Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective

by Benjamin H. Pruett
*Washington, District of Columbia**

Editor's Synopsis: The author, formerly a lawyer in private practice and now in-house counsel to a corporate fiduciary, provides insight and advice, from a Trustee's perspective, regarding several specific ways in which estate planning lawyers might draft wills and trust instruments with a view to anticipating and addressing some of the problems most commonly confronted in trust administration. The article contains many sample provisions for wills and trust instruments.

Introduction

The following materials come from the author's observations since leaving private practice to join the fiduciary side of the trusts and estates profession. The issues addressed are all matters that the author has encountered, both good and not so good.

Most of the suggestions in this outline assume that the trust in question is designed to last a very long time, either to the end of the *Rule Against Perpetuities* period or longer, thus increasing the likelihood that during the term of the trust, circumstances, including both beneficiary personal circumstances and governing law, will change, and in ways not foreseen at the time a trust instrument was written. Moreover, the assumption here is that it is desirable to provide flexibility *without* necessity of court involvement, thus avoiding potentially significant delay, expense, and public disclosure of facts that are usually better left within the family. While one occasionally still encounters situations where heavy oversight by a court is necessary or desirable, the trend in this country is clearly away from such oversight, with a view toward allowing all parties interested in a trust to address their issues by agreement, rather than by court order.

Many of the sample provisions in these materials bestow very broad discretion upon trustees, so, as discussed in more detail below, it is of critical importance that trustees be given adequate guidance as to how the settlor intends for such powers to be exercised.

Note on Federal Transfer Tax Law in 2010

At the time this article is being finalized, the provisions of EGTRRA[1] which (among other things) eliminate the federal estate and generation-skipping transfer ("GST") taxes for decedents dying in 2010, and reinstate the pre-EGTRRA law regarding federal wealth transfer taxes in 2011 and thereafter, have become effective, as a result of Congress having failed to enact any legislation to change the post-2009 provisions of EGTRRA. The author will not hazard to predict when, or even whether, Congress will enact such legislation. Accordingly, the portions of this article relevant to federal wealth transfer tax issues assume the existence and applicability of a wealth transfer tax system similar to that in effect prior to EGTRRA or during 2009, and no attempt is made to address the various exceptions or other issues implicated by the peculiar status of the law at this juncture in 2010.

Amendments and Codicils: Just Say "No" — A Plea from the Poor Fiduciary

In the case of wills, modifications can be made any time as long as the testator is still living and has the requisite capacity. Accordingly, the author humbly asks, nay, *begs on bended knee*, an indulgence: Please, please, *PLEASE*, resist the urge to engage in significant modification of wills by codicil, as opposed to simply writing a new will.[2]

The author makes no bones about the fact that he does not favor the use of codicils under almost any circumstances, especially given the ease with which new documents can be produced in our modern, technological age. Long gone are the days when producing an entirely new will, rather than a codicil, required some overworked secretary to re-type dozens of pages of text on an Underwood manual typewriter. Moreover, the modification of wills by codicil entails a signifi-

[1] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16, 115 Stat. 38 (2001).

[2] While this discussion is focused on modification of wills by codicils, the points raised here are equally applicable to revocable trusts, and their modification by amendment, rather than complete restatement.

cant risk of error, and an even greater risk of fiduciary exasperation.

If codicils *are* to be used, they should be limited to *minor*, and uncontroversial, changes to the terms of a will meaning, generally, those changes that can be expressed in a single page. Extensive changes by codicil, particularly multiple codicils, can be quite cumbersome to deal with. To be sure, the author's interest in this subject is somewhat selfish, since administering a document that includes multiple and substantial modifications requires the fiduciary to cobble the various documents together in an effort to determine what the end result is supposed to be.

A Codicil Too Far

By way of demonstration, the Appendix to this article is a copy of a will, as amended by two (2) codicils. The portions of the original will and the first codicil that were subsequently changed by later codicil have been marked out, to demonstrate how substantial the changes were in each case.[3] This will was written in 2002, well within the modern technological era.

Note that the original will consisted of *seventeen* pages, *four* of which (nearly 25%) were eliminated by the later codicils. The first codicil consists of *eleven* pages demonstrating rather substantial modification of the will. Moreover, more than *half* the first codicil was eliminated or changed by the second codicil, which consisted of *seventeen* pages of text (as many pages as the entire original will), demonstrating even more substantial modification than the first codicil. In the author's humble opinion, each of these modifications were well beyond anything that should be dealt with by mere codicil. Moreover, the changed provisions are the actual dispositive provisions, which are the most important, and tend to cause the most litigation.

It is understandable that clients tend to be fee sensitive and therefore may wish to limit the scope of the attorney's engagement to a codicil, under the belief that such is less expensive than a complete rewrite. In the case of simple changes, that may be the case, but it has been the author's experience, as well as that of many other practitioners with whom the author has spoken, that it often takes less time and effort (and, therefore, expense) to simply write a new will than it does to piece together extensive changes to an existing document. Moreover, when the practitioner rewrites the entire document, he or she will presumably start with his or her current "form" that includes the practitioner's "best thinking" on the subject at the current time.

Extensive amendment by codicil can present many "traps" for both the attorney and the client. Codicils typically include language that either expressly *republishes* the original will (as modified by codicil) or states that the original will continues in full force and effect, as modified. Either way a will modified by codicil "speaks from the date of the codicil,"[4] meaning that the will, as modified, is treated the same as a will originally executed on the date of the codicil. Two recent Georgia cases, *Honeycutt v. Honeycutt*,[5] and *Dyess v. Brewton*,[6] demonstrate the potential perils of codicils.

Honeycutt v. Honeycutt

In *Honeycutt*, the testator executed a will leaving his residuary estate to his wife, if she survived, otherwise equally to the testator's three children. The testator and his wife subsequently divorced, but the testator never revoked the will. At some point after the divorce, the testator executed a codicil to his will in which he made specific bequests of $500 to each of his children and then stated that his will otherwise "shall remain in full force and effect."[7] As frequently happens, the testator died.

The ex-wife offered the will and codicil for probate, claiming entitlement to the entire residuary estate. The children argued that because the residuary bequest to the ex-wife was part of a will that predated the divorce, the ex-wife was treated as having predeceased the testator, so the children were entitled to the residue of the estate.[8] The ex-wife countered that the will, as originally written, was republished by the execution of the codicil, which occurred *after* the divorce, with the same effect as if the testator had executed an entirely new will leaving the residue to the ex-wife. The children argued that the will was *not* republished because the codicil did not *expressly* republish the will. After much legal wrangling through both the

[3] Information that might identify the testator or the testator's family has also been redacted, lest the reader gain access to a scanning electron microscope and try to read the actual text. Pages consisting only of signatures and notary blocks have also been omitted.

[4] Citizens & Southern Nat. Bank v. Martin, 244 Ga. 522, 260 S.E.2d 901 (1979).

[5] Honeycutt v. Honeycutt, 284 Ga. 42, 663 S.E.2d 232 (2008).

[6] Dyess v. Brewton, 284 Ga. 583, 669 S.E.2d 145 (2008).

[7] Honeycutt at 42, 663 S.E. 2d at 233.

[8] O.C.G.A. § 53-4-49 provides that if a testator's will does not contemplate the possibility of divorce, then following the entry of a decree of divorce, the testator's spouse is treated, for all purposes of the will, as having predeceased the testator, *but* the entry of the divorce decree does *not* result in the revocation of any part of the will. (Note, all citations to the Georgia statutes use the "O.C.G.A." format commonly used by Georgia practitioners and courts, rather than the "GA. CODE ANN." format prescribed in A UNIFORM SYSTEM OF CITATION (hereinafter, the "Blue Book".))

probate court and the superior court, the Georgia Supreme Court ultimately held in favor of the ex-wife.

First, the court held that where a codicil makes express reference to an earlier will being modified, it is presumed that the testator intended for the codicil to be a republication of the will, as modified by the codicil, irrespective of whether the codicil included express words of republication. Moreover, a republication of a will "speaks from the date of the codicil,"[9] and therefore has the effect of an entirely new will executed on the date of the codicil, so the rule treating the ex-wife as predeceased did not apply.

It is not entirely clear whether the outcome of *Honeycutt* was consistent with the testator's desires, but it is difficult to see any reason for the small specific bequests to the children if the testator believed they would receive the entire estate. Nevertheless, the extensive litigation among the parties would likely have been avoided had the testator executed an entirely new will that removed any doubt about his intent to leave his property to his ex-wife.

Dyess v. Brewton

In *Dyess v. Brewton*, the decedent executed one will in March 2000, then executed a new will in May 2000, expressly revoking the March will. Twenty months later, the testator executed a codicil in which he referred to the *March* will as his existing will, both by date and by reference to the witnesses to the March will, and the codicil contained language expressly republishing the referenced will, with no express revocation, or other mention, of the May will. The original codicil was found in the decedent's safety deposit box, along with the original of the *May* will, in a sealed envelope from the attorney's office. Moreover, the attorney executed an affidavit stating that the reference to the March will, rather than the May will, was merely scrivener's error, because the testator did not intend to revive the March will, but instead intended the May will to remain in force.

The proponents of the March will argued that the codicil expressly republished the March will, and that because there was no ambiguity in the language of the codicil, the attorney's affidavit, being parol evidence, could not be considered for the purpose of contradicting the clear terms of the codicil. The Georgia Supreme Court, however, ruled that there was enough ambiguity in the entire factual situation to permit the attorney's testimony, and ruled that the May will (and codicil) should stand, which is no doubt the correct result.

Observations

Both *Honeycutt* and *Dyess* involved extensive litigation over issues that never would have arisen had the testators executed entirely new wills. No doubt, the attorney's fees that were incurred by the parties in litigating these cases more than offset any cost savings resulting from the testators' use of codicils, rather than new wills.

General Powers of Appointment to Avoid GST Tax—The Rules Have Changed!

The author frequently reviews trust documents, including newly drafted documents, that subject all trust property that is not exempt from the GST tax to a general power of appointment at the death of a trust beneficiary who is a non-skip person. While this may have been prudent tax planning once upon a time, the result under current law could be a dramatic increase in the overall tax liability at the beneficiary's death.

The property of a GST nonexempt trust is subject to GST tax at the death of the last non-skip person beneficiary *unless* the trust property is included in the non-skip beneficiary's estate for estate tax purposes. Under I.R.C. § 2641(a)(1), the GST tax is imposed at a flat rate equal to the highest marginal estate tax rate. Prior to EGTRRA, the estate tax was imposed at *graduated* rates from 37% to 55% of the portion of the estate in excess of the applicable exclusion amount.[10]

Finally, any *state* death tax imposed on property included in an individual's estate was typically offset entirely by *credit* against federal estate tax for state death taxes under I.R.C. § 2011, since most states'

[9] Honeycutt at 45, 663 S.E.2d at 235, *citing* Citizens & Southern Nat. Bank v. Martin, *supra*, note 4,. From a very technical standpoint, Georgia law only provides for "republication" of a will after it has been revoked, and the author has been forced to debate the issue of whether a will can be "republished" if it has never been revoked. Remember that the Georgia statute setting forth the effect of divorce on a will does ***not*** result in a revocation of any part of the will, only a rule of how the will is to be carried out. Clearly, the court in *Honeycutt* has no reservation about finding a republication of the will that was never revoked.

[10] The maximum rate of 55% only applied to the portion of the estate in excess of $3,000,000, and there was an additional 5% surtax on the portion of the estate in excess of $10,000,000, to the extent necessary to cause the entire estate to be subject to estate tax at 55%, thus eliminating the benefit of lower tax brackets on the first $3,000,000. I.R.C. § 2010(c). Thus, when the applicable exclusion amount was $675,000, the portion of the estate from $10,000,000 to $18,340,000 was subject to a marginal rate of 60%. Should pre-EGTRRA law become effective again in 2011 as scheduled, the applicable exclusion amount will be $1,000,000, and the 60% marginal rate will apply to the portion of the estate from $10,000,000 to $17,184,000.

death taxes were imposed at an amount equal to the maximum available credit against federal estate tax.

Therefore, the conventional wisdom was that causing nonexempt property to be included in a non-skip beneficiary's estate would almost always result in a lower tax liability than allowing the property to be subject to GST tax since, by definition, the *estate* tax would frequently be lower, but *never* higher, than the GST tax.[11] Accordingly, it was common practice to confer a testamentary general power of appointment upon the last surviving non-skip person beneficiary to intentionally cause estate inclusion, thus avoiding the taxable termination.

EGTRRA changed all that, in a major way.

First, the credit for state death tax was reduced by 25% in each of 2002, 2003 & 2004, and was therefore eliminated for decedents dying on or after January 1, 2005. The credit was replaced by a *deduction* for state death tax under I.R.C. § 2058(a), which provides some relief from the additional tax burden imposed by the states, but the relief is a far cry from the complete offset previously provided by the credit. The reduction and eventual elimination of the credit automatically had the effect of reducing and eliminating any state death tax that was imposed based upon the amount of the federal credit, which was the case in almost all of the states. Accordingly, since 2001, approximately half of the states have imposed a new, "decoupled" state death taxes, to replace the revenue lost by the elimination of the credit. Most of the new state death tax statutes continue to base the tax upon the credit against federal estate tax, but under the law as it existed prior to 2001 or, in some cases prior to the elimination of the credit. This means not only that estates subject to federal estate tax also bear an additional burden for state death tax, but that many estates that are not subject to federal estate tax still incur state death tax, because most states' death taxes have exemptions that are significantly smaller than the applicable exclusion amount.

Additionally, effective January 1, 2006, the federal estate tax, to the extent it applies, is imposed at a single, flat rate of 45%. Accordingly, the GST tax rate, being equal to the highest, and only, estate tax rate, is now exactly the same as the estate tax rate.

Therefore, if a non-skip beneficiary's estate is already equal to or greater than the federal applicable exclusion amount, causing the trust property to be included in the beneficiary's gross estate to avoid GST tax will not result in any *federal* tax savings, and may result in a substantial *state* tax liability that otherwise might not have applied.[12]

That having been said, there are at least two situations where causing estate inclusion would be beneficial.

First, if the beneficiary's estate is less than the applicable exclusion amount, then at least a portion of the nonexempt property included in the beneficiary's estate will avoid federal tax entirely, since it will not be subject to estate or GST tax. Even if the inclusion of such property in the beneficiary's estate triggers state death tax, the state death tax will be less than the federal GST tax would have been. *Note, however*, that this does not suggest that all of the nonexempt trust property should be included in the beneficiary's estate, but only the amount by which the applicable exclusion amount exceeds the beneficiary's estate, because any property in excess of that amount will trigger federal estate tax equal to the GST tax avoided, and may incur state death tax as well.

Second, even if the beneficiary's estate is subject to federal estate tax, inclusion of a portion of the nonexempt property may allow the beneficiary's estate to allocate the beneficiary's unused GST exemption to a portion of the property, rendering it GST exempt thereafter, assuming a portion of the beneficiary's GST exemption would otherwise have been wasted. Causing estate inclusion to allocate GST exemption, however, will likely only be attractive if estate inclusion does not trigger a state death tax.

In any event, the better solution is to make the general power of appointment applicable *only* if, and to the extent that, inclusion of the property in the beneficiary's gross estate will reduce, or will not increase, the aggregate amount of federal and state tax payable as a result of the beneficiary's death, or will provide some benefit (such as use of the beneficiary's GST exemption that otherwise would be wasted) that will not increase the overall tax burden.

[11] In fact, this was not necessarily the case that the estate tax was never higher than the GST tax, for two reasons. First, the GST tax would only be triggered if, as a result of the beneficiary's death, the property would pass to beneficiaries in a *lower* generation, which was not always the case, particularly where the non-skip beneficiary had no descendants, and his share passed to or for the benefit of one or more of his siblings. Second, the GST tax was equal to the highest marginal rate of 55%, but *not* the 5% surcharge that applied to a portion of estates in excess of $10,000,000. Therefore, even prior to EGTRRA, if the beneficiary's estate was more than $10,000,000, the estate tax, with the 5% surcharge, could actually result in a higher tax liability than the GST tax.

[12] Note that very few states impose any state level GST tax, so in most cases, if the property is excluded from the beneficiary's gross estate for federal estate tax purposes, it will not be subject to any state tax triggered by the beneficiary's death.

Sample Provision: General Power of Appointment Contingent Upon Tax Reduction

If upon the death of the beneficiary for whose primary benefit a trust is established hereunder, all or any part of the trust property would, but for the grant of a general power of appointment to the beneficiary under this paragraph, pass in a manner that would cause such property to be subject to the federal generation-skipping transfer ("GST") tax, then such beneficiary shall have the power by his or her last will and testament, making express reference to this power, to appoint to such beneficiary's estate that amount of property in such trust, if any, that, when included in the beneficiary's gross estate by virtue of this power, will result in the maximum reduction in the sum of the federal and state GST, estate, legacy, succession, inheritance and similar taxes imposed by reason of such beneficiary's death with respect to the property in such trust, when compared to the sum of such taxes that would be imposed by reason of such beneficiary's death with respect to the property in such trust if no general testamentary power of appointment were conferred on such beneficiary under this paragraph. Additionally, the foregoing general power of appointment shall be exercisable with respect to an amount of property equal to such beneficiary's unused GST exemption, to the extent that the inclusion of such property in the beneficiary's gross estate does not result in an increase in such taxes. The trustee shall, prior to distributing such trust as hereinabove directed, distribute to the beneficiary's estate or directly to the appropriate taxing authority, as the trustee may determine, that portion of such taxes payable by such beneficiary's estate, if any, which is attributable to the inclusion in such beneficiary's estate of the assets of the trust over which the beneficiary had a general power of appointment. Such payment shall be equal to the amount by which (1) the total of such taxes payable by the beneficiary's estate exceeds (2) the total of such taxes that would have been payable if the value of the trust property had not been included in the beneficiary's estate. The amount of such taxes due hereunder shall be based upon the values in the beneficiary's estate as finally determined for federal estate tax purposes.[13]

Dealing with Changing Circumstances

Virtual Representation

Consider the following situations:

- The trustee is asked to invest most of the trust assets in a family partnership or business venture over which the trustee would have little or no control. Such an investment normally would *not* be consistent with the trustee's duties of prudent investment and diversification, or with the duty to take and keep control over the trust assets, and may also violate the prohibition against delegating the trustee's investment responsibilities (because the general partner controls the investments of the partnership, and the trustee does not). Making the investment may well be consistent with the settlor's intention, but difficult to justify under general principles of trust law, if the settlor's intention is not explicitly stated in the trust.

- The trustee is asked to exercise its discretion to distribute corpus of a QTIP marital trust by dis-

[13] An alternative approach used by some firms is to give the trustee the power to confer a general power of appointment on the beneficiary, if the trustee determines it is in the best interests of the beneficiary to do so. The author believes that this alternative would not be as desirable as the foregoing "hard wired" provision, except in very rare circumstances. First and foremost, there is always the danger that the trustee may neglect to confer the power where it would be helpful, resulting in a missed opportunity to save taxes. Second, vesting a trustee with such a power presents several potential conflicts of interest that implicate the trustee's duty of impartiality as between beneficiaries, since the decision to grant the general power, or the failure to do so, could have the result of preferring one group of beneficiaries over another. That having been said, if the trustee is to be vested with the power to confer a general power, then the trustee should be exculpated for liability for any decision to exercise or not exercise the power, and if the power is exercised, the beneficiary's estate should be reimbursed for any taxes incurred as a result of the grant of the power.

tributing the entire corpus of the trust to the surviving spouse, so that the surviving spouse can make taxable gifts to the children, thus taking advantage of the tax exclusive nature of the gift tax, especially since the spouse's independent resources are more than adequate for her needs.

In each situation, the trustee is being asked to take an action that is inconsistent with normal fiduciary practice, and therefore could result in the trustee incurring liability for breach of trust, if taking the requested action turns out, in hindsight, to have been less beneficial than not taking those actions. Therefore, the "safe" course of action for the trustee is to either refuse the request or to seek the approval of a court of competent jurisdiction, thus insulating itself from liability. Such an action, depending upon the jurisdiction, may take many months to conclude, could involve significant attorney fees, and could risk placing information in the public court records that the family would rather keep private. Moreover, the court will likely require the appointment of a guardian *ad litem* for any minor and unborn beneficiaries (an extra expense). Finally, even though all *sui juris* interested parties may be willing to consent, the natural conservatism of the guardian and/or the court, who likely are not familiar with the family and its circumstances, may carry the day, and they may not be willing to consent to the action.

Another way to proceed may be for the interested parties to consent to the action in writing, thus releasing the trustee from any liability that could result from taking the action, and to indemnify the trustee for any claim that might be brought as a result of taking the action. It is well established in both statute and common law that beneficiaries may not assert a claim against a trustee for an action consented to by the beneficiary assuming, of course, that the consent was "knowing" and "voluntary."[14] The problem is that it may not be possible for minor, incapacitated, or unborn persons to give such consent, at least without a court appointed guardian.

Virtual representation provisions permit certain beneficiaries and other persons to "*represent*" the interests of other beneficiaries (whose interests are not in conflict with the interests of the representative), in any matter that requires notice to, or the consent of, the beneficiaries or other interested persons. Virtual representation has been recognized at common law, to permit judicial actions to move forward and bind all interested persons, even though some interested persons may not easily be located.

By permitting certain persons to virtually represent and bind others, issues such as those described above can be resolved quickly, easily and inexpensively by agreement, without court involvement, and can provide to the trustee the necessary degree of comfort that the action will not be "second guessed," with the benefit of hindsight, years down the road. Virtual representation is of even greater utility with regard to more mundane issues, such as nominating successor trustees without court involvement, relieving trustees of filing formal accountings or of auditing prior trustees, and setting trustee compensation.

The Uniform Trust Code includes extensive virtual representation provisions,[15] and virtual representation provisions also appear in the statutes and or common law of some non-Uniform Trust Code jurisdictions. Nevertheless, the author recommends including a virtual representation provision in the document itself for two reasons. First, even if the original law governing the administration of the trust includes virtual representation provisions, the situs of the trust could later be moved to a jurisdiction without a statutory provision, or with a statutory provision that is less extensive. Second, not all virtual representation statutes are created equal, so including the provision in the document can provide benefits that might not be provided by state law.

Sample Provision: Virtual Representation

Notice. If the trustee provides any notice required either pursuant to the terms of this trust or by law to a representative (as determined in accordance with subparagraph (3) below) of a beneficiary of this trust, such notice shall have the same effect as if given directly to such beneficiary.

Consent. If the trustee wishes to obtain the consent of any beneficiary of this trust concerning any particular action with respect to the administration of the trust, such beneficiary's representative (as determined in accordance with subparagraph (3) below) may provide consent on behalf of such beneficiary, and such consent shall be binding on the beneficiary represented.

---

[14] *See* Restatement (Second) of Trusts (hereinafter "Restatement (2nd)") § 216 (1992), Unif. Trust Code (hereinafter "UTC") § 1009 (2005).

[15] *See* UTC §§ 301-304 (2005).

Determination of Representative. To the extent there is no conflict of interest between the representative and the beneficiary represented, concerning the particular matter with respect to which notice is given or consent is requested: (i) a parent may represent and bind his or her minor, disabled or unborn child, unless a court has appointed a guardian of the person or property of such child; (ii) if a minor, disabled or unborn person is not otherwise represented under the preceding item (i), a grandparent or more remote ancestor may represent and bind such minor, disabled or unborn person; (iii) a minor, disabled or unborn person, or a person whose identity or location is unknown and not reasonably ascertainable, may be represented and bound by another having a substantially identical interest with respect to the particular matter with respect to which notice is given or consent is requested, unless such person is otherwise represented under the preceding items (i) or (ii); and (iv) the holder of a general or limited power of appointment under the terms of this trust may represent and bind the persons whose interests, as permissible appointees, takers in default or otherwise, are subject to the power of appointment.[16]

The Alabama version of the Uniform Trust Code provides that the "presumptive remainder beneficiaries" may represent and bind contingent remainder beneficiaries, to the extent there is no conflict, but does not require that the interests of the presumptive and contingent remainders be identical.[17] Such a provision might be a useful addition to a virtual representation provision.

"Decanting" to Another Trust

A "decanting" power is a power to appoint or distribute property to another trust for the benefit of the permissible appointees or distributees of trust property. Decanting powers can be extremely useful to deal with changing circumstances or to cure "defects" in trusts, by simply pouring the trust assets over to a new trust with more desirable provisions.[18]

Many states recognize that a *power of appointment* may be exercised in favor of a trust.[19] Some state laws consider any distribution power, including a fiduciary principal encroachment power, to be a power of appointment, while others only consider *non*-fiduciary powers to be powers of appointment. If state statute or case law recognizes a trustee's distribution power to be a power of appointment, then the distribution power should be exercisable in further trust to the same extent that any other power of appointment may be so exercised.[20]

---

[16] This provision is slightly broader than UTC § 302, which only applies to the holder of a *general* power of appointment. There is no apparent reason for the distinction between holders of general or limited powers, because in both cases, the holder of the power has the power to *appoint* to, or to *dis*appoint, persons who are permissible appointees and takers in default of the exercise of the power.

[17] Code of Ala. § 19-3B-304(b). Code of Ala. § 19-3B-103(12) defines a "presumptive remainder beneficiary" as a person who would be entitled to the property at present if the current income interest terminated and includes anyone holding a power of appointment. The term "presumptive remainder beneficiary" is not found in the uniform act.

[18] For a thorough, timely, and downright useful discussion of the various state and tax law implications of decanting, as well as a discussion of statute and case law from various jurisdictions, *see* M. Patricia Culler and Diana S.C. Zeydel, *Decanting: An In-Depth View of the Latest Techniques*, ACTEC Fall Mtg. (2009). *See also* Alan S. Halperin, *You May Not Need to Whine About Problems With Your Irrevocable Trust-State Law and Tax Considerations in Trust Decanting*, U. Miami Inst. on Est. Plan. (2008) and Laird F. Lile, *Decanting 101*, ACTEC Ann. Mtg. (2008).

[19] See Culler & Zeydel, *supra*, note 18, at 3, and Restatement (Second) of Prop.: Donative Transfers § 19.3 (1983), and the comments thereto, for a listing of many state court decisions supporting the right of a holder of a power of appointment to appoint in further trust. *See also* Va. Code Ann. § 55-25.1, as an example of a statutory provision (found in the property statutes, rather than the trust statutes) supporting this view.

[20] *See* Restatement (Second) of Prop.: Donative Transfers § 11.1 cmt. d (1983), which states that a trustee's power to make discretionary distributions is a power of appointment. Unlike § 19.3, cited above, § 11.1 does not cite to any authority for this proposition. Perhaps shepardizing this provision might turn up case law adopting this provision. Note, however, that according to Alan Halperin's materials from the 2008 Heckerling conference, a not yet published draft of the portion of the Restatement (Third) of Prop.: Wills and Donative Transfers, dealing with powers of appointment, takes the opposite position, namely, that a fiduciary principal invasion power is *not* a power of appointment. In any event, where a document does not expressly grant a decanting power, but it would be useful to have, a thorough review of state trust law and property law provisions dealing with powers of appointment would be in order. It may be that a recognition that a distribution power is a power of appointment may be cobbled together with a recognition that a power of appointment may be exercised in further trust.

Several states have enacted decanting statutes specifically permitting a trustee to make distributions to trusts, as well as outright, assuming the trust instrument does not indicate that the settlor intended otherwise.[21] Decanting has also been recognized in case law.[22] Perhaps the most often quoted case recognizing decanting is *Phipps v. Palm Beach Trust Company*, which held 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."[23] The statutes and cases vary as to the circumstances under which decanting is permitted, such as whether decanting is permitted where the trustee's discretion is limited by an ascertainable standard, or is only permitted where the trustee has unlimited discretion.

In any event, if the power to decant is expressly stated in the trust agreement, then there should be no doubt about the existence or extent of such a power.

> <u>Sample Provision: Power of Appointment Including Decanting Power</u>
>
> The beneficiary shall have a special power … to direct the trustee to distribute all or any part of the property … to any one or more of my lineal descendants, ***in trust or otherwise***, as the beneficiary shall choose.
>
> <u>Sample Provision: Decanting Power in List of Trustee Powers</u>
>
> To make any application of principal or income for the benefit of any beneficiary by payment to such person or persons (***including, without limitation, other estates or trusts, individuals and institutions***) as the trustee, in the exercise of sole and absolute discretion, may determine (including, without limitation, a trust of which any trustee hereunder is also acting as trustee, and whether any such trust was created pursuant to authority granted to the trustee hereunder or otherwise);
>
> <u>Sample Provision: Decanting Power With Respect to Trustee Distributions</u>
>
> Any application of principal or income for the benefit of any beneficiary hereunder made pursuant to the provisions of this agreement may be made by payment to such person or persons (including, but not limited to, other trusts, estates, individuals and institutions) . . . .

Cautionary Note—"Delaware Tax Trap"

There are limits to the prudent use of decanting powers. If trust property is subject to a *rule against perpetuities*, then a decanting power generally cannot be exercised in a manner that would delay or postpone the ultimate vesting of the trust property beyond the rule that is applicable to the trust, at least not without potentially adverse tax consequences under the "Delaware Tax Trap."[24]

Trustee Power to Amend Trust

The trustee or, perhaps, a third party special trustee, protector, or advisor, can be given the power to make certain modifications in the terms of the trust to maintain or achieve certain tax or other advantages for the beneficiaries. Generally, such powers are limited

[21] *Alaska*: ALASKA STAT. § 13.36.157; *Arizona*: ARIZ. REV. STAT. § 14-10819; *Delaware*: 12 DEL. C. § 3528, *Florida*: FLA. STAT. ANN. § 736.04117; *Nevada*: N.R.S. § 163.57; *New Hampshire*: N.H. REV. STAT. § 564-B:4-418; *New York*: E.P.T.L. § 10-6.6(b); *North Carolina*: N.C.G.S. § 36C-8-816.1; *South Dakota*: S.D. CODIFIED LAWS §§ 55-2-15 to 55-2-21; *Tennessee*: TENN. CODE ANN. § 35-15-816(b)(27). (Note, all citations to the Delaware statutes use the "DEL. C." format commonly used by Delaware practitioners and courts, rather than the "DEL. CODE. ANN." format prescribed in the Blue Book. Likewise, references to New York Statutes use the "E.P.T.L." format used by New York practitioners and courts, rather than the "EST. POWERS AND TRUSTS" format prescribed in the Blue Book.)

[22] *See*, RESTATEMENT (2ND) § 17, cmt. f (1992); Regents of the University System of Georgia v. Trust Company of Georgia, 186 Ga. 498; 198 S.E. 345 (Ga. 1938); Phipps v. Palm Beach Trust Company, 142 Fla. 782; 196 So. 299 (Fla. 1940); Marx v. Rice, 1 N.J. 574 (1949).

[23] Phipps at 785-6, 196 So. at 301. Phipps continues to be good law in Florida, in addition to Florida's decanting statute, cited above.

[24] I.R.C. 2041(a)(3). A discussion of the this issue is well beyond the scope of these materials, but there are several good articles on the subject, including Richard W. Nenno, *Terrors of the Deep: Tax Dangers When Exercising Powers Over Trusts — The GST Regulations and the Delaware Tax Trap*, 34 EST., GIFTS AND TR. J. 76; James P. Spica, *A Trap for the Wary: Delaware's Anti-Delaware-Tax-Trap Statute is Too Clever by Half (of Infinity)*, 43 REAL PROP. TR. & EST. L. J. 673.

so as to prevent abuse of the power to the detriment of beneficiaries.

A "real life" example of where such a power came in handy involved a trust that gave the trustee broad discretion to distribute income and principal to the beneficiaries, but did not expressly provide that undistributed income be added to principal. In such a case, if income is not distributed, the trustee may be required to hold the accumulated income in a separate account indefinitely, and may be limited as to investment options, instead of investing the funds as part of the principal. The trustee was able to administratively amend the trust to provide for the addition of undistributed income to principal assuming, of course, that doing so does not favor one group of beneficiaries to the detriment of another.

> <u>Sample Provision: General Trustee Power to Amend to Secure Settlor Objectives</u>
>
> Any corporate trustee shall have the authority to amend this agreement from time to time as it deems necessary or advantageous to secure tax or other legal benefits for the beneficiaries, but no such amendments shall adversely affect any beneficial interests hereunder.

Enhancing Flexibility

Powers to Hold Property for Use of Beneficiaries

Traditional rules require a trustee to invest trust assets for the production of income (or, perhaps, total return) to be distributed to or for the beneficiaries. Moreover, all trust investments typically must comply with any applicable *prudent investor* standards with regard to risk, productivity, liquidity, diversification, etc. However, it may be beneficial for a trustee to retain or purchase a *primary or secondary residence*, or even *tangible personal property*, for a beneficiary's use, rather than distributing property to the beneficiary or distributing the funds to purchase the property. After all, once the funds are distributed, they are in the beneficiary's gross estate and fully subject to creditor claims.

The challenge is that even though the purchase and maintenance of such property benefits a beneficiary, it may be difficult to justify the retention or purchase of such property under normally applicable "prudent investor" principles. Moreover, even where a trustee can justify holding such property, the custody and control of the property will necessarily be turned over to the beneficiary, thus limiting the trustee's ability to protect the property from loss or damage at the hands of the beneficiary.

To eliminate any doubt, consider a provision that expressly permits the retention or acquisition of property for the personal use of the beneficiaries.

> <u>Sample Provision: Trustee Power to Hold Personal Residence</u>
>
> To acquire, hold and maintain any residence (whether held as real property, condominium or cooperative apartment) for investment or for the use and benefit of such one or more of the beneficiaries of any trust, as the trustee, in the exercise of sole and absolute discretion, determines, and, if the trustee, in the exercise of sole and absolute discretion, determines that it would be in the best interests of the beneficiaries of any trust to maintain a residence for the use of such one or more of the beneficiaries, but further determines that the residence owned by the trustee should not be used for such purposes, the trustee is authorized to sell said residence and to apply the net proceeds of sale to the purchase of such other residence or residences or to make such other arrangements as the trustee, in the exercise of sole and absolute discretion, deems suitable for the purpose, any proceeds of sale not needed for reinvestment in a residence as provided above to be added to the principal of the trust and thereafter held, administered and disposed of as a part thereof; to pay all carrying charges of such residence, including but not limited to, any taxes, assessments and maintenance thereon, and all expenses of the repair and operation thereof, including the employment of domestic servants and other expenses incident to the maintenance of a household for the benefit of one or more of the beneficiaries of the trust. The trustee is authorized to grant custody over any such property to any trust beneficiary, and shall not be liable for any damage to, destruction of, or other loss of such property while in the custody of a beneficiary;

Sample Provision: Power to Hold Tangible Personal Property

To acquire, hold and maintain as a part of each trust created hereunder any and all articles of tangible personal property or any other property for investment or for the use and benefit of the beneficiaries of any trust, whether such property is productive, underproductive or unproductive of income, and without any duty to convert such property to productive property, provided, however, that nothing herein to the contrary, the Spouse shall have the right to demand that any property held in the [QTIP] trust be made productive; to pay the expenses of safekeeping of any such property, including insurance, and all expenses of the repair and maintenance of such property, and to sell such property and to apply the net proceeds of sale to the purchase of such other property as the trustee, in the exercise of sole and absolute discretion, deems suitable for the purpose; provided, however, that the trustee is authorized to grant custody over any such property to any trust beneficiary, and shall not be liable for any damage to, destruction of, or other loss of such property while in the custody of a beneficiary;

Note that the foregoing powers expressly permit the trustee to give custody of the property to the beneficiary without risk of liability. Absent such a provision, a trustee may be required to retain possession and control over the property. Note also that any personal use property held in a QTIP trust must be subject to the beneficiary's right to compel the trustee to make the property productive of income.

Sample Provision: Trustee Power to Hold Both Real and Tangible Personal Property

To permit any one or more of the beneficiaries of any trust hereunder, as the trustee, in the exercise of sole and absolute discretion, determines, to occupy any real property and to use any tangible personal property forming part of the trust estate on such terms as the trustee, in the exercise of sole and absolute discretion, may determine, whether for rent, rent-free, in consideration of payment of taxes, insurance, maintenance or ordinary repairs, or otherwise as the trustee, in the exercise of sole and absolute discretion, determines; provided, however that, in the case of any trust hereunder which is eligible for the marital deduction, such occupancy shall be rent free and any other condition shall be consistent with the settlor's intention that the Spouse have that degree of beneficial enjoyment of the trust property during life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust, so that the Spouse's interest is a qualifying income interest for life for purposes of the marital deduction;[25]

Power to Change Situs and Governing Law

Attorneys are understandably fond of specifying that their home state law applies for all time to come, because that is the law they know, and they do not wish to be accused of the unauthorized practice of law in another jurisdiction. However, home state law may not always be in the best interests of the beneficiaries over the long haul, so great flexibility can be achieved by permitting a trustee to change the situs and governing law of a trust. By way of example, the ability to move the situs of a trust from one state to another might allow the trust to avoid state income tax on any undistributed income or capital gains. The situs and governing law may change anyway, if there is a change of trustees to a new trustee that is resident in another state, but great confusion can arise as to what law applies. Therefore, it is most helpful to specify in the document the governing law at the outset, but to permit the trustees to change the situs and governing law when it deems it beneficial to do so.

Sample Provision: Power to Change Situs and Governing Law

If at any time, in the opinion of the trustee, it is in the best interests of the beneficiary or distributee for the trust

[25] Note that this marital deduction savings clause is advisable whenever such a provision applies to a marital deduction qualifying trust.

> to be located in a jurisdiction other than the one in which the trust is administered at the time, the trustee may move the trust to such other jurisdiction. The trustee may elect that the law of such other jurisdiction shall govern the trust to the extent necessary or appropriate under the circumstances, but not so as to enlarge or shift any beneficial interest.

Power to Lend to Beneficiaries

It may be beneficial for a trust to make a loan to a beneficiary to assist the beneficiary to purchase a home or for another purpose, particularly where an outright distribution may not be appropriate. If the trust does not specifically permit the lending of money, then loans may not be permitted under the default provisions of governing state law, unless, perhaps, the loan can be justified as a trust investment under prudent investor standards. The following are but a few examples of circumstances where such a power would be beneficial:

- Outright distribution will increase beneficiary's taxable estate, but a loan will not do so, at least not until the property appreciates to an amount more than the loan, plus interest.

- Outright distribution may be inappropriate as providing too much benefit to current beneficiary at expense of remainder beneficiary, while a secured loan may preserve principal for remainder beneficiary, while still assisting the current beneficiary.

- Beneficiary needs a new house, but has a history of financial irresponsibility such that making a distribution out of the trust to purchase the house may give the beneficiary too much access to the value of the house, if the beneficiary is inclined to sell or mortgage the house to raise cash that can be squandered. However, the trust does not wish to own the house because the beneficiary's history of drug abuse indicates that the house may be used for illegal purposes and may involve activities that would expose the owner of the house to unacceptable risk of liability, liability insurance notwithstanding. The trust can loan the money on the house, thus preventing the beneficiary from being able to blow the money, without exposing the trustee to liability as property owner.

The common law recognizes loans to beneficiaries to be appropriate in some circumstances, and the Restatement (Third) of Trusts goes so far as to state that a loan is a type of discretionary benefit that need not qualify as a prudent investment.[26] Nevertheless, the law differs substantially from state to state, so if the trust expressly permits loans and, more specifically, loans to beneficiaries, perhaps even on less than commercial terms, then the trustee should have the flexibility to use the trust assets to benefit the beneficiary, again under circumstances where an outright distribution is ill advised.

> <u>Sample Provision: Trustee Power to Lend to Beneficiaries—Very Broad</u>
>
> In their discretion to make loans to the beneficiary with or without security and with or without interest, upon such terms as they deem advisable;

Guiding the Trustee—Accomplishing the Settlor's Goals

One of the most difficult tasks trustees face is how to exercise broad (and generic) discretion in the administration of trusts, whether the trust is fully discretionary, with no standards whatsoever, or discretionary subject to an ascertainable standard. To the extent that the settlor's intent is expressed in the trust, it is much easier for the trustee to carry out that intent. For example, if the primary purpose for passing property in trust, rather than outright, is to gain tax and asset protection advantages, and separating the control over the property from the beneficial enjoyment of the property (more than necessary to obtain tax and asset protection benefits) is not a primary motivation behind using a trust, then the trust can be drafted to make that intent clear, so that the trustee can act more liberally than might be the case where control *is* a key issue. The importance of setting forth the settlor's intent can be demonstrated by a brief discussion of the default rules governing trustees where the trust instrument contains no contrary expression of intent. What follows are a sampling of different discretionary guide-

---

[26] "The loan need not qualify as a prudent investment under § 90 [Restatement Third, Trusts (Prudent Investor Rule) § 227]. It is a form of discretionary benefit, and may be made at a market rate of interest or at low or no interest; and funds may be advanced with recourse only against the beneficiary's interest, without personal liability." RESTATEMENT (THIRD) OF TRUSTS (hereinafter "RESTATEMENT (3RD)") § 50, cmt. d(6) (2003).

lines. Needless to say, these should be tailored to reflect a settlor's desires, but they are examples of the type of detail that can be invaluable.[27]

An alternative, especially for trusts that are already in existence, is for the settlor to provide the trustee with a *letter of wishes* giving guidance as to how discretion should be exercised.[28]

Priority Among Multiple Beneficiaries

Where there are multiple beneficiaries of the trust, meaning either concurrent beneficiaries or successive beneficiaries (current and remainder) a trustee needs guidance as to how to exercise that discretion with respect to the various competing interests, given the trustee's duty of *impartiality* among trust beneficiaries.[29]

The most traditional conflict among beneficiaries occurs in the case of a trust that directs that income be paid to a current beneficiary and that the principal be paid to a remainder beneficiary at the death of the current beneficiary. The current beneficiary will expect the trustee to invest the trust to maximize the production of income, while the remainder beneficiaries will expect the trustee to invest to maximize the growth of principal. The trustee, therefore, must balance these needs by investing to produce a reasonable amount of income, while at the same time preserving the value of the principal by ensuring sufficient growth in value to keep up with inflation.

But what about a trust that gives the trustee the discretion to distribute not only income, but to encroach upon principal for the current beneficiary? The trustee will normally be hesitant to encroach on principal for the current beneficiary if doing so is contrary to the interests of the remainder beneficiary, unless circumstances can justify such action.

Take a typical family trust that gives the trustee discretion to distribute income and principal to or among the settlor's spouse and descendants during the spouse's lifetime, with the trust splitting into separate shares for each child at the spouse's death.

How much discretion does the trustee have? In most cases, the intent is probably to give primary consideration to the surviving spouse for his or her lifetime, even if that means encroaching on the principal that otherwise would pass to the descendants at the spouse's death. On the other hand, there may be circumstances, particularly in second (or third, or fourth) marriage situations, where the settlor's intent is that principal be used for the spouse's benefit only to the extent that trust income and/or other resources are insufficient for that purpose.

Absent some indication of that intent, however, the trustee would typically be expected to balance the needs of both sets of beneficiaries, which might mean restricting distributions to the spouse so as to preserve principal for the current or future needs of the children.

Therefore, it is always advisable to address the following issues in the trust agreement:

- Is the trust primarily for the benefit of current beneficiaries, with remainder beneficiaries being entitled only to that amount, if any, that is left over after the current beneficiary's death, or is the intent to preserve assets for later generations?

- As to current beneficiaries, should the trustee give priority to the interests of one beneficiary over another? For example, if the trust is for the benefit of a spouse and descendants, are the needs of the spouse to be given paramount consideration, even to the point of depleting principal? Likewise, where a trust is for a child and his or her issue, what consideration is the trustee supposed to give the issue, particularly after they are grown and have left home?

In the author's experience, the settlor usually desires that that trusts be for the primary benefit of the oldest generation of living beneficiaries, with the rights of later beneficiaries being secondary.

It is important to state whether discretionary distributions to beneficiaries must be equal, or can be unequal, and whether and to what extent there is an intent to preserve principal for remaindermen. The following are examples of various distribution provisions:

> <u>Sample Provision: Trustee Distribution Power—Equal or Unequal</u>
>
> The trustee may distribute to or for the benefit of the beneficiary and/or the beneficiary's descendants, so much or all of the net income and principal of

[27] Two excellent articles on this subject are Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 Colum. L. Rev. 1425 (1961) (hereinafter "Halbach") which, although approaching 50 years of age, still appears to be the seminal article on this subject, and Michael J. Cenatiempo and Caroline S. Marciano, *Discretionary Trusts Primer*, Tr. & Est. (February 2008), at 42.

[28] *See* Alexander A. Bove, Jr., *The Letter of Wishes: Can We Influence Discretion in Discretionary Trusts?*, 35 ACTEC J. 38 (Summer 2009).

[29] This is discussed at some length in the Restatement (3rd) § 50, cmt. f.

this trust as the trustee deems desirable to provide for the health, support, education and welfare of the beneficiary and/or such descendants. Making a distribution to one beneficiary under this subparagraph does not require making a distribution to any other beneficiary. Any beneficiary of this trust who is then serving as trustee may not participate in a decision to make a distribution for such beneficiary's welfare. The trustee shall annually add any undistributed income to principal.

Distributions for a beneficiary's (or his or her descendants') welfare may include, but are not limited to, distributions to enable the person to (i) make a down payment on the purchase of a home consistent with such beneficiary's standard of living; (ii) invest a reasonable amount in business enterprises in which the beneficiary would be an active participant, including the purchase by the trustee of such enterprises as investments of the trust; and (iii) pay for a wedding and honeymoon, or other special trip at any time. I may provide the trustee with additional guidance by letter or memorandum to assist the trustee in ascertaining my intent, but any such writing would be non-binding.

<u>Sample Provision: Intent regarding Conservation for Remaindermen (or not)</u>

It is not my intention that the assets of any trust created hereunder be conserved for the benefit of remaindermen. On the contrary, my primary purpose in creating this trust is to provide for the named beneficiaries' health, education, maintenance and support in reasonable comfort. The rights and interests of remaindermen are subordinate and incidental to that purpose.

Note: A good addition to this provision would be to expressly permit distributions to facilitate estate and tax planning by the beneficiary, such as to prevent waste of the beneficiary's unified credit or GST exemption, or to facilitate gifts by the beneficiary, to take advantage of the tax exclusive nature of the federal gift tax.

Guidance on Exercise of Distribution Discretion

The following are examples of various provisions governing or guiding trustee discretion with respect to distributions.

<u>Sample Provision: Settlor Intent for Distributions</u>

It is the Settlor's intent that this trust be used to enhance the beneficiaries' quality of life, including (without limitation) travel, purchase of a home, cultural appreciation and enjoyment (music, arts, etc.), and education. In addition, the Settlor would like this trust to provide a source of funds in the event that a beneficiary, through accident or misfortune, does not have sufficient sources of income to provide for his or her own support. The Settlor expects his [her] descendants to support themselves independently and to be productive members of their communities and not to become dependent upon distributions from the trusts to the extent that they lose their ambition and incentive. Where a beneficiary is able to be gainfully employed and is not actively engaged in raising his or her children, income and principal of a trust established hereunder should not be used to replace the beneficiary's own efforts to work and accumulate financial security. However, it is not the Settlor's intent to force a parent to work outside the home when he or she has determined that it is important to stay at home to raise a family. In addition, the Settlor does not intend that the trustee place undue emphasis on the amount a beneficiary earns if he or she is actively engaged in a worthwhile pursuit, including working as an unpaid volunteer for charitable purposes.

<u>Sample Provision: Distributions to Guardians</u>

<u>Distributions to Guardians</u>. The trustee is specifically authorized, in its sole discretion, to make distributions of income or corpus directly to the guardian of any beneficiary of this trust for expenses incurred by the

guardian because of his or her care for such beneficiary. Such expenses are to include, by way of illustration and not limitation, the guardian's reasonable travel expenses in visiting the beneficiary, the reasonable cost of additions or improvements to the guardian's home, and the reasonable cost of additional household help or appliances in the guardian's home, providing such expenditures are necessary in the judgment of the trustee to enable the guardian to care for such beneficiary. It is my intention that such expenses by paid even though such payments may directly or indirectly benefit the guardian or the guardian's family. To the extent that such expenditures do not frustrate the primary purpose of this trust, I direct the trustee to be generous in making such distributions to guardians, and direct that whenever feasible, doubts should be resolved in favor of the guardian. Notwithstanding any provision in this paragraph to the contrary, however, if a guardian is also serving as trustee of this trust, and there is no corporate or other disinterested co-trustee, then no payments for the benefit of the guardian may be made pursuant to this section.

Health, Education, Maintenance and Support

Careful thought should be given to the use of the famous "ascertainable standard" which is often included in trusts automatically, without regard to whether it is the best standard, or even necessary. This distribution standard is often thought of as a limit on trustee discretion, especially where a beneficiary is serving as the sole trustee or a co-trustee, to avoid the beneficiary having a general power of appointment. Therefore, this standard is often considered a "safe harbor" standard that is included in trusts by default. However, if the trustee is independent, or if there is an independent co-trustee, such a standard may not be necessary, and may prevent distributions that serve other worthwhile purposes. For example, a marital deduction qualified trust will be included in the surviving spouse's gross estate at his or her death, so it might be beneficial, if resources permit, to make distributions from the trust to the spouse to facilitate annual exclusion gifts, tuition and medical gifts, or even taxable gifts that take advantage of the tax exclusive nature of the gift tax. However, if distributions of principal are limited to amounts needed for the spouse's health, maintenance and support, it may be difficult to justify a distribution that is requested by the spouse so that the funds may immediately be given away.

It is also possible that trust property subject to an ascertainable standard may not be as well protected from the claims of a beneficiary's creditors as assets held in a purely discretionary trust. For example, beneficiaries may argue that distributions *must* be made for such purposes, even where other resources are available, which may or may not be the intention of the settlor. This has been known to arise where creditors of a beneficiary argue that a trustee must make a distribution, because support of a beneficiary includes distributions to enable the beneficiary to pay debts.

Consideration of Beneficiary Resources

One issue of critical significance to a trustee is the question of whether a beneficiary's other resources should be considered in making discretionary distribution decisions, especially where the trustee's discretion is not absolute, and the trustee is to make distributions for the beneficiary's support. May, or must, the trustee consider other resources? What other resources should the trustee consider? Assuming there are or are not other resources, how should that information impact the trustee's distribution decisions?

Many attorneys' "form" trust documents routinely say that the trustee should take other resources into consideration, but in many cases, that may not be consistent with the settlor's desires, especially for a surviving spouse. If the trust mandates that other resources be taken into consideration, then the trustee must request information regarding such resources from the beneficiary, which may include requests for tax returns and/or bank or investment account statements.

Many, if not most, beneficiaries of trusts, particularly surviving spouses and children, are of the opinion that the trust assets are *their* assets, to which they are entitled, and they do not appreciate being made to "jump through hoops" to get *their* money. Beneficiaries often resent the fact that property was passed in trust, rather than outright, in the first place, especially where the trust was created at the settlor's death, and the beneficiaries were not expecting a trust to stand between them and *their* money. Such conflicts are often exacerbated when a beneficiary is required to produce tax returns or other financial information to the trustee, since most beneficiaries feel that their personal finances are none of the trustee's business.

Needless to say, conflicts of this type may be unavoidable where the settlor's purpose in passing property in trust is to limit the beneficiary's access to the funds, as may be the case where the settlor considers the beneficiary to be financially irresponsible, or where the settlor considers a trust necessary to preserve assets for remainder beneficiaries (as may be the case with a marital trust for a surviving spouse who is not the parent of the settlor's children). On the other hand, if the settlor has no particular concern about a beneficiary's access to trust property, and passed the property in trust only because the settlor's attorney recommended that structure to achieve tax or asset protection benefits, the settlor very well may not intend for the beneficiary to be required to produce tax returns or otherwise "jump through hoops" to get distributions, especially in the case of a trust for a surviving spouse who was happily married to the settlor for decades.

Of course, to a certain extent, if a trustee is to make distributions for support and maintenance, the trustee must obtain *some* information about the beneficiary's needs and resources to carry out its duties.[30]

Silence Is Not Golden

It is critical to address this issue in the trust instrument itself, because, as Ron Aucutt might say, with respect to the default rules that apply where a trust is silent on these issues, "the states are all over the map."

> *Significance of beneficiary's other resources*. It is important to ascertain whether a trustee, in determining the distributions to be made to a beneficiary under an objective standard (such as a support standard), (i) is ***required*** to take account of the beneficiary's other resources, (ii) is ***prohibited*** from doing so, or (iii) is to consider the other resources but has some ***discretion*** in the matter. If the trust provisions do not address the question, the general rule of construction presumes the last of these.[31]

Even if the attorney knows that the default rule under the law initially governing administration is consistent with the settlor's intent, a change in the situs of the trust later on may result in a very different default rule governing trust administration.

By way of example, the rule in Virginia (which is the author's current state of residence, and the law of which will govern any trust created under the author's will), is that a trustee *may* consider the beneficiary's other resources, absent an expression of intent to the contrary.[32] By contrast, the rule in Georgia (which was the author's state of residence when the author's will was executed) is that the trustee is *forbidden* from considering other resources, absent expression of intent to the contrary.[33]

Accordingly, the only way to assure that the settlor's wishes will be followed in this regard is to spell it out.[34]

In many cases, the trustee will be guided by the settlor's intent as expressed in provisions of the trust that do not specifically address consideration of other resources. For example, if the settlor's intention is to preserve principal to the maximum extent possible for later generations, and to limit distributions to current beneficiaries based upon actual need, then other resources probably should be considered, with an eye toward limiting distributions. On the other hand, if the settlor's intention is to provide as well as possible for current beneficiaries, and the rights of remainder beneficiaries are merely incidental, then it may be that the beneficiary's other resources are significant only to the extent that they demonstrate that the trustee can be more generous in making distributions, because the beneficiary is not wholly dependent upon the trust for support for the beneficiary's lifetime.

What Impact Should Beneficiary Resources Have on Distributions?

Presumably, if the trustee has discretion to consider other resources, then the trustee also has discretion to determine the *significance* of other resources, based upon all of the surrounding circumstances. If, however,

[30] "The trustee has a duty to act in a reasonable manner in attempting to ascertain the beneficiary's needs and, under the usual rule of construction, other resources that may be appropriately and reasonably available for purposes relevant to the discretionary power. The trustee generally may rely on the beneficiary's representations and on readily available, minimally intrusive information requested of the beneficiary. This reliance is inappropriate, however, when the trustee has reason to suspect that the information thus supplied is inaccurate or incomplete." Restatement (3rd) § 50, cmt. e(1) (2003).

[31] Restatement (3rd) § 50, cmt. e (2003).

[32] NationsBank of Virginia v. Estate of Grandy, 248 Va. 557, 450 S.E.2d 140 (1994). The Restatement (3rd) cites this case for the proposition that other resources *must* be considered, but the court's actual holding was that it was *not improper* for a trustee to consider other resources.

[33] Hamilton National Bank v. Childers, 233 Ga. 427, 427, 211 S.E.2d 723, 724 (1975).

[34] *See* Halbach, *supra*, note 27, at 1442.

the trust mandates consideration of other resources, how is that knowledge supposed to impact the trustee's decision? Georgia case law holds that even if a trustee is required to consider other resources, the existence of other resources does not necessarily mandate that distributions from a trust be less than they would be in the absence of such other resources.[35]

The view of the Restatement (2nd), and the rule in some, but not all states, appears to be that, absent some expression of intent to the contrary, the settlor of a trust for support intends that the trust provide for *all* of the beneficiary's support needs, irrespective of whether the beneficiary may have other resources that could be used for that purpose.[36] The Restatement (3rd), however, suggests that a trustee *should* consider other resources, unless the settlor's purposes are better served by not doing so.[37]

Again, the author's experience is that most people assume that the existence of other resources will serve to reduce distributions from the trust, but this is not necessarily so. If the trustee knows that the beneficiary's other resources are adequate to support the beneficiary, and that the beneficiary will not need to rely upon the trust for support, the trustee may be more liberal in making distributions, especially if the settlor has expressed the intent that the primary purpose of the trust is to provide for current beneficiaries, and that the rights of remainder beneficiaries are merely incidental. On the other hand, if the trust resources are limited, and the beneficiary has no other resources, the trustee may need to limit distributions in an effort to ensure that the trust will not be exhausted during the beneficiary's lifetime, leaving the beneficiary without support.

If So, What Resources Should Be Considered?

Should the trustee consider only the beneficiary's sources of *income*? What about *principal*? Is the beneficiary expected to deplete his or her assets?

The general rule seems to be that the resources to be considered are limited to *income*, and not the beneficiary's assets in general.[38] Nevertheless, there are certainly circumstances where the trust may require the beneficiary to consume his or her own assets before encroaching on the principal of a trust. For example, a marital deduction trust for the benefit of a surviving spouse that is not the parent of the decedent's children may mandate that the spouse consume his or her own resources before any principal is distributed, so as to preserve the principal for the decedent's children. Also, a trust may specify that a beneficiary's assets that will be taxable in the beneficiary's estate be consumed before encroaching upon GST exempt trust principal that will not be subject to transfer tax at the beneficiary's death.

What Evidence of Resources Should Be Required?

Assuming the foregoing questions are answered, what evidence may or should the trustee request or demand from the beneficiaries? Should the trustee request the beneficiary's tax returns? Bank and investment statements? Beneficiaries can be quite resistant to providing copies of tax returns and other information, on the grounds that the trust settlor did not intend for the beneficiary to bare his or her entire financial soul to the trustee in order to get distributions. However, the trustee is expected to maintain some degree of diligence in collecting reliable information, especially where the trustee is required, or at least encouraged, to consider other resources.

If the trust *mandates* consideration of other resources, the trustee may not have much choice, unless the trust agreement specifically states that the trustee may rely solely upon the beneficiary's statement of other resources assuming, of course, there is no reason to question the beneficiary's veracity. If the trust merely *permits* the trustee to consider other resources, there is an increased likelihood of conflict with the beneficiary, who may well argue that the trustee is not required to obtain such information, and therefore should not do so.

> <u>Sample Provision: Trustee Distribution—Consider Other Resources</u>
>
> The trustee may pay to or for the benefit of each descendant of mine who is the primary beneficiary of a trust created hereunder, and such primary beneficiary's descendants from time to time living, (i) such amounts from the income and principal of that trust as the trustee may deem appropriate for the support of those persons in their accustomed manner of living and for their health and education,

[35] Griffith v. First National Bank, 249 Ga. 143; 287 S.E.2d 526 (1982).

[36] Restatement (2nd) § 128, cmt. e (1992). The Reporter's notes to this comment include citations to numerous cases holding that a beneficiary is entitled to distributions irrespective of other resources, and other cases holding to the contrary.

[37] Restatement (3rd) § 50, cmt. e (2003).

[38] *Id*.

taking into consideration any other resources available to them to the knowledge of the trustee, and (ii) such additional amounts of income and principal of that trust, in such amounts and proportions among them, as the trustee in its sole discretion deems best.

In determining the advisability and amount of any payment, the trustee may, but need not, rely on a statement of any beneficiary's or distributee's assets, signed by such beneficiary or distributee, or any parent, guardian, or similar fiduciary of such beneficiary or distributee. Within the scope of the trustee's discretion, the trustee's judgment as to the advisability, amount and recipient of any such payment shall be final and conclusive upon all parties interested or who may become interested in the trust; and upon making any such distribution, the trustee shall be fully released and discharged from all further liability therefor.

Trustee Succession Issues

Corporate Trustee—Power to Remove and Replace

Giving someone, whether the beneficiary or some other person, the power to remove and replace a corporate trustee is the best way to keep a corporate trustee honest and responsive, and avoids the awkward situation that is created where a corporate trustee must be asked to resign, and the even more awkward situation where the corporate trustee refuses to do so.

<u>Sample Provision: Co-Trustee or Beneficiary Power to Remove and Replace Corporate Trustee</u>

Notwithstanding anything herein to the contrary, the individual co-trustee of any trust created hereunder, if any, and if none, the primary beneficiary of such trust, may remove the corporate co-trustee or trustee serving hereunder from office by instrument in writing delivered to such trustee or co-trustee being so removed, provided that such instrument designates a successor corporate trustee that is not a related or subordinate party, within the meaning of Section 672(c) of the Code, to any person holding such a removal power or his or her guardian.

Individual Trustee—Incapacity and HIPAA Concerns

In the case of individual trustees or co-trustees, the trust agreement should address the issue of an individual trustee who loses the capacity to administer the trust, but will not, or is medically unable to, resign. Most trusts provide that an individual trustee's (or beneficiary's) loss of mental capacity is to be established by *physician certification*. Where the individual is clearly unconscious, obtaining such a certification may not be problematic, but if the individual suffers from a progressive dementia, such that loss of capacity may not be immediately apparent, obtaining an examination, and the physician's findings, could be quite problematic, especially if the individual trustee refuses to submit to examination or refuses to permit the physician to disclose his or her findings. Under HIPAA,[39] a physician is not at liberty to disclose the results of an examination, unless authorized to do so by the patient or a person holding a medical power of attorney.

The author frequently encounters trust agreements that purport to waive HIPAA protections on behalf of an individual trustee, sometimes by saying that acceptance of a trust constitutes automatic consent by the individual to the release of "protected health information." The HIPAA rules, however, are fairly clear that a consent to the release of protected health information must be in writing and signed by the individual, and may not be implied. Moreover, HIPAA rules state that a release of information must be a stand-alone document, and may not be incorporated into any other agreement, with the exception of a medical power of attorney.

Perhaps the simplest way to address this issue is to provide that interested persons, such as co-trustees, beneficiaries, etc. can ask a trustee to submit to examination, and if the trustee refuses to do so or refuses to permit the physician to release his findings, the trustee is deemed to have resigned.

<u>Sample Provision: HIPAA Avoiding Provision for Incapacitated Trustee</u>

A settlor's, trustee's or protector's incapacity shall be deemed to exist: (l) during any period that such person is legally incompetent as determined by

[39] Health Insurance Portability and Accountability Act of 1996, Pub. L. 104-191, 42 U.S.C. § 1171 *et seq.*

> a court of competent jurisdiction; (2) during any period that a conservator or guardian for such person has been appointed, based upon his or her incapacity; (3) during any period when two physicians licensed to practice medicine certify in writing to the settlor or protector (if the trustee's capacity is at issue) or to the settlor or trustee (if the protector's capacity is at issue), that in the opinion of such physicians, such person, as a result of illness, age or other cause, no longer has the capacity to act prudently or effectively in financial affairs; or (4) thirty (30) days after any trust beneficiary requests the settlor or protector, as applicable, to provide a certificate from a physician licensed to practice medicine that, in the opinion of such physician, such person has the capacity to act prudently or effectively in financial affairs and the settlor or protector, as applicable, fails to provide such certification.

Formal and Informal Account Settlement

Most trust agreements, and the laws of many states, eliminate the requirement of formal judicial settlement of accounts. In most such cases, where a trustee ceases to serve, due to the termination of the trust or for other reason, the trustee will accept an informal settlement with the beneficiaries, in the form of a release executed by the beneficiaries, especially where minor and unborn beneficiaries can be "represented" by *sui juris* beneficiaries.

Where informal settlement is not adequate, either because one or more beneficiaries refuses to release the trustee, or because one or more minor, disabled, or unborn beneficiaries cannot be adequately represented without a court appointed guardian, the trustee may petition a court for judicial settlement, even though it is not required to do so, especially if the only alternative is to wait out the limitations of actions period. Naturally, the trustee will want to charge the expense of judicial settlement to the trust, rather than incurring that expense on its own.

In many, if not most, states, the trustee is entitled to have the cost of the settlement paid by the trust, even though judicial settlement is not mandatory, assuming, of course, that the petition is granted and there has been no breach of trust. In other states, there may be some question as to whether the trustee's incurring such an expense on behalf of the trust is appropriate, especially if no breach of trust action has been asserted or threatened. In still other states, such as Delaware, a trustee clearly is *not* entitled to have the cost of judicial settlement paid by the trust, unless the trust agreement says otherwise.[40]

The argument against permitting a trustee to charge the trust for a non-required judicial settlement is that the expense is incurred solely for the benefit of the trustee (to protect the trustee from future claims) and provides no benefit to the beneficiaries. On the other hand, a trustee who has faithfully executed its duties should not be denied the closure that is provided by full and final settlement merely because an obstinate beneficiary refuses, without cause, to agree to informal settlement, especially where the settlor has specifically provided a means for informal settlement in the document itself. The ability of the trustee to charge the expenses of judicial settlement to the trust should serve as an incentive to the beneficiaries to either assert any claims they have or to respect the settlor's desire to keep administrative burdens and expenses to a minimum.

The following provision expressly permits the beneficiaries to settle a trustee's account, provides for virtual representation of certain beneficiaries (which may not be necessary if there is a general virtual representation provision, as discussed above) and permits the trustee to seek judicial settlement at the expense of the trust.

> <u>Sample Provision: Release of Trustee by Beneficiary Approval of Account</u>
>
> The trustee, in its sole and absolute discretion, may render an account or similar report of its proceedings as trustee to any or all living or then existing beneficiaries at any time. All living and then existing beneficiaries, acting by majority (so long as at least one income beneficiary and one remainder beneficiary are represented), shall have full power to settle finally any such account or report and, on the basis of such settlement, to release the trustee from all liability for its acts or omissions as trustee. Such settlement and release shall be binding upon all interested parties, including those who may be under legal disabili-

[40] Bankers Trust Company v. Duffy, 295 A.2d 725 (Del. 1972); Merrill Lynch Trust Company v. Campbell, 2009 Del. Ch. Lexis 160, C.A. No. 1803 - VCN (Del. Ch. 2009)

ty or not yet in being, and shall have the force and effect of a final decree of a court of competent jurisdiction rendered in an appropriate proceeding for an accounting. Nothing herein shall preclude the trustee from having its accounts judicially settled at the expense of the trust if it shall so desire. If any beneficiary is suffering under a legal disability (including minority), then accounts or reports may be requested by or issued to or settled by the parent, guardian, or similar fiduciary of such person.

Powers to Fill Vacancies in Office of Trustee

This power allows certain persons to fill a vacancy without the need for court involvement. Note that the Uniform Trust Code also permits vacancies to be filled by agreement of the beneficiaries without court approval, but the laws of some states still require court approval of any appointment that is not specifically provided for in the trust instrument.[41]

Sample Provision: Beneficiary Power to Fill Vacancy in Trustee Office

If a vacancy occurs in the office of executor of this will or of trustee of any trust created by this will and there is no other provision for appointing a successor, my wife, if then living, and if not, the persons who are then income beneficiaries of my estate or such trust (or, if any such beneficiaries are then minors or otherwise under legal disability, their parents or guardians), shall, within sixty (60) days after such office becomes vacant, appoint a successor executor or trustee by written instrument delivered to the retiring executor or trustee, to the executor or trustee being appointed and, in the case of an executor, to the court having jurisdiction over the administration of my estate. Should such persons fail or refuse to appoint a successor within sixty (60) days, then such successor may be appointed by any court having jurisdiction over my estate or such trust upon application of any person interested in my estate or such trust, or upon application of the retiring executor or trustee.

Trustee Qualification Issues

Trust instruments often establish the criteria that any successor corporate trustee must meet in order to serve in that capacity. The most common types of criteria typically appear in the form of minimum requirements as to capital and surplus, assets under management, and/or years of experience administering trusts. While such requirements certainly may have their place, they can have the result of unduly narrowing the possible universe of qualified trustees, especially in the case of a relatively small trust that might get more attention from a smaller corporate trustee than from a larger trustee. For example, a corporate trustee with $100,000,000 capital and surplus may be advisable for a $20,000,000 trust, but may well be overkill for a $200,000 trust.

Moreover, it is often the case that there are benefits to be gained by using a fiduciary in a particular jurisdiction, such as Delaware, to facilitate a perpetual trust, an asset protection trust, a directed trust, or some other structure that may not be as "reliable" in other jurisdictions. In the case of Delaware, many Delaware trust companies are relatively small, and cannot, standing alone, meet the criteria set forth in certain trust instruments, but they may be part of an affiliated group of trust companies that, in the aggregate, can easily meet such requirements. Accordingly, if such qualification requirements are to be imposed, consider allowing an institution to meet the requirement on an aggregate basis, by including the type of language shown below:

Sample Provision: Minimum Capital and Surplus

Any successor executor or trustee appointed hereunder shall be a bank or trust company with trust powers and combined capital and surplus (***when combined with the capital and surplus of all corporations that control, are controlled by, or are under common control with, such bank or trust company***) of not less than One Hundred Million Dollars ($100,000,000).

Sample Provision: Minimum Assets under Management

[41] *See, e.g.*, O.C.G.A. § 53-14-2.

> Any successor executor or trustee appointed hereunder shall be a bank or trust company with trust powers and assets under management (***when combined with the assets under management of all corporations that control, are controlled by, or are under common control with, such bank or trust company***) of at least Five Hundred Million Dollars ($500,000,000).
>
> Sample Provision: Minimum Experience Administering Trusts
>
> Any successor executor or trustee appointed hereunder shall be a bank or trust company with trust powers and (along with all corporations that control, are controlled by, or are under common control with, such bank or trust company) not less than twenty-five (25) years continuous experience administering trusts.

Compensation of Trustees

A trust should provide that a corporate trustee is entitled to compensation according to its published fee schedule, in the absence of a written agreement to the contrary. While provisions for "reasonable" compensation or compensation at the "prevailing rate" may sound good, the reality is that most corporate fiduciaries will require compensation according their published schedules, and if the trust agreement does not provide for such compensation, the issue may have to be addressed by agreement with the beneficiaries or by judicial action, which can delay the transition of a trust from one trustee to another. In this day and age, the competitive marketplace serves as a check on unreasonable fees, especially where the trustee can easily be replaced, as discussed above. Another consideration is that there are some state fiduciary compensation statutes that call for compensation at a much higher level than the standard rates charged by corporate fiduciaries, which could tempt a corporate fiduciary to charge the statutory rate, rather than the published rate that the settlor likely anticipated.

If the named trustee is a lawyer, accountant, or other professional who customarily charges for his or her time at a given hourly rate, a provision permitting such person to be compensated at that rate can avoid the conflicts of interest that may otherwise arise, especially if those hourly rates are higher than might otherwise be appropriate for a trustee. For example, if a lawyer cannot charge as much for trustee services as she can for legal services, the lawyer may not be inclined to accept the appointment, or may have an incentive not to spend as much time on the trust as the situation requires.

There is always the possibility that special circumstances may call for compensation at rates higher than, or different from, a corporate trustee's fee schedule or a professional's normal hourly billing rate, so a compensation provision should also contemplate a possible fee agreement.

> Sample Provision: Trustee Compensation
>
> Each trustee shall be entitled to receive reasonable compensation, which may be charged to principal or to income or partly to each at the discretion of the trustee. Reasonable compensation may be established by a written fee agreement between the trustee and the person by whom the trustee was appointed or who holds the power to remove and replace the trustee. A corporate trustee's compensation specified in its published fee schedule in effect at the time it renders services shall be presumed reasonable in the absence of a fee agreement. In the case of an individual professional who maintains standard hourly rates for his or her professional services, such professional's hourly rate at the time services are rendered shall be presumed to be reasonable compensation, in the absence of a fee agreement. Notwithstanding the foregoing, however, no trustee shall charge a termination or distribution fee upon resignation or removal of the trustee unless, upon acceptance of its trusteeship, the trustee obtains written consent of the grantor, if living, or if not, the individual co-trustee, or if none, the beneficiary of each trust that is in a generation closest to mine.

Note that this above provision expressly prohibits termination fees, which some corporate trustees routinely charge, generally as a disincentive to removing the trustee. The author's view is that a trustee should not receive a bonus for being fired. Some state laws specifically permit the charging of a termination fee, absent a provision to the contrary, even if the fee is not included in the trustee's published fee schedule. The above provision is intended to negate a termination fee, even if it is included in the trustee's fee schedule.

Trustee Power to Resign

In many states, other than Uniform Trust Code jurisdictions, the default rule is that a trustee cannot resign without court approval, which can cause a trustee to be stuck with a bad situation if there are unreasonably litigious beneficiaries or persons who make the efficient administration of the trust impossible.[42]

> Sample Provision: Trustee Power to Resign Without Court Approval
>
> Any trustee of any trust under this agreement may resign at any time from such trust by giving prior written notice of his, her or its resignation, such resignation to become effective immediately or upon such date or contingency as the resigning trustee may specify in such notice, without the need for any judicial or other approval. The notice of resignation shall be delivered to any other trustee then serving, or if none, to any nominated successor trustee, or if none, to a majority of the adult beneficiaries (or the parents or guardians of any minor beneficiaries) of that trust to whom the trustee could at that time distribute income.

An alternative would be to provide that such resignation becomes effective at the earlier of the acceptance of the trust by a replacement trustee or a stated period of time, such as 60 or 90 days, to allow the interested parties a reasonable time to find and nominate a replacement trustee.

Deviant Trusts—Varying Default Rules in Terms of Trust

Some trusts contemplate or mandate that the trustee administer the trust in a way that deviates from what are normally considered to be standard, prudent, or otherwise "good" practices. Institutional trustees should have well established policies and procedures on matters such as investment policies for trusts, frequency and mode of communication with beneficiaries, discretionary distribution decision making, etc. Presumably, these practices and procedures are developed to help the trustee carry out its fiduciary duties to the best of its ability and in a manner that will not cause the trustee to incur liability. Often, however, the settlor of a trust will desire, or even mandate, that the trust be administered in a way that significantly deviates from established normal procedure, and in a way that, under normal circumstances, might even be considered a breach of the trustee's fiduciary duties.

General Rule—Trust Terms Trump Default Rules, Subject to Exceptions and Limitations

The vast majority of legal rules governing trusts and their administration, whether statute law or common law, are *default* rules that apply only to the extent that the subject matter of such rules is not otherwise provided for in the terms of the trust itself.[43] The trustee is under a duty to administer the trust according to the terms of the trust or, where the trust does not address a particular issue, as provided by law, and as long as the trustee follows that rule, it should not incur liability.[44] The general rule, however, is not without its exceptions or limitations.

The Uniform Trust Code sets forth a list of "mandatory" rules that may not be varied by the terms of the trust instrument, although the states have varied considerably over which rules are included on the "mandatory" list. The most controversial "mandatory" items in the Uniform Trust Code are the requirements as to information that must be provided to beneficiaries under the *Duty to Inform and Report*.[45] These "mandatory" provisions are so controversial, in fact, that they have been omitted from most states' versions of the code, because there is a strong desire on the part of many trust settlors to keep the provisions of a trust, or even the existence of the trust, secret from the beneficiaries, at least for a certain period of time.

Even where certain issues are not specifically included in the "mandatory" list, there are more general "mandatory" requirements, that have been included in all states' versions of the code, that may limit the extent to which a settlor may negate the default provisions of state law:

---

[42] *See, e.g.,* O.C.G.A. § 53-12-175.

[42] UTC § 105(a) (2005) provides that "*Except as otherwise provided in the terms of the trust*, this [Code] governs the duties and powers of a trustee, relations among trustees, and the rights and interests of a beneficiary." (Emphasis added). *See also* Restatement (2nd) § 164 (1992).

[44] UTC § 801 (2005).

[45] UTC § 105(b)(8) & (9) (2005) (emphasis added). *Accord* Restatement (2nd) § 164(b) (1992).

> The terms of a trust prevail over any provision of this [Code] ***except***:
>
> * * *
>
> (2) the duty of a trustee to act in good faith and in accordance with the terms and purposes of the trust ***and the interests of the beneficiaries***;
>
> (3) the requirement that a trust and its terms be ***for the benefit of its beneficiaries***, and that the trust have a purpose that is lawful, not contrary to public policy, and possible to achieve;[46]

These provisions leave open the possibility that *any* provision of a trust that deviates from normal fiduciary practice might be found to be "out of bounds" on the grounds that such a provision violates the rule that the trust provisions must be "in the interests of" and "for the benefit of" the beneficiaries.

Certain trust terms will be void, *ab initio*, such as trust terms that are, or require the trustee to act in a way that is, illegal, impossible or against public policy.[47]

Trustee Duties Where Circumstances Change Over Time

Some provisions may be fine when the trust is created, but may, due to a change in circumstances, become so contrary to the interests of the beneficiary that it is no longer reasonable for the trustee to comply with the provision. Of course, a trustee is always free to seek direction from a court or to seek permission to deviate from the terms of a trust where compliance with the terms of the trust is sufficiently detrimental to the beneficiaries.[48] In an emergency, there is authority that a trustee may deviate from the express terms of a trust even without court approval, if necessary to prevent some harm to the beneficiaries, and if there is not adequate time to seek court review.[49] The question, then is whether the trustee is *required* to seek court permission to deviate from the terms of the trust.

Both the Restatement (Second) and the Restatement (Third) take the position that a trustee is subject to liability for failing to petition a court for permission to deviate from the express terms of the trust, if the trustee knows or should know that circumstances have changed so dramatically from the creation of the trust that deviation from its terms is necessary.[50] The Uniform Trust Code, by contrast, intentionally stops short of imposing on the trustee an affirmative *duty* to petition the court for permission to deviate.[51]

The point is that even if a trustee may rely on the mandate of a trust when the trust is created, that does not mean that the trustee is protected forever by the trust provisions, if circumstances change materially.

Trustee's Right to Rely on Trust Terms and Exculpation from Liability

Because of the potential uncertainties associated with trust terms that deviate from the norm, trusts often include exculpatory provisions that will protect a trustee from liability for any action taken in reliance upon the trust terms. Such provisions are necessary in many cases to encourage a trustee to act other than in the most conservative manner. There are, however, limits as to the protection that can be granted to a trustee.

The Uniform Trust Code protects a trustee who relies on the terms of the trust only if the reliance is *reasonable*.[52] Moreover, all state laws limit the extent to which a trustee can be exculpated from liability, generally. The following Uniform Trust Code provision is fairly typical of state law limits on exculpation:

> A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that it … 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.[53]

Many states also add "gross negligence" into the mix. The foregoing provision may be cause for concern, depending upon how deviant a trust provision might be, because even if a trustee is not acting in

[46] UTC § 105(b) (2005) (emphasis added). *Accord* RESTATEMENT (2ND) § 164(b) (1992).

[47] *See, e.g.,* RESTATEMENT (2ND) § 167 (1992); RESTATEMENT (3RD) § 66 (2003); UTC § 412 (2005).

[48] RESTATEMENT (2ND) § 167(1) (1992); RESTATEMENT (3RD) § 66(1) (2003); *Accord* UTC § 412 (2005).

[49] RESTATEMENT (2ND) § 167(2) (1992); *Accord* UTC § 412 (2005).

[50] *See* RESTATEMENT (2ND) § 167(3) (1992) and RESTATEMENT (3RD) § 66(2) (2003). While the RESTATEMENTS are generally supposed to be reflective of the common law, it is noteworthy that the Reporters Notes to these provisions contain no citations to any judicial decisions that have actually imposed liability on a trustee for failing to seek judicial deviation from the express terms of a trust.

[51] UTC § 412 (2005).

[52] UTC § 1006 (2005).

[53] UTC § 1008(a)(1) (2005). *See also* RESTATEMENT (2ND) § 222 (1992), O.C.G.A. § 53-12-194.

bad faith, who is to judge when the trustee's following of the trust terms rises to the level of "reckless indifference?"

Depending upon how deviant a trust provision is, specific provisions in the trust agreement may not be sufficient to carry out the settlor's intent, and it may be necessary to establish the situs of a trust in a jurisdiction that is more respectful of a settlor's right to deviate from normal practice or, at the very least, away from a jurisdiction that is intolerant of such deviations.

<u>New York Law—Low Tolerance for Deviance from Standard Practice</u>

New York law appears to prohibit exculpation from even simple negligence, declaring that it is against public policy to exonerate a trustee "from liability for failure to exercise *reasonable care, diligence and prudence*.[54] In *Matter of Dumont*[55] the decedent's estate consisted almost exclusively of stock in Eastman Kodak Company, about which the decedent's will provided as follows:

> It is my ***desire and hope*** that said stock will be held by my said Executors and by my said trustee to be distributed to the ultimate beneficiaries under this Will, and ***neither my Executors nor my said trustee shall dispose of such stock for the purpose of diversification of investment and neither they or it shall be held liable for any diminution in the value of such stock***.
>
> The foregoing provisions ***shall not prevent*** my said Executors or my said Trustee from disposing of all or part of the stock of Eastman Kodak Company in case there shall be some ***compelling reason other than diversification*** of investment for doing so.[56]

Based upon the foregoing provision, the trustee retained the concentration in Kodak stock, and the stock fairly consistently outperformed the benchmarks for the first 17 years following the decedent's death. In the early 1970's, the stock price began to fall, but no more so than the stock market in general. When the market later recovered, Kodak's recovery was significantly more sluggish than the overall stock market. Thirty years later, the beneficiaries sued the bank for breach of trust for failing to sell the stock when its value began to decline. The bank argued that it was bound to follow the terms of the trust, and was exculpated from liability for any loss resulting from the retention of the Kodak stock, and that there had been no compelling reason to sell the stock.[57]

The Surrogate's Court held that while a trustee is supposed to follow the terms of the trust to carry out the intent of the testator, the trustee is still required to act in a prudent manner, and if the terms of the trust are contrary to the best interests of the beneficiaries, then the testator's intent and wishes must yield to the best interests of the beneficiaries:

> It is clear that a fiduciary must use good faith and prudence to carry out its duties (EPTL 11-2.3,b,3,A), and that a retention clause cannot trump the application of prudence in the management of an estate. *In Re Hubbell*, 302 N.Y. 246, 97 N.E.2d 888). ***The Hubbell case holds that where a retention clause conflicts with the legal duty of prudence imposed upon a fiduciary, the clause must lose***.[58]

The court held that the language in the will directing retention of the Kodak stock was not a mandate, but was merely "precatory,"[59] and that the trustee was at all times free to sell the stock under the general administration provisions of the trust, which included a general power to purchase and sell investments. The end result was a surcharge against the trustee of nearly

[54] N.Y. E.P.T.L. § 11-1.7(a)(1) (emphasis added).

[55] In re Judicial Settlement of the Second Intermediate Account of Chase Manhattan Bank (Matter of Dumont), 4 Misc. 3d 1003A, 791 N.Y.S.2d 868, 2004 Slip Op. 50647U (N.Y. Sur. Ct., June 25, 2004) (all citations to particular pages of this opinion are citations to the Slip Opinion page number), *reversed*, 26 A.D.3d 824; 809 N.Y.S.2d 360 (N.Y. App. Div. 4th Dep't, Feb. 3, 2006); *appeal denied*, 28 A.D.3d 1257; 813 N.Y.S.2d 689 (N.Y. App. Div. 4th Dep't, Apr. 28, 2006); *appeal dismissed* 2006 N.Y. LEXIS 2560, (N.Y. Ct. App., Sept. 12, 2006).

[56] 26 A.D.3d at 826; 809 N.Y.S.2d at 362 (emphasis added).

[57] The bank was even able to cite to authority that a decline in stock price does *not* necessarily compel its sale by a trustee.

[58] Slip Op. 50647U at 5-6 (emphasis added). A review of the *Hubbell* case really does not support the court's assertion, however, since the trust agreement in *Hubbell* merely *permitted* the retention of the trust property, rather than *mandating* such retention.

[59] *See* Frank L. Schiavo, *Does The Use of "Request," "Wish," or "Desire" Create a Precatory Trust or Not?*, 40 REAL PROP. PROB. & TR. J. 648 (Winter 2006).

[60] Matter of Kettle, 73 A.D.2d 786; 423 N.Y.S.2d 701 (N.Y. App. Div. 1979).

$21,000,000. This holding was particularly troublesome in light of an earlier New York decision, *Matter of Kettle,*[60] which involved a testamentary trust that provided as follows:

> I am particularly ***desirous*** that my TRW, Inc., securities be retained by my Executrix and by my Trustee unless ***compelling reasons*** arise for the disposal thereof.[61]

The trustee in *Kettle* would have made the *Dumont* Surrogate quite proud, since the trustee determined that the prudent course of action was to sell most of the TRW stock, notwithstanding the objections of the beneficiary, and to reinvest the proceeds in a well diversified portfolio. Unfortunately for the trustee in *Kettle*, the diversified portfolio did not perform as well as the concentration in TRW stock would have performed. Consequently, the beneficiary sued the trustee for breach of trust because the trustee did not follow the directions in the trust agreement. The trustee argued not only that the statement of the testator's *desire* was merely precatory, but that in any event, the general provisions of the trust permitted the trustee to buy and sell any asset, so it was authorized to diversify the portfolio. Does this sound familiar? The end result was that the court found the trustee liable for breach of trust for not following the testator's instructions, and the court ordered the trustee to repurchase the TRW shares, even if it had to use its own money to do so. *Kettle* does not appear to have been cited by any of the parties or the various courts involved with *Dumont*, but if the trustee in *Dumont* had followed the holding in *Kettle*, it would likely have concluded that its duty was to follow the trust, not the general standards of "prudence," and it would still have been found liable for doing so.

The lesson of these cases is that "deviant" trust provisions can cause significant risk for trustees, at least in some jurisdictions, thus making it more difficult for the settlor of the trust to have his or her wishes honored. Such deviant trust provisions can greatly multiply the work and the risk of a trustee, which may result in higher trustee fees and higher trust expenses, especially if the trustee is constantly having to seek court guidance to comply with the grantor's wishes.

Delaware Law—Strong Emphasis on Settlor's Intention

In contrast with the New York's view of deviation from normal trust administration practices, Delaware law provides that the trust terms can vary any provision of state law, and can exculpate a trustee for relying upon trust provisions that do so:

> The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this section. ***It is the policy of this section to give maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments***.[62]

A trustee can be exculpated from liability for following the terms of a trust, as long as there is no willful misconduct, so a trustee need not be concerned about an allegation that following a trust provision constitutes "gross negligence" or "reckless indifference" to the consequences.[63]

Accordingly, where a settlor desires that a trust be administered in a way that departs materially from standard practices, the settlor should consider establishing such a trust in a state such Delaware, where the law will clearly support the trustee in following those desires.

Negating or Reducing The Duty to Inform and Report

Among the most thorny issues facing fiduciaries is a request or demand by a trust settlor, or the parent of a trust beneficiary, to withhold from a beneficiary the details of a trust's investments and administration, or even the very existence of the trust itself, usually out of a concern that the knowledge of such available wealth will "ruin" the beneficiary. While the concern may be valid, the duty of the trustee to provide information to beneficiaries about the trust is, in most cases, clear. The Restatement (Second) states that, at the very least, a trustee is required to provide certain information to a beneficiary if the beneficiary so requests.[64] Moreover:

---

[61] *Id.* at 786; 423 N.Y.S.2d at 702 (emphasis added).
[62] 12 Del. C. § 3303 (a) (emphasis added).
[63] 12 Del. C. § 3313 (a).
[64] Restatement (2nd) § 173 (1992) (emphasis added). For a good discussion of this topic, *see* T.P. Gallanis, *The Trustee's Duty to Inform*, 85 N.C. L. Rev. 1595 (hereinafter, "Gallanis").

> Although the terms of the trust may regulate the amount of information which the trustee must give and the frequency with which it must be given, ***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***.[65]

The Uniform Trust Code is far more detailed in its requirements for notice.[66]

In a 2002 Delaware case, *McNeil v. McNeil*,[67] a trust beneficiary successfully sued the trustees for failing to inform him that he was a permissible beneficiary of a trust, thus denying him the opportunity to request distributions from the trust. Note that *McNeil* did not involve a situation where the trust agreement mandated keeping the existence of the trust a secret.

To demonstrate what a hot issue this really is, the drafters of the Uniform Trust Code considered the beneficiary's right to information to be so important that the duty to inform was one of the few provisions that could not be altered by the terms of the trust:

> The terms of a trust prevail over any provision of this [Code] except:
>
> * * *
>
> [(8) the duty under Section 813(b)(2) and (3) to notify qualified beneficiaries of an irrevocable trust who have attained 25 years of age of the existence of the trust, of the identity of the trustee, and of their right to request trustee's reports;]
>
> [(9) the duty under Section 813(a) to respond to the request of a [qualified] beneficiary of an irrevocable trust for trustee's reports and other information reasonably related to the administration of a trust;][68]

Note that the issue under discussion is not merely withholding knowledge of the trust until a beneficiary reaches adulthood and obtains a certain level of maturity. Even the Uniform Trust Code provision quoted above contemplates that information about a trust may be withheld from a beneficiary until the beneficiary reaches age 25. The situation contemplated here is that where a settlor feels a need to keep even fully grown beneficiaries from having knowledge of the trust. Given the controversy surrounding the Uniform Trust Code's attempt to make the provision of information mandatory, and the refusal of many states to enact any version of the requirement, it would appear that, at least in some jurisdictions, it is possible to largely or entirely negate a trustee's duty to inform beneficiaries.

Frankly, it is difficult to imagine a potential danger of a beneficiary's knowledge of a trust that cannot be fairly easily addressed with careful drafting. For example, if the concern is that the beneficiary will be disinclined to engage in gainful employment or any other worthwhile use of his or her time, that issue is easily addressed by adding incentive provisions that make clear that sloth will not be tolerated. In fact, this approach probably works better than ignorance, because if the requirements are spelled out in black and white for everyone to see, it will be clear that the beneficiary must pull his or her own weight. Moreover, concerns about creditors and greedy spouses are also easily addressed through spendthrift provisions and/or the level of discretion given to the trustee. Accordingly, the first recommendation would be to dissuade a client from including such a mandate in a trust, by trying to identify the root of the client's concern and addressing that concern in the trust instrument.

If the client cannot be so dissuaded, then there should be some person to whom the trustee must report, so that the trustee is not completely without any checks or balances. However, it would be wise to advise a client in writing that the validity of such a provision is by no means guaranteed.[69]

An additional practical problem with eliminating a trustee's duty to inform or, more strongly, prohibiting a trustee from providing information, is that the trustee has a strong interest in providing information to beneficiaries to limit its liability exposure. For example, if there is an applicable statute of limitations for breach of trust claims, in most cases the statute will be subject to a discovery rule, so the limitations period will not begin to run until a beneficiary is provided with enough information that he knew or should have known that a breach had occurred.[70] In fact, under the Uniform Trust Code,

[65] Restatement (2nd) § 173, cmt. c (1992) (emphasis added).

[66] UTC § 813 (2005).

[67] McNeil v. McNeil, 798 A.2d 503 (Del. 2002), affirming in part and reversing in part McNeil v. Bennett, 792 A.2d 190 (Del. Ch. 2001).

[68] UTC § 105(b)(8) & (9) (2005).

[69] *See* Gallanis, *supra*, note 64 at 1623.

[70] *See* O.C.G.A. § 53-12-198.

there is a relatively short limitations period that applies if the notice requirements of the Uniform Trust Code are met, which should be a strong motivation to a trustee to provide the information.[71] Even where a specific limitation of actions period does not apply, the equitable defense of *laches* may apply to beneficiaries who have sufficient information to protest, but sit on their rights.[72] Therefore, if the trustee is prohibited from providing information to the interested parties, the trustee may have a potentially very long liability "tail."

Negating the Duty to Diversify

Trust settlors often feel that their beneficiaries will be better off if the trust retains a concentration in a particular security, typically the stock that made the settlor wealthy in the first place (*Dumont*), or some other undiversified asset, such as real estate or a closely held business. While modern portfolio theory would indicate that such a belief, much less a mandate, is ill advised, many settlors have remarkably strong opinions on the issue.

It is probably not sufficient to provide general waivers of the Prudent Investor Rule, the duty of diversification, and whatnot, since there is a growing trend toward holding that such duties can only be waived with regard to specific circumstances. Such a position is not wholly unreasonable, since settlors wishing to avoid diversification are generally not opposed to the idea in general, but believe that a particular investment will be superior overall to a diversified portfolio. As shown in *Dumont*, even an express direction with regard to a named security may not be enforceable in some jurisdictions where such a mandate is not in the best interests of the beneficiary.

Accordingly, where a settlor wishes for a trustee to substantially depart from what is considered to be normal practice, such as diversification of investment, consideration should be given to a state such as Delaware, with a stated public policy of enforcing the wishes of the settlor, above all else. That having been said, the following is an example of a provision permitting retention of a stock concentration, with specificity.

Sample Provision:

> The trustee is authorized to receive and retain, without regard for diversification or prudence, all assets it receives upon the funding of this trust. Specifically, the trustee is authorized to retain indefinitely all shares of [name of security], even though such a concentration is generally considered inappropriate for trusts. The grantor realizes that there are specific reasons for engaging in certain estate planning techniques, with particular assets, and that the retention of such assets by the trustee, and other facts and circumstances, may conflict with a fiduciary's reasonable business judgment, but may, nonetheless, further the purposes of the trust and the grantor's intent. This trust's purpose represents the grantor's intent to plan his estate with shares of [name of security], and not necessarily to provide beneficiaries with a diversified portfolio. The grantor hereby waives the prudent investor rule, the trustee's standard of care and performance, a fiduciary's reasonable business judgment, and the trustee's duty to diversify, [including but not necessarily limited to sections ___________ and __________ of the ___________Statutes.] The trustee shall be held harmless from all liability for holding and retaining shares of [name of security].

Investment Direction Adviser

An alternative to "hardwiring" investment requirements into a trust instrument is to provide for an investment *direction adviser* with the authority to direct the trustee as to all or certain trust investments, combined with provisions making clear that the trustee bears no responsibility for losses resulting from following the adviser's instructions.[73] This may be particularly useful where there is a desire for the trust to be able to invest outside traditional "prudent investor" guidelines without having to obtain an investment committee's approval for each such investment. This is also a useful provision where there is a desire to maintain a concentration in a single stock, or a closely held business. The laws of some states expressly recognize the trustee's right to follow the instructions of such an adviser without fear of liability:

[71] Va. Code Ann. § 54-550.05 provides for a 1 year limitations period after the provision of certain information; Ky. Rev. Stat. § 386.735 provides for a 6 month limitations period after a final accounting upon termination of a trust; UTC § 1005 (2005).

[72] Restatement (2nd) § 219 (1992).

[73] Restatement (2nd) § 185 (1992).

Uniform Trust Code

The Uniform Trust Code provides that a trustee shall follow the instructions of a direction advisor, if so required under the terms of the trust instrument. However, this provision also goes on to provide an exception where the instruction is "manifestly contrary to the terms of the trust" or the trustee knows that following the direction would constitute a "serious breach of a fiduciary duty."[74] Certainly, such a provision could open the door to a claim that if the direction advisor's instruction was sufficiently outside the realm of "prudent" investing, then following the direction could result in a breach of trust.

Delaware

Delaware law has one of the more explicit statutes stating that where a trust requires a trustee to take direction on investment, distribution or other matters from a third party *adviser*, a trustee has no liability for negative consequences flowing from following such direction, and is exculpated from all but "wilful misconduct." Thus, to impose liability on a trustee, the beneficiary must meet a standard even greater than "gross negligence."[75]

Recommendations

The estate planning attorney, when presented with a client who wants to include deviant provisions in a trust, should counsel with the client in an effort to make sure the client understands the inherent risks in trying to dictate future investment policy. At the very least, by delving into the issue, perhaps the attorney can get a handle on what the client is really trying to accomplish and can include in the trust document better guidance for the trustee.

One of the issues that engendered much argument in the *Dumont* cases was the intent of the testator. The trustee argued that the intent was to maintain the Kodak stock. The beneficiaries and the court argued that the intent was to benefit the beneficiaries, and that the stock should have been sold as soon as retention of the stock became inconsistent with that intent. Therefore, the drafter should be very clear as to the settlor's intent, which may include the following:

- Specific identification of the investment to be retained, without reliance upon general trustee investment powers;
- Specific acknowledgement that retention of the investment or the concentration is contrary to normal prudent investment practices and may increase the risk of loss to the trust;
- Specific expression of the settlor's intention that the investment be retained, notwithstanding the increased risk;
- Specific exculpation of the trustee for following the settlor's wishes, absent intentional misconduct and, preferably, specific authority for the trustee to sell the investment if it determines to do so, without incurring liability to the beneficiaries.
- Specific guidelines regarding the circumstances under which the trustee may sell the investment.

Hopefully, this process will cause the settlor to conclude that mandating a retention is not such a good idea or, at the very least, that the trustee should be empowered to sell the investment without incurring liability. In any event, careful drafting can avoid endless squabbles over the settlor's true intent.

Finally, deviant trust provisions are a good example of where virtual representation provisions can be most useful. If a trustee requires additional comfort that following the peculiar dictates of a trust will not result in liability, the trustee can seek the consent of all of the interested beneficiaries, which may not be difficult to obtain where there is virtual representation.

Crummey Withdrawal Powers—Miscellaneous Thoughts

Crummey withdrawal powers, designed to qualify gifts in trust for the gift tax annual exclusion under I.R.C. § 2503(b), have been around for quite some time.[76] They have been around for so long, in fact, that practitioners sometimes take them for granted, and don't carefully review their provisions in light of cur-

[74] UTC § 808 (2005). Ky. Rev. Stat. § 286.3-275, a provision of Kentucky's *banking* laws, states that a *corporate* trustee who is required by the trust to follow the instructions of a trust advisor is not liable for losses resulting from doing so, and does not even have the responsibility to monitoring the investments of the advisor to act as a "back stop."

[75] 12 Del. C. § 3313 (a). This provision is also read in light of 12 Del. C. § 3303 (a), which provides that the terms of the trust may vary the default rules of law, and that the public policy of the state of Delaware is that the trustor's desires are to be followed.

[76] Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968), held that where a gift to a trust is subject to a beneficiary's immediate and unrestricted right to withdraw the gift from the trust, the gift is of a present interest that qualifies for the gift tax annual exclusion under I.R.C. § 2503(b), even if the withdrawal right lapses, to the extent not exercised, thereafter.

rent law. The author has therefore encountered many situations where withdrawal provisions have, for a variety of reasons, been less than optimal.

Following the discussion below of individual issues is a sample withdrawal rights provision that incorporates the author's suggestions.

Limit Withdrawal Rights to Transfers that Otherwise Would be Taxable Gifts

Some withdrawal powers are worded so as to apply to "any addition" to the trust, without limiting the application of the powers to transfers that, but for the qualification for the annual exclusion, would be taxable gifts by the donor. Consequently, a literal reading of such provisions would mean that the beneficiaries have withdrawal rights over amounts passing to the trust as pour-over bequests from an estate, or the distribution of a remainder interest in a successful GRAT. Accordingly, the application of withdrawal powers should be limited to those additions to the trust that need to qualify for the annual exclusion to avoid being treated as a taxable gift.

Limit Amount Subject to Withdrawal Right by Statute Reference, Not by Amount

It is certainly prudent to limit withdrawal rights to the maximum available annual exclusion, *but* that limit should be expressed as the maximum amount set forth in the statute, rather than a specific dollar amount.

From 1982 to 1998, the amount of the annual exclusion was fixed at $10,000 per donee, per year. Consequently, many trust withdrawal powers limit the withdrawal right to a maximum of $10,000 per beneficiary. In 1997, however, the Taxpayer Protection Act of 1997[77] indexed the annual exclusion to inflation, such that as of January 1, 2009, the annual exclusion limit is $13,000 per year, rather than $10,000, and will continue to increase in the future. Arguably, therefore, in those trusts that limit the withdrawal right to $10,000, a donor may not be able to make an annual exclusion qualified gift up to the available annual exclusion. For that reason, the better practice is to limit the withdrawal right by reference to the statute itself, rather than the amount stated in the statute, so that the limit applicable to the trust will automatically adjust with changes in the statute.

Do Not Make Amount Contingent on Gift-Splitting Election by Married Donor

Many withdrawal provisions anticipate that the donor of a gift to the trust will be married and will elect to split gifts with the donor's spouse under I.R.C. § 2513, so the amount subject to a beneficiary's withdrawal right will potentially be twice the annual exclusion amount, if the donor is married at the time the gift is made. The author occasionally encounters withdrawal provisions that provide that the maximum amount subject to the power increases to twice the annual exclusion only if the donor and the donor's spouse elect to split gifts for that year. Imposing such a condition *disqualifies* the portion of the gift in excess of a single annual exclusion, because the withdrawal right is conditioned upon an election that will not be made until the filing of gift tax returns during the calendar year following the calendar year in which the gift is made, thus preventing the beneficiary from having the *present* interest necessary to qualify for the exclusion.[78]

Moreover, if the beneficiary's potential access to the funds is contingent upon a tax election that is necessarily within the control of the donor, then the donor arguably has retained a power "to designate the persons who shall possess or enjoy the property" under I.R.C. § 2036(a)(2), because the donor retains the ability to determine whether the beneficiary will gain access to the funds after the property becomes property of the trust by retaining the power to elect gift splitting (or not). Even more troublesome is that if the donor retains a § 2036 power over trust property, the property could be included in the donor's estate under § 2035 if the donor dies during the three year period of time following the release or lapse of that power.

From a practical standpoint, a well advised married donor will rarely give more than the amount of a single annual exclusion unless he or she intends to split gifts, in which case the amount of the withdrawal right is limited by the amount of the transfer, rather than the amount of the exclusion. Moreover, the trust can permit the donor to vary the terms of the withdrawal rights as to any specific gift, as discussed below.

---

[77] P.L. 105-34 (1997).

[78] *See* PLR 8022048 (Mar. 4, 1980), which held that where the right to withdraw twice the amount of the annual exclusion was contingent upon a gift splitting election, only one-half of the gift would qualify for the exclusion, because the beneficiary's right to withdraw the other half was subject to a condition subsequent. *See also* PLR 9030005 (Apr. 19, 1990), which includes the following statement: "When the delivery of property to a trust is accompanied by limitations upon the donee's present enjoyment of the property in the form of conditions, contingencies, or the will of another, either under the terms of the trust or other circumstances, the interest is a future interest even if the enjoyment is deferred only for a short time. The question is not when title vests, but when enjoyment begins."

Take Prior Annual Exclusion Gifts into Consideration, But Go Easy on the Trustee

Withdrawal provisions frequently provide that the amount subject to the withdrawal power is the lesser of the amount of the gift or the amount of the annual exclusion, but *without* any express adjustment to account for annual exclusion gifts the donor may have already given to one or more beneficiaries during the same calendar year. If a reference to the amount of the annual exclusion under § 2503(b) is construed to refer to the remaining annual exclusion, if any, available to the settlor with respect to each particular beneficiary, then the reference may automatically take prior gifts into consideration. On the other hand, if reference is made to the amount specified in § 2503(b) in a more generic sense, it could be construed the same way as a withdrawal right over a specified dollar amount.

Of course, if a donor has a power to vary withdrawal rights, that power can be exercised to account for earlier gifts, but it may be helpful for the trust to include an "automatic" adjustment provision that lowers the maximum withdrawal right by the amount of any prior annual exclusion gifts.

Please note, however, that adjusting the amount of a withdrawal power based upon other gifts by the donor may place a trustee in the difficult position of not knowing for sure whether the entire amount of the gift is subject to the withdrawal power, or only a part of the gift. Such information is crucial, where the trustee is charged with notifying the beneficiaries of the gift and the withdrawal right. Therefore, the document should specify that the trustee may assume that there have not been any such prior gifts, unless the trustee is notified to the contrary by the donor.

Limit Lapse of Withdrawal Right by Statute Reference, Not by Amount

Most withdrawal rights lapse, to the extent not exercised by the beneficiaries within a limited period of time, but the lapse of a withdrawal right is treated as a release (by the beneficiary) of a general power of appointment under I.R.C. § 2514(e), to the extent that the amount subject to the lapsed withdrawal power exceeds the greater of $5,000 or 5% of the property out of which the withdrawal right could have been exercised. Therefore, trusts often provide that a withdrawal right will *not* lapse, to the extent that the amount subject to the right exceeds the foregoing limit, and that the beneficiary's withdrawal right will continue until such future time as a lapse does not result in a release under I.R.C. § 2514(e). Alternatively, many trusts limit the withdrawal right to the lower of the annual exclusion or the I.R.C. § 2514(e) amount from the outset, so that there will never be withdrawal rights that "hang" into the future.

As is the case with the limit on the annual exclusion, the I.R.C. § 2514(e) limit is frequently expressed either by reference to the statute or by actually limiting the lapse to the greater of $5,000 or 5%. Unlike the annual exclusion, the I.R.C. § 2514(e) amount has *not* been indexed for inflation, nor are there any pending proposals to do so. Nevertheless, it is always possible that I.R.C. § 2514(e) could be amended in the future, in which case it would likely be preferable for withdrawal right lapses to be limited by the amount set forth in the statute, rather than by the specific dollar amount.

Take Prior Lapses into Consideration

The IRS has taken the position that the I.R.C. § 2514(e) limitation is a *single* limitation that applies to the *aggregate* amount of *all* withdrawal rights of a single beneficiary with respect to all trusts for the benefit of that beneficiary in a single year. Thus, the IRS position is that where a single individual holds withdrawal powers over multiple trusts in a single year, the limit on the amount of the withdrawal power that may lapse without such lapse being treated as a release of a general power of appointment is *not* $5,000 *per trust*, but $5,000 *in the aggregate*, at least with respect to trusts where $5,000 is greater than 5% of the trust assets.[79] Therefore, it may be prudent to word the lapse provision in such a way that takes into consideration other withdrawal right lapses during the same year.

Please note, however, that such a provision should direct the trustee to presume that there have been no such other lapses, unless the trustee is informed otherwise at the time of the gift.

[79] In Rev. Rul. 85-88, 1985-2 C.B. 201 (July 1985), the IRS held that a trust beneficiary was entitled to only one $5000/5% lapse exception per year for a single trust, irrespective of the number of separate gifts during a single year, and only one lapse exception per year for gifts to multiple separate trusts, where all of the trusts were settled by the same grantor. This ruling, and others, however, indicate that powers over separate trusts created by different grantors may be aggregated as well, although the IRS has never actually taken that position in a published ruling. *See* Georgiana J. Slade, *Tax Management Portfolio 807-1st, Personal Life Insurance Trusts* (BNA), at Section II.B.2.(3)(f).

Consider Giving Donor Power to Vary Withdrawal Rights

It may prove beneficial to give any donor the power, exercisable at or before (but never after) the time of the transfer, to expand or contract withdrawal rights of any or all beneficiaries so that the donor can deal with changing circumstances.[80] Examples of circumstances where a power to change withdrawal rights would include the following:

- A concern that a beneficiary will exercise a withdrawal right;

- A concern that a judgment creditor of a beneficiary will attempt to attach the property subject to the withdrawal right, if local law provides that a creditor may seize property subject to a beneficiary's general power of appointment; and

- The donor has already made annual exclusion gifts to one or more beneficiaries, thus reducing, or entirely eliminating, the available annual exclusion to such beneficiaries. If the amount of the gift to the trust is less than the total available annual exclusion, the donor may wish to reduce the withdrawal right of the beneficiary who received other gifts, and expand another beneficiary's withdrawal rights, so that the entire gift still qualifies for the annual exclusion, even though one beneficiary's annual exclusion is no longer entirely available.

Some practitioners are not comfortable giving the settlor or other donor any power to change withdrawal rights, out of a concern that such a power could be construed as a retained "right … to designate the persons who shall possess or enjoy the property" under I.R.C. § 2036(a)(2) and/or as a retained power to "alter, amend, revoke, or terminate" under I.R.C. § 2038(a)(1). However, as long as the donor's power is limited to changing the beneficiary withdrawal rights over property *before* the property is transferred to the trust, and the donor retains no powers to alter withdrawal rights *after* the transfer, neither 2036 nor 2038 should be implicated.[81] That having been said, the author has been unable to find any binding authority that directly addresses this issue.

<u>Sample Withdrawal Rights Provision</u>

> After each direct or indirect transfer to this trust which is treated as a gift under the federal gift tax law, each beneficiary who is a current permissible distributee of income or principal from this trust shall have the absolute right and power to withdraw from this trust an amount equal to the lesser of: (i) the maximum amount that can qualify for the gift tax "annual exclusion" as set forth in Internal Revenue Code Section 2503(b) (currently $13,000, or $26,000 if the donor is married and his or her spouse is then living), considering any prior annual exclusion gifts by the donor to such beneficiary during the same calendar year, or (ii) the amount of such transfer, divided by the number of beneficiaries holding such withdrawal rights, provided, however, that for purposes of this provision, the trustee shall presume that there have been no prior annual exclusion gifts by the donor to the beneficiary, unless the donor provides written notice to the contrary at the time of the transfer to this trust.
>
> Whenever any transfer is made that gives rise to a withdrawal right under this item, the trustee, upon receipt of

[80] Sebastian V. Grassi, Jr., *Key Issues to Consider When Drafting Life Insurance Trusts*, EST. PLAN. (Vol. 31, No. 8, August 2004).

[81] *Id.* Footnote 14 of the article cites to four private letter rulings that are not precisely on point (and, of course, may not be cited as binding authority), but support the notion that the power to vary withdrawal rights as to future gifts should not be cause for concern. In all of the rulings, the donor retained the power to eliminate the withdrawal rights of some or all of the trust beneficiaries, as long as the power was exercised in advance of a gift. In PLR 8003033 (Oct. 23, 1979) and PLR 8103074 (Oct. 23, 1980), the IRS ruled that gifts to the trust would be complete under I.R.C. § 2511 and Treas. Reg. § 25.2511-2(b) because the donor so parted with dominion and control as to leave him no power to change its disposition. In PLR 8901004 (Sep. 16, 1988), the IRS ruled that the power to eliminate withdrawal rights was not a retained power to affect beneficial enjoyment under I.R.C. § 674(a), because the power was only exercisable before the contribution of the property to the trust and once the property became property of the trust, the donor no longer retained any control. Finally, in PLR 9030005 (Apr. 19, 1990), the IRS discussed possible grounds for estate inclusion, including I.R.C. §§ 2036 and 2038, and concluded that the property would not be included in the grantor's gross estate, except in a certain circumstance not relevant to this discussion.

the transferred property, shall give immediate notice of such transfer to each person who has a withdrawal right or, if any such person is under a legal disability, to his or her legal guardian or, in the case of any such person for whom no legal guardian has been appointed, to a parent of such person other than the donor. If any person who has a withdrawal right under this item, or has the power to exercise a withdrawal right on behalf of a beneficiary under this item, is then acting as trustee of this trust, he or she shall be deemed automatically to have received the notice required to be given by the trustee under this item.

Any person may exercise his or her withdrawal right granted hereunder by delivering a written instrument to the trustee at any time on or before the thirtieth (30th) day after receiving notice of the transfer to the trust that gives rise to the withdrawal right as provided hereinabove. If any such person is under legal disability, such written instrument may be executed by his or her legal guardian or, in the case of any such person for whom no legal guardian has been appointed, by a parent of such person acting solely on such person's behalf.

Upon timely receipt of a written instrument of withdrawal, the trustee shall forthwith distribute out of the trust the amount necessary to satisfy the withdrawal right, and for this purpose the trustee shall, notwithstanding any other provision of this agreement, retain in the trust sufficient transferable assets to satisfy any outstanding and exercisable withdrawal rights. The trustee, in satisfying any withdrawal right, may distribute cash or other property of the trust, including a share of the interest of the trust in any insurance policy, and the trustee may borrow against the cash value of any policy to obtain cash for such distribution.

To the extent that a withdrawal right has not been exercised by a timely delivery of a written instrument to the trustee as specified above, such withdrawal right shall lapse and the beneficiaries shall forever cease to have any further withdrawal right with respect to the transfer to the trust which gave rise to the withdrawal right, except to the extent that the amount subject to such lapse exceeds the amount then set forth in Code Section 2514(e) (currently the greater of $5,000 or 5% of the assets out of which the withdrawal right could have been satisfied). Any portion of the withdrawal right that does not lapse as provided in the foregoing sentence shall continue in existence, and shall lapse at such future date to the extent that such lapse shall not constitute a release of a general power of appointment under Code Section 2514, after giving due consideration to any prior lapse during the same calendar year of any withdrawal right held by such beneficiary over property in this or any other trust. It is the grantor's express intent that after such initial thirty (30) day period, all unexercised withdrawal rights lapse as soon as possible without causing any holder of such lapsed right to have made a taxable gift as a result of the release of a general power of appointment, and this Item shall be so construed. For purposes of this provision, the trustee shall presume that there have been no such prior lapses with respect to gifts to any other trust unless the donor provides written notice of such lapses to the trustee at the time of such gift.

Notwithstanding the foregoing provisions of this item, the donor shall have the right, by a written instrument filed with the trustee at the time of the transfer, (i) to exclude any individual who would otherwise have a power of withdrawal from exercising the power over such transfer, (ii) to increase or decrease the amount subject to such power of withdrawal over such transfer, or (iii) to change the period during which any power of withdrawal may be exercised with respect to such transfer.

Grantor Retained Annuity Trusts—Miscellaneous Thoughts

Separate GRAT Document from "Continuing" Trust Document

A good planning strategy with respect to GRATs is to provide that following the termination of the "qualified annuity interest," any property remaining in the GRAT will thereafter be held in trust, rather than being distributed outright to the remainder beneficiaries.

One way to accomplish this result is for the trust agreement for the GRAT to provide that following the retained annuity period, any remaining property will be retained in trust by the trustee, subject to more traditional trust terms than those required for a qualified annuity interest. The author strongly recommends against using a single document to create both the GRAT and the trust to hold the property thereafter.

A better practice is to create two separate trusts from the outset, one of which qualifies as a GRAT, but terminates at the end of the retained annuity period, and the other of which is a traditional trust that is named as the remainder beneficiary of the GRAT.

One reason why separate agreements is preferable is that circumstances may change in the future, calling for remedial action that may not be possible with a single trust. For example, suppose that settlor of a GRAT is diagnosed with a terminal illness two years into a five year GRAT, and the settlor is not expected to survive until the end of the retained annuity period. If the settlor dies during the GRAT term, all of the assets in the GRAT will be included in the settlor's estate, and no wealth transfer will have been accomplished. Some commentators have suggested, however, that a way to salvage the wealth transfer in such a situation is for the settlor to purchase the remainder interest in the GRAT from the remainder beneficiary for the actuarially determined value of the remainder beneficiary's future interest. While such a transaction will not prevent the GRAT assets from being included in the settlor's estate, there is an argument that the property transferred to the remainder beneficiary in payment of the purchase price *will* be removed from the settlor's estate.

If the remainder beneficiary is the same trust as the GRAT, then the purchase transaction might not be possible, because the remainder trust, by definition, does not come into existence until the termination of the GRAT, so there is no remainder beneficiary to whom the settlor can pay the purchase price, and all property in that particular trust will be includable in the settlor's estate in any event. Assuming that a purchase of the remainder interest is possible, it is only possible if the remainder interest is held by some trust, the assets of which will not be included in the settlor's estate.

Omit Spendthrift Provisions from GRATs

In the foregoing fact scenario, it would not be possible for the settlor to purchase the remainder interest in the GRAT from the remainder beneficiary if the GRAT contains a spendthrift provision that prohibits any transfers of a beneficiary's interest. Moreover, as a general rule, spendthrift provisions do not provide any protection from the creditors of the settlor of a self-settled trust. Accordingly, it is better practice to omit spendthrift provisions from GRATs.

Out-of-Wedlock Descendants

The laws of most, if not all, states provide that for purposes of interpreting wills, trusts and other documents, terms such as "child" and "descendant" include persons born out-of-wedlock, if (as to the father) paternity is proved and certain other conditions are met.[82] Moreover, if necessary to prove paternity, a person claiming to be a biological child of a decedent may be entitled to obtain an order requiring exhumation of a decedent's body to get tissue samples for DNA testing.[83] Needless to say, such actions can make an already difficult time for a decedent's family all the more stressful, especially where the putative illegitimate child was previously unknown to the family.

The author is aware of one case in Georgia where the decedent's will divided the estate *per stirpes* among the testator's "*descendants*," but the will did not specifically name the testator's children (or any other descendants), nor did the will specifically address the status of out-of-wedlock descendants. After the testator's death, an individual, previously unknown to the testator's immediate family, claimed to be the decedent's out-of-wedlock child, and therefore claimed a right to one-fifth of the decedent's rather sizable estate, much to the chagrin of the other four children. The probate court held that under applicable law, an ambiguous provision in a will should be construed in a manner that is consistent with the rules of intestacy, if possible, and since the applicable intestacy rules permitted an out-of-wedlock child to inherit from a father, assuming paternity could be proved, the court determined that the term "descendants" as used in the will, *could* include persons born out-of-wedlock. The parties settled the case after this ruling.

[82] *See, e.g.*, VA. CODE ANN. § 64.1-5.1.

[83] *See, e.g.*, Martin v. Howard, 273 Va. 722, 643 S.E.2d 229 (Va. 2007).

The result would likely have been different in Kentucky, where out-of-wedlock children have inheritance rights under the rules of intestacy, but terms such as "child" and "descendant" when used in a will are generally presumed to refer only to legitimate children, and not to include out-of-wedlock children, absent some expression of intent to the contrary.[84]

Accordingly, a provision used by some practitioners expressly provides that terms such as "children" and "descendants" do not include persons born out-of-wedlock unless the parents subsequently marry or the father otherwise acknowledges the child to the trustee or the community. The idea is not so much to punish children born out-of-wedlock for their status, as much as to prevent protracted litigation by persons, previously unknown, who claim to be descendants. The presumption is that where an out-of-wedlock child is well known to the family, paternity will have been acknowledged, even if not by formal legitimation.

> <u>Sample Provision: Definition of "Descendants"</u>
>
> The terms "children" and "descendants" apply only to persons who were born in wedlock, born to unmarried parents who married subsequent to the birth, or otherwise acknowledged to the trustee by the putative father during the putative father's lifetime, or otherwise acknowledged by the father indicating intent that the putative child be treated as his own (such as formal legitimation).

Valuation Date for Unitrust Payments

Unitrusts, such as charitable remainder unitrusts, base distributions upon the value of the trust assets determined annually, typically at the beginning or the end of the year. A variation on the unitrust is a provision that calls for distributions of all income or a stated percentage of trust assets, whichever is greater (or less, in some cases). The author recommends that in such circumstances, the valuation date should be the *last* day of a month, quarter or year, and *not* the first day or the first business day, since financial institutions, whether serving as trustee or as custodian of the assets of the trust, will, in the normal course of business, produce statements showing the value of the trust assets on last day of a month, quarter or year. By contrast, if the trust assets are to be valued as of the *first business day of the year*, then a special valuation of the trust assets is necessary, which can take extra time or expense. Moreover, if there is a fluctuation in value between, for example, the last day of December and the first business day of January, a beneficiary that is provided with regular year-end statements may become unduly concerned if the distribution is calculated based upon a value different than the value reported to the beneficiary.

Similarly, the author once was faced with a situation where a decedent's will included a specific bequest to a theretofore unfunded inter-vivos trust, and distributions from the trust were to be determined as of the first business day following the date of the decedent's death. This meant that in addition to calculating the value of the decedent's estate on the date of death, all assets had to be re-valued as of one day later. Needless to say, matters would have been much simpler had date of death values been used.

Adding Undistributed Income to Principal

A provision included in most, but not all, trust agreements is a provision stating that any income that is not distributed currently is to be added to principal at least annually. This seemingly innocuous provision is so commonplace (although not universal) that it rarely attracts notice. However, without this provision, a trustee may be required to retain any undistributed income in an accumulated income account, which must be invested separately from principal, typically in highly liquid short term investments, which may not be what the settlor intended. In cases where the beneficiaries' interests in income and principal are the same, and there is otherwise no advantage to be gained by segregating income from principal, the ability to add income to principal greatly simplifies record keeping.

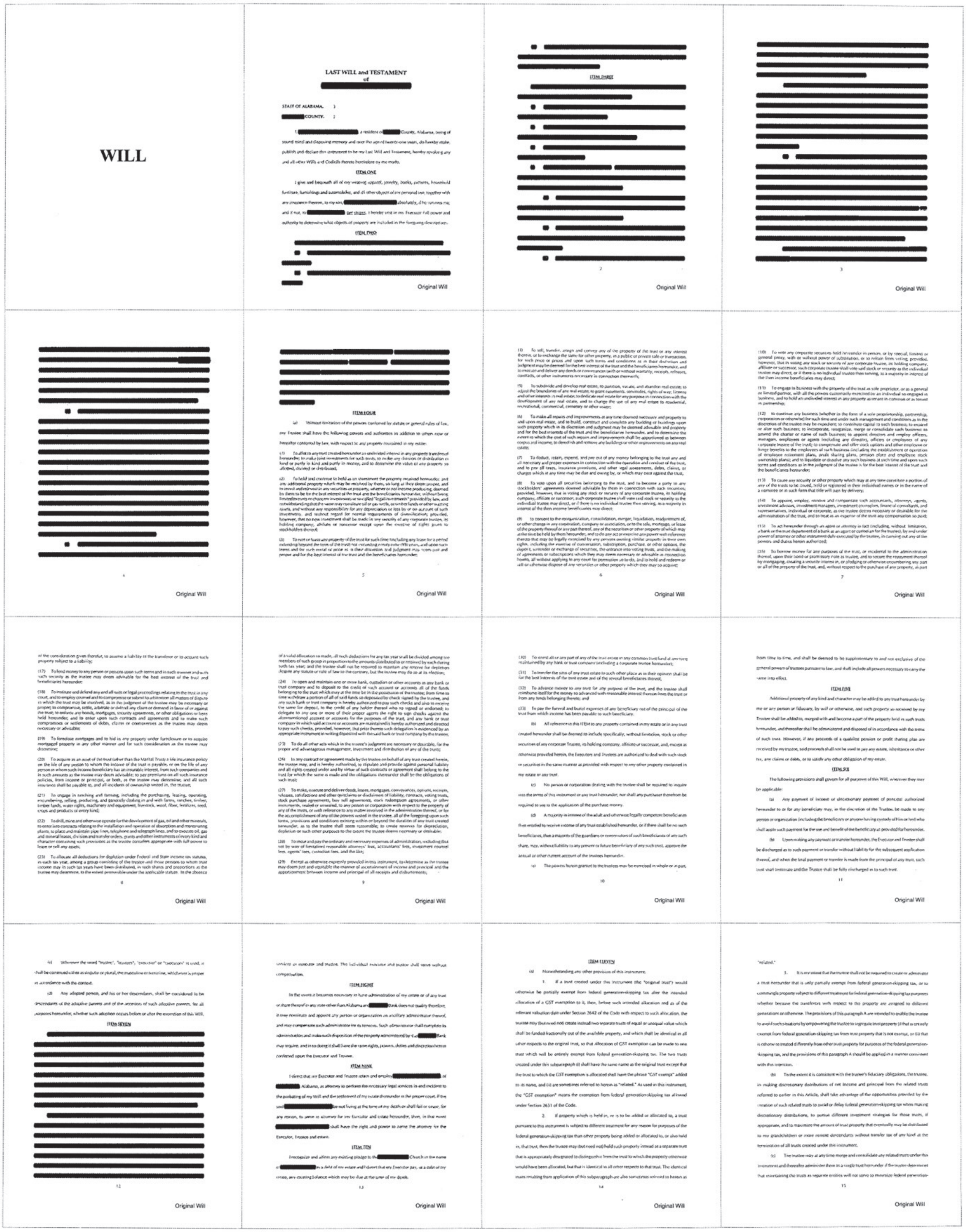
Concluding Thought—Consult the Fiduciary Before Signing

The foregoing discussion demonstrates that much value can be added by seeking the input of a proposed fiduciary before the document is finalized and executed, with the result that the settlor's (and the planner's) intentions are more likely to be fulfilled.

---

[84] *See* Carey v. Janes, 2008 Ky. App. Lexis 72 (No. 2007-CA-000138-MR, 03-21-08; Modified 04-11-08).

Appendix A



skipping trust.

(d) As of the division date, but before funding the separate trusts created and named for my grandchildren, the trustee shall segregate all property then available for distribution which is fully exempted from federal generation-skipping tax due to the allocation of my GST exemption, or for any other reason, into a separate GST Exempt Fund, and shall segregate all remaining property then available for distribution into a separate Nonexempt Fund. In funding the trusts named for my grandchildren, the trustee shall divide and allocate the GST Exempt Fund and Nonexempt Fund so that the total value of principal allocated to each child's trust is the same as if only one Fund existed, but the trustee need not allocate pro-rata amounts from each Fund to each child's trust, if the trustee determines that a different allocation is more likely than not to minimize the aggregate federal generation-skipping tax assessed against the trusts. Determinations made by the allocating trustee under this paragraph in good faith shall be conclusive on all persons. It is my intention that the GST exemption available at my death be used in all cases to the maximum extent possible.

(e) If any portion of a trust named for a grandchild of mine hereunder, in the absence of any testamentary power of appointment granted under this instrument to that child, would immediately incur a federal generation-skipping tax upon the child's death as a result of a taxable termination, then in addition to any other power of appointment granted to that child under this instrument, the child may appoint that portion to the creditors of his or her estate. To the extent that the foregoing general power of appointment is in existence on the child's death, then unless the child directs otherwise by will, the trustee shall pay to the personal representative of the child's estate, from the portion of the trust to which the power

16

Original Will

pertains, the amount, if any, by which the estate and inheritance taxes payable in any jurisdiction by reason of the child's death shall be increased as a result of the inclusion of that portion in the child's estate for such tax purposes, as certified in writing by that personal representative.

(f) No trustee who is also a beneficiary hereunder on or after the division date shall participate in exercising discretion under this Article to create separate trusts, to merge and consolidate trusts, or to allocate GST exempt and non-exempt property among trusts, and if no trustee who would qualify to exercise those discretions is then acting, then the said grandchildren shall appoint a Qualified Appointee who is not such a beneficiary as a special trustee, whose authority shall be limited to exercising those discretions.

ITEM TWELVE

In the event that I die during or after 2010 and if Section 1022 of the Internal Revenue Code or a similar section relating to an allocation of a permitted basis increase is in effect at my death, my Executors shall select assets to satisfy my bequests having the lowest aggregate fair market value necessary to utilize the 1.3 million dollar basis increase or such increase as may be in effect at such time, but I authorize my Executor to depart from this direction if my Executor determines that there is good reason to do so. My Executor shall not be liable to any beneficiary for the selection of assets whose basis has increased pursuant to this paragraph unless such selection is made in bad faith. My Executor can determine what property shall receive basis increases pursuant to Section 1022 of the Internal Revenue Code and the amount of such increases and make such determinations without regard to any duty of impartiality as between different beneficiaries.

17

Original Will

[Signature Pages Omitted]

FIRST CODICIL

FIRST CODICIL TO THE LAST WILL AND TESTAMENT

OF

[redacted]

STATE OF ALABAMA,)

[redacted] COUNTY,)

I, [redacted] a resident of [redacted] County, Alabama, being of sound mind and disposing memory and over the age of twenty-one years, do hereby make, publish, and declare this to be the First Codicil to my Last Will and Testament executed by me on the [redacted] day of [redacted] 2002. I hereby ratify, confirm and republish said will in all respects except as changed by this First Codicil.

ARTICLE ONE

[redacted]

First Codicil to Will

[redacted]

- 2 -

First Codicil to Will

[redacted]

- 3 -

First Codicil to Will

[redacted]

- 4 -

First Codicil to Will

[redacted]

- 5 -

First Codicil to Will

[redacted]

- 6 -

First Codicil to Will

ARTICLE TWO

I hereby insert the following new Paragraphs after the last Paragraph of Item Eight.

"[redacted] and [redacted] or the survivor of them, shall have the power to remove, the trustee of any trust created under this will (other than [redacted] or [redacted]) at any time with or without cause, and, unless a successor trustee is named under this will, they or the survivor of them shall have the power to appoint a substitute or successor non-beneficiary trustee, provided, however, in the case of any person who is under legal disability but who is entitled under the provisions of this sentence to vote for a substitute or successor non-beneficiary trustee, such person shall be represented by the natural or judicially appointed guardian of his or her person; and, provided further, that any successor trustee of such trust appointed under the provisions of this Paragraph shall not be a related or subordinate party within the meaning of Section 672(c) of the Internal Revenue Code of 1986, as amended (applied as though the beneficiaries of the trust involved were the Grantors).

"If [redacted] or [redacted] is serving as trustee, the trustee shall have the power to appoint

- 7 -

First Codicil to Will

and to remove at any time, with or without cause, a non-beneficiary co-trustee or co-trustees of such trust, provided, however, that such non-beneficiary co-trustee or co-trustees shall cease to serve when (1) the trustee who appointed such non-beneficiary co-trustee or co-trustees himself ceases to serve as trustee or, if sooner, (2) the trustee who appointed such non-beneficiary co-trustee removes such non-beneficiary co-trustee; and, provided further, that if an individual trustee who appointed a non-beneficiary co-trustee removes such non-beneficiary co-trustee, and if, at any time, the trustee being removed or the trustee being appointed has the power to make discretionary distributions of income or principal from the trust involved that are not subject to ascertainable standards (as defined in Section 20.2041-1(c)(2) of the Treasury Regulations), then any successor co-trustee of such trust appointed by such individual trustee under the provisions of this Paragraph shall not be a related or subordinate party within the meaning of Section 672(c) of the Internal Revenue Code (applied as though the beneficiaries of the trust involved were the Grantors).

"For all purposes under this instrument, the term 'non-beneficiary trustee' refers to a trustee of a trust created hereunder who, in his individual capacity, does not have a 'beneficial interest' in trust property as that phrase is used in Section 25.2511-1(g)(2) of the Treasury

- 8 -

First Codicil to Will

Regulations. The term "Treasury Regulations" refers to regulations issued by the Department of the Treasury, whether in final, temporary, or proposed form, and shall be deemed to refer to the provision or section of the Treasury Regulations in effect on the date of my death that corresponds to the provision or section referred to that was in effect at the time of the execution of this instrument."

ARTICLE THREE

I hereby add the following after the last sentence of Subparagraph (a)1. of Item Eleven:

"The term 'available GST exemption from the federal generation-skipping transfer tax' means an amount equal to the generation-skipping transfer exemption provided in Section 2631(a) of the Code that has not been allocated (i) by the transferor (as defined in Section 2652(a) of the Code) or by operation of law to property transferred by the transferor during his lifetime, or (ii) in any case in which I am not the transferor, by the transferor's executor to direct skips (as defined in Section 2612(c)(1) of the Code) occurring at the transferor's death or to any other property (of which such person is the transferor) the disposition of which after such person's death is not controlled by any will or by a trust established by me. For this purpose, (i) if the transferor has died without filing a gift tax

- 9 -

First Codicil to Will

return which is required to be filed and which has a due date (including extensions) that is after his death, then the transferor shall be deemed to have allocated his GST exemption, first, to all the property with respect to which he is the transferor that (A) may at some time be subject to the federal generation-skipping transfer tax, (B) is required to be reported on such gift tax return, (C) is to or for the benefit of the transferor's lineal descendants, and (D) does not qualify for any other exemption or exclusion from the federal generation-skipping transfer tax; and (ii) the transferor shall be deemed to have allocated his GST exemption, second, to any other gift made by the transferor in the year of the transferor's death or in the year immediately preceding the year of his death, which has an inclusion ratio (as herein defined) greater than one-tenth. Notwithstanding the provisions of the previous sentence, the transferor shall not be deemed to have allocated his GST exemption to any trust if (A) the entire trust principal may, at any time, be required under the terms of the governing instrument to be paid to a child of the transferor or to a person treated as a child of the transferor under Section 2651(e) of the Code (other than as an invasion of principal in the discretion of the trustee or pursuant to a standard), or (B) the entire trust principal may be subject to federal estate tax by reason of the death of a child of the transferor or the death of a person treated as a child of the transferor under Section 2651(e) of the

- 10 -

First Codicil to Will

Code unless such trust described in (A) or (B) is a GST trust as defined in Section 2632(c) of the Code with respect to which no election is in effect at my death not to apply Section 2632(c) to all transfers by me to the trust."

ARTICLE FOUR

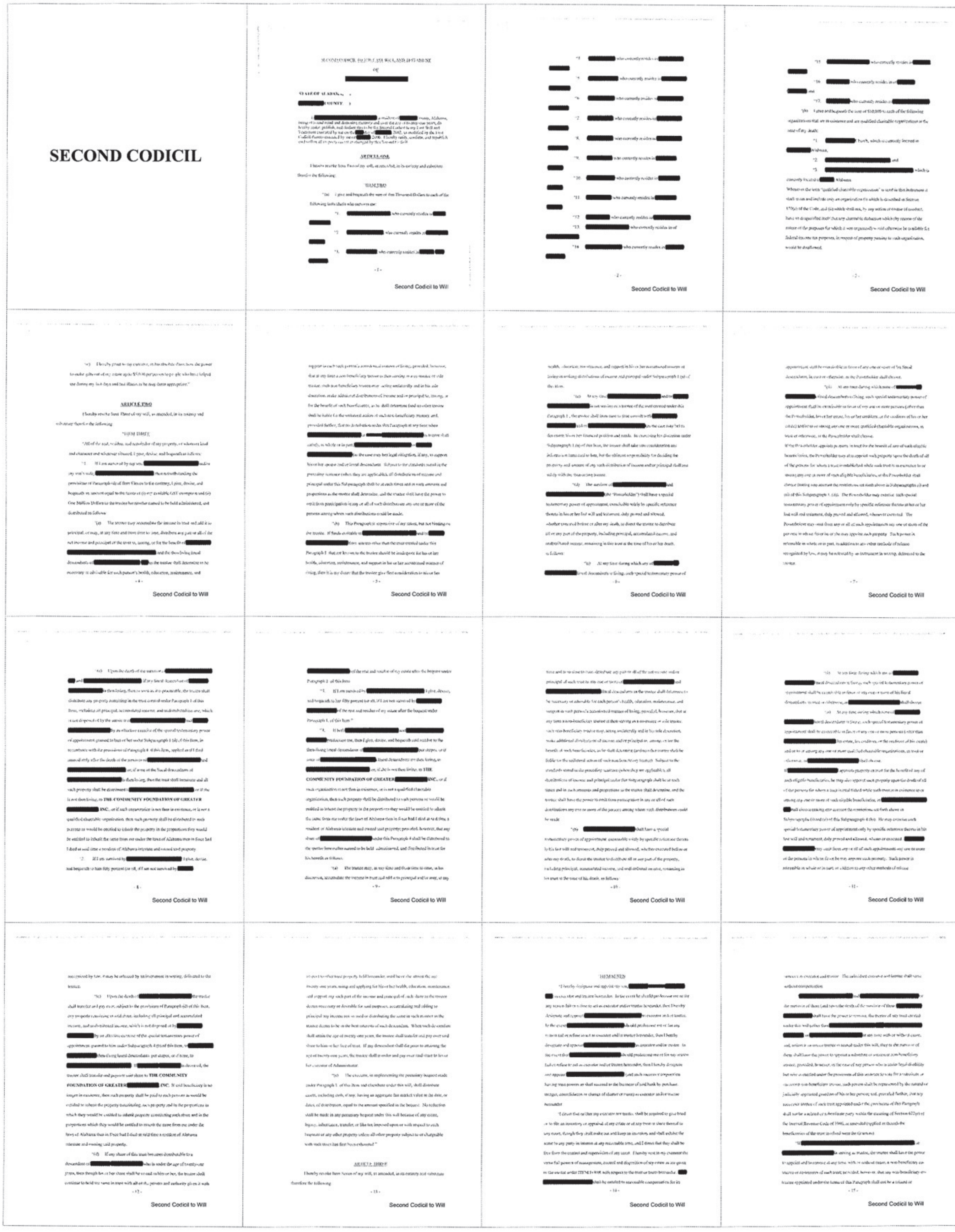
I hereby delete the first word of Paragraph (f) of Item Eleven and substitute the following therefor:

"Other than [redacted] and [redacted] no".

- 11 -

First Codicil to Will

[Signature Pages Omitted]


SECOND CODICIL

Second Codicil to Will

subordinate party within the meaning of Section 672(c) of the Internal Revenue Code (applied as though the beneficiaries of the trust involved were the Grantors), and provided further, that such non-beneficiary co-trustee or co-trustees shall cease to serve when (1) the trustee who appointed such non-beneficiary co-trustee or co-trustees himself ceases to serve as trustee or, if sooner, (2) the trustee who appointed such non-beneficiary co-trustee removes such non-beneficiary co-trustee.

"For all purposes under this instrument, the term 'non-beneficiary trustee' refers to a trustee of a trust created hereunder who, in his individual capacity, does not have a 'beneficial interest' in trust property as that phrase is used in Section 25.2511-1(g)(2) of the Treasury Regulations. The term 'Treasury Regulations' refers to regulations issued by the Department of the Treasury, whether in final, temporary, or proposed form, and shall be deemed to refer to the provision or section of the Treasury Regulations in effect on the date of my death that corresponds to the provision or section referred to that was in effect at the time of the execution of this instrument."

ARTICLE FOUR

Any references in my will, as amended, to "[redacted]" shall instead refer to "[redacted]"

- 26 -

Second Codicil to Will

ARTICLE FIVE

Whenever the terms "Code", "Internal Revenue Code", and "the Internal Revenue Code of 1986, as amended" are used in my will, as amended, they shall refer to the Internal Revenue Code of 1986, as amended, and reference to any provision or section of that Code shall be deemed to refer to the provision or section of the federal tax law, in effect on the date of my death, that corresponds to the provision or section referred to that was in effect at the time of the execution of this instrument.

ARTICLE SIX

In applying any provision of my will, as amended, which refers to a person's lineal descendants "per stirpes," the children of that person shall be taken to be the heads of the respective stocks of lineal descendants.

- 27 -

Second Codicil to Will

[Signature Pages Omitted]