Shelter From the Gathering Storm: Protection for Trustees Facing Fiduciary Challenges

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It never was easy to be a trustee and now it seems to be getting harder. Perhaps there was a time when beneficiaries were forgiving of trustees; however, those days are long gone. Beneficiaries today are perfectly willing (and eager) to use 20-20 hindsight to second guess every decision made by a fiduciary. It seems not to matter whether the trustee is an individual or a corporate fiduciary. What can a trustee do to minimize exposure in this mine field?

Investment Management

A trustee's greatest after-the-fact exposure arises whenever the investment management of the trust does not conform to the terms of the trust instrument. How could this ever happen, you wonder. Here are some examples I have encountered.

Investment concentrations, closely-held business interests and real estate. The assets of the trust may be concentrated in one specific stock or even in one industry group. The stock may have been acquired by the testator and left to the trust at his or her death. The family does not want to sell it, either for sentimental or capital gains tax reasons.

The trust may hold an interest in a closely-held family business or a family farm. The beneficiaries to not want the asset sold, even if the Prudent Investor Act would seem to require that action.

The creator of the trust can override the trustee's normal duty to diversify investments. Look at the trust instrument (will or trust agreement). Does the trust instrument specify any treatment for this asset?

A document which merely *authorizes* a trustee to retain originally deposited assets does not protect the trustee against liability. The power to retain does not have to be exercised; it is discretionary with the trustee. The power to retain necessarily includes the power not to retain. Authorization alone is not enough to override the duty to sell this asset.

In order to permit the trustee to retain this concentration, closely-held business interest or real estate, the trust instrument must (a) mandate the retention of the asset by name and (b) relieve the trustee of liability for its retention. If your trust instrument does not do these two things, the trustee is still liable for the investment.

The creator of the trust could have solved this problem with careful drafting of the trust instrument. If he or she failed to include the appropriate mandate to retain and the necessary release of trustee liability, the trustee has to take positive steps to address the problem.

<u>Can the trustee rely on consents to solve the problem</u>? If the trustee obtains the written consents of the beneficiaries, is that not sufficient protection? There are several potential areas of concern for a trustee who has these consents.

Did the right people sign the consents? If the consent is signed only by the current income beneficiary, the trustee still has exposure to the remainder beneficiaries. The widow who does not want her children to learn about the trust until her later death has put the trustee in an untenable position. Any consent to retain these assets must also be signed by the remainder beneficiaries.

Even if the consent was signed by the remainder beneficiaries, is that consent binding on those who might succeed to the interest of those who signed? If the trust is to terminate at a widow's death, for example, with the assets distributed outright to grown children, is the consent of the grown children enough protection? What if a child dies before the widow, leaving minor children to take his or her share when the widow later dies? Is that consent binding on those contingent remainder beneficiaries?

Indiana has codified the common law doctrine of "virtual representation."[2] If the interest of the contingent remainder beneficiaries is *exactly the same* as the interest of the remainder beneficiary who signs the consent, that consent is binding on the contingent remainder beneficiaries.

If the descendants of a deceased child will take exactly the same interest which the child would have received if living when the trust terminated, the doctrine of virtual representation means that the child's consent is binding on his descendants. I recommend that the consent be signed by the remainder beneficiary "both individually and on behalf of anyone who may succeed to my interest in the trust."

The consent is binding on those contingent remainder beneficiaries only so long as their interest is contingent. If the child who consented on behalf of those contingent remainder beneficiaries were to die during the administration of the trust (in which case his or her descendants are now the remainder beneficiaries to the extent of the deceased child's interest), the trustee must get new consents from these new actual remainder beneficiaries. While the deceased child's consent would prevent these new remainder beneficiaries from criticizing the trustee for prior acts in reliance on the consent (before their parent died), it will not protect the trustee going forward after the child's death. A new consent is required from these new beneficiaries.

Recall that this doctrine can be utilized only if the interests are identical. An income beneficiary's consent is not binding, for example, on the interests of the remainder beneficiaries because their interests are not the same. The widow cannot sign consents on behalf of the children under this doctrine.

Did they understand what they were signing? It may be too easy for an unhappy beneficiary to get out from under a previously signed consent by claiming he or she did not understand what was being signed. “I did not know what my rights were.” “The trustee never advised me to seek the advice of my lawyer.” “My mother would not feed us Thanksgiving dinner until we all signed the consents!”

The younger the beneficiary who consents, the harder it is to enforce. The less sophisticated the beneficiary who consents, the harder it is to enforce. The consent signed by an older, infirm person may be difficult to enforce.

Indiana law states that the consent by a beneficiary does not relieve the trustee of liability if the beneficiary was under an incapacity.[3] A beneficiary may be under an “incapacity” even if not under a court supervised guardianship. The unhappy beneficiaries (such as children of an elderly mother who signed the consent) will argue that she actually was incapacitated when she signed the consent. Obviously, a consent signed by a beneficiary who is under eighteen does not relieve the trustee of liability.

Indiana law goes on to provide that, even if the beneficiary was not incapacitated, the consent does not relieve the trustee of liability if “the beneficiary did not know of his rights or all of the material facts which the trustee knew or should have known."[4] The trustee should advise each beneficiary in writing to seek advice from his or her own lawyer before signing the consent. If a beneficiary signs the consent without seeking advice of counsel, that fact should be documented.

The trustee should tell each beneficiary why the consent is being requested and what will happen if not all the consents are signed. Policies should be in place to deal with the possibility that some, but not all, of the beneficiaries will sign consents. Can the trust be partitioned, perhaps with court authority, to retain the asset in one new account which benefits those who signed consents and to diversify the asset in the other new account which benefits those who refused to consent?

How long ago were the consents signed? How stale is the consent? Can the beneficiary later claim that, due to new circumstances (market conditions, cash needs and so forth), an old consent should no longer be binding. "I signed the consent under different economic circumstances, which have significantly changed over time. I would not have signed a new consent had one been asked of me.

If your consent is more than one year old, it may not be sufficient to relieve the trustee of liability. Get them updated each year.

<u>Asset allocations</u>. Many corporate trustees have a written policy about the percentage of trust principal which is to be invested in fixed income and in equity, depending on the investment goals of the beneficiaries. Are there maximum percentages which can be invested in stocks or in bonds? How does an individual trustee invest the trust assets?

How are the investment objectives of the beneficiaries to be determined? How is investment risk tolerance measured? Did the trustee consult only with the income beneficiary or also with the remainder beneficiaries? How are these efforts documented?

Can an unhappy beneficiary later claim that he or she was not consulted, did not understand what was being asked or said and so forth? Of course! Once again, the younger, the less sophisticated or the elderly are the beneficiaries, the more the trustee must redouble the efforts to have meaningful conversations about investment risk tolerance, investment objectives, non-trust assets available to the beneficiary and so forth. Must the trustee consult with the remainder beneficiaries about these matters, too? Of course.

What happens when a widow who is stretching for income pleads that all the portfolio be invested in (low to no growth) bonds? What happens, on the other hand, if the widow explains that she has ample income from other sources, so all the portfolio should be invested in low yield (but higher risk) equities?

I believe the issues are the same with respect to any consents signed by the beneficiaries. Did the right people sign the consents to the investments? Did they understand what they were signing? How long ago were the consents signed?

<u>Someone else manages the investments</u>. More and more people are attempting to involve someone other than the trustee in the management of the trust assets. This may be the decedent's stock broker or financial planner, for example. These people do

not want to be the trustee, but they do want to manage the assets after the death of their good clients.

In an effort to accommodate the wishes of the beneficiaries, a trustee may allow this to happen. What liability does the trustee have for investment decisions made by this third party? Does the trust instrument direct or permit this delegation of the investment management responsibility? What exactly is said in the trust instrument?

Some wills or trust agreements *permit* a trustee to delegate investment management. But does the trust instrument merely authorize this action or does it mandate it? If the trustee is merely permitted to delegate investment management decisions to a third party, the trustee remains liable for decisions made by that advisor. The trustee was merely permitted to do so and was not required to delegate investment management. If the trustee elects to do so, the trustee is still liable for the third party's management of the trust assets.

If the trust instrument *directs* the trustee to work with a third party on investments, does the advisor merely give advice or must the trustee do what the outsider directs? If it is not crystal clear that the trustee must follow the direction of the third party, the trustee may easily be liable if the trustee does not stop the advisor from making an inappropriate investment.

Is the trustee relieved of liability for following the directions of the investment manager? Indiana law provides that a trustee must follow the third party's direction and is relieved of liability only if (a) the trust instrument specifically gives to the third party the power to direct the trustee and (b) the trust instrument specifically relieves the trustee from liability if the trustee does follow the third party's directions.[5]

If the trust instrument directs the trustee to delegate investment management and makes it clear that the trustee must follow the instructions of the outsider, but does not expressly relieve the trustee of liability, then that language does not relieve the trustee of liability. Indeed, the trustee is required to refuse to comply with the outsider's directions if the trustee "knows or should know" that the instructed action would constitute a breach of trust.[6]

If there is no language in the trust instrument or if the language provides inadequate protection to the trustee, the trustee should have all the parties sign a document which does provide that needed protection from liability. I recommend that this agreement be signed by the trustee, the outside investment manager and the current and remainder beneficiaries of the trust.

The agreement needs to address a number of significant issues:

- Does the outside investment manager merely give advice or must the trustee follow the instructions?
- Is the trustee specifically relieved of liability for following those directions? If the trustee is to be "indemnified and held harmless," by whom is the trustee so indemnified? Will the outside investment manager hold the trustee harmless? What if the outside investment manager dies or retires or files for bankruptcy? Will the beneficiaries hold the trustee harmless? Who is liable to protect the trustee?
- Does the trustee still have investment oversight and must the trustee still make investment recommendations? If the trustee is relieved of those duties, what impact will that have on the fees which the trustee can reasonably charge?

- Who custodies the trust assets?
- Does the outside investment manager actually make the trades for the trustee or does the outside investment manager direct the trustee to make the trades? Must those instructions be in writing?
- Who can remove the outside investment manager from that office? The trustee still has investment liability if the *trustee* can remove the investment manager; that is, if the trustee can fire the outside investment manager at any time, how can the trustee later claim the trustee is protected against liability for actions taken by the investment manager? "You should have fired the advisor before that investment was made!" If one or more of the beneficiaries is given this power, can or must they name a new investment manager? Does the trustee take back the investment management responsibility if there is no outside investment manager serving at any given time?
- How are the outside investment manager's fees to be charged? Against principal or income? Does the trustee have liability for paying those fees without question or must they first be approved by the beneficiaries? If the advisor is compensated when trades are made, how mechanically are those fees to be split between income and principal by the trustee?
- Who is responsible for tax reporting? If the assets are custodied by the outside investment manager, how will the trustee get 1099s?

<u>What's the Real Problem?</u>

The creator of the trust could have dealt with each of these issues by carefully drafting the trust instrument. That was not done. The trustee who seeks to comply with the wishes of the beneficiaries is required to take steps which could have been and should have been taken by the patriarch of the family.

Can the trustee rely on the consents of the beneficiaries? Can the trustee comply with investment management decisions of a third party even with a complete agreement among all the parties?

Is there still potential liability? Of course! Beneficiaries are more and more anxious to seek relief from a trustee with the benefit of hind sight.

What is the preferred strategy to minimize the trustee's potential liability? Get a court order.

I recommend that you get court approval whenever the administration of the trust is at variance with the terms of the document. Consents alone are not sufficient protection for the trustee.

Consents are the minimum protection you should have; however, the larger the size of the trust, the more inadequate is the protection provided by the consents. It is simply too easy for beneficiaries later to claim that they were not adequately informed by the trustee when the consent was signed, did not understand their rights or that circumstances changed after the consent was signed, rendering it meaningless (in their opinion).

If the trustee has current, adequate consents from all the beneficiaries, it probably is not worth the expense of getting court approvals in *small* trusts. But in larger trusts, why would the trustee not demand the protection of a court order? If the beneficiaries all want the trustee to deviate from the terms of the trust on these issues, the trustee should reasonably ask for a court order to accomplish their wishes.

Suppose the beneficiaries do not want the trustee to diversify an investment concentration, do not want the trustee to sell non-approved securities, or want the trustee to delegate investment management to an outside investment manager? The trust instrument could have provided for each of these things, but did not do so. Nevertheless, the beneficiaries want the trustee to deviate from the express terms of the trust instrument to accomplish *their* objectives.

Indiana law permits a trustee to petition the local court to permit a deviation from the express terms of a trust instrument if the court finds that (a) there are new circumstances which exist that were not reasonably foreseen by the creator of the trust and (b) due to these new circumstances, compliance with the terms of the trust, as written, would "defeat or substantially impair the accomplishment of the purposes of the trust."[7] If the court makes that determination, the judge can approve new language to be put into an otherwise irrevocable trust agreement or last will and testament, which would "direct or permit the trustee to do acts which are not authorized or are forbidden by the terms of the trust, or may prohibit the trustee from performing acts required by the terms of the trust."

How can a trustee utilize this statutory procedure? Suppose the trust holds an investment concentration or wants to delegate investment management responsibilities? Indiana law requires a trustee to comply with the "prudent investor" rule.[8] An investment concentration are generally understood to violate that rule. A trustee cannot delegate investment management responsibilities.

The "new circumstance" which might exist is the requirement that the trustee diversify the concentration and manage the trust assets *regardless of the wishes of the beneficiaries.*

The trustee can assert that, had the creator of the trust known that the trustee would be required to overrule the wishes of the beneficiaries, he or she would have directed in the trust instrument the retention of the concentration or the investment management delegation. This new circumstance was not reasonably anticipated by the creator of the trust. Compliance with the terms of the trust instrument, as written, would require the trustee to overrule the wishes of the beneficiaries, which would "defeat or substantially impair the accomplishment of the purposes of the trust."

Therefore, the trustee requests that the court insert a new provision in the trust instrument which prohibits the trustee from diversifying the investment concentration or permits investment management delegation. Because no one can predict the future, I recommend that the new court-approved provision prohibit the sale without the written consent of specific beneficiaries.

Those issues identified above with respect to a written contract with an outside investment manager must also be addressed in the new provision which the trustee and beneficiaries wish the court to insert into the trust instrument.[9]

Who bears the expense of the court action? This is an appropriate expense of the trust, to be charged to trust principal. The trustee does not bear this expense personally. The legal fees and court costs are paid out of the trust assets themselves.

It is possible that the beneficiaries will object to the expense of a court order on the grounds that it is being sought merely to protect the trustee. Why should the trust bear that expense? The proper response to this objection is that the requested court order merely puts into the trust instrument language which the creator of the trust should have included. The trustee is seeking a court modification of the language *in order to accomplish the wishes of the beneficiaries.*

If the beneficiaries are not willing to bear the expense, the trustee has no alternative but to diversify the concentration, and manage the trust assets. If the beneficiaries do not want the trustee to take those actions – which are required by Indiana law because the creator of the trust failed to include the necessary language in the trust instrument – they should and must bear the expense of "cleaning up" the trust instrument.

If the beneficiaries realize that, without a court order, the trustee has no alternative but to diversify the concentration and manage the investments without the assistance of the outside investment manager, I believe the beneficiaries will understand that the court process is not designed to protect the trustee, but is to give the trustee the authority to do (or not do) what *the beneficiaries* want.

Administration of the Trust

A trustee faces similar exposure whenever the administration of the trust does not comply with the terms of the trust instrument. How is this possible?

Discretionary distributions - why is the money needed? The trustee must not assume that every trust instrument gives discretion to make distributions for "health, education, maintenance and support." Some documents restrict those four purposes to only education, for example. Some documents permit broader latitude, with distributions authorized for “happiness” or “comfort.”

Does the purpose for which the distribution is requested meet the standards of the trust instrument? A reasonableness factor comes into play here. These four standards are very, very broad. Let's examine them in a little more detail.

"Health." The trustee may reasonably interpret this language to permit the payment of those medical expenses incurred by the beneficiary which are not covered by the beneficiary's medical insurance. But what if the beneficiary has no medical insurance coverage? The beneficiary may elect not to incur that personal expense because of the expectation that all medical expenses will be paid from the trust.

I recommend that the trustee demand annual proof the fact that the beneficiary has adequate medical insurance coverage. If the beneficiary refuses to provide that information or has no coverage, I recommend that the trustee consider the acquisition of coverage at the expense of the trust. Depending on the terms of the trust, the trustee can reasonably charge the premiums to the interests of that beneficiary. It is not reasonable, on the other hand, for a trustee to permit a beneficiary to have no medial insurance and to pay *all* the health expenses from the trust, in my opinion.

How does the trustee know whether the beneficiary has adequate medical insurance? Ask!

"Education." I'm all in favor of education; however, I do not like perpetual students. The old four year undergraduate program has turned into a five, six or even more year marathon (at least my children tell me that!). When can and should a trustee say "no" to a beneficiary who stays on and on and never seems to reach graduation?

I think the answer to that question depends on the size of the trust assets, the existence of other beneficiaries who are dependent on those assets and the probable intention of the parents who created the trust.

Suppose the child who wants to stay in college is the sole beneficiary of the trust, which might terminate, for example, when he or she reaches a higher age, with the assets distributed to that same child? By consuming his or her own trust assets for these continuing education pursuits, the beneficiary is hurting no one other than himself or herself. I see no reason, under those circumstances, to say "no" to the request for more tuition dollars.

But if this is a "family" trust, designed to hold all the assets together in one trust for the benefit of several children, one child's continued demand for tuition dollars might jeopardize the trustee's financial ability to educate the younger children. It is under these circumstances that I recommend the trustee put a limit on the number of years of undergraduate education which will be paid from the trust.

A related problem arises with a “small” trust. If the oldest child of four children requests distributions for an expensive undergraduate education from a trust holding only $300,000, it is certainly possible that the trust assets will be exhausted long before the youngest child graduates from high school. While the parents, if still living, would have incurred that expense (with the expectation that, some how, they will get more money to educate the younger children), the trustee must understand that there will be no new money coming into the trust.

A reasonableness standard must be adopted by the trustee of a trust with limited assets. If the trustee believes that there is a risk the trust assets will be consumed if the trustee pays all the anticipated education expenses of one child, the trustee must limit how much is distributed for the education of that child. Even though the trust instrument permits distributions for that child’s “education,” the trustee has a duty of impartiality and cannot favor the interests of that child at the expense of the other children.

“Maintenance and support" can literally mean whatever the trustee decides those words should mean. Almost any expenditure can arguably be brought within the scope of that standard. So when can and should a trustee say "no" to a beneficiary? Once again, a reasonableness standard must be applied.

I know of beneficiaries who demand to be supported and maintained by benevolent trustees long after they have left school. Trustees know of "trust babies" who lie around the swimming pool and expect a trustee to pay their rent and buy them groceries. Is this what the parents intended when they included the words "support and maintenance" in the trust instrument? Probably not.

If there are other beneficiaries of the trust, I believe that it is unreasonable for a trustee to give in to a beneficiary's demand to be supported and maintained, even if that is a standard in the trust instrument. To do so might jeopardize the trustee's ability to raise and educate the younger children. The trustee who depletes trust assets in the support of an older child may face liability to the younger beneficiaries when the trustee later has insufficient funds to meet their legitimate needs.

A reasonableness standard should be applied. A trustee might, for example, tell a child who is in his twenties that the trust will only match the child's own earned income. The trust will supplement, but not replace, the beneficiary's ability to support and maintain himself or herself. This standard may not be necessary if the trustee has millions of dollars in trust; however, I believe it to be a reasonable standard in many smaller trusts.

Many trust instruments authorize a trustee to help a child purchase a residence or start a business. How much of the trust principal should be depleted for these purposes? Should the principal be distributed to the beneficiary who then purchases the home or business in his own name or could not the trustee buy those as assets of the trust? Title to the home or the business can later be distributed to the child when the beneficiary reaches the stated ages for distribution.

Should the trustee expect the beneficiary to contribute some amount towards the purchase of the residence or business? Perhaps the trustee would agree to match whatever down payment is put up by the beneficiary. A beneficiary who has his own money invested in a new business (perhaps matched by a discretionary distribution from the trust) will devote more effort to the success of the venture.

Discretionary distributions - outside resources. Must the trustee consider the resources otherwise available to the beneficiary when requested to make a discretionary distribution? What are the terms of the trust instrument? There are probably three alternatives:

1. The trust instrument expressly directs the trustee to take into consideration the outside resources which can meet the beneficiary's needs. But does the document direct the trustee to consider "all resources" or only the "income" of the beneficiary?

Must the trustee require the beneficiary to use up all those outside resources before any distribution can be made from the trust? The instrument typically says that the trustee is to "take into consideration" those resources. The beneficiary should not be required to exhaust them.

If the outside resources are illiquid, for example, the trustee should not refuse a reasonable request for distributions. But if the beneficiary has ample outside liquid resources, on the other hand, it would violate the terms of the trust instrument if the trustee, in spite of those outside liquid resources, distributed money from the trust.

If the trustee is to consider outside resources, the trustee should request a personal financial statement from the beneficiary. The trustee might also request copies of back income tax returns, to see whether the reported income on the tax returns is consistent with the income producing assets disclosed on the financial statement. If the beneficiary refuses to supply this requested documentation, the trustee should refuse to make the requested distribution.

The trustee's "consideration" of these outside resources should be documented in writing and saved with the records of the trust.

2. The trust instrument expressly directs the trustee *not* to take into consideration the outside resources which can meet the beneficiary's needs. While this type of provision is unusual, I have seen it in a number of documents.

If this is the controlling language in the trust instrument, of course, the outside resources and income of the beneficiary are irrelevant. So long as the need is legitimate, the distribution may be made.

If the remainder beneficiaries are unable to accept the language of the trust and express displeasure with the trustee's discretionary distributions (when the beneficiary has ample non-trust liquid resources which could meet the need), I recommend the trustee petition the court for instructions. Does the language ("do not take into consideration the beneficiary's non-trust assets") really mean what it says?

Send notice of a hearing to all the beneficiaries and let them argue to the judge that the trust assets should not be depleted under these circumstances. When the court issues an order confirming the language of the trust instrument, it will later be difficult for the remainder beneficiaries to complain.

3. The trust instrument is silent on this issue. If that is the case, look carefully the wording of the instrument when it gives the trustee the discretion to make distributions.

Some documents permit the trustee to make discretionary distributions of those amounts of trust income or principal that "the trustee determines to be *necessary* for the reasonable health, education, maintenance and support" of the beneficiary. If the beneficiary has adequate outside liquid resources available, how can the trustee determine that a distribution from the trust is "necessary"? If the beneficiary satisfied those needs with the outside resources, the distribution from the trust would not be necessary, of course. If the trustee nevertheless distributes net income or principal, the trustee may have exposure to those remainder beneficiaries who would otherwise have received those distributed amounts.

Other documents permit the trustee to make discretionary distributions of those amounts of trust income or principal that "the trustee determines to be *necessary or convenient* for the reasonable health, education, maintenance and support" of the beneficiary. If the beneficiary has adequate liquid outside resources available to meet the need, but feels that it would be more *convenient* to have money distributed from the trust, how can a trustee refuse the request? “Why should I spend my money when I can get the trust to pay for it?”

Remember that it is the trustee, rather than the beneficiary, that makes the "convenient" determination. The greater the outside resources available to meet the request, the greater is the trustee's liability for distributing money from the trust in my opinion.

There are two considerations at work here: (a) if the trust assets will not be subject to taxation at the death of the requesting beneficiary, while his or her outside assets will be taxed, it makes no tax sense to distribute assets from the trust when the beneficiary has outside resources; and (b) if the remainder beneficiaries are step-children or other third parties, it makes no sense to distribute assets from the trust without their knowledge and consent, particularly when it is only “convenient” to do so.

Once again, the trustee's consideration of these issues should be documented and saved in the trust records.

Loans as disguised distributions. Some beneficiaries request that the trustee "loan" principal to the beneficiary when the standards for a discretionary distribution are not met. A beneficiary who is scheduled to receive all the trust assets when he reaches thirty may request that the trustee "loan" the entire trust principal to the child at age twenty-seven.

"What is the harm," he asserts, "because I will get the money in less than three years anyway? And since the trustee is to pay all the income earned by the trust assets to me, there is no reason for me to pay interest on this loan," he argues!

If the trustee gives in to this demand/request for the "loan," Murphy's Law can almost guarantee that (a) the loaned funds will be depleted and (b) the beneficiary will die before he reaches age thirty! The trustee will then be required to explain to the remainder beneficiaries why this "loan" was made in the first place.

Do not pretend that a loan under these circumstances is anything other than a disguised discretionary distribution. If the trustee is not willing to make a discretionary distribution, do no make one under the guise of a loan.

Ambiguity in the trust instrument. Ambiguities may arise when a trust is being administered. The language is simply not clear or the situation presented to the trustee was not dealt with in the trust instrument.

Here is one example of how ambiguities can arise in the administration of a trust. Suppose the trust assets are divided when both parents have died into separate trusts for each of the children. The assets are then to be distributed as each child reaches 25, 30 and 35. If a child were to die before his 35th birthday, his or her remaining trust assets are to be distributed to his or her descendants or, if none, are to be added to the trusts for the siblings.

Suppose the son dies when he is 28 and has no children of his own. The remaining assets are added to the trust for his sister when she is 33 years old. She had previously received distributions from her trust when she had reached 25 and 30. She now demands that the trustee distribute two-thirds of the assets which have been added to her trust.

Does the trust instrument deal with the possibility that assets will be added to her trust after a distribution has been made? Many do not.

What should the trustee do when presented with this ambiguity? The trustee must *always* petition the court for instructions to resolve any ambiguity. The trustee must not interpret the language and come up with the trustee's own interpretation. Almost by definition, the trustee's resolution of an ambiguity will harm the interests of some of a beneficiary.

If the trustee in the example just given decides to distribute two-thirds of the addition to the daughter who survived her brother's death, what liability does the trustee have to her descendants if she dies at age 34? Those descendants would have received the distributed assets had no distribution been made.

It is important that, when the trustee seeks a judicial interpretation of the trust instrument, the trustee not argue for a particular construction. This may be difficult to do when the trustee (or the trustee's lawyers) participated in the planning and the drafting of the trust instrument. The trustee may rightly feel that he or she knows the "correct" interpretation of the language which creates the ambiguity.

If the trustee asserts a position in the judicial proceedings, however, that action will violate the trustee's duty of impartiality towards the interests of all the beneficiaries. This well settled matter of common law was expressed in the dissenting opinion in Estate of Goulet v. Goulet[10] as follows:

> "It has long been settled, not only in California but elsewhere, that a fiduciary (such as the trustee of a trust or the personal representative of a decedent's estate) administering property on behalf of multiple beneficiaries must act impartially towards all the beneficiaries and must not favor, or expend funds litigating, the interest of one beneficiary over another. *The fiduciary may not take sides when a dispute arises as to the relative rights and interests of various beneficiaries, and may not work to advance or oppose the claim of any beneficiary."* (emphasis added)

The application of this principle to ambiguities in the interpretation of a trust instrument was brought vividly home in The Northern Trust Company v . Heuer.[11] The trustee asserted a construction in the judicial proceeding which was unfavorable to the position taken by a beneficiary. The court held that, while it was proper for the trustee to seek the court's construction of the trust instrument by filing the action and in gathering and presenting the information necessary for the court to interpret the instrument, the trustee breached its duty of impartiality and exceeded its duty as the trustee when it argued for an interpretation adverse to a beneficiary.

The court disallowed the trustee's request that the attorneys' fees it incurred in the construction action be paid out of trust assets:

> "[G]enerally the costs of litigation to construe a trust in which there are adverse claims are paid by the trust estate .... *[W]here a trustee breaches its duty to administer the trust according to its terms and performs in a manner which favors one beneficiary over another, the trustee is not entitled to attorney fees and costs even though the breach is technical in nature, done in good faith and causes no harm."* (emphasis added)

Northern Trust was required to pay the trustee's legal fees out of its own assets, rather than from the trust.

The trustee's duty of impartiality applies to the trustee's attorneys, of course, who also may not assert a position which is adverse to the interests of any trust beneficiary.

Suppose the trustee is an individual and one of several beneficiaries of the trust. He or she wishes to take a position on the resolution of the ambiguity. I recommend that the individual trustee engage a new lawyer who can petition the court for instructions on behalf of the trustee. That new lawyer thereafter takes no position on the resolution of the ambiguity. The "regular" lawyer for the individual trustee can then enter an appearance on behalf of the individual *as beneficiary* and not as trustee and the beneficiary can then argue in favor of a particular resolution of the ambiguity.

<u>Total Return Trusts v. Uniform Principal and Income Act</u>. Indiana law was changed to permit a trustee to convert an ordinary "income only" trust to a total return unitrust.[12] If a trustee decides not to convert an ordinary "income only" trust to a total return unitrust, the trust will be subject to Indiana's Uniform Principal and Income Act.[13]

What should a trustee do? With respect to trusts which call for only the distribution of income (and not principal), it is no longer business as usual. That is, the trustee cannot merely continue to distribute net income and ignore the option of conversion to a total return unitrust or to adjust income and principal under the UPIA. The trustee must either convert the trust to a total return unitrust or elect to be governed by the Uniform Principal and Income Act. The option of "continue as we have always done" is *not* available.

If the trust instrument gives the trustee the discretion to distribute principal as needed, however, there is no reason, in my opinion, to convert the trust to a total return unitrust or to make adjustments between income and principal under the UPIA. Rather, the trustee can make reasonable distributions of trust principal in those amounts necessary to accomplish the purposes of the trust.

If the trustee manages a portfolio of marketable securities, I do not believe the trustee need convert the trust to a total return unitrust nor be terribly concerned with adjustments between income and principal. Nevertheless, conversion to a unitrust means that both the current and the future beneficiaries share an investment goal of growth and the age old tug of war over the asset allocation decisions can be minimized.

But if the trust has an investment concentration in a stock with a low dividend yield (hopefully with language in the trust instrument or a court order directing its retention and relieving the trustee of liability), capital appreciation favors the remainder beneficiaries over the interests of the current income beneficiaries. If the trust is not converted to a unitrust, the UPIA requires the trustee to consider shifting some of the principal appreciation to income. That is, the income beneficiary suffers financially due to the retention of the concentration; the concentration is retained so as to obtain capital appreciation which, in the absence of an adjustment under UPIA, would benefit only the remainder beneficiaries.

The trustee might also hold commercial real estate as a trust asset. If the tenant leaves at the end of the lease and the rental income ceases, the income beneficiary will suffer financial harm unless and until the real estate is sold. Should the trustee consider shifting some principal to income under UPIA or should the trustee convert the trust to a total return unitrust?

Finally, the trustee may hold farm land as a trust asset. The value of the ground continues to appreciate, which drives the current income yield to low levels. The family wants to maintain the farm in the trust for ultimate distribution to the remainder beneficiaries. Should the trustee consider shifting some the real estate appreciation to income, so as to compensate the current beneficiary?

If the trustee is dealing with a document which permits or requires the distribution of only trust income, I recommend that the trustee make an affirmative decision either (a) to convert the trust to a total return unitrust or (b) to continue the administration of the trust as written, but with application of UPIA. The trustee must make a decision to go one way or the other. It is no longer business as usual.

If the trustee merely ignores this choice and continues to distribute only the income, the trustee could easily have liability to the beneficiary who later argues that the trustee should have converted the trust to a unitrust or should have made adjustments between income and principal under UPIA. A decision not to decide merely postpones the inevitable second guessing.

Should the trustee consult with the beneficiaries before making this decision? Of course!

A trustee may decide to convert the income only trust to a total return unitrust. If this conversion takes place, the trustee will thereafter determine the net fair market value of the trust assets on an annual basis and will distribute a "unitrust" amount in the following year to the beneficiary. The unitrust rate cannot be less than 3% nor more than 5% of the value of the trust assets.[14]

The trustee's conversion to a total return unitrust is done primarily to resolve the historic asset allocation battle between the income and remainder beneficiaries. If the "current beneficiary" is to receive a fixed percentage of the annually revalued trust portfolio, that beneficiary shares the same investment goals with the remainder beneficiaries. All the trust beneficiaries want the value of the trust assets to increase over time.

If the decision is made to convert the trust to a total return unitrust, the trustee should follow the procedures outlined in I.C. 30-2-15-1 et seq. If all the beneficiaries consent *in writing* to this conversion, no court order is required.[15] If the trustee receives an objection or if the trustee merely wants the comfort of a court order, the trustee should follow the procedures outlined in I.C. 30-2-15-11. Because an unhappy beneficiary is always able to argue in the future that he or she did not know her rights when signing the consent, I still recommend court approval of the conversion to a unitrust, with the consents of the beneficiaries attached as exhibits to the trustee's petition.

If the trustee elects to continue to administer the trust as written, on the other hand, the Uniform Principal and Income Act will apply to the trust unless to do so might jeopardize an estate tax deduction or a gift tax exclusion, would violate a fixed annuity distribution provision or would cause the trustee to be treated as the owner of the trust assets for income or estate tax purposes. The power to make adjustments between income and principal also cannot be exercised if the trustee is a beneficiary of the trust.[16]

For the thousands of trusts which are now subject to UPIA, the trustee must follow the procedures outlined in the Act when deciding whether to shift income to principal or vice versa for trust accounting purposes.[17]

The trustee must become familiar with the nine factors which the Act says the trustee should consider when deciding whether to make an adjustment:

1. The nature, purpose and expected duration of the trust;

2. The identity of the person who created the trust;

3. The identity and the circumstances of the beneficiaries of the trust;

4. The needs for liquidity, regularity of income and preservation and appreciation of principal;

5. The assets in the trust, including the extent to which they consist of liquid investments, ownership interests in a closely held business, tangible personal property, intangible personal property or real estate; the extent to which these trust assets are used by a beneficiary; and whether the assets were deposited to the trust by its creator or were purchased by the trustee;

6. The normal allocation of receipts and disbursements between income and principal;

7. Whether the trust instrument permits the trustee to make discretionary distributions of trust principal and the extent to which the trustee has exercised this power from time to time;

8. That actual and anticipated effects of the economy and inflation; and

9. The anticipated tax consequences of the adjustment.[18]

I recommend that the trustee establish a written checklist, with these nine factors identified, so that the trustee can document the trustee's consideration of these issues *every year*. Even if, after consideration, the trustee determines that no adjustment between income and principal should be made, the trustee should document the consideration of these nine factors, so that the trustee can later justify the decision not to adjust income and principal.

<u>The allocation and distribution of trust assets</u>. A trustee is commonly called upon to allocate trust assets to one or more continuing trusts, perhaps between a credit trust and a marital gift. What liability might a trustee incur when performing these routine functions?

If assets are to be allocated between a credit trust and a marital gift, the manner in which those allocations are made can be very complex. Suppose the trust instrument calls for the trustee to allocate to the credit trust the largest amount which can pass free from federal estate tax by reason of the decedent's applicable credit amount, with the remaining trust assets to be distributed outright to a surviving spouse? The trust holds

$5 million in assets, based on the final *date of death* federal estate tax values; therefore, the trustee thinks that $3.5 million should be allocated to the continuing credit trust and the remaining $1.5 should be distributed to the surviving spouse.[19]

However, the assets cannot be divided between the credit trust and the marital gift on the date of death. The estate must be administered and tax clearances must be obtained. Months will pass before the trustee is in a position to distribute the assets. When it is appropriate to fund the trusts, the trustee must determine the *current* value of the assets which remain to be distributed.

Suppose, when the trustee revalues the assets before making these allocations, the trustee learns that the assets have appreciated during the estate administration period and are now worth $6 million. Where should the trustee allocate the $1 million of appreciation which has occurred after the date of death? If the value of the assets which are available to fund the trusts has fallen to $4 million, on the other hand, which trust bears the market loss?

The answer depends on the language in the trust instrument. If the trustee is directed to distribute assets in kind *at their value on the date of distribution*, the trustee must allocate assets which, when the allocation is made, equal the date of death value of the *first* gift made in the trust instrument. Is that the credit trust or the marital gift? All the appreciation or depreciation then passes to or falls on the residuary gift.

If the trustee, on the other hand, is to distribute assets in kind *which are fairly representative of overall appreciation and depreciation which has occurred during the estate administration*, then both the allocation to the credit trust and the distribution to the surviving spouse are to be increased by the amount of the appreciation (or decreased by the amount of depreciation). Both gifts share ratably in the appreciation or depreciation which has occurred. [20]

Next, what does the trustee do with the income which has been earned on those assets during the estate administration? The answer to that question may be even more complicated due to arguable conflicts between the Probate Code and the Trust Code.

If these distribution decisions are being made by a personal representative in a supervised estate, the fiduciary can ask the court to approve the proposed action after notice to all the beneficiaries. However, if these decisions are being made by a trustee who receives assets under a pour over will, no thought may be given to court approval. Why not? I recommend that the trustee docket the trust and petition the court for an order which, after notice to all the beneficiaries, approves of the allocation to the credit trust and the distribution to the surviving spouse and the distribution of the net income.

The Internal Revenue Service is now routinely looking at these funding decisions when the surviving spouse later dies. There is anecdotal evidence that the IRS is finding that credit trusts were incorrectly funded more than 50% of the time. If a trustee incorrectly funds a credit trust, causing assets to be subject to federal estate tax at the death of the surviving spouse, will the trustee have liability for that error? Of course.

Conflicts of Interest

A very pervasive problem for trustees arises when a trustee has a conflict of interest. Conflicts can arise in two fairly common situations: (1) when a beneficiary is serving as a trustee or co-trustee; and (2) when the same trustee is serving as trustee of two related trusts.

Indiana Code Section 30-4-3-5(a) reads as follows:

> "If the duty of the trustee in the exercise of any power conflicts with the trustee's individual interest or the trustee's interest as trustee of another trust, the power may be exercised only under one (1) of the following circumstances:
>
> (1) The trustee receives court authorization to exercise the power with notice to interested persons as the court may direct.
>
> (2) The trustee gives notice of the proposed action in accordance with IC 30-2-14-16 and
>
> (A) The trustee receives the written authorization of all interested persons to the proposed course of action within the period specified in the notice of the proposed action; or
>
> (B) A beneficiary objects to the proposed action within the period specified in the notice of the proposed action, but the trustee receives court authorization to exercise the power.
>
> (3) The exercise of the power is specifically authorized by the terms of the trust."

A beneficiary is serving as the trustee. How many beneficiaries are serving as a trustee or as a co-trustee of Indiana trusts today? I believe that the number will be in the thousands. How many of those trust instruments specifically acknowledge the trustee/beneficiary's conflict of interest and waive any liability which the trustee/beneficiary may have? I believe that the number will be very, very low.

Every beneficiary who serves as a trustee or a co-trustee inherently has a conflict of interest in the exercise of virtually every trustee power. The allocation of trust assets between stocks and bonds will have an economic impact on all the beneficiaries, including the conflicted trustee. The trustee/beneficiary's exercise (or refusal to exercise) the power to make discretionary distributions will have an economic impact on all the beneficiaries, including the conflicted trustee.

I.C. 30-4-3-5(a) gives to every other beneficiary of that trust the power to bring an action against the trustee/beneficiary who failed to comply with subjections (1) and (2), all with the benefit of hindsight. Suppose, for example, that the trustee/beneficiary purchased an investment which later declined in value.

Another beneficiary could bring an action to compel the trustee/beneficiary to reimburse the trust for the full amount invested in that stock. The traditional defense to that sort of action was to show that the investment was prudent when made and that there is no trustee liability if it later declines in value.

The unhappy beneficiary will argue, however, that the action is not brought because the investment was imprudent; rather, the action was brought because the trustee/beneficiary *had no power to make the investment in the first place*! That is, because the conflicted trustee failed to comply with I.C. 30-4-3-5, the investment was per se invalid.

<u>A beneficiary is serving as a co-trustee with a bank</u>. This statute presents a serious problem to professional trustees and individual trustees alike. If a beneficiary is serving as a co-trustee with a corporate fiduciary, all decisions of the co-trustees must be unanimous unless the trust instrument provides otherwise.[21] Assuming that the trust instrument does not provide otherwise, that necessarily means that the "vote" of the individual trustee is required for every decision made by the co-trustees. Unless the co-trustees comply with I.C. 30-4-3-5, the participation by the co-trustee/beneficiary is not authorized. I argue that this means evert *decision* by the co-trustees was invalid.

<u>A corporate trustee is also trustee of a related trust</u>. Kentucky has a statute which is remarkably similar to I.C. 30-4-3-5. PNC Bank was serving as the trustee of an

irrevocable trust created by the beneficiary's mother. The daughter also created her own revocable trust and named PNC Bank as her trustee. When the daughter requested a discretionary distribution of principal from her mother's trust, PNC Bank failed to realize that it had a conflict of interest because it simultaneously served as trustee of the daughter's revocable trust.

Because the remainder beneficiaries of the two trusts were different, PNC Bank's decision to make a discretionary distribution from the mother's trust violated its fiduciary obligation to take only those actions which are in the best interests of the beneficiaries. PNC Bank's failure to obtain prior court authorization for the discretionary distribution violated Kentucky's version of I.C. 30-4-3-5. While the amount of damages was remanded to the trial court, it appears likely that PNC Bank would be ordered to reimburse the mother's trust for the entire amount of the discretionary principal distribution.[22]

<u>How to deal with this problematic issue</u>?

<u>New trust instruments</u>. If you are drafting new trust instruments which name a beneficiary as the trustee or as a co-trustee, you must have the client specifically acknowledge the trustee/beneficiary's conflict of interest and waive any liability which the trustee/beneficiary would otherwise have under I.C. 30-4-3-5.

The mere naming of a beneficiary as the trustee or as a co-trustee *is not sufficient* to overcome I.C. 30-4-3-5. The waiver of the conflict must be "*specifically* authorized by the terms of the trust." (emphasis added) If the mere naming of a conflicted beneficiary as the trustee or as a co-trustee were sufficient to overcome the statute, why have the statute in the first place?

Existing trust instruments. If you today are a trustee who is also a beneficiary of an irrevocable trust, you must take corrective action now. I recommend that you docket the trust and petition the court to modify the provisions of the irrevocable trust in accordance with the provisions of I.C. 30-4-3-26. The "new circumstance" not foreseen by the creator of the trust, I believe, would be the inability of the named trustee/beneficiary to exercise the powers of the trustee without prior court authority. You ask the court to modify the language of the trust instrument to insert language in which the creator of the trust acknowledges the trustee/beneficiary's conflict of interest and waives any liability which the fiduciary may otherwise have.

The failure to take this corrective action leaves a loaded shotgun in the hands of every other beneficiary who can bring an action against the trustee/beneficiary with the full benefit of hindsight.

Successor Trustee Liability for Acts of Prior Trustee

There are many instances in which the serving trustee was not the original trustee. This is the successor trustee. Indiana law[23] provides that the successor trustee can exercise all powers granted to the original trustee in the will or trust agreement.

However, Indiana law[24] is equally clear that a successor trustee "becomes liable for a breach of trust of his predecessor if he … fails to make a reasonable effort to compel a redress of a breach of trust committed by the predecessor trustee."

The steps which can and should be taken by the successor trustee depend on the circumstances in which the successor becomes the trustee.

The trustee who succeeds a deceased creator of a revocable trust. Suppose an individual creates a revocable living trust and is the initial trustee. The trust agreement becomes irrevocable when the creator of the trust dies and a successor trustee takes over. That successor trustee should have no liability to the beneficiaries of the trust for any action taken while the trust was revocable because those beneficiaries had no real interest in the trust until it became irrevocable.

The trustee who succeeds a trustee of an irrevocable trust. Suppose the trust is already irrevocable, on the other hand. There is an existing trustee of this irrevocable trust. That trustee becomes incapacitated, resigns, is removed or dies. A successor trustee takes over.

I.C. 30-4-3-13(b) states that the new trustee must make a "reasonable effort" to redress any breach of trust committed by the predecessor trustee. However, the terms of the trust may expressly relieve the successor trustee of any liability for acts of the predecessor trustee.[25]

Therefore, if the terms of the trust instrument *expressly* relieve the successor trustee of liability for acts of the predecessor trustee, there is no reason for the successor trustee to examine the books and records of the predecessor trustee. I recommend, however, that the successor trustee be certain that the beneficiaries of the trust understand that the predecessor trustee may still be liable to the beneficiaries for any breach of trust committed by the predecessor trustee while in office, so they can take the necessary steps to protect their interests.

If the terms of the trust do not expressly relieve the trustee of liability for acts of the predecessor trustee, on the other hand, the successor trustee *must* take steps to protect itself from fiduciary liability for acts of the predecessor trustee. If the successor trustee takes no action before the applicable statute of limitations expires, the beneficiaries can bring an action against the successor trustee for breaches of trust committed by the predecessor trustee.

Therefore, I recommend that the successor trustee do one of two things: (a) docket the trust and ask the court to order the predecessor trustee to prepare and file a complete accounting of the acts of the predecessor trustee for the entire period in which the predecessor trustee was in office. Have the accounting, when filed, served on the beneficiaries who should be given a reasonable opportunity to file objections. The successor trustee is not relieved of fiduciary liability if the beneficiaries fail to object, however, because it is the successor trustee who must protect their interests; nevertheless, it is reasonable for the successor trustee to give them that opportunity. The successor trustee must conduct a careful review of the accounting and must file appropriate objections with the court, which will ultimately rule on any alleged breaches of trust; or (b) the successor trustee must obtain written consents from the beneficiaries which expressly relieve the successor trustee of liability for acts of the predecessor trustee. I note that all of the problems with written consents noted earlier[26] have equal applicability to this issue.

Revocation of a Revocable Trust

When the creator of a revocable trust elects to revoke the trust agreement, it seems pretty straightforward. Right? Not necessarily.

If the trustee has any question about the competency of the creator of the trust or the susceptibility of that person to undue influence by others, alarm bells should sound. A recent Kentucky Supreme Court case illustrated the point.

J.P. Morgan Chase Bank, N.A. v. Longmeyer[27] dealt with the trustee of a revocable trust which had been revoked. Because the trustee suspected that the creator of the trust had been unduly influenced to revoke the trust, the trustee notified the charitable beneficiaries of the revoked trust of its revocation. After the charities brought an action to invalidate the revocation, the trustee of the new trust created by the settlor brought this action against the predecessor trustee. The successor trustee argued that notice should not have been given to the charitable beneficiaries, that notice was a breach of trust and that the predecessor trustee should be personally liable for the costs of the settlement which had been paid to the charities.

Is the trustee of a revoked revocable trust under a fiduciary duty to notify the beneficiaries of the revocation? The Kentucky Supreme Court not only ruled that the predecessor trustee had no liability for notifying the charities, it went further and ruled that the trustee had an *affirmative duty* to notify the beneficiaries of the revoked trust. Kentucky's statute requires a trustee to "keep the beneficiaries of the trust reasonable informed of the trust and its administration."[28]

Many of us thought that the purported beneficiaries of a revocable trust had no real interest in the trust until it became irrevocable; therefore, we thought that there was no duty to keep those *maybe* beneficiaries informed. Nevertheless, the Kentucky court refused to create an exception for revocable trusts.

I believe that the ruling in this case may have turned on the trustee's suspicion of undue influence. That is, if the creator of the trust lacked the capacity to revoke the trust, its beneficiaries did have an interest which needed to be protected.

If the trustee of a revocable trust has no reason to believe the creator of the trust lacks competency or is the victim of undue influence or fraud, there is no reason in my opinion to notify the beneficiaries of the revoked trust. The competent creator of the trust is the only beneficiary of the trust so long as it is revocable and it is a real stretch to believe that the trustee must notify the *maybe* beneficiaries.

If the trustee of a revocable trust has reason to believe, on the other hand, that the creator of the trust lacks competency or is the victim of undue influence or fraud, I believe that the trustee must notify the beneficiaries of the trust. Indeed, I recommend that the suspicious trustee docket the trust and petition the court for instructions *before* the trustee recognizes the validity of the revocation.

If the trustee fails to do that and honors the revocation, the trustee may end up in a very difficult position. Suppose that the creator of the trust dies shortly after revoking the trust. Federal estate tax is payable by the creator's estate; however, none is paid by those who now have the assets which had been in the trust.

The Internal Revenue Service is not bound by any determination of state law by any court other than the Supreme Court of that state.[29] Even if the trustee obtains a court order affirming the revocation of the trust, the IRS can later assert that the revocation was invalid for any number of reasons. If successful, the trustee will become *personally liable* for the unpaid federal estate tax.[30]

Even if the suspicious trustee obtains a court determination which upholds the validity of the attempted revocation, I recommend that the trustee deposit into an escrow account sufficient funds with which to pay the federal estate tax due from the creator's estate simply because the IRS is not bound by the trial court's determination of an effective revocation.

Conclusions and Final Recommendations

An individual who is serving as trustee of one or only a few trusts should examine these issues immediately.

No corporate trustee can review all its accounts after reading this material. There are too many accounts to look at. I recommend, on the other hand, that careful attention be paid as accounts are cycled up for administrative or investment review.

Are the investments being made in accordance with the terms of the trust instrument? Is there an investment concentration or are there non-approved securities whose retention is not directed by the trust instrument, with the trustee relieved of liability? Has the trustee informally permitted an outside investment manager to make investment decisions? How old are the consents which approve of the trustee's actions or inactions? Do the consents expressly relieve the trustee of liability?

Is the trust being administered in accordance with the terms of the trust instrument? Should discretionary distributions be denied because they are excessive?

Has the trustee given appropriate consideration to outside resources available to the beneficiary before making a discretionary distribution from the trust? Has that consideration been documented in the trust records? Has the trustee made disguised discretionary distributions in the form of unsecured loans to a beneficiary?

Has the trustee considered conversion of an income only trust to a total return unitrust or has the trustee decided to continue administration of the trust as written, but with application of Indiana's Uniform Principal and Income Act?

The first step for a trustee is to evaluate the trusts of which the trustee serves as fiduciary. Identify the skeletons in the closet. The trustee can then determine what action to take, whether that be (at a minimum) updated consents from all the beneficiaries or court orders after notice to the beneficiaries.

Doe the trustee have a conflict of interest in the exercise of the trustee's powers? Does the trust instrument specifically acknowledge the conflict of interest and waive any liability? If not, has the trustee complied with I.C. 30-4-3-5 *every* time it exercises the powers of trustee? If not, should the trustee seek judicial modification of the trust instrument to insert the necessary language?

It never was easy to be a trustee and now it seems to be getting harder.

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2 I.C. 29-1-1-20(a)(4) and I.C. 30-4-6-10.
3 I.C. 30-4-3-19(b)(1).
4 I.C. 30-4-3-19(b)(2).
5 I.C. 30-4-3-9(a).
6 I.C. 30-4-3-9(b).
7 I.C. 30-4-3-26(a).

[8] I.C. 30-4-3.5-1.

[9] See the discussion which begins "The agreement needs to address a number of significant issues" on page 7 of this paper.

[10] 10 Cal. 4th 1074 at 1086, 898 P.2d 425 at 432 (1995). See, also, In the Matter of the Trust for Duke, 305 N.J. Super. 408, 702 A.2d 1008 (1995), In re Cudahy, 26 Wis.2d 153, 131 N.W.2d 882 (1965) and In re James Estate, 86 N.Y.S.2d 78 (Surr. Ct. 1948).

[11] 202 Ill.App.3d 1066, 560 N.E.2d 961 (1990).

[12] I.C. 30-2-15-1 et seq.

[13] I.C. 30-2-14-15.

[14] I.C. 30-2-15-15.

[15] I.C. 30-2-15-10.

[16] I.C. 30-2-14-15(c).

[17] I.C. 30-2-14-15.

[18] I.C. 30-2-14-15(b).

[19] Assume the decedent died when the applicable credit amount would shelter $3.5 million from federal estate tax.

[20] A fractional formula allocation between a credit trust and marital gift works the same way.

[21] I.C. 30-4-3-4(a).

[22] *Wiggins et al. v. PNC Bank, Kentucky, Inc.*, 988 S.W.2d 498 (Ky. 1999).

[23] I.C. 30-4-3-4(d).

[24] I.C. 30-4-3-13(b).

[25] I.C. 30-4-1-3 states that the terms of the trust instrument can override the provisions of the Trust Code “unless the rules of law clearly prohibit or restrict the article which the terms of the trust purport to authorize.” Because the rule of I.C. 30-4-3-13(b) does not clearly prohibit a trust instrument from varying the general rule of trustee liability for acts of a predecessor trustee, the trust instrument can relieve the successor trustee of this liability if it *expressly* does so.

[26] See the discussion beginning on page 2.

[27] 275 S.W.3d 697 (Ky. 2009).

[28] Ky. Rev. Stat. Section 386.715.

[29] *Commissioner v. Bosch’s Estate,* 19 AFTR 2d 1891 (2d Cir., 1967).

[30] Internal Revenue Code of 1986, as amended, Section 1002; Regulations Section 20.2002-1.