PERPETUAL DYNASTY TRUSTS: TAX PLANNING AND JURISDICTION SELECTION

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I. INTRODUCTION

A. Background

This paper explores two important developments in trust law that emerged in the waning years of the Twentieth Century.[1] The first was the recognition of the tax and nontax benefits of creating long-term or "dynasty" trusts. The second was the recognition of the benefits that a client may achieve in many situations by creating trusts in a state other than the state of his or her residence.[2]

Specifically, after covering some preliminaries in this I, I will summarize the federal transfer- and federal income-tax attributes of these trusts in II. I then will discuss factors for clients to consider in choosing a jurisdiction for a new trust, a client's freedom to choose a jurisdiction for a new trust, and the ability of courts to disregard that selection in III through V. In VI, VII, and VIII, respectively, I will address ethical and practical concerns, relocating existing trusts, and the creation of dynasty trusts by nonresident aliens ("NRAs"). Appendixes A through L contain illustrations and state law charts.

B. Advisability of Creating Trusts

1. Reasons Not to Create Trusts

An individual might not create a trust because he or she:

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[1] I would like to thank Robert H. Sitkoff, John L. Gray Professor of Law, Harvard Law School, for his helpful comments on material that led to the preparation of this paper. For expanded coverage of this material see Richard W. Nenno, 867 T.M., Choosing a Domestic Jurisdiction for a Long-Term Trust.

[2] In this paper, a reference to a "jurisdiction" or a "state" means the District of Columbia or one of the 50 states of the United States.

a. Does not have enough money to create one;

b. Does not obtain estate-planning advice and does not otherwise learn about trusts;

c. Obtains estate-planning advice but is not informed of this option or is counseled not to use it;

d. Does not care what happens to assets after his or her death and the death of any spouse;

e. Believes that children will need to spend their inheritances;

f. Wants children to be able to decide what to do with assets regardless of the tax consequences;

g. Does not want to "tie up" assets in trust;

h. Finds the subject to be too complicated or cannot understand it;

i. Does not choose this vehicle from the wide array of available legal and financial choices;

j. Does not devote sufficient time to the subject because of demands on time by occupational, recreational, religious, or other matters;

k. Finds the documentation to be too long and too complicated; and/or

l. Feels that the costs of developing and implementing the plan are too high.

2. Reasons to Create Trusts

An individual might create a trust:

a. To provide investment management;

b. To protect assets from beneficiaries' creditors;

c. To protect assets in divorce proceedings involving a beneficiary;[3]

d. To protect a beneficiary from improvidence or designing persons;

[3] See Marc A. Chorney, Interests in Trusts as Property in Dissolution of Marriage: Identification and Valuation, 40 Real Prop., Prob. & Tr. J. 1 (Spring 2005).

e. To manage assets for a minor or handicapped child or for someone who becomes disabled due to illness or old age;

f. To encourage a beneficiary to act in desired ways (e.g., by providing funds only if the beneficiary earns a certain amount of income, marries, or has children);[4]

g. To discourage a beneficiary from acting in undesirable ways (e.g., by providing funds only if the beneficiary is not addicted to drugs or alcohol);

h. To preserve the character of separate or community property;

i. To prevent assets (e.g., stock in a close corporation) from being encumbered or sold;

j. To consolidate voting interests in closely held entities without having to deal with voting-trust restrictions; and/or

k. To avoid state and local income taxes.

3. Comments

In my view, the default setting should be to create trusts rather than to leave assets outright. A trust may be designed to give the trustee discretion to distribute assets to a beneficiary to enable him or her to utilize the advantages of outright ownership, but the benefits of holding assets in trust cannot be restored entirely once an individual owns the assets.

C. Advisability of Creating Perpetual Trusts

1. Reasons Not to Create Perpetual Trusts

An individual might not create a perpetual trust because:

a. His or her objectives will be accomplished within the period of the applicable rule against perpetuities;

[4] See Feinberg v. Feinberg (In re Estate of Feinberg), 919 N.E.2d 888 (Ill. 2009). See also David A. Handler & Alison E. Lothes, The Case for Principle Trusts and Against Incentive Trusts, 147 Tr. & Est. 30 (Oct. 2008); Michele C. Marquardt, Incentive Trusts? Beware!, 33 Tax Mgmt. Est., Gifts & Tr. J. 204 (Sept. 11, 2008); Joshua C. Tate, Conditional Love: Incentive Trusts and the Inflexibility Problem, 41 Real Prop., Prob. & Tr. J. 445 (Fall 2006).

b. He or she is not interested in planning for people whom he or she does not know;

c. The rule against perpetuities has been around a long time and "the prevailing academic view is that the Rule 'does, by and large, effectively prevent tying up property for an inordinate length of time' ";[5]

d. It is impossible to predict the future so that the creation of a perpetual trust constitutes hubris by the individual and his or her attorney; and/or

e. Even though a trust is practicable now, it won't be in the future because of the birth of beneficiaries, inadequate investment results, and the unwillingness of trustees to relinquish miniscule trusts for fear of losing fees.

2. Reasons to Create Perpetual Trusts

An individual might create a perpetual trust because:

a. If trusts are desirable now, they probably will be in the future;

b. The principal alternative to creating a perpetual trust—leaving everything outright at some point—presents difficulties of its own (e.g., forcing beneficiaries to cope with a sudden influx of funds; denying them protection from claims by creditors, spouses, designing persons, or themselves; preventing them from saving taxes);

c. Creating trusts will equip people whom the individual does know with tools to plan for their beneficiaries;

d. Attorneys should not be reluctant to take on the challenge of attempting to help their clients meet family needs;

e. Trustees are just as eager to terminate small trusts as are the beneficiaries because such trusts require trustees to provide full service for inadequate compensation; and/or

f. Trusts may adapt to changing circumstances through powers of appointment, decanting and distribution powers, and judicial and nonjudicial modification procedures.

[5] Robert H. Sitkoff & Max M. Schanzenbach, Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds, 42 U. Miami Inst. on Est. Plan. ¶ 1402 at 14-6 (2008).

3. Comments

If an individual had to choose a termination date for his or her trusts, it certainly would not be at the expiration of the common-law rule against perpetuities period (i.e., 21 years after the death of an individual living when the trust became irrevocable) and it probably would not be at the end of the 90-year period of the Uniform Statutory Rule Against Perpetuities ("USRAP").[6] In any event, as discussed in III, D, below, the desire of clients to create perpetual trusts to use their exemptions from the federal Generation-Skipping Transfer Tax ("GST tax") and their wish to exert control far into the future has led over half the states to allow perpetual or very long trusts.[7]

D. Advisability of Creating Trusts in Another Jurisdiction

1. Reasons Not to Create Trusts in Another Jurisdiction

An individual might not create a trust in a jurisdiction where he or she does not live because:

a. In many instances, the trust law of the individual's home state might be perfectly adequate for his or her purposes.

b. The individual might be unaware that his or her objectives might be better served by creating a trust elsewhere. This might result from the attorney's ignorance of the laws of other states or the attorney's failure to acquaint the client with the possible superiority of other jurisdictions' laws.

c. Even though an attorney knows that a client might be better served by creating a trust in another state (e.g., because the trust will escape state income tax), he or she might not share that information with the client for fear of losing legal business or for fear of losing fees for serving as trustee of the client's trust.

d. Perhaps the most significant reason why individuals don't take advantage of the better trust laws of other states is that it's simply easier to stay home. Even though the individual and the attorney might recognize the advantages of going elsewhere, the client

[6] The text of the USRAP may be viewed at www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/usrap90.htm (last visited Sept. 1, 2011). To determine which jurisdictions have enacted the USRAP go to www.nccusl.org/LegislativeFactSheet.aspx?title=Statutory Rule Against Perpetuities (last visited Sept. 1, 2011).

[7] Robert H. Sitkoff & Max M. Schanzenbach, Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds, 42 U. Miami Inst. on Est. Plan. ¶¶ 1402.4–1402.5 at 14-10–14-11 (2008).

might decide that, by staying home, he or she will have ready access to counsel, trust officers, and other advisers.

e. It is troubling that otherwise well-informed attorneys refuse to recognize that their clients would fare better by creating a trust in another state.

2. Reasons to Create Trusts in Another Jurisdiction

In III below I discuss numerous factors that an individual and his or her attorney should consider in choosing a jurisdiction for a trust.

3. Comments

I hope that more attorneys will approach this subject with an open mind because it often will redound to their client's benefit. Even if an individual ultimately decides to stay home for trusts, the subject at least should be brought to his or her attention.

E. Observations

Regardless of what one thinks about creating long-term trusts in other states, many people already are doing it. A 2005 empirical study found that:[8]

> The jurisdictional competition for trust funds is both real and intense. Since 1986 a host of states have altered their perpetuities laws to give their local banks and lawyers a competitive advantage in what our results show is a national market for trust fund services. Our estimates imply that, [from 1987] through 2003, the movement to abolish the Rule Against Perpetuities has affected the situs of $100 billion in [federally] reported trust assets—roughly 10% of the 2003 total. Not surprisingly, the trend toward abolition has accelerated in recent years.

In 2008, the authors of the above study observed:[9]

> Our analysis demonstrates that choice of law and trust situs are important considerations in trust practice. Trust funds flow to states with more

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[8] Robert H. Sitkoff & Max M. Schanzenbach, Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes, 115 Yale L.J. 356, 412 (Nov. 2005) (footnote omitted).

[9] Robert H. Sitkoff & Max M. Schanzenbach, Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds, 42 U. Miami Inst. on Est. Plan. ¶ 1412.2 at 14-28 (2008).

> favorable laws and lower taxes. States that do not provide such benefits will lose trust business.

A 2003 UCLA Law Review article concludes:[10]

> If there is a case against perpetual trusts, it must in our judgment be found in the argument that their costs and burdens at some point become too great. As we have seen, most of the difficulties of duration can be eliminated by skillful drafting of the trust instrument: creating special powers of appointment in beneficiaries; discretionary powers in trustees; enabling beneficiaries to remove trustees and, when a trustee's office is vacant, to appoint a successor trustee; providing that trustees account to adult beneficiaries, so as to avoid judicial accountings; and so on.

Indeed, some have suggested that an attorney might face liability if he or she does not discuss the dynasty-trust option with clients.[11]

II. FEDERAL TAX IMPLICATIONS OF PERPETUAL DYNASTY TRUSTS

A. Introduction

1. Scope

For purposes of the GST tax, most dynasty trusts created by U.S. citizens and residents fall into one of the following three categories:[12]

a. Exempt Dynasty Trust—a trust that uses an individual's GST exemption from the GST tax;

b. Grandfathered Dynasty Trust—a trust that is not subject to the GST tax because it was irrevocable on September 25, 1985; and

[10] Jesse Dukeminier & James E. Krier, The Rise of the Perpetual Trust, 50 UCLA L. Rev. 1303, 1339–40 (Aug. 2003). See also Daniel L. Daniels & David T. Leibell, Dynasty Trusts: The Basics, 146 Tr. & Est. 36 (Apr. 2007); Note: Dynasty Trusts and the Rule Against Perpetuities, 116 Harvard L. Rev. 2588 (June 2003); Stewart E. Sterk, Jurisdictional Competition to Abolish the Rule Against Perpetuities: R.I.P. for the R.A.P., 24 Cardozo L. Rev. 2097 (May 2003).

[11] See Michael J. Myers & Rollyn H. Samp, South Dakota Trust Amendments and Economic Development: The Tort of "Negligent Trust Situs" at Its Incipient Stage?, 44 S.D.L. Rev. 662 (1998/1999).

[12] I discuss a fourth kind of dynasty trust—the NRA Dynasty Trust—in VIII, below.

c. Nonexempt Dynasty Trust—a long-term trust that is not exempt or grandfathered for GST tax purposes.[13]

2. Observations

a. My observations about the use of the three types of dynasty trusts since 1987 (when the current GST-tax system took effect) are as follows:

(1) Exempt Dynasty Trust—Almost immediately, the wealthy began revising their revocable estate-planning documents to provide for the use of their GST exemptions. Many have created irrevocable inter vivos trusts to use part or all of their exemptions. But, my experience is that the use of the GST exemption during life or at death has not gained general acceptance among those of moderate wealth—individuals with no more than $5 million.

(2) Grandfathered Dynasty Trust—Because a Grandfathered Dynasty Trust had to be established before September 26, 1985, no new ones are being created. As a result, a beneficiary of such a trust who holds a limited power of appointment (not the creator of the trust) has the ability to extract the greatest tax benefit from the trust. Virtually every individual with whom I have discussed the exercise of a limited power of appointment over such a trust has exercised the power to maximize the benefit of the trust's grandfathered status, probably because he or she already is familiar with trusts and because doing so does not involve a loss of income during life.

(3) Nonexempt Dynasty Trust—With few exceptions, the almost universal reaction following the enactment of the Tax Reform Act of 1986 was to revise estate planning documents to leave all assets in excess of the GST exemption outright to beneficiaries. However, many individuals whose assets have grown through success in business, savvy investing, or the receipt of inheritances have begun to recognize the tax and nontax benefits of leaving assets over the GST exemption in long-term trusts.

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[13] See Robert A. Vigoda, Powers to Replace Trustees: A Key Element of (and Risk to) Dynasty Trusts, 35 Est. Plan. 20 (June 2008); Richard B. Covey & Dan T. Hastings, The GST Tax at Twenty: A Brief Look Back and Selected Current Issues, Prac. Drafting 8351–75 (Jan. 2006); Carol A. Harrington, 850-2nd T.M., Generation-Skipping Transfer Tax.

b. Planning a dynasty trust, particularly an Exempt Dynasty Trust or a Grandfathered Dynasty Trust, requires a knowledge of arcane principles of tax, property, and fiduciary law and should be undertaken only by those with a thorough grounding in these principles.

Drafting a dynasty trust should be undertaken with care. Far too often, such trusts contain unclear language. For example, unless the governing instrument provides a definition, the phrase "in equal shares to trustor's then living issue, per stirpes" is unclear because "in equal shares" indicates a per capita or equal division among issue whereas "per stirpes" indicates division by representation. Similarly, dynasty trust instruments sometimes do not reflect an understanding of the nature of these trusts by omitting entire generations of beneficiaries.

The job of creating a dynasty trust is not always complete with the signing of the document. In particular, it is imperative that all members of the estate planning team make sure that all requisite GST exemption allocations (or elections out of automatic allocations) are made in a timely fashion.

c. As discussed in I, C, 3, above, I believe that the planner's bias should be in favor of creating perpetual dynasty trusts.

B. The Exempt Dynasty Trust

1. Introduction

Section 2631(a) of the Internal Revenue Code of 1986 ("IRC") gives every individual—U.S. citizen, resident alien, or NRA—a $1 million GST exemption from the GST tax that the individual or the individual's executor may allocate to any property of which the individual is the transferor. Under the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Tax Act"),[14] as modified by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Tax Act"),[15] the GST exemption will be $5 million in 2011[16] and $5 million adjusted for inflation in 2012.[17] Unless additional federal legislation is enacted, the GST exemption will decline to $1 million adjusted for inflation in 2013. No tax law or regulation prevents an Exempt Dynasty Trust from being perpetual, so that a client may create a

[14] Pub. L. No. 107-16.

[15] Pub. L. No. 111-312.

[16] IRC §§ 2631(c), 2010(c)(3)(A).

[17] IRC §§ 2631(c), 2010(c)(3)(B).

perpetual dynasty trust simply by establishing a trust in one of the many jurisdictions that permit trusts to last forever.[18] In recognition of this, President Obama's 2012 budget proposals would limit the tax-savings opportunities from an Exempt Dynasty Trust to 90 years.[19]

Some practitioners say that the 90-year USRAP period or the common-law rule against perpetuities period (i.e., lives in being when the trust became irrevocable plus 21 years) is "long enough." Nevertheless, Delaware is a state in which long-term trusts have proven to be useful, and, in recent years, new trusts have flocked to Delaware because trusts of personal property may be perpetual.[20]

2. Illustrations

Given that the gift-tax exemption has increased dramatically to $5 million in 2011 and that, absent further federal legislation, it will decline to $1 million in 2013, clients, who can afford to do so, should fund Exempt Dynasty Trusts with part or all of their gift- and GST-tax exemptions as soon as possible. Appendix A contains simplified illustrations comparing the amount that would be in a $1 million Exempt Dynasty Trust at the end of 100 years with the amount that would remain if assets were left from generation to generation and taxed at 35% using various rates of return and assuming that each generation would last 25 years. Assuming a 3% return, the Exempt Dynasty Trust would be worth $19,218,632 whereas the no-trust arrangement would be worth only $3,430,646 at the end of 100 years. Assuming a 10% return, the Exempt Dynasty Trust would be worth $13,780,612,340 whereas the no-trust arrangement would be worth only $2,459,925,431 at century's end. These examples assume either that no distributions would be made or that an after-tax return of the indicated rate could be earned despite distributions.

Other individuals fund a charitable-lead unitrust ("CLUT") with assets equal in value to their gift-tax exemption plus the federal gift-tax deduction for the charitable interest. Appendix B shows the amount that can be placed in a CLUT to produce a taxable gift of $1 million using

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[18] See Joshua C. Tate, Perpetual Trusts and the Settlor's Intent, 53 Kan. L. Rev. 595, 604 (Apr. 2005). See also III, D, below.

[19] See General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals at 129 (Feb. 2011), available at www.treasury.gov/resource-center/tax-policy/Documents/Final Greenbook Feb 2012.pdf (last visited Sept. 1, 2011).

[20] See Robert H. Sitkoff & Max M. Schanzenbach, Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds, 42 U. Miami Inst. on Est. Plan. ¶ 1407.1 at 14-19, ¶ 1407.2 at 14-19–14-20, ¶ 1407.5 at 14-22–14-23 (2008); Max M. Schanzenbach & Robert H. Sitkoff, Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust, 27 Cardozo L. Rev. 2465, 2479, 2495–96 (Apr. 2006); Robert H. Sitkoff & Max M. Schanzenbach, Jurisdictional Competition For Trust Funds: An Empirical Analysis of Perpetuities and Taxes, 115 Yale L.J. 356, 375 n.62, 393–94 (Nov. 2005).

various payout rates and charitable terms and assuming that the CLUT will achieve 6% annual growth. Using a 3% payout and a 1.8% IRC § 7520 rate, I calculate that a 20-year CLUT can be funded with $1,833,916 whereas an 80-year CLUT can be funded with $11,304,033. Using an 8% payout and the same IRC § 7520 rate, I calculate that a 20-year CLUT can be funded with $5,257,595 whereas an 80-year CLUT can be funded with $762,776,506.

Given the availability of the $5 million gift-tax exemption, some clients might want to consider creating a Supercharged Credit Shelter Trust (SM)[21] while others might want to structure a domestic asset-protection trust ("APT") as a completed gift.[22]

C. The Grandfathered Dynasty Trust

1. Introduction

The GST tax generally does not apply to transfers from a trust that was irrevocable on September 25, 1985.[23] Preserving the assets of such a trust is desirable because they will not be subject to federal transfer tax as long as they remain in the trust. Although no tax law or regulation requires a Grandfathered Dynasty Trust to terminate at the end of the USRAP period (or any other statutory period) or the common-law rule against perpetuities period, I doubt that many perpetual Grandfathered Dynasty Trusts exist because, for the most part, the movement to extend or abolish the rule against perpetuities began after September 25, 1985.

2. Exercising a Limited Power of Appointment

Many Grandfathered Dynasty Trusts provide for their continuation as long as is permitted by the applicable rule against perpetuities and thereby defer the imposition of federal transfer tax as long as possible, but many do not. For example, a trust might provide for the payment of income to the client's child for life with remainder to the child's issue, per stirpes, living at the child's death. Although the principal of the trust would not be subject to federal transfer tax at the child's death, it would again be subject to the federal transfer-tax system once it is distributed to the child's issue.

Often, a trust, like the one described above, gives the child a limited power to appoint the principal at his or her death (e.g., to or in trust for his or her issue). In such a situation, the child should consider exercising

[21] See III, H, 6, below.

[22] See III, I, 1–III, I, 3, below.

[23] Regs. § 26.2601-1(b)(1)(i).

his or her power to extend the grandfathered status of the trust.[24]

D. The Nonexempt Dynasty Trust

1. Introduction

In my experience, interest in keeping assets that are not exempt from the GST tax in trust has grown in recent years for nontax and tax reasons. Unlike the creator of an Exempt Dynasty Trust and the donee of a limited power of appointment over an Exempt Dynasty Trust or a Grandfathered Dynasty Trust, an individual planning the disposition of nonexempt assets often is faced with the unpalatable but unavoidable choice between subjecting assets either to federal estate tax or to GST tax at the deaths of his or her children. Nevertheless, planning can produce significant savings.

No tax law or regulation limits the duration of a Nonexempt Dynasty Trust. In fact, the Internal Revenue Service ("IRS") withdrew former Regs. § 26.2652-1(a)(4) because it would have enabled a donee of a limited power of appointment over a Nonexempt Dynasty Trust to move assets down a generation free of federal transfer tax.[25]

A typical Nonexempt Dynasty Trust might provide for the payment of income to the client's child for life, then to the child's child for life, then to that child's child for life, etc. Assuming that no GST exemption is allocated, GST tax will be payable at each generation. Each time GST tax is paid, however, the transferor will be moved down a generation so that distributions to the income beneficiary will not be taxable distributions.[26]

I, B, 2, above, listed some reasons to place nonexempt assets in trust. The rest of this II, D, discusses some federal transfer-tax advantages of leaving nonexempt assets outright, some federal transfer-tax advantages of keeping nonexempt assets in trust, and some ways of choosing between paying federal estate tax or GST tax.

Given that the GST exemption and the federal estate-tax exemption are equal at $5 million in 2011 and that the GST-tax rate and the estate-tax rate are equal at 35% this year, the long-standing bias in favor of subjecting assets to estate tax in order to use the graduated estate-tax rates no longer applies. Indeed, in states where there is no state GST tax (or in which the state GST-tax rate is relatively low) but there is a state estate or

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[24] See II, F, below, for tax dangers in exercising a limited power of appointment over a Grandfathered Dynasty Trust.

[25] T.D. 8720, 1997-1 C.B. 187 (Jan. 1997).

[26] IRC § 2653(a).

inheritance tax, it might be preferable, depending upon the client's goals, to subject the assets to GST tax rather than estate tax.

2. Federal Transfer-Tax Advantages of Leaving Nonexempt Assets Outright

a. Annual Exclusion Gifts are Available

In 2011, an individual may reduce his or her gross estate by making $13,000 annual-exclusion gifts during life.[27] There are no equivalent exclusions for taxable distributions or taxable terminations. An individual[28] and the trustee of a Nonexempt Dynasty Trust[29] both may make tax-free medical and tuition payments by direct payment to the service provider.

b. Previously Taxed Property Credit is Available

A decedent's estate is entitled to a credit for property includable in the gross estate that was subject to federal estate tax within ten years before and two years after his or her death.[30] There is no equivalent GST-tax credit.

c. Marital Deduction is Available

If a decedent makes a gift that qualifies for the federal estate-tax marital deduction, payment of federal estate tax on the property may be deferred until the surviving spouse's death, and the property will receive a stepped-up income-tax basis at the first spouse's death.[31] No such basis increase is available under the GST tax if, following a beneficiary's death, the trust continues for a beneficiary in the same or a higher generation.[32]

d. GST Exemption is Available

An individual may allocate his or her GST exemption to assets includable in his or her gross estate, but a beneficiary of a Nonexempt Dynasty Trust may not allocate GST exemption to trust assets because he or she is not the transferor.

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[27] IRC § 2503(b), as adjusted for inflation by Rev. Proc. 2010-40 § 3.21(1), 2010-46 I.R.B. 663, 666 (Oct. 28, 2010). To be exempt from GST tax, a gift in trust to a skip person must comply with IRC § 2642(c).

[28] IRC §§ 2503(e), 2611(b)(1).

[29] IRC §§ 2611(b)(1), 2642(c)(3)(B).

[30] IRC § 2013.

[31] IRC § 1014(a).

[32] IRC § 2654(a)(2).

e. Qualified Disclaimer is Possible

A beneficiary may disclaim an interest (other than in qualified terminable-interest property ("QTIP") assets) that is includable in a decedent's gross estate within nine months of death.[33] A taxable termination does not begin a new qualified-disclaimer period.

3. Federal Transfer-Tax Advantages of Keeping Nonexempt Assets in Trust

a. Tax-Free Gifts Are Possible

If a trust is structured as a grantor trust for federal income-tax purposes, the grantor may, in effect, make tax-free gifts to the trust by paying income taxes attributable to it. The IRS initially attempted to treat such income tax payments as additional transfers to the trust but since has confirmed that it will not pursue this issue, subject to a few caveats.[34]

b. Tax May Be Avoided

An interest in a Nonexempt Dynasty Trust can pass to a beneficiary in the same or a higher generation without payment of GST tax (e.g., if a child dies without issue and the trust continues for his or her siblings). If a decedent leaves assets outright to beneficiaries in any generation, federal estate tax might have to be paid.

c. Longer Tax Deferral is Possible

Payment of the GST tax may be deferred without meeting the requirements of the federal estate-tax marital deduction until no person in the same or a higher generation has an interest in a Nonexempt Dynasty Trust. No complete basis increase will be received, however, until a taxable termination occurs.[35]

d. Tax on Double Skip is Lower

If the trustee of a Nonexempt Dynasty Trust distributes assets to the current income beneficiary's great-grandchild, only one GST

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[33] IRC § 2518.

[34] Rev. Rul. 2004-64, 2004-2 C.B. 7 (July 6, 2004). See PLR 200822008 (Feb. 6, 2008) (reformation of exempt trust to give trustee discretion to reimburse grantor for income taxes on grantor trust did not cause trust to cease to be exempt, subject to certain conditions, because modification would have been acceptable for grandfathered trust).

[35] IRC § 2654(a)(2).

tax is payable.[36] If assets are left outright, estate tax must be paid in each generation.

e. Total Tax Might Be Lower

Given that the federal state death-tax credit was repealed[37] and replaced with a deduction,[38] many states "decoupled" from the federal system by enacting separate estate or inheritance taxes, and other states already had such taxes.[39] Consequently, many estates will pay state death tax as well as federal estate tax. Although the federal state GST-tax credit also was eliminated,[40] only three states—Massachusetts, New York, and Vermont—have a separate GST tax.[41] New York imposes its own estate tax at a rate of up to 16%[42] and its own GST tax at a rate of only 2.75%.[43] Thus, the state and federal transfer-tax burden on Nonexempt Dynasty Trusts often will be lower than on assets owned outright.

4. Choosing Between the Federal Estate Tax and the GST Tax

If a family has enough wealth to warrant GST-tax planning, it is impossible to predict whether it will be better to pay federal estate tax or GST tax at a decedent's death. Consequently, an individual's estate plan should be flexible enough to permit the payment of either federal transfer tax. Although the trustee of a Nonexempt Dynasty Trust may be able to distribute enough assets to the income beneficiary to allow him or her to use the options described in II, D, 2, above, a trust must already be in place for the beneficiary to avail himself or herself of the benefits described in II, D, 3, above. Thus, the best planning course would seem to involve creating a Nonexempt Dynasty Trust and giving the trustee or the beneficiary enough discretion to minimize the federal transfer tax payable at the beneficiary's death.

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[36] IRC § 2653(a).

[37] IRC § 2011(f).

[38] IRC § 2058.

[39] See Charles D. Fox, IV, & Adam M. Damerow, The ACTEC State Death Tax Chart—Still Going Strong After Seven Years, 35 ACTEC J. 53 (Summer 2009); Jeffrey A. Cooper, Wrestling with Decoupling, 145 Tr. & Est. 61 (Feb. 2006); Richard B. Covey & Dan T. Hastings, Survey of State Death Taxes, Prac. Drafting App. 8428–60 (Jan. 2006).

[40] IRC § 2604(c).

[41] Mass. Gen. Laws ch. 65C, § 4A; N.Y. Tax Law § 1022; Vt. Stat. Ann. tit. 32, § 7460.

[42] N.Y. Tax Law § 952.

[43] Id. § 1022. See TSB-M-11(1)M (Feb. 3, 2011), available at www.tax.ny.gov/pdf/memos/estate_&_gift/m11_1m.pdf.

A frequently suggested method for choosing between the payment of federal estate tax and GST tax is to give a trustee the power to grant and to take back a general power of appointment. This approach is an imperfect solution because, for many reasons, the trustee may not have complete financial information for the beneficiary. An individual trustee also must satisfy himself or herself that the exercise of such a power will not be a taxable gift.[44]

Given that clients might move or state transfer-tax laws might change after the preparation of an estate plan, the attorney might consider two other alternatives. First, instead of forcing the payment of estate tax or GST tax, the attorney might include a formula that will produce the more advantageous outcome. Second, another approach might involve the use of limited powers of appointment as discussed in II, F, 3, below.

E. Federal Income-Tax Implications

From an estate-planning standpoint, it might be desirable for a dynasty trust to be a grantor trust for federal income-tax purposes.[45] The client might want grantor-trust treatment because the trust will not be depleted to pay taxes on accumulated ordinary income and capital gains or because trust income may be taxed at a lower rate if it is taxed to the grantor. In 2011, a trust will reach the 35% bracket at only $11,350 of income whereas a single taxpayer and joint filers will not do so until $379,150 of income.[46] The client might not want grantor-trust treatment, however, because he or she might not be willing and able to pay income tax on income that he or she does not actually receive and/or because creating the trust as a grantor trust might subject it to state income tax that could be avoided if it were structured as a separate taxpayer.

There are various ways to structure a dynasty trust so that it will be a grantor trust but not includable in the client's gross estate,[47] and the trust instrument might contain more than one of them to ensure that grantor-trust treatment is achieved. In my experience, the most common ways to do so are to give the

[44] See In re Estate of Goldman, 196 Misc. 2d 968 (Sur. Ct. N.Y. Co. 2003).

[45] See Stephen R. Akers, Jonathan G. Blattmachr & F. Ladson Boyle, Creating Intentional Grantor Trusts, 44 Real Prop., Tr. & Est. L.J. 207 (Summer 2009); Howard M. Zaritsky, Taxable is the New Sexy, 36 Est. Plan. 48 (May 2009); Laura H. Peebles, Mysteries of the Blinking Trust, 147 Tr. & Est. 16 (Sept. 2008); Todd Steinberg, Jerome M. Hesch & Jennifer M. Smith, Grantor Trusts: Supercharging Your Estate Plan, 32 Tax Mgmt. Est., Gifts & Tr. J. 66 (Jan. 11, 2007).

[46] Rev. Proc. 2011-12 § 2.01, 2011-2 I.R.B. 297, 297–98 (Jan. 10, 2011).

[47] See Robert T. Danforth & Howard M. Zaritsky, 819 T.M., Grantor Trusts: Income Taxation Under Subpart E at A-89–A-107; Michael D. Mulligan, Power to Substitute in Grantor Does Not Cause Inclusion, with a Significant Caveat, 109 J. Tax'n 32 (July 2008).

client[48] or a third party[49] the power, exercisable in a nonfiduciary capacity, to reacquire trust assets by substituting property of an equivalent value[50] and to give an independent trustee the power to add charitable beneficiaries.[51]

In Rev. Rule 2008-22,[52] the IRS ruled, inter alia, that:[53]

> A grantor's retained power, exercisable in a nonfiduciary capacity, to acquire property held in trust by substituting property of equivalent value will not, by itself, cause the value of the trust corpus to be includible in the grantor's gross estate under § 2036 or 2038, **provided the trustee has a fiduciary obligation (under local law or the trust instrument) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value. . .**

States, including Delaware and South Dakota, have codified this requirement.[54] The Delaware statute provides:[55]

> Notwithstanding the terms of a governing instrument, if a trustor has a power to substitute property of equivalent value, the fiduciary responsible for investment decisions has a fiduciary duty to determine that the substituted property is of equivalent value prior to allowing the substitution.

A 2009 IRS chief counsel advice memorandum concluded that the conversion of a nongrantor trust into a grantor trust was not a transfer for federal income-tax purposes.[56]

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[48] See Rev. Rul. 2008-22, 2008-16 I.R.B. 796 (Apr. 21, 2008); PLRs 200848006, 200845015–017 (Aug. 4, 2008). See also Michael D. Mulligan, Power to Substitute in Grantor Does Not Cause Inclusion, with a Significant Caveat, 109 J. Tax'n 32, 32–33 (July 2008).

[49] See Rev. Proc. 2008-45 § 8.09(1), 2008-30 I.R.B. 224, 236 (July 28, 2008); Rev. Proc. 2007-45 § 8.09(1), 2007-29 I.R.B. 89, 99–100 (July 16, 2007) (charitable lead trust might be grantor trust if person other than donor, trustee, or disqualified person has power to substitute trust assets in nonfiduciary capacity).

[50] IRC § 675(4)(C).

[51] IRC § 674(c). See PLR 200747001 (Aug. 3, 2007).

[52] Rev. Rul. 2008-22, 2008-16 I.R.B. 796 (Apr. 21, 2008).

[53] Id. at 798 (emphasis added).

[54] 12 Del. C. § 3316; S.D. Codified Laws § 55-2-22.

[55] 12 Del. C. § 3316.

[56] CCA 200923024 (Dec. 31, 2008).

F. Tax Dangers When Exercising Powers Over Trusts

1. Introduction

When a beneficiary is considering exercising a limited power of appointment over a Grandfathered Dynasty Trust, an Exempt Dynasty Trust, or a Nonexempt Dynasty Trust or when a trustee[57] is considering taking action that will affect such a trust, the attorney advising the beneficiary or trustee must be wary of the following two federal transfer-tax hazards:[58]

a. Any restrictions that regulations under the GST tax impose on such action; and

b. IRC §§ 2041(a)(3) and 2514(d) generally known as the "Delaware tax trap."

2. The GST Regulations

a. Grandfathered Dynasty Trusts

(1) Exercise of Limited Power of Appointment by Beneficiary

A beneficiary's exercise of a limited power of appointment over a Grandfathered Dynasty Trust will not produce adverse federal transfer-tax consequences if it does not:[59]

> [P]ostpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of this paragraph (b)(1)(v)(B)(2), the exercise of a power

[57] For convenience, I will discuss these actions as being taken by a trustee but understand that beneficiaries, advisers, protectors, and committees might also be involved.

[58] See Richard W. Nenno, Terrors of the Deep: Tax Dangers When Exercising Powers Over Trusts—The GST Regulations and the Delaware Tax Trap, 34 Tax Mgmt. Est., Gifts & Tr. J. 76 (Jan. 8, 2009).

[59] Regs. § 26.2601-1(b)(1)(v)(B)(2).

> of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

Note that the regulation applies even if the donee does not create another limited power of appointment and that the donee may expand the class of measuring lives in the original trust, provided that all members of the new class were living at the date of creation of the original trust.[60] In addition, it says that the donee may exercise the power to extend the trust until the expiration of the common-law rule against perpetuities, 90 years from the trust's creation, or the shorter (not the longer) of such periods.[61] The IRS has approved exercises of powers of appointment that comply with the above regulation.[62] The validity of the regulation is questionable because one can argue that the IRS may not limit actions involving Grandfathered Dynasty Trusts—trusts to which the GST tax does not apply.[63] Nevertheless, only a foolhardy practitioner would counsel a client to exercise a limited power of appointment over a Grandfathered Dynasty Trust to extend the trust beyond what is permitted by the regulation without first obtaining a favorable private letter ruling, which the IRS certainly would not be willing to issue. Hence, practitioners should make sure that exercises of limited powers of appointment do not violate the regulation's restriction.

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[60] Regs. §§ 26.2601-1(b)(1)(v)(B)(2), 26.2601-1(b)(1)(v)(D), Exs. 4–5.

[61] Regs. §§ 26.2601-1(b)(1)(v)(B)(2), 26.2601-1(b)(1)(v)(D), Exs. 6–7.

[62] See, e.g., PLRs 201136017 (June 8, 2011), 201029011 (Apr. 12, 2010), 200928013 (Mar. 12, 2009), 200821013 (Jan. 17, 2008), 200812022 (Nov. 7, 2007), 200712008 (Oct. 26, 2006).

[63] See Carol A. Harrington, 850-2nd T.M., Generation-Skipping Transfer Tax at A-116–A-117.

(2) Other Modifications

A beneficiary may change the terms of a Grandfathered Dynasty Trust by exercising a limited power of appointment. The GST regulations also govern when other methods for modifying the terms of trusts will cause such trusts to lose their tax-favored status.[64] They include four safe harbors—for trustee discretionary powers (i.e., decanting powers),[65] court-approved settlements,[66] judicial constructions,[67] and other changes (including decanting powers[68] and other modifications that do not meet the three previous safe harbors)[69]—as well as 12 examples.[70]

Because the regulations provide four "safe harbors" other permitted modifications theoretically are possible. I am not aware, though, of a private letter ruling that does not fall within a safe harbor. Two examples[71] cover the safe harbor for a trustee's exercise of a decanting power.[72] Like a beneficiary exercising a limited power of appointment over a Grandfathered Dynasty Trust,[73] a trustee exercising a decanting power over such a trust that satisfies the first safe harbor[74] may extend the trust until the end of the common-law rule against perpetuities, 90 years, or the shorter of such periods. But, a trustee exercising a decanting power under the fourth safe harbor (because the first safe harbor is not satisfied) may not lengthen the trust beyond the "period provided for in the

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[64] Regs. § 26.2601-1(b)(4)(i). See Carol A. Harrington, 850-2nd T.M., Generation-Skipping Transfer Tax at A-110–A-117.

[65] Regs. § 26.2601-1(b)(4)(i)(A). See, e.g., PLR 201025026 (Feb. 26, 2010).

[66] Regs. § 26.2601-1(b)(4)(i)(B). See, e.g., PLRs 201123014 (Mar. 4, 2011); 201121002 (Jan. 28, 2011); 201104001 (July 29, 2010); 201102004–024, 051–052 (July 29, 2010); 201101001–009 (July 29, 2010).

[67] Regs. § 26.2601-1(b)(4)(i)(C). See, e.g., PLRs 201121011, 201121007–009 (Feb. 14, 2011).

[68] See, e.g., PLR 201025026 (Feb. 26, 2010).

[69] Regs. § 26.2601-1(b)(4)(i)(D). See, e.g., PLRs 201129021 (Apr. 8, 2011); 201129013–015 (Mar. 23, 2011); 201128018 (Apr. 8, 2011); 201128011–015 (Mar. 23, 2011); 201123014 (Mar. 4, 2011); 201122007 (Feb. 24, 2011); 201109004 (Nov. 9, 2010); 201104003 (Oct. 8, 2010).

[70] Regs. § 26.2601-1(b)(4)(i)(E).

[71] Regs. § 26.2601-1(b)(4)(i)(E), Exs. 1–2.

[72] Regs. § 26.2601-1(b)(4)(i)(A).

[73] Regs. § 26.2601-1(b)(1)(v)(B)(2).

[74] Regs. § 26.2601-1(b)(4)(i)(A).

original trust."[75] Very few Grandfathered Dynasty Trusts probably will qualify under the first safe harbor for two reasons. First, in my experience, relatively few pre-September 26, 1985, trusts conferred a decanting power upon the trustee. Second, although caselaw in Florida, New Jersey, and Iowa might have empowered a trustee to decant,[76] New York did not enact the first decanting statute until 1992.[77]

The regulations also include an example[78] that demonstrates the application of the safe harbor for judicial constructions.[79] Example 2 and Examples 4–12 involve the application of the fourth safe harbor.[80] Examples 4–12 cover:

1. Change in trust situs;[81]

2. Division of a trust;[82]

3. Merger of a trust;[83]

4. Modification that does not shift an interest to a lower generation;[84]

5. Conversion of an income interest into unitrust interest;[85]

6. Allocation of capital gain to income;[86]

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[75] Regs. § 26.2601-1(b)(4)(i)(D).

[76] See Phipps v. Palm Beach Trust Co., 196 So. 299 (Fla. 1940); Wiedenmayer v. Johnson, 254 A.2d 534 (N.J. Super. Ct. App. Div. 1969); In re Estate of Spencer, 232 N.W. 2d 491 (Iowa 1975).

[77] N.Y. Est. Powers & Trusts Law § 10-6.6.

[78] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 3.

[79] Regs. § 26.2601-1(b)(4)(i)(C). See, e.g., PLRs 201121007–009, 201121011 (Feb. 14, 2011) (scrivener's error).

[80] Regs. § 26.2601-1(b)(4)(i)(D).

[81] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 4.

[82] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 5.

[83] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 6.

[84] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 7.

[85] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 8.

[86] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 9.

7. Administrative change to terms of a trust;[87]

8. Conversion of income interest to unitrust interest under state statute;[88] and

9. Equitable adjustments under state statute.[89]

Reflecting that it is issued under the fourth safe harbor, Example 4—the example regarding the change of a trust's situs provides in relevant part as follows:[90]

> If, in this example, as a result of the change in situs, State Y law governed such that the time for vesting was extended beyond the period prescribed under the terms of the original trust instrument, the trust would not retain exempt status.

A trust would flunk this test if it provides that the duration of the trust will be governed by the law of the state where the trust is administered from time to time and if the trust is moved from a state that follows the common-law rule against perpetuities to a state that does not. Conversely, a trustee might not degrandfather a trust if the trust expresses the intent that the trust be perpetual and if the trustee moves the trust as described in the preceding sentence, but it probably is impossible to get assurance on this point from the IRS. A Delaware statute provides that the duration of a trust does not change merely because it is moved to Delaware.[91]

Accordingly, attorneys should consider carefully any action (e.g., the modification of a trust's administrative terms,[92] the exercise of

[87] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 10.

[88] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 11.

[89] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 12.

[90] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 4.

[91] 12 Del. C. § 3332(a).

[92] See, e.g., PLRs 201129013–015 (Mar. 23, 2011); 201128011–015 (Mar. 23, 2011); 201109004 (Nov. 9, 2010).

a decanting power,[93] the change of a trust's situs,[94] the division of a trust,[95] a unitrust conversion,[96] the exercise of the power to adjust,[97] or the partial termination of a trust[98]) that might affect a Grandfathered Dynasty Trust. In this regard, the IRS takes the position that moving a Grandfathered Dynasty Trust to avoid state income tax[99] or to utilize (or to avoid) another state's total-return unitrust conversion law[100] or statutory power to adjust[101] will not cost the trust its grandfathered status.

The IRS no longer will issue rulings on:[102]

> Whether a trust exempt from generation-skipping transfer (GST) tax under § 26.2601-1(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in § 26.2601-1(b)(4)(i)(E).

A trustee therefore may, without risk, modify a trust that is covered by a safe harbor without first obtaining a favorable private letter ruling. Nevertheless, it's not clear whether a trustee will cause a Grandfathered Dynasty Trust to lose its tax status if a proposed action meets the requirements of one safe harbor but fails the requirements of another. This might arise, for example, if the exercise of a decanting power complies with the first safe

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[93] See PLRs 201025026 (Feb. 26, 2010); 201013032 (Nov. 9, 2009), 201013027 (Nov. 9, 2009), 200924008 (Feb. 12, 2009), 200744020 (June 8, 2007), 200723006 (Mar. 6, 2007), 200607015 (Nov. 4, 2005), 200406041 (Oct. 10, 2003). Early in 2011, the IRS announced that, for the time being, it will not issue rulings on certain tax issues relating to decanting powers: Rev. Proc. 2011-3 §§ 5.09, 5.16–5.17, 2011-1 I.R.B. 111, 120–21 (Jan. 3, 2011).

[94] See PLRs 201109004 (Nov. 9, 2010); 200607015 (Nov. 4, 2005).

[95] See, e.g., PLRs 201133007 (May 17, 2011), 201131014 (Apr. 19, 2011).

[96] See, e.g., PLR 201104003 (Oct. 8, 2010).

[97] See, e.g., PLRs 201129013–015 (Mar. 23, 2011); 201128011–015 (Mar. 23, 2011).

[98] See, e.g., PLR 201122007 (Feb. 24, 2011).

[99] Regs. § 26.2601-1(b)(4)(i)(D)(2).

[100] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 11.

[101] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 12.

[102] Rev. Proc. 2011-3 § 3.01(69), 2011-1 I.R.B. 111, 115 (Jan. 3, 2011).

harbor but violates the fourth safe harbor because a change of trust situs is involved. The situation is further complicated by the fact that, after more than 20 years under the current version of the GST tax, the tax effects of the forfeiture of grandfathered status remain uncertain.[103]

b. Exempt Dynasty Trusts

(1) Exercise of Limited Power of Appointment by Beneficiary

Given that Exempt Dynasty Trusts have been around since 1987, beneficiaries have begun to consider exercising limited powers of appointment over them. By statute, these trusts are "exempt" from the reach of the GST tax, so that the IRS has no clear authority to limit them. In recognition of this, the IRS has issued no pertinent regulations concerning the exercise of limited powers over Exempt Dynasty Trusts.

In a few instances, the IRS considered whether a beneficiary's exercise of a limited power of appointment over an Exempt Dynasty Trust would change its inclusion ratio.[104] Each time, the IRS ruled that the trust would not lose its zero inclusion ratio because the donee did not exercise the power in a manner that would subject the trust assets to gift or estate tax and thereby cause him or her to become the transferor for GST-tax purposes.

(2) Other Modifications

There also is a dearth of guidance on the GST-tax consequences of other modifications of Exempt Dynasty Trusts. In numerous private letter rulings, the IRS approved modifications because they would have been permissible for Grandfathered Dynasty Trusts.[105] In a

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[103] See William R. Culp, Jr. & Briani Bennett Mellen, Trust Decanting: An Overview and Introduction to Creative Planning Opportunities, 45 Real Prop., Tr. & Est. L.J. 1, 22 (Spring 2010); Carol A. Harrington, 850-2nd T.M., Generation-Skipping Transfer Tax at A-115–A-116.

[104] See PLRs 201013002 (Nov. 4, 2009), 200928013 (Mar. 12, 2009), 200236030 (June 5, 2002), 200219034 (Feb. 12, 2002).

[105] See, e.g., PLRs 201138027 (June 15, 2011), 201134017 (May 26, 2011), 201050005–006, 008 (Sept. 8, 2010), 201049008 (Aug. 26, 2010); 201026018 (Mar. 22, 2010), 200841027 (May 30, 2008), 200841023 (May 20, 2008), 200840024, 200839025–027 (May 30, 2008), 200822008 (Feb. 6, 2008).

2008 ruling,[106] for example, the IRS approved the reformation of an Exempt Dynasty Trust to give the trustee discretion to reimburse the grantor for income taxes attributable to a grantor trust and included the following typical language:

> No guidance has been issued concerning the GST tax consequences of the modification of a trust created after September 25, 1985. At a minimum, a modification that does not affect the exempt status of a trust that is not subject to the GST tax because it was irrevocable on September 25, 1985 should similarly not affect the inclusion ratio of a trust created after September 25, 1985.

In other private letter rulings, it approved modifications of Exempt Dynasty Trusts that would have been acceptable for Grandfathered Dynasty Trusts without justifying the application of these rules to Exempt Dynasty Trusts.[107] As a result, an Exempt Dynasty Trust may be modified,[108] terminated,[109] or divided and modified,[110] a trustee may exercise a decanting power over[111] or make a unitrust conversion for[112] an Exempt Dynasty Trust, and the situs of an Exempt Dynasty Trust may be changed,[113] provided

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106 PLR 200822008 (Feb. 6, 2008). A trustee, which has a fiduciary duty to protect and preserve trust assets, probably should not initiate or consent to such a modification because the trust will be diminished by taxes that otherwise would be paid by the grantor. See Jonathan E. Gopman, PLR 200822008 Provides Planning Opportunity to Make Existing Defective Grantor Trusts More Flexible, 33 Tax Mgmt. Est., Gifts & Tr. J. 196 (Sept. 11, 2008). But, a trustee may join in a proceeding like that addressed in PLR 200848017 (Aug. 4, 2008), in which the IRS, without discussing GST-tax issues, approved the conversion by the trustor and all beneficiaries of a nongrantor trust into a grantor trust. See Howard M. Zaritsky, Toggling Made Easy—Modifying a Trust to Create a Grantor Trust, 36 Est. Plan. 48 (Mar. 2009).

107 See, e.g., PLRs 200910003 (Nov. 17, 2008), 200908003 (Oct. 28, 2008), 200714016 (Nov. 15, 2006), 200708001 (Oct. 24, 2006).

108 See, e.g., PLRs 201138027 (June 15, 2011), 201026018 (Mar. 22, 2010), 200910003 (Nov. 17, 2008), 200822008 (Feb. 6, 2008).

109 See PLR 200908003 (Oct. 28, 2008).

110 See PLR 201026018 (Mar. 22, 2010).

111 See PLRs 201134017 (May 26, 2011), 200817009 (Dec. 28, 2007), 200743028 (May 29, 2007), 200406041 (Oct. 10, 2003).

112 See, e.g., PLR 201049008 (Aug. 26, 2010).

113 See PLRs 200841027, 200840024, 200839025–027 (May 30, 2008), 200817009 (Dec. 28, 2007), 200743028

that the modification would have been allowed for a Grandfathered Dynasty Trust. Interestingly, the IRS several times approved changes of trust situs between jurisdictions that allow perpetual trusts.[114]

As noted above, the IRS no longer will issue private letter rulings regarding modifications of Grandfathered Dynasty Trusts that satisfy the safe harbors in the GST tax regulations. It probably is safe for a beneficiary exercising a limited power of appointment over an Exempt Dynasty Trust and for a trustee initiating a modification of such a trust to proceed without first getting a private letter ruling if the exercise or modification meets one of those safe harbors, but the cautious attorney advising the beneficiary or trustee might conclude otherwise. In addition, a beneficiary or trustee of an Exempt Dynasty Trust might be able to go beyond the Grandfathered Dynasty Trust safe harbors, but the IRS has not conceded this and I am not aware of a private letter ruling that considers such an action.

I often am asked whether a Grandfathered Dynasty Trust or an Exempt Dynasty Trust may be moved to Delaware from a state that does not permit perpetual trusts if the governing instrument expresses the intent that the trust be perpetual. This should be possible under the language from Example 4 quoted above.

c. Nonexempt Dynasty Trusts

Given that a Nonexempt Dynasty Trust has an inclusion ratio of one, a beneficiary's exercise of a limited power of appointment over such a trust and a modification of its provisions usually will not affect its GST-tax status. But, as shown in several 2010 private letter rulings,[115] the modification of trusts that are not grandfathered or exempt for GST-tax purposes may raise GST-tax concerns. In the rulings in question, the initial transfers were direct skips into trust so that GST tax was payable at the outset. The parties were concerned that merger of the trusts might cause distributions that otherwise would be tax-free to be subject to tax. The IRS issued reassuring rulings as follows:

(May 29, 2007), 200714016 (Nov. 15, 2006).

[114] See PLRs 200841027, 200840024, 200839025–027 (May 30, 2008), 200817009 (Dec. 28, 2007).

[115] PLRs 201025026, 201024014–016 (Feb. 26, 2010).

No guidance has been issued concerning modifications that may affect the status of GST exempt distributions to the highest generation individual having an interest in a direct skip trust. At a minimum, a modification that would not affect the GST status of a grandfathered trust should similarly not affect the exempt status of distributions to the highest generation individual having an interest in a direct skip trust.

3. IRC §§ 2041(a)(3) and 2514(d)—The Delaware Tax Trap

a. Introduction

As interest in long-term trusts has grown, practitioners have inquired about the implications of the Delaware tax trap for trust planning. The Delaware tax trap is of concern whenever a beneficiary is considering exercising a power of appointment and trusts resulting from such exercise might last beyond the common-law rule against perpetuities, which is the case in the 21 states that allow perpetual trusts (including Alaska, Delaware, and South Dakota), the eight states that permit very long trusts (including Florida and Nevada), and Louisiana. Note that the Delaware tax trap is an estate-tax or a gift-tax issue not a GST-tax issue and that a donee exercising a limited power of appointment cannot fall into the Delaware tax trap if he or she does not create a second power.

b. History

Under Delaware statutory law, the exercise of a limited or general power of appointment usually begins a new perpetuities period.[116] When the predecessor to this provision was enacted in 1933,[117] it offered the possibility, through the exercise of limited powers of appointment in successive generations, of having a perpetual trust without the imposition of federal transfer tax. To prevent this from happening, the predecessor to IRC § 2041(a)(3) was enacted in 1951.[118]

[116] 25 Del. C. § 503(c).

[117] 38 Del. Laws 198.

[118] The corresponding federal gift-tax provision is IRC § 2514(d).

Under IRC § 2041(a)(3), a trust will be subject to federal estate tax at the death of a beneficiary who has a limited power of appointment over the trust if the beneficiary:

> [E]xercises a power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

The legislative history to IRC § 2041(a)(3) makes clear that the Delaware power of appointment statute was Congress's target:[119]

> In at least one state [i.e., Delaware] a succession of powers of appointment, general or limited may be created and exercised over an indefinite period without violating the rule against perpetuities. In the absence of some special provision in the statute, property could be handed down from generation to generation without ever being subject to estate tax.

c. <u>Analysis</u>

For a trust to be includable in the gross estate of the donee of a limited power of appointment created after October 21, 1942, the donee must:

(1) Exercise the power of appointment;

(2) Exercise the power of appointment to create another limited power of appointment; and

(3) Exercise the power of appointment to create another limited power of appointment that, under the applicable local law, can be validly exercised to do one of the following for a period ascertainable without regard to the date of the creation of the first power:

[119] S. Rep. No. 82-382 (1951).

(a) Postpone the vesting of any estate or interest in such property; or

(b) Suspend the absolute ownership or power of alienation of such property.

The determination as to whether the donee springs the Delaware tax trap is based on:

(1) The instrument that created the power of appointment;

(2) The instrument that exercises the power of appointment; and

(3) Applicable local law.[120]

Consequently, even though Delaware law provides that the exercise of a limited power of appointment starts a new perpetuities period and even if the instrument granting the power of appointment does not limit its exercise, the donee may avoid invoking IRC § 2041(a)(3) by including appropriate limitations in the instrument exercising the power to create another power. To avoid springing the Delaware tax trap, instruments exercising Delaware limited powers of appointment over Grandfathered Dynasty Trusts typically include language such as the following:

> I further direct that any power of appointment conferred upon any person under the provisions of this instrument may not be exercised in any manner which would vest an interest in trust beyond the expiration of twenty-one (21) years after the death of the last survivor of my spouse and my issue living on [date original trust became irrevocable]. If any such power is so exercised, I direct that it be declared void ab initio.

The regulations under IRC § 2041 illustrate the application of the Delaware tax trap as follows:[121]

> If . . . the decedent appoints the income from the entire fund to a beneficiary for life with

[120] Regs. § 20.2041-3(e). See Christopher P. Cline, 825-3rd T.M., Powers of Appointment—Estate, Gift, and Income Tax Considerations at A-20, A-64–A-65; Carol A. Harrington, 850-2nd T.M., Generation-Skipping Transfer Tax at A-62.

[121] Regs. § 20.2041-3(e)(2) (citation omitted).

> power in the beneficiary to appoint the remainder by will, the entire $100,000 will be includable in the decedent's gross estate under section 2041(a)(3) if the exercise of the second power can validly postpone the vesting of any estate or interest in the property or can suspend the absolute ownership or power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

The only reported case that considered IRC § 2041(a)(3) is Estate of Murphy v. Commissioner,[122] in which one Tax Court judge held that the exercise of a limited power of appointment to create another limited power of appointment did not spring the Delaware tax trap because, under applicable Wisconsin law, the exercise of a limited power of appointment did not commence a new perpetuities period. The IRS acquiesced in the decision.[123] The Action on Decision explained that:[124]

> Section 2041(a)(3) refers to the creation of a power which under state law can be validly exercised so as to postpone vesting or suspend ownership "for a period ascertainable without regard to the date of the creation of the first power." Since the Wisconsin rule measures the period from the creation of the first nongeneral power, the statute by its very words cannot apply. This conclusion is supported by Treas. Reg. § 20.2041-3(e)(1)(ii). While an argument can be made that Congress intended to tax all creations of successive powers where vesting or ownership/power of alienation are affected, without regard to state law, such an argument ignores the very language of the Code and regulation. The regulation itself indicates that postponing of vesting and suspension of ownership/alienation power are mutually exclusive conditions of includability which are governed by the particular applicable state law. Finally, under Wisconsin law, ownership

[122] Estate of Murphy v. Comr., 71 T.C. 671 (1979).

[123] 1979-2 C.B. 1 (May 1979).

[124] AOD 1979-87, 1979 AOD Lexis 27 at 2–3 (May 1979).

> has not been suspended because the trustee was given the power to sell trust assets. The regulation, as it is written, appears to say that because local law is phrased in terms of the suspension of ownership/power of alienation, and if there is no such suspension under that local law, then section 2041(a)(3) cannot apply.

Murphy is a division or unreviewed regular Tax Court opinion.[125] As such, it has limited precedential value. It is not binding on any court other than the Tax Court.[126] Whereas it binds individual Tax Court judges, it may be overruled by the court as a whole.[127] In any event, Murphy is so fact specific that it should have little impact in other cases involving the Delaware tax trap.

d. Application to Nonexempt Dynasty Trusts

The Delaware tax trap provides an intriguing planning option for a Nonexempt Dynasty Trust that is of particular interest in 2011 given the substantial increase in the federal estate-tax exemption to $5 million. An individual's transfer-tax liability sometimes might be lower if trust assets are subject to estate tax and sometimes might be lower if they are subject to GST tax. Various mechanisms have been suggested to minimize a trust beneficiary's total transfer-tax liability, but they usually depend upon the inclusion of a formula in the original trust instrument or the exercise of discretion by a trustee who might possess less than complete information.[128]

The Delaware tax trap might provide the ideal mechanism because it gives a beneficiary holding a limited power of appointment the ability to choose between estate tax and GST tax in light of circumstances as they are at the time of the choice. Thus, if the beneficiary's transfer-tax liability will be lower if the trust is subject to estate tax (which might be the case if the estate is below $5 million and if a stepped-up income-tax basis is desirable), he or she may exercise the limited power of appointment to create another power in a way that springs the Delaware tax trap. Conversely, if the beneficiary's tax liability

[125] Peter A. Lowy, 100 T.M., U.S. Federal Tax Research at A-63.

[126] Id.

[127] Id.

[128] See Jonathan G. Blattmachr & Jeffrey N. Pennell, Adventures in Generation-Skipping, or How We Learned to Love the "Delaware Tax Trap," 24 Real Prop., Prob. & Tr. J. 75 (Spring 1989).

will be lower if a trust is subject to the GST tax (which might be the case if he or she lived in a state that has a death tax), he or she may refrain from exercising the power or exercise it in a way that does not spring the trap.[129] Note that this option might not be available if the power holder becomes incompetent or if the state of residence requires that the duration of trusts created by the exercise of limited powers of appointment be measured from the date of creation of the original trust not from the date of exercise of the power. To preserve flexibility, the trustee might also be given broad discretion to invade principal.

e. Application to Grandfathered Dynasty Trusts and Exempt Dynasty Trusts

The Delaware tax trap is of particular concern for a beneficiary who is exercising a limited power of appointment over a Grandfathered Dynasty Trust or an Exempt Dynasty Trust because, if the power is exercised improperly, he or she will subject an otherwise tax-free trust to estate or gift tax.

Nonetheless, the Delaware tax trap rarely will be of concern for Grandfathered Dynasty Trusts for at least two reasons. First, very few states allowed perpetual trusts before September 26, 1985. Therefore, most Grandfathered Dynasty Trusts expressly require all trusts to terminate at the end of the common-law period. Second, in F, 2, a, above, I discussed how the GST tax regulations allow a beneficiary exercising a limited power of appointment over a Grandfathered Dynasty Trust (whether or not he or she creates a second power) to extend the trust until the expiration of the common-law rule against perpetuities, the passage of 90 years, or the end of the shorter of those periods. If a donee complies with these regulations, he or she probably has no Delaware tax trap concerns.

The IRS has ruled privately that a Grandfathered Dynasty Trust will not be degrandfathered if a beneficiary holding a limited power of appointment exercises the power to create another limited power of appointment if all resulting trusts must terminate within the common-law rule against perpetuities period[130] or

[129] See Christopher P. Cline, 825-3rd T.M., Powers of Appointment—Estate, Gift, and Income Tax Considerations at A-65; Ellen K. Harrison, Generation-Skipping Planning in Light of EGTRRA, 39 U. Miami Inst. on Est. Plan. ¶ 1004.2 at 10-68 (2005); Jonathan G. Blattmachr & Jeffrey N. Pennell, Using the "Delaware Tax Trap" to Avoid Generation-Skipping Taxes, 68 J. Tax'n 242, 246 (Apr. 1988).

[130] PLRs 201029011 (Apr. 12, 2010), 200535009 (May 10, 2005), 200124006 (Mar. 12, 2001), 9351016 (Sept. 24, 1993).

within 88 years[131] measured from the creation of the original trust.

However, the Delaware tax trap poses a significant problem for Exempt Dynasty Trusts. Currently, over half the states authorize perpetual or very long trusts, and many Exempt Dynasty Trusts take advantage of these statutes. Exempt Dynasty Trusts typically also confer limited powers of appointment that enable beneficiaries to modify trust terms over time to adapt to changing circumstances. Assessing the potential impact of the Delaware tax trap is crucial to this planning.

As discussed above, the donee of a limited power of appointment over an Exempt Dynasty Trust or a Grandfathered Dynasty Trust should not create federal gift- or estate-tax liability if he or she does not exercise the power or includes appropriate limiting language in the Will or instrument by which the power is exercised. To eliminate all doubt in Delaware, the state adopted legislation in 2000 that provides that the perpetuities period applicable to the exercise of a limited power of appointment over a Delaware trust that is exempt or grandfathered for GST tax purposes is measured from when the original trust was created and not from when the power is exercised.[132] Thus, it now should be impossible to spring the Delaware tax trap in a Delaware Grandfathered Dynasty Trust or Exempt Dynasty Trust.

Nevertheless, some commentators suggest that the Delaware tax trap makes it impossible for beneficiaries to exercise limited powers of appointment over Exempt Dynasty Trusts created in states, such as Delaware, that allow perpetual trusts without adverse tax consequences.[133] As a result of this concern, Alabama, Florida, Pennsylvania, and Tennessee place a 360-year limitation on the duration of trusts created by the exercise of powers of appointment;[134] Nevada places a 365-year limitation on the

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[131] PLR 200243048 (July 31, 2002).

[132] 25 Del. C. § 504.

[133] See, e.g., 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. J. 673 (Winter 2009); Stephen E. Greer, The Alaska Dynasty Trust, 18 Alaska L. Rev. 253, 276 (Dec. 2001). Contra William R. Culp, Jr. & Briani L. Bennett, Use of Trust Decanting to Extend the Term of Irrevocable Trusts, 37 Est. Plan. 3, 11–12 (June 2010); William R. Culp, Jr. & Briani Bennett Mellen, Trust Decanting: An Overview and Introduction to Creative Planning Opportunities, 45 Real Prop., Tr. & Est. L.J. 1, 31–32 (Spring 2010); Daniel G. Worthington & Marc Merric, Which Situs Is Best?, 149 Tr. & Est. 54, 55 (Jan. 2010).

[134] Ala. Code § 35-4A-424(9) (effective Jan. 1, 2012); Fla. Stat. § 689.225(2)(f); 20 Pa. C.S. § 6107.1(a)(3); Tenn. Code Ann. § 66-1-202(f). The Tennessee statute probably is unconstitutional because Tenn. Const. Art. I, § 22, provides "That perpetuities . . . are contrary to the genius of a free State, and shall not be allowed."

duration of such trusts;[135] Arizona sets a 500-year limitation on them;[136] and Alaska, Colorado, Utah, and Wyoming place a 1,000-year limitation on the duration of such trusts.[137] These commentators suggest that, in a state that no longer follows the common-law rule against perpetuities, if a beneficiary wishes to exercise a limited power of appointment over an Exempt Dynasty Trust, he or she must place a finite ending period on the trusts created by the exercise of the power. Oddly enough, this argument assumes that IRC § 2041(a)(3) requires the existence of a "fixed period" to avoid its application. In fact, by its terms, IRC § 2041(a)(3) only applies to a second power that can be exercised to suspend vesting for one type of period—a "period ascertainable without regard to the date of the creation of the first power." If the second power can be exercised to suspend vesting indefinitely and if this is not a "period," the statute literally does not apply.

Even if avoidance of IRC § 2041(a)(3) does require a "period" to demonstrate such period was ascertainable with regard to the date of the creation of the first power, Delaware and other perpetual trust states do have such a period—an indefinite one. The notion that a period may be indefinite is consistent with dictionary meanings of the word. For example, the Oxford English Dictionary[138] defines "period" as both "an indefinite portion of time" and as "any specified portion or division of time."

In any event, it is difficult to distinguish in any practical sense among states that permit perpetual trusts and states such as Alaska, Colorado, Utah, and Wyoming (1,000-year periods), Arizona (500-year period), Nevada (365-year period), or Alabama, Florida, Pennsylvania, and Tennessee (360-year periods) with their definite periods of such inordinate length that they might as well be indefinite. Note that the foregoing fixed periods greatly exceed the IRS's "safe harbor" period (the common-law rule against perpetuities, 90 years, or the shorter of such periods) in the regulations for the exercise of limited powers

[135] Nev. Rev. Stat. § 111.1031. The statute probably is unconstitutional because Nev. Const. Art. 15, § 4, provides that "[no] perpetuities shall be allowed except for eleemosynary purposes." In 2002, a ballot initiative to repeal this prohibition was disapproved by the voters.

[136] Ariz. Rev. Stat. § 14-2901(A). The statute probably is unconstitutional because Ariz. Const. Art. II, § 29, provides that "no law shall be enacted permitting any perpetuity . . . in this State." Ariz. Rev. Stat. § 33-261 still provides that the common-law rule is in effect.

[137] Alaska Stat. § 34.27.051; Colo. Rev. Stat. § 15-11-1102.5; Utah Code Ann. § 75-2-1203; Wyo. Stat. Ann. § 34-1-139(b)(ii). The Wyoming statute probably is unconstitutional because Wyo. Const. Art. 1, § 30, provides that "Perpetuities . . . are contrary to the genius of a free state, and shall not be allowed."

[138] Oxford English Dictionary (24th ed. 1985).

of appointment over Grandfathered Dynasty Trusts,[139] which apply to any exercise of a power and not just to an exercise of a power creating a second power.[140] The regulations suggest that if an ending period is essential to avoid the application of IRC § 2041(a)(3), the IRS will require such ending period to be no longer than the traditional period or 90 years. No tax policy would be served by a different tax result under state laws with "phony" periods and states with indefinite periods. In informal discussions in 2003, IRS representatives confirmed this view with me. At that time, the IRS declined to issue a revenue ruling or private letter ruling on the application of the Delaware tax trap to Exempt Dynasty Trusts.

Placing a fixed limitation on the duration of Exempt Dynasty Trusts puts a state that is trying to attract trust business at a serious competitive disadvantage. This is particularly true for Alabama, Florida, Nevada, Pennsylvania, and Tennessee that set relatively short limitations. The problem is that once an Exempt Dynasty Trust is established in one of those states, it cannot be moved to a state with a longer perpetuities period without adverse transfer-tax consequences, which will discourage wealthy families who want to preserve flexibility from creating the trust there in the first place.[141]

As noted above, the Delaware tax trap must be considered by a beneficiary exercising a limited power of appointment over a trust governed by the law of as many as 44 states. Given the prevalence of the issue, attorneys drafting new trusts or instruments exercising powers of appointment should include language to alert donees and their attorneys to the concern.

In a 2002 private letter ruling,[142] the IRS concluded unhelpfully that a donee's exercise of a limited power of appointment to create another limited power of appointment did not cause an Exempt Dynasty Trust to lose its zero inclusion ratio if all resulting trusts had to terminate within the common-law perpetuities period determined from the date of creation of the original trust.

f. Definition of "Power of Appointment"

[139] Regs. § 26.2601-1(b)(1)(v)(B)(2).

[140] See F, 2, above.

[141] See Daniel G. Worthington & Marc Merric, Which Situs Is Best?, 149 Tr. & Est. 54, 57 (Jan. 2010).

[142] PLR 200219034 (Feb. 12, 2002).

Unlike the GST regulations, the regulations under IRC § 2041 do define "power of appointment" as follows:[143]

> The term "power of appointment" includes all powers which are in substance and effect powers of appointment regardless of the nomenclature used in creating the power and regardless of local property law connotations. For example, if a trust instrument provides that the beneficiary may appropriate or consume the principal of the trust, the power to consume or appropriate is a power of appointment. Similarly, a power given to a decedent to affect the beneficial enjoyment of trust property or its income by altering, amending, or revoking the trust instrument or terminating the trust is a power of appointment. If the community property laws of a State confer upon the wife a power of testamentary disposition over property in which she does not have a vested interest she is considered as having a power of appointment. A power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment. For example, if under the terms of a trust instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and the decedent has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, the decedent is considered as having a power of appointment.

They also describe instances in which an individual does not have a "power of appointment":[144]

> However, the decedent is not considered to have a power of appointment if he only had the power to appoint a successor, including himself, under limited conditions which did not exist at the time of his death, without an

[143] Regs. § 20.2041-1(b)(1).

[144] Id.

> accompanying unrestricted power of removal. Similarly, a power to amend only the administrative provisions of a trust instrument, which cannot substantially affect the beneficial enjoyment of the trust property or income, is not a power of appointment. The mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment. Further, the right in a beneficiary of a trust to assent to a periodic accounting, thereby relieving the trustee from further accountability, is not a power of appointment if the right of assent does not consist of any power or right to enlarge or shift the beneficial interest of any beneficiary therein.

Given that the above definition of "power of appointment" is expansive, attorneys advising trustees regarding exercises of decanting powers,[145] changes of trust situs, and other modifications (as well as beneficiaries exercising limited powers of appointment) must be mindful of §§ 2041(a)(3) and 2514(d).

III. FACTORS TO CONSIDER IN SELECTING A TRUST STATE

A. Introduction

Some attorneys do not look beyond the state where clients reside ("Home State") and where they are admitted to practice when they advise clients on the creation of trusts. But, as shown in I, E, above, other attorneys actively work with clients to find the best state for trusts ("Trust State").

This III summarizes factors that attorneys and clients should consider in choosing Trust States.[146]

B. Favorable Trust Climate

[145] See PLR 200744020 (June 8, 2007) (exercise of decanting power over Grandfathered Dynasty Trust did not fall within IRC § 2041(a)(3)).

[146] See Douglas Moore, Situs Shopping, 149 Tr. & Est. 33 (Jan. 2010).

When an attorney is developing an estate plan with a client that involves the use of trusts, the attorney should help the client to find a Trust State where the client's trusts will be more likely to accomplish what the client wants them to achieve. Such a Trust State should have a well thought-out body of trust statutes; an ongoing commitment to update those statutes to respond to changing federal tax laws, financial conditions, and other circumstances; a competent judiciary; a supportive legislature, executive branch, and legal and banking community; and several financial institutions that compete for trust business. Delaware developed such a system early in the 20th century;[147] South Dakota did so starting in about 1983.[148] Since 1997, several other states have taken steps to attract trust business. According to two recent sources, the leading trust jurisdictions, in alphabetical order, are Alaska, Delaware, Nevada, and South Dakota.[149]

It might not be possible to house a trust in a state that will meet all of a client's goals, but I hope that the rest of this III and the Appendixes to this paper will help attorneys to find the most appropriate Trust State for each client given all pertinent circumstances.

C. Clients' Objectives

1. Introduction

Some clients want their dynasty trusts to promote definite objectives (e.g., to prevent a concentrated block of publicly traded stock from being diversified, to prevent stock in a closely held company from being sold except in specified circumstances, or to prevent a beneficiary from being

[147] See Richard B. Covey & Dan T. Hastings, Delaware Trust Law; Cost of Accounting Proceeding, Prac. Drafting 9897, 9897–98 (Oct. 2009) ("Delaware trust law is considered up-to-date and favorable as to the creation and administration of trusts"); Robert H. Sitkoff & Max M. Schanzenbach, Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds, 42 U. Miami Inst. on Est. Plan. ¶ 1407.1 at 14-19, ¶ 1407.2 at 14-19–14-20, ¶ 1407.5 at 14-22–14-23 (2008); Max M. Schanzenbach & Robert H. Sitkoff, Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust, 27 Cardozo L. Rev. 2465, 2495–96 (Apr. 2006); Robert H. Sitkoff & Max M. Schanzenbach, Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes, 115 Yale L.J. 356, 375 n.62, 393–94 (Nov. 2005).

[148] Robert H. Sitkoff & Max M. Schanzenbach, Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds, 42 U. Miami Inst. on Est. Plan. ¶ 1407.3 at 14-20–14-21. But, South Dakota's low capital requirement to obtain a trust license is coming under criticism: Scott Martin, Alaska, Delaware, Nevada, South Dakota Remain Top Trust States (Feb. 2011), at thetrustadvisor.com/news/states2011 (last visited Sept. 1, 2011).

[149] See Daniel G. Worthington & Marc Merric, Which Situs Is Best?, 149 Tr. & Est. 54, 54, 62 (Jan. 2010); Scott Martin, Alaska, Delaware, Nevada, South Dakota Remain Top Trust States (Feb. 2011), at thetrustadvisor.com/news/states2011 (last visited Sept. 1, 2011).

provided with details about trusts until he or she reaches a "responsible" age).[150] Not only do such clients want to see language in the trust instrument that is in keeping with their wishes, but they also want assurance that the provisions in question will be respected.

2. Permitted Provisions

In addition to a variety of optional provisions,[151] the Uniform Trust Code ("UTC")[152] contains 14 mandatory provisions and forbids a testator or trustor who creates a trust in that state from departing from them.[153] The drafting attorney may not opt out or draft around these mandatory provisions. For example, the UTC specifies instances in which creditors may reach the assets of a third-party spendthrift trust[154] or discretionary trust,[155] prohibits domestic APTs,[156] and forbids resident testators and trustors to adopt different terms.[157]

Similarly, the UTC suggests that a trustee furnish a beneficiary with certain information by age 25[158] and suggests that a client not be able to override that requirement.[159] Adopting states have deviated from these provisions. For example, the District of Columbia allows a trustor to waive or modify the trustee's duties to give notice, information, and reports to beneficiaries.[160]

[150] See Johnson v. Johnson, 967 A.2d 274, 282 (Md. Ct. Spec. App. 2009) (trust instrument may not relieve trustee of duty to account to beneficiaries). See also John H. Langbein, Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments, 90 B.U.L. Rev. 375, 378–85 (Feb. 2010).

[151] UTC§ 105(a) (2005).

[152] UTC (2005). The text of the UTC may be viewed at www.law.upenn.edu/bll/archives/ulc/uta/2005final.htm (last visited Sept. 1, 2011); a list of enacting states may be viewed at www.nccusl.org/LegislativeFactSheet.aspx?title=Trust Code (last visited Sept. 1, 2011). Appendix C gives citations for the statutes of the states that have enacted the UTC.

[153] Id. § 105(b).

[154] Id. § 503.

[155] Id. § 504.

[156] Id. § 505(a)(2).

[157] Id. § 105(b)(5).

[158] Id. §§ 813(b), 105(b)(8).

[159] Id. § 105(b)(8). See Kevin D. Millard, The Trustee's Duty to Inform and Report Under the Uniform Trust Code, 40 Real Prop., Prob. & Tr. J. 373 (Summer 2005).

[160] D.C. Code § 19-1301.05(c).

Regarding the disclosure of information to beneficiaries, a 2005 article notes that:[161]

> [S]tates with statutes regarding the responsibility of a trustee to provide information and reports to a beneficiary vary considerably and are often unclear concerning the ability of the creator to negate the statutory requirements. The Delaware statute provides the creator with the greatest flexibility.

The Delaware statute referred to above now provides in pertinent part that:[162]

> (a) Notwithstanding any other provision of this Code or other law, the terms of a governing instrument may expand, restrict, eliminate or otherwise vary the rights and interests of beneficiaries, including, but not limited to, the right to be informed of the beneficiary's interest for a period of time, the grounds for removal of a fiduciary, the circumstances, if any, in which the fiduciary must diversify investments, and a fiduciary's powers, duties, standard of care, rights of indemnification and liability to persons whose interests arise from that instrument; provided however, that nothing contained in this section shall be construed to permit the exculpation or indemnification of a fiduciary for the fiduciary's own wilful misconduct or preclude a court of competent jurisdiction from removing a fiduciary on account of the fiduciary's wilful misconduct. 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

[161] Richard B. Covey & Dan T. Hastings, Notice, Disclosure and Trustee Reporting Requirements Under Various State Laws and Trust Codes, Prac. Drafting app. B at 8001 (Jan. 2005). See Philip J. Ruce, The Trustee and the Remainderman: The Trustee's Duty to Inform?, 46 Real Prop., Tr. & Est. L.J. 173 (Spring 2011); Julia C. Zajac & Robert Whitman, Fiduciary Accounting Statutes For the 21st Century, 36 ACTEC L.J. 443 (Fall 2010); Turney P. Berry, David M. English & Dana G. Fitzsimons, Jr., Disclose. Disclose! Disclose? Longmeyer Distorts the Trustee's Duty to Inform Trust Beneficiaries, 24 Prob. & Prop. 12 (July/Aug. 2010); Turney P. Berry, David M. English & Dana G. Fitzsimons, Jr., Longmeyer Exposes (or Creates) Uncertainty About the Duty to Inform Remainder Beneficiaries of a Revocable Trust, 35 ACTEC J. 125, 132–33 (Fall 2009); Dana G. Fitzsimons, Jr., Navigating the Trustee's Duty to Disclose, 23 Prob. & Prop. 40 (Jan./Feb. 2009).

[162] 12 Del. C. § 3303(a).

governing instruments.

Accordingly, if Delaware law governs a trust, the terms of the trust instrument will be carried out regardless of other statutes or laws. Thus, a client may set an age before which beneficiaries will not be notified of their interests in a trust. By contrast, Nevada requires trustees of nontestamentary trusts to furnish information to beneficiaries, and it appears that the settlor may not waive that requirement in the governing instrument.[163] Because a trustee's duty to keep beneficiaries informed is a matter of trust administration if the trust holds movables,[164] the trust instrument's designation of the law of a state, such as Delaware, on this issue should be respected for such a trust.

Notice to beneficiaries is one of the aspects of the UTC that can be most troubling to clients who wish to protect their children from full knowledge of their wealth. Thus, clients may wish to consider establishing a trust in Delaware or in another state that offers similar flexibility.

In any event, testators and trustors who want to accomplish specific goals that might be frustrated in their Home States should consider creating trusts in Trust States where their wishes will be honored. In this regard, a 2010 article counsels that:[165]

> [I]f the client resides in a state with undesirable law, the instrument could include a choice of law provision adopting "better" law in line with the client's wishes. Such a provision is most likely to be effective if the trustee is located in the state with the desirable law so that the choice of law clause has a relationship to the trust and the validity of the provision would likely have to be litigated in that state.

3. Modification or Termination of a Trust

a. Introduction

It may be well and good for a testator or trustor to set specific requirements in a Will or trust, but the attorney must be mindful

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[163] See Nev. Rev. Stat. Ann. §§ 165.135, 165.160.

[164] Restatement (Second) of Conflict of Laws § 271 cmt. a (1971).

[165] Turney P. Berry, David M. English & Dana G. Fitzsimons, Jr., Disclose. Disclose! Disclose? Longmeyer Distorts the Trustee's Duty to Inform Trust Beneficiaries, 24 Prob. & Prop. 12, 16 (July/Aug. 2010).

of ways in which the trustee or beneficiaries might undo those provisions or terminate the trust altogether after the testator or trustor is gone. Set forth below are three such dangers.

b. Beneficiaries' Power to Amend or Terminate a Trust

The UTC[166] and the codified and/or common law in certain states[167] authorize beneficiaries to amend or terminate trusts rather easily. UTC § 411(b), a version of which has been adopted by 23 states,[168] provides as follows:

> A noncharitable irrevocable trust may be terminated upon consent of all of the beneficiaries if the court concludes that continuance of the trust is not necessary to achieve any material purpose of the trust. A noncharitable irrevocable trust may be modified upon consent of all of the beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust.

An optional UTC provision suggests that, "[A] spendthrift provision . . . is not presumed to constitute a material purpose of the trust."[169]

Some jurisdictions, which claim to be trust-friendly, are even less respectful to testators' and trustors' wishes. In this connection, South Dakota advertises itself as having the best rules for remodeling trusts[170] and New Hampshire and Pennsylvania facilitate the modification and even the termination of trusts following the testator's or trustor's death by a judicial proceeding[171] or by a nonjudicial settlement agreement.[172]

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[166] UTC § 411(b) (2005).

[167] See, e.g., Wash. Rev. Code §§ 11.96A.210–11.96A.250.

[168] Ala. Code § 19-3B-411(b); Ariz. Rev. Stat. § 14-10411(A); Ark. Code Ann. § 28-73-411(b); DC Code § 19-1304.11(b); Kan. Stat. Ann. § 58a-411(b); Me. Rev. Stat. Ann. tit. 18-B, § 411(2); Mich. Comp. Laws § 700.7411(1); RSMo. § 456.4B-411(1); Neb. Rev. Stat. § 30-3837(b); N.H. Rev. Stat. Ann. § 564-B:4-411(a); N.M. Stat. Ann. § 46A-4-411(B); N.C. Gen. Stat. § 36C-4-411(b); N.D. Cent. Code § 59-12-11(1); Ohio Rev. Code Ann. § 5804.11(B); Or. Rev. Stat. § 130.200(2); 20 Pa. C.S. § 7740.1(b); S.C. Code Ann. § 62-7-411(b); Tenn. Code Ann. § 35-15-411(b); Utah Code Ann. § 75-7-411(2); 14A V.S.A. § 411(b); Va. Code Ann. § 55-544.11(B); W. Va. Code § 44D-4-411(b); Wyo. Stat. Ann. § 4-10-412(c).

[169] UTC § 411(c)(2005).

[170] See Rashad Wareh, Trust Remodeling, 146 Tr. & Est. 18 (Aug. 2007).

[171] See N.H. Rev. Stat. Ann. § 564-B:4-411(a); 20 Pa. C.S. 7740.1(b).

Modification or termination of the trust will be all the easier if the state's virtual-representation statute will eliminate the need to involve a guardian or trustee ad litem in a judicial or nonjudicial proceeding.[173]

c. Decanting Power

A "decanting power" authorizes a trustee to transfer the assets of a trust to a new or existing trust.[174] Such a power might be granted by the governing instrument, caselaw,[175] or a state statute.[176] Trustees might use a decanting power to postpone a distribution until a beneficiary is more "responsible," to revise a trust's administrative provisions, to consolidate or divide trusts, to fix drafting mistakes, to change the trust's governing law, or to react to changed circumstances.[177] Decanting powers present

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[172] See N.H. Rev. Stat. Ann. § 564-B:1-111(d)(7); 20 Pa. C.S. § 7710.1(d)(11).

[173] Susan T. Bart & Lyman W. Welch, State Statutes on Virtual Representation—A New State Survey, 35 ACTEC J. 368 (Spring 2010); Martin D. Begleiter, Serve the Cheerleader—Serve the World: An Analysis of Representation in Estate and Trust Proceedings and Under the Uniform Trust Code and Other Modern Trust Codes, 43 Real Prop., Tr. & Est. L.J. 311 (Summer 2008).

[174] See Ann Marie Levin & Todd A. Flubacher, Put Decanting to Work to Give Breath to Trust Purpose, 38 Est. Plan. 3 (Jan. 2011); William R. Culp, Jr. & Briani L. Bennett, Use of Trust Decanting to Extend the Term of Irrevocable Trusts, 37 Est. Plan. 3 (June 2010); William R. Culp, Jr. & Briani Bennett Mellen, Trust Decanting: An Overview and Introduction to Creative Planning Opportunities, 45 Real Prop., Tr. & Est. L.J. 1 (Spring 2010); Diana S.C. Zeydel & Jonathan G. Blattmachr, Tax Effects of Decanting—Obtaining and Preserving the Benefits, 111 J. Tax'n 288 (Nov. 2009); Richard B. Covey & Dan T. Hastings, State "Decanting" Statutes, Prac. Drafting 9158 (Jan. 2008); Alan S. Halperin & Lindsay N. O'Donnell, Modifying Irrevocable Trusts: State Law and Tax Considerations in Trust Decanting, 42 U. Miami Inst. on Est. Plan. ¶ 1300 (2008).

[175] See In re Estate of Spencer, 232 N.W.2d 491 (Iowa 1975); Wiedenmayer v. Johnson, 254 A.2d 534 (N.J. Super. Ct. App. Div. 1969); Phipps v. Palm Beach Trust Co., 142 Fla. 782 (1940). See also Restatement (Second) of Property § 19.3 (1986).

[176] See Alaska Stat. § 13.36.157; Ariz. Rev. Stat. § 14-10819; 12 Del. C. § 3528; Fla. Stat. § 736.04117; Ind. Code § 30-4-3-36; Nev. Rev. Stat. § 163.556; N.H. Rev. Stat. Ann. § 564-B:4-418; N.Y. Est. Powers & Trusts Law § 10-6.6; N.C. Gen. Stat. § 36C-8-816.1; S.D. Codified Laws §§ 55-2-15–55-2-21; Tenn. Code Ann. § 35-15-816. See also Anne Marie Levin & Todd A. Flubacher, Put Decanting to Work to Give Breath to Trust Purpose, 38 Est. Plan. 3, 4–5 (Jan. 2011); Alan S. Halperin & Lindsay N. O'Donnell, Modifying Irrevocable Trusts: State Law and Tax Considerations in Trust Decanting, 42 U. Miami Inst. on Est. Plan. ¶ 1303 at 13-8–13-21 (2008).

[177] See Anne Marie Levin & Todd A. Flubacher, Put Decanting to Work to Give Breath to Trust Purpose, 38 Est. Plan. 3, 6–12 (Jan. 2011); William R. Culp, Jr. & Briani Bennett Mellen, Trust Decanting: An Overview and Introduction to Creative Planning Opportunities, 45 Real Prop., Tr. & Est. L.J. 1, 13–16 (Spring 2010); Diana S.C. Zeydel & Jonathan G. Blattmachr, Tax Effects of Decanting—Obtaining and Preserving the Benefits, 111 J. Tax'n 288, 290–91 (Nov. 2009); Alan S. Halperin & Lindsay N. O'Donnell, Modifying Irrevocable Trusts: State Law and Tax Considerations in Trust Decanting, 42 U. Miami Inst. on Est. Plan. ¶ 1301 at 13-3–13-6 (2008).

GST-, gift-, and income-tax issues.[178] Because a decanting power is a potent device, a trustee might not want to exercise it without court approval or beneficiary consent.

d. Change of Situs

Even if a trust begins in a state where the beneficiaries may not defeat the testator's or trustor's intent by modifying or terminating a trust or where a trustee may not do so by exercising a decanting power, the trustee or beneficiaries might change the trust's situs to a state where such a modification, termination, or decanting is available.[179]

4. Preventing Modification or Termination of a Trust

a. Introduction

Clients who want trust terms to be respected should choose Trust States that do not give beneficiaries such powers and should include language in trust instruments that discourages courts, trustees, and beneficiaries from modifying or eliminating those terms and that prevent trusts from being moved to more permissive states. Other actions may be taken as well.[180]

b. Lifetime Proceedings

If a client wants certain trust provisions to be respected, it is desirable to establish the validity of the trust while the best witness—the client—is living.[181] Some states have procedures to accomplish this. Thus, a Delaware statute provides in pertinent part that:[182]

> (a) A judicial proceeding to contest whether a revocable trust or any amendment thereto, or an irrevocable trust, was validly created

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[178] See Anne Marie Levin & Todd A. Flubacher, Put Decanting to Work to Give Breath to Trust Purpose, 38 Est. Plan. 3, 5–6 (Jan. 2011); William R. Culp, Jr. & Briani Bennett Mellen, Trust Decanting: An Overview and Introduction to Creative Planning Opportunities, 45 Real Prop., Tr. & Est. L.J. 1, 16–37 (Spring 2010); Alan S. Halperin & Lindsay N. O'Donnell, Modifying Irrevocable Trusts: State Law and Tax Considerations in Trust Decanting, 42 U. Miami Inst. on Est. Plan. ¶¶ 1304–1306 at 13-21–13-32. See also PLRs 201134017 (May 26, 2011), 201033025 (May 13, 2010) (income tax issues only), 200723006 (Mar. 6, 2007).

[179] See VII below.

[180] See Rachel Emma Silverman, Wills: Leaving One Heir Less, Wall St. J., Sept. 10–11, 2011, at B8.

[181] See Dana G. Fitzsimons, Jr., Guardianship Litigation and Pre-Death Will Contests are on the Rise, 36 Est. Plan. 39, 44–45 (Jan. 2009).

[182] 12 Del. C. § 3546. See Anne Tergesen, A Will and a Way, Wall St. J., March 21, 2011, at R6.

> may not be initiated later than the first to occur of:
>
> (1) One hundred twenty days after the date that the trustee notified in writing the person who is contesting the trust of the trust's existence, of the trustee's name and address, of whether such person is a beneficiary, and of the time allowed under this section for initiating a judicial proceeding to contest the trust . . . .

Delaware practitioners have found this procedure to be useful in confirming trust provisions by getting beneficiaries to "put up or shut up" while the trustor is alive.

A 2008 California case illustrates how the validity of a trust may be confirmed during the trustor's lifetime through a conservatorship proceeding.[183]

c. No-Contest Clauses

A client might also try to prevent beneficiaries from challenging certain provisions by including a no-contest clause in the trust.[184] Black's Law Dictionary defines such a clause as follows:[185]

> A provision designed to threaten one into action or inaction; esp., a testamentary provision that threatens to dispossess any beneficiary who challenges the terms of the will.

For a no-contest clause to be effective, the client must make the provision for a beneficiary large enough that he or she will not

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[183] Murphy v. Murphy, 164 Cal. App. 4th 376 (Cal. Ct. App. 2008). See David W. Baer & S. Anne Johnson, Wake-Up Call, 147 Tr. & Est. 59 (Aug. 2008).

[184] A no-contest clause also may be called an in terrorem, penalty, or forfeiture clause. See Keener v. Keener, 682 S.E.2d 545 (Va. 2009) (no-contest clause in revocable trust valid but construed narrowly to find no violation of such clause); Griffin v. Hall, 760 N.W.2d 318 (Mich. Ct. App. 2008) (Michigan no-contest clause unenforceable because there was probable cause that contestant's challenge would succeed). See also Marc S. Bekerman, Is There Terror in In-Terrorem Clauses—And for Whom?, 51 Tax Mgmt. Memo. 67 (Mar. 1, 2010); Jonathan G. Blattmachr, Reducing Estate and Trust Litigation Through Disclosure, In Terrorem Clauses, Mediation and Arbitration, 9 Cardozo J. Conflict Resol. 237, 243–47 (Spring 2008), reprinted at 36 ACTEC L.J. 547, 564–65 (Winter 2010).

[185] Black's Law Dictionary at 1146 (9th ed. 2009).

risk losing that gift by challenging undesirable trust provisions.

Since 1991, California has honored no-contest clauses by statute in specified circumstances[186] and has provided a judicial procedure for establishing whether a challenge constitutes a "contest."[187] The legislation has spawned an enormous amount of litigation.[188] California's no-contest clause legislation was completely revamped in 2010.[189]

Other states enforce no-contest clauses as well. For instance, Alaska and Massachusetts will enforce a penalty clause even if probable cause exists for instituting the proceedings,[190] and other states will enforce one, subject to specified exceptions.[191] Under Georgia law, a no-contest clause is honored provided that the Will disposes of a forfeited gift.[192] Some states prohibit forfeiture clauses altogether.[193]

It seems to me that no-contest clauses should not be enforced indiscriminately because they should not be enforced if they result from undue influence, inadequate capacity, or forgery. Not only might an unscrupulous beneficiary forge a Will or trust that unduly benefits him or her, but he or she also might include a no-contest clause to deter challenges.[194] This should not be allowed to stand.

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[186] Cal. Prob. Code §§ 21300–21308.

[187] Id. §§ 21320–21322.

[188] See, e.g., Johnson v. Greenelsh, 217 P.3d 1194 (Cal. 2009); Cook v. Cook, 99 Cal. Rptr 3d 913 (Cal. Ct. App. 2009); Giammarrusco v. Simon, 171 Cal. App. 4th 1586 (Cal. Ct. App. 2009); Safai v. Safai, 164 Cal. App. 4th 233 (Cal. Ct. App. 2008); Taubman v. Taubman, 2008 Cal. App. Unpub. Lexis 4938 (Cal. Ct. App. 2008).

[189] Cal. Prob. Code §§ 21310–21315.

[190] Alaska Stat. § 13.36.330 (Wills and trusts); Mass. Gen. Laws ch. 190B, § 2-517 (effective Jan. 2, 2012) (Wills). I wonder how an Alaskan or a Massachusetts court would apply the statute in a situation in which the testator or settlor truly lacked capacity or the instrument was forged.

[191] See, e.g., Colo. Rev. Stat. § 15-12-905 (Wills); 12 Del. C. § 3329 (Wills and trusts); Mich. Comp. Laws §§ 700.2518 (Wills), 700.7113 (trusts); Neb. Rev. Stat. § 30-24,103 (Wills); Nev. Rev. Stat. § 137.005 (Wills), Nev. Rev. Stat. § 163.00195 (trusts); N.J. Stat. § 3B:3-47 (Wills); N.M. Stat. Ann. § 45-2-517 (governing instruments); N.Y. Est. Powers & Trusts Law § 3-3.5 (Wills); 20 Pa. C.S. § 2521 (Wills and trusts); S.D. Codified Laws §§ 29A-2-517, 29A-3-905 (Wills); Tex. Prob. Code § 64 (Wills), Tex. Prop. Code § 112.038 (trusts).

[192] Ga. Code Ann. § 53-4-68(b). See Sinclair v. Sinclair, 670 S.E.2d 59 (Ga. 2008) (action to remove executor does not violate no-contest clause).

[193] See Fla. Stat. §§ 732.517 (Wills), 736.1108 (trusts); Ind. Code Ann. § 30-4-2.1-3 (trusts).

[194] See Harrison v. Morrow, 977 So. 2d 457 (Ala. 2007) (no-contest clause does not bar Will contest based on alleged forgery).

5. Striking a Balance

Most clients understand that, whereas they might want their trusts to further certain objectives, it also might be necessary for trusts to be modified due to unanticipated circumstances. A commentator describes the tension between incentive provisions and the need to respond to change as follows:[195]

> This Article questions whether the current trend toward trust modification reform adequately takes into account the particular difficulties posed by contemporary incentive trusts. Scholars who have examined recent reforms in the area of trust modification generally have assumed that allowing greater latitude to courts is a positive development, especially given the rise of perpetual dynasty trusts. In the case of an incentive trust, however, mandatory modification rules may enable the beneficiaries to undo the scheme created by the settlor and remove conditions that encourage certain types of positive behavior. One might argue that some of the conditions imposed by settlors are actually good for the beneficiaries and that the ability of courts to tinker with the provisions of an incentive trust should be limited. A valid case can be made in support of the dead hand. Nonetheless, sound arguments also exist for allowing the courts to step in when the terms of the trust are more of a hindrance than a benefit to the beneficiaries. The inflexibility problem posed by incentive trusts is not easy to resolve.

This tension also might arise if a testator or trustor wants to create a perpetual trust.[196]

A possible approach to resolving this tension might be to charge a corporate trustee, adviser, or protector with responsibility for representing the testator's or trustor's wishes; require that person's consent to a modification, termination, unitrust conversion, exercise of a decanting power, or change of situs; and prohibit removal for refusing to give such consent.

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[195] Joshua C. Tate, Conditional Love: Incentive Trusts and the Inflexibility Problem, 41 Real Prop., Prob. & Tr. J. 445, 451–52 (Fall 2006) (footnotes omitted).

[196] See Joshua C. Tate, Perpetual Trusts and the Settlor's Intent, 53 Kan. L. Rev. 595, 620–21 (Apr. 2005).

D. Trust Duration

1. Introduction

A client should be able to create a trust of movables in a Trust State which has a different perpetuities rule from that of his or her Home State because:

a. The determination of whether a trust violates the rule against perpetuities is a matter of trust validity; [197]

b. The trust instrument may designate the law of a state that governs matters of validity that will be effective unless the Trust State's statute offends a strong public policy of a state that has a closer connection to the trust;[198] and

c. It generally is the case that no strong public policy is involved in differences in the rule against perpetuities.[199]

2. Perpetuities Statutes

The perpetuities rules in the states vary considerably. Since 1983, a number of states have repealed the rule against perpetuities for trusts. Several others have enacted statutes that permit testators and trustors to opt out of the rule. As shown in Appendix D, 21 states permit perpetual trusts, eight states permit very long trusts, 14 states follow the USRAP, seven states follow the common-law rule against perpetuities, and one state—Louisiana—usually requires trusts to terminate at the later of the death of the last income beneficiary or 20 years after the trustor's death.[200] But, the Simes & Smith treatise points out:[201]

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[197] Restatement (Second) of Conflict of Laws § 269 cmt. d (1971).

[198] Id. §§ 269–270.

[199] Id. § 269 cmt. i.

[200] See Kerr v. Bauer, 222 P.3d 1117 (Or. Ct. App. 2009) (trust that violates rule against perpetuities fails altogether). See also Joel C. Dobris, Undoing Repeal of the Rule Against Perpetuities: Federal and State Tools for Breaking Dynasty Trusts, 27 Cardozo L. Rev. 2537 (Apr. 2006); Susan F. French, Perpetual Trusts, Conservation Servitudes, and the Problem of the Future, 27 Cardozo L. Rev. 2523 (Apr. 2006); Mary Louise Fellows, Why the Generation-Skipping Transfer Tax Sparked Perpetual Trusts, 27 Cardozo L. Rev. 2511 (Apr. 2006); Max M. Shanzenbach & Robert H. Sitkoff, Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust, 27 Cardozo L. Rev. 2465 (Apr. 2006); Robert H. Sitkoff, The Lurking Rule Against Accumulations of Income, 100 Nw. U.L. Rev. 501, 507–08 (2006); Joshua C. Tate, Perpetual Trusts and the Settlor's Intent, 53 Kan. L. Rev. 595, 603–05 (Apr. 2005).

[201] John A. Borron, Jr., Simes & Smith: The Law of Future Interests § 1410 at 326 (3d ed. 2004) (footnotes omitted). Contra Brown Brothers Harriman Trust Co. v. Benson, 688 S.E.2d 752 (N.C. Ct. App. 2010), notice of appeal dismissed, 2010 N.C. Lexis 514 (N.C. 2010).

> In several states are found constitutional provisions to the effect that perpetuities shall not be allowed. The North Carolina constitution contains the following clause: "Perpetuities and monopolies are contrary to the genius of a free state and ought not to be allowed." If no legislation, other than such a constitutional provision, exists in a given state on the subject of perpetuities, the constitutional provision would seem, as a practical matter, to be without effect. However, if legislative modification of the common law rule is attempted, then such a constitutional provision might be held to restrict its operation.

The nine states that have constitutional prohibitions on perpetuities are: Arizona, Arkansas, Montana, Nevada, North Carolina, Oklahoma, Tennessee, Texas, and Wyoming.[202] Oklahoma and Texas adhere to the common-law rule against perpetuities; Arkansas and Montana follow the USRAP; Tennessee (360 years), Nevada (365 years), Arizona (500 years), and Wyoming (1,000 years) allow very long trusts; and North Carolina permits perpetual trusts. The statutes of the five states that do not follow the common-law rule or the USRAP appear to be vulnerable to constitutional attack because they authorize trusts that are much longer than what was permitted at common law.

As I discuss in II, F, 3, above, Delaware first made it possible to create a perpetual trust through the exercise of limited powers of appointment in 1933. In 1995, Delaware enacted legislation that permits stocks, bonds, and other personal property to remain in trust forever.[203] Although a parcel of real property may stay in trust for only 110 years under Delaware law,[204] this limitation may be avoided by putting the property in a limited-liability company ("LLC") or a family limited partnership ("FLP") because an interest in such an entity is personal property.[205]

Regarding the current status of the rule against perpetuities, a 2008 article observes that: [206]

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[202] See Ariz. Const. art. 2, § 29, Ariz. Rev. Stat. § 33-261; Ark. Const. art. 2, § 19; Mont. Const. art. 13, § 6; Nev. Const. art. 15, § 4; N.C. Const. art. 1, § 34; Okla. Const. art. 2, § 32; Tenn. Const. art. 1, § 22; Tex. Const. art. 1, § 26; Wyo. Const. art. 1, § 30.

[203] 25 Del. C. § 503.

[204] Id. § 503(b).

[205] Id. § 503(e).

[206] Robert H. Sitkoff & Max M. Schanzenbach, Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds, 42 U. Miami Inst. on Est. Plan. ¶ 1413.3 at 14-28–14-29 (2008).

Even if some states retain the Rule Against Perpetuities, the Rule will apply, in effect, only to real property within those states. When it matters, people move their financial assets to escape the Rule's reach. The evidence indicates that the demand for perpetual trusts was sparked chiefly by tax considerations, not solely by dynastic impulses. However, an intent to extend tax benefits to lineal descendents is clearly evident.

The federal wealth transfer taxes have thus mortally wounded the once-mighty Rule by reducing it to a mere transaction cost. As a result, Congress has inadvertently transformed the question of trust duration into an issue of federal tax law.

3. Creating a Long-Term Trust

a. Introduction

Suppose that a testator or trustor wants to create a trust in a Trust State that will last longer than the period permitted by the common-law rule against perpetuities or the USRAP that is in effect in the Home State. (Naturally, if the Home State is one of the many states that now allow perpetual or very long trusts, he or she may safely fund a long-term trust there with movables, land, or both.) If the Home State is one of the seven states that still have the common-law rule or is one of the 14 states that follow the USRAP, may a beneficiary successfully challenge in a Home State court the creation of a long-term trust elsewhere? To my knowledge, no court has yet considered this question, which is not surprising because, until the mid-1990s, only a handful of states had departed from the common-law rule or the USRAP and because the issue is unlikely to arise until the death of an original beneficiary of such a trust. Will the result differ depending on whether the testator or trustor lives in a state that has a constitutional prohibition on perpetuities?

The resolution of the question will depend on whether the trust is funded with movables or land and might arise in the following four contexts:

(1) If a testator creates the trust by Will;

(2) If a testator's Will pours over assets in the probate estate to a revocable or irrevocable trust created during life;

(3) If a trustor funds a revocable trust in the Trust State during life; or

(4) If a trustor funds an irrevocable trust in the Trust State during life (e.g., to use part or all of the gift-tax exemption or the GST exemption).

b. Trust of Movables

(1) Trust Under Will

Under the Second Restatement of Conflict of Laws, because the duration of a trust is a matter of trust validity,[207] a testator's designation of a Trust State's law to govern the duration of trusts established under his or her Will will stand unless, inter alia, the Trust State's provision offends a strong public policy of the Home State.[208] A Home State court is not justified in departing from a testator's designation merely because Home State law and Trust State law differ on an issue,[209] and differences between perpetuities rules normally don't justify applying Home State law.[210] It has been pointed out to me, though, that, when the Restatement was promulgated in 1971, virtually every state followed the common-law rule against perpetuities so that state law differences were not as significant as they are now and that a constitutional prohibition of perpetuities might amount to a matter of strong public policy.[211] (As just noted, however, such prohibitions did not deter legislatures in Arizona, Nevada, North Carolina, Tennessee, and Wyoming from leaving the traditional rule far behind.) For these reasons and because funding of the trusts will be within the control of a Home State court, attempting to create a trust in a Trust State that is substantially longer than what is allowed in the Home

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[207] Restatement (Second) of Conflict of Laws § 269 cmt. d (1971).

[208] Id. § 269(b).

[209] Id. § 269 cmt. i.

[210] Id.

[211] I would like to thank Carol A. Harrington, Esquire, McDermott Will & Emery LLP, Chicago, Illinois, for sharing these insights with me.

State through a testamentary trust is not without significant risk.

(2) Pour Over to Existing Trust

This approach is not without substantial risk either. Under the Second Restatement of Conflict of Laws, whereas the law of the Home State should govern whether a pour-over Will is valid, the law of the Trust State should govern issues that come up in the administration of the trust (e.g., whether the perpetuities period is acceptable) and there is no strong-public-policy exception.[212] Nonetheless, a Home State court again might get involved and impose Home State law. So, the testator should minimize the assets to be poured over at death.

(3) Revocable Trust Funded During Life

If a trustor funds a revocable trust in a Trust State during life, the courts of the Trust State should supervise the administration of the trust[213] and the Home State's perpetuities rule should prevail only if the Home State not the Trust State has the more significant relationship to the trust on the matter at issue.[214] In normal circumstances, this will not be the case.[215] To strengthen the case, the trustor should appoint a trustee that is not subject to personal jurisdiction in the Home State.[216]

(4) Irrevocable Trust Funded During Life

Because there should be little, if any, interaction between the Home State and the Trust State regarding an irrevocable trust created and funded during life, this vehicle should offer the best chance of success.

(5) UTC Approach

Under the UTC, "the law of the place having the most significant relationship to the trust's creation will govern

[212] Restatement (Second) of Conflict of Laws §§ 269 cmt. b, 271 cmt. f (1971).

[213] Id. § 267.

[214] Id. § 270(a).

[215] See V, D, 3, b, below.

[216] See V, B, 4, below.

the dispositive provisions" [which should include the trust's duration].[217] Of the four funding options, establishing a revocable trust or an irrevocable trust in a Trust State should offer the best prospect for success.

c. Trust of Land

Because courts of the situs supervise the administration of trusts funded with interests in land[218] and because the validity of provisions of trusts that hold land is controlled by the law of such state,[219] funding a trust with Home State land in a Trust State with the hope of getting a longer perpetuities period probably will fail. Some suggest that this problem may be avoided by putting such an interest in an FLP or LLC and thereby converting it into personal property. I am not aware of an instance in which this strategy has succeeded and fear that a Home State court might be able to pierce the entity's veil. Moreover, this strategy is under attack in analogous situations. For example, attorneys sometimes suggest that real property be placed in an FLP or LLC to avoid a state's estate or inheritance tax on real property owned by nonresidents. To counter this strategy, a Maine statute provides that:[220]

> When real or tangible personal property is owned by a pass-through entity, the entity must be disregarded and the property must be treated as personally owned by the decedent if the entity does not actively carry on a business for the purpose of profit and gain; the ownership of the property in the entity was not for a valid business purpose; or the property was acquired by other than a bona fide sale for full and adequate consideration and the decedent retained a power with respect to or interest in the property that would bring the real or tangible personal property located in this State within the decedent's federal gross estate.

Similarly, as discussed in III, E, 4, a, below, New York legislation restricted the usefulness of this technique to avoid New York

[217] UTC § 107 cmt. (2005).

[218] Restatement (Second) of Conflict of Laws § 276 (1971).

[219] Id. § 278.

[220] Me. Rev. Stat. Ann. tit. 36, § 4064.

State income tax.

d. Planning Point

Remember that the IRS says that a Grandfathered Dynasty Trust will lose its grandfathered status if it is moved in a way that will increase its duration[221] and that the IRS applies the rules for Grandfathered Dynasty Trusts to Exempt Dynasty Trusts.[222] Accordingly, to preserve flexibility, clients probably should create new trusts in states that permit perpetual trusts rather than in Florida or other states that limit the duration of trusts.

4. Rule Against Accumulations

When a client is creating a long-term trust, the attorney must ensure that he or she will not violate the rule against accumulations, which forbids the accumulation of income beyond the rule against perpetuities.[223] The continued relevance of the rule against accumulations came to light in the 1999 White v. Fleet Bank of Maine case, [224] in which the Supreme Judicial Court of Maine held that a direction to accumulate 25% of the income of the trust violated the rule. Among states that allow perpetual trusts, Delaware, Illinois (provided that it is a qualified perpetual trust), Michigan, Pennsylvania, and Wisconsin also permit income to be accumulated perpetually.[225] Although South Dakota repealed its statutory rule against accumulations,[226] no South Dakota statute specifically says that the perpetual accumulation of income is allowed.[227] Other states that permit perpetual or long-term trusts may not yet have dealt with the rule against accumulations.

[221] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 4.

[222] See, e.g., PLR 201026018 (Mar. 22, 2010).

[223] See Black's Law Dictionary at 24 (9th ed. 2009). See also Robert H. Sitkoff, The Lurking Rule Against Accumulations of Income, 100 Nw. U.L. Rev. 501 (2006); Karen J. Sneddon, The Sleeper Has Awakened: The Rule Against Accumulations and Perpetual Trusts, 76 Tul. L. Rev. 189 (Nov. 2001).

[224] White v. Fleet Bank of Maine, 739 A.2d 373, 380 (Me. 1999).

[225] 25 Del. C. § 506; 765 Ill. Comp. Stat. 315/1; Mich. Comp. Laws § 554.93; 20 Pa. C.S. §§ 6106, 6107.1; Wis. Stat. § 701.21(2).

[226] S.D. Codified Laws §§ 43-6-4–43-6-6, repealed by 1998 S.D. Laws 282 §§ 27–29.

[227] Karen J. Sneddon, The Sleeper Has Awakened: The Rule Against Accumulations and Perpetual Trusts, 76 Tul. L. Rev. 189, 209 (Nov. 2001).

E. State Income Tax

1. Introduction

a. Background

Most states impose a tax on the income of trusts. Rates range in 2011 from a low of 3.07% in Pennsylvania[228] to a top rate of 10.30% in California,[229] 11.00% in Oregon,[230] and 12.846% in New York City.[231] With proper planning, this tax may be minimized or avoided in many instances. Conversely, without proper planning, the income of a trust might be subject to tax by more than one state.

All income of a trust that is treated as a grantor trust for federal income-tax purposes generally is taxed to the trustor, distributed ordinary income of a nongrantor trust generally is taxed to the recipient, and source income of a trust (e.g., income attributable to real property, tangible personal property, or business activity) generally is taxed by the state where the property is situated or the activity occurs.[232] Thus, this III, E, will focus on the tax-savings opportunities for accumulated nonsource ordinary income and capital gains of nongrantor trusts.

b. Problem

In some instances, minimizing state fiduciary income tax will not be important, but, in others, proper planning might produce large tax savings. Some clients who do not wish to create grantor trusts are very interested in establishing trusts in Trust States with no

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[228] 72 P.S. § 7302(b). See Richard W. Nenno & Howard M. Zaritsky, Proposed New York Fiduciary Income Tax Changes: Let My Trustees Go!, 35 Tax Mgmt. Est., Gifts & Tr. J. 147 (May 13, 2010).

[229] Cal. Rev. & Tax Code §§ 17041(a), 17041(e), 17043(a).

[230] Or. Rev. Stat. § 316.037(1)(a).

[231] N.Y. Tax Law §§ 601(c)(1), 1301(a), 1304(a)(3).

[232] See In re Linde, N.Y. DTA 823300, 2011 N.Y. Tax Lexis 161 (July 21, 2011) available at www.nysdta.org/Determinations/823300.det.pdf (all income realized as result of sale by nonresident partnership of N.Y. real property properly allocated solely to N.Y.); TSB-M-10(9)I (Aug. 31, 2010), available at www.tax.state.ny.us/pdf/memos/income/m10_9i.pdf (description of N.Y. source income of nonresidents); TSB-A-07(1)I, 2007 N.Y. Tax Lexis II (Feb. 7, 2007), available at www.tax.ny.gov/pdf/advisory_opinions/income/a07_1i.pdf (sale of interest in Ga. partnership not N.Y. source income); In re Ittleson, N.Y. DTA 819283, 2005 N.Y. Tax Lexis 199 (Aug. 25, 2005) available at www.nysdta.org/Decisions/819283.dec.pdf (nonresidents' gain from sale of painting was N.Y. source income); Tina Schiller Trust for Benefit of Siegelbaum v. Director, Dept. of Treasury, Div. of Taxation for State of N.J, 14 N.J. Tax 173, 181 (N.J. Super. Ct. App. Div. 1994) ("The disposition of the corporate stock here constitutes the nontaxable sale of the intangible asset").

fiduciary income tax.

For example, if a nongrantor trust, which had a California trustee but no California beneficiaries, incurred a $1 million long-term capital gain in 2010, had no other income, and paid its California income tax by the end of the year, the trust would have paid $93,209 of California income tax on December 31, 2010, and $149,655 of federal income tax on April 18, 2011. If the trust had a Washington trustee, however, the trust would have owed $0 of state tax and the same $149,655 of federal income tax.

Similarly, if a nongrantor trust, which was created by a New York City resident and was subject to New York State and City tax, incurred a $1 million long-term capital gain in 2010, had no other income, and paid its New York State and City income tax by year-end, the trust would have owed $127,189 of New York State and City tax on December 31, 2010, and $149,655 of federal income tax on April 18, 2011. If the trust had been structured to avoid New York tax, however, it would have owed $0 of state and city tax and $149,655 of federal income tax.

State income tax is deductible for federal purposes,[233] but the deduction is worthless in the above examples due to the alternative minimum tax ("AMT"). Even if the AMT did not apply, the state-income-tax deduction would have been of limited value because it is a deduction not a credit and because, in 2010, the maximum tax rate on long-term capital gains was 15%.[234]

c. Scope

The rest of this III, E, will summarize:

(1) The circumstances, if any, in which each of the states taxes the nonsource accumulated ordinary income and capital gains of a nongrantor trust based on state statutes, regulations, and 2010 fiduciary income-tax return instructions;

(2) Pertinent cases and rulings;

(3) The taxation schemes of particular states; and

(4) Planning and other issues for new trusts.

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[233] IRC §§ 164(a)(3), 641(b).

[234] Id. § 1(h)(1).

2. Rules for Taxation of Trusts

a. Introduction

Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—do not tax the income of trusts. New Hampshire[235] and Tennessee[236] tax interest and dividends only.

As noted above, if a trust is a grantor trust for income-tax purposes, all income (including accumulated ordinary income and capital gains) is taxed to the trustor, making planning difficult if not impossible while that status continues. With the exception of Pennsylvania and Tennessee, which do not follow the federal grantor-trust rules at all for irrevocable trusts, and for the District of Columbia and Louisiana, which tax the grantor only in limited circumstances,[237] all of the states that tax trusts essentially honor the federal grantor-trust rules. Nevertheless, it might be possible to exploit differences between the federal and the applicable state grantor-trust rules in a particular case. For instance, even though a trust might be a grantor trust for federal purposes in a given situation, it might be possible to structure it as a nongrantor trust for state purposes and to arrange matters so that the trust is not subject to that state's tax.

b. Bases of Taxation

All of the 44 taxing states, including New Hampshire and Tennessee, tax a nongrantor trust based on one or more of the following five criteria:

(1) If the trust was created by the Will of a testator who lived in the state at death;

(2) If the trustor of an inter vivos trust lived in the state;

(3) If the trust is administered in the state;

(4) If one or more trustees live or do business in the state; or

(5) If one or more beneficiaries live in the state.

235 N.H. Rev. Stat. §§ 77:1–77:37.

236 Tenn. Code Ann. §§ 67-2-101–67-2-122.

237 D.C. Code §§ 47-1809.08–47-1809.09; La. Rev. Stat. Ann. § 47:187.

Louisiana taxes an inter vivos trust if the trust specifically provides that Louisiana law governs, but it does not tax such a trust if the trust specifies that the law of another state applies. Idaho and North Dakota consider the designation of their laws as a factor in determining whether a trust is a resident trust. Otherwise, the designation of a state's law to govern a trust has no bearing on its tax classification.

In some states, a trust might be a resident trust under more than one category (e.g., because the trust was created by the Will of a resident and because the trust is administered in the state). In some other states, one or more of the above criteria will lead to the classification of a trust as a resident trust only in combination with other factors.

Because statutes that tax trusts on the same basis are not identical, it is imperative to analyze the statute in question. A trust might be treated as a resident trust by more than one state based on the residence of the testator or trustor, the place of administration, the residence of the trustees, and the residence of the beneficiaries. When creating a new trust in or moving an existing trust to an unfamiliar jurisdiction, the attorney must consider the income tax system of the intended situs.

Appendix E summarizes the criteria that the 44 taxing states employ in taxing trust income.

c. Trust Created by Will of Resident

Sixteen states—Connecticut, the District of Columbia, Illinois, Louisiana, Maine, Maryland, Michigan, Minnesota (trusts created or first administered in state after 1995), Nebraska, Ohio, Oklahoma, Pennsylvania, Vermont, Virginia, West Virginia, and Wisconsin—tax a trust created by the Will of a resident. New Jersey and New York tax on this basis if a trust has resident trustees, assets, and/or source income, and Idaho, Iowa, and Montana tax if this is one of several factors. Although Delaware, Missouri, and Rhode Island tax if the trust has at least one resident beneficiary, Arkansas and Massachusetts tax if the trust has at least one resident trustee. Alabama taxes on this basis if a trust has a resident fiduciary or current beneficiary. Utah taxes on this basis, but after 2003, a Utah trust that has a Utah corporate trustee may deduct all nonsource income.

d. Inter Vivos Trust Created by Resident

Twelve states—the District of Columbia, Illinois, Maine, Maryland, Minnesota (trusts created or first administered in state after 1995), Nebraska, Oklahoma, Pennsylvania, Vermont, Virginia, West Virginia, and Wisconsin (trusts created or first administered in state after October 28, 1999)—tax an irrevocable trust created by a resident. New Jersey and New York tax on this basis if a trust has resident trustees, assets, and/or source income, and Connecticut, Delaware, Michigan, Missouri, Ohio, and Rhode Island tax if the trust has at least one resident beneficiary. Massachusetts taxes if the trust has at least one resident trustee and at least one resident beneficiary, but Arkansas taxes if the trust has at least one resident trustee. Idaho and Montana tax if this is one of several factors; Alabama taxes on this basis if a trust has a resident fiduciary or current beneficiary.

e. Trust Administered in State

Fourteen states—Colorado, Georgia, Indiana, Kansas, Louisiana (inter vivos trusts unless trust designates law of another state), Maryland, Minnesota (trusts created or first administered in state before 1996), Mississippi, New Mexico, North Dakota, Oregon, South Carolina, Virginia, and Wisconsin (inter vivos trusts created or first administered in state before October 29, 1999)—tax a trust if it is administered in the state. Idaho, Iowa, and Montana tax on this basis if it is combined with other factors. Hawaii taxes if the trust has at least one resident beneficiary. Utah taxes inter vivos trusts on this basis, except that after 2003, a Utah inter vivos trust that has a Utah corporate trustee may deduct all nonsource income. Oregon provides guidance on whether a corporate trustee is administering a trust in the state.

f. Resident Trustee

Eight states—Arizona, California, Georgia, Kentucky, New Mexico, North Dakota, Oregon, and Virginia—tax if one or more trustees reside in the state. Idaho, Iowa (inter vivos trusts only), and Montana tax on this basis when combined with other factors. Delaware, Hawaii, and New Hampshire tax on this basis only if the trust has one or more resident beneficiaries. Arizona, California, and Oregon provide guidance on whether a corporate trustee is a resident. If some, but not all, of the trustees of a trust are California residents, California taxes only a portion of the income.

g. Resident Beneficiary

Five states—California, Georgia, North Carolina, North Dakota, and Tennessee—tax a trust if it has one or more resident beneficiaries. If a trust is taxed on this basis, California and Tennessee tax only income attributable to resident beneficiaries.

3. Determining Whether Imposition of Tax is Constitutional

a. Introduction

Notwithstanding the rules described above, a state may tax the income of a trust only if doing so will not violate either the Due Process Clause[238] or the Commerce Clause[239] of the United States Constitution. The Due Process Clause provides that:

> No State shall make or enforce any law which shall . . . deprive any person of life, liberty, or property, without due process of law . . . .

The Commerce Clause provides that:

> The Congress shall have Power . . . [t]o regulate Commerce . . . among the several States . . . .

b. Trust Created by Will of Resident

(1) Supreme Court Cases

Although they did not involve the income taxation of trusts, two United States Supreme Court cases are relevant to this discussion.

(a) In Safe Deposit and Trust Company v. Virginia,[240] the Court held that a Virginia tax on the value of an inter vivos trust, which had Virginia beneficiaries but a Maryland trustee, violated the Due Process Clause. The Court said:[241]

[238] U.S. Const. amend. XIV, § 1.

[239] U.S. Const. art. I, § 8, cl. 3.

[240] Safe Deposit & Trust Co. v. Virginia, 280 U.S. 83 (1929).

[241] Id. at 93.

> Here we must decide whether intangibles—stocks, bonds—in the hands of the holder of the legal title with definite taxable situs at its residence, not subject to change by the equitable owner, may be taxed at the latter's domicile in another State. We think not.

(b) In Quill Corporation v. North Dakota,[242] the Court considered the constitutionality of North Dakota's use tax on an out-of-state mail-order business that had no outlets or sales representatives in the state. At the time, about $1 million of the business's $200 million of annual sales were made to about 3,000 North Dakota residents.[243] Regarding the Due Process Clause, the Court held that:[244]

> In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State. We therefore agree with the North Dakota Supreme Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill.

Regarding the Commerce Clause, however, the Court reaffirmed prior decisions that a business

[242] Quill Corp. v. North Dakota, 504 U.S. 298 (1992). For a recent analysis of the applicability of Quill to state corporate income taxes, see Stephen W. Long, Jeffrey M. Slade & Robert H. Albaral, The State Tax Game of Chicken Continues: Economic Nexus Claims Another State with 'KFC', 117 DTR J-1 (June 17, 2011).

[243] Id. at 302.

[244] Id. at 308.

must have a physical presence in a state to justify the imposition of a use tax.[245]

Whereas post-Quill state court decisions have applied Quill in fiduciary income-tax cases, the United States Supreme Court never has indicated that Quill is relevant in this context.

(2) State Court Cases

The following state court decisions involve the constitutionality of taxing trusts on this basis.

(a) In Harrison v. Commissioner of Corporations and Taxation,[246] the trustees of two trusts created by the Wills of New York residents sought abatements of Massachusetts income tax on realized capital gains. The trustees already had paid New York income tax on the gains because the testators were New York residents,[247] but it appeared that the gains also were subject to Massachusetts income tax because the trusts had Massachusetts trustees and beneficiaries.[248] The Supreme Judicial Court of Massachusetts concluded that Massachusetts could not tax in the circumstances.[249]

(b) In First National Bank v. Harvey,[250] the Supreme Court of Vermont considered a request for a refund of Vermont income tax by the trustees of a Massachusetts trust created by the Will of a Vermont decedent. The court sustained Vermont's power to tax.[251]

(c) In Taylor v. State Tax Commissioner,[252] a New York intermediate appellate court reviewed a

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[245] Id. at 318–19.

[246] Harrison v. Comr. of Corps. & Taxation, 272 Mass. 422 (1930).

[247] Id. at 424.

[248] Id. at 425.

[249] Id. at 428.

[250] First Nat'l Bank v. Harvey, 111 Vt. 281 (1940).

[251] Id. at 297.

[252] Taylor v. State Tax Comr., 445 N.Y.S.2d 648 (3d Dept. 1981).

determination by the New York State Tax Commission that New York income tax was payable on gain incurred upon the sale of Florida real property held in a trust created by the Will of a New York decedent. Although the Will appointed two nonresident individual trustees and a New York corporate trustee, Florida law prohibited the corporate trustee from serving so that only the nonresident trustees served with respect to the Florida real estate. The court held that New York could not tax the gain as follows:[253]

> New York's only substantive contact with the property was that New York was the domicile of the settlor of the trust, thus creating a resident trust. The fact that the former owner of the property in question died while being domiciled in New York, making the trust a resident trust under New York tax law, is insufficient to establish a basis for jurisdiction.

Taylor suggests that a state may not tax income simply because a trust was created by the Will of a resident.

(d) In Pennoyer v. Taxation Division Director,[254] the New Jersey Tax Court framed the question as follows:[255]

> Taxpayer trustee contests a deficiency tax assessment of $100.68 for the fiscal year ended February 29, 1980, imposed by the Director of the Division of Taxation under the New Jersey Gross Income Tax Act. The assessment was

[253] Id. at 649 (citations omitted).

[254] Pennoyer v. Taxation Div. Dir., 5 N.J. Tax 386 (1983).

[255] Id. at 388 (citations omitted).

> imposed on the undistributed income of a testamentary trust created by the will of a New Jersey domiciliary. The trustee, beneficiaries and assets of the trust are all located outside New Jersey.

The court held:[256]

> Based on the facts of this case, I conclude that the creation of the subject trust in New Jersey in 1970, the probate proceeding in a New Jersey court and the jurisdiction and availability of the New Jersey courts are not sufficient contacts with the State of New Jersey to support taxation of the 1979-1980 undistributed income of the trust, and therefore, N.J.S.A. 54A:1-2(o)(2) may not constitutionally be applied in the subject case.

Thus, Pennoyer agreed with Taylor.

(e) In In re Swift,[257] the Supreme Court of Missouri addressed the challenge to a Missouri tax assessment made by the trustees of an Illinois trust created by the Will of a Missouri testator. The court described the pertinent facts and legal principles as follows:[258]

> In this case, the trustees, the beneficiaries, the trust property, and the administration of the trust are in Illinois; the income earned by the trusts which the Director seeks to tax is the product of Illinois

[256] Id. at 399.

[257] In re Swift, 727 S.W.2d 880 (Mo. 1987).

[258] Id. at 882.

administration. The only connections with Missouri are Swift's domicile and death in this state and the creation and funding of the testamentary trusts through the probate administration of Swift's estate.

The Director argues that the administration of Swift's estate by a Missouri probate court, together with Swift's Missouri domicile at death and the creation of the subject trusts by a "Missouri" will, provide a sufficient nexus to justify the imposition of income tax.

We disagree. An income tax is justified only when contemporary benefits and protections are provided the subject property or entity during the relevant taxing period. In determining whether this state has a sufficient nexus to support the imposition of an income tax on trust income, we consider six points of contact: (1) the domicile of the settlor, (2) the state in which the trust is created, (3) the location of trust property, (4) the domicile of the beneficiaries, (5) the domicile of the trustees, and (6) the location of the administration of the trust. For purposes of supporting an income tax, the first two of these factors require the ongoing protection or benefit of state law only to the extent that one or more of the other four factors is present.

Applying the above standard, the court held that Missouri could not tax the income in question.[259]

(f) In <u>Westfall v. Director of Revenue</u>,[260] the Missouri Supreme Court applied the <u>Swift</u> factors to a different fact pattern and upheld Missouri's right to tax trust income. The court reasoned:[261]

> Missouri was connected to the trust in <u>Swift</u> only by the settlor's domicile, point (1), and the situs of the trust's creation, point (2). Because of those limitations this Court properly determined Missouri lacked sufficient connection with the trust to impose Missouri income tax. The Rollins trust differs, however, from the trusts in <u>Swift</u> because the Rollins trust also satisfies point (3) of the test by its ownership of real estate in Columbia, Missouri. In addition, the trust instrument shows that under certain contingencies charities in Columbia will receive distributions; it specifies the Board of Trustees of the Columbia [Missouri] Public Library as a contingent beneficiary and the Boone County National Bank as a possible successor trustee. These considerations taken together with points (1), (2) and (3) provide a sufficient nexus to support the imposition of an income tax on trust income.

[259] <u>Id.</u>

[260] <u>Westfall v. Director of Revenue</u>, 812 S.W.2d 513 (Mo. 1991).

[261] <u>Id.</u> at 514 (citations and internal quotation marks omitted).

(g) In District of Columbia v. Chase Manhattan Bank,[262] the first relevant case decided after the Supreme Court's Quill decision (summarized above), the District of Columbia Court of Appeals denied a $324,315 District of Columbia income-tax refund claimed by the trustee under the Will of a resident of the District. At the outset, the court summarized the facts and its conclusion as follows:[263]

> This case presents an issue of first impression in this court: can the District of Columbia, consistent with the Due Process Clause, tax the annual net income of a testamentary trust created by the will of an individual who died while domiciled in the District, when the trustee, trust assets, and trust beneficiaries are all presently located outside the District. We hold that the Due Process Clause does not prevent the District from imposing such a tax, given the continuing supervisory relationship which the District's courts have with respect to administration of such a trust, and in so doing we reject several decisions in other states holding that due process requires a greater connection between the trust and the taxing jurisdiction than the residence of the settlor.

Departing from Taylor and Pennoyer, this case indicates that a state may tax on due-process

[262] District of Columbia v. Chase Manhattan Bank, 689 A.2d 539 (D.C. 1997). See Bradley E.S. Fogel, What Have You Done For Me Lately? Constitutional Limitations on State Taxation of Trusts, 32 U. Rich. L. Rev. 165 (Jan. 1998).

[263] Id. at 540.

grounds solely because the trust arises under the Will of a resident.

(h) In Chase Manhattan Bank v. Gavin,[264] the Supreme Court of Connecticut denied the trustees' request under the Due Process Clause and the Commerce Clause for Connecticut income-tax refunds in four testamentary trusts. The court summarized its analysis and conclusions as follows:[265]

> [T]he taxability of the income of the resident testamentary trusts in this case is based on the fact that the testators were Connecticut domiciliaries at the time of their deaths . . . . The plaintiff claims that this taxation scheme, as applied to it, violates the due process clause and the commerce clause of the federal constitution. We consider the plaintiff's contentions in turn. We conclude that none of them is persuasive.

In a 2006 article,[266] Professor Blackburn described Gavin as a "misguided holding"[267] and opined that:[268]

> The result in Gavin is not consistent with the relations of states within the American Union or with the expectations of U.S. citizens.

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[264] Chase Manhattan Bank v. Gavin, 249 Conn. 172 (1999). See Joseph W. Blackburn, Constitutional Limits on State Taxation of a Nonresident Trustee: Gavin Misinterprets and Misapplies Both Quill and McCulloch, 76 Miss. L.J. 1 (Fall 2006); Bernard E. Jacob, An Extended Presence, Interstate Style: First Notes on a Theme From Saenz, 30 Hofstra L. Rev. 1133 (Summer 2002).

[265] Id. at 183.

[266] Joseph W. Blackburn, Constitutional Limits on State Taxation of a Nonresident Trustee: Gavin Misinterprets and Misapplies Both Quill and McCulloch, 76 Miss. L.J. 1 (Fall 2006).

[267] Id. at 4.

[268] Id. at 52 (footnote omitted).

> Instead of butchering constitutional limitations on state taxation of foreign trustees, whether testamentary or inter vivos, states should merely review and revise their own rules on taxation of grantors, trustees, and beneficiaries.

He then observed that:[269]

> Gavin is a badly flawed ruling which, in most respects, has no precedent whatsoever. It was founded on state desperation for revenues and local politics, reflecting the tax adage "Don't tax you, don't tax me, tax the fella behind the tree." In Gavin, the "you" and the "me" are Connecticut resident settlors and beneficiaries, and the "fella behind the tree" is a nonresident trustee.

Nevertheless, Gavin is the law in Connecticut.

c. Inter Vivos Trust Created by Resident

(1) Supreme Court Cases

The two United States Supreme Court cases cited in III, E, 3, b, above, are relevant here as well.

(2) State Court Cases

The following state court decisions involve the constitutionality of taxing trusts on this basis.

(a) In Mercantile-Safe Deposit and Trust Company v. Murphy,[270] a New York intermediate appellate

[269] Id. at 53–54.

[270] Mercantile-Safe Deposit & Trust Co. v. Murphy, 19 A.D.2d 765 (3d Dep't 1963), aff'd, 15 N.Y.2d 579 (1964).

court addressed whether New York could tax the accumulated income of an inter vivos trust that had a resident current discretionary beneficiary. In holding that it could not, the court said:[271]

> It is conceded that the trustee is domiciled in the State of Maryland, that the trust is administered there and that the intangibles constituting its corpus have been at all times in its exclusive possession and control in that State. Although this trust must be deemed a resident trust by statutory definition the related statutes which impose a tax upon its accrued income undertake in the circumstances disclosed here to extend the taxing power of the State to property wholly beyond its jurisdiction and thus conflict with the due process clause of the Fourteenth Amendment of the Federal Constitution. We find no merit either in the continuing jurisdiction theory advanced by defendants or in their thesis that since the resident beneficiaries of the trust could be taxed on income distributed the nonresident trustee can be taxed on income accumulated.

Mercantile stands for the proposition that a state may not tax an inter vivos trust created by a resident simply because the trust has a resident current contingent beneficiary.

(b) In Potter v. Taxation Division Director,[272] the New Jersey Tax Court described its task as follows:[273]

[271] Id. at 765–66 (citations omitted).

[272] Potter v. Taxation Div. Dir., 5 N.J. Tax 399 (1983).

[273] Id. at 401 (citation omitted).

> Taxpayer trustee contests a deficiency tax assessment for the fiscal year ended February 29, 1980, imposed by the Director of the Division of Taxation under the New Jersey Gross Income Tax Act. The assessment was imposed on the undistributed income of an irrevocable inter vivos trust created by a New Jersey domiciliary. The trustee, beneficiaries and assets are all located outside New Jersey.

The court rejected New Jersey's ability to tax the trust for the following reasons:[274]

> Any benefit to the trust from the laws of the State of New Jersey relative to the distribution of assets from the estate to the trust can be accounted for in terms of the inheritance tax paid to the State of New Jersey on the assets distributed and transferred to the trust. The facts of this case indicate that the irrevocable inter vivos trust has a situs in New York, not New Jersey. The fact that contingent beneficiaries reside in New Jersey does not alter this conclusion. These beneficiaries are taxable on trust income distributed to them or on undistributed income over which they have control. The state in which a beneficiary is domiciled may tax trust income distributed to the beneficiary. The fact that

[274] Id. at 405 (citation omitted).

> contingent beneficiaries are domiciled in New Jersey does not constitute a contact sufficient to empower New Jersey to tax undistributed trust income where the contingent beneficiaries have no right to the undistributed trust income.

Hence, Potter stands for the same proposition as Mercantile.

(c) In Blue v. Department of Treasury,[275] the Michigan Court of Appeals considered whether Michigan could tax the income of an inter vivos trust created by a resident. In concluding that imposition of Michigan tax in the circumstances would violate the Due Process Clause of the Fourteenth Amendment, the court said:[276]

> We hold that there are insufficient connections between the trust and the State of Michigan to justify the imposition of an income tax. We choose to follow the cases in Missouri and New York restricting the state's power to impose tax on resident trusts where neither the trustee nor the trust property are within the state. We conclude that there is no ongoing protection or benefit to the trust. All of the income-producing trust property is located in Florida while the only trust property in Michigan is nonincome-producing. Both the income beneficiary of the trust and the trustee are domiciled in Florida. Most importantly, the

[275] Blue v. Department of Treasury, 185 Mich. App. 406 (1990).

[276] Id. at 410–11.

> trust is administered and registered in Florida. We are unpersuaded by defendant's arguments that the fact that the trust is defined as a resident trust imparts legal protections and jurisdiction. We find that these protections are illusory considering that the trust is registered and administered in Florida. The state cannot create hypothetical legal protections through a classification scheme whose validity is constitutionally suspect and attempt to support the constitutionality of the statute by these hypothetical legal protections.

Notably, the court held that Michigan could not tax the trust even though the trust held Michigan real property.

(d) District of Columbia v. Chase Manhattan Bank,[277] summarized in b above, dealt exclusively with the income taxation of a trust, created by the Will of a District of Columbia decedent, that had no trustees, beneficiaries, or assets in the District. Nevertheless, the case sometimes is cited erroneously to support the taxation of an inter vivos trust in the same circumstances. But, the court was careful to note that it might not have upheld the District's right to tax an inter vivos trust as follows:[278]

> We express no opinion as to the constitutionality of taxing the entire net income of inter vivos trusts based solely on the fact that the settlor was domiciled in the District when she died and the trust therefore

[277] District of Columbia v. Chase Manhattan Bank, 689 A.2d 539 (D.C. 1997).

[278] Id. at 547 n.11.

> became irrevocable. In such cases, the nexus between the trust and the District is arguably more attenuated, since the trust was not created by probate of the decedent's will in the District's courts. An irrevocable inter vivos trust does not owe its existence to the laws and courts of the District in the same way that the testamentary trust at issue in the present case does, and thus it does not have the same permanent tie to the District. In some cases the District courts may not even have principal supervisory authority over such an inter vivos trust. The idea of fundamental fairness, which undergirds our due process analysis, therefore may or may not compel a different result in an inter vivos trust context.

(e) In Chase Manhattan Bank v. Gavin,[279] mentioned in b above, the Connecticut Supreme Court also denied the trustees' request on constitutional grounds for Connecticut income-tax refunds in an inter vivos trust that had a current resident noncontigent beneficiary. The court held as follows:[280]

> The taxability of the income of the inter vivos trust in this case is based on the fact that the settlor of the trust was a Connecticut domiciliary when the trust was established and the beneficiary is a Connecticut domiciliary. The plaintiff claims that this taxation

[279] Chase Manhattan Bank v. Gavin, 249 Conn. 172 (1999).

[280] Id. at 183.

> scheme, as applied to it, violates the due process clause and the commerce clause of the federal constitution. We consider the plaintiff's contentions in turn. We conclude that none of them is persuasive.

As shown above, Gavin's constitutional analysis has been roundly criticized.

(f) In Frances M. Rosen Irrevocable Trust v. State ex rel. Oklahoma Tax Commission,[281] the Court of Civil Appeals affirmed a decision of the Tax Commission that denied the trustee of an irrevocable trust refunds of Oklahoma fiduciary income taxes for 1994, 1995, and 1996. Although the trustor lived in Oklahoma when she created the trust in 1990, she and the trustee had moved to Nevada by 1994. The court did not consider the constitutional aspects of the matter.

d. Trust Administered in State

(1) Supreme Court Cases

There are no relevant United States Supreme Court cases.

(2) State Court Cases

The following Wisconsin cases considered this issue.

(a) In Wisconsin Department of Taxation v. Pabst,[282] the Supreme Court of Wisconsin held that Wisconsin could not tax a trust because the administration did not occur in the state. The court justified its conclusion as follows:[283]

> To administer the trusts involved would be to manage, direct, or superintend the

[281] Frances M. Rosen Irrevocable Trust v. State ex rel. Okla. Tax Comm'n, 2001 OK Civ. App. 114 (2001).

[282] Wisconsin Dep't of Taxation v. Pabst, 15 Wis. 2d 195 (1961).

[283] Id. at 202.

> affairs of these trusts. Weber [a Wisconsin resident] did not perform these functions. The policy decisions were made by the nonresident trustees. Weber implemented those policy determinations. The trustees decided whether to distribute the income, whether to seek investment advice, and whether ministerial duties should be delegated to someone other than themselves. Ministerial acts performed in Wisconsin included an annual audit made by a Milwaukee certified public accountant and the filing of federal tax returns in the Milwaukee office of the internal revenue department. The activities carried on in Wisconsin were only incidental to the duties of the trustees.

(b) In Pabst v. Wisconsin Department of Taxation,[284] the same court held that Wisconsin could tax a different Pabst family trust because administration did occur in the state. At the outset, the court indicated a change of approach regarding income taxation in Wisconsin:[285]

> The key word of the statute, insofar as this appeal is concerned, is 'administered.' In Wisconsin Department of Taxation v. Pabst, we had before us the application of this same statute to two other trusts created by the settlor Ida C. Pabst. The decision cited the definition of 'administer' in Webster's Third New

[284] Pabst v. Wisconsin Dep't of Taxation, 19 Wis. 2d 313 (1963).

[285] Id. at 321 (citation omitted).

> International Dictionary which stressed the element of managing, directing, or superintending affairs.
>
> Nevertheless, upon further consideration we now conclude that the statutory word 'administered' as applied to an inter vivos trust of intangibles means simply conducting the business of the trust. The problem of determining whether such a trust is administered in Wisconsin may be made more difficult when the business of the trust is partly conducted in other states as well as in Wisconsin. In such a situation, a proper application of the statute would appear to require the conclusion that the trust is being administered in Wisconsin within the meaning of the statute if the major portion of the trust business is conducted in Wisconsin.

The court concluded:[286]

> In the instant case Wisconsin has extended the protection of its laws to the activities of Weber in carrying on the business of the trust at the office of Pabst Farms, Inc. Although no rent was paid by the trust for the use of such office, we deem this an entirely fortuitous circumstance. The only office that the trust had was maintained in Wisconsin and the major portion of the

[286] Id. at 329.

> trust's business was transacted here during the period in question. We are satisfied there was a sufficient nexus with Wisconsin to permit it to impose the income taxes which it did, and we so hold.

e. Resident Trustee

(1) Supreme Court Cases

In Greenough v. Tax Assessor of Newport,[287] the United States Supreme Court held that Rhode Island's ad valorem tax on an out-of-state trust with a Rhode Island cotrustee did not violate the Due Process Clause.

(2) State Court Cases and Ruling

The following state cases and ruling addressed this issue.

(a) In Harrison v. Commissioner of Corporations and Taxation,[288] discussed in b above, the Supreme Judicial Court of Massachusetts also considered the trustees' request for an abatement of Massachusetts income tax on gains incurred by a trust created by the Will of a resident of the District of Columbia. In holding that the Commonwealth could not tax the entire gain, the court observed that:[289]

> The jurisdiction to tax rests solely on the fact that one of three trustees was resident in this Commonwealth. We are of opinion that this fact will not support a tax upon the entire gain to the trust.

[287] Greenough v. Tax Assessor of Newport, 331 U.S. 486 (1947).

[288] Harrison v. Comr. of Corps. & Taxation, 272 Mass. 422 (1930).

[289] Id. at 430.

The court then rejected the Commonwealth's contention that a proportionate amount of the gain was taxable as follows:[290]

> The defendant argues upon this aspect of the case that if the tax is bad to the extent that the nonresident trustees had an undivided part interest, then it is valid upon the proportion of the income attributable to the resident trustee. This contention cannot be supported. Manifestly that situation was not before the mind of the Legislature in enacting § 10.

(b) In McCulloch v. Franchise Tax Board,[291] the Supreme Court of California held that California could tax a beneficiary on accumulated income distributed to him from a Missouri trust because a cotrustee was a California resident. The court said:[292]

> We conclude that California could constitutionally tax plaintiff as the resident beneficiary upon the accumulated income when it was distributed to him. But plaintiff in the instant case was simultaneously beneficiary and a trustee. No possible doubt attaches to California's constitutional power to tax plaintiff as a trustee. His secondary role as a trustee reinforces the independent basis of taxing plaintiff as beneficiary.

[290] Id. at 431.

[291] McCulloch v. Franchise Tax Board, 61 Cal. 2d 186 (1964).

[292] Id. at 198.

(c) In P.D. 97-121,[293] the Virginia Department of Taxation ruled that the trustee's residence in the Commonwealth was sufficient, by itself, to justify imposition of Virginia's income tax, even though the trusts in question were not created by Virginians and were not being administered in Virginia.

f. Resident Beneficiary

(1) Supreme Court Cases

There are no pertinent United States Supreme Court cases.

(2) State Court Cases

The following California cases considered this issue.

(a) In McCulloch v. Franchise Tax Board,[294] the Supreme Court of California held that California could tax a California resident beneficiary on accumulated income distributed to him from a Missouri trust for the reason just quoted.[295]

(b) In In the Matter of the Appeal of The First National Bank of Chicago, Trustee for Virginia Kirk Cord Trust, et al.,[296] the California State Board of Equalization ruled that California could tax six trusts being administered in Illinois because all beneficiaries were California residents. It said:[297]

> Appellant also urges that section 17742 (formerly 18102) is unconstitutional if it purports to tax the non-California income of a foreign trust which is administered by a

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[293] P.D. 97-121, 1997 Va. Tax Lexis 122 (Va. Dept. Tax 1997).

[294] McCulloch, 61 Cal. 2d at 186.

[295] Id. at 198.

[296] In the Matter of the Appeal of The First National Bank of Chicago, Trustee for Virginia Kirk Cord Trust, et al., 1964 Cal. Tax Lexis 39 (Cal. State Bd. Equalization 1964), available at www.boe.ca.gov/legal/pdf/64-sbe-054.pdf.

[297] Id. at 6–7 (citation omitted).

nonresident trustee. This argument has been fully answered by the California Supreme Court in McCulloch v. Franchise Tax Board, wherein the court held that California could constitutionally tax a Missouri trust on income which was payable in the future to a beneficiary residing in this state, although such income was actually retained by the trust. The fact that the resident beneficiary was also one of the trust's three trustees was not relied upon by the court in holding that the residence of the beneficiary afforded a constitutionally sufficient connection to bring the trust's income within California's tax jurisdiction.

(c) In In the Matter of the Appeal of C. Pardee Erdman,[298] the California State Board of Equalization, following McCulloch and Cord, ruled that California could require California resident remainder beneficiaries to pay California tax on accumulated income and capital gains that had not previously been paid by the trustee of two trusts being administered in Illinois.

4. Specific State Considerations

a. New York

In 2011, the top rate for a nongrantor trust that is a resident of New York State but not of New York City is 8.97% on income over $500,000.[299] If a trust resides in New York City, it also is subject to New York City tax at a rate of up to 3.876% on income

[298] In the Matter of the Appeal of C. Pardee Erdman, 1970 Cal. Tax Lexis 50 (Cal. State Bd. Equalization 1970), available at www.boe.ca.gov/legal/pdf/70-sbe-0007.pdf.

[299] N.Y. Tax Law § 601(c)(1).

over $500,000.[300] Hence, a New York City resident trust is taxable at a rate of up to 12.846%.

The New York tax law defines "resident trust" as:[301]

> (B) a trust, or a portion of a trust, consisting of property transferred by will of a decedent who at his death was domiciled in this state, or
>
> (C) a trust, or portion of a trust, consisting of the property of:
>
> (i) a person domiciled in this state at the time such property was transferred to the trust, if such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable; or
>
> (ii) a person domiciled in this state at the time such trust, or portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

But, the following provision was added in 2003 to read in relevant part as follows:[302]

> (D)(i) Provided, however, a resident trust is not subject to tax under this article if all of the following conditions are satisfied:
>
> (I) all the trustees are domiciled in a state other than New York;
>
> (II) the entire corpus of the trusts, including real and tangible property, is located outside the state of New York; and

[300] N.Y. Tax Law §§ 1301(a), 1304(a)(3). See TSB-M-10(7)I (Aug. 17, 2010), available at www.tax.ny.gov/pdf/memos/income/m10_7i.pdf.

[301] N.Y. Tax Law § 605(b)(3)(B)–(C).

[302] Id. § 605(b)(3)(D).

(III) all income and gains of the trust are derived from or connected with sources outside of the state of New York, determined as if the trust were a non-resident trust.

(ii) For purposes of item (II) of clause (i) of this subparagraph, intangible property shall be located in this state if one or more of the trustees are domiciled in the state of New York.

The above provision codifies the holdings of the Taylor and Murphy cases cited above, which later were implemented by administrative regulations.

Commentators succinctly summarize the reach of the New York fiduciary income tax as follows:[303]

> Essentially, New York will not tax a trust that has no New York trustees, no New York assets, and no New York source income.

Part G of 2009 N.Y. S.B. 6610,[304] which contained Governor Paterson's 2010–2011 budget proposals, would have adopted a revised taxation scheme. Specifically, it would have repealed above-quoted N.Y. Tax Law § 605(b)(3)(D)—the provision that codified the Mercantile and Taylor holdings.[305] It also would have amended N.Y. Tax Law § 618 to tax all income of inter vivos trusts that had any New York source income[306] and to tax the income of inter vivos trusts based on the proportion of resident ascertainable beneficiaries.[307] The proposed changes would have taken effect immediately and would have applied to

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[303] Philip J. Michaels & Laura M. Twomey, How, Why, and When to Transfer the Situs of a Trust, 31 Est. Plan. 28, 29 (Jan. 2004). See TSB-A-10(4)I, 2010 N.Y. Tax Lexis 196 (June 8, 2010), available at www.tax.ny.gov/pdf/advisory_opinions/income/a10_4i.pdf. See also Alvina H. Lo, Income Taxation of Trusts in New York and Connecticut—There Are Solutions, 35 Tax Mgmt. Est., Gifts & Tr. J. 126 (Mar. 11, 2010).

[304] 2009 N.Y. S.B. 6610, Part G. See Richard B. Covey & Dan T. Hastings, State Taxation of Trust Income; New York Law; Proposed Changes, Prac. Drafting 10035–38 (Apr. 2010).

[305] Id. § 1.

[306] Id. § 2.

[307] Id. § 3.

tax years beginning on or after January 1, 2010.[308] It appears that they would have applied to trusts designed initially or later modified to avoid tax under the current rules.

It should be noted that the proposed changes would have adopted provisions that Mercantile and Taylor found to be unconstitutional. Hence, even if the proposals had become law, the taxation of trust income by New York would have been unconstitutional in many instances.[309]

The Paterson proposals were not enacted. But, later in 2010, the New York State Department of Taxation and Finance announced that, beginning in 2010, a trustee must file a tax return even if no tax is due because the trust has no New York fiduciary, assets, or source income,[310] and, in 2011, that agency announced that this filing requirement applies to the trustee of a trust that was not required to file a return prior to 2010.[311] I suspect that the new requirement is intended to gather information on trusts that are not currently paying tax with the hope that they can be taxed in the future. Given that no tax is payable on which penalties can be assessed, I wonder what the downside of not filing would be.

The New York State Department of Taxation provided guidance in 2003 on whether or not the donee of a power of appointment is the "transferor" to the appointive trust for New York income-tax purposes.[312] It concluded that:[313]

> [T]he residency of an appointive trust created by the exercise of a power of appointment is determined based on the domicile of the donor of the property who transferred the property to the trust. A person who transfers property held in trust to an appointive trust by the exercise of a

[308] Id. § 4.

[309] See Richard W. Nenno & Howard M. Zaritsky, Proposed New York Fiduciary Income Tax Changes: Let My Trustees Go!, 35 Tax Mgmt. Est., Gifts & Tr. J. 147 (May 13, 2010).

[310] TSB-M-10(5)I (July 23, 2010), available at www.tax.ny.gov/pdf/memos/income/m10_5i.pdf.

[311] TSB-A-11(4)I, 2011 N.Y. Tax Lexis 181 (July 27, 2011), available at www.tax.ny.gov/pdf/advisory_opinions/income/a11_4i.pdf.

[312] TSB-A-03(6)I, 2003 N.Y. Tax Lexis 313 (Nov. 21, 2003), available at www.tax.ny.gov/pdf/advisory_opinions/income/a03_6i.pdf. Accord Conn. Dep't of Revenue Servs. Ruling 2005-2, 2005 Conn. Tax lexis 15 (Jan. 14, 2005), available at www.ct. gov/drs/cwp/view.asp?a=1513&q=289024.

[313] Id. (citation omitted).

> general power of appointment over the trust property is considered the donor of the trust property for purposes of determining the residency of the appointive trust. Conversely, a person who transfers property held in trust to an appointive trust by the exercise of a special power of appointment over the trust property is not considered the donor of the trust property for purposes of determining the residency of the appointive trust. The donor of the special power of appointment is considered the donor of the trust property for purposes of determining the residency of the appointive trust.

In 2004, that agency issued guidance that indicated that an adviser or committee that directs the trustee on investment, distribution, or other matters or that has a veto power over the trustees actions will be treated as a cotrustee.[314] Accordingly, a trust might be subject to New York tax if such an adviser or committee member lives in New York even if the trustee and all trust property are outside the state.

A 2010 decision of the New York Division of Tax Appeals illustrates the importance of paying attention to detail in this context.[315] In 1992, the trustor, who resided in New York City, created an irrevocable nongrantor trust in which he named his attorney, also a New York resident, as trustee. The trust initially was subject to New York State and City income tax because of the trustor's and the trustee's New York City residence. In 1995, the trustee moved to Florida, but continued to file tax returns using his law firm's New York City address and to pay State and City tax. Subsequently, it was discovered that the trustee should have ceased paying tax upon his move to Florida. The New York Division of Taxation granted refunds for the open years—2001–2003, but the administrative law judge upheld the Division of Taxation's refusal to pay refunds for the closed years—1996–2000.[316] The amount of tax in question was not discussed.

b. New Jersey

[314] TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 (Nov. 12, 2004), available at www.tax.ny.gov/pdf/advisory_opinions/income/a04_7i.pdf.

[315] Matter of Joseph Lee Rice III Family 1992 Trust, DTA No. 822892, 2010 N.Y. Tax Lexis 268 (N.Y. Div. Tax App. 2010), available at www.nysdta.org/Determinations/822892.det.pdf.

[316] See NY Tax Law § 697(d).

New Jersey follows New York's current approach. Thus, New Jersey defines resident trust as follows:[317]

> A resident . . . trust means: . . .
> (2) A trust, or a portion of a trust, consisting of property transferred by will of a decedent who at his death was domiciled in this State, or
> (3) A trust, or portion of a trust, consisting of the property of:
>
> (a) A person domiciled in this State at the time such property was transferred to the trust, if such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable; or
>
> (b) A person domiciled in this State at the time such trust, or portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

The top rate for a New Jersey resident trust in 2011 is 8.97% on income over $500,000.[318]

The instructions for the 2010 New Jersey Gross Income Tax Fiduciary Return provide in relevant part as follows:[319]

> If a resident trust . . . does not have any assets in New Jersey or income from New Jersey sources, and does not have any trustees . . . in New Jersey, it is not subject to New Jersey tax. However, a New Jersey Gross Income Tax Fiduciary Return should be filed with a statement attached certifying the trust's . . . exempt status.

c. <u>Connecticut</u>

Connecticut taxes the income of the following types of resident

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[317] NJSA § 54A:1-2(o).

[318] <u>Id.</u> § 54A:2-1(b)(5).

[319] 2010 Form NJ-1041 at 1.

trusts:[320]

> (C) a trust, or a portion of a trust, consisting of property transferred by will of a decedent who at the time of his death was a resident of this state, and (D) a trust, or a portion of a trust, consisting of the property of (i) a person who was a resident of this state at the time the property was transferred to the trust if the trust was then irrevocable, (ii) a person who, if the trust was revocable at the time the property was transferred to the trust, and has not subsequently become irrevocable, was a resident of this state at the time the property was transferred to the trust or (iii) a person who, if the trust was revocable when the property was transferred to the trust but the trust has subsequently become irrevocable, was a resident of this state at the time the trust became irrevocable.

For inter vivos trusts, the statute apportions the tax based on the number of resident and nonresident noncontigent beneficiaries.[321] In 2011, the tax rate is 6.70%.[322] In the Gavin case discussed in 3, b, and 3, c, above, the Connecticut Supreme Court confirmed that the state could tax a testamentary trust solely because the testator was a resident at death and that it could tax an inter vivos trust created by a resident if the trust had a noncontingent resident beneficiary.

d. Illinois

In 2011, Illinois taxes the income of nongrantor trusts at a rate of 6.50%.[323] Also following the New York pattern, Illinois defines "resident trust" as follows:[324]

> (C) A trust created by a will of a decedent who at his death was domiciled in this State;

[320] Conn. Gen. Stat. § 12-701(a)(4)(C), (D). See Alvina H. Lo, Income Taxation of Trusts in New York and Connecticut—There Are Solutions, 35 Tax Mgmt. Est., Gifts & Tr. J. 126, 129 (Mar. 11, 2010).

[321] Id. § 12-701(a)(4).

[322] Id. § 12-700(a)(8)(E).

[323] 35 Ill. Comp. Stat. 5/201(a), (b)(5), (d). See Ill. Dept. of Revenue Informational Bulletin FY 2011-09, 2011 Ill. Tax Bull. Lexis 4 (Feb. 2011), available at www.revenue.state.il.us/Publications/Bulletins/2011/FY-2011-09.pdf.

[324] Id. 5/1501(a)(20)(C)–(D).

> and
>
> (D) An irrevocable trust, the grantor of which was domiciled in this State at the time such trust became irrevocable. For purpose of this subparagraph, a trust shall be considered irrevocable to the extent that the grantor is not treated as the owner thereof under Sections 671 through 678 of the Internal Revenue Code.

There is no pertinent caselaw, but commentators have observed that:[325]

> What if Client Smith resided in a Resident Trust state such as Illinois or Pennsylvania that has not ruled on the constitutionality of its state's taxation statute? Because Safe-Deposit has not been overruled, one could reasonably take the position that the Smith Trust is not subject to tax under the insufficient contacts analysis employed in the Mercantile line of cases.

e. California

Under California's sui generis system, a resident trust is taxed in 2011 at a rate of up to 10.30% on income over $1 million[326] on two bases:[327]

> The tax applies to the entire taxable income . . . of a trust, if the fiduciary or beneficiary (other than a beneficiary whose interest in such trust is contingent) is a resident, regardless of the residence of the settlor.

Rules are provided for determining the residence of a corporate fiduciary[328] and for other purposes.[329]

[325] Philip J. Michaels & Laura M. Twomey, How, Why, and When to Transfer the Situs of a Trust, 31 Est. Plan. 28, 30–31 (Jan. 2004) (footnotes omitted).

[326] Cal. Rev. & Tax. Code §§ 17041(a), (e), (h), 17043(a). See Edward J. McCaffery, Alan T. Yoshitake, Keith A. Davidson, The Advantages of Creating Out-of-State Trusts, 28 L.A. Law. 19 (Sept. 2005).

[327] Id. § 17742(a). See id. §§ 17743–17744.

[328] Id. § 17742(b).

[329] Id. § 17745.

Even if a Californian is receiving current income distributions from a trust that has a non-California trustee, the trustee should be able to defer or avoid California taxation of accumulated ordinary income and capital gains if distribution of such income and gains is within the trustee's discretion. In this connection, in a 2006 Technical Advice Memorandum, [330] the California Franchise Tax Board ruled that:

(1) A resident beneficiary of a discretionary trust has a noncontingent interest in the trust only as of the time, and to the extent of the amount of income, that the trustee actually decides to distribute;

(2) Accumulated income is taxable to a trust when it is distributed or distributable to a resident beneficiary; and

(3) The conclusion in (1) above is unaffected if the trustee may or does distribute principal (capital gains) to the current beneficiary.[331]

The California Franchise Tax Board may enter into voluntary disclosure agreements with certain trusts and nonresident beneficiaries.[332] A trustee or beneficiary might want to take advantage of this procedure, for example, because a trust that had not been subject to California income tax now must pay such tax due to the move of a trustee or beneficiary to California.

f. Virginia

Virginia follows the federal grantor-trust rules.[333] In 2011, the trustee of a Virginia resident trust is taxed on accumulated ordinary income and capital gains at a rate of up to 5.75%.[334] In Virginia, "resident trust" is defined as follows:[335]

> 2. A trust created by will of a decedent who at his death was domiciled in the

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[330] Cal. Franchise Tax Board Technical Advice Memorandum 2006-0002, 2006 Cal. FTB Tam Lexis 14 (Feb. 17, 2006), available at www.ftb.ca.gov/law/Technical_Advice_Memorandums/2006/20060002.pdf.

[331] Id.

[332] Cal. Rev. & Tax. Code §§ 19191–19192.

[333] Va. Code Ann. § 58.1-322.

[334] Id. §§ 58.1-320, 58.1-360; Instructions to 2010 Va. Form 770 at 1.

[335] Id. § 58.1-302. See 23 Va. Admin. Code § 10-115-10.

Commonwealth;

3. A trust created by or consisting of property of a person domiciled in the Commonwealth; or
4. A trust . . . which is being administered in the Commonwealth.

The Virginia Department of Taxation has ruled that an individual trustee's residence in Virginia justifies taxation by Virginia[336] but that an inter vivos trust or a testamentary trust is not subject to tax if it has no Virginia trustee, assets, or beneficiaries.[337]

g. Delaware

A trust is a resident trust in Delaware if it was created by the Will of a Delaware resident or by an inter vivos instrument created by such a resident or if the trust has a resident trustee.[338] The top 2011 rate is 6.95% on income over $60,000.[339] Significantly, though, the trustee of a Delaware resident trust may deduct income (including capital gains) set aside for future distribution to nonresident beneficiaries.[340] In calculating comparable deductions, some states deem all unknown or unascertained beneficiaries to be residents,[341] but Delaware makes this determination based on the residences of relevant existing beneficiaries on the last day of the tax year.[342] Because Delaware has a small population, few Delaware resident trusts pay Delaware income tax.

5. Planning, Ethical, and Other Issues

a. Introduction

The state fiduciary income-tax implications of a trust should be

[336] Va. Rulings of the Tax Comm'r 97-121, 1997 Va. Tax Lexis 122 (Mar. 7, 1997), available at www.policylibrary.tax.virginia.gov/OTP/Policy.nsf.

[337] Va. Rulings of the Tax Comm'r 93-189, 1993 Va. Tax Lexis 187 (Aug. 26, 1993), available at www.policylibrary.tax.virginia.gov/OTP/Policy.nsf. (inter vivos trust); Va. Rulings of the Tax Comm'r 99-110, 1999 Va. Tax Lexis 109 (May 13, 1999), available at www.policylibrary.tax.virginia.gov/OTP/Policy.nsf (testamentary trust).

[338] 30 Del. C. § 1601(8).

[339] Id. § 1102(a)(12).

[340] Id. § 1636.

[341] See, e.g., Mass. Gen. Laws ch. 62, § 10(a).

[342] 30 Del. C. § 1636(b).

considered in the planning stage because it is much easier not to pay a tax in the first place than to obtain a refund. In planning to avoid one state's tax, the attorney must make sure that the trust will not be taxed in one or more other states.

b. Trust Created by Will of Resident

As a general rule, a client will have a better chance of avoiding state income tax by creating and funding a revocable trust in another state during life than by creating trusts in his or her Will. This is because the cases summarized in 3, b, and 3, c, above, show that courts are less likely to tax inter vivos trusts than testamentary trusts. Even in New York and New Jersey, where a testamentary trust can avoid tax by having no fiduciary, assets, or source income in the state, the inter vivos trust might be the preferred vehicle because it will escape the income tax that otherwise would be payable by the probate estate.

Regardless of the above, clients will create testamentary trusts. In 2, c, above, I listed 16 states that tax a trust solely because the testator lived in the state at death. Although the highest courts in two of these jurisdictions—the District of Columbia and Connecticut—have upheld the state's ability to tax on this basis, the constitutionality of the imposition of the tax might be subject to attack in another state.

In New York and New Jersey, the rules for avoiding tax are clear and should be followed strictly. In Idaho, Iowa, and Montana, where the testator's residence is one of several factors that determine taxability, the attorney should arrange other factors to avoid tax. Delaware, Missouri, and Rhode Island tax a testamentary trust that has at least one resident beneficiary. If the applicable tax law does not apportion tax based on the number of resident and nonresident beneficiaries, the client might create multiple trusts to free the income attributable to assets held for nonresident beneficiaries from tax.

Because Alabama, Arkansas, and Massachusetts might tax a testamentary trust that has a resident fiduciary, tax may easily be avoided by appointing a nonresident fiduciary. In this connection, it is common practice for attorneys in Boston law firms to serve as trustees of trusts created by Massachusetts residents. In such a case, the attorney should discuss the appointment and its implications with the client because such an appointment often will cause the trust's accumulated income and capital gains to be subject to Massachusetts income tax (usually at 5.30%)[343] that could be avoided by appointing a non-Massachusetts trustee.[344] Utah tax usually may be avoided by appointing a Utah corporate trustee.

The courts that sustained a state's right to tax a testamentary trust solely because of the testator's residence did so because of ongoing benefits available to the trust through that state's judicial system. In the District of Columbia, Connecticut, and other states, a trust might escape taxation if the Will designates the law of another state to govern the trust and gives the courts of that other state exclusive jurisdiction over the trust. The Will also might direct the trustee to initiate a proceeding to have the court of the other state accept jurisdiction.

A state that taxes on this basis is a good place for a resident of another state to create a trust.

c. Inter Vivos Trust Created by Resident

In 2, d, above, I listed 12 states that tax a trust solely because the trustor lived in the state. None of the cases summarized in 3, c, above, held that a state could tax solely on this basis. Although the Gavin case in Connecticut held that taxation was constitutional if a trust has a resident noncontingent beneficiary, the Mercantile case in New York held that the state could not tax a trust that had a resident current discretionary beneficiary and the Blue case in Michigan held that the state could not tax a trust that held unproductive Michigan real estate.

With proper planning, the attorney easily can avoid taxation by New York and New Jersey in many situations. In Idaho and Montana, the attorney often may manipulate other factors to avoid taxation. In Alabama, Connecticut, Delaware, Massachusetts, Michigan, Missouri, Ohio, and Rhode Island, the attorney should make sure that portions of trusts attributable to nonresident beneficiaries are not taxed needlessly. The attorney should avoid appointing resident fiduciaries in Alabama, Arkansas, and Massachusetts.

As with a testamentary trust, the attorney might increase a trust's ability to escape tax by designating in the governing instrument

[343] Mass. Gen. Laws ch. 62, § 4.

[344] Id. § 10(c).

that the law of another state will govern the trust and that the courts of that state will have exclusive jurisdiction over it.

Residents of other states should consider creating trusts in states that tax on the basis of the trustor's residence.

d. Trust Administered in State

An attorney should think long and hard before having a client create a trust in one of the 14 states listed in 2, e, above—Colorado, Georgia, Indiana, Kansas, Louisiana (inter vivos trusts unless trust designates law of another state), Maryland, Minnesota (trust created or first administered in state before 1996), Mississippi, New Mexico, North Dakota, Oregon, South Carolina, Virginia, and Wisconsin (inter vivos trusts created or first administered in state before October 29, 1999)—that tax a trust solely because it is administered in the state. This is a factor that can be managed to avoid taxation by Idaho, Iowa, and Montana, which tax based on several factors. Taxation can be avoided in Hawaii even if the trust has a resident beneficiary. Utah tax generally may be escaped by involving a Utah corporate trustee. In any event, the attorney should ensure that all administration occurs outside the state in question.

e. Resident Trustee

A trust can avoid taxation by the eight states listed in 2, f, above—Arizona, California, Georgia, Kentucky, New Mexico, North Dakota, Oregon, and Virginia— if it does not have a resident fiduciary. This factor may be managed to avoid taxation by Idaho, Iowa, and Montana. The attorney must be mindful of this factor if a trust has resident beneficiaries in Delaware, Hawaii, and New Hampshire.

f. Resident Beneficiary

The five states listed in 2, g, above, tax a trust solely because it has resident beneficiaries. The attorney should ensure that income on assets attributable to nonresident beneficiaries won't be taxed unnecessarily. He or she also should make sure that tax on accumulated income and capital gains that might ultimately be distributed to nonresident beneficiaries won't be taxed prematurely.

g. Filing Position

In some cases, it will be entirely clear whether a trust must pay a state's fiduciary income tax, while, in others, taxability will not be so evident. In uncertain cases, the attorney might request a ruling from the state's taxation department if it has a procedure for issuing rulings. To minimize penalties and interest in unclear situations, the attorney might advise the trustee to file a timely return reporting that no tax is due and citing comparable cases from other jurisdictions. The attorney might also counsel the trustee to segregate funds to pay taxes, penalties, and interest if the filing position is unsuccessful. In any event, the attorney and trustee should take a no-tax position in an uncertain case only after advising the trustor and beneficiaries in writing of the proposed action.

I am not aware of a case in which the taxation department of one state has sued a trustee in a court in another state to collect tax allegedly due the first state. Nor am I aware of a reported case in which a trustee has been surcharged for failing to minimize income tax. But, I've heard that such cases are pending in New York State and believe that a successful surcharge case is inevitable.

In clear cases, my firm—Wilmington Trust—will take the position that state fiduciary income tax is not due. If the issue is uncertain, we will file a return and pay tax unless counsel in the relevant state provides a reasoned opinion advising us not to do so.

h. Self-Settled Trust Option

In several instances,[345] the IRS has ruled that an irrevocable self-settled trust was a nongrantor trust. This vehicle often is referred to as a Delaware incomplete nongrantor trust ("DING trust"). On the basis of these rulings, clients are avoiding California, Massachusetts, New Jersey, and New York income tax on accumulated income and capital gains. Such trustors might later be able to get discretionary distributions of the untaxed income. Although the IRS announced in July of 2007 that it was studying one aspect of the structure approved in the rulings (i.e., whether a member of a distribution committee has a general power of

[345] PLRs 200731019 (May 1, 2007), 200729025 (Apr. 10, 2007), 200715005 (Jan. 3, 2007), 200647001 (Aug. 7, 2006), 200637025 (June 5, 2006), 200612002 (Nov. 23, 2005), 200502014 (Sept. 17, 2004), 200247013 (Aug. 14, 2002), 200148028 (Aug. 27, 2001). See Thomas R. Pulsifer & Todd A. Flubacher, Eliminate a Trust's State Income Tax, 145 Tr. & Est. 30 (May 2006); Bruce D. Steiner, The Accidentally Perfect Non-Grantor Trust, 144 Tr. & Est. 28 (Sept. 2005).

appointment),[346] clients may continue to use this strategy while that study is ongoing by employing different approaches (e.g., by appointing a three-member distribution committee in which a member who ceases to act is not replaced). In addition, an IRS representative told me early in 2011 that the IRS again will consider private letter ruling requests in this area.

i. Source Income

The attorney should make sure that a small amount of source income will not cause a nonresident trust to be taxed as a resident trust.[347] For example, it appears from the statute quoted in 4, a, above, that this is the case in New York.

In this regard, effective May 7, 2009, New York State treats the gain incurred upon the sale of interests in certain entities that hold New York real property as source income.[348] Specifically, real property located in New York now includes an interest in an entity (i.e., a partnership, limited liability corporation, S corporation, or non-publicly traded C corporation with 100 or fewer shareholders) that owns real property in New York having a fair market value that equals or exceeds 50% of all the assets of the entity on the date of sale or exchange of the taxpayer's interest in the entity.[349] Only the assets that the entity owned for at least two years before the date of the sale or exchange of the taxpayer's interest in the entity are to be used in determining the fair market value of all the assets of the entity on the date of sale or exchange.[350] The gain or loss derived from New York sources from the taxpayer's sale or exchange of an interest in an entity that is subject to the provisions of the new law is the total gain or loss for federal income-tax purposes from that sale or exchange multiplied by a fraction, the numerator of which is the fair market value of the real property located in New York on the date of sale or exchange and the denominator of which is the fair market value of all the assets of the entity on the date of sale or exchange.[351] Shortly after the legislation was passed, the New York State

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[346] I.R. 2007-127, 2007 I.R.B. Lexis 589 (July 9, 2007).

[347] See Philip J. Michaels & Laura M. Twomey, How, Why, and When to Transfer the Situs of a Trust, 31 Est. Plan. 28, 29 (Jan. 2004).

[348] N.Y. Tax Law § 631(b)(1)(A)(1).

[349] Id.

[350] Id.

[351] Id.

Department of Taxation and Finance issued a technical services bulletin that illustrates the application of the new provision.[352]

New Jersey is less aggressive than New York regarding the taxation of source income. Hence, in 1994, a New Jersey intermediate appellate court granted New Jersey income tax refunds to twelve Florida trusts on gain recognized upon the liquidation of a corporation whose stock was owned by a partnership held by the trusts, even though the corporation owned several parcels of New Jersey real estate connected with business activity conducted in the state.[353] The court concluded that:[354]

> The disposition of the corporate stock here constitutes the nontaxable sale of the intangible asset.

In Minnesota, gain on the sale of a partnership interest is allocable to Minnesota in the ratio of the original cost of partnership tangible property in Minnesota to the original cost of partnership tangible property everywhere, determined at the time of the sale.[355]

j. Ethical Concerns

In some instances, it will be clear to the attorney that a trust will not be subject to state fiduciary income tax. In other situations, however, it will not be clear whether the tax of a given state applies to the trust or, if it does, whether imposition of the tax is constitutional in the circumstances. The ABA Committee on Ethics and Professional Responsibility has advised that:[356]

> [A] lawyer may advise reporting a position on a return even where the lawyer believes the position probably will not prevail, there is no "substantial authority" in support of the position, and there will be no disclosure of the

[352] TSB-M-09(5)I (May 5, 2009), available at www.tax.ny.gov/pdf/memos/income/m09_5i.pdf.

[353] Tina Schiller Trust for Benefit of Siegelbaum v. Director, Dept. of Treasury, Div. of Taxation for State of N.J., 14 N.J. Tax 173 (N.J. Super. Ct. App. Div. 1994). See Bruce Steiner, New York Will Tax Nonresidents on Gain on Sales of Interests in Real Estate Entities, Steve Leimberg's Estate Planning Email Newsltr. # 1458 (May 6, 2009), at www.leimbergservices.com.

[354] Id. at 181.

[355] See Minn. Stat. § 290.17(2)(c).

[356] ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 352 (1985). See Dennis J. Ventry, Jr., Lowering The Bar: ABA Formal Opinion 85-352, 112 Tax Notes 69 (July 3, 2006).

> position in the return. However, the position to be asserted must be one which the lawyer in good faith believes is warranted in existing law or can be supported by a good faith argument for an extension, modification or reversal of existing law. This requires that there is some realistic possibility of success if the matter is litigated. In addition, in his role as advisor, the lawyer should refer to potential penalties and other legal consequences should the client take the position advised.

F. Investment Return

All U.S. jurisdictions now follow the prudent-investor rule. As shown in Appendix F, nine states have a stand-alone statute and 42 states have enacted the 1994 Uniform Prudent Investor Act ("UPIA"),[357] which includes the following components:

1. In managing investments, a trustee must invest as a prudent person would in the circumstances;[358]

2. A trustee may acquire any type of investment, and each investment is considered as part of an overall investment strategy;[359]

3. The propriety of a particular investment is assessed on what the trustee knew or should have known when it made the investment, and any determination of liability must consider the performance of the whole portfolio not just the particular investment;[360] and

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[357] See Trent S. Kiziah, The Trustee's Duty to Diversify: An Examination of the Developing Case Law, 36 ACTEC L.J. 357 (Fall 2010); Stewart E. Sterk, Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine?, 95 Cornell L. Rev. 851 (July 2010); Melvin A. Warshaw, ILIT Trustees: Bridge Out Ahead. . . Lock in Your Navigation System Now, 24 Prob. & Prop. 32 (July/Aug. 2010); Max M. Schanzenbach & Robert H. Sitkoff, The Prudent Investor Rule and Trust Asset Allocation: An Empirical Analysis, 35 ACTEC J. 314 (Spring 2010); John H. Langbein, Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments, 90 B.U.L. Rev. 375, 385–96 (Feb. 2010); Edward A. Moses, J. Clay Singleton & Stewart A. Marshall, III, Measuring the Effectiveness of a Trust Portfolio's Diversification, 35 ACTEC J. 303 (Winter 2009); W. Curtis Elliot, Jr., & Briani L. Bennett, Closely Held Business Interests and the Trustee's Duty to Diversify, 148 Tr. & Est. 44 (Apr. 2009); Christopher P. Cline, The Uniform Prudent Investor and Principal and Income Acts: Changing the Trust Landscape, 42 Real Prop., Prob. & Tr. J. 611, 612–47 (Winter 2008); Andy Kirkpatrick, A Global Approach to Diversification, 22 Prob. & Prop. 45 (Mar./Apr. 2008); Max M. Schanzenbach & Robert H. Sitkoff, Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?, 50 J. Law & Econ. 681 (Nov. 2007); Lauren J. Wolven, Investment Concepts Every Estate Planner Should Know and Understand, 34 Est. Plan. 29 (Nov. 2007); Douglas Moore, Ajay Badlani & Edwin L. Ford, Trustees' Choice, 146 Tr. & Est. 38 (Oct. 2007).

[358] UPIA § 2(a) (1994).

[359] Id. §§ 2(e), 2(b).

[360] Id. §§ 8, 2(b).

4. The governing instrument may expand or restrict the trustee's investment responsibilities.[361]

Because so many states have enacted the UPIA, most state statutes are quite similar. But, some differences do exist. For example, Delaware law permits a trustee to consider beneficiaries' other trust interests and resources in establishing the investment policy for a trust and no longer requires it to determine such a policy for each trust without regard to other factors.[362]

G. Division of Responsibilities

1. Introduction

Clients sometimes want to appoint a corporate trustee for a trust but also want to have a cotrustee, adviser, committee, or protector (not the corporate trustee) control certain trust decisions.[363] For example, if a client funds an inter vivos trust with stock in the family company, he or she might want to continue to make decisions regarding the purchase, sale, and voting of such stock. Similarly, a family that has a long-standing relationship with a successful money manager might want that manager (not the corporate trustee) to make investment decisions for trust assets. In addition, a client might want someone other than the corporate trustee to decide when to make income or principal distributions to beneficiaries. A 2008 article observes that:[364]

> Despite the fact that there is no perfect solution to the question of trustee appointment and supervision, it is the author's opinion that the best course of action for our clients and their families is to appoint a single trustee—a trustee who is trained for the job—preferably a corporate institution, who will be responsible for all trust administration issues, and then appoint an advisor or a committee

[361] Id. § 1(b).

[362] 12 Del. C. § 3302(c).

[363] See David A. Diamond & Todd A. Flubacher, The Trustee's Role in Directed Trusts, 149 Tr. & Est. 24 (Dec. 2010); John P.C. Duncan & Anita M. Sarafa, Multi-Participant Trusts Need a Coordinator, 147 Tr. & Est. 32 (Nov. 2008); Sheldon G. Gilman, How and When to Use Trust Advisors Most Effectively, 35 Est. Plan. 30 (Feb. 2008); Richard W. Nenno, Directed Trusts: Can Directed Trustees Limit Their Liability?, 21 Prob. & Prop. 45 (Nov./Dec. 2007); Dennis I. Belcher, Not My Fault—The Devil Made Me Do It! Responsibilities and Duties of a Delegating or Directed Trustee, 41 U. Miami Inst. on Est. Plan. ¶ 1300 (2007); Al W. King, III, & Pierce H. McDowell, III, Delegated vs. Directed Trusts, 145 Tr. & Est. 26 (July 2006); Stewart E. Sterk, Trust Protectors, Agency Costs, and Fiduciary Duty, 27 Cardozo L. Rev. 2761 (Apr. 2006).

[364] Sheldon G. Gilman, Effective Use of Trust Advisors Can Avoid Trustee Problems, 35 Est. Plan. 18, 23 (Mar. 2008) (emphasis in original).

> of advisors who will provide the corporate fiduciary with the necessary insight into the clients' family members and will provide meaningful oversight of the trustee's administrative services.
>
> The combination of a corporate trustee with a competent group of advisors should produce the best results for clients' families. The approach combines the strength of the corporate trust department and the personal touch that we humans demand and expect. While the use of an advisory committee might not solve all the problems, the recommended action has substantial merit and should be thoroughly evaluated with clients.

In these situations, the client wants to minimize the corporate trustee's involvement in such decisions and wants such trustee to lower its fees to reflect its reduced duties.

Unfortunately, even if a trust ("directed trust") directs the corporate trustee to make investments or distributions on the direction of someone else ("directing person") and relieves it from liability for following such directions, such trustee might have considerable monitoring or other responsibilities under applicable state law. Thus, the corporate trustee might be in the unenviable position of being pressured to charge low fees while being subject to substantial potential liability.

For directed trusts, some states follow the approach of § 185 of the Second Restatement of Trusts,[365] other states follow § 808(b) of the UTC,[366] still other states have statutes that greatly limit a trustee's liability, and other states have no relevant statute. Appendix G contains citations for the foregoing statutes.

2. Restatement of Trusts Approach

Section 185 of the Second Restatement of Trusts provides as follows:[367]

> If under the terms of the trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in

[365] Restatement (Second) of Trusts § 185 (1959).

[366] UTC § 808(b) (2005).

[367] Restatement (Second) of Trusts § 185 (1959). See 3 Austin W. Scott, William F. Fratcher & Mark L. Ascher, Scott and Ascher on Trusts § 16.7 (5th ed. 2007) (hereafter "3 Scott and Ascher on Trusts").

> accordance with the exercise of such power, unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of the power.

A trustee usually must follow the directions of someone who is given a power to direct in the trust instrument and may be held liable for not doing so.[368] If the power on which the trustee is directed is for the sole benefit of the directing person (e.g., a power in a widow to direct the sale of trust real estate), the trustee's sole responsibility is to ensure that the direction is within the terms of the trust.[369] If the power on which the trustee is directed is held by the directing person in a fiduciary capacity for the beneficiaries of the trust, however, the trustee might have to make sure that the directing person does not violate that duty and might have to petition a court for instructions in certain cases.[370] Ordinarily, the trustee may await instructions from the directing person but, in certain situations, might have to suggest that the directing person take action or to petition a court for instructions.[371]

As shown in Appendix G, only two states—Indiana and Iowa—have statutes based on § 185.

Section 185 is not comforting to directed trustees because they must devote resources to ensuring that the directing person is not violating the terms of the trust or a fiduciary duty.

3. UTC Approach

For the most part, the UTC is not more helpful to directed trustees than Restatement § 185. Subsection (b) of UTC § 808 provides as follows:[372]

> If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious

[368] Id. cmt. b.

[369] Id. cmts. c–d.

[370] Id. cmts. c, e.

[371] Id. cmt. f.

[372] UTC § 808(b) (2005).

> breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.

Section 808's comment discusses subsection (b) as follows:[373]

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

The comment to § 808 does continue, though, that:[374]

> The provisions of this section may be altered in the terms of the trust. . . . A settlor can provide that the trustee must accept the decision of the power holder without question. Or a settlor could provide that the holder of the power is not to be held to the standards of a fiduciary.

Again, unless the governing instrument provides otherwise, a directed trustee must devote considerable resources to ensure that the directing person's action is not "manifestly contrary to the terms of the trust" or "a serious breach of a fiduciary duty." Section 808's comment describes this as "minimal oversight responsibility," but my colleagues, who would provide such oversight, assure me that it would be far more challenging to review someone else's investment and distribution decisions than to make those decisions themselves.

As shown in Appendix G, 19 states—Alabama, Arkansas, the District of Columbia, Florida, Kansas, Maine, Michigan, Missouri, Nebraska, New Mexico, North Carolina, North Dakota, Oregon, Pennsylvania, South Carolina, Texas, Vermont, Virginia, and West Virginia—have statutes based on UTC § 808(b).

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[373] Id. cmt.

[374] Id.

Section 75 of the Third Restatement of Trusts,[375] which was issued in 2007, contains comparable rules.

4. Protective Approach

As shown in Appendix G, 15 states—Arizona, Colorado, Delaware, Georgia, Idaho, Indiana, Kentucky, Nevada, New Hampshire, Ohio, Oklahoma, South Dakota, Tennessee, Utah, and Wyoming—afford more protection to directed trustees than Restatement § 185 or UTC § 808(b). For example, a Delaware trustee is liable for following a distribution or investment direction only if it engages in wilful misconduct. Some other states only extend protection to directed trustees in investment matters, some require the directed trustee to carry out the direction properly, and some place no restrictions on the directed trustee's conduct.

5. No Statute

As shown in Appendix G, 16 states—Alaska, California, Connecticut, Hawaii, Illinois, Louisiana, Maryland, Massachusetts, Minnesota, Mississippi, Montana, New Jersey, New York, Rhode Island, Washington, and Wisconsin—have no directed trust statute, and the effectiveness of directed trust language in trusts governed by the laws of these states is questionable. For example, a New York surrogate court held in 2011:[376]

> [T]his Court cannot allow the proposed investment of the Helen Rivas Trust corpus, as such investment in the LTIP is contrary to the Agreement and the intent of the settlor, may give rise to an impermissible division of fiduciary loyalties among the majority of the Advisory Committee, and would also violate the Prudent Investor Act.

6. Delaware's Experience

Delaware's long-standing directed trustee law permits someone other than the trustee to make distribution decisions and investment decisions for particular assets (e.g., closely held stock) or with the hope of maximizing the trust's investment performance and makes it clear that a trustee may follow the direction of an adviser authorized by the

[375] Restatement (Third) of Trusts § 75 (2007).

[376] See Matter of Rivas, 30 Misc. 3d 1207A (Surr. Ct. Monroe Co. 2011). But see In re Estate of Rubin, 143 Misc. 2d 303, 308 (Surr. Ct. Nassau Co. 1989), aff'd, 570 N.Y.S.2d 996 (2d Dept. 1991) ("[T]he designation of advisors . . . to make directives controlling the actions of the coexecutors in any disputes is a valid limitation upon the powers of such executors").

governing instrument to give such direction without breaching the trustee's fiduciary responsibility.[377] To recognize this diminished responsibility, Delaware corporate trustees customarily charge less to administer directed trusts than trusts over which they have investment duties. An unreported 2004 case upheld the Delaware statute.[378]

7. Caselaw

Two courts have considered directed trust statutes.

In Duemler v. Wilmington Trust Company,[379] just mentioned, a Delaware Vice Chancellor ruled that a corporate trustee was not liable for the failure of a sophisticated (i.e., securities lawyer) investment adviser to direct it on an investment decision where the trustee forwarded relevant information to the adviser. The Vice Chancellor held:[380]

> It Is Hereby Ordered this 24th day of November, 2004, that:
>
> 1. Judgment is entered in favor of defendant Wilmington Trust Company ("Wilmington Trust") and against plaintiff R. Leigh Duemler ("Plaintiff");
>
> 2. The Court finds that Wilmington Trust did not breach its fiduciary duty, as co-trustee of a trust dated May 29, 1985 between Robert F. Duemler as trustor and R. Leigh Duemler and Wilmington Trust Company as trustees (the "Trust"), to Plaintiff as co-trustee, investment advisor and remainder beneficiary of the Trust by allegedly not forwarding to Plaintiff materials related to an exchange offer for certain securities held in the Trust (the "Exchange Offer");
>
> 3. The Court further finds that even if Wilmington Trust had been negligent in not forwarding to Plaintiff materials related to the Exchange Offer, which the Court has not found, such negligence would not have been the proximate

[377] 12 Del. C. § 3313.

[378] Duemler v. Wilmington Trust Co., 2004 Del. Ch. Lexis 206 (Del. Ch. 2004).

[379] Id.

[380] Id.

cause of the loss to the Trust resulting from Plaintiff's decision not to tender the securities in the Exchange Offer; and

4. The Court further finds that section 3313(b) of title 12 of the Delaware Code insulates fiduciaries of a Delaware trust from liability associated with any loss to the trust where a governing instrument provides that the fiduciary is to follow the direction of an advisor, the fiduciary acts in accordance with such direction and the fiduciary did not engage in willful misconduct. The trust agreement involved in this case appointed Plaintiff as the investment advisor to the Trust and, at all times, Plaintiff made all of the investment decisions for the Trust, including not to tender the securities in the Exchange Offer. In connection with Plaintiffs decision not to tender the securities in the Exchange Offer, Wilmington Trust acted in accordance with Plaintiff's instructions, did not engage in willful misconduct by not forwarding the Exchange Offer materials to Plaintiff and had no duty to provide information or ascertain whether Plaintiff was fully informed of all relevant information concerning the Exchange Offer. Accordingly, 12 Del. C. § 3313(b) insulates Wilmington Trust from all liability for any loss to the Trust resulting from plaintiff's decision not to tender the securities in the Exchange Offer.

In Rollins v. Branch Banking & Trust Co. of Va.,[381] a Virginia trial court held that a trustee was not liable for the $25 million loss caused by the retention of stock as directed by the beneficiaries. But, the court did not dismiss the beneficiaries' claim that the trustee had violated a duty to warn them about the deteriorating condition of trust investments, and the case was settled on this issue.

8. Commentary

A 2008 article observes that:[382]

[381] Rollins v. Branch Banking & Trust Co. of Va., 2001 Va. Cir. Lexis 146 (Va. Cir. Ct. 2001).

[382] Mary Clarke & Diana S.C. Zeydel, Directed Trusts: The Statutory Approaches to Authority and Liability, 35 Est. Plan. 14, 22–23 (Sept. 2008).

[W]e would suggest the following guidelines in drafting a directed trust statute to achieve the settlor's objectives of having a directed trust while at the same time protecting the interests of the directed trustee and the beneficiaries:

1. <u>Limit liability of directed trustee and advisor.</u> If the settlor wishes to have a true directed trust in which the trustee will follow the direction of an advisor, who may or may not be a co-trustee, without the trustee being required independently to evaluate the prudence of those directions, then the Delaware approach under which the trustee is liable for losses only in the event of "wilful misconduct" would appear optimal. By a "true directed trust," we mean a trust over which the advisor has authority to direct or prevent actions of the trustee. This should be distinguished from a trust that requires a trustee to obtain the consent of an advisor, which is more in the nature of a co-trustee relationship, and would be subject to different obligations and liabilities on the part of the trustee.

   In the case of a true directed trust that exonerates the directed trustee, the advisor should be held to a fiduciary standard of good faith that may not be waived in the governing instrument. Otherwise, it seems to us that the trust might fail, as no one would be acting in a fiduciary capacity with respect to the decisions in the hands of the advisor. Section 105 of the UTC provides that the trustee's duty to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries may not be waived. This principle seems to us fundamental to the existence of a trust. Therefore, if the advisor effectively takes on certain aspects of the trust administration by directing or preventing certain actions of the trustee, the advisor should become a fiduciary to that extent and be subject to a minimum fiduciary standard of good faith.

2. Scope of authority of the advisor. We believe the South Dakota approach of defining certain types of trust advisors is very helpful because it permits a settlor to incorporate those definitions by reference, thus adding certainty to the scope of the advisor's authority. Any definition should make clear that the advisor may be designated for all or any part of the statutorily defined scope of duties. Thus, for example, an investment trust advisor should be permitted to act with respect to the entire trust estate, or with respect to only one asset or category of assets, such as interests in entities that are not publicly traded. Similarly, a distribution trust advisor should be permitted to act exclusively with respect to distributions to a particular beneficiary or with respect to a particular trust asset, such as an interest in a closely held business.

   If the advisor is also a co-trustee, we believe the Florida approach of expressly excluding all other trustees from authority over and liability for following the directions (except in the case of willful misconduct) of the advisor is optimal. We believe this will encourage settlors to name multiple trustees, each particularly suited to one or more tasks of trusteeship, and allow each to be exclusively responsible as a trustee in his, her or its area of expertise. Accordingly, in the case of a trustee/advisor, all other trustees would be defined as excluded trustees and substantially exonerated from liability. If, on the other hand, the advisor is not a co-trustee, then we suggest that the approach in paragraph 1 above be followed.

3. We believe any directed trustee statute should clarify the ambiguity in the UTC with respect to an advisor who is also a beneficiary. If a beneficiary is the advisor,

> the beneficiary should not be subject to a fiduciary standard only if the beneficiary is the only person whose interest in the trust (as defined under state law taking account of virtual representation) is affected by directions given by the advisor. So, in Florida, for example, where a beneficiary with a special power of appointment may represent the interests of the takers in default, if the beneficiary were the investment advisor of a trust for the exclusive lifetime benefit of that beneficiary over which the beneficiary has a testamentary special power of appointment, then the beneficiary, as investment advisor, would not have a fiduciary duty to anyone else. But if the beneficiary is only an income beneficiary or is only one of multiple permissible income and principal beneficiaries, then the beneficiary, acting as advisor, should be held to a minimum fiduciary standard of good faith.

I must emphasize that the relief provided to a directed trustee by even the most protective statute is not unlimited. A directed trustee statute is a state-law creation and will protect a directed trustee only from state-law claims. Specifically, it will not shield a directed trustee from claims arising under federal law (e.g., tax laws, anti-money laundering penalties).

9. Applicable Law

The operation of a directed trust and the directed trustee's liability to beneficiaries under it are matters of trust administration.[383] A testator's or trustor's designation of a state's law to govern administration matters for a trust that holds movables almost always is respected.[384]

10. CRTs and Advisers

In 1980, the IRS ruled that the use of a direction investment adviser would disqualify a charitable-remainder trust ("CRT"),[385] but, in 1994,

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[383] See Restatement (Second) of Conflict of Laws § 271 cmt. a (1971).

[384] See id. §§ 271 cmt. h, 272 cmt. f.

[385] See PLR 8041100 (July 21, 1980).

the IRS ruled that it would not in certain circumstances.[386]

11. The Protector

Since the turn of the 21st Century, the "protector," which long has been a feature of offshore trusts, has begun to appear in trusts created in the United States, and states have begun enacting statutes defining the protector's role.[387] The protector sometimes becomes involved in decisions (e.g., directing investments or distributions) that traditionally have fallen within the domain of the adviser or committee and, at other times, is charged with responsibilities (e.g., replacing trustees and advisers, amending trust provisions, changing situs) that used to require court involvement. In what may be the first reported U.S. case considering a protector, a Missouri intermediate appellate court refused in 2009 to grant a protector's motion for summary judgment that he had no duty to monitor the trustee's conduct.[388]

H. Asset Protection—Third-Party Trusts

1. Introduction

A client may protect interests in a trust that he or she creates for others ("third-party trust") from claims by the beneficiaries' creditors by making such interests wholly discretionary or by subjecting them to spendthrift clauses. The degree of protectiveness of discretionary trusts and spendthrift trusts differs from state to state, and the underlying concepts have been threatened by the Third Restatement of Trusts.[389]

2. Discretionary Trusts

a. Second Restatement of Trusts Approach

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[386] See PLR 9442017 (July 19, 1994).

[387] See, e.g., Alaska Stat. §§ 13.36.370–13.36.375; Ariz. Rev. Stat. § 14-10818; 12 Del. C. § 3313(f); Idaho Code § 15-7-501; Mich. Comp. Laws § 700.7809; Nev. Rev. Stat. §§ 163.417(b), 163.5547–163.5555; N.H. Rev. Stat. Ann. §§ 564-B:12-1201–564-B:12-1205; S.D. Codified Laws §§ 55-1B-1–55-1B-11; 14A V.S.A. §§ 1101–1105; Wyo. Stat. Ann. §§ 4-10-710–4-10-718. See also Mitchell M. Gans, Trust Protector Powers: Fiduciary Duty and Tax Issues, 132 Tax Notes 1133 (Sept. 12, 2011); Peter B. Tiernan, Evaluate and Draft Helpful Trust Protector Provisions, 38 Est. Plan. 24 (July 2011); Philip J. Ruce, The Trustee and The Trust Protector, 59 Drake L. Rev. 67 (Fall 2010); Richard C. Ausness, The Role of Trust Protectors in American Trust Law, 45 Real Prop., Tr. & Est. L.J. 319 (Summer 2010).

[388] Robert T. McLean Irrevocable Trust U/A/D v. Patrick Davis, P.C., 283 S.W.3d 786 (Mo. Ct. App. 2009). See Ronald R. Volkmer, Court Examines the Status and Legal Liability of a Trust Protector, 36 Est. Plan. 40 (Nov. 2009).

[389] See Kevin D. Millard, Rights of a Beneficiary's Creditors Under the Uniform Trust Code, 34 ACTEC J. 58 (Fall 2008).

The Second Restatement of Trust's protection of a beneficiary's interest in a discretionary trust from creditor claims rests on two foundations—one is based on the nature of the beneficiary's interest; the other is based on limiting a court's ability to interfere with a trustee's exercise of discretion.

First, § 155(1) of the Second Restatement of Trusts provides that:[390]

> [I]f by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal.

A trust described in § 155 is a "discretionary trust" not a "spendthrift trust" or a "support trust."[391] The beneficiary's protection results from the nature of the interest and is available whether or not the trust contains a spendthrift clause.[392] A creditor may not reach the beneficiary's interest because the beneficiary cannot force the trustee to make a distribution.[393]

Second, § 187 of the Second Restatement of Trusts provides that:[394]

> Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion.

Comment d to § 187 enumerates factors for a court to consider when deciding whether a trustee has abused its discretion,[395] and subsequent comments provide that a court will interfere with a trustee's exercise or nonexercise of discretion only if the trustee

[390] Restatement (Second) of Trusts § 155(1) (1959).

[391] Id. cmt. b.

[392] Id.

[393] Id.

[394] Id. § 187.

[395] Id. cmt. d.

acts dishonestly or with an improper motive, fails to exercise judgment, or acts beyond the bounds of a reasonable judgment, even though the court would have acted differently.[396] If the trustee's action is subject to a standard by which its conduct may be judged, the court may interfere if the trustee acts unreasonably.[397] If the trust contains no such standard, though, the court will interfere only if the trustee acts dishonestly or with an improper motive.[398] Inclusion in the trust of language that gives the trustee absolute, unlimited, or uncontrolled discretion relieves it from the duty to act reasonably even if the trust contains a standard by which the trustee's conduct may be judged.[399]

b. Third Restatement of Trusts Approach

Sections 50 and 60 of the Third Restatement of Trusts undermine both foundations.[400] This erosion poses a serious threat to the security of trusts in jurisdictions with no discretionary trust statute.

With respect to the first foundation, comment e to § 60 begins innocuously enough as follows:[401]

> A transferee or creditor of a trust beneficiary cannot compel the trustee to make discretionary distributions if the beneficiary personally could not do so.

But, in the very next sentence, it continues that:[402]

> It is rare, however, that the beneficiary's circumstances, the terms of the discretionary power, and the purposes of the trust leave the beneficiary so powerless.

With respect to the second foundation, the Third Restatement makes it much easier for a court to interfere with a trustee's

396 Id. cmts. e–h.

397 Id. cmt. i.

398 Id.

399 Id. cmt. j.

400 Restatement (Third) of Trusts §§ 50, 60 (2003).

401 Id. § 60 cmt. e.

402 Id.

exercise or nonexercise of discretion. Thus, comment b to § 50 provides that:[403]

> It is not necessary . . . that the terms of the trust provide specific standards in order for a trustee's good-faith decision to be found unreasonable and thus to constitute an abuse of discretion.

Comment d continues as follows:[404]

> Reasonably definite or objective standards serve to assure a beneficiary some minimum level of benefits, even when other standards are included to grant broad latitude with respect to additional benefits. . . . Sometimes trust terms express no standards or other clear guidance concerning the purposes of a discretionary power, or about the relative priority intended among the various beneficiaries. Even then a general standard of reasonableness, or at least of good-faith judgment, will apply to the trustee . . . based on the extent of the trustee's discretion, the various beneficial interests created, the beneficiaries' circumstances and relationships to the settlor, and the general purposes of the trust.

The 2007 edition of the Scott treatise explains the difference between the approaches of the Second and Third Restatements of Trusts as follows:[405]

> Under the Second Restatement, the relevant inquiry seems to have been whether "reasonable men might differ" on the propriety of the exercise of the power. The inference is that the trustee's decision should stand, in the absence of a judicial finding that no reasonable person could conclude that the trustee had acted

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[403] Id. § 50 cmt. b.

[404] Id. cmt. d.

[405] 3 Scott and Ascher on Trusts § 18.2.6 at 1361 n.2 (citations omitted).

reasonably. Under the Third Restatement, the relevant inquiry seems to be whether "the trustee's decision is one that would not be accepted as reasonable by persons of prudence."

c. UTC Approach

With respect to the first foundation, § 504 of the UTC provides as follows:[406]

(a) In this section, 'child' includes any person for whom an order or judgment for child support has been entered in this or another State.

(b) Except as otherwise provided in subsection (c), whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if:
   (1) the discretion is expressed in the form of a standard of distribution; or
   (2) the trustee has abused the discretion.

(c) To the extent a trustee has not complied with a standard of distribution or has abused a discretion:
   (1) a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child, spouse, or former spouse; and
   (2) the court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the

[406] UTC § 504 (2005).

> beneficiary had the trustee complied with the standard or not abused the discretion.
>
> (d) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution.
>
> (e) If the trustee's or cotrustee's discretion to make distributions for the trustee's or cotrustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee or cotrustee.

With respect to the second foundation, § 814(a) provides as follows:[407]

> Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as "absolute", "sole", or "uncontrolled", the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.

Many states modified the above provisions when they enacted their versions of the UTC.[408]

d. Current Law

A 2010 article summarizes the competing views as to the ability of creditors' to reach a discretionary interest as follows:[409]

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[407] Id. § 814(a).

[408] See In re Estate of Skaff, 2011 Mich. App. Lexis 10 at 16–17 n.5 (Mich. Ct. App. 2011) ("Thomas Martin has no more than the possibility of receiving discretionary payments"); Paulson v. Paulson, 783 N.W. 2d 262, 272–73 (N.D. 2010) (beneficiary's interest in a discretionary trust is only an expectancy).

[409] Frederick R. Franke, Jr., Resisting the Contractarian Insurgency: The Uniform Trust Code, Fiduciary Duty, and Good Faith in Contract, 36 ACTEC L.J. 517, 531 n.44 (Winter 2010) (citations and internal quotation marks omitted).

> Critics of the approach adopted by the Restatement (Third) of Trusts and the Uniform Trust Code perceived that there was a change from the common law of trusts and that this change exposed trust assets to heightened exposure to the claims of the beneficiaries' creditors. This criticism has drawn pronounced refutation. Note that the theory that a creditor could not reach the trust because the creditor stood in the shoes of the beneficiary and the beneficiary could not force distributions from the trust was flawed, because no matter how broadly worded the trustee's discretion was, it was always subject to review by a court for abuse. Implicit in the critics' argument is the assertion that, by granting a trustee extended discretion, the trustee's exercise of that discretion becomes essentially unreviewable. But this has never been true at common law. An essential principle of the common law of trusts is that a trustee's exercise of discretion is always subject to judicial review, no matter how broadly the trustee's discretion may be described. That will not be interpreted so as to relieve the trustee from an obligation to account for its discretionary judgments. Because a trustee is a fiduciary, it would be inconsistent with the concept of a trust to insulate a trustee's exercise of discretion from all judicial review.

e. State Statutes

A few states have had discretionary trust statutes for some time. For example, under California's statutes, which were enacted beginning in 1990, an interest in a discretionary trust may be reached to pay claims for spousal or child support, restitution for commission of a felony, and public support,[410] and the amount

[410] Cal. Prob. Code §§ 15305, 15305.5, 15306. See Ventura County Dept. of Child Support Services v. Brown, 117 Cal. App. 4th 144 (Cal. Ct. App. 2004) (trustee's refusal to exercise discretion to pay child support was abuse of discretion). Contra Young v. McCoy, 147 Cal. App. 4th 1078 (Cal. Ct. App. 2007) (trustee's refusal to exercise discretion to pay restitution not abuse of discretion).

that may be protected is limited.[411] The undermining of the creditor protection that traditionally was afforded by discretionary trusts is of particular concern in a state that has no discretionary trust statute because a court is free to embrace the Third Restatement of Trust's approach. In recognition of this concern, states such as Delaware and South Dakota have enacted statutes that confirm the Second Restatement of Trust's view. Twenty-two states have adopted variations of one or both of the UTC provisions. Several states developed their own approaches. Appendix H contains citations for state discretionary trust statutes.

3. Spendthrift Trusts

a. Second Restatement of Trusts Approach

The Second Restatement of Trusts defines a "spendthrift trust" as follows:[412]

> A trust in which by the terms of the trust or by statute a valid restraint on the voluntary and involuntary transfer of the interest of the beneficiary is imposed is a spendthrift trust.

If a third-party trust contains a spendthrift clause, a beneficiary's right to current income or future principal distributions is not subject to voluntary or involuntary transfer in most circumstances.[413] Even if such a trust contains a spendthrift clause, though, creditors may reach the beneficiary's interest to pay claims for spousal or child support, alimony, necessary services or supplies, costs incurred to protect the beneficiary's trust interest, or governmental obligations.[414] The beneficiary's interest also may be reached to pay claims dictated by public policy (e.g., a claim resulting from the beneficiary's commission of a willful tort).[415]

b. Third Restatement of Trusts Approach

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[411] Id. §§ 15306.5–15307. See Anthony F. Vitiello & Daniel B. Kessler, The Fully Discretionary Ascertainable Standard, 149 Tr. & Est. 21 (Mar. 2010).

[412] Restatement (Second) of Trusts § 152(2) (1959).

[413] Id. §§ 152(1), 153(1).

[414] Id. § 157, id. § 157 cmts. b–e.

[415] Id. § 157 cmt. a.

The Third Restatement of Trusts defines "spendthrift trust" in substantially the same manner as does the Second Restatement.[416] Creditors may reach a beneficiary's interest in such a trust for the support of a child, spouse, or former spouse; for necessary services and supplies provided to the beneficiary; and for costs incurred to protect the beneficiary's trust interest.[417] The beneficiary's interest also may be reached to pay governmental claims.[418] Ominously, from the beneficiary's perspective, the interest might be reachable in the following circumstances:[419]

> The exceptions to spendthrift immunity stated in this Section are not exclusive. Special circumstances or evolving policy may justify recognition of other exceptions, allowing the beneficiary's interest to be reached by certain creditors in appropriate proceedings . . . .

c. <u>UTC Approach</u>

UTC §§ 502 and 503, respectively, describe spendthrift protection and exceptions to it as follows:[420]

> Section 502. Spendthrift Provision.
>
> (a) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest.
>
> (b) A term of a trust providing that the interest of a beneficiary is held subject to a 'spendthrift trust,' or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest.
>
> (c) A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as

[416] Restatement (Third) of Trusts § 58(1) (2003), <u>id.</u> cmt. a.

[417] <u>Id.</u> § 59, <u>id.</u> § 59 cmts. b–d.

[418] <u>Id.</u> cmt. a(1).

[419] <u>Id.</u> cmt. a(2).

[420] UTC §§ 502–503 (2005).

> otherwise provided in this [article], a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.
>
> Section 503. Exceptions to Spendthrift Provision.
>
> (a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State.
>
> (b) A spendthrift provision is unenforceable against:
>
> (1) a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance;
> (2) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; and
> (3) a claim of this State or the United States to the extent a statute of this State or federal law so provides.
> (c) A claimant against which a spendthrift provision cannot be enforced may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances.

As with discretionary trusts, states sometimes modified these provisions in enacting their versions of the UTC.[421]

d. State Statutes

The third-party spendthrift trust statutes of the various states differ significantly. For example, Delaware long has enforced spendthrift trusts. Under Delaware's statute, a creditor of a beneficiary of such a trust has only such rights to the trust

[421] For a summary of Arizona's spendthrift trust rules, see Fid. Nat'l Fin., Inc. v. Friedman, 2010 U.S. Dist. Lexis 61835 at 19–22 (C.D. Cal. 2010).

property as are afforded the creditor by the terms of the instrument and no limit is placed on the amount that may be sheltered from creditors' claims.[422] Although the courts created an exception for obligations to support a current—but not a former—spouse,[423] Delaware law provides virtually complete protection from claims of creditors of a beneficiary. Delaware law bars a creditor from seizing the interest of a beneficiary even when the beneficiary commits a willful tort.[424]

Delaware and states with similar laws might offer more protection than the laws of other states. For example, Georgia permits a creditor to reach spendthrift-trust assets if he or she is the victim of a willful tort committed by a beneficiary.[425] California permits spendthrift-trust assets to be reached to pay claims for spousal or child support, restitution for commission of a felony, and public support,[426] and it limits the amount that may be protected.[427] Oklahoma permits income distributable to a beneficiary of a spendthrift trust to be reached for child- and spousal-support claims and claims for necessaries and limits the annual income that may be protected from garnishment to $25,000.[428]

Appendix H gives citations for state third-party spendthrift trust statutes.

4. Subsequent Protection

Comment j to § 152 of the Second Restatement of Trusts provides that:[429]

> After the income of a spendthrift trust has been paid to the beneficiary it can be transferred by him and can be reached by his creditors.

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[422] 12 Del. C. § 3536.

[423] Garretson v. Garretson, 306 A.2d 737 (Del. 1973).

[424] Parsons v. Mumford, 1989 Del. Ch. Lexis 70 (Del. Ch. 1989); Gibson v. Speegle, 1984 Del. Ch. Lexis 475 (Del. Ch. 1984).

[425] Ga. Code Ann. § 53-12-80.

[426] Cal. Prob. Code §§ 15305, 15305.5, 15306.

[427] Id. §§ 15306.5–15307. For a summary of California's spendthrift trust rules, see Fid. Nat'l Fin., Inc. v. Friedman, 2010 U.S. Dist. Lexis 61835 at 22–23 (C.D. Cal. 2010).

[428] Okla. Stat. Ann. tit. 60, § 175.25(B).

[429] Restatement (Second) of Trusts § 152 cmt. j (1959). See Restatement (Third) of Trusts § 58 cmts. d, d(2) (2003).

Some states offer protection from creditor claims for funds distributed from discretionary and spendthrift trusts. For instance, in New York, 90% of the income or other payments from a third-party trust is exempt from application to satisfy a money judgment, except to the extent that a court determines that it is needed to meet the reasonable requirements of the judgment debtor and his or her dependants.[430] Moreover, a Delaware statute provides that creditors of non-Delaware residents as well as Delaware residents may not reach assets of accounts in Delaware banks. The current statute provides as follows:[431]

> Banks, trust companies, savings institutions and loan associations . . . shall not be subject to the operations of the attachment laws of this State.

This protection is not new. In fact, the earliest predecessor of the statute was enacted in 1871.[432] Over the years, Delaware courts have read the protection broadly as follows:

a. Sterling v. Tantum (1915)[433]—Funds in trust department of corporation having banking powers are exempt from attachment even though trust department is distinct from banking business;

b. Provident Trust Co. v. Banks (1939)[434]—Filing of creditor bill in equity court does not enable creditors to reach assets of self-settled trust at Delaware trust company;

c. Bank of Delaware v. Wilmington Housing Authority (1976)[435]—Wages of employee of Delaware bank are not subject to garnishment;

d. Delaware Trust Co. v. Partial (1986)[436]—Request for temporary restraining order to enjoin withdrawal of funds from bank denied.

However, in 1973, the Delaware Supreme Court held in Garretson v. Garretson that "the seizure by sequestration of spendthrift trust income in the hands of a bank as Trustee at the suit of a wife seeking maintenance

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[430] N.Y. C.P.L.R. § 5205(d)(1).

[431] 10 Del. C. § 3502(b).

[432] 14 Del. Laws 90 (1871).

[433] Sterling v. Tantum, 94 A. 176 (Del. Super. Ct. 1915).

[434] Provident Trust Co. v. Banks, 9 A.2d 260 (Del. Ch. 1939).

[435] Bank of Delaware v. Wilmington Housing Authority, 352 A.2d 420 (Del. Super. Ct. 1976).

[436] Delaware Trust Co. v. Partial, 517 A.2d 259 (Del. Ch. 1986).

from a husband is not an attachment within the meaning of § 3502."[437] Nevertheless, in the nonmarital context, a Delaware or non-Delaware resident may obtain substantial protection from creditors by placing funds in a checking, savings, trust, or other account at a Delaware institution. Even in the marital context, an individual will be no worse off by so doing than he or she would have been by holding funds elsewhere and might be better off because, in Delaware Trust Co. v. Partial, the Delaware Court of Chancery indicated in 1986 that Garretson has limited application:[438]

> It has been held that Section 3502 does not directly exempt Delaware banks from the operation of our sequestration process. The statute authorizing sequestration, however,—and the Garretson case construing it—is limited to the seizure of property to compel appearance and thus has no application to the case at bar.

In addition, mandatory or discretionary distributions from a trust into an account in a Delaware bank or trust company will insulate the funds from creditor claims.

Whereas the statute prohibits attachment of assets in a non-bankruptcy context, it will not apply upon the filing of a petition under the United States Bankruptcy Code ("Bankruptcy Code") unless the account fits within one of the exemptions or exclusions provided by the Bankruptcy Code. It also will not afford protection from the federal tax lien under IRC § 6321.

5. Applicable Law

The law that determines whether or not creditors may reach a beneficiary's interest in a trust is the law designated by the trust instrument.[439] Consequently, clients' designations of other states' laws to govern the ability of creditors to reach the assets of third-party trusts should stand.[440]

[437] Garretson v. Garretson, 306 A.2d 737, 742 (Del. 1973).

[438] Delaware Trust Co. v. Partial, 517 A.2d 259, 261 (Del. Ch. 1986) (citations omitted)

[439] Restatement (Second) of Conflict of Laws §§ 273, 280 (1971); 7 Austin W. Scott, William F. Fratcher & Mark L. Ascher, Scott and Ascher on Trusts (5th ed. 2010) (hereafter "7 Scott and Ascher on Trusts") §§ 45.7–45.7.3, 46.7; George G. Bogert & George T. Bogert, The Law of Trusts and Trustees § 293 (rev. 2d ed. 1992) (hereafter "Bogert on Trusts").

[440] See Fid. Nat'l Fin., Inc. v. Friedman, 2010 U.S. Dist. Lexis 61835 at 25 (C.D. Cal. 2010) (Arizona and California courts would apply Jersey, Channel Islands, law designated by trust).

6. Lifetime Marital-Deduction Trusts and the Supercharged Credit Shelter Trust (SM)

Thanks to the 2010 Tax Act, the federal gift-tax, estate-tax, and GST exemptions have jumped to $5 million per individual for 2011. This might cause wealthier spouses to create QTIP trusts for less wealthy spouses to enable the latter to use their estate and GST exemptions in whole or in part. It should be noted that, with a lifetime QTIP trust, the donee spouse's income interest cannot terminate if the spouses are divorced,[441] an irrevocable QTIP election must be made on a timely gift-tax return,[442] and the IRS has very limited authority to grant an extension of time to make such an election.[443]

One concern with this strategy is that the trust might be treated as self-settled if the donor spouse will benefit from trust assets if he or she survives the donee spouse, thereby producing adverse tax- and asset-protection results. Long ago, the Treasury Department issued regulations specifying that trust assets will not be included in a donor spouse's gross estate under IRC §§ 2036 or 2038 if this eventuates.[444] However, whether creditors might reach trust assets under state law remained unresolved for many years.

Arizona, Delaware, Florida, Michigan, North Carolina, Virginia, and Wyoming recently amended their spendthrift-trust statutes to provide that an inter vivos marital-deduction trust generally will not be treated as self-settled even if the donor spouse might benefit from trust assets by surviving the donee spouse.[445] The Delaware provision reads:[446]

> For the purposes of this section, property contributed to an inter vivos marital trust that is treated as qualified terminable interest property under § 2523(f) of the Internal Revenue Code of 1986 [26 U.S.C. § 2523(f)], as amended, or to an inter vivos marital trust that is treated as a general power of appointment trust for which a marital deduction would be allowed under § 2523(a) and

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[441] See IRC § 2523(f)(2)(B).

[442] See IRC § 2523(f)(2)(C), (4).

[443] See PLR 201109012 (Nov. 15, 2010), revoking PLR 201025021 (Feb. 19, 2010).

[444] Regs. § 25.2523(f)-1(f), Ex. 11.

[445] Ariz. Rev. Stat. § 14-10505(E); 12 Del. C. § 3536(c)(2); Fla. Stat. § 736.0505(3); Mich. Comp. Laws § 700.7506(4); N.C. Gen. Stat. § 36C-5-505(c); Va. Code Ann. § 55-545.05(B)(3); Wyo. Stat. § 4-10-506(e).

[446] 12 Del. C. § 3536(c)(2).

(e) of the Internal Revenue Code of 1986 [26 U.S.C. § 2523(a) and (e)], as amended, over which the settlor's spouse holds either a general power of appointment exercisable in favor of the settlor's spouse's estate or a limited power of appointment, or both, shall not be deemed to have been contributed by the settlor even if the settlor would be a beneficiary of the trust subsequent to the death of the settlor's spouse.

In 2007, Mitchell Gans, Jonathan Blattmachr, and Diana Zeydel introduced the concept of the Supercharged Credit Shelter Trust (SM),[447] under which a donor spouse creates an inter vivos QTIP trust who subsequently dies and creates a credit-shelter trust for the donor spouse. The credit-shelter trust is "supercharged" because it is treated as a grantor trust with respect to the donor spouse for federal income-tax purposes.[448] The Treasury Regulation mentioned above allays any IRC §§ 2036 and 2038 concerns, but it is silent regarding § 2041. Accordingly, the designers of the Supercharged Credit Shelter Trust (SM) recommend subjecting distributions to an ascertainable standard and creating the trust in a state that recognizes self-settled trusts.[449] Attorneys creating such trusts for clients also should consider the just-mentioned state statutes which were passed subsequent to introduction of the Supercharged Credit Shelter Trust (SM) concept, as an alternative to a self-settled trust because they offer a straightforward solution and present fewer unresolved issues than the domestic APT.[450]

I. Asset Protection—Self-Settled Trusts

1. Introduction

A trust in which the trustor retains a beneficial interest often is referred to as a "self-settled trust." The Second Restatement of Trusts, the Third Restatement of Trusts, and the UTC do not extend creditor protection to a trustor-beneficiary's interest in a self-settled discretionary trust.[451] Thus, § 156(2) of the Second Restatement provides as follows:[452]

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[447] Mitchell M. Gans, Jonathan G. Blattmachr, & Diana Zeydel, Supercharged Credit Shelter Trust (SM), 21 Prob. & Prop. 52 (July/Aug. 2007).

[448] Id. at 54–55.

[449] Id. at 56–57.

[450] See III, I, below.

[451] Restatement (Second) of Trusts § 156(2) (1959), id. cmt. e; Restatement (Third) of Trusts § 60 cmt. f (2003); UTC § 505(a)(2) (2005). See Kevin D. Millard, Rights of a Trust Beneficiary's Creditors Under the Uniform Trust Code, 34 ACTEC J. 58, 64–66 (Fall 2008).

[452] Id.

> Where a person creates for his own benefit a . . . discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.

Nor do they give any protection to a trustor-beneficiary's interest in a self-settled spendthrift trust.[453] For example, § 156(1) of the Second Restatement says that:[454]

> Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.

As society became increasingly litigious, Americans began to look for trusts that offered creditor protection and continued benefits. Until 1997, that option only was available in foreign countries. Since then, however, several states have enacted APT statutes.

2. State Statutes

Thirteen states permit trustors to obtain protection from creditors by creating domestic APTs.[455] Appendix I gives citations for the domestic APT statutes and for statutes of other states that do not recognize them.

3. Applicable Law

As noted previously, the general rule is that the law that determines whether or not creditors may reach a beneficiary's interest in a trust of personal property is the law designated by the trust instrument.[456] Hence,

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[453] Id. § 156(1); Restatement (Third) of Trusts § 58(2) (2003), id. cmt. e; UTC § 505(a)(2) (2005).

[454] Id.

[455] See Richard W. Nenno & John E. Sullivan, III, 868 T.M., Domestic Asset-Protection Trusts; Richard W. Nenno & Jeffrey C. Wolken, DAPT Lite: A Practitioner-Friendly Guide to the Delaware Asset Protection Trust, 32 Tax Mgmt. Est., Gifts & Tr. J. 227 (Sept. 13, 2007); Adam J. Hirsch, Fear Not the Asset Protection Trust, 27 Cardozo L. Rev. 2685 (Apr. 2006); Jeffrey A. Schoenblum, In Search of a Unifying Principle for Article V of the Uniform Trust Code: A Response to Professor Danforth, 27 Cardozo L. Rev. 2609, 2610–13 (Apr. 2006); Richard W. Nenno & John E. Sullivan, III, Delaware Asset Protection Trusts Should Survive Bankruptcy, 33 Est. Plan. 31 (Jan. 2006); Richard W. Nenno & John E. Sullivan, III, Delaware Asset Protection Trusts Create Obstacles for Creditors, 32 Est. Plan. 3 (Dec. 2005); Richard W. Nenno & John E. Sullivan, III, Delaware Asset Protection Trusts: Avoiding Fraudulent Transfers and Attorney Liability, 32 Est. Plan. 22 (Jan. 2005). See also Richard W. Nenno, William H. Lunger & Mary B. Hickok, Structuring CRTs as Delaware APTs to Provide Protection from Creditors and Surviving Spouses, 31 Tax Mgmt. Est., Gifts & Tr. J. 71 (Mar. 9, 2006).

[456] Restatement (Second) of Conflict of Laws § 273 (1971).

although the question is controversial, a client's designation of another state's statute to govern the ability of creditors to reach the assets of a self-settled trust should be effective.

4. Protection for Distributions

As described in H, 4, above, mandatory or discretionary distributions from self-settled trusts into bank accounts or trusts may enjoy protection from creditor claims under the laws of certain states.

5. Crummey Powers

Because the possessor of a Crummey power has the ability to withdraw property for a period of time, he or she might be treated as contributing property to the trust when the power lapses. Several state statutes provide that a Crummey-power holder will not be treated as the trustor of the trust in these circumstances.[457]

6. Income-Tax Reimbursement Clauses

As discussed in II, E, above, a trustor may greatly enhance the transfer-tax savings provided by a dynasty trust by structuring it as a grantor trust for federal income-tax purposes. In Revenue Ruling 2004-64,[458] the IRS confirmed that inclusion of a provision giving the trustee discretion to reimburse the trustor for income taxes attributable to a grantor trust would not result in the trust being included in the gross estate provided that, under applicable state law, inclusion of such a provision would not cause the trust to be self-settled and thereby enable creditors to reach its assets. Several state statutes now provide that inclusion of a discretionary income-tax reimbursement clause will not cause a trust to be self-settled.[459]

7. Tenancy-by-the-Entireties Property Contributed to Trust

Numerous states recognize tenancies by the entireties in real and/or personal property.[460] In 2007, Vice Chancellor Parsons of the Delaware Court of Chancery described the rules for tenancy by the entireties in Delaware real property as follows:[461]

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457 See, e.g., UTC § 505(b)(2) (2005); 12 Del. C. § 3536(c)(1); Idaho Code § 15-7-502(5)(b); Tex. Prop. Code § 112.035(e)(2); Wash. Rev. Code § 19.36.020; Wis. Stat. § 701.06(6)(b).

458 Rev. Rul. 2004-64, 2004-2 C.B. 7 (July 6, 2004).

459 See, e.g., Alaska Stat. § 34.40.110(m)(2); 12 Del. C. § 3536(c)(1); Fla. Stat. § 736.0505(1)(c); N.Y. Est. Powers & Trusts Law § 7-3.1(d).

460 See, Fred Franke, Asset Protection and Tenancy by the Entirety, 34 ACTEC J. 210 (Spring 2009).

461 Wilmington Sav. Fund Soc'y, FSB v. Kaczmarczyk, 2007 Del. Ch. Lexis 33 at 12–13 (Del. Ch. 2007)

> In Delaware, a husband and wife generally hold title to real property in a tenancy by the entirety. Consequently, neither interest can be sold, attached, or liened except by the joint act of both spouses. Specifically, a judgment against the husband cannot be executed against a property interest he holds in a tenancy by the entirety.

A tenancy by the entireties also may be created in Delaware personal property.[462]

From an estate-planning standpoint, working with tenancy-by-the-entireties property is problematic because:[463]

> Assets held as TBE transferred to another TBE account retain their TBE status and are exempt from creditors holding a claim against one of the owners individually. Transferring assets held TBE to a trust destroys the assets' TBE status when the terms of the trust allow only one of the owners to exercise control over the assets.

Once the property's character is destroyed, it cannot later be restored:[464]

> [E]ven if the trust were revoked, the Debtor provides no legal support for the assertion that the property will return to the Debtor and his wife as tenants by the entirety, and the Court can find nothing that would support such an assertion. To the contrary, the initial transfer of the property to the trust thirteen years ago terminated the tenancy by the entirety. While it is true that one spouse acting alone cannot terminate a tenancy by the entirety without the consent of the other, nothing prevents such termination by the two acting together. In the present case, when the Debtor and his wife together transferred the property to the trust, to be controlled by the Debtor alone, they terminated the joint ownership and control that is a

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(footnotes omitted). See 25 Del. C. § 309.

[462] Id. at 43.

[463] In re Quaid, 2011 Bankr. Lexis 216 at 10 (Bankr. M.D. Fla. 2011) (citations omitted).

[464] In re Cowles, 143 B.R. 5, 10-11 (Bankr. D. Mass. 1992) (citation omitted). Accord In re Goldman, 111 B.R. 230, 232-233 (Bankr. E.D. Mo. 1990).

> requirement of a tenancy by the entirety. Such a tenancy does not renew itself automatically in the future. For these reasons, the Debtor's argument that creditors will only be able to reach his fifty percent interest in the property is irrelevant.

In 2010, Delaware enacted a statute that allows tenancy-by-the-entireties property contributed to a revocable trust to retain its character and thereby its ability to protect the property from a spouse's separate creditors.[465] The statute, as amended in 2011,[466] provides as follows:[467]

> Where a husband and wife make a contribution of property to one or more trusts, each of which is revocable by either or both of them, and, immediately before such contribution, such property or any part thereof or any accumulation thereto was, pursuant to applicable law, owned by them as tenants by the entireties, then notwithstanding such contribution and except where the provisions of the trust instrument may expressly provide to the contrary, that property and any accumulation thereto shall, while held in trust during the lifetime of both spouses, be treated as though it were tenancy by the entireties property to the extent that, in any action concerning whether a creditor of either or both spouses may recover the debt from the trust, the sole remedy available to the creditor with respect to trust property that is treated as though it were tenancy by the entireties property shall be an order directing the trustee to transfer the property to both spouses as tenants by the entireties.

Illinois, Maryland, and Virginia offer similar protection.[468]

Delaware provides one more level of protection for tenancy-by-the-entireties property added to a Delaware APT. Hence, under Delaware's

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[465] 12 Del. C. § 3334. I would like to thank Jonathan E. Gopman of Akerman Senterfitt, Naples, Florida, for suggesting this legislative change. See Jonathan E. Gopman, STET: Delaware Introduces New Asset Protection Trust for Tenancy by the Entireties Property, LISI Asset Protection Planning Newsletter #161 (Sept. 8, 2010), at www.leimbergservices.com.

[466] 78 Del. Laws 117, § 4.

[467] 12 Del. C. § 3334.

[468] 765 Ill. Comp. Stat. 1005/1c; Md. Code Ann., Est. & Trusts § 14-113, Md. Code Ann., Cts. & Jud. Proc. § 11-504(B)(8)–(9); Va. Code Ann. § 55-20.2(B).

APT statute, tenancy-by-the-entireties property transferred to a Delaware APT retains its character until the death of the first spouse,[469] and, if the trust is set aside (e.g., as a fraudulent transfer or a sham), the property retains its traditional protection from creditors.[470] The current provision says:[471]

> Where a husband and wife make a qualified disposition of property to one or more trusts and, immediately before such qualified disposition, such property or any part thereof or any accumulation thereto was, pursuant to applicable law, owned by them as tenants by the entireties, then notwithstanding such qualified disposition and except where the provisions of the trust instrument may expressly provide to the contrary, that property and any accumulation thereto shall, while held in trust during the lifetime of both spouses, be treated as though it were tenancy by the entireties property to the extent that, in any action concerning whether a creditor of either or both spouses may recover the debt from the trust, upon avoidance of the qualified disposition, the sole remedy available to the creditor with respect to trust property that is treated as though it were tenancy by the entireties property shall be an order directing the trustee to transfer the property to both spouses as tenants by the entireties.

In connection with the foregoing change, the Delaware Act was amended in 2010 to clarify that multiple transferors may contribute undivided interests to a Delaware APT as follows:[472]

> "Qualified disposition" means a disposition by or from a transferor (or multiple transferors in the case of property in which each such transferor owns an undivided interest) to 1 or more trustees, at least 1 of which is a qualified trustee, with or without consideration, by means of a trust instrument.

The conflict-of-laws issues relating to the funding of a Delaware APT with tenancy-by-the-entireties property are comparable to those for

[469] 12 Del. C. § 3574(f), as amended by 2011 Del. S.B. No. 83, § 13.

[470] Id.

[471] Id.

[472] 12 Del. C. § 3570(7).

Delaware APTs that are covered in 3, above. In short, Delaware and non-Delaware residents should be able to take advantage of this technique for tenancies in personal property, but its effectiveness for tenancies in non-Delaware real property is questionable.

J. Power to Adjust and Total-Return Unitrust Statutes

1. Introduction

For generations, lawyers drafted trusts that direct the trustee to distribute the income (e.g., interest, dividends, and rent) to a beneficiary for a specified period of time—normally the life of that beneficiary. Often, the trustee has a discretionary power (which usually requires it to assess the current beneficiary's needs) to distribute principal to that beneficiary. At the current beneficiary's death, the remaining principal (which usually includes capital gains incurred during the trust's administration) will go to, or continue in trust for, a beneficiary or group of beneficiaries.

Traditionally, trustees invested trust assets to produce enough income to meet the current beneficiary's needs. At one extreme, a trustee might invest all trust assets in stocks that pay no dividends and thereby generate no current income. At the other extreme, a trustee might invest all trust assets in junk bonds and thereby generate substantial interest income. Trustees understand that these extremes might accomplish income goals but create unacceptable investment risk. The trustee's obligation to preserve or grow principal for the remainder beneficiaries as well as to produce income for the current beneficiary renders the trustee's task more difficult. Consequently, trustees select a mix of investments to provide satisfactory income flow and an opportunity for principal growth. In so doing, trustees risk displeasing both groups.

Since the 1980s, all states have replaced the prudent-man rule with the prudent-investor rule for assessing a trustee's investment performance. Under the latter standard, the trustee's performance is measured on the whole portfolio rather than on the asset-by-asset basis of the prudent-man rule. The prudent-investor rule compels trustees to invest trust assets for total return. The goal is to maximize the sum of income and growth irrespective of income yield, which requires a heavier emphasis on stocks and a lighter emphasis on fixed-income investments than in the past.

2. The Problem

In recent years, current beneficiaries of irrevocable trusts have seen their distributions decrease for two reasons. First, trustees have been investing more heavily in equities, and equities normally provide less current income than fixed-income investments. Second, the interest provided by fixed-income investments and the dividends provided by stocks have been falling. Indeed, some widely held stocks pay no dividend at all. This situation has been particularly pronounced for beneficiaries of income-only trusts such as traditional marital-deduction trusts with no discretion to distribute principal to the surviving spouse. Such trusts are particularly common in the case of second marriages where the decedent was survived by children of the first marriage. The pressure to increase distributions is more than that posed by the ability of a surviving spouse to require the trustee of a marital-deduction trust to make trust assets productive. Often, a beneficiary will demand a monthly or quarterly "allowance" of a size that currently available income yields cannot match.

Consider the following example, in 1980, a $1 million trust that was invested 50% in long-term government bonds and 50% in S&P 500 stocks would have produced $78,500 of gross income, but, in 2010, the same trust would have produced only $32,350 of gross income. The gross income of the $1 million trust would have been 58.79% lower in 2010 than in 1980.

As a result of this trend, current beneficiaries more frequently "demand" that trustees increase their distributions.

3. Statutory Changes

To solve the problems raised by declining income yields, the desire of trustees to invest for total return, and the need to balance the interests of current beneficiaries and remainder beneficiaries, states are changing the statutory definition of income. They are considering two types of statutory changes.[473]

The first approach is to amend the state's principal and income act to give trustees the power to adjust income to principal or principal to income if the trustee is managing the trust's investments under the prudent-investor rule, the trust describes the amount that may or must be distributed as "income," and, after application of the provisions of the governing instrument and the statutory rules governing income and principal, the trustee is unable to administer a trust impartially between the current and remainder beneficiaries.[474]

[473] See Christopher P. Cline, The Uniform Prudent Investor and Principal and Income Acts: Changing the Trust Landscape, 42 Real Prop., Prob. & Tr. J. 611, 647–54 (Winter 2008); Richard W. Nenno, The Power to Adjust and Total-Return Unitrust Statutes: State Developments and Tax Considerations, 42 Real Prop., Prob. & Tr. J. 657 (Winter 2008).

[474] See Whittier Trust Co. v. Getty (In re Orpheus Trust), 179 P.3d 562 (Nev. 2008) (trustee may exercise power to adjust retroactively in circumstances). See also Margaret E.W. Sager, Litigation and the Total Return Trust, 35 ACTEC J. 206 (Winter 2009); Sherry A. Levitan & Howard J. Castleman, There Will Be Litigation, 147 Tr. & Est. 56 (Dec. 2008); S. Alan Medlin, Limitations on the Trustee's Power to Adjust, 42 Real Prop., Prob. & Tr. J. 717 (Winter 2008).

The second approach is to revise state law to permit a trustee to pay a percentage of the value of the trust (i.e., a unitrust amount) rather than the fiduciary accounting income to the current beneficiary.

Appendix J shows that, to date, 45 states and the District of Columbia have enacted some form of the power to adjust. Although most of them enacted the power to adjust as part of the rest of the 1997 Uniform Principal and Income Act ("UPAIA"), two states—Iowa and North Dakota—did not include the power to adjust in their versions of the UPAIA and five states—Delaware (UPAIA since adopted), Georgia, Louisiana, Minnesota, and Rhode Island—have enacted the power to adjust but not the rest of the UPAIA.[475]

Appendix J also shows that, to date, 32 states have enacted statutes that permit a trustee of an income trust to convert it to a unitrust, so that, after the conversion, the amount of "income" that must or may be distributed to the current beneficiary or beneficiaries will be defined as a percentage of the total assets of the trust. Because there is no model statute, each jurisdiction must draft its own law.

As shown in Appendix J, 29 states have enacted both the power to adjust and a unitrust-conversion statute, so that a trustee may choose either to follow the traditional income-and-principal rules (in which case it has the power to make adjustments between income and principal) or to convert the trust to a unitrust.

Attorneys are drafting new trusts that provide for the distribution of a unitrust amount to the current beneficiary. Because regulations under IRC § 643 specify that such distributions will be respected for federal tax purposes only if they are allowed by state statutes, 18 state statutes now contemplate that trusts will be drafted in this manner. (See Appendix J.)[476]

4. Federal Tax Safe Harbors

On January 2, 2004, the IRS issued regulations under IRC § 643 ("the § 643 regulations") to redefine income for various purposes under federal tax law, including the definitions of income and distributable net income ("DNI"), qualification for the marital deduction, and modifications of grandfathered generation-skipping trusts.[477]

[475] The text of the UPAIA is available at www.law.upenn.edu/bll/archives/ulc/upaia/2008_final.htm (last visited Sept. 1, 2011). To determine which jurisdictions have enacted the UPAIA, go to www.nccusl.org/LegislativeFactSheet.aspx?title=Principal and Income Act (last visited Sept. 1, 2011).

[476] See PLR 201117005 (Jan. 5, 2011) (3% or 4% QTIP unitrust approved).

[477] T.D. 9102 (Jan. 2, 2004).

The § 643 regulations provide the following safe harbor for a state unitrust conversion statute:[478]

> For example, a state statute providing that income is a unitrust amount of no less than 3% and no more than 5% of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis, is a reasonable apportionment of the total return of the trust.

They provide the following safe harbor for state power-to-adjust statutes:[479]

> Similarly, a state statute that permits the trustee to make adjustments between income and principal to fulfill the trustee's duty of impartiality between the income and remainder beneficiaries is generally a reasonable apportionment of the total return of the trust. Generally, these adjustments are permitted by state statutes when the trustee invests and manages the trust assets under the state's prudent investor standard, the trust describes the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee after applying the state statutory rules regarding the allocation of receipts and disbursements to income and principal, is unable to administer the trust impartially.

The regulations continue by providing the following helpful rules:[480]

> Allocations pursuant to methods prescribed by such state statutes for apportioning the total return of a trust between income and principal will be respected regardless of whether the trust provides that the income must be distributed to one or more beneficiaries or may be accumulated in whole or in part, and regardless of which alternate permitted method is actually used, provided the trust complies with all requirements

[478] Regs. § 1.643(b)-1.

[479] Id.

[480] Id.

> of the state statute for switching methods. A switch between methods of determining trust income authorized by state statute will not constitute a recognition event for purposes of section 1001 and will not result in a taxable gift from the trust's grantor or any of the trust's beneficiaries.

Finally, they give the following warnings for actions that do not fall within the unitrust or power-to-adjust safe harbor:[481]

> A switch to a method not specifically authorized by state statute, but valid under state law (including a switch via judicial decision or a binding non-judicial settlement) may constitute a recognition event to the trust or its beneficiaries for purposes of section 1001 and may result in taxable gifts from the trust's grantor and beneficiaries, based on the relevant facts and circumstances.

5. Observations

The § 643 regulations allay many concerns regarding the federal income-, GST-, and gift-tax consequences of the exercise of the power to adjust and the conversion of income trusts to unitrusts under state statutes that satisfy their safe harbors. Accordingly, the exercise of the power to adjust over a Grandfathered Dynasty Trust[482] or the conversion of such a trust to a unitrust[483] under a qualifying statute will not result in loss of grandfathered status, a taxable gift, or a taxable exchange.

Because the regulations give no such assurance for the exercise of the power to adjust or a unitrust conversion under a nonqualifying statute or without statutory authority, clients should create new trusts in and move existing trusts to states that have statutes that fall within both safe harbors. Pennsylvania's power to adjust might not satisfy the safe harbor because it does not require the trustee to invest under the prudent-investor rule.[484] Similarly, the unitrust conversion statutes of Alaska, Georgia, Maine, Maryland, New Hampshire, Oregon, Pennsylvania, and South

[481] Id.

[482] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 12. See PLRs 201129013–015(Mar. 23, 2011), 201128011–015 (Mar. 23, 2011), 200901030 (Sept. 29, 2008).

[483] Id. Ex. 11. See PLR 201104003 (Oct. 8, 2010).

[484] Louis A. Mezzullo, Final Regulations on the Definition of Fiduciary Income, 19 Prob. & Prop. 26, 28 (Mar./Apr. 2005).

Dakota might not qualify because they permit percentages outside the 3%–5% range.[485] Nonetheless, the IRS did not express concern about possible deviation from that range in rulings that involved such a statute.[486]

Sometimes, it will be appropriate to convert a trust (e.g., a qualified subchapter S trust) to a 3% unitrust; other times, it will be appropriate to convert a trust (e.g., a marital-deduction trust) to a 5% unitrust. Hence, trusts should be created in or moved to states where the entire 3%–5% range is readily available.[487]

The § 643 regulations contain no examples that illustrate the inclusion in or exclusion from DNI of capital gains incurred in connection with the exercise of the power to adjust that falls within their safe harbor, and some commentators are concerned that the inclusion of capital gains in DNI in these circumstances is problematic.[488] Consequently, clients might consider creating trusts in or moving them to states (e.g., Delaware, New Hampshire, or South Dakota) that specifically authorize such inclusion. This might be desirable, for example, if the trustee can distribute taxable gains to offset taxable losses that the beneficiary has in his or her personal portfolio.

6. Delaware's Experience

In 2001, Delaware enacted the first total-return unitrust conversion statute.[489] When the statute is available, the trustee may convert an income trust to a total-return unitrust with or without court approval. The trustee may select a unitrust percentage of not less than 3% nor more than 5%; decide how to account for and value illiquid assets; select the number of prior periods, if any, to use in calculating the unitrust percentage; and determine whether the current beneficiary or the trust will pay income tax attributable to capital gains incurred to make unitrust

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[485] Id. at 31.

[486] See PLRs 201104003 (Oct. 8, 2010); 2010490008 (Aug. 26, 2010); 201025030 (Mar. 10, 2010) (probably South Dakota); 200842028 (July 15, 2008); 200842026 (July 11, 2008); 200840035 (May 23, 2008); 200818019, 200818015, 200818008 (Jan. 14, 2008); 200812018–020, 200810019–022, 200809023–027 (Nov. 30, 2007); 200801011–036, 200752026–028 (Sept. 24, 2007); 200609003 (Nov. 21, 2005).

[487] See Robert B. Wolf, Total Return Trusts—A Decade of Progress, But Are We There Yet? (Parts 1 & 2 of 4), 32 ACTEC J. 5, 26–27 (Summer 2006); Jonathan G. Blattmachr & Mitchell M. Gans, The Final 'Income' Regulations: Their Meaning and Importance, 103 Tax Notes 891, 896–97 (May 17, 2004).

[488] Jonathan G. Blattmachr & Mitchell M. Gans, The Final 'Income' Regulations: Their Meaning and Importance, 103 Tax Notes 891, 914 (May 17, 2004). See PLRs 201129013–015 (Mar. 23, 2011), 201128011–015 (Mar. 23, 2011), 200901030 (Sept. 29, 2008) (capital gain adjusted to income treated as income for tax purposes).

[489] 12 Del. C. § 61-106. See Richard B. Covey & Dan T. Hastings, State Revised Principal and Income Act (1997), Power to Adjust and Unitrust/Total Return Trust Statutes and Ordering Rules for Unitrust Payments, Prac. Drafting app. C at 8256–57 (July 2005).

distributions. Under the Delaware statute, the trustee is not liable if it makes the "wrong" decision.

In 2004, Delaware amended its total-return unitrust statute to take account of three years of experience with the statute and the above regulations that the IRS issued early that year. The 2004 amendments also added a provision to Delaware law that recognizes newly created total-return unitrusts.[490]

Delaware enacted the power to adjust in 2005.[491] In 2009, the power to adjust[492] was moved into Delaware's version of the UPAIA.[493]

K. Court System

1. Introduction

A client should establish a trust in a state where judges will render the "right" decision if the trust ends up in court. I am not aware of a ranking of probate courts, but Appendix K summarizes a 2010 U.S. Chamber of Commerce study that rated the liability systems of the states that should be helpful in assessing this factor.

A Delaware court will not become involved in the administration of a trust unless an interested party seeks relief. When judicial involvement is needed (e.g., when the proper interpretation of the governing instrument is uncertain or a fiduciary is believed to be acting in breach of duty), prompt and efficient relief is available in the Delaware Court of Chancery and, if necessary, the Delaware Supreme Court.[494]

The Chancellor and Vice Chancellors of the Delaware Court of Chancery and the Justices of the Delaware Supreme Court (the courts that handle corporate as well as fiduciary matters in Delaware) are not elected. Instead, the Delaware Constitution requires that they be appointed by the Governor with the consent of a majority of the members of the Senate and that all Delaware judges come as equally as possible from the two major political parties.[495]

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[490] Id. § 61-107.

[491] Id. § 6113.

[492] Id. § 61-104.

[493] Id. §§ 61-101–61-605.

[494] See Randy J. Holland & David A. Skeel, Jr., Deciding Cases Without Controversy, 5 Del. L. Rev. 115, 118–28 (2002).

[495] Del. Const. art. IV, § 3.

2. Administrative Costs

The client should establish his or her trust in a state that will not burden the trust with unnecessary administrative costs. Thus, by making an informed designation of the law to govern matters of administration of the trust, the client may avoid periodic court accounting requirements, statutory fee schedules for trustees, and other undesirable features that would apply if the trust were created in the Home State.[496]

For example, in Delaware, trustees do not have to file inventories or reports for inter vivos or testamentary trusts unless required by the trust or ordered by the court.[497] In Delaware, there is little reason to have judicial accountings because they do not have res judicata effect other than for matters to which exceptions have been taken and that have been determined by the court.[498] Although the Supreme Court of Delaware held in 1973 that a trustee that files a judicial accounting simply to obtain exculpation might have to pay the cost of the accounting itself,[499] the Delaware Court of Chancery held in 2009 that a trustee may pay its accounting costs from a trust if the governing instrument contains appropriate language.[500]

3. Confidentiality

The client should establish a trust in a Trust State that respects confidentiality. In Delaware, for example, if a court proceeding is needed for any reason, the court may, upon request, agree to seal the record so that neither the trust instrument nor the court proceeding becomes a matter of public record.[501]

4. Recourse to Highest Court

Following the United States Supreme Court's decision in Commissioner v. Estate of Bosch,[502] the IRS generally is bound in a tax controversy only if a matter is adjudicated by a state's highest court. Massachusetts law gives the Supreme Judicial Court original jurisdiction in such

[496] See Bogert on Trusts § 301 at 335.

[497] 12 Del. C. § 3522.

[498] Del. Court of Chancery Rule 129.

[499] In re Corcoran Trusts, 282 A.2d 653 (Del. Ch. 1971), aff'd sub nom. Bankers Trust Co. v. Duffy, 295 A.2d 725 (Del. 1972).

[500] Merrill Lynch Trust Co., FSB v. Campbell, 2009 Del. Ch. Lexis 160 at 37–38 (Del. Ch. 2009), appeal dismissed as moot, 2011 Del. Lexis 51 (Del. 2011).

[501] Del. Court of Chancery Rule 5(g).

[502] Comr. v. Estate of Bosch, 387 U.S. 456 (1967).

disputes.[503]

5. Availability of Declaratory Judgment

Whereas courts in some states refuse to consider petitions for declaratory judgment, courts in other states welcome them.[504]

L. Surviving Spouses' Rights of Election

Most common-law jurisdictions allow a surviving spouse to take an elective share of the deceased spouse's assets if the deceased spouse does not provide adequately for the survivor. For good and bad reasons, individuals sometimes ask whether they may defeat their spouses' elective-share rights by creating revocable or irrevocable trusts in other jurisdictions.[505]

The comments to § 270 of the Second Restatement of Conflict of Laws suggest that the designation of a law to govern an inter vivos trust might be disregarded if it would frustrate a surviving spouse's elective-share rights. For various reasons, such a public policy, if it ever existed, probably is not as strong as it once was.[506] Nevertheless, the Restatement, the Scott treatise, and the Bogert treatise all indicate that there should be such an exception.[507] According to the Scott treatise:[508]

> If . . . there is a statute in the settlor's domicil that gives the settlor's surviving spouse an elective share of the trust property, it would appear that for this purpose the settlor's domicil, rather than the place of administration, would have the most significant relationship with the trust. Because the purpose of the statute is to protect the decedent's surviving spouse, the decedent should not be able to avoid that policy simply by creating a trust to be administered in another state, in which there is no, or less, protection for the surviving spouse.

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[503] Mass. Gen. Laws ch. 215, § 6. See Pellegrini v. Breitenbach, 926 N.E.2d 544 (Mass. 2010); Seegel v. Miller, 820 N.E.2d 809 (Mass. 2005); Simches v. Simches, 671 N.E.2d 1226 (Mass. 1996).

[504] See V, D, 3, b, (7), below.

[505] See Restatement (Second) of Conflict of Laws § 265 (1971). See also Jeffrey N. Pennell, Minimizing the Surviving Spouse's Elective Share, 32 U. Miami Inst. on Est. Plan. ¶ 900 (1998).

[506] See Ronald Z. Domsky, Till Death Do Us Part . . . After That, My Dear, You're on Your Own: A Practitioner's Guide to Disinheriting a Spouse in Illinois, 29 S. Ill. U.L.J. 207 (Winter 2005).

[507] Restatement (Second) of Conflict of Laws § 270 cmts. b, e (1971); 7 Scott and Ascher on Trusts § 45.4.2.4 at 3254–60; Bogert on Trusts §§ 294 at 268–70, 297 at 298–99, 301 at 330.

[508] 7 Scott and Ascher on Trusts § 45.4.2.4 at 3255 (footnotes omitted).

But, three pertinent cases go the other way.[509]

Hence, in National Shawmut Bank v. Cumming,[510] the Supreme Judicial Court of Massachusetts applied Massachusetts rather than Vermont law to deny a Vermont widow's attempt to satisfy the elective rights granted her by Vermont law from a Massachusetts trust.

A commentator discusses the other two pertinent cases as follows:[511]

> The courts of at least one other jurisdiction—Illinois—have embraced the principle articulated in Shawmut Bank that the law of the situs of a trust should control with respect to elective share issues. In the first Illinois case to address this issue, Rose v. St. Louis Union Trust Company, an Illinois decedent established an irrevocable trust with a Missouri corporation as trustee. The trust was administered in Missouri, and the trust instrument specified the application of Missouri law to its administration. Under these circumstances, the court ruled that the validity of the trust with respect to the surviving spouse's elective share rights would be determined under Missouri law, which it further determined precluded the spouse from having any rights to the trust property.
>
> In Johnson v. La Grange State Bank, the Supreme Court of Illinois extended its ruling in Rose to assets held in a revocable trust. As described earlier in this article, shortly before her death the decedent in Johnson established a revocable trust in Illinois, naming herself as trustee and La Grange State Bank, an Illinois trust company, as successor trustee. She then moved to Florida and lived there at her death. The decedent's husband brought an action in an Illinois court to set aside the revocable trust insofar as it deprived him of his elective share rights under Florida law. The Supreme Court of

[509] National Shawmut Bank v. Cumming, 91 N.E.2d 337 (Mass. 1950); Rose v. St. Louis Union Trust Co., 253 N.E.2d 417 (Ill. 1969); Johnson v. La Grange State Bank, 383 N.E.2d 185 (Ill. 1978).

[510] Cumming, 91 N.E.2d 337.

[511] Robert T. Danforth, Estate Planning Implications of Surviving Spouse's Elective Share Rights, 22 Tax Mgmt. Est., Gifts & Tr. J. 235, 242 (Nov. 11, 1997) (footnotes omitted). See Ronald Z. Domsky, Till Death Do Us Part . . . After That, My Dear, You're on Your Own: A Practitioner's Guide to Disinheriting a Spouse in Illinois, 29 S. Ill. U.L.J. 207, 225–30 (Winter 2005).

> Illinois ruled that the trust assets were not subject to the surviving spouse's elective share claim. In reaching its decision, the court made the following comment on the relevance of Illinois law:
>
> As our appellate court properly noted, the trust was created in this State, the corpus has remained here, the [surviving spouse] was domiciled here at the time of the decedent's death, and the principal defendants are located in this State.
>
> Based on these factors, the court applied Illinois law and determined that the trust assets were not subject to the spouse's claim.

The Maryland Court of Appeal's 2008 Karsenty v. Schoukroun[512] decision might illustrate a weakening of the strong public policy against defeating surviving spouses' elective-share rights. There, the surviving spouse attempted to reach the assets in the deceased spouse's inter vivos trust. The court summarized its views as follows:[513]

> [W]hen a surviving spouse seeks to invalidate the non-probate disposition of an asset, a scrutinizing court must focus on the nature of the underlying inter vivos transfer. If it was "complete and bona fide" or done in "good faith" (both phrases meaning the same thing in this context), the court must respect the estate planning arrangements of the decedent and may not invalidate the transaction; however if it was "a mere device or contrivance," "a mere fiction," "a sham," or "colorable" (each also sharing the same meaning in this context), the court shall invalidate the underlying transaction as to the surviving spouse. In order to answer this question, a court must consider whether the decedent truly intended that the inter vivos transfer divest her or him of ownership in form, but not in substance. Stated in more practical language, the question for a court to decide is whether the decedent intended that the transfer change nothing, except how the property is directed at the decedent's death. Notwithstanding our previous references to "fraud" on marital rights, because we ultimately are not

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[512] Karsenty v. Schoukroun, 959 A.2d 1147 (Md. 2008).

[513] Id. at 1172–73 (citations omitted). See 755 Ill. Comp. Stat. 25/1 (regarding illusory inter vivos transfers).

> concerned with whether a decedent intended to deprive her or his surviving spouse of property, we emphasize today that it is more helpful for a court to think of a sham transfer in this context as an unlawful frustration of the surviving spouse's statutory share.

The court then enumerated factors for Maryland courts to consider in future cases[514] and remanded the case to the trial court for further proceedings.[515]

The surviving spouse of a Delaware decedent never has been able to reach trust assets by electing against the Will,[516] and Delaware law does not defer to the law of a decedent's domicile to determine a surviving spouse's elective-share rights.[517]

Hence, by creating a revocable or irrevocable trust in Delaware, Illinois, or another state that has comparable laws, a trustor might be able to defeat his or her spouse's elective-share rights.

The IRS shocked the estate-planning world in 2005 when it issued Rev. Proc. 2005-24,[518] which required spouses of trustors of certain post-June 27, 2005, inter vivos CRTs to waive rights to reach such trusts by electing against the Will. Under § 2-205 of the UPC, a surviving spouse may reach the assets of an inter vivos CRT created during his or her marriage to the deceased spouse (but not while the deceased spouse was unmarried or was married to a prior spouse) by electing against the Will.[519] Section 2-205 (or the comparable provision of the earlier version of the UPC) is in effect in at least 13 states―Alaska, Colorado, Hawaii, Kansas, Maine, Minnesota, Montana, Nebraska, New Jersey, North Dakota, South Dakota, Utah, and West Virginia―and a similar statute is in effect in Virginia.[520] Although the IRS deferred the effective date of the revenue procedure in 2006,[521] it alerted taxpayers in 2008 that it has not forgotten the issue by requesting comments on procedures to ensure that elective rights do not

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[514] Id. at 1173–80.

[515] Id. at 1180.

[516] 12 Del. C. §§ 901(a), 908(b). See Bernstein v. Lovett (In re Estate of Bernstein), 17 A.3d 1172 (Del. Ch. 2011).

[517] Id. § 901(b).

[518] 2005-1 C.B. 909 (Apr. 18, 2005). See Wendy C. Gerzog, The Collision Between CRTs and the UPC Elective Share, 111 Tax Notes 583 (May 1, 2006).

[519] UPC § 2-205 (2004).

[520] See Alaska Stat. § 13.12.205; Colo. Rev. Stat. § 15-11-202; Haw. Rev. Stat. § 560:2-205; Kan. Stat. Ann. § 59-6a205; Me. Rev. Stat. Ann. tit. 18-A, § 2-202; Minn. Stat. § 524.2-205; Mont. Code Ann. § 72-2-222; Neb. Rev. Stat. § 30-2314; NJSA § 3B:8-3; N.D. Cent. Code § 30.1-05-02; S.D. Codified Laws § 29A-2-205; Utah Code § 75-2-205; Va. Code Ann. § 64.1-16.1; W. Va. Code § 42-3-2.

[521] Notice 2006-15, 2006-1 C.B. 501 (Feb. 21, 2006).

affect assets for which a charitable deduction was taken on the creation of a CRT.[522] A client therefore should consider choosing a jurisdiction for a CRT where it will be immune from a spouse's election so that the trust's assets will be protected in case the IRS issues similar restrictions in the future or in case a surviving spouse actually elects against the Will.[523]

M. Insurable Interest of Trusts

In 2005, a federal district court in Virginia held that an insurer could rescind an insurance policy owned by an irrevocable life-insurance trust ("ILIT") following the insured's death because the applicant made misrepresentations on the application and because, under Maryland law, the trust lacked an insurable interest in the insured's life.[524] Even though the Fourth Circuit affirmed the district court's holding on the first ground only and vacated its holding on the insurable-interest ground,[525] trustors should create ILITs in states (e.g., Delaware, Florida, Georgia, Maine, Maryland, Oklahoma, South Dakota, Utah, Virginia, or Washington)[526] where a trust clearly has an insurable interest in the insured's life, regardless of the identity of the beneficiaries.

In 2010, the Uniform Laws Commission added § 113 to the UTC to cover this issue.[527] Hence, trustors also may consider Colorado, Kansas, New Mexico, and North Dakota and other states that adopt § 113 for their ILITs.[528]

N. Noncharitable Purpose Trusts

At common law, a trust created for a noncharitable purpose (e.g., to care for pets living at a decedent's death) was invalid because no one could enforce the trust.[529]

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522 2008 TNT 93-33 (May 12, 2008).

523 See Richard W. Nenno, William H. Lunger & Mary B. Hickok, Structuring CRTs as Delaware APTs to Provide Protection From Creditors and Surviving Spouses, 31 Tax Mgmt. Est., Gifts & Tr. J. 71 (Mar. 9, 2006).

524 Chawla v. Transamerica Occidental Life Ins. Co., 2005 U.S. Dist. Lexis 3473 (E.D. Va. 2005).

525 Chawla v. Transamerica Occidental Life Ins. Co., 440 F.3d 639 (4th Cir. 2006).

526 18 Del. C. § 2704(c)(5); Fla. Stat. § 627.404; Ga. Code Ann. § 33-24-3(c); Me. Rev. Stat. Ann. tit. 24-A, § 2402(3)(E); Md. Code Ann., Insurance § 12-201; 36 Okla. Stat. § 3604(c)(4); S.D. Codified Laws § 58-10-4(6); Utah Code Ann. § 31A-21-104; Va. Code Ann. § 38.2-301(B)(5); Wash. Rev. Code § 48.18.030(3)(c). See PHL Variable Ins. Co. v. Price Dawe 2006 Ins. Trust, 2011 Del. Lexis 510 (Del. 2011). See also Stephan R. Leimberg, PHL Variable Insurance Company v. Dawe: Delaware Supreme Court Holds Lack of Insurable Interest Voids Policy Ab Initio, LISI Est. Plan. Newsltr. #1872 (Sept. 26, 2011), available at www.leimbergservices.com.

527 To view UTC § 113, go to www.law.upenn.edu/bll/archives/ulc/iirta/2010final.htm (last visited Sept. 1, 2011).

528 Colo. Rev. Stat. §§ 10-7-704(1)(d), 15-16-501; Kan. Stat. Ann. § 58-113; N.M. Stat. § 46A-1-113 (effective Jan. 1, 2012); N.D. Cent. Code § 59-09-13. To determine which states have enacted UTC § 113, go to www.nccusl.org\LegislativeFactSheet.aspx?title=Insurable Interests Amendment to the Uniform Trust Code (last visited Sept. 12, 2011).

529 Nat'l City Bank v. Pharmacia & Upjohn Co., L.L.C. (In re Estate of Upjohn), 2010 Mich. App. Lexis 352 at 23–24 (Mich. App. 2010) (noncharitable purpose trust did not violate rule against perpetuities). See also Wendy S.

As shown in Appendix L, several state statutes authorize noncharitable purpose trusts to last for 21 years, some state statutes permit such trusts to last for a longer period, and others allow them to be perpetual. Nevertheless, Professor Hirsch explained in 2009 why Delaware then was the only state where one could create a perpetual noncharitable purpose trust:[530]

> Statutes in Wyoming (dating to 2003), Idaho (dating to 2005), Maine (dating to 2005), New Hampshire (as amended in 2006), North Dakota (dating to 2007), and South Dakota (as amended in 2008), likewise set no limit on the duration of a noncharitable purpose trust. Yet all these other statutes are vulnerable to litigation on this score, for none of them affirmatively authorizes perpetual noncharitable purpose trusts. Legislators simply omitted express durational limitations, while also, in most of these states, repealing "the rule against perpetuities."
>
> The respective drafters apparently assumed that perpetual noncharitable purpose trusts become effective once the rule against perpetuities disappears. That assumption is erroneous: The rule against perpetuities applies only to remote contingencies, which a noncharitable purpose trust need not contain. Technically speaking, these trusts are subject to a second, unnamed common-law rule, limiting the duration of a noncharitable purpose trust to "the period" of the rule against perpetuities. Whether a court would construe the repealing statutes so strictly remains uncertain, but they leave sufficient ambiguity as to invite litigation. In comparison, Delaware's repealing statute applies more assuredly to "the common-law rule against perpetuities, [and] any common-law rule limiting the duration of noncharitable purpose trusts."

Goffe, An Introduction to Lesser-Known But Useful Trusts—Part 2, 37 Est. Plan. 3, 3–4 (Aug. 2010); Adam J. Hirsch, Delaware Unifies the Law of Charitable and Noncharitable Purpose Trusts, 36 Est. Plan. 13 (Nov. 2009); Alexander A. Bove, Jr., Rise of the Purpose Trust, 144 Tr. & Est. 18 (Aug. 2005); Adam J. Hirsch, Bequests For Purposes: A Unified Theory, 56 Wash. & Lee L. Rev. 33 (Winter 1999); Adam J. Hirsch, Trusts for Purposes: Policy, Ambiguity, and Anomaly in the Uniform Laws, 26 Fla. St. U.L. Rev. 913 (Summer 1999).

[530] Adam J. Hirsch, Delaware Unifies the Law of Charitable and Noncharitable Purpose Trusts, 36 Est. Plan. 13, 18–19 (Nov. 2009) (footnotes omitted; emphasis in original). See Adam J. Hirsch, Trusts for Purposes: Policy, Ambiguity, and Anomaly in the Uniform Laws, 26 Fla. St. U.L. Rev. 913 (Summer 1999). Effective in 2011, South Dakota abolished the unnamed common-law rule as well (see S.D. Codified Laws § 55-1-20).

IV. CLIENTS' ABILITY TO CHOOSE A JURISDICTION FOR A TRUST

A. Introduction

When someone is creating a trust, the Will or inter vivos instrument, as the case may be, should designate the law of a jurisdiction to govern various aspects of the trust's operation. This IV discusses the effectiveness of such a designation under the Second Restatement of Conflict of Laws[531] and the UTC.

B. Restatement Approach

1. Introduction

To determine how much latitude a client who resides in a Home State has to select the law of a Trust State to govern a trust that he or she creates, the attorney must analyze the conflict-of-law principles that have been developed in trust matters. These matters are covered in Chapter 10 of the Restatement,[532] Chapters 44–46 of the Scott treatise,[533] and Chapter 16 of the Bogert treatise.[534] I must emphasize that the Restatement's objective is to carry out—rather than to defeat— the testator's or trustor's intent.[535]

Under the Restatement, the client's freedom to select the law of a Trust State to govern a trust is a function of the following:

a. Type of Asset Whether the trust holds personal property or real property (the Restatement refers to it as "movables" or "land," respectively);

b. Type of Trust Whether the trust is created by Will or inter vivos; and

c. Type of Question Whether the issue involves:

(1) The "validity" of a trust provision;

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[531] Restatement (Second) of Conflict of Laws (1971). In this IV and in V, below, a reference to the "Restatement" refers to the Second Restatement of Conflict of Laws.

[532] Id. §§ 267–282 (1971). Delaware courts follow the Second Restatement of Conflict of Laws in trust matters (Sloan v. Segal, 2009 Del. Ch. Lexis 70 at 39 n.70 (Del. Ch. 2009)).

[533] 7 Scott and Ascher on Trusts §§ 44.1–46.9.

[534] Bogert on Trusts §§ 291–301.

[535] See Restatement (Second) of Conflict of Laws Ch. 10, Introductory Note (1971).

(2) The “administration” of the trust;

(3) The “construction” of a trust provision; or

(4) Restraints on alienation of a beneficiary’s interest.

2. Summary

The Bogert treatise summarizes the applicable principles as follows:[536]

(A) As to interests in personal property held in a testamentary trust:

1. A testator may designate the local law to govern the validity of the trust, except that (a) his designation will not control if application of the designated law would be contrary to a “strong public policy” of the state of his domicile at death and (b) the designated state must have a “substantial relation” to the trust. A substantial relation exists when the designated state is that in which the trust is administered or in which the trustee has his place of business or his domicile at his death, or is the state of the domicile of the beneficiaries.

2. A testator may designate the state whose local law is to govern construction of the terms of the trust, and it is not required that the designated state have any connection with the trust.

3. A testator may designate the local law of one state to govern administration of the trust even though that state has no relation to the trust, except that on public policy grounds certain matters of

[536] Bogert on Trusts § 301 at 332–33 (emphasis in original). For a detailed discussion of these principles, see Richard W. Nenno, 867 T.M., Choosing a Domestic Jurisdiction for a Long-Term Trust.

administration cannot be controlled by the trust terms. These matters include attempts to grant the testamentary trustee exoneration from liability for failure to exercise prudence or for acts of self-dealing, or a power to fix the value of trust assets for all purposes.

(B) As to interests in <u>personal property</u> held in a <u>living</u> <u>trust</u>:

1. The settlor of a living trust may designate the local law of one state to govern the <u>validity</u> of the trust (a) if that state has a substantial relation to the trust and (b) if application of its local law does not violate a "strong public policy of the state with which as to the matter at issue the trust has its most significant relationship."

2. As in the case of a testamentary trust, a settlor may designate the state whose local law is to govern <u>construction</u> under the terms of the trust; the designated state need not have any connection with the trust.

3. Except where matters of administration cannot be controlled by the trust terms on public policy grounds, a settlor may designate the local law of one state to govern administration of the trust even though that state has no relation to the trust.

(C) As to trust interests in <u>real property</u>:

The opportunity of a testator or settlor of a trust of land to effectively designate a local law of a state other than that of the situs of the land to govern the validity and administration of a trust of land is more

> limited. The effectiveness of such a designation will depend upon whether the situs courts recognize the designated state as having a more significant relationship to the particular issue than the situs state.
>
> Generally speaking, questions relating to the validity or administration of a trust of land, whether living or testamentary, will be governed by the law that would be applied by the courts of the situs state, in most cases (but not necessarily) its own local law. The "legal effect" of a trust of land, as that term has been defined hereinabove (section 293), will depend upon the local law of the situs of the land. As in the case of a trust of personal property, the courts will give effect to a provision in the trust instrument that the trust of land should be construed in accordance with the rules of construction in effect in a particular state, whether or not those of the situs state.

C. UTC Approach

Section 107 of the UTC provides in relevant part that:[537]

> The meaning and effect of the terms of a trust are determined by:
>
> (1) the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue . . . .

Section 107's comment describes the general rule as follows:[538]

> Paragraph (1) allows a settlor to select the law that will govern the meaning and effect of the terms of the trust. The jurisdiction selected need not have

[537] UTC § 107(1) (2005).

[538] Id. cmt.

> any other connection to the trust. The settlor is free to select the governing law regardless of where the trust property may be physically located, whether it consists of real or personal property, and whether the trust was created by will or during the settlor's lifetime. This section does not attempt to specify the strong public policies sufficient to invalidate a settlor's choice of governing law. These public policies will vary depending upon the locale and may change over time.

UTC § 107 is concerned with matters of "meaning and effect," which seem to correspond most closely to matters of "construction" under the Restatement. Regarding other matters, § 107's comment provides:[539]

> Usually, the law of the trust's principal place of administration will govern administrative matters and the law of the place having the most significant relationship to the trust's creation will govern the dispositive provisions.

To determine a trust's "principal place of administration," UTC § 108(a) stipulates:[540]

> (a) Without precluding other means for establishing a sufficient connection with the designated jurisdiction, terms of a trust designating the principal place of administration are valid and controlling if:
>
> (1) a trustee's principal place of business is located in or a trustee is a resident of the designated jurisdiction; or
> (2) all or part of the administration occurs in the designated jurisdiction.

Regarding the governance of the trust's "dispositive provisions," which seems to correspond to "validity" under the Restatement, § 107's comment refers to "the law of the place having the most significant relationship to the trust's creation."[541]

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[539] Id.

[540] Id. § 108(a).

[541] Id. § 107 cmt.

No UTC section or comment addresses what state's law governs the ability of creditors to reach a trust beneficiary's interest, but UTC § 106 provides that matters not covered by the UTC are to be resolved under common-law principles,[542] so that the above discussion of the Restatement's treatment of these issues remains relevant.

Section 107's comment offers guidance when the relative interests of two jurisdictions are being weighed (e.g., to determine which state's law governs a trust's "dispositive provisions" or their "meaning and effect").[543] The factors to be considered are based on and therefore are quite similar to the Restatement guidelines. I quote and analyze them in V, D, 3, b, below.

D. Suggested Language

If a client wants an inter vivos trust to be governed by the law of a particular state and to have all issues involving the trust adjudicated there, he or she might include the following language:

> This agreement creates a [Trust State] trust, and all matters pertaining to the validity, construction, and application of this agreement or to the administration of the trusts created by it shall be governed by [Trust State] law. The courts of [Trust State] shall have exclusive jurisdiction over any action brought with respect to a trust hereunder.

If the client wants the law that governs questions of administration and the supervising court to change if the trust's situs is moved to another state, the following sentence might be inserted after the above sentences:

> However, if the successor trustee hereunder is located in any state other than the State of [Trust State], the situs of such trust shall become that of the location of the successor trustee, and thereafter the laws governing the administration of such trust shall be those of the new situs and the courts of that state shall have exclusive jurisdiction over any action brought with respect to a trust hereunder.

V. BENEFICIARIES' ABILITY TO DEFEAT CLIENT'S SELECTION OF A TRUST STATE

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542 Id. § 106.

543 Id. § 107 cmt. (cross references omitted).

A. Introduction

Suppose that a client's Will or inter vivos trust designates the law of a Trust State to govern the validity, administration, and construction of trusts created thereunder as well as restraints on alienation of beneficiaries' interests. Also suppose that one or more beneficiaries are unhappy with one or more of the Trust State's laws and seek redress by bringing an action in a court of the Home State. Under what circumstances may a beneficiary defeat a testator's or trustor's designation of a Trust State's law and what may the client and the attorney do in the planning process to counter such an attack? This V will explore these issues in the context of four substantial legal obstacles that the beneficiary and the Home State court must surmount to defeat the designation.

B. Obstacle 1: Home State Court Might Lack Jurisdiction

1. Introduction

Comment a to § 104 of the Second Restatement of Conflict of Laws states in relevant part:[544]

> Due process forbids the rendition of a judgment within the United States unless the State of rendition has judicial jurisdiction. . . . A judgment rendered in violation of these requirements is void in the State of rendition itself, and due process forbids the recognition and enforcement of such a judgment in sister States.

Hence, a Home State court may render a valid judgment against a trustee of a trust only if that court has jurisdiction. Such jurisdiction might be based on in rem jurisdiction over trust assets or personal jurisdiction over a trustee.

2. In Rem Jurisdiction

A Home State court will have in rem jurisdiction over trust assets that are held in the court's jurisdiction.[545] To prevent a Home State court from having in rem jurisdiction over a trust, the trustee should hold all assets in the Trust State because "[a] court sitting in [one state] . . . cannot assert jurisdiction over the corpus of a trust with a situs outside the State."[546]

[544] Restatement (Second) of Conflict of Laws § 104 cmt. a (1971) (citation omitted). See Wilkes v. Phoenix Home Life Mut. Ins. Co., 902 A.2d 366, 382 (Pa. 2006); Estate of Waitzman, 507 So. 2d 24, 25 (Miss. 1987).

[545] Hanson v. Denckla, 357 U.S. 235, 246 (1958).

[546] Walker v. W. Mich. Nat'l Bank & Trust, 324 F. Supp. 2d 529, 534 n.3 (D. Del. 2004), aff'd, 2005 U.S. App. Lexis 16829 (3d Cir. 2005).

3. Personal Jurisdiction—General Principles

Courts may exercise personal jurisdiction over a defendant only if constitutional due process requirements are satisfied.[547] The classic International Shoe Co. v. Washington test is whether a nonresident defendant has "certain minimum contacts with [the forum state] such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice."[548] A court may satisfy this test under either of two theories.[549] The first theory is the "general jurisdiction" theory. Under it, a nonresident defendant's ongoing contacts with the forum state may be so pervasive that jurisdiction is appropriate even in connection with suits over matters separate and distinct from those contacts.[550] A defendant's contacts with the forum must be "a continuous and systematic, [even if] limited, part of its general business."[551]

The second theory is the "specific personal jurisdiction" theory. Under it, jurisdiction is established if: (a) there is a nexus between the defendant, the forum, and the matter in dispute;[552] and (b) the nonresident defendant's link to the forum arises from the defendant's "purposefully avail[ing] itself of the privilege of conducting activities within the forum state."[553]

Courts consider various factors to determine whether sufficient minimum contacts exist to establish personal jurisdiction. These were catalogued, in part, by the United States Supreme Court in World-Wide Volkswagen v. Woodson and include the following acts in the forum state:

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[547] See, e.g., Ins. Corp. of Ireland v. Compagnie Des Bauxites, 456 U.S. 694 (1982); World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286 (1980); International Shoe Co. v. Washington, 326 U.S. 310 (1945). This discussion assumes that the local long-arm statute has been satisfied, which is a prerequisite for the exercise of personal jurisdiction over out-of-state defendants by a state court or a federal court sitting in diversity. See, e.g., Fed. R. Civ. P. 4(k)(2); Walker v. W. Mich. Nat'l Bank & Trust, 324 F. Supp. 2d 529 (D. Del. 2004), aff'd, 2005 U.S. App. Lexis 16829 (3d Cir. 2005); Delgado v. Reef Resort Ltd., et al, 364 F.3d 642 (5th Cir. 2004); Emberton v. Rutt, 2008 U.S. Dist. Lexis 69074 at 7–8 (D.N.M. 2008); Caesars Riverboat Casino, LLC v. Beach, 336 S.W. 3d 51, 57 (Ky. 2011).

[548] International Shoe, 326 U.S. at 316 (internal quotation marks omitted).

[549] See generally Helicopteros Nacionales de Columbia v. Hall, 466 U.S. 408, 414 (1984); Emberton v. Rutt, 2008 U.S. Dist. Lexis 69074 at 12–13 (D.N.M. 2008); Walker v. N. Trust Co., 2007 U.S. Dist. Lexis 4261 at 9–10 (N.D. Ill. 2007).

[550] See, e.g., Rose v. Firstar Bank, 819 A.2d 1247, 1250 (R.I. 2003).

[551] Helicopteros Nacionales, 466 U.S. at 415 (citations and internal quotation marks omitted).

[552] Rose, 819 A.2d at 1251.

[553] Id. See also Walker v. N. Trust Co., 2007 U.S. Dist. Lexis 4261 at 10–11 (N.D. Ill. 2007); Walker v. W. Mich. Nat'l Bank & Trust, 324 F. Supp. 2d 529, 533 (D. Del. 2004), aff'd, 2005 U.S. App. Lexis 16829 (3d Cir. 2005); Sloan v. Segal, 2008 Del. Ch. Lexis 3 at 29–34 (Del. Ch. 2008).

a. Closing sales;

b. Performing services;

c. Soliciting business;

d. Availing themselves of the privileges and benefits of the forum state's law;

e. Indirectly, through others, serving or seeking to serve the forum state's market; and

f. Delivering products into the stream of commerce with the expectation that they will be purchased by consumers in the forum state.[554]

However, not all acts within a state create an adequate nexus for jurisdiction. As a general proposition, occasional trips into a state or receipt of payments issued from inside a state will be insufficient.[555] And, the fact that "several bits of trust administration"[556] may be carried on is also routinely inadequate to establish jurisdiction.

4. Personal Jurisdiction—Trustee Concerns

A Home State court might be able to adjudicate a matter if it has personal jurisdiction over a trustee. One way that a client may avoid this pitfall is to use only trustees with little or no contact with the Home State. This gives courts in the Home State substantially less basis to assert general jurisdiction over the trustee, and the court may be able to assert only specific personal jurisdiction over the trustee. This, however, isn't always an easy task. Although the issue turns on the specific facts of each case, many opinions show that specific personal jurisdiction can't be established over an out-of-state trustee merely because of routine trustee activities like mailings and phone calls from the defendant trustee's state into the plaintiff's state.

The leading case in this area is Hanson v. Denckla,[557] which involved a controversy concerning the right to part of the principal of a trust established in Delaware by a Pennsylvania trustor who subsequently moved to Florida. The United States Supreme Court held that a

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[554] World-Wide Volkswagen, 444 U.S. at 295–98. See, e.g., Emberton v. Rutt, 2008 U.S. Dist. Lexis 69074 at 11–12 (D.N.M. 2008).

[555] See Helicopteros Nacionales, 466 U.S. 408.

[556] Hanson, 357 U.S. at 252.

[557] Id. at 253.

Delaware court was under no obligation to give full faith and credit to a judgment of a Florida court that lacked jurisdiction over the trust's assets and the trustee. The court discussed the jurisdictional issues as follows:[558]

> [I]t is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws. The settlor's execution in Florida of her power of appointment cannot remedy the absence of such an act in this case.

Hanson remains controlling precedent and continues to be the starting point for analyzing whether personal jurisdiction exists in trust cases. Since Hanson, numerous cases have found that sufficient minimum contacts did not exist to create personal jurisdiction,[559] whereas numerous cases also have found that sufficient minimum contacts existed to create such jurisdiction.[560]

5. Rules in Federal District Court

When a case is before a court on the basis of diversity jurisdiction, a federal district court may exercise personal jurisdiction over a nonresident defendant only if a state court in the state where the federal court sits would have jurisdiction.[561] For diversity purposes, a national association is deemed to be a citizen of the state of its headquarters.[562] In an action to remove a trustee, the "amount in controversy" for diversity purposes is the value of the trust.[563]

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[558] Id. at 253–54 (citation omitted).

[559] See, e.g., In re Estate of Ducey, 787 P.2d 749, 752 (Mont. 1990); In re Frumkin, 912 S.W.2d 138 (Tenn. App. 1995); Dreher v. Smithson (In re George M. Naylor Revocable Ins. Tr.), 986 P.2d 721 (Or. Ct. App. 1999); Rose v. Firstar Bank, 819 A.2d 1247, 1255 (R.I. 2003); Nastro v. D'Onofrio, 263 F. Supp. 2d 446, 453 (D. Conn. 2003); Walker v. W. Mich. Nat'l Bank & Trust, 324 F. Supp. 2d 529, 534 (D. Del. 2004), aff'd, 2005 U.S. App. Lexis 16829 (3d Cir. 2005); Walker v. N. Trust Co., 2004 U.S. Dist. Lexis 15012 (D. Del. 2004), aff'd, 2005 U.S. App. Lexis 16829 (3d Cir. 2005); Andreas v. Stisser (In re Estate of Stisser), 932 So. 2d 400, 402 (Fla. Dist. Ct. App. 2006); Walker v. N. Trust Co., 2007 U.S. Dist. Lexis 4261 at 13–15 (N.D. Ill. 2007).

[560] See, e.g., Seijo v. Miller, 425 F. Supp. 2d 194, 201 (D.P.R. 2006); Cummings v. Pitman, 239 S.W.3d 77, 80, 82 n.3, 89 (Ky. 2007); Sloan v. Segal, 2008 Del. Ch. Lexis 3 at 33–34 (Del. Ch. 2008); Emberton v. Rutt, 2008 U.S. Dist. Lexis 69074 at 23–32 (D.N.M. 2008); Anglo Irish Bank Corp., PLC v. Superior Court, 165 Cal. App. 4th 969, 981–85 (Cal. Ct. App. 2008).

[561] Walker v. N. Trust Co., 2007 U.S. Dist. Lexis 4261 at 7–8 (N.D. Ill. 2007); Seijo v. Miller, 425 F. Supp. 2d 194, 198 (D.P.R. 2006).

[562] Wachovia Bank, N.A. v. Schmidt, 546 U.S. 303 (2006).

[563] See Glass v. Steinberg, 2010 U.S. Dist. Lexis 3483 at 8–9 (W.D. Ky. 2010).

6. Implications

If the trustee of a trust has extensive contacts in the Home State, the Home State court will have jurisdiction, but if all trustees and trust assets are located in the Trust State and if the trustees have insufficient contacts in the Home State, the Home State court will fail to have jurisdiction over the trust. Admittedly, the minimum-contacts issue can provoke sharp debate, but this is still a significant hurdle for plaintiffs to overcome.

Nonetheless, although the facts may sometimes be murky, the law is very clear: courts from Home States can't enter valid orders or judgments against a trustee unless the court has personal jurisdiction over the trustee, nor can it enter orders or judgments against trust assets that are safely beyond the forum state's borders. This will indeed be a serious obstacle in many cases. But, even if jurisdiction exists, the court's analysis is only beginning.

C. Obstacle 2: Home State Court Should/Must Decline Jurisdiction

1. Restatement Approach—Movables

For trusts of movables created by Will or inter vivos, § 267 of the Restatement provides that:[564]

> The administration of a trust of interests in movables is usually supervised . . . by the courts of the state in which the trust is to be administered.

A comment to § 267 indicates that the Will or trust instrument may designate the state of administration,[565] and a later comment describes the implications of such a designation as follows:[566]

> If the trust is to be administered in a particular state, that state has jurisdiction to determine through its courts not only the interests of the beneficiaries in the trust property but also the liabilities of the trustee to the beneficiaries, even though it does not have jurisdiction over the beneficiaries, or some of them. . . . .
>
> So also a court of the state in which the trust is

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[564] Restatement (Second) of Conflict of Laws § 267 (1971). See 7 Scott and Ascher on Trusts §§ 45.2.2.4.1 at 3102–14, 45.2.2.4.2 at 3114–22, 45.2.2.5 at 3122–25; Bogert on Trusts § 292 at 237–46.
[565] Id. cmt. c.

[566] Id. cmt. d.

> administered may give instructions as to the powers and duties of the trustee, although the beneficiaries or some of them are not subject to the jurisdiction of the court, provided they are given opportunity to appear and be heard.

Another comment discusses the role of the court of primary supervision as follows:[567]

> Where the trustee has not qualified as trustee in any court and the trust is to be administered in a particular state, the courts of that state have primary supervision over the administration of the trust. They have and will exercise jurisdiction as to all questions which may arise in the administration of the trust. Thus, if an inter vivos trust is created with a trust company as trustee, the courts of the state in which the trust company was organized and does business will exercise jurisdiction over the administration of the trust.

If the Home State court has jurisdiction over the trustee or the trust, comment e to § 267 suggests that it should defer to the Trust State's courts.[568]

The Scott treatise summarizes the applicable principles as follows:[569]

> Trust administration is ordinarily governed by the law of the state of primary supervision, and the rights of the parties ought not depend on the fact that a court of some other state happens to have acquired jurisdiction. Such a court may give a judgment based on its own local law, or it may attempt to apply the law of the state of primary supervision but apply it incorrectly.

These principles have been codified in some states. Section 7-203 of the Uniform Probate Code ("UPC") provides as follows:[570]

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[567] Id. cmt. e.

[568] Id. See Holdeen Trust, 58 Pa. D.&C.2d 602, 622–25 (O.C. Div. Phila. 1972) (summarizing cases in which Home State court deferred to court of primary supervision).

[569] 7 Scott and Ascher on Trusts § 45.2.2.6 at 3125.

[570] UPC § 7-203 (2008). The text of the UPC may be viewed at www.law.upenn.edu/bll/archives/ulc/upc/2008final.htm (last visited Sept. 1, 2011). To determine which states have adopted the UPC, go to www.nccusl.org/LegislativeFactSheet.aspx?title=Probate Code (last visited Sept. 1, 2011).

> The Court will not, over the objection of a party, entertain proceedings under Section 7-201 involving a trust registered or having its principal place of administration in another state, unless (1) when all appropriate parties could not be bound by litigation in the courts of the state where the trust is registered or has its principal place of administration or (2) when the interests of justice otherwise would seriously be impaired. The Court may condition a stay or dismissal of a proceeding under this section on the consent of any party to jurisdiction of the state in which the trust is registered or has its principal place of business, or the Court may grant a continuance or enter any other appropriate order.

Currently, § 7-203 is or will be in effect in the above form in at least seven states[571] and Florida's version does not even contain the interests-of-justice exception.[572]

The identical predecessor to the Florida statute was considered in Meyer v. Meyer.[573] There, a beneficiary of a trust, which was created by a New York resident but which was governed by Florida law, brought suit in Florida to obtain funds to which she allegedly was entitled. As permitted by the trust, the trustee had relocated the trust from Florida to New York. The court reversed the lower court and held:[574]

> New York is the principal place for administration of the trust because the trustee is a resident of that state and the trustee's attorney for legal matters pertaining to the trust is also in New York. In any event, the trust agreement provides the trustee discretion to remove the principal place of the trust from Florida to another state if he or she desires. Since the trustee has chosen New York, the choice of law provision in the trust agreement does not present a sufficient legal basis for affirmance.

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[571] Alaska Stat. § 13.36.045; Colo. Rev. Stat. § 15-16-203; Haw. Rev. Stat. § 560:7-203; Idaho Code § 15-7-203; Mass. Gen. Laws ch. 190B, § 7-203 (effective Jan. 2, 2012); Mich. Comp. Laws § 700.7205; Utah Code Ann. § 75-7-204.

[572] Fla. Stat. § 736.0205.

[573] Meyer v. Meyer, 931 So. 2d 268 (Fla. Dist. Ct. App. 2006).

[574] Id. at 270–71.

Caselaw confirms that courts are cautious about construing trust questions governed by the laws of other states and that consequently they often abstain from exercising jurisdiction. For example, in Bartlett v. Dumaine,[575] the New Hampshire Supreme Court deferred to Massachusetts courts in a suit regarding the duties of trustees of a Massachusetts trust to account to its beneficiaries, even though the New Hampshire court had personal jurisdiction over all interested parties. The Scott treatise cites cases from Illinois, New York, Pennsylvania, and Texas that reached comparable results.[576]

If it is important for proceedings involving a trust to be handled in Trust State courts, the trustee and beneficiaries might commence a proceeding (e.g., to appoint a successor trustee, to make a unitrust conversion) early in the trust's existence to confirm jurisdiction.

2. Restatement Approach—Land

The testator or trustor is much more constrained for trusts that hold interests in land created by Will or inter vivos. Hence, § 276 of the Restatement provides as follows:[577]

> The administration of a trust of an interest in land is supervised by the courts of the situs as long as the land remains subject to the trust.

3. UTC Approach

No UTC provision covers this subject. Indeed, in enacting their versions of the UTC, several states repealed and, except for Florida and Michigan, did not replace their versions of UPC § 7-203, quoted above.

4. Federal District Court

When a case involving a trust meets the requirements for diversity jurisdiction[578] so that the case may be removed from state to federal

[575] Bartlett v. Dumaine, 523 A.2d 1, 14–15 (N.H. 1986). But see Flaherty v. Flaherty, 638 A.2d 1254, 1255–57 (N.H. 1994) ("Since the New Hampshire Superior Court issued the divorce decree, it should decide every facet of the property division," but Massachusetts law governed construction, administration, and creditor rights issues).

[576] 7 Scott and Ascher on Trusts § 45.2.2.4.1 at 3112 n.36. See, e.g., Walton v. Harris, 647 N.E.2d 65, 67–69 (Mass. App. Ct. 1995) (Massachusetts courts could exercise jurisdiction because Massachusetts continued to be situs even though assets had been moved to Florida); Holdeen Trust, 58 Pa. D.&C.2d 602, 612–22 (O.C. Div. Phila. 1972) (Pennsylvania courts could exercise jurisdiction because settlor set administration in Pennsylvania even though assets were in New York).

[577] Restatement (Second) of Conflict of Laws § 276 (1971). See id. cmt. b; 7 Scott and Ascher on Trusts §§ 46.2.2–46.2.2.2 at 3373–82, 46.2.3–46.2.3.2 at 3382–89; Bogert on Trusts § 292 at 237–46.

[578] See 28 U.S.C. § 1332.

court, the federal district court must decide whether to exercise jurisdiction. Sometimes such courts decline to do so,[579] other times they do not.[580]

D. Obstacle 3: Home State Court Should Apply Trust State Law

1. Restatement Approach―Movables

a. Introduction

In IV above, I summarized the provisions of the Restatement regarding the effectiveness of a designation by a testator or trustor of a law to govern the validity, administration, and construction of a trust of movables as well as restraints on alienation of beneficiaries' interests.

b. Sections 269 and 270—Validity

(1) Introduction

Section 269 of the Restatement covers the law that is used to resolve questions involving the validity of provisions of a trust of movables created by Will,[581] and § 270 covers the law that is used to resolve questions involving the validity of provisions of a trust of movables created inter vivos.[582]

When analyzing the validity of a trust provision under § 269 or § 270, it is necessary to answer the following three questions:

(a) Is the question one of "validity"?

(b) Does the Trust State have a substantial relation to the trust?

(c) Does the trust provision in question violate a strong public policy of the Home State?

For an inter vivos trust it also is necessary to determine whether the Trust State or the Home State has the most

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[579] See Norton v. Bridges, 712 F.2d 1156 (7th Cir. 1983).

[580] See Barnes v. Brandrup, 506 F. Supp. 396 (S.D.N.Y. 1981).

[581] Restatement (Second) of Conflict of Laws § 269 (1971).

[582] Id. § 270. See Toledo Trust Co. v. Nat'l Bank of Detroit, 362 N.E.2d 273, 278–79 (Ohio Ct. App. 1976).

significant relationship to the matter at issue.

(2) Questions of Validity

The "validity" of trust clauses addresses matters such as whether the trust violates the rule against perpetuities or a rule against accumulations.[583] The ability of creditors to reach trust assets is not a matter of validity but is addressed separately by the Restatement.

(3) Substantial Relation to the Trust

The Trust State has a substantial relation to the trust if, inter alia, the trustor designated it as the place of the trust's administration, the trustee lives or does business in the Trust State when the trust is created, or the trust assets are located in the Trust State at that time.[584]

(4) Strong Public Policy

According to the authorities, the strong-public-policy issues that justify a departure from § 270's general rule involve trust provisions designed to defeat a surviving spouse's right of election and that violate a state's restrictions on testamentary gifts to charity,[585] but they do not include jurisdictional differences in the rule against perpetuities or the rule against accumulations.[586] Moreover, the spousal elective share exception is not always followed as a matter of common law, and courts have sometimes allowed deceased spouses from one state to establish inter vivos trusts under the law of another state to defeat their surviving spouse's elective shares.[587]

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[583] Id. § 269 cmt. d.

[584] Id. § 270 cmt. b. See Annan v. Wilmington Trust Co., 559 A.2d 1289, 1293 (Del. 1989) (Delaware courts recognized trust agreement's designation of Quebec law because trust was created and initially administered in Quebec).

[585] Id. §§ 269 cmts. c, i, 270 cmts. b, e; 7 Scott and Ascher on Trusts § 45.4.2.4 at 3254–60; Bogert on Trusts §§ 294 at 268–70, 297 at 298–99, 301 at 330.

[586] Id. cmt. i. See Equitable Trust Co. v. Ward, 48 A.2d 519, 529 (Del. Ch. 1946) (Delaware Court of Chancery held that testamentary trust created by Pennsylvania testator to be administered in Delaware did not violate Pennsylvania rule against accumulations).

[587] See III, L, above.

(5) Most Significant Relationship to the Matter at Issue

Section 270 refers to § 6 of the Restatement quoted above on this issue.[588] I discuss this subject in detail below with respect to the UTC.

c. Sections 271 and 272—Administration

A trustor's designation of a state's law to govern questions regarding the administration of a testamentary trust[589] or inter vivos trust[590] of personal property will be respected, even if the designated state has no connection with the trust. Administration questions involve the duties, powers, and liability of the trustee; trust investments; the trustee's right to compensation and indemnity; the replacement of the trustee; and the beneficiaries' power to terminate the trust.[591]

d. Section 268—Construction

A testator's or trustor's designation of the law of a state to govern questions regarding the construction of a trust that holds personal property will be respected, even if the designated state has no connection with the trust.[592] Construction questions involve the identity of the beneficiaries and, generally, decisions involving allocations between principal and income.[593]

e. Section 273—Restraints on Alienation of Beneficiaries' Interests

For trusts that hold personal property, the analytical starting point for determining whether creditors may reach trust assets is § 273 of the Restatement.[594] Section 273 and its comments specify that

[588] Restatement (Second) of Conflict of Laws § 6(2) (1971).

[589] Id. § 271(a). See Pitts v. First Union Nat'l Bank, 262 F. Supp. 2d 593, 595–96 (D. Md. 2003) ("In the absence of a written choice of law provision in the applicable document, Maryland will apply the law of the state whose law governs the administration of the trust").

[590] Id. § 272.

[591] Id. § 271 cmt. a.

[592] Id. § 268. See In re Dumaine, 600 A.2d 127, 129 (N.H. 1991) (New Hampshire court honored designation of New Hampshire law on construction question); In re Lykes Estate, 305 A.2d 684 (N.H. 1973) (New Hampshire court honored designation of Texas law on construction question).

[593] Id.

[594] Id. § 273. See Estate of German, 7 Cl. Ct. 641 (Cl. Ct. 1985) (In suit to establish whether estate was entitled to estate-tax refund, court, without discussion, applied Maryland law (law designated by trust) not Florida law (law of trustor's domicile) to determine whether creditors could reach trustor's interest).

the law of the place of administration designated by the testator or trustor is to be respected and do not contemplate that a different rule might apply if the law of the Trust State violates a strong public policy of the Home State. Consequently, the law that governs a trust should be determinative with respect to the ability of creditors to reach its assets without further inquiry.

For inter vivos trusts, the Scott treatise suggests that there might be a strong-public-policy exception to the rule in § 273.[595] It does not discuss whether a state's provision of greater protection from creditor claims for an inter vivos trust amounts to a violation of a forum state strong public policy, but, in discussing the issue for testamentary trusts (where the law of the testator's domicile traditionally is given more weight than the law of the domicile of the trustor of an inter vivos trust), it takes the position that a difference in the effectiveness of spendthrift clauses should not justify a departure from the general rule.[596] Indeed, the Scott treatise criticizes dictum in Erdheim v. Mabee,[597] which suggested that forum courts should have more latitude.[598]

The Scott treatise summarizes the applicable principles as follows:[599]

> There are conflicting policies in the various states as to the rights of the creditors of a beneficiary of a trust of movables to reach the beneficial interest, and as to the rights of an assignee of such an interest. In some jurisdictions, the policy is to protect the beneficiary; in others, the policy is to protect creditors and assignees; and in yet others, the policy attempts, within limits, to protect all of them. When more than one jurisdiction is involved, the question is which jurisdiction's law should apply.
>
> Although the matter is not entirely clear, we submit that the applicable law should, ordinarily at least, be that of the situs of the

[595] 7 Scott and Ascher on Trusts § 45.7.1.2 at 3350.

[596] Id. § 47.7.1.1 at 3345.

[597] Erdheim v. Mabee, 113 N.E.2d 433 (N.Y. 1953).

[598] 7 Scott and Ascher on Trusts § 45.7.1.1 at 3347.

[599] Id. § 45.7.3 at 3365–66 (footnote omitted).

> trust. To the extent that under that law a beneficiary's interest cannot be reached by creditors or assignees, it ought not be possible to reach that interest simply by choosing a different forum . . . .
>
> If under the law of the situs of the trust a beneficiary's interest cannot be reached, it should ordinarily be immaterial that the plaintiff chooses to bring the proceeding in a jurisdiction in which the result would or might have differed. The law of the forum, merely because it is the law of the forum, should not apply. It should also generally be immaterial where the beneficiary is domiciled, where the creditor or assignee is domiciled, and where the debt was incurred or the assignment was made.

Until very recently, the effectiveness of spendthrift clauses in third-party trusts was quite controversial, and, when the 4th edition of the Scott treatise was published in 1989, some states did not respect spendthrift trusts at all, whereas others did so to one degree or another. It nevertheless suggested that differences between these laws did not constitute differences of "strong public policy."

2. Restatement Approach—Land

In IV above, I also summarized the provisions of the Restatement regarding the effectiveness of a designation by a testator or trustor of a law to govern the validity, administration, and construction of a trust of land as well as of restraints on alienation of beneficiaries' interests. Although the law that governs questions of construction for a trust of land is the law designated by the testator or trustor,[600] the law that governs questions of validity,[601] administration,[602] or restraints on alienation[603] for such a trust is the law that would be applied by the courts of the situs of the land.

3. UTC Approach

[600] Restatement (Second) of Conflict of Laws § 277 (1971).

[601] Id. § 278.

[602] Id. § 279.

[603] Id. § 280.

a. General

Under the UTC, a Home State's public policy may not bar application of a Trust State's law regarding the "meaning and effect" of a trust provision unless the Home State has the "most significant relationship" to the trust.[604] More significantly for present purposes, a trust's "dispositive provisions" are governed by the law of "the place having the most significant relationship to the trust's creation."[605]

As a general rule of trust law, the overriding principle of construction is that courts should discern and honor a trustor's intent whenever possible.[606] This rule applies in choice-of-law issues as well,[607] and "[t]he jurisdiction selected need not have any other connection to the trust."[608] Any other considerations are typically just factors used to divine a trustor's intent when it is

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[604] UTC § 107(1) (2005).

[605] Id. cmt.

[606] See, e.g., Nixon v. Wilmington Trust Co., 543 F.3d 354, 356 (6th Cir. 2008); Ladysmith Rescue Squad, Inc. v. Newlin, 280 Va. 195, 201–02 (2010); Smith v. Hallum, 286 Ga. 834, 836 (2010); Matter of Singer, 13 N.Y.3d 447, 451 (2009); Feinberg v. Feinberg (In re Estate of Feinberg), 919 N.E. 2d 888, 896 (Ill. 2009); Chavin v. PNC Bank, 816 A.2d 781, 783 (Del. 2003); Dickinson v. Wilmington Trust Co., 734 A.2d 605, 609 (Del. Ch. 1999), aff'd, 734 A.2d 642 (Del. 1999); Domo v. McCarthy, 612 N.E.2d 706, Syl. ¶ 1 (Ohio 1993); Scharlin v. Superior Court, 11 Cal. Rptr. 2d 448, 451–52 (Cal. Ct. App. 1992); Central Trust Co. of Northern Ohio, N.A. v. Smith, 553 N.E.2d 265, 270 (Ohio 1990).

[607] Rudow v. Fogel, 426 N.E.2d 155, 160 (Mass. Ct. App. 1981); The First Nat'l Bank of Mount Dora v. Shawmut Bank of Boston, 389 N.E.2d 1002, 1008 (Mass. 1979); National Shawmut Bank v. Cumming, 91 N.E.2d 337, 341 (Mass. 1950). See also Conflict of Laws as to Trusts Inter Vivos, 139 A.L.R. 1129, 1130 (1942).

[608] See UTC § 107 cmt. (2005).

not expressed.[609] This rule honoring a trustor's intent is well established in Delaware.[610]

b. Application

When the relative interests of jurisdictions are being weighed, the UTC sets the following guidelines for determining which state has the most significant relationship to a trust:[611]

> Factors to consider in determining the governing law include the place of the trust's creation, the location of the trust property, and the domicile of the settlor, the trustee, and the beneficiaries. Other more general factors that may be pertinent in particular cases include the relevant policies of the forum, the relevant policies of other interested jurisdictions and degree of their interest, the protection of justified expectations and certainty, and predictability and uniformity of result.

These factors can be managed or addressed in ways that maximize the Trust State's relation to a trust and/or minimize the Home State's relation.

(1) Place of Trust's Creation

A trust executed by a trustee in a particular state is typically deemed to be created in that state.[612] Accordingly, so long as a trustee executes its trust in the Trust State, the "place of creation" test is satisfied. To be safe, a trustor could also execute the trust in the Trust State.[613] Because a prudent client should meet with his or her trustee in any event, a trip to the trustee's place of business is hardly a serious burden. Additionally, a trust's situs, which arises from the creation of a trust, is based on the trustee's domicile and the trust's place of

[609] Conflict of Laws, 139 A.L.R. at 1130.

[610] See Wilmington Trust Co. v. Wilmington Trust Co., 186 A. 903, 907–08 (Del. Ch. 1936), modified on rehearing on other grounds, 15 A.2d 153 (Del. Ch. 1940), aff'd, 24 A.2d 309 (Del. 1942). See Annan v. Wilmington Trust Co., 559 A.2d 1289, 1292 (Del. 1989).

[611] UTC § 107 cmt. (2005) (citations omitted).

[612] See, e.g., Cumming, 91 N.E.2d at 341; In re Gower, 184 B.R. 163, 164 (Bankr. M.D. Fla. 1995).

[613] See, e.g., Toledo Trust Co. v. National Bank of Detroit, 362 N.E.2d 273, 278–79 (Ohio Ct. App. 1976).

administration.[614] Hence, accepting and administering a trust from within the Trust State will also, in many cases, be the same as creating the trust in the Trust State.

(2) Location of Trust Property

"[T]he situs of intangibles is often a matter of controversy."[615] The common-law maxim is that "movables follow the person,"[616] and hence personalty is situate where the legal title holder is located.[617] Although this view has been somewhat displaced in recent years by the notion that property is situate where it is physically located,[618] personal property is still often considered situate with the owner.[619] In keeping with this rule, personalty can be situated in a Trust State simply by retitling it in the name of a trustee.[620]

Situs selection may be reinforced by good planning. Certain tangible assets (such as valuables held in a safe deposit box) are easily located within the Trust State. Cash, securities, and comparable assets can be placed in accounts maintained in the Trust State.

(3) Trustee's Domicile

The fact that a trustee is located, incorporated, or organized in the Trust State will make this factor weigh in the Trust State's favor.[621]

(4) Testator's/Trustor's Domicile

A testator's or trustor's domicile in the Home State admittedly lessens the Trust State's relation to a trust. However, in an increasingly mobile society, the weight

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614 Warner v. Florida Bank & Trust Co., 160 F.2d 766, 771 (5th Cir. 1947). See also 90 C.J.S. § 221 (2002).

615 Hanson v. Denckla, 357 U.S. 235, 246–47 (1958).

616 Appraisal Review Board of Galveston County v. Tex-Air Helicopters, Inc., 970 S.W.2d 530 (Tex. 1998); Delaware v. New York, 507 U.S. 490, 503 (1993).

617 Zanes v. Mercantile Bank & Trust Co. of Texas, 49 S.W.2d 922, 926 (Tex. Civ. App.—writ refused 1932). See also Sadler v. Industrial Trust Co., 97 N.E.2d 169, 170 (Mass. 1951).

618 See, e.g., 16 Am. Jur. 2d Conflict of Laws § 52; Bogert on Trusts § 291 at 229.

619 Id.

620 Cf. Cumming, 91 N.E.2d at 339.

621 See, e.g., Toledo Trust Co., 362 N.E.2d at 278–79; Cumming, 91 N.E.2d at 339.

accorded to a testator's or trustor's domicile, which may be transient, can often be considered a less important consideration, and hence given less weight, than the trustee's domicile, particularly that of an institutional trustee with a more-or-less permanent presence in the Trust State. The impact of a testator's or trustor's domicile may be further lessened by other considerations.

(5) Beneficiaries' Domiciles

Not all beneficiaries will necessarily live in the Home State. A scattered group of beneficiaries residing in multiple states dilutes the relationship of any one beneficiary's home state to the trust. And, if the beneficiaries are also mobile, then the permanency and primacy of the trustee's relationship is further heightened. This dilution effect is also manipulable to an extent. A testator or trustor can always name charitable or institutional beneficiaries that reside outside his or her home state, and perhaps even one or more who reside in his or her home state. Such planning will reduce the impact of any one beneficiary's state.

(6) Policies of Forum State—Trust State Not the Forum

This factor's impact is clearly based on which state is the forum for a dispute. If someplace other than the Trust State is the forum, then the Trust State's relation to the trust is arguably diminished, and a local judge may conclude that his or her state—and hence its policy, if any, has a greater relation to the trust.[622]

(7) Policies of Forum State—Trust State as the Forum

If the Trust State is the forum, then that state's relation to a trust, and hence the interest in advancing its policies, is obviously enhanced. This, in turn, suggests that trustors expecting challenges to their trusts might preemptively sue in that state. A preemptive suit could take the form of an

[622] See In re Smith, 415 B.R. 222, 234–35 (Bankr. N.D. Tex. 2009); Dexia Credit Local v. Rogan, 624 F. Supp. 2d 970, 975–76 (Bankr. N.D. Ill. 2009); In re Lawrence, 227 B.R. 907, 917 (Bankr. S.D. Fla. 1998); In re Brooks, 217 B.R. 98, 101–02 (Bankr. D. Conn. 1998); In re Portnoy, 201 B.R. 685, 698 (Bankr. S.D.N.Y. 1996).

action for a declaratory judgment that the Trust State's law applies.[623]

Preemptive suits might raise nettlesome questions of whether the prospective challenger is a necessary or indispensable party to the suit, whether the Trust State had good jurisdiction over him or her, and whether a case has become ripe for adjudication. Nonetheless, if a preemptive suit can be filed in the Trust State, then it should be. This will plainly enhance the Trust State's relation to the trust and give that state's law the legal advantage as to the forum state's policies.

A preemptive suit may also create a very practical advantage—Trust State judges are likely to think long and hard before finding that their own state's relation to a trust is somehow displaced by another state's interest. This is evident in the following passage from the 1957 decision of the Delaware Supreme Court in Lewis v. Hanson:[624]

> [W]e think the public policy of Delaware precludes its courts from giving any effect at all to the Florida judgment of invalidity of the 1935 trust. We are dealing with a Delaware trust. The trust res and trustee are located in Delaware. The entire administration of the trust has been in Delaware. The attack on the validity of this trust raises a question of first impression in Delaware and one of great importance

[623] See Unif. Declaratory Judgments Act § 4 (1922), which is in effect in Alabama (Ala. Code § 6-6-225); Arizona (Ariz. Rev. Stat. § 12-1834); Arkansas (Ark. Code Ann. § 16-111-105); Colorado (Colo. Rev. Stat. § 13-51-108); Delaware (10 Del. C. § 6504); Florida (Fla. Stat. § 86.041); Georgia (Ga. Code Ann. § 9-4-4); Idaho (Idaho Code § 10-1204); Illinois (735 Ill. Comp. Stat. 5/2-701); Indiana (Ind. Code § 34-14-1-4); Iowa (Iowa R. Civ. P. 1.1104); Kansas (Kan. Stat. Ann. § 60-1706); Louisiana (La. Code Civ. Proc. Ann. art. 1874); Maine (Me. Rev. Stat. Ann. tit. 14, § 5956); Maryland (Md. Code Ann., Cts. & Jud. Proc. § 3-408); Minnesota (Minn. Stat. Ann. § 555.04); Missouri (RSMo § 527.040); Montana (Mont. Code Ann. § 27-8-204); Nebraska (Neb. Rev. Stat. § 25-21,152); Nevada (Nev. Rev. Stat. § 30.060); New Jersey (NJSA § 2A:16-55); North Carolina (N.C. Gen. Stat. § 1-255); North Dakota (N.D. Cent. Code § 32-23-04); Ohio (Ohio Rev. Code Ann. § 2721.05); Oklahoma (Okla. Stat. tit. 12, §§ 1651–1657); Oregon (Or. Rev. Stat. § 28.040); Pennsylvania (42 Pa. C.S. § 7535); Rhode Island (R.I. Gen. Laws § 9-30-4); South Carolina (S.C. Code Ann. § 15-53-50); South Dakota (S.D. Codified Laws § 21-24-5); Tennessee (Tenn. Code Ann. § 29-14-105); Texas (Tex. Civ. Prac. & Rem. Code § 37.005); Utah (Utah Code Ann. § 78B-6-410); Vermont (12 V.S.A. § 4714); Virginia (Va. Code Ann. §§ 8.01-184–8.01-191); West Virginia (W. Va. Code § 55-13-4); Wisconsin (Wis. Stat. § 806.04); Wyoming (Wyo. Stat. Ann. § 1-37-105). To view that act go to www.law.upenn.edu/bll/archives/ulc/fnact99/1920_69/udja22.htm (last visited Sept. 1, 2011).

[624] Lewis v. Hanson, 128 A.2d 819, 835 (Del. 1957), aff'd, 357 U.S. 235 (1958). See Sloan v. Segal, 2008 Del. Ch. Lexis 3 at 33–34 (Del. Ch. 2008).

> in our law of trusts. To give effect to the Florida judgment would be to permit a sister state to subject a Delaware trust and a Delaware trustee to a rule of law diametrically opposed to the Delaware law. It is our duty to apply Delaware law to controversies involving property located in Delaware, and not to relinquish that duty to the courts of a state having at best only a shadowy pretense of jurisdiction.

If the filing of a preemptive suit smacks of forum shopping, then so be it. Plaintiffs show no remorse over this practice; there is no reason why trustees should be less willing to use this tool to their advantage.

(8) Policies of Nonforum State

The forum court should consider the relevant policies of other interested states and the degree of their interest. Thus, a Home State court must consider the Trust State's policies and interests.[625] The reverse, of course, also is true—a Trust State court must consider the policies and interests of the Home State. As suggested above, there will sometimes be little conflict between the laws and policies of the Trust State and the Home State. In other instances, there might be. Such conflict merely means that the competing policies may cancel out each other as factors regarding which state has the most significant relationship to a trust, which leaves the outcome determined by other factors, most of which strongly cut in the Trust State's favor.

(9) Justified Expectations, Certainty, Predictability, and Uniformity of Results

These final factors strongly weigh in favor of a Trust State being deemed the state with the most significant relationship to a trust.

As noted above, the primary duty of a court is to discern and apply a testator's or trustor's intent. If a testator or trustor intended a trust to be governed by the Trust State's

[625] See Bartlett v. Dumaine, 523 A.2d 1, 14–15 (N.H. 1986).

law, to contain property legally situate in the Trust State, and to be administered by a Trust State trustee, then it seems probable that the testator or trustor intended that the Trust State have the most significant relationship with the trust. Moreover, these factors also show that both the trustor and the trustee have an expectation that the law will govern.

Considerations of certainty, predictability, and uniformity also point to finding the Trust State's relationship more significant than the Home State. Although Home State courts may only occasionally deal with the Trust State's law in question, Trust State trustees and their many testators, trustors, and beneficiaries have a constant need to know which body of law governs their rights and duties. The knowledge that trusts are governed by Trust State law will facilitate stability, predictability, and uniformity in connection with trust planning and administration. In contrast, an ad hoc, result-oriented approach will create much uncertainty, unpredictability, and inconsistency. Such chaos simply is not good for interstate commerce and transactions. As noted by a Massachusetts court:[626]

> [T]he interests of our interstate system . . . are furthered by applying a single law in determining whether a given situation creates a fiduciary relationship. It is desirable that the same law apply to all property involved in the same transaction wherever situated.

In sum, then, it will be very hard to deny that the Trust State is the state with the most significant relationship to a trust, even if the Home State has a strong public policy regarding the matter at issue.

c. Rights of Creditors

Article 5 of the UTC[627] covers the ability of creditors to reach the assets of third-party and self-settled trusts, and UTC § 105(b)(5)[628] prohibits a governing instrument from departing from

[626] Rudow v. Fogel, 426 N.E.2d 155, 160 (Mass. Ct. App. 1981).

[627] UTC §§ 501–507 (2005).

[628] Id. § 105(b)(5).

that rule. Therefore, a resident of a state that has enacted the foregoing provisions may not create a trust with different terms under that state's law. Nevertheless, he or she may explore creating a domestic APT or a third-party trust containing more protective provisions in another state because the UTC does not offer choice-of-law rules for these issues.

4. Rules in Federal Court

The conflict-of-laws analysis essentially is the same if a controversy ends up in federal district court due to diversity of citizenship. The United States Supreme Court laid down the governing principles in Klaxon Company v. Stentor Electric Manufacturing Company as follows:[629]

> The conflict of laws rules to be applied by the federal court in Delaware must conform to those prevailing in Delaware's state courts. Otherwise, the accident of diversity of citizenship would constantly disturb equal administration of justice in coordinate state and federal courts sitting side by side. Any other ruling would do violence to the principle of uniformity within a state, upon which the Tompkins decision is based. Whatever lack of uniformity this may produce between federal courts in different states is attributable to our federal system, which leaves to a state, within the limits permitted by the Constitution, the right to pursue local policies diverging from those of its neighbors. It is not for the federal courts to thwart such local policies by enforcing an independent general law of conflict of laws. Subject only to review by this Court on any federal question that may arise, Delaware is free to determine whether a given matter is to be governed by the law of the forum or some other law. This Court's views are not the decisive factor in determining the applicable conflicts rule. And the proper function of the

[629] Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487, 496–97 (1941) (footnote, citations, and internal quotation marks omitted). Accord Hobbs v. Legg Mason Inv. Counsel & Trust Co., N.A., 2011 U.S. Dist. Lexis 999 at 7 (N.D. Miss. 2011); 2004 Stuart Moldaw Trust v. XE L.I.F.E., LLC, 642 F. Supp. 2d 226, 232 (S.D.N.Y. 2009) aff'd, 2010 U.S. App. Lexis 5392 at 5 (2d Cir. 2010); Dexia Credit Local v. Rogan, 624 F. Supp. 2d 970, 975 (N.D. Ill. 2009); Murnan v. Stewart Title Guar. Co., 585 F. Supp. 2d 825, 833 n.10 (E.D. Va. 2008); Nixon v. Wilmington Trust Co., 2007 U.S. Dist. Lexis 53931 at 4 (N.D. Ohio 2007), aff'd, 543 F.3d 354 (6th Cir. 2008); Walker v. N. Trust Co., 2007 U.S. Dist. Lexis 4261 at 17 (N.D. Ill. 2007); Pitts v. First Union Nat'l Bank, 262 F. Supp. 2d 593, 595–96 (D. Md. 2003); Hanahan v. Chase Manhattan Bank, 2002 U.S. Dist. Lexis 27350 at 6 (D. Conn. 2002).

> Delaware federal court is to ascertain what the state law is, not what it ought to be.

E. Obstacle 4: Trust State Court Might Not Have to Give Full Faith and Credit to Judgment of Home State Court

In this country, "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State."[630]

1. Respect Due Statutes

The Full Faith and Credit Clause applies to statutes and to judgments of another state, but it does not operate in the same manner with respect to them. The United States Supreme Court examined the Full Faith and Credit Clause's application to state statutes in Franchise Tax Board v. Hyatt,[631] in which the Court unanimously held that the Nevada Supreme Court's refusal to extend full faith and credit to California's statute immunizing its tax-collection agency from suit did not violate the Full Faith and Credit Clause. In contrasting the application of the Full Faith and Credit Clause to statutes and to judgments, the Court stated:[632]

> [O]ur precedent differentiates the credit owed to laws (legislative measures and common law) and to judgments. Whereas the full faith and credit command is exacting with respect to a final judgment . . . rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, it is less demanding with respect to choice of laws. We have held that the Full Faith and Credit Clause does not compel a state to substitute the statutes of other states for its own statutes dealing with a subject matter concerning which it is competent to legislate.

Although the Full Faith and Credit Clause does not compel a court in one state to adopt a statute of another state, a court may not simply ignore a sister state's law and apply its own, and it must satisfy two criteria before its statute may constitutionally displace another state's statute. First, as noted above, a state must be "competent to legislate" regarding the subject matter in question. This criterion is usually easy to satisfy in the absence of some form of preemption or constitutional prohibition. Second, full faith and credit and due process require "that for a State's

[630] U.S. Const. art. IV, § 1.

[631] Franchise Tax Board of California v. Hyatt, 538 U.S. 488 (2003).

[632] Id. at 494 (citations and internal quotation marks omitted).

substantive law to be selected in a constitutionally permissible manner, that State must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair."[633] It's often a close question whether, and to what extent, a state court may apply its own law to the exclusion of another state's law that is arguably more applicable, and, as a constitutional matter, states will be given significant leeway in developing local conflict-of-law rules that satisfy the broad constitutional mandates.[634] Nonetheless, one state cannot disregard another state's statutes when the other state had sufficiently significant contacts to the issues being litigated and the first state's interest was weak.[635]

2. Implications

Although the Home State court often will have constitutional discretion to apply or ignore the Trust State's statutes, the facts of some cases will strongly suggest, or perhaps require, as in Phillips Petroleum Co. v. Shutts,[636] the application of the Trust State's law rather than the Home State's law. On the one hand, a forum court in a defendant's home state may have a strong argument for applying forum law because of the defendant's residence and because the plaintiff, whatever his or her residence, chose the forum. On the other hand, the argument for applying forum law is weaker when a defendant's contact with the forum is limited and the defendant's conduct took place outside the forum state. This has potentially significant impact for out-of-state trustees with limited and minimal ties to the forum state. Even if the United States Constitution doesn't mandate adherence to a Trust State's statute, someone arguing against application of Trust State law must still satisfy the choice-of-law rules that will often weigh in the Trust State's favor, as outlined above.

3. Respect Due Judgments

As noted above, "the full faith and credit command 'is exacting' with respect to a final judgment . . . rendered by a court with adjudicatory authority over the subject matter and persons covered by the judgment."[637] However, this "exacting" requirement has its limits.

[633] Allstate Ins. Co. v. Hague, 449 U.S. 302, 312–13 (1981). Accord Hyatt, 538 U.S. at 494.

[634] See, e.g., Hague, 449 U.S. 302.

[635] See, e.g., Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985) (Kansas not allowed to apply its statutes to oil and gas lease controversies involving properties located in Texas, Oklahoma, and elsewhere).

[636] Id.

[637] Hyatt, 538 U.S. at 494.

To begin, Trust State courts may disregard judgments entered against trustees by Home State courts if the judgment did not satisfy the requirements of due process.[638] Hence, any failure to join a trustee in an action regarding a trust, or any defect in service of process on or jurisdiction over a trustee, can open a Home State court's judgment to collateral attack.

Further, a Trust State court might not have to give full faith and credit to a judgment rendered by a Home State court. In this regard, § 103 of the Restatement states:[639]

> A judgment rendered in one State of the United States need not be recognized or enforced in a sister State if such recognition or enforcement is not required by the national policy of full faith and credit because it would involve an improper interference with important interests of the sister State.

Section 103's comments emphasize that it has an extremely narrow scope of application[640] and would probably include such things as one state refusing to respect a judgment from another state that "purport[s] to accomplish an official act within the exclusive province of that other State or interfere[s] with litigation over which the ordering State had no authority."[641] Nevertheless, authorities indicate that § 103 might apply if a Trust State court is asked to give full faith and credit to a judgment rendered by a Home State court.

The Scott treatise frames the issue as follows:[642]

> In some situations, however, the court that has primary supervision over the administration of the trust may regard the judgment as an undue interference with its power to control trust administration. It may take the position that the court rendering the judgment applied its own local law, though it should have applied the law of the state of primary supervision, or that it incorrectly

[638] Hanson v. Denckla, 357 U.S. 235, 255–56 (1958). See also Nastro v. D'Onofrio, 822 A.2d 286, 292–94 (Conn. 2003); Toledo Trust Co. v. Nat'l Bank of Detroit, 362 N.E.2d 273, 280 (Ohio Ct. App. 1976).

[639] Restatement (Second) of Conflict of Laws § 103 (1971). Accord Bartlett v. Dumaine, 523 A.2d 1 (N.H. 1986).

[640] Id. cmts. a–b.

[641] Baker v. General Motors Corp., 522 U.S. 222, 235 (1998).

[642] 7 Scott and Ascher on Trusts § 45.2.2.6 at 3126.

> applied the law of the state of primary supervision. The question then is whether the court of primary supervision is bound to give full faith and credit to the judgment. The final determination of this question rests, of course, with the Supreme Court of the United States.

As noted above, Hanson v. Denckla held that Delaware did not have to give full faith and credit to a judgment of a Florida court that lacked jurisdiction over the trustee and the trust property. The Scott treatise states that:[643]

> It seems clear that the Florida court in applying its own local law and holding that the Delaware trust and the exercise of the power of appointment thereunder were invalid, unduly interfered with the administration of the trust by the Delaware courts.

It describes the implications of the above observation as follows:[644]

> Since the Delaware court could properly regard the judgment of the Florida court as unduly interfering with the administration of a trust that was fixed in Delaware, it was not bound by that judgment, notwithstanding the fact that the Florida court had jurisdiction over some or all of the beneficiaries. Indeed, it may well be argued that the Delaware court would not be bound by the Florida judgment even if the Florida court had jurisdiction over the trustee also. A court may acquire jurisdiction over an individual trustee who happens to be in the state or over a corporate trustee that happens to have such a connection with the state as to give the state jurisdiction over it, or the trustee may appear in the action. We submit, however, that such a judgment would unduly interfere with the Delaware courts' supervision of the administration of the trust. It might, indeed, be held that not only would the Delaware courts not be bound to give full faith and credit to the Florida judgment, but that the Florida judgment would so interfere with the

[643] Id. at 3128.

[644] Id. at 3128–29 (footnotes omitted).

> administration of the trust that it would be invalid as a denial of due process of law.

The Scott treatise suggests that the same principle should apply in other contexts:[645]

> In Hanson v. Denckla the issue was the validity of the disposition of the trust property. A similar question may arise as to the effect of a judgment rendered by a court, other than that which has primary supervision, instructing the trustee as to the trustee's powers and duties or authorizing or directing the trustee to deviate from the terms of the trust. These matters are ordinarily for determination by the court that has primary supervision over the administration of the trust. Certainly in most cases the courts of other states would decline to exercise jurisdiction, though they happened to have jurisdiction over the trustee or some or all of the beneficiaries. If, however, such a court does exercise jurisdiction, the Supreme Court might well hold that the court of primary supervision is not bound to give full faith and credit to the judgment. Indeed, it might hold the judgment to be invalid, even in the state in which it was rendered, on the ground that it unduly interferes with the administration of the trust and thus constitutes a denial of due process of law.

In the related case of Lewis v. Hanson, the Delaware Supreme Court unequivocally stated that Delaware courts would not have given full faith and credit to the Florida judgment even if the Florida courts had jurisdiction over the trustee and/or the trust property. It declared:[646]

> [W]e think the public policy of Delaware precludes its courts from giving any effect at all to the Florida judgment of invalidity of the 1935 trust. We are dealing with a Delaware trust. The trust res and trustee are located in Delaware. The entire administration of the trust has been in Delaware. The attack on the validity of this trust raises a question of first impression in Delaware and one of great importance in our law of trusts. To give

[645] Id. at 3129.

[646] Lewis v. Hanson, 128 A.2d 819, 835 (Del. 1957) (citation omitted).

> effect to the Florida judgment would be to permit a sister state to subject a Delaware trust and a Delaware trustee to a rule of law diametrically opposed to the Delaware law. It is our duty to apply Delaware law to controversies involving property located in Delaware, and not to relinquish that duty to the courts of a state having at best only a shadowy pretense of jurisdiction.

The Supreme Court of New Hampshire applied the above principles in a 1986 case—Bartlett v. Dumaine.[647] There, the beneficiaries of a New Hampshire trust (the Dumaine Trust) and a Massachusetts trust (the Dexter Trust) brought claims against the trustees of the two trusts. After affirming findings that the claims against the trustees of the New Hampshire trust were meritless,[648] the court, citing § 103 of the Restatement and pertinent sections of a prior edition of the Scott treatise, dismissed the request for an accounting for the Massachusetts trust, even though it had personal jurisdiction over all interested parties. The court reasoned as follows:[649]

> In determining whether the superior court should have exercised or declined to exercise its jurisdiction in this case, we consider the relationships which New Hampshire and Massachusetts have with the Dexter Trust. New Hampshire's interest in the proper administration of Dexter is substantial because Dumaines, a New Hampshire trust, has the vested remainder interest in Dexter. Nevertheless, we cannot help but conclude that Massachusetts' interest in the administration of Dexter is greater. Both the petitioners and the respondents acknowledge that Dexter is a Massachusetts trust which is administered in Massachusetts, and which is governed by the trust law of that commonwealth. The question we are asked to decide is whether the Dexter trustees need only account to the Dumaines' trustees under the Massachusetts general rule that in matters involving the trust and the outside world the trustees represent the beneficiaries, or whether the Dexter trustees must account directly to the Dumaines' beneficiaries

[647] Bartlett v. Dumaine, 523 A.2d 1 (N.H. 1986).

[648] Id. at 14.

[649] Id. at 14–15 (citations omitted).

> under exceptions to the general rule which govern when certain conflicts of interest exist. It is our conclusion that the Massachusetts courts, and not those of New Hampshire, are the courts of "primary supervision" over the Dexter Trust and the satellite trusts, and that this question should be left to a Massachusetts court to decide.
>
> Both New Hampshire and Massachusetts jealously seek to preserve jurisdiction over their own trusts. Both States also willingly decline jurisdiction over another State's trust. Both practices are sound. Although there is a strong policy favoring an end to litigation, there is an equally strong policy favoring the orderly administration of trusts.

The court further stated:[650]

> A final consideration stays our hand from divining the law of Massachusetts in this area; namely, what effect that Commonwealth is likely to give any judgment we might render. A judgment rendered in one State of the United States need not be recognized or enforced in a sister State if such recognition or enforcement is not required by the national policy of full faith and credit because it would involve an improper interference with important interests of the sister State. There is ample evidence that the Massachusetts Supreme Judicial Court would consider a decision by this court regarding the Dexter trustees' duty to account as improper interference with the Commonwealth's important interests.

4. The Role of Strong Public Policy

In IV above and in this V, I have adverted to situations in which a Home State court has refused to honor a Trust State's statute for the reason that it violated a strong public policy of the Home State. Not all scholars are of the mind that this strong-public-policy exception should have any role in American jurisprudence. For example, in a 1992 Columbia Law Review article, a commentator observed that:[651]

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[650] Id. at 15 (citations and internal quotation marks omitted).

[651] Douglas Laycock, Equal Citizens of Equal and Territorial States: The Constitutional Foundations of Choice of Law, 92 Colum. L. Rev. 249, 313 (1992) (footnotes omitted).

> Traditional approaches to choice of law contain an even more offensive variation on better-law approaches. This is the rule that the forum can reject sister-state law on the ground that it too deeply offends the public policy of the forum. This is the extreme case of better-law rules. Texas would reject California law not just because Texas law is better, but because California law is so offensive that it cannot be tolerated in a Texas court. Texas can reject the law of Libya in this high-handed way, or even the law of Alberta, and it may occasionally need to do so. But it cannot so treat a sister state admitted to the Union on an equal footing with itself. The public-policy exception is a relic carried over from international law without reflection on the changes in interstate relations wrought by the Constitution.

He continued that:[652]

> Texas has no authority to change California law, and no authority to deny faith and credit to California law on the ground that California ought to change its own law, or on the ground that California would not seriously object.

He then pointed out that:[653]

> If a Texas court genuinely believes that a California court would change California law if the case were presented there, the best solution is to certify the legal question to the Supreme Court of California. It is familiar practice for federal courts to certify questions to state supreme courts, and some fifteen states authorize their supreme courts to answer such questions from courts of other states. If no certification procedure is available, and if a Texas court genuinely believes that a California court would decide the case in a way that departs from prior California precedent, then perhaps the Texas court should follow its prediction of California law and not the old California precedent. Federal courts

[652] Id. at 314.

[653] Id. at 314–15 (footnotes omitted).

> have a limited power to do this in diversity cases, and when properly done it gives full faith and credit to a more accurate statement of California law. It reduces an incentive to forum shop when one side is relying on a vulnerable precedent due for overruling.
>
> But this practice would likely be abused. Unlike a federal trial judge sitting in California, Texas judges have no realistic experience of California law on which to base a judgment that a particular precedent is ripe for overruling. More important, Texas judges have a strong temptation to predict that California would now adopt the Texas rule that they consider more enlightened. This temptation may be especially strong if a Texas citizen would benefit. Even though the ideal is for a Texas court to decide the case as a California court would decide it, we may achieve that goal more often with a prophylactic rule that the courts of one state cannot predict change in the law of another state.

VI. ETHICAL AND PRACTICAL CONCERNS WHEN CREATING A DYNASTY TRUST IN A TRUST STATE

A. Background

If an attorney and a client conclude that the client should create a trust in a state in which the attorney is not licensed to practice law, the attorney must determine how to implement the trust without engaging in the unauthorized practice of law or committing any other ethical violation, committing malpractice, or losing the client.

B. Ethical Principles

Although each state has its own rules that govern conduct by attorneys admitted to practice in the state, the ABA Model Rules of Professional Conduct ("Model Rules")[654] are the basis of the rules in effect in 49 states and the District of Columbia.[655] (California has its own rules.[656]) Two Model Rules are of particular concern. First, Rule 5.5 of the Model Rules provides in pertinent part

[654] Model Rules of Prof'l Conduct (2002).

[655] A list of the states that have adopted the Model Rules may be viewed at www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/alpha_list_state_adopting_model_rules.html (last visited Sept. 1, 2011).

[656] See Anne-Marie Rhodes, Engagement Letters, 147 Tr. & Est. 25 (Apr. 2008).

as follows:[657]

> (a) A lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction, or assist another in doing so.
>
> (b) A lawyer who is not admitted to practice in this jurisdiction shall not:
>
> > (1) except as authorized by these Rules or other law, establish an office or other systematic and continuous presence in this jurisdiction for the practice of law; or
> >
> > (2) hold out to the public or otherwise represent that the lawyer is admitted to practice law in this jurisdiction.
>
> (c) A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services on a temporary basis in this jurisdiction that:
>
> > (1) are undertaken in association with a lawyer who is admitted to practice in this jurisdiction and who actively participates in the matter; . . .
> >
> > (4) are not within paragraph (c)(2) or (c)(3) [that relate to judicial and alternative-dispute-resolution proceedings] and arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.

Second, Model Rule 1.1 provides as follows:[658]

> A lawyer shall provide competent representation to a client. Competent representation requires the

[657] Model Rules of Prof'l Conduct R. 5.5 (2002).

[658] Id. R. 1.1.

legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

Neither the commentaries to the Model Rules nor the 2006 American College of Trust and Estate Counsel ("ACTEC") commentaries[659] on them specifically address the subject with which we are concerned.

C. Malpractice Concerns

Each state has its peculiarities. For example, whereas the residuary clause in a Will exercises the testator's general powers of appointment in New York and Pennsylvania,[660] it does not in Connecticut.[661] Similarly, because the exercise of a limited power of appointment over a Delaware trust begins a new perpetuities period in certain circumstances,[662] the attorney must make sure that his or her client's exercise of such a power will not inadvertently subject the trust to federal estate or gift tax pursuant to the Delaware tax trap.[663] Nevertheless, the malpractice risks of creating a trust in another state may be minimized through research, experience, and/or the involvement of local counsel.

D. My Experience

In my experience, attorneys from various parts of the country draft Delaware estate-planning documents regularly without engaging Delaware counsel. Other attorneys draft such documents but insist that they be approved by local counsel prior to execution. In the latter situation, Delaware counsel always is sensitive to the existing attorney-client relationship.

VII. MOVING A DYNASTY TRUST TO A MORE FAVORABLE STATE

A. Introduction

1. Background

From time to time, the beneficiaries of a trust might explore replacing a trustee or the beneficiaries and trustees of a trust might investigate whether they may change the law that governs the trust's validity, construction, or administration or the place where it is administered. The

[659] ACTEC Commentaries on the Model Rules of Prof'l Conduct (4th ed. 2006).

[660] N.Y. Est. Powers & Trusts Law § 10-6.1(a)(4); 20 Pa. C.S. § 2514(13). See Est. of Greve v. Comr., 87 T.C.M. 1201 (2004).

[661] Matter of Chappell, 883 N.Y.S.2d 857, 863 (Sur. Ct. N.Y. Cty. 2009).

[662] 25 Del. C. § 503(c).

[663] IRC §§ 2041(a)(3), 2514(d). See II, F, 3, above.

remainder of this VII, A, gives reasons why beneficiaries might want to change a trust's trustee, governing law, or situs; identifies potential roadblocks to such a change; and offers some comments. I then will focus on how changing governing law or trust situs might benefit a trust and its beneficiaries.

2. Reasons to Move a Trust

In descending order of frequency, the most common reasons why beneficiaries explore moving a trust are:[664]

a. To address dissatisfaction with the current corporate trustee (whether or not a purported breach of trust is involved);

b. To avoid state income tax on the trust's accumulated ordinary income and capital gains;

c. To improve the trust's investment performance (e.g., because a new trustee will provide better investment results or because a change of governing law will enable a cotrustee or adviser to direct investments);

d. To reduce fees and administrative costs (including accounting costs);

e. To consolidate trusts at a single location;

f. To amend the terms of the trust;

g. To convert an income trust to a total-return unitrust;

h. To obtain more effective creditor protection for beneficiaries;

i. To extend the trust's duration;

j. To avoid burdensome state regulatory requirements (usually on charitable trusts);

k. To take advantage of a virtual-representation statute in order to avoid the appointment of a guardian or trustee ad litem to represent unknown or minor beneficiaries in a court proceeding;

[664] This information is based on comments made by Carol A. Johnston, Joshua S. Rubenstein, W. Donald Sparks, II, and me at The Nuts and Bolts of Changing the Situs of a Trust, 40 U. Miami Inst. on Est. Plan. Special Sess. 3-B (Jan. 12, 2006). See Irina S. Shea & Kevin Matz, Successor Trustee Liability, 149 Tr. & Est. 26 (Mar. 2010); Richard W. Nenno, The Trust From Hell: Can It Be Moved to a Celestial Jurisdiction?, 22 Prob. & Prop. 60 (May/June 2008).

l. To use a statute that offers more grounds for removing a trustee;

m. To qualify for diversity jurisdiction so that a dispute may be litigated in federal district court.

3. Roadblocks to Moving a Trust

In descending order of frequency, the most common roadblocks to moving a trust are:[665]

a. Lack of agreement among the beneficiaries;

b. Lack of appropriate language in the governing instrument;

c. Court intervention (e.g., refusal of a court to permit the move or excessive cost of a court proceeding);

d. Fee issues (e.g., principal termination fee for current trustee; excessive fees of new trustee);

e. Uncooperative trustees;

f. Accounting requirements and liability issues (e.g., releases and indemnifications);

g. Choice-of-law issues;

h. Conflict-of-interest issues;

i. Involvement of guardian or trustee ad litem who objects to the move;

j. Inability to terminate all ties to the original jurisdiction.

4. Comments

Although beneficiaries might have valid reasons to move a trust, one or more of the above roadblocks might make it impossible or impracticable to make the change. Accordingly, it is essential in the creation of a new trust to select the right trustees, situs, and governing law and to include appropriate language in case a change is needed in the future.

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[665] Id.

B. What Law Applies?

1. Restatement Approach—Introduction

Moving the situs or place of administration of a trust from one state to another does not automatically result in a change in the law that applies.[666] Thus, if the governing instrument provides that the validity, construction, administration, and restraints on the alienability of a beneficiary's interest will be governed by the law of a specific state, moving the trust won't change the applicable law. But, if the governing instrument provides that the trust will be governed by the law of the state where the trust is administered or has its situs, moving the trust is worth exploring.

Under the Second Restatement of Conflict of Laws, the determination of what state's law is used to resolve an issue that arises in the administration of a trust is a function of whether the trust holds movables or land; whether the trust was created by Will or inter vivos; and whether the issue implicates the validity or construction of a trust provision, the administration of the trust, or restraints on the alienation of beneficiaries' interests.[667] It also is relevant whether the governing instrument designates the law of a particular state on the matter.[668]

2. Restatement Approach—Trust of Movables—Law Designated

a. Trust Under Will

(1) Validity

The validity of a provision of a trust of movables created by Will (e.g., whether the provision violates the rule against perpetuities or the rule against accumulations) is determined by the law designated by the testator provided that:

(a) The designated state has a substantial relation to the trust; and

[666] See 7 Scott and Ascher on Trusts § 45.5.3.2 at 3302–03.

[667] See IV, B, above.

[668] Id.

(b) The provision does not offend a strong public policy of the testator's domicile.[669]

The beneficiaries and trustee might want to change the law that governs a trust's validity to get a longer perpetuities period or to escape a state where the rule against accumulations is in effect. As noted previously, these issues should not raise considerations of strong public policy.[670] A state has a substantial relation to a trust if it is the state in which the trust is to be administered, the place of business or domicile of the trustee at the testator's death, the testator's domicile at that time, or the domicile of the beneficiaries.[671] If the Will designates a particular Trust State to govern questions of validity, subsequent events (e.g., a change of trustee) probably will have no bearing on that choice. But, if the Will provides that questions of validity are to be resolved by the law of the state where the trust is administered from time to time, a change of trustee or place of administration should result in a change of governing law.

(2) Administration

The administration of a provision of a trust of movables created by Will is determined by the law designated by the testator.[672] The beneficiaries and trustee might want to change the law that governs a trust's administration to get a better directed trustee statute, a better unitrust-conversion or power to adjust law, or a statute to modify or terminate the trust. If the Will designates a particular Trust State to govern questions of administration, subsequent events (e.g., a change of trustee) might have no bearing on that choice. But, Delaware attorneys have told me that, when trusts are moved to Delaware, a court order sometimes changes the law that governs administration (but not validity or construction) to Delaware because that is where the trust will be administered. Also, if the Will provides that questions of administration are to be resolved by the law of the state where the trust is administered from time to time, a change of trustee or place of administration should result in a change of

[669] Restatement (Second) of Conflict of Laws § 269(b) (1971).

[670] Id. cmt. i.

[671] Id. cmt f.

[672] Id. § 271(a).

governing law as well.

(3) Construction

The law that governs the construction of a provision of a trust of movables created by Will is the law designated in the Will.[673]

(4) Restraints on Alienation

The law that governs the ability of creditors to reach a beneficiary's interest in a trust of movables created by Will is the law of the state in which the testator has fixed the administration of the trust.[674]

b. Trust Created Inter Vivos

(1) Validity

The validity of a provision of a trust of movables created inter vivos (e.g., whether the provision violates the rule against perpetuities or the rule against accumulations) is determined by the law designated by the trustor provided that:

(a) The designated state has a substantial relation to the trust; and

(b) The provision does not offend a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6.[675]

The beneficiaries and trustee of a trust might want to explore moving a trust to get a longer perpetuities period or to avoid the rule against accumulations. A state has a substantial relation to a trust when it is the state, if any, which the trustor designated as that in which the trust is to be administered, the place of business or domicile of the trustee at the time of the creation of the trust, the location of the trust assets at that time, the domicile of the trustor at

[673] Id. § 268(1).

[674] Id. § 273(a). See id. cmt. b.

[675] Id. § 270(a).

that time, or the domicile of the beneficiaries.[676]

(2) Administration

The administration of a provision of a trust of movables created inter vivos is determined by the law designated by the trustor.[677] The beneficiaries and trustee of such a trust might want to investigate changing the law that governs questions of administration to get a better directed trustee statute. If the trust specifies that issues of administration are to be governed by the law of a particular state, changing the situs of the trust or the trustee might not result in a change of governing law, but Delaware practitioners have told me that court decrees relating to the move of trusts to Delaware sometimes contain a change of law governing administration. If the trust says that questions of administration will be resolved by the law of the state where the trust is administered from time to time, then the governing law will change upon the change of situs.

(3) Construction

The law that governs the construction of a provision of a trust of movables created inter vivos is that designated in the governing instrument.[678]

(4) Restraints on Alienation

Whether a creditor may reach a beneficiary's interest in an inter vivos trust of movables is determined under the law of the state in which the trustor has manifested an intention that the trust be administered.[679]

3. Restatement Approach—Trust of Movables—Law Not Designated

a. Trust Under Will

(1) Validity

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[676] Id. cmt. b.

[677] Id. § 272(a).

[678] Id. § 268(1).

[679] Id. § 273(b). See id. cmt. c. See also Bowne of Phoenix, Inc. v. Bank One Arizona, NA, 1996 Ariz. App. Lexis 284 at 2–5 (Ariz. Ct. App. 1996) (Arizona not Pennsylvania law governed ability of creditors to reach beneficiary's interest because Pennsylvania court had transferred situs to Arizona).

Regarding the determination of the law that will be used to resolve a question of validity under a trust of movables created by Will when no governing law is designated, § 269 of the Restatement provides in pertinent part:[680]

> The validity of a trust of interests in movables created by will is determined . . .
>
> (b) As to matters that affect only the validity of the trust provisions, except when the provision is invalid under the strong public policy of the state of the testator's domicil at death,. . .
>
> (ii) if there is no such effective designation, by the local law of the state of the testator's domicil at death, except that the local law of the state where the trust is to be administered will be applied if application of this law is necessary to sustain the validity of the trust.

A comment to § 269 further develops the above rule as follows:[681]

> When the testator does not designate a state whose local law is to govern the validity of the trust, or when the designation will not be given effect, the trust will be upheld if it is valid under either the local law of the state of the testator's domicil at death or the local law of the state where the trust is to be administered, provided that this would not be contrary to the strong public policy of the state of the testator's domicil at death.
>
> If a testator by will creates a trust to be administered in a state other than that of

[680] Id. § 269(b).

[681] Id. cmt. g (cross references omitted).

> his domicil, the trust will not be invalid as in violation of the rule against perpetuities, if it would be valid either under the local law of the state of his domicil or under the local law of the state of the place of administration. This is true also as to a rule against accumulations. It is true also where by the local law of one or the other of these states trusts are not permitted. In these situations, there is no such strong policy of the state of the domicil as to preclude upholding the trust if valid under the local law of the state of administration.. . . .
>
> If the testator has not manifested an intention that the trust should be administered in a particular state, and has not designated a state whose local law is to govern the validity of the trust, the validity of the trust will be governed by the local law of the state of the testator's domicil.

(2) Administration

Section 271 of the Second Restatement of Conflict of Laws provides in pertinent part that:[682]

> The administration of a trust of interests in movables created by will is governed as to matters which can be controlled by the terms of the trust. . .
>
> (b) If there is no such designation, by the local law of the state of the testator's domicil at death, unless the trust is to be administered in some other state, in which case the local law of the latter state will govern.

A comment under Restatement § 271 describes whether or

[682] Id. § 271(b). See id. cmt. d.

not the law governing administration will change as follows:[683]

> When the court has authorized a change in the place of administration to another state, the question arises whether thereafter the administration of the trust is governed by the local law of the other state. It will be so governed if this is in accordance with the intention of the testator, express or implied. Thus, the testator may expressly provide for a change in the place of administration. So also, the change of the place of administration may be authorized by implication, such as when the will contains a power to appoint a new trustee and the new trustee appointed is domiciled or does business in another state. Where the court authorizes a change in the place of administration because of a change of domicil of the beneficiaries or of the trustee, the court may direct that the trust be administered thereafter in accordance with the local law of the other state. In such cases the trust will be administered in accordance with the local law of the new state of administration.
>
> On the other hand, there will be no change in the law governing the administration of the trust if this would be contrary to the intention of the testator, such as when he has expressly or by implication provided in the will that the administration of the trust should be governed by the local law of the state of his domicil at death, even though the place of administration should subsequently be changed.

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[683] Id. cmt. g.

(3) Construction

Section 268(2) of the Restatement provides that:[684]

> (2) In the absence of such a designation, the instrument is construed
>
> (a) as to matters pertaining to administration, in accordance with the rules of construction of the state whose local law governs the administration of the trust, and
>
> (b) as to matters not pertaining to administration, in accordance with the rules of construction of the state which the testator or settlor would probably have desired to be applicable.

The law that governs questions of administration is discussed in (2) above.[685] Rules of construction relate to the disposition of the trust property.[686] For testamentary trusts, a comment under § 268 provides that:[687]

> As to the rules of construction which relate to the disposition of the trust property rather than to the administration of the trust, the will is ordinarily construed in the case of movables in accordance with the rules of construction of the state of the testator's domicil, even though the trust is to be administered in

[684] Id. § 268(2). See id. cmt. c.

[685] See id. cmt. d.

[686] See id. cmt. e.

[687] Id. cmt. f.

some other state.

Although ordinarily the courts will apply the rule of construction of the testator's domicil at death, it will not do so if the testator is found to have intended that the rule of construction of some other state should be applicable. Although when a trust is created by will, the will is ordinarily construed in accordance with the rules of the state of the testator's domicil at death, the fact that he executed the will when domiciled in another state is usually sufficient to show that he presumably intended that the will should be construed in accordance with the rules of that state. So also, the fact that he executed the will in a state other than that of his domicil at the time when he executed it and at the time of his death may show an intention that the will should be construed in accordance with the rules of that state.

(4) Restraints on Alienation

If a testator has not manifested an intention that a trust of movables created by Will is to be administered in a particular state, whether a creditor may reach a beneficiary's interest in such a trust is determined by the law of the testator's domicile.[688]

b. Trust Created Inter Vivos

(1) Validity

Section 270 of the Restatement provides in relevant part:[689]

An inter vivos trust of interests in

[688] Id. § 273(a).

[689] Id. § 270.

> movables is valid if valid. . . .
>
> (b) If there is no such effective designation, under the local law of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6.

A comment amplifies the general rule as follows:[690]

> When the settlor does not designate a state whose local law is to govern the validity of the trust, or when the designation will not be given effect because the state has no substantial relation to the trust, the trust will be valid if valid under the local law of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6.
>
> Of the states having relationships with the trust, much the most important insofar as the validity of the trust is concerned is the state, if any, where the settlor manifested an intention that the trust should be administered.
>
> If the settlor has not manifested an intention that the trust should be administered in a particular state, the trust will be upheld if valid under the local law of the state which, as to the matter at issue, has the most significant relationship to the trust under the principles stated in § 6.

Another comment emphasizes the importance of carrying out the trustor's intent as follows:[691]

> One factor which the courts consider in

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[690] Id. cmt. c.

[691] Id. cmt. d.

determining the state of the applicable law is whether application of a particular law would result in sustaining the validity of the trust. It is improbable that the settlor intended to execute an instrument wholly or partially invalid. Some indication of his intention, if any, as to which law should govern the validity of the trust may be provided by the circumstance that under the local law of one state closely connected with the trust, the trust or a particular trust provision would be invalid, whereas under the local law of another state also closely connected with the trust there would be no such invalidity.. . . .

The rule of this Section is applicable to questions of substantial validity, such as those involved in the rule against perpetuities or a rule against accumulations or a rule precluding the creation of a charitable trust or of any trust. As to these matters the trust will be upheld if the settlor has manifested an intention that it should be administered in a particular state, and if under the local law of that state the trust would be valid, even though the settlor was domiciled in a state in which it would be invalid. . . . . On the other hand, the trust will also be upheld if valid under the local law of the settlor's domicil, even though it would be invalid under the local law of the place of administration. The settlor could have designated the state of the applicable law and it is to be inferred even though he made no such designation that he would intend to make applicable the local law of a state under which the trust would be valid.

(2) Administration

Section 272 of the Restatement provides in relevant part that:[692]

> (b) if there is no such designation, by the local law of the state to which the administration of the trust is most substantially related.

A comment under § 272 elaborates as follows:[693]

> When the settlor does not designate a state whose local law is to govern the administration of the trust, its administration will be governed by the local law of the state to which the administration is most substantially related.
>
> Of the states having relationships with the administration of the trust, much the most important is the state, if any, where the settlor manifested an intention that the trust should be administered. If the settlor has manifested an intention that the trust should be administered in a particular state, the local law of that state will be held to be the law governing the administration of the trust, unless it appears that the settlor desired to have some other law applied. . . . .
>
> If the settlor has not manifested an intention that the trust should be administered in a particular state, and has not designated the law to control the administration of the trust, the administration of the trust will be determined by the local law of the state to which the administration is most substantially related. . . . .

I analyzed those factors in V, D, 3, b, above.

[692] Id. § 272(b).

[693] Id. cmt. d.

Another comment under § 272 discusses whether the law governing administration changes upon a change of the place of administration as follows:[694]

> When an inter vivos trust has not become subject to the control of a particular court, a question arises as to the effect of a change in the place of administration of the trust. If the actual place of administration is changed, either because the trustee acquires a place of business or domicil in another state, or if in the exercise of a power of appointment a trustee is appointed whose place of business or domicil is in another state, the question arises whether thereafter the administration of the trust is governed by the local law of the other state. This depends upon the terms of the trust, express or implied. Such a change of the applicable law may be expressly authorized by the terms of the trust, or it may be authorized by implication, such as when the trust instrument contains a power to appoint a trustee in another named state. A simple power to appoint a successor trustee may be construed to include a power to appoint a trust company or individual in another state. In such cases, the law governing the administration of the trust thereafter is the local law of the other state and not the local law of the state of original administration.
>
> On the other hand, the terms of the trust may show the testator's intention that the trust is always to be administered under the local law of the original state. In such a case the mere fact that the trustee acquires a domicil in another state or that by the

[694] Id. cmt. e.

> exercise of a power of appointment a successor trustee is appointed who is domiciled in another state does not result in a change of the law applicable to the administration of the trust.
>
> When an inter vivos trust has become subject to the continuing jurisdiction of a court to which it is thereafter accountable, it becomes necessary to obtain the permission of that court to terminate such accountability. The question arises when the court is thereafter asked to appoint a successor trustee, or when the trustee acquires a place of business or domicil in another state, or when by the exercise of a power of appointment a trustee is appointed whose place of business or domicil is in another state. The same rules are applicable as are applicable in the case of a testamentary trustee.

(3) Construction

Restatement § 268(2) covers trusts of movables created inter vivos as well as by Will.[695] Regarding inter vivos trusts, one of § 268's comments provides:[696]

> The domicil of the settlor of an inter vivos trust is of less importance than it is in the case of a trust created by will. Where an inter vivos trust is to be administered in a state other than that of the settlor's domicil, the cases are not altogether clear whether the applicable rules of construction as to matters not relating to administration are those of the settlor's domicil or those of the place of administration. All that can be said with assurance is

[695] Id. § 268(2).

[696] Id. cmt. g.

> that the courts attempt to apply the rules which the settlor would probably have desired to be applicable. In a number of cases the courts have applied the rules of construction of the place of administration in the case of an inter vivos trust, although they would presumably have applied the rules of construction of the state of the testator's domicil in the case of a testamentary trust. If the settlor engages a lawyer at his domicil to draw the trust instrument, it may be that he intends to apply the rules of construction of his domicil, although he names as trustee a trust company of another state. On the other hand, if the instrument is drawn by a lawyer of the state in which the trust company does business, it may well be that the settlor intends to apply the rules of construction of the state where the trust company does business.. . . .
>
> If the settlor of an inter vivos trust has not manifested an intention that the trust should be administered in a particular state, the applicability of rules of construction will be determined by those contacts which for the matter at issue have the most significant relationship to the trust. . . .

I discussed those factors in V, D, 3, b, above.

A comment under § 268 provides that:[697]

> The question of the allocation of receipts and expenditures to principal or income presents a different problem. If a testator creates a trust to be administered in a state other than that of his domicil, the question is whether the allocation, as for instance

[697] Id. cmt. h (cross reference omitted).

of extraordinary dividends, is to be determined by the local law of his domicil or the local law of the place of administration. This could conceivably be treated as a question of administration and governed by the local law of the place of administration. On the other hand, it can be treated as a question of the distribution of the trust property and governed by the local law of the testator's domicil. For the purposes of the choice of the applicable law, it is generally held that it is a question of construction and that the local law of the testator's domicil is applicable.

(4) Restraints on Alienation

If a trustor has not manifested an intent that an inter vivos trust of movables is to be administered in a particular state, whether a creditor may reach a beneficiary's interest in such a trust is determined "by the local law of the state to which the administration of the trust is most substantially related."[698] I discussed those factors in V, D, 3, b, above.

4. Restatement Approach—Trust of Movables—Delaware's Experience

Delaware courts have looked to a number of factors in determining what governing law should apply in interpreting or administering trusts. These factors include the location of the trustee, the place where the trust assets are held, any governing law provisions set forth in the trust instrument, the domicile of the testator (in the case of a testamentary trust) or the domicile of the trustor (in the case of an inter vivos trust), and the location of the beneficiaries of the trust.[699] In Delaware cases that involve inter vivos trusts, in the absence of an explicit governing law provision, the courts have tended to emphasize the location of the trustee and the location of the administration of the trust as the most significant factors in determining the nexus for the application of the appropriate governing law.[700]

[698] Id. § 273(b).

[699] See Lewis v. Hanson, 128 A.2d 819, 826 (Del. 1957), aff'd sub nom. Hanson v. Denckla, 357 U.S. 235 (1958).

[700] Id.

5. Restatement Approach—Trust of Movables—Summary

The Scott treatise describes the impact of the move of a trust on the law that governs various aspects of its operation as follows:[701]

> Even when a change in the place of administration is authorized, any resulting change in the applicable law ordinarily pertains only to matters of administration. Thus, the law of the new place of administration ordinarily applies, for example, to the trustee's compensation, trust investments, and the trustee's powers and duties. In contrast, a change in the place of administration ordinarily has no effect on the law that applies to the disposition of the trust property. Thus, a change in the place of administration does not ordinarily affect the determination of who the trust beneficiaries are or the allocation of receipts and expenses between income and principal. Presumably, as to these matters, the settlor did not intend that the applicable law would change merely because there was a change in the place of administration.

6. Restatement Approach—Trust of Land

The law that is used to resolve questions of construction of a trust of land created by Will or inter vivos is the law designated by the testator or trustor in the instrument.[702] Otherwise, questions of construction, validity, administration, and restraints on alienation involving such a trust are determined using the law that would be applied by the courts of the situs.[703]

7. UTC Approach

Unlike the Restatement, the UTC does not distinguish between trusts of movables and trusts of land or between trusts created by Will or inter vivos. UTC § 107(1) provides that the meaning and effect (probably comparable to the Restatement's "construction") of the terms of a trust are determined by the law of the jurisdiction designated by the trust unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship

[701] 7 Scott and Ascher on Trusts § 45.5.3.2 at 3306 (footnotes omitted). See Restatement (Second) of Conflict of Laws § 272 cmt. e (1971).

[702] Restatement (Second) of Conflict of Laws § 277(1) (1971).

[703] Id. §§ 277(2), 278, 279, 280.

to the matter at issue.[704] Section 107(2) provides that, in the absence of an effective designation, the meaning and effect of the trust is determined under the law of the jurisdiction having the most significant relationship to the matter at issue.[705] The UTC stipulates that the law of the state that has the most significant relationship to the trust's creation should govern the "dispositive provisions" (probably comparable to the Restatement's "validity")[706] and that the law of the trust's principal place of administration should control administrative matters.[707] The UTC does not cover the determination of which state's law should govern the ability of creditors to reach trust interests.

I analyzed the factors that determine which state has "the most significant relationship" in V, D, 3, b, above.

C. Effecting the Move

The transfer of a trust's situs or place of administration from one state to another might be accomplished through an express provision in the trust instrument, a pertinent statute, or a court petition. If the governing instrument provides for the removal and replacement of the trustee without the necessity for court proceedings, the nomination of a trustee in the more favorable state might be sufficient in itself to accomplish the transfer of the situs. Frequently, however, the governing instrument is silent on the issues of removal, resignation, and replacement. In such a case, the beneficiaries must either obtain the trustee's agreement to resign or convince the local probate court to remove the trustee. In this connection, California has had a procedure for transferring a trust to another jurisdiction since 1991.[708] In addition, UPC § 7-305, [709] which is or will be in effect in at least five states,[710] provides as follows:

> A trustee is under a continuing duty to administer the trust at a place appropriate to the purposes of the trust and to its sound, efficient management. If the principal place of administration becomes inappropriate for any reason, the Court may enter any order furthering efficient administration and the interests of beneficiaries, including, if appropriate,

[704] UTC § 107(1) (2005).

[705] Id. § 107(2).

[706] Id. § 107 cmt.

[707] Id.

[708] Cal. Prob. Code §§ 17400–17405. See 7 Scott and Ascher on Trusts § 45.5.3.1 at 3301–02 n.28.

[709] UPC § 7-305 (2008).

[710] See, e.g., Alaska Stat. § 13.36.090; Colo. Rev. Stat. § 15-16-305; Haw. Rev. Stat. § 560:7-305; Idaho Code § 15-7-305; Mass. Gen. Laws Ch. 190B, § 7-305 (effective Jan. 2, 2012).

> release of registration, removal of the trustee and appointment of a trustee in another state. Trust provisions relating to the place of administration and to changes in the place of administration or of trustee control unless compliance would be contrary to efficient administration or the purposes of the trust. Views of adult beneficiaries shall be given weight in determining the suitability of the trustee and the place of administration.

Whereas the Supreme Court of Nebraska refused to replace a corporate trustee pursuant to the Nebraska version of § 7-305 in a 1982 case,[711] the Supreme Court of Alaska replaced the corporate trustee and transferred the situs of the trust out of Alaska in a 2004 case,[712] and a Michigan intermediate appellate court replaced the corporate trustee and transferred the trust's situs from Michigan to Georgia in an unpublished 2008 case.[713]

Similarly, § 108(b) of the UTC,[714] which is the law in 14 states,[715] specifies that:

> (b) A trustee is under a continuing duty to administer the trust at a place appropriate to its purposes, its administration, and the interests of the beneficiaries.

Even in the ten states that have enacted § 108 without adopting subsection (b) in the above form,[716] the provision might be helpful in replacing trustees and transferring trusts. For example, Pennsylvania practitioners have told me that they have used Pennsylvania's version of § 108[717] to transfer trusts to Delaware to avoid Pennsylvania income tax.

To move a trust in conjunction with the resignation or removal of a trustee, the beneficiaries or the trustee must file a petition (often accompanied by an

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[711] In re Zoellner Trust, 325 N.W.2d 138 (Neb. 1982).

[712] Marshall v. First Nat'l Bank Alaska, 97 P.3d 830 (Alaska 2004).

[713] In re Wege Trust, 2008 Mich. App. Lexis 1259 (Mich. Ct. App. 2008).

[714] UTC § 108(b)(2005).

[715] See Ariz. Rev. Stat. § 14-10108(B); Ark. Code Ann. § 28-73-108(b); D.C. Code § 19-1301.08(b); Me. Rev. Stat. Ann. tit. 18-B, § 108(2); Mich. Comp. Laws § 700.7108(2); Neb. Rev. Stat. § 30-3808(b); N.H. Rev. Stat. Ann. § 564-B:1-108(b); N.M. Stat. Ann. § 46A-1-108(B); N.D. Cent. Code § 59-09-08(2); Ohio Rev. Code Ann. § 5801.07(B); S.C. Code Ann. § 62-7-108(c); Tenn. Code Ann. § 35-15-108(b); Utah Code Ann. § 75-7-108(2); 14A V.S.A. § 108(B).

[716] See Ala. Code § 19-3B-108; Fla. Stat. § 736.0108; Kan. Stat. Ann. § 58a-108; RSMo § 456.1-108; N.C. Gen. Stat. § 36C-1-108; Or. Rev. Stat. § 130.022; 20 Pa. C.S. § 7708; Va. Code Ann. § 55-541.08; W. Va. Code § 44D-1-108; Wyo. Stat. Ann. § 4-10-108.

[717] See 20 Pa. C.S. § 7708.

accounting) in the local probate court. In many instances, it also is necessary to file a petition in a court in the new state seeking the court's approval of the transfer of situs and acceptance of jurisdiction over the trust prior to the proceeding in the local probate court. Thus, the local court knows of the new trustee's willingness to serve and the new court's acceptance of jurisdiction upon the local court's approval of transfer.

For trusts of movables created by Will, a comment under Restatement § 271 provides that:[718]

> [A] testamentary trustee may be required by statute to qualify as trustee in the court of the testator's domicil having jurisdiction over the testator's estate, when the trust is to be administered in that state. The trustee is then accountable to that court. Thereafter, however, the question may arise whether the administration of the trust may be changed to another state. In such a case, in contrast to the usual situation that prevails in the case of an inter vivos trust, it is necessary to obtain the permission of the court for a change in the place of administration. Since the trustee is accountable to the court, it is necessary to obtain the permission of the court to terminate the accountability of the trustee to it.
>
> The court should permit a change in the place of administration and a termination of the trustee's accountability to it if this would be in accordance with the testator's intention, either express or implied. Such a change may be expressly authorized in the will. It may be authorized by implication, such as when the will contains a power to appoint a new trustee in another state, or simply a power to appoint a new trustee if this is construed to include the power to appoint a trustee in another state.
>
> The court may permit a change in the place of administration and a termination of the trustee's accountability to it even though such change was not expressly or impliedly authorized by the testator. The court may authorize such a change when this would be in the best interests of the

[718] Restatement (Second) of Conflict of Laws § 271 cmt. g (1971).

> beneficiaries, as, for example, when the beneficiaries have become domiciled in another state or when the trustee has become domiciled in another state.
>
> The court may refuse to permit a change in the place of administration and termination of the trustee's accountability to it, unless the trustee qualifies as trustee in a court of the state in which the trust is to be thereafter administered.

For trusts of movables created inter vivos, a comment under Restatement § 272 provides that:[719]

> When an inter vivos trust has become subject to the continuing jurisdiction of a court to which it is thereafter accountable, it becomes necessary to obtain the permission of that court to terminate such accountability. The question arises when the court is thereafter asked to appoint a successor trustee, or when the trustee acquires a place of business or domicil in another state, or when by the exercise of a power of appointment a trustee is appointed whose place of business or domicil is in another state. The same rules are applicable as are applicable in the case of a testamentary trustee.

The means by which the trust is moved may have a bearing on which of the more favorable state's benefits can be made available. Thus, in one case, it might be possible to get perpetual duration, no state fiduciary income taxation, avoidance of accounting requirements, effective spendthrift protection, a favorable total-return unitrust law, reduction in administrative costs, and a direction investment adviser. In another case, however, it might not be possible to get one or more of these benefits.

Generally, courts will permit a trust to be moved if the trust instrument does not express a contrary intent, the administration of the trust will be facilitated, and the interests of the beneficiaries will be promoted.[720] Trustees and beneficiaries should not assume, though, that courts automatically will grant petitions to transfer situs. For example, courts have denied such petitions when the

[719] Id. § 272 cmt. e.

[720] See Est. of Gladys Perkin, N.Y.L.J., June 9, 2010, at 33, col. 2 (Sur. Ct. N.Y. Co. 2010); In re Estate of McComas, 165 Misc. 2d 947, 948 (Surr. Ct. N.Y. Co. 1995); In re Hudson's Trust, 286 N.Y.S.2d 327 (3d Dept. 1968), aff'd, 23 N.Y.2d 834 (1969); In re Second Intermediate Accounting of Henry Weinberger, 250 N.Y.S.2d 887 (1st Dept. 1964).

accomplishment of the stated objective—the avoidance of New York fiduciary income tax—did not require the change.[721]

Some states facilitate the application of their laws to the administration of trusts moved from other states. For example, a Delaware statute provides that Delaware law governs the administration of a trust unless the governing instrument or a court order provides otherwise.[722]

D. Moving to Carry Out Clients' Objectives or to Facilitate Amendment or Termination of a Trust

As discussed in III, C, above, states vary on the degree to which they will honor a client's wishes. Thus, if a trustee is concerned that the client's objectives might be better accomplished in another state, it might investigate moving the trust. But, the trustee and the beneficiaries might want to amend or terminate a trust, in which case they should explore moving the trust to a state (e.g., New Hampshire,[723] South Dakota,[724] or Washington[725]) where this can be accomplished readily.

E. Moving to Create a Perpetual Trust

A provocative question is whether a trust created in a state that does not countenance perpetual trusts may be moved to another state and become a perpetual trust. As I discussed in IV, B, above, the determination of how long a trust may last is a matter of validity and the law that governs such matters rarely changes upon the move of a trust. I am aware of one instance, however, in which the trust instrument expressed the client's intent that the trust be perpetual and encouraged the trustee to consider moving the trust to achieve this objective.

The task of converting a trust into a perpetual trust should be easier if the trust confers powers of appointment. Thus, based on Delaware cases decided in the 1940s, it might be possible to turn a trust into a perpetual trust if the trust was written with sufficient flexibility and if it confers a limited power of appointment on a beneficiary.[726]

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[721] In re Bush, 2 Misc. 3d 744 (Surr. Ct. N.Y. Co. 2003); In re Estate of Rockefeller, 2 Misc. 3d 554 (Surr. Ct. N.Y. Co. 2003).

[722] 12 Del. C. § 3332(b).

[723] See N.H. Rev. Stat. Ann. §§ 564-B:1-103(19), 564-B:1-111, 564-B:4-411(a), 564-B:8-801.

[724] See Rashad Wareh, Trust Remodeling, 146 Tr. & Est. 18 (Aug. 2007).

[725] See Wash. Rev. Code §§ 11.96A.210–11.96A.250.

[726] See Wilmington Trust Co. v. Wilmington Trust Co., 24 A.2d 309 (Del. 1942); Wilmington Trust Co. v. Sloane, 54 A.2d 544 (Del. Ch. 1947).

Consequently, a beneficiary who possesses a limited power of appointment over an irrevocable trust that is governed by the common-law rule against perpetuities or the USRAP should, in certain circumstances, be able to move the trust to a state that allows perpetual trusts so that he or she can exercise the power to make it possible for the trust to last forever.

F. Moving to Avoid State Income Tax

1. Introduction

Every trustee should review all trusts that he, she, or it administers to identify all trusts that are paying state income tax. With the assistance of counsel, the trustee should determine whether that tax can be reduced or eliminated. If tax has been paid erroneously, the trustee should request refunds for open years. If the trustee discovers that tax can be escaped, the trustee should consider filing a "final" return in the year before the occurrence of a major transaction (e.g., the sale of a large block of low-basis stock). At the same time, the trustee and the advising attorney must make sure that steps taken to avoid one state's tax won't subject the trust to tax elsewhere.

2. Trust Created by Will of Resident

If a state imposes its tax on a testamentary trust if the testator lived there at death, whether or not tax will continue to apply raises complex constitutional issues that were discussed in III, E, above. The constitutional issues involve the question of whether the state statute creating the basis on which the income tax is imposed violates various federal and state constitutional mandates, including the Commerce Clause and the Due Process Clause of the United States Constitution, and therefore can be safely ignored in the absence of any continuing nexus between the trust and the original state.

As discussed in III, E, 4, above, New York, New Jersey, and other states offer clear guidance on how to avoid tax. To escape tax in these states or to improve prospects for avoiding tax in states where the rules are not as clear, the trustee might explore transferring the trust's situs to another state, which might be accomplished by a provision in the governing instrument or by a state statute or court proceeding. Wisconsin recognizes that a change of situs will end a testamentary trust's liability for tax,[727] and a Pennsylvania ruling came to this result.[728]

[727] See 2010 Wis. Form 2 at 1.

[728] No. PIT-01-040 (July 27, 2001).

3. Inter Vivos Trust Created by Resident

To determine whether a state's income tax on an inter vivos trust created by a resident can be avoided, the trustee and attorney should go through a process comparable to that described in 2 above.

4. Trust Administered in State

Here, it might be possible to escape tax simply by changing the place where the trust is administered, with or without court involvement.

5. Resident Trustee

In states that tax on this basis, it should be possible to escape tax simply by replacing the resident fiduciaries with nonresident fiduciaries.

6. Resident Beneficiary

Short of having the beneficiary move, it is difficult if not impossible to prevent a resident beneficiary from being taxed on current distributions. Nonetheless, the attorney and trustee should make sure that tax is not paid prematurely on accumulated income and capital gains.

G. Moving to Provide More Investment Flexibility

A state's explicit recognition of directed trusts may, by itself, be a sufficient reason to move a trust. This feature might be particularly attractive to trustees and beneficiaries of trusts that hold closely held business interests, lack diversification of assets, or invest in assets (e.g., limited partnerships) that traditionally were viewed as inappropriate because of the trustee's deemed delegation of its investment responsibility.

H. Moving to Provide Greater Protection From Creditor Claims

As I discussed in III, H, above, some states provide more protection than other states against creditor claims for beneficiaries of a third-party trust, and, as I discussed in III, I, above, some states offer protection from creditor claims for the trustor-beneficiary of a self-settled trust. Because a trustee has fundamental duties to use reasonable care to protect a trust from unnecessary exposure to risk of loss[729] and to ensure that a trust is administered in an appropriate jurisdiction,[730] trustees of certain third-party and self-settled trusts might have an

[729] Restatement (Second) of Trusts § 176 (1959). Accord UTC § 809 (2005).

[730] See C above.

obligation to explore moving them to more protective jurisdictions.[731]

I. Moving to Avoid Accounting Requirements and Administrative Costs

Moving a trust might avoid court-accounting requirements in the original state. If the trust to be moved is an inter vivos trust, it should be possible to avoid future court accountings. Even if the trust to be moved is a testamentary trust for which judicial accountings are required, it might be possible to avoid court accountings if the governing instrument contains language waiving the requirement. For example, Delaware courts have demonstrated some flexibility in interpreting governing instruments to avoid the necessity for judicial intervention.

J. Moving to Use the Power to Adjust or to Convert to a Total-Return Unitrust

It might be desirable to move a trust to take advantage of a state's total-return unitrust statutes or its power to adjust statute, particularly because there is greater assurance regarding the tax consequences of action taken pursuant to such a statute than there is for action taken without statutory authority.[732] Several states' unitrust-conversion statutes[733] and a few states' power to adjust statutes[734] provide that conversion of a trust to a total-return unitrust or the exercise of the power to adjust is a matter of trust administration and that the statute is available to trusts administered in that state under that state's law. Thus, if moving a trust changes the law that governs its administration, the trust will be able to take advantage of such a statute. Nevertheless, changing the situs of a trust will not automatically change the law that governs its administration. Consequently, absent an applicable statute in the new jurisdiction or specific language in the court order or the trust instrument stating that the laws governing the administration of the trust will be those of the new situs, the governing law of the original state might still apply.

K. Federal Transfer-Tax Consequences of Moving

The attorney should confirm that moving a trust will not produce adverse federal transfer-tax consequences.

Great care should be taken in moving a Grandfathered Dynasty Trust because the IRS takes the position that such a trust will lose its grandfathered status if it is

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[731] See In re Joseph Heller Inter Vivos Trust, 613 N.Y.S.2d 809 (Surr. Ct. N.Y. Co. 1994) (trustee petitioned court to divide trust in order to protect cash and securities from liabilities from realty).

[732] See Regs. § 1.643(b)-1.

[733] See, e.g., Colo. Rev. Stat § 15-1-404.5(13); 12 Del. C. § 61-106(l); Fla. Stat. § 738.1041(10); 760 Ill. Comp. Stat. 5/5.3(1); Iowa Code § 637.613; Neb. Rev. Stat. Ann. § 30-3119.01(13)(b); N.M. Stat. Ann. § 46-3A-113(B); S.D. Codified Laws § 55-15-12; Va. Code Ann. § 55-277.4:1(J).

[734] See, e.g., 12 Del. C. § 61-104(g); Fla. Stat. § 738.104(11).

moved to lengthen its duration.[735] As noted above, moving a trust to a state that has a longer perpetuities period than that of the original state will not lengthen a trust's duration if the trust instrument specifies that the trust must terminate on a particular date (e.g., at the end of the USRAP period or the common-law perpetuities period). A Delaware statute provides that the duration of a trust does not change merely because it is moved to Delaware.[736] In addition, a beneficiary of a Grandfathered Dynasty Trust may not exercise a limited power of appointment to create a perpetual trust and preserve the trust's grandfathered status.[737]

The IRS also takes the position that moving a Grandfathered Dynasty Trust to avoid state income tax[738] or to utilize (or to avoid) another state's total-return unitrust conversion law[739] or statutory power to adjust[740] will not cost the trust its grandfathered status.

The IRS has ruled that an Exempt Dynasty Trust will not lose its exempt status if it is moved in a way that is acceptable for grandfathered trusts.[741]

VIII. THE NRA DYNASTY TRUST

A. Introduction

IRC § 2663 provides in relevant part:[742]

> The secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this chapter . . . including—
>
> (2) regulations (consistent with the principles of chapters 11 and 12 . . . providing for the application of this chapter . . . in the case of transferors who are nonresidents not citizens of the United States . . . .

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[735] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 4.

[736] 12 Del. C. § 3332(a).

[737] Regs. § 26.2601-1(b)(1)(v)(B)(2).

[738] Regs. § 26.2601-1(b)(4)(i)(D)(2).

[739] Regs. § 26.2601-1(b)(4)(i)(E), Ex. 11.

[740] Id. Ex. 12.

[741] See PLR 200714016 (Nov. 15, 2006) (change of situs of exempt trust did not affect tax status because duration of trust not lengthened).

[742] IRC § 2663(2).

Pursuant to the above directive, the Treasury Department issued regulations providing that a generation-skipping transfer is subject to GST tax only if it also is or was subject to gift or estate tax.[743] This creates planning options that are discussed below. Certain citizens of U.S. possessions are treated as NRAs for these purposes.[744]

B. Gift- and Estate-Tax Rules

Whereas every U.S. citizen or resident potentially must pay gift tax on lifetime transfers of every kind of property wherever it is located,[745] an NRA generally only is taxable on lifetime transfers of property situated in the United States,[746] which does not include intangible property even if it is situated in this country.[747] Thus, although an NRA might be taxed on gifts of real property and tangible personal property located in the United States, an NRA may make gifts of stock, bonds, notes, and other obligations without having to file a gift-tax return. For these purposes, cash is treated as tangible personal property.[748]

The rules are different for estate-tax purposes. All property situated in the United States is included in the gross estate of an NRA,[749] and there is no parallel to the gift-tax exemption of intangible property. Thus, if an NRA dies owning shares of stock in a U.S. company, the stock is subject to federal estate tax unless the decedent resided in a country with which the United States has an estate-tax treaty and the treaty exempts the U.S. stock.[750]

The anomaly for the treatment of intangible property situated in the United States permits an NRA to give away stock in U.S. companies free of gift tax but not to bequeath it at death free of estate tax. The planning opportunities for NRAs with U.S. beneficiaries who wish to fund dynasty trusts with U.S.-situs intangible property are obvious. If the trust is funded with assets other than real estate or

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743 Regs. § 26.2663-2(b).

744 See IRC §§ 2208–2209. See PLR 200848014 (Aug. 18, 2008) (U.S. citizen/Puerto Rico resident considered NRA for estate-tax purposes).

745 IRC § 2501(a)(1).

746 IRC § 2511(a).

747 IRC § 2501(a)(2). See PLR 201032021 (Apr. 28, 2010) (NRAs transfer of shares of stock in holding company to or for U.S. beneficiaries not subject to gift tax).

748 Rev. Rul. 55-143, 1955-1 C.B. 465 (Jan. 1955). See PLRs 200748008, 200748011–013, 200748016 (July 25, 2007); 200340015 (June 27, 2003); 8138103 (June 25, 1981); 7737063 (June 17, 1977).

749 IRC § 2103. See Bridget J. Crawford, Troy Lipp & Jonathan Blattmachr, U.S. Estate Taxation of Nonresident Noncitizens: A Primer, 132 Tax Notes 759 (Aug. 15, 2011).

750 See Estate of Charania v. Shulman, 608 F.3d 67 (1st Cir. 2010) (NRA's stock in U.S. Corporation—Citigroup—is situated in U.S. and subject to federal estate tax). See also ILM 201020009 (Apr. 16, 2010) (gift tax paid by NRA within three years of death not includible in gross estate).

tangible personal property located in the United States, no gift-tax return is required and no gift tax is due.[751]

C. GST-Tax Rules

Because the GST tax applies to a transfer of property by an NRA only if the transfer is subject to gift or estate tax,[752] there is no GST tax on a gift of intangible property (e.g., U.S. stock) to a dynasty trust for the benefit of an NRA's U.S. children and grandchildren because such gift is exempt from gift tax. If the same NRA donor bequeaths the same assets to the dynasty trust on death, however, the transfer will be subject to the GST tax because it will be subject to estate tax. Again, this anomaly gives rise to an opportunity for NRAs to create inter vivos dynasty trusts of unlimited amount (the GST exemption need not be applied) for the benefit of their children and grandchildren who are U.S. citizens or residents without any gift- or GST-tax consequences.[753]

D. Location of Property

Even though the tax laws give examples of property situated within the United States[754] and of property situated without the United States,[755] it still often is difficult to determine with certainty where property will be deemed to be located for estate-tax purposes. For example, certain types of property (i.e., deposits with U.S. banks and savings and loan associations and life insurance proceeds paid by, and amounts left at interest with, U.S. insurance companies) are clearly

[751] See S. Andrew Pharies & Michelle C. Glasser, The Accidental Foreign Trust, 36 Tax Mgmt. Est., Gifts & Tr. J. 170 (May 12, 2011); Jeffrey S. Levin, Transfers to Foreign Trusts Could Trigger Gain Recognition, 37 Est. Plan. 14 (Oct. 2010); Chris K. Gawart, Amalia L. Todryk & Adam W. Kiracofe, Beware the Foreign Trust Tax Trap, 24 Prob. & Prop. 40 (Sept./Oct. 2010); Alexander M. Popovich, Avoiding the Disadvantageous Tax Consequences of a Foreign Nongrantor Trust, 36 Est. Plan. 29 (May 2009); Amy P. Jetel, When Foreign Trusts Are Non-Grantor, 147 Tr. & Est. 53 (Apr. 2008); Dina Kapur Sanna, Save U.S. Beneficiaries From Tax Disaster, 146 Tr. & Est. 48 (Nov. 2007); Carolyn F. Devore, When Your U.S. Trust Accidentally Becomes a Foreign Trust, 146 Tr. & Est. 58 (Nov. 2007); Glenn G. Fox, Kevin J. Mullin & Michael A. Heimos, Some Hot Topics in Inbound Estate Planning, 32 Tax Mgmt. Est., Gifts & Tr. J. 147 (May 10, 2007); Diana S.C. Zeydel & Grace Chung, Estate Planning For Noncitizens and Nonresident Aliens: What Were Those Rules Again?, 106 J. Tax'n 20 (Jan. 2007). For a discussion of whether the beneficiary of a foreign trust must pay U.S. income tax on distributions of income accumulated by the trust before he or she becomes a U.S. tax resident, see Jose L. Nunez & Andrea L. Mirabito, Just Off the Boat, Trust Fund in Hand, 144 Tr. & Est. 57 (Dec. 2005).

[752] IRC § 2663(2); Regs. § 26.2663-2. See PLRs 201032021 (Apr. 28, 2010), 200817009 (Dec. 28, 2007), 200748008, 200748011–013, 200748016 (July 25, 2007).

[753] See Michael W. Galligan, You Must Remember This, 144 Tr. & Est. 49, 50 (Dec. 2005).

[754] IRC § 2104.

[755] Id. § 2105.

situated within the United States and yet deemed to have a situs outside the United States.[756] For an NRA wishing to create a U.S. dynasty trust to take advantage of the favorable gift- and GST-tax rules applicable to such a transfer, the difficult question of where property has its situs is generally avoided if neither real estate nor tangible personal property located in the United States is used to fund the trust. Clearly, an NRA may create a perpetual dynasty trust of unlimited amount with intangible property free of gift and GST tax.

E. U.S. as Trust Situs

A commentator observes that the United States traditionally was not an attractive trust jurisdiction for NRAs[757] but that this no longer is true because this country now offers clear rules for determining whether a trust is a domestic or foreign trust for federal tax purposes and for determining whether a trust is a grantor or nongrantor trust for federal income-tax purposes. He also points out that the United States is not on any country's list of tax havens (which are subject to special tax rates and reporting requirements) and provides low income-tax rates under certain treaties and on passive income.[758] In addition, he notes that states, such as Delaware and South Dakota, afford protection from creditor claims through self-settled spendthrift trusts, permit perpetual trusts, recognize investment and distribution advisers, and deny forced heirship claims.[759]

Another commentator observes that:[760]

> [T]he transfer tax consequences of establishing a foreign trust and a domestic trust are identical. Thus, if there are no NRA beneficiaries, the grantor should consider establishing the trust in a U.S. jurisdiction. A suitable choice would be Delaware or another state that permits the grantor to retain a discretionary interest in the trust while shielding the assets from the reach of the grantor's future creditors. One significant advantage of

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[756] Id. §§ 2103–2105. See ILM 201003013 (Sept. 30, 2009) (Canadian decedent's registered retirement savings plan is includable in gross estate), PLRs 200842013 (June 13, 2008) (proceeds of certain annuity contracts not situated in U.S.), 200752016 (Aug. 27, 2007) (portfolio debt obligations not situated in U.S.). See also Bridget J. Crawford, Troy Lipp & Jonathan Blattmachr, U.S. Estate Taxation of Nonresident Noncitizens: A Primer, 132 Tax Notes 759 at 3–5 (Aug. 15, 2011); Dina Kapur Sanna, Calling for Clarity on NRAs' Partnership Situs, 148 Tr. & Est. 36 (Nov. 2009); Jane Tse & Dina Kapur Sanna, Nonresident Aliens, 144 Tr. & Est. 42 (Dec. 2005).

[757] G. Warren Whitaker, The U.S. May Be a Good Trust Jurisdiction for Foreign Persons, 33 Est. Plan. 36 (Feb. 2006).

[758] Id. at 36–39.

[759] Id. at 37–39.

[760] Mark W. Smith, Careful Pre-Immigration Planning Can Save Significant Taxes, 34 Est. Plan. 30, 33 (Feb. 2007) (footnote omitted).

> doing so would be to circumvent the throwback regime and the interest charge on distributions of accumulated income to U.S. persons. Another advantage would be to avoid the reporting requirements to which any U.S. beneficiary, the trustee, or the grantor of the trust would otherwise be subject.
>
> Alternatively, the grantor may wish to establish two trusts—a foreign trust that generates foreign-source income for distribution to NRAs and a domestic trust that generates income from whatever source for distribution to U.S. persons.

NRAs sometimes create U.S. trusts by having the U.S. trustee sign a declaration of trust rather than by entering into a trust agreement with the trustee. Some states recognize the declaration approach.[761]

For these and other reasons, an NRA should consider the United States in choosing a jurisdiction for his or her trusts.[762]

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[761] See, e.g., 12 Del. C. § 3545.

[762] Mark W. Smith, Careful Pre-Immigration Planning Can Save Significant Taxes, 34 Est. Plan. 30, 38 (Feb. 2007). See Henry Steinway Ziegler, Come to America, 144 Tr. & Est. 22 (June 2005).

APPENDIX A

EXEMPT DYNASTY TRUST ILLUSTRATIONS

EXEMPT DYNASTY TRUST ILLUSTRATIONS

Value of Property in	25 Years		50 Years		75 Years		100 Years	
ANNUAL AFTER TAX GROWTH	GST EXEMPT DYNASTY TRUST	NO TRUST OR NON-EXEMPT TRUST	GST EXEMPT DYNASTY TRUST	NO TRUST OR NON-EXEMPT TRUST	GST EXEMPT DYNASTY TRUST	NO TRUST OR NON-EXEMPT TRUST	GST EXEMPT DYNASTY TRUST	NO TRUST OR NON-EXEMPT TRUST
3%	$ 2,093,778	$ 1,360,956	$ 4,383,906	$ 1,852,200	$ 9,178,926	$ 2,520,762	$19,218,632	$ 3,430,646
4%	2,665,836	1,732,794	7,106,683	3,002,574	18,945,255	5,202,841	50,504,948	9,015,449
5%	3,386,355	2,201,131	11,467,400	4,844,976	38,832,686	10,664,426	131,501,258	23,473,796
6%	4,291,871	2,789,716	18,420,154	7,782,515	79,056,921	21,711,007	339,302,084	60,567,543
7%	5,427,433	3,527,831	29,457,025	12,445,593	159,876,019	43,905,952	867,716,326	154,892,787
8%	6,848,475	4,451,509	46,901,613	19,815,931	321,204,530	88,210,794	2,199,761,256	392,671,133
9%	8,623,081	5,605,002	74,357,520	31,416,052	641,190,893	176,087,049	5,529,040,792	986,968,338
10%	10,834,706	7,042,559	117,390,853	49,597,635	1,271,895,371	349,294,266	13,780,612,340	2,459,925,431

Note: Computations assume $1 million initial gift and 35% tax imposed on assets owned outright or held in Nonexempt Dynasty Trust every 25 years.

APPENDIX B

CHARITABLE-LEAD UNITRUST ILLUSTRATIONS

CHARITABLE-LEAD UNITRUST ILLUSTRATIONS

Annual Payout Rate to Charity	Duration of Trust				
	20 Years	40 Years	60 Years	80 Years	99 Years
3%	$ 1,833,916	$ 3,362,893	$ 6,165,912	$ 11,304,033	$ 20,102,926
4%	2,253,810	5,078,926	11,443,480	25,779,840	55,756,899
5%	2,776,389	7,706,950	21,389,459	59,354,226	156,470,035
6%	3,426,922	11,741,223	40,218,790	137,741,046	443,458,980
7%	4,240,288	17,957,589	76,184,671	322,788,896	----
8%	5,257,595	27,634,233	145,222,189	762,776,506	----

Note: Chart shows the amount that can be placed in a charitable-lead unitrust with the indicated annual payout rate to charity (with payments made annually) and the indicated term to produce a $1 million taxable gift, using a 1.8% IRC § 7520 rate and assuming 6% annual growth.

APPENDIX C

STATE UNIFORM TRUST CODE STATUTES

STATE UNIFORM TRUST CODE STATUTES

STATE	CITATION	EFFECTIVE DATE
Alabama	Ala. Code §§ 19-3B-101–19-3B-1305	2007
Arizona	Ariz. Rev. Stat. §§ 14-10101–14-11102	2009
Arkansas	Ark. Code Ann. §§ 28-73-101–28-73-1106	2005
District of Columbia	D.C. Code § 19-1301.01–19-1311.03	2004
Florida	Fla. Stat. §§ 736.0101–736.1303	2007
Kansas	Kan. Stat. Ann. §§ 58a-101–58a-1107	2003
Maine	Me. Rev. Stat. Ann. tit. 18-B, §§ 101–1104	2005
Michigan	Mich. Comp. Laws §§ 700.7101–700.8204	2010
Missouri	RSMo §§ 456.1-101–456.11-1106	2005
Nebraska	Neb. Rev. Stat. §§ 30-3801–30-38,110	2005
New Hampshire	N.H. Rev. Stat. Ann. §§ 564-B:l-101–564-B:11-1104	2004
New Mexico	N.M. Stat. Ann. §§ 46A-1-101–46A-11-1105	2003
North Carolina	N.C. Gen. Stat. §§ 36C-1-101–36C-11-1106	2005
North Dakota	N.D. Cent. Code §§ 59-09-01–59-19-02	2007
Ohio	Ohio Rev. Code Ann. §§ 5801.01–5811.03	2007
Oregon	Or. Rev. Stat. §§ 130.001–130.910	2005
Pennsylvania	20 Pa. C.S §§ 7701–7799.3	2006
South Carolina	S.C. Code Ann. §§ 62-7-101–62-7-1106	2006
Tennessee	Tenn. Code Ann. §§ 35-15-101–35-15-1103	2004
Utah	Utah Code Ann. §§ 75-7-101–75-7-1201	2004
Vermont	14A V.S.A. §§ 101–1204	2009
Virginia	Va. Code Ann. §§ 55-541.01–55-551.06	2006
West Virginia	W. Va. Code §§ 44D-1-101–44D-11-1105	2011
Wyoming	Wyo. Stat. Ann. §§ 4-10-101–4-10-1103	2003

Note: The information in this appendix is derived from material that is available at www.nccusl.org/LegislativeFactSheet.aspx?title=Trust Code (last visited Sept. 1, 2011).

APPENDIX D

STATE PERPETUITIES STATUTES

STATE PERPETUITIES STATUTES

State		Citation
PERMITS PERPETUAL TRUSTS		
Alaska		Alaska Stat. §§ 34.27.051, 34.27.100
Delaware		25 Del. C. § 503
District of Columbia		D.C. Code § 19-904(a)(10)
Hawaii		Haw. Rev. Stat. § 525-4(6) (trusts under Permitted Transfers in Trust Act only)
Idaho		Idaho Code §§ 55-111, 55-111A
Illinois		765 Ill. Comp. Stat. §§ 305/3(a-5), 305/4(a)(8)
Kentucky		Ky. Rev. Stat. Ann. §§ 381.224–381.226
Maine		Me. Rev. Stat. Ann. tit. 33, § 101-A
Maryland		Md. Code Ann., Est. & Trusts § 11-102(b)(5)
Michigan		Mich. Comp. Laws §§ 554.91–554.94
Missouri		RSMo § 456.025
Nebraska		Neb. Rev. Stat. § 76-2005(9)
New Hampshire		N.H. Rev. Stat. Ann. §§ 547:3-k, 564:24, 564-A:1
New Jersey		NJSA §§ 46:2F-9–46:2F-11
* North Carolina		N.C. Gen. Stat. § 41-23
Ohio		Ohio Rev. Code Ann. § 2131.09(B)(1)
Pennsylvania		20 Pa. C.S. § 6107.1(b)(1)
Rhode Island		R.I. Gen. Laws § 34-11-38
South Dakota		S.D. Codified Laws §§ 43-5-1, 43-5-8
Virginia		Va. Code Ann. §§ 55-13.3(C), 55-12.1
Wisconsin		Wis. Stat. § 700.16(1)(a)
PERMITS VERY LONG TRUSTS		
Alabama	(360 years)	Ala. Code § 35-4A-104(9) (effective 1/1/12)
* Arizona	(500 years)	Ariz. Rev. Stat. § 14-2901(A)
Colorado	(1,000 years)	Colo. Rev. Stat. § 15-11-1102.5(1)(b)
Florida	(360 years)	Fla. Stat. § 689.225(2)(f)
* Nevada	(365 years)	Nev. Rev. Stat. § 111.1031(1)(b)
* Tennessee	(360 years)	Tenn. Code Ann. § 66-1-202(f)
Utah	(1,000 years)	Utah Code Ann. § 75-2-1203(1)
Washington	(150 years)	Wash. Rev. Code § 11.98.130
* Wyoming	(1,000 years)	Wyo. Stat. Ann. § 34-1-139(b)(ii)
FOLLOWS USRAP		
* Arkansas		Ark. Code Ann. § 18-3-101
California		Cal. Prob. Code § 21205
Connecticut		Conn. Gen. Stat. § 45a-491
Georgia		Ga. Code Ann. § 44-6-201
Hawaii		Haw. Rev. Stat. § 525-1 (except trusts under Permitted Transfers in Trust Act)
Indiana		Ind. Code § 32-17-8-3
Kansas		Kan. Stat. Ann. § 59-3401
Massachusetts		Mass. Gen. Laws ch.184A, § 1 (effective until 1/2/12); Mass. Gen. Laws ch. 190B, § 2-901 (effective starting 1/2/12)
Minnesota		Minn. Stat. § 501A.01
* Montana		Mont. Code Ann. § 72-2-1002
New Mexico		N.M. Stat. Ann. § 45-2-901
North Dakota		N.D. Cent. Code § 47-02-27.1
Oregon		Or. Rev. Stat. § 105.950
South Carolina		S.C. Code Ann. § 27-6-20

STATE PERPETUITIES STATUTES

FOLLOWS USRAP (cont'd)	
West Virginia	W. Va. Code § 36-1A-1
FOLLOWS COMMON-LAW RULE AGAINST PERPETUITIES	
Alabama	Ala. Code § 35-4-4 (until 1/1/12)
Iowa	Iowa Code § 558.68
Mississippi	Miss. Code Ann. § 79-15-21
New York	N.Y. Est. Powers & Trusts Law § 9-1.1
* Oklahoma	Okla. Stat. tit. 60, § 31
* Texas	Tex. Prop. Code Ann. § 112.036
Vermont	27 V.S.A. §§ 501–503
REQUIRES TRUST TO TERMINATE AT LATER OF DEATH OF LAST INCOME BENEFICIARY OR 20 YEARS AFTER SETTLOR'S DEATH	
Louisiana Note: Special rules apply to class trusts (La. Rev. Stat. Ann. §§ 9:1891, 9:1901).	La. Rev. Stat. Ann. § 9:1831(1)

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* State's constitution contains prohibition of perpetuities.

APPENDIX E

BASES OF STATE INCOME TAXATION OF NONGRANTOR TRUSTS

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Alabama	Ala. Code §§ 40-18-1, 40-18-2, 40-18-5, 40-18-25; Ala. Admin. Code r. 810-3-25-.10–810-3-25-.12, 810-3-25-.14; Pp. 2–3 of instructions to 2010 Ala. Form 41.	5.00% on inc. over $3,000	✓[1]	✓[1]			
Alaska	No income tax imposed on trusts.						
Arizona	Ariz. Rev. Stat. §§ 43-1001(2), 43-1011(5)(a), 43-1301(5), 43-1311; Pp. 1, 2, 12 of instructions to 2010 Ariz. Form 141AZ	4.54% on inc. over $150,000				✓	
Arkansas	Ark. Code Ann. §§ 26-51-201–26-51-203, 26-51-406; Ark. Inc. Tax. Reg. §§ 4.26-51-102, 9.26-51-102; P. 1 of instructions to 2010 Ark. AR1002.	7.00% on inc. over $49,999	✓[2]	✓[2]			
California	Cal. Rev. & Tax. Code §§ 17041(a), (e), (h), 17043(a), 17731, 17731.5, 17742–17745; Cal. Code Regs. tit. 18, §§ 17743–17744; Pp. 1, 2, 10, 13 of instructions to 2010 Cal. Form 541.	10.30% on inc. over $1 million				✓	✓
Colorado	Colo. Rev. Stat. §§ 39-22-103(10), 39-22-104, 39-22-401; Pp. 1, 4 of instructions to 2010 Colo. Form 105.	4.63%			✓		

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Connecticut	Conn. Gen. Stat. §§ 12-700(a)(8)(E), (a)(9),(d), 12-701(a)(4)(C), (D), (a)(19); Conn. Agencies Regs. §§ 12-701(a)(4)-1, 12-701(a)(9)-1; Pp. 4, 5, 6 of instructions to 2010 Form CT-1041.	6.70%	✓	✓[3]			
Delaware	30 Del. C. §§ 1102(a)(12), 1105, 1601(8), 1605(b), 1631, 1635–1636; P. 1 of instructions to 2010 Del. Form 400-I.	6.95% on inc. over $60,000	✓[4]	✓[4]		✓[4]	
District of Columbia	D.C. Code §§ 47-1806.03(a)(7), 47-1809.01, 47-1809.03, 47-1809.08–47-1809.09; P. 4 of instructions to 2010 D.C. D-41.	8.50% on inc. over $40,000	✓	✓			
Florida	No income tax imposed on trusts; Florida intangible personal property tax repealed for 2007 and later years.						
Georgia	Ga. Code Ann. §§ 48-7-20(b)(1), (d), 48-7-22, 48-7-27, Ga. Comp. R. & Regs. r. 560-7-3-.07; P. 2 of instructions to 2010 Ga. Form 501.	6.00% on inc. over $7,000			✓	✓	✓
Hawaii	Haw. Rev. Stat. §§ 235-1, 235-2.3, 235-4, 235-4.5, 235-51(d); Haw. Admin. Rules § 18-235-1.17; Pp. 1–3, 11 of instructions to 2010 Haw. Form N-40.	8.25% on inc. over $40,000			✓[4]	✓[4]	

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Idaho	Idaho Code §§ 63-3011B, 63-3011C, 63-3024(a); Idaho Admin. Code Regs. 35.01.01.035, 35.01.01.075, 35.01.01.261; Pp. 1, 9 of instructions to 2010 Idaho Form 66.	7.80% on inc. over $26,418	✓[5]	✓[5]	✓[5]	✓[5]	
Illinois	35 Ill. Comp. Stat. 5/201(a), (b)(5), (c), (d), 202, 203(c) 301(a), (c), 803(a), 1501(a)(20)(C)–(D); Ill. Admin. Code tit. 86, §§ 100.2050, 100.3000, 100.3020(a); Pp. 1–2, 4–5 of instructions to 2010 IL-1041.	6.50%	✓	✓			
Indiana	Ind. Code §§ 6-3-1-3.5(a), (e), 6-3-1-12(d), 6-3-1-14, 6-3-2-1(a), 6-3-4-4.1; Ind. Admin. Code tit. 45, r. 3.1-1-1, r. 3.1.1-10, r. 3.1-1-12, r. 3.1-1-21(d), r. 3.1-1-25, r.3.1-1-91; Pp. 1–4, 6 of instructions to 2010 Ind. Form IT-41.	3.40%			✓		

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Iowa	Iowa Code §§ 422.4–422.7, 422.9; Iowa Admin. Code r. 701-89.3(422); P. 1 of instructions to 2010 Iowa Form IA 1041	8.98% on inc. over $64,755	✓[5]		✓[5]	✓[5]	
Kansas	Kan. Stat. Ann. §§ 79-32,109(d), 79-32,110(a)(2), (d), 79-32,134; Pp. 2, 8 of instructions to 2010 Kan. Form K-41.	6.45% on inc. over $30,000			✓		
Kentucky	Ky. Rev. Stat. Ann. §§ 141.010(9)–(11), 141.020, 141.030(1); 103 Ky. Admin. Regs. 19:010; Pp. 1, 2 of instructions to 2010 Ky. Form 741.	6.00% on inc. over $75,000				✓	
Louisiana	La. Rev. Stat. Ann. §§ 47:181–47:182, 47:187, 47:300.1–47:300.3, 47:300.6, 47:300.10(3); P. 5 of instructions to 2010 La. Form IT-541.	6.00% on inc. over $50,000	✓		✓[6]		
Maine	Me. Rev. Stat. Ann. tit. 36, §§ 5102(1-C)(A), (4)(B)–(C), 5111, 5121, 5160, 5403; Pp. 1, 2 of instructions to 2010 Form 1041ME.	8.50% on inc. over $19,750	✓	✓			

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Maryland	Md. Code Ann., Tax–Gen. §§ 10-101 (d), (e), (g), (k), (n), 10-102, 10-103(a)(3), 10-105(a)(3), 10-106(a)(1)(iii), 10-106.1; Pp. 1, 3, 4 of instructions to 2010 Md. Form 504.	6.25% (plus county tax between 1.25% and 3.20%) on inc. over $1,000,000	✓	✓	✓		
Massachusetts	Mass. Gen. Laws ch. 62, §§ 4, 10(a), (c), (e); Mass. Regs. Code tit. 830, § 62.10.1; Pp. 4–6 of instructions to 2010 Mass. Form 2.	5.30% (12.00% for short-term gains & gains on sales of collectibles)	✓[7]	✓[4, 7]			
Michigan	Mich. Comp. Laws §§ 206.16, 206.18(1)(c), 206.36(1), 206.51(1)(g), (6) 206.110, 206.301; P. 2–3, 15 of instructions to 2010 MI-1041, P.1 of 2010 MI-1041	4.35%	✓	✓[8]			
Minnesota	Minn. Stat. §§ 290.01 Subd. 7b, 290.03(3), 290.06 Subd. 2c; P. 1 of instructions to 2010 Minn. Form M2.	7.85% on inc. over $75,000	✓[9]	✓[9]	✓[10]		
Mississippi	Miss. Code Ann. §§ 27-7-5(1), 27-7-27; P. 1 of instructions to 2010 Miss. Form 81-110.	5.00% on inc. over $10,000			✓		

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Missouri	RSMo §§ 143.011, 143.061, 143.111, 143.121, 143.311, 143.331(2), (3), 143.341; Pp. 1, 7 of instructions to 2010 Form MO-1041.	6.00% on inc. over $9,000	✓[11]	✓[11]			
Montana	Mont. Code Ann. §§ 15-30-2101(32)–(33), 15-30-2103, 15-30-2110, 15-30-2151, 15-30-2153; Pp. 3, 15, 17 of instructions to 2010 Mont. Form FID-3.	6.90% on inc. over $16,000	✓[5]	✓[5]	✓[5]	✓[5]	
Nebraska	Neb. Rev. Stat. §§ 77-2714.01(6), 77-2715, 77-2715.02, 77-2716, 77-2717; Neb. Admin. Code tit. 316, Ch. 23, REG-23-001, REG-23-004; Pp.5–7 of instructions to 2010 Neb. Form 1041N.	6.84% on inc. over $15,150	✓	✓			
Nevada	No income tax imposed on trusts.						
New Hampshire	N.H. Rev. Stat. Ann. §§ 77:1, 77:3, 77:4, 77:4-c, 77:10–77:12; N.H. Code Admin. R. Ann. 902.07; Pp. 1, 3, 5 of instructions to 2010 N.H. Form DP-10.	5.00% (interest and dividends only)				✓[4]	

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
New Jersey	NJSA §§ 54A:1-2(o), 54A:2-1, 54A:5-1, 54A:5-3; P. 1 of instructions to 2010 Form NJ-1041.	8.97% on inc. over $500,000	✓[12]	✓[12]			
New Mexico	N.M. Stat. Ann. §§ 7-2-2–7-2-3, 7-2-7(C); Pp. 1, 3 of instructions to 2010 N.M. Form F1D-1.	4.90% on inc. over $16,000			✓	✓	
New York	N.Y. Tax Law §§ 601(c)(1), 605(b)(3), 611–612, 618, 1300–1313;N.Y. Comp. Codes R. & Regs. tit. 20, §§ 105.23, 118.1; Admin. Code City of N.Y. §§ 11-1705, 11-1718–11-1719, 11-1721; P. 2, 10, 22 of instructions to 2010 N.Y. Form IT-205.	8.97% on inc. over $500,000 (12.846% for NYC resident on inc. over $500,000)	✓[12]	✓[12]			
North Carolina	N.C. Gen. Stat. §§ 105-134.1, 105-134.2(a)(3), 105-134.5, 105-160.1–105-160.2, 105-228.90; N.C. Admin. Code tit. 17, r. 6B.3716; P. 1 of instructions to 2010 N.C. Form D-407.	7.75% on inc. over $60,000					✓
North Dakota	N.D. Cent. Code §§ 57-38-01(12), 57-38-07, 57-38-30.3(1)(e); 57-38-31; N.D. Admin. Code § 81-03-02.1-04; P. 2 of instructions to 2010 N.D. Form 38.	4.86% on inc. over $11,200			✓	✓	✓

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Ohio	Ohio Rev. Code Ann. §§ 5747.01(A), (I)(3), (S), 5747.02(A)(6), (D), 5747.09; Pp. 2–4, 10–11 of instructions to 2010 Ohio Form IT 1041.	5.925% on inc. over $200,000 (adjusted for inflation)	✓	✓[4]			
Oklahoma	Okla. Stat. tit. 68, §§ 2353(6), (10), (12), 2355(B), (F); Okla. Admin. Code § 710:50-23-1(c); Pp. 2, 4, 15 of instructions to 2010 Okla. Form 513.	5.50% on inc. over $81,000	✓	✓			
Oregon	Or. Rev. Stat. §§ 316.022(6), 316.037(1), 316.267, 316. 282(1)(d), (2); Or. Admin. R. 150-316.282(3); Pp.1, 2 of instructions to 2010 Or. Form 41.	11.00% on inc. over $250,000			✓	✓	
Pennsylvania	72 P.S. §§ 7301(s), 7302(a), 7305; 61 Pa. Code §§ 101.1, 105.4; Pp. 2, 5 of instructions to 2010 Form PA-41.	3.07%	✓	✓			

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Rhode Island	R. I. Gen. Laws §§ 44-30-1(a), (e), 44-30-2(a)(1), (b), 44-30-2.6, 44-30-5(c); R.I. Code R. PIT. 90-13; Pp. 1-1, 1-2 of instructions to 2010 Form RI-1041.	9.90% on inc. over $11,200	✓[4]	✓[4]			
South Carolina	S.C. Code Ann. §§ 12-6-30(5), 12-6-510–12-6-520, 12-6-560, 12-6-610; Pp. 1 and 2 of instructions to 2010 Form SC1041.	7.00% on inc. over $13,700			✓		
South Dakota	No income tax imposed on trusts.						
Tennessee	Tenn. Code Ann. §§ 67-2-102, 67-2-110(a); P. 1 of instructions to 2010 Tenn. Form Inc. 250.	6.00% (interest and dividends only)					✓
Texas	No income tax imposed on trusts.						
Utah	Utah Code Ann. §§ 59-10-103(1)(a)(ii), (r), (w)(iv), 59-10-104(2)(b), 59-10-201, 59-10-201.1, 59-10-202(2)(b), 59-10-204, 59-10-205, 59-10-207, 59-10-209.1, 59-10-210, 59-10-504, 75-7-103(1)(i); Pp. 1–2, 6 of instructions to 2010 UT Form TC-41.	5.00%	✓[13]		✓[13, 14]		

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Vermont	32 V.S.A. §§ 5811(11)(B), 5822(a), (a)(5), (b)(2); Pp. 1, 2 of instructions to 2010 Vt. Form FI-161.	8.95% on inc. over $11,200	✓	✓			
Virginia	Va. Code Ann. §§ 58.1-302, 58.1-320, 58.1-322, 58.1-360–58.1-361; 23 Va. Admin. Code § 10-115-10; P. 1 of instructions to 2010 Va. Form 770.	5.75% on inc. over $17,000	✓	✓	✓	✓	
Washington	No income tax imposed on trusts.						
West Virginia	W. Va. Code §§ 11-21-3, 11-21-4e(a), 11-21-7(c), 11-21-11–11-21-12, 11-21-18; W. Va. Code St. R. § 110-21-7(7.3); Pp. 8, 9 of instructions to 2010 W. Va. Form IT-141.	6.50% on inc. over $60,000	✓	✓			

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2011 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Wisconsin	Wis. Stat. §§ 71.02(1), 71.04(1),(4), 71.06(1p), (2e)(b), 71.09(2), 71.122, 71.125(1), 71.14(2), (3), (3m), 71.16, 71.17(4); Pp. 1, 2, 6, 19 of instructions to 2010 Wis. Form 2.	7.75% on inc. over $225,000 (adjusted for inflation)	✓	✓[15]	✓[16]		
Wyoming	No income tax imposed on trusts.						

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[1] Provided that trust has resident fiduciary or current beneficiary.

[2] Provided that trust has resident trustee.

[3] Provided that trust has resident noncontingent beneficiary.

[4] Provided that trust has resident beneficiary.

[5] Provided that other requirements are met.

[6] Unless trust designates governing law other than Louisiana.

[7] Provided that trust has Massachusetts trustee.

[8] Unless trustees, beneficiaries, and administration are outside Michigan.

[9] Post-1995 trusts only.

[10] Pre-1996 trusts only.

[11] Provided that trust has resident income beneficiary on last day of year.

[12] Unless trustees and trust assets are outside state and no source income.

[13] Post-2003 irrevocable resident nongrantor trust having Utah corporate trustee may deduct all nonsource income but must file Utah return if must file federal return.

[14] Inter vivos trusts only.

[15] Trusts created or first administered in Wisconsin after October 28, 1999, only.

[16] Irrevocable inter vivos trusts administered in Wisconsin before October 29, 1999, only.

APPENDIX F

STATE PRUDENT-INVESTOR RULE STATUTES

STATE PRUDENT-INVESTOR RULE STATUTES

State	Citation
HAS STAND-ALONE PRUDENT-INVESTOR RULE	
Delaware	12 Del. C. § 3302
Florida	Fla. Stat. § 518.11
Georgia	Ga. Code Ann. § 53-12-340
Illinois	760 Ill. Comp. Stat. 5/5–5/5.1
Kentucky	Ky. Rev. Stat. Ann. § 286.3-277
Louisiana	La. Rev. Stat. Ann. § 9:2127
Maryland	Md. Code Ann., Est. & Trusts § 15-114
New York	N.Y. Est. Powers & Trusts Law § 11-2.3
South Dakota	S.D. Codified Laws §§ 55-5-6–55-5-16
FOLLOWS 1994 UNIFORM PRUDENT INVESTOR ACT	
Alabama	Ala. Code §§ 19-3B-901–19-3B-906
Alaska	Alaska Stat. §§ 13.36.225–13.36.290
Arizona	Ariz. Rev. Stat. §§ 14-10901–14-10909
Arkansas	Ark. Code Ann. §§ 28-73-901–28-73-908
California	Cal. Prob. Code §§ 16002(a), 16003, 16045–16054
Colorado	Colo. Rev. Stat. §§ 15-1.1-101–15-1.1-115
Connecticut	Conn. Gen. Stat. §§ 45a-541–45a-541l
District of Columbia	D.C. Code §§ 19-1309.01–19-1309.06
Hawaii	Haw. Rev. Stat. §§ 554C-1–554C-12
Idaho	Idaho Code §§ 68-501–68-514
Indiana	Ind. Code §§ 30-4-3.5-1–30-4-3.5-13
Iowa	Iowa Code §§ 633A.4301–633A.4309
Kansas	Kan. Stat. Ann. §§ 58-24a01–58-24a19
Maine	Me. Rev. Stat. Ann. tit. 18-B, §§ 901–908
Massachusetts	Mass. Gen. Laws ch. 203C, §§ 1–11
Michigan	Mich. Comp. Laws §§ 700.1501–700.1512
Minnesota	Minn. Stat. §§ 501B.151–501B.152
Mississippi	Miss. Code Ann. §§ 91-9-601–91-9-627
Missouri	RSMo §§ 469.900–469.913
Montana	Mont. Code Ann. §§ 72-34-601–72-34-610
Nebraska	Neb. Rev. Stat. §§ 30-3883–30-3889
Nevada	Nev. Rev. Stat. §§ 164.700–164.775
New Hampshire	N.H. Rev. Stat. Ann. §§ 564-B:9-901–564-B:9-907
New Jersey	NJSA §§ 3B:20-11.1–3B:20-11.12
New Mexico	N.M. Stat. Ann. §§ 45-7-601–45-7-612
North Carolina	N.C. Gen. Stat. §§ 36C-9-901–36C-9-907
North Dakota	N.D. Cent. Code §§ 59-17-01–59-17-06
Ohio	Ohio Rev. Code Ann. §§ 5809.01–5809.08
Oklahoma	Okla. Stat. tit. 60, §§ 175.60–175.72
Oregon	Or. Rev. Stat. §§ 130.750–130.775
Pennsylvania	20 Pa. C.S. §§ 7201–7214
Rhode Island	R.I. Gen. Laws §§ 18-15-1–18-15-13
South Carolina	S.C. Code Ann. § 62-7-933

STATE PRUDENT-INVESTOR RULE STATUTES

FOLLOWS 1994 UNIFORM PRUDENT INVESTOR ACT (Cont'd.)	
Tennessee	Tenn. Code Ann. §§ 35-14-101–35-14-114
Texas	Tex. Prop. Code Ann. §§ 113.006, 113.008, 113.055–113.056, 113.0211, 117.001–117.012
Utah	Utah Code Ann. §§ 75-7-901–75-7-907
Vermont	14A V.S.A. §§ 901–908
Virginia	Va. Code Ann. §§ 26-45.3–26-45.14
Washington	Wash. Rev. Code §§ 11.100.010–11.100.140
West Virginia	W. Va. Code §§ 44D-9-901, 44-6C-1–44-6C-15
Wisconsin	Wis. Stat. § 881.01
Wyoming	Wyo. Stat. Ann. §§ 4-10-901–4-10-913

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Note: The text of the Uniform Prudent Investor Act (UPIA) is available at www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/upia94.pdf (last visited Sept. 1, 2011). To determine which states have enacted the UPIA, go to www.nccusl.org/LegislativeFactSheet.aspx?title=Prudent Investor Act (last visited Sept. 1, 2011).

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APPENDIX G

STATE DIRECTED TRUST STATUTES

STATE DIRECTED TRUST STATUTES

State	Citation
Follows § 185 of Second Restatement of Trusts (directed trustee liable if direction violates terms of trust or fiduciary duty of directing person)	
Indiana	Ind. Code § 30-4-3-9(b)
Iowa	Iowa Code § 633A.4207(2)
Follows § 808(b) of UTC (directed trustee liable if direction is manifestly contrary to terms of trust or trustee knows direction is serious breach of fiduciary duty of directing person)	
Alabama	Ala. Code § 19-3B-808(b)
Arkansas	Ark. Code Ann. § 28-73-808(b)
District of Columbia	D.C. Code § 19-1308.08(b)
Florida	Fla. Stat. § 736.0808(2)
Kansas	Kan. Stat. Ann. § 58a-808(b)
Maine	Me. Rev. Stat. Ann. tit. 18-B, § 808(2)
Michigan	Mich. Comp. Laws § 700.7809(4)
Missouri	RSMo § 456.8-808(2)
Nebraska	Neb. Rev. Stat. § 30-3873(b)
New Mexico	N.M. Stat. Ann. § 46A-8-808(B)
North Carolina	N.C. Gen. Stat. § 36C-8-808(b)
North Dakota	N.D. Cent. Code § 59-16-08(2)
Oregon	Or. Rev. Stat. § 130.685(2)
Pennsylvania	20 Pa. C.S. § 7778(b)
South Carolina	S.C. Code Ann. § 62-7-808(b)
Texas	Tex. Prop. Code Ann. § 114.003(b)
Vermont	14A V.S.A. § 808(b)
Virginia	Va. Code Ann. § 55-548.08(B)
West Virginia	W. Va. Code § 44D-8-808(b)
Provides Substantial Protection (directed trustee liable for deficient execution of direction, for willful misconduct, or not at all)	
Arizona	Ariz. Rev. Stat. § 14-10808
Colorado (investment decisions only)	Colo. Rev. Stat. § 15-1-307
Delaware (wilful misconduct)	12 Del. C. § 3313
Georgia (investment decisions only)	Ga. Code Ann. § 53-12-303(c)
Idaho	Idaho Code § 15-7-501(2),(5)
Indiana	Ind. Code § 30-4-3-9(a)
Kentucky (corporate trustees, investment decisions, authorized directions only)	Ky. Rev. Stat. Ann. § 286.3-275
Nevada	Nev. Rev. Stat. §§ 163.553–163.5559
New Hampshire	N.H. Rev. Stat. Ann. § 564-B:8-808(b)
Ohio	Ohio Rev. Code Ann. §§ 5808.08(B), 5815.25(B)
Oklahoma (investment decisions only)	Okla. Stat. tit. 60, § 175.19
South Dakota	S.D. Codified Laws §§ 55-1B-1–55-1B-11, 2011 S.D. HB No. 1155, § 4
Tennessee	Tenn. Code Ann. §§ 35-15-808, 35-3-122–35-3-123
Utah (willful misconduct or gross negligence; investment decisions only)	Utah Code Ann. § 75-7-906(4)
Wyoming	Wyo. Stat. Ann. §§ 4-10-808(b), 4-10-715, 4-10-717–4-10-718

STATE DIRECTED TRUST STATUTES

HAS NO DIRECTED TRUST STATUTE
Alaska
California
Connecticut
Hawaii
Illinois
Louisiana
Maryland
Massachusetts
Minnesota
Mississippi
Montana
New Jersey
New York
Rhode Island
Washington
Wisconsin

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APPENDIX H

STATE THIRD-PARTY TRUST STATUTES

STATE THIRD-PARTY TRUST STATUTES

State	Spendthrift Trust	Discretionary Trust
Alabama	Ala. Code §§ 19-3B-502–19-3B-503	Ala. Code §§ 19-3B-504, 19-3B-814(a)
Alaska	Alaska Stat. § 34.40.110	
Arizona	Ariz. Rev. Stat. §§ 14-10502–4-10503	Ariz. Rev. Stat. §§ 14-10504, 14-10814
Arkansas	Ark. Code Ann. § 28-73-502	Ark. Code Ann. §§ 28-73-504, 28-73-814(a)
California	Cal. Prob. Code §§ 15300–15301,15305–15309	Cal. Prob. Code §§ 15303, 15305–15308, 16080–16082
Colorado		
Connecticut		
Delaware	12 Del. C. § 3536	12 Del. C. § 3315
District of Columbia	D.C. Code §§ 19-1305.02–19-1305.03	D.C. Code § 19-1308.14(a)
Florida	Fla. Stat. §§ 736.0502–736.0503	Fla. Stat. §§ 736.0504, 736.0814(1)
Georgia	Ga. Code Ann. § 53-12-80	Ga. Code Ann. § 53-12-81
Hawaii		
Idaho	Idaho Code § 15-7-502	
Illinois	735 Ill. Comp. Stat. 5/2-1403	735 Ill. Comp. Stat. 5/2-1403
Indiana	Ind. Code § 30-4-3-2	Ind. Code § 30-4-2.1-14
Iowa	Iowa Code § 633A.2302	Iowa Code §§ 633A.2305–633A.2306
Kansas	Kan. Stat. Ann. § 58a-502	
Kentucky	Ky. Rev. Stat. Ann. § 381.180	
Louisiana	La. Rev. Stat. Ann. §§ 9:2001–9:2002, 9:2004–9:2005, 9:2007	
Maine	Me. Rev. Stat. Ann. tit. 18-B, §§ 502–503	Me. Rev. Stat. Ann. tit. 18-B, §§ 504, 814(1)
Maryland		
Massachusetts		
Michigan	Mich. Comp. Laws §§ 700.7502, 700.7504	Mich. Comp. Laws §§ 700.7505, 700.7815(1)
Minnesota		
Mississippi	Miss. Code Ann. §§ 91-9-501, 91-9-503, 91-9-505, 91-9-511	Miss. Code Ann. §§ 91-9-501, 91-9-507, 91-9-511
Missouri	RSMo §§ 456.5-502–456.5-503	RSMo §§ 456.5-504, 456.8-814(1)
Montana	Mont. Code Ann. §§ 72-33-301–72-33-302, 72-33-306	Mont. Code Ann. § 72-33-304
Nebraska	Neb. Rev. Stat. §§ 30-3847–30-3848	Neb. Rev. Stat. §§ 30-3849, 30-3879(a)
Nevada	Nev. Rev. Stat. §§ 166.010–166.170	Nev. Rev. Stat. §§ 166.110, 163.4185–163.419
New Hampshire	N.H. Rev. Stat. Ann. §§ 564-B:5-502–564-B:5-503	N.H. Rev. Stat. Ann. §§ 564-B:5-504, 564-B:8-814(a)–(c)
New Jersey		
New Mexico	N.M. Stat. Ann. §§ 46A-5-502–46A-5-503	N.M. Stat. Ann. §§ 46A-5-504, 46A-8-814(A)
New York	N.Y. Est. Powers & Trusts Law § 7-1.5	
North Carolina	N.C. Gen. Stat. §§ 36C-5-502–36C-5-503	N.C. Gen. Stat. §§ 36C-5-504, 36C-8-814(a)
North Dakota	N.D. Cent. Code §§ 59-13-02–59-13-03	N.D. Cent. Code §§ 59-13-04, 59-16-14(1)
Ohio	Ohio Rev. Code Ann. §§ 5805.01–5805.02	Ohio Rev. Code Ann. §§ 5805.04, 5808.14(A)

STATE THIRD-PARTY TRUST STATUTES

State	Spendthrift Trust	Discretionary Trust
Oklahoma	Okla. Stat. tit. 60, § 175.25	Okla. Stat. tit. 60, § 175.25(F)
Oregon	Or. Rev. Stat. §§ 130.305–130.310	
Pennsylvania	20 Pa. C.S. §§ 7742–7743	20 Pa. C.S. §§ 7744, 7780.4
Rhode Island	R.I. Gen. Laws § 18-9.1-1	
South Carolina	S.C. Code Ann. §§ 62-7-502–62-7-503	S.C. Code Ann. §§ 62-7-504, 62-7-814(a)
South Dakota	S.D. Codified Laws §§ 55-1-24–55-1-26, 55-1-34–55-1-35, 55-1-37, 55-1-41–55-1-42	S.D. Codified Laws §§ 55-1-24–55-1-26, 55-1-38–55-1-40, 55-1-43
Tennessee	Tenn. Code Ann. §§ 35-15-502–35-15-503	Tenn. Code Ann. §§ 35-15-504, 35-15-814(a)
Texas	Tex. Prop. Code Ann. § 112.035	
Utah	Utah Code Ann. §§ 75-7-502–75-7-503	Utah Code Ann. §§ 75-7-504, 75-7-812(1)
Vermont	14A V.S.A. §§ 502–503	14A V.S.A. §§ 504, 814(a)
Virginia	Va. Code Ann. §§ 55-545.02–55-545.03, 55-545.03:1	Va. Code Ann. §§ 55-545.03:1, 55-545.04, 55-548.14(A)
Washington	Wash. Rev. Code § 6.32.250(2)	
West Virginia	W. Va. Code §§ 44D-5-502–44D-5-503	W. Va. Code §§ 44D-5-504, 44D-8-814(a)
Wisconsin	Wis. Stat. § 701.06	
Wyoming	Wyo. Stat. Ann. §§ 4-10-502–4-10-503, 4-10-505	Wyo. Stat. Ann. § 4-10-504

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APPENDIX I

STATE SELF-SETTLED TRUST STATUTES

STATE SELF-SETTLED TRUST STATUTES

State	Citation	Effective Date
PROHIBITS TRUSTOR'S CREDITORS FROM REACHING TRUSTOR'S INTEREST IN OR ASSETS OF SELF-SETTLED TRUST IN CERTAIN CIRCUMSTANCES		
Alaska	Alaska Stat. § 34.40.110	1997
Colorado	Colo. Rev. Stat. § 38-10-111	1861
Delaware	12 Del. C. §§ 3536(c)(1), 3570–3576	1997
Hawaii	Haw. Rev. Stat. §§ 554G-1–554G-12, 2011 Hi. Act 161, § 2	2010
Missouri	RSMo § 456.5-505	2005
Nevada	Nev. Rev. Stat. §§ 166.010–166.170, 2011 Nev. Stat. 270, §§ 202–203	1999
New Hampshire	N.H. Rev. Stat. Ann. §§ 564-B:5-505(c), 564-D:1–564-D:18	2009
Oklahoma	Okla. Stat. tit. 31, §§ 10–18	2005
Rhode Island	R.I. Gen. Laws §§ 18-9.2-1–18-9.2-7	1999
South Dakota	S.D. Codified Laws §§ 55-1-36, 55-16-1–55-16-17, 55-3-39, 55-3-41, 55-3-47	2005
Tennessee	Tenn. Code Ann. §§ 35-16-101–35-16-112	2007
Utah	Utah Code Ann. § 25-6-14	2003
Wyoming	Wyo. Stat. Ann. §§ 4-10-103, 4-10-506(b), 4-10-510–4-10-523	2007
PERMITS TRUSTOR'S CREDITORS TO REACH TRUSTOR'S INTEREST IN SELF-SETTLED TRUST		
Alabama	Ala. Code § 19-3B-505(a)(2)	
Arizona	Ariz. Rev. Stat. § 14-10505(a)(2)	
Arkansas	Ark. Code Ann. § 28-73-505(a)(2)	
California	Cal. Prob. Code § 15304	
Delaware	12 Del. C. § 3536(c)(1)	
District of Columbia	D.C. Code § 19-1305.05(a)(2)	
Florida	Fla. Stat. § 736.0505(1)(b)	
Georgia	Ga. Code. Ann. § 53-12-82(2)	
Idaho	Idaho Code § 15-7-502(4)	
Illinois	735 Ill. Comp. Stat. 5/2-1403	
Indiana	Ind. Code § 30-4-3-2(b)	
Iowa	Iowa Code §§ 633A.2303–633A.2304	
Kansas	Kan. Stat. Ann. § 58a-505(a)(2)	
Kentucky	Ky. Rev. Stat. Ann. § 381.180(7)(a)	
Louisiana	La. Rev. Stat. Ann § 9:2004	
Maine	Me. Rev. Stat. Ann. tit. 18-B, § 505(1)(B)	
Michigan	Mich. Comp. Laws § 700.7506(1)(c)	
Mississippi	Miss. Code Ann. § 91-9-509(1)	
Montana	Mont. Code Ann. § 72-33-305(1)	
Nebraska	Neb. Rev. Stat. § 30-3850(a)(2)	
New Hampshire	N.H. Rev. Stat. Ann. § 564-B:5-505(a)(2)	
New Jersey	NJSA § 3B:11-1	
New Mexico	N.M. Stat. Ann. § 46A-5-505(A)(2)	
New York	N.Y. Est. Powers & Trusts Law § 7-3.1(a), N.Y. C.P.L.R. § 5205(c)(1)	
North Carolina	N.C. Gen. Stat. § 36C-5-505(a)(2)	
North Dakota	N.D. Cent. Code § 59-13-05(1)	
Ohio	Ohio Rev. Code Ann. § 5805.06(A)(2)	
Oklahoma	Okla. Stat. tit. 60, § 175.25(H)	
Oregon	Or. Rev. Stat. § 130.315(1)(b)	
Pennsylvania	20 Pa. C.S. § 7745(2)	
South Carolina	S.C. Code Ann. § 62-7-505(a)(2)	
South Dakota	S.D. Codified Laws § 55-1-36	

STATE SELF-SETTLED TRUST STATUTES

PERMITS TRUSTOR'S CREDITORS TO REACH TRUSTOR'S INTEREST IN SELF-SETTLED TRUST (Cont'd)	
Tennessee	Tenn. Code Ann. § 35-15-505(a)(2)
Texas	Tex. Prop. Code Ann. § 112.035(d)
Utah	Utah Code Ann. § 75-7-505(1)(b)
Vermont	14A V.S.A. § 505(a)(2)
Virginia	Va. Code Ann. § 55-545.05(A)(2)
Washington	Wash. Rev. Code § 19.36.020
West Virginia	W. Va. Code § 44D-5-505(a)(2)
Wisconsin	Wis. Stat. § 701.06
PROVIDES THAT SELF-SETTLED TRUST IS VALID EVEN THOUGH TRUSTOR'S CREDITORS MAY REACH TRUSTOR'S INTEREST	
California	Cal. Prob. Code § 15304(a)
Mississippi	Miss. Code Ann. § 91-9-509(1)
Montana	Mont. Code Ann. § 72-33-305(1)
PROVIDES THAT SELF-SETTLED TRUST IS VOID	
Idaho	Idaho Code § 55-905
Illinois	735 Ill. Comp. Stat. 5/2-1403
New Jersey	NJSA § 25:2-1(a)
New York	N.Y. Est. Powers & Trusts Law § 7-3.1(a), N.Y. C.P.L.R. § 5205(c)(1)
Washington	Wash. Rev. Code § 19.36.020
HAS NO RELEVANT STATUTE	
Connecticut	
Maryland	
Massachusetts	
Minnesota	

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APPENDIX J

STATE POWER TO ADJUST AND UNITRUST STATUTES

STATE POWER TO ADJUST AND UNITRUST STATUTES

STATE	POWER TO ADJUST	PROTECTION FOR TRUSTEE	UNITRUST CONVERSION STATUTE	NEW UNITRUST STATUTE
Alabama	Ala. Code § 19-3A-104	Ala. Code § 19-3A-104(f)		
Alaska	Alaska Stat. § 13.38.210	Alaska Stat. § 13.38.220	Alaska Stat. §§ 13.38.300–13.38.410	
Arizona	Ariz. Rev. Stat. § 14-7403	Ariz. Rev. Stat. § 14-7404(A)	Ariz. Rev. Stat. § 14-11014	
Arkansas	Ark. Code Ann. § 28-70-104			
California	Cal. Prob. Code § 16336	Cal. Prob. Code §§ 16337–16338	Cal. Prob. Code §§ 16336.4–16336.7	Cal. Prob. Code § 16328
Colorado	Colo. Rev. Stat. § 15-1-404	Colo. Rev. Stat. § 15-1-405	Colo. Rev. Stat. § 15-1-404.5	
Connecticut	Conn. Gen. Stat. § 45a-542c			
Delaware	12 Del. C. § 61-104	12 Del. C. § 61-105	12 Del. C. § 61-106	12 Del. C. § 61-107
District of Columbia	D.C. Code § 28-4801.04			
Florida	Fla. Stat. § 738.104	Fla. Stat. § 738.105	Fla. Stat. § 738.1041	Fla. Stat. § 738.1041(11)
Georgia	Ga. Code Ann. § 53-12-361	Ga. Code Ann. § 53-12-363	Ga. Code Ann. § 53-12-362	Ga. Code Ann. § 53-12-364
Hawaii	Haw. Rev. Stat. § 557A-104	Haw. Rev. Stat. §§ 557A-105–557A-106		
Idaho	Idaho Code § 68-10-104	Idaho Code § 68-10-105		
Illinois			760 Ill. Comp. Stat 5/5.3	760 Ill. Comp. Stat. 5/5.3(m)
Indiana	Ind. Code § 30-2-14-15	Ind. Code §§ 30-2-14-16–30-2-14-17	Ind. Code §§ 30-2-15-1–30-2-15-26	
Iowa			Iowa Code §§ 637.601–637.615	
Kansas	Kan. Stat. Ann. § 58-9-104		Kan. Stat. Ann. § 58-9-105	
Kentucky	Ky. Rev. Stat. Ann. § 386.454		Ky. Rev. Stat. Ann § 386.454(2)	
Louisiana	La. Rev. Stat. Ann. § 9:2158–2162	La. Rev. Stat. Ann. § 9:2163		
Maine	Me. Rev. Stat. Ann. tit. 18-A, § 7-704	Me. Rev. Stat. Ann. tit. 18-A, § 7-706	Me. Rev. Stat. Ann. tit. 18-A, § 7-705	
Maryland	Md. Code Ann., Est. & Trusts § 15-502.2	Md. Code Ann., Est. & Trusts § 15-502.3	Md. Code Ann., Est. & Trusts § 15-502.1	

STATE POWER TO ADJUST AND UNITRUST STATUTES

STATE	POWER TO ADJUST	PROTECTION FOR TRUSTEE	UNITRUST CONVERSION STATUTE	NEW UNITRUST STATUTE
Massachusetts	Mass. Gen. Laws ch. 203D, § 4	Mass. Gen. Laws ch. 203D, § 5		
Michigan	Mich. Comp. Laws § 555.504	Mich. Comp. Laws § 555.505		
Minnesota	Minn. Stat. Ann. § 501B.705	Minn. Stat. § 501B.705, Subd. 7		
Mississippi				
Missouri	RSMo § 469.405	RSMo § 469.409	RSMo § 469.411	RSMo § 469.411(5)(1)
Montana	Mont. Code Ann. § 72-34-424	Mont. Code Ann. §§ 72-34-424(8), 72-34-425, 72-34-426		
Nebraska	Neb. Rev. Stat. § 30-3119	Neb. Rev. Stat. §§ 30-3120–30-3121	Neb. Rev. Stat. § 30-3119.01	
Nevada	Nev. Rev. Stat. § 164.795		Nev. Rev. Stat. §§ 164.796–164.799	
New Hampshire	N.H. Rev. Stat. Ann. § 564-C:1-104	N.H. Rev. Stat. Ann. §§ 564-C:1-104(h), 564-C:1-105	N.H. Rev. Stat. Ann. § 564-C:1-106	
New Jersey	NJSA § 3B:19B-4	NJSA § 3B:19B-31		
New Mexico	N.M. Stat. Ann. § 46-3A-104		N.M. Stat. Ann. §§ 46-3A-105–46-3A-113	
New York	N.Y. Est. Powers & Trusts Law § 11-2.3(b)(5)	N.Y. Est. Powers & Trusts Law § 11-2.3-A	N.Y. Est. Powers & Trusts Law § 11-2.4	N.Y. Est. Powers & Trusts Law § 11-2.4(e)(1)(A)
North Carolina	N.C. Gen. Stat. § 37A-1-104	N.C. Gen. Stat. § 37A-1-105	N.C. Gen. Stat. §§ 37A-1-104.1–37A-1-104.9	N.C. Gen. Stat. §§ 37A-1-104.21–37A-1-104.26
North Dakota				
Ohio	Ohio Rev. Code Ann. § 5812.03	Ohio Rev. Code Ann. § 5812.03(G)		
Oklahoma	Okla. Stat. tit. 60, § 175.104			
Oregon	Or. Rev. Stat. § 129.215	Or. Rev. Stat. § 129.220	Or. Rev. Stat. § 129.225	
Pennsylvania	20 Pa. C.S. § 8104	20 Pa. C.S. § 8106	20 Pa. C.S. § 8105	20 Pa. C.S. § 8107
Rhode Island	R.I. Gen. Laws § 18-4-28		R.I. Gen. Laws § 18-4-29	R.I. Gen. Laws § 18-4-29(a)
South Carolina	S.C. Code Ann. § 62-7-904			
South Dakota	S.D. Codified Laws § 55-13A-104	S.D. Codified Laws § 55-13A-105	S.D. Codified Laws §§ 55-15-1–55-15-14	S.D. Codified Laws § 55-15-1(7A)
Tennessee	Tenn. Code Ann. § 35-6-104	Tenn. Code Ann. §§ 35-6-104(g), 35-6-106	Tenn. Code Ann. § 35-6-108	Tenn. Code Ann. § 35-6-109

STATE POWER TO ADJUST AND UNITRUST STATUTES

STATE	POWER TO ADJUST	PROTECTION FOR TRUSTEE	UNITRUST CONVERSION STATUTE	NEW UNITRUST STATUTE
Texas	Tex. Prop. Code Ann. § 116.005	Tex. Prop. Code Ann. § 116.006		Tex. Prop. Code Ann. § 116.007
Utah	Utah Code Ann. § 22-3-104	Utah Code Ann. §§ 22-3-105–22-3-107		
Vermont			14A V.S.A § 907	14A V.S.A. § 908
Virginia	Va. Code Ann. § 55-277.4		Va. Code Ann. § 55-277.4:1	
Washington	Wash. Rev. Code § 11.104A.020	Wash. Rev. Code § 11.104A.030	Wash. Rev. Code § 11.104A.040	Wash. Rev. Code § 11.104A.040(a)(2)
West Virginia	W. Va. Code § 44B-1-104	W. Va. Code § 44B-1-105	W. Va. Code § 44B-1-104a	W. Va. Code § 44B-1-104a(m)
Wisconsin	Wis. Stat. § 701.20(4)	Wis. Stat. § 701.20(4c)	Wis. Stat. § 701.20(4g)	Wis. Stat. § 701.20(4j)
Wyoming	Wyo. Stat. Ann. § 2-3-804	Wyo. Stat. Ann. § 2-3-832	Wyo. Stat. Ann. §§ 2-3-901–2-3-917	Wyo. Stat. Ann. § 2-3-906

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The text of the UPAIA is available at www.law.upenn.edu/bll/archives/ulc/upaia/2008_final.htm (last visited Sept. 1, 2011). To determine which jurisdictions have enacted the UPAIA, go to www.nccusl.org/LegislativeFactSheet.aspx?title=Principal and Income Act (last visited Sept. 1, 2011).

APPENDIX K

STATE LIABILITY SYSTEMS RANKING

STATE LIABILITY SYSTEMS RANKING

State	Ranking		States In Order of Ranking	Ranking
Alabama	47		Delaware	1
Alaska	33		North Dakota	2
Arizona	13		Nebraska	3
Arkansas	44		Indiana	4
California	46		Iowa	5
Colorado	8		Virginia	6
Connecticut	24		Utah	7
Delaware	1		Colorado	8
Florida	42		Massachusetts	9
Georgia	27		South Dakota	10
Hawaii	35		Minnesota	11
Idaho	18		Maine	12
Illinois	45		Arizona	13
Indiana	4		Kansas	14
Iowa	5		Wyoming	15
Kansas	14		New Hampshire	16
Kentucky	40		North Carolina	17
Louisiana	49		Idaho	18
Maine	12		Tennessee	19
Maryland	20		Maryland	20
Massachusetts	9		Oregon	21
Michigan	30		Wisconsin	22
Minnesota	11		New York	23
Mississippi	48		Connecticut	24
Missouri	37		Vermont	25
Montana	43		Washington	26
Nebraska	3		Georgia	27
Nevada	28		Nevada	28
New Hampshire	16		Ohio	29
New Jersey	32		Michigan	30
New Mexico	41		Oklahoma	31
New York	23		New Jersey	32
North Carolina	17		Alaska	33
North Dakota	2		Pennsylvania	34
Ohio	29		Hawaii	35
Oklahoma	31		Texas	36
Oregon	21		Missouri	37
Pennsylvania	34		Rhode Island	38
Rhode Island	38		South Carolina	39
South Carolina	39		Kentucky	40
South Dakota	10		New Mexico	41
Tennessee	19		Florida	42
Texas	36		Montana	43
Utah	7		Arkansas	44
Vermont	25		Illinois	45

STATE LIABILITY SYSTEMS RANKING

State	Ranking		States In Order of Ranking	Ranking
Virginia	6		California	46
Washington	26		Alabama	47
West Virginia	50		Mississippi	48
Wisconsin	22		Louisiana	49
Wyoming	15		West Virginia	50

Note: The data in the above table is taken from the 2010 Liability Systems Ranking Study, dated March 2010, conducted by Harris Interactive, Inc., for the U.S. Chamber of Commerce Institute for Legal Reform. The study was based on interviews with 1,482 practicing corporate attorneys and general counsels from October 22, 2009 – January 21, 2010, available at www.instituteforlegalreform.com/lawsuit-climate.html#/2010 (last visited Sept. 1, 2011).

APPENDIX L

STATE NONCHARITABLE PURPOSE TRUST STATUTES

STATE NONCHARITABLE PURPOSE TRUST STATUTES[1]

State	Citation
PERMITS PERPETUAL TRUSTS	
Delaware[2]	12 Del. C. §§ 3556, 3303(b), 3541; 25 Del. C. § 503(a)
Idaho	Idaho Code §§ 15-7-601, 55-111
Kentucky	Ky. Rev. Stat. Ann. § 381.260
Maine	Me. Rev. Stat. Ann. tit. 18-B, § 409; 33, § 101-A
New Hampshire	N.H. Rev. Stat. Ann. §§ 547:3-k, 564-B:4-409; 564:24
South Dakota[2]	S.D. Codified Laws §§ 55-1-20, 55-1-22
Wisconsin	Wis. Stat. §§ 701.11(1), 700.16
Wyoming	Wyo. Stat. Ann. §§ 4-10-410, 4-10-412, 4-10-712, 34-1-139(b)
PERMITS TRUSTS FOR FIXED PERIOD LONGER THAN 21 YEARS	
Arizona[3]	Ariz. Rev. Stat. § 14-10409 (90 years)
North Dakota	N.D. Cent. Code §§ 59-12-09, 47-02-27.1, 47-02-27.4 (USRAP period —21 years after death of last individual living when trust became irrevocable, 90 years, or shorter of such periods)
Oregon	Or. Rev. Stat. § 130.190 (90 years)
South Carolina	S.C. Code Ann. §§ 62-7-409, 27-6-20 (USRAP period —21 years after death of last individual living when trust became irrevocable, 90 years, or shorter of such periods)
Tennessee	Tenn. Code Ann. § 35-15-409 (90 years)
West Virginia	W. Va. Code §§ 4D-4-409, 36-1A-1 (90 years)
PERMITS 21-YEAR TRUSTS	
Based on UPC § 2-907(a)	
Alaska	Alaska Stat. § 13.12.907(a)
Arizona[4]	Ariz. Rev. Stat. § 14-2907(A)
Colorado	Colo. Rev. Stat. § 15-11-901(1)
Iowa	Iowa Code § 633A.2105(1)
Michigan	Mich. Comp. Laws § 700.2722(1)
Montana	Mont. Code Ann. § 72-2-1017(1)
New Mexico[5]	N.M. Stat. Ann. § 45-2-907(A)
Utah	Utah Code Ann. §§ 75-7-409, 75-2-1001
Based on UTC § 409	
Alabama	Ala. Code § 19-3B-409
Arkansas	Ark. Code Ann. § 28-73-409
District of Columbia	D.C. Code § 19-1304.09
Florida	Fla. Stat. §§ 736.0409, 736.04113
Kansas	Kan. Stat. Ann. § 58a-409
Missouri	RSMo § 456.4-409
Nebraska	Neb. Rev. Stat. § 30-3835
New Mexico[3]	N.M. Stat. Ann. § 46A-4-409
North Carolina	N.C. Gen. Stat. § 36C-4-409
Ohio	Ohio Rev. Code Ann. § 5804.09
Pennsylvania	20 Pa. C.S. § 7739
Vermont	14A V.S.A. § 409
Virginia	Va. Code Ann. § 55-544.09

STATE NONCHARITABLE PURPOSE TRUST STATUTES[1] (cont'd)

State	Citation
Other	
California	Cal. Prob. Code §§ 15211, 15204
Indiana	Ind. Code § 30-4-2-19
HAS NO RELEVANT STATUTE	
Connecticut	
Georgia	
Hawaii	
Illinois	
Louisiana	
Maryland	
Massachusetts	
Minnesota	
Mississippi	
Nevada	
New Jersey	
New York	
Oklahoma	
Rhode Island	
Texas	
Washington	

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[1] This chart does not include citations to statutes that deal specifically with burial lots or animals.

[2] Also has abolished any common-law rule limiting the duration of noncharitable purpose trusts.

[3] The state also has a version of UPC § 2-907(a).

[4] The state also has a version of UTC § 409 that allows 90-year trusts.

[5] The state also has a version of UTC § 409.