



When One Is Not Enough: Dividing Fiduciary Powers and Dispositions

29th Annual Advanced Estate Planning Strategies
April 20-21, 2023
The Ritz-Carlton, Lake Tahoe
Truckee, CA

When One Is Not Enough: Dividing Fiduciary Powers and Dispositions

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Two Changes to Our One Page Summary

- **Making a Beneficiary the Grantor for Income Tax Purposes** has been moved down to replace Texas Directed Trusts.
- We will discuss Texas Directed Trusts as a part of our second section, **Co-Fiduciary Management Issues**



Executor and Trustee Power to Construe Instrument

- Sample provision

If and when in good faith in doubt as to the proper construction, interpretation or operation of this Declaration, or as to any question that may arise during the administration of any trust created hereunder, or as to the application, interpretation or construction of the Texas Trust Code, or as to any other matter involving the administration of any trust created hereunder or the rights of any beneficiary thereof or any person otherwise interested in or affected by any trust created hereunder, trustee (or the distributions trustee, with respect to matters within the discretion of the distributions trustee) is authorized to resolve such doubts in such manner as trustee deems equitable and proper. Settlor's intention is to avoid suits for construction or instruction to the fullest extent possible; provided, however, that nothing in this section shall restrict any ability trustee would otherwise have to present any matter to a court for resolution, including a request for construction or instruction. Subject to trustee's and the distributions trustee's fiduciary obligations, all decisions and actions of trustee or the distributions trustee in the exercise of the discretion and power vested in such trustee by the terms and provisions of this Declaration shall be final, binding and conclusive upon all parties ever interested hereunder.



Executor and Trustee Power to Construe Instrument

- Are these provisions valid?
- Are these provisions useful?
- What is the risk that they trigger a dispute that makes the exercise of the power not worth the candle?
- Advise of counsel and legal opinions



Co-Fiduciary Management Issues

- Co-trustees have co-extensive fiduciary duties
 - Duty to cooperate and removal due to hostility
 - Duty of loyalty
 - Duty of disclosure
 - Duty to properly manage and common law rule of non-delegation
- What if there are three (or more) co-trustees but they are not unanimous?
- Resolving deadlocks
- Corporate trustee with co-trustee?
- Compensation issues
- Attorney/client communication issues



Co-Fiduciary Management Issues

- Section 113.085 discusses delegation and provides:
 - (c) A cotrustee shall participate in the performance of a trustee's function unless the cotrustee:
 - (1) is unavailable to perform the function because of absence, illness, suspension under this code or other law, disqualification, if any, under this code, disqualification under other law, or other temporary incapacity; or
 - (2) has delegated the performance of the function to another trustee in accordance with the terms of the trust or applicable law, has communicated the delegation to all other cotrustees, and has filed the delegation in the records of the trust.
 - (d) If a cotrustee is unavailable to participate in the performance of a trustee's function for a reason described by Subsection (c)(1) and prompt action is necessary to achieve the efficient administration or purposes of the trust or to avoid injury to the trust property or a beneficiary, the remaining cotrustee or a majority of the remaining cotrustees may act for the trust.
 - (e) A trustee may delegate to a cotrustee the performance of a trustee's function unless the settlor specifically directs that the function be performed jointly. Unless a cotrustee's delegation under this subsection is irrevocable, the cotrustee making the delegation may revoke the delegation.



Co-Fiduciary Management Issues

- Co-trustees can be liable for the acts of their co-trustees.
- Section 114.006 states:
 - (a) A trustee who does not join in an action of a co-trustee is not liable for the co-trustee's action, unless the trustee does not exercise reasonable care as provided by Subsection (b).
 - (b) Each trustee shall exercise reasonable care to: (1) prevent a co-trustee from committing a serious breach of trust; and (2) compel a co-trustee to redress a serious breach of trust.
 - (c) Subject to Subsection (b), a dissenting trustee who joins in an action at the direction of the majority of the trustees and who has notified any co-trustee of the dissent in writing at or before the time of the action is not liable for the action.



Co-Fiduciary Management Issues

- The Texas Property Code allows a co-trustee to sue another co-trustee for breach of fiduciary duty, to seek removal of the co-trustee.
- Section 113.082 provides:
 - (a) A trustee may be removed in accordance with the terms of the trust instrument, or, on the petition of an interested person and after hearing, a court may, in its discretion, remove a trustee and deny part or all of the trustee's compensation if: (1) the trustee materially violated or attempted to violate the terms of the trust and the violation or attempted violation results in a material financial loss to the trust; (2) the trustee becomes incapacitated or insolvent; (3) the trustee fails to make an accounting that is required by law or by the terms of the trust; or (4) the court finds other cause for removal.
 - (b) A beneficiary, co-trustee, or successor trustee may treat a violation resulting in removal as a breach of trust.



Co-Fiduciary Management Issues

- In Section 114.008, in addition to common-law damage claims, a co-trustee can seek the following statutory remedies for breach of trust:
 - (a) To remedy a breach of trust that has occurred or might occur, the court may: (1) compel the trustee to perform the trustee's duty or duties; (2) enjoin the trustee from committing a breach of trust; (3) compel the trustee to redress a breach of trust, including compelling the trustee to pay money or to restore property; (4) order a trustee to account; (5) appoint a receiver to take possession of the trust property and administer the trust; (6) suspend the trustee; (7) remove the trustee as provided under Section 113.082; (8) reduce or deny compensation to the trustee; (9) subject to Subsection (b), void an act of the trustee, impose a lien or a constructive trust on trust property, or trace trust property of which the trustee wrongfully disposed and recover the property or the proceeds from the property; or (10) order any other appropriate relief.
- Issues arising from the payment of attorney's fees



Co-Fiduciary Management Issues

- Corporate trustees with trust consultant/protector/advisor
 - What do these terms mean and are they different?
 - Is a Nevada trust protector a fiduciary?
 - Texas Trust Code § 114.0031 (our “Directed Trusts; Advisors” statute) defines an “advisor” as including a protector “in this section”
 - (a)(1) says “‘Advisor’ includes protector.”
 - (d)’s provisions are from the Delaware Directed Trust Statute



Co-Fiduciary Management Issues

- (d) reads:
 - A protector has all the power and authority granted to the protector by the trust terms, which may include:
 - (1) the power to remove and appoint trustees, advisors, trust committee members, and other protectors;
 - (2) the power to modify or amend the trust terms to achieve favorable tax status or to facilitate the efficient administration of the trust; and
 - (3) the power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the trust terms.
- (d)'s (1) to (3) are permissive, but have little substantive meaning



Co-Fiduciary Management Issues

- (a)(2) defines “investment decision” in section 114.0031 as meaning, “with respect to any investment, the retention, purchase, sale, exchange, tender, or other transaction affecting the ownership of the investment or rights in the investment and, with respect to a nonpublicly traded investment, the valuation of the investment.”
- For purposes of section 114.0031, (c) says “an advisor with authority with respect to investment decisions is an investment advisor.”



Co-Fiduciary Management Issues

- (e) If the terms of a trust give a person the authority to direct, consent to, or disapprove a trustee's actual or proposed investment decisions, distribution decisions, or other decisions, the person is an advisor. An advisor is a fiduciary regardless of trust terms to the contrary except that the trust terms may provide that an advisor acts in a nonfiduciary capacity if:
 - (1) the advisor's only power is to remove and appoint trustees, advisors, trust committee members, or other protectors; and
 - (2) the advisor does not exercise that power to appoint the advisor's self to a position described by Subdivision (1).



Co-Fiduciary Management Issues

- (e-1) Subsection (e) does not prohibit the exercise of a power in a nonfiduciary capacity as required by the Internal Revenue Code for a grantor or other person to be treated as the owner of any portion of the trust for federal income tax purposes.
- (f) A trustee who acts in accordance with the direction of an advisor, as prescribed by the trust terms, is not liable, except in cases of wilful misconduct on the part of the trustee so directed, for any loss resulting directly or indirectly from that act.



Co-Fiduciary Management Issues

- (g) If the trust terms provide that a trustee must make decisions with the consent of an advisor, the trustee is not liable, except in cases of wilful misconduct or gross negligence on the part of the trustee, for any loss resulting directly or indirectly from any act taken or not taken as a result of the advisor's failure to provide the required consent after having been requested to do so by the trustee.



Co-Fiduciary Management Issues

- (h) If the trust terms provide that a trustee must act in accordance with the direction of an advisor with respect to investment decisions, distribution decisions, or other decisions of the trustee, the trustee does not, except to the extent the trust terms provide otherwise, have the duty to:
 - (1) monitor the conduct of the advisor;
 - (2) provide advice to the advisor or consult with the advisor; or
 - (3) communicate with or warn or apprise any beneficiary or third party concerning instances in which the trustee would or might have exercised the trustee's own discretion in a manner different from the manner directed by the advisor.



Co-Fiduciary Management Issues

- (i) Absent clear and convincing evidence to the contrary, the actions of a trustee pertaining to matters within the scope of the advisor's authority, such as confirming that the advisor's directions have been carried out and recording and reporting actions taken at the advisor's direction, are presumed to be administrative actions taken by the trustee solely to allow the trustee to perform those duties assigned to the trustee under the trust terms, and such administrative actions are not considered to constitute an undertaking by the trustee to monitor the advisor or otherwise participate in actions within the scope of the advisor's authority.



Co-Fiduciary Management Issues

- Does the Texas Directed Trust Statute work as well as other states' statutes?
 - This concept was substantially developed in asset protection states to minimize amount of work and duties (and fees) of corporate trustees of asset protection trusts
 - As a result, trustees directed trustee expertise is primarily found in asset protection states.
- Are directed trusts useful to keep corporate fiduciaries from practicing all the fiduciary law they know?



Co-Fiduciary Management Issues

- Is there a best practice in Texas in using the term trust consultant, trust protector, or trust advisor?
- If you divided the trusteeship and give one of the trustees all responsibilities for investments or distributions, with the other trustee having all other trustee powers and duties, is either of the trustees an “advisor” under the Texas Directed Trust Statute?
- Does trust protector owe any fiduciary duties to the grantor or co-grantor?
- Should your trust protector’s power be a springing power?



Uniform Prudent Investor Act Delegation

- Section 117.011 provides:
 - (a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in: (1) selecting an agent; (2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and (3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.
 - (b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.



Uniform Prudent Investor Act Delegation

- (c) A trustee who complies with the requirements of Subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated, unless: (1) the agent is an affiliate of the trustee; or (2) under the terms of the delegation: (A) the trustee or a beneficiary of the trust is required to arbitrate disputes with the agent; or (B) the period for bringing an action by the trustee or a beneficiary of the trust with respect to an agent's actions is shortened from that which is applicable to trustees under the law of this state.
- (d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this state, an agent submits to the jurisdiction of the courts of this state.



Impact of Exculpatory Clauses

- Section 114.007 provides:
 - (a) a term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that the term relieves a trustee for liability: (1) a breach of trust committed: (A) in bad faith; (B) intentionally; or (C) with reckless indifference to the interest of the beneficiary; or (2) any profit derived by the trustee from a breach of trust.
 - (c) This section applies only to a term of a trust that may otherwise relieve a trustee from liability for a breach of trust. Except as provided in Section 111.0035, this section does not prohibit the settlor, by the terms of the trust, from expressly: (1) relieving the trustee from a duty or restriction imposed by this subtitle or by common law; or (2) directing or permitting the trustee to do or not to do an action that would otherwise violate a duty or restriction imposed by this subtitle or by common law.



Duty to Act In Good Faith

- Section 111.0035 provides that a settlor cannot create a provision that relieves the trustee of the duty “to act in good faith and in accordance with the purposes of the trust.”
- Section 113.029(a) provides:
 - “Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of terms such as “absolute,” “sole,” or “uncontrolled,” the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.”



Slicing and Dicing Fiduciary Powers and Disposition Powers

- Common ways of dividing these powers
 - Removal & replacement power
 - Interested trustee
 - Distribution powers
 - Other permissible powers
 - Independent trustee or trust consultant
 - Wide-open distribution powers
 - Power to convert power of appointment
 - Modification of trusts for S-Corporation purposes.
 - Controlled Corporate Stock
 - Investment trustee (an advisor?)
 - Distribution trustee (an advisor?)



Slicing and Dicing Fiduciary Powers and Disposition Powers

- Tax issues with each way to divide
 - Can a settlor hold distribution powers limited by ascertainable standard?
 - Do you withhold this power from a prospective fiduciary who is not of a nature to stay within the limits of his or her power?
 - How about power to decant held by trustee who is an interested person?
 - How about Nevada notice of proposed action?



Slicing and Dicing Fiduciary Powers and Disposition Powers

- Logistic and communication issues when you slice and dice
- What happens if the position that holds the power to direct is vacant?
- What drives these choices?
- Advantages and disadvantages of each alternative



Discretionary Charitable Distributions by a Fiduciary or Powerholder

- Ways to do this?
- Are the income tax consequences different with a fiduciary distribution power or pursuant to a power of appointment?
- Is the tax result different with a power in an original document and pursuant to a modification?
- Disadvantages (different if beneficiary v appointee)?
- Can you run afoul of Section 674?



Strategies to Increase Flexibility During Fiduciary Administration

- Decanting or other modification techniques
- Are there any limits on how you can use merger to avoid decanting limitations?
 - What are the consequences if this does not work?
 - Can you fall into a 2036 or 2038 issues for the grantor?



What's Different and What's Changed in Asset Protection States

- Delaware
- Nevada
- Other significant states
- Any unauthorized practice of law issues lurking here?
- Shifting situs under the same document



Advising Fiduciaries Regarding Powers and Acting Pursuant to Them



The Importance of Cooperation
Between Fiduciaries, Attorneys and Accountants



Powers of Appointment vs. Fiduciary Powers

- Differences in powerholder's potential liability?
- Can fiduciary exercise a nonfiduciary power of appointment without regard to fiduciary duties?
- Tax consequences?
- Standing?



Exercising Powers of Appointment by Committee

- DINGs, etc.
- Private foundations are where this idea is commonly seen.
- Split?
- Making exercise subject to approval by third party?



Who Gets Fiduciary Liability Insurance?

- Attorneys covered under legal malpractice policy?
 - What if not acting in a fiduciary capacity?
- Other types of policies for fiduciaries?
- Coverage for “nonfiduciary” power?



Making a Beneficiary the Grantor for Income Tax Purposes

- How would a fiduciary or a grantor do this?
 - Crummey.
 - Give the beneficiary a withdrawal power for limited time, with a limited power of appointment.
- Would you do this if you were okay with the transfer tax, spendthrift, and other consequences?
- Income tax consequences if family members make contributions to pay ranch expenses
- State income tax considerations



Dealing with Conflicts Between Trustees and Medical Agents



Problems Due to Insufficient Planning



Dealing with Difficult Family Dynamics



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