Practical Suggestions for Trust Drafting and Administration

DC Bar Estates, Trusts and Probate Law Community
October 31, 2024

Giannina “Gina” Lynn,
The Law Office of Giannina Lynn

David Jonathan Taylor, Right Size Law PLLC

DC Bar Estates, Trusts and Probate Law Community
October 31, 2024

Overview

- Introduction
- Benefits of Trust-Based Planning
- Overview of Uniform Trust Code
  - Default and Mandatory Rules
- Modifying a Trust
- Update on DC Trust Legislation
- Funding the Trust

Why Should Your Client Create a Revocable Trust?

- Incapacity planning
  - Successor Trustee versus Agent under POA
- Avoiding probate:
  - Only avoid probate if funded!
  - Real property in more than 1 jurisdiction
  - Single people

Why leave an inheritance in trust?

- Long-term holding of assets for various purposes
  - Minors or young adult beneficiaries
    - Better control and management of assets
  - Beneficiaries in high-risk professions or divorce
    - Beneficiary creditor protection (spendthrift protection);
  - Disabled beneficiaries
    - Maintain eligibility for means-tested government benefits.

Review of the Uniform Trust Code

- Read the code, read the comments (on ULC website).
- Only 14 states have not enacted (NY and CA the big ones who have not)
- The UTC fills in provisions that a trust instrument may not contain.
- Most of the provisions in the UTC can be modified by the trust instrument – important to know those that may not.

Important Provisions of the DC UTC

1. What is a qualified beneficiary? What is a distributee?

§ 19–1301.03 (05) “Distributee” means a beneficiary who is currently entitled to receive a distribution from a trust. A “permissible distributee” is a beneficiary who is eligible to receive a distribution

§ 19-1301.03 (10) “Qualified Beneficiary” would receive if distributee or eligible distributee” interest terminated on that date or if trust terminated. Basically a contingent beneficiary.

Important Provisions of the DC UTC

2. Representation § 19-1303.01 et seq.

"To the extent there is no conflict of interest":

- parents can represent minor or unborn child if no guardian has been appointed. § 19-1303.03(6)
- Guardians and conservators can bind their wards

- Also if there is no conflict – a minor or incapacitated or person who cannot be located can be "represented and bound" by a beneficiary with "substantially the same interest" § 19-1303.04

Important Provisions of the DC UTC

3. Giving notice once trust becomes irrevocable - § 19-1308.13

- UTC is pro beneficiary receiving information:

"a trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests." § 19-1308.13 (a)

Important Provisions of the DC UTC

Notice (cont.)

§ 19-1308.13 (b)(3): within 60 days of trust becoming irrevocable, the trustee must give *qualified* beneficiary notice of::

- a. The identity of the settlor
- b. the right to receive a copy of the trust instrument
- c. the right of "distributees and permissible distributees" to a trustee's report. Report is defined as "a report of the trust property, liabilities, receipts, disbursement, and distributions, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market value."
- d. Beneficiary can waive right to a report.
- e. Report must also be given upon termination of trust

Important Provisions of the DC UTC

Notice (cont.)

- Notice is only required for qualified beneficiaries who have reached age 25 – and age can be modified pursuant to § 19-1301.05(c)(2)

- Also, Settlor can designate another person to receive notice for the beneficiary "to act in good faith to protect the interests of beneficiaries" (c)(3).

Important Provisions of the DC UTC

Notice (cont.)

Drafting tips:

- Consider designating a different age for beneficiary to receive notice;

- Consider designating a different person to represent a “problem” beneficiary;

- Consider drafting multiple trusts to protect privacy of distribution terms.

Important Provisions of the DC UTC, Cont.

- Termination of an Uneconomic Trust § 19–1304.14

- If under $50,000.00 (This is the default, can increase to $100,000 or greater if desired).

- Must give notice – and there is a default objection period.

- Powers of Trustee § 19–1308.16

  - Review and see if there are any additions or modifications

  - Consider changing ¶21– May want to modify to provide for delay of distribution due to not only to incapacity but also due to substance abuse, divorce or bankruptcy. Also consider allowing withholding by trustee and allowing payment "for the benefit of the beneficiary" .

Important Provisions of the DC UTC, Cont.

- Trustees to act by majority ("Cotrustees who are unable to reach a unanimous decision may act by majority decision" § 19–1307.03(a)).

- Can change this in trust instrument:
  - give each trustee ability to act independently (frequently used when trustees are spouses) –
  - require trustees to act unanimously or add trust director.

Unalterable UTC Provisions (§ 19-1301.05)

- Rights of creditors § 19-1305.01.
- Power of the court to address issues such as trustee compensation and § 19-1307.08.
- Effect of an exculpatory term - § 19-1310.08.
  - Cannot 100% protect the trustee from liability for acts of bad faith or "reckless indifference".
    - Exculpatory term must be "fair" and "adequately explained to the settlor".
    - Consider having Settlor sign an acknowledgement that the trust limits the trustee's liability

Unalterable UTC Provisions (continued):

- Duty to notify
- Duty to respond to the request of a beneficiary for information
- And the informal accounting requirement

Drafting Tips

- Consider having a “material purpose” of the trust:
  - I.e., “ensure her assets will be properly administered upon his incapacity, and to allow the smooth administration of her assets upon her death.”
  - Or to “ensure the beneficiaries’ interest in this trust are protected from creditors.”
- Who can remove trustees? Only the court under the UTC (§ 19-1307.05). Consider naming a “trust director”? Or allow current distributees to do so?
- Who can name a successor trustee if there is a vacancy?
  - UTC says if no one named you need “the unanimous consent of the qualified beneficiaries” § 19-1307.04(c) - consider changing to a majority of the current distributes.

Modifications

- General reasons to modify
- Likely reasons to modify
- Authority to Modify
- Hierarchy of tools

Typical Reasons for Trust Modification

- Changed Tax Environment
- Personal Circumstances Shift
- Income Tax Drawbacks
- Administrative Costs and Conflicts

Common Reasons to Change

- Deathbed changes
  - Settlor unable to execute changes
- Change in trustee succession
  - Lack of confidence in named trustee
- Preserve assets in trust for life
  - Trust ends at beneficiary's age
- Marital deduction planning
  - Limited to federal exemption
- Change Distribution Method
  - Outright or "in trust"

Authority to Modify/Decant/Terminate

1. Trust Document
2. Common Law – Restatement of Trusts (Third)
3. Uniform Trust Code
4. Uniform Trust Decanting Act

Hierarchy of Tools

- Settlor / Agent - Amend a revocable trust
- Nonjudicial Settlement Agreement (everyone agrees)
- Trustee acting under authority of agreement (high-confidence)
- Trust protector acting under authority of agreement (urgency)
- Court approval of modification (low-confidence)

Use of Settlement Agreements:

- Non-judicial settlement agreements allow parties to modify trusts without court involvement as long as it does not violate a material purpose.
- Tax authorities (e.g., IRS) may challenge such modifications if they alter the trust's original purposes.
- Most common change distribution terms
  - Outright or “In Trust”

Non-Judicial Settlement Agreement

- "Nonjudicial Settlement Agreements." UTC §111 (codified at § 19–1301.11.)
  - **"Interested persons"**: Individuals whose consent is needed for a binding court-approved settlement.
  - **Nonjudicial Settlement Agreement**: Interested persons can settle trust matters without court involvement.
  - **Validity Conditions**: The agreement must not violate a material purpose of the trust and must include **terms that a court could approve** under applicable law.

Cases

- *Miller v. Maples* (Tenn. Ct. App. 2018) (upholding early termination of a discretionary trust without consent of remaindermen, finding that delaying the trust was not a material purpose despite mandatory distributions over 10 years).

Document Authority and UTC Provisions

- Weigh document provisions against UTC provisions
- Default versus mandatory provisions
  - If not mandatory, then UTC provisions should be persuasive guidance.

UTC Provisions:

- UTC § 111: Non-judicial settlement agreements allow modifications without court involvement.
- UTC § 411: Modification/termination of irrevocable trusts by consent:
  - 411(a): Allows modification or termination with consent of settlor and beneficiaries, even if inconsistent with a material purpose.
  - 411(b): Permits modification/termination by beneficiary consent, as long as it does not violate a material purpose of the trust.
- UTC § 412: Allows modification for unanticipated circumstances.
- UTC § 414: Provides for the termination of uneconomic trusts.
- UTC § 415: Corrects mistakes made in the trust.
- UTC § 416: Permits modifications to achieve the settlor's tax objectives.

Trust Document Authority

- Power to Amend
- Trust Protector
- Power to Merge/Sever
- Power to Decant
- Power of Appointment
- Power to Terminate

Trust Document – Power to Amend

- Settlor
  - Reserves right to amend
  - Presumption - revocable (i.e., amendable)
    - UTC 6.02 (codified at D.C. Code § 19–1306.02)
- Agent under Power of Attorney
  - Scope - Disrupt estate plan?
    - Duty to preserve principal's estate plan unless "best interest"
      - D.C. Code § 21–2601.14.
- Trustee/Independent Trustee
  - Limited authority (e.g., change governing law and situs)

Role of Agents and Guardians:

- Agents acting under powers of attorney or guardianships may face limits on trust modifications.
- Courts are generally conservative in approving amendments by fiduciaries on behalf of a settlor.

Trust Document – Trust Protector

- **Authorized by the terms of the agreement**
  - **Uniform Directed Trust Act**
- **Speedy and cost-effective solution**
- **Burden-shifting**
  - **Court sill available for “aggrieved” party**
- **Fiduciary versus non-fiduciary**

Trust Document – Power to Merge

- Trustee:
  - General Principles
    - **Combines trusts** with overlapping terms and beneficiaries.
    - **Requires a common trustee** between the trusts.
    - **Simplifies administration** and reduces costs.
    - **Merged trust ends** as assets consolidate into one.
  - D.C. Code 19–1304.17 (Combination and division of trusts)
    - **Notice to beneficiaries** required
    - Actions must **not impair rights** or **alter trust purposes**.

Trust Document – Power to Sever

- Trustee
  - **Divides a trust** into two or more identical trusts.
  - **Allocates assets** or fractional shares.
    - One trust gets real estate, another gets stocks.
    - Split 1,000 shares into two trusts, 500 each.
  - **Optimizes taxes** or management.
    - Assign income assets to beneficiaries in lower tax brackets.
  - **Maintains separate accounts** and records.
  - **Non-pro rata funding** based on fair market value.
    - A **house** worth $500,000
    - **Stocks** valued at $500,000

Trust Document – D.C. Code

- Combination and Division of Trusts (codified at 19–1304.17)
  - **Notice to beneficiaries** required
  - Actions must **not impair rights** or **alter trust purposes**.

    After notice to the qualified beneficiaries, a trustee may combine 2 or more trusts into a single trust or divide a trust into 2 or more separate trusts, if the result does not impair rights of any beneficiary or adversely affect achievement of the purposes of the trust.

Trust Document - Power to Decant

- Trustee versus independent trustee
- Fiduciary or non-fiduciary capacity
- Alignment with original trust's purpose
- Power to add or remove beneficiaries
- Tax implications
  - Consequences on income, estate, and gift taxes.
- Notice to beneficiaries

Decanting

- Common Law
  - Phipps v. Palm Beach Trust Co., 196 So. 299 (Fla. 1940)
- Statutory Authority
  - 31 States Statutes
  - Uniform Trust Decanting Act
    - 18 states adopted in part (e.g., Maryland) or all (e.g., Virginia)
    - Pending in DC
      - October 17 , 2024 (Judiciary Committee Mark-up)

Decanting Use Cases:

- Fixing errors, clarifying ambiguities, and updating provisions to reflect the settlor's intent.
- Adjusting trustee powers for handling complex assets.
- Facilitating state tax savings by relocating trust situs.
- Modifying powers of appointment for income or estate tax benefits.
- Medicaid planning through modifications to beneficiary access.
  - In re Kroll, 971 N.Y.S.2d 863 (2013), Kroll v. New York State Dep't of Health, 39 N.Y.S.3d 183 (2016) (upholding trustees' decanting of an irrevocable trust's principal into a supplemental needs trust to preserve the beneficiary's eligibility for Medicaid benefits, despite objections from the state).
- Addressing creditor issues.
  - *Ferri v. Powell-Ferri*, 476 Mass. 651 (2017) (allowing decanting of assets from an irrevocable trust into a new trust, even if it removes assets from the beneficiary's marital estate during divorce).
  - *United States v. Lazare*, No. 2:14-cv-01075-APG-VCF (D. Nev. Mar. 4, 2016) (holding that decanting was a fraudulent transfer under Nevada's Uniform Fraudulent Transfer Act and enjoining parties from transferring trust assets pending final judgment).

Challenges and Controversies:

- Eliminating beneficiary interests without settlor's consent.
  - *Harrell v. Badger*, 171 So. 3d 764 (Fla. 2015) (invalidating a decanting that added new beneficiaries not included in the original trust, in violation of Florida law, and for failing to provide the required 60-day notice).
- State statutes vary in the degree of protection offered to trustees (e.g., good faith actions).
- Fiduciary duty risks, even if decanting is legally permissible.
  - *Hodges v. Johnson*, 170 N.H. 470 (2017) (removing trustees for decanting a trust without properly considering future beneficial interests, which the court found to be a serious breach of trust).

Trust Document - Power to Decant

Ethical issue: "boilerplate" decanting power –

Does the client know this power exists?

Does the settlor's intent matter?

Trust Document - Power of Appointment

- **Trustee/ Beneficiary/ Third Party**
  - **Control:** Grants authority to allocate trust assets.
  - **Types:** General (broad) or limited (restricted to specific groups).
  - **Tax Impact:** General powers may trigger estate or gift taxes.
  - **Flexibility:** Adapts trust distributions to changing needs and tax strategies.

DC Law Update

- Adoption of the following
  - Uniform Trust Decanting Act
  - Uniform Directed Trust Act
  - Uniform Powers of Appointment

Uniform Trust Decanting Act

- Passed in 18 states (including MD and VA)
- Now pending in the City Council
- B25-0224 - Uniform Trust Decanting Act of 2023
- Why decant? Decanting can be used for a host of purposes:
  - To conform a trust to the requirements of a “supplemental needs trust”
  - Change trustee provisions, change beneficial interests
  - Change administrative provisions, change the “situs” of a trust
  - Correct a drafting error, and to add or delete a spendthrift provision- Combine trusts for greater efficiency or separate trusts
  - segregate “high risk” assets
  - reduce distribution rights for Medicaid eligibility planning purposes.

Uniform Directed Trust Act

- Passed in 20 states (including VA but not MD)
- Now pending in the City Council
- B25-0225 - Uniform Directed Trust Act of 2023
- Makes clear the role of a non trustee who has authority in a trust, and their responsibility to act as a fiduciary and protection of liability – the trustee is not responsible for the trust director and visa versa
- A power over a trust held by a nontrustee is called a “power of direction.”
- The holder of a power of direction is called a “trust director.” In many trust, this was called a “trust protector” or “trust advisor”. Sometimes has investment authority, sometimes has the power to remove trustees.

Uniform Powers of Appointment Act

- Passed in 13 states (including VA but not MD)
- Now pending in the City Council
- B25-0219- Uniform Powers of Appointment Act of 2023
- Codifies the rights of the powerholder to appoint property in a trust usually limited to a class of people i.e., the descendants of the powerholder.

Overview of Funding

- Importance
- Process
- Specific Assets
- Real Property
- Co-ops
- Investment Accounts
- IRAs/ 401(k)s/ 403(b)s

Funding - Have a Process

- Unfunded Trust = Unhappy Family
  - Pour-over Will
  - “paid all this money and still have to go to probate”
- Are you going to do the funding or not
  - Deed Only
- If not, then
  - Signed acknowledgement
    - Client is responsible for funding
  - “Next Steps” Meeting
  - “2-Year Funding Follow-up”

Real Property

- No Lender Approval
  - Primary residence
- Lender Approval
  - 2nd Home
- Commercial Property
  - Unlikely to get lender approval
- Rent Control
  - If property is exempt from rent control, transfer to trust will lose exemption

Real Property

- Recorder of Deeds
  - Certification of trust, whole trust, or pages from trust
    - “We simply need the pages that establish the revocability of the trust, which is normally the first few pages of the document; pages showing the beneficiaries during the lifetime of the settlors, and the signature pages.”

Co-Ops.

- If not in the trust, then probate
  - Value of co-op in filing fee
- Amendment or Addendum to Trust
  - Call to get transfer package
  - Sign addendum and application at trust signing
- Get lender approval first to transfer trust
  - National Co-Op Bank now approving transfers to trust.
- Co-op Board's Approval
  - Prepare client for fees charged
- Economic interest deed
  - Certification of trust - "Settlor is the beneficiary of the trust."

Tangible Property

- Assignment of Personal Property
  - Inclusive language to cars and boats – does not work
- Pets
  - “Important trust property”

Cars and Boats

- Transfer Title on Death
  - While trust can be a co-owner, transfer title on death is easier.
    - *BENEFICIARY DESIGNATION TO CERTIFICATE OF TITLE APPLICATION*
  - If the client is buying a new car with cash, then let dealership do it
- Excise Tax Exempt
  - If client willing to change the title/ plates, etc., make sure client is prepared to ask for exemption from excise tax not on form.
- Boats
  - Registered with Coast Guard

Investment Accounts

- Start here –
  - –Every financial planner will understand a revocable trust.
  - –Note – Numerous documents to complete transfer has nothing to do with trust – but the account itself.

IRAs/Roths

- PODs
- Pay to the Trust or Beneficiary
  - Advisors will insist that the spouse cannot get a spousal rollover
- Charity Beneficiaries
  - Trust excludes/ addresses charities if client wants people to get IRA
- Consolidated Statements
  - Segregated from ordinary brokerage account
- Special Needs Trust
  - "To the Trustee of the [Child's Name] Special Needs Trust, a sub-trust established under the [Client's Name] Revocable Living Trust, dated [Trust's Execution Date], as amended."

Other Items

- 401(k)s and 403(b)s - PODs
  - –Can readily attach addendum to POD
- TSP - 90-Day Policy
  - –**BIG TAX HIT**
    - If the beneficiary wants an inherited (beneficiary) IRA, they have 90 days from date of death to request distribution
- Treasury Bonds
  - –Treasury will only retitle unmatured bonds

Credit Unions

- Trustee Powers
  - Include power to hold credit union accounts
- Not possible at some (e.g., DC Credit Union)
  - Senate Credit Union now possible

Bank Accounts - (Checking, Savings, MMs)

- Community banks then national banks
  - Private banking exception
- Keep same account or new account?
  - General industry practice – client can keep the same account as long as the trustees mirror the names on the account
  - Client may lose benefits of old account
- Branch staff will encourage POD

Bank Accounts - (Checking, Savings, MMs)

- Tyranny of small amounts.
  - Client will not do accounts with small amounts
  - Client will only do savings account(s)
- Streamline numerous accounts