

TRUSTS

A Trust is a "fiduciary" relationship, historically involving at least three people. Modernly, the law of trusts was established in California by statute. During the time of Henry VIII, Parliament passed the Statute of Uses (1536), which effectively limited trusts (or "uses" as they were called then).

There are various types or classifications of trusts. The following are some of the ways of distinguishing them:

- a. Voluntary, or express trusts - those that are created by a document;
- b. Involuntary - those that are created by law. The area of Wills and Estate Planning does not generally concern itself with these types of trusts. They are imposed upon people typically as a result of a lawsuit, and include resulting and constructive trusts.

Trusts can also be classified as "express" or "implied":

- a. Express - those that are intentionally created by someone (who is called the "trustor" or "settlor");
- b. Implied - trusts that are created where there was no intent to create. Typically, these are the involuntary trusts mentioned above.

The Probate court exercises jurisdiction over both testamentary trusts (those created within a Will) and inter vivos trusts (those created during someone's lifetime (usually by a written document, variously called "Living Trust", "Revocable Living Trust", or just plain "Trust Document").

The Testamentary Trust, since it is created within a Will, obviously does not become effective until the testator dies. As in the case of Henry Miller (*see Lombardi vs. Blois* above), a Testamentary Trust can be used to delay the distribution of a person's estate until many years after his/her death. (But see Rule Against Perpetuities, PC 21200.) Modernly, this device can have important tax implications, especially in the area of federal estate taxes.

Inter Vivos Trusts are those created by a living person. They can be either "revocable" or "irrevocable". In California, all trusts are considered revocable unless specifically labelled irrevocable. In other words, if the settlor decides he/she doesn't like the trust, he/she can revoke it simply by writing "revoked" across the document and signing it (subject, of course, to any other specific requirements of the trust document).

Court proceedings involving trusts are commenced by filing a verified petition in the Superior Court that has jurisdiction (the place that the trust business is carried out). These petitions can include the following:

- a. Disposition of trust property;
- b. Accountings of trust income or property;
- c. Sales or purchases of estate property;
- d. Instructions to the trustee (manager of the trust);
- e. Questions involving the Trustee's powers;
- f. Trustee's compensation;
- g. Appointment or removal of trustee;
- h. Transfer of case to another court/jurisdiction;
- i. Trust termination .

An express trust can be created in one of two ways:

1. The trustor/settlor can sign a declaration of trust; or
2. He/she can transfer property in trust by a deed or other type of transfer document.

A Trust is similar to a corporation. The person who creates the trust, the settlor (sometimes called the trustor), is analogous to the initial incorporator of the business. The manager of the trust is called the Trustee. He or she is the person responsible for the operation of the trust business. One of the primary obligations of the trustee is to hold the trust property for the beneficiary (or "cestui que trust"). Just as the President of a company has a duty to make money for the stockholders, the trustee must, by law (and by the terms of the trust document), manage the trust so that its value does not diminish. The beneficiary is the person who is supposed to gain by the trust. The settlor establishes the trust for that person's benefit. The connection between the trustee and beneficiary, then, is one of faith and trust. We call this a "fiduciary" relationship.

ESTABLISHMENT OF A TRUST

Anyone over age 18 who is mentally competent can create a trust. There are three essential elements for a trust:

1. There must be a valid Trust intent or purpose;
2. There must be Trust property (also called "res" or "corpus"); and

3. There must be a Beneficiary.

On the other hand, the following are not essential to the creation of a trust:

1. Trustee: if none is named in the trust document, or the trustee dies or resigns, the court can appoint one upon the filing of a petition.

2. Notice to or acceptance by the trustee is not necessary. If the trustee does not wish to accept his/her office, he/she can resign.

3. Consideration - a settlor can establish a trust without being paid for it. In other words, he can make a gratuitous (free) transfer of property to the trust out of the goodness of his heart.

4. Notice or acceptance by the beneficiary - not necessary.

Trusts are subject to the Statute of Frauds. That means that a trust involving the transfer of real property must be in writing. However, a transfer of the real property by deed in trust, without a separate trust declaration, qualifies as a "writing", thereby satisfying the Statute.

Historically, courts were reluctant to recognize the so-called "Totten Trust" (also called "pay-on-death" accounts). In this type of trust a depositor opens a bank account in his/her name as trustee for another, intending to reserve the power to withdraw the funds at any time during his/her lifetime. Since this is a tentative trust, which is revocable during the Trustee's lifetime, the beneficiaries' rights could be defeated at any time simply by withdrawing the money. Therefore, the courts typically held that no trust existed. The trustee was adjudged to be the absolute owner of the bank account. However, gradually courts came to change their thinking, until finally they held the modern view that a trust **did** exist, and that at the Trustee's death, it becomes absolute.

When a trust (or a Will) is created, the settlor must be careful to use precise wording so that the document is clear in its intent. If the wording is ambiguous because of "precatory words", the trust may be unenforceable because the words of creation express a mere desire or hope to create a trust.

The Trust Purpose must be a valid, legal one. Courts will not enforce trust established for illegal purposes, or even for reasons that violate public policy.

There are certain restrictions in creating a private (vs. charitable) trust. For example, no trust created in California can violate the Rule Against Perpetuities. The purpose of this rule is to avoid tying up property interests for undue periods of time (such as in trusts) and thus allow people to transfer the property without restriction. Although this law has its roots in the common law, California has recently modified its statutes by updating and refining them in accordance with the Uniform Statutory Rule Against Perpetuities (PC 21200 et seq.). The new

rule states that no interest in property that passes to an heir (or beneficiary) is valid unless it vests (or terminates) no later than 21 years after the death of an individual then alive, or vests or terminates within 90 years after its creation. Thus, the Rule Against Perpetuities may invalidate a trust if the settlor attempts to pass property beyond the period of time mentioned, but there is also a 90 year wait-and-see period. If during the 90 year period any non-vested interests work out, the property passes as intended by the settlor, without the need to engage in speculation.

While the naming of a trustee is not a requirement, it is certainly an important decision for anyone establishing a trust. Often a settlor will name himself as trustee, and husbands and wives will generally name themselves as joint trustees acting together. But anyone can be named as trustee (any adult, that is), including a corporation, bank or trust company, one of several beneficiaries, or one of the trustors/settlors. The trustee may decide he doesn't want to job, of course, and may renounce at any time prior to his acceptance. Afterwards, however, he may resign only with court approval, and usually only after filing a written accounting with the court. And, the Trustee can be removed by a court for misconduct, unfitness, adverse interests, etc. upon the filing of a petition by any interested person (beneficiary, settlor, etc.).

Just about anyone or anything can be named a beneficiary. However, the identity of the person or entity must be definite and ascertainable. Typically, in a standard family trust, mom and dad will name themselves as co-trustees for their own benefit. On their deaths, their property held in the trust will pass (free of the trust) to their children. Established properly, the trust may avoid federal estate taxes on net estates up to \$3,000,000.00 (see new tables on current Federal Estate Tax Exemptions) - depending on the year of death.

Charitable Trust, unlike private trust, must be established for some public purpose or social benefit. This may include the establishment of a library fund, a college endowment, a scholarship, or a chair at a university. Charitable purposes must fall into one of the following typical categories: health, education, religion, cultural projects, and miscellaneous social objectives. Where, however, the purpose of the charitable trust fails, the trust may still be given effect, if at all possible, by applying the CY PRES DOCTRINE. Under this doctrine, the dominant intent of the settlor controls. So, where a general charitable intent is established for a specific purpose, and that purpose cannot be carried out, the court can direct the disposition of the estate to some related charitable purposes in order to carry out the settlor's purpose "as nearly as possible".

Examples of the application of Cy Pres are as follows:

1. The settlor wanted to give his estate to some all-white Protestant school of Engineering training. The court held that the "all-white" term was illegal and that the trust should fail. The estate would then go to the settlor's heirs. But on appeal, the court held that the settlor may have had a general charitable purpose in mind, and didn't care if non-whites were admitted. The case was sent back for new evidence on this issue. ***Estate of Vanderhoofven* (1971) 18 C.A.3d 940, 96 C.R. 260.**

2. In the *Estate of Gatlin* (1971) 16 C.A.3D 644, 94 C.R.925, the testator left his estate to the home for the blind and crippled children in San Francisco. No such place was found, but the court had no trouble directing that the general charitable purpose could be carried out to benefit the classes of people named.

3. On the other hand, the litigation involving the estate of Beryl Buck that limited spending to the poor of Marin County, California (one of the wealthiest counties in the United States), resulted in the denial of Cy Pres application. The \$500,000,000 trust was distributed among a variety of groups, despite the objection of groups in the surrounding areas.

A Trustee and a beneficiary are in a fiduciary relationship; that is, one of trust and good faith. The Trustee must manage the trust estate with reasonable skill, prudence, & diligence. He's liable (mainly to the beneficiaries) for all losses due to a breach of this duty and any negligent acts, including the failure to make a profit. In general, the Trustee must follow the "Prudent Investor Rule". That means that the trustee must invest the trust assets carefully, as though they were his own, and not in speculative ventures. But the trust document can direct or limit the type of investments. At common law, the types of investments that a trustee could invest in were quite limited - and conservative: government securities, corporate bonds, first mortgages on land. The disapproved list was unsecured loans, second mortgages, speculative stocks or bonds, etc. Modernly, the list of investments has been liberalized so that a trustee has the power to invest in any kind of property. Also, a corporate trustee can pool several trusts into a common fund. This allows for more diversification and permits speed, and convenience. Naturally, the Trustee can't deal with the trust on his own behalf. That would be considered a conflict of interest, and would constitute grounds for removal of the trustee.

The Trustee is the general agent for the trust and generally has great discretion, unless limited by the trust document. Although Trustees can be paid for managing the trust, most private trustees, who are typically the settlor or their children, waive their right to a fee. But corporate trustees are, of course, entitled to be paid for their services. California law provides that if the trust instrument is silent as to the amount of compensation, the trustee is entitled to reasonable fees. Most corporate trustees use schedules as to their fees, and some courts have local rules or policy guidelines concerning fees for the trustee and his attorney. Court approval is generally required, although in some cases advance payment of the fees is authorized. In addition to the fees, a trustee is allowed reimbursement for his expenses in connection with his administration. The beneficiary, however, is not liable for these expenses, absent some special agreement to the contrary.

If a settlor establishes a trust (typically for his children) in which he provides that the beneficiary can't assign or sell his interest, and that creditors can't reach the estate, a Spendthrift Trust is created. Some states hold that this type of trust is void as against public policy, but most uphold the arrangement - with a wide degree of limitations.

Creditors, then are not allowed to reach the corpus of the trust, but can reach the income that is actually distributed to the beneficiary. And, of course, if the principal is distributed to

the beneficiary, the creditor can attempt to attach it. Naturally, the Settlor can't set up a spendthrift trust for himself. And certain creditors are, by law, "favored" over other creditors. For example, a claim for child or spousal support can reach into a spendthrift trust, as can a claim by the government for reimbursement for public support (welfare, for example).

In addition to the spendthrift trust, a settlor may also set up Support Trust or a Discretionary Trust.

The support trust, as the name implies, provides that the Trustee must pay income or principal to the beneficiary for the latter's education or support, and the beneficiary's interest in the trust is not reachable by creditors until it is actually received by the beneficiary.

The discretionary trust usually gives the beneficiary whatever the Trustee, in his discretion, decides to pay to the beneficiary. A creditor cannot, therefore, compel the trustee to pay any amount that he chooses not to pay.

TERMINATION OF TRUSTS

A trust terminates:

1. By operation of law (where the court has been asked to terminate a trust; where, for example, all of the beneficiaries have asked that the trust be terminated);
2. Once the trust purpose has been fulfilled (for example, where the trust instrument provides for termination upon the happening of some event, or the passage of a period of time);
3. The Trust ceases to exist, is unlawful, or impossible to administer;
4. The Principal becomes uneconomically too low. By law, a trustee has the power to terminate a trust if the trust principal does not exceed \$20,000.00. A beneficiary may petition to terminate a trust if the value of the estate property becomes so low in relation to the cost of maintaining the trust.
5. A Settlor can revoke a revocable trust if he expressly reserves the right. In California, all trusts are revocable unless specifically made otherwise. And even an irrevocable trust can be revoked, by statute, if all of the beneficiaries agree and the trust purpose has been accomplished.

JUDICIAL PROCEEDINGS

The probate court has jurisdiction to entertain petitions on behalf of trusts, trustees, and beneficiaries. Petitions that are filed in trust proceedings must be filed in the proper court of jurisdiction. In general, this means that petitions must be filed in the superior court district where the trust has its principal place of administration (the usual day-to-day activities).

See Probate Code Sections 15000 through 19403 (Division 9) for trust law.