301(b)
11. I.R.C. § 662(a)(2)
12. I.R.C. § 663(a)(1)
13. Treas. Reg. § 1-662(a)-2(f)
14. Treas. Reg. § 1.663(a)-1
15. DC Code § 19-601.01
16. MD Code, Est. & Trusts § 4-107
17. VA Code §§ 64.2-400, 64.2-400, 64.2-620
18. VA Code § 64.2-415
19. *LeRoy v. Kirk*, 262 Md. 276, 277 A.2d 611 (1971)
20. *Lauter v. Kays*, 753 S.W.2d 302, 304-305 (Ky. Ct. App. 1988)

Disability of Settlor and Trustee

1. DC Code § 19-1306.01
2. MD Code, Est. & Trusts § 14.5-601
3. VA Code § 64.2-750
4. DC Code § 18-102
5. VA Code § 64.2-401(B)

Citations

(cont.)

Disability of Settlor and Trustee (cont.)

6. MD Code, Est. & Trusts § 4-101
7. *Slicer v. Griffith*, 27 Md. App. 502, 510 (1975)
8. DC Code § 19-1306.03(c)
9. MD Code, Est. & Trusts § 14.5-603(b)
10. DC Code § 19-1306.02(e)
11. MD Code, Est. & Trusts § 14.5-602(e)
12. VA Code § 64.2-751(E)
13. DC Code § 19-1306.02(f)
14. MD Code, Est. & Trusts § 14.5-602(f)
15. VA Code § 64.2-751(F)
16. DC Code § 19-1306.03(c)
17. MD Code, Est. & Trusts § 14.5-603(b)
18. Comment to UTC Section 603
19. DC Code § 19-1307.06(a)
20. MD Code, Est. & Trusts § 14.5-706(a)
21. VA Code § 64.2-759(A)
22. Comment to UTC Section 602

Citations

(cont.)

Disability of Settlor and Trustee (cont.)

23. Restatement (Third) of Trusts § 32 (2003)
24. DC Code § 19-1307.03(c), (d)
25. MD Code, Est. & Trusts § 14.5-703 (b),(c)
26. VA Code § 64.2-756(C),(D)
27. *In re Juilliard's Will*, 169 Misc. 270, 7 N.Y.S.2d 290 (Sur. Ct. 1938); 171 Misc. 661, 13 N.Y.S.2d 315 (1939)
28. *Sterling v. Sterling*, 242 Cal. App. 4th 185 (Cal. Ct. App., 2015)

Directed Trustees and Advisors

1. DC Code § 19-1308.08
2. MD Code, Est. & Trusts § 14.5-808
3. VA Code § 64.2-770
4. *Rollins v. Branch Banking Trust Company of Virginia*, 2001 Va. Cir. Lexis 146 (Va. Cir. Ct. 2001)
5. VA Code § 64.2-775(A)
6. DC Code § 19-1308.13(a)
7. *Cobell v. Norton*, 213 F.R.D. 1, 11 (D.D.C. 2003)
8. *Matter of Green Charitable Trust*, 172 Mich. App. 298 (1988)

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