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Heckerling Institute 2017 – Wednesday, Day 3 Afternoon Notes

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The following are rough draft meeting notes prepared at the 2017 51st Heckerling Institute on Estate Planning sponsored by the University of Miami School of Law, and published in Leimberg Information Services, Inc. (LISI). These notes were published within a very short time of the conclusion of the proceedings and could not have been reviewed in order to be completed so quickly. There are no doubt errors, typos, etc. in these notes none of which should be attributed to the presenters. LISI obtained special permission from the Heckerling Institute to publish these notes. Bear in mind that no notes appear below on more than 20 concurrent and other sessions. These sessions can be purchased from the source listed below. The final papers presented at this year's Heckerling Institute can be obtained from Lexis Nexis. For recordings of the sessions contact Convention CDs, Inc. 800-747-6334.

1. **Wednesday: Afternoon: I-B: Minimizing Fiduciary Risk: Wolven, Flubacher, Singer**
   a. Administrative Trustee.
   b. Removal powers.
      i. Should you limit so cannot shop for result beneficiary wants?
   c. Should trustee have retirement age?
      i. But if have retirement age and trustee is doing a good job should they have to step down?
      ii. You could build in a retirement age and at that age the adult beneficiaries have to agree to trustee continuing and then renew approval every say two years.
      iii. Be certain definition of incapacity covers trustee and addresses how you get medical information.
      iv. By accepting role of Trustee I agree to permit access to medical information, or to sign a HIPAA release, etc.
      v. **Example**: Christiansen (sp?) case. Mom and dad acting as co-trustees. Dad diagnosed with Alzheimer's. Mom did not go through the procedures required to remove dad. A child duped Mom. Dad signed documents for sale. Transaction was unwound based on Dad's incapacity.

d. New Trustee due diligence process.
   i. Named trustee, what should be looked at to determine whether to accept the role? What should be done prior to starting to serve?
   ii. Consider:
      1. What are the common law or general duties of the trustee (loyalty, take control over property, etc.)?
      2. What are duties under trust instrument? What are the specific provisions? What restrictions and responsibilities are placed on the trustee? For example, is there a lack of language dealing with concentrated positions and the trust holds a concentrated position? Is it the kind of issue trustee can step in a deal with this or is the type of issue that should be resolved before accepting trusteeship? Might use decanting or non-judicial settlement agreement to resolve.
      3. What are the tax attributes of the trust? Is it a grandfathered GST trust?
      4. Is there an ability to charge fees? Is it limited?
      5. Is there an ability to get out of the position? Can you resign? What is required?
      6. What assets does the trust hold? What are they worth? What efforts will they require to manage?
      7. Are there loans in the trust portfolio? Are there loan documents? Are they signed properly? Are payments current?
      8. Is there real estate? Has an environmental analysis been done? Could or should you at least have some basic analysis done?
      9. Do you have a concentrated position in the trust? Does the trust expressly permit this holding and does it expressly discharge or hold the trustee harmless for this position?
      10. Was the prior trustee a professional or accommodation family member? What type of job did the prior trustee do?
      11. Will beneficiaries sign off on issues?
      12. Has there or should have been a delegation of responsibility to another party?
      13. Are there governing documents for the interests owned (e.g., family business)?
      14. Does the trust have sufficient liquidity to meet its obligations?
      15. Who has received statements? Has the trust complied with UTC or other applicable law? Is the trust a quiet trust? Will new people get statements and be unhappy?
      16. Is it a special needs trust? If so, has it been administered properly?
      17. Does the trust have an employee?
      18. How many prior trustees have there been? Have prior trustees been fired? Is there a concern?
      19. Are you OK taking on this trust?
      20. Document the due diligence done. If you could not identify a problem and you did good faith and reasonable due diligence.

e. Conflicts.
    i. Family members control family business and are trustees, it is a conflict.
    ii. **Example**: Modell sporting goods case. Michael died. Michael and Mitchell were brothers and 50/50 partners. Main asset stock in company. Sued to remove other trustees. Mitchell was enjoying power too much and Joel was going along for ride. Notice of trustee actions not given to 3rd trustee. Salary of surviving brother before brother's death about $1.8M and after death rose to $6M. IRS issues on business over millions in personal expenses. This reduced dividends that would have otherwise been distributed to Michael's children, etc. Large salaries paid to family members who were not working in business. Trust had large concentrated position.
    iii. **Example**: Client had two sons who did not get along. Father new this and insisted on naming two sons as co-executors and co-trustees. Battles ensued and costs escalated.
    iv. When there is a personality conflict or self-interests like the Modell case the settlor can expressly or impliedly waive a conflict. Better to do it expressly in the trust instrument. "I am aware that X has interest in business and nonetheless appoint X as trustee and waive ….."
    v. "He's my brother and he would not do anything to hurt me…."
    vi. This all has to do with a range of trustee duties: duty of care, duty of loyalty, duty of impartiality, etc.
    vii. Delaware cases 1975 case trustee was buying asset from trust. Court said even if in best interests of beneficiaries and for fair value it was held a void transaction. 1999 Magnus case with an interested transaction and a conflict of interest. Court said not void but voidable. It would be valid if deal fair and if beneficiaries consent. The law has evolved.
    viii. UTC 1009 addresses a beneficiary's consent, release or ratification of Trustee action. Comments suggest that in case of a self-dealing transaction consent not binding if not fair and reasonable.
    ix. Mennen v. Wilmington Trust case. 2015 WL 1914599. Could beneficiary represent minor through a virtual representation statute? Court's analysis found conflict of interest because of relationship with brother who was being sued. John and Jeff siblings. Business purchased by Colgate. Jeff did not have a job. Father made him trustee of John's trust. Father appointed Jeff as Jeff had been a good brother and Jeff was financially sophisticated. Dad thought Jeff would act in John's best interest. You don't get this with a corporate trustee. Jeff viewed himself as a great investor, but he wasn't. By the end when John finally sued him the trust had declined dramatically in value do to Jeff investing poorly. $97M award to trust. Court said Jeff used his brother John's trust as his own personally piggy bank. There as a corporate co-fiduciary. Why didn't they stop Jeff? Because the corporate trustee viewed the trust as a directed trust. Court held that the trust company misinterpreted the language.

x. Courts will look at source of hostility. Are the beneficiaries just angry because trustee said no, or are they angry because trustee is not performing properly?
xi. Estate of Gilmaker, 371 P.2d 321 (Cal. 1962) issue of trustee hostility.
xii. Matter of Duell, 258 AD2nd 382. Trustee destroyed rent checks, etc. Trust was doing well and growing but in other aspects trustee was being malicious which is not acceptable. Trustee was removed because of hostility.
xiii. If you have a trustee and know of conflict how can you protect the trustee? Settlor's intent about conflict (I understand the conflict and waive…) that should also be paired with a clause exculpating the trustee for good faith. Waivers should be express. If the trust doesn't expressly alleviate the trustee for the action the trustee will be in a difficult position.
xiv. Trustee can go to court and ask the court to give the trustee instructions. Is the transaction fair?
xv. KY Case US Dist Eastern Dist. Elizabeth Osborne v. Griffin. All about conflicts and issues that arise in a family business.

f. Choice of Law; Conflicts of law.
    i. These issues are important as often trusts are not set up with local bank in home state. Often trusts are set up in jurisdictions that are viewed as more favorable.
    ii. Want to make sure the situs of the trust will be in that jurisdiction and the laws of that jurisdiction will apply so that if a beneficiary wants to challenge validity or administration they cannot.
    iii. Trusts have unique set of rules under conflict of law rules as to how to select law of governing jurisdiction. Contrast a contract just need a reasonable relationship to the jurisdiction. A trust is a fiduciary relation. Trustee takes legal title to the assets and administers trust pursuant to the agreement. The nature of this is what gives rise to the issues.
    iv. Laws may differ for inter-vivos versus testamentary. In many cases real estate will govern (law of jurisdiction where the dirt is located) so will generally want to put real estate into an LLC not only for liability protection but for conflict of laws purposes.
    v. Restatement divides into: validity, construction and administration.
        1. Validity – if you set up a dynasty trust. Was it a valid trust or is it void ab initio because of the RAP. If Texas grantor is setting up a DE trust can he get over conflict of law rules. If a great grandchild of the settlor wants to break the trust that there were no contacts with DE and the Texas RAP applies, etc. FL has a provision against no contest clauses so if a FL resident set up a trust in another jurisdiction that permits no-contest clauses will that work?
        2. Construction goes to meaning of terms in the instrument? Should you define these in the document so that if the trust changes jurisdictions you have consistent definitions? Yes.
        3. Administration.

vi. If a trust migrates the law concerning validity and construction may not change but only the law governing administration of the trust.
vii. Old trusts are often silent on all of these issues. Modern trusts tend to have situs and governing law provision that often contemplate change in situs and governing law.
viii. If trust language gives broad right to change situs does that create an obligation on the trustee to survey various state laws and determine periodically the optimal situs?
ix. 3 prong approach to analysis:
    1. Domicile of trustee.
        a. Where corporate trustee has main office or corporate charter.
        b. If have multiple trustees may list in trust which is the administrative trustee that would determine this.
    2. Place of administration.
        a. Where trust administered.
    3. Settlor intent.
        a. Choice of law provision.
x. If migrate a trust issues may arise. State tax laws may tax based on location of grantor when trust funded, location of beneficiaries, etc.

g. Directed trusts.
    i. 43 states permit directed trusts. Part of uniform law commission is working on a uniform directed trust act. It has become commonplace to structure directed trusts bifurcating traditional trustee roles. 8 states do not have any directed trust statutes.
    ii. Clients often like to have life insurance, closely held business, and so forth in trusts and these types of assets conflict with traditional trustee duties. Liability exposure to trustee holding a concentrated position is significant so a directed trust may resolve that concern.
    iii. Consider changing situs and converting a non-directed trust to a directed trust.
    iv. Strong form state statutes give general trustee the most protection. Settlor may also want this if trust will hold unique or special asset or to have a specific person be responsible for investment or distribution decisions then you want this type of strong protection. Having a trustee to act by direction you need a jurisdiction where there is no duty to monitor. Some statutes do not make this as clear.
        1. Enabling statutes – simple statutes that rely heavily on trust instrument. Trustee will follow direction of the adviser and if so will not have liability absent misconduct. Does not have to be limited to investments or distributions but can be anything. Be careful under this type of statutory approach clarifying what powers are exercised by direction. Some of these statutes like GA, OK, UT only contemplate investment adviser. Some contemplate only investment or distribution. In these cases, only those functions

can be directed. Illinois statute defines role and states trustee shall exercise role as directed by the of investment adviser.

2. Off the rack statutes – provide clarity and detail on direction. But these may have less flexibility.

h. Planning solutions.
   i. Care and feeding of the trust during the administration of the trust to protect the trustee.
   ii. If you have a direction make sure you document it. Get it in writing and signed. Have the back up of what you received, when you received it and when you acted on it.
   iii. There is a fundamental duty to send information, render accounts, keep records.
   iv. Tax elections, document why you did or did not make an election.
   v. Requests for equitable adjustment.
   vi. Whether an asset should be retained or diversify. Retain documentation showing reviewing at least annually and why the decision was made.
   vii. Trustees can make bad decisions but they are not allowed to make lazy decisions. Must have a process, put it in place and follow it.
   viii. Communicate with the beneficiaries. If you don't inform them they cannot raise issues. Big problem is when a beneficiary finds out about something bad long after it happened. Look into who is getting statements and who should get statements.
   ix. Let beneficiaries know what their rights are.
   x. Trust companies have committees that make these decisions and document the discretionary decisions.
   xi. 187 Restatement and Sections 50 and 60 of Restatement 2nd address standard "arbitrary and capricious." Have documented policies and procedures.

2. **<u>Wednesday: Afternoon: II-C: Fiduciary Cases: Fitzsimons</u>**
   a. Use and abuse of Powers of attorney.
      i. State law and uniform POA Act and financial institutions all grappling with how to use them but balancing against risks of abuse of power.
      ii. One has called POAs the most effective tool for burglary since the crowbar.
      iii. Cashion v. Hayden.
         1. Nephew used POA to steal money.
         2. Put funds in Nevada trust.
         3. 2016 voiding all documents and damages confirmed by AL supreme court.
         4. Nephew sued court and judges etc. Alleged constitutional violations and more. Vexatious litigation and abuse of court system.
      iv. Reineck case Virginia Supreme Court decided Nov 2016 2106 VA Lexis 178.
         1. 2nd marriage between Frank and Jane. Frank had children. Parallel estate plans 40% to Frank's kids and 60% to Jane's heirs at law.

        2. Frank incapacitated from Lewy Body dementia.
        3. Jane disinherits kids and leaves all to her heirs at law who got assets after her death.
        4. Frank's kids use POA to fund with Frank's assets and it all passes to Frank's children. Then Frank died.
        5. Jane's complained POA was used to disinherit them from the estate plan.
        6. Compelling fact situation that there was an implicit agreement Jane breached. Court recognized POA as valid to disinherit Jane's heirs.
    v. Glass TN.
        1. Glass v. Sun Trust Bank, 2016 Tenn. App. LEXIS 305.
        2. Do you have duty to fully fund revocable trust and save probate fees?
        3. Court held no. The revocable trust did not have a tangible property clause as did the will. Also because of tax refund avoidance of probate was impossible.

b. State income taxation of trusts.
    i. Non grantor trust sever ties with taxing jurisdiction.
    ii. Cases in prior years were taxpayer friendly, but not all so now.
    iii. Bank of America NA v Mass. Commr. Of Revenue. C314596-8.
        1. Created by in state resident. No in-state income.
        2. Sole issue is whether BofA is an "inhabitant" of Mass. State statute requires a place of abode in Mass to be an inhabitant. How does this apply to a corporation?
        3. Corporation's acting as fiduciary should be taxed like individuals. All decided that an out of state corporation can be "inhabitant" if maintains place of business for 183+ days and performs administrative functions.
        4. Risk/issue is double taxation under the Commerce clause. This issue was not litigated in this case.
    iv. Nov 29 Commissioner of Taxation of Mass issued notice asserting that a single act of fiduciary administration concerning a trust can trigger taxation if maintain an office in the state.
    v. Kaestner
        1. Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dept. of Rev. 2015 NCBC LEXIS 39.
        2. Domicile of beneficiary in NC is only connection.
        3. No mandatory distributions.
        4. NC tax commissioner attempted to impose tax.
        5. 2016 Taxpayer victory with NC Court of appeals found imposition of tax was violation of due process.
        6. NC Supreme Court granted appeal 2016 west Law 71899500.

c. Fiduciary litigation that arises out of tax planning.
    i. Benson v. Rosenthal 201 US Dist. LEXIS 89238.
        1. Swap power retained by grantor if irrevocable trust to make trust a grantor trust under IRC Sec. 675(4).

2. 2016 West Law 2855456.
3. Trust funded with interests in landmark properties and so forth.
4. Fight about the trust. Exercised swap power and puts in a promissory note and some real estate with a value adjustment clause.
5. Trustee rejects substitution and sues to compel trustee to honor swap.
6. Benson adjust the note again and adds more collateral and bases valuation of note on valuation by Empire same appraiser used by trustee and trustee again rejects. Trustee tries to use aggressive discovery requests.
7. Courts reject these.
8. Court rejected trustees attempt to treat this as a loan. If it was a loan trustee had discretion to lend. Court rejected trustee interpretation and said swap power was a unilateral power subject only to verification of value by trustee not a discretionary power of the trustee.
9. Issue as to whether a swap power can be done with an unsecured promissory note is a loan or swap.

ii. Condiotti unpublished CO decision 2014 CA 969
1. dealt with a swap power for an unsecured promissory note into the trust for $9M+ hard assets. Trust prohibited loan to settlor without security.
2. Court reached opposite conclusion as Benson above.

iii. GA case Schinazi v. Eden A16A0769.
1. Settlor tried to swap in 58.3M promissory note swap for business on eve of sale of business and ex-wife trustee objected to valuations.
2. Technicality of assignment of interests under partnership agreement.
3. Will settlor have standing to compel exercise of swap power? How do you value an unsecured promissory note?

iv. Matter of Thomas L. Clancy, Jr. Estate No. 101962.
1. Amended family trust before death to make it qualify for QTIP election to permit it to qualify but did not amend tax apportionment clause. Did include marital deduction tax savings clause.
2. Under these circumstances which prevails? The tax savings clause (lower court enforced this) or the tax apportionment clause? The appeals court agreed that the tax savings clause prevailed.

v. 12/20/16 Heisenjer Case CT 2016 West Law 724539.
1. What is standard of care must an executor exercise in valuing assets for estate tax purposes?
2. Court protected executor.

3. Will gave executor power to hire appraiser without liability so long as selected with due care. Executed used due care in hiring a well-regarded firm.

d. Spousal Desertion.
    i. Lovett v Peterson, 2016 Mich. App. LEXIS 1053.
        1. Husband died.
        2. Tried to disinherit from spousal right of election.
        3. Spouse deserting does not have to make continuous efforts in order to exercise spousal right.
    ii. Estate of Talerico, 2016 PA Super 66.
        1. Moving out did not forfeit marital rights but multiple affairs does.
    iii. Brown v. Alley, 2016 OK 112.
        1. Physical separation alone does not extinguish right to be executor.
        2. But planning to marriage even though marriage was void she was precluded from serving.
    iv. Estes v. Young, 2016 Miss. App. LEXIS 225.
        1. Never lived together. H went into hospital 3 days after marriage and W refused to care for him.
        2. Petitioned to have H involuntarily committed.

e. Business cases.
    i. Rollins v. Rollins, 2013 Ga. App. LEXIS 332.
        1. Ran business and was trustee. What is standard?
        2. Trustees took actions as trustees and directors.
        3. Paid beneficiaries who did not complain $9M and those that complained nothing. Imposed family code of conduct. Conditioned distributions on life pursuits that trustees deemed meaningful and personal good conduct.
        4. GA Supreme Court looked at each action and applied corporate director standards for business actions and trustee standards for trustee actions not the same standard. Basis for this is that the settlor not the individuals involved set this up and the inferred settlor intent to parse the duties.
    ii. Osborne v. Griffin, Civil Action No 2011-89.
        1. Brothers abused their offices to force sister out of the business.
        2. Awarded damages to each of six daughters' plus damages to daughter who had partially settled claims, of over $1B.
    iii. Ellis 2016 Kansas App. LEXIS 65
        1. Decided in November.
        2. Widower abused position of trustee of wife's trust and extracted all of the trust assets and put them all into his revocable trust and then amended it to disinherit children and leave all to charity. Court held it was a willful fraud.
        3. Widower died before holding and court said that punitive and double damages don't survive death of wrongdoer.

f. Trust investments.
    i. Adams v. Regions Bank 2016 US Dist. LEXIS 1027.

1. Courts refused to allow beneficiaries to lure trustee into a breach of trust case.
2. Testator was former bank officer and trust had waiver of diversification.
3. Took loan from same bank to benefit her own business and they pledged bank stock in trust by the brothers for that loan.
4. Brother's resign and Kay appoints same bank as trustee and signs release and indemnification.
5. In 2010 discover deficiency in paperwork and Kay petitions court to fix it.
6. Stock declines in value.
7. Kay defaults on debt.
8. Kay sues bank in 2016 alleging bank erred by holding concentrated position.
9. All claims dismissed.
10. Equitable point is that bank did not put itself in conflict those were put in place before bank became trustee.

ii. Glass v. Sun Trust Bank, 2016 Tenn. App. LEXIS 306.
1. Discussed elsewhere in outline in different context.
2. Beneficiary was head of trust department.
3. Estate had concentration of bank stock and declined during administration in 2007.
4. Courts protected the bank from the beneficiaries' claims.
5. One month after death son chose in kind distribution of assets, he told bank to keep stock, received statements, etc.
6. Court found special circumstances to hold stock and son's request for in kind distributions created the special situation.
7. Good process and good documentation protected bank.

iii. Estate of Gilliland, 2016 Cal. App. Unpub. LEXIS 157.
1. Trustee not liable for investment losses while awaiting instructions (PLR agreed to in settlement agreement).

g. Trust construction.

i. Mechanics Bank v. Hink, 2016 Cal. App. Unpub. LEXIS 5185.
1. Beneficiary was lobbying for own advantage cannot use common fund to shift your costs to trust.

h. Disclosure and Privileges.

i. Schrage v. Serberger, 2016 Ind. App. LEXIS 62.

ii. If your only interest in trust is a pre-residuary cash receipt, e.g. $10,000 if you survive. Does trustee have to give you full trust agreement? Holding only entitled to trust certification as is not a qualified beneficiary but closer to the status of a creditor.

iii. Smith v. SunTrust Bank, A13A225.
1. How much notice and disclosure must beneficiaries get? Statute of limitations in many states 6 months to one year. When does that being to run?
2. Must give sufficient information to begin statute tolling.

iv. Meyers v. First Tennessee Bank, 2016 Tenn. App. LEXIS 371.
    1. Can you use totality of communications to establish a report since the term report is not defined in most states? Comments to UTC don't define report.
    2. Court rejected attempt.
    3. UTC requires an actual report not merely being put on notice. A phone call, fax, email, etc. may suffice but you have to establish the content of those.
    4. You don't want to have a factual trial that is costly. You want to have claims dismissed at a summary stage as being time barred claims.
    5. In this case there was a problem proving what was in the report.

v. Andersen v. Andersen, 2016 Cal. App. Unpub. LEXIS 7677.
    1. Clock doesn't start if trustee left out something material. Trustee cannot determine what is valid or not that is role of courts.

i. Creditor protection.
    i. Turkish v. Brody 201 FL App. LEXIS 17684 November 30, 2016.
        1. Settlor owed $1M gift tax to IRS.
        2. Trust distributed $1M to son and son loaned to mom to pay tax and mom gave $1M promissory note.
        3. Son put $1M promissory note into trust.
        4. All disclosed on trust statements.
        5. Court said this was not adequate to disclose since the statements don't disclose that promissory note is worthless because that was based on mother's lack of assets.
    ii. Pfannenstiehl v. Pfannenstiehl, 2016 Mass. App. LEXIS 123.
        1. Probate court decision included 60% of spendthrift trust in marital estate.
        2. Mass. Supreme Court reversed the probate court since trust was discretionary and ascertainable standard did not change that, trust has spendthrift clause and husband was one of 11 beneficiaries so interest was indeterminate.
    iii. Ducket v. Enomoto, 2016 US Dist. LEXIS 51502.
        1. "Shall be distributed" and used ascertainable standard.
        2. Owed IRS money.
        3. Court held to be discretionary support trust not fully discretionary so IRS can reach it if it can meet burden of prove.
    iv. In re Erskin, Case No. 15-2841-L.
        1. Lesson in how not to do an asset protection trust.
        2. At time of creation he had already filed two bankruptcy cases a case against him for Replevin.
        3. Titled trust as irrevocable but reserved right to revoke.
        4. Named himself as trustee.
        5. Trust had mandatory income distributions to hm.
    v. Summary.
        1. Trusts work, but…

        2. Should use institutional trustee with full discretion
        3. Name multiple beneficiaries and sprinkle.

j. Charity.
    i. IRC Se. 4942 pay out 5% but charities often look to get more access to assets.
    ii. Estate of Loucks, 2016 PA Super 206.
        1. Trust for two churches income only.
        2. One of the church's needs more.
        3. Court rejects petition to modify the trust to provide for discretionary principal right as it will undermine perpetual nature of trust and violate settlor's intent.
    iii. Shriners Hospitals for Children v. First Northern Bank of Wyoming, 2016 WY 51.
        1. Income until 2100. In 2100 whereupon assets distribute outright.
        2. Settlor stated express intent land be open and devoted to agriculture until that time.
        3. Shriner wanted to take land now claiming trust violated RAP.
        4. Court advocated for settlor's intent of land preservation as well as benefitting charities. Desires of charities for more income does not require termination. Trustee owes duty to settlor intent and not just go to whim of charities.
    iv. Matter of Rockefeller University, 2016 NY Slip Op 31556(U).
        1. Want to modernize old trust investment provisions.
        2. This was a successful attempt to do this.

k. Revocable trusts.
    i. General Comments.
        1. Courts grapple with what can be done during settlor's lifetime. Results are inconsistent.
        2. CA seems to have a looser approach.
        3. Deviation from common law rules when the facts have overtones of elder abuse.
        4. Concern about how revocable trusts are being administered.
        5. Cases are split.
        6. Courts will err on side of having some limited standing to sue and deferring until Settlor is dead. This seems to be the trend.

l. Third Party Liability.
    i. Fiduciary breaches but also sue trustee's lawyers, financial institutions who handled transactions and CPAs, etc. Claims are often in tort.
    ii. Deep pocket searching has made its way into trust area.
    iii. Erosion of privity rule has been steady.
    iv. Throson vs. Richmond 292 Va. 257 the privity rule has fallen in Virginia.

m. Litevich v. Legalzoom, 2015 Conn. Super. LEXIS 1702.
    i. Court hit Legalzooom by letting customer who got faulty execution instructions. Disinterred heir sued in tort.
    ii. In same case court chose to enforce the terms of use and forced the disinherited heir into binding arbitration

n. Matter of Levitin, 2015 NY Slip Op 25184.
   i. Archie comics.
   ii. Trustee compelled to submit to mental examination.
o. Stephens v. Beard, 2016 Tex. LEXIS 219.
   i. Texas supreme court. Shot and killed wife and took 2 hours to shoot himself. That was not a common disaster under will.

3. **<u>ABA Book Launch: Trust Owned Life Insurance TOLI Issues</u>**.
   a. The following remarks and comments are based in part on a review of a recent book <u>The Life Insurance Policy Crisis</u> by E. Randolph Whitelaw and Henry Montag published by the American Bar Association, in part based on an article I wrote that appeared in the appendix to the book, remarks made to a presentation about the book January 11, 2017 at Heckerling, and some additional thoughts and comments as to how the changing estate planning environment may have a significant impact on all of this. To purchase Henry and Randy's book go to www.shopABA.org.
   b. Some startling statistics from the book emphasize the importance of practitioners encouraging all clients to monitor their insurance coverage and certainly for trustees of ILITs.
      i. 90% of ILITs are managed by trustees that have no particular background or skill to manage life insurance.
      ii. About 39% of in force non-guaranteed universal life policies, and 34$ of inforce variable universal lie polices, are illustrated by the carriers to lapse during the insured's lifetime or within five years of life expectancy. While this sounds incredibly worrisome, it likely understates the problem. There is a significant correlation between wealth and longevity so that the clients that have significant life insurance inside life insurance trusts are likely to have greater than average life expectancy.
      iii. Those over age 65 appear to lapse life insurance policies at a shocking rate. Based on 2008 data 1.1 million policies with a face value of $112 billion were lapsed. It appears that few of these considered the possibility of a sale of the policies prior to lapse.
      iv. In 2013 the insurance policy lapse rate was 5.7%. 82% of those were merely allowed to lapse with no value to the owner.
   c. ILIT issues arise with common frequency in practice.
      i. Policies about to lapse or that have lapsed because no one had looked at the performance of the policy or the carrier since the policy was purchased decades earlier. **<u>Example</u>**: In one case the client retained counsel to pursue the matter. When presented with two separate retainer agreements that expressly excluded life insurance selection the law firm opted only to pursue the insurance broker.
      ii. Policies cashed in instead of being sold or retained because a client with no input from any adviser decides they no longer need the policy because the estate tax has become less relevant or irrelevant. **<u>Example</u>**: A surgeon by the time he came to me for an initial consult had cancelled a number of Guardian Life policies that had been in force for nearly two decades and which were all owned by a well-crafted ILIT. His reaction was that he did

not need it because of the increase in the estate tax exemption in 2013 without any consideration of the income tax and significant asset protection benefits the well-done plan had afforded.

iii. A policy and trust that may be adequate but for which there are no records. Often there are changes in trustees that have never been reported to the insurance company and no documentation of those changes. **<u>Example</u>**: A new client presented an existing ILIT. The ILIT was so old that the only copies of the trust anyone could find were missing several pages. There were two changes in trustees none of which had been reported to the carrier who continued to list the initial trustee, and the documentation appointing the successor trustees was also lost. Consider preparing a compilation of the trust instrument and all consents, actions or documentation from inception to date anytime there is a significant change.

iv. The policy is found to be adequate but the trust instrument no longer serves the client purposes so a combination of trust protector actions, decanting, disclaimers, etc. may correct the problems. **<u>Example</u>**: The initial ILIT held funds in trust from a survivorship policy until each child was 35. At the time of evaluation each child was 50+. The old ILIT was decanted into a new ILIT with similar timers but lifetime trusts for the children.

d. Flexible premium non-guaranteed death benefit policies have become common and many clients and individual ILIT trustees do not understand that these policies shift the performance risk from the insurance company to the policy owner.

e. Life insurance can be viewed as an asset class: the death benefit does not correlate with other asset classes, tax deferral and tax free withdrawals and loans are unique features that differentiate insurance from other assets.

f. Trusts, including ILITs, are the keystone of most estate plans. Whether a client has sought asset protection benefits, estate tax savings, probate avoidance, or most recently basis step up techniques, trusts have often been part of the solution. The incredible flexibility that trusts bring to financial and estate planning has placed them in a position of prominence in the planner’s toolkit. An essential component of every trust plan is the client’s selection of fiduciaries. Most clients have, and continue to, shun institutional trustees. After all, institutional trustees charge fees, and are rigid in their willingness to act. The solution to many clients appears simple, an individual trustee that is typically a close family member or occasionally a friend. While theoretically that decision can provide as beneficial a result as naming a skilled institutional trustee that is unlikely to be the case. The siren call of simplicity and low cost too often leads clients and their families down a dangerous path.

g. Duties of the ILIT Trustee.

i. The terms of the trust agreement create obligations on the trustee as do state law. The Prudent Investor act may apply.

ii. Because IRC se. 2042 prohibits the grantor/insured from retaining incidents of ownership in the policy the grantor/insured cannot exercise powers of the policy, the trustee must do so.

h. Family and friends can serve effectively as trustees, but most will require professional guidance to do so.

   i. The means of achieving this positive fiduciary experience, for the both the trustee serving and the beneficiaries involved, is rather simple and obvious to the professional adviser, but unfortunately not so for many if not most individual trustees.

   ii. Individual trustees should meet with appropriate professional advisers before beginning to serve. A trust attorney and dissect the trust governing the trustee position so that the trustee can understand in specific terms what the trustee's rights, duties, obligations and so forth are. Annotating and or summarizing the trust instrument to create a more accessible guide to the provisions of the governing trust. A checklist of operations can also be quite useful. Council should advise the client trustee about the importance of periodically reviewing the operations and status of the trust, communications with and distributions to beneficiaries, etc. Unless counsel has the expertise to address insurance specifics consider expressly excluding in the retainer letter insurance design and selection decisions.

   iii. Meet with a CPA who has specific expertise in trust income tax planning to general planning implications, year-end tax planning if the ILIT holds more assets, and trust recordkeeping. The CPA should arrange for the filing of Form 56 informing the IRS of the new trustee relationship and Form 1041 if applicable.

   iv. Meet annually with the professional advisers guiding the investment in trust assets if the client is not an expert in the field. This might be, depending on the nature of the trust, a wealth manager for marketable securities, an insurance consulting for life insurance, or other specialist. Certainly the key take home message of the book is that periodic reviews by an insurance expert to actively monitor insurance coverage. This is important as the ILIT trustee should demonstrate a reasonable process of evaluation of steps taken. See Cochran v. KeyBank.

   v. Non-professional ILIT trustees need to understand that life insurance is not a buy and hold proposition but rather an asset that must be actively managed including the following steps:

      1. Life insurance policy statement.
      2. Product suitability and product design determinations. This is complicated by the broad range of products and product enhancements insurance companies offer.
      3. Carrier selection and underwriting.
      4. Annual performance monitoring and risk management.
         a. Is the policy performing in a manner consistent with the illustrations?
         b. What is the insured's age at the date the policy is projected to lapse?

c. Are policy charges competitive?
d. Has the insured's health changed? Consider an actual life expectancy analysis.
e. What riders exist?

5. Periodic remediation and restructure. The book caution how replacement of policies, while sometimes warranted can be detrimental to the client/policy owner. A new policy may provide a more efficient premium and new benefits. If a policy is sold into the life settlement market consider the income tax implications. Rev. Rul. 2009-13. Agents may have an obligation to inform policy holders of the existence of the life settlement market. Larry Grill et. al. v. Lincoln National Life Insurance Company, 5:2014 cv 00051 S District court, California Central District.

vi. While there are certainly more steps individual trustees can and should take, it is not that difficult or costly to hire the appropriate experts to guide the trustee in carrying out his or her fiduciary duties. Appropriate professional guidance, with a modicum of recordkeeping, diligence and follow up, may suffice for many individual trustees. The reality is that few individual trustees consult with professional advisers after the trust is formed other than to have an accountant (and not always one with particular trust expertise) prepare income tax filings, unless and until a problem arises.

i. Individual Trustees Do Trip Up.

i. While it might be theoretically possible for an unskilled individual trustee to carry out his or her duties in a reasonable manner without consulting professional advisers regularly, unless that individual trustee has particular knowledge and training, or is one of those rare individuals who thoroughly researches and tackles the unfamiliar, that positive result may be unlikely.
ii. Consider the nearly ubiquitous ILIT trust administrative step of completing Crummey powers. How many individual trustees that do not work with their professional advisers actually complete this task reasonably well with any degree of consistency? If this task is not completed often or well, what of more complex tasks?
iii. How many individual trustees have an investment policy statement ("IPS") governing the trust they serve? How many individual trustees are even familiar with what an IPS is?
iv. Individual trustees should solicit trust beneficiaries to identify information relevant to the trustee decision making. How can a trustee identify beneficiaries to whom distributions may provide an overall tax benefit without knowing the current and likely future tax status of the beneficiaries? How can, in the context of an ILIT, the trustee assess the continued relevance of the original rationale for the insurance plan, policy design, etc.?
v. When is the last time individual trustees have reviewed life insurance held in a trust for which they serve as fiduciary? What is the likelihood of a trust insurance plan succeeding without regular professional involvement?

For many ILITs, not particularly likely. This is a key point of the book and why it goes to lengths to stress the importance of advisers guiding unskilled (in terms of life insurance knowledge) ILIT trustees to retain appropriate experts to assist in monitoring coverage.

vi. For ILITs when is the last time that an individual trustee inquired with some specificity as to the health status of the insured? This might actually be a task that is more difficult for the family member or friend then an institutional trustee to perform. How can the appropriateness of an existing life insurance program be evaluated without the trustee having any current medical knowledge?

vii. How many individual trustees have sought guidance as to the usefulness of a particular ILIT insurance plan in light of the dramatic changes in estate and income tax laws in the 2012 tax act? How many have simply cancelled existing policies and terminated ILITs (typically with no formal documentation) because "the policy isn't needed any longer to pay estate tax," with no analysis whatsoever of the performance of the policy, income tax benefits, possible legacy building and other non-estate tax paying purposes? Few of these individual trustees could imagine the liability exposure they might face for inappropriate cancelling a policy with no supporting corroboration. If the Trump administration eliminates the estate tax as proposed, there is likely to be a flurry of cancellations or surrender of ILIT policies for their cash value. Individual ILIT trustees should be warned not to act in haste. Before any modification of the coverage consideration should be given to the original purpose for the policies and the relevance of those factors in the current environment. While a policy may have been purchased to pay a federal estate tax that no longer applies, it may still have relevance to pay a state estate tax or a capital gains tax on death the Trump administration has proposed.

viii. Even if the individual trustees take the appropriate action, in many cases they fail to document that action to demonstrate why their action was reasonable, or to inform beneficiaries of their actions and the reasons for them. Endeavoring to corroborate the rationale for an action after the fact is never easy and rarely as persuasive as contemporaneous records.

ix. As the population continues to age and the myriad of existing trusts mature, the potential for problems with these informalities mounts, and the likelihood of lawsuits grows.

j. Worse Issues with Individual ILIT Trustees.

i. While the "bad" steps above that are so common with individual trustees at the helm of the trust are substantial, individual trustees because they often do not adhere to trust disclosure rules or other formalities may well be tempted to engage in inappropriate self-dealing transactions, mismanagement, over charging and worse. Unless checks and balances are built into the trust (e.g., a trust protector, specified reporting, a co-trustee, etc.) the ability to take advantage of the position of being a trustee, or even to defraud beneficiaries, may be too great.

ii. If the trustee can use trust resources to pay legal fees that can often be a potent weapon that alone can dissuade struggling beneficiaries from pursuing accountability.

iii. Professional and institutional trustees often make a concerted effort to communicate with current and even certain remainder beneficiaries absent quiet trust provisions or extenuating circumstances. Individual trustees may not be aware of the obligation to communicate with beneficiaries about the trust. How likely is it that some or even many beneficiaries do not even know if the existence of the trust?

k. Modern trust drafting, with increasingly complex mechanisms (e.g., swap powers to create grantor trust status and powers of appointment to secure basis step-up) and more fiduciary and other positions (administrative trustee, investment advisor, trust protector, etc.), have made some ILIT trust administration a more involved and variable endeavor. All these trends will increase the advantages of using professional or institutional trustees over individual trustees, or having a proactive professional term working with the individual trustee.

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