

Rules of Trust Administration in Kansas: Trust Provisions

Prepared by:
Richard W. Byrum,
Richard W. Byrum, PC



Rules of Trust Administration in Kansas

III. Trust Provisions

A. Distribution Provisions and the Trustee's Powers

We start with the UTC:

K.S.A. § [58a-814](#): Discretionary powers. Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms 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.

The Trustee can never go beyond the authority in the instrument, or that which can be fairly interpreted from the purposes of the Trust. If there is any doubt, the Trustee should obtain court approval.

There probably is no more possible point of contention than his need or desire to make distributions from the Trust. There could likely be a mix of beneficiaries-minors, those with special needs, those with educational needs, and variances in ages.

The UTC sets forth this guidance for distributions when a trust is completely or partially closed.

K.S.A. § 58a-817: Distribution upon termination. (a) Upon termination or partial termination of a trust, the trustee may send to the qualified beneficiaries a proposal for distribution. The right of any qualified beneficiary to object to the proposed distribution terminates if the qualified beneficiary does not notify the trustee of an objection within 30 days after the proposal was sent but only if the proposal informed the qualified beneficiary of the right to object and of the time allowed for objection.

(b) Upon the occurrence of an event terminating or partially terminating a trust, the trustee shall proceed expeditiously to distribute the trust property to the persons entitled to it, subject to the right of the trustee to retain a reasonable reserve for the payment of debts, expenses, and taxes.

(c) A release, upon termination or partial termination of a trust, by a beneficiary of a trustee from liability for breach of trust is invalid to the extent:

- (1) It was induced by improper conduct of the trustee; or
- (2) the beneficiary, at the time of the release, did not know of the beneficiary's rights or of the material facts relating to the breach.

But what if there are minors, or those who might not be competent to make such a decision? The practitioner might find the following provisions helpful:

Whenever and so long as any Trust beneficiary is under a legal disability or, in the opinion of the Trustees, is incapable of giving timely and adequate attention to business matters, the Trustees are authorized to make any payments which the beneficiary would be entitled to receive in any one or more of the following ways:

- (a) Directly to the beneficiary;
- (b) To the guardian of the beneficiary's property;
- (c) To the person with whom the beneficiary resides at the time of payment, to be expended by such person for the benefit of the beneficiary; or
- (d) By the Trustees' making payment for the benefit of such beneficiary.

These payments shall be made in such manner as the Trustees deem best. The receipt of the beneficiary, guardian or other person to whom such payment is made shall be a full and complete discharge of the Trustees with respect thereto.

The Grantor's primary concern is for the welfare of the immediate Trust beneficiaries, and, to that end, the Trustees are directed to administer the Trust estate to the best advantage of the beneficiaries then entitled to enjoy the benefits of the Trust estate, even though the result might be detrimental to subsequent beneficiaries. Accordingly, the Trustees shall be under no duty to create any reserve for depreciation or depletion out of income, but they may do so if deemed advisable.

B. Succession of Trustees and Applicable Law

K.S.A. 58-2434: Same; appointment, succession, powers, duties, terms and compensation of trustees. The instrument or will creating such trust may provide for the appointment, succession, powers, duties, terms and compensation of the trustee or trustees; and in all such respects the terms of said instrument or will shall be controlling. If the said instrument or will makes no provision in regard to any of the foregoing, then the general laws of the state shall control as to such omission or omissions.

The following provisions to be included in the Trust instrument should be considered:

- (1) Any Trustee may resign at any time by delivering a written instrument of resignation to the Grantor during her lifetime, to any Co-Trustee after the Grantor's death or, if no Co-Trustee is then serving, to a majority in interest of the legally competent adult beneficiaries to whom Trust income is then payable. If a corporate trustee is appointed as Successor Trustee, then the person or persons who have the authority for such appointment may appoint any bank or trust company, authorized by law to conduct a trust business, having a published net worth of not less than Twenty-Five Million and

No/100 Dollars (\$25,000,000.00), as successor Trustee. The person or persons to whom an instrument of resignation may be given by any Trustee may approve the accounts of and give a full and complete release and discharge to the resigned Trustee without liability to any present or future beneficiary.

(2) The Grantor during his lifetime may remove a Trustee by delivering a written notice of discharge to such Trustee at least thirty (30) days prior to the effective date of the removal, and, in such event, the Grantor, at his option, may designate a successor Trustee. On the effective date of the removal, the discharged Trustee shall promptly deliver and transfer title to all Trust assets and records to the appointed successor Trustee.

(3) After the death of the Grantor, a majority in interest of the legally competent adult beneficiaries to whom Trust income is then payable may remove any corporate trustee by delivering a written notice of discharge to such corporate trustee at least thirty (30) days prior to the effective date of its removal; provided, however, that as a prerequisite to such removal, the person or persons having such right of removal shall first designate in the notice of discharge the appointed successor corporate trustee, which shall be a bank or trust company authorized by law to conduct trust business, having a published net worth of not less than Twenty-Five Million and No/100 Dollars (\$25,000,000.00). On the effective date of its removal, the discharged corporate trustee shall promptly deliver and transfer title to all Trust assets and records to the appointed successor corporate trustee.

(4) No successor Trustee shall be held liable for any act, omission or default of a predecessor Trustee or for any loss or expense resulting from or occasioned by the administration of the Trust estate prior to its becoming a Trustee. A successor Trustee shall not be required to examine or approve the acts and accounts of a predecessor Trustee.

C. Crummey Powers and Spendthrift Provisions

1. Crummey Powers.

a. This is a very complicated subject, best treated in as separate seminar on estate planning. Heretofore we have been concerned about trust draftsmanship issues and their relation to state law. The draftsmanship aspect of inserting Crummey Powers is strictly to create a result, with certain favorable tax consequences—particularly Federal Estate and Gift Tax consequences--to those who initiate or are affected by the transaction. The law that must be reviewed and understood, to achieve the desired result, must be carefully researched and applied. What makes it difficult is that it is not based upon a

clear statutory scheme. It is based rather upon judicial precedent, which is fact based. And the facts can vary widely.

b. A gift to a trust is a gift to the trust beneficiaries. Because a gift to a trust does not qualify as a present interest gift, the grantor will not get the benefit of the annual gift tax exclusion under I.R.C. §2503(b). The gift can qualify, however, for the annual gift tax exclusion if the beneficiaries are given an immediate right to withdraw ascertainable amounts cumulatively equal to the value of the gift to the trust. This right has become known as a Crummey power, named after the case upholding the use of a withdrawal right to qualify a gift to the trust for the annual gift tax exclusion.²

c. In *Crummey*, the Ninth Circuit had to choose which legal standard to apply in determining whether a gift to a trust coupled with a withdrawal was adequate to give the donor the applicable annual gift tax exclusion. As a general rule, gifts to an irrevocable trust in which the beneficiary's income interest is discretionary, or in which the trustee is allowed or directed to accumulate income (complex trusts), do not, generally, qualify for the gift tax annual exclusion. The reason is that the beneficiary lacks a present interest in the trust.

d. There are exceptions including gifts to IRC Section 2503(c) trusts and certain custodianships established for minors under the Uniform Gifts to Minors Act (UGMA) to the Unified Transfer to Minors Act (UTMA). Unfortunately, neither of these exceptions is of much help to a donor who wishes to accumulate income and potentially delay the distribution of both principal and income to beneficiaries until they are well into adulthood. Both IRC Section 2503(c) trusts and UGMA and UTMA custodianships

² *Crummey v. Commissioner*, 397 F.2d 82 (9th Circuit 1968).

require that the accumulated income and principal be distributed at the age of 21 (Section 2503(c) trusts) or at the age of majority (UGMA and UTMA custodianships).

e. The Crummey trust offers a solution to this dilemma. A Crummey trust gives beneficiaries the right to withdraw annual contributions for a limited period of time (for example, 30 days). According to the Ninth Circuit, the right of withdrawal gives the donee a present interest in the donated property up to the specified amount.

f. The Crummey trust, featuring withdrawal powers for beneficiaries, has been around for some time, and is a widely used tax planning tool. However, there continues to be uncertainty where the gift and income taxes intersect in connection with these trusts. There are some recent developments that offer clarification. Advisors need to be aware of the issues and the potential risks.

2. Spendthrift Provisions.

a. Spendthrift clauses protect the interests of beneficiaries (except the settlor) from their creditors and prevent the beneficiaries from transferring their interests. Specifically, the trust may provide that the interest of the beneficiary in the income or in the principal or in both may not be voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee

b. Example: If a husband and wife form a revocable trust with a spendthrift clause:

(i). During the lifetimes of both settlors, the spendthrift clause will not protect the interests of the settlors.

(ii) Upon the death of the first spouse to die, the spendthrift clause will protect the interest of the surviving spouse in the marital trust and the interests of the surviving spouse and all other beneficiaries in the non-marital trust.

However, the surviving spouse will continue to hold an interest in his or her share of the assets of the revocable trust. Consequently, the spendthrift clause will not protect the surviving spouse's interest in his or her share of the assets of the revocable trust.

(iii) Upon the death of the surviving spouse, the spendthrift clause will apply to all trusts that remain in existence and will protect all interests in those trusts.

c. The UTC contains the following provisions:

K.S.A 58a-501: Rights of beneficiary's creditor or assignee. To the extent a beneficiary's interest is not subject to a spendthrift provision, the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means. The court may limit the award to such relief as is appropriate under the circumstances.

K.S.A. § 58a-502: Spendthrift provision.

- (a) A spendthrift provision is valid.
- (b) A term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust," or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest.
- (c) A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this article, a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.
- (d) Whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion even if: (1) The discretion is expressed in the form of a standard for distribution; or (2) the trustee has abused the discretion.
- (e) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution.

Following is a sample spendthrift provision:

Excepting only the Grantor from the application of the provisions of this [Section], neither the principal nor the income of any Trust created hereunder shall be liable for the debts of any beneficiary thereof, nor shall the same be subject to seizure by a creditor of any beneficiary under any writ or proceeding at law or in equity, and no beneficiary shall have any power to sell, assign, transfer, encumber or in any other manner anticipate or dispose of his interest in the Trust or the income produced thereby.

