Scope Note: This manuscript covers changes in North Carolina’s General Statutes from the 2011 Long Session of the General Assembly and the 2012 Short Session of the General Assembly. While the manuscript focuses on changes that affect the estate planning practice area, I have included discussions of other statutes not directly related to estate planning that may be relevant or of interest to estate planning attorneys.

I. RECAP OF FOURTH-GRADE CIVICS

The North Carolina General Assembly is a bicameral state legislature – it consists of a Senate and a House of Representatives. The Senate has 50 members, and the House has 120 members. Both Senators and Representatives have two-year terms. Representatives elect a Speaker who presides over the House. The current Speaker is Thom Tillis (R-Mecklenburg). The Lieutenant Governor presides over the Senate (Walter Dalton is the current Lieutenant Governor). The Senate also elects officers, including the President Pro Tempore. The current President Pro Tem is Phil Berger (R-Guilford/Rockingham). The President Pro Tem fills in when the Lieutenant Governor is not available, and is the second-highest official in the state Senate.

The General Assembly meets for a long session starting in January of each odd-numbered year. It adjourns the long session and then reconvenes for a short session in each even-numbered year. The long session typically lasts about six months. The short session typically goes for about six weeks.

Most new legislation is considered in the long session. In the short session, the General Assembly typically considers matters that were introduced and approved by one of the houses, but which were not reached by the other.

II. THE LATEST AND GREATEST – THE 2012 SHORT SESSION

A. Directed Trustees – S.L. 2012-18/H707

This bill made changes and clarifications to the law governing directed trustees, trust protectors, and other fiduciaries

Background:

Law prior to 2012 session — Trustees and Other Fiduciaries: Two different statutes, G.S. 36C-8-808 and G.S. 32-72(d), governed the responsibility of fiduciaries who, by the terms of a governing instrument, must take directions from
others. H707 harmonized these statutes and modernized them in a manner similar to legislation in Delaware and other states.

Chapter 36 of the North Carolina Uniform Trust Code, codified in 2005, attempts to “house” all provisions governing trusts and trustees in one chapter. However, Chapter 32 continues to govern fiduciaries generally, as it is necessary to have provisions that apply to fiduciaries who are not trustees.

The “directed trustee” provision contained in G.S. 36C-8-808(b) of the North Carolina Uniform Trust Code, prior to H707, provided that a directed trustee must follow directions, and was absolved from liability for doing so, “unless the attempted exercise is manifestly contrary to the terms of the trust, or the [directed] trustee knows the attempted exercise would constitute a serious breach of trust.” Commentators pointed out a problem with this provision: the trustee, who was expected to “take a back seat” to the person giving the direction, was required to exercise a considerable amount of due diligence, including a duty to determine the fiduciary duty owed to the beneficiaries by the person giving the direction.

In contrast, the pre-H707 “directed fiduciary” provision in G.S. 32-72(d) provided simply that a directed fiduciary “is not liable” for following the directions of a person authorized to direct that fiduciary.

**Changes made by H707**

Following study of the commentary on directed trustees and legislation on this subject in other states, including Delaware, the Estate Planning and Fiduciary Law Section’s legislative committee made recommendations covered in H 707.

- G.S. 36C-8-808 was amended to retain the provision in G.S. 36C-8-808(a) absolving trustees from liability for following the directions of a settlor of a revocable trust. It was also amended to provide that trustees were not liable for losses resulting from a settlor’s failure to provide consents required in the revocable trust for the trustee to act.

- G.S. 36C-7-703 was amended to add a subsection to G.S. 36C-7-703, which governs co-trustees, to clarify that the provisions of G.S. 36C-8-808 do not apply when a cotrustee is given, to the exclusion of another cotrustee, the power to direct or prevent actions of the trustees. The addition of subsection (e1) is similar to the duty and liability clarifications for directed trustees in the new Article 8A which was added to Chapter 36C (see below).

- H 707 revised G.S. 32-72(d) in a manner consistent with the new Article 8A of Chapter 36C. As noted above under “Background,” it was necessary to have such provisions apply to fiduciaries generally that are governed by Chapter 32 and not by Chapter 36 which governs trustees.

- A new article 8A of Chapter 36C was adopted:
36C-8A-801: Defines a “power holder” as a person other than a trustee with power to take certain actions concerning a trust.

36C-8A-802: Provides explicitly that trust instruments may confer various powers as to investments, distributions, and other administrative matters on persons other than trustees, consistent with current trust practice. The provisions of G.S. 36C-8A-808, prior to H 707, authorized the terms of a trust to confer upon a person the power to amend or terminate a trust. These provisions were carried forward and expanded in G.S. 36C-8A-802 to include other powers typically given to “trust protectors” by statutes of other states and as recommended by commentators. The duty and liability of the power holder is similar to the duty and liability of a power holder with the power to direct or consent.

36C-8A-803 and 36C-8A-804: 36C-8A-804 provides that directed trustees are absolved from liability except in the case of “intentional misconduct.” Keeping the directed trustee’s responsibility to a minimum is based on the rationale that the power to direct is most effective when the trustee is not deterred from exercising the power by fear of possible liability. Like similar statutes in other states, 36C-8A-804 also:

- Absolves the directed trustee from liability for failure to take any action requiring consent when a request is made for a power holder’s consent but the consent is not provided within a reasonable time; and
- Provides that the directed trustee is not responsible for monitoring the actions of or consulting with a power holder.

36C-8A-803 provides that the person who holds a power to direct or consent is generally a fiduciary who is required to act in good faith and is liable for losses arising from a breach of that fiduciary duty. (Prior law in G.S. 36C-8-808(d) only provided that the power holder was “presumptively” a fiduciary.) The changes in H 707 excepted from this fiduciary duty a power holder who (a) only has the power to remove and appoint trustees or other power holders, (b) is a beneficiary where the power to direct constitutes a power of appointment, or (c) is a beneficiary where the power affects only the interests of the beneficiary who is the power holder. This section also provides that Uniform Trust Code provisions on discretionary powers and tax savings, liability of trustees, and prudent investor rules are applicable to a power holder as a fiduciary.

36C-8A-805 through 36C-8A-811: To make the law governing power holders and directed trustees more comprehensive as recommended by commentators, H707 added administrative provisions governing compensation and expense reimbursement of a power holder, jurisdiction over a power holder, accepting or declining appointment as a power holder, powers of the trustee in the absence of a power holder, decisions by multiple power holders, and resignations and removals of a power holder.
B. Corrections to UTC and Probate Statutes S.L. 2012-18/H707

H 707 also made corrections to changes made to the Uniform Trust Code and laws that address probate in North Carolina in the last session.

Transfer of Title to a Successor Trustee – H 707 made a technical amendment to G.S. 36C-7-707(b). The old language required former trustees to execute documents “transferring title” to trust property. The amendment clarifies that, as provided in G.S. 36C-7-704(f), a successor trustee is immediately vested with title to property of the former trustee so that no documents of title are necessary to transfer title. The statute does require the former trustee to comply with reasonable requests to execute documents acknowledging that transfer to facilitate the administration of the trust.

There was a correction to a cross-reference in the Medicaid estate recovery law, with regard to priority of creditors of a decedent’s estate. G.S. 28A-19-6 was amended by Session Law 2009-288, but the reference in G.S. 108A-70.5(c) was not updated, and H 707 fixed the cross-reference.

A Petition for a Personal Representative to Take Possession, Custody, and Control of Real Property is a Special Proceeding. The revisions to Chapter 28A included changes that addressed how a personal representative could deal with real property – especially with regard to persons occupying real property which was in the possession of the personal representative. The revisions created a possible ambiguity in which one could argue a personal representative could take possession of real property in an estate proceeding rather than a special proceeding. H 707 clarified the ambiguity – a petition for a personal representative to take possession, custody, and control of real property is a special proceeding.

Notice of Final Accounts/Annual Accounts. Under G.S. 28A-21-6, if a personal representative chooses, he or she can give notice of a final account to a beneficiary. If the notice is given, the beneficiary has 30 days to object to the notice and is thereafter barred. The statute was clarified to provide that, when the final account is sent to a beneficiary, the personal representative may also include a copy of any annual accounts. The beneficiary can be barred from objecting to matters disclosed in any annual accounts sent with the final account in the same manner that the beneficiary can be barred from objecting to the final account.

Affidavit of Collection in Testate Estate. H 707 made a technical correction to G.S. 28A-25-1.1, to make it consistent with the provisions of G.S. 28A-15-1, which deals with intestate estates, on calculating amounts of a “small estate.” Specifically, in both a testate and intestate situation, an estate may be administered by affidavit after the spouse takes his or her year’s allowance.

H 707 also authorized additional comments on the Uniform Trust Code, consistent with other Uniform Trust Code enactments.
C. The Effective Date Conundrum

When North Carolina’s probate statutes were substantially revised in 2011, the Senate bill which was enacted provided: “This act becomes effective January 1, 2012, and applies to estates of decedents dying on or after that date.”

This effective date language is problematic. It provides a bright line for when the act applies, but it means that attorneys will have to remember the old version of the statute and apply those rules to estates where the decedent died before January 1, 2012. This raises particular problems with the changes to the caveat statutes and other procedural changes.

The effective date represents a trap for unwary practitioners. It is critical that in administering an estate, especially an estate where there may be contentious matters or where any petition may need to be filed, one considers carefully whether the new version of Chapters 28A, 29, 30, and 31 apply, or whether the old versions apply.

D. Landlord-Tenant/Deceased Tenant’s Belongings – S.L. 2012-17/H493-

Updates various provisions regarding rent that accrues after a judgment but before a tenant vacates premises and bond to be posted on appeal. G.S. 42-34.1.

Allows personal property of a tenant who abandons rental property to be delivered to a nonprofit organization, if the personal property is $750 or less in value, and if the organization agrees to hold the property for 30 days and to release the property to the tenant at no charge during the 30-day period. If a tenant’s personal property is less than $500, after summary ejectment, the property is deemed abandoned 5 days after execution of the eviction order, and the landlord may throw away the property.

Introduced a new section 28A-25-1.2 regarding removal of tangible personal property by a landlord after the death of a residential tenant:

- Applies when the decedent was the sole occupant of a dwelling unit
- Landlord can take possession of the property upon filing an affidavit IF
  - At least 10 days has passed since the last day rent was paid through
  - No PR, collector, or receiver has been appointed
  - No affidavit has been filed (collection by affidavit)
- The affidavit must state:
  - Name and address of affiant and that affiant is landlord
  - Name of decedent and fact that decedent was lessee and sole occupant
  - A copy of the decedent’s death certificate must be attached to the affidavit (not sure how the affiant gets this)
  - Address of the dwelling unit
Decedent’s date of death
Date paid rental period expired and the fact that 10 days have elapsed since that date
Affiant’s good faith estimate of the value of the tangible personal property, with an inventory of the property that includes, at a minimum, the categories of furniture, clothing and accessories, and miscellaneous items
That no PR, collector, or receiver has been appointed and no affidavit for collection has been filed
The name of the person listed as an emergency contact for the tenant, and a statement that the affiant tried to contact the person and either was unsuccessful in contacting the person, or if the person was contacted, that the person has not taken action to administer the estate.

- The affidavit must be filed in the county where the dwelling is located. The filing fee is $30.
- The landlord must provide a copy of the affidavit to the emergency contact. If there is not an emergency contact, the affidavit must be posted at the door of the landlord’s rental office and in the courthouse.
- After the affidavit is filed, the landlord can take the personal property out of the premises and can store it. The landlord can then re-let the premises.
- If 90 days after the affidavit is filed, no PR has been appointed, the landlord can sell the property (at public or private sale) and apply the proceeds to the landlord’s costs and past-due rent. The landlord must file an accounting to the clerk showing how the proceeds were used and must turn over any excess proceeds to the clerk.
- Alternatively, the landlord can deliver the personal property to a nonprofit organization.
- If, before the 90 days passes, the landlord receives notice that a PR has been appointed, the landlord must turn the property over to the PR.
- If the personal property has a value of less than $500, the landlord can go ahead and deliver it to a nonprofit organization, just like a landlord could do in the case of personal property abandoned by a tenant (see above).
- This procedure presents an alternative to summary ejectment filed against an estate.
- If a landlord takes possession of property without following this procedure, then the landlord may be liable for damages.

E. Passing Title by Will – H1066

Section 28A-2A-1 was modified to remove the provisions in that section that addressed the effectiveness of a will to pass title to real property.

Section 31-39 was modified to clarify that:

- A duly probated will is effective to pass title to real property.
• If an estate is administered as an intestate estate, and the heirs convey title to real property to a purchaser for valuable consideration, then a will can only divest the intestate heirs of their interest in the property if it is filed before the final account in the estate is filed.

• Likewise, if a buyer purchases real estate from intestate heirs more than two years from the date of the decedent’s death, that buyer’s interest in the property will not be divested by the later filing of a will.

F. Co-owners/Unequal Shares/Simultaneous Death – H1067

G.S. 28A-24-3 was modified to provide that in the case of co-owned property, where the co-owners have simultaneous deaths (defined to mean that one does not survive the others by at least 120 hours), the estate of each co-owner will receive the co-owner’s pro rata share of the property. (Previously if there were 2 co-owners, each co-owner received half, if there were 3 co-owners, each received 1/3, etc., but the change makes the division relate to the actual ownership interest of the deceased co-owner.)

G. Intestate Property/Child’s Year’s Allowance - H1069

Changes the intestate share of personal property of a surviving spouse and increases the child’s year’s allowance amount:

• If decedent is survived by one child/descendants of one child, surviving spouse receives first $60,000 of personal property, plus one-half of the balance of the personal property. (Previously, the surviving spouse received the first $30,000 of personal property.)

• If decedent is survived by two or more children (or descendants thereof), surviving spouse receives first $60,000 of personal property, plus one-third of the balance of the personal property.

• If the decedent had no children surviving, but is survived by one or more parents, the surviving spouse receives the first $100,000 of personal property, plus one-half of the balance of the personal property. (Previously, the surviving spouse received the first $50,000 of personal property.)

• Increases the child’s year’s allowance to $5,000 from $2,000 previously

Applies to estates of decedents dying on or after January 1, 2013.
H. Some very important matters – Session Law 2012-29

The Eastern tiger swallowtail is adopted as the official butterfly of the State of North Carolina.

en.wikipedia.org

The Shelby Livermush Festival is adopted as the official fall livermush festival of the State of North Carolina.

The Marion Livermush Festival is adopted as the official spring livermush festival of the State of North Carolina.

The Swansboro Mullet Festival is adopted as the official mullet festival of the State of North Carolina.

www.dwa.gov.za

III. STATUTES DEALING WITH ESTATE PLANNING AND FIDUCIARY LAW FROM THE 2011 LONG SESSION

A. Payable on Death Accounts – S.L. 2011-236

Allows a payable on death account to name a person other than a natural person as a beneficiary. For example, allows a trust to be named as the payable on death
beneficiary. Provides that if a beneficiary is other than a natural person, there may only be one beneficiary.

The payable on death arrangement must be set out in a “conspicuous manner” and may be on a signature card or on a separate document whose receipt is acknowledged by the person establishing the account.

These modifications apply to accounts at banks (§ 53-146.2A), savings and loan institutions (§ 54B-130A), savings banks (§54C-130A), and credit unions (§54-109.57A).


Defines devisee and devise. Makes changes throughout various sections of the General Statutes to make the use of the words devise and devisee consistent.

A “devise” is defined as “a testamentary disposition of real or personal property and, wherever used in any of the statutes as a verb, shall be construed to mean to dispose of real or personal property by will.”

(Gets rid of the terms “legatee” and “bequest” and related language.)

C. Deeds of Trust/Modernize Procedures – S.L. 2011-312

Makes changes to Chapter 45. If preparing a deed of trust, especially a future-advance deed of trust, be sure to review the current version of the statutes to make sure that your deed of trust complies with the statutes. The session law also makes changes to the way the terms of a deed of trust may be modified.


- **Trustee Compensation.** If a trustee wants compensation in excess of 0.4% in a given year, the trustee can give written notice to the qualified beneficiaries, and if a beneficiary does not file a proceeding for review of the compensation within 20 days, then the trustee can receive the compensation.

- **Deemed Contribution to Trusts.** Provides that the property in certain trusts will be deemed to have been contributed by the settlor’s spouse. The property will be included in the spouse’s estate for estate tax purposes, and the settlor is considered a beneficiary. The trusts to which this rule applies are: (i) a marital general power of appointment trust under IRC §2523(e); (ii) an inter-vivos QTIP trust; (iii) an irrevocable inter-vivos trust of which the settlor’s spouse is the sole beneficiary during the spouse’s lifetime, but which does not qualify for the federal gift tax marital deduction; or (iv) a subtrust or other trust attributable to the previous 3 trusts.
• Adds to §36C-7-704(f) a provision that a successor trustee is vested with the title to property held by the former trustee.

• Clarifies §36C-8-816 to provide that a trustee’s powers, including investment powers and powers to sell assets, continue after termination of the trust to allow for wind-up of the trust administration.

• Provides that a personal representative that is a licensed trust institution does not have to be bonded. §28A-8-1(b).

• Adds several amendments to update references to banking statutes to clarify what institutions may serve as trust institutions and to remove outdated language. Clarifies that all trust institutions must be licensed by the Commission of Banks, and the fee for the license is $500. Also allows the Commissioner to investigate, at a trust institution’s expense, whether the trust institution is in a “hazardous condition.” The “hazardous condition” language replaces the previous solvency standard for trust institutions. If the Commissioner revokes a trust institution’s license because it is in a hazardous condition, notice of the revocation is to be sent to the clerk of court in each county.

• Modifies provisions with regard to the boards of directors of private trust companies, to allow equity owners of a private trust company to delegate functions to advisory groups or sub-groups of the board of directors. Notice of such delegation must be given to the Commissioner within 48 hours of the change to the power of the board of directors.


Chapters 28A, 29, 30, and 31 all received substantial modifications dealing with both procedural and substantive matters. These are covered in a separate presentation.

IV. TAX STATUTES FROM THE 2011 LONG SESSION

A. Repeal Land Transfer Tax – S.L. 2011-18

Removed a provision that allowed a county Board of Commissioners to impose a local land transfer tax on instruments conveying interests in real property located in the county.

B. Eliminate Means Test from 529 Deduction – S.L. 2011-106

Certain taxpayers whose AGI was low enough could deduct from their taxable income up to $2,500 for contribution to a N.C. 529 plan ($5,000 for a married couple). The limits were: $100,000 AGI for a married couple filing jointly; $80,000 for a head of household; $60,000 for a single person; and $50,000 for
married, filing separately. These limits have been repealed, effective as of June 3, 2011.

V. STATUTES THAT AFFECT ELDER LAW FROM THE 2011 LONG SESSION

A. Protect Adult Care Home Residents – S.L. 2011-99. Imposes a variety of requirements upon Adult Care Homes to help reduce the incidence of transmission of HIV, hepatitis B and C, and other blood-borne pathogens. Icky.

Also requires training of employees of Adult Care Homes on the safe administration of medications. By October 1, 2013, no staff members will be permitted to administer medications unsupervised, unless they have completed the Department of Health and Human Services training course.

B. Additional Section 1915 Medicaid Waiver Sites – S.L. 2011-102. Allows the Department of Health and Human Services to implement two Local Management Entities (LMEs), which are Medicaid waiver programs. Allows LMEs to apply to become managed-care organizations.


D. Task Force on Fraud Against Older Adults – S.L. 2011-189. Directs the Department of Justice’s Consumer Protection Division to coordinate a task force to evaluate the issue of fraud against seniors. The task force is charged with identifying areas where current laws can be enhanced to better protect older adults against fraud. Final report and recommendations due by October 1, 2012.

E. Pilot Release of Inmates to Adult Care Homes. S.L. 2011-389. DHHS must establish a pilot programs to allow certain inmates to be placed in adult care homes to provide personal care services and medication management.

VI. STATUTES DEALING WITH BUSINESS LAW FROM THE 2011 LONG SESSION

A. Allow Attorneys’ Fees in Business Contracts – S.L. 2011-341. This addition of section 6.21.6 to Chapter 6 of the General Statutes states that in a business contract, the parties may provide for the payment of reasonable attorneys fees and expenses incurred in a lawsuit, arbitration, or other proceeding involving the contract, but only if the attorney-fee provisions are applicable to all parties. Interestingly, a reciprocal attorney fee provision is only valid if all parties sign the contract by hand. In addition, the attorney fees cannot exceed the monetary damages awarded.

The statute also includes a list of factors in determining whether an attorney’s fee is reasonable:

1. The amount in controversy and the results obtained.
2. The reasonableness of the time and labor expended, and the billing rates of the attorneys.

3. The novelty and difficulty of the questions raised in the action.

4. The skill required to perform properly the legal services rendered.

5. The relative economic circumstances of the parties.

6. Settlement offers made prior to the institution of the action.

7. Offers of judgment pursuant to Rule 68 and whether the judgment was more favorable than an offer of judgment.

8. Whether a party unjustly exercised superior economic bargaining power in the conduct of the action.

9. The timing of settlement offers.

10. The amounts of settlement offers compared to the verdict.

11. The extent to which the party seeking attorneys’ fees prevailed in the action.

12. The amount of attorney’s fees awarded in similar cases.

13. The terms of the business contract.

VII. OTHER ITEMS OF INTEREST FROM THE 2011 LONG SESSION

A. Name Change Requirements. G.S. 101-5 which deals with name changes was amended to require that information from the person’s birth certificate, certified results of an official state and national criminal history record check, a sworn statement regarding the person’s residence, and outstanding tax or child support obligations be provided for a name change. Also creates a process for denial of the name change by the clerk and appeal to superior court.

B. Unborn Victims of Violence Act – S.L. 2011-60. Adds Article 6A to G.S. Chapter 14, which creates a criminal offense for acts that cause the death of or injury to an unborn child or that are committed against a pregnant woman.

C. Amend Various Gun Laws/Castle Doctrine. S.L. 2011-268. Amends numerous gun laws related to the right to own, possess, or carry a firearm in North Carolina. Outlines when a person may use defensive force to protect home, workplace, or vehicle.

D. Appropriations Act – Cut $38 million from the judicial budget for 2011-2012, and $42 million for 2012-2013. Forces elimination of over 300 staff positions, the
removal of drug treatment courts, and reduction in technology funding for the courts.

E. Abortion – Woman’s Right to Know Act. Enacts Article 11 in G.S. Chapter 90 that requires, before an abortion may be performed, a 24-hour waiting period and informed consent of the woman. The law also requires an obstetric ultrasound at least four hours before an abortion is performed (unless it is a medical emergency).

F. Employers and Local Government Must Use E-Verify. Requires expanded use of E-Verify to confirm the work authorization for newly hired employees.


VIII. CONSTITUTIONAL AMENDMENT

A new section was added to Article XIV of the North Carolina Constitution. (Article XIV is titled “Miscellaneous.”)

Sec. 6. Marriage

Marriage between one man and one woman is the only domestic legal union that shall be valid or recognized in this State. This section does not prohibit a private party from entering into contracts with another private party; nor does this section prohibit courts from adjudicating the rights of private parties pursuant to such contracts.

IX. CONCLUSION

Thank you to Kim Crouch, Director of Governmental Affairs of the North Carolina Bar Association. Kim does a great job of representing us with the General Assembly and putting together an annual Legislative Bulletin that summarizes laws affecting North Carolina lawyers. Thank you also to Paula Kohut and E. Knox Proctor V, who both provided valuable bill summaries which I relied upon in preparing this manuscript.
I. RECAP OF FOURTH-GRADE CIVICS

The North Carolina General Assembly is a bicameral state legislature – it consists of a Senate and a House of Representatives. The Senate has 50 members, and the House has 120 members. Both Senators and Representatives have two-year terms. Representatives elect a Speaker who presides over the House. The current Speaker is Thom Tillis (R-Mecklenburg). The Lieutenant Governor presides over the Senate (Dan Forrest is the current Lieutenant Governor). The Senate also elects officers, including the President Pro Tempore. The current President Pro Tem is Phil Berger (R-Guilford/Rockingham). The President Pro Tem fills in when the Lieutenant Governor is not available, and is the second-highest official in the state Senate.

The General Assembly meets for a long session starting in January of each odd-numbered year. It adjourns the long session and then reconvenes for a short session in each even-numbered year. The long session typically lasts about six months. The short session typically goes for about six weeks.

Most new legislation is considered in the long session. In the short session, the General Assembly typically considers matters that were introduced and approved by one of the houses, but which were not reached by the other.

II. NEW LAWS RELATED TO ESTATE PLANNING AND FIDUCIARY LAW


1. Out-of-state will probate and military wills

N.C.G.S. § 31-11.6 was revised to provide that a will can be self proved in North Carolina if:
• The will includes the attestation language contained in N.C.G.S. § 31-11.6 and is properly executed and notarized;
• The propounder of the will shows, to the clerk’s satisfaction, that the will was made self-proving under the laws of another state; OR
• It complies with the rules for self-proved military wills.

Questions: What proof is required to satisfy the clerk that a will was made self-proving under the laws of another state?

Affidavit from an attorney in that state?

Will there be any presumption that a will that appears to be valid on its face complies with the laws of another state?

Will treatment of out-of-state wills vary from county to county?

N.C.G.S. § 31-46 (Validity of will; which laws govern) was revised to be consistent with the changes to § 31-11.6. It now provides that a will is valid if it is consistent with North Carolina law OR (this is the new part:) it complies with the law of the place where it was executed, its execution complies with the law of the place where the testator was domiciled at time of death, or it is a testamentary instrument.

Observation: This would apply when you have a will that was probated in another state (because the decedent lived in another state), and you want the out-of-state will (or an exemplified copy) to be probated in North Carolina and to be effective to convey title to real property.

N.C.G.S. § 28A-2A-17 deals with the recordation of a certified copy of the will of a nonresident, and was revised to expressly provide that wills valid under § 31-46 are effective to pass title or otherwise dispose of real estate in North Carolina.

These changes were intended to allow a valid testamentary instrument to be effective, even if it does not comply exactly with the language of North Carolina’s self-proving statute. The changes arose out of anecdotal evidence that valid wills were not admitted to probate or were not effective to pass title to real property, solely because they did not comply with every part of North Carolina’s self-proving statute. An example of the problem which this fixes is the tale that a will was denied probate because the witness attestation clause failed to state that the testator was over 18 years of age, even if other evidence was available to prove that the testator was over 18 years of age at the time of execution of the will.

2. Elective Share Change
The elective share statute was changed in a substantial way: the percentage, or applicable share, of the surviving spouse has been changed. In the past, the applicable share was tied (to some degree) to North Carolina’s intestacy statute, with an additional reduction that reduced the share of surviving spouse when (1) the surviving spouse was a second or successive spouse; (2) the decedent had children that were not also children of the surviving spouse; and (3) the decedent and the surviving spouse had no children together.

The changes modernize the statute and bring it more in line with the elective share/dissent statutes of other states. The change is also more consistent with the approach of the Uniform Probate Code.

N.C.G.S. § 30-3.1 still provides that the elective share is an amount equal to (i) the applicable share of the Total Net Assets, less (ii) the value of Net Property Passing to Surviving Spouse. The applicable share was changed and is now a percentage based on the length of the marriage. It was discussed that a length-of-marriage approach was more equitable than an approach based on whether a marriage produced children, and whether a marriage was a first marriage. Of course, the elective share is a fairly blunt tool, and is generally not an ideal way to have an estate divided. When an elective share claim is made, it is almost certain that all parties interested in the estate will be less than thrilled with the outcome.

Under the new length-of-marriage approach, the applicable share is as follows:

<table>
<thead>
<tr>
<th>Length of Marriage</th>
<th>Applicable Share Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 5 years</td>
<td>15%</td>
</tr>
<tr>
<td>At least 5 but less than 10 years</td>
<td>25%</td>
</tr>
<tr>
<td>At least 10 but less than 15 years</td>
<td>33%</td>
</tr>
<tr>
<td>15 years or more</td>
<td>50%</td>
</tr>
</tbody>
</table>

There is no longer any reduction for a second marriage, and the applicable share percentage is not dependent on whether the decedent had children or how many children the decedent had.

Notes: (1) Most deceased spouses leave more, by will or intestate succession, to their surviving spouse. (2) This statute defines only the minimum that a spouse must leave his or her surviving spouse. It does NOT define the share a spouse takes in the absence of a will. (3) This
change will not affect prenuptial agreements or other agreements and documents in which a spouse waives his or her rights to an elective share.

The elective share change is effective October 1, 2013 and applies to estates of decedents dying on or after that date.

3. Limited Personal Representatives

A limited personal representative can be appointed in certain circumstances where a full estate administration is not required. The limited personal representative can run a notice to creditors. Previously, some clerks had interpreted the limited personal representative statute in a very restrictive way, so that it could only be used if the decedent had no property in the decedent’s individual name. Thus, some clerks would not allow a limited personal representative to be appointed where the decedent had no assets subject to probate but did have real property (the argument was that real property could potentially be subject to probate if it was needed to pay a decedent’s debts).

N.C.G.S. § 28A-29-1 was amended to provide that a limited personal representative can be appointed and can run a notice to creditors where:

- The decedent left no personal property subject to probate and no real property devised to the personal representative;
- The decedent’s property is being collected by collection by affidavit pursuant to Article 25 of Chapter 28A;
- The decedent’s estate is being administered under the summary administration provisions of Article 28 of Chapter 28A;
- The decedent’s estate consists solely of a motor vehicle that can be transferred by the procedure authorized by G.S. § 20-77(b); or
- The decedent left assets that may be treated as assets of an estate for limited purposes as described in G.S. § 28A-15-10 (tentative trusts, gifts causa mortis, joint accounts with right of survivorship, certain securities passing to a beneficiary)

This revision should allow for more use of the limited personal representative statute.

4. Decanting Statute Improvements

G.S. § 36C-8-816.1 is a modern “decanting” provision, which allows a trustee who has the discretion to distribute both principal and income to distribute those assets by “pouring” the assets of one trust into another trust designed to protect the interests of the beneficiaries to whom the distribution is made. This power is subject to certain limitations, including notice to the qualified beneficiaries and their right to object.
One limitation on the trustee’s ability to decant is that the interest of a beneficiary may not be reduced in certain circumstances. The change to G.S. § 36C-8-816.1(1)(c)(3) clarified that these limitations apply only if a current interest in the trust has come into effect, which of course is the whole point of the decanting statute. Previously, the statute did not expressly state that a beneficiary’s fixed income, annuity, or unitrust interest could be reduced before it became effective, although many practitioners interpreted the statute that way (reasonably).

An additional change to G.S. § 36C-8-816.1(e)(2) deleted an outmoded reference to the rule against perpetuities as a limitation on the power to decant.

5. Insurable Interest

A new section was added to the Uniform Trust Code to clarify North Carolina law with regard to whether the trustee of an irrevocable life insurance trust had an insurable interest in the life of the decedent. This clarification was made in response to some federal district court cases from 2005 that raised the specter that a trustee might not have an insurable interest in the life of the settlor of an irrevocable life insurance trust.

The new N.C.G.S. § 36C-1-114 provides that a trustee does have an insurable interest if the insured is either (1) the settlor of the trust, or (2) an individual in whom the settlor of the trust has an insurable interest or would have had an insurable interest, if living at the time the policy was issued. The life insurance proceeds must also be primarily for the benefit of one or more trust beneficiaries that have an insurable interest in the life of the insured.

This new section follows the lead of the Uniform Law Commission’s model “Insurable Interest Amendments to the Uniform Trust Code.”

6. Inherited IRAs are Exempt from Creditor Claims

Debtors are entitled to retain certain assets under North Carolina law, free of the enforcement of the claims of creditors. These provisions are contained in N.C.G.S. § 1C-1601(a). This statute was amended to state that assets held in an IRA remain exempt after an individual’s death if they are held by one or more subsequent beneficiaries by reason of a direct transfer or eligible rollover that is excluded from gross income.

With this change, it is clear that inherited IRA assets are exempt from the claims of creditors. For example, if two children of the decedent who established the IRA are named the beneficiaries of the IRA, and “roll over” their shares so that they are held in inherited IRAs, the inherited
IRA assets are exempt from the claims of both the decedent’s creditors and the children’s creditors so long as they save them for their retirement.

7. Attorneys’ Fees on Year’s Allowance

When a spouse seeks a year’s allowance in excess of the presumptive statutory amount of $20,000, the clerk of court hears the matter as a special proceeding. The clerk hears evidence about why the surviving spouse is seeking the additional allowance (which is limited to one-half of the average annual income of the decedent for the three years preceding his or her death), and determines the allowance. N.C.G.S. § 30-31 was amended to clarify that the clerk has the power to order that the estate pay the surviving spouse’s attorneys fees and costs, and that if they are so paid, they are properly categorized as administrative expenses.

8. Guardianship Gifting

The general guardian or guardian of the estate of an incompetent person can make gifts of the ward’s property, with the court’s approval.

The court may approve gifting if the court determines that the donee is the spouse, parent, descendant of the incompetent, or descendant of the incompetent’s parent, and the gift qualifies for the federal annual gift tax exclusion under section 2503(b) of the Internal Revenue Code, or is a qualified transfer for tuition or medical expenses under section 2503(e) of the Internal Revenue Code. Previously, only annual exclusion gifts were allowed. (This change was effected by revisions to N.C.G.S. § 35A-1336.1 and 35A-1341.1.)

In addition, the statute regarding the powers of a guardian was modified to state expressly that a guardian may take actions, including seeking approval for gifts, for the purposes of tax planning and public benefits planning. (N.C.G.S. § 35A-1251) This change is helpful for people who deal with guardianships, as it makes it clear that these are proper planning purposes for a guardian to consider.

9. Wrongful Death Statute

There was a small revision of N.C.G.S. § 28A-18-2 to clarify that claims filed for burial expenses and reasonable hospital and medical expenses of a decedent for whom a wrongful death claim has been prosecuted must be approved by the clerk of court before they are paid.

10. Clarifications

a. Trustee Powers Clarification (Help with Fiduciary Income Tax)
N.C.G.S. § 36C-8-816 was amended to allow a trustee to make certain elections with respect to federal, state, and local taxes, including, but not limited to, considering discretionary distributions to a beneficiary as being made from capital gains realized during the year.

This change gives specific statutory authority to trustees to utilize the exception under the Treasury regulations that allows capital gains to be carried out in distributable net income when the trustee of a discretionary trust deems a distribution to be made from capital gains.

b. UTC definition of “settlor’s spouse”

Clarified that for the purposes of N.C.G.S. § 36C-5-505(c) (which deals with an irrevocable trust that is exempt from creditors claims, even though technically “self settled”), the term “settlor’s spouse” refers to the settlor’s spouse at the time the trust was created.

c. Clarification as to Directed Fiduciaries

The topic of directed fiduciaries is covered in a whole separate presentation, so I will just note that the statute that deals with fiduciaries other than trustees was modified to make its provisions with regard to directed fiduciaries mirror the provisions for directed trustees in the UTC. N.C.G.S. § 32-72(d) was modified.

11. Update to North Carolina Investment Advisers Act

The North Carolina Investment Advisers Act was revised to address changes made in federal law governing investment advisers. These changes were recommended by the Estate Planning and Fiduciary Law Section, the NCBA’s Business Law section and the Securities Division of the Secretary of State’s office.

N.C.G.S. § 78C-2 and 78C-8 were amended address changes to the federal law made by the Dodd-Frank Act. “Family offices” maintained by high net worth families to manage their wealth were exempted under the old federal law by the “private adviser” exemption for less than 15 clients. Dodd-Frank did away with this exemption, which was referenced in North Carolina law, but provided that the SEC would define “family offices” that meet certain criteria. These sections continue the policy of not requiring family offices to be registered and also preserve the private adviser exemption at the state level. The revisions also continue the policy of allowing private advisers to charge performance-based fees.

Note on effective date: The changes in S.L. 2013-91 are all effective as of June 12, 2013, except for the elective share change.
B. S.L. 2013-81 – Increase of Year’s Allowance

Increases the spouse’s year’s allowance to $30,000.

Effective on January 1, 2014, and applies to estates of persons dying on or after that date.

C. H101 – Repeal Estate Tax

Proposal to repeal all of Article 1A of Chapter 105. (The title of Article 1A is “Estate Taxes.”) If passed, it would be retroactive to January 1, 2013 and apply to estates of decedents dying on or after that date.

It passed the House of Representatives, and is now under consideration by the Finance Committee in the Senate.

A legislative fiscal note was issued in February that stated that the State would lose the following amounts of general fund revenue if the estate tax is repealed: $52 million in 2013-14; $57 million in 2014-15; $60 million on 2015-16; $63 million in 2016-17; and $66 million in 2017-18. This analysis was based on a $5 million exclusion amount.

D. H399 – Changes Related to Medicaid Estate Recovery

When a person receiving Medicaid dies, the Department of Health and Human Services (DHHS) can file a claim with the decedent’s estate to be repaid for certain amounts spent by the Department on the decedent’s care. This bill changes and clarifies the rights of that department.

The proposed changes clarify that:

- DHHS has all the rights available to estate creditors, including the right to qualify as a collector or personal representative. Changes to N.C.G.S. § 108A-70.5(b)(2).
- DHHS originally proposed changing the language regarding estate recovery to include recovery against a life estate, when the decedent was the life tenant. Many sections of the Bar Association pointed out that there were problems with this idea.
- DHHS had proposed that notice be sent to DHHS in all estates in North Carolina, to assist DHHS in determining when to file a claim. That language, through negotiation, was changed to provide that if the decedent was receiving medical assistance from DHHS, the PR must give a notice to DHHS. In essence, this makes DHHS a known creditor when a
The decedent was receiving medical assistance. Changes to N.C.G.S. § 28A-14-1(b).

- The proposal also modifies N.C.G.S. § 28A-19-6 to state that DHHS is a 6th class creditor, but is in line behind other 6th class creditors whose judgments were docketed and in force before DHHS sought recovery.
- DHHS also proposed that trustees would have to notify DHHS of the trust’s existence whenever any beneficiary of the trust was receiving assistance or medical care from DHHS. The proposal may have betrayed a lack of understanding of the numerous ways that trusts are used, but through negotiation, the proposal was changed to provide that if the settlor of a revocable trust was receiving medical assistance and if the trustee knows of that medical assistance, then the trustee must give notice of the decedent’s death to DHHW within 90 days of the person’s death.

This bill has passed the House and is under consideration in the Finance Committee of the Senate.

E. S.L. 2013-198 – Children Born out of Wedlock

Revised our statutes to allow a child born out of wedlock to inherit from a person who died prior to or within one year after the birth of the child if paternity can be established by DNA testing.

Under current law, for an child born out of wedlock to inherit from the child’s father, the child must show that the father was adjudged to be the child’s father or the father must have acknowledged in a written instrument that the child is his, and then filed that instrument in the office of the clerk during the father’s lifetime and the child’s lifetime. N.C.G.S. § 29-19.

The change allows a child born out of wedlock to inherit from the child’s father if the father died prior to or within one year of the child’s birth and is established by DNA testing to be the child’s father.

The rules for a child born out of wedlock to inherit from the child’s father also apply when the question is whether the child’s putative father inherits from the child.

The change allows paternity to be established, for inheritance purposes, by DNA testing in certain circumstances would also apply to a child’s claim for a year’s allowance. N.C.G.S. § 30-17.

The session law also makes revisions throughout the General Statutes to eliminate the term “illegitimate” when used in connection with an individual and to remove references to “bastardy.”

The sections that were revised are: § 6-21 (relating to costs in proceedings regarding children born out of wedlock); §14-325.1 (relating to failure to pay
child support; §15-155.2 (DA action with regard to children born out of wedlock and Work First family assistance); §15-155.3; §29-12 (Escheats); §29-18 (Succession by, through, and from legitimated children); §29-19 (Succession by, through and from children born out of wedlock); §29-20 (Descent and distribution upon intestacy of children born out of wedlock); §29-21 (Share of surviving spouse); §29-22 (Shares of others than surviving spouse); §30-17 (When children entitled to allowance); §31-5.5 (After-born or after-adopted child; children born out of wedlock; effect on will); all of chapter 49 (formerly titled “Bastardy”); §50-11(b); §97-2 (Definitions – Workers Compensation statute); §130A-119 (Clerk to furnish State Registrar with facts as to paternity of children born out of wedlock when judicially determined); .and §143-166.2(a) and (c) to include a child born out of wedlock as a dependent child of determining whether a child should receive benefits as a result of the child’s father’s death when the father was an officer, fireman, rescue squad worker, or senior member of the Civil Air Patrol killed in the line of duty).

F. S403 – Funeral Investments

(Passed Senate, now in House Committee on Banking)

The revisions to N.C.G.S. § 65-60.1(e) and 90-210.61(a)(1) allow a trustee holding cemetery trust funds to invest those funds consistent with the Uniform Prudent Investor Act contained in Article 9 of the UTC. It also allows preneed funeral funds to be invested consistent with the Uniform Prudent Investor Act. The change allows preneed funeral funds to be held in commingled trust accounts, for ease of management of the funds.

III. LIMITED LIABILITY COMPANY ACT – RESTATED

The North Carolina Limited Liability Company Act was completely restated. It is now contained in Chapter 57D of the General Statutes. See S.L. 2013-157.

Observation: Be sure to update your documents to refer to the right chapter!

LLCs are used more and more in both traditional business situations and in estate planning. We use LLCs in the place of partnerships, for asset management, for planning for families, and for creditor protection purposes.

A. Affirmation of Contractual Underpinnings of the North Carolina Limited Liability Company Act.

1 This summary of the changes to the LLC Act is based upon (and largely copies) a summary of the overhaul of the North Carolina LLC act prepared by Warren P. Kean, K&L Gates LLP, Chair of the Revised LLC Act Drafting Committee, with Mr. Kean’s permission.
The public policy underlying the North Carolina Limited Liability Company Act (the “Act”) is stated in G.S. § 57D-10-01(c): “It is the policy of this Chapter to give the maximum effect to the principle of freedom of contract and the enforceability of operating agreements.” The revisions to the Act were intended more clearly, concisely, and effectively to achieve and implement that stated public policy objective.

1. No writing requirement. The revisions to the Act eliminate all requirements that any part of a North Carolina limited liability company’s operating agreement be in writing. The revisions, however, do not go as far as the Delaware Limited Liability Company Act, which makes the “statute of frauds” inapplicable to Delaware limited liability company agreements. Under the revised Act, the operating agreement may be established in the same ways as any contract: i.e., by written, oral, or implied assent among the parties to the contract. As under the current Act, however, the parties may require that all of the components of the operating agreement be in a signed, written document or in any other prescribed form.

2. Supplemental Nature of the Act. In furtherance of the foregoing, the revised Act would establish that its provisions concerning the internal affairs of North Carolina limited liability companies are intended to apply only if, and to the extent, other provision is not made in the operating agreement. Accordingly, parties are free to modify, waive, and nullify the rules of the Act that would otherwise govern their respective rights and duties. The limited extent to which that freedom of contract is restricted is set forth in Part 3 of Article 2 of the revised Act. (N.C.G.S. § 57D-2-30 through § 57D-2-40.)

3. Objective of the Revised Act. The objective of the revisions is to provide certainty and a more detailed framework and structure to allow members of a North Carolina limited liability company to be confident that their management and ownership arrangements will be accommodated by and enforced under the Act. This flexibility is partially achieved through the introduction of certain new defined terms:

   a. Those relating to the management of the limited liability company: “company officials” (which may but need not be “managers”);

   b. Those relating to the two different types of owners of limited liability companies: “economic interest owners” (referred to under the prior version of the Act as “assignees”) and “members,” and in reference to either economic interest owners or members or both, “interest owners,” and the interest held by either being referred to as an “ownership interest” instead of a “membership interest;”
c. Those relating to the economic interest of an owner: “contribution amount,” “capital interest,” and “economic interest.”

d. These definitions (and others) are contained in N.C.G.S. § 57D-1-03.

4. Clarification of Matters that May be Agreed Upon by the Members. In addition to the members being able to require the operating agreement to be in writing or other prescribed form, the revised Act makes it clear that the members’ freedom of contract extends to decisions concerning the following matters:

a. Management Duties – The duties of those responsible for the management of the company, including the scope or elimination of fiduciary and other duties except nonwaivable contractual duties, including the implied contractual covenant of good faith and fair dealing and the requirement that the terms of the contract not be unconscionable at the time they are made.

b. Exculpation and Indemnification – The liabilities and other consequences to those managing the company for any breach or failure in the performance of their duties.

c. Penalties – The imposition of penalties and other remedies for breach of the operating agreement or the occurrence of proscribed events.

d. ADR – The right of the parties to select the manner in which they are to resolve their disputes, including having such dispute resolution procedures supplant the right to bring derivative actions or actions to cause the company to be judicially resolved.

e. Information Rights – The right to establish certain rules and procedures concerning access that owners may have to certain information, while specifying the type of information that cannot be denied members who comply with prescribed rules and procedures.

B. Foreign Limited Liability Companies

The revised act harmonizes, where appropriate, the rules under the LLC Act with their counterparts under the Business Corporation Act. One such set of rules where this would be accomplished relates to foreign limited liability companies.

C. Clarifying, Modernizing, and Coordinating Provisions of the Act
The remaining revisions are more in the nature of clarifying (i.e., removing ambiguities), simplifying, and modernizing the Act and coordinating its provisions to accommodate the new concepts and features described above. These revisions include those described in the following non-exhaustive list:

1. Coordinating the terms relating to bankruptcy with the current United States Bankruptcy Code;

2. Clarifying that the flexibility of the Act accommodates entities and arrangements such as low profit limited liability companies without the need to adopt separate sets of provisions such as those found in G.S. § 57C-2-03;

3. Providing that organizers may act by majority consent;

4. Removing the requirement that the articles of organization state whether the LLC is “member-managed” or “manager-managed;”

5. Clarifying that an LLC need not have any managers – instead management may be vested in persons having different titles and different powers and duties as may be provided in the operating agreement;

6. Allowing managers to delegate responsibilities to other persons without the approval by the members unless the operating agreement provides otherwise;

7. Providing that the term of a limited liability company is presumed to be perpetual unless other provision is made in the operating agreement (instead of in the articles of organization);

8. Adopting rules of construction to eliminate repetition of phrases and qualifiers, to make the Act easier to read and more user friendly;

9. Clarifying and modernizing the default rules relating to capital contributions and excuses from performance and basing distributions on the proportional contributions (of services as well as capital) of the owners (including promises to make contributions in the future);

10. Conforming the default rules and procedures relative to derivative actions with those in the Business Corporation Act; and

11. The elimination of redundant and otherwise superfluous provisions, including (A) G.S. § 57C-10-03(b) and (c) (concerning the law of estoppel and agency when § 57C-10-05 broadly provides that rules of equity and law supplement those under the Act) and (B) § 57C-2-02(1)-(16)
(illustrating the types of powers a limited liability company may exercise when the breadth of the statement in that section that there are no limitations or restrictions to such power other than not engaging in illegal activity makes doing so unnecessary).

D. Other Changes of Note

1. Override of UCC §§ 9-406 and 9-408. Because the application of UCC §§ 9-406 and 9-408, as currently in effect, may allow a member to encumber his or her economic interest in breach of the operating agreement [which may result in the foreclosure of that interest under circumstances that may result in adverse tax consequences to the other members, the transfer of ownership of the economic interest to a corporation or other ineligible shareholder of an S corporation, for those LLCs that elect to be taxed as S corporations, or a technical termination under I.R.C. § 708(b)(1)(B)], the revised Act adopts the approach taken in states such as Delaware and Virginia (among other states, including those states that have recently restated their LLC Acts: Texas, Mississippi, and New Hampshire) not to have UCC §§ 9-406 and 9-408 apply to LLC ownership interests.

2. Certificate of Existence. An example of the type of clean-up undertaken by the revised LLC Act concerns the certificates of existence issued by the Secretary of State. While the current LLC Act provides that one may conclusively rely on a certificate of existence as to the existence of an LLC, one does so at his or her peril. This is because, as contracted from a corporation under the BCA, the filing of articles of dissolution is not the event that causes an LLC to dissolve. Thus, the Secretary of State is not in a position to certify as to whether the LLC has dissolved. All she can do is certify as to the status of the LLC’s filings made in her office, which certification will be conclusive evidence as to the accuracy of its contents.

During the legislative process, new sections 57D-2-30(c) and (d) were added to provide that third parties may reasonably rely on documents filed with the Secretary of State, which is further inducement to keep current the information provided in an LLC’s annual report, and written operating agreements that have been provided to third parties.

3. Deletion of Low Profit Limited Liability Company (L3C) Provisions. As under current law, the flexibility of the restated Limited Liability Company Act accommodates the organization of limited liability companies that qualify for “program related investments” under I.R.C. § 4944(c) by private foundations, without the need for any additional or special provisions under Chapter 57C.

E. Priority of Charging Orders
During the legislative process, new § 57D-5-03(b) was added to provide for the priority of multiple charging orders on the same economic interest (the first in time has priority, except in the case where a prejudgment garnishment order had been issued).

IV. AMENDMENTS TO NC BUSINESS CORPORATIONS ACT – S.L. 2013-153

A. Modernizes the Business Corporations Act to allow shareholders’ meetings to take place with remote participation. The Board of Directors of the corporation can adopt guidelines and procedures for remote participation, and the statute provides that the corporation must implement procedures to:

- Verify that each person participating remotely is a shareholder; and
- Provide each shareholder a reasonable opportunity to participate in the meeting and to vote on matters submitted to the meeting

_The 21st century’s yesterday._ - INXS

B. Makes changes to rules about delegation of director duties.

C. Makes changes allowing a board of directors to present certain matters to shareholders for a vote, even if the board does not or cannot recommend the action. For example, if the board is presenting a plan of merger or share exchange, but cannot recommend it because of a conflict of interest, the plan can still be submitted to shareholders for a vote.

V. NORTH CAROLINA INCOME TAX

This is so up in the air at the time I am writing this manuscript, I almost don’t know what to say about it.

A. Several bills were introduced. Some common themes:

- Reducing the overall income tax rate
- Reducing/eliminating corporate income tax
- Increasing sales tax rates
- Imposing a sales tax on services
- Increasing the annual fees for various corporate and other entities

B. At the time of the preparation of this manuscript, HB 998 had been reported favorably out of the Senate Finance Committee (although Senator Bob Rucho (R-Mecklenburg) resigned as chairman of the Senate Finance Committee in protest over the legislation the committee approved). The bill:

- Steeply reduces personal income tax rates – a flat rate of 5.25% by 2015
- Eliminates corporate income tax and business franchise taxes by 2017 and 2018
- Repeals state-level sales tax on food effective November 2014
- Does not include extending sales taxes to services
- Eliminates some sales tax exemptions – movie tickets, back-to-school tax holidays
- Bill removes more than $4 billion from state revenues over 5 years

C. On the corporate tax side, the new tax scheme may be a disincentive to organize a North Carolina entity (other than a non-LLP general partnership). The bill includes a business privilege tax that would replace the annual fee for business entities and the franchise tax for corporations and income tax for corporations (phased in). The new annual tax will be $0 for non-LLP general partnerships, $5,000 for C corporations (which it appears would only apply to an entity that actually is a corporation, and not an alternate entity that files IRS Form 8832 to be classified as a corporation for federal tax purposes), and $750 for all other entities, including LLCs and S corporations. The tax would be imposed on all domestic entities, regardless of their activities in North Carolina, and all foreign entities that are “required to obtain a certificate of authority” under Chapter 57C/D to “transact business” in North Carolina.

If an LLC is going to hold investments or other assets, such as a holding company or family LLC/partnership that owns marketable securities or otherwise is not deemed to be transacting business in North Carolina, there may be an incentive to organize in another state – Delaware’s annual tax is $250, and South Carolina’s is $0. Perhaps the proposal will be amended to lower the tax in North Carolina to $250 or less for NC business entities that do not “transact business” in North Carolina.

VI. ELDER LAW

A. SL 2013-5 – Turn down federal expanded Medicaid funding, not operate a state-run or partnership health benefit exchange.

B. S.L. 2013-4 – Temporary Funding for Group Care Homes – Result of cuts in benefits of people who received personal care services (and risk of those people being turned out)

C. S.L. 2013-167 – Drug Testing for Long Term Care Facility Employees

Requires long-term care facilities to require applicants for employment and certain employees to submit to drug testing for controlled substances.

D. H 399 – Expand Medicaid Estate Recovery – discussed above

1. North Carolina had imposed an irrebuttable presumption that one-third of any tort recovery by a Medicaid beneficiary was attributable to medical expense and was therefore recoverable by the State.

2. The Supreme Court ruled in a 6-3 decision that the anti-lien provision of federal Medicaid law pre-empts North Carolina’s statute.

3. The statute was revised to include a rebuttable presumption.

VII. CIVIL PROCEDURE/LITIGATION/THE COURTS

A. Change to Jurisdictional Amounts. S.L. 2013-159

1. Small claims cannot exceed $10,000.

2. District court – amount in controversy is $25,000 or less.
   a. Also court-ordered nonbinding arbitration
   b. Adds nonbinding arbitration for small claims verdicts that are appealed.

3. Superior Court – amount in controversy exceeds $25,000

B. S. L. 2013 -204/H 332 – Notary Act

1. Strikes requirement that to be commissioned, a Notary must get the recommendation of a publicly elected official

2. Clarifies the rules regarding notarization by a “party” to a transaction

3. For an attorney who is also a notary, requires notice to the State Bar if the notary commits an untoward act

4. Loosens restrictions – makes it easier to validate a jurat if the notary made a mistake (for example, wrote the wrong date of the expiration of their commission)

5. Changes the rules regarding recording a power of attorney that affects real property

6. Deals with corrective affidavits for deeds


C. H 926 – Creates a private right of action against a notary, allowing a party or attorney to seek damages or injunctive relief against a notary who violates the notary act.

D. S.L. 2013-225 – Court Fees

1. Arbitration in all district court civil cases, regardless of amount at issue, unless all parties waive arbitration.
2. If a case is designated as a complex business case, there is an additional $1,000 court fee, for support of the General Court of Justice.
3. Excepts motions filed pursuant to G.S. 1C-1602 or 1603 (for debtor to claim exemptions) and motions filed by a child support enforcement agency from the $20 motion filing fee.
4. Clarifies that counties and municipalities are required to pay all court costs at the time of filing (but the clerk can grant a 45 day extension for payment).

VIII. REAL PROPERTY

A. S.L. 2013-34 – Clarifies laws regarding the powers and duties of a planned community and amends the procedures regarding amendment of a recorded declaration of planned community. Also provides that a unit owner in a condominium and a land owner in a planned community have to give access, when necessary, to other owners for the purpose of maintenance or repairs.

It seemed like there were several bills about home owners associations and planned communities.

B. H 802 (passed house) – Shortens the time period required to evict a tenant.

C. S.L. 2013-117 – Technical correction to law related to lien agents

The laws regarding the filing of mechanics and materialmen’s liens were substantially rewritten in the last legislative session. These 2012 changes make it imperative that parties to a construction contract act when they begin work to protect their real property lien and bond right claims, or risk losing them.

The law now requires the use of a lien agent, a company that is to track information concerning parties who may have potential real property lien rights. The idea is to create an easy and early way to identify potential lien claimants and avoid the risk of unknown claims arising after the property is sold or refinanced. Parties with lien rights (the contractor and, particularly, subcontractors) must give notice to the lien agent, and failure to give timely and full notice may result in the loss of lien rights.

The revision made it clear, also, that execution of a lien waiver by the general contractor can cut off the subcontractor’s subrogation lien rights against the real property (but the subcontractor can still have a lien on property that may arise by
operation of law if the recipient of a notice of lien upon funds pays over funds without holding back adequate money to pay the lien on funds).\(^2\)

The technical corrections make some clarifications applicable to personal residences and the use of a lien agent, and define a “custom contractor,” among other changes.

IX. FAMILY LAW

A. S.L. 2013-140 – Amending the laws pertaining to contracts between a husband and wife to allow a spouse to waive or establish alimony and post separation support during the marriage.

Amends G.S. § 52-10 and 50-16.6(b).

1. Previously, alimony could only be waived in a pre marital agreement.
2. There was a long line of NC cases that held that attempts to contractually affect alimony after a marriage were not effective.
3. This law overturns those cases.

B. S.L. 2013-27 – Uniform Deployed Parents Custody and Visitation Act
- Changes and loosens many of the rules that apply to child custody matters where a parent who is a member of the armed services is being deployed
- Allows for temporary custody agreements
- Allows for a power of attorney made by a deploying parent to delegate all or part of custodial responsibility to a nonparent for the period of deployment.
- Allows testimony in a hearing for a temporary custody order to be provided by electronic means
- Allows for temporary child support orders

C. S.L. 2013-42 – Clarify Name Change Requirements for Minors in Certain Circumstances.

Allows a parent to change a child’s name without the consent of the other parent if the other parent is convicted of felonious or misdemeanor child abuse, taking indecent liberties with a minor, rape, incest, assault, communicating a threat or any other crime of violence, if the crime was committed against the minor child or a sibling of the minor child.

Also allows a minor who has reached the age of 16 to file an application on his or her own behalf to change the minor’s name, if one parent consents, and the non-consenting parent is shown, to the satisfaction of the clerk of court, to have

---

\(^2\) This explanation of the lien law’s status is borrowed from an article written by Matt Martin, Anna B. Osterhout, and Wayne K. Maiorano in the *Change Order*, which is the newsletter of the Construction Law Section of the North Carolina Bar Association, with permission.
abandoned the minor (this is different from the prior statute, which required that there have been a determination that the non-consenting parent abandoned the child).

Adds a requirement that a person who desires to change his or her name must provide the results of a station and national criminal history check conducted within 90 days of the date of application by the SBI, the FBI or a “Channeler” approved by the FBI. (This criminal record check does not apply to a name change of a minor under age 16.)

D. 50B Protective Orders

S.L. 2013-237 provides that a consent protective order may be entered without findings of fact and conclusions of law if the parties agree in writing that no findings of fact and conclusions of law will be included in the consent protective order.

E. S.L. 2013-336 – Amend Adoption Laws

If spouses petition jointly to adopt, and one spouse dies before the entry of the adoption decree, the adoption may proceed in the name of both spouses, and upon completion of the adoption, the deceased parent will be included on the new birth certificate issued for the adopted child. The adopted child is treated as a child of the deceased spouse for inheritance purposes (testate or intestate).

If a stepparent who has petitioned to adopt a child dies before entry of a final decree, a person who had previously consented to the adoption must be given notice and has 15 days to request a hearing on the adoption. If the adoption is completed, the deceased stepparent will be added as one of the adopted child’s parents, and the adopted child will be treated as a child of the deceased stepparent for purposes of inheritance.

(This bill made other changes to some of the requirements for notice and for relinquishments.)

X. OTHER STUFF


a. Allows for captive insurance companies to be established in North Carolina.

b. What is a captive insurance company?

---

3 Much of this discussion of captive insurance was borrowed from a summary prepared by W. Y. Alex Webb, JD, CPA, who is a member of the NCBA Tax Section Council, and is used with his permission.
i. It insures certain risks of its owner, who is also the insured. In other words, the insured (or the insured’s parent or common owners) own the insurance company.

ii. There are several types of CICs:
1. Pure Captive
2. Association or Industrial Captive
3. Sponsored Captive
4. Risk Retention or Purchasing Group.

iii. CICs can insure:
1. Limited types or amounts of worker’s comp and group health and life insurance (generally requires special regulatory exemption or approval)
2. A wide variety of property, casualty, and liability insurance
3. NOT individual life insurance, automobile insurance, or homeowner’s insurance.

iv. Business Advantages:
1. Lower insurance cost
2. Improved cash flow (because the owner invests the funds, controls payment terms)
3. Fast resolution of claims
4. Tax law encourages “formal” self-insurance program (IRC § 831)
5. Allows coverage when over priced in the commercial market
6. Allows for coverage where no coverage exists
7. Focus risk management efforts of the business
8. Allows a business to access the reinsurance market (and wholesale prices)
9. Reserves are protected (asset protection) – “Reserves” are preserved in an entity reachable only by policyholders
10. Business planning opportunities
   a. Reward managers responsible for risk reduction and control
   b. Create a buyer for succession purposes
   c. Reduce the value of an operating entity to enable purchase by the buyer
   d. Can be a companion to ESOP
   e. Allows transfer of wealth with no gift tax
   f. Wealth grows with no future estate tax

v. Makes North Carolina more competitive
1. S.C. licenses approx. 200 CICs.
2. Tennessee is aggressively pursuing this business
3. 32 states and DC have CIC laws. About 10 are very active
4. Would allow NC business owners to form a CIC instead of having to go out of state.
B. S.L. 2013-162 – Modifies the maximum interest rate allowed in NC and makes amendment to the North Carolina Consumer Finance Act.
   a. The maximum rate varies, depending on the amount of the loan and the terms, but in some cases the maximum is 18%; in others 24%; and in some 30%.

C. North Carolina Symbols – More things to love about NC! (note, all of these facts come from S.L. 2013-189.
   a. North Carolina school children suggested the adoption of various official State symbols after studying history, science, social studies, and geography.
   b. State fossil
      i. The fossilized teeth of the megalodon shark
      ii. The megalodon shark is extinct and lived over 1.5 million years ago.
      iii. It may have reached over 40 feet in length and weighed over 100 tons.
      iv. It had serrated, heart-shaped teeth that may have grown to over seven inches in length.
   c. State frog
      i. The pine barrens tree frog (Hyla andersonii)
      ii. It can be found in the Sandhills and Coastal Plain regions of NC
      iii. It is considered to be one of the most striking and beautiful frogs in the Southeast United States.
   d. State salamander
      i. The marbled salamander (Ambystoma opacum)
      ii. It is found throughout the state and is unique in that it is a “charismatic, striking, chunky-bodied, fossorial amphibian, of which no two are exactly alike in color pattern.”
   e. State marsupial
      i. The Virginia opossum (Didelphis virginiana)
      ii. It is native to North Carolina and is the only marsupial found in North America (our choices of State marsupial were limited).
      iii. The female carries its underdeveloped young in a pouch until they are capable of living independently, similar to a kangaroo.
      iv. It is one of the oldest and most primitive species of mammal found in North America.
      v. It is about the size of a large housecat, with a triangular head, a long pointed nose, dark eyes, a long, scaly, prehensile tail, and short, black, leathery ears.
      vi. It is nocturnal and lives in deciduous forests, open woods, and farmland, but prefers wet areas such as marshes, swamps, and streams.
   f. State folk art
      i. The whirligigs created by Vollis Simpson, of Wilson, North Carolina.
g. State art medium
   i. Clay.
   ii. “The use of clay has grown from the State’s early Native American making mostly utilitarian wares and European settlers continuing the traditions of their ancestors to today’s potters designing pottery with utilitarian and aesthetic elements.”
   iii. The potting tradition continues, especially in the Seagrove area, and clay continues to be an important art medium, contributing to the State’s cultural, social, and economic prosperity.
Practical Life & Estate Planning Issues for Service Members & Retirees

Helping Your Clients Avoid the Minefields
Overview of Life & Estate Planning

- Life Planning
  - Durable Powers of Attorney/Rev Living Trusts
  - Advance Medical Directives
  - Do Not Resuscitate Orders (DNRs)
  - Medical Orders for Scope of Treatment
Overview of Life & Estate Planning

- Estate Planning
  - Wills/Revocable Living Trusts
  - Estate Planning Issues
    - Estate Tax Planning
    - Beneficiary Designation Issues
- Planning for Families with Disabilities
Life Planning Options

- Durable Power of Attorney
  - Springing vs Immediately Effective
  - Naming Multiple Agents (Attorneys-in-Fact)
  - Gifting Powers
  - Multi-state Issues (witness provisions)
Life Planning Options

- DPOA vs. DPOA + Revocable Living Trust
  - Avoidance of Courts in Multiple States
  - Guardianship/Conservatorship
  - DPOA may be revoked upon guardian appointment
- Avoidance of Delays in Asset Management
- Privacy
Life Planning Options

- Advance Medical Directives
  - Living Will
  - Health Care Power of Attorney (HCPOA)
  - State Forms vs Custom
  - When activated?
  - Conflicts btw Health Care Agent & AIF under DPOA
Estate Planning Issues

- Will vs Pour-Over Will + Rev Living Trusts
  - Will alone
    - Simpler, cheaper
    - Testamentary Special Needs Trust for Surviving Spouse
  - Downside: Probate, Need to Update When Moving
Estate Planning Issues

Will vs Pour-Over Will + Rev Living Trusts

Will + Rev Living Trust Positives

- Avoids Probate & Ancillary Probate (other states)
- No Delay in Administration if Co-Trustee
- Privacy
- Less updating (when moving to new state)
Estate Planning Issues

- Will vs Pour-Over Will + Rev Living Trusts
  - Will + Rev Living Trust Negatives
    - Must fund trust to avoid probate
    - Less understood by clients
    - Cashing checks at grocery store
    - Overhyped, sold as means to get financial info by fly-by-night “financial advisers”
Typical Trusts in Wills & RLTs

- Holdback Trusts
- Special Needs Trusts
  - Spousal (must be under Will, not RLT)
  - Special Needs Trust for Children
- Credit Shelter (A/B) Trusts Tax Planning
Typical Trusts in Wills & RLTs

- Spendthrift Trusts
- Planning with Retirement Benefits
  - Leaving IRA Outright
  - Conduit Trusts
- Accumulation Trusts
Payback Special Needs Trusts

- Under Age-65 Payback SNT
  - 42 U.S.C. §1396p(d)(4)(A)

- Pooled Charity-Managed SNT’s
  - 42 U.S.C. §1396p(d)(4)(C)
  - Life Plan Trust, Inc. (one example)

- Income Cap or Miller Trusts (not an option in NC)
Developing Issues in NC Estate Planning and Fiduciary Law

- Acceptance of Out-Of-State Attestations
- Digital Assets (What happens to your Facebook, Pay Pal Accounts?)
- Probate & Real Property Issues
Finding an Estate Planning Attorney

- NC Bar Elder Law & Estate Planning Sections
  www.ncbar.org
  Elder Law Attorneys
  www.naela.com

- Bailey Liipfert
  - www.craigebrawley.com
  - 1.336.917.3236
Finding a Special Needs Planning Attorney

- Special Needs Alliance
  - Network of disability and public benefits planning attorneys
  - www.specialneedsalliance.org
  - 1.877.572.8472

- Bailey Liipfert
  - www.craigebrawley.com
  - 1.336.917.3236
A. PRINCIPLES IN WILL DRAFTING

Precision and clarity are crucial when an attorney drafts a will. A will speaks at the death of the testator, and any ambiguities or mistakes in the will are often difficult to handle at that time.

In North Carolina, the guiding principle of will construction is to honor the intent of the testator. In drafting a will or revocable trust, it is your job to make sure that the testator’s intent is accurately expressed in the document. It is your job to chase down potential ambiguities and ensure that you have made provision for the testator’s estate to be handled in such a way that the testator’s intent will be carried out.

An important piece of the estate planning puzzle is the “executive” piece. That is, who will carry out the testator’s intent? Do not give this piece short shrift. Although fiduciaries have a well established legal duty to act appropriately, it is important to appoint a capable, honest fiduciary who will be able to carry out his or her duties to the beneficiaries without causing problems for himself or herself.

1. FIDUCIARIES

The term “fiduciary” is a general term used to describe a person in whom another person has placed special faith, confidence and trust. Because of the trust and confidence placed in him by another person, a fiduciary is required to act honestly, in good faith and in the best interests of that person.\(^1\) When wills and trusts are being drafted, the selection of fiduciaries is one of the most important decisions the client makes. The fiduciaries selected by the client will be tasked with carrying out the client’s wishes at a time when the client is unable to do so. In addition, fiduciaries must often navigate tricky family

situations while carrying out what can be complex duties. There are several kinds of fiduciaries which may be appointed by a client in his or her will or trust.

a. Executor.

An executor’s duties are set out in Article 13 of Chapter 28A of the North Carolina General Statutes. The executor’s duties commence upon the executor’s appointment by the clerk of superior court, which is memorialized by the issuance of letters testamentary. Section 28A-13-2 sets out a general statement of the executor’s duties:

A personal representative is a fiduciary who, in addition to the specific duties stated in this Chapter, is under a general duty to settle the estate of [his] decedent as expeditiously and with as little sacrifice of value as is reasonable under all of the circumstances. [He] shall use the authority and powers conferred upon him by this Chapter, by the terms of the will under which [he] is acting, by any order . . . applicable to fiduciaries, for the best interests of all persons interested in the estate, and with due regard for their respective rights.

The statute refers to a “personal representative,” which includes an administrator - a person appointed to handle an intestate estate - as well as an administrator C/T/A - a person other than the named executor who is appointed to administer an estate where there is a will.

A testator has the right to name in his or her will a person who shall administer his estate after his death, provided that the person designated is not disqualified by law. The person named in a testator’s will is the executor of the estate. The person the testator names as executor has the right to administer the estate and can only be deprived of that right by his refusal or neglect to probate the will or take out letters, or his inability or unsuitableness to execute the will or trust. Courts will give deference to the person appointed by the testator, but in some circumstances the person named by the testator may not be appointed as executor.

---

4 Id.
5 Id. At 65, 231 S.E.2d at 854.
North Carolina General Statutes Section 28A-4-1 states that “Letters testamentary shall be granted to the executor or executors designated in the will, or, if no such person qualifies, the clerk shall grant letters of administration in accordance with subsection (b).” The statute then provides a list of persons who may serve as administrator in the order they are preferred: (1) surviving spouse of decedent; (2) devisee of testator; (3) heir of decedent; (4) next of kin, with a person who is of closer kinship having priority; (5) any creditor to whom the decedent became obligated prior to his death; (6) any person of good character residing in the county; and (7) any other person of good character not disqualified under G. S. 28A-4-2.

A person may be disqualified from acting as executor if: he is under 18 years of age; he has been adjudged incompetent and remains under such disability; he is a convicted felon and his citizenship has not been restored; he is a nonresident of this state and has not appointed an in-state agent to accept service of process; he was a resident of North Carolina at the time of appointment but then moved from the state without appointing an in-state agent; it is a corporation not authorized to act as an executor/personal representative in North Carolina; he has lost the right to serve as executor as provided by Chapter 31A (this includes a spouse who is divorced from the decedent, who abandoned the decedent, who is separated from the decedent and is living in un-condoned adultery, etc.); he is illiterate, he is a person whom the clerk finds otherwise unsuitable; or he is a person who has renounced.6

Some of the reasons for which a person can be disqualified from being executor are obvious - an incompetent person cannot serve as executor. The general exception that a person may not serve as executor if “the clerk of superior court finds [such person] otherwise unsuitable” is more of a gray area. This reason for disqualification is often used and examined in situations in which there is an argument over who should be the executor. One of the most common reasons that is covered in this catch-all exception is a conflict of interest. Where an executor has a conflict of interest that will prevent him from impartially performing his fiduciary duties, he may be disqualified.7 For example, where the person appointed executor performed services as an accountant for a company,

---

7 In re Moore's Estate, 25 N.C. App. 36, 212 S.E.2d 184 (1975).
and one of the assets of the estate was a potential claim against the company, the person appointed had a conflict of interest such that he was properly disqualified from serving as executor. The court determined that “[e]specially when a decision to bring suit might endanger [the accountant’s] chances of future employment by the firm, the possibility that his decision to bring suit will be influenced by his own personal interests is great. One cannot represent his own interest and at the same time represent those of another which are in conflict with his own with fairness and impartiality to either.”

When the person who has qualified as executor fails in his duties or has a conflict of interest, the clerk may upon his or her own motion initiate a hearing seeking to remove the executor, or, may initiate such a hearing upon a verified complaint for removal filed by an interested party. The clerk may remove the executor if he or she finds that the person appointed was originally disqualified or has become disqualified; if letters were obtained by false representation or mistake, if the person appointed has violated his or her fiduciary duty through default or misconduct; or if the person has a private interest that “might tend to hinder or be adverse to a fair and proper administration. The relationship upon which the appointment was predicated shall not, in and of itself, constitute such an interest.” If an executor is removed because of bad acts, then the executor may not receive a commission for his or her services.

In will drafting, it is important to help your client ensure that he or she chooses an executor who will be able to handle executor duties. In a fractious family, for example, it may be best to choose an independent third party to serve as executor.

When a will is being drafted, it is wise for the testator to name successor or alternative executors, to cover the possibility that the testator’s first choice for executor cannot serve. This allows the testator to remain in control of who will serve to administer the will. If no successor is named, the decision of who will administer the estate is left to the persons interested in the estate or the clerk of superior court. If, for example, the named executor renounces his right to serve as executor, he may name a person and ask

---

8 Id. At 40, 212 S.E.2d at 187.
that the clerk appoint that person, but those wishes are not binding upon the clerk of court.\textsuperscript{11}

Sometimes, testators may want to appoint more than one person to serve jointly as executors. If a client wishes to appoint joint executors, it is important that the will set out how they will work together - the provisions of the will govern, but if the will is silent, then North Carolina General Statutes Section 28A-13-6 will determine how co-executors will function. The general rule is that acts and duties must be performed by both joint executors, if there are two, and if there are more than two, by a majority of the executors. One way to address the situation of co-executors is to provide for them to have joint and several powers, so that a single one of the executors may act on behalf of the estate without having to obtain the signature or joint action of the other executor(s). If the will does not provide for a division of powers, the executors may, by written agreement signed by all of the executors and approved by the clerk of court, provide that certain powers exercised by one executor can bind all executors.\textsuperscript{12}

Sometimes, a testator may appoint a person who is not a resident of North Carolina to be executor. Generally an out-of-state resident may serve as executor of a North Carolina estate, but the person appointed must submit himself or herself to the jurisdiction of the North Carolina courts and appoint a person to serve as his or her agent for service of process within North Carolina.

A good practice in drafting wills is to waive the bond for an executor. If there is no express waiver of the bond, an executor must be bonded. Bonding can be difficult (depending on the person who is named as executor) and expensive. If the testator trusts the person being named as executor, then often it eases the administration process to also waive the bond.

b. Trustees

If a person’s will establishes any trusts, then the will should also appoint a trustee for the trust. The trustee’s fundamental duty is to “administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries and in

\textsuperscript{11} See AOC form E-200.
accordance with [Chapter 36C of the North Carolina General Statutes].” North Carolina has adopted a Uniform Trust Code, which is contained in Chapter 36C, and which presents a code governing the creation and administration of trusts, including testamentary trusts. Generally speaking, the Trust Code sets out default settings for a trust. The terms which are set forth in the document establishing a trust (whether it is a will or trust declaration or agreement) can override most of the provisions of the Trust Code.

Again, the decision of who is appointed as a trustee is an important one which should be carefully considered by the client.

In a trust established for minor children, for example, it is a good idea to choose a trustee who is someone other than the guardian named for the children. This can provide a system of checks and balances that can stem the risk of abuse of a trust by a guardian. Often in a situation where clients are in a second marriage, a marital trust is used to provide for the surviving spouse during his or her lifetime, with the remainder to the children of a prior marriage. In second marriage circumstances, an independent trustee can be quite valuable. The independent trustee can protect the interests of the surviving spouse and the children, while appointment of a family member has a high likelihood of leading to family conflict and even litigation.

In some circumstances, a corporate trustee will be the best choice, while in others an individual trustee will be a better choice. Often, corporate trustees require that a trust have assets of a certain threshold value before they will serve, whereas individual trustees are generally more flexible regarding the asset value of a trust.

A testator or settlor of a trust may appoint more than one person to serve as trustee. In this circumstance, the default rule is that if there are two trustees, trustee action must be unanimous. If there are more than two trustees, trustee action must be taken by a majority of the trustees. If more than one trustee is appointed, it may be desirable for the general rule not to apply. For example, in some circumstances, it makes sense to appoint a family trustee and an independent trustee. The family trustee may have more personal contact with the beneficiary, while the independent trustee may be in

---

14 N.C. Gen. Stat. § 36C-7-703.
charge of investments or have the final say-so as to distribution decisions, taking some of the pressure off of the family trustee. In such a situation, careful delineation of the role of each type of trustee is important.

The Trust Code sets out the duty of loyalty which a trustee owes to the beneficiaries of the trust and says that the trustee “shall administer the trust solely in the interest of the beneficiaries.”\(^{15}\) This provision may be overridden by the terms of the trust, so if the client wants for the trustee to be able to engage in any self-dealing, then the instrument creating the trust may so provide. Use of an investment firm related to or affiliated with a corporate trustee is generally not considered to be self-dealing, so long as the investment complies with the prudent investor rules.\(^ {16}\)

The trustee has a duty to be impartial to multiple beneficiaries of a trust.\(^ {17}\) (This is where an independent trustee can be important, as explained above.) The trustee has a duty to exercise reasonable care, skill, and caution in dealing with a trust,\(^ {18}\) but a trustee with special skill or expertise must use that special skill or expertise in administering the trust.\(^ {19}\)

The Trust Code contains many default powers for the trustee.\(^ {20}\) These are a valuable resource of trustee powers, but they are also subject to the rule that the express terms of the trust can override them.

c. Guardians

The parents of minor children can appoint another kind of fiduciary in their wills. They can name a guardian for minor children. Parents may name a guardian or guardians in a writing signed in the presence of two witnesses who are at least 18 years of age other than the guardian being named.\(^ {21}\) A written attested will complies with the requirements for the appointment of a standby guardian for a minor child. The testator can appoint alternate guardians. The appointment may waive bond for the guardian. Before a guardian officially becomes guardian of a minor child, the clerk must make findings that the guardian was properly appointed, that the best interests of the minor child will be

\(^{15}\) N.C. Gen. Stat. § 36C-8-802.
\(^{16}\) N.C. Gen. Stat. § 36C-8-802(f).
\(^{17}\) N.C. Gen. Stat. § 36C-8-803.
\(^{18}\) N.C. Gen. Stat. § 36C-8-804.
\(^{19}\) N.C. Gen. Stat. § 36C-8-806.
\(^{20}\) N.C. Gen. Stat. § 36C-8-815 and 8-816.
promoted by the appointment of the person designated as guardian, and that the guardian named is fit, among other findings.\(^{22}\)

For families with minor children, the selection of a guardian can be one of the hardest decisions in the estate planning process. In wills or trusts in which appointment of a guardian is appropriate, it can be helpful to explain what can be distributed to the guardian and why. For example, you may provide that a guardian may receive funds to renovate a home so that the minor child can live with them.

2. FORMS

In drafting wills and trusts, there are several good sources for forms that may serve as a starting point for a particular client’s estate planning. Several banks have will and trust manuals, including BB&T. It can be helpful to find forms that are North Carolina specific. Several software systems are also available. Menu Forms is available and it uses forms produced by attorneys at Robinson & Bradshaw in Charlotte.\(^{23}\) Other national providers often document assembly programs for estate planning such as Wealth Counsel\(^{24}\) and Wealth Transfer Planning.\(^{25}\) In using the systems of national providers, it is very important to customize forms to include North Carolina law.

As always, if you begin drafting with a form, it is critical to carefully proofread and ensure that the document you have prepared fits the client’s needs and is specifically tailored to the client. Form books are a good starting point for estate planning, but the importance of proofreading and customizing drafts to your client’s needs cannot be overstated.

3. CLAUSES

There are certain clauses and provisions that are included in all wills, and forms give you a good beginning place to draft these. Some of the important and common clauses in wills are:

a. Introductory paragraph. This paragraph usually states the testator’s name, can state the testator’s county of residence, and can give family information. Providing

\(^{22}\) Id.
\(^{24}\) www.wealthcounsel.com
family information in the will can help with the administration process and can help eliminate ambiguity. For example, if the testator wants to include stepchildren in the will and treat them as natural children, a family information section is very important in explaining how these beneficiaries are to be treated.

b. Revocation of prior wills. All wills should include a statement that the will being executed revokes any prior will. If the person is executing a codicil that is not intended to revoke a prior will, it is smart to recite that purpose in the introductory language of the will, and it is also smart to state that terms of the will that are not addressed in the codicil are ratified and affirmed. With word processors and with the likelihood that an attorney can easily alter terms of a will, as a general rule, it is better for a client to execute a new will rather than a codicil. This is because piecemeal modification in a codicil can be susceptible to inadvertent omission and other mistakes.

c. Tangible personal property. Tangible personal property can be lumped in with the residue of the estate or it can be treated separately. Tangible personal property includes items such as a testator’s furniture, clothing, jewelry and automobiles, but does not include money or other intangibles, such as stocks and bonds. In some states, a memorandum or other writing may be incorporated in the will that directs that tangible personal property be distributed in a certain way. In those states, the memorandum approach to dealing with tangible personal property is useful, because it allows the testator to make provision for specific items of tangible personal property to be distributed to specific individuals without making a number of specific bequests in the will. In those states, the memorandum may be revised without having to go through the formalities of re-executing a will, and the memorandum is binding upon the executor. North Carolina does not have this rule, however. If a memorandum is incorporated by reference in a North Carolina will, it cannot be revised after the will has been executed unless it constitutes a codicil to the will. An option in North Carolina is to devise the tangible personal property to the executor of the estate, and include precatory language that states that the testator expects and trusts that the executor will follow the testator’s directions as set forth in a memorandum or written note in distributing the tangible personal property.

25 www.interactivelegal.com
d. Specific bequests/devises. Wills may contain bequests or devises of specific property. When specific devises are used, it is important to be careful in describing the property devised and describing the beneficiary. The will should also provide what happens to the property if the devisee is deceased. North Carolina does have an anti-lapse statute that may apply, depending on the relationship of the devisee to the testator, but it is better practice to state what happens to specific devises in the event that the devisee is deceased (because the anti-lapse statute will not apply to every specific devise, and because it is a lot easier to explain language you have drafted to a client than it is to explain the anti-lapse statute to a client! A specific devise may be made to a class of beneficiaries. For example, a testator may devise a sum to all of his or her grandchildren living at the time of his or her death.

e. Residuary estate. Every will should contain a clause that deals with the testator’s residuary estate to avoid a situation of partial intestacy. Even if the testator is sure that in his specific bequests, he has devised every interest in any property that he owns, a residuary clause is necessary to deal with lapsed gifts and forgotten or unexpected property interests.

f. Fiduciary appointments. In this section, the testator should name an executor and possible successors to the executor. Again, the reason why it is desirable to name successors is so that the testator can control who is administering the estate rather than relying upon the clerk to name someone. If the testator establishes any trusts or if there is a possibility that any trusts may be established under the will (for example, under a catch-all “holdback” trust provision), the testator should name trustees in this section. If the testator has any minor children, then the testator can name guardians for minors in this section.

g. Debts and Expenses. The will should provide for the payment of the testator’s debts and administration expenses. If the testator desires, he or she may include a provision that the testator’s charitable pledges are to be paid, regardless of whether such pledges would be considered “enforceable” obligations of the testator’s estate. In addition, it is smart to provide that the decedent’s funeral expenses are to be paid, regardless of whether the costs of a funeral or cremation and suitable marker or memorial exceed the amount allowed by statute. Currently, funeral expenses that are authorized -
absent a specific provision in the will - are limited to $3,500\textsuperscript{26}, and the amount allowed for a gravestone is $1,500 (which amount may be increased in the clerk’s discretion upon petition by the executor or administrator).\textsuperscript{27} These amounts are not sufficient to pay for the costs of a funeral or often even a cremation, so it is important that the will itself authorize expenses in excess of these statutory amounts.

Generally, when property devised to a person is encumbered, the devisee takes the property subject to the encumbrance.\textsuperscript{28} If the testator wishes for the secured obligation to be paid and for the property to pass free of encumbrances, there must be an express provision in the will which exonerates the devised property from the encumbrance.

h. Taxes. The testator should provide for how death taxes are to be paid. Tax allocation clauses are generally included in wills even if the estate will most likely not be a taxable estate. There are a few ways to address this. Sometimes, the testator may provide that death taxes are to be paid from the residuary estate. This means that no part of the tax burden on the estate will be expected to be paid from any specific devises or bequests. Sometimes, if the specific bequests and devises are a substantial portion of the estate, the testator may provide that every devise shall bear its pro rata share of the taxes. Carefully describing how taxes are to be paid has become even more important as non-probate assets such as IRAs, retirement plans and life insurance constitute larger portions of decedent’s estates. For example, if the beneficiary of an IRA is different than the residuary beneficiary of the estate, it may be unfair to force the residuary beneficiary to foot the estate tax bill for the IRA.

Also, if part of an estate qualifies for the estate tax marital deduction or charitable deduction, a testator may want any taxes to be borne by the non-marital or non-charitable deduction, because the payment of taxes out of a marital or charitable share will cause a reduction of the marital or charitable deduction, which in turn would cause circular reductions to be calculated.

i. Executor’s powers. It is wise to recite the powers given to the executor in the will. Often, the statutory powers given to an executor are incorporated by reference (N.C. General Statutes § 32-27, § 32-26). The section which recites the executor’s

powers can be a good place to describe how joint executors are to exercise their powers (for example, giving joint executors joint and several powers). Beware: a personal representative in North Carolina has the powers set forth in N.C. Gen. Stat. § 28A-13-3 except as qualified by the express provisions of a will. The power to sell real property in § 28A-13-3(1) requires a personal representative to follow the procedures set out in subsection G.S. 28A-13-3(c) in selling real property, which requires a special proceeding in order to sell real property. If a testator wishes for real property to be sold following death, the personal representative can authorize the executor to sell the property at public or private sale in his discretion, with or without court order, but to be effective, such a direction should spell out which specific real property the executor may sell. Often property is devised to the executor, with instruction for the executor to sell. Most will forms contain a general authorization for an executor to handle (sell, lease) the real property of a testator, but these clauses, without more, are held to be ineffective and if such a clause is the only authorization for the sale or lease of real estate, then the clerk will require that the executor file a petition to take control and custody of the real property in order to sell it. In this section, the testator may waive the executor’s bond as well.

j. Trustee powers. If the will establishes any trusts, it is important to set out the powers given to the trustee. N.C. Gen. Stat. § 36C-8-816 gives a trustee certain specific powers, but those powers may be modified by the terms of the trust, and the statutory powers of N.C. Gen. Stat. § 32-27 may be incorporated by reference, but additional powers may also be included. For example, if a trust will hold an ownership interest in a business, it would be wise to include powers allowing the trustee to deal with the stock or other ownership interest. If a family farm or business is included, and if the testator wants it to remain in trust, it would be smart to include a provision that the trustee does not have to diversify the trust’s assets.

k. Custodianship/stand-by or holdback trusts. The will may include a provision for what happens if any property is to be distributed to a minor child or incompetent adult under the will. There are several options in making provision for this circumstance. A simple reference to the Uniform Transfers to Minors act may suffice, or

the testator may want to add provisions for a trust to be established for any distribution to a person under a certain age. A testator may give the executor the authority to determine how a devise is distributed. For example, a testator may provide that if a property is to be distributed to a minor child, the executor may decide whether to distribute the property to the child’s guardian, a custodian of a UTMA account, or to hold the property in trust for the child. A provision like this one can give the executor flexibility to deal with varying circumstances, such as the size of the devise, the age of the beneficiary, and other relevant factors. Likewise, for incompetent or disabled individuals, a testator may want to establish a discretionary trust or simply have the funds held by a custodian or paid to a community trust.

1. Definitions and construction. Many wills contain a definitions and construction section. A common provision is that masculine and feminine pronouns may include each other as the context of the will requires. Many wills define the terms “children” and “issue.” Many wills address how adopted persons are treated. The detail of the definition section often depends on the complexity of the will. For example, if the will contains generation-skipping transfer trust provisions, then “available exemption” may be a defined term.

m. Attestation clause. In written attested wills, it is usual to have a clause in which the testator acknowledges that the foregoing document is the testator’s will, that the testator executes it freely and of his or her own will, that he or she is of sound mind, that he or she is 18 years of age or older, and that he or she executes the will free of undue influence and under no undue constraint. Likewise, there is a clause that the witnesses to the will sign. A sample attestation clause is:

We, _______________________, _______________________, and _______________________, the witnesses, sign our names to this instrument, being first duly sworn, and do hereby declare to the undersigned authority that the testator signs and executes this instrument as his/her last will and that he/she signs it willingly, and that each of us, in the presence and hearing of the testator, hereby signs this will as witness to the testator’s signing, and to the best of our knowledge the testator is
eighteen years of age or older, of sound mind, and under no constraint or undue influence.

Some practitioners use two witnesses, because that is the number of witnesses required in North Carolina for a valid written attested will. Some practitioners use three witnesses, because some states still require three witnesses, and by using three witnesses, the will is more likely to be valid in such a state, if circumstances arise in which the will is probated in such a state. Also, there would be an additional witness who could testify as to the proper execution of the will, in the event of a will caveat.

n. Notarization. The will should be notarized so that it is a self-proving will. The Notary Public confirms that the testator and the witnesses all duly signed the will. If the will is not self-proven, then for the will to be probated, you must find the witnesses at the time the will is presented to the court for probate, to prove that the will was properly executed.

As a final matter, the North Carolina General Statutes regarding wills and estates (N.C.Gen. Stat § 28A through §32) are frequently amended and updated, so it is important to be aware of current changes. I have attached the 2011 through 2013 (to date) Legislative Updates for your reference.
B. REVOCABLE AND IRREVOCABLE TRUSTS

A trust is a fiduciary relationship with respect to property in which the trustee holds legal title to the trust property pursuant to agreement with the trust’s grantor or settlor, subject to enforceable equitable rights in the beneficiary.

1. FUNDING THE TRUSTS

Revocable trusts are commonly used as will substitutes. A typical revocable trust (or “living trust”) provides that during the settlor’s lifetime, he or she may withdraw or direct the use of trust assets. The trust agreement may provide for how trust assets are to be used during the settlor’s incapacity and therefore can be helpful in planning for a client’s incapacity. Using a trust to plan for incapacity can have benefits over using a durable power of attorney. Generally, a trustee has an easier time dealing with financial institutions, because institutions are more familiar with trust arrangements and the law that applies to them. In some instances, financial institutions will give an attorney-in-fact a hard time. North Carolina has a statute to address difficulties in getting institutions to accept a durable power of attorney - N.C. Gen. Stat. § 32A-41. Even armed with this statute, this practitioner has had trouble with some out-of-state financial firms accepting a valid power of attorney. The settlor of a revocable trust usually retains sufficient power over the trust assets that the trust is disregarded for income tax purposes, and all of the trust’s assets are deemed to belong to the settlor for income tax purposes, even if title is technically in a trustee. If one of the powers retained by the settlor is listed in IRC §§ 671-677, then the trust will be considered a “Grantor” trust and will be disregarded for estate tax purposes.

If a revocable trust is used, the dispositive provisions of a client’s estate plan can be kept private - a revocable trust is not filed with the clerk of court like a will is. The desire for privacy is a reason that many clients choose a revocable trust for estate planning. As public records become more and more accessible online, the likelihood of information in a will being viewed is higher.

One of the main benefits of a revocable trust is that, if it is properly funded, it can help a settlor avoid the probate process. If a person’s assets are all held in a revocable trust at the time of that person’s death, then none of those assets would be held in the person’s individual name, so there would be no assets subject to probate. The key to
having a revocable trust help minimize probate is to have the trust be properly funded. Clients need detailed guidance in funding revocable trusts, and it is best if clients will allow their attorney to oversee the funding process.

Certification of Trust. A certification of trust sets out important information about a trust without disclosing the dispositive terms of the trust. Some financial institutions have their own certification of trust form, but preparation of a certification of trust form for clients is useful, because it allows them to provide the information that financial institutions require about a trust without having to turn over the entire trust agreement.

North Carolina allows for certifications of trust in N.C. Gen. Stat. § 36C-10-1013. That statute provides that “Instead of furnishing a copy of the trust instrument to a person other than a beneficiary, the trustee may furnish to the person a certification of trust. . .” The certification includes: the existence and date of the trust, the identity of the settlor (unless withheld under a specific provision in the trust), the identity and address of the current trustee, the powers of the trustee, the revocability or irrevocability of the trust, disclosure of who has power to revoke the trust, the authority of co-trustees to execute documents, the trust’s taxpayer identification number, and the manner of taking title to trust property.

Use of a certificate of trust can be helpful, especially for clients who are concerned about privacy. An institution may require copies of excerpts from the trust containing the information described in the trust, but the statute gives protection to institutions that rely upon certifications of trust.

Identifying the Trust. To put assets into a trust, the trust must be adequately identified. For example, the title of trust assets may be held in this form:


This title lists the trustee’s name, the name of the trust, and the date of the trust agreement. It supplies sufficient identifying information for the trust. Remember that title to assets is held by the trustee; the trust is a relationship, not an entity.

Cash Accounts. A client’s bank accounts should be re-titled in the name of the trust. A client may not wish to use small joint accounts to fund the trust. In fact, some
clients prefer to retain a small joint account to be used primarily for household expenses. An alternative would be to have a revocable trust as owner of an account but to have the checks printed in the client’s name, instead of disclosing the trust relationship.

When changing bank accounts to fund the trust, remember that the client’s social security number is the identification number for the account. The account withholding and reporting will essentially remain the same.

Before clients re-title certificates of deposit, they should consult with a bank officer to make sure that the bank will not consider the change in account name to be an early withdrawal that incurs a penalty.

If a trust has joint trustees, when re-titling bank accounts, be careful to give each trustee signature power over the account. New signature cards should be signed by the trustee(s) in his or her capacity as trustee.

**Investment Accounts.** If a client has a brokerage or investment account, a broker or custodian can help change the title of the account so that the account will belong to the trust. The procedure for changing the title of investment accounts is the same as it is for re-titling cash accounts.

**Stocks and Bonds Not Held in Investment Accounts.** There are two ways to deal with stock or bond certificates: A client can open a brokerage or investment account in the name of the trust and deposit the certificates in the account or the client can work with the transfer agent for the stock or bond and direct the agent to reissue the stock with the trustee as the new owner. Working with transfer agents generally takes longer than working with brokers.

**Tangible Personal Property.** If any tangible personal property has separate title documents, those should be used to transfer the property to the trust. Most tangible personal property does not have a “title,” however. A declaration that the trust is the owner of the tangible personal property is often used. This is simply a signed statement by the settlor that he or she is transferring his or her tangible personal property to the trust. A declaration that the tangible personal property has been transferred can even be included in the terms of the trust agreement.

Vehicles are included in tangible personal property, but they frequently are not transferred to revocable trusts. Owning a vehicle in trust can give automobile insurance
companies pause, and sometimes can cause the insurance company to apply a business rating to the vehicle. In addition, title to a vehicle after the owner’s death can often be transferred without formal probate proceedings.

Retirement Plans. This topic is included only to emphasize that a client should **NEVER** transfer the ownership of a qualified retirement or pension plan or individual retirement account to a living trust during the client’s lifetime. Instead, the client should examine beneficiary designations to ensure that the beneficiary designations, in combination with the trust (or will, for that matter) will accomplish the client’s goals in regard to the plan after the client’s death. In dealing with beneficiary designation forms, it is wise to get a confirmation that the beneficiary change has been accepted from the plan administrator. More and more frequently, a large portion of clients’ assets are held in qualified retirement plans. These assets require very careful planning, because of the income tax issues that apply to them. You must consider who will end up paying the income tax associated with these assets, when it will be payable, and at what rates. If a client wants to leave retirement plan assets in trust for a beneficiary, it is critical to review the Code and to draft the trust so that the tax-preferred status of the account will not be jeopardized.\(^\text{29}\)

Promissory Notes and Other Receivables. Clients may assign interests in promissory notes and other receivables to their revocable trusts by endorsement or by a written document. The client should also notify the debtor of the assignment.

Partnership Interest. Partnership agreements often contain restrictions on the transferability of partnership interest. Attorneys may need to work with the partners in a partnership to allow for a transfer of partnership interest. If a transfer is permitted, partnership interests may be transferred through a written assignment of interest signed by the owners of the partnership interest and acknowledged by the other partners.

Corporate Business or Professional Interests. Corporate counsel should help with this transfer. Corporations will have to cancel certificates held in the settlor’s name and issue new certificates in the name of the trust. If the business is a limited liability

---

\(^{29}\) A great resource for dealing with retirement plan assets is *Life and Death Planning for Retirement Benefits* by Natalie Choate. It is available at www.ataxplan.com.
company, the way a transfer may be effected will depend on the terms of the company’s operating agreement.

Real Property. A deed is required to transfer an interest in real property. It is important to remember that the title will be held by the trustee of the trust, not by the trust itself (because a trust is not an entity).

Helping clients to fully fund their revocable trusts is crucial to accomplishing the goals of most revocable trusts. If properly funded, revocable trusts are very useful in allowing for a way to help a client manage property if he or she is incapacitated, to ease administration following death, and to protect a client’s privacy.

2. USING IRREVOCABLE TRUSTS TO PURCHASE LIFE INSURANCE

Irrevocable trusts have different purposes. Some common uses of irrevocable trusts include life insurance trusts, gifting (“Crummey”) trusts, charitable remainder trusts, and retained interest trusts. A useful tax-planning tool is the use of an irrevocable trust to purchase life insurance.

Life insurance has a useful place in estate planning. In exchange for the payment of a fixed premium, usually in periodic payments, an insurance company agrees to pay a death benefit in a certain amount at the insured’s death. There are many kinds of life insurance products, and it takes expertise to select the appropriate product for an individual. If a life insurance policy is owned by the insured on the date of his death or if it is payable to his estate, the insurance will be part of the insured’s taxable estate. If owned by and payable to someone other than the insured, it is generally not subject to estate tax, unless the insured owned the policy and gave it away less than three years prior to the date of death.

It is not necessary to have an irrevocable life insurance trust in order to keep life insurance from being part of a decedent’s taxable estate, but irrevocable trusts offer many advantages. An insurance policy may be owned by individuals or, sometimes, even business entities. Insurance policies owned by revocable trusts are deemed to belong to the grantor of the trust. Please note that an insurance policy has both an owner and a beneficiary, who are not necessarily the same. If someone wants to give away a life insurance policy in order to get the policy out of the insured’s taxable estate, he should change both the owner and the beneficiary designation; a change of beneficiary without
an accompanying change of owner will not suffice to remove the policy out of the taxable estate. When an existing policy is transferred, the three-year rule discussed above is applicable.

The proceeds of a life insurance policy are included in a decedent’s estate for estate tax purposes if the proceeds are receivable by the executor of the estate or if the decedent died having “incidents of ownership” in the insurance policy. Some examples of incidents of ownership include: (i) The rights to the economic benefits of the policy; (ii) The power to change the beneficiary of the policy; (iii) The power to cancel the policy; (iv) The power to assign the policy or revoke an assignment; (v) The power to pledge the policy as collateral for a loan; (vi) The right to borrow against the cash surrender value of the policy; (vii) The retention of a reversionary interest that exceeds 5% of the value of the policy immediately before the death of the decedent; (viii) The right to convert a policy from a whole life policy to a limited payment life policy or endowment life policy; (ix) The right to withdraw accumulated dividends or surrender paid up additions for their cash value; (x) The right to substitute a policy of equal value for the policy; or (xi) if the proceeds are payable to the creditors of the insured in satisfaction of the insured’s debts.

Making a gift of a life insurance policy can be an effective estate planning tool, because life insurance has a lower present value than the death benefit. To make an effective gift of the life insurance, the donor cannot retain any incidents of ownership over the policy. Often, the donor wants to make the gift in trust, so that he or she can set parameters as to how the proceeds will be used, while giving the policy away and having the value of the policy’s proceeds not be included in the donor’s estate.

An irrevocable life insurance trust cannot be altered, amended, revoked, or terminated by the settlor of the trust once it is created and funded. The settlor of the trust funds the trust either with cash, which is then used to purchase life insurance, or with an existing policy. If done properly, the irrevocable life insurance trust will not be

---

30 Internal Revenue Code §2042(1).
31 Internal Revenue Code § 2042(2).
32 Although the Uniform Trust Code does allow for the modification or termination of irrevocable trusts in certain circumstances.
included in the decedent’s estate, but the proceeds will be paid to the trust established by the decedent. The life insurance trust can then make loans to the decedent’s estate or use the proceeds to purchase assets from the estate, which is a good way for the life insurance policy proceeds to supply liquidity for payment of estate taxes and debts. Or, the life insurance trust may provide a source of income for future generations of a decedent’s family.

When the life insurance trust is set up, the funding of the trust is a gift to the beneficiaries of the trust. The trust itself can purchase a policy, or an existing policy can be transferred to the trust. If an existing policy is transferred to the trust, the value of the gift can be difficult to determine. If the policy is a paid-up policy or single premium, the value of the gift is the amount the insurance company would charge for a single premium contract of the same specified amount on the life of a person of the age and health of the insured. The measuring policy for determining the value of the gift must be identical to the original policy, including the same surrender value. If the policy is not new or is not paid up, then the value of the gift is the policy’s interpolated terminal reserve, plus the policy’s unearned premium. This amount may be slightly different than the cash surrender value of the policy and the insurance company should furnish those values.

Once the trust owns a policy, the trustee is responsible for payment of premiums. Usually, the grantor makes contributions to the trust to cover the payment of the premiums, which results in a gift to the beneficiaries of the trust. Since the gift is to the trust instead of being an outright gift to the beneficiary and is not a gift of a present interest, the grantor generally cannot use his gift tax annual exclusion for the gift. There is an exception to this rule, however. The grantor can give “Crummey” withdrawal powers over the contributions to the trust, which makes those contributions present gifts. A Crummey power is a power given to a trust beneficiary to withdraw, for a limited period of time (often 30 days), any property transferred to the trust. The beneficiary’s power to withdraw creates a sufficient present interest in the beneficiary that the gift is considered a gift of a present interest to the beneficiary for gift tax purposes.

---

33 The proceeds are not included because the decedent is deemed to have made a completed gift of the policy, so long as the decedent does not retain incidents of ownership over the property.
34 Treasury Regulation § 25.2512-6(a).
The use of a right to withdraw to create a present interest was tested in the case of *Crummey v. Commissioner*, decided in 1968, so the power of withdrawal is often referred to as a “Crummey” power. The Internal Revenue Service has vigorously attacked Crummey powers, but the courts have generally allowed Crummey powers to create a present interest.

Use of a Crummey power requires written notice of gifts from the trustee of an irrevocable life insurance trust to the beneficiaries. Making sure that notices to a beneficiary of his or her right to withdraw property is important to show that the right given was a “real” right to withdraw. The IRS has ruled that beneficiaries cannot waive their right to receive future Crummey notices (instead, the trust agreement can provide that the Crummey right of withdrawal will lapse if not exercised within a certain amount of time)\(^\text{35}\). A beneficiary should not, upon receipt of a Crummey notice, waive his or her right of withdrawal prior to the end of the withdrawal period. Each time a contribution is made, the trustee should give to each beneficiary who has withdrawal rights notice of the contribution and preferably will receive from each beneficiary a written acknowledgment that the beneficiary is aware of the contribution and is aware of his or her right to withdraw the contribution. If premiums are due monthly or quarterly, the grantor may make a single contribution each year and the trust may make the periodic payments. A single Crummey notice can be sent, covering the full amount, and then the trustee can use the funds to pay the policy premiums as they come due.

The trustee should have broad power to satisfy any withdrawal rights that are exercised, including the right to borrow funds to satisfy such a withdrawal.

To protect the “present gift” aspect of the Crummey power, take care in drafting distribution or termination provisions so that distributions will not defeat an existing power of withdrawal that has not lapsed but is unexercised. If the amount of the Crummey withdrawal right is conditioned on whether the gift will be a split gift on a gift tax return, then the condition may be considered a condition subsequent to the gift, which makes the gift unascertainable until the condition subsequent occurs, which may defeat the whole point of having a Crummey withdrawal right.
The grantor of a life insurance trust may not exercise Crummey powers on behalf of a beneficiary. Likewise, the grantor should not be the trustee of the trust. Holding these powers may be considered a retained interest in the trust or an incident of ownership of the policy, so that the value of the trust would be considered part of the grantor’s estate at the time of his death, defeating the purpose of the trust.

Often, “hanging” withdrawal powers are used in irrevocable life insurance trusts. The reason for this is that if the amount subject to a beneficiary’s Crummey power in any year is greater than $5,000 or 5% of the value of the trust, and the power lapses, then the person holding the Crummey power is deemed to have made a gift of the excess amount to the other beneficiaries of the trust. The hanging power cures this problem by allowing the power to hang until a year in which it can lapse and the amount subject to the withdrawal power does not exceed the $5,000 or 5% limit. An alternative way to deal with this gift problem is to give the power holder limited testamentary power of appointment over the property which the beneficiary would be considered the grantor.

Please note that Crummey withdrawal powers may result in an irrevocable trust’s having several grantors for income tax purposes in determining the trust to be a grantor trust. This can be confusing and may make the preparation of fiduciary income tax returns more difficult. Consequently, it is recommended that trusts with Crummey withdrawal powers hold only life insurance policies and not other income-producing assets. Normally if life insurance policies are the only assets of a trust, the trust will not be required to file fiduciary income tax returns.

Care must be exercised in the drafting, funding, and administering insurance trusts, but they are a valuable estate planning tool.

Conclusion

While wills and trusts are an important part of an estate plan, it is equally important to make sure that you have an understanding of your client’s assets, priorities, and planning goals. Once you have met with your client, then you can develop a plan, keeping in mind that a will addresses probate assets, that a revocable trust can act as a

35 Internal Revenue Code § 2514(e) provides that a lapse of the power is not equivalent to an exercise of the power, whereas a waiver of the power by the beneficiary may be deemed an exercise of the power which
will substitute, but can do even more than a will by providing for how assets will be handled during incapacity and by providing privacy. Many assets may be controlled by beneficiary forms or contractual arrangements (such as pay-on-death accounts or assets held jointly with right of survivorship), and these assets must be addressed. Irrevocable trusts, like life insurance trusts, may be used to add additional layers of planning. Underlying the use of any of these documents, however, is the need to be careful and thorough in providing an estate plan.

Drafted by: Rebecca Smitherman, J.D.
Craig Brawley, Liipfert & Walker LLP
©Copyright 2010, All Rights Reserved