

**OUTLINE OF PRESENTATION ON
ESTATE PLANS AND THE PROBLEMS THEY CAN CAUSE IN A
DIVORCE: WHEN TRUST LAW, ENTITY LAW,
AND DIVORCE LAW COLLIDE**

RICHARD R. ORSINGER, *San Antonio*
Orsinger, Nelson, Downing & Anderson, LLP

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1. Estate Planning Devices

Intervivos sales
 Intervivos gifts
 Transfers w. retained life estate
 Power of attorney
 Survivorship agreements
 Last Will and Testament
 POD, survivorship, and trust accounts
 Life insurance
 Revocable trusts
 Irrevocable trusts
 Family limited partnerships

Unless decree or insured re-designates, or if in trust for children

Under Tex. Fam. Code §9.302:

Beneficiary designation under IRA, ESOP, stock option, savings, bonus, profit-sharing, or other employer plan (doesn't apply to retirement benefits)

Unless decree or participant spouse re-designates, or if in trust for children

2. Non-Testamentary Transfers

Life insurance - beneficiary designation
 Financial accounts: P.O.D., JTWROS, trust
 Retirement benefits - beneficiary designation
 Survivorship agreements

3. Planning for Incapacity

Powers of attorney - money
 Power of attorney - medical
 Declarations of guardian

4. Lifetime Planning

Intervivos sales
 Intervivos sales to defective trusts
 Intervivos gifts to irrevocable trusts
 Irrevocable life insurance trusts (ILIT)
 Family limited partnerships (FLP)
 Discounting techniques to reduce value
 Transfer with retained life estate

5. Automatic Revocations Upon Divorce

Under Estates Code §123.052:

Provisions in revocable trust favoring ex-spouse
 General and special powers of attorney
 Designations as personal representative
 Applies to relatives of only former spouse

Unless otherwise provided in:

Court order
 Express term of the trust instrument
 Express provision in divorce settlement agreement

6. Automatic Revocations Upon Divorce

Under Tex. Fam. Code §9.301:

Beneficiary designation in life insurance policy

POWER OF ATTORNEY**7. Power of Attorney (#1)**

Must be in writing and signed

To be "durable" must say effective during incompetency

Establishes principal/agent relationship

Agent has powers described in POA

Agent has fiduciary duty to principal

Filing of divorce does not affect POA

Granting of a divorce terminates POA

Revoking POA; communicating revocation; filing of revocation record

8. Power of Attorney (#2)

Power of agent to amend or revoke trust should be in POA and trust agreement

Enforceability of power to amend or revoke trust not certain

Guardian of estate needs court order to revoke a trust

GIFT**9. Gift**

Voluntary gratuitous transfer of property

Inconsistent with payment of consideration

Requires donative intent, delivery, and acceptance

Parent-to-child transfer raises presumption of gift

Gift of property subject to debt (w and w/o assumption)

Set aside for fraud, duress, mistake, breach of fiduciary duty, etc.

Gift tax issues (reporting to IRS, lifetime exemption, paying tax)

SURVIVORSHIP AGREEMENTS

10. Survivorship Agreements

Non-testamentary transfer
 Not part of decedent's probate estate
 Included in Federal taxable estate
 By two or more persons who "hold" an interest in property
 Must be in writing
 Not inferred from joint ownership
 Conflict of laws – if >50% in Tx, Tx law applies
 Unclear how to revoke survivorship agreement in non-community property

11. Community Property Survivorship Agreements

Must be in writing and signed by both spouses
 Can be revoked per terms in agreement
 Absent terms, revoked by written instrument signed by both spouses
 Or revoked in writing by one spouse, w. signed written notice to other spouse
 Ends if property is conveyed away (unless agreement provides otherwise)
 Survivorship in com. property allowed after 1987

MULTI-PARTY FINANCIAL ACCOUNTS**12. Multi-Party Financial Accounts**

Governed by Estates Code ch. 113
 Account -- "contract of deposit of funds"
 Account -- "between depositor and financial institution"
 Financial institution – bank, S&L, credit union, brokerage firm
 Multi-party account includes
 P.O.D. account
 Right of survivorship account
 Trust account

13. Pay on Death Account

Payable to depositor(s) during life; on death payable to P.O.D. payee(s)
 Prior to death, owned by parties in proportion to "net contributions"
 On the death of last surviving party, ownership passes to P.O.D. beneficiary
 To terminate: withdraw funds; close account

14. Survivorship Account

Owned in proportion to net contributions
 On death ownership passes to surviving party

To terminate: withdraw funds; close account

15. Trust Account

Held in name of one or more parties as trustee for one or more beneficiaries
 Essentially a revocable trust
 Legal title/beneficial interest is with trustee
 Beneficiary has no rights prior to trustee's death
 If beneficiary dies first, trust lapses
 Non-testamentary transfer
 Not in probate estate
 Included in taxable Federal estate
 To terminate: withdraw funds; close account

EXPRESS TRUSTS**16. Express Trust Terminology (#1)**

Tex. Trust Act/Tex. Trust Code
 Express trust
 Trust agreement
 Testamentary trust
 Legal title/beneficial interest
 Settlor, trustee, beneficiary
 Revocable/Irrevocable trust
 Spendthrift trust
 Self-Settled trust

Charitable Trust

17. Express Trust Terminology (#2)

Trust assets
 Trust liabilities
 Trust principal/corpus
 Trust income/expenses
 Trust fiduciary accounting

Current beneficiary
 Income beneficiary
 Remainder beneficiary
 Contingent beneficiary

18. Express Trust Terminology (#3)

General power of appointment
 Special power of appointment
 Trustee resignation/removal
 Rule Against Perpetuities

19. Express Trust Terminology (#4)

Estate Planning Trusts:
 QPRT

- GRAT
- GRUT
- Charitable remainder trust
- Irrevocable life insurance trust
- Grantor trust
- “Defective” trust
- Crummey trust
- Generation skipping trust

- Federal Tax Exemptions
- Trust Income Tax –
 - Revocable/irrevocable
 - Simple trust/complex trust
 - Defective trust
 - Accumulated trust income
 - Distributable net income (DNI)
 - Claim of Right Doctrine
 - IRS Form 1041/K-1

Beneficiary’s income tax: IRS Form 1040 and Schedule E

20. Creating an Express Trust

- Oral declaration (subject to Statute of Frauds)
- Putting “trust” in financial account name
- Reciting “in trust” in deed for real estate
- By agreement with trustee
- In Last Will & Testament

21. Trustee’s Powers & Duties

- Hold title to trust assets
- Follow instructions in trust agreement/Will
- Exercise discretion in reasonable manner
- Manage trust assets
- Allocate principal & income
- Make distributions per trust standards
- Accounting; tax reporting
- Manage legal affairs

22. Trustee’s Powers Over Distributions

- Mandatory distribution
- Discretionary distribution
- Ascertainable Standard
 - HEMS Standard
 - Best Interest Standard
 - Other resources of beneficiary
- Consequences of violating standard
- Maturing of trust

23. Beneficiaries’ Rights

- Own beneficial interest in trust assets
- Rights are stated in trust agreement or Will
- Fiduciary duty owed by trustee
- Right to accounting upon request
- Right to sue trustee
- Right to sue on behalf of trust
- Right to participate in trust litigation

24. Trust Taxation

- Transfer tax –
 - Estate and Gift Tax
 - Generation Skipping Tax

25. Trust Principal and Income Defined

“Principal” means property held in trust for distribution to a remainder beneficiary when the trust terminates.”

Tex. Prop. Code §116.002(10)

“Income” means Money or property that a fiduciary receives as current return from a principal asset.”

Tex. Prop. Code § 116.002(4).

26. Calculating Trust Net Income

- + Total receipts allocated to income during a period
- Less disbursements made from income during that period
- +/-Transfers to or from income during the period

Tex. Prop. Code § 116.002(8)

27. Taxable Income vs. Trust Accounting Income

Trusts with mandatory distribution of “net income”

“Net Income” means trust accounting income, not taxable income. Has the spouse/beneficiary received the required distributions?

Example: Trust requires (mandatory) distribution of net income. Trust receives \$100 of tax exempt income. This income is not reportable so not on trust tax return. Beneficiary is still entitled to the \$100.

Divorce attorney must look beyond trust tax return.

28. Characterization of Trust Assets

- Beneficial interest vs. assets held in trust
- Premarital trust
- Gift trust

- Testamentary trust
- Self-settled revocable trust
- Self-settled irrevocable trust
- Remainder interests
- Contingent interests
- Undistributed income added to principal
- Transfer of sep. pty. into trust
- Transfer of com. pty. into trust
- Commingling inside trust

29. Characterization of Trust Distributions

- Spendthrift Trust
- Self-settled revocable trust
- Self-settled irrevocable trust (w or w/o reversion)
- Gift or testamentary trust
- Mandatory distributions of principal/income
- Discretionary distributions of principal/income
- Undistributed income added to principal
- Distributions of commingled funds
- Sharma v. Routh
 - “Present possessory right” to part of corpus (Frost/ Guzman)
 - “Interest in” corpus (Hedges)

30. Attacking Creation of or Conveyances to Trust

- Dry /passive trust
- Illusory trust (retained control or benefits)
- Colorable trust (secret/tacit agreement)
- Power to revoke/power of appointment
- Settlor’s intent
- Delivery and acceptance of gift
- Fraud/constructive fraud/breach of fid. duty
- Fraud on the community
- Accident
- Mistake
- Duress
- Fraudulent conveyance
- Statute of Frauds

31. Unwinding Irrevocable Trust (By Agreement)

- Rescission/Reformation (mistake, accident, etc.)
- Judicial modification (changed circumstances)
- Decanting
- Fiduciary duties
- Distributing assets
- Exercising power of appointment
- Payments in settlement
- Rights of beneficiaries
- Tax consequences

- Irrevocable life insurance trust

32. Trust Litigation: Claims

- Fraud
- Constructive Fraud
- Breach of fiduciary duty (+ aiding and abetting)
- Declaratory judgment
- Reformation/rescission
- Damages
- Impose resulting trust
- Impose constructive trust
- Remove trustee
- Divorce claims:
 - Fraud on the community
 - Reconstitute community estate

33. Trust Litigation: Mechanics

- Which court?
- Capacity/standing
- Necessary parties
- Permissive joinder (TRCP 40)
- Third Party claims (TRCP 38)
- Separate trials (TRCP 40(b))
- Toll limitations: minority/for fraudulent concealment
- Guardian/attorney ad litem
- Virtual representation
- Discovery
- Tax consequences
- Arbitration

34. Trial Court’s Powers

- Interpret trust agreement
- Review trustee’s abuse of discretion
- Modify/terminate trust
- Remove trustee
- Alter trustee’s bond
- Alter trustees’ compensation
- Disgorge profits
- Appoint receiver/auditor
- Award money damages
- Temporary and final injunction
- Impose constructive/resulting trust
- Award attorney’s fees (TPC § 114.064)
- Divorce property division

FAMILY LIMITED PARTNERSHIPS (flp)

35. FLP Terminology

TBOC ch. 153
 Limited partnership
 Limited partnership agreement
 Certificate of Organization
 General partner
 General partner interest
 Limited partner
 Limited partner interest
 %, units
 FLP initial capital
 Later capital contributions
 Capital accounts

36. Use of FLP In Estate Planning

Retaining GP interest in older generation
 Transferring LP interests to younger generation
 Transferring assets into FLP
 Discounts on value (for tax purposes)
 Utilizing FLP assets for parents' benefit
 Distributing assets to partners
 Fiduciary obligations
 Conflict of law issues

37. Taxation of FLP

Gift of partnership interest
 Gift of assets to FLP
 Pass-through income
 IRS Form 1065/K-1
 IRS Form 1040, Schedule E
 Texas Gross Margin Tax
 Phantom income
 Distributions to pay tax on phantom income

38. FLP Problems Upon Divorce

SP contributed to FLP
 Court has no jurisdiction over FLP assets
 Court can award only transferee's interest
 Insufficient assets outside FLP
 When control is in one spouse only
 Equal control by spouses = impasse
 If GP is LLP, LLP can be awarded by Court
 Partnership as party to divorce
 Conflict of interest in GP suing FLP
 LPs need representation
 Minor LPs need ad litem

39. Unwinding FLP (By Agreement)

Conveyances to new entities
 Distributions to partners

Redemption of ownership interest
 Replacement of GP
 Division into two FLPs
 Dissolution of FLP
 Payments to settle claims against FLP assets
 Rescission of transfers into FLP
 Ad litem's consent
 Court approval

40. Unwinding FLP (By Litigation)

Rescission of partnership agreement
 Dissolution pursuant to partnership agreement
 Dissolution under TBOC
 Set aside conveyances into FLP
 Can't pierce entity veil
 Can't divide FLP assets
 Charging order remedy
 Fraud, breach of fid. duty, accident, mistake
 Unjust enrichment
 Resulting trust
 Constructive trust

41. Tax Issues on Winding Up FLP (#1)

No tax unless cash exceeds basis
 Gain - ordinary income vs. capital gain - hot assets
 754 Elections – critical but often missed
 Inside basis
 Outside basis

42. Tax Issues on Winding Up FLP (#2)

ASSETS CONTRIBUTED TO PARTNERSHIP

Pre-contribution appreciation special allocations
 Sales of contributed property
 Distribution of contributed property – 7 year rule
 Gifts of FLP interests during lifetime – effect on pre-contribution appreciation

43. Unwinding Partnership-Disproportionate Distribution

Gift Tax
 Constructive Transfers
 Claim of Right Doctrine vs. amended returns
 Capital accounts

44. General Comments

Changing Perspectives on family's plan
 Active vs. passive spouse

Support needs during lifetime
Recovery to trust/FLP vs. recovery to community
Complicated paperwork
Need for estate planning/tax advice
Rights of next generation
Intrafamily dynamics
Jeopardizing estate planning
Estate planner liability

THE END