ESTATE PLANNING BASICS

LAVENDER LAW 2021

by

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NOTE: The sample language and explanatory information below are intended to provide general guidance to members of the Bar. An attorney should be independently satisfied as to the accuracy and to the legal consequences of use of a form in a particular case.

I. ESSENTIAL CONSIDERATIONS IN DRAFTING WILLS, REVOCABLE TRUSTS AND BENEFICIARY DESIGNATIONS:

A. Specific Bequests of Tangible Personal Property.

1. Income Tax Benefits: If a gift is a specific bequest as opposed to a portion of the residuary estate, the value of property distributed does not "carry out" any taxable income from the estate during that tax year. Internal Revenue Code (I.R.C.) §§ 661, 662.

2. Keeping Title to Tangible Personal Out of Minor Beneficiaries' Names and Trusts: Leaving personal property to adult children (or heirs) avoids the need for a guardian or custodian (too expensive for property with little resale value) to hold title for minor beneficiaries, as well as non-income producing and cumbersome property for a trustee to administer.

3. Memorandum to Dispose of Tangible Personal Property: In North Carolina, a memorandum outside of a will is not legally binding upon an executor. In such states, consider using the precatory language requesting the executor for follow a memorandum [see, (a)(iii) below]. In other states, a memorandum can have testamentary effect. See, SC Code § 62-2-512.

PRACTICE TIP: A substantial portion of estate disputes are over tangible personal property. Clear drafting can help minimize conflict.

SAMPLE PROVISIONS FOR GIFTS OF TANGIBLE PERSONAL PROPERTY:

(a) Gift of Tangible Personal Property. All my tangible personal property that was not held by me solely for investment purposes, including, but not limited to, my automobiles, household furniture and furnishings, clothing, jewelry, collectibles and personal effects, shall be disposed of as follows:

(i) I give all such tangible personal property to [PRIMARY BENEFICIARY], if [SHE/HE] survives me.

(ii - ALT 1) [IF ALL CHILDREN ADULTS; NOTE UNEQUAL DIVISION IF ONE CHILD PREDECEASED BUT SURVIVED BY ISSUE] If [PRIMARY BENEFICIARY] does not survive me, I give all such tangible personal property (i) to my children who survive me to be divided among them by my Executor in shares of as nearly equal value as may be practicable or (ii) to the survivor of my children if only one of them survives me.

(ii - ALT 2) [IF BENEFIARIES ARE MINORS OR EXECTUOR SHOULD HAVE DISCRETION ON WHETHER TO DISTRIBUTE OR SELL] If [PRIMARY BENEFICIARY] does not survive me, I direct my Executor, in my Executor's discretion, either to (i) divide any or all of such tangible personal property, or the proceeds of its sale, among my children who survive me in such manner as my Executor may determine or (ii) add any or all of such property, or the proceeds of its sale, to my residuary estate. In making any division of such property among my children, my Executor shall consider but shall not be bound by their respective wishes.

(iii) I may leave a writing which, although not a part of my will, expresses my desires concerning the disposition of my tangible personal property. I request, but do not require, that my wishes as set forth in any such writing be observed. [**Note:** Some state laws provide the memorandum are effective testamentary instruments. e.g., SC Code § 62-2-512. In such states, precatory language is not necessary.]

(iv) The costs of safeguarding, insuring, packing, storing and delivering my tangible personal property to any beneficiary under this Paragraph shall be paid as expenses of administration**. [Note:** State law varies on whether in absence of an express provision, delivery expenses are to be paid by the beneficiary.**]**

B. Specific Bequests/Gifts versus Residuary Bequests/Gifts.

1. Income Tax Considerations: Specific gifts do not "carry out" income provided they are paid out in three or less installments. I.R.C. § 663(a)(1)

2. Estate Settlement Complications: Naming multiple residuary beneficiaries can create unnecessary expenses and complications, as opposed to a gift of a pecuniary sum (which can be limited to a percentage of the overall estate).

3. Effect Upon Beneficiaries' Income Tax and Need to Disclose Social Security Numbers: To file a proper fiduciary income tax return, the executor will need the social security number of each residuary beneficiary, each of whom will receive a K-1 which may include taxable income reportable on the beneficiaries' personal income tax returns.

4. Inability to Distribute Gifts Promptly: Since the estate must be completely settled prior to distributions, distributions of residuary gifts must be made at the conclusion of the administration, as opposed to specific bequests which can generally be made once the creditors' period has expired.

C. Trusts versus Life Estates. Many estate planners, including this author, find life estates to be cumbersome and to invite disputes between the life tenant and remaindermen, as opposed to a well drafted trust which can define the rights of the lifetime beneficiary (exclusive if desired).

1. Trusts can generally better protect against:

a. Control of Property/Interference from Family Members.

b. Potential for Waste by Life Tenant.

c. Undue Restraints Upon Sale Of Property.

d. Insufficient Funding to Maintain the Property.

e. Countable Resource/Creditor Protections.

2. Proper provisions for Trust Holding Residential Real Estate: Be sure to consider provisions which (a) direct that the trustee should allow the beneficiary the right to live in the residence rent free, (b) state whether trust is responsible for maintenance of the property, taxes, insurance etc., (c) whether there is any obligation to preserve principal for the remaindermen.

SAMPLE LANGUAGE IF RESIDENCE WILL BE HELD IN TRUST

(A) Gift of Principal Residence. If my [SPOUSE/PARTNER] survives me, I give all my interest in and to any property which my [SPOUSE/PARTNER] and I are using as our principal residence at the time of my death, including any interest as owner, lessee, shareholder or otherwise and all rights that I may have under any insurance policies relating to such residence, to the Trustee named below to be disposed of for the benefit of my [SPOUSE/PARTNER] in accordance with the provision so the section of this Article entitled "[SPOUSE/PARTNER] 's Trust".

……

D. [SPOUSE/PARTNER] 's Trust. The trust property directed to be held in the [SPOUSE/PARTNER]'s Trust in accordance with the provisions of this Section shall be disposed of as follows:

1. Distribution During [SPOUSE/PARTNER] 's Lifetime. During the lifetime of my [SPOUSE/PARTNER],

[TERMS OF TRUST DURING LIFETIME OF SURVIVING SPOUSE/PARTNER]

…..

I anticipate that at my death if my [SPOUSE/PARTNER], survives me, all or a part of my interest in the principal residence in which my [SPOUSE/PARTNER] and I reside at the time of my death will become part of this trust. If so, during my [SPOUSE/PARTNER]'s lifetime the Trustee is directed as follows with respect to my interest in such residence and any other interest in a residence purchased by the Trustee as provided in this Paragraph:

a. Retention and Use of Residence. The Trustee, in the Trustee's discretion, may retain the interest in the residence in trust and, if retained, shall permit my [SPOUSE/PARTNER] to use and occupy the residence rent free.

b. Payment of Expenses of Residence. The Trustee shall pay out of the trust that percentage of all expenses incurred in connection with the carrying, upkeep, maintenance and repair of the residence including, without limitation, all mortgage payments, taxes, assessments, insurance and repairs, which is equal to the trust's percentage ownership of the residence.

c. Sale or Other Disposition of Residence. The Trustee shall sell or rent the trust's interest in the residence within a reasonable time upon receipt of signed instructions from my [SPOUSE/PARTNER] to that effect. In addition, the Trustee, in the Trustee's discretion, may sell, rent or otherwise dispose of the trust's interest in the residence if the Trustee determines that occupancy of such residence by my [SPOUSE/PARTNER] is contrary to her best interests <u>and the interests of the beneficiaries succeeding to the trust property after [HIS/HER] her death</u>. **[Note:** Do not include underlined language if there any potential for conflict with remaindermen. Instead, consider: "Without limiting the discretion of the trustee with regarding to distributions from the trust, during the lifetime of my [SPOUSE/PARTNER], [HE/SHE] shall be deemed the primary beneficiary of this trust and [HIS/HER] welfare, enjoyment and education should be regarded as paramount to the conservation of the trust for the benefit of all succeeding beneficiaries or remaindermen."**]**

d. Purchase of Replacement Residence. If my [SPOUSE/PARTNER] so desires, the Trustee, in the Trustee's discretion, may **[Can make this mandatory if desired – "shall".]** purchase an interest in a replacement residence using such portion of the principal of the trust, including, but not limited to, the trust's share of net proceeds from any sale or other disposition of the trust's interest in the residence, as the Trustee, in the Trustee's discretion, may determine. To the extent not so used, the net proceeds of any sale or other disposition of the trust's interest in the residence shall be added to the other property of the trust and administered as part of such property.

3. Distribution Upon [SPOUSE/PARTNER] 's Death. Upon the death of my [SPOUSE/PARTNER] ,

[DISPOSITVE PROVISIONS FOR PROPERTY UPON DEATH OF SPOUSE/PARTNER]

[Note: Be sure to include a general testamentary power of appointment (or, alternatively use QTIP - qualified terminable interest property - provisions if married) to assure step up in income tax basis upon beneficiary's death.**]**

….

D. Disinheriting Potential Heirs:

1. DO <u>NOT</u> LEAVE A GIFT OF $1.00: Leaving a person a gift of any amount gives that person all the rights as a beneficiary of an estate or trust. A beneficiary of an estate or trust has direct legal standing to challenge the executor, trustee and estate and trust administration. Moreover, the nominal gift provides the beneficiary with both an economic and emotional incentive to challenge the will.

Although in some circumstances acceptance of a gift under a will preclude a caveat, leaving a nominal gift is a risky strategy in dealing with potentially disgruntled heirs. If used, consider making it a specific gift that can be distributed soon after the creditor period expires and in an amount which will assure acceptance. *In re Will of Lamanski*, 561 S.E.2d 537 (NC App 2002) (acceptance of tangible personal property barred caveat by beneficiary); *distinguished by*, *In Re Will of Smith*, 582 S.E.2d 356 (NC App 2003) (where beneficiary would have received the property if the caveat was successful, acceptance of the gift did not bar caveat).

2. STATEMENTS OF WHY THE HEIR IS DISINHERITED ARE UNECESSARY. Instead consider a simple statement to the following effect:

I have intentionally and purposefully omitted my daughter _____ and my brother, _____ as beneficiaries under this will and from my scheme of distribution hereunder.

It is a good practice to draft a memo to the file with a view towards it being put in evidence if there is a challenge to the will. See, *In re Will of Jarvis*, 334 N.C. 140, 430 S.E.2d 922 (1993) (The testator's attorney, who also served as a witness to the execution of the testator's will, can recount the circumstances under which the testator read and signed his will to show that testator had mental capacity to make a will.) .

3. <u>DO</u> Include Strong No Contest Language. Although forfeiture provisions are strictly construed and generally subject to a public policy exception for challenges

made in good faith, well drafted provisions are often effective in dissuading potential challengers and their counsel from filing a caveat to a will or action to set a trust. *Haley v. Pickelsimer*, 261 N.C. 293, 134 S.E.2d 697 (1964) (Beneficiary's unsuccessful civil action for alleged breach of an oral contract with the decedent's estate, though unsuccessful, did not bar beneficiary's right to take under the will which contained a forfeiture clause. Forfeiture clauses are to be strictly construed.). *Ryan v. Wachovia Bank*, 235 N.C. 585, 70 S.E.2d 853 (1952) (Beneficiary's right to take under a will is not barred by a no contest or forfeiture clause, provided that the challenge is made in good faith and with probable cause.).

SAMPLE NO CONTEST PROVISIONS

FORFEITURE IN THE EVENT OF CONTEST

Pour Over Will

Should any beneficiary under this will contest the validity of this will, or the validity of that certain _____Revocable Trust, dated _____, as amended at the time of my death, including without limitation that certain First Amendment to Revocable Trust Agreement dated _____ and that certain Second Amendment to Revocable Trust Agreement dated _____ (collectively "my Will and/or Trust") or any provision of my Will and Trust or attempt to prevent any provision of my Will or Trust from being carried out in accordance with its terms in legal proceedings or otherwise, then any such beneficiary shall be barred from serving as a fiduciary under my Will and Trust, and any interest provided for such beneficiary in my Will and Trust is revoked and the interest that such beneficiary would otherwise have received shall be disposed of as if such beneficiary had predeceased me without surviving issue. Each and every interest conferred by my Will and Trust is made on the condition that the beneficiary thereof accepts and agrees to all of the provisions of my Will and Trust, and the provisions of this Article are essential to every interest conferred by my Will and Trust.

FORFEITURE IN THE EVENT OF CONTEST

Trust with Pour Over Will.

Should any beneficiary under this trust contest the validity of this trust, as amended at the time of my death, including without limitation that certain First Amendment to Revocable Trust Agreement dated _____ and that certain Second Amendment to Revocable Trust Agreement dated _____, or contest the validity of my will dated _____ including any and all codicils to such will in effect at the time of my death, or the validity of the _____ Trust, dated _____, as amended at the time of my death, (collectively "my Will and/or Trust") or any provision of my Will or Trust, or attempt to prevent any provision of my

Will or Trust from being carried out in accordance with its terms in legal proceedings or otherwise, then any such beneficiary shall be barred from serving as a fiduciary under my Will and Trust, and any interest provided for such beneficiary in my Will and Trust is revoked and the interest that such beneficiary would otherwise have received shall be disposed of as if such beneficiary had predeceased me without surviving issue. Each and every interest conferred by my Will and Trust is made on the condition that the beneficiary thereof accepts and agrees to all of the provisions of my Will and Trust, and the provisions of this Article are essential to every interest conferred by my Will and Trust.

Will Without Revocable Trust.

Should any beneficiary under this will contest the validity of this will or attempt to prevent any provision of this will from being carried out in accordance with its terms in legal proceedings or otherwise, then any such beneficiary shall be barred from serving as a fiduciary under this will, and any interest provided for such beneficiary in this will is revoked and the interest that such beneficiary would otherwise have received shall be added to my residuary estate and disposed of as if such beneficiary had predeceased me without surviving issue. Each and every interest conferred by this will is made on the condition that the beneficiary thereof accepts and agrees to all of the provisions of this will, and the provisions of this Article are essential to every interest conferred by this will.

E. Outright Gifts versus Trusts and Life Estates: Consider whether the use of a trust or life estate is creating a death for the remaindermen to look forward to. Outright gifts to all beneficiaries may be a better alternative.

F. All Revocable Trusts Require a Pour Over Will: Always draft a will as a companion to a revocable trust which names the trustee of the revocable trust as both the sole residuary beneficiary and executor of the estate. Without a will, disgruntled family members and heirs can seek qualification as administrator of the probate estate and, even in absence of probate assets, potentially obtain legal standing to make inquiries about the trust property.

G. Qualified Retirement Benefits: Qualified retirement benefits, including (401(k)s, 403(b)s, IRAs, SEP IRAs, and Roth IRAs, have powerful income tax benefit (and burdens) and can provide significant asset protection. Unfortunately, in the case of persons qualifying for Medicaid or other federal or state financial assistance, qualified retirement benefits are typically countable assets.

1. Asset Protection: Under federal law and many state laws, retirement benefits "qualified" under the Employee Retirement Income Security Act of 1974 (ERISA) are exempt from claims of creditors. *Patterson v. Shumate*, 504 U.S. (1992); 11 USCA §522(b)(3)(C)(4)(A). However, IRAs are established under Section 408 of the Internal Revenue Code and are only exempt under state law. The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act amended Section 522 of the Bankruptcy Code to provide and exemption for IRA accounts but the exemption is limited to $1,245,475 which cap is <u>not</u> adjusted for inflation (although the statute does state that "such amount may be increased if the interests of justice so require"). The IRA limitation does not apply to rollovers of qualified retirement benefits, so

clients are well advised to establish separate accounts to assure they can trace the exempt rollover accounts and contributory IRA account. Rothschild and Rubin, 810-3rd T.M., *Assets Protection Planning*, §III.C.4.b.

2. Inherited IRAs: On June 12, 2014, the United States Supreme Court settled a split among the Circuit Courts of Appeals and held that inherited IRA's are not "retirement funds" within the meaning of Bankruptcy Code Section 522(b)(C) and as such not exempt from claims of creditors. *Clark v. Rameker*, 2014 U.S. LEXIS 4166 (2014). The Supreme Court affirmed the Seventh Circuit Court of Appeals holding that the debtor's $300,000 balance in an inherited IRA, which the debtor claimed was exempt property, was properly recoverable by the bankruptcy trustee. However, since states can opt out of the exemptions set forth in the Bankruptcy Code and for purposes of the Bankruptcy Code adopt the state's exemptions under Section 522 of the Bankruptcy Code, state law may extend the exemption to inherited IRAs. For example, in 2011, North Carolina, an opt out state, amended its statutory exemptions to expressly affirm that inherited IRAs are exempt assets. N.C.G.S. §1C-1601(9).

3. Income Tax Deferral: The rules regarding income tax deferral can be complex, particularly when there are trusts or charitable beneficiaries. An excellent resource for estate planning considerations relative to qualified retirement benefits is Natalie B. Choate, *Life and Death Planning for Retirement Benefits*, 8th Edition (2019). Natalie Choate's website is ***.ataxplan.com.

a. Outright Beneficiaries. Generally, outright beneficiaries will receive the most favorable income tax deferral on inherited benefits and, depending upon state law, inherited qualified retirement benefits are exempt from creditors.

b. Trusts. To qualify for income tax deferral, a trust must qualify as a "designated beneficiary." The rules for such trusts are complex and addressed in *Life and Death Planning for Retirement Benefits*. Due to the fact that the 2021 income tax rate for trusts is 37.0% for annual income over $13,030, income tax planning is essential whenever the beneficiary of qualified retirement benefits is a trust.

c. Charities. If a client is charitably inclined, qualified retirement benefits left to a charity are not subject to income tax. However, if the beneficiary designation of a retirement account names both a charity and an individual, the individual will generally be unable to defer income taxes on the benefits beyond five (5) years. There is a means to "fix" a beneficiary designation which names both an individual and a charity. If the charity's portion of the death benefits are paid on or before September 30 of the calendar year following the year of the date of death (the Beneficiary Finalization Date), remaining beneficiaries, if Designated Beneficiaries, may be able to defer income taxes over their life expectancy. See, *Life and Death Planning for Retirement Benefit*, p. 112.

d. SECURE Act. Effective for retirement benefits inherited on and after January 1, 2020, the SECURE Act, with the exception of surviving spouses, minor children of the plan participant, beneficiaries not more than 10 years younger than the plan participant and disabled and chronically ill beneficiaries (as defined under the

Internal Revenue Code), requires that inherited retirement benefits be distributed and taxed within 10 years from the date of death. See, Kohut, *Estate Planning Basics Supplement*, Lavender Law, 2021.

H. Life Insurance: Asset protection considerations should be given when naming beneficiaries of life insurance. Most state laws provide that life insurance benefits payable to a beneficiary are exempt from claims of creditors. N.C.G.S. § 58-58-95. Yet, death benefits payable to the insured's estate, as property of the probate estate, will be subject to claims of the estate. Consideration of the following should be undertaken before a revocable trust is named as a beneficiary of death benefits:

1. Naming a Revocable Trust as Beneficiary of a Cash Value Life Insurance Policy During the Life of the Insured. Prior to the Great Recession, estate planners frequently named the insured's revocable trust as the death benefits payable on life insurance since the revocable trust would direct the death benefits to the intended beneficiaries without the need to name contingent beneficiaries. However, North Carolina, like many states, protects the cash value of life insurance *during the lifetime of the insured* from creditors' claims if and only if the beneficiaries of the insurance are the insured's spouse or children. N.C.G.S. § 1C-1601(a)(6). Thus, by naming the insured's spouse or children as the beneficiaries of the insured's policy, the cash value of the property would be an asset exempt from the claims of the insured's creditors. If there is any potential need for creditor protection, name the insured's spouse or children as the beneficiary as opposed to a revocable trust.

2. Naming Estates and Revocable Trust Agreements as The Beneficiary of Life Insurance Can Subject Death Benefits to Creditor Claims. There is a split of authority on whether insurance payable to a revocable trust is exempt from creditors of the insured's estate:

a. ***In the Matter of the Estate of King*, 269** P.3d 1189 (AZ Ct App. 2012). State statute exempting insurance proceeds from claims of the insured's estate applied to death benefits paid to trustee of the insured revocable trust despite a generic provision in the trust directing the trustee to pay for not paid out of the insured's residuary estate. The court found the debt payment clause in the trust did not constitute a waiver of the exemption for life insurance death benefits.

b. ***Morey v. Everbank and Air Craun, Inc*, 93** So.2d 482 (Fla. 1 Dist. Ct. App. 2012). Where life insurance death benefits were paid to a revocable trust with a provision directing the trustee to pay the debts of the insured, the terms of the revocable were deemed to waive the state law creditor exemption and such death benefits were available to satisfy debt of the estate.

Practice Tip: When practical, draft beneficiary designations for life insurance payable directly to beneficiaries. If the death benefits are to be paid to a trust funded upon the death of the settlor, make the benefits payable to that specific trust:

the beneficiary of the death benefits shall be paid to the Trustee(s) acting under the _____ Revocable Trust u/a dated [DATE OF RTA], and all

amendments to such agreement, to be added to and disposed of for *the benefit of [NAME OF TRSUT BENEFICIARY(IES)] under the provisions of Section of Article III of the trust instrument entitled "Trust for [NAME OF TRUST]*."

Additionally, consider adding language to the debt payment provisions of the revocable trust specifically excluding otherwise exempt assets:

> Notwithstanding the foregoing, the Trustee, in the Trustee's discretion, may decline to pay any of my debts or expenses from life insurance proceeds which are exempt from creditors' claims.
>
> Limit the direction to pay debts out of only… "that portion of the principal of the trust that is not exempt under applicable state law from any claims of my [settlor's] creditors."

I. Property Outside of Domicile – Avoiding Ancillary Administrations:

1. Real Property: Title in name of a revocable trust or LLC to avoid probate. Always confirm that there are no adverse transfer fees, state property tax ramifications, including, without limitation, grandfathered valuations, special use exemptions (e.g., farm, timber, etc.) *before* recording the deed (and preferably before the client signs the deed).

2. Single member LLCs – Tax Situs. Be careful with LLCs. Some state tax codes ignore single member LLC for purpose of tax situs for estate and gift tax purposes. (e.g., Connecticut and New York).

3. Confer with Local Counsel. Avoid engaging in the unauthorized practice of law in another state and for the protection of both your client and you, engage a local lawyer to assist (and at least review) any deeds or other transfer instruments.

J. Contingent Beneficiaries for Couples: Do not to disinherit the heirs of the first to die.

> Distribution if No Issue of Grantor is Living. If no issue of mine is then living, the [EXECUTOR/TRUSTEE] shall distribute (i) one-half (1/2) of such trust property to the person or persons who would have been entitled to receive my personal property under the laws providing for the distribution of property in case of intestacy had I died intestate at that time the owner of the trust property, unmarried and domiciled in North Carolina, and (ii) one-half (1/2) of such trust property to the person or persons who would have been entitled to receive my [PARTNER/SPOUSE]'s personal property under the laws providing for the distribution of property in case of intestacy had my [PARTNER/SPOUSE] died intestate at that time the owner of the trust property, unmarried and domiciled in North Carolina.

K. Presumption of Survivorship. Prior to the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (TRA of 2010), if there was a likelihood for an estate to be subject to estate tax, it was typically preferred to presume the spouse with the smaller estate would be deemed to have survived a simultaneous death. Such a provision insured that the

spouse with the smaller estate could use all of predeceased spouse's estate tax exemption. Under the TRA of 2010, it may be preferable with respect to married persons that the spouse with the larger estate be presumed to survive a simultaneous death due to the fact that it will be easier to prepare an estate tax return to claim the deceased spousal unused exemption amount (DESUE) for the smaller estate. I.R.C. § 2010(c)(2) (discussed below).

SAMPLE PROVISIONS FOR PRESUMPTION OF SURVIORSHIP

Provision for Lesser "Moneyed" Spouse:

For purposes of this trust instrument, (i) if my [SPOUSE] and I should die under such circumstances that there is uncertainty as to which person predeceased the other, it shall be conclusively presumed that my [SPOUSE] survived me, and (ii) if it is not established by clear and convincing evidence that any other beneficiary under this trust instrument survived me by at least one hundred and twenty (120) hours, it shall be conclusively presumed that such beneficiary predeceased me.

Provision for Greater "Moneyed" Spouse

For purposes of this trust instrument, (i) if my [SPOUSE], and I should die under such circumstances that there is uncertainty as to which person predeceased the other, it shall be conclusively presumed that my [SPOUSE] predeceased me, and (ii) if it is not established by clear and convincing evidence that any other beneficiary under this trust instrument survived me by at least one hundred and twenty (120) hours, it shall be conclusively presumed that such beneficiary predeceased me.

L. Basic Trust Terms.

1. Appointment Language for Hold Back Trusts. Always include a holdback trust for minor beneficiaries even if there is only a remote contingency that any heirs would be minors. A generic hold back trust will obviate the need for the appointment of a guardian of the minor's estate to take title to such a bequest. Some estate planners prefer to suggest twenty-five (25) years of age.

SAMPLE HOLD BACK TRUST

Trust for Beneficiary Under Age Twenty-Five

If in accordance with the provisions of this trust instrument any trust property becomes distributable outright to a beneficiary who is less than twenty-five (25) years of age, equitable title to such property shall be indefeasibly vested in such beneficiary, but the Trustees are authorized, in the Trustees' discretion, to retain such property and administer it in a separate trust for the benefit of such beneficiary as follows:

Distribution Until Beneficiary Reaches Age Twenty-Five or Dies. Until the beneficiary reaches the age of twenty-five (25) or sooner dies, the Trustees may distribute all or any portion of the trust property to the beneficiary in such amounts and at such times as the Trustees, in the Trustees' discretion, may determine.

Distribution When Beneficiary Reaches Age Twenty-Five or Dies. When the beneficiary reaches the age of twenty-five (25), the Trustees shall distribute the then remaining trust property to the beneficiary. If the beneficiary dies before reaching such age, then upon the death of the beneficiary, the Trustees shall distribute the then remaining trust property to the estate of the beneficiary.

Trustee Appointment Provisions for Hold Back Trust in a Will

Appointment of Trustee. With respect to any trust established for a beneficiary under the Article of this will entitled "Trust for Beneficiary Under Age Twenty-Five," the surviving parent of such beneficiary who is issue of mine shall serve as Trustee. If such issue of mine has predeceased me, the other surviving parent of such beneficiary shall serve as Trustee provided that such surviving parent was married to my deceased issue at the time of his or her death. If the surviving parent of such beneficiary fails or ceases to act as Trustee a Trustee shall be appointed by a court of competent jurisdiction. The Trustee shall have the right to resign without court order at any time in a writing signed by the Trustee, such resignation to be effective upon the acceptance of the trusteeship by a successor Trustee. The Trustee shall also have the right to appoint without court order a successor individual or corporate Trustee in a writing signed by the Trustee which states the event or events upon which the successor Trustee shall act.

OR

Appointment of Trustee. With respect to any trust established for a beneficiary under the Article of this will entitled "Trust for Beneficiary Under Age Twenty-Five," my _____,[NAMED TRUSTEE] shall serve as Trustee. [NAMED TRUSTEE] shall also have the right to appoint without court order a successor individual or corporate Trustee in a writing signed by the Trustee which states the event or events upon which the successor Trustee shall act. If [NAMED TRUSTEE] fails or ceases to serve and does not appoint a successor Trustee, a Trustee shall be appointed by a court of competent jurisdiction. A Trustee shall have the right to resign without court order at any time in a writing signed by the Trustee, such resignation to be effective upon the acceptance of the trusteeship by a successor Trustee

2. Considerations in Selecting a Trustee (and for that matter executors). The best qualities of a trustee are someone who will seek professional help when needed, communicate with the beneficiaries and serve the best interests of the beneficiaries. Generally, persons who are more dictatorial, combative or secretive in nature make bad trustees. Consider conflicts of interests such as having a remainderman serve as trustee for a trust.

3. Broad removal and appointment powers. Consider broad removal and appointment powers to give the beneficiaries that ability to remove a bad trustee without court order, but make sure the beneficiary cannot appoint their neighbor or best friend as successor trustee.

Successor Trustees

The procedure for the removal and resignation of a then acting Trustee of any separate trust without court order and for the appointment of a successor Trustee and independent Special Trustee without court order shall be as follows:

ii) Removal of Trustee and Independent Special Trustee. I shall have the right at any time and from time to time to remove a Trustee by giving written notice of such removal to the Trustee being removed. If I am not living and competent, the following persons in the order named, shall have such right:

(1) _____, if she is living and competent.

(2) _____, if he is living and competent.

(3) _____, if she is living and competent.

(4) A majority of the beneficiaries (other than me) to whom the income of the trust could then be paid. If a beneficiary is a minor or not competent, the appointment on his or her behalf may be made by a person who is (i) the guardian or conservator of the beneficiary's estate or, if none, (ii) the parent of the beneficiary who is an issue of mine or, if no such parent is living and competent, (iii) the other parent of the beneficiary, or if no such parent is living and competent, (iv) the guardian of the person of the beneficiary.

Removal of a Trustee shall become effective only upon the acceptance of the trusteeship by a successor Trustee if the Trustee given notice of removal is then acting as sole Trustee.

iii) Resignation of Trustee

A Trustee shall have the right to resign at any time by giving written notice to the successor Trustee or Trustees designated below or, if the designated successor Trustee or Trustees fail to act, to the person or persons designated below who are authorized to appoint a successor Trustee. Resignation of a Trustee shall become effective only upon the acceptance of the trusteeship by a successor Trustee if the Trustee giving notice of resignation is then acting as sole Trustee.

iv) Appointment of Successor Trustee.

(1) The following provisions govern the appointment of a successor Trustee to act if a Trustee is given notice of removal, gives notice of resignation, becomes incapacitated, dies or otherwise ceases to act as Trustee (the "retiring Trustee"):

(a) I shall have the right to appoint a successor Trustee.

(b) If I am not living and competent, (i) _____ shall become successor trustee, (ii) if _____, fails or ceases to serve, _____, shall become successor trustee (iii) if both _____ and _____ fail or cease to serve, _____ shall become successor Trustee and (ii) the following in the order named shall have the right to appoint any other successor Trustee including a successor if all of _____, _____ and _____ fail or cease to serve:

(i) _____.

(ii) If _____ is not living and competent, _____.

(iii) If _____ is not living and competent, _____.

(iv) A majority of the beneficiaries (other than me) who are distributees or permissible distributees of the trust income. If a beneficiary is a minor or not competent, the appointment on his or her behalf may be made by a person who is (i) the guardian or conservator of the beneficiary's estate or, if none, (ii) the parent of the beneficiary who is an issue of mine or, if no such parent is living and competent, (iii) the other parent of the beneficiary, or if no such parent is living and competent, (iv) the guardian of the person of the beneficiary.

(v) If no adult child of mine is living and competent, the then acting Trustee other than the retiring Trustee.

(vi) If there is no such Trustee, the retiring Trustee.

(2) Any successor Trustee or successor independent Special Trustee appointed pursuant to the foregoing provisions (other than one appointed by me) must be a corporate Trustee. In addition, any such successor Trustee (other than one appointed by me) may not be "related" or "subordinate" within the meaning of Section 672(c) of the Code to any beneficiary of the trust who at any time has the right to remove the Trustee.

(3) The appointment of any successor Trustee shall be effected by an instrument which has been signed by the person or persons having the right of such appointment and by the successor Trustee in acceptance of the appointment and which has been delivered to the then acting Trustee or Trustees, if any. This method of

acceptance by the successor Trustee shall be exclusive to any other method otherwise allowed by law.

v) Powers and Liability of Successor Trustee. Any successor Trustee may exercise all the powers and authority conferred upon the Trustee being replaced, including the right to resign. A successor Trustee shall have no duty to inquire into the acts or omissions of any predecessor Trustee or examine such Trustee's accounts in the absence of actual knowledge of or information concerning a possible breach of trust that would cause a reasonable person to conduct such an inquiry or examination. A successor Trustee shall not be personally liable to the beneficiaries of the trust or to any other party for any acts or omissions of any predecessor Trustee.

M. Estate and Estate Tax Basics.

1. Federal Transfer Tax Exemptions (Gift, Estate and Generation-Skipping Tax). $5,430,000 in 2015 and indexed for inflation. The tax rate is 40%.

2. State Exemptions. Varies by state.

3. State Inheritance Tax. Varies by state.

4. 2021 Supplement to Manuscript. A summary of estate and income tax issues for probate and non-probate estates is set forth in Kohut, Estate *Planning Basics Supplement*, Lavender Law 2021.

N. Tax Trap for United Kingdom "Domiciliaries" (even those living in the US). Be sure to screen for United Kingdom "domicillairies" when drafting or amending revocable trusts. As noted in *The Pitfalls of U.S./UK Tax Planning*, Probate and Property, March/April 2013 (ABA/RPTE), the creation of or amendment of a revocable trust for a client with "UK origins or with strong connections with the UK" runs the risks of triggering an immediate charge to UK inheritance tax at a 20% tax rate. The trap for the unwary is that this tax applies based upon domicile as defined in in UK law which can apply to a long-time resident of the US. The details of this trap are outside the scope of this paper but well-addressed in the above article.

O. Asset Protection and Spendthrift Trusts. Asset protection considerations are an essential part of all estate plans. The following is a general discussion of asset protection considerations:

1. Self-Settled Trusts – In General. In most jurisdictions, self-settled trusts offer little protection from the settlors creditors. Rothschild and Rubin, 810-3rd T.M., *Assets Protection Planning*. In fact, some states have statutory prohibitions against the enforcement of spendthrift provisions in self-settled trusts: Ariz. Rev. Stat. Ann. §14-7705; Cal. Prob. Code §150304; Ga. Code Ann. §53-12-28(c); Ind. Code Ann. §30-4-3-2; Kan. Stat. Ann. §33-101; La. Rev. Stat. Ann. §9:2004(2); Mo. Ann. Stat. §456.080.3(2); Mont. Code Ann. §72-33-305; N.Y. C.P.L.R. 5205(c); Okla. Stat. Ann. tit. 60, §175.25G; Tex. Prop. Code Ann. §112.035(d); Va. Code Ann. §55-19(C); W. Va. Code §36-1-18; Wis. Stat. §701.06(1).

2. Domestic Asset Protection Trust Statutes. Starting with Alaska and Delaware in 1997, there is a growing trend of states which have adopted domestic asset protection statutes, including Alaska, Colorado, Delaware, Hawaii, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rohde Island, Tennessee, South Dakota and Wyoming.. See Alaska Stat. §13.36.035(c)(1); 12 Del. Code Ann. tit. 12, §3570(8); H.R.S. §554G; Nev. Rev. Stat. §166.015(1); N.H. Rev. Stat. Ann. §564-D:3; Okla. Stat. Ann. tit. 31, §11.5; Tenn. Code Ann. §35-16-102(12); R.I. Gen. Laws §18-9.2-2(8)(ii); S.D. Codified Laws §55-3-39(1); Utah Code Ann. §25-6-14(1)(a); Wyo. Stat. Ann. §4-10-103. The creditor protection under each state's statutory scheme varies greatly from state to state.

> *In re Huber*, 493 B.R. 798 (W.D. Wash 2013): The bankruptcy court granted summary judgment in favor of the bankruptcy trustee finding that Washington state law applied under conflicts of law principles rendering the creation and funding of a self-settled Alaska Domestic Asset Protection Trust void as self-settled trust and was also fraudulent transfer properly recoverable by the trustee under Bankruptcy Code Section 548(e)(1). In disregarding the Alaska choice of law provisions in the trustee, the court noted that the debtor-settlor was domiciled in Washington, the assets transferred to the trust were located in Washington, and all the creditors and beneficiaries of the trust were located in Washington. Additionally, the court noted a number of badges of fraud, including the existence of threatened litigation at the time of the transfers, the transfer of substantially all of the debtor's assets to the trust, the existence of significant indebtedness of the debtor at the time of the transfers to the trust, the family relationship between the settlor and trustee (the settlor's son) and the fact that the settlor effectively retained (through trust distributions) the assets transferred to the trust.

3. Asset Protection Other Than Domestic Asset Protection Trusts. Even without the benefit of state law authorizing a domestic asset protection trust, there are a number of estate planning techniques which are available to assist a client in achieving asset protection goals:

> **a. Basic Asset Protection for the Client.** Determine the extent of client's non-exempt assets and plan around that exposure. Associate bankruptcy counsel before transferring assets. Fraudulent transfers can bar a discharge in bankruptcy. Before assisting a client with asset transfers consider obtaining a solvency affidavit. See, Godlberg v. Rosen (In re Akram Niroomand), 493 Fed. Appx. 11 (11th Cir. Fla. 2012) (In an adversary proceeding brought by bankruptcy trustee against lawyer and law firm which assisted debtor in establishing an offshore trust, the client's Affidavit of Solvency was successfully used to impeach the debtor's testimony against her former lawyer that she was insolvent at the time of the transfers.)
>
> **Practice note:** If a client cannot establish solvency, limited, but careful, planning may still be warranted.
>
> **b. Third Party Trusts.** While state law varies on what types of third party trust [those established by someone by a third party (e.g., parent) for another (e.g.,

child)], protection of beneficiaries interests can be accomplished through the following types of trusts:

(1) Discretionary Trusts: An independent trustee has complete discretion on whether ditributions are to be made. N.C.G.S. §36C-5-504(a)(2).

(2) Protective Trusts: A trust which provides that an interest of the trust either terminates or becomes discretionary if the beneficiary attempts to transfer or alienate the interest, any creditor attempts to reach the beneficiary's interest by attachment, levy or otherwise or the beneficiary becomes insolvent or bankrupt. N.C.G.S. §36C-5-508.

(3) Spendthrift Trusts: In states which adopted the Uniform Trust Code, Section 502 of the UTC provides that spendthrift provisions which restrain voluntary and involuntary transfers of the beneficiary's interest in a trust and "a term of [the] trust provid[es] that the beneficiary's interest are subject to a "spendthrift trust' or words of similar import" will be protected from claims of creditors. N.C.G.S. §36C-5-501(b)(1), 502.

(4) Child Support Obligations: North Carolina, like most states, provides an exception to spendthrift provisions for child support obligations set forth in a judgment or court order. NC.G.S. . §36C-5-503.

SAMPLE SPENDTRHIFT PROVISIONS

Spendthrift Trust Provisions. No beneficiary of any trust created under this [WILL/TRUST] shall have the power to, voluntarily or involuntarily, to anticipate, encumber, or transfer any interest in the trust estate in any manner. No part of any trust estate shall be liable for or charged with any debts, contracts, liabilities, or torts of a beneficiary or be subject to seizure or other process by any creditor of a beneficiary. Notwithstanding the foregoing, if any beneficiary of any trust created under this trust agreement (except my spouse to the extent my spouse is a beneficiary of any such trust whose value absent this provisions would be allowable as a marital deduction in the estate tax proceeding relating to my death) shall attempt to anticipate, pledge, assign, sell, transfer, alienate or encumber his or her interest in the income or principal of such trust; or if any creditor or claimant shall attempt to subject such interest to the payment of any debt, liability or obligation of any such beneficiary; or if such beneficiary shall be subject to bankruptcy, insolvency or receivership proceedings, thereupon any absolute right of such beneficiary to income or principal from such trust shall cease. Thereafter, and until such time as the Trustee is also able to distribute such property to such beneficiary, the Trustee may accumulate trust income, if any, to which such beneficiary would otherwise be entitled or the Trustee may distribute the same to the beneficiaries, if any, of the trust entitled to receive such income and shall be held harmless in making such discretionary distributions. In no event shall the Trustee be required or compelled to pay any income

or principal to or for the benefit of such beneficiary, and, upon the death of such beneficiary, any property held or accumulated in his or her trust shall be distributed in accordance with the provisions provided for principal dispositions at his or her death.

AND/OR:

(1) In addition, this trust is a spendthrift trust and no beneficiary of the Trust for _____--- shall have the power to, voluntarily or involuntarily, to anticipate, encumber, or transfer any interest in the trust in any manner. No part of this trust shall be liable for or charged with any debts, contracts, liabilities, or torts of a beneficiary or be subject to seizure or other process by any creditor of a beneficiary.

P. Community Property. Eight states have community property laws derived from Spanish or French property law systems: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington. Wisconsin adopted the Uniform Marital Property Act in 1983 and become a community property state. In 1998, Alaska adopted the Alaska Community Property Act, which is based upon the Uniform Martial Property Act, and allows married couples to opt in to a community property system by agreement or by establishing a community property trust. In 2010, Tennessee adopted the Tennessee Community Property Trust Act which permits married couples to establish a community property trust, but does not permit a married couple to hold community property without establishing a trust.

Since the focus of tax planning for clients with less than the federal estate tax exemption amount ($11,700,000) is income tax planning, estate planners in common law states must be able to identity and recognize community property. Community property is entitled to a 100% step up in tax basis upon all community property upon the first spouse's death which can greatly reduce the potential income tax burden upon a surviving spouse.

North Carolina, like many common law states, has adopted the Uniform Disposition of Community Property Rights at Death Act. N.C.G.S. §31C-1, et seq. A surviving spouse may, by affirmative written demand, may preserve the community property rights acquired in a community property jurisdiction. The written demand must be made within nine (9) months of the date of death (or qualification of a personal representative). N.C.G.S. §31C-6.

Note: As discussed in the supplement to these materials, Congress may be considering substantial changes in the law concerning capital gains and potentially limiting the ability to receive a step up in tax basis. Kohut, Estate *Planning Basics Supplement*, Lavender Law 2021.

Q. Gifting and Support Provisions for Powers of Attorney for Unmarried Persons and Residents in Non-Recognition States. For those clients in committed relationship outside of marriage and married same-sex persons residing in non-recognition states, consider the following provisions (after proper counselling and considerations of the risk to the principal if the relationship ends or the attorney in fact could abuses the power of attorney):

PROVISIONS OF POWERS OF ATTORNEY FOR UMARRIED PERSONS (AND SAME SEX COUPLES IN NON-RECOGNITION STATES)

Gifts. If, in the opinion of my Agent, my remaining property is more than sufficient to provide for the continued support and medical care in accordance with my customary standard of living, the power to make periodic gifts of my real and personal property or my interest in such property to or for the benefit of _____ (including such times during which he is serving as my Agent), as follows:

Gifts may be made (i) that qualify for and do not exceed the annual exclusion for federal gift tax purposes, with or without spousal gift-splitting, and (ii) that qualify for the exclusion for tuition or medical care for federal gift tax purposes;

Such gifts may be made in any manner that will qualify for the exclusion, including, but not limited to, outright gifts, gifts in trust, gifts to a custodian under a uniform gifts or transfers to minors act, and gifts to qualified state tuition plans as described in section 529 of the Internal Revenue Code;

Notwithstanding the foregoing, the aggregate amount of gifts in any calendar year to or for the benefit of an Agent or to satisfy an Agent's legal obligations shall not exceed the greater of (i) five percent (5%) of the value of the assets over which my Agent has the power to act or (ii) five thousand dollars ($5,000.00);

[**Note:** In the case of special needs or elder law planning, broader gifting powers may be more appropriate.]

Support. The power to do any acts, including the disbursing of any moneys belonging to me, which, in the opinion of my Agent, may be necessary or proper for any purpose in connection with my support and maintenance of _____ and me in accordance with my customary standard of living, including, but not limited to, provisions for housing, clothing, food, transportation, recreation, education and the employing of any person whose services may be needed for such purposes;

Additionally, consider the following language for health care powers of attorney and other advanced directives:

This health care power of attorney, including, without limitation, the appointment of my health care agent(s) hereunder, is an advance directive and all of my health care providers, including, without limitation, those subject to 42 C.F.R. §§ 489.100-489.102 (Conditions for Medicare and Medicaid Participation), wherever located, shall follow the directives contained herein and the directions of my health care agent(s) appointed hereunder without interference from any third parties.

R. Savings Clause for Charitable Bequests. When drafting charitable bequests consider adding a savings provision in the event the charity is not in existence or not qualified as a tax exempt entity at the time of the testamentary disposition. Sample language follows:

> If [CHARITY(IES)]is not in existence at the time of distribution pursuant to this Section or if such organization does not then qualify as a charitable organization as defined under Sections 170(c)(2), 2055(a) and 2522(a) of the Internal Revenue Code of 1986, as amended, then the gift to that organization shall lapse and be distributed to a qualified charitable organization as defined under Sections 170(c)(2), 2055(a) and 2522(a) of the Internal Revenue Code of 1986, as amended, chosen by my executor which organization has as one of its primary activities the support of [TESTATOR'S CHARITABLE AREA OF INTEREST/PRUPOSE].

II. INTERPRETING DISTRIBUTION STANDARDS, DISCLOSURES TO BENEFICIARIES AND EXCULPATORY PROVISIONS

A. DISTRIBUTION STANDARDS

1. Complete Discretion:

SAMPLE PROVISION: The trustee may distribute all or any portion of the trust property to any one or more of my issue in such amounts and at such times as the Trustee, in his discretion, may determine.

a. ***Woodard v. Mordecai*,** 234 N.C. 463 (1951):

The trustee has discretionary power when he may either exercise it or refrain from exercising it or when the time, manner, or extent of its exercise is left to his discretion. The court will not control the trustee's exercise of a discretionary power, except to prevent an abuse of discretion. A trustee abuses his discretion when he fails to use his judgment, acts dishonestly, with improper motive, or beyond the bounds of reasonable judgment.

b. ***Finch v. Wachovia*,** 156 N. C. App. 343 (2003):

The trustee did not approve a request of the surviving spouse to enable her to make gifts of $28,000 per year from a marital trust with a principal balance of $1,100,000 (the trust principal had decreased by $500,000 over a ten year period). Although the court noted that it could not decide for the trustee, the trustee had concluded improperly that it had no power to consider the request. The operative trust language read:

> If, in the judgment of the trustee, the income payable to Helen in accordance with the provision of paragraph 3) [sic] above, supplemented by income (other than corporate [sic] gains) from

> other sources to her, shall not be sufficient to meet the reasonable needs of Helen in her station of life – as to all of which the judgment of the Trustee shall be conclusive – then, and in that event, the Trustee will be authorized to pay or apply for the benefit of Helen so much of the principal as the Trustee*, in its sole discretion,* shall from to time to time deem requisite or desirable to meet the reasonable needs of Helen – even to the full extent of the entire principal of this Trust.
>
> (emphasis added)

2. Health, Support and Maintenance:

SAMPLE PROVISION: The trustee may distribute all or any portion of the trust property to any one or more of my issue for such issues' health, support and maintenance in such amounts and at such times as the Trustee, in his discretion, may determine.

a. Support and maintenance is more than mere subsistence and includes normal living expenses (e.g., housing, clothing, food, and medical care).

b. ***Grainger v. National City Bank of Indiana,*** 849 N.E. 2d. 1191 (Ct. App. Ind. 2006)**.** Court upheld Trustee's refusal to make discretionary principal distributions for reimbursement of home healthcare costs in excess of $10,000 per month under a standard of "reasonable health, support and maintenance" when the remaindermen of the trust were children from a prior marriage, the reimbursement would deplete principal beyond the spouse's 5 x 5 power of appointment and the spouse had income of $141,000 from other sources.

c. ***Wells Fargo Bank, N.A. v. Estate of Mansfield,*** 739 N.E. 2d 170 (Neb. 2007). An income beneficiary's estate could recover undistributed principal distributions for "accident or illness…as [the trustee] may deem proper" where trustee knew or should have known of her medical condition but did nothing to inquire about the need for financial support.

d. ***Hartford-Connecticut Trust Co. v. Eaton***, 36 F.2d 710 (2d Cir. 1929). The term support limits the withdrawal to what is necessary according to the circumstances or beneficiary's station of life. The power is intended to secure the kind of living to which the beneficiary is accustomed.

e. ***Seattle-First Nat'l Bank v. Crosby***, 254 P.2d 732 (Wash. 1953). A trust for the maintenance or support of the beneficiary involves a certain amount of discretion on the part of the trustee. However, the trustee must furnish support to the beneficiary whenever support is necessary. The needs of the named beneficiary are a purely personal standard. Payment to creditors or assignees of the beneficiary is not considered satisfaction of the beneficiary's needs.

f. ***In re Sullivan's Will***, 12 N.W.2d 148 (Neb. 1943): A trust for the maintenance and support of a named beneficiary who was an invalid with no possibility of recovery can be invaded for the expenses of the beneficiary's spouse and minor children.

g. ***Cavett v. Buck***, 397 P.2d 901 (Okla. 1964): A trust request distribution reasonably within any of the justified proper care, maintenance and support of each such grandchild does not include a grandson's wife and children.

h. Whether expenses of a child fall within the support obligation of a parent:

(1) ***In the Matter of the Estate of Niles Stevens,*** 617 S.E.2d. 736 (Ct. App. SC 2005): Court reversed trial court and held that it was proper for the trustee to consider private education expense of a beneficiary's minor children under a standard of "the health, education, support and maintenance of my said children…"

(2) ***Grapin v. Grapin***, 450 So.2d 853 (Fla. 1984): The court held that a parent does not have a legal duty to provide a college education for child who has reached the age of majority.

(3) ***Jones v. Jones***, 225 Cal. Rptr. 95 (Cal. Ct. App. 1986): California Civil Code gives the father and mother to share equal responsibility to support and educate their child. A child, as defined under California Civil Code, is a daughter or son under the age of 18 or incapacitated. This responsibility does not extend to college expenses for a child over the age of 18.

(4) ***Griffin v. Griffin***, 558 A.2d 75 (Pa. Super. Ct. 1989): Pennsylvania does not limit child support to minor children. Parents may be liable for the support of a child age 18 or over if the child is incapacitated or if the child wishes to obtain a college education. The child's own resources may be taken into account but the child is not required to attend a less expensive school or contribute as much as possible. The parent's obligation to pay for college expenses typically ends when the child reaches age 23.

3. Other Standards

a. Comfort:

(1) The term "comfort" is interpreted in some jurisdictions to be broader than "support or maintenance," and can include the beneficiary's enjoyment, happiness, satisfaction or peace of mind.

(2) ***In re Mirfield's Estate***, 126 N.Y.S.2d 465 (N.Y. Sur. Ct. 1953). A trust was created for the "comfort, maintenance and support" of the beneficiary. This court allowed the distributions from the trust to be used to purchase a car for the beneficiary's daughter because the daughter's visits eased the mind of the beneficiary.

(3) ***Gulf National Bank v. Sturtevant***, 511 So.2d 936 (Miss. 1987). The term "comfort" includes more than bare subsistence. It is generally interpreted to provide for the maintenance of the beneficiary in the position in which he was at the time the trust was created. The term "comfort" can also be construed as relating to the grantor's accustomed standard of living.

(4) ***Estate of Vissering***, 990 F.2d 578 (10th Cir. 1993). Held that under Florida law and in light of the limitation "*required for* the continued comfort" (emphasis added), the word "comfort" is limited to an ascertainable standard. This decision provides a good list of citations to other jurisdiction on the issue of what "comfort" means in the context of a trustee's duties to make distributions.

b. Best Interests, Welfare and Needs

(1) **"**Bests interests" or "best interests and welfare" are broadly construed and encompass a liberal attitude towards distributions. The trustee may make distributions to the beneficiary to allow for a high standard of living, which could include extensive travel and the purchase of luxury items such as expensive cars and jewelry. Note: "Welfare" is not an ascertainable standard. Carlson v. Sweeney, Dabagia, Donoghue, Thames, Jones & Pagos, 868 N.E. 2d. 4 (Ct. App. Ind. 2007) (Malpractice action against law firm drafting will).

(2) ***Weidenmayer v. Johnson***, 254 A.2d 534, *aff'd*, 259 A.2d 465 (N.J. 1969). The definition of the term "best interests" is not limited to pecuniary interests but also includes peace of mind. Allowed trustee to "decant" an $18,000,000 trust to a new trust established by current beneficiary.

(3) ***Lees v. Howarth***, 131 A.2d 229 (R.I. 1957). In some jurisdictions, courts have held that if a trustee is authorized to distribute principal under a best interests or similar standard, then the trustee has the authority to distribute the entire trust principal to the beneficiary in a lump sum. (compare decanting)

(4) ***Smith v. First Community Banc Shares, Inc.,*** 575 S.E.2d 419 (W. Va. 2002): The standard of "any need or condition" of the surviving spouse (when coupled with a general testamentary power of appointment) included a distribution to fund a charitable remainder trust with $3,000,000. Children's lawsuit against trustee after their mother's death for improper distributions was properly dismissed.

NOTE: If the term "best interests" is used to describe the trustee's powers, limitations such as "within the context of reasonable personal and social conduct" or "shall not be construed so generously as to discourage the descendant from assuming the responsibilities of self-support" will be helpful to provide the trustee with guidance. If the grantor wants to preserve trust principal for the remaindermen, the trust instrument should expressly state that intention.

c. Education

(1) ***Murphy v. Morris***, 141 S.W.2d 518 (Ark. 1940). Generally, the term "education in college" in a trust instrument did not include graduate or professional school. See also, *Wood v. wood 667 N.W. 2d 235 (Neb. 2003).*

(2) ***Epstein v. Kuvin***, 95 A.2d 753 (N.J. Super. 1953). The term "college education" includes a four year course that leads to a bachelor's or engineering degree but the term does not include medical school.

(3) ***Security Trust Co. v. Smith***, 145 S.W.2d 512 (Ky. 1940). "College education" can include the cost of a high school education, since high school is necessary to prepare for college.

d. Health/Medical

"Health" includes all routine medical care, medication, surgery and hospitalization and should extend to nursing care and mental health. The term "medical care" may be more limited than "health" because it may not cover treatment that has not been generally accepted as "medical," such as chiropractic services, psychological or mental health problems and addictions. The settlor may want to specify a preference for home health care over nursing home care and authorize distributions for that purpose.

e. Emergency

(1) ***Nardi v. United States***, 385 F.2d 343 (7th Cir. 1967); ***Budd v. Commissioner***, 49 T.C. 468 (1968). Many jurisdictions consider the term "emergency" to be an ascertainable objective standard capable of being stated in terms of money. The term "emergency" typically authorizes distributions only for the beneficiary's unusual and unexpected expenses and not for routine support and maintenance.

NOTE: With respect to estate inclusion due to a general power of appointment, the IRS has taken the position on several occasions that the term "emergency" is not an ascertainable standard for federal estate and gift tax purposes.

f. Standard of Living/Reasonable Needs

(1) Distribution standards will often refer to the beneficiary's standard of living. It is helpful to clarify the time to which the standard of living refers, e.g., when the instrument was drafted, when it became effective, or when the beneficiary's interest vested.

(2) ***Goss v. McCart,*** 847 P.2d 184 (Colo. 1992): Trustee, who was both the brother-in-law of the income beneficiary and a remainderman of the trust, acted arbitrarily and capriciously by refusing to distribute trust income to income beneficiary after the latter remarried. The court noted that the trust terms did not authorize the trustee to control and dictate the income beneficiary's standard of living.

(3) ***Hart v. Connors***, 228 N.E.2d 273 (Ill. App. 1967). The Appellate Court of Illinois held that "present standard of living" referred to beneficiary's standard of living at the time the will was executed, not at the time of the testator's death.

(4) ***In re Golodetz' Will***, 118 N.Y.S.2d 707 (N.Y. Sur. 1952). "Standard of living" is a fact to be established by proof of the relevant circumstances. These circumstances can include the beneficiary's dwelling, membership in recreational and social clubs, automobiles, wardrobe, philanthropic and religious interests, customary vacations and domestic help employed by the beneficiary. The New York Surrogate Court held that the trustee's authority to invade principal to maintain the beneficiary's "standard of living" referred to the beneficiary's standard of living at the time of death of the testator.

NOTE: A distribution standard tied to the beneficiary's standard of living may not carry out the settlor's intent if the beneficiary's standard of living dramatically improves or is decreased between the drafting of the instrument and the settlor's death.

g. Priority Among Beneficiaries

SAMPLE PROVISIONS:

(1) For a Family Trust (credit shelter trust):

My wife shall be the primary beneficiary of the Family Trust, and my children and issue of my children shall be secondary beneficiaries of the Family Trust. A distribution to a child or the issue of a child shall be made only after ascertaining that the Family Trust and other assets of my spouse are sufficient for providing for my spouse and shall not endanger my spouse's lifetime security.

(2) For a Family/Minor's Trust:

After my death my wife, during her lifetime and thereafter my children should be deemed the primary beneficiaries of any trust the property of which may be distributed to them, and their welfare, enjoyment and education should be regarded as paramount to the conservation of the trust for the benefit of succeeding beneficiaries or remaindermen.

(3) Generation Skipping Trust – Single Beneficiary Without Children

My son, John Doe, should be considered the primary beneficiary of the Child's Generation Skipping Tax Trust Exempt Trust. His welfare and enjoyment should be regarded as paramount to the conservation of the trust for the benefit of succeeding beneficiaries or remainder.

h. Consideration of Beneficiary's Other Assets

(1) General Rule: Unless directed to by the trust instrument, the trustee may not consider the beneficiary's other assets and income in determining what distributions are required for the support of the beneficiary.

(a) ***Nielsen v. Duyvejonck***, 236 N.E.2d 743 (Ill. App. 1968). When the testator gives a life tenant the absolute power to sell and consume, the life tenant is under no obligation to deplete his own assets or income to exercise the power.

(b) ***Demitz' Estate***, 208 A.2d 280 (Pa. 1965). The court found no abuse of discretion where a trustee with discretionary power to invade principal refused to pay principal for a beneficiary's maintenance and support based solely on the existence of an independent estate of the beneficiary.

NOTE: The Court considered circumstances to justify an exception to the general rule as a different decision would have disinherited settlor's children in favor of the beneficiary's creditors.

(2) Exception to General Rule - Conditioned by "when in need": If the distribution standard is conditioned on need, then it is proper to consider the beneficiary's other income and assets.

(a) ***Boston Safe Deposit & Trust Co. v. Boynton***, 443 N.E. 2d 1344 (Mass. App. 1983). When terms such as "when in need" or "if

necessary" are used, the trustee should consider other resources of the beneficiary.

(b) ***Matter of Martin***, 199 N.E. 491 (N.Y. 1936). Gifts from the principal can be separated from the gift of income if the language used makes invasion of the principal conditional on the needs or requirements of the beneficiary.

NOTE: There are many cases where the courts have not required the trustee to consider the beneficiaries' other assets and income even though the standard of distribution was conditioned on terms such as "as needed" or "necessary." ***Hamilton Nat'l Bank of Chattanooga, TN v. Childers***, 211 S.E.2d 723 (Ga. 1975); ***Sibson v. First Nat'l Bank & Trust Co. of Paulsboro***, 160 A.2d 76 (N.J. Super. 1960); ***In re Stern's Will***, 228 N.Y.S.2d 90 (1960).

Godfrey v. Chandley, 811 P.2d 1248 (Kan. 1991). If the trust instrument directs the trustee to pay the beneficiary what is "necessary" for support and maintenance, the court infers that the settlor intended the beneficiary to receive support from the trust estate, regardless of other assets and income.

(3) Exception If Provisions of Trust Implies: *Peoples Bank & Trust Co. v. Shearin*, 219 S.E.2d 299 (N.C. App. 1975). When testatrix instructed the trustee to be guided "by practical considerations such as whether my husband is still working," the court interpreted it to require the trustee to consider the beneficiary's income, but not his other property**.**

(4) Support and Maintenance With Broad Discretion: The trustee may consider the beneficiary's other assets if the trustee holds broad discretionary power, even in absence of language directing trustee to consider the beneficiary's financial resources.

(a) ***In re Estate of Tahjian***, 544 A.2d 67 (Pa. Super. 1988). The trustee had the power to make distributions of principal which she "in her sole discretion, determines necessary for the support and maintenance" of the beneficiary. The court held that this broad discretion served as an indication that the trustee had the authority to withhold trust principal from a beneficiary with independent resources.

(b) ***Matter of Estate of McNab***, 163 A.D.2d 790 (N.Y. App. Div. 1990). Distributions to "augment the income derived [from an annuity]" did not permit the trustee to refuse distributions based upon the beneficiary's savings and monthly social security check.

(c) ***Norton Family Trust v Schmitt, 655 So.2d 398 (La App 1995):*** A trust provision providing that the Trustee should "take into account funds available form other sources known to the Trustee" in determining distributions did not mean that the beneficiary must first deplete her personal assets before a distribution could be made.

DRAFTING TIP: Trust should clearly state if the trustee should or should not consider the beneficiary's "other resources." Additionally, the trust should clarify which resources the trustee may or may not consider.

The settlor may give the trustee the maximum amount of flexibility with regard to considering the beneficiary's other assets and income by authorizing the trustee to consider those resources, but expressly state that those resources need not be considered.

(5) Sample Language – Health, Education and Support:

The Trustee may distribute all or any portion of the principal of the trust to [BENEFICIARY] in such amounts and at such times as the Trustee, in its discretion, determines to be necessary for [BENEFICIARY]'s health and support in reasonable comfort and in his accustomed manner of living after taking into consideration other financial resources available to [BENEFICIARY].

To the extent that sufficient trust property is available to provide for [BENEFICIARY] under subparagraph 1 above, the Trustee may distribute any portion of the trust property to any one or more of [BENEFICIARY]'s issue in such amounts and at such times as the Trustee, in the Trustee's discretion, determines to be necessary for such issue's health, education and support in reasonable comfort after taking into consideration other financial resources available to such issue.

B. INCENTIVE/OTHER STANDARDS:

1. Trust of Children/Grandchildren: (Roy Adams, Use of Trusts to Achieve Personal and Family Goals, UCB, Charlotte, 1995)

I am firmly convinced that the initiative, industry and ambition of a young person can easily be impaired if the young person is not prodded by financial necessity. Accordingly, after the death of the last to die of my spouse and me, I intend for the Trustee to distribute income and principal to a descendant of mine only sparingly, if at all; provided that, it is my intent that the Trustee may, in such Trustee's discretion, assist with reasonable living expenses. I do place a high premium on education and I intend for the Trustee to be

liberal in making distributions for that purpose so long as a descendant is making good educational progress as a student. I do not intend to limit the Trustee's discretion to make such distributions as may be appropriate to permit a descendant of mine to live in dignity, if the descendant suffers from a true disability that prevents the descendant from becoming productive. I do not believe it beneficial for a young person to be given expensive automobiles which they cannot otherwise afford. Therefore, I request that my Trustee not use trust assets for the purchase of expensive automobiles but instead expect the Trustee to insure that if trust funds are used for the purchase of an automobile, the automobile will be of reasonable price relative to the age of such beneficiary.

OR

Whether the beneficiary would not only benefit from such distributions, but also the manner in which the trustee believes the beneficiary will use such distribution. The trustee should consider whether distributions of income and principal are reasonable under the circumstances and factors that the trustee believes relevant, including the other income of the beneficiary, the advisability of supplementing such income and assets, the diligence, progress and aptitude of the beneficiary in acquiring education and the ability of the beneficiary to handle money usefully and prudently and to assume the responsibilities of adult life and self-support.

2. Prudent Spending:

With respect to the Wife's Trust created under this trust instrument, my wife should be deemed the primary beneficiary of such trust; however, the Trustee shall consider that during my lifetime my wife and I were able to support ourselves "in reasonable comfort and in our accustomed manner of living" without invading the principal of our assets. It is my intention that the principal of the assets held in the Wife's Trust shall be preserved for the benefit of my children and shall only be distributed in extraordinary circumstances, such as an extreme financial downturn or extraordinary health, medical or caretaking needs of my wife, under which the income from the assets held in the Wife's Trust is insufficient to provide for my wife's health and support in reasonable comfort and in her accustomed manner of living after taking into consideration other financial resources available to my wife. Notwithstanding the foregoing, nothing in this Paragraph shall be deemed to permit distributions of principal from the Wife's Trust to any person other than my wife during her lifetime. With respect to the Trusts for Children, my children should be deemed the primary beneficiaries of the trusts the income of which may be paid to them, and their welfare, enjoyment and education should be regarded as paramount to the conservation of the trusts for the benefit of succeeding beneficiaries or remaindermen.

OR

In determining whether to make discretionary distributions of net income and principal of any trust created hereunder for the benefit of my issue, the trustee may consider:

a. Whether a distribution will impair the future growth of the principal of the trust. In exercising such discretion, the Trustee shall consider that during my lifetime my wife and I were able to support ourselves "in reasonable comfort and in our accustomed manner of living" without invading the principal of our assets. I anticipate that the income from the trusts created for the benefit of [BENEFICIARY] during his lifetime and for the benefit of my grandchildren after [BENEFICIARY]'s death should provide sufficient financial means without the necessity of invading principal of the trust.

OR

In exercising such discretion, the Trustee shall consider that during my lifetime my wife and I were able to support ourselves "in reasonable comfort and in our accustomed manner of living" without invading the principal of our assets. It is my intention that the principal of the trust property held in this trust shall be preserved for the benefit of my grandchildren, and shall only be distributed in extraordinary circumstances, such as an extreme financial downturn or extraordinary health, medical or caretaking needs of [BENEFICIARY], under which the income from the assets held in this trust is insufficient to provide for [BENEFICIARY]'s health and support in reasonable comfort and in his accustomed manner of living after taking into consideration other financial resources available to [BENEFICIARY]. Provided that, the Trustee may, but shall not be required, to consider any financial emergency created by imprudent or other unreasonable conduct on the part of [BENEFICIARY].

3. Beneficiary with Financial Troubles:

This trust is established for the benefit of my son, Jeff, who has encountered financial difficulties during his adulthood. I love and care for Jeff no less than my other children, but am concerned that his financial difficulties could leave him destitute and without financial means of support. Accordingly, I request the Trustee to use his discretion to assure, to the best of the Trustee's ability, that distributions from the trust never impede Jeff's productivity and that distributions do not result in imprudent spending.

4. Beneficiary with Alcoholism:

This trust is established for the benefit of my son, David, who has encountered difficulties with alcoholism during his adulthood. I love and care for David no less than my other children, but am concerned that his alcoholism could leave him destitute and without financial means of support. Accordingly, I request of the Trustee to use his discretion to assure, to the best of the Trustee's ability, that distributions do not exacerbate David's difficulties with alcoholism.

C. DISCLOSURE OF TRUST TO BENEFICIARY

1. Duty to Disclose/Case Law

a. ***Taylor v. Nations Bank Corp.***, 125 N.C. App. 515 (1997): Held that contingent beneficiaries are entitled to view the trust instrument from which their interest is derived. This right does not include trust documents that are no longer operative due to revocation. Unless there is an explicit provision in the trust instrument, the trustee has a duty to reveal the terms of the trust to the beneficiaries. The court followed the view of *Section 173 of the Restatement (Second) of Trusts* which entitles the beneficiaries to view trust documents relating to their interest. The court also notes that Comment c of *§ 173 of the Restatement (Second) of Trusts* states that the beneficiary is always entitled to information that is "reasonably necessary to enable him to enforce his rights under the trust or to prevent or redress a breach of trust" but the terms of the trust may determine the frequency and amount of information the trustee may give. The court also held that the plaintiffs' receipt of cash bequest did not terminate their status as beneficiaries because they were named as beneficiaries in the trust documents.

b. ***McNeil v. Bennett ("McNeil II")***, 792 A2d 190, 2001 Del. Ch. LEXIS 91(Del. Ch. 2001): Held that trustees had an affirmative obligation to inform an eligible current beneficiary of his status in an accurate and balanced way even though plaintiff had his own assets in the form of a separate trust established for his interests. The trust in question had three classes of intended beneficiaries: wife of the grantor, the grantor's lineal descendants, and spouses or widows of lineal descendents. If a beneficiary makes a reasonable request for information, the trustee has a duty to furnish information. The trustees not only failed to inform the beneficiary of his income interest in his mother's trust, but also misinformed him and told him that he held only a remainder interest in the trust. The trustees also breached their fiduciary duty to act impartially by allowing the other beneficiaries (plaintiff's siblings) to participate in the decision-making process for their mother's trust while the plaintiff did not. These failures on the part of the trustees constituted gross negligence.

D. RELIANCE UPON LEGAL ADVICE, INDEMNITY AND EXCULPATORY PROVISIONS AND RELEASES

1. Reliance Upon Legal Advice

a. ***Walker v. Board of Trustees,*** 2003 U.S. App. LEXIS 14603 (2003): Unpublished opinion of the 11th Federal Circuit Court of Appeals held that trustees of a qualified pension plan could not defend the adoption of a plan amendment which would adversely effect vested pension rights upon the grounds that the trustees relied upon legal advice. Reliance upon legal advice which proves erroneous is not a defense to a breach of trust by a fiduciary.

b. ***Frazen v. Norwest Bank Colorado, NA,*** 955 P.2d 1018 (1998):
Court held that although a trustee cannot defend his actions by claiming reliance upon advice of counsel, a trustee is entitled to rely upon a court order, even if the order is overturned on appeal. Additionally, when a trustee in good faith seeks direction from a court, the trustee is entitled to reimbursement of legal expenses incurred in connection therewith.

2. Exculpatory Provisions

a. **General Rule:** Any clause that goes beyond exculpation for ordinary negligence is of doubtful validity. The trustee cannot be relieved of liability for a breach of trust/fiduciary duty. Exculpatory provisions in testamentary trusts are void as against public policy in New York. There is an issue of improper insertion of an exculpatory provision when the drafting attorney is also the trustee.
Charles Round Jr., ***Loring A Trustee's Handbook*** § 7.2.6 (8th ed. 2001).

b. ***Restatement (Third) of Trusts*** § 29 cmt. m (2003). If a provision would undermine proper administration of the trust, then it may not be enforced. An example of an invalid provision is one that purports to relieve the trustee from all accountability and the duty to provide information to the beneficiaries, or to relieve the trustee from liability for dishonest or reckless acts.

c. ***Restatement 2d of Trust §222:*** An exculpatory provision in a trust instrument is "not effective to relieve a trustee of liability for breach of trust committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary, or of liability for any profit which the trustee has derived from a breach of trust."

3. Indemnity / The Advancement of Fees and Expenses by Trustee

a. ***Restatement (Third) of Trusts*** § 38 (2003). A trustee is entitled to indemnity out of the trust estate for expenses properly incurred in the administration of the trust. With respect to matters incurred in the administration of the trust (as opposed to alleged breaches of duty by the trustee), the right of indemnification allows the trustee to pay directly from the trust funds, or to obtain reimbursement from the trust estate if the trustee has personally paid.

b. ***Scott, The Law of Trusts*** § 244 (4th ed. 2001). When a trustee properly incurs expenses that are necessary or appropriate for carrying out the purposes of the trust, the trust estate, rather than the trustee, should ultimately bear the expenses. A trustee is entitled to indemnity for any expenses incurred in defending or prosecuting actions for the benefit of the trust. The trustee may advance his own funds to discharge obligations properly incurred in the

administration of the trust. He is then entitled to reimbursement out of the trust estate.

c. ***Wells Fargo Bank, N.A. v. Superior Court of Los Angeles County***, 990 P.2d 591, 599 n.4 (Ca. 2000). A trustee may charge the trust for the cost of successfully defending against claims by beneficiaries. The court noted that "[t]he better practice may be for a trustee to seek reimbursement after any litigation with beneficiaries concludes, initially retaining separate counsel with personal funds."

d. ***Masters v. Bissett***, 790 P.2d 16, *modified*, 794 P.2d 445, *review denied*, 800 P.2d 1789 (Or. 1990). The trustee has the burden of proving that the expenses incurred were made for trust purposes and that they were reasonable and proper.

e. ***Goss v. McCart*, 847 P.2d 184 (Colo. 1992):** Trustee, who was both the brother-in-law of the income beneficiary and a remainderman of the trust, was not entitled to seek reimbursement of his legal expense incurred in defending his refusal to distribute trust income to income beneficiary after the latter remarried.

f. ***Hannam v. Brown***, 956 P.2d 794 (Nev. 1998). When the trust instrument has expressly provided for the reasonable compensation and expenses of the trustee, it is an abuse of discretion by the court to refuse reimbursement.

g. ***Wilson v. Daley***, 97 N.E.2d 596 (Ill. App. Ct. 1951). A trustee may waive his right to reimbursement for expenses if he pays the income to the income beneficiary for many years without claiming reimbursement.

h. ***Williamson v. Williamson***, 158 S.W.2d 264 (Ark. 1942). When the terms of a trust preclude the trustee from compensation or reimbursement for expenses, the trustee may not recover for expenses incurred that would otherwise be proper.

E. EFFECT OF "DESIRABLE" ON ASSET PROTECTION.

In re McCoy, 274 B.R. 751 (Brnkpty. E.D. IL 2002). Principal was distributable "as the trustee determines to be required or desirable for his health, maintenance or support."

Held: Self trusteed family trust was recoverable by Chapter 7 trustee.

F. ELECTIVE SHARE RIGHTS/DISSENT FROM WILL.

It is important to note that most states require that the terms of a marital trust have specific language (e.g., in North Carolina, the trust terms must provide that all income of the trust be distributable to the surviving spouse and "[t]he trustee shall distribute to or for the benefit of the surviving spouse out of the principal of the trust such amounts and at such times as the trustee, in its discretion, determines necessary for the health, maintenance, and support of the

surviving spouse" for the trust principal to count as property passing to the surviving spouse for purposes of determing the surviving spouse's right to an elective share. See, N.C.G.S. §30-3.3A(e).

4840-5180-2350, v. 1