IS THE WILL DEAD

AS THE

PRIMARY TESTAMENTARY INSTRUMENT?

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This outline should not be utilized as a substitute for professional service in specific situations or to provide legal advice. This outline is intended to provide general information about certain aspects of the law. Since the law changes over time, questions about individual problems should be addressed to the attorney of your choice.

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IS THE WILL DEAD AS THE PRIMARY TESTAMENTARY INSTRUMENT?

I. INTRODUCTION.

A. Origins of Living Trusts.

Living trusts were originally a creation of English law and have been used for over 400 years. In pre-industrial England, wealth and power resided largely in the ownership of land. Inheritance of land was a political matter of direct concern to the king, so land transfers after a death were done through the king's courts. The proceedings were technical, formal and expensive. Living trusts arose as a method for avoiding many of the harsher aspects of this probate. The United States not only adopted the traditional British legal system for land inheritance, but also tossed all types of property, not just land, into our probate courts.

B. Norman F. Dacey.

Norman F. Dacey was an aggressive mutual fund salesman, and developed his attack on probate as part of a sales strategy, peddling mutual funds (with huge and disadvantageous front-end loads). With no law degree, Dacey became famous by tapping into immense public outrage at the probate system.

Although probate-avoidance living trusts have always been legal in the U.S., they remained largely obscure and little understood until Dacey came on the scene. Although Dacey helped popularize living trusts with more progressive attorneys, as well as the public, for many years many lawyers continued to advise that relying on a will to transfer property at death was the only right plan. Living trusts, it was claimed, had grave risks. Some lawyers argued that living trusts were burdensome to maintain, even though in reality no additional paperwork is required once they're set up and property is transferred into the name of the trust. Others claimed that probate provided "protections" that somehow benefited the public.

In 1965, Dacey, a Connecticut resident, was enjoined in the State of Connecticut from engaging in the unauthorized practice of law.[1] That injunction was the outgrowth of a 30-page booklet written by Dacey entitled *A Modern Plan For Your Tomorrows* with the subtitle *An Explanation of the Dacey Trust*. The first six pages of the booklet contain general information about the history and use of intervivos and testamentary trusts, together with some tax information. The balance of the booklet contains a detailed description of the Dacey trust arrangement, consisting of the Dacey trust and the Dacey will, and of the claimed unique advantages of the trust arrangement. The booklet was

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[1] see *Grievance Committee of Bar of Fairfield County v. Dacey*, 154 Conn. 129, 222 A. 2d 339, rehearing den. 387 U.S. 938

supplied to prospective customers who met with Dacey and whom he advised and supervised in the filling of the blanks in the forms. In some instances Dacey supplied forms which varied somewhat from those in the book.

Although it did not appear that Dacey ever charged for the preparation of a trust or will, he did provide in the will form that upon the death of the testator the entire estate, except for tangible personal property, should go into the corpus of the trust and that substantially the entire corpus should be invested in shares of the Wellington Fund which should be purchased from Dacey. Under his contract with the Wellington Fund, Dacey received a 6 percent commission on all sales of shares of the Wellington Fund. Thus, as a direct consequence of his preparation of the Dacey trust arrangement, Dacey virtually assured himself of what amounted to a 6 percent sales commission on almost the entire assets of each estate. The money involved in the trust arrangements prepared by Dacey amounted to several million dollars. On most, if not all, of this sum, he would receive a 6 percent commission.

Dacey also incorporated these intervivos trusts, wills and related forms into his book, *How to Avoid Probate!*. The book itself consisted of approximately 55 pages of text and approximately 310 pages of forms. It toped the best seller list thirteen weeks after publication.[2] It beat *Human Sexual Response* by Masters and Johnson, *In Cold Blood* by Truman Capote, and *Games People Plan* by Eric Berne.

By explaining how to pass property with little or no attorney fees, he drew the ire of many lawyers. The New York County Lawyers' Association brought a proceeding to enjoin publication of the book. On September 12,1967, the Supreme Court Of New York adjudged Norman F. Dacey and Norman F. Dacey doing business as National Estate Planning Council, guilty of criminal contempt of court by reason of the unauthorized practice of the law.[3] Dacey was fined $250 and upon default in payment was to be committed for 30 days. Crown Publishers Inc., Doubleday & Co., Inc. and Brentano's Inc. were likewise found to be engaged in the unauthorized practice of law. They, however, were not held in criminal contempt. All were enjoined from continuation of

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[2] In 1965, the most Popular Nonfiction Books were:

1."*How to Avoid Probate*" ... Norman F. Dacey
2."*Human Sexual Response*" ...Masters and Johnson
3."*In Cold Blood*" ... Truman Capote
4."*Games People Play*" ... Eric Berne, M.D.
5."*A Thousand Days*" ... Arthur M. Schlesinger, Jr.
6."*Everything But Money*" ... Sam Levenson
7."*The Random House Dictionary of the English Language*"
8."*Rush to Judgment*" ... Mark Lane. Holt
9."*The Last Battle*" ... Cornelius Ryan
10."*Phyllis Diller's Housekeeping Hints*" ... Phyllis Diller.

3 Matter of New York County Lawyers' Assn. v. Dacey, 54 Misc. 2d 564

certain acts as set forth in the order and decree. In 1967, the opinion was reversed by the New York Court of Appeals.[4]

Dacey's troubles did not end with the litigation in Connecticut and New York. The Securities and Exchange Commission also censured Dacey and his company in 1970 for attempting to sell mutual fund shares without making proper disclosures.

How to Avoid Probate! has gone through five editions, the last one being printed in 1993. The book is one of the great success stories of American publishing, selling over 2 million copies. Dacey also published *What's Wrong With Your Life Insurance* (1963), *Dacey on Mutual Funds* (1969), *Democracy in Israel* (1976), and *Fight Back : The Prevention and Control of Cancer* (1988).

C. Increasing Life Expectancy and Wealth.

Life expectancy has been increasing rapidly in the United States in the last century. In 1900 life expectancy was 46.3 years for men and 48.3 years for women. In 2000 it was 73.0 years for men and 79.7 years for women. The population of the United States in 1900 was 75,995,000. The population in 1999 was 272,330,000, and it is projected to increase to 393,931,000 by the year 2050. Not only is the population increasing, but the population is aging, and along with an aging population, we are seeing an increasingly wealthy population.

Between now and 2020, Americans between ages 35 and 53 will inherit $12 trillion. The number of millionaires increased from 3,000 in 1900 to 3.5 million in 2000. According to *Forbes Magazine,* the number of billionaires in the U.S. increased to 268 in 1999, from 79 in 1998. The minimum required to be placed on the Forbes 400 list in 1999 increased to $625 million from $500 million in 1998.

The income and wealth disparity between rich and poor continues to widen in this country. The Federal Reserve Board reports that the top one percent of U.S. households have net worths over $2.7 million and account for 35.1 percent of the total net worth in the U.S. The top 10 percent of U.S. households account for 68 percent of total net worth. By contrast, 64 percent of U.S. households have net worths below $100,000 accounting for just 9.8 percent of the nation's total net worth.

D. Effect of Dacey, Wealth, and Longevity.

Certainly, the major tax reform acts in the last 25 years have had a significant effect on transfer planning. There is also little doubt that Dacey, the tremendous increase in wealth, and the increasing life expectancies has led to more efforts for simplified estate administration and probate avoidance.

I have heard that more than 50% of all assets today pass outside the probate system. These transfers take the form of joint tenancy assets with right of survivorship, assets held in living trusts, life insurance, transfer-on-death, and employee benefit plans

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[4] *In the Matter of New York County Lawyers' Association v. Norman F. Dacey et al.,* 283 N.Y.S.2d 984, 28 A.D.2d 161 (October 24, 1967)

among others. Obviously, probate avoidance devices have become increasingly popular over the years, and this trend will in all likelihood continue.

The increasing volume of assets passing outside of probate is the result of the frustration of beneficiaries and lawyers over the time and expense caused by court supervision of the probate process and the administration of estates. Much of this so-called supervision is seen as unnecessary, overly bureaucratic and as a self-serving way of keeping court personnel and probate lawyers busy and enriched.

In Texas, where I practiced for 10 years, there is virtually no court supervision of probate. Texas has recognized the concept of the independent executor for many decades. A lawyer's only contact with the probate court is a short appearance before a probate court to offer the will for probate. Letters testamentary are received immediately, and in the typical estate there is no further contact with the probate court, except to file an inventory. The probate court only becomes involved if a beneficiary is dissatisfied with the performance of the executor or is unable to obtain information from him. In this situation, such a beneficiary can complain to the court, in which case the court will require the executor to respond. Very few require cases require court intervention.

E. Probate Avoidance Devices.[5]

Probate avoidance devices allow an individual to legally pass title to property without the necessity of a probate procedure, creating certain benefits. First, they save the time and expense of a probate proceeding. Second, most probate avoidance devices are not a matter of public record. Third, probate avoidance devices involve a less cumbersome procedure to transfer title following death than probate.

There are three general types of probate avoidance devices: (1) joint tenancies with rights of survivorship; (2) beneficiary designations (including transfer and pay on death designations); and (3) revocable trusts. However, the different devices available are often used by laypersons with little thought given to the potential drawbacks in choosing one probate avoidance device over another.

1. Joint Tenancies with Rights of Survivorship.

An individual may avoid probate by titling property with another person(s) as "joint tenants with rights of survivorship." Joint tenancy ownership is simple and inexpensive to create. To create "joint tenants with right of survivorship" for Kansas property, the language must be clear that a joint tenancy was intended. K.S.A. 58-501. Upon a joint tenant's death, the property interest of the deceased joint tenant immediately passes to the surviving joint tenant(s), and avoids the cost and inconvenience of probate.

Notwithstanding its benefits, joint tenancy ownership has several disadvantages. Setting up joint tenancy ownership with individuals other than a spouse can be financially hazardous. Joint tenants become co-owners and obtain full rights of co-ownership. This means that joint tenancy property is subject to the claims of co-owners, the creditors of co-owners in the event of a garnishment or attachment, and spouses of co-owners in the

[5] The KBA is publishing a new brochure entitled "*Probate Avoidance Devices*.

event of a divorce. Upon death, the survivor or survivors take all, even against lawful heirs of the deceased joint tenant.[6]

Joint tenancy ownership also requires the signatures of all joint tenants (and their spouses with regard to real estate) if the property is to be sold, transferred, mortgaged or otherwise encumbered. This can pose not only logistical problems, but can be particularly problematic if all parties are not willing to execute the necessary documents or if a joint tenant becomes incapacitated.

A significant problem of joint tenancy ownership arises because joint tenancy ownership does not provide for coordination of affairs following the creator's death. When the creator of a joint tenancy ownership dies, no one has authority, at least arising out of the joint tenancy arrangement, to sell property, pay the decedent's debts, or file the decedent's final income tax return or any required Federal or state death tax returns. Another significant problem arises because joint tenants may not die in the anticipated order.

Joint tenancy ownership can also cause adverse gift tax consequences. The act of naming a person as a joint tenant is normally a gift unless the other joint tenant or joint tenants either paid full consideration for a proportionate interest in the joint tenancy property or the joint tenancy is revocable, such as a joint tenancy account in a bank, savings and loan, or credit union.[7] Bank accounts are normally revocable because any joint tenant, including the creator, can withdraw the entire account at any time. Although a donor does not incur a gift tax for a gift to a spouse, gifts to other parties, to the extent of their undivided share of the joint tenancy property, constitute a taxable gift if the gift exceeds the annual gift tax exclusion.

Joint tenancy ownership can also cause adverse estate tax consequences. The death of a joint tenant results in outright ownership in the surviving tenant, causing the property to be includible in the surviving tenant's estate for Federal estate tax purposes, possibly wasting one exemption for federal estate tax purposes. If the surviving tenant is not the surviving spouse, immediate estate taxation could also result depending on the value of the property and the amount of unused estate tax exemption of the first tenant to die. Even between spouses, joint tenancy ownership can cause other problems, such as subjecting the property to the claims of a subsequent spouse upon a remarriage.

Even though joint tenancy ownership between spouses avoids probate upon the first spouse's death, probate would still be required upon the surviving spouse's death unless the surviving spouse subsequently creates and funds a revocable trust. If the creator of the joint tenancy and his or her spouse die simultaneously, probate also would be required because one-half of the joint tenancy is deemed by law to pass through each spouse's probate estate.

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[6] *Walnut Valley State Bank v. Stovall*, 223 Kan. 459 (1978).

[7] *Estate of Buchholtz*, 70 T.C. 814 (1978).

In short, joint tenancy ownership can result in several potential problems which can be mitigated, if not entirely avoided, by proper planning.

2. Beneficiary Designations.

Beneficiary designations are another type of probate avoidance device. Due to recent changes in Kansas law which expanded the ability to use beneficiary designations, there are few types of property located in Kansas which cannot have beneficiary designations. These beneficiary designations are frequently termed "POD" (for "payable on death") or "TOD" (for "transfer on death").[8]

As probate avoidance devices, beneficiary designations provide several advantages over joint tenancies. For instance, because a beneficiary is not a co-owner, property having a beneficiary designation is not subject to the claims of the beneficiary, the beneficiary's creditors, or the beneficiary's spouse in the event of a divorce. Also, for the same reason, no signature of a beneficiary or a beneficiary's spouse is required to convey title to property and naming a beneficiary on property does not result in any adverse gift or income tax consequences. Third, there is no taxable gift for federal gift tax purposes.

As a final benefit of beneficiary designations over joint tenancy ownership, beneficiary designations generally allow for a contingent beneficiary in addition to a primary beneficiary, making it less likely that an individual's estate plan will be distorted if the primary beneficiary does not survive the individual. For example, if a parent has two children and names both of them as primary beneficiaries on property, the parent can name the primary beneficiary's children as contingent beneficiaries. Thus, in the event a primary beneficiary predeceases his or her parent, the predeceased child's interest would go to his or her children as contingent beneficiaries. Conversely, if property is held in joint tenancy ownership, upon a joint tenant's death the property automatically passes to the surviving joint tenants.

Beneficiary designations do not remedy all of the problems of joint tenancy ownership. For married couples, having a spouse as a beneficiary on property means the spouse will succeed to full ownership of the property upon the owner's death. This can subject property to potential spousal mismanagement and the claims of the spouse's creditors or those of a subsequent spouse. It can also place too much property in the surviving spouse's estate for Federal estate tax purposes and create Medicaid qualification problems. For single individuals, outright ownership in a beneficiary can subject the property to a beneficiary's mismanagement, to the claims of a beneficiary's spouse and creditors, to potential Federal estate tax or state death tax liability upon the beneficiary's death, and preclude the beneficiary's eligibility for governmental resource benefits such as Medicaid or SSI. As noted above, these problems may be minimized by placing property in trust under the provisions of a Will or Revocable Trust for the benefit of the beneficiary.

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[8] K.S.A. § 59-3501, et seq.; K.S.A. § 17-49a01, et seq., with respect to securities; K.S.A. 9- 1215, 9-1216, 17-5828, 17-5829, 17-2263 and 17-2264, with respect to payable on death accounts.

For unmarried individuals, or for married individuals who want a substantial amount of their property to pass to their children at the death of the first spouse, beneficiary designations also fail to provide for the coordination of the decedent's estate.

In addition, if beneficiary designations are part of an estate plan in which it is desired the beneficiaries share proportionately, the estate plan may be distorted unless the beneficiaries are named to share proportionately on each and every item of property that carries a beneficiary designation. Otherwise, a beneficiary's inheritance will depend upon the value of the asset on which he or she is named as a beneficiary and should the owner or the owner's legal representative (e.g., following the owner's incapacity) sell the property having a beneficiary designation, that beneficiary is disinherited.

3. Revocable Trusts.

Revocable trusts solve many of the problems characteristic of joint tenancy ownership and beneficiary designations. The grantor transfers property to the trust, and the trustee has the legal responsibility of managing, investing, and distributing the property in accordance with the provisions of the trust instrument. Revocable trusts avoid probate because the title to property placed in the trust is in the name of the trustee at the time of the grantor's death, and the trustee (or the named successor trustee if the grantor was serving as trustee during the grantor's lifetime) has full authority under the instrument to sell and transfer the property.

Revocable trusts are particularly advantageous as probate avoidance devices because, unlike joint tenancies or beneficiary designations, they can be used with virtually all types of property, no matter where it may be located. In addition, by providing for contingent beneficiaries under the trust provisions in the event any trust beneficiary predeceases the grantor, they avoid the distortion of the disposition of the grantor's estate which might otherwise occur through the use of joint tenancy or beneficiary designations. Revocable trusts allow the grantor to avoid probate, while reserving in the grantor the right to control the trust property and amend or revoke the trust at any time.

In addition to the foregoing advantages, there are two situations in which revocable trusts are particularly desired over other probate avoidance devices: (1) when the owner of property wants to avoid probate, but does not want to leave assets outright to beneficiaries following the owner's death; and (2) when the owner of property wants to avoid probate, but desires coordination of the affairs of the estate after death.

Revocable trusts have a few potential disadvantages, including (i) a greater initial cost and effort in titling assets in the trust; and (ii) lack of court supervision (which is a reason in and of itself to use trusts). The risk of probate with revocable trusts is minimized with proper supervision of the re-titling process and the use of universal assignment documents. While revocable trusts avoid probate, they have no estate or death tax planning advantage over wills, nor do they normally significantly accelerate the disposition of the estate upon a decedent's death over property passing through probate, as the trustee still must file required tax returns, sell property of the decedent not passing directly to family members, and settle the decedent's debts.

When an individual leaves assets in trust for beneficiaries, as noted above, asset protection planning can be achieved. The trust provisions normally protect the assets from the claims of the beneficiary's creditors or spouse, exclude all or a substantial portion of property from the beneficiary's estate for Federal estate and state death tax purposes, and preclude trust assets from being considered a resource for governmental resource benefits such as Medicaid or SSI. If there is no desire to protect the trust assets from the beneficiary's mismanagement, the beneficiary can be named as trustee and be given authority to expend trust assets for the beneficiary's health, education, support and maintenance needs, as well as providing for such needs for the beneficiary's family members. If protection against mismanagement is desired, the grantor would name a third party as Trustee.

Even if a grantor desires to leave assets outright following the grantor's death, a revocable trust is beneficial in that it can be used to coordinate the affairs of the estate after the grantor dies. The grantor may name a trustee to file any required tax returns, pay any debts of the grantor, sell any property that must be sold upon the grantor's death, and distribute the remainder of the trust estate (including the personal effects) as directed by the grantor in the trust instrument. As discussed above, joint tenancy ownership and beneficiary designations do not provide for coordination of affairs following death. A will provides for coordination of affairs upon death, but not without probate. Thus, a revocable trust is the only estate planning technique which both avoids probate and provides for coordination of the decedent's affairs and property distribution following death.

F. The Selling of Living Trusts to the Public.

Many books are available to the public that promote living trusts. The main theme in promoting these books is that living trusts help to avoid probate first and save taxes second. A secondary theme of some books is the avoidance of attorneys. Some of the more common titles now available are:

> *Understanding Living Trusts – How You Can Avoid Probate, Save Taxes and Enjoy Peace of Mind*, by Vickie Schumacher
>
> *The Living Trust – The Failproof Way to Pass Along Your Estate to Your Heirs Without Lawyers, Courts, or the Probate System*, by Henry W. Abts III
>
> *Your Living Trust & Estate Plan – How to Maximize Your Family's Assets and Protect Your Loved Ones*, by Harvey J. Platt
>
> *Make Your Own Living Trust – Avoid Probate, Cut Estate Taxes*, by Denis Clifford

Nolo, the publisher of *Make Your Own Living Trust – Avoid Probate, Cut Estate Taxes*, had to relive the Dacey litigation of 35 years ago. A Texas Supreme Court Unauthorized Practice of Law Committee tried to ban Nolo's products from Texas. In a 1999, the Committee announced its decision to drop its investigation of Nolo and other self-help law publishers. The Committee's decision to fold its cards was based on a Texas statute signed into law in June of 1999 (HB 1507) that exempts publications and products such as Nolo's from the unauthorized practice of law. To get the benefit of the new

statute, Nolo and other publishers are supposed to put statements on their products that the products are not a substitute for advice from a lawyer. This book contains such a disclaimer.

G. What Prompts the Probate Avoidance Message?

The perception [or reality] about costs of a probate proceeding (because of fees of lawyers and executors) is probably the biggest factor that fuels the promoters of living trusts and the public's interest in probate avoidance devices. Certainly, the high (or certainly higher) cost of probate in some states, such as California, Florida, and New York, has been fueling the "bad" press about probate the most. The far cheaper costs of probate in some states, such as Texas (which has the "independent executor"), gets lost in the fog. With the mobility of the population, the high cost factor gets spread far more and faster among the states than any legitimate competing factor. Bad news spreads faster.

The second biggest factor is the time the probate process can take, which is closely related to the "loss of control" factor over the decedents assets. Certainly, there is some truth to this factor, at least with respect to some estates. With larger estates, the probate process is not the limiting factor.

Loss of privacy is the next most often cited factor. We all read about the wills of Jacqueline Kennedy and that of Natalie Wood, but how many of us have the opportunity or desire to go to the courthouse to read wills. However, there are some that do – perhaps telemarketers?

Often times the message "avoid probate" completely overshadows the reason (some legitimate – some not) to avoid probate, with the result that many clients now want to avoid probate because (and only because) that is the message they have heard for years.

H. For Every Action there is an Opposite [and Equal?] Reaction.

Not to be outdone by the promoters of books selling probate avoidance and living trusts to the public are the naysayers. One, but not the only one, of the more notable books, at least by its title, is:

Living Trust, Living Hell – Why You Should Avoid Living Trusts, by John P. Huggard

Mr. Huggard is a lawyer, professor and a member of a North Carolina law firm (he calls himself the senior member). He is also board certified in estate planning and probate law in North Carolina. His book is aptly titled – at least based on its content. In his introduction, he states that an increasing portion of his income comes from helping clients get out of living trusts. Its hard to tell why he is so negative, but his book has just as many statements and examples (bad facts make bad law) taken out of context as the bookstore books promoting living trusts. The most pausible explanation of his depressing title and analysis is that it is his marketing strategy to the public, perhaps to attract clients who have been sold living trusts at ballroom seminars sponsored by promoters of living trusts.

II. COMPARISONS AND DISTINCTIONS

A. Advantages and Disadvantages.

1. Are Living Trusts the Perfect Solution?

Living trusts serve several purposes, some purposes more important to clients than other purposes. Certainly, one size doesn't fit all as the ballroom promoters would have one believe. They are certainly a solution, with many positive attributes and some negative. In preparing an estate plan for a client, an attorney who is a proponent of living trusts in general should ask the question – "Is there some particular reason why this client should not use a living trust?" An attorney who is a proponent of wills only in general should ask the question - "Is there some particular reason why a living trust would better serve this client?"

None of us should always be on one side of the "living trust" fence – we must make a judgment decision about what is best for the client. Even if we believe one solution is "best" for a client, the client may have a predisposition towards or against living trusts in general (because he read some of the books mentioned above) or attended a ballroom seminar. How much time should be spent in educating the client that there must (or might) be a better mousetrap? And does it really make a difference in the long run?

2. Do Living Trusts Reduce Litigation?

One of the reasons frequently cited by estate planners for the desirability of the *intervivos* trust estate plan is that a trust is more difficult to contest than a will. A 1990 review[9] of statutory authority and case law by the Will and Trust Contests Subcommittee of the ACTEC Fiduciary Litigation Committee suggests that there is some validity to this belief, since there appear to be relatively few reported cases regarding contests of *intervivos* trusts. However, the Committee concluded that because the *intervivos* trust is relatively new as an estate planning strategy, this lack of reported cases may simply be a result of fewer instances of trust contests, as compared to the traditional volume of will contests. Huggard, in *Living Trust, Living Hell*, cites the confidential nature of living trusts (which he assumes continues after death for the benefit of the settlor) as a reason such trusts promote and encourage litigation instead of reducing it.

3. Privacy – Does Anyone Care?

The privacy advantage of living trusts is probably oversold. The contents of someone's living trust are of little or no interest to most people. Even if someone has an interest, if the living trust leaves assets to the "natural objects of your bounty" what difference would it make if someone obtained a copy of the trust? Perhaps the privacy advantage has more meaning when assets are left in unusual ways, when second or greater marriages with children of the prior marriages are involved, or charitable gifts are made where the donor wishes to remain anonymous. However, certain wealthy

[9] *Contesting Inter Vivos Trusts, T. Jack Challis 2000*, ACTEC Notes 221 (2000). ACTEC is the American College of Trust and Estate Planning Council.

individuals who are public figures may be more interested in the privacy issue, both as to the contents of their estate plan and the value of their estates, in which case a living trust and funding of the living trust will be required.

4. Cure for Incapacity.

One frequently proclaimed benefit of living trusts is their ability to avoid conservatorship in the event of incapacity. This benefit is probably overstated somewhat. Durable powers of attorney normally can secure the same benefit at a lesser cost, although such powers may not be accepted by third parties. Some states require powers of attorney to be recognized by third parties – Kansas does not.[10] Even with a living trust, it is desirable to have a durable power of attorney to cover any non-trust assets, as well as the ability to deal with personal decisions having no bearing on trust asses, such as income tax returns, lawsuits, etc. It should also nominate a conservator in the event one would become necessary.

5. Basis Step-up Opportunities.

In general, we all know that living trusts are not vehicles to save taxes, whether income taxes or estate taxes. The living trust is simply ignored while the settlor is alive. Only at death does the living trust become a separate taxable entity.

However, there are some ways where income taxes might be saved with the use of a living trust that can't be accomplished with a will. For example, if husband and wife own highly appreciated assets as tenants in common, and they have wills which leave all to the survivor. If the husband dies first, he is the owner of one-half the assets in question, and because of Section 1014 of the Internal Revenue Code (which says that all property owned at death (with some exceptions) is includible in the decedent's gross estate for federal estate tax purposes), one-half of the assets passing to the wife under the will receive a step-up. The other one-half of the assets owned by the wife do not receive a step-up.

However, let's have the husband and wife place these assets in a joint revocable trust for their benefit, and have them grant each other (in the trust agreement) a testamentary general power of appointment exercisable alone and in all events, to appoint part or all of the assets of the trust to the estate of the first spouse to die or to anyone the deceased spouse may appoint. If either spouse dies, then all assets in the joint trust will be included in that spouse's estate for federal estate tax purposes. Certainly, one-half of the assets receive a step-up, and as long as §1014(e) of the Internal Revenue Code doesn't apply, then both halves receive a new tax basis.

Section 1014(e) is entitled "Appreciated property acquired by decedent by gift within 1 year of death." It provides that:

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[10] For example, IL ST CH 110 1/2 ¶ 802-8 provides, in part:

> "Each person to whom a direction by the named agent in accordance with the terms of the copy of the document purporting to establish an agency is communicated shall comply with that direction, and any person who fails to comply arbitrarily or without reasonable cause shall be subject to civil liability for any damages resulting from noncompliance."

"... if (A) appreciated property was acquired by the decedent by gift during the 1-year period ending on the date of the decedent's death, and (B) such property is acquired from the decedent by (or passes from the decedent to) the donor of such property (or the spouse of such donor), the basis of such property in the hands of such donor (or spouse) shall be the adjusted basis of such property in the hands of the decedent immediately before the death of the decedent."

In the above example, there was no gift by the wife to the husband as to one-half of the assets. The wife merely gave her husband a testamentary general power of appointment over her one-half, and he didn't exercise the power.

That is essentially what the taxpayers did in PLR 200101021, except that the technique was used to fully fund a credit shelter trust for the benefit of the surviving spouse regardless of who might die first. In that ruling the Internal Revenue Service stated:

"In addition, section 1014(e) will apply to any Trust property includible in the deceased Grantor's gross estate that is attributable to the surviving Grantor's contribution to Trust and that is acquired by the surviving Grantor, either directly or indirectly, pursuant to the deceased Grantor's exercise, or failure to exercise, the general power of appointment."

Perhaps this basis step-up technique will work, but it seems probable that the Internal Revenue Service will take issue with it.[11] Certainly, if the assets remain in the names of the spouses as tenants in common or joint tenants (instead of being placed in a joint living trust), then it is clear that a step-up occurs as to only one-half of the assets.[12]

In larger estates, where there is a desire to fully fund a credit shelter trust or gain a step-up in basis, it is probably better to use separate trusts with reciprocal general powers of appointment instead of a joint trust. However, a joint trust with reciprocal general powers of appointment to gain a step-up in basis may be preferable in smaller estates. If separate trusts are used, then, because of real ownership transfer issues (the first spouse to die might just exercise the power), the testamentary power should be limited, for example, in exercise to the creditors of the decedent's estate (which is still a general power). This technique of reciprocal general powers is probably of less utility in second and subsequent marriages.

6. To Transfer Assets or Not.

Avoiding probate comes at a cost – to avoid probate, assets must be held in trust, owned in joint tenancy with right of survivorship, or be subject to a beneficiary or pay on death form. Pay now or pay later is for sure, and the only question is whether you pay more now or pay more later. It all depends on the nature and extent of the assets now and the nature and extent of assets might be at death. In general, the younger and more active clients are, the more difficult it is to say "transfer all your assets into the trust now," or

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[11] See also 2002210051.

[12] Community property assets have an advantage in that the entire property receives a step-up at the first death.

stated differently, the older and less active clients are, the easier it is to say "transfer all your assets into the trust now."

Some practitioners prefer to have clients actually change title of assets to their living trust, while others prefer to use a declaration of trust ownership form. Actually changing title to the clients living trust most likely avoids any future problems with third parties (such as transfer agents), but it is easy to overlook some assets currently held, and even easier to forget about the trust with respect to assets acquired in the future. Relying on a declaration of trust ownership is somewhat problematical because of the possibility that it won't be recognized by a third party when the client (or successor trustee) needs it. Perhaps an actual transfer of most assets to the living trust in combination with a declaration of ownership is desirable, especially if probate avoidance is an important goal in having the living trust.

The case of *Taliaferro v. Taliaferro*[13] recognized validity of the declaration of trust ownership. The Court held that the declaration of trust is enough to "fund the trust," and transfer of legal title to the trust is not necessary. However, the Court also stated "it is the commended practice to execute documents of transfer. Such documents may help . . . avoid the necessity of probating the property . . ." Section 22 of the new Kansas Uniform Trust Code further validates the use of a declaration of trust ownership. Section 22 reads, in part, as follows:

> "A trust may be created by . . . (2) declaration by the owner of property that the owner holds identifiable property as trustee, so long as such property would not otherwise pass at the owner's death by a beneficiary designation to a party other than the trust;"

Whether we use a will or a pour over will and living trust, we always need to be mindful of life insurance policies, IRAs and retirement benefits. The beneficiary designations need to be coordinated with the overall estate plan, which means a trust (either under the will or under the living trust) might need to be named as beneficiary. Too often, the beneficiary forms our clients have signed for these types of assets result in a different distribution scheme than does the estate plan. It is not uncommon to see these beneficiary designation name the surviving spouse as the primary beneficiary, followed by the surviving children (i.e., grandchildren are omitted), or minors are named as beneficiaries which may require a conservatorship. These beneficiary designation forms should always be examined and new ones will often be required. If a new one is required, the pre-printed form of the institution may have to be revised substantially.

Real property transfers require special attention, and a complete treatment of this issue is beyond the scope of this presentation. However, since most real properties secure a mortgage or deed of trust, attention must be paid to the "due on sale" provisions of those instruments. Under federal law, real property that is the residence of the settlor may be transferred into a revocable living trust, and the mortgagee may not invoke the "due on sale" clause of the security instrument.[14] On the other hand, a mortgagee must provide

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[13] 260 Kan. 573, 921 P.2d 803 (Kan Sup Ct. 1996).

[14] See Garn-St. Germain Depositary Institutions Act of 1982, 12 U.S.C. § 341(d)(8).

consent to any transfer of real property that does not constitute the residence of the settlor into a revocable living trust. Often this is not a problem so long as the mortgagee is given a copy of the revocable trust agreement, although the mortgagee may require certain language to be included in the deed. Any such mortgagee should be contacted prior to transferring the non-residential property into trust to assure compliance with the security instrument.

7. Title Insurance.

Transfer of real estate into a revocable trust may result in loss of owners' title insurance coverage. The trust may be treated as an entity, separate and distinct from the transferor.

In a Wyoming case, a Colorado domiciliary purchased ranch land in Wyoming. An owners' title insurance policy was obtained. It contained no exclusions relating to access. After holding title to the property in his own name for some time, the owner, shortly before his death, *conveyed the ranch by quit claim deed into his revocable trust*. After the death of the purchaser-settlor, the successor trustee, Covalt, sold the property, and the buyers requested insured access. Certain Indian tribes in the vicinity made claims resulting in a dispute over access to the land and the title company therefore refused to guarantee access. The title company further took the position that the purchaser's transfer of the ranch into his revocable trust was a conveyance that terminated the company's title policy obligations. A reduction in the sale price of $60,000 was negotiated, and the successor trustee sought recovery from the title company.

The 10th Circuit Court of Appeals held, in *Covalt v. First American Title,*[15] that"[t]he plain language of the policy limits coverage to the [individual purchaser] and to his heirs, devisees, and personal representatives. The [purchaser's] trust is not [such a person - not an heir, devisee nor fiduciary] thus the [title] policy does not cover the transfer of the property into the former insured's revocable trust."

To avoid the loss of title insurance upon transfer to a revocable trust, the deed of conveyance probably should be at least a special warranty deed. Before recording, the executed deed should be forwarded to the title company with a request for an endorsement to the title policy adding the grantee to the policy as a named insured.

B. Creation Issues.

1. Validity Of Testamentary Pourovers.

In the earlier days of our practices, there was some question about the validity of testamentary bequests to living trusts. However, in every jurisdiction now, a testamentary bequest or devise to a trustee of an amendable intervivos trust (which must be funded at least with the right to receive life insurance proceeds and/or other assets of nominal value), in existence at or prior to the date of the will, is valid even if the trust was amended after the date of the decedent's last will but prior to his death, and property so bequeathed or devised shall be treated as an addition to the trust and governed by the

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[15] *Covalt v. First American Title Ins. Co*., 105 F.3d 669 Table, Unpublished Disposition (C.A.10,1997).

terms of the trust as amended. A revocation of the trust before the death of the testator will cause the disposition to fail unless the testator has made an alternative disposition.

The statutes of some states (including Kansas) are broader and, among other things, permit pourovers (1) to trusts established or amended after the date of the will and, if so authorized by the will, after the death of the grantor; and (2) to trusts, regardless of the existence, size, or character of the corpus of the trust. K.S.A. 59-3101, Testamentary Additions to Trusts, provides:

> "Subject to the provisions of K.S.A. 59-1701 [dealing with corporate fiduciaries], a devise or bequest, the validity of which is determinable by the law of this state, may be made by a will to the trustee or trustees of a trust established or to be established by the testator or by the testator and some other person or persons or by some other person or persons (including a funded or unfunded life insurance trust, although the trustor has reserved any or all rights of ownership of the insurance contracts) if the trust is identified in the testator's will and its terms are set forth in a written instrument (other than a will) executed before or concurrently with the execution of the testator's will or in the valid last will of a person who has predeceased the testator (regardless of the existence, size, or character of the corpus of the trust). The devise or bequest shall not be invalid because the trust is amendable or revocable, or both, or because the trust was amended after the execution of the will or after the death of the testator. Unless the testator's will provides otherwise, the property so devised or bequeathed (a) shall not be deemed to be held under a testamentary trust of the testator but shall become a part of the trust to which it is given, and (b) shall be administered and disposed of in accordance with the provisions of the instrument or will setting forth the terms of the trust, including any amendments thereto made before the death of the testator (regardless of whether made before or after the execution of the testator's will) and, if the testator's will so provides, including any amendments to the trust made after the death of the testator. A revocation or termination of the trust before the death of the testator shall cause the devise or bequest to lapse."

2. Due Execution and Capacity.

In a will contest action, the party seeking to uphold the validity of a will must generally prove due execution of the document and compliance with statutory formalities. In Kansas, a person signing a will must be at least age 18 or have rights of majority. Two competent witnesses must sign as well. Some states require three witnesses. Does applicable state law contain any statutory formalities for the creation or execution of an intervivos trust? Have formalities been established or developed by case law or by custom and practice? There appear to be relatively few states having statutory requirements for the creation of an intervivos trust beyond the requirement that such a trust be a written instrument.

In Florida the testamentary aspects of an express trust are invalid unless the trust is executed with the formalities required for a will.[16] There is an exception for a trust created by a non-resident settlor, when the trust was executed outside of Florida and was

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[16] Fla. Stat. Ann. § 737.111(1) (West 1995), with reference to formalities of will execution in Fla. Stat. Ann. § 732.502 (West1995). The will statute requires attestation by two witnesses.

valid under laws of the resident jurisdiction when and where created. The *Restatement 3d of Trusts* provides that testamentary trusts are subject to the same formal requirements for the valid execution of a will, but an intervivos trust is not subject to the formal requirements necessary for the valid execution of a will.

In most jurisdictions, including Kansas, neither witnesses nor a notary are required to create an intervivors trust. Under Section 23 of the new Kansas Uniform Trust Code, effective January 1, 2003, a trust is created if the settlor has capacity, indicates an intent to create a trust, the trust has a definite beneficiary, the trustee has duties to perform, and the same person is not the sole trustee and sole beneficiary. [17] Regardless of differences, if any, in capacity now in executing wills and living trusts, the test for capacity will be the same after this year with the enactment of Section 45 of the Kansas Uniform Trust Code. Section 45 provides:

> "CAPACITY OF SETTLOR OF REVOCABLE TRUST. The capacity required to create, amend, revoke, or add property to a revocable trust, or to direct the actions of the trustee of a revocable trust, is the same as that required to make a will."

Some practitioners may suggest we should consider including witness/attestation provisions in trusts, similar to parallel provisions in wills, in view of the mobility of settlors and in anticipation of a statutory requirement similar to that in Florida. However, such a practice should not be necessary. Both Florida, and the new Kansas Uniform Trust Code, have provisions [18] that recognize trusts which are valid where executed.

3. Understandability of Documents.

Is a will by itself any simpler than a pour over will and living trust? Probably, but not by much – it really depends on the draftsman and drafting.

The answer is obvious – they are all complex, especially to the layperson client. We have to include in our instruments complex definitions and formulae in the larger estates where estate tax savings are important, definitions of issue and descendents, provisions for executor and trustee powers, distribution powers and provisions for all the trusts, savings clauses, contingent trusts, guardianship appointments, and on and on. Our

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[17] Section 23 provides, in part:

(a) A trust is created only if:

(1) The settlor has capacity to create a trust;
(2) the settlor indicates an intention to create the trust;
(3) the trust has a definite beneficiary or is:

(A) A charitable trust;
(B) a trust for the care of an animal, as provided in section 29, and amendments thereto; or
(C) a trust for a noncharitable purpose, as provided in section 30, and amendments thereto;

(4) the trustee has duties to perform; and
(5) the same person is not the sole trustee and sole beneficiary.

(b) A beneficiary is definite if the beneficiary can be ascertained now or in the future, subject to any applicable rule against perpetuities.

[18] 4. Fla. Stat. Ann. § 737.111(2) (West 1995); Section 24, Kansas Uniform Trust Code.

documents read like a James Joyce novel, fit to be read and studied only in the classroom or courthouse.

Of course, this is not all our fault. Laws have become more complex and tax savings more important, and if someone is unhappy, litigation is more likely, making us anticipate and draft for all the possibilities. In the last 30 years, the regulations under the Internal Revenue Code have multiplied by at least a factor of four, maybe five, and we have had to react to the expanding laws and estate planning options. Is it any wonder that clients are more often than not signing complex documents with little review?

What can we do about this? Is there any way we can have clients leaving our office saying "wow, that is a neat will and trust – I even understand it!" I doubt it but we can try. One way is to write more simply with shorter sentences. Even I have difficulty in reading someone else's will and trust that may be technically great but grammatically a nightmare. We all have our forms, and we have spent a lot of years making them the best – at least in our eyes.

Stanley Johanson, Professor of Law, University of Texas, has long been a proponent of simpler and more readable wills and trusts. About 10 years ago, the Houston law firm of Vinson & Elkins hired Professor Johanson to be Of Counsel to the firm. One of his responsibilities was to assist in the redrafting their will and trust forms. He currently teaches in his Wills and Estate Planning course an outline developed by him entitled "User-Friendly Will Drafting." One suggestion of Professor Johanson in measuring readability of our documents is to use the Fog Index.

The Fog Index is a proven method of analyzing written material to see how easy it is to read and understand. The steps you can use to calculate the Fog Index are outlined below.[19] The "ideal" Fog Index level is 7 or 8. A level above 12 indicates the writing sample is too hard for most people to read.

Other tools include the grammar checker in Microsoft Word. Under the TOOLS Menu, Microsoft Word contains a grammar checker, as well as a word counter and thesaurus. These tools can be used to help simplify your writing style. The grammar checker doesn't use the Fog Index. It uses three Flesch tools to analyze style:

? Flesch Reading Ease (100 = easiest, 70-80 = average)

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[19] Find the average number of words you use per sentence. Take a fair sample of 5 to 8 sentences. Count clearly independent clauses as separate sentences. Example: "By and by I ran; I jumped; I hid." This counts as three sentences.

Calculate the percentage of words that are three syllables or more. Don't count proper names. Don't count verbs that make three syllables or adding -es or -ed.

Add these two figures. Example: if your average number of words per sentence was 15, and the percentage of words three syllables or more was 12%, you would add 15 and 12 to get 27.

Multiply that sum by 0.4. The resulting number is your Fog Index, a rough measure of how many words of schooling it would take to understand what you have written. In our example, multiplying 27 by 0.4 equals a Fog Index of 10.8. The Bible, Shakespeare, Mark Twain, and TV Guide all have Fog Indexes of about 6. Time, Newsweek, and the Wall St. Journal average about 11.

? Flesch Grade Level (Assigns a grade level reader must have to understand your writing, 6 = average)

? Flesch Kincaid (Another formula for determining reader grade level)

The grammar checker will also report the percentage of sentences written in the passive voice. Acceptable percentages for sentences with passive voice are zero! The grammar checker will also find typos that spell checkers miss, like transpositions, capitalization errors and double words.

For example, the following pour over bequest to the revocable trust is perhaps too wordy:

> "I hereby give, devise and bequeath to the then acting Trustee under the Trust Agreement previously executed on January 1, 2002, by Jane Doe, as Trustor, and Jane Doe, as Trustee, all of the rest, residue and remainder of my interest in any property which I may own at the time of my death (including lapsed and void bequests and devises)."

For this paragraph with 61 words, the Flesch Reading Ease is 10.3 and the Flesch Grade Level is 12.0 – not good.

Why not shorten this sentence to read more simply? Is "*I give, devise and bequeath*" more meaningful than "*I give*"? Is "*all of the rest, residue and remainder of my interest in any property"* more meaningful than "*all of the [rest or residue or remainder] of my property*"?

> "I give my remaining property to the Trustee under my Revocable Trust Agreement. I created the Revocable Trust Agreement on January 1, 2002. This gift shall include any lapsed and void bequests."

A sentence with 61 words has been reduced to three simpler sentences with 32 words. However, for this revised paragraph, the Flesch Reading Ease is 45.2 and the Flesch Grade Level is 9.2 – not good but better.

Compare the following two paragraphs in a living trust. The first paragraph uses the impersonal noun – "Trustor's" or "Trustor," while the second paragraph uses personal pronouns – "I," "my," "me." Which one will the client most likely read? Why can't we make a trust read more personal like a will?

> "If the Trustor's Husband survives the Trustor, the Trustor gives the Unused Tax-Exempt Amount to the Trustee under the Article of this Trust Agreement entitled "THE TAX AVOIDANCE TRUST." If the Trustor's Husband does not survive the Trustor, this gift shall lapse."

Compare the above paragraph with 42 words, a Flesch Reading Ease of 54.5, and a Flesch Grade Level of 10.8, with the following:

> "If my Husband survives me, I give the Unused Tax-Exempt Amount to the Trustee of The Tax Avoidance Trust. If my Husband does not survive me, this gift shall lapse."

This paragraph has been reduced to two simpler sentences with 30 words, a Flesch Reading Ease of 75.9 and a Flesch Grade Level of 6.3 – much better.

4. Drafter as [Principal] Beneficiary.

Prior to July 1, 2002, K.S.A. §59-605 applies to wills and provides that a will is void if the will was prepared by the "sole or principal beneficiary" who was in a position of confidence with the testator unless the testator knew the contents of such will, and had independent advice.

K.S.A. §59-605 has been amended effective July 1, 2002 to void *any* bequest to the preparer or relatives of the preparer unless the preparer is related to the testator and doesn't take more than an intestate share, or the testator knew the contents of such will and had independent advice. As amended, K.S.A. §59-605 provides:

> "Any provision in a will or trust, written or prepared for another person, that gives the writer or preparer or the writer's or preparer's parent, children, issue, sibling or spouse *any devise or bequest is invalid* unless: (a) The writer or preparer is related to the testator or grantor by blood or marriage and such provision that gives such devise or bequest does not give the writer or preparer or the writer's or preparer's parent, child, issue, sibling or spouse more than the writer or preparer or the writer's or preparer's parent, child, issue, sibling or spouse would receive under the laws of intestate succession; or (b) it affirmatively appears that the testator or grantor had read or knew the content of the will or trust and had independent legal advice with reference thereto. As used in this section, ''children'' and ''issue'' shall have the same meaning as provided in K.S.A. 59-501, and amendments thereto."

Section 27(b) of the Kansas Uniform Trust Code, effective January 1, 2003, provides a more liberal rule. In a living trust, a bequest to the preparer or relative of the preparer will be invalid unless the preparer is related to the settlor (regardless of the amount of the gift), or the settlor knew the contents and had independent advice. Section 27(b) reads as follows:

> "(b) Any provision in a trust, written or prepared for another person, that transfers property and that gives the scrivener or the scrivener's parent, children, issue, sibling or spouse *any direct or indirect gift is invalid* unless: (1) The scrivener is related to the settlor by blood or marriage; or (2) it affirmatively appears that the settlor had read and knew the contents of the trust and had independent legal advice with reference thereto. The words ''children'' and ''issue'' as used in this section, are defined in K.S.A. 59-501, and amendments thereto."

5. Two Better than One?

From *In Re Estate of Leonard Mettee*,[20] we know that having a testator execute more than one original will is asking for trouble. In that case, where an original and two photocopies of will were executed with required testamentary formalities. The original was retained by testator but could not be found after his death. Because of the lost original, the Supreme Court held that a rebuttable presumption arose that testator revoked the will or destroyed it with intention of revoking it.

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[20] 10 Kan.App.2d 184, 694 P.2d 1325 (Kan. App. 1985), judgment affirmed, 237 Kan. 652, 702 P.2d 1381 (Kan. 1985).

Is the rule the same for revocable trusts? No, as it makes no difference how many original trust documents are executed, as long as the trust provides a method for its revocation or amendment such as shown in the above example. Thus, it is not near as important to keep the trust in a safe place, such as a lock box, because any copy of the trust will be evidence of its terms.[21] If the trust contains no method, and after January 1, 2003, the method, if any, is not exclusive, it is not clear if a missing original of the trust might be deemed to be equivalent to a revocation. After January 1, 2003, does a missing trust original "manifest clear and convincing evidence"[22] of intent to revoke? See Article II.C.2 below where the new Kansas Uniform Trust Code is discussed.

6. Taxation of Living Trusts.

A transfer to a living trust (a grantor trust under the income tax law) is not treated as an actual transfer which triggers any tax consequences, and the grantor of the trust is taxed on all items of trust income. A separate income tax return and federal EIN is not required if the grantor is the co-trustee or the sole trustee. IRC Reg. §1.671-4(b).

There is virtually no difference between the tax savings between a living trust and an equivalent estate plan utilizing only a will. Or stated differently, an estate plan that could be incorporated into a will can be included in a living trust with virtually identical tax results.

If an executor is appointed as a result of the probate of a decedent's will, it is usually a good idea to notify the Internal Revenue Service of the appointment of the executor. That notification is made by filing IRS Form 56 (Notice Concerning Fiduciary Relationship) with the Internal Revenue Service. If no will is probated because all assets are held by a living trust, the trustee should file the same form. That allows the executor/trustee to receive notices and communications from the Internal Revenue Service that might otherwise go to the decedent's address, leaving the executor/trustee potentially exposed to unpaid income tax liabilities.

All trusts, with certain exceptions, must adopt a calendar year as their tax year. The fiduciary of an estate may adopt in its first return either the calendar year or any acceptable fiscal year as the estate's tax year. The Taxpayer Relief Act of 1997 added Code Sec. 645, which permits an executor and a trustee to elect that a qualified revocable trust be treated and taxed as part of a decedent's estate for income tax purposes. The Section 645 election makes available to trusts some of the income tax advantages traditionally available only to estates. Making the election means that only one Form 1041 (fiduciary income tax return) is filed, rather than separate returns for the trust and the estate. Under proposed regulations, an electing trust is no longer required to file an income tax return for the balance of the taxable year after the date of death. During the election period, the trustee has to file only one fiduciary income tax return for the

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[21] The principal drawback of a lost original would be the inability to file the trust, if otherwise notarized, with the register of deeds.

[22] Section 46(c)(2)(B), Kansas Uniform Trust Code: ". . . any other method manifesting clear and convincing evidence of settlor's intent"

combined trust and estate under the name and taxpayer identification number (TIN) of the estate. All items of income, deduction, and credit are combined. If there is no estate representative, the trustee files the Form 1041. The electing trust is treated as part of the related estate.

There are also other tax issues, elections and decisions that the executor/trustee must/may make in the event of the grantor's death. For example, will income tax returns have to be filed for the decedent? Should the decedent's final return be a joint return with the surviving spouse? Has a joint return covering the decedent's final tax year been filed by the surviving spouse without the executor's consent? Will income taxes of the decedent have to be paid? Will gift tax returns have to be filed for the decedent? Are gift taxes due on transfers made by the decedent before his death? Has consent been given for gift splitting by the decedent and surviving spouse? Is the decedent entitled to a tax refund or credit?

If a living trust is used and fully funded (therefor avoiding probate after the death of the grantor/trustee), and the successor trustee is an individual instead of a corporate fiduciary, its possible an individual might be more inclined to miss certain elections and/or forget about the income tax issues for which he or she may become liable as successor trustee.

The lesson to be learned is that the selection of the successor trustees of a living trust who will succeed to a fiduciary position at the death of the grantor is just as important as selecting the executor. It might even be more important if the successor trustee is inclined to go it alone and not work with an attorney or accountant.

C. Comparisons.

1. Limitation Period for Contesting Intervivos Trust.

While the statutory period of limitations for filing a will contest is well settled in most jurisdictions, the same has not been true for contesting intervivos trusts. This created a potential dilemma for the trustee.

In advising our estate planning clients that an intervivos trust may be more difficult to contest than a will, we should keep in mind the potentially long limitations period (or lack of a specific limitations for contesting trusts). If applicable state law does not include a specific trust contest period, or if the trust contest period is lengthy, the trust proponent might consider opening a "no asset" probate administration to establish the terms of the will. If no will contest were prosecuted within the applicable period, the settlor's will would be established including the provisions incorporating the trust distribution by reference. In this case, a later trust contest, if successful, would require that the assets revert to the probate estate where they would be distributed under the will in the same manner as in the trust using incorporation by reference language.[23]

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[23] However, one Pennsylvania court has held that the failure to appeal from the probate of a will within one year, the statutory appeal period for a will contest, did not preclude the later contest of an intervivos trust, that was in existence at the time the will incorporated the trust by reference, where the trust itself was not offered for probate. 20 Pa. Cons.Stat.Ann. § 908 (West 1975).

Section 604 of the Uniform Trust Code provides for a 3-year limitations period for trust contests and a notice procedure 120 days after notice from the trustee. Section 48 of the Kansas Uniform Trust Code, effective January 1, 2003, has shortened the 3-year period to 1-year. It provides:

> "Sec. 48. Limitation On Action Contesting Validity Of Revocable Trust; Distribution Of Trust Property.
>
> "(a) A **person** may commence a judicial proceeding to contest the validity of a trust that was revocable at the settlor's death within the earlier of:
>
> "(1) One year after the settlor's death; or
>
> "(2) four months after the trustee sent the **person** a copy of the trust instrument and a notice informing the person of the trust's existence, of the trustee's name and address, and of the time allowed for commencing a proceeding.
>
> "(b) Upon the death of the settlor of a trust that was revocable at the settlor's death, the trustee may proceed to distribute the trust property in accordance with the terms of the trust. The trustee is not subject to liability for doing so unless:
>
> "(1) The trustee knows of a pending judicial proceeding contesting the validity of the trust; or
>
> "(2) a potential contestant has notified the trustee of a possible judicial proceeding to contest the trust and a judicial proceeding is commenced within 60 days after the contestant sent the notification.
>
> "(c) A beneficiary of a trust that is determined to have been invalid is liable to return any distribution received."

The "person(s)" entitled to notice, if given, and the "person(s)" who "may commence a judicial proceeding to contest" a trust are not just "qualified beneficiaries" as defined in Section 3(12)[24] of the Kansas Uniform Trust Code, or even "beneficiaries" as defined in Section 3(2)[25] of the Kansas Uniform Trust Code. If a decedent's will is filed for probate, the persons interested in the estate (each heir, devisee and legatee) are entitled to the statutorily required notice under K.S.A. §§59-2208, 59-2209, and 59-2222. Presumably, the same persons who would be entitled to notice if a probate proceeding was commenced should also be given notice if the benefit of the four-months period of limitation is sought with respect to a living trust.

Contingent beneficiaries may also need to be given notice in some circumstances. For example, if a charitable bequest is made which would fail if the charity no longer existed or had lost its exempt status, the persons who would then take should be given notice if their claims are to be cut off after four months. If they receive notice, they might

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[24] "3(12) 'Qualified beneficiary' means a beneficiary who, on the date *of* the beneficiary's qualification is determined:

(A) Is a distributee of trust income or principal; or

(B) would be a distributee of trust income or principal if the trust terminated on that date."

[25] "3(2) 'Beneficiary' means a person that:

(A) Has a present or future beneficial interest in a trust, vested or contingent; or

(B) in a capacity other than that of trustee, holds a power of appointment over trust property.

commence an action challenging the charitable bequest based on facts not even known to the trustee or other beneficiaries.

While notice under the probate code has specific rules and procedures which operate to create a fixed and short cut-off point applicable to all possible contestants, the same is not true with respect to notices involving living trusts, as multiple notices may be needed to be given at differing times depending on the circumstances (if the shorter four month period of limitations is important). Otherwise interested persons not receiving notice have one year after death in which to contest the trust.

2. Revocation.

A will may be revoked by (i) a subsequent writing, (ii) physical act, or (iii) operation of law. An intent to revoke must exist for a will to be revoked under the first two methods. In Kansas, as well as most jurisdictions, revocation is largely governed by statute, and such statutes are mandatory and must be strictly construed.[26] K.S.A. 59-611 provides, in part, as follows:

> ". . . no will in writing shall be revoked or altered otherwise than by some other will in writing; or by some other writing of the testator declaring such revocation or alteration and executed with the same formalities with which the will itself was required by law to be executed; or unless such will be burnt, torn, canceled, obliterated or destroyed, with the intent and for the purpose of revoking the same, by the testator himself or herself or by another person in the testator's presence by his or her direction."

A will containing the following revocation clause will revoke any prior wills regardless of the lack of revocation provisions in the prior will because the sole method of revocation is specified by statute.

> "I, John Doe, hereby revoke all wills and codicils previously made by me, and make, publish and declare this to be my Last Will and Testament.
>
> But don't forget readibility.
>
> "I, John Doe, declare this is my Last Will and Testament. I revoke all earlier wills and codicils."

There is no similar statutory provision governing the revocation of living trusts, other than K.S.A. §58-2417 which states that all trusts are irrevocable unless otherwise provided. Section 46 of the Kansas Uniform Trust Code reverses this rule as to trusts executed after December 31, 2002. Because there is no statutory method of revocation of a trust, it should contain a provision specifying its method of amendment or revocation. Such a provision might read as follows:

> "I reserve, during my lifetime, the absolute right and power to alter, amend or revoke the Revocable Trust and this Trust Agreement at any time or from time to time, either in whole or in part, without the consent of the Trustee. Any such alteration, amendment or revocation shall be evidenced by written notice of such act delivered to the Trustee, which notice makes specific reference to this Trust

[26] *In re Rinker's Estate*, 158 Kan. 406, 147 P.2d 740 (1944); *In re Grattan's Estate*, 157 Kan. 116, 138 P.2d 497 (1943).

> Agreement. No guardian or other similar representative of mine shall have the right or power to alter, amend or revoke the Revocable Trust or this Trust Agreement."[27]

In *Sanders,*[28] a case of first impression in Kansas, the Supreme Court ruled that if a settlor reserved the power to revoke a trust only in a particular manner and under particular circumstances, then the settlor can revoke the trust only in that manner or under those circumstances. Ellen M. Sanders executed a trust on July 23, 1990, and a restatement and amendment on November 29, 1990. She was the grantor, trustee, and lifetime beneficiary of the trust. The terms of both trust agreements were amendable, as follows:

> "TRUST REVOCABLE BY ELLEN M. SANDERS. This Agreement may be amended from time to time, and may be revoked partially or fully by ELLEN M. SANDERS during her lifetime by a writing delivered to the Trustee, which shall specify the term of such amendment or revocation."

Contemporaneous with execution of the amended trust, Ellen executed a pour-over will, which left her entire estate to the trust. She also fully funded the trust. During 1992, Ellen executed two more amendments to her trust, using the same attorney who prepared the original trust. The trust, as amended, provided primarily for her son and grandson, omitting to a large extent her daughter.

In 1993, Ellen decided to change her will. However, this new will was prepared by another attorney, and was executed on July 8, 1993. It divided all of Ellen's property more equitably among her son, daughter and her grandson. The new will specifically revoked any prior wills, but it made no reference of any nature whatsoever to her prior revocable trust.[29] Ellen died in 1994, and the daughter filed it for probate. The son and grandson challenged the will on several grounds and asserted that even if the new will was valid, it did not revoke the trust because the terms of revocation were not followed. The trial court found the new will valid and ruled that it revoked the trust. The Supreme Court reversed and ruled that the new will had no legal effect on the assets in the trust, as amended, i.e., the trust was valid and the assets of the trust passed according to its terms.

What lesson can be learned from the *Sanders* case? First of all, ask the question of whether there is a prior will and/or revocable trust. Second of all, obtain a copy of such documents and determine how they are to be revoked or amended. If there is a prior revocable trust, the new trust should contain the following:

> "This is an amendment and restatement of the JANE DOE REVOCABLE TRUST previously executed on January 1, 2002 and all assets held thereunder shall be now held under the terms and provisions of this Trust Agreement."

If the prior trust has not been funded, then the above language would not be needed. In any event, never rely on language in a will revoking a trust. The *Sanders* case made this

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[27] Notice the use of the personal pronouns instead of the impersonal noun.

[28] *In re Estate Of Ellen M. Sanders*, 261 Kan. 176, 929 P.2d 153 (Kan. 1996).

[29] The opinion makes no mention of whether Ellen informed her new attorney of the existence of the trust or will which she previously executed.

perfectly clear by referencing Comment (*j*) to §330(1) of the Restatement (Second) of Trusts (1957), which reads in part:

> "If the settlor reserves a power to revoke the trust by a transaction intervivos, as, for example, by a notice to the trustee, he cannot revoke the trust by his will."

Let's refer back to the language to be included in a revocable trust providing or its amendment or revocation and determine what problems could arise with respect to subsequent amendments.

> "I reserve, during my lifetime, the absolute right and power to alter, amend or revoke the Revocable Trust and this Trust Agreement at any time or from time to time, either in whole or in part, without the consent of the Trustee. Any such alteration, amendment or revocation shall be evidenced by written notice of such act delivered to the Trustee, which notice makes specific reference to this Trust Agreement. No guardian or other similar representative of mine shall have the right or power to alter, amend or revoke the Revocable Trust or this Trust Agreement."

If husband establishes a revocable trust and names himself as sole trustee, then he can execute a new trust at any time, probably without regard to whether he includes a provision that refers to the prior trust (although such a reference would be best). From *Sanders*, we know that a new will has no legal effect on assets transferred to such a trust, although a new will does control the disposition of any probate assets. If the husband and his wife are co-trustees, does any subsequent amendment or revocation by the husband of his trust have to involve notice to his wife? What if husband simply wants a new trust with him being sole trustee, in addition to the other changes he makes to the document? Based on *Sanders*, it might appear that such a new document would be ineffective, unless (1) the omitted trustee executed the new trust acknowledging the change, (2) the omitted trustee resigned by a separate document, or (3) the husband simply give the required written notice to the omitted trustee. Probably the better analysis is that notice to one trustee is the same as notice to all trustees, but that is not clear.

If *Sanders* were decided after January 1, 2003, the effective date of the Kansas Uniform Trust Code, *Sanders* would probably be decided differently. Section 46 of the new code provides that a revocable trust may be revoked by "substantial compliance with a method provided in the terms of the trust."[30] In addition, if the terms of the trust do not provide a method or the method provided in the terms is not expressly made exclusive, then a later will that expressly refers to the trust,[31] or specifically devises property that would otherwise have passed according to the terms of the trust,[32] may revoke the trust. In addition, a revocable trust may be revoked by "any other method manifesting clear and convincing evidence of settlor's intent."[33]

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[30] Section 46(c)(1), Kansas Uniform Trust Code.

[31] Section 46(c)(2)(A), Kansas Uniform Trust Code.

[32] Section 46(c)(2)(A), Kansas Uniform Trust Code.

[33] Section 46(c)(2)(B), Kansas Uniform Trust Code.

Under the Kansas Uniform Trust Code, the risk of inadvertent termination has been increased, and the power to amend or revoke set forth in the trust should be modified to provide that it is exclusive.[34] As an example:

> "I reserve, during my lifetime, the absolute right and power to alter, amend or revoke the Revocable Trust and this Trust Agreement at any time or from time to time, either in whole or in part, without the consent of the Trustee. Any such alteration, amendment or revocation shall be evidenced by written notice of such act delivered to the Trustee, which notice makes specific reference to this Trust Agreement. ***This power to alter, amend or revoke is exclusive and may not be exercised by any other means.*** No guardian or other similar representative of mine shall have the right or power to alter, amend or revoke the Revocable Trust or this Trust Agreement."

The Kansas Uniform Trust Code also provides that these powers may be exercised by an agent under a power of attorney to the extent authorized in either the power of attorney or trust, and that a conservator may exercise such powers only with court approval. It is not clear if a conservatory may exercise this power if the trust expressly forbids it.

3. Should the Trust be Incorporated into the Will?

I know of some practitioners who incorporate the trust document into the will by reference. I do not because I see no need to. It also adds complexity to the will. I have asked those practitioners why they include the incorporation language. One response is that if the trust is invalid for some reason (presumably because of lack of capacity, etc.), its incorporation into the will saves it. Another response is that if the trust is lost, then the will can be probated which will include the terms of the trust – thus, saving the trust.

I cannot imagine an invalidity prepared and executed trust agreement if a pour over will is validly prepared and executed. So, assuming I am competent to prepare a valid will for execution, then I should be able to prepare a valid trust for execution. If the testator is incompetent to sign a will, then he or she is also incompetent to sign a trust, as capacity to sign both documents is the same for all practical purposes. Incorporation by reference therefor does not increase the validity of the trust at the time of its original execution.

What if the trust document is later lost? As long as the trust contains a method for its amendment or revocation, it makes no difference if the original is lost. A trust still exists regardless of a lost document. Certainly, the attorney should have a copy of the trust as executed in his or her files so the terms will be known even if the settlor loses his or her original document and all copies.

What if the settlor attempts to revoke a trust by physically destroying it? That might not result in its revocation, especially if there is another person who is the sole trustee or a co-trustee. However, after January 1, 2003, physical destruction by the trustor probably will be considered "manifest clear and convincing evidence" of a trust's revocation, unless a method of revocation set forth in the document is made exclusive.

[34] Because the Kansas Uniform Trust Code goes into effect January 1, 2003, and applies to all trusts regardless of when executed, the exclusivity language should be added to new trusts now.

However, if a method of revocation in the trust document (i.e., written notice of such to the trustee) is made exclusive, it is difficult to imagine physical destruction by the settlor being a revocation. If the trust is incorporated into the will, then the attempted revocation may be defeated unless the will is also destroyed. What if the trust is revoked by the method required in the trust, but the will is not destroyed? Has incorporation by reference resurrected the trust despite its revocation?

Thus, I see nothing gained by incorporation, and potentially unhappy heirs and/or beneficiaries if they believe the trust was intended to be revoked but was not because of the incorporation by reference.

4. The Elective Share.

Prior to 1995, the surviving spouse was entitled to take under the will or to elect to take against the will. Transferring assets to a revocable trust did not eliminate the right of a surviving spouse to also elect against the trust. This right was recognized as a result of the *Ackers v. First National Bank of Topeka*[35] and *Newman v. George*[36] cases.

In 1995, the new Kansas Elective Share [37] law went into effect. The surviving spouse no longer elects to take against the will, but simply elects to take her elective share, which is a percentage (up to 50% based on the length of marriage) of the "augmented estate", less what the surviving spouse already has and receives from the deceased spouse (whether under the deceased spouse's will, as surviving joint tenant, or from beneficiary designations or POD designations). The augmented estate is the totality of assets owned or controlled by both spouses.

5. In Terrorem Clauses.

These clauses essentially provide that a beneficiary who challenges the trust instrument or will, perhaps to obtain a larger share of the property by intestate succession or under a prior document, will be disinherited if such an action is filed. The substance of such a no contest clause varies with the language used in the instrument, and generally excludes actions filed for probable cause or in compliance with guardianship and conservatorship responsibilities. Forfeiture clauses have generally been upheld and enforced by courts for two reasons: (1) the intent of the settlor should be given effect; and (2) the clauses discourage litigation.

The Uniform Probate Code negates the effectiveness of an *in terrorem* clause if probable cause exists for contest. There, a no-contest clause is not enforceable if a beneficiary with probable cause contests a provision that benefits a drafter or transcriber of the instrument or a person who gave directions to the drafter or witnessed the instrument. But, such a beneficiary may not seek advance declaratory relief as to whether he or she would have probable cause to bring the action, since probable cause requires a determination of the merits of the proposed action.

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[35] 192 Kan. 319, 387 P. 2d 840 (1963).

[36] 243 Kan. 183, 755 P. 2d 18 (1988).

[37] K.S.A. §§59-6a201 through 59-6a217.

In Kansas, an *in terrorem* clause will not be enforced if the person challenging the will, or a provision thereof, does so with probable cause. Justification for this proposition is found in *Restatement (Second) of Property* § 9.1 (1981) which provides:

> "An otherwise effective provision in a will or other donative transfer, which is designed to prevent the acquisition or retention of an interest in property in the event there is a contest of the validity of the document transferring the interest or an attack on a particular provision of the document, is valid, unless there was probable cause for making the contest or attack."[38]

Although there is no case in Kansas involving an *in terrorem* clause in a living trust, it is likely that the same analysis will apply.

6. Antilapse Statute.

The antilapse statute, K.S.A. §59-615(a) specifically applies to wills "unless a different disposition is made or required by will." Although there is no case law in Kansas on this issue, limited case law in other jurisdictions suggests the trend is to apply antilapse statutes to living trusts as will substitutes.[39]

7. Guardians.

K.S.A. § 3004 provides that any natural guardian, by last will, may nominate a conservator or guardian for the natural guardian's minor children. Settlors of living trusts have the same authority under the statute.

8. Revocation by Divorce, Marriage and Children.

K.S.A. § 59-610 provides that if after making a will, a testator is divorced, all provisions in the will in favor of the testator's spouse are revoked. Although there is no statute relating to living trusts analogous to K.S.A. § 59-610, nor any Kansas cases on this issue, the same result would probably ensue with respect to a dispositive provision in favor of a divorced spouse in a living trust. Such has been the result in other jurisdictions.[40] Because of the uncertainty of the application of K.S.A. § 59-610 to a living trust, a spousal definition ***might*** be used which disinherits a divorced or separated spouse of the settlor. Revocation of a will also occurs upon remarriage and children, but it is not clear if the same rule applies to trusts.

9. Tangible Personal Property.

Both wills and living trusts may refer to a separate writing to dispose of tangible personal property not specifically disposed of by the will or living trust. The writing may be prepared before, with or after the will or living trust is executed and may be altered at any time after its preparation. These separate writings would seem to create substantial problems because they can be prepared by the testator/settlor at any time, but little

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[38] Matter of Estate of Campbell, 876 P.2d 212 (Kan.App.1994).

[39] See e.g., *Dollar Savings & Trust Company v. Turner*, 39 Ohio St. 3d, 529 N.E. 2d 1261 (1988); *Superseded by statute as stated in Polen v. Baker*, 92 Ohio St.3d 563, 752 N.E.2d 258 (Ohio 2001).

[40] See, e.g., *Clymer v. Mayo*, 393 Mass. 754, 473 N.E. 2d 1084 (1985); *Miller v. First Nat'l Bank & Trust Co.*, 637 P.2d 75 (Okla 1981).

conflict seems to have arisen because of a separate writing. K.S.A. §59-623 and K.S.A. §59.-2296

10. Creditors.

Under K.S.A. §59-709 and 59-2236, publication of notice to creditors within 10 days of a petition for administration or probate is required. Actual notice to known or reasonable ascertainable creditors is also required.[41] Creditor claims are cut off if not filed within four months of first publication. If there is no estate proceeding, then claims are cut off six months after death. Thus, whether a living trust is used as the sole instrument disposing of an estate or a will is used, creditor claims will be barred within a short time after death if not properly presented. If the trustee of a living trust is not comfortable relying on the six month cutoff because of the constitutional issues arising from the *Pope*[42] case, the pour over will can still be filed for probate (and it may have to anyway if there are probate assets) in order to commence the nonclaim period after publication of notice. But don't forget, in a probate proceeding, actual notice must be given to known or reasonable ascertainable creditors.

III. EPILOGUE

Dacey retired from the financial field a few months after his problems with the Securities and Exchange Commission. In 1979, Dacey moved to Ireland in an attempt to beat taxes. He died on March 16, 1994, at the age of 85 at the London Clinic in London. A search of the probate records in Ireland and England found no will for Dacey.

Prof. John H. Langbein[43], a Connecticut member of the American College of Trust and Estate Council (ACTEC), perhaps has aptly summarized Dacey's accomplishments by saying:

> "But it's an ill wind that blows no good, and Dacey was the catalyst to probate reform that led to the Uniform Probate Code and to the legitimization of the nonprobate system. His core complaint was right: Most decedents' estates do not need court-supervised administration, any more than most businesses need court supervision in bankruptcy. The theme of the Uniform Probate Code, which traces back to common-form/solemn form probate in England, is to treat unsupervised administration as the norm, while making it easy for anybody who is unhappy to force the estate into supervised administration."[44]

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[41] See *In re Estate of McDowell*, 245 Kan. 278, 777 P.2d 826 (1989) which held the prior provisions unconstitutional insofar as it did not require such notice.

[42] *Tulsa Professional Collection Services v. Pope*, 485 U.S. 478, 108 S.Ct. 1340, 99 L.Ed.2d 565 (1988)

[43] Yale University Law School.

[44] Email (May 29, 2002).