



# Estate Planning Review

Volume 31, No. 1

January 21, 2005

## THE UTC: A CONTINUING THREAT TO ESTATE PLANNING

**CCH:** It appears that considerable controversy has been generated over the Uniform Trust Code (UTC). In fact, some commentators seem to think that the UTC is

*In the following interview, Mark Merric and Douglas Stein provide our readers with their views as to the potentially negative impact of the Uniform Trust Code on the protection of beneficial interests. Mark Merric is the manager of Merric Law Firm, LLC based in Denver, Colorado. Douglas Stein is a partner in Barris, Sott, Denn and Driker, PLLC, Detroit, Michigan, and is also a member of the Michigan Uniform Trust Code Review Committee. Both Messrs. Merric and Stein are national speakers and their writings have been published in numerous national publications.*

more controversial than the Uniform Probate Code when it was first introduced. I thought the UTC was based on common law. If so, why is the UTC so controversial?

**Mr. Stein:** The National Conference of Commissioners on Uniform State Laws (NCCUSL) dedicated a lot of time to this project and some of the provisions should

be enacted. However, there are significant departures from common law which are cause for concern and are proving to be extremely controversial. While many parts of the UTC embody common law, some parts of the UTC are built on principles of the Second Restatement of Trusts that did not gain much popularity among the states. Other parts of the UTC are built on the Third Restatement, which, with respect to some issues, creates a new theory and a new philosophy of trust law. In fact, there are many areas in which the Third Restatement adopts a minority position and the UTC then imposes these minority views on all states. It is these departures from common law that are generating most of the controversy.

In this regard, I would note that the UTC was drafted in "close coordination with the revision of the Restatement

of Trusts" (English, *The Kansas Uniform Trust Code*, 51 *University of Kansas Law Review* 311 (2003)). Further, the UTC specifically states that it is to be read in conjunction with the Restatement Third and that the Restatement Third may even have priority in interpretation over common law (UTC Section 107, the official comment thereunder). In addition to the general reference under the comment to UTC Section 107, there are over one hundred specific references in the UTC official comments to the Restatement Third for interpretation. This is what makes amending the UTC so difficult when it departs from common law, and that can only be resolved by overhauling the UTC.

**CCH:** What are the major areas where the UTC has departed from common law?

**Mr. Stein:** The key areas of departure are:

1. Decreased asset protection as applied to beneficial interests in non-self settled trusts. Basically, much of Article 5 is new law. It is not based on our 400 years of common law.
2. Authorizing judges and beneficiaries to rewrite a trust may thwart the grantor's intent. This is a significant departure from common law. While many states permit, either by case law or by statute, an irrevocable trust to be revoked with the grantor's consent and then only if all beneficiaries consent (an excellent ap-

### INSIDE

|   |   |
|---|---|
| The UTC: A Continuing Threat to Estate Planning ... | 1 |
| Alternate Valuation Regs Finalized .....            | 6 |
| Post-Death Sale Price Controlled Stock's Value ...  | 7 |
| Brief Ideas .....                                   | 8 |

proach if there are no adverse tax consequences), the UTC goes further. The UTC allows these changes to be made after the grantor's death. This is extremely problematic because the grantor can no longer be certain that their wishes will be carried out.

3. Mandatory disclosure of financial information to all beneficiaries, regardless of the grantor's intent. This will have a particularly chilling effect on government employees, executives, and families where a beneficiary may feel they are not being treated fairly. While some disclosure may be appropriate there are times when letting the settlor's intent under common law govern is a much better solution.
4. The lack of flexibility is another issue. Many of the provisions of the UTC are mandatory. Historically, trusts have been drafted to maximize flexibility—an element that is necessary to deal with changing markets as well as the changing needs of beneficiaries. The UTC should have added significant flexibility by making most, if not almost all, of its provisions optional.
5. There are several provisions in the UTC that conflict with each other. These conflicts need to be addressed. For example, a revocable trust becomes irrevocable upon the grantor's death yet a will or codicil may revoke the trust. Section 403 (trusts created in other jurisdictions) appears to conflict with Section 107 (governing law). These conflicts pose an interesting conundrum, to wit; which section takes precedence. In addition, the governing law provisions create significant conflict of laws issues.
6. Historically, the existence of a spendthrift provision is, by itself, a valid purpose for a trust. In fact, most of my clients insist on a spendthrift trust and many would create a trust only because of the spendthrift protection. The UTC states that a spendthrift provision alone is not a valid purpose of a trust. Unfortunately, most trusts do not include a statement of intent, so there will always be a cloud over those trusts. The only way to know if the trust is valid is to go to court.
7. The UTC introduces the concept of the "purpose" of a trust and allows a judge with the consent of the living beneficiaries a *cy pres* type power to rewrite trusts in accordance with the grantor's perceived purpose. The problem here is that seldom, except possibly in the case of a special needs trust, does a grantor specifically express the purpose of the trust in the trust instrument.
8. There is an undertone in the UTC that a grantor is not free to dispose of their property as they see fit.

This is simply contrary to American jurisprudence and extremely paternalistic.

9. Historically, the applicable state's attorney general (AG) had the right to intervene in a matter, as an interested person, involving a trust or will and represented the beneficiaries of the charities. However, under the UTC the AG is now a qualified beneficiary who has all the rights of a beneficiary. This is expected to have a chilling effect on charitable gifts.

There are many more. The deviations from common law are not limited to creditor protection but extend well beyond what Mark and I have been writing about.

**CCH:** These appear to be significant deviations from common law. Unfortunately, in our interview, we will only be able to touch upon a few. In his comments Doug mentioned decreased asset protection for beneficial interests of non-self settled trusts. Mark, how does the UTC decrease the asset protection available to beneficiaries of estate planning trusts—non-self settled?

**Mr. Merric:** The following nine key areas are those in which the UTC decreases asset protection that was traditionally available to beneficiaries and holders of powers of appointment for non-self settled trusts:

- Contrary to the common law of almost every state, the discretionary-support distinction is abolished and the UTC adopts a new theory of trust law known as "the continuum of discretionary trusts."
- Many third party special needs trusts may become an available resource, and their governmental benefits may be denied;

## Estate Planning Review

### Consulting Editor

Sidney Kess, J.D., LL.M., C.P.A.

### Portfolio Managing Editor

Karen A. Notaro, J.D., LL.M.

### Editors

Bruno Graziano, J.D., M.S.A.

Alicia C. Ernst, J.D.

Laura A. Tierney, J.D.

James F. Walschlager

ESTATE PLANNING REVIEW (ISSN 0098-2873), published monthly by CCH INCORPORATED, 4025 W. Peterson Ave., Chicago, Illinois 60646. **POSTMASTER:** SEND ADDRESS CHANGES TO ESTATE PLANNING REVIEW, 4025 W. PETERSON AVE., CHICAGO, IL 60646. Printed in U.S.A. All rights reserved.

© 2005, CCH INCORPORATED, A WoltersKluwer Company.

- The UTC creates new remedies which are available to exception creditors, and possibly *all* creditors allowing attachment of all present or future distributions at the trust level;
- The UTC allows exception creditors to force the sale of both *current* as well as remainder interests;
- The UTC permits creditors to attach distributions that are based on a discretionary distribution standard when a judge determines that such distributions are overdue;
- The UTC adopts a distinctly minority position that allows all creditors to attach and exercise an *inter vivos* general powers of appointment;
- Under the UTC, a bankruptcy trustee may be able to exercise the debtor's power to force a distribution from a discretionary trust to benefit the debtor's creditors;
- If a future federal statute lists the bankruptcy trustee as an exception creditor under Section 503(c), the spendthrift protection of all trusts (i.e., discretionary and support trusts) would, for the most part, be completely defeated; and
- The UTC most likely creates a property interest in all *current distribution interests* as well as remainder interests with the result in many states that in a divorce, every beneficial interest will need to be valued to determine whether the beneficial interest is (1) marital property; (2) a factor or economic circumstance to determine the equitable division of marital property; (3) or whether income should be imputed to determine child support or alimony.

**CCH:** The UTC classifies all trusts as "discretionary trusts." Am I correct in assuming that if a trust is "discretionary" the end result is that there is more asset protection?

**Mr. Merric:** The term "continuum of discretionary trusts" is a misnomer. The UTC and Restatement Third abolish the common law distinction of almost every state thereby causing all trusts (both discretionary and support trusts) to solely rely on spendthrift protection. A discretionary trust may no longer rely on the added protection that the beneficiary does not hold a property interest or an enforceable right. Rather, under the UTC, an exception creditor (and possibly all creditors) may attach present and future distributions at the trust level. An exception creditor may force the sale of all current distribution interests and remainder interests. In this respect, the continuum of discretionary trusts affords no greater asset protection. A creditor either attaches

the beneficiary's so called discretionary interest or the creditor does not. The beneficiary's current distribution interest or remainder interest is either sold or it is not. None of these remedies depend on the continuum of discretionary trust theory. In this respect, the continuum of discretionary trusts functions much more like a "continuum of support trusts," with a significant decrease in asset protection to both discretionary and support trusts under common law.

**CCH:** If a beneficial interest in a trust is attachable or if all trust interests are sellable at judicial foreclosure how does the continuum of discretionary trusts provide any asset protection?

**Mr. Merric:** There is no sure fire way to provide any asset protection under the continuum of discretionary trusts. This is because the continuum is amorphous and lacks the contours of the common law. Under common law, the outcome of drafting a discretionary trust was highly predictable. The same cannot be said under the UTC, because, at present, it is completely undefined and will only be defined with a new wave of litigation.

**CCH:** If I understand your position correctly, prior to the UTC and the Restatement Third, planners could follow the common law definition of a discretionary or support trust and, thus, could easily draft to obtain the desired result. In effect, there was a "bright line" test. Now, the UTC replaces this bright line test with what amounts to a *facts and circumstances* test? If this is truly the case, why would anyone support the UTC not knowing how to draft their trusts to determine the desired results?

**Mr. Merric:** We have posed the same question. In trust law, certainty is a goal in and of itself. However, in answering your first question of how does the continuum of discretionary trusts provide any asset protection, the continuum of discretionary trust theory may provide a small amount of asset protection that prior to the UTC and Restatement Third was unnecessary. It is in the imputed income theories.

**CCH:** What is an imputed income theory?

**Mr. Merric:** Imputed income theory means that, regardless of whether a beneficiary has received a distribution, income is imputed to a beneficiary because he or she has an enforceable right to demand a distribution. As noted above, the discretionary-support distinction was abolished. Now, under the good faith standard of judicial review in Section 814(a) and the recognized right of Section 504(d), all beneficiaries have an enforceable right to demand a distribution. The only question is how much will a judge determine the beneficiary could demand on the "undefined continuum?" In this regard,

imputed income theories appear in three separate areas: (1) special needs trusts; (2) an undefined overdue distribution; and (3) child and spousal support.

**CCH:** With the exception of child or spousal support, isn't it true that Section 504(b) prevents any creditor from forcing a distribution?

**Mr. Merric:** I think you are missing the point of an imputed distribution. It does not matter whether a creditor can force a distribution for an imputed income argument. The only question is whether a beneficiary may force such a distribution. In fact, the article in the December 2004 UTC Notes titled *UTC Article 5 on Creditor's Rights* states, "Of course Section 504(d) makes clear, the beneficiary could compel a distribution for his or her own benefit by proving the trustee violated a standard or committed an abuse of discretion" (Valerie Vollmar, *UTC Article 5 on Creditors' Rights*, UTC Notes, December 2004).

In the SNT context, current cases in Ohio, Iowa, Pennsylvania, and possibly Connecticut indicate that when the court rules that a beneficiary has an enforceable right to a distribution the court will also rule that the trust is an available resource. This is an imputed income argument that is adopted by both the UTC, under the "good faith" standard of judicial review in Section 814(a), and the Restatement Third, under the reasonableness standard.

**[Ohio]**—see *Bureau of Support in the Department of Mental Hygiene and Correction v. Kreitzer*, 243 N.E.2d 83 (Ohio 1968); *Matter of Gantz*, 1986 WL 12960; *Samson v. Bertok*, 1986 WL 14819 (the creditor did not recover because it was not a governmental claim); *Matter of Trust of Stum*, 1987 WL 26246; *Schierer v. Ostafin*, 1999 WL 493940 (the creditor did not recover because it was not a governmental claim); and *Metz v. Ohio Dept. of Human Services*, 762 N.E. 2d 1032 (OH App. 2001)).

**Iowa**—see *Strojek v. Hardin County Board of Supervisors*, 602 N.W. 2d 566 (Iowa App. 1999); also see the follow up unpublished opinion where the Iowa Appellate Court expanded the definition of the distribution language as much broader than "basic needs;" *Strojek v. Hardin County Board of Supervisors*, 2002 WL 180377 (Iowa App. 2002); also see the unpublished opinion of *McCabe v. McKinnon*, 2002 WL 31757533 (Iowa App. 2002)).

**Pennsylvania**—see *Estate of Taylor v. Department of Public Welfare*, 825 A.2d 763 (Penn. 2003); *Shaak v. Pennsylvania Department of Public Welfare*, 747 A.2d 883 (Penn. 2000); *Estate of Rosenberg v. Department of Public Welfare*, 679 A.2d 767 (Penn. 1996); and *Commonwealth Bank and Trust Co.*, 598 A.2d 1279 (Penn. 1991)).

**Connecticut**—see *Corcoran v. Department of Social Services*, 859 A.2d 533 (Conn. 2004)].

**CCH:** In the SNT context, proponents of the UTC claim that "the UTC clarifies and improves creditor protection for third-party special needs trusts because it prohibits creditors from forcing trustees to exercise discretion regardless of the standard employed" (Michelle Clayton, *Uniform Trust Code 2005*, UTC Notes Winter 2004). How does this relate to the imputed income or "available resource issue?"

**Mr. Stein:** The imputed income issue is separate and distinct from whether a distribution may be forced. The UTC article you refer to ignores the "available resource issue." Once a beneficiary has an available resource, that resource will be counted unless it is exempt (42 U.S.C. §1396p(b)(4)). Unless an SNT is drafted with "special needs language" either a portion or all of a third party SNT's assets will most likely be imputed to the beneficiary under the imputed income theory thereby disqualifying the beneficiary from governmental benefits. This is contrary to the common law of most states. In sum, as applied to *discretionary trusts*, the UTC provides no increased benefit. In the long run, it appears to be a detriment, because all trusts must now rely solely on spendthrift protection. In this respect, with the rising state budgetary deficits, it may be only a matter of time before SNTs are greatly curtailed if not eliminated.

**CCH:** The "available resource" issue created by the UTC appears to present a major problem for elder law attorneys. How does the implied income argument apply to other creditors?

**Mr. Merric:** Any creditor may attach an undefined "overdue distribution."

**CCH:** I thought that an "overdue distribution" would be one that occurs when all income was required to be paid quarter annually? Are you saying that the terms "mandatory" or "overdue distribution" are undefined terms? Does this mean that a judge could interpret a beneficiary's right to demand a distribution under a discretionary trust as a mandatory distribution?

**Mr. Merric:** Yes. How else would a continuum of discretionary trusts make sense? To the extent that a judge determines that a trustee should have made a distribution based on (1) the purpose of the trust; (2) all language contained in the trust especially the distribution language; and (3) any extrinsic evidence, the beneficiary has an enforceable right under Section 504(d), that distribution is available. The only question is the degree to which a creditor is allowed to step into the shoes of the beneficiary under Section 506. From the literal language of Section 506, it appears that the creditor will step into the shoes of the beneficiary and

exercise this right to force an overdue distribution. It is quite possible that, under the UTC, a judge may conclude that some amount should be distributed based on almost any discretionary distribution standard. Fortunately, three state UTC committees (i.e., South Carolina, North Carolina, and Ohio) have realized the importance of this issue and have corrected it.

**CCH:** And what about the imputation of income for divorce or alimony from all trusts?

**Mr. Stein:** By either a direct application of the available resource rules, the so called overdue distribution analysis, or from a constructive receipt type of analogy, it appears that the same analysis is applicable in determining child support or spousal support. In fact, this was the result in the only case citing the Restatement Third. Income from a discretionary trust under common law was imputed to a beneficiary for the purpose of child support (see *Dwight v. Dwight*, 756 N.E. 2d 17 (Mass. Ct. of App. 2001)). *Dwight* references the Restatement Third § 59 and *Gershaw v. Gersfield*, 751 N.E.2d 424 (Mass. App. 2001). Section 59 contains the exceptions to spendthrift trusts. *Gershaw* is a support trust case. Therefore, under common law, the exception creditors of spousal and child support are appropriate to a support trust. However, *Dwight* involves a discretionary trust. Prior to the UTC and the Restatement Third, there were no exception creditors to a discretionary trust.

**CCH:** As I understand your position, you are saying that in addition to significantly weakening asset protection for almost all beneficial interests in trusts due to the increased remedies, abolishing the superior asset protection of a discretionary trust, the UTC removes the bright lines that estate planners have used in designing trusts. In essence, a judge now, in almost all cases, would have to decide where each trust lies on this newly created continuum of discretionary trusts and there is not much a grantor can do to be where he or she wants to be on that continuum. Do you therefore expect this to result in a greater amount of litigation?

**Mr. Stein:** As trial attorneys become aware of the litigation opportunities under the UTC, the amount of litigation in an area that typically has had very little litigation, should begin to sky rocket. For example, the following situations may result in significant trust litigation:

- Almost all third party SNTs which lack a purpose clause (i.e., specific special needs language) will need to go to court to determine where the SNT lies on the continuum of discretionary trusts.
- In many states, almost all divorce cases will need to go to court to (1) determine whether a remainder

interest or current beneficial interest is property, and then possibly marital property; (2) whether the value of a current beneficial interest as well as a remainder interest should be considered a factor or economic circumstance to award the non-beneficiary party a greater share of the marital property; and (3) whether income should be imputed to a beneficiary for the purpose of computing child support or alimony.

- All trusts would need to go to court to determine whether a creditor is entitled to an undefined overdue distribution or whether all creditors may attach the present and future distributions at the trust level.
- Any trusts in the bankruptcy court where the bankruptcy trustee attempts to force a distribution either as overdue or as standing in the shoes of the beneficiary.
- Any creditor seeking to attach an inter-vivos general power of appointment.
- In addition, the UTC increases the number of persons who may sue the trustee. Any power of appointment holder is treated as a beneficiary under the UTC. Furthermore, *problem children* (often times suffering from extreme emotional, drug or alcohol dependency issues) whom the settlor purposefully did not want to have a right to sue the trustee or receive an equal share of the trust, now have grounds to question every distribution from a trust.
- Finally, Section 503(b) encourages litigation by providing the fuel for such litigation. The UTC provides that a judge may award attorney fees to beneficiaries, persons holding powers of appointment, estranged spouses, and any exception creditor standing in the shoes of the beneficiary.

**CCH:** What about the possibility of someone simply moving their trusts from a UTC state in order to avoid all of these problems to a jurisdiction with more favorable trust law?

**Mr. Stein:** The UTC adds a whole new dimension to “forum shopping.” Where forum shopping generally was limited to state income tax and rule against perpetuities issues—the exception with most estate planning clients—it may well become the rule under the UTC. Almost any state that does not adopt the UTC will have significantly more favorable law than a UTC state. We are not talking about merely how long the trust lasts, we are talking about what the grantor wants and implementing his or her desires. In sum, the UTC encourages forum shopping.

**CCH:** Due to the significant deviations from common law, are states making many changes to the UTC?

**Mr. Merric:** As more and more concerns are being vetted regarding the UTC, states are making more modifications to the act. Some individuals have even suggested that the UTC may come to be known as the “un-uniform trust code” or the “not so uniform trust code.”

**CCH:** How many states are anticipated to adopt the UTC?

**Mr. Merric:** At the Colorado Statutory Review Committee on November 19, 2004, former Judge Wade, who was a member of the Restatement Third Committee as well as the UTC Committee, mentioned that passage was expected in only twenty-five states. Further, it appears that the major financial centers of New York, Illinois, and Delaware are unlikely to adopt the UTC. Also, states that are known for their cutting-edge trust laws such as Alaska, Nevada, and Texas will not be adopting the UTC.

**CCH:** If there are going to be significant changes to the UTC, the major financial centers are not going to adopt the Act, and approximately one-half of the states are not either, what is the benefit of a uniform law?

**Mr. Stein:** That is a good point. Further, in NCCUSL’s December’s newsletter Valerie Vollmar, a professor at Willamette University College of Law in support of UTC Article 5 states “The important point here is that UTC Section 504 is not some “monolithic” new rule likely to sweep the country. Individual states will continue to make their own policy decisions about whether child and spousal claimants should be afforded special treatment that departs from traditional trust rules about discretionary trusts.” [Emphasis added] This speaks volumes about at the UTC. The primary purpose behind a uniform act is to keep the law uniform by limiting the changes each state makes which NCCUSL appears to admit is not the case.

**CCH:** Doug, you mentioned that the UTC takes a new view of trust law, what is that view?

**Mr. Stein:** It is a parental point of view where the government and judges have much more power to determine how a trust will be governed. It can be best summed up by the following quotation from the foreword of the Restatement Third of Trusts, which in many areas, is the interpretive guide to the UTC:

“The principles restated in these two volumes have two main themes. One is to make it easier to accomplish the settlor’s intentions, so long as those intentions can be reliably established and do not offend public policy. The second is to recognize appropriate authority, through doctrines that include *cy pres*, to enable the living—especially judges—to

adapt the settlor’s expressed purposes to contemporary circumstances.”

It is this change from the grantor controlling the disposition of his or her property to judges and living beneficiaries rewriting the grantor’s intent that has many estate planners as well as clients gravely concerned.

**Mr. Merric:** On a side note, if I was trying to talk one of my clients out of creating a trust, I would simply read the client those three sentences from the Restatement Third of Trusts that Doug just quoted. As soon as they heard words such as “public policy,” “judges,” and “contemporary circumstances,” many clients would have concerns as to whether their desires as expressed in their trusts would actually be carried out. ♦

## ESTATE TAX

### Alternate Valuation Regs Finalized

Prior to 1984, an estate wanting to value the gross estate as of an alternate date was required to make the election on a timely filed estate tax return which

*The IRS has finalized regulations under Code Sec. 2032 regarding the election to value a decedent’s gross estate on an alternate valuation date. The final regulations, which became effective January 4, 2005, reflect changes suggested by practitioners to the regulations that were proposed in December 2003 (NPRM-REG 139845-02).*

included only extensions of time to file that were actually granted. After the passage of the Deficit Reduction Act of 1984 (P.L. 98-369), the election could be made on estate tax return, even one filed late, provided that the

return was filed within one year after the due date, including extensions *and* only if the election would result in a decrease in both the value of the decedent’s gross estate and the estate tax liability. Although Temporary Reg. §301.9100-6T(b) was issued to reflect the changes made by P.L. 98-369, it went one step further by requiring an estate that failed to make the election on its estate tax return to file the election on a subsequent return by the due date of the original return, including extensions, thus preventing an estate’s ability to obtain extension relief under Reg. §301.9100-1 and Reg. §301.9100-3.

As proposed, an estate that failed to file an alternate valuation election before the due date of the return, including extensions, or on the first return