THE RIVERVIEW WAY
25 DRAFTING TIPS

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INTRODUCTION

What part of our professional lives HASN'T changed in the last 20 years? Estate and gift tax reform, sweeping changes to state laws (including the adoption of many Uniform Acts) and the breathtaking changes to our economy all make this a very different environment. As a result of these changes, many practitioners have started to focus on more exotic (and, some might argue, esoteric) tools to fill the void once occupied by the estate tax discussion.

But this focus on the exotic and esoteric has come, to a large extent, at the expense of the foundational. Rather than thinking of new techniques for enhancing our practice, a more fruitful exercise may be to take a harder look at our own preconceived notions. Those of us who have seen both the drafting and administration sides of the business know that, as in sports, it's the fundamentals that need the most attention.

This booklet attempts to bring attention to those fundamentals by identifying the areas that create the most problem for administrators, but that are often given the least attention by drafters. These twenty-five drafting tips are divided into five categories: Purpose, Distribution, Control, Fiduciaries and (the critically important) Miscellaneous.

I. PURPOSE.

We will discuss, in Section II below, the importance of control in estate planning. But before we even get there, if a trust is to give greater control to both trustees and beneficiaries, its purpose has to be very clearly spelled out. Purpose in a document gives the beneficiaries and trustee knowledge about why the trust exists. Failure to define purpose is one of the biggest drafting flaws because it allows the beneficiary to say, "but Mom always wanted me to have . . . [fill in the blank with bigger distributions]." In fact, most planners would acknowledge that this is so.

However, even though we might recognize its importance, most drafters still don't seem to use "purpose" language. This has been a historical problem. Over 50 years ago, the Oregon Supreme Court noted that

> "[t]he difficulty in many if not most of these [abuse of trustee discretion] cases is finding the purpose of the settlor with sufficient definiteness to be helpful . . . The settlor's specific design in framing a discretionary trust is normally unexpressed or vaguely outlined." [1]
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> Two years later, Professor Edward C. Halbach, Jr., repeated those sentiments:
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> "[t]oo frequently trust instruments provide no guidance as to the purpose and scope of the [discretionary] power. Although determining and assisting in the formulation of the donor's intentions is a primary counseling function, it is apparently one of the most neglected aspects of estate planning. A poorly defined discretionary power often results." [2]

Tip 1: Add general purpose language to all trusts.

Regardless of the purpose for which it is intended, any trust can benefit from a clear statement of the grantor's intent. This is the area of drafting most overlooked by lawyers, and also the most critical to the success of a trust administration. Such language should be included in a separate paragraph, so that there is no risk of a trustee or the court confusing precatory purpose language with distribution language.

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1 Rowe v. Rowe, 219 Or. 599, 606; 347 P.2d 968, 972 (1959).

2 Halbach, Problems of Discretion in Discretionary Trusts, 61 Colum. L. Rev., 1424, 1434 (1961).

Tip 2: Add beneficiary preference to all trusts.

Is this a trust primarily for the benefit of the current or remainder beneficiaries? Should one class be favored over another? Although this is sometimes very hard for a grantor to deal with, if such expressions of preference were used more frequently, many trust disputes would be resolved more quickly (to the extent that they are ever resolved at all).

Setting forth beneficiary preference is not optional; if the drafter doesn't do so, state law, by imposing on the trustee a duty of undivided loyalty, requires that the trustee must treat all beneficiaries' interests equally. So there's always a beneficiary preference. Even if the grantor really does want the beneficiaries treated equally (which is, in the author's experience, often not the case), it's a good idea to say so explicitly in the document. This is not a matter of defining the trustee's duty, so much as it is communicating to the beneficiary the reasons why a trustee is making or withholding distributions.

Tip 3: Find out who the client is trying to protect, and from what?

The only reason any trust is put in place is to protect one or more people from one or more other people. The universe of protection can be broken down into four categories:

- Protect beneficiaries from themselves (minors, spendthrifts, those with special needs);
- Protect beneficiaries against creditors (including future ex-spouses);
- Protect beneficiaries against each other (kids from a prior marriage vs. the second spouse); and
- Protect beneficiaries from the IRS.

Identifying with the client the thing that they are protecting beneficiaries from will go a long way to identifying the real purpose of the trust. This is more of an interview technique than a drafting one, but if you get this one right, the rest of the tips discussed below lay out much more easily.

II. BENEFICIARY CONTROL.

Now we come to the most important point in the presentation: nothing is more important than control. Control over your own circumstances leads to greater happiness. However, our clients can feel lacking in control: over their finances, the state of the tax law, their kids' futures, everything. Whatever feelings of control we can give back to our clients will reap huge benefits for us, regardless of our professional discipline. Control, not money, is a much greater determinant of happiness. The opposite is also true. When people lack control over a thing, they tend to become cynical about it and withdraw (politics is an easy example).

Defining Control

"Control" has many different connotations, not all of them positive. Control can be defined in three different ways. First, there is control of external things (like controlling others through rewards or punishment). Second, there is internal control over our assets, attitudes and outlook. Finally, knowledge is a third type of control.

Generally, exercising external control through rewards or punishment actually decreases internal motivation. There are only a couple of exceptions to this rule: motivating someone to undertake a boring activity or to try something new.[3]

On the other hand, more internal control leads to greater "self-efficacy," [4] which is inspiring. Self-efficacy is a "better predictor of career selection and success than actual ability, prior preparation, achievement and level of interest."[5]

The importance of self-efficacy is shown in the fact that happiness leads to success, not the other way around (it's not true, in other words, that a person becomes happy only after he or she becomes successful, a common misperception).[6] And becoming happy is within a person's control. In fact, research shows that behaving as though you are happy makes you happier.[7] In a "walking" study, undergraduates who walked in a depressed manner showed signs of depression, while those who walked in a "happy" manner showed the opposite. Another study showed that sitting in a slumped manner tended to make people more depressed, while sitting upright improved mood. Similar results occurred when commuters in trains and cabs struck up conversations with strangers and found themselves happier than those commuting quietly (the same is also true for people who strike up conversations with their local barista!).

One of the most famous happiness studies tracked the journals of 180 nuns, all of whom were born before 1917. When in their 20's, the nuns were asked to write down autobiographical journal entries. Fifty years later, researchers coded the entries for positive emotional content. It turned out that the nuns whose entries were more positive lived nearly ten years longer than those whose entries were negative or neutral. In fact, by age 85, 90 percent of the happiest quartile of nuns was still alive, as compared to only 34 percent of the least happy quartile.[8]

Further, research with entry-level accountants confirms the proposition that the more you believe in your ability to succeed, the more likely it is that you will. Of the 112 accountants surveyed, those who believed they could accomplish what they set out to do scored the best performance ratings ten months later. Put another way, a specific focus on your strengths during a difficult task produces the best results.[9] Feelings of control are important for well-being and performance. Among students, feeling in control leads to higher grades and motivation to pursue desirable careers. Among employees, it leads to more job satisfaction and better performance. Further, control at work spreads happiness everywhere: family, job, relationships.[10]

3 Stephens, infra note 13.

4 Id. (citing Bandura, Self-Efficacy: The Exercise of Control (1997)).

5 Id.

6 Achor, The Happiness Advantage, 37 (2010).

7 Walk This Way: Acting Happy Can Make It So," Wall St. J., D-3 (11/18/14).

8 Achor, supra note 6, at 42.

9 Id. at 74-75.

10 Id. at 130.

And research also confirms that actual control is less important than perceived control. The most successful people have what psychologists call an "internal locus of control," the belief that their actions have a direct effect on their outcomes. People who believe that they have this internal control have "higher academic achievement, greater career achievement, and are much happier at work." [11]

In fact, the importance of this kind of control goes beyond job performance and outward success; it impacts our health as well. One sweeping study indicated that employees who felt they had little control over deadlines imposed by others had a 50% higher rate of coronary heart disease than their counterparts. In a study of the elderly, a group of nursing home residents who were given more control over simple daily tasks, like being in charge of their own house plants, not only became happier, but cut their mortality rate in half.[12]

Finally, if a person has sufficient information about a process or outcome so that he or she can respond based on that knowledge, then he or she has at least a feeling of control. This third type of control indicates that one's involvement, even if it is only to be fully informed and without any actual control, can be empowering.

Control and Others

If control is critical to happiness, it also is contradictory, at least when more than one person is involved. Our clients' habit of being in control (and specifically external control) often extends to the estate planning decisions they make. However, when the goal of those decisions is to make for happier and more productive beneficiaries, they may be more successful by giving control away.

For instance, many clients (and some advisors) believe that withholding information will help their heirs. The general idea is that if the heirs (especially the client's children) don't know the family has money, then they will go about leading a "normal" life. In other words, the knowledge itself will spoil them.

There are several reasons why this approach may be misguided. First, children almost always figure out the family has money, based on membership in clubs, vacations taken, the cars the family drives, and so on. Most clients won't want to deny themselves those things simply to create the illusion of a "normal" life. Second, plenty of children who were kept in the dark about money come out spoiled anyway (this is an entirely unscientific observation based on experience). Finally, we've learned that knowledge, if dispensed properly, is a form of self-control and can be used to help the heirs develop by getting them to ask the right questions and giving them the proper tools to handle the information.

Tip 4: (Almost) always give beneficiaries the power to remove and replace trustees.

The whole point of having a trust is to vest control in the hands of someone other than the beneficiary. So deciding how to give a beneficiary more control with that in the background is a challenge. The best way to achieve this is to give adult beneficiaries the power to remove and replace trustees, even if it's only with a corporate trustee. This is actually a form of internal control over the beneficiaries' own interest in the trust.

The interesting thing is that, in most cases, if a beneficiary knows that he or she has this power, the beneficiary tends not to use it. Knowing that he or she has some level of control creates a sense of calm about problems that may arise with the trustee, and tends to enable the beneficiary to arrive at a compromise regarding that problem.

Like any rule of thumb, this is a generalization. Of course some beneficiaries should not have this power. Of course some beneficiaries will be unhappy no matter what. But the ability to remove and replace trustees, in our view, should be the rule, not the exception.

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11 Id. at 131.
12 Id. at 132.

Tip 5: Give the adult beneficiaries the power to change situs, jurisdiction, state law.

This is a power typically given to trust protectors (which, for reasons discussed below, tend to be less useful than most drafters believe). But why shouldn't the beneficiaries have this power instead? When a beneficiary is informed about issues and consulted, he or she feels more empowered, which in turn tends to make them more reasonable and cooperative. This is a small matter, to be sure, but it argues in favor of giving the power to beneficiaries.

After all, if it's a small matter, there's no harm in giving the power to the beneficiaries.

Tip 6: Consider giving beneficiaries veto power over selling inception assets, along with intent language.

If a grantor funds a trust with an asset that has a special connection with the family (a business, a vacation home, income-producing real estate), the trustee is always in a dilemma: should the trustee sell the asset in order to comply with its duty to diversify? Washington law creates an exception to the duty for inception assets, and it's always possible to draft around the duty to diversify, but trustees have still been sued (and even lost) when such language is in place.

Giving beneficiaries the veto power over sale (rather than having a party like a trust protector or advisor govern such decisions) accomplishes two goals. First, it gives the beneficiaries greater control over trust assets, which we've already established is a good thing. Second, it eliminates the confusion over where fiduciary duty lies. The trustee is in charge of all assets, but cannot sell an inception asset if all or a majority of adult trustees object. If the trustee feels strongly enough about selling, it can seek a TEDRA or nonjudicial settlement agreement.

Adding such a veto power is best done in conjunction with precatory language about the purpose of the trust being to hold the inception asset, and also a provision eliminating the duty to diversify with respect to this asset. This may be seen as overkill, but in light of ways in which courts have strictly construed "nondiversification" language, it is probably warranted.

Tip 7: Make it clear that minors don't have to be consulted, and create a clear system for decision-making.

When giving beneficiaries these kinds of control rights, it's probably a good thing to develop a decision-making process. For instance:

- Do a majority of beneficiaries have to agree, or does it have to be unanimous?

- Should it be all "qualified beneficiaries" as defined in the Uniform Trust Code? Probably, since remaindermen should be included in the decision as well as current beneficiaries. On the other hand, if the purpose of the trust (discussed above) is to benefit current beneficiaries to the exclusion of remaindermen, then maybe the latter should not have a vote.

- Give only adult beneficiaries the vote. This eliminates the need to appoint guardians ad litem or special representatives for minor and unborn beneficiaries, which only leads to delay and confusion.

Tip 8: Develop a beneficiary communication system. It's better to keep them more informed than less.

A lot of lawyers were outraged when the Uniform Trust Code imposed the mandatory duty of annual reporting to qualified beneficiaries (which begs the question whether a trustee can ever exercise its fiduciary duty without even telling a beneficiary about the trust's existence). This outrage, however, was misplaced: giving a beneficiary knowledge of a trust's existence, its assets, income and expense, can only be good. If only because all beneficiaries find out about a trust's existence sooner or later, and when they find out later, trust-devouring litigation often ensues.

This is less a drafting tip than a client-communication tip. Discussing the fact that beneficiaries have to be given notice can lead to very fruitful discussions about distributions, trust purpose and the whole reason for the trust's existence.

III. DISTRIBUTIONS.

The universe of trust distribution provisions can be divided into two large subsets: subjective and objective provisions. Since the only provisions that most beneficiaries care about are those that deal with what they get and when, reviewing the pros and cons of these two types with clients is very useful.

Objective Terms

There are generally two groups of objective trust terms: income-based and incentive-based. The income-based terms are the traditional group most estate planners are familiar with; under this model a beneficiary is entitled to all the income from the trust. There are a couple of modern offshoots, the unitrust and the adjustment between principal and income. Both, however, are based on the traditional notion of "all income," but with modifications to take into account the mandates of modern portfolio theory.

The second group, incentive trusts, has increased dramatically in popularity over the past twenty years. Indeed, a 1999 article in the Wall Street Journal discussed their use.[13] The article actually mentioned several incentive trust provisions, which are illustrative of the type of provisions common to the trust: matching earned income up to a specified amount; distributing a fixed amount for the beneficiary to start a business or professional practice; making a monthly payment for a "stay-at-home" parent; denying distributions if the beneficiary fails a drug or alcohol test; and making fixed distributions for each year in which a beneficiary has no driving violations.[14]

Such provisions have some superficial appeal and (at least in the case of drug testing) may be critical in caring for a beneficiary. They encourage or discourage positive or negative beneficiary behaviors. They are also easy to administer: show me your W-2 and I give you the money, pass your drug test and I give you the money. They leave no room for a trustee to be over-indulgent.

However, objective provisions also have serious problems. The traditional "income only" provisions are virtually useless in most settings, because they bear no relation to any goals that the grantor might have. The income might be too much or too little for purposes for which the trust was created. The same is true for unitrusts and for income with the trustee ability to adjust between principal and income: neither relates to real-world client goals for the beneficiary. They are often as not short-hand solutions suggested by the drafter.

One variant of the "income-only" model has some relevance to real world goals, and that is the dollar amount, adjusted for inflation. For instance, the beneficiary is to receive $100,000 per year, adjusted for inflation. This type of provision allows the grantor to establish a standard of living by creating essentially a salary from the trust. Inflation adjustment is obviously critical in this context to ensure that the beneficiary does not lose pace to inflation over time. Note that, even in those cases when an "all income" provision is required (for example, in the case of QTIP trusts), a "greater of" provision can be used (i.e., the beneficiary shall be entitled to the greater of all net income or the inflation adjusted dollar amount).

Another problem with objective provisions is that they cannot adapt to the needs of a particular individual. For example, by promoting a daughter to stay at home with her children, they might discourage her developing her natural abilities in other areas. Further, by simply encouraging higher earnings, the trust terms might convince a beneficiary who wanted to be a school teacher to be a lawyer instead. To take this notion further, a document that specifically provides for one thing specifically excludes another. Behaviors not specifically set forth, but which may be equally desirable are not accounted for.

A third problem is that objective provisions, which are fundamentally restrictive, do not allow for changing circumstances. The beneficiary who develops a debilitating illness that prevents her from earning at prior levels, for example, may find herself impoverished if the trust is not drafted broadly enough. In a more general sense, anyone who drafts a long-term trust with specific, objective terms, believing he knows what the world will look like 20 or 50 years from now, is probably thinking too narrowly.

Finally, and most importantly, a grantor who creates an incentive trust that focuses on behaviors usually doesn’t seek to promote those behaviors per se. Instead, the grantor seeks to promote something that the behaviors represent. For example, a client is not really trying to encourage W-2 income, but rather productivity; entrepreneurship is ultimately less important than “independence, ingenuity and innovation.”[15] In other words, the grantor identifies certain behaviors that are a surrogate for maturity and drive. But by naming surrogates rather than the thing itself, the grantor runs the very serious risk of missing the mark altogether: a “teacher of the year” might receive smaller trust distributions than a mediocre lawyer.

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13 cited in Stephens, Incentive Trusts: Considerations, Uses and Alternatives, 29 ACTEC Journal 5 (Summer 2003) (hereinafter “Stephens”). See also McCue, Planning and Drafting to Influence Behavior, 34 U. of Miami, Phillip E. Heckerling Inst. of Est. Plan. (2000) (hereinafter “McCue”).
14 Id.
15 Id.

Subjective Provisions

So if objective provisions are inadequate, does that mean that we should favor subjective instead? Subjective provisions are those that require the exercise of discretion by the trustee in making certain value judgments. For example, the subjective standard most of us are familiar with is the trustee's ability to distribute principal for "health, education, maintenance and support." The trustee must decide what constitutes "support," which could include living in anything from a shack to a mansion. This flexibility is seen by many as a significant benefit. At least one commentator has noted that objective, "incentive" provisions are not the solution to most family relationship problems, and so should not be the "first weapon out of the arsenal." [16] Indeed, the incentive trust works best "in the most desperate situations" (as an alternative to disinheritance for a beneficiary engaging in anti-social behavior, for instance).[17] Discretionary trusts "should be seen as generally preferable to incentive trusts" because the increased flexibility. [18]

However, if a discretionary trust is to be used, several additional provisions should be added. First, the grantor should give clear guidance as to the exercise of the discretion. The grantor's intention "should be set forth in sufficient detail to tell the trustee what the [grantor] really wants." [19] Further, trustee exculpation should be added, including perhaps provisions that set forth how the costs of litigation are to be paid (such costs may be assessed against the beneficiary who brought it, for example). These measures will ensure that the trustee will exercise discretion in a manner as close as possible to that the grantor intended, and may do so with less fear that he or she will be sued for doing so.

Finally, even if such provisions are added, some problems remain. First, the more discretion given to the trustee, the greater the likelihood that the trustee will exercise it in a manner the grantor would not have agreed with. This may not be all bad, by the way. Second, discretion guarantees only flexibility, not success.

Tip 9: Don't use "all income"

There are few habits in trust drafting as thoughtless and counterproductive as giving a beneficiary "all income." Excluding the few times when it is required (in QTIP trusts, for example), there is no reason to give a beneficiary all income. It has no relation to any real world goal, and pits beneficiaries against each other, because the trustee's investment choices benefit one beneficiary over another.

Honestly, "all income" just makes no sense. So then what does?

Tip 10: Consider an inflation-adjusted dollar amount.

If "all income" is the most overused distribution provision, the most underused is the inflation-adjusted dollar amount (e.g., "beneficiary shall receive $75,000 per year, increased in each year by CPI"). No client knows how much "all income" will buy in the future, but everyone knows how much $75,000 per year in today's dollars will buy. Using this standard makes principal distributions easier to draft as well, because there will be less need for "support" or "maintenance" if a minimum standard has been applied.

Tip 11: Consider a unitrust.

If the inflation-adjusted dollar amount is too radical for you, at least consider the unitrust distribution. This has two benefits over "all income:" the trustee can invest for total return, and not income production, and the percentage can be fine-tuned more than "income" can.

16 McCue, supra note 3, at §609.2.

17 Id.

18 Id. at §609.3.

19 Id.

Tip 12: Add "standards" preferences to all trusts.

A great many, probably most, irrevocable trusts allow for distributions of principal for a beneficiary's "health, education, maintenance and support." However, not all of these standards necessarily are created equal. Is education more important than other purposes, for example? Clarity about standards is not often included, but many grantors do have strong feelings about priority. This tip is especially useful with the inflation adjusted dollar amount. In that case, education and medical care would likely be emphasized over support or maintenance.

Tip 13: Be more specific about what the standards mean

For too long we've blindly referred to "health, education, maintenance and support," for no good reason other than they're included in the Internal Revenue Code. Consider the following:

- First, why do we even use "maintenance" and "support" when the Regulations state clearly that they are identical terms? This is not a substantive issue, but rather evidence that we've tended to gloss over the issue.

- Second, paying for a beneficiary's support can often be contrary to not only the grantor's objectives (most grantors want their beneficiaries to be productive) but also the factors that tend to create happiness (namely, self-efficacy). Of course, there are plenty of circumstances in which support is appropriate (when a beneficiary is attending college, for instance, or for a surviving spouse who has spent her life working in the home). But the number of times that the term is actually used probably outweighs the number of times it's appropriately used.

- Third, broaden "education" to include things like personal enrichment classes and courses that lead to professional designations. Such courses may help with the beneficiary's personal growth (a happiness factor) and are unlikely to sap a beneficiary's incentive.

- Fourth, distributions for "health" should almost always be added, and might be expanded to be clear that the trustee can pay insurance premiums and perhaps also reimburse employee co-pays for such insurance. While we're on the subject of insurance, by the way, "health" might also include payment of insurance premiums for disability, AD&D and perhaps even long-term care or life insurance designed to replace the income of the working spouse in the event of her death (being mindful, of course, not to create any "incidence of ownership" problems).

Tip 15: Realize that "may" look to other resources means "shall" look to them

Many trust agreements state that the trustee "may" consider other resources when considering whether to make discretionary principal distributions to a beneficiary. However, when considering the trustee's undivided duty of loyalty to both current and remainder beneficiaries, a strong argument can be made that a trustee with the ability to consider other resources should always do so. For this reason, most if not all corporate trustees consider "may" in this context to mean "shall."

IV. FIDUCIARIES (AND NON-FIDUCIARIES).

Any experienced estate planner can tell you that there is no estate plan so poorly written that thoughtful and well-meaning beneficiaries and trustees can't work with. Nor any plan so well written that a bad trustee can't dismantle it.

Tip 16: Determine needs before choosing a trustee.

As mentioned before, start with the purpose of the trust, the control given to the beneficiaries and the distribution terms. Once the client has laid out all of these issues, then the conversation can begin about who should be in charge as trustee and successor trustee.

Perhaps even more importantly when considering a successor trustee of a revocable living trust is who will serve when the clients are incapacitated. So much of the conversation circles around what happens after death, yet what happens during life is often of even greater (if sometimes unstated) concern.

Tip 17: Don't use trust protectors or advisers unless you absolutely have to. And then don't anyway.

One of the most popular recent topics in estate planning has been the use of trust protectors and advisors.[20] Although it may be that trust protectors are more spoken of and written about than actually used, the argument for using them is that they can provide greater flexibility to accommodate changes in beneficiary circumstance, oversee trustee behavior and do so without generating the cost of court proceedings.[21] However, in their haste to try the latest flavor, many drafting lawyers are missing the nuance, and potentially creating confusion.

For example, the terminology itself is confusing, as the terms "trust protector" and "trust advisor" are often used interchangeably.[22] It can be argued, however, that they are different, as a trust protector tends to be the holder of a power, while a trust advisor tends to have the power to control or constrain a trustee. Maintaining this distinction may be useful for the drafter and the client.

Of much more importance is the unresolved question of fiduciary duty, and whether the document or state law effectively can eliminate such a duty altogether. If those duties can be completely eliminated, where does the fiduciary duty lie, if anywhere? If a trustee's fiduciary duty is trumped by a person with no such duty, where does that leave the beneficiaries? Many commentators and even some state laws seem to believe that those duties can be eliminated, even though the Restatement (Third) of Trusts and the Uniform Trust Code both indicate that a non-beneficiary holding a trust power is presumed to be a fiduciary.[23] This "obsession" with exculpating trust protectors from liability for breach of fiduciary duty is perhaps the original product of those who drafted and promoted offshore asset protection trusts,[24] even though subsequent offshore cases involving the question of whether a trust protector is a fiduciary seem to say that they are.[25]

Regardless of where the fad came from, however, eliminating a trust protector's fiduciary duty raises practical and ethical concerns. To begin with, doesn't the drafting attorney have an obligation to let the grantor-client know that, when a protector is exculpated from liability from certain actions, the beneficiaries are at the protector's mercy, with no potential recourse?[26] Indeed, taken to its logical conclusion, no drafting lawyer, in allowing a non-fiduciary trust protector with the power to remove or replace a trustee, would feel comfortable with the following language in a trust agreement:

20 See, e.g., Alexander A. Bove, Jr., The Case Against the Trust Protector, 37 ACTEC L. J., 77 (Summer 2011).
21 Id.
22 Id. at 78.
23 Id. at 82.
24 Id. at 84.
25 Id. at 85.
26 Id. at 82.

> *It is the settlor's intention that in exercising this power the protector shall not be deemed a fiduciary, shall not be required to monitor the trustee's performance, and shall not be bound by or required to consider any particular standards of trustee performance. He shall not be required to act upon notice that a trustee is in breach of its fiduciary duty, and in the event of appointment of a successor trustee, the protector shall not be required to consider whether any such successor trustee has any experience in or knowledge of trust administration, or is a suitable person or entity to act as trustee. The protector may exercise or refrain from exercising such power in a capricious or whimsical manner at his total personal discretion, without liability therefor.* [27]

Yet this is exactly what the grantor (through the drafting lawyer) is saying by allowing a non-fiduciary to remove and replace a trustee. This already challenging problem is almost insurmountable in the case of longer-term trusts, because even if the grantor has absolute faith in the trust protector initially named in the trust agreement, the grantor will almost certainly not know who might be appointed in the future.

Second, at least one commentator has opined that

> there is little question that if the "drafted-away" duty is breached by a disinterested protector who is deemed to be a fiduciary and a claim is made, the particular state law exculpating the protector would have to be struck down by a court. [28]

Further, faced with a decision made by a non-fiduciary trust protector, which would be considered a breach of duty if made by a trustee, it is also quite likely that a court would go out of its way to find that some kind of minimum standard exists, regardless of the document or state law. In light of these concerns, drafting lawyers who are thinking of adding third-party decisionmakers (either trust advisors or trust protectors) to a trust agreement should think hard about whether said decisionmaker is really necessary, or just fashionable? At least one important commentator has said that, except in enumerated circumstances, "most trusts do NOT need a trust advisor or trust protector." [29] A trust advisor or protector is best added to address specific needs in specific circumstances. Adding one simply in the name of general "flexibility" is probably a bad idea because the uncertain identity of the trust advisor or protector many years in the future is probably riskier than the uncertainty of future laws. Put another way, it's probably better to deal with changed circumstances through judicial process than through an unnamed future party, especially one with no fiduciary duty.

27 Id. at 89.
28 Id. at 83.
29 Kathleen R. Sherby, In Protectors We Trust: The Nature and Effective Use of "Trust Protectors" as Third Party Decision Makers, 49th Ann. Heckerling Inst. on Est. Plan., ch. 15, ¶1508.1 (2015).

Tip 18: If you must violate Tip 17, be clear about the exact role.

Be clear about whether the decision-maker is a "trust advisor" or a "trust protector." Even though, as noted above, the terms are often used interchangeably, at least one commentator has drawn the useful distinction between "trust advisors," who should be considered the persons "to whom one or more powers are given to direct the trustee in carrying out the trustee's traditional trustee duties," and "trust protectors," the persons "to whom one or more powers have been given that relate to one or more specific trust matters but do not involve or infringe on the trustee's performance of traditional trustee duties." [30] Under this approach, a trust advisor may be responsible for participating investment decisions, for example, while trust protectors may be responsible for things like changing trust situs.

This seemingly esoteric distinction is actually very helpful, because you and your client can clarify what you expect the decision-maker to actually do.

Tip 19: Be clear about relationships and responsibilities.

Even though many states, including Washington and Oregon, have statutes governing the relationships of trustees and third-party decisionmakers, do not rely on them alone.[31] State law varies significantly with regard to these relationships, and is still developing. Further, one of the chief roles of a trust protector may be to change situs or jurisdiction. Therefore, a thoughtful drafter who has distinguished between trustees, advisors and protectors also will want to distinguish among the powers, duties and liabilities of those parties.

And even more importantly, in the absence of a good reason to the contrary, all third-party decisionmakers should be held to a fiduciary standard. To do otherwise might create a situation in which important trust decisions are being made without any fiduciary oversight.

Tip 20: Carefully limit the scope of a decisionmaker's duties.

This can come in two forms. First, limit all third-party decisionmakers to powers and duties that are specifically enumerated in the document. The trust agreement should spell out that those parties have only those powers specifically included, with no additional powers being implied.[32] Second, consider giving third-party decisionmakers only the power to veto a trustee's decisions, rather than independent decision-making authority. While not perfect for every situation, thinking about it in these terms limits the scope of the third party's power, especially if that third party is not being held to a fiduciary standard.

30 Id. at ¶1501.2.
31 Id. at ¶1508.2.
32 Id. at ¶1508.4.

V. MISCELLANEOUS.

What follows are a number of miscellaneous thoughts about trust drafting that don't really have any unifying theme to them, but are important anyway.

Tip 21: Always review the tax clause

Less a drafting tip than a reminder, there is no clause more consistently wrong in wills or trusts than the tax clause. In particular, be careful when copying and revising a trust agreement in its entirety as the basis for an amendment. Look especially to:

- Who pays tax on specific gifts;
- Who pays tax on assets outside the trust or will (especially retirement plan assets);
- Who pays tax on marital trust assets; and
- Who pays state estate tax, even when federal tax isn't due.

Be sure to add this to a checklist for final review.

Tip 22: Don't use pot trusts (except in very specific situations).

One factor in determining how money can affect happiness is "social comparison:" a majority of people surveyed would rather make $50,000 a year when those around them are making $25,000 on average, than make $100,000 a year when those around them are making an average of $250,000. Happiness as measured by income, in other words, can be more a function of comparison rather than absolute dollars. [33]

This study reinforces a fact that most estate planners know: pot trusts are a bad idea. This is because beneficiaries are always comparing what they get against what other beneficiaries are getting. This is especially true when distributions are coming from the same place, because if one beneficiary is getting more it means that another might be getting less, and they are all receiving the same accountings.

Pot trusts are appropriate when one beneficiary has medical or other needs that may require that he or she receive a disproportionate share of the trust property. In that case, it's a good idea to add specific language favoring that beneficiary over the others.

Tip 23: Don't rely on "initial assets" exception in WA to prudent investor act.

Pursuant to RCW 11.100.060, a trustee may "hold and retain any real or personal property received into or acquired by the trust from any source" and, if acquired without consideration, may hold such property "without need for diversification as to kinds or amount and whether or not the property is income producing." A trustee following this statute "is not liable for any loss incurred with respect to any investment" covered by this statute if "permitted when received" and if the trustee "exercises due care and prudence in the disposition or retention of any such investment."

Do not rely on this statute if you know that the grantor actually wants the trustee to retain a single asset representing a significant concentration in the trust asset mix. There are three reasons for this concern. First, the trust situs could be moved to a state with no such similar statute. Second, courts like to go out of their way to find a duty to diversify, and reliance only on statute, with no precatory language indicating the grantor's intent provides little back up. Finally, even if the statute holds up, it doesn't provide any context: under what conditions should the asset be sold? Why is it being held?

The solution, as already discussed, is to provide precatory language indicating that the trust's purpose is to hold this special asset, guidance regarding when the asset might be sold, and exculpation language for the trustee for failing to diversify.

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33 Layard, Happiness: Lessons from a New Science, 41-42 (2005).

Tip 24: When debating state-only shelter trusts, consider disclaimers, terminatables and divisibles.

Before 2011, married clients who didn't want to waste their exemption amounts had to create a "shelter trust" at the first spouse's death for the benefit of the survivor. The deceased spouse would have access to as much of the trust property as he or she needed, but at his or her passing the trust property would pass to the remainder beneficiaries (usually the couple's children) without being taxed at the surviving spouse's death.

Starting in 2011, the federal law was changed to allow a spouse to "give" his or her exemption amount to the other spouse by making a "portability" election at the first spouse's death. This greatly reduced the need for creating a shelter trust at the first spouse's death.

The pros of using portability rather than a shelter trust in an estate plan are:

- An irrevocable trust, which has separate tax reporting, higher tax rates and disclosure requirements to remainder beneficiaries, never has to be created; and
- At the surviving spouse's death, all of the assets get a full stepped-up basis for capital gains tax purposes, whereas the basis in the shelter trust assets only gets stepped up at the first spouse's death.

The cons of using portability are:

- The amount of the first spouse's exemption isn't indexed for inflation (it's fixed as of the date of the first spouse's death), so less might be sheltered from estate taxes on the second spouse's death;
- Oregon and Washington don't allow portability, so although it protects federal exemption amounts, state exemption amounts are still wasted without a shelter trust; and
- Using portability requires filing a potentially expensive election within 9 months of the first spouse's death.

The fact that the Oregon or Washington estate tax exemption of the first spouse might be wasted is not as bad as it seems. Although a shelter trust will help avoid at least some state estate taxes for the couple's heirs, it comes at a cost. First, the trust generates administrative costs and potentially higher income tax than if the surviving spouse owned the assets outright. More importantly, the trust assets do not receive a stepped up basis for either state or federal incomes taxes at the surviving spouse's death. This means the heirs may have to pay additional income tax when they sell assets after the surviving spouse's death. So the state estate tax savings to heirs has to be compared against the increased income tax cost.

All of this means that flexibility in planning is more important than ever. A prudent planner may choose to kick the state estate tax can down the road by using one of three techniques: a disclaimer trust, a "terminatable" trust or a "divisible" trust.

As we all know, disclaimer trusts provide the ability to wait until the first spouse's death to make the decision to create a shelter trust, allowing the surviving spouse to make the decision (with her advisors) after taking into account any change in the laws or the couple's financial picture. However, as we also know, IRC §2518 imposes a number of requirements for a disclaimer to be "qualified," and therefore not a taxable gift. Most important of these is that the spouse cannot have taken any benefit from the asset, and that the disclaimer must be made within 9 months of the decedent's death.

If such uncertainty is unacceptable, another option is to automatically create a shelter trust in each spouse's estate plan, but allow that trust to be terminated by a third party (this actually might be a good place for a trust protector!). This provides the same flexibility as the disclaimer trust, but without the restrictions. The downside here is in finding a willing third party to make that decision. It can't be the surviving spouse or any potential beneficiary, in order to avoid adverse tax consequences. So an advisor or family friend is the likeliest suspect. This is a case where the third party advisor definitely should NOT be a fiduciary, because he or she might be deemed to have a duty to the remainder beneficiaries to allow the trust to stand. There also should be fairly extensive precatory and exculpatory language included as well.

Finally, if the estate plan is to leave everything in trust to the surviving spouse in any event, allow the shelter trust to be created based upon the election to treat only a portion of the trust as marital deduction property. The portion of the trust over which no election is made becomes the shelter trust. The only requirement of course is that the shelter trust (because it is an offshoot of the marital trust) will have to have the same terms (e.g., all income to the surviving spouse, no other beneficiaries, etc.).

Tip 25: Exonerate the trustee from the acts of the prior trustee, and don't require the trustee to pursue any prior acts of earlier trustees (or specifically REQUIRE it).

OK, this might be just a little self-serving at the end of the presentation, but no trustee wants to be hired simply to go beat up a prior trustee. And no trustee wants to be held liable for the bad actions of a prior trustee either. So in general, it's a good idea to both exonerate the current trustee from liability for the acts of prior trustees, and to relieve the current trustee to pursue prior acts.

Having said that, there are times when that's exactly what you DO want the trustee to do. In this case, it might be wise to state that expectation in the document naming the successor trustee. It can be drafted into the appointment document, and could be a part of the beneficiary's ability to remove and replace trustees, discussed above. That way, the new trustee would have a clear understanding of its duties.

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