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THE USE OF TRUSTS

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The “Trust” (from Restatement (3d) of Trusts §2)

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

- Thus, a trust is administered **by** the trustee **for** the beneficiaries.

Trusts in England

The Franciscan Friars of the Thirteenth Century

- Could not hold land.
- A “feoffee” could **hold** title to land “**for** the **use** of” a Friar as the “cestui que use.”
- The Chancellor enforced a feoffee’s loyalty and **duties** to the “cestui que use.”

The Developing Uses of Uses

- Use for noncharitable successors could avoid “feudal incidents.”
 - Crops.
 - Service of knights.
- And it could provide donative freedom.
- A “committee” of feoffees could ensure continuity.

The Statute of Uses (1535)



Henry the Eighth

*MAKE ENGLAND
GREAT AGAIN!*

- The Statute of Uses “executed” (collapsed) uses.
- Lawyers found workarounds.
 - E.g., “active uses.”
- Chancellor supported this.



Elizabeth the First

- The Statute of Charitable Uses (1601).
- Foreshadowed section 501(c)(3) of the Internal Revenue Code.

Trusts in America

Origins and Distinctions



George the Third

*FREE
AND INDEPENDENT
STATES*

- But the law remained English.
- Rugged Individualism and Donative Freedom thrived.
- And so did the modern “feudal incidents” of taxation!

“A Quiet Revolution”

The Uniform Prudent Investor Act (UPIA) (1994)

- Standard of prudence applied to entire portfolio (“modern portfolio theory” – “total return”).
- No categorically prohibited investments.
- Diversification integrated in prudent investing.
- Delegation of investment and management functions permitted.
- **Expanded discretion ... Expanded responsibility.**

The Revised Uniform Principal and Income Act (RUIPIA) (1997)

- Addresses the tension between total return investing and distribution standards.
- Allows “adjustment” between income and principal if:
 - The trustee invests as a prudent investor.
 - Distributions are limited with reference to “income.”
 - Impartiality is therefore impossible.
- Provides a list of “factors” to consider.

The Uniform Fiduciary Income and Principal Act (UFIPA) (2018)

- Section 203 detaches the power to adjust from distribution standards.
- Article 3 adds the ability to convert to a “unitrust.”
 - The ultimate “adjustment.”
 - Current “**income**” is defined as a percentage of the value of the trust assets.
 - Thus current and successive beneficiaries have a “**unity** of interest” in a “**unified** fund.”
 - Respected by the IRS, with limitations (e.g., 3-5% unitrust rate), in Reg. §1.643(b)-1 (2003).

The Uniform Trust Code (UTC) (2000)

- Court supervision as the exception, not the norm.
- “Virtual representation” of minors, etc. (Section 304).
- Nonjudicial settlement agreements (Section 111).
 - Must not “violate a material purpose of the trust.”
 - A “spendthrift” provision is not a “material purpose of the trust” (Section 411(c)).
- Hint of role for a “trust director,” without using the term (Section 808).

The Uniform Directed Trust Act (UDTA) (2017)

- Formalizes the role of a “trust director.”
- Confirms the duty and liability of a trust director, matching those of a trustee (Section 8).
- A directed trustee must comply with a trust director’s direction, unless compliance would be willful misconduct (Section 9).

Uniform Trust Decanting Act (UTDA) (2015)

- Codifies the doctrine traced to *Phipps v. Palm Beach Trust Co.*, 142 Fla. 782 (1940) (“the power vested in a trustee **to create an estate in fee** includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent”).
- Compare *Morse v. Kraft*, 992 N.E.2d 1021 (Mass. 2013) (broad grant of authority **to make distributions “for the benefit of” beneficiaries** is “evidence of the settlor’s intent that the disinterested trustee have the authority to distribute assets in further trust for the beneficiaries’ benefit”).
- New York’s decanting statute was the first (1992).

Decanting

- The IRS has ruled on decanting, without necessarily calling it that, in rulings from 1993 to 2011.
- Since 2011, decanting has been on a no-rule list.
- IRS Notice 2011-101 asked for comments on decanting.
- Section 19 of UTDA specifically guards against jeopardizing tax benefits through a decanting.

Talking to Families About Trusts

Views of Wealth Can Reflect Views of Life

- Someone who is self-centered may be concerned with possession, enjoyment, and **control**.
- Someone who is others-centered may be concerned with stewardship, service, charity, and **values**.
- Put another way:
 - Creating wealth involves entrepreneurship and innovation.
 - Sharing wealth involves values, gratitude, and generosity.
- So talking to families about wealth necessarily involves (or should involve) discussion of all these concepts, including transferable family values.

And Views of Wealth Inform Views of Trusts

- Control begs to be kept; values beg to be shared.
- Sharing involves roles for younger generations:
 - Co-trustees.
 - Trust directors.
 - Officers of a private foundation.
 - Even donees of outright gifts.

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

Changes in the Environment over Time

- Repeal or relaxation of the Rule Against Perpetuities.
- Proliferation of the family line.
 - Dispersion, demographics, diversity, dissent.
- Evolving understandings of “issue” (assisted reproductive technology), “spouse,” etc.
- One constant: The grantor chose the trust form.

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

Prelude: Henry's Revenge: The Influence of Tax Law



- Income tax treatment of a trust requires that “the beneficiaries not, **qua beneficiaries**, control trust affairs.”

Bedell Trust v. Commissioner,
86 T.C. 1207, 1220 (1986).

- Or else it may be a partnership.
Reg. §301.7701-3(b)(1)(i)
- A trust must be administered
 - **by** the trustee
 - **for** the beneficiaries.

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Threats to Fiduciary Duty

- Exculpation?
 - Different from Standard of Scrutiny.
- Dividing Fiduciary Roles?
 - Upstream – in director?
 - Downstream – in trustee?

From Judge Learned Hand...

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

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

Two Components of the Enforceability of Fiduciary Duties:

- 1. Access to Information**
- 2. Access to a Forum**

The Beneficiaries' Access to Information

- Section 813(a) of the Uniform Trust Code:

A trustee shall **keep the qualified beneficiaries of the trust reasonably informed** about the administration of the trust and of the material facts necessary for them to protect their interests. Unless unreasonable under the circumstances, a trustee shall **promptly respond to a beneficiary's request for information** related to the administration of the trust.
- But the provision is not mandatory!
- North Carolina enacted the UTC without making that access to information mandatory.
- And *Wilson v. Wilson*, 690 S.E.2d 710 (N.C. App. 2010) considered two 1992 trusts that purported to relieve the trustee of any duty to give accounts or reports to any beneficiary.

The Beneficiaries' Access to Information

- The North Carolina Court of Appeals held that the beneficiary is always entitled to such information as is reasonably necessary to enable him to enforce his rights under the trust or to prevent or redress a breach of trust ...

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

The Beneficiaries' Access to a Forum

- No-contest (or *in terrorem*) clauses?
 - *Callaway v. Willard*, 739 S.E.2d 533 (Ga. Ct. App. 2013): “not favored in the law.”
 - *Hamel v. Hamel*, 299 P.3d 278 (Kan. 2013): valid in the absence of probable cause.
- Mandatory binding arbitration?
 - Allowed by statute in Arizona and Florida.
 - Questionably allowed by the Supreme Court of Texas.
 - In PLR 201117005, the IRS was wary but willing to reserve judgment until there is an actual arbitration.
 - But isn't arbitration a “forum”?

Summation: The Model of a Trust Relationship

- Trusting: Administered by the trustee for the beneficiaries.
- Transitory: Humble and flexible.
- Truthful: Moderate and honest. Disclosure helps.
- Tax-Smart: No shame in preserving tax benefits.

Questions and Comments

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