DRAFTING AGREEMENTS FOR FAILURE TO FUND A TRUST OR TO INTENTIONALLY NOT FUND A TRUST

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State Bar of Texas
29TH ANNUAL
ESTATE PLANNING & PROBATE DRAFTING
October 4-5, 2018
Dallas

CHAPTER 15

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EDUCATION:

- University of Texas School of Law, J.D. with High Honors, 1982. Chancellors; Order of the Coif; Associate Editor, TEXAS LAW REVIEW; Member, Board of Advocates
- University of Arizona, B.B.A. with High Distinction, 1979. Beta Alpha Psi; Beta Gamma Sigma

OTHER QUALIFICATIONS:

- Fellow, The American College of Trust and Estate Counsel (ACTEC), (Regent, 2017- ; Member: Business Planning, Estate & Gift Tax, and Fiduciary Income Tax Committees; Chair: Estate & Gift Tax Committee, 2013-2016)
- Board Certified, Estate Planning and Probate Law, Texas Board of Legal Specialization
- Adjunct Professor, University of Houston Law Center, 1988–2017, teaching Income Taxation of Trusts and Estates and Postmortem Estate Planning
- Best Lawyers in America, Trusts and Estates; Texas Super Lawyer, *Texas Monthly* and *Super Lawyers Magazine*
- Named *Best Lawyers'* 2013 Houston Trusts and Estates "Lawyer of the Year"
- Named by *Texas Lawyer* as a 2013 "Top Notch Lawyer" for Trusts and Estates
- Awarded 2017 Jim D. Bowman Award for Outstanding Contributions to the Profession by the Texas Bar College
- Awarded 2017 Standing Ovation Award by TexasBarCLE staff
- Admitted to Practice: State Bar of Texas; Federal District Court for the Southern District of Texas; United States Tax Court
- Certified Public Accountant, Texas, Certified 1983 (retired status, 2018)

PROFESSIONAL ACTIVITIES:

- Member, State Bar of Texas (Sections of Real Estate, Probate and Trust Law; Tax); Houston Bar Association (Probate, Trusts and Estates Section); Texas Bar College
- Member, Texas Society of Certified Public Accountants, Houston Chapter
- Member of the Board of Directors, ACTEC Foundation (2013-2018) (Former Chair: Grants Committee)
- Editor, ACTEC LAW JOURNAL (2012-2013)
- Estate Planning and Probate Law Exam Commission, Texas Board of Legal Specialization (Member 1993-2003, Chair 2000-2003)

RECENT SPEECHES AND PUBLICATIONS:

- Author: DAVIS'S TEXAS ESTATE PLANNING FORMS (O'Connor's, 2017, updated annually)
- Co-Author: Streng & Davis, RETIREMENT PLANNING–TAX AND FINANCIAL STRATEGIES (2nd ed., Warren, Gorham & Lamont, 2001, updated annually)
- Author/Speaker: Fiduciary Income Taxation and Subchapter J, American Bar Association Section of Real Property, Trust & Estate Law, Skills Training for Estate Planners – Fundamentals Course, 2015-2018
- Co-Author/Speaker: All About that Basis: How Income Taxes Have Reshaped Estate Planning, Estate Planning Council of Saint Louis, 2017; Philadelphia Estate Planning Council, 2016; 42nd Annual Notre Dame Tax and Estate Planning Institute, 2016; 36th, 37th, and 38th Annual ALI CLE Planning Techniques for Large Estates, 2016-2018
- Co-Author/Speaker: Estate Planning for Married Couples in a World with Portability and the Marital Deduction, 44th Annual Midwest/Midsouth Estate Planning Institute, 2017; 38th Annual ALI CLE Planning Techniques for Large Estates, 2018
- Panelist: Fiduciary Duties, State Bar of Texas 24th Annual Advanced Estate Planning Strategies Course, 2018
- Co-Author/Co-Presenter: Income Taxation of Trusts and Estates: Ten Things Estate Planners Should Know, National Association of Estate Planning Councils, 54th Annual NAEPC Advanced Estate Planning Strategies Conference, 2017
- Co-Author/Speaker: What Estate Planners Absolutely Have to Know about Income Taxation of Trusts and Estates, 44th Annual Midwest/Midsouth Estate Planning Institute, 2017
- Co-Author/Panelist: It's 1:45 p.m. in the Garden of Good and Evil: Now How Do We Deal with Value in Estate and Business Planning and Estate and Trust Administration?, 23rd Annual Advanced Estate Planning Strategies Course, 2017
- Co-Author/Panelist: Yes, I'll Order That Trust "Fully Loaded", State Bar of Texas 41st Annual Advanced Estate Planning and Probate Course, 2017; University of Miami 51st Annual Heckerling Institute on Estate Planning, 2017
- Co-Author/Co-Presenter: Planning for Married Clients: Charting a Path with Portability and the Marital Deduction, 42nd Annual Notre Dame Tax and Estate Planning Institute, 2016; 36th and 37th Annual ALI CLE Planning Techniques for Large Estates, 2016, 2017
- Co-Author/Co-Presenter: Maneuvering Among the Mazes and Minefields of Modern Estate Planning: Helping Clients Plan in a High Exemption World, Dallas Jewish Community Foundation 21st Annual Professional Advisors Seminar, 2016

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I. INTRODUCTION

In a perfect world, our clients would come to see us on a regular basis to ensure that their Wills and other estate planning documents are ideally suited to their current circumstances. In reality, however, the time that passes between the date that a Will or revocable trust is drafted, and the client dies, can be years or decades. In the meantime, the decedent's family and financial circumstances may have changed dramatically. In addition, tax and state laws may have also undergone substantial changes.

From a tax standpoint, two recent legislative enactments have had the effect of dramatically changing the math for traditional tax-planned estate planning documents. These same legislative enactments have also changed the priorities of many of our clients. Specifically, the American Taxpayer Relief Act of 2012, P.L. 112-240, 126 Stat. 2313 (2013) ("ATRA"), returned us to unified estate, gift, and generation-skipping transfer ("GST") tax laws. ATRA also made permanent some other important features, like portability, which allows a surviving spouse to use the "deceased spousal unused exclusion amount" (the "DSUE" amount) of his or her last deceased spouse if an estate tax return making the election to do so was filed by the deceased spouse's executor. High transfer tax exclusions and a tick up in the transfer tax rate, which closed much of the gap between income and transfer tax rates, caused estate planners to step back and refocus how they help clients plan their estates. More recently, the Tax Cut and Jobs Act of 2017, P.L. 115-97, 131 Stat. 2054 (2018) ("TCJA 2017")0F0F[1] made additional significant changes to the income and transfer tax laws. Of course, these changes are far from unique in the history of the federal estate tax. **Exhibit A** summarizes the federal estate tax exemptions, top rates, gift tax annual exclusions and GST tax exemptions from the inception of the estate tax in 1916 through 2018.

From a state law standpoint, the founding fathers of the State of Texas showed their wisdom by allowing the Texas Legislature to meet only every other year, and then for not more than 140 days. Nevertheless, the cumulative effect of legislative changes over many years can dramatically change how Wills and trusts are administered and interpreted.1F1F[2] In addition, Texas appellate courts are constantly called upon to interpret Wills and trusts, administrative requirements, fiduciary duties, and similar topics, all of which may alter how a Will or trust, being implemented years after its preparation, may be interpreted after the testator or grantor's death.

Legislative changes and judicial decisions, when combined with naturally occurring changes in a client's family and financial circumstances, often mean that the decedent, if given the chance, might well have chosen to change his or her estate planning documents immediately before death. However, probate laws relating back to the English Statute of Wills enacted in 1540 generally preclude family members from using parole or other evidence to alter a decedent's estate plan. There are, however, mechanisms that permit a family, in a cooperative setting, to accomplish some types of changes. These mechanisms include tried and true tools such as disclaimers and simple gifts, to more sophisticated tools, including judicial trust modifications (and now, in some limited circumstances, Will reformations), trust modification without court involvement, trust decanting, and family settlement agreements.

II. ISSUES WHEN FUNDING TRUSTS[3]

A. Probate vs. Non-Probate Assets

In order to fund bequests made by a Will, an executor must first identify which assets are within his or her control. Estate planning professionals know that while a variety of assets may transfer wealth as a result of a client's death, only some of those assets will be controlled by the terms of the decedent's Will. This fact often comes as a surprise, however, to many executors (and beneficiaries). Life insurance, retirement accounts, and accounts held as payable-on-death to a named beneficiary or in survivorship form all pass outside the

[1] The technical name of the Act is "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018", but "AAPRPTIIVCRBFY 2018" seems to be a remarkably unhelpful acronym. Some have suggested "the Act Formerly known as TCJA 2018," or perhaps its abbreviation, "AFKATCJA."

[2] *See, e.g.,* Featherston, *The Changing World of Will Construction: The Legislature's Influence*, State Bar of Texas 18th ANN. ADV. EST. PL. & PROB. COURSE (1994); Featherston, *The Interpretation, Construction and Drafting of Wills and Trusts: The Legislature's Influence*, UTCLE 10th ANN. EST. PL. GUARD. & ELD. LAW CONF. (2008).

[3] There are numerous outlines that provide a thorough discussion of issues that arise in funding testamentary bequests. *See, e.g.,* Davis, *Funding Unfunded Testamentary Trusts*, 48 UNIV. OF MIAMI ANN. HECKERLING INST. ON EST. PL., Ch. 8 (2014). For sample documents commonly used to document funding these bequests, *see* Prangner, *Don't Let the Door Hit You on the Way Out: Funding Agreements, Receipts and Releases, and All That Jazz,* State Bar of Texas 26th ANN. EST. PL. & PROB. DRAFTING COURSE (2015); Ben-Yaacov, *Are We Having Fun(ding) Yet?: Practical Funding Issues Encountered in Estate Administrations*, State Bar of Texas 35th ANN ADV. EST. PL. & PROB. COURSE (2011).

Will, and are thus typically unavailable to fund testamentary bequests unless paid to the executor or the estate, to the trustee of a revocable trust, or to a testamentary trustee. For clients that have accumulated amounts in retirement plans while residing in community property states, one must be mindful that, although retirement accounts are non-probate assets as to the participant or employee, to the extent of the non-participant spouse's community property interest in those assets, they are probate assets as to that spouse. *See Allard v. Frech*, 754 S.W.2d 111 (Tex. 1988). In addition, the U.S. Supreme Court has ruled that as to retirement accounts governed by ERISA, federal law preempts state community property laws, and the non-participant spouse has no devisable interest in those plans. *Boggs v. Boggs*, 520 U.S. 833, 138 L. Ed. 2d 45 (1997). Since IRAs are not governed by ERISA, common law principles of ownership, which may include community property rights of a non-participant spouse, continue to apply to IRAs and other non-ERISA retirement assets.

B. Payment of Debts and Expenses

One of an executor's primary responsibilities during the administration process is payment of debts and expenses of the decedent and the estate, including applicable taxes. In fact, much of local probate law deals with the procedure for filing claims against estates, the procedure for executors to evaluate and pay those claims, identification of assets used to pay claims, and the order in which the bequests "abate" or are diminished to the extent that estate assets are used to pay debts and expenses. *See, e.g.,* TEX. ESTS. CODE Chpt. 355 ("Presentment and Payment of Claims"); UNIF. PROB. CODE Art. III, Part 8 ("Creditors' Claims") (2010). Thus, although executors do not owe a fiduciary duty to estate creditors, a part of the process in administering an estate is insuring that debts of the decedent are paid or provided for to the extent that the estate has the resources to do so. Obviously, to the extent that assets are used to pay estate creditors, they are unavailable to fund testamentary gifts.

C. Apportionment of Taxes

In those estates in which estate or inheritance taxes are owed, some assets of the estate will necessarily be utilized in paying those taxes. In the absence of specific instructions contained in the Will to the contrary, local law generally sets forth a specific mechanism to allocate taxes, interest, and penalties among the various beneficiaries of the Will. *See, e.g,* TEX. ESTS. CODE Chpt. 124, Subchpt A; UNIF. PROB CODE Art. III, Pt. 9A ("Uniform Estate Tax Apportionment Act") (2010).

D. Other Changes in Assets During Administration

In addition to the payment of debts, expenses, and taxes, the assets of the decedent's estate are likely to undergo a number of other changes during administration. As a result of these changes, the assets used to fund bequests are rarely identical to those on hand at the date of the decedent's death. These changes can take a variety of forms.

1. <u>Income Earned During Administration</u>

If the decedent owns income-producing assets, the executor will earn income during the administration of the estate. Local law will generally outline how the income generated by estate assets is to be allocated among beneficiaries. *See* TEX. ESTS. CODE Chpt. 310 ("Allocation of Estate Income and Expenses"), which incorporates by reference in part TEX. PROP. CODE Chpt. 116 ("Uniform Principal and Income Act").

2. <u>Sales and Exchanges of Estate Assets</u>

It is not unusual for the executor to dispose of assets during the administration process. In fact, it is frequently necessary for an executor to sell one or more of the assets of the estate in order to acquire sufficient cash to pay debts and expenses as they come due. Moreover, the executor may dispose of assets in the exercise of prudent discretion, to protect and preserve the value of the estate. For example, an asset that is declining rapidly in value may be converted into an asset of more stable value. Although it is unusual for an executor to actively acquire new assets with cash (except safe, short-term investment assets), it is not uncommon for assets in the estate to change form during administration. Surprisingly, under historical common law principles, the executor of an estate did not have an inherent power to continue a decedent's business. Instead, the executor was normally charged with a duty to wind up the business. *See, e.g., Willis v. Sharp*, 113 N.Y. 586, 21 N.E. 705 (1889); *In re Wolf's Estate*, 87 N.Y.S.2d 327 (Surr. Ct. 1943). The rationale for this holding is that the continuation of the decedent's business often prolongs the administration of an estate and delays the payment of creditors, contrary to public policy that estates be promptly settled and distributed. *See* Davis, *Income Tax Consequences (and Fiduciary Implications) of Trusts and Estates Holding Interests in Pass-Through Entities*, State Bar of Texas 25th ANN. ADV. EST. PL. & PROB. COURSE (2001). In the modern setting, however, executors often act to preserve and protect estate assets that might include business interests. Thus, for example, an executor may determine to incorporate a proprietorship or partnership operated by the decedent. This incorporation may be undertaken to minimize liability of the estate to the claims of the business. As a result of this transaction, the business assets formerly owned outright by the decedent are converted into stock in the new enterprise. An executor may also transfer assets to a partnership or limited liability company ("LLC") in order to provide a convenient mechanism to manage assets that might

Title search: Drafting Agreements for Failure to Fund a Trust or To Intentionally Not Fund a Trust

First appeared as part of the conference materials for the
24th Annual Estate Planning, Guardianship and Elder Law Conference session
"What the Surviving Spouse Needs to Do, and What to Do if They Don't"