

Trust Reform- 2014 Legislation Session

Most agree that Mississippi is in need of amending/updating its trust laws. Mississippi's laws are old, provide little guidance, and, most importantly, do not encourage grantors to situs a trust in Mississippi. The 2014 Legislative Session provides Trust Departments, the Mississippi Bankers' Association, the Mississippi Bar Association, and the Mississippi Society of CPAs an opportunity to usher in new trust laws. This memorandum sets forth the major goals that can be accomplished through new laws and addresses the notable provisions of the Uniform Trust Code.

Major Goals

A. UNIFORM TRUST CODE

The Uniform Trust Code (UTC) is a model code for states to use to create a uniform, comprehensive, easy-to-find body of trust law. With some exceptions, it is generally a default statute or is used to supplement and revise state's existing laws concerning trusts.

It was written by the Uniform Law Commissioners, part of the National Conference of Commissioners on Uniform State Laws, in 2000 and last amended in 2010. It is approved by the American Bar Association and the American Bankers Association as well as the AARP.

The UTC is part of a movement to codify trust laws as opposed to relying primarily on common law; however, it is not a simple codification of common law. **Twenty-five (25)** states have adopted the UTC (and it is pending in Maryland and New Jersey), usually with modifications. The UTC as a whole would provide an excellent method of modernizing Mississippi trust laws.

Below are notable provisions from the UTC:

Article 1- General Provisions and Definitions

Section 105: Most of the UTC is trumped by the terms of the trust. However, this section lays out the various provisions that are mandatory and cannot be overridden by the terms of the trust. Most notable are provisions regarding creditor protection, notice to beneficiaries, venue/subject matter jurisdiction, and the power of the court to modify/terminate a trust.

Section 110: The Attorney General is designated as a qualified beneficiary of a charitable trust. This provision has made some charities uneasy in other states because they do not want grantors to be scared to settle a charitable trust for fear that the Attorney General can receive statements about a normally private trust.

Section 111: This section allows for non-judicial settlements to resolve matters that include: interpretation/construction of the terms of the trust; approval of a trustee's report or accounting; direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power; resignation or appointment of a trustee and the determination of a trustee's compensation; transfer of a trust's principal place of administration; and liability of a trustee for an action relating to the trust.

The agreement must be entered into by "interested persons," a term that is defined. Tennessee changed that to "qualified beneficiaries," which is also defined.

Article 2- Judicial Proceedings

Section 204: This section provides for the venue of an action. Currently, lawsuits would be heard in the county where the corporate trustee's office is located. This would lay venue where the trust is administered.

This section would be mandatory.

Article 3- Representation

Section 302: This section lays out the provisions of virtual representation. In general, virtual representation is allowed on many levels as long as there is no "conflict of interest." Tennessee changed that language to "material conflict of interest."

Article 4- Creation, Validity, Modification, and Termination of Trust

Section 411: Article 4 provides for many ways to modify and terminate a trust. This section states that a non-charitable irrevocable trust can be modified or terminated with the consent of the settlor and all beneficiaries with court approval even if the modification/termination is inconsistent with a material purpose of the trust. This provision indicates that the court is almost mandated to accept any such petition.

Additionally, a trust may be terminated if all beneficiaries consent and the court finds that the continuance of the trust is not necessary to achieve a "material purpose of the trust." A trust may be modified if all beneficiaries consent and the court finds that the modification is not inconsistent with a "material purpose of the trust." Section 411 then states that a spendthrift provision is not a material purpose of the trust.

Section 414: This section provides a much better Small Trust Statute. It allows a trustee to terminate on its own and without court approval for trusts with few than X assets. Currently, Mississippi law requires a trustee to get court approval to terminate under the Small Trust Statute.

Sections 410-416 would be mandatory and could not be trumped by the terms of the trust.

Section 417: This section appears to make combining trusts a bit easier. Trusts can be combined if “the result does not impair rights of any beneficiary or adversely affect achievement of the purposes of the trust.”

Article 5- Creditor’s Claims: Spendthrift and Discretionary Trusts

Section 501: Article 5 addresses creditors’ rights. This section makes clear that creditors may attach a judgment to present or future distributions any time that no spendthrift clause exists.

Section 503: This section states that a spendthrift clause is not enforceable against a judicial order for child support, a creditor who has provided services for the protection of a beneficiary’s interest in the trust, or against a claim of the state or the federal government.

Section 504: Even if a creditor can attach a judgment to present or future distributions, he cannot force a distribution unless the trustee has not complied with a standard of distribution or has abused discretion. In that case, a creditor may force a distribution for child support.

Section 505: This section prevents self-settled asset protection trusts and would not be included in any legislation.

Section 506: Regardless of a spendthrift provision, a creditor may reach mandatory distributions of income or principal if the trustee has not made the distribution within a reasonable time.

These provisions may actually be a little more creditor-friendly than Mississippi’s current laws. Some states have modified these provisions or even deleted them, like Arizona. Under the UTC, these terms cannot be trumped by the terms of the trust.

Article 6- Revocable Trusts

Section 602: A trust must specifically state that it is irrevocable, or the grantor may revoke it.

Article 7- Office of Trusteeship

Section 701: This section lays out how a trustee can reject a trusteeship.

Section: 703: If a trust has multiple trustees, a trustee may dissent; however, a dissenting trustee that joins in the action of the majority is not relieved of potential liability associated with a “serious breach of trust.” Currently, Miss. Code Ann. § 91-9-113 does not relieve a co-trustee of liability if it fails to try to prevent a “breach of trust” as opposed to a “serious breach of trust.” I do not think the distinction would be very relevant.

Section 705: This provision allows a trustee to resign but does not provide for a trustee to be discharged once the accounting is approved by all beneficiaries like Miss. Code Ann. § 91-9-205 does.

Section 706: This section allows a grantor, co-trustee, or beneficiary to request the court to remove a trustee. A trustee may also be removed on the court's own initiative. This section lays out when a court may remove a trustee. While this provides a nuance to Mississippi law, it may not be very relevant since nearly every trust document now includes removal provisions.

Article 8- Duties and Powers of Trustee

Section 802: This section details the various conflicts of interest that may arise between a trustee's personal investments and the trust investments.

Section 808: This section is the UTC's Directed Trustee Statute. It orders a trustee to act in accordance with the instructions of anyone with a power to direct under the terms of the trust UNLESS "the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust." That language should not be included. Mississippi should pattern its statute after the Tennessee trust statutes detailed below.

Section 813: This section provides various notification requirements as far as beneficiaries are concerned. The trustee must keep "qualified beneficiaries" reasonably informed about the administration of the trust. A "qualified beneficiary" is defined Section 103 and is essentially current beneficiaries and a vested remaindermen. However, a trustee must promptly respond to a beneficiary's request for information related to the administration of the trust.

This section also provides that within 60 days after accepting a trusteeship, the trustee shall notify qualified beneficiaries of the acceptance and of the trustee's name, address, and telephone number.

In general, these are mandatory provisions under the UTC. Tennessee has made them optional. Tennessee made the requirement for keeping "qualified beneficiaries" reasonably informed applicable only to distributees or permissible distributees.

Article 9- Uniform Prudent Investor Act

The UPIA has not been integrated into the UTC because so many states have already adopted the UPIA.

Article 10- Liability of Trustees and Rights of Persons Dealing with Trustee

Section 1004: The Court may award attorneys' fees to a party. This is critical because attorneys' fees can only be awarded in Mississippi if permissible under contract or statute.

Section 1005: 1-year statute of limitations on breach of trust. The statute starts running when a report adequately discloses the existence of a potential claim for breach of trust and **informs the beneficiary of the time allowed for commencing a proceeding. A report adequately**

discloses the potential for a claim if the beneficiary or a representative knows of the potential claim or should have inquired into its existence. Otherwise, the statute is 5 years after the first to occur of: 1) removal, resignation, death of a trustee; 2) termination of a beneficiary's interest in the trust; or termination of the trust.

Section 1009: This section states that a release is enforceable unless obtained by improper conduct or the beneficiary did not know of his rights or of the material facts relating to the breach.

Section 1106: This section makes clear that the UTC applies to all trusts created before and after its effective date.

B. Other Laws

When discussing which states are the most trust-friendly¹, commentators generally require 3 basic attributes of state trust law: Asset Protection/Self-Settled Trusts; Directed Trustee Statutes; and Perpetual Trusts (or Laws that do away with the Rule Against Perpetuities). Mississippi should consider adopting all 3 in an effort to keep more money in the State.

1. Asset Protection Trusts/Self-Settled Trusts

The major type of Asset Protection Trusts deemed to be “business-friendly” is the Self-Settled Trust. In Tennessee², a settlor can create a Tennessee Investment Services Trust or an Asset Protection Trust (“APT”) through the Tennessee Investment Services Act of 2007. The settlor can transfer assets to an irrevocable trust that contains a spendthrift clause and incorporates Tennessee law to govern the validity, construction, and administration of the trust. In order to trigger the provisions of the act, at least one of the trustees of the APT must be an individual who is a resident of Tennessee or a Tennessee corporate fiduciary. Further, the Tennessee trustee must “materially participate” in the administration of the APT which creates additional business for Tennessee trust companies.

The settlor may retain certain rights without jeopardizing spendthrift protection, including: 1) the right to be a discretionary beneficiary of income and principal distributions; 2) the power to veto a distribution from the trust; 3) a testamentary limited power of appointment; 4) the right to remove and appoint trustees; and 5) the right to act as investment advisor to the trust.

¹ <http://thetrustadvisor.com/tag/best-trust-states>

² All commentary on Tennessee Asset Protection Trusts is from Bryan Howard, “Tennessee Asset Protection Trusts,” Presentation November 13, 2009.

Prior to the transfer of assets to the APT, the settler must sign an affidavit essentially stating this is not a fraudulent conveyance. These cannot be used to manipulate existing creditors or a future bankruptcy. Tennessee APTs are subject to a short list of exception creditors.

APTs are generally treated as grantor trusts, and the assets are also included in the estate of the grantor. The primary advantage of the trust is to allow a grantor to give his assets protections from his own creditors and still have access to the assets. Currently, an individual looking to protect his assets from creditors but retain access/use has no option in Mississippi. In fact, Mississippi expressly prohibits the protections of self settled trusts. Miss. Code Ann. §91-9-509. Tennessee, Alaska, and Nevada are among around 12 states that have enacted some form of self-settled trust statute.

2. Directed Trustee Statutes

A directed trustee statute abolishes a trustee's duty to supervise third-party investors and absolves a trustee of any liability when the grantor requires the trustee to follow the investment instructions of a third party. Current Mississippi law really does not address the protections a trustee might be afforded if a trust directs the trustee to follow the instructions of another party.

Tennessee adopted the Uniform Trust Code **and directed trustee protection**. Tennessee Code Annotated §35-15-808 states, in part:

- (a) While a trust is revocable, the trustee may follow a direction of the settlor that is contrary to the terms of the trust or contrary to the normal practice of the trustee in regard to the action requested.
- (b) If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power.
- (c) The terms of a trust may confer upon a trustee or other person a power to direct the modification or termination of the trust.
- (d) A person, other than a beneficiary, who holds a power to direct is presumptively a fiduciary who, as such, is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from breach of a fiduciary duty.

(e) In so following the directions under this section, the trustee is protected from liability as provided in §§ 35-3-122 and 35-3-123.

Tennessee Code Annotated § 35-3-122 states:

Whenever an instrument under which a fiduciary is acting reserves to the settlor or vests an advisory or investment committee or in any other person or persons including one (1) or more other fiduciaries, to the exclusion of the fiduciary or to the exclusion of one (1) or more of several fiduciaries, authority to direct the making or retention of any investment, or to perform any other act in the management or administration of the fiduciary account, the excluded fiduciary or fiduciaries shall not be liable, either individually or as a fiduciary, for any loss resulting from the making or retention of any investment or other act pursuant to that direction.

Finally, Tennessee Code Annotated § 35-3-123 provides:

(a) A trustee of a revocable, irrevocable or testamentary trust is not liable to any beneficiary for any act performed or omitted pursuant to written directions from the person holding the power to revoke, terminate or amend the trust.

(b) A trustee of a revocable, irrevocable or testamentary trust is not liable for any investment action performed or omitted pursuant to written directions from the person to whom the power to direct the investment or management of the account is delegated by the trustor.

Tennessee is not alone. Delaware protects fiduciaries under a directive from liability unless the fiduciary exhibits “willful misconduct.” Del. Code Ann. Tit. 12, §3313. South Dakota, like Tennessee, provides fiduciaries with strong protection. See S.D. Codified Laws §§ 55-1B-1-3, 5-6, 9-11.

While the UTC and Restatements provide for a trustee to take direction, they also fail to provide the trustee with much, if any, protection from liability. “The problem with the approaches taken by the UTC and Restatements of Trusts is that the trustee, who is presumably expected to take a back seat to the individual who is directing the trustee, must exercise a considerable amount of due diligence to comply with the trustee’s continuing fiduciary obligations.”³ Mississippi should

³ See Mary Clarke and Diana S.C. Zeydel, “Directed Trusts: The Statutory Approaches to Authority and Liability,” Estate Planning September 2008 (Vol 35, No. 9).

consider drafting legislation that not only allows directed trustees but fully **protects** directed trustees. Otherwise, the legislation will be hollow.

3. Extending the Life of Trusts (or excluding trusts from the Rule Against Perpetuities)

Mississippi currently follows the Rule Against Perpetuities. Therefore, most trusts have a life expectancy of fewer than 100 years.

All of the States labeled as “trust-friendly” or “business-friendly” have done away with the Rule Against Perpetuities with regard to trusts. In fact, Delaware (Del. Code Ann. tit. 25, §503) and South Dakota (S.D. Codified Laws §§ 43-5-1, 43-5-8) now allow trusts to last in perpetuity. Tennessee allows a trust to last 360 years while Alaska “limits” a trust life to 1,000 years (§§ 34.27.100, 34.27.051). One of the most compelling reasons to leave property in trust is so that it can stay in trust for many years as a “Dynasty Trust,” a planning tool that is appealing to high net worth individuals.

C. Conclusion

Mississippi should adopt the Uniform Trust Code (with modifications) in order to make Mississippi trust laws more modern, more efficient, and more helpful. In addition, Mississippi should consider adopting a self-settled trust statute, a directed trustee statute, and a statute excluding trusts from the Rule Against Perpetuities in an effort to help Mississippi trusts customers and to keep more money in the State of Mississippi.