The Creation, Modification, and Termination of Trusts

Course #6035D/QAS6035D
Course Material
# The Creation, Modification, and Termination of Trusts
(Course #6035D/QAS6035D)

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Chapter 1: Creation, Modification, and Construction of Trusts

I. Overview of Trust Creation

A. PROPER SUBJECTS OF A TRUST

Virtually anything can be the subject of a trust – real property, personal property such as a coin collection or furniture as well as stocks, bonds, and other investment vehicles. The only significant limitation is that a trust cannot be used for an illegal purpose or to support an illegal activity, i.e. a trust to support domestic terrorism would be invalid. Also, as a general rule a trust cannot be used to operate a business. The IRS will generally classify such an entity as either a corporation or a partnership for purposes of federal taxation.

B. PARTIES TO A TRUST

1. Trustee

The trustee is the individual who is in charge of managing the trust. Every trust must have a trustee. If for whatever reason the trustee cannot serve, however, the trust will not fail. Rather, an alternative trustee will be named either by a court or by the trust document itself if it contains the name of an alternate or successor trustee. In a living trust, the trustor may be the trustee and the beneficiary.

The trustee owes a fiduciary duty to the trustor and the beneficiaries. The trustee’s concern must be for the benefit of the beneficiary. This means that he or she must act in the best interests of the trustor. The specific powers of the trustee are either set forth in the trust document or provided for in accordance with applicable state law.

2. Beneficiary

The beneficiary or beneficiaries are the person or persons for whose benefit the trust has been created. There must be a designated beneficiary in order to have a valid trust. Without a beneficiary, a court cannot ascertain who should benefit from the trust. Nor is there a person who can enforce the obligations of the trustee. The beneficiary can be a specifically named individual or individuals or a class of persons.

Example 1.

_In his will, John creates a testamentary trust for the benefit of his sons, Roger, Egbert and Michael. The proceeds are to be held in trust for the sons until they have all reached the age of 21. This is a trust in which the beneficiaries are specifically named._
Example 2.

*In his will, John, who is childless, creates a testamentary trust for the benefit of “my nieces and nephews.” Each niece and nephew is a beneficiary under the trust even though the names of each individual are not specifically used. This is referred to as a “class” gift.*

3. Trust Property

To be valid, a trust must also have some identifiable trust property. Whether or not a formal transfer of the property is required depends on the law of each state and the nature of the property that is the subject of the trust. For example, real property must typically be formally transferred in order to be placed in a trust. In some cases, however, a mere declaration of trust by the trustor or grantor will be sufficient to change the nature of the property and place it in a trust.

C. TITLE TO TRUST PROPERTY

The creation of a trust vests equitable title of the property in a trust with the beneficiary or beneficiaries, while legal title is transferred to the trustee. The exception is testamentary trusts, which do not come into being until the death of the trustor. Title to property that is the subject of a testamentary trust remains with the trustor until his or her death. In the case of a revocable trust, title can be reclaimed by the trustor according to the terms of the trust instrument. The language of the trust document establishes the terms and conditions for the usage of the assets of the trust.

Example 1.

*Jack creates a trust for the benefit of his son, Roger, the proceeds of which are to pay for Roger’s education. Any funds leftover at the end of his education are to be distributed to charity. Roger may not use the proceeds of the trust to buy a car, to take a vacation or to pay for a wedding. The limits are dictated by the language of the trust instrument.*

Example 2.

*Richard establishes a trust for the benefit of his wife, Lois, so long as his wife remains alive. After Lois’ death, the proceeds are to be distributed to his children and grandchildren in equal amounts. Under the terms of this type of life interest, Lois is free to remain on and use the property, but is not free to dispose of or otherwise encumber it.*
D. STATE LAW

State law plays an important role in governing the use of trusts. The formalities of trust creation differ from state to state and, to some extent, based upon the type of property that is the subject of the trust. In the case of real property, it is governed by the laws of the state in which the property is located. In the case of all other property, the law of the state of the trustor's domicile generally governs the trust. An individual's domicile is the state in which he or she makes his or her permanent home. Each person may have only one domicile. As always, refer to the laws of each state for more specific guidance.

II. Elements of a Valid Trust

As we said above, trusts are governed by state law. That means that anyone considering creating a trust should be familiar with the laws of his or her state of domicile. However, as an illustration, most states require each of the elements described below.

A. PRECATORY LANGUAGE

Precatory language is an expression of the trustor's wishes. There must be a declaration – either orally or in writing – to create a valid trust. As a practical matter, oral trusts are never a good idea. Even if they are technically enforceable, any problems that might arise during their administration would be difficult to resolve absent a written document to provide guidance to a court. As with a will, the trustor must have the requisite intent to create a trust in order for the document to be effective. This intent is set forth in the precatory language.

Example.

Roger, as part of his estate plan, drafts a living trust in which he is the primary beneficiary and his children, Bob and Brenda, are the contingent beneficiaries. The precatory language provides as follows: “I Roger Applebe, do hereby place all of my property, real and personal, in trust for my benefit during my lifetime and, at the end of my lifetime, for the benefit of my children Bob and Brenda.” This language is a clear indication of Roger’s intentions.

B. WRITTEN INSTRUMENT

A trust that involves real property must generally be in writing. As we said above, however, it is a good idea to reduce any declaratory trust to writing in order to better protect the trustor’s wishes.

The statute of frauds, a common law doctrine that has been codified in every state, generally requires that a trust be in writing if the subject matter of the trust is an interest in land. Courts have also commonly held that the statute of frauds likewise governs a trust where the subject matter of the trust is both land and the proceeds from the sale of the land. Some states view such a situation as two separate and severable trusts. Maryland, for example, follows the rule that an express oral trust involving land is void and the alleged trust or promise involving the proceeds of the sale of the land is also void.
C. DELIVERY

In most cases, no formal hand over of property is required to execute a valid trust. A mere declaration of trust normally, however, requires delivery of the trust property in order to be effective. In addition, the title to certain property often must be placed in the name of the trust, i.e. real property or motor vehicles in certain circumstances. The law of Iowa, set forth below, is fairly representative of the above general requirements for the creation of a valid trust.

Iowa Code § 633.2102. Requirements for validity

1. A trust is created only if all of the following elements are satisfied:
   a. The settlor was competent and indicated an intention to create a trust.
   b. The same person is not the sole trustee and sole beneficiary.
   c. The trust has a definite beneficiary or a beneficiary who will be definitely ascertained within the period of the applicable rule against perpetuities, unless the trust is a charitable trust, an honorary trust, or a trust for pets.
   d. The trustee has duties to perform.

2. A power in a trustee to select a beneficiary from an indefinite class is valid. If the power is not exercised within a reasonable time, the power fails and the property passes to the person or persons who would have taken the property had the power not been conferred.

3. A trust is not merged or invalid because a person, including but not limited to the settlor of the trust, is or may become the sole trustee and the sole holder of the present beneficial interest in the trust, provided that one or more other persons hold a beneficial interest in the trust, whether such interest be vested or contingent, present or future, and whether created by express provision of the instrument or as a result of reversion to the settlor's estate.

D. KNOWLEDGE OF BENEFICIARY

It is not necessary for the validity of a voluntary trust that the beneficiary have knowledge of the existence of the trust or its provisions. In many cases, a trustor may wish to keep his estate plan confidential, at least until his or her death. In particular, a trustor may not want the beneficiaries of a testamentary trust to rely on its proceeds.

E. TERMINATION PROVISIONS

Every trust should contain the conditions under which it is to be terminated. This is necessary to help a trustee carry out the trustor’s wishes and for a court to enforce the provisions of a trust in the event of conflict. As we have said, most express terms of a trust, including termination provisions, are enforced so long as they are not illegal or do not violate public policy.

In some cases, a trust will be self-terminating, such as when all of its assets have been paid to its beneficiaries. In other cases, the trustor may want to impose more artificial conditions that act to terminate the trust, such as when the beneficiaries have finished college.
Example.

Estelle creates a living trust for her benefit during her lifetime and, after her death, for the benefit of her son until his 40th birthday. By its terms, the trust will terminate when her son reaches the age of 40.

The subject of termination of trusts is discussed in more detail in the next chapter.

III. Duration of Trusts: The Rule Against Perpetuities

A. TRUSTORS GENERALLY FREE TO SET TERMS OF TRUST

A trustor is generally free to establish the terms, including duration, of a trust. One significant limitation in the creation of a trust, however, is the duration for which the trust is to last. With the exception of charitable trusts, most states do not allow trusts that last in perpetuity, i.e. forever. This limit arose at common law and is referred to as the Rule Against Perpetuities. The essence of the rule is that no interest in real or personal property is good unless it must vest, if at all, no later than twenty-one years after a life in being.

Example 1.

William, a 75-year-old widower, leaves his property in trust for his grandchildren, under the terms of which the grandchildren receive income from the trust until their 35th birthday, at which time they are entitled to the body of the trust. William is free to impose the 35-year-old requirement, as he would be to pick a different age, such as 25 or 40-years-old. This does not violate the Rule Against Perpetuities.

Problems with the Rule Against Perpetuities arise when a trustor attempts to control the assets of the trust for a long period of time following his or her death.

Example 2.

William, a 75-year-old widower, leaves his property in trust for his grandchildren. His grandchildren are to receive income from the trust for their life. When they die, the profits from the trust are to be paid to his future great-grandchildren. At their death, the profits are to be paid to his future great-great-grandchildren. This disposition violates the Rule Against Perpetuities.

B. POLICY OF RULE

The policy behind this rule has historically been to keep individuals from controlling their property for too long after their death. At some point in time, the policy goes, a dead person should no longer be able to exert control. As formulated in North Carolina law, for example, the Rule Against Perpetuities provides as follows:
N.C.G.S.A. § 41-15. Statutory rule against perpetuities

(a) A nonvested property interest is invalid unless:
(1) When the interest is created, it is certain to vest or terminate no later than 21 years after the death of an individual then alive; or
(2) The interest either vests or terminates within 90 years after its creation.

Example 1.

Ivan creates a testamentary trust in which he leaves all of his property in trust for the benefit of his wife, Lisa, during her lifetime, and after her lifetime for the benefit of their son, Augustus, until he reaches his 40th birthday, at which time he shall be entitled to the assets of the trust. By its terms the trust will not last longer than 21 years after the death of an individual then alive, because Augustus will receive the assets of the trust during his lifetime.

Example 2.

Ivan creates a testamentary trust in which he leaves all of his property in trust for the benefit of his wife, Lisa, during her lifetime, and after her lifetime, for the benefit of any grandchildren that might be born to his minor son Augustus until they reach the age of 40. Because by its terms the trust would not end within 21 years after the death of an individual alive at the time, it violates the Rule Against Perpetuities.

C. SAVINGS CLAUSES

Because running afoul of the rule is fatal – that is, it makes the trust unenforceable – it is common practice to put "savings clauses" in trust instruments. These clauses basically state that if the interest created should be deemed to violate the rule against perpetuities it shall terminate one day before twenty-one years after the last life in being has passed.

D. TREND TOWARD MODIFICATION OR REPEAL

Recently, there has been movement to simplify the rule against perpetuities or, in some states, to repeal it. In 1998, for example, Maryland adopted an important exception to the rule against perpetuities. Under Estates and Trusts Article 11-102(e) the rule against perpetuities does not apply to "[a] trust in which the governing instrument states that the rule against perpetuities does not apply to the trust and under which the trustee, or other person to whom the power is properly granted, has the power under the governing instrument, applicable statute, or common law to sell, lease, or mortgage property for any period of time beyond the period that is required for an interest created under the governing instrument to vest, so as to be good under the rule against perpetuities." In other words, if the trustee were given the power to sell or otherwise dispose of property which is the subject of the trust after the rule against perpetuities would have required that the trust be terminated, such a trust will be upheld.
IV. Construction of Trust Gifts

Although most trustors attempt to clearly set forth their wishes in the instrument creating the trust, controversy does arise in interpreting a trust. State law has generally adopted various rules used to construe gifts made through a trust, particularly in the case of class gifts, i.e., those given to a group of people identified by a title rather than by name (e.g., a trust for the benefit “of all my grandchildren”).

A. CONSTRUCTION OF CLASS GIFTS

1. Increase in Class Membership

When a trustor makes a gift to a class of people, i.e. “to all my nieces and nephews”, membership in the class may continue to increase until at least one member of the class becomes entitled to possession of the property that is the subject of the class gift.

Example 1.

William, a 65-year-old man, creates a trust in which he placed certain securities for the support and benefit of his grandchildren. At the time the trust is created, William has three grandchildren. During the next 10 years, five additional grandchildren are born. All eight grandchildren are entitled to the benefit of the proceeds of the trust, according to its language.

The exception to this rule occurs if, at the time an interest is intended to become possessory, no member of the class has yet been born. In such a case, the trust will generally close to potential new members.

Example 2.

Same as the facts above except that the trust provides that the proceeds of the trust are to be given outright to his grandchildren at the time of his death. When William dies, he has four grandchildren, all of whom will share in the proceeds of the trust. Grandchildren born after his death will not, by the terms of the trust, be entitled to its proceeds.

2. Decrease in Class Membership

A different scenario occurs when a class decreases in size to the surprise of the trustor. For example, what happens if the trustor established a trust for the benefit of his children, and one of them unexpectedly dies? There are three possible scenarios:

- No survivorship requirement is imposed. Thus, a predeceased child would still take her share and it would be distributed to that child’s heirs.

- A survivorship requirement is imposed. The predeceased child’s share is divided among the surviving members of the class.
- If the predeceased child has children of his own, the court may allow the grandchildren to “step into the shoes of the child” and become the heir.

The rule here is that the language of a will creating a trust should be so construed as to give effect to the intention of the testator, if that intention is able to be ascertained from the language of the will itself, considered in the light of the surrounding circumstances. Implied conditions of survival tell us that courts treat the problem in three varied ways:

- Treat the shares as vested (no condition of survival) (children means children);
- Treat the shares as subject to a condition of survival (children means children); or
- Treat the shares as a gift to the class members and their issue (children means issue).

Given the potential for judicial interpretation, individuals should make their wishes as clear as possible when executing a trust or provisions of a will that establish a trust.

3. Adoptive Members of a Class

The modern trend is to include adopted members in a class described generically as “my child, my children, my grandchildren, etc…” An adoptive child is deemed an heir of his or her adoptive parents but not necessarily a child of his or her natural parents. In many states, there are express probate codes dealing with adoptive children.

4. Class Gift of Income

Some testators direct that income should be divided among her children until the death of the last surviving child. If one child dies, what happens to that child’s share of the income? The majority rule provides that the surviving child shall take the predeceased child’s share (the doctrine of cross remainders). Most commentators argue that the income should go to the issue of the deceased child. Well drafted trusts provide the latter answer.

V. Powers of Appointment

A. INTRODUCTION

A power of appointment allows either a beneficiary or another designated person to designate how certain assets in a trust are to be disposed.

Example.

*Luther, an elderly man, establishes a trust to pay for the education of his grandson, Tad. After Tad completes his education, the trust provides that Tad has the authority to determine how to dispose of any remaining assets. This power is referred to as a power of appointment.*
The trust may or may not limit the scope of authority available to the individual with the power of appointment.

B. TYPES OF POWERS OF APPOINTMENT

In general, there are two main types of powers of appointment.

1. General Power of Appointment

A general power of appointment is one that results in the property of the trust becoming the property of the beneficiary who retains the power of appointment. A general power of appointment is exercisable in favor of the beneficiary, his or her estate, or creditors.

2. Special Power of Appointment

A special power of appointment is a power that is not exercisable in favor of the donee, his estate, his creditors, or the creditors of his estate.

C. IMPORTANCE OF DISTINCTION

The distinction for federal tax purposes between a special and a general power of appointment is extremely important.

1. Tax Implications

A general power of appointment brings the property into the beneficiary's estate for estate tax purposes. One area where this distinction is important is in marital deduction trusts. Although a QTIP trust is currently the most common, the other way property can be left in trust for a surviving spouse yet still qualify for the marital deduction is to give the spouse a general power of appointment. Another area under federal tax laws where a general power of appointment becomes an important planning tool involves non-exempt GST trusts. Granting a general power of appointment in such circumstances will sidestep the generation-skipping transfer tax rates.


(a) In general.--The value of the gross estate shall include the value of all property.

(1) Powers of appointment created on or before October 21, 1942.--To the extent of any property with respect to which a general power of appointment created on or before October 21, 1942, is exercised by the decedent--

(A) by will, or

(B) by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive; but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof. If a general power of appointment created on or before October 21, 1942, has been partially released so that it is no longer a general power of appointment, the exercise of such power shall not be deemed to be the exercise of a general power of appointment if--
(i) such partial release occurred before November 1, 1951, or
(ii) the donee of such power was under a legal disability to release such power on October 21, 1942, and such partial release occurred not later than 6 months after the termination of such legal disability.

(2) Powers created after October 21, 1942.--To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive. For purposes of this paragraph (2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

(3) Creation of another power in certain cases.--To the extent of any property with respect to which the decedent--

(A) by will, or

(B) by a disposition which is of such nature that if it were a transfer of property owned by the decedent such property would be includible in the decedent's gross estate under section 2035, 2036, or 2037, exercises a power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

(b) Definitions.--For purposes of subsection (a)--

(1) General power of appointment.--The term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that--

(A) A power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

(B) A power of appointment created on or before October 21, 1942, which is exercisable by the decedent only in conjunction with another person shall not be deemed a general power of appointment.

(C) In the case of a power of appointment created after October 21, 1942, which is exercisable by the decedent only in conjunction with another person--

(i) If the power is not exercisable by the decedent except in conjunction with the creator of the power--such power shall not be deemed a general power of appointment.

(ii) If the power is not exercisable by the decedent except in conjunction with a person having a substantial interest in the property, subject to the power, which is adverse to exercise of the power in favor of the decedent--such power shall not be deemed a general power of appointment. For the purposes of this clause a person who, after the death of the decedent, may be possessed of a power of appointment (with respect to the property subject to the decedent's power) which he may exercise in his own favor shall be deemed as having an interest in the property and such interest shall be deemed adverse to such exercise of the decedent's power.
(iii) If (after the application of clauses (i) and (iii)) the power is a general power of appointment and is exercisable in favor of such other person--such power shall be deemed a general power of appointment only in respect of a fractional part of the property subject to such power, such part to be determined by dividing the value of such property by the number of such persons (including the decedent) in favor of whom such power is exercisable.

For purposes of clauses (ii) and (iii), a power shall be deemed to be exercisable in favor of a person if it is exercisable in favor of such person, his estate, his creditors, or the creditors of his estate.

(2) Lapse of power.--The lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts:

(A) $5,000, or
(B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

(3) Date of creation of power.--For purposes of this section, a power of appointment created by a will executed on or before October 21, 1942, shall be considered a power created on or before such date if the person executing such will dies before July 1, 1949, without having republished such will, by codicil or otherwise, after October 21, 1942.


(a) Powers created on or before October 21, 1942.--An exercise of a general power of appointment created on or before October 21, 1942, shall be deemed a transfer of property by the individual possessing such power; but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof. If a general power of appointment created on or before October 21, 1942, has been partially released so that it is no longer a general power of appointment, the subsequent exercise of such power shall not be deemed to be the exercise of a general power of appointment if--

(1) such partial release occurred before November 1, 1951, or
(2) the donee of such power was under a legal disability to release such power on October 21, 1942, and such partial release occurred not later than six months after the termination of such legal disability.

(b) Powers created after October 21, 1942.--The exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

(c) Definition of general power of appointment.--For purposes of this section, the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power (hereafter in this subsection referred to as the "possessor"), his estate, his creditors, or the creditors of his estate; except that--
A power to consume, invade, or appropriate property for the benefit of the possessor which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor shall not be deemed a general power of appointment.

A power of appointment created on or before October 21, 1942, which is exercisable by the possessor only in conjunction with another person shall not be deemed a general power of appointment.

In the case of a power of appointment created after October 21, 1942, which is exercisable by the possessor only in conjunction with another person--

(A) if the power is not exercisable by the possessor except in conjunction with the creator of the power--such power shall not be deemed a general power of appointment;

(B) if the power is not exercisable by the possessor except in conjunction with a person having a substantial interest, in the property subject to the power, which is adverse to exercise of the power in favor of the possessor--such power shall not be deemed a general power of appointment. For the purposes of this subparagraph a person who, after the death of the possessor, may be possessed of a power of appointment (with respect to the property subject to the possessor's power) which he may exercise in his own favor shall be deemed as having an interest in the property and such interest shall be deemed adverse to such exercise of the possessor's power;

(C) if (after the application of subparagraphs (A) and (B)) the power is a general power of appointment and is exercisable in favor of such other person--such power shall be deemed a general power of appointment only in respect of a fractional part of the property subject to such power, such part to be determined by dividing the value of such property by the number of such persons (including the possessor) in favor of whom such power is exercisable.

For purposes of subparagraphs (B) and (C), a power shall be deemed to be exercisable in favor of a person if it is exercisable in favor of such person, his estate, his creditors, or the creditors of his estate.

Creation of another power in certain cases.--If a power of appointment created after October 21, 1942, is exercised by creating another power of appointment which, under the applicable local law, can be validly exercised so as to postpone the vesting of any estate or interest in the property which was subject to the first power, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power, such exercise of the first power shall, to the extent of the property subject to the second power, be deemed a transfer of property by the individual possessing such power.

Lapse of power.--The lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The rule of the preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of the following amounts:

(1) $5,000, or
(2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied.
(f) Date of creation of power.—For purposes of this section a power of appointment created by a will executed on or before October 21, 1942, shall be considered a power created on or before such date if the person executing such will dies before July 1, 1949, without having republished such will, by codicil or otherwise, after October 21, 1942.

2. Reach of Creditors

It is not only for federal tax purposes that a general power of appointment will make the property subject to the power deemed to be in the estate of the holder of the power. A general power of appointment also has consequences for the creditors of the beneficiary of the power. For example, courts have commonly ruled that creditors of a trust beneficiary could reach the assets of the trust in cases where the beneficiary had been granted a general power of appointment.

Example.

In *Brent v. State Central Collection Unit*, 311 Md. 626 (1988) the Court of Appeals held that the creditors of a trust beneficiary could reach the assets of the trust after the beneficiary gained the power to appoint such assets to herself. The trust had spendthrift provisions that governed the trust. The terms of the trust, however, stated that when the beneficiary reached the age of 40 years she could direct that the trustees pay her all of the trust assets.

The trust beneficiary had reached the age of 40 but at that time was legally incompetent and was an in-patient at a state mental hospital. The state sought to reach the trust assets to pay for her care. The Court of Appeals held that there was a general power of appointment in this trust and that not only the beneficiary of a general power of appointment could reach those assets but her creditors as well. The Court followed the rule that whenever property is subject to alienation by the owner it then also becomes subject to his debts.

Additionally, the Court held: "The key is the right of the beneficiary to the corpus as distinguished from his actual possession of it. So the rights of the beneficiary's creditors depend upon the beneficiary's interest in the property, not on the actual distribution of the funds to him." The Court of Appeals also held that the fact the beneficiary was incompetent to actually exercise her power to withdraw trust assets was immaterial: "It was her right to demand distribution of the corpus that governed, not her ability to demand."
VI. Modification of Trusts

The laws of most states assume a trust to be revocable unless it specifically states that it is irrevocable. For example, California Probate Code § 15400 provides that “[u]nless a trust is expressly made irrevocable by the trust instrument, the trust is revocable by the settlor.”

A. REVOCABLE TRUSTS

To the extent that a trust is revocable, a trustor can modify or terminate the trust at virtually any time.

Example.

Tommy creates a living trust for his benefit during his lifetime with the remainder to be used for the support of his grandchildren following his death. Tommy appoints himself trustee during his lifetime and names his CPA, Dennis, to be the successor trustee following his death. The trust is revocable during Tommy’s lifetime and becomes irrevocable upon his death, at which time Dennis will become the trustee. A year after creating the trust, Tommy meets and marries Doris. Tommy is free to change the trust to make Doris a beneficiary either in addition to or in lieu of his grandchildren. The trust does not become irrevocable until his death. It can therefore be modified or terminated according to Tommy’s wishes at any time.

California Probate Code § 15401, for example, provides as follows:

(a) A trust that is revocable by the settlor may be revoked in whole or in part by any of the following methods:

(1) By compliance with any method of revocation provided in the trust instrument.

(2) By a writing (other than a will) signed by the settlor and delivered to the trustee during the lifetime of the settlor. If the trust instrument explicitly makes the method of revocation provided in the trust instrument the exclusive method of revocation, the trust may not be revoked pursuant to this paragraph.

(b) Unless otherwise provided in the instrument, if a trust is created by more than one settlor, each settlor may revoke the trust as to the portion of the trust contributed by that settlor, except as provided in Section 761 of the Family Code.

(c) A trust may not be modified or revoked by an attorney in fact under a power of attorney unless it is expressly permitted by the trust instrument.

(d) Nothing in this section limits the authority to modify or terminate a trust pursuant to Section 15403 or 15404 in an appropriate case.

(e) The manner of revocation of a trust revocable by the settlor that was created by an instrument executed before July 1, 1987, is governed by prior law and not by this section.
B. AMENDING TESTAMENTARY TRUSTS

A will does not have legal effect until the death of the testator. Many wills contain provisions creating testamentary trusts. Because a testamentary trust cannot take effect until the death of the trustor, its provisions within a will can be altered at any time prior to the trustor’s death. The only limitation is that the new trust provisions must comply fully with the requirements for the creation of a valid will or codicil. Each state has its own laws governing the execution of a valid will or codicil.

Example.

*Linda drafted a valid will 10 years ago, the provisions of which included the creation of a testamentary trust for the benefit of her children. Lately, however, Linda has been very disappointed with the choices that some of her children have been making and wants to leave the proceeds that would have funded the trust to charity instead. Linda can accomplish this by drafting a new valid will that will supercede the prior will. She also has the option of amending the trust in a new valid will eliminating some but not all of her children as beneficiaries of the trust rather than eliminating it altogether.*

C. AMENDING IRREVOCABLE TRUSTS

There are many circumstances that can arise and lead to a desire to amend an irrevocable trust. The circumstances are as varied as the reasons for creating a trust in the first place. Examples may include the following:

- The desire to achieve certain tax goals;
- The desire to remove a restriction prohibiting the sale of certain trust assets in the face of changed financial conditions;
- The existence of an unanticipated beneficiary; or
- The death or incapacitation of a beneficiary.

The laws of each state govern the ability to amend an irrevocable trust (remember that the subject of termination is discussed separately in Chapter 2, next). Whether the IRS recognizes the change for tax purposes is a separate question. Changes must be authorized by the Internal Revenue Code to have an effect on federal tax obligations.

California, for example, allows for the amendment, modification or termination of an otherwise irrevocable trust under certain circumstances. California Probate Code § 15403 provides that, if all beneficiaries of an irrevocable trust consent, they may compel modification or termination of the trust upon petition to the court.
California law also sets forth detailed procedures involved in seeking a modification or termination of an irrevocable trust, including the filing of a petition setting forth the grounds for the requested modification or termination and the provision of notice to all beneficiaries.

California Probate Code § 15402 provides that where all of the beneficiaries of an irrevocable trust consent, a court can either modify or terminate the trust if either it is no longer necessary to carry out the essential purpose of the trust or if the benefit in changing or terminating it outweighs the benefits of not doing so. If any beneficiary does not consent to the modification or termination of the trust, Probate Code § 15404 provides that upon petition to the court, the other beneficiaries, with the consent of the trustor, may compel modification or a partial termination of the trust if the interests of the beneficiaries who do not consent are not substantially impaired.

In entertaining any modification to an irrevocable trust, the courts are careful to ensure that any change helps to effectuate the wishes of the trustor.
Chapter 1 – Review Questions

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. The trustee of a trust:
   a) is the one in charge of managing the trust
   b) is the person for whose benefit the trust has been created
   c) is the person who created the trust
   d) is the property included in the trust

2. Which of the following is not a requirement for establishing a valid trust:
   a) the trustor must have at least $100,000 in assets
   b) the beneficiary must be made aware of the existence of the trust
   c) there must be property that is the subject of the trust
   d) both a and b above

3. A trustor is generally free to establish the terms, including the duration, of a trust.
   a) true
   b) false

4. A power of appointment allows either a beneficiary or other designated person to designate how certain assets in a trust are to be disposed.
   a) true
   b) false

5. When can the provisions of a testamentary trust be revised:
   a) never; once a testamentary trust is included in the provisions of a will, it cannot be amended
   b) so long as the testator is alive and has the capacity to revise his or her will, the provisions of a testamentary trust can be revised, amended, or revoked
   c) within five years of its creation
   d) anytime following the death of the trustor
Chapter 1 – Solutions and Suggested Responses

1. **A: Correct.** Every trust must have a trustee. The trustee owes a fiduciary duty to the trustor and the beneficiaries.

   B: Incorrect. The person for whose benefit the trust has been created is known as the beneficiary. There must be a beneficiary in order to have a valid trust.

   C: Incorrect. The person who created the trust is known as the trustor.

   D: Incorrect. The property included in the trust is known as the trust property. To be valid, a trust must have some identifiable trust property.

   (See page 1-1 of the course material.)

2. A: Incorrect. A trust can contain any property. There is no income or asset requirement. However, this is not the best answer.

   B: Incorrect. There is no requirement that the beneficiary be made aware of the existence of a trust. However, this is not the best answer.

   C: Incorrect. A trust cannot exist in a vacuum. It must contain some property or asset.

   **D: Correct.** Because both A and B are not true, this is the best answer.

   (See pages 1-2 to 1-3 of the course material.)

3. **A: True is correct.** With the exception of charitable trusts, most states do not allow trusts that last in perpetuity.

   B: False is incorrect. Although a trustor is generally free to establish the duration of the trust, most states do not allow trusts that last in perpetuity other than charitable trusts.

   (See page 1-5 of the course material.)

4. **A: True is correct.** There are two main types of powers of appointment: general and special. The distinction for federal tax purposes between these two types is important.

   B: False is incorrect. The trust may or may not limit the scope of authority available to the individual with the power of appointment.

   (See page 1-9 of the course material.)
5. A: Incorrect. Because the trust does not take effect until after the death of the trustor, it can be revised at any time (prior to his or her death or loss of testamentary capacity).

**B: Correct.** Such trusts can be revised any time by the trustor, so long as he or she is alive and has the requisite capacity.

C: Incorrect. There is no such time limitation.

D: Incorrect. To the contrary, changes can only be made so long as the trustor is alive to make them.

(See page 1-15 of the course material.)
Chapter 2: Termination of Trusts and the Rights of Beneficiaries

I. Introduction

Once a trust is created, can it be terminated? Can a beneficiary demand that a trust be terminated or is that decision solely in the hands of the trustor? Under what circumstances does a court have the authority to end a trust and order the assets to be distributed? These are common questions that can result in a variety of answers depending on how the trust was created. The first thing to note is that all trusts fall into one of two general categories: (1) revocable trusts; and (2) irrevocable trusts. The law generally assumes a trust to be revocable unless it specifically states that it is irrevocable.

To the extent that a trust is revocable, the trustor can modify or terminate the trust at virtually any time. If a trust is irrevocable, there are still circumstances under which the trust can be terminated. Those circumstances are governed by two things: (1) the intent of the trustor as expressed in the language of the trust itself; and (2) state law, which governs the creation, operation and termination of trusts.

Ideally, every trust should contain the conditions under which it is to be terminated. This is helpful for the trustee whose job it is to carry out the wishes of the trustor. It is also helpful when a court is asked to enforce the provisions of a trust in the event of a conflict.

In some circumstances, a trust will be self-terminating, such as when all of the assets have been distributed to its beneficiaries. In other cases, the trustor may want to impose more artificial conditions that act to terminate the trust, such as when the beneficiaries have finished college.

Example 1.

Rita established a testamentary trust in which she placed $100,000 for the care and support of her nephew, Lincoln. Five years after the trust was funded following Rita’s death, the proceeds have been exhausted. In the absence of any remaining assets, the trustee will have to terminate the trust.

Example 2.

Estelle creates a living trust for her benefit during her lifetime and, after her death, for the benefit of her son until his 40th birthday. By its terms, the trust will terminate when her son reaches the age of 40.
II. Common Methods of Revocation

There are a number of ways that a valid trust can be terminated. Remember that termination is governed by the terms of the trust instrument and the law of the state in which the trust was created. In general, they can be grouped into four categories:

- Termination by operation of the express terms of the trust;
- Termination by revocation of the trust by the trustor (in the case of a revocable trust);
- Termination by order of a court; or
- Termination by agreement of the beneficiaries.

California law, for example provides as follows:

Probate Code § 15407. Termination of Trusts

(a) A trust terminates when any of the following occurs:
   (1) The term of the trust expires.
   (2) The trust purpose is fulfilled.
   (3) The trust purpose becomes unlawful.
   (4) The trust purpose becomes impossible to fulfill.
   (5) The trust is revoked.

(b) On termination of the trust, the trustee continues to have the powers reasonably necessary under the circumstances to wind up the affairs of the trust.

A. TERMINATION BASED ON OPERATION OF TRUST INSTRUMENT

Trusts often terminate based on the language of the trust document itself. Texas law, for example, provides as follows:

§ 112.052. TERMINATION.

A trust terminates if by its terms the trust is to continue only until the expiration of a certain period or until the happening of a certain event and the period of time has elapsed or the event has occurred. If an event of termination occurs, the trustee may continue to exercise the powers of the trustee for the reasonable period of time required to wind up the affairs of the trust and to make distribution of its assets to the appropriate beneficiaries. The continued exercise of the trustee's powers after an event of termination does not affect the vested rights of beneficiaries of the trust.

1. Purpose Has Been Achieved

If a trustor creates a trust for a particular purpose, rather than to provide a general means of support, the trust will generally end when that purpose has been achieved. For example, a trustor may provide money in trust to pay for the education of his grandchildren. Such trusts commonly provide for the distribution of the assets at the time the purpose of the trust no longer exists – namely the beneficiary has finished his education.
A trust may also be terminated on the grounds that it is no longer necessary. However, a trust will not be terminated if its purpose has not been completed. The termination of a trust on accomplishment of its purpose, however, does not affect the validity of acts of the trustee before the date of termination.

However, even when the purposes of the trust have clearly been met, termination generally cannot take place when it is contrary to the clearly expressed intention of the trustor.

**Example.**

"Paul created a testamentary trust that provided, in part: I hereby place in trust the sum of $100,000, the proceeds of which are to be used to pay the educational expenses of my nephew, Vladamir. In no event, however, shall the trust be terminated prior to his 30th birthday. Based on the language of the trust, it cannot be terminated even if, at age 25, Vladamir has finished both law school and medical school."

2. **Time Provisions**

A trust may also terminate if, by its terms, the trust is to continue only until the expiration of a certain period or until the happening of a certain event and the period of time has elapsed or the event has occurred. In some cases, a trust will also terminate by operation of law where the terms of the trust violate the Rule Against Perpetuities. This rule limits the number of years that a trust can operate in many states.

3. **Purpose Has Become Impossible**

What if the trustor established a trust for a particular purpose and such purpose is no longer possible? A trustee would probably have discretion under those circumstances to either terminate the trust or modify its provisions to carry out the intentions of the trustor.

**Example.**

"William creates a testamentary trust to provide support for the education of his niece, Mary. Mary is a 21-year-old college student at the time of William's death. Shortly thereafter, she is involved in a serious accident that renders her a quadriplegic. Unable to continue school, the trustee wishes to use the funds intended to pay for her education to help defray her medical expenses. Since William's intention was to provide support for Mary, it is probably fair for the trustee to infer that he would want to help Mary with her medical expenses under these extreme and unforeseen circumstances."
B. TERMINATION BY CONSENT

Under some circumstances, and in compliance with state law, the beneficiaries of a trust can elect to terminate. The laws of each state vary. In some cases, a trust can be terminated at the election of all of the beneficiaries unless continuance of the trust is necessary to carry out a material purpose of the trust. The trend in these cases is in favor of allowing early termination so long as there is no material purpose remaining for the trust. Given the potential for judicial interpretation, individuals should make their wishes as clear as possible when executing a trust or provisions of a will that establish a trust.

Case-in-Point

In Carnahan v. Johnson, 127 Ohio App.3d 195, 711 N.E.2d 1093 (1998), the Ohio Court of Appeals addressed the request of a trust's primary and contingent beneficiaries to allow the trustee to sell certain trust property. The trustee of testamentary trust filed petition to sell real estate held by the trust. The trust's primary and contingent beneficiaries filed response and requested that petition be granted. The Probate Court denied petition and the trustee and the beneficiaries appealed.

The decedent, Edward T. Leach, died on March 10, 1984. The terms of Leach's will pertinent herein are the following:

"I give and devise my 142 acre tract at 801 Alton Road in Prairie Township, Franklin County, Ohio, to Robert Richards, as Trustee and to his Successor Trustees hereinafter named, for the equal benefit of my two grand-daughters, Melanie [sic] R. Young and Sandra E. Patton, or to their children, per stirpes, in the event of their death; or to the survivor of my grand-daughters if either should die without children prior to the termination of this Trust. Said Trust shall continue for a period of thirty (30) years upon the following terms and conditions:

"The Trustee shall encourage and may assist the beneficiaries of this Trust to develop said land into cemetery lots as an extension of the adjoining Sunset Cemetery. If and when any cemetery lots in said 142 acre tract are sold the net proceeds shall be paid by the Trustee at least quarterly to the said beneficiaries."

"While said tract remains as farm land the Trustee shall rent or crop-share the same and the net proceeds divided at least annually to said beneficiaries. At the end of said thirty years this Trust shall terminate and the said land and/or the remaining unsold cemetery lots and undistributed net funds shall be conveyed and delivered to said beneficiaries."

Named as defendants in the petition were Melonie R. Johnson (f.n.a. Young) and Sandra E. Patton, granddaughters of the decedent and primary beneficiaries of the trust. Additional defendant-contingent beneficiaries are the children of Melonie and Sandra, Jennifer T. Young, a minor, David T. Young, a minor, Robert A. Patton, John P. Patton, William M. Patton, and Katherine E. Patton. A guardian ad litem was appointed for the two minor contingent beneficiaries, who filed an answer opposing approval of the sale. The adult primary and contingent beneficiaries filed a joint response to the petition, requesting the probate court to grant the petition to sell the real estate.
The real estate involved in the trust is a one-hundred-forty-two-acre tract of land adjacent to the Sunset Cemetery in Franklin County, Ohio. In 1983, the one hundred forty-two acres were owned by Edward Leach, who also owned an approximate one-third interest in Sunset Cemetery. The other two-thirds interest in Sunset Cemetery were owned by Leach's son-in-law, John Erwin, who had inherited his interest in the cemetery from his wife, Elizabeth Erwin, who died in 1982.

The Erwins had two daughters, Melonie Johnson and Sandra Patton. Pursuant to Leach's last will and testament, his granddaughters, Melonie and Sandra, were to inherit all of his one-third interest in Sunset Cemetery. Also included in the will was the trust consisting of the one hundred forty-two acres.

After Leach died in 1984, his will was duly admitted to probate, and Leach's interest in Sunset Cemetery was transferred to Melonie and Sandra, who sold this interest to their father, John. The one hundred forty-two acres in the trust were transferred to the trustee, Robert R. Richards, who administered the trust until his death, when John A. Carnahan became the successor trustee pursuant to the will.

Subsequently, John Erwin died, leaving all his interest in Sunset Cemetery to his daughters, Melonie and Sandra. However, it was necessary for the estate to sell the shares of Sunset Cemetery to pay federal and state estate taxes. The shares of Sunset Cemetery were sold to SCI Ohio Funeral Services, Inc. SCI was also interested in purchasing the one hundred forty-two acres held in trust and entered into a contract, subject to probate court approval, to purchase the one hundred forty-two acres for $900,000. It is this contract for sale that is at issue in the case.

It is well settled that a fundamental tenet for the construction of a trust is to ascertain, within the bounds of the law, the intent of the settlor, the court said. The trustee and beneficiaries argued that the sale of the one hundred forty-two acres is permitted by state law, which provides in part:

"[I]n an action by the trustee or beneficiaries, if the estate is held in trust, courts of common pleas may * * * authorize the sale of any estate, whether it was created by will * * * when satisfied that such sale would be for the benefit of the person holding the first and present estate, interest or use, and do no substantial injury to the heirs in tail, or others in expectancy."

A trust may be ordered terminated if all beneficiaries consent to its termination, and if the trust instrument does not express terms or by implication prohibit its termination, the court said. Furthermore, a trust should be terminated if all beneficiaries consent to its termination unless such termination would defeat a material purpose of the trust.

In this case, the court said that a careful reading of the trust instrument shows that Edward Leach's intent was to provide for the primary beneficiaries, Melonie and Sandra. While Leach may have preferred that the one hundred forty-two acres be developed as cemetery lots as an extension of Sunset Cemetery, the language of the trust does not mandate that cemetery lots be the only possible use of the one hundred forty-two acres, the court said. Leach left one hundred forty-two acres in trust and directed the trustee to "encourage" and "assist" the primary beneficiaries to develop the land into cemetery lots as an extension of the adjacent family-owned cemetery. When "words of recommendation must be followed to carry out the clear intention of the settlor, such
words are regarded as words of command or direction." On the other hand, the words, "encourage" and "assist" mean to help or aid. Accordingly, the court said it did not find that the words "encourage" and "assist" are words of recommendation which must be followed as if they are a command or direction.

Furthermore, it is clear from the words of the trust that Leach intended that the primary beneficiaries benefit from the sale of the property. "If and when any cemetery lots in said 142 acre tract are sold the net proceeds shall be paid by the Trustee at least quarterly to the said beneficiaries." Accordingly, the court said that the material purpose of the trust was to provide for the primary beneficiaries.

Appellants further argue that the doctrine of deviation applies because due to changed circumstances they no longer own Sunset Cemetery and therefore the trust purpose is impossible to accomplish. Under the doctrine of deviation, a court can "direct or permit a deviation from the terms of the trust where compliance is impossible or illegal, or where owing to circumstances not known to the settlor and not anticipated by him compliance would defeat or substantially impair the accomplishment of the purposes of the trust."

The court also addressed the issue of whether compliance with the trust purpose was impossible and, therefore, the trust should be terminated. The probate court disagreed as to whether the purpose of the trust was impossible, finding that "there is no evidence that the primary beneficiaries have attempted to use the land as security for obtaining the necessary endowment fund, nor evidence of any other attempt to determine the feasibility of fulfilling decedent's wishes. Without such evidence the court cannot find that all possible avenues have been explored, and therefore that sale as cemetery lots is, in fact, impossible."

However, on appeal the court said the material purpose of the trust is to provide for the primary beneficiaries, even if a purpose of the trust was to develop the land into cemetery lots as an extension of Sunset Cemetery, this purpose is now impossible. Sunset Cemetery has been sold to SCI. The primary beneficiaries no longer have any control over the expansion of Sunset Cemetery. As a result, the court said that it is impossible for the primary beneficiaries to "develop said land into cemetery lots as an extension of the adjoining Sunset Cemetery."

Accordingly, the court concluded that the probate court erred in not granting the petition to sell real estate, as the material purpose of the trust was to provide for the primary beneficiaries and the suggested purpose to develop the real estate into cemetery lots had become impossible. However, where "real property, which is held in trust, is sold under court order pursuant to a petition for sale in accordance with state law, the sale results in a mere substitution of assets; hence, the proceeds of the sale must be held by the trustee, just as the land was originally held, with the income payable to the beneficiaries in the same manner or order as the income from the land, in accordance with the distribution set forth in the trust instrument."

The court ruled that while the petition to sell real estate is granted, the proceeds from the sale of the land must be held in trust and distributed according to the terms of the trust.
When a trust contains a spendthrift provision, one of the material purposes of the trust is the protection afforded a beneficiary by that clause. Consequently, courts are reluctant to modify or terminate a trust with a spendthrift provision. It does happen in some cases, however. Texas law, § 112.054, expressly provides that "[t]he court shall consider spendthrift provisions as a factor in making its decision whether to modify or terminate, but the court is not precluded from exercising its discretion to modify or terminate solely because the trust is a spendthrift trust."

**Case-in-Point**

In *In re Estate of Somers*, 277 Kan. 761, 89 P.3d 898 (2004), the life beneficiaries and remainder beneficiary of a charitable spendthrift trust brought a joint petition to terminate the trust. Eula M. Somers died in 1956. She left a testamentary trust for her grandchildren, Susan Somers (now Smiley), then age 7, and Kent Somers, then age 5. The trust was funded from the residuary estate of Eula Somers in an amount of approximately $120,000. By January 2001, the value of the Trust had increased to approximately $3,500,000. The payout provision of the Trust instrument states in Article X(b): "I authorize and direct my Trustee to pay, from the Trust Estate, beginning August 25, 1966, or one year after my death, whichever is the later date, the sum of $100.00 per month each to my said granddaughter, SUSAN ANN SOMERS, and to my grandson, KENT CLIFFORD SOMERS, so long as she or he shall live or until my Trust Estate is exhausted. If either of my such grandchildren should die before or after such monthly payments begin and before the Trust Estate is exhausted, then such deceased grandchild shall have no further interest in or right to receive monthly payments accruing after the date of her or his death, from the Trust Estate. If both of such grandchildren should die before or after such monthly payments begin and before the Trust Estate is exhausted, then there shall be no monthly payments accruing after the date of the death of the survivor of my such grandchildren made from the Trust Estate, and the remainder of the Trust Estate, after payment of the expenses of the trust, shall be distributed and paid over to the SHRINERS HOSPITALS FOR CRIPPLED CHILDREN, a Colorado Corporation, free of any trust and this trust shall terminate."

The Trust was originally placed with the Johnson County National Bank and Trust Company. Firstar Bank, N.A. (Firstar) is the successor to the original trustee. The Shriners Hospitals for Children (Shriners) and the grandchildren reached an agreement to terminate the trust. They agreed that the Grandchildren would each receive a distribution of $150,000 from the trust and that the remainder of the trust assets would immediately be distributed to Shriners. Shriners agreed to continue the $100 monthly payments to the grandchildren.

Firstar opposed the termination of the trust. Shriners and the grandchildren then filed a joint petition in district court asking that the trust be terminated immediately. The district court denied the petition to terminate the trust and the grandchildren’s request for individual distributions of $150,000. However, the district court ordered an immediate, partial distribution of the corpus of the Trust to Shriners, but required that $500,000 remain in the trust to fund the annuity payments to the grandchildren. The court further ordered that the attorney fees and expenses of the grandchildren’s attorneys be paid from the Shriners’ distribution. Firstar, the trustee appealed.
The grandchildren argued that the district court should have terminated the trust because all of the beneficiaries agreed to the termination and the termination would not frustrate a material purpose of the trust. On appeal, Shriners appeared to adopt a different view than the grandchildren, arguing that the district court properly resolved the issue by distributing a portion of the trust to them. In contrast, Firstar, the trustee, argued that the district court properly concluded that it could not terminate the trust.

All of the parties agreed that the trust is a spendthrift trust. Thus, the court said, the question is whether a court can terminate a spendthrift trust at the request of the beneficiaries, who are all in agreement and competent to consent, if the trustor is not available to consent to the termination. The grandchildren claimed that the district court had the power to terminate the trust with all of the beneficiaries' consent because the spendthrift provision is not a material purpose of the trust.

State law gives the court authority to evaluate the circumstances of the trust and determine whether the trustor anticipated such circumstances, the court said. If the trustor did not anticipate the circumstances, the court can modify the trust in furtherance of the trust's purpose. The district court found that the dramatic growth in the trust's corpus presented a "unique and unusual set of facts" justifying modification of the trust. The court on appeal agreed.

The district court concluded that Eula Somers intended to provide for Shriners, that a partial distribution from the trust assets furthered her goal of providing for Shriners, and that the partial distribution was not detrimental to the payment of the grandchildren's annuity. On appeal, the court agreed with the district court's finding that the growth of the trust and its present worth constituted a circumstance that was not anticipated by the trustor and that modification or a partial distribution of the trust assets furthers the purposes of the trust, to benefit Shriners. "We are, therefore, in agreement with the finding and order of the trial court that the corpus of the trust be distributed to Shriners, with the exception of $500,000 to be kept in the trust to provide for the payments to the grandchildren under the provision of the spendthrift clause," the court wrote.

The grandchildren further argued that if the district court had authority to modify the trust to distribute funds to Shriners, it should have modified the trust to grant the $300,000 in distributions in accordance with their agreement with Shriners. The grandchildren claimed that the $300,000 distribution would not have affected the spendthrift portion of the trust because it was intended to come from Shriners' remainder interest. However, the court noted that Eula Somers' will and the Trust do not provide for any cash distributions to the grandchildren aside from the $100 monthly payments. Other than the distribution of Eula Somers' jewelry and some miscellaneous household items that were devised to Susan, there are no other provisions in the will authorizing distributions to the grandchildren. Consequently, the court said, the district court had no power to authorize a distribution from the trust that was not authorized by Eula Somers' will even though the beneficiaries consented to the distribution.
C. JUDICIAL MODIFICATION OR TERMINATION

States generally give courts authority to modify or even terminate a trust under appropriate circumstances. Typically, this can only occur if the court determines that termination would achieve the wishes of the trustor. California law, for example, provides as follows:

**Probate Code §15409.**

(a) On petition by a trustee or beneficiary, the court may modify the administrative or dispositive provisions of the trust or terminate the trust if, owing to circumstances not known to the settlor and not anticipated by the settlor, the continuation of the trust under its terms would defeat or substantially impair the accomplishment of the purposes of the trust. In this case, if necessary to carry out the purposes of the trust, the court may order the trustee to do acts that are not authorized or are forbidden by the trust instrument.

(b) The court shall consider a trust provision restraining transfer of the beneficiary's interest as a factor in making its decision whether to modify or terminate the trust, but the court is not precluded from exercising its discretion to modify or terminate the trust solely because of a restraint on transfer.

**Case-in-Point**

**Frost National Bank of San Antonio v. Newton**, 554 S.W.2d 149 (1977), is a Texas Supreme Court decision that addresses many of the important issues involving termination of a trust. The trustee in the case, the Frost National Bank of San Antonio, instituted a suit to obtain a declaration as to whether a testamentary trust created by the decedent, Louise Cozby, should be terminated. The district court entered judgment terminating the trust and the trustee appealed.

The terms of Cozby's will included the creation of a testamentary trust, the pertinent terms of which provided:

"I hereby give, devise and bequeath unto the FROST NATIONAL BANK OF SAN ANTONIO, AS TRUSTEE, in trust for the following beneficiaries and for the uses and purposes hereinafter set forth, all of my right, title and ownership in and to all of the residue and remainder of my property and estate, not otherwise hereinabove disposed of, . . . all of which property will be hereinafter referred to as the "TRUST ESTATE", and is to be held, managed, controlled and disposed of by said Bank as Trustee, as hereinafter provided.

"The said Trust shall become effective as soon as my Independent Executor shall have completed the administration, or sooner if the said Bank as Executor or Trustee shall so elect, and shall continue in force and effect during the remainder of the lifetime of the last survivor of the following named three beneficiaries, viz: Rexford S. Cozby, Karolen Newton and Louise Purvis, and shall terminate upon the date of death of the last survivor of said three last named beneficiaries. Provided, however, that said Trustee shall have the right, at its option, to sooner terminate said Trust in the event the income from the trust property shall hereafter cease to be sufficient in amount to justify the further continuance of such Trust, in the opinion of the Trustee."
The decedent’s will further set forth how the proceeds of the trust were to be distributed:

“During the entire existence of the term of said Trust, the said Trustee is directed to pay, out of said Trust funds, to or for the use and benefit of the following named respective beneficiaries the following periodical payments:

One-third (1/3) of the net income from said Trust Estate shall be by said Trustee paid to my husband, Rexford S. Cozby, during the remainder of his lifetime; and the remaining two-thirds (2/3) of said net income from said Trust Estate (plus such portions of the principal thereof as the Trustee may deem necessary) shall be applied to the payment of the expenses incident to: (a) The support and education through high school and college of my great-nephew, Warren S. Wilkinson, Jr., so long as he may attend and continue in school or college during the term of said Trust; and (b) The support and education through college of my great-niece, Susan Arnette, so long as she may attend and continue in college during the term of said Trust; and (c) The support and education through college of my great-niece, Karolen (Lyn) Wilkinson, so long as she may attend and continue in college during the term of said Trust; and (d) If, as and when any one or more of said three student beneficiaries shall, during the term of said Trust, obtain a college degree, he or she shall be paid by said Trustee the sum of $1,000.00 in cash out of the interest or principal of said two-thirds (2/3) of said total Trust Estate, as a graduation present.

In addition to other provisions directing the trustee in how to distribute the assets of the trust, the will provided as follows:

“Upon the final termination of said Trust Estate all of the property then comprising said Trust Estate, and all of the remainder and residue of my property and estate, if any, not hereinabove otherwise disposed of, I hereby give, devise and bequeath to the following named ultimate beneficiaries, in equal shares, an undivided one-half (1/2) to each, viz: Karolen Newton and Louise Purvis. If either one of said last named beneficiaries be not living at the time of the final termination of the Trust Estate above provided for, then the share of my estate which such deceased beneficiary would be otherwise entitled to receive if living, shall go to and vest in her then living children, in equal shares.”

The will was executed on August 25, 1965. Mrs. Cozby died in December 1967, her husband having predeceased her. All other beneficiaries of the will survived Mrs. Cozby. The Bank administered the trust as provided in the will, making the specified payments to the student beneficiaries and disbursing the excess income to Louise Purvis and Karolen Newton, the nieces of the decedent. Warren Wilkinson, Jr., the last of the beneficiaries to be entitled to the educational benefits provided for in the trust, graduated from college in 1971 and received the stipulated one thousand dollars as a graduation present.

In 1974 the Bank brought this declaratory judgment suit to determine whether the trust had terminated upon the completion of the payments to the student beneficiaries or whether the trust remained in effect until the death of the last to survive of Karolen Newton and Louise Purvis. Named as defendants in the suit were Karolen Newton, Louise Purvis, Warren S. Wilkinson, Jr., Susan Arnette, Karolen (Lyn) Wilkinson Dittmar, Doreen N. Levine, Howard P. Newton, L. Inez Newton, and Alibel M. Pardue. Warren Wilkinson, Jr., Susan Arnette, and Karolen Dittmar, the student beneficiaries of the trust, are the only three children of Louise Purvis. Doreen Levine, Howard P. Newton, and L.
Inez Newton are the children of Karolen Newton. Alibel M. Pardue is the testatrix’s surviving sister.

Karolen Newton, Louise Purvis, and their children entered into an agreement urging the court to terminate the trust and releasing the Bank from all responsibilities in connection with such termination. After a hearing at which all parties were represented, including the unborn and unadopted children of Karolen Newton and Louise Purvis, the trial court rendered a judgment terminating the trust on the ground that, while the trust estate was sufficient in amount to justify its continuance, its primary purposes had been accomplished and fulfilled and all the beneficiaries except the unborn and unadopted children of Karolen Newton and Louise Purvis had agreed to the termination of the trust. The court ordered the Bank to deliver the funds comprising the trust estate to the ultimate beneficiaries, Karolen Newton and Louise Purvis. The Court of Civil Appeals affirmed the trial court judgment, agreeing that the primary purposes of the trust had been accomplished and that its termination would not subvert the wishes of the testatrix.

The Bank and the guardian ad litem for the unborn and unadopted children of Karolen Newton and Louise Purvis here contend the lower courts erred in decreeing termination of the trust. They argue the language of the will is unambiguous and clearly states that, unless the Bank voluntarily terminates the trust due to insufficient income, the trust is to terminate only upon the death of the last to survive of Karolen Newton and Louise Purvis.

Newton and Purvis asserted that they were "ultimate beneficiaries" only in the sense that they would be entitled to the corpus of the trust in the event the Bank terminated it because of insufficient income. Furthermore, according to the Bank and the guardian ad litem, the primary purposes of the trust have not been fulfilled because the provision for the payment of excess income to Karolen Newton and Louise Purvis is not incidental and is a continuing obligation of the Bank as trustee. The beneficiaries argued the two primary purposes of the trust have been accomplished and that therefore termination of the trust as decreed by the lower courts is proper and does not defeat the intent of the decedent.

The Texas Supreme Court disagreed. Louise Cozby could not have stated more clearly her intention regarding the termination of the Trust, the court concluded. The language provides that the trust is to remain in effect until the death of the last surviving named beneficiaries. The will then provides that the Frost National Bank, as trustee, could terminate the trust if in its opinion the income from the trust property was insufficient to justify the continuation of the trust.

The Supreme Court noted that the trial court found the income of the trust was sufficient to justify the continued existence of the trust. “That being the case,” the court wrote, “it is clear the trust established under the will of Louise Cozby will terminate upon the death of the last to survive of Karolen Newton and Louise Purvis unless circumstances dictate an earlier termination due to insufficient income.”

The beneficiaries also argued that the payment of "excess income" to Karolen Newton and Louise Purvis was merely an incidental purpose of the trust and that the primary purposes of the trust – the support for education – had been accomplished and therefore the trust could be terminated.
“To accept such a contention would require a determination of what the [decedent] considered to be the principal purposes of the trust and what she considered only incidental,” the court said. “Such a determination would take the court beyond the express language of the will into the realm of conjecture and speculation, for it is by no means clear that the provision for excess income distribution was merely an incidental purpose of the [decedent]. It is consistent with the estate plan of Louise Cozby to infer that after the death of her husband and the education of the student beneficiaries, the trust was to continue in effect, with periodical payments of excess income to Karolen Newton and Louise Purvis, until the death of the last to survive of Purvis and Newton. In construing an unambiguous will, the cardinal rule is to give effect to the intentions of the testator or testatrix as they are expressed within the four corners of the instrument.”

Absent an express declaration of purpose in the instrument, the court said it lacked authority to go beyond the face of the will to make an ad hoc and speculative assessment of which purposes the trustor or testator considered "primary" and which he considered merely "incidental." Thus, the court said, "the trust established by Louise Cozby in her will cannot be judicially terminated on the ground that its primary purposes have been accomplished where, as in the instant case, the trust expressly provides for its termination upon the happening of specified events."

D. LACK OF FUNDS

In some cases, a trust may fail for lack of assets. For example, a trustor may have the intention in creating a trust to support the education of his children or grandchildren. But what happens if the first two children go to college and medical school and there are no funds remaining for the other children? Under such circumstances, the trustee will generally have authority to terminate the trust.

Texas law, for example, provides as follows:

§ 72-33-412. Trust with uneconomically low principal.

(1) On petition by a trustee or beneficiary, if the court determines that the fair market value of the principal of a trust has become so low in relation to the cost of administration that continuation of the trust under its existing terms will defeat or substantially impair the accomplishment of its purposes, the court may, in its discretion and in a manner that conforms as nearly as possible to the intention of the trustor, order any of the following:
   (a) termination of the trust;
   (b) modification of the trust; or
   (c) appointment of a new trustee.
(2) Notwithstanding subsection (1), if the trust principal does not exceed $20,000 in value, the trustee has the power to terminate the trust.
(3) The existence of a trust provision restraining transfer of the beneficiary's interest does not prevent application of this section.
E. COMBINATION OR DIVISION OF SIMILAR TRUSTS

Under some circumstances, a trustee may have authority – with or without the consent of a court – combine two or more trusts into one or to dissolve one trust into several smaller trusts when it is necessary to carry out the wishes of the trustor.

1. Combination of Similar Trusts

If the terms of two or more trusts are substantially similar, on petition by a trustee or beneficiary, a court may combine the trusts if the court determines that administration as a single trust would not impair the goals of the trust or infringe on the interests of the beneficiaries.

2. Division of Trusts

On petition by a trustee or beneficiary, a court in some circumstances may divide a trust into two or more separate trusts if the court finds that it is in the best interests of the beneficiaries and will not defeat the purpose of the trust.

F. AUTHORITY OF TRUSTEE UPON TERMINATION

When a trust is terminated, the trustee has responsibility for winding up of the trust and producing a final accounting to be provided to the beneficiaries. Depending on how and why the trust is being terminated, the trustee’s obligations can vary. For example, if a trust is terminated because there are no remaining assets, there is little work involved. If, on the other hand, there are remaining assets, the trustee will be responsible for selling those assets, if appropriate, and distributing them to the beneficiaries. A trustor may provide in the trust instrument how property may or may not be disposed of in the event of failure, termination, or revocation of the trust. In other cases, the trustee will have discretion to distribute the assets and wind up the trust.

Texas law, for example, provides as follows:

§ 72-33-414. Disposition of property upon termination.

At the termination of a trust, the trust property shall be disposed of as follows:
(1) In the case of a trust that is revoked by the trustor, as directed by the trustor.
(2) In the case of a trust that is terminated by the consent of the trustor and all beneficiaries, as agreed by the trustor and all beneficiaries.
(3) In any other case, as provided in the trust instrument or in a manner directed by the court that conforms as nearly as possible to the intention of the trustor as expressed in the trust instrument. If a trust is terminated by the trustee pursuant to 72-33-412(2), the trust property shall be distributed as determined by the trustee pursuant to this subsection.
At the termination of a trust, the trust property shall be disposed of as follows:
(a) In the case of a trust that is revoked by the settlor, as directed by the settlor.
(b) In the case of a trust that is terminated by the consent of the settlor and all beneficiaries, as agreed by the settlor and all beneficiaries.
(c) In any other case, as provided in the trust instrument or in a manner directed by the court that conforms as nearly as possible to the intention of the settlor as expressed in the trust instrument.
(d) If a trust is terminated by the trustee pursuant to subdivision (b) of Section 15408, the trust property may be distributed as determined by the trustee pursuant to the standard provided in subdivision (c) without the need for a court order.
Where the trust instrument does not provide a manner of distribution at termination and the settlor's intent is not adequately expressed in the trust instrument, the trustee may distribute the trust property to the living beneficiaries on an actuarial basis.

III. Types and Rights of Beneficiaries

A. TYPES OF BENEFICIARIES

1. Primary and Contingent

Simply put, a beneficiary is an individual (or institution, group, charity, etc.) who is designated to receive a gift through a trust. In many if not most cases, there is little need to discuss “types” of beneficiaries.

Example.

In his will, Larry creates a testamentary trust to provide financial support to his nephew, Chris. Chris is the primary beneficiary of the trust.

But what if Larry is concerned that Chris, who has cancer, might not recover. In such a case, Larry could revise his will to provide that in the event Chris does not survive him, his nephew Michael will become the beneficiary of the trust. Michael is therefore the “contingent” beneficiary. That means he is only entitled to receive the gift if a contingency occurs, in this case, the death of Chris. Chris would be referred to as either the “primary beneficiary” or simply as the “beneficiary.”

2. Income Beneficiary

In some cases, a trustor may wish to make a gift that includes income from certain property but not the underlying property itself.
Example 1.

Roger drafts a will in which he creates a testamentary trust that includes an apartment complex. The trust provides that his nephews Richard and Rob are entitled to the income from the complex during their lifetimes. Richard and Rob are “income beneficiaries,” as they are entitled to the income only from the asset.

Example 2.

Stanley establishes a trust for the benefit of his children, Susan, Emily and Alex. The three are entitled to income from the property during their lives, with the remainder of the assets being distributed to their children upon their death. Susan, Emily and Alex do not have any rights to distribute the property within the trust. They are only entitled to income during their lifetimes. They are therefore income beneficiaries.

3. Life Estates

In most cases, people own property in a form that is referred to using the archaic British terminology as “fee simple.” This means that the owner has total ownership of the property in question. The owner may hold it, dispose of it during life or death in any manner he or she so chooses.

Example.

Brian dies with a will that leaves his one-half interest in his home to his wife, Linda. Linda is said to have a fee simple in the home. It is hers to live in or sell or otherwise dispose of as she wishes.

One of the reasons that an individual establishes a trust rather than making an outright gift or testamentary disposition is that he or she does not want the beneficiary to have complete control over the asset. The individual may also want to ensure that assets are available for successive generations. One way this can be achieved is through the use of so-called “life estates”.

Example.

Brian’s will creates a testamentary trust that a will that allows his wife, Linda, to receive the income from their properties during her lifetime. However, she is not free to dispose of them. Upon her death, the properties are to go to his son Collin. Linda does not receive a fee simple to the farm; she receives a life estate only. When she dies, the farm passes to Collin, who will become the owner in fee simple. Collin is referred to in this scenario as a “remainderman,” namely the individual who is to receive the remainder of the estate following the end of the life estate.
B. RIGHTS OF BENEFICIARIES

Simply put, the beneficiary of a trust has only those rights that are established by the trustor in the trust instrument. For example, if a trust gives Ed the right to receive $1,000 per month for the rest of his life, that is all Ed is entitled to. He does not generally have any other rights or obligations under the trust.

1. Right to Compel Distribution

Whether the beneficiary of either a living or testamentary trust has the right to compel the trustee to make a distribution of principal and/or income to him or any other beneficiary depends on the circumstances of each case. The answer depends on a number of factors, most importantly the provisions of the trust itself and, secondly, the finding by a court that the failure to make such a distribution would be a violation of the trustee’s fiduciary responsibility.

For example, it is common for family trusts to provide for the mandatory payment of income only to a surviving spouse and such amounts of principal as the trustee determines are appropriate and reasonable. For example, a surviving spouse who did not receive the mandatory payments of income would have a right to seek a court order compelling those income payments. However, whether or not the trustee’s refusal to pay principal to the spouse amounted to a violation of fiduciary duty would be for the Court to determine after hearing all of the relevant facts of the case.

Case-in-Point

In *Hertel v. Nationalsbank*, 37 S.W.3d 408 (2001), the court ruled that a trustee had no duty to ignore the beneficiary’s other assets in deciding whether to provide additional support from a trust, despite the objections of the beneficiary. The beneficiary, Susan Hertel, asserted that the trustees should not be allowed to consider the financial resources available to her in determining what amount, if any, should be paid to her from the principal of a trust created by her father, Robert Tuhro (“Trustor”).

Since the early 1980’s, Hertel has suffered from multiple sclerosis. Trustor, aware of his daughter’s illness, established a trust over his assets in December 1991 and executed a trust detailing the administration of the trust. In essence, the trust provided that when Trustor died, his assets were to be divided into two equal trusts, one for Hertel and the other for her children from a previous marriage. Hertel’s provided that all income is to be paid to her and at her death, the principal is to be distributed to her children’s trust. The trustor died in December 1994.

Since being diagnosed with multiple sclerosis, Hertel’s health has steadily declined. She has been unable to drive, work, or walk since the late 1980’s. As her condition has worsened, she has had multi-day hospital stays, including a 10-week hospital stay in 1995 after suffering an aneurysm. Hertel was placed in a skilled-care nursing facility in July 1998, where she continues to reside.
As her medical and nursing facility bills accumulated, income from the trust was not adequate to pay the bills, including $21,000 due the nursing home. Although Hertel received an inheritance from her grandmother of almost $156,000, she requested that Trustees encroach upon the trust principal, which was valued at over $400,000, to pay her medical expenses. Trustees requested Hertel to provide details of her financial resources before determining whether to encroach upon the principal. When the information was not forthcoming, Trustees denied her request.

Hertel then filed suit against Trustees for breach of trust and breach of fiduciary duties, claiming Trustees were obligated, under the terms of the trust to encroach on the principal to pay her medical bills without considering her other financial resources. Trustees counterclaimed for a declaratory judgment that would authorize them to consider the financial resources available to Hertel under the terms of the trust.

The issue in this case, the court said, is whether a trustee has the right to consider the other resources of a beneficiary when there is a request to invade the principal of a trust. To resolve this issue, the limited case law in this area has developed the following test: does the trust constitute an absolute gift of support and maintenance, or is the gift of income coupled with a provision that the principal may be invaded in case of need? If the trust is an absolute gift, then the private income of the beneficiary cannot be considered, the court said. If, however, the income gift includes principal encroachment based on need, then a beneficiary's private income must be considered in determining whether such need exists.

In order to make this determination the court examined the language of the trust and the circumstances surrounding its creation. In reviewing the trust instrument, its various provisions support a finding that Trustor did not intend an absolute gift, the court said, but rather conditioned encroachment of the principal upon a showing of need.

The trust agreement addresses encroachment of the principal in Article IV, section 4.00 as follows:

"The Trustees shall have power in their discretion to encroach upon the principal of this share of the trust estate during the life of Grantor's daughter for her health, education, maintenance and support and such encroachments may be made from time to time and in such amounts as the Trustees may consider necessary or advisable under the circumstances."

The court interpreted this provision to grant Trustees the power to encroach upon the principal in their discretion. Use of the word "may" grants Trustees discretion to encroach upon the principal when and in the amount they consider necessary or advisable.

Further, the court found that the "necessary or advisable" language applies to the amount of the encroachment as well as to its timing. Thus, Trustor intended Trustees to exercise their judgment and discretion in determining whether an encroachment for the health, education, maintenance, and support of Beneficiary is necessary or advisable, and whether the amount requested is necessary or advisable.

Trustor also included administrative provisions that further delineate the broad discretion he gave Trustees in the trust agreement.
Article V, in pertinent part, provides:

1.00 The Trustees of the trusts shall have full power and authority to do any and all things necessary or proper to manage and control the property of the trust estate and every part thereof ... all of which may be exercised by the Trustees at any time or from time to time upon such terms and conditions as the Trustees may deem best....

1.10 Should any doubt or uncertainty arise as to the meaning or interpretation of any word, phrase, clause or part of this trust instrument, due to any claimed ambiguity or choice of words, or any controversy of fact, the Trustees are authorized to determine the proper construction or interpretation and what are the true facts, and any such determination made by the Trustees in good faith shall be binding upon all beneficiaries and other persons concerned.

1.11 The Trustees are further authorized to do all other similar or dissimilar acts and things which the Trustees deem to be for the benefit of the trust estate and the beneficiaries thereof, whether or not such acts and things are hereinabove specifically set forth. In the exercise of any or all of the foregoing powers, all decisions of the Trustees made in good faith shall be conclusive and binding upon all parties in interest.

Sections 1.00 and 1.11 lend support to Trustees’ argument that they have the power to request financial information prior to performing their discretionary power of encroachment. Section 1.10 gives Trustees the power to interpret provisions of the trust, and this interpretation is binding upon the beneficiaries, the court said. Moreover, the Trustor included a spendthrift provision in Article VIII, Section 1.00. This provision provides that beneficiaries under the trust do not have the power to transfer, assign, encumber, or anticipate their interest in the trust property, nor is their interest subject to garnishment or attachment. Essentially, these provisions are meant to prolong the life of the trust principal, by preventing other persons from attaching a beneficiary’s interest in the trust before it has been disbursed.

In total, the court said, these provisions evidence Trustor’s intent to give Trustees the power and authority to preserve and maintain the trust corpus while also allowing Trustees to accommodate for unforeseen events. The trust provisions grant Trustees the broad discretion to do any act that effectuates management of the trust, including inquiring as to whether encroachment is necessary or advisable. Trustees, however, must be mindful of their duty to act in the best interests of the beneficiary.

The court said its conclusion that it was Trustor’s intent to give a gift of income to the beneficiary coupled with a provision that the principal may be invaded only in cases of need, is also supported by the circumstances surrounding creation of the trust. First, upon the beneficiary’s death, the trust corpus is to be paid over into the trust established for Hertel’s children from a previous marriage. Given that the trust principal is to be paid over to successor beneficiaries, it is unlikely that Trustor intended an absolute gift.

2. Periodic Accounting and Right to Information

The trustee of either a testamentary or living trust should communicate periodically and regularly with the trust beneficiaries as the trust or circumstances dictate. Beneficiaries should normally be kept abreast of major decisions affecting the trust. For example:
• The sale or exchange of a major asset of the trust;
• A major expense;
• The fees, if any, of the trustee and any other professional hired by the trustee;
• Amounts distributed to beneficiaries; and
• Other matters of direct concern.

If the trustee does not so communicate, or if any beneficiary believes he or she is being kept “in the dark” by the trustee, the beneficiary has the right to petition the appropriate probate court for relief.

For example, § 45a-175(c) of the Connecticut General Statutes permits the probate court to order an accounting from the trustee of a living trust, if the Court finds:

• The beneficiary has a sufficient interest in the trust;
• Cause has been shown that an accounting is necessary; and
• The request for an accounting is not for the purpose of harassment.

Under Connecticut law, a beneficiary of a testamentary trust may ask a court for an accounting at any time upon a proper showing of cause. In addition, the trustee of such a trust must render a written accounting to the court at least every three years, unless the filing is excused by the will itself and the court.

A periodic accounting may also be mandated by the trust instrument itself. In most such cases, a beneficiary will receive an accounting on an annual basis and at such time as the trust is terminated.

Typically only an “interested person” has the right to demand an accounting. Courts have generally found the following persons to be “interested”:

• Every trust beneficiary, including those who hold only a present interest in the trust; and
• The remainderman or remainderners of a testamentary trust.

On the other hand, the courts have typically held that mere contingent beneficiaries do not have a present right to demand an accounting. It would be up to current beneficiaries to make such a request.

3. Modification or Termination

As we saw above, beneficiaries also have the right to demand modification or termination of a trust either according to the terms of the trust instrument or based on state law.
4. Right to a Copy of the Trust Instrument

If the beneficiary or other interested party of a living trust requested the trustee to supply a copy of the trust but was refused, that person may apply to either the probate court or the appropriate superior court for an order compelling that disclosure as part of an action for an accounting. It is within the discretion of either court to grant the request or not. Normally, the Court would be inclined to do so if the party could prove sufficient economic interest in the trust, which might be jeopardized without direct knowledge of the terms of the trust.
Chapter 2 – Review Questions

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Under what circumstances can a revocable trust be amended or terminated:
   a) never; trusts, once created, cannot be amended
   b) virtually anytime
   c) only where there is approval by the beneficiaries
   d) only upon approval by a court of law

2. Under any circumstance, a trust can be terminated if all of the beneficiaries of the trust agree.
   a) true
   b) false

3. The trustee generally has authority to terminate a trust due to lack of funds.
   a) true
   b) false

4. Who is responsible for winding up a trust when it is terminated:
   a) only the trustor has such responsibility
   b) the trustee
   c) the beneficiaries
   d) an executor appointed by a court of law

5. Why might a trustor establish a trust in which the beneficiary receives a life estate:
   a) to keep the beneficiary from having complete control over the property of the trust
   b) for tax savings purposes
   c) to maximize the income of the beneficiary
   d) all of the above
Chapter 2 – Solutions and Suggested Responses

1. A: Incorrect. By definition, a revocable – as opposed to an irrevocable – trust can generally be amended or revoked by the trustor at any time.

   **B: Correct.** The lynchpin of a revocable trust is that the trustor can generally either revoke or amend the trust at any time during his or her lifetime.

   C: Incorrect. There is no such requirement for a revocable trust.

   D: Incorrect. There is no such requirement for a revocable trust.

   (See page 2-1 of the course material.)

2. A: True is incorrect. Termination by consent is only permitted in some circumstances, and must be in compliance with state law. The laws of each state vary.

   **B: False is correct.** If continuance of the trust is required to carry out a material purpose of the trust, it generally cannot be terminated.

   (See page 2-4 of the course material.)

3. **A: True is correct.** A trust may fail due to lack of assets.

   B: False is incorrect. If a trustor intended to be able to support the education of his children with the trust funds, but the first child uses all of the funds for his/her education, the trustee generally can terminate the trust prior to the other children completing their education.

   (See page 2-12 of the course material.)

4. A: Incorrect. The trustor established the trust but, unless he or she also acts as trustee, does not have responsibility for winding up a trust upon termination.

   **B: Correct.** The trustee, not the beneficiary or trustor, is responsible for winding up the trust.

   C: Incorrect. The beneficiaries are not responsible for the winding up of the trust.

   D: Incorrect. It is the trustee who has such responsibility.

   (See page 2-13 of the course material.)
5. **A: Correct.** In a life estate, the beneficiary can use and enjoy the assets of the trust while alive but cannot dispose of them.

   B: Incorrect. There is no tax savings.

   C: Incorrect. To the contrary, a life estate generally limits income potential.

   D: Incorrect. Only one of the responses is correct.

   (See page 2-15 of the course material.)
**Beneficiary**

An individual, institution, trustee or other entity designated in a will or trust to receive something of value.

**Corpus of a Trust**

Literally “the body" of the trust. Used to refer to the money or property placed in a trust. Distinguished from the income produced by the trust.

**Decedent**

An individual who has died.

**Donee**

One who receives a gift.

**Donor**

An individual who makes a gift. Also referred to as trustor, grantor or settler in certain circumstances.

**Estate**

The assets owned by a decedent at the time of his or her death.

**Executor / Executrix**

The person (male/female) names in a will to manage a decedent’s estate. The more modern term is a “personal representative”, which removes any reference to the sex of the person.

**Fiduciary**

A person with the legal duty to act primarily for another’s benefit in a position of trust, good faith, candor and responsibility. “Fiduciary” is often used as an alternative term for “trustee.”

**Fiduciary Duty**

The duty of a fiduciary to act in a position of trust, good faith, candor and responsibility, on behalf of another. The duty is one of the best defined responsibilities under the law and is very strictly enforced by the courts.
**General Power of Appointment**

A power of the donee (the one who is given the power) to pass on an interest in property to whomever he pleases, including himself or his estate.

**General Power of Attorney**

A legal document that gives one person (the agent) the legal authority to act on behalf of the other (the principal). The scope of the document can be as broad or narrow as the principal desired. A general power of attorney becomes invalid when the principal dies or becomes incompetent.

**Gift**

Literally a gratuitous transfer of something of value from the owner to another person. To be a valid gift there must be intent, actual transfer to the donee or recipient of the gift and acceptance.

**Grantor**

Another name for trustor or settler.

**Inherit**

To receive property from a deceased person.

**Irrevocable Trust**

A trust that cannot be changed or terminated after it is established.

**Judicial Modification or Termination**

States generally give courts authority to modify or even terminate a trust under appropriate circumstances.

**Life Estate**

An estate or interest that someone has in property which lasts only during his lifetime, or the lifetime of some other person or persons. The life tenant has no ownership rights to transfer the interests after the life estate runs out.

**Living Trust**

A trust created and in effect during the lifetime of the maker.
**Power of Appointment**

A right given to another in a written instrument, such as a will or trust that allows the other to decide how to distribute your property. The power of appointment is “general” if it places no restrictions on who the distributee may be. A power is “limited’ or “special” if it limits the eventual distribute.

**Power of Attorney**

A document established by an individual (the principal) granting another person (the agent) the right and authority to handle the financial affairs for the principal. A power of attorney becomes invalid at the death or incompetency of the principal, unless the power of attorney is a “durable power of attorney” which remains in effect after the principal becomes incompetent.

**Revocable Trust**

A trust in which the trustor (maker of the trust) has, by the terms of the trust agreement, reserved the power to alter, amend or terminate the trust as to receive the property back from the trustee.

**Settlor**

A person who establishes a trust. The term settler is used interchangeably with the terms “trustor” and “grantor”.

**Successor Trustee**

The trustee who takes over when the initial trustee can no longer function.

**Termination by consent**

Under some circumstances, and in compliance with state law, the beneficiaries of a trust can elect to terminate.

**Testator**

An individual who executes a will.

**Trust**

A legal document by which one person, call the trustor, donor, grantor or settler, places property in the title of the trust for the benefit of himself or another. Normally involves trustor, trustee, who is charged with managing the trust, and beneficiary, in who behalf the trust is established.
Trust Instrument

Refers to the document created by a grantor to establish the trust. It provides the governing guidelines, identifies the trustor(s), identifies the beneficiaries, and identifies the powers of the trustees and others involved with the trust. It should also include a listing of the assets that were transferred to the trust and constitute the corpus of the trust.

Trustee

The personal or institution that manages trust property under the terms of the trust. The trustee becomes the legal owner of the corpus of the trust. The duties and obligations of the trustee are laid out in the trust instrument and imposed by law.

Trustor

A person who establishes a trust. The term trustor is used interchangeably with the “settler” and “grantor” or “donor”.
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