Why the Uniform Trust Code Failed in Various States

The Uniform Trust Code was almost unanimously passed by the Arizona legislature in Arizona in May of 2003. It was unanimously repealed by both the House and Senate in May of 1994. Other states apparently deciding not to follow the UTC at this point in time are as follows:

- Colorado – the UTC was effectively defeated in the Senate.
- Oklahoma – Support for the UTC was withdrawn in the Senate Committee
- Texas – where over seven subcommittees could not get the UTC to work, and currently is drafting Anti-Third Restatement provisions. Please note that many parts of the UTC are based on the Restatement (Third) of Trusts.
- Minnesota – where the UTC on the whole was rejected, with minor provisions adopted.
- Indiana – seems to be following the same approach as Minnesota.
- Alaska, Delaware, and Nevada also appear that they will not adopt the UTC.

The reasons given by various persons for not adopting the UTC are detailed in the following pages. These reasons have nothing to do with self settled trusts or asset protection legislation.

Oklahoma

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Subject: [WCMLS]UTC Defeated in Oklahoma
Date: Fri, 2 Apr 2004 07:17:37 -0600

Colleagues --

The Uniform Trust Code ("UTC") has been defeated in Oklahoma. After a 98-1 vote to pass the UTC in the House, the UTC was defeated in the Senate Judiciary Committee when the primary sponsor of the bill withdrew his support. From what I can tell, these are some of the major reasons for the UTC defeat:

A. The UTC's elimination of the discretionarysupport difference for asset protection purposes would drastically reduce the asset protection provided by the following types of trusts:

1. Third Party Special Needs Trusts Probably, the recognized expert in Oklahoma on elder law, Lee Holmes, believed that the UTC was the first of two steps necessary to allow governmental agencies to recover directly from all trusts. The monumental step would be the elimination of the discretionary trust difference, which the UTC does. The second, less difficult baby step is for a federal or state government to pass a law indicating that they may recover as an exception creditor.

2. Advanced Estate Planning Trusts Any use of a discretionary trust in Oklahoma under the UTC could be met with an unfortunate result. These trusts would most likely flee Oklahoma in the event the UTC was passed. One of the major trust companies that had previously indicated support for the UTC naturally withdrew support for the UTC once the validity of this issue was brought to their attention.

B. Due to the notice requirements and the state attorney general being designated as a qualified beneficiary, it appears some charities were greatly concerned regarding being eliminated as possible remainder beneficiaries. A University's head person for charitable giving personally expressed his concern to me regarding this issue.

C. It appeared the UTC could not be easily corrected by amendment. This is because the comments to the UTC made references to the Restatement (Third) of Trusts for interpretation. Many key parts of the Restatement (Third) of Trusts do not reflect existing Oklahoma law. In fact, it appears that in some areas the Restatement (Third) of Trusts was creating new trust law.

D. The UTC was to be applied to all trusts -- both old and new. This would require amendment of all of the old revocable trusts and possibly many irrevocable trusts. The head person for charitable giving previously mentioned was also from one of the major churches. He felt that it was morally wrong to pass a law that required the public to have to incur attorney fees a second time for no apparent reason other than to generate fees for attorneys.

E. There are apparently unaddressed tax problems in the UTC. The most simple to identify is whether a client may create an irrevocable trust, and without a court order modify, revoke, or terminate the trust with the consent of all of the beneficiaries? Whether this is an estate tax inclusion issue does not depend on Strangi. Leaving Strangi out of the equation, the analysis is dependent only on IRC 2036 and IRC 2038. Oklahoma law currently requires a court order to modify a trust. Rather, than receiving an analysis that addressed the IRC 2036 and 2038 issues, all I received was a Strangi analysis. As I indicated, it appears the possible estate inclusion issues are present regardless of whether Strangi remains law or is reversed.

F. Inter Vivos powers of appointment were to be treated as the equivalent of ownership under the UTC. In other words, any creditor could attach an inter vivos general power of appointment and reach the underlying trust assets. To some estate planners this was a major problem, because they had older marital trusts as well as some new ones that used a general power of appointment marital trust. Other estate planners had non-exempt dynasty trusts that naturally gave the beneficiary a general power of appointment.

G. Some estate planners also expressed concerns that Spendthrift protection was being reduced. The concern seems to generate from the UTCs referencing into the Restatement (Third) of Trusts and the discussion on spendthrift protection. It is obvious the Restatement (Third) of Trusts view of spendthrift protection is opposite that of most clients and estate planners.

H. It appeared that the UTC would escalate claims against trusts in the domestic relations context.

I. Finally, the UTC seemed to give judges broad powers to rewrite trust through encouraging public policy exceptions. One must realize that estate planners represent the client/settlor. One of the last things any client wants to hear is that a judge can rewrite his wishes based on whatever a judge self proclaims is public policy.

Much thanks go to a cast of professionals working behind the scenes to monitor and raise awareness of the UTC. Special recognition should be extended to Jerry Balentine for his efforts.

Best regards,

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February 6, 2004

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Re: Arizona's Uniform Trust Code

Dear Mark:

It was a pleasure to speak with you regarding Arizona's major concerns with the entire Uniform Trust Code. Unfortunately, our state bar did not disseminate the Uniform Trust Code to the estate planning community until after it had virtually become law. Further, upon recommendation of the National Uniform Commissioners and the Arizona Bar, the Arizona legislature almost unanimously adopted the Uniform Trust Code without modification. Now it appears the Arizona UTC will be repealed in its entirety.

Unfortunately, the UTC contradicts much of Arizona trust law. In this respect, the UTC is not a restatement of trust law at all; **it is a completely new and untested approach to trust law.** Currently, I have been speaking with members of the advisory committees regarding this Act as well as counseling a few banks and trust companies on the concerns involved. **Unfortunately, the estate planning community's concerns with the UTC is the substance of most of the statute.** Due to time constraints, I will address the overall concern with the entire UTC statute in four major classifications:

A. Disclosure of Financial Information

The UTC imposes certain notification and financial disclosure requirements by trustees to qualified beneficiaries. It even provides that the Attorney General is a qualified beneficiary and may merely request the disclosure of this private financial information. These notification and financial disclosure issues appear to apply even to revocable trusts. This was the first wave of the public response to the UTC.

B. Wealth Preservation and the Discretionary Trust

Most advanced estate planners use the discretionary dynasty trust to pass wealth from generation to generation. The UTC effectively eliminates most of the benefits of using this type of an estate planning vehicle. Unfortunately, as we have discussed in the past, these clients will merely move these trusts out of Arizona; most likely to states like Alaska, Delaware, Nevada, Rhode Island, or Utah. Other trusts, such as special needs trusts, also rely on the discretionary trust distinction that was developed at common law. Many of these trusts may also flee from a UTC state.

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C. Tax Problems

Apparently, the UTC was not fully analyzed regarding the possible estate tax inclusion issues under IRC §2036 and §2041. These are tax areas where, if there is an estate inclusion issue, the entire estate plan fails. These possible tax issues would apply to any Arizona trust created both before and after the UTC was adopted. Both those for and against the UTC have presented strong arguments for and against estate tax inclusion. The problem is that if leading professionals from both sides strongly disagree on the issue, there definitely is a tax issue that needs to be resolved before adopting the UTC. In this respect, further guidance needs to be obtained from the Internal Revenue Service before a state should even begin to adopt such a controversial act.

D. Flight of Arizona Trusts and Capital

As you know, in December of last year, I had advised clients of the major changes with the Uniform Trust Code and some of my concerns with the legislation. Almost all of my clients were concerned and authorized me to help them move their trusts out of Arizona. Fortunately, our legislators started to question the legislation that was supposed to be enacted on January 1, 2004 and the Governor called an emergency session to suspend implementation of the UTC for two years. Therefore, I did not need to deal with adverse UTC legislation and move trust administration and assets out of the State of Arizona.

Even more alarming regarding the flight of Arizona trusts and capital was when **I was asked by an attorney for a large multi-state bank if I would assist their clients in creating trusts outside of Arizona or changing the situs of the trusts from Arizona to other states.** This large multi-state bank had concerns dealing with trust administration in Arizona and the more onerous requirements imposed on trustees. They knew that I had active licenses and offices in both Arizona and Illinois. Since the multi-state bank had offices in Illinois as well, they indicated that they preferred to have all irrevocable trusts with a situs in Illinois instead of in Arizona. This should avoid most, if not all, of the UTC concerns that we have discussed.

Originally, it was thought that the UTC was possibly salvageable by wholesale amendments to the pure version of the UTC. For example, HB 2020 was introduced earlier this year in January to begin the amendment process. It is twenty-nine pages long. Unfortunately, it did not even begin to deal with the financial disclosure issues as well as the discretionary trust issues. It was originally thought that one or even two more massive amendments to the UTC would be needed. Most likely, this would be another fifty pages of amendments to the statute.

Fortunately, after hearing from quite a few lead estate planning professionals and concerned financial institutions, the Senate Finance Committee has realized that making close to eighty pages of amendments to a statute that is not even one hundred pages long is not a particularly wise move. Therefore, the Senate Finance Committee voted 6 to 0 to repeal the UTC in its entirety.

It is true that some still believe that the UTC may be salvaged through massive amendments. However, it appears that the vast majority of informed estate planners have come to the conclusion that the UTC is such a fundamental difference from current trust law, it is not salvageable.

I hope you and the State of Colorado have better sense than they did in Arizona when the legislators blindly approved a Uniform Act.

Sincerely,

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RE: Arizona's Uniform Trust Code

Dear Mark:

Thank you for your inquiry regarding the problems that we are experiencing with the Arizona Uniform Trust Code. As you well know, the Arizona legislature originally adopted the pure UTC, almost without any modification. **The result was an incredible public out cry for complete repeal of the bill.** As I understand it, Colorado is about to also adopt an almost pure version of the UTC.

I am on one of the attorneys advising Arizona legislators about the statute. Unfortunately, I as well as most estate planners had not read the UTC at the time it was passed to realize that it was diametrically opposed to over five hundred years of trust law. After the public outcry as well as many estate planners reading the UTC to see what it really said, a grass roots movement has developed for complete repeal of the bill.

In this respect, it is true that the Senate Finance Committee as voted 6-0 to repeal the act in its entirety. The House has proposed a bill for amendment of the UTC which is 29 pages. The House's proposed amendments are almost 1/3 of the original pure UTC. Unfortunately, our present view in advising the Senate committee is that the entire structure of the UTC is flawed. We do not think the 29 pages of amendments even begin to address the numerous flaws in the UTC.

Specifically, some of the major concerns are as follows:

1. The UTC eliminates the common law distinction of a discretionary trust. This is an incredible change to hundreds of years of trust law. It is not the quote "modern" view as proposed by the UTC proponents.

   Many high end estate planners use these types of trusts for transferring wealth to future generations. **Most of these clients will most likely move their trusts and assets out of Arizona to non-UTC states.** These clients simply do not have to put up with poor legislation, and they can easily move their assets to states that have adopted progressive trust statutes such as: Delaware, Alaska, Nevada, Rhode Island, or Utah.

2. The UTC invades the privacy of many clients with its notice and disclosure requirements. Most clients simply will not tolerate this, and many of these trusts will also consider moving their trust assets out of Arizona.

3. **The UTC even affects charitable remainder beneficiaries.** As noted above, most clients are outraged regarding the disclosure of trust assets to charitable remainder beneficiaries. In this respect, they are asking attorneys to eliminate charitable remainder beneficiaries from their trusts (or removing Arizona charities from their trusts and move the trust out of Arizona). Therefore, charities in UTC states will also suffer greatly from the UTC.

4. Unfortunately, it appears the UTC has been drafted with the intent to greatly increase litigation in an area of law where there has been very little litigation. In this respect, society is being asked to pay the cost of litigation for an area where there is no identified problem.

I wish I had more time to write you regarding all of the specific areas of concern with the UTC. However, let me say, the UTC flies so fundamentally in the face of current trust law of all states, I do not think 29 pages or even 50 to 100 pages of amendments to the statue could save it. In this respect, at this point in time, I think the most likely result will be complete repeal of the UTC by the Arizona legislature.

Very Truly Yours

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David J. Harowitz

Colorado

Colorado

Re: Why The UTC Failed In Colorado

To whom it may concern:

The reasons why so many estate planners opposed the UTC and many of the reasons why the UTC failed in the Colorado Senate were as follows:

1. The UTC reverses over one hundred and twenty five years of the common law discretionary/support trust dichotomy, which many estate planners rely on for traditional asset protection purposes. In other words, discretionary trusts would now rely solely on spendthrift protection, and the related exception creditors would be able to attach a beneficial interest in a discretionary trust. This is a monumental change from common law. Prior to the UTC's newly invented law, attachment of a discretionary beneficial interest by a creditor was virtually unheard of.

   This would greatly affect the planning with third party special needs trusts and the wealth preservation (i.e., the mega trusts and beneficiary controlled trusts) which relies on the discretionary/support dichotomy. Some estate planners have noted that the UTC is the **"beginning of the end" for third party special needs trusts.** This is because the UTC completes the first (and most important) of two steps for the government to recover against a discretionary trust – elimination of the difference between discretionary/support dichotomy. Once the UTC completes step one, it is only a matter of time before either the federal and/or state governments pass a statute where the government would enable governmental agencies to reach the assets of a third party special needs trust.

2. The UTC appears to be merely a skeleton statute. There are over 100 specific references in the UTC comments to the Third Restatement. There is also a general reference in the comment under Section 106 of the UTC, which implies that the Third Restatement will have priority in interpretation over common law.

3. Both the UTC and Third Restatement allow for a judge to completely void a trust or rewrite it under a public policy exception. The UTC merely mentions "public policy," but the Third Restatement gives little guidance regarding the degree of latitude a judge has under this section. Rather Section 29, Comment i, states . . . "simple and precise rules of validity and invalidity frequently cannot be stated." Does this and other extremely lose language in the Third Restatement give a judge close to a "blank check" when making a public policy exception?

4. Many have noted how the Third Restatement takes a "third world," "socialistic," or "parental view" of trust law. In fact, the introduction to the Third Restatement says:

> The principles restated in these volumes have two main themes. One is to make it easier to accomplish the settlor's intentions, so long as those intentions may 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 [i.e., beneficiaries] – **especially judges** – to adapt the settlor's express purposes **to contemporary standards.**

For over four hundred years, trust law has been based on the settlor's being able to transfer his or her property subject to whatever restrictions he or she wished to impose. While there were some exceptions to this rule (e.g., in areas of marriage and possibly career choices), the settlor's intent was primary. The Third Restatement of Trusts is the first time in trust history where the Restatement tends to focus on beneficiaries challenging trusts through litigation as well as the large expansion of the imposition of societal values from a judge's view of contemporary standards.

5. As noted above, "judges" will have greater in deciding issues revolving trusts. What must happen before a judge would be called on to make a decision - **litigation?** In this respect, many estate planners are concerned about the expected great rise in litigation with trusts, an area that historically has had little litigation.

6. Colorado has a notice statute and case law interpreting it. There was some flexibility with working with this statute. Many Colorado estate planners had strong disagreement with the mandatory notice and financial disclosure requirements, regardless of the settlor's intent. This appears to be a concern expressed by estate planners and clients on a national level, as well in a recent article published in Trusts & Estates, *The Quiet Trust.*

7. The rights of charitable remainder beneficiaries to notice and more particularly the financial information has been a concern for both clients and charities. Many clients are greatly offended if a charity asks for financial information long before the charity is to receive its respective share. In this respect, some clients have looked at removing charitable remainder beneficiaries that make such a request. Also, many charities are concerned because they think they are obligated to request such information to properly report the charities' financial information.

8. How much the UTC expands trusts to litigation in divorce is also a hot topic. In many, if not most states, most beneficial interests in a trust were not considered either marital property or a factor in equity to be used in dividing marital property. This is particularly true in the case of a discretionary trust. Unfortunately, again the UTC to gives a judge a blank check in deciding whether a discretionary

interest is a property interest and how it should be valued either as marital property or as a factor for the equitable division of the marital property.

9. In response to these drastic changes to the common law, many estate planners would need to advise clients of their options in more favorable trust jurisdictions (i.e., any Non-UTC state). It was anticipated that many high net worth trusts as well as the underlying liquid assets would simply move out of Colorado. This would have an effect on Colorado state income tax revenue on these trusts, a loss of trust business to Colorado, as well as possibly an economic multiplier effect due to the lost investment capital.

10. For some reason, the UTC supporters seemed to think that it was critical to quickly pass the UTC. However, there was no perceived public problem that was being addressed by the UTC. There was no public outcry for this legislation. It was as if legislation was being proposed for a harm that did not exist. Many estate planners wondered why legislation of the UTC could not be postponed until the estate planning community had time to discuss the issues.

11. There are unresolved estate tax inclusion issues with the Uniform Trust Code. For example, under IRC §2036(a)(2) and IRC §2038, can a statute allow for an irrevocable trust in essence to be revocable? In other words, under UTC §411 may the settlor and all of the beneficiaries, <u>without court approval</u>, modify, amend, alter, or terminate an irrevocable trust? From an estate planning perspective, I like the idea. However, from a tax perspective, this may result in an estate tax inclusion issue. This is particularly the case if the beneficiaries are minors and the Settlor may represent the minors under the virtual representation provisions of UTC §303(6). This analysis was presented by Susan Smith and Les Raatz. There is a reply by a Professor Dodge. Unfortunately, Professor Dodge's reply does not address the virtual representation issues, many disagree with his equating of IRC §2036 and §2038, the memo only discussed termination as addressed by the *Hemholtz* case (i.e., it omits "modifying, altering, or revoking" a trust). Further, there appears to be such controversy over this estate tax inclusion issue that apparently Jonathan Blattmachr as well as the Estate and Gift Tax Committee of the American College of Trust and Estate Council are considering requesting a ruling from the Service. **It should be noted that this estate tax inclusion issue is <u>completely independent</u> of whether or not *Strangi* is reversed or affirmed on appeal**.

The upside if the UTC proponents are correct, we can all now begin to draft **"revocable–irrevocable trusts."** In other words, all a settlor/client need do to retrieve the gifted assets from an irrevocable trust is to get all the beneficiaries to agree to revoke it without a court order pursuant to UTC §411(a). Since in most cases, family members would most likely work in harmony, the **"revocable-irrevocable trust"** could become one of the most popular estate planning tools: heads the settlor/client wins because the property is out of the settlor's estate or tails Internal Revenue Service loses because the settlor/client (assuming family

harmony) can get the property back whenever her or she needs it. The downside if the tax opponents of the UTC are correct is an estate inclusion issue for settlor's who die in a state that have enacted the UTC. Regardless, who is correct on this issue, there is no urgent reason to pass the UTC before the tax issues are settled.

12. Some of the Colorado senators were wondering why the Uniform Trust Code was in the process of being completely repealed in Arizona – less than one year after it had been almost unanimously voted to be enacted.

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In summary, many of the estate planners who opposed the UTC, were hopeful that amendment of the UTC was possible. Unfortunately, due to the UTC's drastic changes to many areas of Colorado's common law compounded by the incredible amount of referencing into the Third Restatement, it was highly questionable whether even wholesale amendments to the UTC could salvage it. Eventually, similar to the majority of estate planning attorneys in Arizona, much of the Arizona public, and the almost unanimous vote of the Arizonal legislators, we came to the same conclusion: even wholesale amendments most likely could not save the UTC. For these reasons, the estate planning attorneys as well as the general public opposed the UTC and it was defeated in the Colorado senate.

Respectfully,

Mark Merric