The Use of Trusts

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Prepared for

The Mid-Atlantic Fellows Institute
of
The American College of Trust and Estate Counsel

New York, New York

Developing Our Profession's Future Leaders

September 12, 2019

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I. The Origin of Trusts

A. The Trust

> A trust, as the term is used in this Restatement when not qualified by the word "resulting" or "constructive," is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.

RESTATEMENT (3D) OF TRUSTS §2 (2003).

B. English History

1. The trust – or the medieval "use" – is traced to the middle of the Thirteenth Century, when the Franciscan Friars arrived in England.

   a. Because the Friars were prohibited from owning land, benefactors of the Franciscans developed the technique of conveying land to friends of the Friars as "feoffees," to hold for the "use" of the Friars. The Friars could possess and occupy the land as the "cestui que use," or what we would today call the "beneficiaries" or "beneficial owners." But they would not be violating the prohibition against owning land, because the feoffees would be the legal owners.

   b. Any attempt by the feoffees to abuse their legal title would result in enforcement in ecclesiastical courts and eventually by the Chancellor, the "keeper of the king's conscience," who as a matter of equity could not tolerate disloyalty to the benefactor and the purpose of the use.

2. The "use" also picked up noncharitable applications.

   a. A landholder could convey legal title to feoffees, who would hold it for the use of that landholder and his heirs. Employing a committee of such feoffees would ensure that any feoffee who died could simply be replaced, thus maintaining uninterrupted the legal title. As the landholder, and in turn the landholder's heirs, died, their beneficial interests would descend free of the "feudal incidents" that served as the inheritance taxes of the day, paid in crops and the service of knights to the overlord and eventually to the ultimate owner of all lands, the Crown.

   b. The same technique could also be used to bypass the strict primogeniture rules that would demand descent only to the eldest son. The use thus embodied an early uprising of donative or testamentary freedom.

3. In 1535, King Henry VIII, not pleased with the revenue impact of such uses, persuaded an unenthusiastic Parliament to enact the Statute of Uses, basically requiring all such uses to be "executed" – that is, the mere equitable interests would be converted into legal interests. Today we would say the trust is "pierced," "collapsed," or simply "terminated."

4. Ironically, Henry's daughter, Elizabeth, saw the enactment in 1601 of the Statute of Charitable Uses, often called the "Statute of Elizabeth," arguably affirming charitable uses her father had viewed as a fiscal threat. The fountainhead of codifications of charitable purposes, such as the much less ornate codification found in section 501(c)(3) of the Internal Revenue Code, the Preamble to the 1601 Statute stated:

   > Relief of the aged, impotent, and poor people; maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities, repair of bridges, ports, havens, causeways, churches, seabanks, and highways, education and preferment of orphans, for or towards relief of stock, or maintenance for houses of correction, marriages of poor maids, supportation, aid, and help of young tradesmen, handicraftsmen, and persons decayed, relief or redemption of prisoners or captives, aide or ease of any poor inhabitants concerning payments of fifteens, setting out soldiers of soldiers and other taxes.

5. Meanwhile, lawyers and the courts (that is, the Chancellor) developed exceptions or workarounds for the Statute of Uses, including "active uses" where the feoffees had active duties to perform and powers with which to perform those duties.

6. Thus, the Sixteenth Century legislature, lawyers, and courts all contributed in their ways to give shape to the rudimentary law of trusts, in the context of the Rule of Law and the principle that the trust is regulated by the law.

II. Trust Law in America

A. Origin, Distinctions, and Taxes

1. The Colonies declared independence from King George III, but kept most of his laws, including the law of trusts, as well as his people's commitment to the Rule of Law. But American trust law has reflected a commitment to a donor's freedom of disposition to a degree that has now largely been abandoned by England and the rest of the common law world. This commitment has become translated into our respect for the donor's *intent*.

2. While wealth in Sixteenth Century England consisted largely of land, an increasing proportion of wealth today, including wealth in trusts, consists of intangible personal property such as stocks and bonds and more exotic financial arrangements.

3. Just as the burden of feudal incidents drove some of the interest in uses, developments in the last century of federal tax law have provided incentives to modern designers of estate planning techniques, often extravagantly referred to as "strategies."

   a. The "modern" federal estate tax was enacted in 1916.

b. The current federal gift tax was enacted in 1932 and strengthened by its "integration" or "unification" with the estate tax in 1976.

c. The federal generation-skipping transfer tax was first enacted in 1976 and then redesigned and reenacted in 1986. Although the main objective of the GST tax is to "catch" long-term trusts and make them less useful as tax planning vehicles, there is something about *taxing* something that is almost as effective as *forbidding* it in making it irresistibly attractive.

(1) When the current GST tax was enacted in 1986, its exemption of $1 million was high, compared to the $600,000 estate and gift tax exemption that became fully phased in in 1987.

(2) Even when the Taxpayer Relief Act of 1997 increased the estate and gift tax exemption to $1 million (to have been fully phased in by 2006), it indexed the GST exemption for inflation, which would have still kept it higher than the other exemptions. In 2002 and 2003, when the estate and gift tax exemptions had been raised to $1 million by the Economic Growth and Tax Relief Reconciliation Act of 2001, the indexed GST exemption was $1.1 million and $1.12 million, respectively. Only in 2004 did the GST exemption and estate tax exemption become the same ($1.5 million), and then the gift tax exemption was left behind at $1 million. All three exemptions were never the same until 2011 (then $5 million, now temporarily $10 million, indexed for inflation).

B. "A Quiet Revolution"

1. "A quiet revolution in American trust law is upon us." Thus began Professors Max M. Schanzenbach and Robert H. Sitkoff, in "The Prudent Investor Rule and Trust Asset Allocation: An Empirical Analysis," 35 ACTEC J. 314 (Spring 2010). The article expanded on a portion of Professor Sitkoff's Joseph Trachtman Memorial Lecture, "The Quiet Revolution in American Trust Law: An Empirical Assessment," presented to ACTEC on March 7, 2009.

2. The authors continued:

> Some of the new trust law has been produced top-down by the American Law Institute and the Uniform Law Commission, through the Restatements and Uniform Acts. The top-down process is typified by academic reporters (drafters) and advisors working in concert with practitioner representatives from the American College of Trust and Estate Counsel and the Section on Real Property, Trusts, and Estates of the American Bar Association. In general, the top-down reforms are designed to update the law in view of the transformation of the irrevocable trust into a management device for financial assets, the increasingly common use of the revocable trust as a will substitute, and the rise of the statutory business trust.
>
> Other major changes to the trust law canon have been bottom-up, driven by local lawyers and bankers in response to the increasingly national scope of the competition for trust business. These reforms are implemented through the lobbying efforts of state bar and bankers' associations, spurred on by a desire to attract or retain trust business. As a consequence, the bottom-up reforms

> tend to promote dead hand control, reflecting the commercial necessity of appealing to apparent donor preferences.

Id. at 314-15 (citations omitted).

C. The Uniform Prudent Investor Act

1. The Uniform Prudent Investor Act was approved by the National Conference of Commissioners on Uniform State Laws ("NCCUSL," but more recently known simply as the "Uniform Law Commission") in 1994. It has been adopted in whole or in part (or with modifications) by almost all states and the District of Columbia. The Act undertakes to update trust investment law in recognition of the changes that have occurred in investment practices. The Act thus reflects the "modern portfolio theory" of investments and focuses on total return.

2. The Act makes at least five fundamental changes to the former criteria for prudent investing.

    a. The standard of prudence is applied to any investment as part of the total portfolio, rather than to investments individually. In the trust setting, the term "portfolio" embraces all the trust assets. In other words, the trustee's decisions are not looked at on an individual-investment-by-individual-investment basis but rather are evaluated in the context of the trust portfolio as a whole, and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

    b. The tradeoff in all investing between risk and return is identified as the fiduciary's central consideration.

    c. All categorical restrictions on types of investments are eliminated. The trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and meets the other requirements of prudent investing.

    d. The familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing. The prudent investor standard requires a trustee to diversify investments, unless, because of special circumstances, the purposes of the trust are better served without diversifying.

    e. The much criticized former rule forbidding a trustee to delegate investment and management functions has been reversed. Delegation is now permitted, subject to strict statutory safeguards, which include establishing the scope and terms of the delegation consistently with the purposes and terms of the trust and periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

3. The standard of care is that of a "prudent investor," who considers the purposes, terms, distribution requirements, and other circumstances of the trust and exercises reasonable care, skill, and caution. Section 2 of the Act sets out a nonexclusive list of considerations a trustee must consider in developing an investment strategy and managing trust assets. These considerations include general economic conditions, effect of inflation or deflation, expected total return from income and the

appreciation of capital, other resources of the beneficiaries, and the specific needs of the beneficiaries.

4. A trustee under the Act must consider factors that generally affect the marketplace as a whole in making investment decisions and also the individual characteristics of the trust assets and the trust beneficiaries.

5. The prudent investor standard is the default standard in the absence of contrary language in the governing instrument.

D. The Revised Uniform Principal and Income Act

1. The Revised Uniform Principal and Income Act ("RUPIA") was approved by the Uniform Law Commission in 1997 and amended in 2008. (Earlier versions had been approved in 1931 and 1962.) RUPIA has been adopted in whole or in part (or with modifications) by nearly all states and the District of Columbia. One of the stated purposes of the 1997 Act was to ease the tension in satisfying both the income and remainder beneficiaries while complying with "modern portfolio theory" under the Uniform Prudent Investor Act.

2. The Act helps a trustee who has made a prudent, modern portfolio-based investment decision that has the initial effect of skewing return from all the assets under management, viewed as a portfolio, as between income and principal beneficiaries.

3. Among other remedies, Section 104 of RUPIA (not included in the version approved by every state) gives that trustee the power to reallocate the portfolio return by adjusting between income and principal.

   a. This power is meant to alleviate the situation in which the income beneficiaries or remainder beneficiaries would otherwise be adversely affected by the total return investment strategy. Specifically, the power to reallocate principal to income where certain requirements are met allows the trustee to invest trust assets for total return and discharge the duty of impartiality without investing in assets that produce traditional "income."

   b. The trustee typically has the power to adjust under Section 104 of the 1997 RUPIA only when the following three conditions are met:

      - The trustee invests and manages the trust assets as a prudent investor.

      - The terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income.

      - The trustee determines that it cannot administer the trust impartially on the basis of what is fair and reasonable to all of the beneficiaries, unless the trust clearly manifests an intention that the fiduciary shall or may favor one or more beneficiaries.

   (1) The first condition will typically be met, even if the state has not adopted the Uniform Prudent Investor Act or similar legislation, if the prudent investor rule has been approved by the courts or the terms of the trust require it. Further, even if none of these factors can be pointed to, the Restatement establishes the prudent investor rule as an authoritative interpretation of the

common law prudent man rule, referring to the prudent investor rule as a "modest reformulation of the Harvard College dictum and the basic rule of prior Restatements." RESTATEMENT (3D) OF TRUSTS: PRUDENT INVESTOR RULE, Introduction at 5 (1992). *See Harvard College v. Amory*, 9 Pick. (26 Mass.) 446, 461 (1830) (the acknowledged source of the "prudent man" rule); RESTATEMENT (2D) OF TRUSTS §227 (1959). As a result, there is a basis for concluding that the first condition is satisfied in virtually all states except perhaps those states (if any) in which a trustee is permitted to invest only in assets set forth in a statutory "legal list."

(2) The second condition will be met when the terms of the trust require all of the "income" to be distributed at regular intervals; or when the terms of the trust require a trustee to distribute all of the income, but permit the trustee to decide how much to distribute to each member of a class of beneficiaries; or when the terms of a trust provide that a beneficiary shall receive the greater of the trust accounting income and a fixed dollar amount, or of trust accounting income and a fractional share of the value of the trust assets. If the trust instrument gives the trustee discretion to distribute the trust's income to the beneficiary or to accumulate some or all of the income, the condition will be met if the terms of the trust do not permit the trustee to distribute more than the trust accounting income.

(3) The third condition will be met if the trustee determines that either it is impossible to administer the trust impartially or that it is impossible to achieve the degree of impartiality required, encouraged, or permitted under the trust agreement.

E. The Uniform Fiduciary Income and Principal Act

1. The Uniform Fiduciary Income and Principal Act (UFIPA) was approved by the Uniform Law Commission in July 2018. It supersedes RUPIA.

2. UFIPA makes many changes to increase a fiduciary's flexibility, including the availability of the power to adjust. In Section 203 of UFIPA, the power to adjust is not limited to cases where all three of the conditions identified in the bullet points above are met. Instead, it is available "if the fiduciary determines the exercise of the power to adjust will assist the fiduciary to administer the trust or estate impartially." In that way, giving the trustee of a modern trust *more* discretion over distributions of both income and principal will not ironically cause the trustee to have *less* discretion to adjust between income and principal. Therefore, within the bounds of the power to adjust, the trustee will still be able to treat the beneficiaries impartially, while still respecting the simple tradition of "distributing income."

3. Before making an adjustment the trustee still must consider the factors that are relevant to the trust and its beneficiaries, including the following factors set forth in Section 201(e) of UFIPA, which is an updated restatement of RUPIA Section 104(b):

   a. The terms of the trust.

   b. The nature, distribution standards, and expected duration of the trust.

c. The effect of the allocation rules, including specific adjustments between income and principal, under Articles 4 through 7 of UFIPA, which are generally updates of the default allocation rules generally carried over from Articles 2 through 5 of RUPIA.

d. The desirability of liquidity and regularity of income.

e. The desirability of the preservation and appreciation of principal.

f. The extent to which an asset is used or may be used by a beneficiary.

g. The increase or decrease in the value of principal assets, reasonably determined by the fiduciary.

h. Whether and to what extent the terms of the trust give the fiduciary power to accumulate income or invade principal or prohibit the fiduciary from accumulating income or invading principal.

i. The extent to which the fiduciary has accumulated income or invaded principal in preceding accounting periods.

j. The effect of current and reasonably expected economic conditions.

k. The reasonably expected tax consequences of the exercise of the power.

4. In addition, like Section 104(c)(7) and (8) of RUPIA, Section 203(e)(7) of UFIPA generally prevents the adjustment power from being exercised by a trustee who is also a beneficiary or is otherwise not "independent." If there are independent cotrustees, they alone should exercise the power. If there are no independent trustees, one should be appointed.

5. Therefore, under both RUPIA and UFIPA, one way to resolve the tension between income and remainder beneficiaries in a low-yield environment is to reallocate principal to income to increase the amount payable to the income beneficiaries each year. In a high-interest rate or high-inflation environment, the opposite might be true, and the trustee might reallocate income to principal to increase the growth of trust.

F. Conversion to a Total Return Unitrust

1. The word "unitrust" can be traced at least to the literature of the mid-1960s. Lovell, "The Unitrust: A New Concept to Meet an Old Problem," 105 TRUSTS & ESTATES 215 (1966); Del Cotto & Joyce, "Taxation of the Trust Annuity: The Unitrust Under the Constitution and the Internal Revenue Code," 23 TAX L. REV. 257 (1968).

   a. An estate planner's first reaction to the word is principally influenced, of course, by the use of the term "charitable remainder unitrust" by Congress in section 664, added to the Internal Revenue Code by the Tax Reform Act of 1969.

   b. The word was reprised following the enactment of section 2702 in Reg. §25.2702-3(c), governing "qualified unitrust interests" in grantor retained unitrusts ("GRUTs"), although GRUTs are hardly ever used, if they are used at all).

c. While the precise origin or intent of the word is not totally clear, it appears derived from the notion that the trust consists of a *unified* fund—"a single fund [in which] there would be no distinction between income and principal," only between "receipts" and "payouts." Lovell, *supra*. The "unitrust" can be thought of as a trust in which there is a "unity" of interest between the current income beneficiaries and the remainder or successive beneficiaries, because both benefit from a higher value of the trust assets.

2. Thus, in today's legal usage, a "unitrust" is simply a trust in which the periodic payout to the current income beneficiaries is determined with reference to a percentage of the net value of the trust assets, determined from time to time, regardless of how much income is produced by the trust assets or the growth of the trust assets. As the value of the trust assets increases, the unitrust amount increases. As the value decreases, the unitrust amount decreases.

3. The "unity" of interest between the current income beneficiaries and the remainder or successor beneficiaries will enable the trustee to invest the assets for long-term growth to the benefit of all beneficiaries. This will permit the mission of the trustee and investment team to become more focused. Investment decisions can be based on the needs and risk tolerances of the beneficiaries, and there is less likelihood of dissension between the current and future beneficiaries over investment policy.

4. In addition, to the extent that a unitrust approach makes discretionary invasions of principal unnecessary (or less necessary), the trustee is protected against challenges by the remainder beneficiaries that any discretionary principal distributions were excessive.

5. Similarly, a unitrust approach eliminates the need to make adjustments between income and principal under Section 203 of UFIPA and thus protects the trustee against challenges that such adjustments were improper.

6. Refinements of the unitrust approach can permit a total return unitrust to even better serve the objective of achieving more stability and predictability for the income beneficiaries.

   a. One such refinement is to provide that the trust distribute a percentage of its market value determined on the basis of a two (or more) year rolling average, rather than using the market value in a single year. Twelve quarters (three years) is a common example. This will reduce potential fluctuations in distributions caused by short-swing movements in the stock market. Although the rate of increase in the unitrust distribution to the income beneficiaries will lag the performance of the portfolio, the income beneficiaries will benefit in down years.

   b. Another similar refinement designed to reduce risk to all the beneficiaries is to place a ceiling and/or a floor on the unitrust payout amount, or a limit on the upward or downward fluctuation of the unitrust amount from year to year.

7. When a multi-generation trust is converted to a unitrust, consideration might be given to whether it is appropriate at the same time to divide the trust among family lines, in order to allow individual family lines to invest as they see fit.

8. Although RUPIA does not provide for conversion of a trust to a unitrust, many states have enacted statutes expressly allowing for conversion, either as part of their Uniform Principal and Income Acts or as separate legislation.

9. New Article 3 of UFIPA does provide for conversion of a trust to a unitrust. Unlike the statutes in effect in some states, however, it provides broad flexibility in the design of the unitrust provisions, except that Section 309(b) of UFIPA limits that flexibility for certain tax-advantaged trusts to the parameters of what amounts to a safe harbor in Reg. §1.643(b)(1), which states that

> an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation. For example, a state statute providing that income is a unitrust amount of no less than 3% and no more than 5% of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis, is a reasonable apportionment of the total return of the trust.

G. The Uniform Trust Code

1. The Uniform Trust Code ("UTC") was completed by the Uniform Law Commission in 2000, and was promulgated with the following expectations:

> There is a serious need for certainty and clearly articulated rules as the use of trusts burgeons in the United States. The Uniform Trust Code is timely in the year 2000. It meets the needs of the citizens of the United States for decades to come.

Then the Commission revised the UTC in 2001, 2003, 2004, and 2005!

2. The UTC has been adopted in various forms in about two-thirds of the states. It is an ambitious and sometimes controversial blend of codification (distilled from Restatements) and law reform. It recognizes court supervision as the exception and not the norm.

3. Section 304 of the UTC recognizes "virtual representation," by which a minor, incapacitated, unborn, or unknown person may be represented and legally bound by someone with "a substantially identical interest with respect to the particular question or dispute" unless that would present a conflict of interest.

4. Section 111 of the UTC provides that "interested persons may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust … to the extent it does not violate a material purpose of the trust."

   a. Matters that may be resolved by such an agreement expressly include the interpretation or construction of the terms of the trust, direction to a trustee to refrain from performing a particular act, the grant to a trustee of any necessary or desirable power, and transfer of a trust's principal place of administration.

   b. One might question whether and to what extent any trust is "irrevocable" under such a statute. *See* Redd, "Flexibility vs. Certainty – Has the Pendulum Swung Too Far," TRUSTS & ESTATES (March 2015).

c. The requirement that the action "not violate a material purpose of the trust" codifies the "Claflin Doctrine." *See Claflin v. Claflin,* 20 N.E. 454 (Mass. 1889).

(1) Section 411(c) of the UTC (not included in the version approved by every state) provides that "[a] spendthrift provision in the terms of the trust is not presumed to constitute a material purpose of the trust."

(2) In this regard, the Foreword to the RESTATEMENT (3D) OF TRUSTS (2012) states:

> The principles restated in these volumes have two main themes. One is to make it easier to accomplish the settlor's intentions, so long as those intentions can be reliably established and do not offend public policy. The second is to recognize appropriate authority, through doctrines that include cy pres, to enable the living – especially judges – to adapt the settlor's expressed purposes to contemporary circumstances. This second purpose is increasingly important because of changes, complexities, and opportunities in tax law, other legal developments, improved life expectancies, and the creation of more trusts that survive long after the settlor expressed her or his intentions.

5. Section 808 of the UTC ratifies the role of trust "advisers" and "protectors," although without using those terms.

a. As a model for "directed trust" legislation, it also ratifies the power conferred on a person to direct actions of the trustee and provides, in subsection (b), that "[i]f the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust." *See* Radigan, "Defining Responsibilities When Multiple Parties Administer Trusts," 40 ESTATE PLANNING 12, 17-20 (Jan. 2013).

b. The comment to Section 808 explains that "[p]owers to direct are most effective when the trustee is not deterred from exercising the power by fear of possible liability. On the other hand, the trustee does have overall responsibility for seeing that the terms of the trust are honored. For this reason, subsection (b) imposes only minimal oversight responsibility on the trustee. A trustee must generally act in accordance with the direction. A trustee may refuse the direction only if the attempted exercise would be manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty owed by the holder of the power to the beneficiaries of the trust."

c. For thoughtful observations, including the answer to the question "once and for all, is the protector a fiduciary?", see Bove, "The Case Against the Trust Protector," 37 ACTEC J. 77 (2011); Bove, "The Trust Protector: Friend or Fiduciary?", published in volume II of ASSET PROTECTION STRATEGIES –

WEALTH PRESERVATION PLANNING WITH DOMESTIC AND OFFSHORE ENTITIES (Am. Bar Ass'n 2005, Alexander A. Bove, Jr., ed.), and Bove, "The Trust Protector: Trust(y) Watchdog or Expensive Exotic Pet," 30 ESTATE PLANNING 390 (Aug. 2003). The author's answer is yes, by the way.

H. The Uniform Directed Trust Act

1. In 2017, the Uniform Law Commission approved the Uniform Directed Trust Act (http://www.uniformlaws.org/shared/docs/divided%20trusteeship/UDTA_Final_2017nov3.pdf).
2. Under the Uniform Directed Trust Act ("UDTA"), a power over a trust held by a nontrustee is called a "power of direction," and the holder of that power is called a "trust director." A trustee that is subject to a power of direction is called a "directed trustee."
3. As the drafters stated in its Prefatory Note:

   > By validating terms of a trust that grant a trust director a power of direction, the Uniform Directed Trust Act promotes settlor autonomy in accordance with the principle of freedom of disposition. At the same time, the act imposes a mandatory minimum of fiduciary duty on both a directed trustee and a trust director in accordance with the traditional principle that a trust is a fiduciary relationship. *See, e.g.*, Restatement (Third) of Trusts §96 comment c (2012) ("[F]or reasons of policy trust fiduciary law imposes limitations on the types and degree of misconduct for which the trustee can be excused from liability.").

4. The fiduciary duty and liability of a trust director are addressed in Section 8 of UDTA. Both the fiduciary duty and liability of the trust director (Section 8(a)(1)) and the ability of the terms of the trust to vary that duty and liability (Section 8(a)(2)) are the same as in the case of a trustee "in a like position and under similar circumstances." But the law varies among states. Alaska Statutes §13.36.370(d), for example, provides:

   > Subject to the terms of the trust instrument, a trust protector is not liable or accountable as a trustee or fiduciary because of an act or omission of the trust protector taken when performing the function of a trust protector under the trust instrument.

5. Under Section 9 of UDTA, a directed trustee is required to take reasonable action to comply with a trust director's direction, except to the extent that such compliance would be willful misconduct, and may ask a court for instructions if in doubt.
6. For more on UDTA, see Morley & Sitkoff, "Making Directed Trusts Work: The Uniform Directed Trust Act," 44 ACTEC L.J. 3 (Winter 2019); Ditelberg, "Am I My Brother's Keeper: Willful Misconduct and the Directed Trustee under the Uniform Directed Trust Act," 44 ACTEC L.J. 207 (Spring 2019); Spica, "From Strength to Strength: A Comment on Morley and Sitkoff's *Making Directed Trusts Work*," *id.* at 215; Bieber & Chang, "Spinning Straw Into Gold—Modifying Irrevocable Trusts," 46 EST. PLAN. 3, 5-7 (Jan. 2019).
7. For more on the division of fiduciary roles, see Part VI.A.3 beginning on page 25.

I. Decanting

1. "Decanting" is generally the discretionary authority to distribute some or all the assets of one trust (a "Distributing Trust") to another (often new) trust (a "Receiving Trust") pursuant to a power of appointment, the governing instrument, or applicable state law, without the need for prior court approval or the prior consent of any beneficiary of the trust. *See generally* Bieber & Chang, *supra* at 9-11; Culp & Mellen, "Trust Decanting: An Overview and Introduction to Creative Planning Opportunities," 45 REAL PROP. TR. & EST. L. J. 1 (2010); Simmons, "Decanting and Its Alternatives, Remodeling and Revamping Irrevocable Trusts," 55 S.D.L. REV. 253 (2010); Skeary, "The Power of Trust Decanting," PROB. & PROP. 22 (Sept.-Oct. 2018); Willms, "Decanting Trusts: Irrevocable, Not Unchangeable," 6 EST. PLAN. & COMMUNITY PROPERTY L.J. 35 (2013).

   a. Decanting is authorized by statute in about half of the states.

   b. It is also viewed by many as permitted in many circumstances under the common law first applied (as far as we know) in *Phipps v. Palm Beach Trust Co*., 142 Fla. 782, 196 So. 299 (1940). Citing RESTATEMENT OF TRUSTS §17, The *Phipps* court concluded that "the power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent."

   c. To the same effect was *Wiedenmayer v. Johnson*, 106 N.J. Super. 161, 164-65, 254 A.2d 534 (App. Div.), *aff'd sub nom. Wiedenmayer v. Villanueva*, 55 N.J. 81, 259 A.2d 465 (1969), in which the court of appeals states: "If [trustees] could make [a] distribution to the end, as the trust indenture expressly stated, that the trust property would be the son's 'absolutely, outright and forever,' it seems logical to conclude that the trustees could, to safeguard the son's best interests, condition the distribution upon his setting up a substituted trust."

   d. In contrast, *In re Estate of Spencer*, 232 N.W.2d 491 (Iowa 1975), held that a testamentary power of appointment authorized to be exercised by life estates for children with the remainders to children's surviving issue could not be exercised in favor of a multi-generation trust that vested later than the children's deaths.

2. RESTATEMENT (2D) OF PROPERTY: DONATIVE TRANSFERS §11.1 comment d (1986) states that "the trustee holding a discretionary power has a power of appointment …." RESTATEMENT (2D) OF PROPERTY: DONATIVE TRANSFERS §19.4 recognizes that a nongeneral power of appointment may be exercised by creating a general or nongeneral power. And RESTATEMENT (3D) OF PROPERTY: WILLS AND OTHER DONATIVE TRANSFERS §19.14 (2011) clarifies that "[e]xcept to the extent that the donor has manifested a contrary intention, the donee of a nongeneral power is authorized to make an appointment in any form, including one in trust and one that creates a power of appointment in another, that only benefits permissible appointees of the power." Finally, RESTATEMENT (3D) OF PROPERTY: WILLS AND OTHER DONATIVE TRANSFERS §19.14 comment f concludes that "[s]ubject to fiduciary standards and the terms of the power, a trustee or other fiduciary can exercise a fiduciary distributive power such as a power of invasion to create another trust."

3. In *Morse v. Kraft*, 992 N.E.2d 1021 (Mass. 2013), citing a cross-reference in RESTATEMENT (3D) OF PROPERTY: WILLS AND OTHER DONATIVE TRANSFERS §17.1 comment g, but not the clearer conclusion in §19.14 comment f *supra*, the Massachusetts Supreme Judicial Court held that a trust instrument that authorized distributions to a beneficiary or "for his or her benefit" authorized distributions to new trusts.

   a. The court reasoned simply that the trust provisions in question

      > give the disinterested trustee discretion to distribute property directly to, or applied for the benefit of, the trust beneficiaries, limited only in that such distributions must be "for the benefit of" such beneficiaries. We regard this broad grant of almost unlimited discretion as evidence of the settlor's intent that the disinterested trustee have the authority to distribute assets in further trust for the beneficiaries' benefit.

   b. The Boston Bar Association had submitted an amicus brief requesting the court to "extend the decanting power to purely discretionary trusts where the trustee has the power to distribute assets 'to' the beneficiary, but not 'for the benefit of' the beneficiary." Di Cola, "Joan Di Cola on Morse v. Kraft – Massachusetts Supreme Judicial Court Allows Decanting," LEIMBERG INFORMATION SERVICES ESTATE PLANNING NEWSLETTER #2125 (Aug. 2, 2013).

      (1) The court expressly declined to adopt that position of recognizing "an inherent power of trustees of irrevocable trusts to exercise their distribution authority by distributing trust property in further trust, irrespective of the language of the trust."

      (2) The court viewed the case as a matter of interpreting the trust instrument, and pointed several times in its opinion to the broad discretion of the trustee in making distributions and the specific authorization in the trust instrument that a payment to a beneficiary could be "applied for his or her benefit" and that distributions could be made "for the benefit of" the beneficiaries.

      (3) Many trust instruments merely authorize distributions "to" beneficiaries and do not explicitly include the phrase "for the benefit of" beneficiaries. The case leaves in greater question whether those trusts have a decanting authority without court approval.

   c. If the focus of the analysis is on the specific terms of the trust, there may be more need to obtain a judicial order that the trustee has the authority to make distributions in further trust without court approval in order to be assured that the decanting will not have adverse GST tax consequences, particularly if there is any possibility of shifting benefits to younger generation beneficiaries or any possibility of extending the trust term.

   d. But for future drafting purposes, the court noted that trusts created in the future may need to authorize decanting specifically if that is intended:

      > In the absence of express authorizing legislation, practitioners are including express decanting provisions in standard trust agreements with increasing frequency…. The 2012 Trust [*i.e.*, the newly created trust

> under the decanting power], for example, twice states expressly that the trustee has decanting power. In light of the increased awareness, and indeed practice, of decanting, we expect that settlors in the future who wish to give trustees a decanting power will do so expressly. We will then consider whether the failure to expressly grant this power suggests an intent to preclude decanting.

e. Other recent cases:

(1) *Ferri v. Powell-Ferri*, 72 N.E.3d 541 (Mass. 2017), ruling on issues in a Connecticut case certified from the Supreme Court of Connecticut and citing *Morse v. Kraft*, allowed a trustee to decant a trust in which the beneficiary had a power to withdraw trust corpus at certain ages into a new spendthrift trust in which the beneficiary had no such power.

(2) The Connecticut Supreme Court followed the Massachusetts decision in *Powell-Ferri v. Ferri*, 326 Conn. 457 (2017).

(3) *Davidovich v. Hoppenstein*, 162 A.D.3d 512, 79 N.Y.S.3d 133 (N.Y. App. 2018), affirmed the Surrogate Court's decision allowing a trustee to distribute a life insurance policy to a new trust that excluded one of the grantor's children from the class of beneficiaries, even though the trustee had allegedly not followed all the requirements of New York's decanting statute. The rulings confirmed in effect that the decanting statute supplemented, but did not override, the provisions of the trust agreement and the common law.

(4) Meanwhile, in contrast, the courts in *Hodges v. Johnson*, 177 A.3d 86 (N.H. 2017), declined to allow a decanting that eliminated beneficiaries. The rather extreme facts of the case revealed that the two trustees of the trust resigned, the grantor's estate planning attorney became the trustee and executed decanting documents, and then the attorney resigned and was replaced by the two original trustees. This happened three times over three years, each time eliminating one or two beneficiaries, apparently reflecting discord outside the trust: the termination of a stepchild's employment by the family business, the disappointment of a son over the engagement of an outside manager, and finally the grantor's divorce. Each time, the new trusts resulting from the decanting were not funded because the decanting documents deferred that detail until the grantor's death. Although the trust terms clearly allowed unequal distributions, even to the exclusion of some beneficiaries, the courts believed that the trustees had violated their duty of impartiality by failing to consider the interests of all present and future beneficiaries.

4. In early GST tax rulings on decanting transactions, the IRS treated them like any other change to a trust.

a. Letter Ruling 9737024 (June 17, 1997) addressed a New York trust, called

"Trust II," that had been irrevocable in 1976.

(1) The trustees had

> the discretion to pay to the Beneficiary at any time, as much of the current income and principal as they may determine advisable for the "proper support, comfort and welfare of the Beneficiary (without regard to the income or other resources of the Beneficiary)" or the Beneficiary's dependents or to assist the Beneficiary (or the Beneficiary's dependents) in the event of illness, accident or emergency.

(2) Under New York's decanting statute, N.Y. EST. POWERS & TRUSTS §10-6.6(b)(1), which had become effective in 1992, as quoted by the IRS (including the explanations in square brackets, which are in the original ruling):

> A trustee, who has the absolute discretion, under the terms of a[n] … irrevocable inter vivos trust agreement, to invade the principal of a trust for the benefit of the income beneficiary … of the trust, may exercise such discretion by appointing so much or all of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument with the consent of all persons interested in the trust but without prior court approval, provided, however, that (A) the exercise of such discretion does not reduce any fixed income interest of any income beneficiary of the trust (B) the exercise of such discretion is in favor of the beneficiaries of the trust, and (C) does not violate the limitations of [E.P.T.L. section] 11-1.7 [which prohibits waivers of liability].

(3) Under the authority of that statute, the trustees proposed to transfer the assets of Trust II to another trust, which would be identical except for the provisions for trustee succession. The IRS ruled

> The substantive and dispositive provisions of the new trust are identical to those of Trust II. Moreover, the new trust, like Trust II, will include Article THIRTEENTH, which provides that the trust will be administered and regulated in accordance with the laws of New York State.
>
> … [T]he proposed changes in [the trustee succession provisions] of the new trust will be administrative in nature and will not result in any change in the quality, value or timing of any beneficial interest in the trust.
>
> Accordingly, because the substantive and dispositive provisions of Trust II are identical to the new trust, the proposed transfer of the corpus of Trust II to the new trust will not change the quality, value, or timing of any power, beneficial interest, right, or expectancy originally provided for under the terms of Trust II.
>
> … Thus, the new trust will be subject to Chapter 13 to the same extent Trust II was subject to Chapter 13.

b. Other favorable rulings involving the New York decanting statute include Letter Rulings 9332014 (May 13, 1993), 9450036 (Sept. 20, 1994), 9804046 (Oct. 28, 1997), 9848043 and 9849007 (Sept. 1, 1998), and 200227020 (April 1, 2002). Similar favorable rulings, with no state specified, include Letter Rulings 200520023 (Jan. 28, 2005) (court-approved transfer of three trusts into three similar "Receiving Trusts"), 200607015 (Nov. 4, 2005) (court-approved transfer of nine trusts into nine new trusts), 201133007 (May 17, 2011) (court-approved division of two trusts along family lines into three trusts each after a court-approved change of situs), and 201134017 (May 26, 2011) (distribution from a post-1985 trust to a similar "Receiving Trust" pursuant to specific authority in the trust instrument would not affect the trust's zero inclusion ratio),

c. Letter Ruling 200410015 (Oct. 10, 2003), addressing what it called a "restructuring" of 16 separate trusts in a state that apparently did not have a decanting statute or case (*i.e.*, a state other than New York, Alaska, Delaware, Florida, or New Jersey), stated in part (emphasis added):

> [The trust instruments provide that] during the existence of the separate trusts, any part or even all of the then net income and/or corpus of the trust … may, at any time or times, in the sole discretion of the independent trustee of the trust, *be distributed to or for the benefit of* [the beneficiary], or any one or more of [the then beneficiaries], of such separate trust and/or *to or for the benefit of* any one or more of those of the lineal descendants of the beneficiary or beneficiaries who are also lineal descendants of the grantors and who are then living even though not now living, including those whose parent or parents are then living.
>
> …
>
> The current trustees propose to consolidate [certain] trusts …. [Other trusts] will [be] merged and then divided, generally on a per stirpes basis, into four new trusts …. The … consolidations and the … division will be achieved *by the independent trustee's exercise of his distribution discretion* over the sixteen current trusts to appoint their assets to six new trusts, each governed by a new trust agreement.
>
> …
>
> On Date 10, the trustees filed a Petition for Instructions with Probate Court in State 2. Probate Court is the court having jurisdiction over all the trusts that are the subject of this private letter ruling. The Petition for Instructions sought *confirmation* of the independent trustee's authority to exercise his discretionary power of distribution *in favor of further trusts*. On Date 11, Probate Court issued sixteen separate orders (one for each trust) contingent upon a private letter ruling from the Internal Revenue Service regarding the estate and generation-skipping transfer tax consequences of the exercise. The orders stated that the trust instruments grant the independent trustee a discretionary power of distribution that *may be exercised in favor of one or more new trusts created by him* for the benefit of all or any one of the permissible distributees under the original trusts, equally or unequally. The orders further provided that the power could be exercised by the independent trustee without either beneficiary consent or court approval if the new trusts do not benefit anyone who was

> not a current or future permissible distributee under the relevant original trust and the terms of the new trust do not extend the duration of the trusts beyond the perpetuities period of the relevant original trust.
>
> …
>
> The present transaction is similar to that in Example 1 of [Reg.] §26.2601-1(b)(4)(i)(E). With respect to the original trusts, the independent trustee has the discretion to make the proposed distributions in the respective trust agreements. Furthermore, the terms of the new trust agreements will not extend the time for vesting that was provided for in the original trusts because the individuals used as measuring lives for the new trusts were included as measuring lives under the original trust. Therefore, the new trusts will terminate at the same time the original trusts were to terminate. Accordingly, the terms in the new trust agreements do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property in contradiction to §26.2601-1(b)(4)(A)(2) or §26.2601-1(b)(1)(v)(B). *We therefore conclude that the proposed transaction will not change the status of the trusts as exempt from the generation-skipping transfer tax.*

d. Letter Ruling 200406041 (Oct. 10, 2003), favorably addressing what was apparently the same or related "restructuring" transactions as in Letter Ruling 200410015, stated in part that "[t]he current independent trustee proposes to distribute the assets of Trust 2 and Trust 3 to two new trusts, Trust 2A and Trust 3A, respectively."

5. Then, in January 2011, sections 5.09, 5.16, and 5.17 of Rev. Proc. 2011-3, 2011-1 I.R.B. 111, included decanting among the "areas under study in which rulings … will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations or otherwise." This designation was continued in subsequent "-3" Revenue Procedures. *See, e.g.*, sections 5.01(7), (12), and (13) of Rev. Proc. 2018-3, 2018-1 I.R.B. 130.

6. The 2011-2012 Treasury-IRS Priority Guidance Plan, released on September 2, 2011, included, as item 13, "Notice on decanting of trusts under §§2501 and 2601."

7. On December 20, 2011, the IRS published Notice 2011-101, 2011-52 I.R.B. 932, asking for comments from the public by April 25, 2012, on the tax consequences of decanting transactions. Notice 2011-101 asked for comments on the relevance and effect of the following 13 facts and circumstances (as well as the identification of any other factors that might affect the tax consequences):

   a. A beneficiary's right to or interest in trust principal or income is changed (including the right or interest of a charitable beneficiary);

   b. Trust principal and/or income may be used to benefit new (additional) beneficiaries;

   c. A beneficial interest (including any power to appoint income or corpus, whether general or limited, or other power) is added, deleted, or changed;

d. The transfer takes place from a trust treated as partially or wholly owned by a person under §§671 through 678 of the Internal Revenue Code (a "grantor trust") to one which is not a grantor trust, or vice versa;

e. The situs or governing law of the Receiving Trust differs from that of the Distributing Trust, resulting in a termination date of the Receiving Trust that is subsequent to the termination date of the Distributing Trust;

f. A court order and/or approval of the state Attorney General is required for the transfer by the terms of the Distributing Trust and/or applicable law;

g. The beneficiaries are required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law;

h. The beneficiaries are not required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law;

i. Consent of the beneficiaries and/or a court order (or approval of the state Attorney General) is not required but is obtained;

j. The effect of state law or the silence of state law on any of the above scenarios;

k. A change in the identity of a donor or transferor for gift and/or GST tax purposes;

l. The Distributing Trust is exempt from GST tax under §26.2601-1, has an inclusion ratio of zero under §2632, or is exempt from GST under §2663; and

m. None of the changes described above are made, but a future power to make any such changes is created.

8. Notice 2011-101 also "encourage[d] the public to suggest a definition for the type of transfer ('decanting') this guidance is intended to address" and encouraged responses to consider the contexts of domestic trusts, the domestication of foreign trusts, and transfers to foreign trusts. Meanwhile, the IRS said, it "generally will continue to issue PLRs with respect to such transfers that do not result in a change to any beneficial interests and do not result in a change in the applicable rule against perpetuities period."

9. That was it!

   a. The Plan predicted a "Notice on decanting," and the IRS published Notice 2011-101.

   b. Decanting was omitted from the 2012-2013 Plan and has been omitted again from subsequent Plans.

   c. There were extensive public comments in response to the Notice, however, including comments by ACTEC (described below), and there is no doubt that the Treasury and IRS will continue to study the issues raised by decanting.

10. Meanwhile, a new Uniform Trust Decanting Act (UTDA) was approved by the Uniform Law Commission in July 2015. The Act is available at http://www.uniformlaws.org/shared/docs/trustdecanting/UTDA_Final%20Act.pdf and generally allows decanting whenever the trustee has discretion to make

principal distributions, or even if the trustee does not have such discretion if it is appropriate to decant into a special-needs trust.

a. Generally, decanting may not add beneficiaries, and Section 19 of UTDA includes extensive explicit safeguards, called "tax-related limitations," to prevent decanting from jeopardizing any intended beneficial tax characteristics of the trust. The beneficial tax characteristics explicitly addressed are the marital deduction, the charitable deduction, the annual gift tax exclusion, the eligibility of the trust to hold S corporation stock, an inclusion ratio of zero for GST tax purposes, preservation of the use of the trust beneficiary's life expectancy in determining minimum required distributions from a retirement plan or IRA, and the preservation, creation, or termination of grantor trust status as the circumstances might warrant.

b. UTDA in effect now provides the "definition" Notice 2011-101 asked for, and its publication should now pave the way for the long-awaited tax guidance for decantings done under UTDA or substantially identical statutes. And because of the care to avoid tax problems that UTDA exhibits, that guidance should not be as hard to complete or as harsh in its application as many might have feared. The comments, Q&As, and proposed revenue ruling ACTEC submitted on April 2, 2012 (http://www.actec.org/resources/comments-on-transfers-by-a-trustee/) may help.

III. What Kind of Trust?

A. Views of Wealth

1. Typically, in frank conversation with clients about the extent to which trusts should be used in their estate plans and the kinds of trusts that should be used, the answers depend on the client's view of property, or view of ownership, or view of the life experience itself. All anyone ultimately has is a life estate. It is possible to view the focus of life as *acquisition* or as *stewardship* (with these two characteristics blended in various degrees and various ways from client to client).

a. If the client's view is self-centered and concerned with possession, enjoyment, and control (not coincidentally the common "strings" that cause inclusion in the gross estate), the desire might be to use a trust to control both the property *and* the beneficiaries for as long and as tightly as the law (or available avenues around the law) will tolerate.

b. But if the client's view is others-centered and concerned with stewardship, service, and charity, the desire might also be to preserve the property and to use it to teach and model values to beneficiaries. "Stewardship" itself varies from client to client; it can involve a sense of stewardship of values and principles, physical and intellectual health, the earth and the environment, the arts and sciences, history and culture, moral and spiritual values, and, of course, wealth. The greater the orientation to stewardship, the greater the client's objectives typically include passing that commitment to future generations and preparing those future generations for that stewardship, including instilling gratitude and generosity. Such clients are often more content and more relaxed in disposing of their estates. They are focused on people, not things. In that case, while the ends might be superficially similar, the means might involve much more freedom and autonomy, tempered with responsibility and accountability.

c. The objectives will often vary asset by asset. Some assets are financial; some are emotional. Emotional assets are typically tangible (like a vacation home) or reflect tangible efforts (like interests in a family business); they usually demand much more sensitivity and care from the planner and the plan.

d. While mapping a one-to-one correspondence between a grantor's view of property and the law's view of trusts is hard to do and would miss the point, there is what one observer, in the context of trust investments, has recently called "a vigorous debate" over whether the dominant element in trust administration should be the interests and benefit of the beneficiaries or the intent and purpose of the grantor. Horton, "Testation and Speech," 101 GEORGETOWN L. REV. 61, 64-65 n.22 (2012), comparing Langbein, "Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments," B.U.L. REV. 375 (2010), and Langbein, "Mandatory Rules in the Law of Trusts," 98 NW. U.L. REV. 1105 (2004), with Cooper, "Empty Promises: Settlor's Intent, the Uniform Trust Code, and the Future of Trust Investment Law," 88 B.U.L. REV. 1165, 1175-1201 (2008), and Cooper, "Shades of Gray: Applying the Benefit-the-Beneficiaries Rule to Trust Investment Directives," 90 B.U.J. REV. 2383, 2383-84 (2010). *See also* Cooper, "Dead Hand Investing: The Enforceability of Trust Investment Directives," 37 ACTEC J. 365 (2011).

B. Views of Trusts

1. The estate planner can explain the uses of a trust and the benefits of a trust, including professional management, asset protection, spendthrift protection, and tax savings. Some clients will readily choose trusts with all the frills. But many will say no to trusts, at least for part of their estates, and will conclude that they are better *stewards* by strategically drawing younger generations – especially their children – into their value systems by passing wealth to them *outright*. Today, with historically high gift tax exemptions, this can be started during life, producing the same effect as *phased* distributions after death, but with an opportunity to both model and monitor the kind of response to wealth that is important to their values.

2. Some of this can be achieved or emulated in a trust, of course. Whether during the grantor's life or long-term, for example, trust accounting and reporting can actually be done in a *meeting*, not just with sterile correspondence. Maybe this could even be done in conjunction with a regular family meeting, where the kinds of family values this paper contemplates can be intentionally nurtured. See the books and articles cited in Part VI.B.9.b on page 31.

3. But a benefit of an *outright* gift during the donor's life is that it will more easily permit *failure* and *correction* – which build character and commitment to family values – with respect to a smaller amount before inheritance of a larger amount.

4. Speaking of failure, we must acknowledge that this entire approach could fail. It would be naïve to assume, for example, that this approach would guarantee that every child will celebrate when siblings receive more.

IV. The Core Elements of a Modern Trust

A. In General

In view of the modern evolution in trust law, it is important to ask what a trust needs to be respected. It may be a simple as two core elements:

1. The ability to change.
2. The ability to challenge.

B. The Influence of Tax Law

1. "Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit." Reg. §301.7701-4(a).
2. Respect for the essential nature of a trust for income tax purposes has been viewed as requiring that the beneficiaries' interests be non-transferable and that "the beneficiaries [do] not, qua beneficiaries, control trust affairs." *Bedell Trust v. Commissioner*, 86 T.C. 1207, 1220 (1986). This highlights the importance that the trust be administered *by* the trustee *for* the beneficiaries, and that the beneficiaries' rights are to monitor and enforce the discharge of the trustee's duties, not take over.
3. If, for tax purposes, a domestic trust with more than one beneficiary is not treated as a trust, it is likely to be treated as a partnership (Reg. §301.7701-3(b)(1)(i)), creating, among other things, some unpleasant income tax surprises.

V. The First Core Element of a Modern Trust: The Ability to Change

History leaves no doubt about the importance of flexibility in designing and administering a trust. Trusts must change because times change, values change, circumstances change, families change, and families grow.

A. Repeal or Relaxation of the Rule Against Perpetuities and Implications for Family Growth

1. Nothing both highlights and complicates the growth of families more than the demands of perpetual trusts in jurisdictions that have repealed or relaxed their Rule Against Perpetuities, fueled by increases in the GST exemption.
2. Consider the record-keeping that might be required.
   a. A "pot" trust, after a century or two, will resemble a publicly-owned corporation!
   b. Individual trusts for each family line, which in turn divide each generation, are appealing, but they may sacrifice flexibility.

c. In addition, consider the challenge of determining the disposition of a separate trust if its family line dies out – that is, if the beneficiaries of the trust die without issue surviving. Where does the trust go? To the descendants of some common ancestor? How far back? Back to the original grantor, if necessary? Back to the original grantor in every case? How is "per stirpes" defined in such a case – *i.e.*, at which generation is the trust divided per capita? Even if the trust instrument or the governing law is clear, who will keep the records?

3. How should standards for the exercise of discretion be written?

4. How will developments in reproductive technology affect the determination and treatment of beneficiaries?

   a. Is there any doubt that biology will be one of the cutting edges of technology in this century? *See* Stone, "The New Genesis in Estate Planning," 47TH ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING ch. 8 (2013). *See also* Archer, "Scrambled Eggs: Defining Parenthood and Inheritance Rights of Children Born of Reproductive Technology," 3 LOYOLA JOURNAL OF PUBLIC INTERNATIONAL LAW 152 (Spring 2002); Campisi, Lowder & Challa, "Heirs in the Freezer: Bronze Age Biology Confronts Biotechnology," 36 ACTEC L.J. 179 (Summer 2010); Gibson & Michaels, "Determining Heirship In the World of Modern Reproduction," 40 ESTATE PLANNING 29 (Jan. 2013); Goffe, "Postmortem Conception Quandary: When Must an Heir Be Here?," 40 ESTATE PLANNING 17 (July 2013); Klein, "The Issue With Issue: Rights of Posthumously Conceived Children," 41 ESTATE PLANNING 14 (Nov. 2014); McCrimmon, "Gametes, Embryos and the Life in Being: The Impact of Reproductive Technology on the Rule Against Perpetuities," 34 REAL PROP., PROB. & TRUST J. 697 (Winter 2000); Riedel, "The Impact of Modern Reproductive Technology on the Law of Probate: 'Frozen Pops' and Inheritance," the ACTEC Mary Moers Wenig Writing Competition 2004 3rd Place Winner; Shayne & Quigley, "Defining 'Descendants': Science Outpaces Traditional Heirship," 38 ESTATE PLANNING 14 (April 2011).

   b. In *Astrue v. Capato,* 566 U.S. 541, 132 S. Ct. 2021, No. 11-159 (May 21, 2012), the Supreme Court held that twins posthumously conceived through in vitro fertilization were not "children" for purposes of "child's insurance benefits" under the Social Security Act. The Court deferred to a Social Security Administration rule that in turn deferred to state intestacy law, and the law of Florida, which applied in this case, treated posthumous children as children only if they were conceived before death. But the Court also appeared to be influenced by the fact that the purpose of the "child's insurance benefits" was to "provide … dependent members of [a wage earner's] family with protection against the hardship occasioned by [the] loss of [the insured's] earnings." (citing *Califano v. Jobst*, 434 U.S. 47, 52 (1977)), a purposes not served in a case where the death of the twins' father before they were even conceived was arguably not a "loss" to the twins.

   c. But *Capato* and similar rulings should not necessarily govern the administration of trusts or even decedent's estates, and it is increasingly important that governing documents address such issues themselves or provide the necessary flexibility to permit trustees to do so.

5. Different issues are presented by the evolving diverse understanding of the term "marriage." *United States v. Windsor*, 570 U.S. 12, 133 S. Ct. 2675 (No. 12-307, June 26, 2013); *Obergefell v. Hodges*, 576 U.S. ___, 135 S. Ct. 2584 (No. 14-556, June 26, 2015), recognizing the rights of same-sex couples to marry. *See* T.D. 9785 (Sept. 8, 2016), implementing *Obergefell*.

    a. In addition to the estate tax marital deduction (section 2056), which was the issue in *Windsor*, other notable tax benefits of marriage include gift-splitting (sections 2513(a) and 2652(a)(2)), portability of the estate and gift tax unified credit (section 2010(c)), reverse-QTIP elections (section 2652(a)(3)), *per se* same generation assignment for GST tax purposes (section 2651(c)), the availability of disclaimers even if the property passes for the disclaimant's benefit (section 2518(b)(4)(A)), the personal exemption (section 151(b)), non-recognition of gain on transfers between spouses (section 1041(a)), expanded eligibility to exclude gain from the sale of a principal residence (section 121), and treatment as one shareholder of an S corporation (section 1361(c)(1)).

    b. On the other hand, *not* being married can avoid, where it is unwelcome, "family" treatment for such purposes as the special valuation rules of chapter 14 (sections 2701(e)(1) and 2704(c)(2)), disallowance of losses (section 267(c)(4)), attribution of stock ownership (section 318(a)(1)), exceptions to stepped-up basis (section 1014(e)(1)(B)), and identification of disqualified persons with respect to private foundations (section 4946(d)), as well as the "marriage penalty" of being unable to file income tax returns as single taxpayers when both have significant income.

    c. Other tax attributes that attach to marriage can be good or bad, depending on the circumstances. This includes the filing of a joint income tax return itself (section 6013), which can be a benefit when one spouse has all or most of the income, but can produce a "marriage penalty" when both have significant income, and married persons in such cases cannot elect the more advantageous filing as single taxpayers. Similarly, married status can make it easier to qualify a trust as a grantor trust (sections 672(e) and 677(a)(1)), whether that is desirable or undesirable.

    d. Meanwhile, relying on the law might not be enough and this will often be another issue to address in drafting.

        (1) Some grantors and testators may want to be *more* inclusive than the law requires, allowing their descendants' unmarried companions (of either sex) to be successive beneficiaries or permissible appointees. That has always been possible and should create no problem or controversy.

        (2) Others may choose to be *less* inclusive than the law would require in the absence of their direction. For example, some might wish to exclude their descendants' same-sex companions, even if they are married. Besides being controversial and contentious, that could raise justiciable public policy

concerns. It might not be clear for a long time how the balance should be struck between public policy and testamentary freedom. *See, e.g.*, *In re Estate of Feinberg*, 919 N.E.2d 888 (Ill. 2009) (overruling a lower court and honoring a direction in the exercise of a power of appointment to treat as predeceased any descendant who had married "outside the Jewish faith"), discussed in Horton, "Testation and Speech," 101 GEORGETOWN L. REV. 61 (2012). The Supreme Court of Illinois acknowledged a broad "tension between the competing values of freedom of testation on one hand and resistance to 'dead hand' control on the other," but concluded that "there is no 'dead hand' control or attempt to control the future conduct of the potential beneficiaries" because the holder of the power of appointment "did not impose a condition intended to control future decisions of their grandchildren regarding marriage or the practice of Judaism; rather, she made a bequest to reward, at the time of her death, those grandchildren whose lives most closely embraced the values she and [her husband] cherished."

B. Other Changes in the Family

1. **Dispersion.** As a family trust lasts longer and longer, families can be scattered widely. Maintaining unity and identity, especially through in-person meetings, is hard.

2. **Demographics.** Similarly, over time conventional definitions of generations can break down. Family members who are approximately the same age can actually be in different generations. And family members nominally in the same generation can be of widely different ages.

3. **Diversity.** While diversity is good and can enrich a family and should be celebrated, it is unfortunately true that it can sometimes cause strain. Moreover, diversity in views of wealth and diversity in appreciation of the family values that are even more important than wealth can threaten the foundation on which some trusts are built.

4. **Dissent.** Other differences – even as predictable as having Republicans and Democrats in the same family! – can be troublesome, at least without strict and likely unworkable rules about conversation.

C. Facilitating and Justifying Changes to a Trust

1. This is where nonjudicial settlements (see Part II.G.4 beginning on page 9) and decanting (see Part II.H beginning on page 11) can come in handy.

2. Aside from practical necessity, the justification for such changes may lie in the fact that the grantor *chose* the trust form, subject to the Rule of Law maintained by legislatures, lawyers, and courts since the Sixteenth Century.

VI. The Second Core Element of a Modern Trust: The Ability to Challenge

A. The Importance of Fiduciary Duty

1. Recall this simple and fundamental definition of a trust:

> A trust, as the term is used in this Restatement when not qualified by the word "resulting" or "constructive," is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and *subjecting the person who holds title to the property to duties* to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.

RESTATEMENT (3D) OF TRUSTS §2 (2003)(emphasis added).

2. Attempts at Exculpation

   a. Section 1008(a) of the UTC provides that "[a] term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that it (1) relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries; or (2) was inserted as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor."

      (1) Section 1008(b) adds that "[a]n exculpatory term drafted or caused to be drafted by the trustee is invalid as an abuse of a fiduciary or confidential relationship unless the trustee proves that the exculpatory term is fair under the circumstances and that its existence and contents were adequately communicated to the settlor." Lawyers who draft trust documents appointing themselves as trustees or successor trustees should beware.

      (2) RESTATEMENT (3D) OF TRUSTS §96(1) (2003) is similar, but it adds that an exculpation clause cannot be enforced to relieve a trustee from "accountability for profits derived from a breach of trust."

   b. As stated above, the comment to Section 808 of the UTC, regarding "directed trusts," explains that Section 808(b) "imposes only minimal oversight responsibility on the [directed] trustee." See Part II.G.5 beginning on page 10.

   c. *Vena v. Vena*, 899 N.E.2d 522 (Ill. App. 2008), held that even when a trustee had obtained the approval of a majority of the beneficiaries, which the trust instrument viewed as sufficient, an exculpation clause was ineffective against a beneficiary who had not agreed, demonstrating that such clauses would be very strictly construed.

   d. *See* Filmore, "Drafting Tips for Exemplary Enforceable Exculpatory Clauses," 40 ESTATE PLANNING 27 (Oct. 2013); Pieterse & Coates, "Exculpatory Clauses May Give Trustees Extra Protection From Liability," 37 ESTATE PLANNING 26 (March 2010).

3. Dividing Fiduciary Roles

   a. It is a modern trend – almost a fad – to share and divide the administration of the trust and the corresponding fiduciary duties in various ways among cotrustees, directed trustees, officers and employees of a private trust company, and advisers, counselors, special trustees, or protectors.

b. In July 2017, the Uniform Law Commission approved a Uniform Directed Trust Act (http://uniformlaws.org/Act.aspx?title=Directed%20Trust%20Act), which is described in Part II.H beginning on page 11.

c. Viewed simply as a form of specialization, such division seems entirely appropriate and unobjectionable, even if some of the actors involved are *not* fiduciaries (which makes them no different than, say, an employee). And in a directed trust setting, fiduciary duty can be found either

   (1) upstream in the one who makes the decision and gives the direction or

   (2) downstream in the one who receives the direction and has the power to second-guess the direction as inconsistent with the purposes of the trust or otherwise not in the beneficiaries' best interests.

d. In simple cases, the IRS has shown that it has no problem with the division of responsibilities in this way, for example in a trust that is grandfathered for purposes of the GST tax. See Letter Rulings 201345004, 201345026, 201345027 & 201345028 (Aug. 1, 2013) and 201432005, 201433006, 201434004 & 201434005 (March 5, 2014).

e. But when splitting up fiduciary duties among several fiduciaries in more complicated settings, care is required in distinguishing some functions. For example:

   (1) Section 674(c) of the Internal Revenue Code provides certain exceptions from grantor trust treatment. But it does not apply if any *person* has a power to add beneficiaries (other than after-born or after-adopted children). Thus, it is well known that in certain circumstances the power to add beneficiaries can make a trust a wholly-owned grantor trust. But consider two trusts. In one, an independent trustee has the power to sprinkle income and principal among the grantor's descendants and either the same trustee or someone else has the power to add spouses of descendants as beneficiaries. In the other, an independent trustee simply has the power to sprinkle income and principal among the grantor's descendants and their spouses. Is there a real difference? If not, the "power" to add spouses of descendants as beneficiaries is illusory and perhaps insufficient to make the trust a grantor trust after all.

   (2) Or suppose a trust "protector" can confer on a beneficiary – say, a surviving spouse – a testamentary general power of appointment, which could be useful in providing a step-up in the basis of appreciated assets at the spouse's death, especially if the spouse's gross estate will not be large enough to generate an estate tax. But under section 2041(b)(1)(C)(iii) of the Internal Revenue Code, what would otherwise be a general power of appointment exercisable in conjunction with another person *is* a general power if the other person does not have an adverse interest (as a protector ordinarily would not), and it is a general power as to the *entire* value of the

trust property if the other person is not a permissible appointee (again as a protector ordinarily would not). Is there a real difference between a power that is conferred by the protector and a power held jointly with the protector? If not, the surviving spouse (in this example) has a general power in all events, regardless of the size of the estate and whether or not the protector acts.

(3) Shifting gears slightly (or greatly), suppose that a trust "protector" can add the grantor as a beneficiary after the grantor has created an irrevocable trust. Going forward, the trust then can be like a self-settled trust for the grantor's benefit – a common form of asset-protection trust – but isn't really "self-settled." Of course the parties would avoid the appearance of any explicit or implied "understanding" or "pre-arrangement." But in some cases it will be hard to argue that that wasn't the whole purpose from the beginning.

(4) Not every shift from stated purpose to ultimate use is suspect. For example, a trust could be created for the stated principal purpose of financing the education of the grantor's grandchildren and younger descendants, with the grantor's GST exemption allocated to it. But as long as the grantor is alive, it may well be more efficient for the grantor to pay tuition directly, exempt without limit from gift tax under section 2503(e) of the Internal Revenue Code, and allow the trust to accumulate free from GST tax for other uses and for still younger generations.

4. The Intent and Purpose of a Trust

a. Understanding the intent and purpose of a trust can be important in identifying

(1) the "duties" owed to beneficiaries which give the trust its very nature (see Part VI.A.1),

(2) the values, objectives, and priorities that might inform an adjustment, conversion, or other action under modern Prudent Investor and Principal and Income statutes (see Parts II.C and II.D),

(3) the "material purposes" of the trust for purposes of a nonjudicial settlement under Section 111 of the UTC (see Part II.G.4), and

(4) the "terms of the trust" for purposes of what would be a "manifestly contrary" direction under Section 808 of the UTC (see Part II.G.5) (although arguably reading the "terms" is a more mechanical and sterile exercise than discovering the "purposes").

b. Articulating the intent and purpose of a trust can often be as challenging as drafting the technical terms – sometimes more so, because "forms" don't work well.

5. Standard of Scrutiny

a. Strict liability is not required.

(1) The duties of loyalty and prudence are non-negotiable if one is to have a trust at all. And "[n]ot honesty alone, but the punctilio of an honor the most

sensitive, is then the standard of behavior." *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928)(Cardozo, C.J.).

(2) But the *standard* of scrutiny or the *degree* of scrutiny can be altered and have been altered in many jurisdictions (which, again, is just part of choosing the trust form) or of course in trust instruments themselves. The standard of scrutiny can be expressed in formulations such as bad faith, reckless indifference, and willful misconduct, or fraud, gross negligence, and intentional malfeasance, or the like.

b. But *someone* must have a fiduciary duty to the beneficiaries of the trust, enforceable by those beneficiaries, with respect to *each* basic function of a trustee:

(1) Custodial.

(2) Administrative.

(3) Investment.

(4) Distribution.

c. Judge Learned Hand summed up this way:

> [N]o language, however strong, will entirely remove any power held in trust from the reach of a court of equity. After allowance has been made for every possible factor which could rationally enter into the trustee's decision, if it appears that he has utterly disregarded the interests of the beneficiary, the court will intervene. Indeed, were that not true, *the power would not be held in trust at all*; the language would be no more than a precatory admonition.

Stix v. Commissioner, 152 F.2d 562, 563 (2d Cir. 1945)(emphasis added).

d. The enforceability of fiduciary duties to beneficiaries necessarily has two components: access to *information* and access to a *forum*.

B. The Beneficiaries' Access to Information

1. A beneficiary cannot challenge a trustee's action the beneficiary does not know about. It is therefore axiomatic – although apparently still controversial – that a beneficiary is entitled to receive regular information from the trustee, to receive additional information on request, and to be notified, promptly or even in advance, of extraordinary events such as amendments, decanting, and the like.

2. Section 813 of the UTC provides:

> **SECTION 813. DUTY TO INFORM AND REPORT.**
>
> (a) A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests. Unless unreasonable under the circumstances, a trustee shall promptly respond to a beneficiary's request for information related to the administration of the trust.

> (b) A trustee:
>
> (1) upon request of a beneficiary, shall promptly furnish to the beneficiary a copy of the trust instrument;
>
> (2) within 60 days after accepting a trusteeship, shall notify the qualified beneficiaries of the acceptance and of the trustee's name, address, and telephone number;
>
> (3) within 60 days after the date the trustee acquires knowledge of the creation of an irrevocable trust, or the date the trustee acquires knowledge that a formerly revocable trust has become irrevocable, whether by the death of the settlor or otherwise, shall notify the qualified beneficiaries of the trust's existence, of the identity of the settlor or settlors, of the right to request a copy of the trust instrument, and of the right to a trustee's report as provided in subsection (c); and
>
> (4) shall notify the qualified beneficiaries in advance of any change in the method or rate of the trustee's compensation.
>
> (c) A trustee shall send to the distributees or permissible distributees of trust income or principal, and to other qualified or nonqualified beneficiaries who request it, at least annually and at the termination of the trust, a report of the trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values. Upon a vacancy in a trusteeship, unless a cotrustee remains in office, a report must be sent to the qualified beneficiaries by the former trustee. A personal representative, [conservator], or [guardian] may send the qualified beneficiaries a report on behalf of a deceased or incapacitated trustee.
>
> (d) A beneficiary may waive the right to a trustee's report or other information otherwise required to be furnished under this section. A beneficiary, with respect to future reports and other information, may withdraw a waiver previously given.

3. Section 105(b) of the UTC provides that the terms of a trust prevail over any provision of the UTC, with certain enumerated exceptions. Among the enumerated exceptions are the duty under Section 813(b)(2) and (3) to notify qualified beneficiaries who have attained 25 years of age of the existence of the trust, the identity of the trustee, and their right to request a trustee's reports and the duty under Section 813(a) to respond to a request for a trustee's reports and other information reasonably related to the administration of the trust. But the drafting committee placed those two exceptions in brackets out of what it described as "a recognition that there is a lack of consensus on the extent to which a settlor ought to be able to waive reporting to beneficiaries, and that there is little chance that the states will enact [these two exceptions] with any uniformity." (The drafting committee was correct in that regard; the versions enacted in the respective states vary greatly.)
4. The drafting committee went on to quote Joe Kartiganer's and Ray Young's summary of the policy debate in Kartiganer & Young, "The UTC: Help for

Beneficiaries and Their Attorneys," PROB. & PROP., March-April 2003, at 18, 19-20:

> The beneficiaries' rights to information and reports are among the most important provisions in the UTC. They also are among the provisions that have attracted the most attention. The UTC provisions reflect a compromise position between opposing viewpoints.
>
> Objections raised to beneficiaries' rights to information include the wishes of some settlors who believe that knowledge of trust benefits would not be good for younger beneficiaries, encouraging them to take up a life of ease rather than work and be productive citizens. Sometimes trustees themselves desire secrecy and freedom from interference by beneficiaries.
>
> The policy arguments on the other side are: that the essence of the trust relationship is accounting to the beneficiaries; that it is wise administration to account and inform beneficiaries, to avoid the greater danger of the beneficiary learning of a breach or possible breach long after the event; and that there are practical difficulties with secrecy (for example, the trustee must tell a child that he or she is not eligible for financial aid at college because the trust will pay, and must determine whether to accumulate income at high income tax rates or pay it out for inclusion in the beneficiary's own return). Furthermore, there is the practical advantage of a one-year statute of limitations when the beneficiary is informed of the trust transactions and advised of the bar if no claim is made within the year. UTC §1005. In the absence of notice, the trustee is exposed to liability until five years after the trustee ceases to serve, the interests of beneficiaries end, or the trust terminates. UTC §1005(c).

5. *See also* Fitzsimons, "Navigating the Trustee's Duty to Disclose," PROB. & PROP., Jan./Feb. 2009, at 40; Foster, "Privacy and the Elusive Quest for Uniformity in the Law of Trusts," 38 ARIZ. ST. L.J. 713 (2006); Gallanis, "The Trustee's Duty to Inform," 85 N.C.L. REV. 1595 (2007); Millard, "The Trustee's Duty to Inform and Report Under the Uniform Trust Code," 40 REAL PROP. PROB. & TR. J. 373 (2005); Ruce, "The Trustee and the Remainderman: The Trustee's Duty to Inform," 46 REAL PROP. TR. & EST. L. J. 173 (2011).

6. In 2005, the North Carolina General Assembly enacted the Uniform Trust Code with the exceptions discussed above, thus permitting a grantor to override the default requirements to give notice to qualified beneficiaries and respond to requests from qualified beneficiaries for information. In *Wilson v. Wilson*, 690 S.E.2d 710 (N.C. App. 2010), the Court of Appeals (the single intermediate appellate court in North Carolina) considered two irrevocable trusts created in 1992, in which the grantor had purported to relieve the trustee of any duty to give accounts or reports to any court or beneficiary. Quoting RESTATEMENT (2D) OF TRUSTS §173 comment c (1959), the court noted that "the beneficiary is always entitled to such information as is reasonably necessary to enable him to enforce his rights under the trust or to prevent or redress a breach of trust." 690 S.E.2d at 715. The court concluded that the statute "does not override the duty of the trustee to act

in good faith, nor can it obstruct the power of the court to take such action as may be necessary in the interests of justice." The court added:

> If a fiduciary can be rendered free from the duty of informing the beneficiary concerning matters of which he is entitled to know, and if he can also be made immune from liability resulting from his breach of the trust, equity has been rendered impotent. The present instance would be a humiliating example of the helplessness into which courts could be cast if a provision, placed in a trust instrument through a settlor's mistaken confidence in a trustee, could relieve the latter of a duty to account. Such a provision would be virtually a license to the trustee to convert the fund to his own use and thereby terminate the trust.

690 S.E.2d at 716, quoting *Wood v. Honeyman,* 178 Or. 484, 169 P.2d 131, 164 (1946). The court got it right.

7. See *Fletcher v. Fletcher,* 480 S.E.2d 488 (Va. 1997) (a trustee has an affirmative duty to disclose the terms of the trust to a beneficiary).

8. The encouragement for "quiet trusts" is not hard to understand.

    a. Clients for whom secrecy is a goal typically hold to that goal quite fiercely. If the trust is large, it is understandable that grantors would not want to encourage beneficiaries to become dependent, lazy, entitled, and unproductive.

    b. But is it really credible that the children or other beneficiaries will not see wealth and guess there is a trust?

    c. And if the trust is too large to tell the beneficiaries about, when will they be told about it? Ever? And what will they think when they learn about the trust? What message from their parents, or other grantor, will that send?

9. In contrast, involving children early, but in an age-appropriate manner (the UTC uses age 25), can contribute to a dialogue about the trust and about wealth that will foster family unity and the transmission of family values.

    a. If the trust is viewed as just too large for the beneficiaries to handle, maybe it is. Why in that case shouldn't significant sums be devoted to charity instead? Again, a charitable arrangement that permits the children themselves to be involved, such as a donor-advised fund, will serve the additional purpose of further modeling and encouraging stewardship and philanthropy.

    b. I have had the honor of addressing ACTEC on the role the counselor, the trusted advisor, can have in encouraging communication within a family and helping to shape and pass on family values. *See* Aucutt, "Creed or Code: The Calling of the Counselor in Advising Families" (The 2011 Joseph Trachtman Memorial Lecture), 36 ACTEC L.J. 669 (Spring 2011). *See also* J.W. AMBRECHT, H. BERENS & R. GOLDWATER, FOR LOVE & MONEY (Content: 2007); J.E. HUGHES, JR., FAMILY WEALTH: KEEPING IT IN THE FAMILY (Bloomberg Press: 2004); G. LE VAN, HEALTHY WEALTH IN FAMILIES (iUniverse: 2007); J.S. MAURER, RICH IN AMERICA (Wiley: 2003); Collier, "A 'Family Systems' Approach to the Estate Planning Process," 30 ACTEC J. 146 (Fall 2004); Le Van, "Organizing Wealthy Families around Family Value and Vision: Creating a Family Council," 30 ACTEC J. 150 (Fall 2004); Llewellyn, "Anticipate and Smooth the Evolutionary Path of a Beneficiary," 38 ESTATE PLANNING 30 (Oct. 2011); Odom, "Statements of Wealth Transfer Intent: The New "Gold Standard" of Estate Planning," TRUSTS & ESTATES, May 2012.

10. Some trusts permit the trustee or someone else to appoint a representative to receive information on a beneficiary's behalf. But that just adds the representative to the circle of fiduciaries who owe duties, including duties of disclosure, to the beneficiaries. Ultimately, it does not work. But in some cases where the *beneficiary* appoints the representative, as in certain "blind trusts" established for legitimate ethical reasons, there should be no objection.

C. The Beneficiaries' Access to a Forum

1. The second component of effective enforceability is access to the assistance of a forum. Judge Learned Hand described such a forum as "a court of equity." The North Carolina Court of Appeals in *Wilson v. Wilson* stated that a statute cannot "obstruct the power of the court to take such action as may be necessary in the interests of justice."

2. No-Contest or In Terrorem Clauses

   a. A "no-contest clause" or "in terrorem clause" that reduces or eliminates the interest of a beneficiary who challenges a trust, its funding, or its administration can of course discourage a beneficiary from seeking the protection of a court. Indeed, that is typically the purpose of such a clause.

   b. In *Callaway v. Willard*, 739 S.E.2d 533 (Ga. Ct. App. 2013), the court held that in terrorem clauses "are not favored in the law" and that a challenge to trust administration and fiduciary conduct would not trigger an in terrorem provision because "in terrorem clauses cannot be construed so as to immunize fiduciaries from Georgia law governing the actions of such fiduciaries."

   c. In *Hamel v. Hamel*, 299 P.3d 278 (Kan. 2013), the court applied Kansas law that presumed no-contest clauses to be valid unless probable cause exists and applied the same rule to an in terrorem clause in a trust.

      (1) Citing *In re Campbell*, 19 Kan. App. 2d 795, 801, 876 P.2d 212 (1994), the court followed the Restatement definition of "probable cause" as "the existence, at the time of the initiation of the proceeding, of evidence which would lead a reasonable person, properly informed and advised, to conclude that there is a substantial likelihood that the contest or attack will be successful." RESTATEMENT (2D) OF PROPERTY: DONATIVE TRANSFERS §9.1 comment j (1981).

      (2) With one dissent, the court then found probable cause, based in part on the fact that at least a portion of the beneficiary's challenge was accepted as correct and in part on the fact that "the beneficiary relied upon the advice of disinterested counsel sought in good faith after a full disclosure of the facts," quoting from *id*.

      (3) The Kansas court also quoted with approval Restatement comments that "[a] suit to construe the language of a will is not a contest of the will" and

"[a]n action commenced solely for the purpose of obtaining information concerning a donative transfer does not violate a no-contest provision." *Id.*

d. As in the Kansas case, Uniform Probate Code §§2-517 and 3-905 provide these nearly identical rules:

> **SECTION 2-517. PENALTY CLAUSE FOR CONTEST.** A provision in a will purporting to penalize an interested person for contesting the will or instituting other proceedings relating to the estate is unenforceable if probable cause exists for instituting proceedings.
>
> **SECTION 3-905. PENALTY CLAUSE FOR CONTEST.** A provision in a will purporting to penalize any interested person for contesting the will or instituting other proceedings relating to the estate is unenforceable if probable cause exists for instituting proceedings.

e. For an example of the Tax Court's possible wariness about in terrorem clauses, see the discussion of the *Mikel* case in Part VI.C.3.d(4) on page 35.

f. In my experience (not scientific study), there is a substantial correlation between the use of no-contest clauses and the presence of bizarre, vindictive, or otherwise improper dispositions or, worse, undue influence. The estate planner should be alert for such behavior and affirmatively discourage it, not facilitate it, or, in the case of undue influence, absolutely prevent it. The use of no-contest clauses in documents intended to create fiduciary duty and transparency may not be a red flag, but it is at least a yellow flag.

3. Mandatory Binding Arbitration

a. Unenforceable under common law, a binding arbitration clause may be made enforceable by various state laws dealing with "contracts" (Uniform Arbitration Act, 1956) or "agreements" (Revised Uniform Arbitration Act, 2000). Outside of the scope of the arbitration statutes, arbitration clauses are still unenforceable. This was held to make arbitration clauses in trust instruments and wills unenforceable. *See, e.g., Schoneberger v. Oelze*, 96 P.3d 1079 (Ariz. Ct. App. 2004) (a trust is not a "contract," despite similarities to third-party beneficiary contracts); *In re Mary Calomiris*, 894 A.2d 408 (D.C. 2006) (a will is not a contract).

b. Encouraged by a report of the ACTEC Arbitration Task Force, which included a model statute, some states have responded with specific legislation. ARIZ. REV. STAT. ANN. §14-10205; FLA. REV. STAT. §731.401; KAN. STAT. ANN. §58a-205; MO. REV. STAT. §456.2-205; NEV. REV. STAT. §164.930; OHIO REV. CODE §5802.05; S.D. CODIFIED LAWS §55-1-54. The Florida statute, for example, enforces an arbitration clause in a will or trust other than for "disputes of the validity of all or a part of a will or trust." *See* Goldman, "Simplified Trial Resolution: High Quality Justice in a Kinder, Faster Environment," 41ST ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING ch. 8 (2007).

c. Then came *Rachal v. Reitz*, 403 S.W.3d 840 (Tex. 2013).

(1) Hal Rachal, Jr. drafted a revocable trust document for his client, Andrew Reitz. The trust instrument included an arbitration clause. The beneficiaries

were Andrew's children, James and John. The successor trustee after the grantor's death was Rachal. After the grantor's death, John sued Rachal, individually and as trustee, for misappropriation of assets. Rachal moved to compel arbitration. The trial court denied the motion. The Court of Appeals affirmed, but the Texas Supreme Court reversed and enforced the arbitration clause.

(2) The court reasoned that the Texas Arbitration Act requires only an "agreement," not a "contract." A "contract" requires consideration and meeting of the minds. An "agreement" requires only mutual assent, which can be achieved through accepting one's rights under the terms of the trust, through the principle of direct benefits estoppel. Thus, a beneficiary who accepts any rights under a trust is estopped from challenging the validity of the arbitration clause.

(3) Under *Rachal*, any action by the beneficiary to enforce rights under the instrument would be sufficient to estop the beneficiary from challenging the arbitration clause. To avoid being required to arbitrate the dispute, under *Rachal* the beneficiary apparently must challenge the instrument itself. Even a beneficiary's action to invalidate the arbitration clause could be deemed an acceptance of benefits under the trust.

(4) The *Rachal* court's reasoning seems weak and forced. But it does address the public policy concerns that had made arbitration of disputes under trust instruments uncertain and could also apply in any state whose arbitration statute enforces an arbitration clause in an "agreement." Because the *Rachal* court required only that the beneficiary accept benefits under the instrument, the reasoning might also apply to disputes under wills, although it is less clear that a will would be treated as an "agreement," despite the *Rachal* court's "benefits" analysis.

d. Meanwhile, the IRS has been wary of arbitration clauses that could affect the tax treatment of a gift or trust.

(1) In Letter Ruling 201117005 (Jan. 5, 2011), applying the Florida statute, the IRS warned:

> [W]e conclude that inclusion of [a binding arbitration provision] will not prevent [a] CRUT from qualifying as a charitable remainder unitrust that meets the requirements of §664, nor will it prevent the property passing to [a] QTIP Trust from qualifying as qualifying terminable interest property. However, we note that any final decision reached in … binding arbitration … is subject to the scrutiny of the Service to determine if the decision is based on an enforceable right under state law properly interpreted.

(2) Then, in Chief Counsel Advice (CCA) 201208026 (Sept. 28, 2011), the IRS held that certain Crummey withdrawal rights were illusionary because a beneficiary could press a withdrawal demand only before what the IRS called an "Other Forum," which it said will not recognize state or federal law. The CCA stated: "As a matter of public policy, the federal courts are

the proper venue for determining an individual's federal tax status, and the federal courts are not bound by the determinations of a private forum (such as Other Forum) concerning such status."

(3) In *Mikel v. Commissioner*, T.C. Memo. 2015-64, the Tax Court considered what was apparently the same case that the IRS addressed in CCA 201208026, identified the "Other Forum" as an Orthodox Jewish panel sometimes called a beth din, noted that under the trust instrument the beth din was directed to "give any party the rights he is entitled to under New York law," and held that the transfer did constitute present interests that qualified for the annual exclusion by reason of the Crummey powers. The court reasoned that "it is not obvious why the beneficiary must be able to 'go before a state court to enforce that right.' … A beneficiary would suffer no adverse consequences from submitting his claim to a beth din, and respondent has not explained why this is not enforcement enough."

(4) But in both the CCA and the Tax Court case, an important issue was the following "in terrorem" provision:

> In the event a beneficiary of the Trust shall directly or indirectly institute, conduct or in any manner whatever take part in or aid in any proceeding to oppose the distribution of the Trust Estate, or files any action in a court of law, or challenges any distribution set forth in this Trust in any court, arbitration panel or any other manner, then in such event the provision herein made for such beneficiary shall thereupon be revoked and such beneficiary shall be excluded from any participation in the Trust Estate.

The court interpreted this in terrorem provision as applying only to an action to oppose or challenge a distribution, not an action to enforce a Crummey withdrawal right (implying that it might have had a problem with an in terrorem clause that actually applied to the issue before it). And in *Mikel v. Commissioner*, T.C. Memo. 2015-173, the court, noting that the in terrorem provision was "not a paragon of draftsmanship," denied the donors' request for attorney's fees under section 7430, finding that the position of the IRS, though losing, had a reasonable basis in fact and law and was justified to a degree that could satisfy a reasonable person. (In terrorem clauses are also discussed in Part VI.C.2 beginning on page 32.)

e. Mandatory binding arbitration is an attractive dispute resolution option in the design and administration of trusts, as it is in partnerships, LLCs, and similar entities. Compared to litigation, it can be quicker, less expensive, and in some cases more likely to make available an arbitrator who understands the subject matter and is committed to reaching a solution. And it does not deny beneficiaries access to an impartial forum – the arbitrator *is* that forum.

f. But can arbitration offer everything a court can?

(1) While an appeal from a judge's decision can be longer and costlier (the very reasons arbitration is attractive), is does permit the correction of one-time mistakes.

(2) Because the Chancellor, unlike the common law courts, could render advisory opinions, a court (in equity) can often entertain requests for aid and direction, which is helpful to fiduciaries and beneficiaries alike. (Courts, however, might consider reforming their procedures and nomenclature. For example, there is no reason the beneficiaries in an otherwise non-contentious request for the court's help should be called "defendants," or even "respondents," which suggest conduct the beneficiaries need to answer for in some way.)

(3) Finally, there is the lingering concern that because binding arbitration ousts courts of their historic role, it might threaten the nature of a trust as a trust. A compromise of that concern might be to have more confidence in binding arbitration in a state like Arizona or Florida (but not Texas) where the legislature has specifically authorized it, thus maintaining the historic shared roles of legislatures, lawyers, and courts. But even there, providing a parallel path to court if necessary to preserve the trust as a trust may be prudent.

(4) *See generally* Murphy, Note: "Judicial Review of Arbitration Awards Under State Law," 96 VA. L. REV. 887 (2010).

VII. Summation: The Model of a Trust Relationship

A. Recall one more time the simple and fundamental definition of a trust:

> A trust, as the term is used in this Restatement when not qualified by the word "resulting" or "constructive," is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.

RESTATEMENT (3D) OF TRUSTS §2 (2003). It might be thought that much of this definition is an obvious tautology ("A trust … is a fiduciary relationship") or at least not profound ("arising from a manifestation of intention to create that relationship"). The core of the definition, the way to recognize this relationship when we see it, is that it "subject[s] the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons." From this relationship of duty, then, comes not just the various forms of duty – loyalty, care, impartiality, and the like – but the elements of the template by which trust relationships can be judged and made to work – objectives and standards, transparency and accountability, and *trust*.

B. In that light, estate planning counselors and advisors need to strive toward a model of a trust relationship that is all of these four things:

1. **Trusting.** Language matters. We don't call them "trustees" (usually) and "trustors" (occasionally) for no reason. If trustees can do anything they choose (or others like "advisors" or "protectors" choose for them), they may not be trustees, and the relationships may not be trusts. And for enforceable duties to have substance requires the beneficiaries to have proper access to both relevant information and an appropriate forum. But on the other hand, the standards for the

beneficiaries' enforcement of these duties are derived from the trust instrument and trust law, and the beneficiaries cannot do anything they choose either. The trust is still administered *by* the trustee *for* the beneficiaries. (See Part IV.B.2 on page 21.)

2. **Transitory.** The best trusts reflect a humble stewardship view of property that acknowledges that ownership does not last forever. Nothing lasts forever. Trustees don't. Even corporate trustees, while they might nominally be perpetual, act only through and by individuals who change. Even a trust that purports to last forever will require both flexibility and moderation in exercising that flexibility, but must be a trust that can be changed. Maybe, even if it can change, that trust itself will not last forever. And maybe it shouldn't.

3. **Truthful.** However a trust is designed, it shouldn't try to pretend to be something it isn't, and we shouldn't try to pretend it is not what it is. Disclosure serves well for that purpose. And the advisor must not be complacent about the most aggressive approaches that might overlook the *trusting* aspects of duty and pretend the entity is still a trust.

4. **Tax-smart.** There is no point in pretending that tax benefits – exclusion from the gross estate, GST exemption or grandfathering, passthrough treatment (one income tax), grantor trust status (or avoidance of grantor trust status), situs in a low-tax or no-tax jurisdiction, or the like – aren't worth preserving, even while non-tax reasons are important. Ultimately, it might even be the tax law that curbs the most hazardous designs and uses of trusts, because if such a trust oversteps these simple boundaries its recharacterization as some other form of entity for income tax purposes may prove to be the biggest hazard of all. (See Part IV.B on page 21.)