The Uniform Trust Code

Is Arizona's Nightmare About to Become Yours?

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In addition to being a national speaker, Mark Merric is a co-author Commerce Clearing House's (i.e., "CCH") treatise, The Asset Protection Planning Guide: A State-of-the-Art Approach to Integrated Estate Planning. He has also written many articles regarding offshore and domestic trusts, the U.S. taxation of foreign mutual funds, international tax planning, and domestic estate planning.

Any Non-UTC State
Will Generally Have More Favorable Trust Law Than a UTC State

① Many larger trusts and the underlying assets will simply move out of Colorado

② Invasion of Privacy Issues

③ Fewer Colorado Charities Named as Beneficiaries

④ Maximizing Divorce Attorney Fees

⑤ Who Pays For Kicking the Gift Horse?

⑥ The UTC is a Regressive Statute

⑦ Winners and Losers

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SUMMARY PAGE

The UTC makes fundamental changes to over four hundred years of well established trust law. ***The end result is that any non-UTC state will almost always have more favorable trust law than a UTC state.***

1. Larger trusts (those with $2 million in assets and more) simply do not have to put up with such a controversial trust act, and these trusts may easily move the trust and the underlying liquid assets out of Colorado.
2. The UTC requires disclosure of certain private financial trust information to remainder beneficiaries (who usually have no right to any trust assets for many years to come). This invasion of privacy will have many clients who have created trusts consider moving even the smaller trusts out of Colorado.
3. Many times a charity is named as a remainder beneficiary of a trust. Under the UTC, a charity would have the right to financial information regarding the trust many years before the charity is entitled to any share of the trust property. Most clients will not put up with this invasion of privacy. Therefore, many Colorado charities will be eliminated as remainder beneficiaries.
4. Believe it or not under Colorado law, for many types of irrevocable trusts that you as a parent create for your children, an estranged spouse of your child may subpoena your trust and documents into your child's divorce proceeding. The UTC expands the ability of estranged spouses to litigate against virtually all irrevocable trusts that you may create for your children. *Remember most revocable trusts as well as many wills become irrevocable trusts on your death.*
5. The UTC will significantly increase litigation in an area where historically there has been little litigation, adding a much greater burden on the court systems.
6. The UTC is modeled after the regressive California Trust (Probate) Code, which is a state known as one of the top three (if not the top one) for its litigious nature.

A Lesson From Arizona

- Ø Arizona adopted an almost pure UTC statute
- Ø The UTC was originally passed almost unanimously by the Arizona legislature
- Ø The public outcry has been so great:
  - One House committee has approved a 29 page amendment **(over 1/3 of the entire UTC)**
  - The Senate Finance Committee Voted 6-0 to repeal the UTC in its entirety.
  - February 23, 2004, the Senate voted 25 to 3 for complete repeal
- Ø The flaws in the Arizona statute are at the heart of the pure UTC
- Ø To date, only five smaller states and Washington, D.C. have passed the UTC, most major states have killed the UTC.

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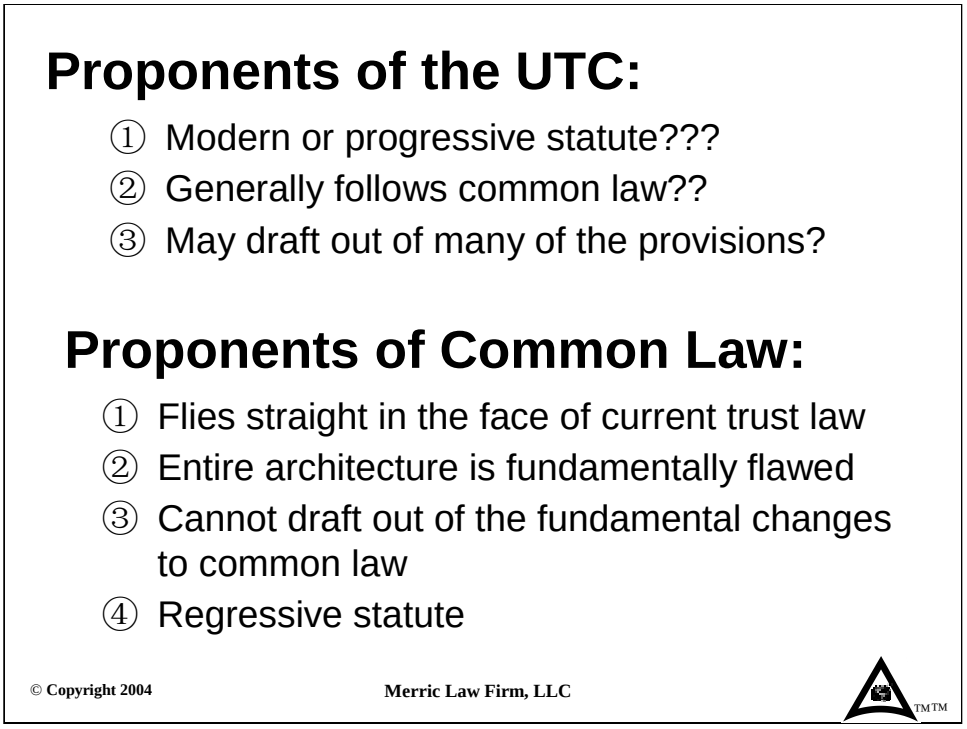
A LESSON TO BE LEARNED FROM ARIZONA

Arizona adopted an almost pure version of the UTC. In other words, Arizona made very few departures from the model UTC statute. The Colorado statute is also an almost pure version of the UTC. When estate planners have voiced concerns with the Colorado UTC, they have generally been informed that no changes can be made in order to keep uniformity with the statute.

The Arizona legislature passed the UTC almost unanimously. Then someone read and began to understand what the UTC actually said. The result was a public outcry that began by complaints to Arizona senators and representatives and spread to talk radio. The Arizona statute was passed in May of 2003. In December of 2003, the public outcry was so loud a special legislative session passed a two year moratorium preventing the implementation of the statute. One of the Arizona House committee's has approved a first amendment which is 29 pages long. But one must remember that this amendment is literally over 1/3 the size of the original UTC. On February 3, 2004, the Senate Finance Committee voted to repeal the UTC in its entirety.

To date only five smaller states (by population) have passed the UTC: Arizona, Kansas, Nebraska, New Mexico, and Wyoming. On the other hand, the following states have killed the bill:

a. Connecticut defeated the bill in both 2002 and 2003;
b. Colorado defeated the bill in 2003 **due to a $1 million fiscal note** & Colorado defeated the bill in the Senate in 2004;
c. Maine's legislature introduced the bill in 2003. However, it became a legislative study as opposed to a Maine bar association study;
d. Oklahoma killed the bill in 2002;
e. West Virginia killed the bill in 2002; and
f. Utah killed the bill in 2003.



UNIFORM TRUST CODE COMPARED TO COMMON LAW

I. Proponents of the UTC

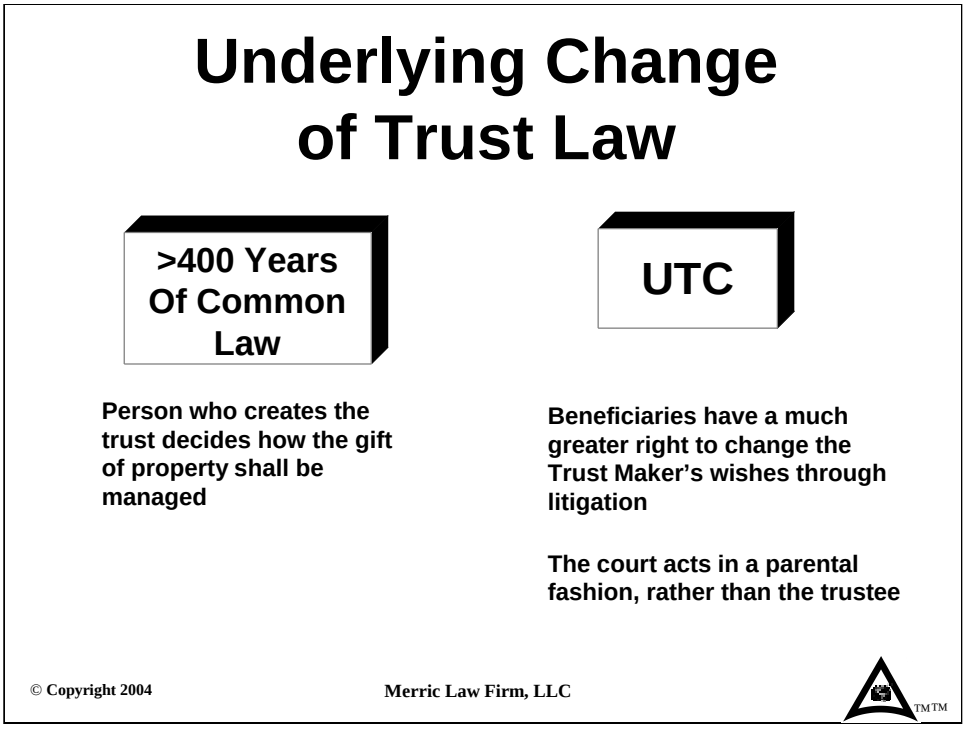
Proponents of the UTC have self-proclaimed that the UTC is the progressive and modern view of trust law. They have also said the UTC generally follows common law, and that many areas of the UTC are optional depending on the drafters preferences. Some proponents of the UTC have admitted that there is some dispute over the notification requirements.

II. Proponents of the Common Law

Proponents of the common law have noted that the UTC, "flies straight in the face of historical trust law" (i.e., the common law of most states).* In fact, the architecture of the UTC is fundamentally built on major assumptions that directly contradict current law. In this respect, proponents of common law also note that *there is no way to draft around these fundamental changes– other than to advise many of their clients to move their trusts and the underlying assets out of UTC states.*

Finally, many proponents of the common law have noted that the UTC is not progressive, it is regressive. Many parts of the UTC are modeled after the California Trust Code, which no state has ever decided to adopt on its own. On the other hand, many proponents of the common law look to the trust laws of Alaska, Delaware, Nevada, Rhode Island and Utah as being the progressive trust statutes. All of these trust statutes have been enacted since 1997.

* This quotation by David Harowitz was reprinted with permission. It reflects the views of numerous estate planning attorneys.



UNDERLYING PHILOSPHICAL CHANGE IN TRUST LAW

I Common Law

The common law of trusts is built on the theory that a person may make a gift subject to almost whatever terms he or she may wish. The recipient of the gift has the choice to accept or reject the gift, pursuant to any restrictions.

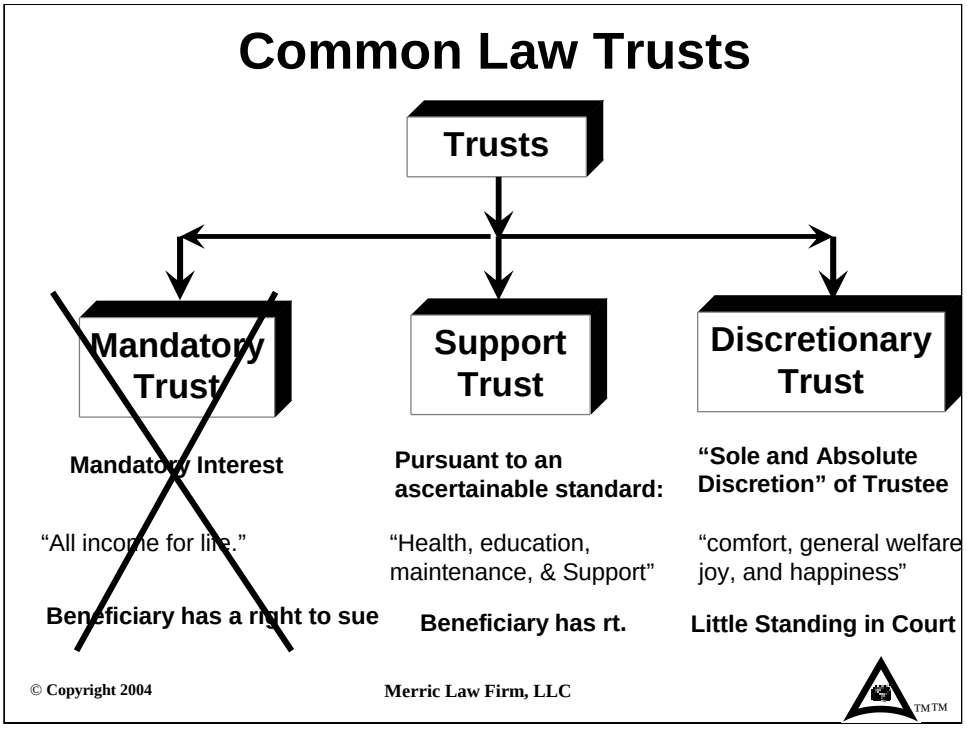
II Uniform Trust Code

The UTC is built on the assumption that the judiciary should assume a "parental" type of a role over <u>all</u> trusts by reviewing a trustee's discretion in making distributions. While for support trusts (defined in the next couple of pages) this has always been the case. Under common law, the same is not true for a "discretionary" trust (defined in the next couple of pages). In this respect, proponents of the common law note that the UTC rewrites 400 years of trust law in this area, allowing discretionary beneficiaries a much greater right to change and challenge the trust maker's wishes through litigation. Further, such a change in trust philosophy directly contradicts that the trust maker (i.e., the client) may make a gift of property subject to whatever restrictions he or she may wish to impose.

Finally, as discussed later in this outline, much more judicial resources in each state will be needed for the judiciary to assume this supervisory "parental function." Paradoxically, discretionary beneficiaries suing trustees has been an area where there has been little trust litigation.

III Background Before Discussion of First Major Item

In order to understand the fundamental change in philosophy under the UTC, one must first understand the primary types of trusts (i.e., by distribution standard) under common law: (1) mandatory distribution trust; (2) distributions pursuant to an ascertainable standard; and (3) a discretionary distribution standard.



COMMON LAW TRUSTS

Under the common law, there are three primary types of trusts as related to the rights of a beneficiary: (1) mandatory distribution trust; (2) support trust; (3) discretionary trust.

I. Mandatory Trust

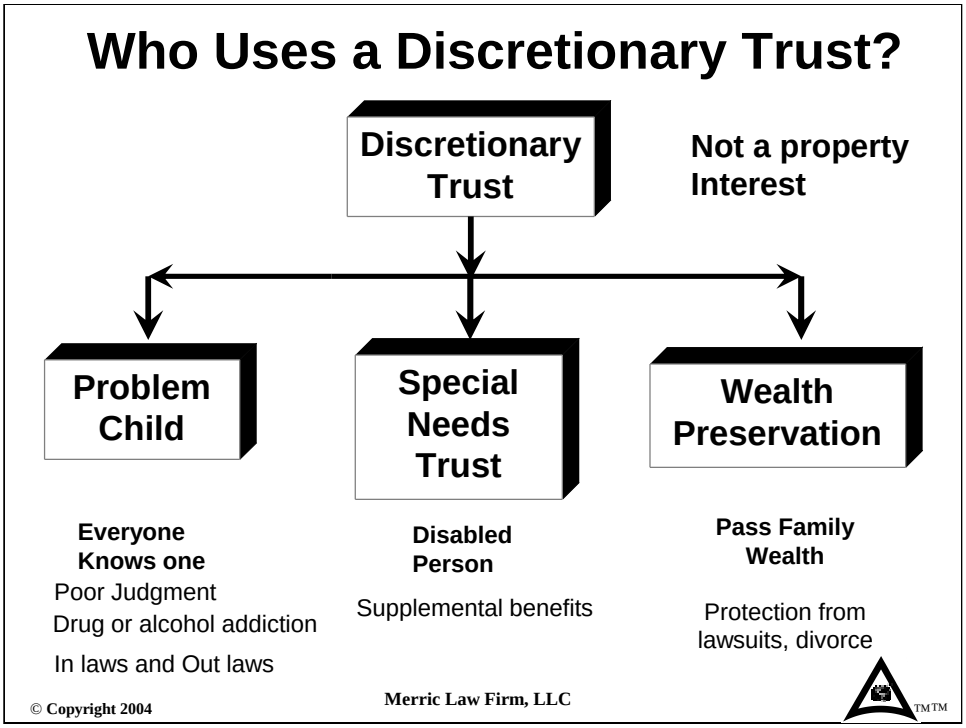
With a mandatory distribution trust, distributions must be made to the beneficiary. The trustee has no discretion whether or not to make a distribution. For example, with a marital trust, "all income must be distributed at least annually to the surviving spouse."

II. Support Trust

With a support trust, the trustee must make distributions pursuant to an "ascertainable standard." An ascertainable distribution standard (i.e., external standard or reasonably definite standard) is a standard which may be interpreted by a court such as health, education, support or maintenance. Health, in most cases, is easy for a court to determine whether a beneficiary is sick or not sick. The same is true for education, most college types of education would qualify as a proper distribution from a trust. Generally, maintenance and support are determined by reference to the beneficiary's current standard of living. Should a trustee not make distributions pursuant to the ascertainable standard, a beneficiary has a right to sue a trustee for a distribution.

III. Discretionary Trust

With a purely discretionary trust, a beneficiary has little ability to sue a trustee for a distribution, because the trustee may make distributions in the trustee's "sole and absolute" discretion. Most of the time, pursuant to the Second Restatement of Trusts, a discretionary trust will include a standard that cannot be interpreted by a court. For example, the trustee may, in the trustee's sole and absolute discretion, make distributions for the beneficiary's health, education, support, maintenance, general welfare, comfort, joy, and happiness.



DISCRETIONARY TRUSTS

Discretionary trusts are primarily used for the following three purposes:

I. Problem Child or Child With a Problematic Spouse

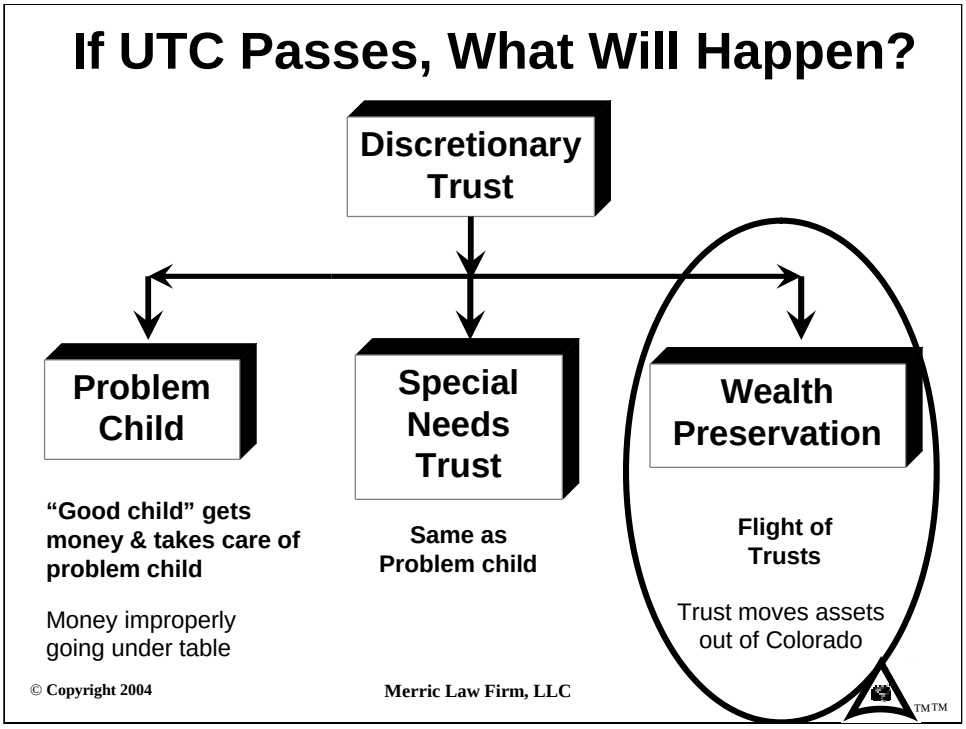
Unfortunately, many families (maybe every other family) has a child where the parent does not trust the child's decisions. This is true even though the child in many cases has grown to be an adult. In these cases, the parent typically will transfer this child's inheritance in trust. The trustee will be a close friend or relative that the settlor (i.e., parent) has the utmost confidence to make the "hard" decisions. The client's trusted friend, financial advisor, or relative is willing to accept the "thankless" trustee position and make the hard decisions, because the beneficiary has few rights to sue the trustee in court. (If the client [i.e., trust makor] had wanted the trust makor to have greater rights to sue the trustee, the client would have created a support trust.) Sometimes, it is not the child with the problem, rather the child's spouse is considered an "outlaw" instead of an "in law" by the family. In this case, a discretionary trust may again be used as part of the planning process.

II. Special Needs Trust

A special needs trust is generally created by a parent for a person who is incapacitated: either physically or mentally. The parent wishes to restrict the gift to provide for benefits that are not covered by a governmental agency. Since a discretionary trust is not a "property interest," a governmental agency cannot reach the assets in the trust. These trusts are generally not large trusts.

III. Wealth Preservation

These trusts tend to be the larger dollar trusts (usually greater than $1 million in assets). For families of wealth, these trusts are the preferred option of choice. Frequently, national speakers discuss these trusts under the names of the "mega trust," "the beneficiary controlled trust," the "intentionally defective beneficiary controlled trust," "the dynasty trust," the "beneficiary controlled trust," and the "discretionary dynasty trust."



IF UTC PASSES, WHAT WILL HAPPEN?

When abolishing over 400 years of common law in the discretionary trust area, the UTC in essence destroys the previous benefits for people who used discretionary trust planning.

I. Problem Child

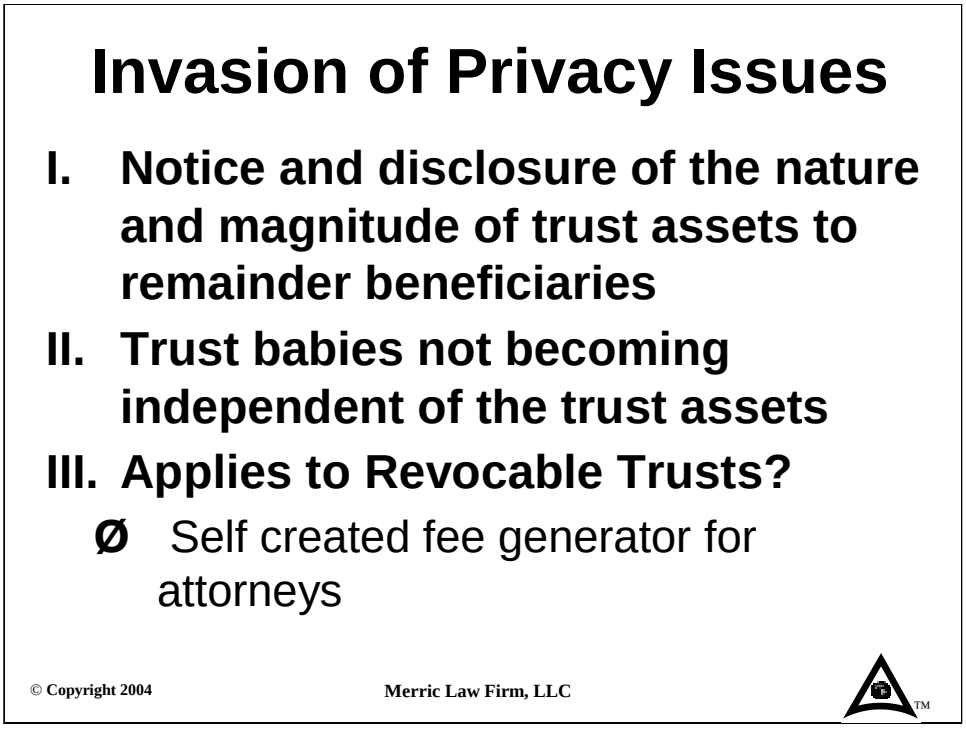
Clients (i.e., trust makors) who create a discretionary trust for a problem child almost always appoint a trusted friend, financial advisor, or relative as the trustee. The client wishes for the trustee to have the same philosophy about life that the client has. The client needs the trustee to make those hard "no distribution decisions" when the beneficiary does not act responsibly. For this reason, seldom is a bank or trust company ever appointed as trustee in this situation. Most of these trusts have less than $1 million of assets. Therefore, in the event the UTC passes, many parents will no longer create trusts for their problem child. Rather, they will leave the money to the other child, and have the other child make gifts, most likely "under the table."

II. Special Needs Trust

The fundamental asset protection provided by many types of special needs trusts is based on the historical discretionary trust. Therefore, in the long run, the UTC also strikes at the heart of these trusts. Since these trusts typically also have assets less than $1 million dollars, the most likely solution will be the same as the problem child – money will be gifted to another child, and the other child will take care of the special needs person – again most likely under the table.

III. Wealth Preservation

These trusts tend to be the larger dollar trusts. Due to the size of these trusts (i.e., usually greater than $1 million of assets), many, if not most, of these trusts will move out of UTC states. These clients simply do not have to put up with poor trust legislation. Unfortunately, not only will the trust move out of Colorado, but all of the underlying liquid assets (i.e., cash and securities) will move out of Colorado.



INVASION OF PRIVACY ISSUES

Most clients do not want a beneficiary to know the nature or the magnitude of the trust assets until it is time for such beneficiary to share in the trust assets. In this respect, there are generally two types of beneficiaries: (1) current beneficiaries (those who may receive a distribution currently) and (2) remainder beneficiaries. Regardless of the situation, the UTC requires disclosure to all qualified beneficiaries.

I Current Colorado Statute

Unlike many other states, Colorado currently has a notice statute. However, under Colorado law, notice to remainder beneficiaries does not appear to be absolutely required. Further, the Colorado statute does not require absolute disclosure of the nature of the trust assets, rather the beneficiary's request must be reasonable.

II The UTC Supports Trust Babies Being Dependent

Most, if not all clients (i.e., trust makors), wish for their children to become financially independent - regardless of the trust assets. In other words, clients do not wish for their children to depend on the trust assets for their future. In this respect, most clients do not wish for children to know the size or magnitude of the trust assets, until the client feels that the time is appropriate. The current Colorado statute provides for this flexibility. The UTC defeats client (i.e., trust makor's) wishes in this respect, and *for irrevocable trusts there is no method to opt out of this provision.*

III Revocable Trusts

Unfortunately, the UTC has such confusing language in this area, many planners are taking the position that the notice and financial disclosure provisions also apply to revocable trusts. In this case, clients are now forced to incur unnecessary additional attorney fees to amend revocable trusts to draft out of this provision.

Fewer Colorado Charities Will be Named as Remainder Beneficiaries

- Financial information provided to remainder charitable beneficiaries?
- Colorado Attorney General is a qualified beneficiary?
- Moving the charitable trust and assets out of Colorado
- Removing Colorado Charities as beneficiaries

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FEWER ASSETS LEFT TO COLORADO CHARITIES

I Financial Information

As noted on the previous page, the UTC requires notice to all qualified beneficiaries, which includes any remainder beneficiary. This is true even for charitable remainder beneficiaries. *This also means that a charity that may have no current interest in the trust for ten, twenty, or even thirty years would have access to the financial information.* David Harowitz, an attorney from Arizona, has already reported of clients eliminating testamentary charitable beneficiaries when they learned that charities could receive the financial information from the trust.

II State Attorney General is a Qualified Beneficiary

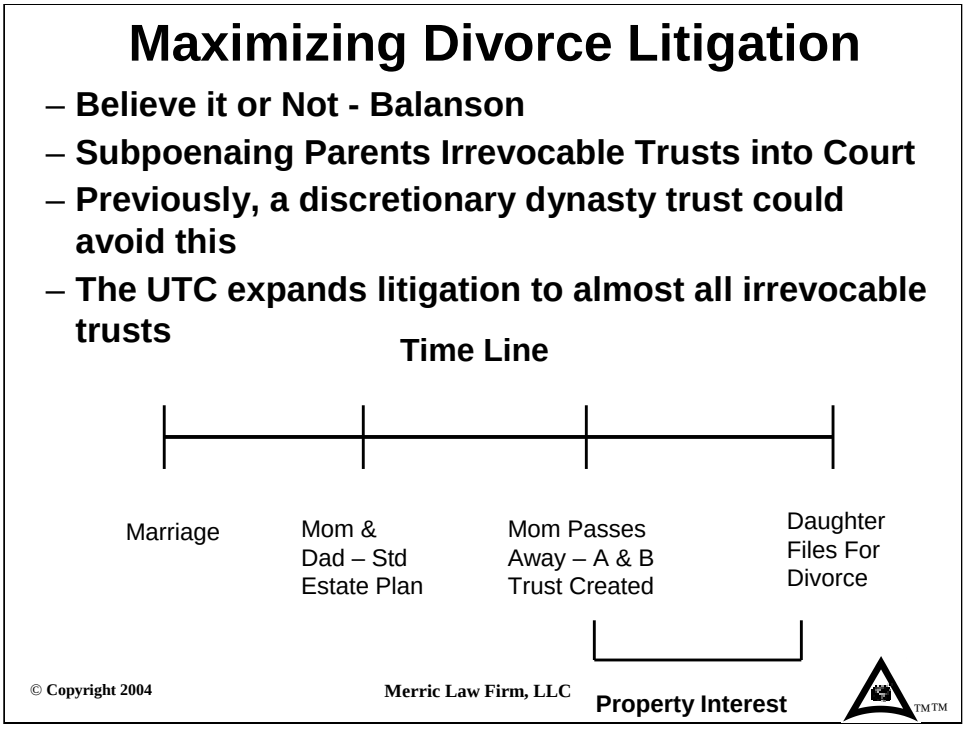
Under the UTC, the state attorney general becomes a qualified beneficiary entitled to merely request the financial information from the trust. Most clients have extreme concerns with giving the government blanket authority to inquire into their or the trust's financial matters, particularly without a court order.

III Moving Charitable Trusts and Assets Out of Colorado

Again, the most viable solution to the UTC is to move both the charitable trust and the underlying assets out of Colorado to a non-UTC state.

IV Removing Colorado Charities as Beneficiaries

Unfortunately, the long arm jurisdictional clause of the UTC is so broad, the mere presence of a charitable beneficiary in Colorado could possibly give Colorado jurisdiction over a charitable trust that left Colorado. Therefore, in many cases, once the charitable trust and underlying assets are moved out of Colorado, removing Colorado charities as a beneficiary would also be considered as part of the planning process.



MAXIMIZING DIVORCE LITIGATION

I Believe it or Not - Balanson

Mom passes away and creates a trust for the benefit of Dad and her two children. Dad may well consume the trust assets before he dies. Daughter will receive nothing unless she outlives dad. Further, dad has a power to redirect the trust assets solely to the son. After Mom's death, during Dad's life, daughter files for divorce. *Held by the Colorado Supreme Court – any appreciation during the marriage on the trust assets was marital property subject for division in your child's divorce.*

II Subpoenaing Parents Irrevocable Trusts into Court

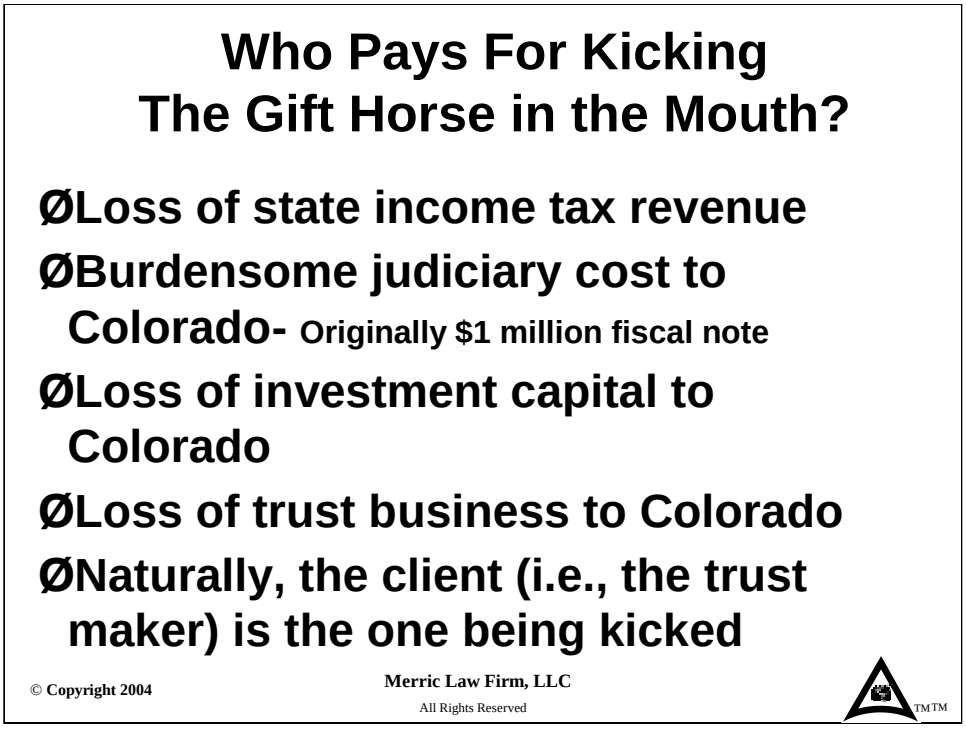
Now, under Colorado law, we have estranged son and daughters in law subpoenaing parents trust documents and the related financial information into divorce courts. Unfortunately, when the related Gorman problem was corrected by the Colorado legislature, the domestic relations attorneys objected to correcting this issue. Hence, members of the bar never even presented a solution to this problem.

III Discretionary Dynasty Trust

Even with Balanson not being corrected, a discretionary dynasty trust was not a property interest under Colorado law. Therefore, this type of trust would avoid being pulled into an estranged daughter or son in law's divorce.

IV UTC Expands Divorce Litigation to Discretionary Dynasty Trusts

Again, the UTC will result in more litigation in Colorado. Even thought a discretionary dynasty trust is not a property interest under state law, the UTC now lets a judge almost pull a number out of the air to determine what and how much of the property should be a property interest and what and how much of the property should be used to determine any alimony.



WHO PAYS FOR KICKING THE GIFT HORSE IN THE MOUTH?

I Loss of State Income Tax Revenue

As previously noted, most of the trusts that will be leaving Colorado will be trusts with assets greater than $1 million. Further, due to the design of these trusts, most of them are trusts that had previously paid Colorado income tax on the trust assets. Therefore, Colorado is looking at losing substantial income tax revenue due to the migration of trusts out of Colorado.

II Burdensome Cost to the Judiciary

The original Colorado UTC act had a $1 million fiscal note attached to it. For some reason it has been deleted. As noted in this outline, the UTC invites litigation in many areas. Most likely the litigation cost will continue to rise as more and more trial attorneys learn about the UTCs litigation opportunities.

III Loss of Investment Capital to Colorado

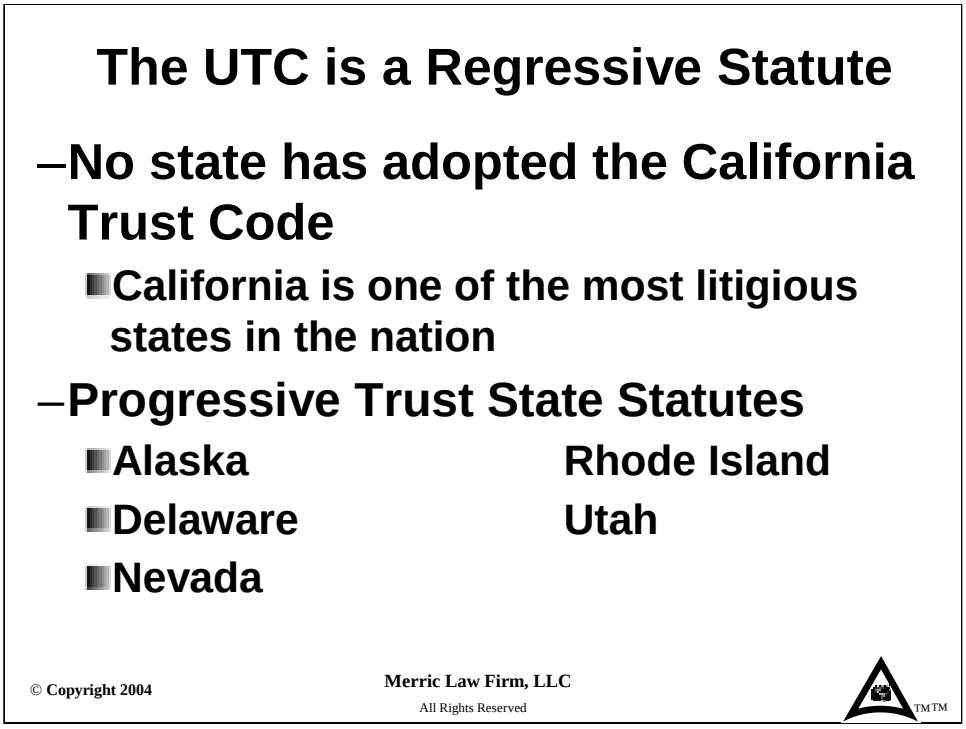
Naturally, when the trust moves the underlying investment capital out of Colorado, it will be invested in other states. This may well have an economic multiplier effect to the detriment of Colorado's economy.

IV Loss of Trust Business to Colorado Trust Companies

Multi-state trust companies are not worried about the UTC. So what if they move the trust assets from their Colorado bank to their Nevada bank. In fact, Robert Gillen, an Arizona and Illinois attorney was actually contacted by a multi-state bank in Arizona for this exact purpose. The Arizona branch did not want to meet the UTC's onerous administrative requirements. Therefore, the Arizona branch asked Robert Gillen to draft Illinois trusts and move Arizona trusts to the multi-states Illinois bank.

V The Client is the One Being Kicked

In all of this discussion regarding massive changes to basic trust law by the UTC, one must remember that it is the client's right to make a gift as she or he sees fit that is being challenged by the UTC.



THE UTC IS A REGRESSIVE TRUST STATUTE

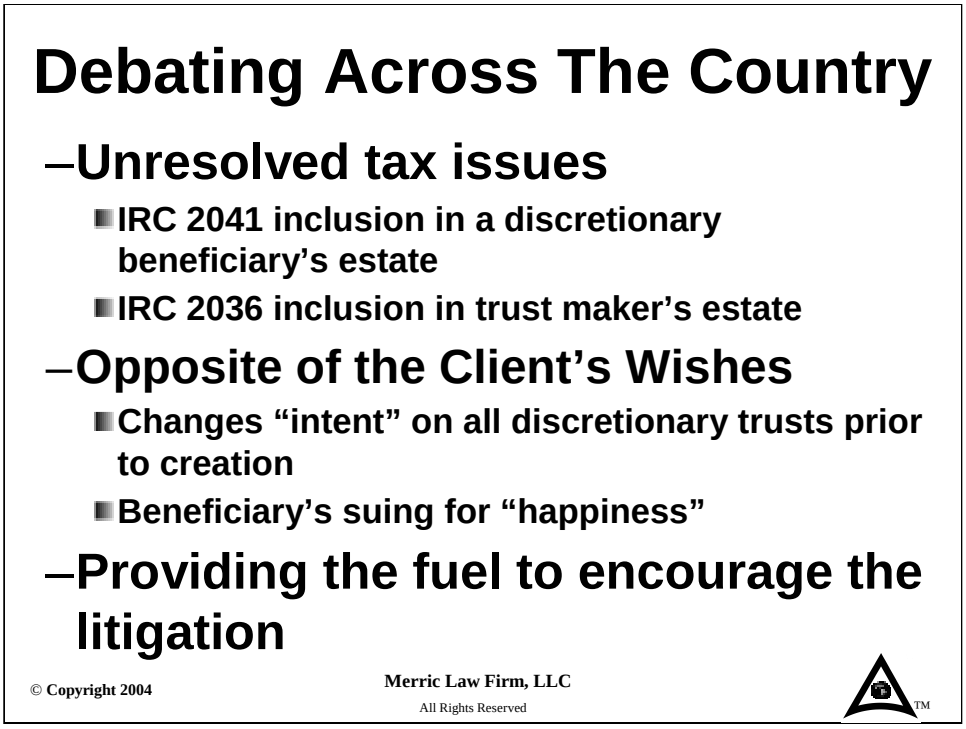
I Regressive Trust Statute

One prominent estate planner who directly wrote to every Colorado state senator stated:

> **"**It appears that large parts of the UTC were modeled after the California Trust Act [Probatee Code]. The California Trust Act has been around for some period of time, and no other state has decided to pass another act similar to it. Further, from the California WealthCounsel members, we generally do not hear any complimentary remarks regarding the California Trust Act. In this respect, I am questioning whether the UTC was modeled after a regressive trust statute.
>
> On the other hand, we constantly hear many complimentary remarks regarding the Alaska, Delaware, Nevada, Rhode Island, and Utah trust acts. These seem to be the progressive trust statutes that are attracting trust business to these states."

II Progressive Trust Statutes

Since 1997, the above five states have passed trust legislation that has been considered by most estate planning professionals to be progressive trust statutes. These states take the exact opposite approach to a trust code than the UTC. Rather, than intentionally drafting a statute that will require the judiciary to supervise in a parental role, these progressive trust statutes provide clear bright lines codifying the common law. These progressive trust statutes have also been designed to attract trust business to the state – instead of driving it out of the state.



DEBATING ACROSS THE COUNTRY

I Unresolved Tax Issues

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 estate plan fails all of the assets would be included in the client's estate or part of the assets would be included in a beneficiary's estate. These possible tax issues would apply to any Colorado 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, further guidance should be obtained from the Internal Revenue Service prior to ever consider implementing the UTC.

II Opposite of the Client's Wishes

Prior to the UTC, a client would draft a discretionary trust for a problem child by using a standard incapable of judicial interpretation, such as "the trustee may make distribution, in the trustee's sole and absolute discretion, for health, education, maintenance, support, general welfare, happiness, and joy." As previously mentioned, the UTC gives the problem child now standing in court that the child may sue that he or she did not receive enough "happiness or joy." In essence, the UTC changes Colorado law to the exact opposite intent of the client (trust maker)..

III Providing The Fuel to Encourage Litigation

The UTC gives a judge much greater discretion in awarding attorney fees to a beneficiary who sues the trustee. In essence, the UTC creates a situation where problem children and charitable remainder beneficiaries may sue to challenge the client's (i.e., trust maker's) wishes, and the client in essence gets to fund the litigation. The amendments to the UTC by the Colorado version do little, if anything, to reduce this litigation.

Other Asset Protection Problems

- **General Power of Appointment = Equivalent of Ownership**
  - This is the rule in many states
  - Not the rule in Colorado
  - Even if the rule in your state, why not change it by statute

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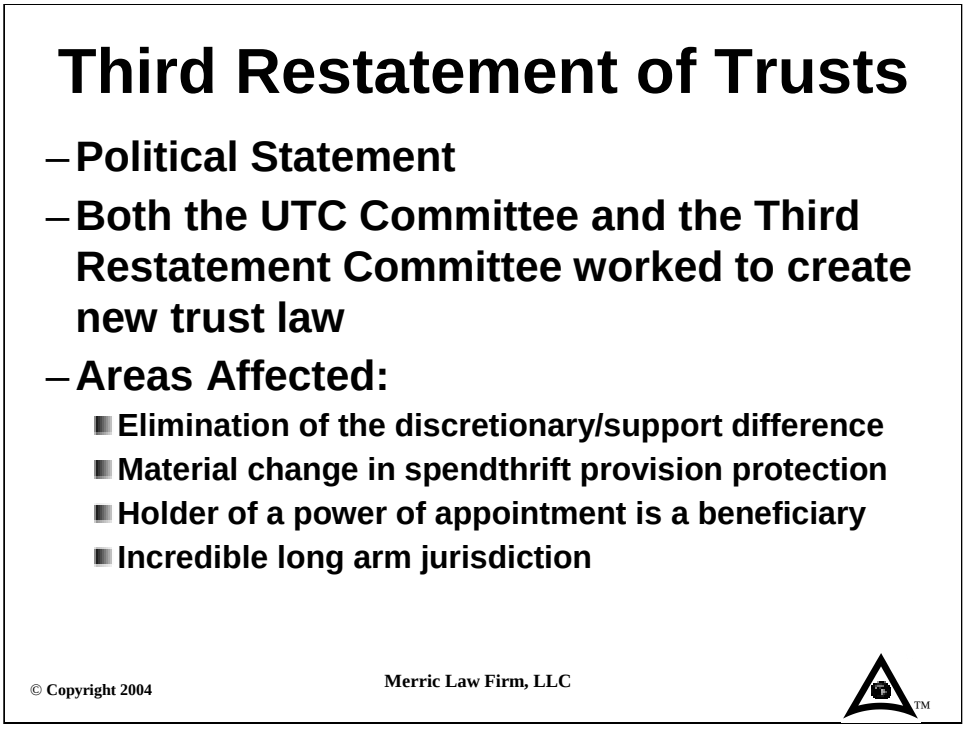

THIRD RESTATEMENT OF TRUSTS

I Political Statement

Unfortunately, at least in many of the areas discussed in this outline, the Third Restatement of Trusts ("Third Restatement") is not a restatement of trust law. Rather, it is the view of what certain political factions would like trust law to become. In this respect, extreme caution must be made when citing the Third Restatement as law with particular due diligence regarding the underlying case law that is cited by the Third Restatement.

II Common Committees Cite Each Other As Authority

It should be noted that both these committees worked hard together to formulate some of these **new and untested** views of trust law. In this respect, the UTC and the Third Restatement constantly cite each other as authority. Again, the practitioner must investigate whether there is underlying case law and how applicable such case law to the legal position taken when there is such a cross-cite.

III Areas Affected

- Elimination of the discretionary/support trust distinction.
- Allowing a federal or state agency to merely mention in a statute that either one may recover under (any) the spendthrift provisions of any trust.
- Classifying any person who holds a power of appointment as a beneficiary.
- Containing a long arm jurisdiction clause where the mere presence of a beneficiary in a state may invoke jurisdiction over a trust.

Who Wins, Who Loses if UTC Passes

Winners:

- Trial Attorneys
- Multi-State Banks
- Alaska, Delaware, Nevada, Rhode Island & Utah

Who Pays For the UTC - Losers:

- Coloradans due to trusts leaving Colorado
- State of Colorado
- Local Estate Planning Attorneys

WINNERS AND LOSERS

I Winners

Naturally, the group that will most likely benefit the most from passage of the Uniform Trust Code is the trial attorneys due to the increased litigation in an area that traditionally has had very little litigation. As previously noted, the underlying theme of the UTC is to give beneficiaries a greater right to change the client's (i.e., trust maker's) wishes through litigation. One prominent estate planning attorney has noted that the UTC is a "lawyer's full employment bill – creating a true lawyer's bonanza." – Jane Freeman.

The trustee requirements under the UTC are also quite onerous. This fact combined with problem children now having much greater ability to sue trustees will create a situation where fewer individuals will be willing to serve as an individual trustee.

Due to the flight of trusts and capital from UTC states, these trusts will most likely move to jurisdictions that have the most favorable trust law: Alaska, Delaware, Nevada, Rhode Island, and Utah.

II Losers

Part of the discussion of the losers has already been covered under the page titled, "Who Pays For Kicking the Gift Horse in the Mouth?" As discussed in detail, due to the flight of trusts from Colorado to non-UTC states, Colorado loses the income tax revenue from many Colorado trusts that flee the state. Also, Colorado picks up the tab for burdening the judicial system. Clients are outraged that they are paying additional unnecessary attorney and trustee fees due to the UTC. Finally, local estate planning attorneys are upset for two reasons: (1) because client's now lose fundamental estate planning alternatives; and (2) the local estate planning attorney must now co-counsel with a non-UTC state attorney and move the trust out of Colorado.