Steve Leimberg's Estate Planning Email Newsletter - Archive Message #571

Date: 14-Aug-03 11:44 PM
From: Steve Leimberg's Estate Planning Newsletter
Subject: **The Seven Deadly Sins of Trust Drafting**

During a recent lunch with **Jeffrey R. Lauterbach**, Chairman & CEO of The Capital Trust Company of Delaware, we discussed the many drafting problems that frequently are encountered during a trust company review of a trust document.

I asked Jeffrey if he would create a list of the serious mistakes and troublesome issues his associates encounter most often.

Jeffrey teamed up with **Trisha W. Hall**, AVP and Staff Attorney at Capital Trust to provide LISI members with this exceptionally useful checklist!

Please share your appreciation with Jeffrey and Trisha (jrl@ctcdelaware.com) and be sure to check out some of the many goodies on their web site http://www.ctcdelaware.com/sitemap.html and conferences@ctcdelaware.com

3 DIMENSIONAL PRE-ACCEPTANCE QUALITY CONTROL:

At Capital Trust we routinely review every trust document that comes though our door before agreeing to serve as initial or successor trustee. The review is threefold: an initial review by one of our marketing officers, a second review by our legal department, and a final review by administration.

These three perspectives often allow us to see things that the drafter may not have seen or to see things in a different light. In addition, we see a broad range of trust documents, varying by the time period in which they were drafted, jurisdiction, which document assembly system is being used, and the nature of the trust itself (charitable, dynasty, etc.).

The perspective, the variety, and the volume create a unique vantage point, which we are utilizing here to pass information on to future drafters and reviewers with the ultimate goal of more professional client service.

THE SEVEN DEADLY SINS:

So here is our list of seven common mistakes in drafting trust documents. The list is not intended to be all-inclusive, nor is it a "how-to" lesson in drafting. Enjoy!

1. FAILURE TO PROOFREAD DOCUMENTS BEFORE EXECUTION

Proofreading a document before execution not only allows you to spot and correct minor typographical, spelling, and grammatical errors. It will (or should) allow you to clear up confusing provisions or clauses.

For example, trust instruments often contain numerous cross-references to other parts of the document. Confusion can arise when a cross-reference refers to a section heading that is not actually in the document or when the section number referred to does not match the heading title. This may sound like an inconsequential matter, and it may be most of the time. But when the trust is meant to outlast the grantor and the drafter, it may indeed lead to unintended and often serious consequences!

2. FAILURE TO CO-ORDINATE DOCUMENTS

The trust is usually just one piece of the overall estate planning puzzle. For the plan to be effective, the trust must fit with the other puzzle pieces, which may include a will, power of attorney, other trusts, retirement plans, and life insurance policies.

Consideration should be given to including the ability to disclaim interests coming to the trust from plans, policies, other trusts, etc. In addition, drafters should determine whether the beneficiary designations of plans are effective for the desired result and permissible, whether similar interests may be merged, and whether an agent under a power of attorney can make amendments, among other things.

Surprisingly, many practitioners do not coordinate trust amendments to the trust document itself. Failure to do so leads to obvious confusion and potential administration that was not intended by the grantor. (This potential arises any time there is room to interpret the document's provisions.) But when is it appropriate to amend, rather than restate the document in its entirety?

Our belief: if more than one article or section will be changed or if it will be one of several amendments made (sometimes it seems a trust is amended each year of its existence!) it is probably better to restate and negate the problems of uncoordinated amendments. Also, it is always better to restate a trust that you did not draft in the first place.

3. OVERLY BURDENSOME DOCUMENTS

There are multiple versions of this sin:

Overdrafting. Although it is never good to leave room to interpret a trust document, drafting for every possible remote contingency is also problematic.

Redundancy. A frequent example of redundancy occurs when the trust is divided into subtrusts and then each subtrust contains the same or extremely similar provisions. Not only is this unnecessarily redundant, but it is also unnecessarily confusing. If there is the slightest substantive change in one subtrust, two possibilities exist, neither of them desirable: if it's something the grantor intended to be different, it may be buried and not carried out; if it's not something the grantor intended to be different, it could be carried out.

Insertion vs. Incorporation. There are many good ideas floating around out there for the taking by practitioners who keep current and strive for superb, up-to-date documents. While there is absolutely nothing wrong with borrowing (indeed, we would like to see more practitioners do so), it can wreak havoc on an otherwise excellent document when the new provision or clause is merely inserted and not incorporated in a well thought out manner. The new provision may conflict with another part of the document or it may be similar but not the same as another provision, leading to the question of which should control.

Overdrafting, redundancy, and thoughtless borrowing lead to documents that are hard to follow – for the trust administrator, for the client and for the beneficiaries.

4. TYING THE HANDS OF THE GRANTOR, BENEFICIARY, OR TRUSTEE

Admittedly, this is not always a mistake; in fact, certain situations demand it. In order to remove or keep assets out of an estate, the grantor's powers should be limited in accordance with the tax code, and, where applicable, the beneficiary's powers should likewise be limited to avoid inadvertently giving them a deemed general power of appointment.

Through proper drafting, such goals can be attained while also allowing the grantor, beneficiaries and trustee some freedom and flexibility. For example, in those instances where you do not want the grantor or beneficiary to have the power to remove and appoint a trustee, give the power to someone else, a trust protector perhaps.

Silence may be golden, but not for the grantor and beneficiaries. Drafters should consider that state law (the default for silence) which will control, will change over time. Being aware of statutory provisions and drafting around them is not only prudent, it will contribute to the smooth operation of the trust for years and possibly generations. Going to court costs money and the outcome may well interfere with the grantor's incompletely stated intent.

5. FAILURE TO DRAFT FLEXIBILITY INTO A DOCUMENT

This is related to sin number 4, but we think it deserves a separate category because there are different concerns here. Above, we were concerned with defaults and limited control over the functioning of the trust. Here, the concern is not providing sufficient flexibility to handle the universal inability to predict future circumstances or changes in law.

Some documents are written so much "in the present", reflecting current laws and personal circumstances, that problems will inevitably arise in the future. Sometimes, statutory law provides this flexibility (some states allow modification of a trust's terms with the consent of the trustee and the beneficiaries, for example). But most of the time it does not.

Allow for amendment to reflect tax law changes! Allow for change of jurisdiction! Allow for change of trustee, investment advisor, and other parties with responsibilities to the trust! Allow for provisions that would prevent efficient administration to be waived! If you do not

want any of these powers held by the grantor, beneficiary or trustee, appoint a trust protector or trust advisor to have them.

6. VAGUENESS

Vagueness differs from and is not equivalent to flexibility. Flexibility means leaving options open for interested trust parties to respond to and address future circumstances. Vagueness on the other hand is not using clear, precise, plain language. (Forget the legalese!)

Sometimes a word or clause can mean two different things to two different people. For example, "No successor trustee will be liable for the acts of any prior trustee until the trust assets are in the possession of the successor trustee." Normally, a trust protects the successor trustee from the acts of prior trustees. So naturally, upon a first reading, this is what comes to mind when reading this sentence. However, read literally, it provides that the successor trustee will be liable for the acts of prior trustees when it has the trust assets in hand. Ugh!

Vagueness could lead to ambiguity, which leads to lawsuits, which leads to court proceedings – all draining valuable trust assets in the process. One good rule of thumb: always define terms that could be subject to different meanings (e.g., adult.) when they are used throughout the document.

7. FAILURE TO MIND THE TAX CODE

Practitioners not thoroughly familiar with the tax code and drafting in practice make good candidates for malpractice.

Estate planning, as opposed to drafting, is tax planning, and tax traps abound for the unwary practitioner. This is especially so when dealing with possible generation skipping taxes, the marital deduction, income and estate charitable deductions, grantor trusts, and irrevocable life insurance trusts, to name just a few.

QUALITY CONTROL EQUALS BETTER SERVICE EQUALS MORE BUSINESS AND LESS AGGREVATION!

In summary, a good trust instrument works for the benefit of all interested parties, is flexible, but not ambiguous, conforms to the tax code, and is easy to read, follow and understand.

As we stated in the beginning (we did, you don't have to double-check) our goal in providing these insights is better client service. Better client service leads to more business, better business, and less potential malpractice woes.

To borrow from one of America's most famous domestic "goddesses" and alleged felons:

"Client service: "It's a good thing!"

HOPE THIS HELPS YOU HELP OTHERS!

Jeffrey R. Lauterbach *Trisha W. Hall*

Edited by Steve Leimberg

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