CHOICE OF SITUS FOR ITINERANT TRUSTEES AND PERIPATETIC BENEFICIARIES

Jo Ann Engelhardt, Managing Director, Bessemer Trust, Palm Beach, FL
Philip J. Hayes, Principal, Bessemer Trust, San Francisco, CA

I. INTRODUCTION

Choosing and moving situs can be a complex task. Choice of situs has also become highly competitive in recent times, with jurisdictions offering various legal inducements to choose a state as “home”. This outline modestly addresses differences among states in areas affecting trust administration.

II. WHAT IS SITUS?

A. GENERAL DEFINITION OF SITUS

The term “situs” when used in reference to an inter vivos or testamentary trust is usually defined as: the primary place of the trust’s administration, the state whose laws apply to the trust, or the state that has primary jurisdiction over the trust. The concept is important since a trust’s situs will delineate the laws that apply to the trust, including laws defining the duration of the trust, the identity of the beneficiaries, when and to whom a trustee must account, and required income tax reporting. Some states have adopted uniform laws that may offer favorable provisions regarding investment or trust assets or trust administration. With only a few exceptions, discussed below, a settlor or testator can choose the situs of a trust. Moreover, the situs of a trust can often be changed after the trust has been established to take advantage of more favorable laws in a different jurisdiction, or to escape onerous ones in the current jurisdiction.

In practice, the concept of situs comes into play when planners or fiduciaries attempt deliberately to choose the law that will apply to the trust in question regarding four key issues: (1) Validity of the trust; (2) Construction or interpretation of the trust; (3) Administration of the trust; and (4) Taxation of the trust.

1. Land vs. moveables and intangibles – Historically, a trust that held land was governed by the law of the land’s physical situs, given the courts’ strong jurisdictional authority over local real property. That tie is obviously weaker when moveables or intangibles, such as stocks and bonds, are concerned.

2. Many states have also treated testamentary trusts differently from inter vivos trusts, finding a compelling connection to apply the laws of the domicile of the testator in the case of testamentary trusts while looking to the grantor’s intent or the law of the jurisdiction with the most substantial relation to the trust.
3. These rules vary depending on whether we are analyzing the trust’s validity, construction, administration, or taxation.

B. VALIDITY OF THE TRUST

Whether a trust is valid concerns issues of the purely formal, e.g., number and nature of witnesses to the document, notarization requirements, etc. as well as substantive of dispositive matters such as:

- Spousal or children’s rights
- Rule against perpetuities
- Creditor protection
- Purpose Trusts, such as Pet Trusts
- No-contest clauses
- Public policy issues

1. Trusts of land – *Scott on Trusts* (Fourth ed. 1989) (hereinafter “Scott”) presents the black letter rule regarding inter vivos trusts in § 652 that “the validity of the trust is determined by the law of the situs of the land”. In the case of trusts created under will, the law of the trust’s situs governs regardless of the domicile of the decedent. Scott, § 651. However, the Uniform Trust Code (hereinafter, “UTC”), § 403 provides that a settlor can designate the law that governs validity as long as there is some connection or nexus between that situs and the trust in question, such as the location of the trustee, the location of the trust property, or the settlor’s domicile.

2. Trusts of moveables or intangibles – As might be expected, the law is more relaxed and gives settlors and testators greater flexibility. If a testator has not provided in the will which law governs validity, courts would look to the law of the domicile or the law where the trust is administered. When inter vivos trusts that contain no choice of law provision regarding validity, Scott, § 599 states that it is proper to apply the law of the state with which the trust has the “most significant relationship”.

   a. If the settlor or testator wishes to designate the law of the jurisdiction that will govern validity, there is little to stand in his or her way. Provided there is some relationship with the chosen jurisdiction, some nexus between the trust and its chosen law, the trust should be considered valid. Certainly nexus exists if the law is that of the domicile of the settlor or testator, the place of administration of the trust, the domicile of the beneficiaries, the domicile of one or more trustees, or the location of trust assets. The courts will strive to uphold the intent of the settlor or testator unless the choice of law is clearly to defeat public policy (see below).

3. Spousal or Children’s Rights – States vary in the protection they afford spouses, and, in some cases, children. For example, in Florida, the owner of real property cannot devise the homestead if he or she is survived by a spouse or minor children, other than to devise the homestead to the spouse if there is no minor child. *Fla. St.* § 732.4015.
4. Rule Against Perpetuities – Several states have abolished, provided an opt-out (e.g., Maryland), or allowed a trust to last for a determined number of years, including Alaska; Arizona; Colorado; Delaware; Florida (360 years); Idaho; Illinois; Maine; Maryland; Missouri (modified); Nebraska; Nevada (365 years); New Hampshire; New Jersey; Ohio; Rhode Island; South Dakota; Utah (1,000 years); Virginia; Washington (150 years); Washington D.C.; Wisconsin; Wyoming (1,000 years). The topic has been much discussed, usually in the context of encouraging planners to draft specifically to designate a particular state’s law as the law governing validity of the trust.

a. As desirable as the availability of such a jurisdiction’s laws may be, it may be quite difficult to move a trust and have the non-perpetuities state law apply. Many trusts contain provisions regarding the term of the trust or include savings clauses that refer to the rule against perpetuities of a particular state. Thus, it is often very difficult, absent a valid power of appointment in a beneficiary, to avoid the original rule against perpetuities. See the discussion of *Wilmington Trust Co. vs. Wilmington Trust Co.*, 24 A.2d 309 (Del. 1942) in Nenno and Sparks, “The Use of Delaware Trusts in Estate Planning”, 33 Heckerling Institute, III A 9-10 (1999).

b. Bear in mind that some states, such as Delaware, distinguish between trusts of real property and trusts of moveables and will not allow a trust of real property a perpetual life. 25 Del.C. § 205(b).

5. Creditor Protection -- Assuming there is no intent to defraud current creditors, it may be possible to move a trust to take advantage of the laws of a state that limit creditors’ rights. The Alaska statute states its requirements for accepting jurisdiction of a trust as follows: (1) some or all of the trust’s assets must be deposited in Alaska; (2) at least one of the trustees must be a “qualified person” under Alaska law; (3) the Alaska trustee must maintain records and arrange for the preparation of the trust’s income tax returns; and (4) at least part of the trust’s administration must occur in Alaska. Delaware has similar provisions under its Qualified Dispositions in Trust Act, 12 Del. C. § 3570 et seq. See Section IV D, below, for a discussion of the efficacy of domestic asset protection trusts.

6. Purpose Trusts – While purpose trusts, that is, trust created for a specific purpose rather than to benefit a specific person or class of persons, are generally not recognized under domestic law, some states have enacted legislation to benefit pets. For example, Florida’s § 737.116, valid for trusts created on or after January 1, 2003, allows for the valid creation of a trust for a pet alive during the settler’s lifetime. Cal. Prob. Code § 15212 also permits trusts for pets. For a useful discussion of purpose trusts, see Bove, “The Purpose of Purpose Trusts”, Probate & Property, May/June 2004. Settlors or testators who feel strongly about the care of their pets may wish to create a trust subject to the laws of a jurisdiction allowing such trusts.

7. No Contest Clauses – No contest, or *in terrorem*, clauses, are not much favored, as many states see them as an impediment to a beneficiary’s right to contest the validity of a will or trust. Thus, many states that once considered such clauses valid have enacted legislation to make them unenforceable. See, *e.g.*, Fla. St. 737.207. Settlors or testators who wish to rely on such clauses may wish to seek a jurisdiction, such as California, Illinois or New York that
uphold them. (Note that the Trusts and Estates section of the State Bar of California, however, has proposed legislation making “no contest” clauses unenforceable. The proposal is currently under study by the California Law Revision Commission.)

8. Public Policy Issues – Some dispositive or administrative provisions, no matter how earnestly desired by a settlor or testator, are repugnant to the public policy of a given state. For example, provisions that encourage divorce, exonerate a fiduciary from gross negligence or willful misconduct, or even eliminate the rule against perpetuities may not be granted validity. See Scott § 600, distinguishing grounds for invalidity when there is a strong public policy at issue.

C. CONSTRUCTION OR INTERPRETATION

Rules of construction or interpretation can apply both to dispositive and administrative matters. The types of questions often raised include:

- Definitions of classes of beneficiaries, such as “issue”
- Whether adopted individuals are considered issue and under what circumstances (e.g. only if adopted during minority)
- How intestate heirs are defined
- Whether and how virtual representation will apply

In addition, states may vary in how they define “common” terms such as *per stirpes* and *per capita* and they may or may not recognize common law marriage.

1. Trusts of land – Issues of construction are meant to determine the settlor’s or testator’s intention, not the validity of the trust. Thus, the settlor or testator is generally free to designate the law of a particular state with regard to issues of construction regarding a trust of land. Scott, § 648(1). There does not appear to be any distinction made between inter vivos or testamentary trusts in this case. Absent a designation by the settlor or testator the law of the situs of the property would apply.

2. Trusts of moveables or intangibles – Similarly, the settlor or testator can designate the law of a particular state with regard to issues of construction for a trust holding moveables. Scott § 575. Again, there is no distinction made between inter vivos and testamentary trusts. Moreover, there does not need to be a connection between the chosen state’s provisions and the creation or administration of the trust.

D. ADMINISTRATION

The range of administrative provisions can be quite broad, covering issues that may have a direct substantive impact on beneficiaries (such as rules regarding principal and income allocation or trustees’ fees) or an indirect impact (which trustees must be bonded or whether formal accountings are required).

1. Trusts of land – Although, as one would expect, absent a designation by the settlor or testator, the law of the land’s situs applies, Scott makes clear that the settlor or testator may designate the law of a different state to govern matters of administration.
2. Trusts of moveables or intangibles – As is the case with issues of construction, the settlor or testator is free to designate which law will govern administration, whether the trust is created inter vivos (see Scott, § 610) or under will (see Scott, § 605).

3. Specific Examples of Administrative Provisions to Consider – Because the application of a certain state’s law may produce a desirable result in administrative matters, it is worthwhile to examine not only the administrative provisions of the trust’s current situs, but that of alternative states whose provisions may be more favorable in areas such as:

a. Principal and Income. These terms can be defined differently in different states, thus producing varied allocations of the same receipts depending upon which state’s law is applied. Many states, but not all, have adopted some or all of the provisions of the Revised Uniform Principal and Income Act (hereinafter “RUPAIA”), which defines which receipts fall into which category. See, e.g., Fla. St. § 738.101 et seq.

i. For an interesting discussion of the effect of the adoption of the RUPAIA’s provision regarding allocation of royalty payments between principal and income, see Michaels and Twomey, “How, Why, and When to Transfer the Situs of a Trust”, WG&L Estate Planning Journal, Jan. 2004. The authors point out the radical change wrought by New York State’s adoption of the RUPAIA, including a provision that receipts from royalties, copyrights, and patents are to be allocated 10% to income and 90% to principal after the rule’s effective date. Previously, New York allowed the trustee to allocate in a “reasonable and equitable” manner. NY EPTL § 11-2.1(j). (Note: California has made the same radical change, see Cal. Probate Code § 16362(b).) If the new law produces an undesirable result, the trustee of a trust with substantial royalty interests may seek a state with different provisions, such as Vermont (all to income), Illinois (all to principal), or Delaware (in the trustee’s discretion). Of course, the fiduciary must act fairly regarding all beneficiaries.

ii. The December, 2004 Microsoft dividend of $3 per share, which impacted trust administration around the country, illustrates that the exact same provision of the RUPAIA may yet be interpreted differently. The New York Bankers Association Trust & Investment Division issued a bulletin on November 30, 2004, indicating its opinion that the Microsoft distribution should be treated as a partial liquidation under RUPAIA Section 401, which New York (and California) enacted verbatim, because the total dividend distribution of $32 billion significantly exceeded the statute’s threshold of 20% of Microsoft’s gross assets. However, that same month a California appellate court handed down Estate of Thomas (2004) 124 Cal.Rptr.4th 711, which held that it is the distribution received by a particular trust, rather than the total amount distributed by the company, that must meet the 20% of gross assets threshold under RUPAIA Section 401(d). As of June 15, 2005, a bill to correct the Thomas holding is making its way through the California legislature as an urgency measure, in part to cope with fallout from the Microsoft dividend.