Trust-Drafting Essentials

Edward L. Perkins

*JD, LLM (Tax), CPA*

Gibson & Perkins, PC

www.gibperk.com
CHAPTER SEVENTEEN

OVERVIEW AND INTRODUCTORY PROVISIONS

§17.1 Overview

A trust is essentially an instrument of property transfer, but unlike a sale or an outright gift, a transfer of property by trust is unique in that the settlor/transferor can impose terms and conditions on use and disposition of the property long after the transfer is complete. Just what the nature of the terms and conditions imposed will depend in large part on the specific objectives that the settlor is trying to achieve by transferring the property in trust.

In Pennsylvania, a trust can only be legally created if the settlor executes a written document.¹ The objective of the trust document is to define the terms and conditions of the property transfer. Because a transfer by trust will of necessity involve a settlor, the trust property, trust beneficiaries, and one or more trustees, how those terms and conditions are defined in the document will also define the relationship of the settlor, the trust beneficiaries, and the trustee to the trust property. This Chapter and the Chapters that follow will offer some insight into how to approach the drafting of effective trust documents.

§17.2 Before You Draft

In any trust, there are certain fundamental elements of the trust which must be identified and defined before you can draft an effective document. These include the following:

– The Trust Purpose – What is the purpose that the settlor is trying to achieve in establishing the trust? In many trusts, there will be more than one purpose to be served. It is the scrivener’s job to determine what the settlor wants to achieve through the trust and then draft the trust consistent with the settlor’s objectives.

– The Settlor – What is the post transfer relationship of the settlor to the trust? Does the settlor want to retain powers over the trust such as the right to amend or even revoke the trust? Will the settlor retain any administrative powers over the trust, such as the power to control the trust investments?

– The Trust Beneficiaries – What individuals or entities are to benefit from the trust? Who are the current beneficiaries? Who are the remaindermen? If no named beneficiary survives who will succeed to the property in the trust?

– The Trust Property – What property will be initially transferred to the trust on formation? What property will be added at a later time?

¹ 20 Pa. CSA § 7732(a)(2)
The Trustee – What individual or entity will be appointed to serve as the initial trustee? As the successor? What is the procedure for replacing or removing trustee? How will multiple trustees make decisions?

The Terms of Disposition – How, when, and to whom and within whose direction and control, will the trust income and principal be distributed and disposed? What is the level of discretion vested in the trustee? What are the rights of the beneficiaries to compel distributions from the trust?

The Terms of Administration – What powers and rights does are vested in trustee?

Under what terms and conditions is the trust property to be held and administered, e.g., how and on what terms and conditions is the trust property to be invested by the trustee?

§17.3 Structure

The document provisions should of course be organized in a certain logical sequence. It is recommended that the document begin with provisions which establish the trust and identify certain fundamental trusts aspects. These introductory provisions should be followed by the provisions which govern the actual disposition of the trust property. Administrative and trustee provisions should follow, and lastly certain miscellaneous provisions should come at the end of the document. Here is that suggested sequence in more detail:

Introductory Provision

A statement of the settlor’s intention to create a trust;

Identification of and acceptance by the trustees;

Identification of the trust itself;

Identification of the trust property;

Identification of the trust beneficiaries;

A statement of the trust purpose;

A statement of irrevocability (if applicable).

Dispositive Provisions

Income and Principal Disposition during the Trust Term

Ultimate Disposition of the Trust Property Upon Termination

Administrative Provisions

Trustee Provisions

Miscellaneous Provisions

§17.4 Introductory Provision
Overview

The introductory provisions of a trust agreement should cover the provisions which are essential to create a valid trust. These provisions should include the following:

- A statement of the settlor’s intention to create a trust;
- Identification of and acceptance by the trustees;
- Identification of the trust itself;
- Identification of the trust property;
- Identification of the trust beneficiaries;
- A statement of the trust purpose;
- A statement of irrevocability (if applicable).

Statement of Intention to Create a Trust.

To create a trust there must also be a definite expression by the trust settlor of his or her intention to create a trust. No specific words are required to create the trust and the words may be written or spoken. Here is some sample language:

“I, WILLIAM A. MILLER, as Settlor, transfer to myself, WILLIAM A. MILLER, as Trustee, the Trust Estate, as described herein and I direct the Trustee to hold said property in Trust, according to the terms and conditions as provided herein.”

Trustees

1. Identification

In the introductory provisions of a trust, it is only necessary to identify the trustees first appointed. If an individual is appointed identify the person by their formal name and also by relationship to the settlor. Here is sample language:

“I, Michael Smith, as Settlor, transfer to my wife, Alice Mason Smith, as Trustee, the Trust Estate, as described herein and I direct the Trustee to hold said property in Trust, according to the terms and conditions as provided herein.”

If an institutional trustee such as a bank or trust company is appointed try to avoid confusion by making sure that you identify the institution by its full legal name such as “First National Bank, N.A.,” rather than simply “First National”, or “First National Bank”. In some cases, the bank may have a trust company subsidiary which should be named. Check the website or talk to a representative of the institution to ascertain how the institution should be designated.

2. Acceptance by the Trustee
It is also important that in order to impose any fiduciary duties upon the trustee appointed that the trustee accept the trusteeship. Under 20 Pa. CSA § 7761 the PUTA, a person designated as trustee accepts a trusteeship by either complying with the method of acceptance provided in trust agreement; or if the trust agreement does not provide a method of acceptance by accepting delivery of the trust property, exercising powers or performing duties as trustee, or otherwise indicating acceptance of the trusteeship. To avoid any issue as to whether the trustee has accepted the appointment or not the trustee appointed should evidence their acceptance of the trusteeship.

§17.4.4 Identification of the Trust

A clause which identifies the trust by a specific reference will often prove useful. This is particularly true when external documents, such as a pour- over will, designates the trust as the recipient of a testamentary gift or deed of gift documents an inter vivos transfer, and references the trust. In naming the trust the following protocol is suggested:

“The [Name of the Settlor or Primary Beneficiary] [Revocable or Irrevocable][Type of Trust such as “Special Needs Trust”] dated [date trust is established].”

For example, if a settlor, Joseph Smith, establishes a revocable trust on June 1, 2014, naming his wife, Martha Smith, as trustee, the title of assets or accounts transferred to the trust should read as follows:

“The Joseph Smith Revocable Trust, dated June 1, 2014.”

By way of further identification, a statement of the general purpose or the type of the trust created could also be added. For example, if the trust was a special needs trust established for the benefit of Joseph Smith’s son, William, the trust might be designated as follows:

“The William Smith Special Needs Trust, dated June 1, 2014.”

Trusts, except certain grantor trusts, must obtain an Employer Identification from the Internal Revenue Service. That number could provide a useful reference to identify the trust. The following is some suggested language for the provision:

“A. Trust Name. The Trust created herein shall be named the "JOSEPH SMITH REVOCABLE TRUST".

B. Tax Identification No. The Employer Identification Number of the Trust is 23-563478661.”

§17.4.5 Trust Property

1. Identifiable Property

---

2 In re Estate of Cavalier, 399 Pa. Super 637
3 See §20.2.3., for an example of some suggested language.
Under 20 Pa.C.S. § 7731(1), a valid trust is generally created by the transfer of property during the settlor’s lifetime or by will or other written disposition taking effect upon the settlor’s death. 4 The definition of “property” in the PUTA, is intended to be as an expansive one encompassing anything that may be the subject of property ownership. 5 However, for a valid trust to be created the trust property, i.e., the “subject matter” of the trust, must be sufficiently defined and identified. 6 Therefore it is fundamental that the property to be held by the trust be described specifically in the document. In addition, since the creation of a trust generally results from a transfer of property by the settlor to the trustee, 7 the means of transfer must also sufficiently identify the subject property. Finally, there should also be evidence of acceptance of receipt of the trust property by the trustee.

2. The Acceptance by the Trustee - Identifying the Property

In order to provide evidence of the trustee’s acceptance of the property, as well as to avoid any confusion as to what property is subject to the trust, it is good practice to provide a schedule which specifically identifies the trust property. Reference within the trust document incorporating the schedule with language like the following is also recommended:

“C. Trust Estate. The property originally held hereunder as reflected on Schedule A, attached hereto, has been accepted by the Trustee, first herein appointed, and shall be held in trust by the Trustee for the purposes, and under the conditions hereinafter set forth.”

3. The Transfer

a. Overview

A trust can be created by re-titling each asset that comprise the trust into the settlor’s name as trustee. However, such re-registration is not necessary to create the trust. 8 A trust can be created by self-declaration, i.e., by simply declaring the existence of the trust. A declaration of trust can be evidenced merely by attaching a schedule listing the assets that are to be subject to the trust without executing separate instruments of transfer. However, the failure to retitle the trust property in the name of the trust can make it difficult to later confirm title and for this reason is not recommended. 9

b. Titled Property and Designations of Beneficiary

If the property is titled property, such as real estate or corporate stock, or held in a titled account, such as a bank or investment account, the transfer can be accomplished by retitling the

---

4 20 Pa.C.S. § 7731(1).
5 20 Pa.C.S. § 7703, Comment.
8 20 Pa. C.S. §7731, Comment; also; Restatement (Third) of Trusts Section 10 cmt. e (Tentative Draft No. 1, approved 1996);
9 Id.
property or renaming the account in the name of the trust. To do this properly, the retitled asset or renamed account should be held in the name of the trustee, as trustee of the trust, designated as follows:

[Name of the Trustee] as Trustee of the [Name of the Trust], executed [date of the Trust]

For example, if a settlor, Joseph Smith, establishes a revocable trust on June 1, 2014, naming his wife, Martha Smith, as trustee, the title of assets or accounts transferred to the trust should read as follows:

“Martha Smith, as Trustee of the Joseph Smith Revocable Trust, executed June 1, 2014.”

The same form designation should also be used when the trust is designated as the beneficiary of a retirement plan, or life insurance policy.

c. Deeds of Gift – Non-titled Property

In the case of property which is not titled, for instance a collectible, a transfer document, such as a deed of gift, should be drafted and executed in order to evidence the transfer of the subject property to the trust. Language such as the following should be included in the transfer document:

“I, Joseph Smith transfer the Vincent Van Gogh painting “Sunflowers” to Martha Smith, Trustee of the Joseph Smith Revocable Trust, dated June 1, 2014, to be held and administered under the terms of that trust.”

d. Transfers by Will

Sec. 7731(1), of the PUTA allows a trust to be created by the transfer of property by will effective upon the settlor’s death. This section allows a trust to be funded by a so-called “pour over” provision included in the will of the settlor such as the following:

“I give my entire residuary estate to the Trustee of the Joseph Smith Revocable Trust established by me on June 1, 2014, my estate, after being added to the principal of that trust, will be subject in all respects to its terms and conditions in effect at the date of my death, including any amendments made during my lifetime.”

In cases where a trust is created by such a provision, it is also advisable to include as clause like the following to prevent the gift from lapsing, if the trust somehow fails prior to the death of the testator.

“If for any reason that trust is not in existence at the time of my death or is not able to accept distribution of my estate, my estate must be held and distributed in accordance with the provisions of that trust as it now exists, which are incorporated by this reference into this Will, the Trustee to be the Trustee named in the trust.”

e. Funding by Power of Appointment
A power of appointment is the authority vested into someone by a decedent to designate who is to receive property left by the decedent. A trust could therefore be funded through the exercise of a power of appointment, granted to someone in another document. The language granting the power could be like the following:

“Upon the death of my wife, my trustee shall pay and distribute the remaining principal of this marital trust to and among such person or persons and upon such terms and conditions as she, by her will, containing a specific reference to this power, may direct and appoint.”

In appointing property by the exercise of a power of appointment it is important not only to identify the trust to which the property is appointed, and the specific property appointed, but also to make sure the power is exercised in the specific manner prescribed according to the terms of the document creating the power. Here is some sample language which would effectively exercise the general power provided above. In this case this language must be included in the will of the individual holding the power:

“I exercise that certain power of appointment granted to me under Article IV of the Michael Smith Revocable Trust established by my husband on April 21, 2001, by appointing the remaining principal of the marital trust established thereunder to the Trustee of Joseph Smith Revocable Trust established by son, Joseph Smith on June 1, 2014, to held and administered under the terms of such trust.”

f. Division of Trust Property into Shares

In certain cases, a trust or trust share may be created by the division of the principal of a pre-existing trust upon the occurrence of a specified event, such as the death of a trust beneficiary; or a trust beneficiary attaining a certain age. Here is some sample language:

“Upon the death of wife, the Trustee shall divide the then principal balance of the trust into as many equal shares as there are children of mine then living and children of mine then deceased represented by descendants then living, and to retain in a further separate trust each such share, as follows: ...”

§17.4.6 Trust Beneficiaries

Unless the trust is a charitable trust, or a trust for the care of an animal, the intended beneficiaries, must be sufficiently described to be ascertainable by the trustee. Under the 20 Pa. CSA § 7732(d) the term "definite beneficiary" means a beneficiary that can be ascertained either contemporaneously or in the future. A power granted to the trustee to select a beneficiary from an indefinite class is also valid. The trust beneficiaries are generally identified most specifically in dispositive provisions of the trust document. See §18.3.2., below for a discussion of the recommended drafting to adequately identify trust beneficiaries.

---

§17.4.7 Statement of Trust Purpose.

1. Overview

A well drafted trust should include a statement of the settlor’s intent in establishing the trust regarding both the treatment of the trust beneficiaries and the management of trust assets. The extent of the interest of the beneficiary in a trust depends upon the manifestation of the intention of the settlor. As discussed in the Chapter 4, a court will generally determine the settlor's intent from an examination of the trust instrument, the surrounding circumstances, and the condition of the estate and the family. In construing, various provisions to arrive at the settlor's intent a court will not read additional conditions into an otherwise clearly worded trust instrument.

The PUTA, provides in several specific instances that an otherwise non-charitable irrevocable trust can be modified or even terminated provided such modification or termination is not inconsistent with the settlor’s intentions:

− Sec. 7740.1(b) of thePUTA provides that an otherwise irrevocable trust may be reformed or even terminated with court approval if such modification or termination is not inconsistent with a material purpose of the trust.

− Sec. 7740.2. provides that the court may or terminate the trust if, because of circumstances that apparently were not anticipated by the settlor, modification, allowance or termination will further the purposes of the trust. To the extent practicable, the modification or allowance must approximate the settlor’s probable intention.

− Sec. 7740.5, provides that the court may reform a trust instrument, even if unambiguous, to conform to the settlor’s probable intention if it is proved by clear and convincing evidence that the settlor’s intent as expressed in the trust instrument was affected by a mistake of fact or law.

− Sec. 7740.6 provides that the court may modify a trust instrument in a manner that is not contrary to the settlor’s probable intention to achieve the settlor’s tax objectives.

For these reasons, it is important that the trust agreement adequately state the settlor’s purpose and intention in forming the trust.

2. Areas to be addressed.

2a. Overview

Some of the areas to be addressed should be the settlor’s intent regarding the following:

− Taxation – both estate and income;

− Investment of trust assets;

− Allocation of expenses between income and principal; and
Treatment of beneficiaries in terms of intent, and priority.

b. Taxation

Here is Sample Language:

“It is my intention in establishing this trust to qualify the property passing under the Marital Deduction Share for the federal estate tax marital deduction. Any provision of this Agreement which may appear to conflict with my intention to qualify the Marital Deduction Share for the federal estate tax marital deduction shall be construed to accomplish that intention.”

“It is my intention in establishing this trust that it be treated under IRC §§ 671 through 678, as a grantor trust for federal income tax purposes.”

c. Investment of Trust Assets

“It is my intention that my trustee maximizes the income interest provided for my spouse under the Marital Trust established under Article III, hereof; therefore, I direct that all investments related to such Marital Trust be made in a manner consistent with such objective.”

d. Allocation of Expenses between Income and Principal

“The trustee shall have the power to allocate any property received or charge incurred to principal or income or partly to each, as the trustee may think reasonably appropriate.”

e. Treatment of beneficiaries in terms of intent, and priority.

“My priority and intention in establishing this trust is the care and maintenance of my wife during her lifetime, and my Trustee shall in all respects in administering this Trust make every effort to fulfill that intention.”

§17.4.8 Powers Reserved to the Settlor

1. Overview

Under trust law the settlor of a trust can reserve to him or herself under the trust agreement any power with respect to the trust property, provided the power is not illegal, and the reservation of the power will not of itself make the trust invalid.\(^\text{11}\) There is no specific limit to the nature or extent of the powers which the settlor may reserve. He or she may reserve a power to revoke the trust, or a power to alter or amend the trust, either in addition to the power to revoke or in exclusion of such a power. He or she may reserve the power to control the trustee in making investments or in disposing of investments, or to veto an investment. He or she may even reserve the power to change the beneficiaries of the trust, or to change the respective shares, or interests, or the nature of the interests, which they are to take. This is not an exhaustive enumeration of the powers which may be reserved, however. There is no specific limitation on

\(^{11}\text{See Restatement (Second) of Trusts § 57.}\)
the number or the nature of such powers, and they may be included in the terms of the trust in such number and of such nature as the settlor desires.

In addition, the settlor may grant powers to some else who may be the trustee, a beneficiary, or a third person otherwise unconnected with the trust. There is no specified number or kind of powers which may be so created, but, as in the case of powers reserved by the settlor to himself, those powers may be established as the settlor thinks appropriate. If those powers are to be exercised by two or more persons, settlor may include him or herself, or the trustee, or a beneficiary, in this group, or not, as he or she sees fit. If that power is given to more than one person, the settlor may provide whether it is to be exercised by them unanimously or by the concurrence of a majority of them.

2. Revocability

Under 20 Pa. CSA § 7752, a trust is revocable unless it states that it is irrevocable. The trust agreement should include a provision like the following in order to make the intention clear:

“Irrevocable - “Right to Amend or Revoke; Retention of Power.
This Trust is irrevocable. The Settlor retains no power to amend or revoke this Trust, in whole or in part, nor does the Settlor retain any power to participate in any amendment decision made pursuant to subparagraph B. hereof.”

“Revocable - “Powers Retained; Right to Amend or Revoke.
I shall have the following powers, exercisable whenever and as often as I may wish to revoke or amend this Agreement of Trust, in whole or in part, at any time or times, by written instrument, other than a Will, lodged with my Trustee; provided that the duties, powers and liabilities of my Trustee shall not be substantially increased without my Trustee's written consent.”
CHAPTER EIGHTEEN

DISPOSITIVE PROVISIONS

§18.1 Overview

The beneficial interest of the trust beneficiary in the trust assets and the income produced by those assets is fixed by the settlor’s intent as reflected in the express terms of the trust document. Therefore, the dispositive provisions of the trust should address when and on what basis the income, principal, and the trust remainder, are to be distributed or retained by the trust, and to whom. More specifically dispositive provisions should address:

– To what individual or entity may or must distributions be made
– Whether a distribution may or must be made from income or principal?
– When a distribution may or must be made?
– In what amount or to what degree a distribution may or must be made?
– What level of discretion is vested in the trustee to determine the distributions made by the trust?

§18.2 To Whom?

§18.2.1 Overview

Of course, of prime importance when drafting dispositive provisions is the identification of the party or parties to whom the distributions can or must be made. You should make every effort drafting to identify the trust beneficiaries, to make their identity as clear as possible to the trustee.

§18.2.2 Identifying Specific Individuals

Therefore, when you can, identify the trust beneficiaries by name and relationship to the settlor. For example:

“...my son, William...”
“...my friend, Joseph Miller...”
“...the Settlor’s cousin, Wilma Franks...”

For someone outside the immediate family, use a first and last name. It doesn’t have to be their formal legal name, but the name must be sufficient to identify the person in question. If you believe there is any possibility of confusion, you might consider adding an address or other phrase of identification to clarify. For example:

13 The definitions of “income”, “income beneficiary”, “net income”, “income interest”, “mandatory income Interest, “principal” and “remainder beneficiary”, under the Principal and Income Act are discussed in Chapter 4.
“...my friend, Bill Smith, who at the time of execution of this Trust resides at 19 Penn Avenue, Reading, Pennsylvania.”

or

“... my nephew, Robert L. Smith, who is the son of my sister Susan Smith, and who should not be confused with my nephew Robert L. Smith, who is the son of my brother Timothy Smith.”

§18.2.3 Identifying Groups

In some cases, a dispositive provision may be drafted for the benefit of a class or group of beneficiaries. Perhaps the most common class gift is a gift to “children”

14 Under §2507(4) of the PEF Code, a class gift to “children” includes after-born or after-adopted children. This is true unless there is an express provision stating a contrary intent.

15 The terms “issue”, and “descendants” are both defined when used in their common legal or technical sense, as a multigenerational term meaning all succeeding generations. See In re Deed of Trust of McCargo, supra at 578, 652 A.2d at 1334; Restatement (Second) of Property (Donative Transfers) § 25.9

or “descendants.”

In drafting trusts which are for the benefit of a group or class of beneficiaries, make sure to define the class in terms of the identity of the class of beneficiaries and the specific point in time when the class is to be determined. Here is some sample language:

“Upon the death of my husband, the Trustee then serving shall divide the then existing principal into as many equal shares as there are children of mine then living and children of mine then deceased but represented by descendants then living, and...”

Another provision sometimes used allows the trustee to make distributions to an identified group of beneficiaries at the time and in the amount determined by the trustee. This type of dispositive provision is sometimes termed a “sprinkle” provision.

“To pay to such one or more or all of my descendants living on each quarterly or more frequent distribution date so much of the entire net income in such proportions, equal or unequal, as my Trustee, in Trustee’s absolute discretion, deems advisable.”

§18.2.4 Gifts to Charitable Organizations

In making a charitable gift, it is important to first properly identify the charity. Go to the charity’s web-site, call them on the telephone -- but be sure to get it right. Google produces over 3900 results for the term “First Presbyterian Church” in Pennsylvania alone.

Second, state the purpose of the gift:

“I give the sum of Five Thousand dollars ($5,000.00) to the Reading Hospital, 6 Spruce Street, Reading, Pennsylvania, or its successors, to be used to endow a bed in the name of my father, DAVID JONES.”

Make sure the purpose is practical, however. Often the charity will prefer that the gift be unrestricted in its use:
“I give the sum of Five Thousand dollars ($5,000) to the Reading Hospital, 6 Spruce Street, Reading, Pennsylvania, or its successors, to be used for its general purposes.”

§18.3 Income or Principal

§18.3.1 Overview

A typical dispositive provision might read something like the following:

“The trustee shall pay the net income therefrom at least quarterly to my son, Robert; and may also pay to or apply for the benefit of my son, so much of the principal as the trustee deems advisable for his maintenance, health and support, and education as hereinafter defined, after considering funds available to him from other sources.”

In drafting a trust instrument, the novice draftsman may assume that the terms “income” and “principal” have clear and universally accepted definitions which do not require further clarification in the document. However, this assumption would be only partially correct. Depending on the way the document addresses or does not address the issue, the definition or principal and income can either be mandated by the document itself, by the applicable statute, or completely left to the discretion of the trustee. In actual practice a receipt must be allocated to income or principal, or partly to both, based on the following hierarchy:

- If the governing instrument mandates an allocation, according to the terms of the governing instrument even if there is a different provision in the Pennsylvania Uniform Principal and Income Act (“PUPIA”);¹⁶
- If not; if the governing instrument grants the trustee the authority to determine the allocation of receipts and disbursements between principal and income as the fiduciary determines;¹⁷ then the allocation is determined by the trustee; and.
- Finally, if not; then as mandated by the PUPIA.¹⁸

§18.3.2 A Mandate in the Document

Of course, the document itself can provide its own definitions when appropriate, and the extent of the interest of the beneficiary of a trust will depend upon the manifestation of intention of the settlor within the document.

“The trustee shall allocate of any receipts resulting from the sale of the assets of the trust to income rather than principal.”

§18.3.3 Authority Granted the Trustee in the Document

“The trustee shall have the power to make discretionary allocations of receipts or expenses as between income and principal.”

¹⁶ 20 Pa. C.S.A § 8103(a)(1)
¹⁷ 20 Pa. C.S.A § 8103(a)(2)
¹⁸ 20 Pa. C.S.A § 8103(a)(3); see Chapter 4.
The Statute

The definitions of “income”, “net income”, “income interest”, “mandatory income interest”, “principal” and “remainder beneficiary”, under the Pennsylvania Uniform Principal and Income Act are discussed in detail in Chapter 4. Under the PUPIA, “income” is defined as money or property which a fiduciary receives as current return from a principal asset. “Principal” has a limited definition as property held in trust for distribution to a remainder beneficiary when the trust terminates or property held in trust in perpetuity, but should be interpreted in a more expansive way to include everything that is not considered income.

Under the common law, the trust property and any substitutions for it constitute the principal, while the return derived from the principal constitutes the income. “Net income” is ascertained by subtracting expenditures allocable to income from receipts allocable to income. In addition; a trustee is permitted to adjust between principal and income by allocating an amount of income to principal or an amount of principal to income to the extent the trustee considers appropriate under the circumstances.

18.4 When?

18.4.1 Overview

It is also important for dispositive provisions to delineate when the distribution of income or principal can or must be made. The question of when may also turn on whether the distributions are mandatory, subject to the discretion of the trustee, or based on an ascertainable standard. In some cases, the right to a trust distribution might also be subject to the fulfillment of a condition, such as the occurrence of the marriage or death of a beneficiary holding a prior interest. The question of when is therefore generally fixed in terms of either: (i) a specific time, (ii) the occurrence of a specific event, or (iii) at the discretion of the trustee.

18.4.2 A Specific Time

Here is an example of a distribution to be made at a specific point in time:

“Upon tenth anniversary of the execution of this trust....”

“The trust shall terminate 21 years after the death of the last survivor of my husband and all of my issue living at my death, and all property in the trust shall be paid, per stirpes, to the then living issue of the child, or in default of such issue, to my issue then living.

18.4.3 Upon the Occurrence of a Specific Event

Here is an example of a distribution to upon the occurrence of a specific event:

“Upon the occurrence of my daughter's marriage, my trustee shall distribute to her a gift of $10,000, from the trust.”

---

19 Bloomberg BNA Tax and Accounting Portfolio 5202-2nd, Acker, Accounting for Trusts and Estates (Accounting Policy and Practice Series) V. Defining Income and Principal, C. Principal.
“If the child dies before becoming entitled to all principal in this trust, all remaining principal shall be paid to his or her estate.”

“Upon the death of the survivor of my husband and me, ....”

18.4.4 Discretion of the Trustee

Finally, sample language if the timing is left to the discretion of the trustee:

“Principal may be distributed or applied in the discretion of the Trustees for the child's support, education, and health care, after considering other available resources and economies of taxation.”

§18.5 How Much?

§18.5.1 Overview

The question of how much of the income or principal can or may be distributed can range from the full balance of the trust to whatever amount the trustee might determine.

§18.5.2 A Specific Amount

A specific amount:

“Upon her marriage the trustee then serving shall distribute to my daughter a gift of $10,000.”

§18.5.3 A Fractional Amount or Percentage

A fraction or percentage:

“One half of the principal in the trust shall be paid to the child at age 25.”

“...five percent (5%) of the value of the principal of the trust as determined at the end of such calendar year...”

§18.5.4 Discretion of the Trustee

To be determined in the trustee’s discretion

“Such amounts of principal as the Trustees in their sole discretion determine may determine....”

§18.5.5 All of the Principal or Income

All of the principal or income

“My trustee shall distribute all of the net income of the trust to my wife, MARY, on no less than a quarterly basis.”

“All of the principal in the trust shall be paid to the beneficiary at age 21.”

§18.5.6 Unitrust Interest

20 See the discussion of trustee’s discretion in §18.6., below.

15
As another alternative the trust could provide for a “unitrust” interest. A unitrust interest which provides for a distribution mandated by the terms of a trust in an amount equal to a fixed percentage, generally not less than three or more than four percent per year, of the net fair market value of the trust's assets, valued at least annually. Such a provision allows a trustee to follow an investment policy seeking a total return for the investments held by the trust, whether the return is to be derived (i) from appreciation of capital; (ii) from earnings and distributions from capital; or (iii) from both. Here is some sample language:

“In each taxable year of the trust, trustee shall pay to or for the benefit of settlor an amount (hereinafter the "unitrust amount") equal to four (4%) percent of the net fair market value of the trust principal determined as of the first day of each taxable year of the trust (hereinafter the "valuation date").”

§18.6 Powers of Distribution based on Exercise of Trustee’s Discretion.

§18.6.1 In General

A dispositive provision may be drafted so as to vest discretion in the trustee to either make or not make distributions from the trust, and even in what amounts. The trustee may have discretion whether or not to make payments to a particular beneficiary; or the trustee may have discretion only to determine the time, manner, and amount of distributions, pursuant to a particular standard or otherwise. Here is an example of this type of provision:

“Principal may be distributed or applied in the discretion of the Trustees for the child's support, education, and health care, after considering other available resources and economies of taxation.”

In drafting such provisions, the settlor is placing faith in the judgment of the trustee to make the proper decisions regarding distributions from the trust. The draftsman should understand that there are different levels of discretion, and that in certain cases the discretion may be attached to an ascertainable standard, such as a direction to pay "amounts appropriate to my son, William's support and maintenance."

In drafting, discretionary dispositive provisions, the draftsmen must determine the level of discretion intended, and any limitations or conditions in terms of an accompanying standard which might be placed on the exercise of that discretion by the trustee. Furthermore, a court will intervene where the exercise of a power is left to the judgment of a trustee who improperly fails to exercise that judgment. Thus, even where a trustee has discretion whether to make any payments to a particular beneficiary, the court will interpose if the trustee, arbitrarily or without knowledge of or inquiry into relevant circumstances, fails to exercise the discretion.

A court will not interfere with a trustee's exercise of a discretionary power when that exercise is reasonable and not based on an improper interpretation of the terms of the

---

22)ld
trust. Thus, judicial intervention is not warranted merely because the court would have differently exercised the discretion. The benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend upon the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purposes in granting the discretionary power and in creating the trust. On the other hand, a court will not permit abuse of discretion by the trustee. What constitutes an abuse depends on the terms of the trust, as well as on basic fiduciary duties and principles.

Of importance are the purposes of the power and the standards, if any, applicable to its exercise and the extent of the discretion conferred upon the trustee. Relevant fiduciary principles include: (1) the general duty to act, reasonably informed, with impartiality among the various beneficiaries and interests; and (2) the duty to provide the beneficiaries with information concerning the trust and its administration. This combination of duties entitles the beneficiaries (and also the court) not only to accounting information but also to relevant, general information concerning the bases upon which the trustee's discretionary judgments have been or will be made.

§18.6.2 Extended Discretion

Although the discretionary character of a power of distribution does not ordinarily authorize the trustee to act beyond the bounds of reasonable judgment, a settlor may manifest an intention to grant the trustee greater than ordinary latitude in exercising discretionary judgment. How does such an intention affect the duty of the trustee and the role of the court? It is contrary to sound policy, and a contradiction in terms, to permit the settlor to relieve a "trustee" of all accountability. Once it is determined that the authority over trust distributions is held in the role of trustee words such as "absolute" or "unlimited" or "sole and uncontrolled" are not interpreted literally. Even under the broadest grant of fiduciary discretion, a trustee must act honestly and in a state of mind contemplated by the settlor. Thus, the court will not permit the trustee to act in bad faith or for some purpose or motive other than to accomplish the purposes of the discretionary power. Except as the power is for the trustee's personal benefit, the court will also prevent the trustee from failing to act, either arbitrarily or from a misunderstanding of the trustee's duty or authority.

Within these limits, it is a matter of interpretation to ascertain the degree to which the settlor's use of language of extended (e.g., "absolute") discretion manifests an intention to relieve the trustee of normal judicial supervision and control in the exercise of a discretionary power over trust distributions. Under 20 Pa. CSA § 7780.4, a trustee is required to exercise a

23 Id
24 Restatement (Third) of Trusts §§ 76-83 (2003).
26 Restatement (Third) of Trusts § 82 (2003).
27 Restatement (Third) of Trusts § 50 cmt. c (2003Id
28 Restatement (Third) of Trusts §§ 87 and 76 (2003).
discretionary power in good faith and in accordance with the provisions and purposes of the trust and the interests of the beneficiaries, notwithstanding the breadth of discretion granted to a trustee in the trust instrument, including the use of such terms as "absolute," "sole" or "uncontrolled." 20 Pa. CSA § 8106 provides that a court will not change a fiduciary's decision to exercise or not to exercise a discretionary power unless it determines that the decision was an abuse of the fiduciary's discretion.

Sample Language:

“A trustee's discretion shall be absolutely conclusive regarding any and all distributions or lack of them and shall not be subject to judicial review under any circumstances. In addition, trustee is under no obligation to distribute any amounts to or for settlor's child if such child has available other funds or assets, or if such child shall have distributed or disposed of any assets without receiving adequate or acceptable consideration for them.”

Sample Language:

"Such additional amounts from the principal of the trust as the Trustee, in its sole and uncontrolled discretion, believes appropriate for W's comfortable support and care.”

§18.6.3 Discretion Subject to an “Ascertainable Standard”

1. Overview

In certain cases, the trust will provide that the trustee’s discretion is limited by a standard. Here is an example - a trust could provide something like the following:

“The settlor’s spouse shall be entitled to such distributions of principal to provide for her health, education, support, and maintenance.”

This type of standard of discretion is often referred as an “ascertainable standard”. This means the term will have an accepted and defined meaning which provides a standard in order to measure the exercise of discretion by the trustee. If such a standard is provided in the trust it both directs the action of the trustee, and at the same time creates an entitlement to the defined benefit on behalf of the beneficiaries which is enforceable by the court.

2. The meaning of “support” and “maintenance”

The terms "support" and "maintenance" are normally construed as synonyms, even when this treats the terms as redundant. Probably the most common guides used in grants of discretion, these terms are sometimes accompanied by a reference to the beneficiary's accustomed standard of living or station in life. That level of intended support is normally implied from "support" or "maintenance" even without an express reference to the beneficiary's customary lifestyle. Whether this accustomed style is expressed or implied, a lower level of distributions may be justifiable if the trust estate is modest relative to the probable future needs of the beneficiary. The accustomed manner of living for these purposes is ordinarily that enjoyed by the beneficiary at the time of the settlor's death or at the time an
irrevocable trust is created. The distributions appropriate to that lifestyle not only increase to compensate for inflation but also may increase to meet subsequent increases in the beneficiary's needs resulting, for example, from deteriorating health or from added burdens appropriately assumed for the needs of another.

Also, if a beneficiary becomes accustomed over time to a higher standard of living, that standard may become the appropriate standard of support if consistent with the trust's level of productivity and not inconsistent with an apparent priority among beneficiaries or other purpose of the settlor. Furthermore, distributions allowing the beneficiary an increased standard of living may be appropriate if, considering the “productivity” of the trust estate, the eventual result would otherwise favor the remainder beneficiaries over the present beneficiary to a degree unlikely to have been intended by the settlor.

3. **The meaning of “education”**:

Supplementary terminology may affect the degree of generosity appropriate to a beneficiary's support, or it may suggest a special emphasis. For example, the term "education," without elaboration, is ordinarily construed as extending to payment of living expenses as well as fees and other costs of attending an institution of higher education, or the beneficiary's pursuit of a program of trade or technical training, and the like, as may be reasonably suitable to the individual and to the trust funds available for the purpose. Here are two examples:

“In addition, the trustee shall from time to time pay to or for the benefit of such child as much of the principal of such share as the (corporate or disinterested) trustee, in its discretion, may consider desirable, after considering all resources available to such child, for such child's education at a public or private grammar or high school, college, university or vocational or technical institution, to pay associated expenses including, but not limited to, tuition, laboratory fees, books and supplies, travel, room and board.”

A second example:

“In addition, trustee shall from time to time pay to such child (or such child's issue) as much of the principal of such share as (disinterested or corporate) trustee, in its absolute discretion, may consider desirable for the health, maintenance, support and education, including college, graduate level or professional education of such child, after considering all resources available to such child.”

4. **The meaning of “health”**: 

Similarly, without more, references to "health," "medical care," and the like in the terms of a discretionary power may be useful to inform beneficiary expectations or guide an inexperienced trustee, but presumptively they provide merely for health and medical benefits like those normally implied by a support standard. Thus, if the intention is to assure the beneficiary

29"Productivity" for these purposes refers not only to trust income but also to a pattern of appreciation beyond maintenance of purchasing power, such as might result from a growth-oriented investment program.
some special form of education, or expensive home care when not cost efficient, further elaboration would be helpful. Even a grant of extended discretion is likely to make it more difficult, if the trustee does not act generously, for a beneficiary to compel a trustee to follow a particular course of action. Here is a sample provision:

“Trustee is authorized and shall pay over to, or apply for the benefit of, or loan to, settlor’s child, at any time and from time to time, so much of the principal, as trustee, in the exercise of trustee's sole and absolute discretion, shall deem needful, proper, or necessary to provide adequately for such child's maintenance and health if income from other sources and the income from this trust share are insufficient for such purpose. Whenever possible, all payments are to be made directly to the providers of medical services or equipment after insurance coverage benefits.”

§18.7 Mandatory Distributions.

A mandatory distribution must be made by the trustee without the exercise of discretion at a specified time or upon the occurrence of an event provided in the trust instrument. The following are some examples of mandatory distribution provisions:

“The trustees shall distribute all of the net income of the trust to my wife, no less frequently than quarter annually.”

“One-half of the principal in the trust shall be paid to the child at age 25, and the balance at age 30.”

“Upon her marriage the trustee then serving shall distribute to my daughter a gift of $10,000.”

If the provision is couched in precatory terms, the discretion of the trustee is implied in making the distribution. Typically, the use of the word “may” would as an antecedent would imply such discretion in the trustee: Example:

“Upon her marriage the trustee then serving may distribute to my daughter, Susan, a gift of $10,000.”

§18.8 Limited Exercise of Prohibited Power.

20 Pa. CSA § 7504(a)(1), provides that a trustee who is also a trust beneficiary cannot exercise certain powers which exercised in a manner which could directly in indirectly benefit that trustee/beneficiary. The prohibited powers include:

---

This is not particularly good drafting, however since it provides little direction to the trustee as to whether the conditions the settlor may have intended before the gift was to be made. Additional language like the following should be considered: “…in exercising its discretion in making such gift the trustee should consider whether the assets of the trust are adequate to otherwise to continue to provide for the support and maintenance my daughter, for the remainder of the trust term.”
– The power to make discretionary distributions of either principal or income to or for the benefit of the trustee, the trustee’s estate or the creditors of either.

– The prohibition does not apply if the power is limited by an ascertainable standard relating to the trustee’s health, education, support or maintenance; or the power is exercisable by the trustee only in conjunction with another person having a substantial adverse interest in the property subject to the power.

– The power to make discretionary distributions of either principal or income to satisfy any of the trustee’s personal legal obligations for support or other purposes.

– The power to make discretionary allocations in the trustee’s personal favor of receipts or expenses as between income and principal unless the trustee has no power to enlarge or shift any beneficial interest except as an incidental consequence of the discharge of the trustee’s fiduciary duties.

– The power to exercise any of the proscribed powers with regard to an individual other than the trustee to the extent that the individual could exercise a similar prohibited power in connection with a trust that benefits the trustee.

If a trustee is prohibited by 20 Pa. CSA § 7504(a)(1) from exercising a power conferred upon the trustee, the trustee nevertheless may exercise that power but shall be limited to distributions for the trustee's health, education, support or maintenance to the extent otherwise permitted by the terms of the trust. Unless otherwise prohibited by the provisions of this section, a trustee may exercise a power described herein in favor of someone other than the trustee, the trustee's estate or the creditors of either.

§18.9 Power to Withdrawal

A power of withdrawal provision generally will allow the beneficiary the right to require withdrawals form the trust, rather than placing the discretion in the hands of the trustee. Under 20 Pa. CSA §7703, a “power of withdrawal” is defined as the unrestricted power of a beneficiary, acting as a beneficiary and not as a trustee, to transfer to himself or herself the entire legal and beneficial interest in all or a portion of trust property. Examples of a “power of withdrawal” are the right to withdraw a fixed fraction, fixed amount or all the principal of a trust after the holder reaches a certain age. Such a power granted by the trust therefore grants the trust beneficiary the right to compel a distribution from the trust. The holder of a power of withdrawal has under the PUTA, the same rights as a settlor of a revocable trust to the extent of the property subject to the power during the period the power may be exercised. Here is an example of a power of withdrawal provision:

---

31 20 Pa. CSA § 7504(b)(1)
32 20 Pa. CSA § 7504(b)(2)
33 20 Pa. CSA §7753(b)
“...my daughter, ANNE, shall have the right to withdraw up to one (1/2) half of the principal balance of the trust after having attained age 30, ....”

It should be noted the granting of a power of withdrawal may have estate tax consequences. Under IRC§ 2041 the value of the gross estate of the holder of such a power includes property which is subject to a power exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, unless the power is limited by an ascertainable standard relating to the health, education, support, or maintenance. Here an example of withdrawal provision which if still held on the date of death would cause inclusion in the holder’s estate under IRC§ 2041:

“...my son, THOMAS shall have the right to withdraw the entire balance of the trust, upon the tenth anniversary of this Trust....”

The failure to exercise a general power of appointment will result in a lapse of the power, and such a lapse or release of the power during the holder’s lifetime will cause the appointive property to be subject to gift tax. However, a lapse or release of the power is treated as taxable transfer only to the extent that the value of the property that could have been appointed by exercise of the lapsed powers exceeds the lapsed power exclusion at the time of the lapse. Under IRC § 2041(b)(2). The lapsed power exclusion is the greater of $5,000, or 5% of the aggregate value, at the time of the lapse, of the assets out of which the exercise of the lapsed power could have been satisfied. In order to avoid unintended gift tax consequences as provision like the following, which is sometimes termed a “5 and 5” power may be used:

“... to pay to my said wife as much of the principal as she may, from time to time, request in writing, not exceeding, in any calendar year, the greater of Five Thousand Dollars ($5,000) or Five Percent (5%) of the value of the principal at the end of such calendar year on a noncumulative basis; provided that no such payments shall be made until the Marital Deduction Trust is completely exhausted.”

It should also be noted also that a power of withdrawal is relevant to the rights of the holder’s creditors. Under 20 Pa.C.S.7748, trust property that is subject to a power of withdrawal, during the period the power may be exercised and after its lapse, release or waiver, may be reached by a creditor or an assignee of the holder of the power. This is true whether or not the interest of the holder in the trust is subject to a spendthrift provision.

§18.10  Remainder Interest

---

34 Under IRC Sec. 2041, the provision as provided here would constitute a “general power of appointment”, which would result of inclusion of the property subject to the power to inclusion in the holder’s gross estate for federal estate tax purposes.

35 Code Sec. 2041(b)(2) ; Reg § 20.2041-3(d)(3)

36 Excepted from the definition of “power of withdrawal” are Crummey powers, defined by reference to the Internal Revenue Code, and powers that are restricted, such as a power limited to an ascertainable standard. Unlike the UTC, Crummey powers are not powers of withdrawal and thus are not subject to the claims of the holder’s creditors either during the period the power may be exercised or thereafter.
§18.10.1 In General

20 Pa. CSA § 7780.7 of the PEF Code provides that upon the occurrence of an event terminating or partially terminating a trust, the trustee shall proceed to distribute the trust property within a reasonable time 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. The provisions for disposition of the remaining balance of the trust can take several different forms. Here are some examples:

§18.10.2 Based on a Percentage of the Remaining Balance of the Trust

“a. I give the residue of my estate as follows:

1. Ezra Rogers - 5%
2. Joseph Strong - 15%
3. Alice Downey - 5%
4. The balance to my then living descendants in equal shares per stirpes.”

When drafting such provisions, you should anticipate that the named remainderman, might not survive at the time the trust is terminated. Therefore, a provision like the following should be included:

“b. If any of the named legatees predecease me, I bequeath his or her share to his or her then living descendants, per stirpes, who survive me, and in the absence of such then living descendants, that share shall lapse and pass under subsection 4, above.”

§18.10.3 Based on Shares

Here is one example of such a provision:

“The balance of the trust shall be distributed in equal shares to my then-living descendants, per stirpes, and in default of such descendants to the Good Foundation, Hemlock, Pennsylvania, a Pennsylvania not for profit corporation.”

Here is another:

“I direct that the residue of my estate be divided into equal shares and distributed as follows:

a. One share to my sister-in-law, Laura Law, if she survives me by thirty days, and if she does not so survive me, her share shall be distributed to such of her descendants, per stirpes, and in default of such descendants her share shall be added to the share for the other named person in this paragraph

b. One share to my sister-in-law, Mary Dunn, if she so survives me and if she does not so survive me her share shall be distributed in equal per capita shares among such as so survive me of her husband and her children, provided that if any such child fails so to
survive me, his or her share shall be distributed to his or her descendants, per stirpes, who so survive me (it being my intention that the share of her husband shall not exceed the share of each child) and in default of such husband and descendants, her share shall be added to the share for the other named person in this paragraph.”

§18.10 4  Hotch Potch

A so-called “hotch potch” provision is often used when the settlor wishes to consider life-time gifts as advancements on a particular remainderman’s share of the trust. This is most often the case when the trust balance represents a significant share of the balance of the settlor’s estate, and the trust is distributed to the settlor’s children. Here is an example:

“I direct my Trustee to divide the residue of my estate into shares as follows:

a. To calculate an amount (the "Augmented Residue") equal to the sum of (i) the residue of my estate and (ii) the total of all lifetime gifts of cash, stock certificates, or other property made by me to my children as reflected by my personal financial records (the "Advancements").

b. To divide the Augmented Residue into as many equal shares as are necessary to create one share for each child of mine who survives me and each child of mine who fails to survive me but is represented by descendants who survive me.

c. To reduce each share created under Section 2 above by the amount of the total Advancements made to the child representing such share and/or such child’s descendants.

d. To pay each share so calculated to the child for whom the share is created, or if such child fails to survive me, to such of the descendants of such child as survive me.”

§18.10.5  Continuing Trust

When the disposition is being made to the younger remaindermen, the document may provide that the trust share passing to that beneficiary be held in further trust. Such a provision will avoid the need for the appointment of a guardian of the property, and allow administration of the trust property under terms dictated by the trust document:

“c. In the event any share passing hereunder is otherwise distributable to a descendant of mine (other than a child of mine) who has not then attained age twenty-five (25), I direct the Trustee to retain such share in a further separate trust for such descendant, and

(1) To pay the net income therefrom at least quarterly to such descendant.

(2) To pay to or apply for the benefit of such descendant, so much of the principal as the Trustee deems advisable for his or her maintenance, health and support, and
education as hereinafter defined, after considering funds available to him or her from other sources.

(3) To pay the principal to such descendant upon his or her written request, after attaining age twenty-five (25), the remaining principal.”


What if none of the named remaindermen are living at the time the trust terminates? A “wipe out” provision provides for the disposition of the trust estate if no one who has been named as trust beneficiary survives. If there is nothing stated in the trust, then the intestate statute will determine who will be entitled to the trust property. Some people will not care at all, some will care very much, and still others will care more about who they don’t want to receive the property, rather than who will. Naming one or more charitable beneficiaries may serve as a good wipe out clause. In any case, the trust should address the issue. Here is some sample language which will split the estate between the intestate heirs of the husband and the wife rather than having it go 100% to the heirs of the surviving spouse: Here is an example of a wipe out clause:

“If at any time there is no one living who is entitled to income or principal under the forgoing provisions, to pay the then-remaining principal as follows:

(1) One-half (1/2) thereof to my intestate heirs, such heirs to be identified and in such amounts, as determined as the time of my death, under the laws of the Commonwealth of Pennsylvania, as if I had died intestate, unmarried and without surviving descendants, and

(2) One-half (1/2) thereof to the intestate heirs of my wife, such heirs to be identified and to receive such amounts as determined under the laws of the Commonwealth of Pennsylvania, as if she had then died intestate, unmarried and without surviving descendants.”

§18.12 Powers of Appointment

A power of appointment is created when one person (the donor) confers upon another (the donee, possessor, or holder), by will, trust, or other instrument, the right to designate who is to receive certain specific property or an interest in it at some future time. In the context of a trust instrument, the settlor conveys the power on another person to determine how the balance of the trust is to be distributed. This allows the trust beneficiary some discretion as to how the trust balance is to be distributed. A power of appointment may provide complete discretion as to who the potential appointees may be or limit permissible appointees to a name class. Here are some examples of powers of appointment language:

“General Power of Appointment - On the death of settlor's wife, trustee shall pay and distribute the then remaining principal of the marital trust to and among such persons, corporations, or entities, including the creditors and the estate of the settlor's wife and the creditors of the estate of the settlor's wife, on such terms and conditions as she, by her
will, containing a specific reference to this power, may direct and appoint. Such payment and distribution shall be free and clear of the terms and provisions of this trust agreement and the power of appointment may be exercised by her alone and in all events in favor of her estate or otherwise as she, by her will, containing a specific reference to this power, may direct and appoint."

The following is an example of a more limited power:

“Limited Power of Appointment - On the death of settlor's wife, trustee shall pay and distribute the then remaining principal of the (marital or residuary) trust to and among such of settlor's then-living issue (or other specified individuals or charitable institutions), on such terms and conditions as she, by her will, containing a specific reference to this power, may direct and appoint. Such payment and distribution shall be free and clear of the terms and provisions of this trust and the power of appointment may be exercised by her alone and in all events.”

A power of appointment which meets the definition of a “general power of appointment” under will result in the subject property being includable in the gross estate of the holder. Under IRC §2041(b)(1), the term “general power of appointment” means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, unless its exercise is limited by an ascertainable standard. A limited or special power of appointment will not result in such inclusion under IRC §2041.
CHAPTER NINETEEN

ADMINISTRATIVE PROVISIONS

§19.1 Overview

Upon acceptance of a trusteeship, the trustee must administer the trust in good faith, in accordance with its provisions and purposes and the interests of the beneficiaries and in accordance with applicable law. The trust must administer the trust solely in the interests of the beneficiaries, as a prudent person would, by considering the purposes, provisions, distributional requirements and other circumstances of the trust and by exercising reasonable care, skill and caution.

§19.2 General Powers and Duties of Trustees

Under 20 Pa.C.S. § 7780.5, a trustee unless limited by the terms of the trust or the trustee’s general fiduciary duty, holds all powers over the trust property which an unmarried competent owner has over individually owned property. In addition, the trustee is generally vested with any other powers appropriate to carry out the terms and purposes of the trusts, and achieve the proper investment, management, and distribution of the trust property. Under the common law, a trustee has the affirmative duty of not complying with trust provision which are impractical or impossible to perform or which are unlawful or against public policy. When in doubt as to the proper interpretation of the powers or duties of the trustee, the trustee or trust beneficiary may always apply to an appropriate court for instructions.

§19.3 Illustrative Powers of Trustee

20 Pa.C.S. § 7780.6 provides that the powers that illustrate the powers which a trustee may exercise pursuant to section 7780.5 include the following powers:

(1) To accept, hold, invest in and retain investments as provided in Chapter 72 (relating to prudent investor rule).

---

38 20 Pa.C.S. § 7771
39 20 Pa.C.S. § 7773
40 20 Pa.C.S. § 7774
41 20 Pa.C.S. § 7780.5; see Restatement (Third) Trusts at §85(1)(a); it should be pointed that a power differs from a duty. A duty imposes an obligation or a mandatory prohibition. A power, on the other hand, is a discretion, the exercise of which is not obligatory.
42 See Restatement (Third) Trusts at §70(a)
43 Unif. Trust Code § 815(a)(1)(2)(B);
44 See Restatement (Third) Trusts at §73
45 Restatement (Third) Trusts at §72
46 Restatement (Third) Trusts at §71
(2) To pay or contest a claim; settle a claim by or against the trust by compromise, arbitration or otherwise; and release, in whole or in part, any claim belonging to the trust.

(3) To resolve a dispute regarding the interpretation of the trust or the administration of the trust by mediation, arbitration or other alternative dispute resolution procedures.

(4) To prosecute or defend actions, claims or proceedings for the protection of trust assets and of the trustee in the performance of the trustee’s duties.

(5) To abandon or decline to administer any property which is of little or no value, transfer title to abandoned property and decline to accept title to and administer property which has or may have environmental or other liability attached to it.

(6) To insure the assets of the trust against damage or loss and, at the expense of the trust, protect the trustee, the trustee’s agents and the beneficiaries from liability to third persons arising from the administration of the trust.

(7) To advance money for the protection of the trust and for all expenses, losses and liability sustained in the administration of the trust or because of the holding or ownership of any trust assets. The trustee has a lien on the trust assets as against the beneficiary for an advance under this paragraph, including interest on the advance.

(8) To pay taxes, assessments, compensation of the trustee and employees and agents of the trustee and other expenses incurred in the administration of the trust.

(9) To receive additions to the assets of the trust.

(10) To sell or exchange any real or personal property at public or private sale, without obligation to repudiate an otherwise binding agreement in favor of better offers. If the trustee has been required to give bond, no proceeds of the sale of real estate, including proceeds arising by the reason of involuntary conversion, shall be paid to the trustee until: (i) the court has made an order excusing the trustee from entering additional security; or (ii) the court has made an order requiring additional security and the trustee has entered the additional security.

(11) To enter for any purpose into a lease as lessor or lessee with or without option to purchase or renew for a term within or extending beyond the term of the trust.

(12) To grant options for sales or leases of a trust asset and acquire options for the acquisition of assets, including options exercisable after the trust terminates.

(13) To join in any reorganization, consolidation, merger, dissolution, liquidation, voting trust plan or other concerted action of security holders and to delegate discretionary duties with respect thereto.
(14) To vote a security, in person or by general or limited proxy, with or without power of substitution.

(15) To borrow funds and mortgage or pledge trust assets as security for repayment of the funds borrowed, including repayments after the trust terminates.

(16) To make loans to and buy property from the personal representatives of the settlor and the settlor’s spouse. Loans under this paragraph shall be adequately secured, and the purchases under this paragraph shall be for fair market value.

(17) To partition, subdivide, repair, improve or develop real estate; enter into agreements concerning the partition, subdivision, repair, improvement, development, zoning or management of real estate; impose or extinguish restrictions on real estate; dedicate land and easements to public use; adjust boundaries; and do anything else regarding real estate which is commercially reasonable or customary under the circumstances.

(18) With respect to possible liability for violation of environmental law: (i) to inspect or investigate property the trustee holds or has been asked to hold or property owned or operated by an organization in which the trustee holds or has been asked to hold an interest, for the purpose of determining the application of environmental law with respect to the property; (ii) to take action to prevent, abate or otherwise remedy any actual or potential violation of environmental law affecting property held directly or indirectly by the trustee, whether taken before or after the assertion of a claim or the initiation of governmental enforcement; (iii) to decline to accept property into trust or disclaim a power with respect to property that is or may be burdened with liability for violation of environmental law; (iv) to compromise claims against the trust which may be asserted for an alleged violation of environmental law; and (v) to pay the expense of inspection, review, abatement or remedial action to comply with environmental law.

(19) To operate, repair, maintain, equip and improve any farm or farm operation; to purchase and sell livestock, crops, feed and other property that is normally perishable; and to purchase, use and dispose of farm equipment and employ one or more farm managers and others in connection with farm equipment and pay them reasonable compensation.

(20) To make ordinary or extraordinary repairs or alterations in buildings or other structures; demolish improvements; and raze existing or erect new party walls or buildings.

(21) To enter into a lease or arrangements for exploration and removal of minerals or other natural resources or enter into a pooling or utilization agreement.

(22) To exercise all rights and incidents of ownership of life insurance policies held by the trust, including borrowing on policies, entering into and terminating split-
dollar plans, exercising conversion privileges and rights to acquire additional insurance and selecting settlement options.

(23) To employ a custodian; hold property unregistered or in the name of a nominee, including the nominee of any institution employed as custodian, without disclosing the fiduciary relationship and without retaining possession and control of securities or other property so held or registered; and pay reasonable compensation to the custodian.

(24) To apply funds distributable to a beneficiary who is, in the trustee’s opinion, disabled by illness or other cause and unable properly to manage the funds directly for the beneficiary’s benefit or to pay such funds for expenditure on the beneficiary’s behalf to: (i) the beneficiary; (ii) a guardian of the beneficiary’s estate; (iii) an agent acting under a general power of attorney for the beneficiary; or (iv) if there is no agent or guardian, a relative or other person having legal or physical custody or care of the beneficiary.

(25) To pay funds distributable to a minor beneficiary to the minor or to a guardian of the minor’s estate or to apply the funds directly for the minor’s benefit.

(26) To do any of the following: (i) pay any funds distributable to a beneficiary who is not 21 years of age or older to: (A) the beneficiary; (B) an existing custodian for the beneficiary under Chapter 53 (relating to Pennsylvania Uniform Transfers to Minors Act) or under any other state’s version of the Uniform Transfers to Minors Act; (C) an existing custodian for the beneficiary under the former Pennsylvania Uniform Gifts to Minors Act or under any other state’s version of the Uniform Gifts to Minors Act; or (D) a custodian for the beneficiary appointed by the trustee under Chapter 53; (ii) Apply the funds for the beneficiary.

(27) To pay calls, assessments and other sums chargeable or accruing against or on account of securities.

(28) To sell or exercise stock subscription or conversion rights.

(29) To continue or participate in the operation of any business or other enterprise and to effect incorporation, merger, consolidation, dissolution or other change in the form of the organization of the business or enterprise.

(30) To select a mode of payment under a qualified employee benefit plan or a retirement plan payable to the trustee and exercise rights under the plan.

(31) To distribute in cash or in kind or partly in each and allocate particular assets in proportionate or disproportionate shares.

(32) To appoint a trustee to act in another jurisdiction with respect to trust property located in the other jurisdiction, confer upon the appointed trustee all the powers
and duties of the appointing trustee, require that the appointed trustee furnish security and remove the appointed trustee.

(33) To exercise elections with respect to Federal, State and local taxes.

(34) To execute and deliver instruments which will accomplish or facilitate the exercise of the trustee’s powers.

Because of the expansive nature of 20 Pa.C.S. § 7780.5, as illustrated by 20 Pa.C.S. § 7780.6, the job of the scrivener in drafting the administrative provisions of a trust may be the limit the powers of the trustee. As a scrivener, should examine the list and edit that list to fit the requirements of the trust at issue. Here is an example

“The trustee shall not borrow funds, mortgage or pledge trust assets as security for repayment of the funds borrowed, without approval of the court.”


§19.4.1 Overview

As discussed in Chapter 5, the way the trustee handles the investments of the principal of the trust is a central issue in the administration of a trust. The manner in which the trust investments are made is controlled by the trustee’s fiduciary duty, particularly the duties of loyalty and impartiality, and in Pennsylvania, under the terms of the Prudent Investor Rule (the “Rule”). It is well established in Pennsylvania case law that "where a trust instrument is explicit as to the duty owed, it, as evidencing the settlor's (testator's) intent should govern." This principle is codified in 20 Pa. C.S.A.§ 7202(a) which provides that a trustee is required to invest and manage property held in a trust in accordance with the provisions of the Prudent Investor Rule except where provided by the governing instrument.

Therefore, under Pennsylvania law a trust settlor is permitted to direct the investment protocol for the trust property through specific provisions of the trust. This rule is not without exceptions. The trustee cannot, in exercising or failing to exercise its discretion, act dishonestly, or with an improper motive, or fail to use or act beyond the bounds of reasonable judgment. Also, the trustee, when investing trust property remains under the duty to the beneficiary to administer the trust solely in the interest of the beneficiary. Therefore, the trustee cannot engage in self-dealing, nor can he place himself in a position inconsistent with the interests of the trust. Further, exculpatory clauses which would run contrary to public policy will not be given effect by the courts.

48 In re Estate of Niessen, 489 Pa. 135, 139, 413 A.2d 1050, 1052 (1980).
51 Id.
In addition, §7202(b) provides that when a trust instrument contains a restriction on the trustee’s power of investment a court may release the trustee from the restriction with conditions which the court deems appropriate. This is provided the court finds that adherence to the original restriction is impractical or that existing or foreseeable economic conditions are so far different from those prevailing at the creation of the trust that adherence to that restriction could deprive the trust beneficiaries of the full benefits intended by the trustee. In situations where the governing document does not provide for specifics in regard to how the investments of the trust should be handled, the Prudent Investor Rule provides the default rules.\(^5\) These specific are reviewed in Chapter 5.

§19.4.2 Illustrative Provisions

As a result, the trust is generally free to direct the form of investment of the trustee assets. If that is the case, the trustee has the duty to conform to the provisions of the trust. Here is an illustrative provision:

“To accept, hold, invest only in Triple A Rated bonds.”

If, as is more often the case, the document does not specifically direct the trustee as to how to make investments, the manner in which they are made is controlled by the Act. Here is a provision which essentially restates that principle:

“To accept, hold, invest in and retain investments as provided in Chapter 72 (relating to prudent investor rule).”

§19.4.3 Delegation

A trustee is permitted under §7206 of the Rule to delegate investment and management functions. As a result, a trustee may delegate investment functions to an agent or a co-trustee. Further, under §7206(b), a trustee will not be held responsible for the investment decisions made by an agent to whom the trustee has delegated investment functions. This is provided, however, that the trustee has exercised reasonable care, skill and caution in selecting the investment agent, and in establishing the scope and specific terms of the delegation. Under §7206, the trustee retains responsibility for reviewing periodically the investment agent’s actions in order to monitor the investment agent’s performance and compliance with the scope and specific terms of the delegation. The investment agent is required to comply with the scope and terms of the delegation and must exercise reasonable care, skill and caution. Here is an illustrative provision, enabling such a delegation:

“The trustee shall be permitted hereunder to delegate the authority to make investments on behalf of the trust provided the trustee exercises reasonable care, skill and caution in selecting the investment agent, and in establishing the scope and specific terms of the delegation, and the further that the trustee retains responsibility for reviewing periodically the investment agent’s actions in order to monitor the investment agent’s

performance and compliance with the scope and specific terms of the delegation. Any such investment agent so appointed shall be required to comply with the scope and terms of the delegation and must exercise reasonable care, skill and caution.”

Here is another sample provision:

“XXVI.Investment Advisor: If the person who is or presently could be an individual trustee notifies my corporate trustee in writing he or she may direct and control the sale, purchase, management or retention of any investment in which event no trustee shall review the investment at any time nor be subject to liability for acting in accordance with those directions. He or she may appoint one or more successor investment advisors to serve during his or her lifetime by writing delivered to my corporate trustee. If in my corporate trustee’s opinion, the advisor is disabled by illness or other cause and unable to properly serve as advisor and there is no successor willing to serve, my corporate trustee may act as advisor.”

§19.5 Income and Principal Act

§19.5.1 Overview

In administering a trust, it is necessary to apply fiduciary accounting principles in order to account for the receipts and disbursements of the trust during the term the trust is being administered. In performing this accounting, a distinction must be drawn between “principal” and “income”. In addition, there is the question of how the receipts are credited and how the expenses are charged against principal and income is necessary in order to properly determine the relative shares of the beneficiaries in the trust. In cases when the trust document is silent, the rules as provided in Pennsylvania Uniform Principal and Income Act of 1997 (the “PUPIA”), apply. The accounting principles provided under the PUPIA, are reviewed in Chapter 6.

§19.5.2 Trustee’s Power to Adjust

20 Pa. CSA § 8104 of the PEF Code allows the trustee the right to make adjustment between income and principal to achieve a “fair and reasonable result” if: the document provides an “income interest” in the trust, and if either application of the rules provided in the document or the statutory rules do not otherwise allow such a result to be reached.

The condition regarding the prerequisite that the trust contain an “income interest” is met when the terms of the trust require all of the “income” to be distributed at regular intervals; or when the terms of the trust require a trustee to distribute all of the income, but permit the trustee to decide how much to distribute to each member of a class of beneficiaries.54 In addition, this condition will be met when the terms of a trust provide that the beneficiary is to receive the greater of the trust accounting income or a fixed dollar amount, or of trust accounting income and a fractional share of the value of the trust assets.55 If the trust authorizes the trustee in its

54 Comment, 20 Pa.C.S. § 8104
55 Id.
discretion to distribute the trust’s income to the beneficiary or to accumulate some or all of the income, the condition will be met because the terms of the trust do not permit the trustee to distribute more than the trust accounting income. \(^5^6\) The governing instrument limiting the power of the trustee to make such adjustments will not limit the application of this provision unless the governing instrument clearly intends to deny the power of adjustment. \(^5^7\) Here is an illustrative provision which enables the trustee to adjust:

“To allocate receipts and disbursements between income and principal in such manner as trustee in its absolute discretion determines, even though a particular allocation or allocations may be made in a manner inconsistent with what would otherwise be applicable state law.”

As a contrast here is an illustrative provision which denies the trustee the power to adjust:

“20 Pa. CSA § 8104 of the PEF Code notwithstanding, the trustee is prohibited from allocating receipts and disbursements between income and principal in such manner which would in any way reduce the income interest otherwise provided in Section IV.A.1.”

§19.5.3 Power to Convert to Unitrust

Unless expressly prohibited in the instrument the trustee may release the power to adjust under 20 Pa. CSA § 8104, and convert the trust to a “unitrust”, if: (a) the trustee determines that the conversion will enable the trustee to better carry out the intent of the settler and the purposes of the trust; (b) the trust beneficiaries are notified and do not object. If a trust beneficiary objects, the trustee alternatively may seek court approval of the conversion.

“To convert the trust to a “unitrust” if the trustee determines I the trustee’s sole discretion that the conversion will enable the trustee to better carry out the intent of the settler and the purposes of the trust.”

\(^5^6\) Id.
\(^5^7\) Id.
CHAPTER TWENTY

TRUSTEE PROVISIONS

§20.1 Overview.

The trustee provisions of the document should provide at the very least for: (1) the appointment of the original trustee or trustees; (2) the appointment of successor trustees in the case of a vacancy; and (3) a process for removing a trustee.

§20.2 Trustee Appointments and Replacements

§20.2.1 Who Can Serve

As already reviewed in Chapter 2, any individual who has the capacity to hold as a beneficial owner of property has capacity to serve as a trustee. This generally means that minors and incompetent adults may not serve. A corporation can also serve as trustee unless it is limited by the law of the jurisdiction in which it operates. In Pennsylvania, only banks, trust companies, and certain savings banks are authorized to act as trustees. Under the doctrine of “merger” the same person or entity cannot be the sole trustee and the sole beneficiary of a trust. A trust does not terminate however, when one of several beneficiaries becomes the sole trustee, or when the sole beneficiary becomes one of several trustees. Subject to these limitations, a settlor has the right to name the trustee or trustees of the trust.

§20.2.2 Appointment

The trustee appointed should be clearly identified in the document. If an institutional trustee is named, make sure that you use the proper name of the institutional trustee. Here is sample language:

“I appoint my husband, Walter J. Thomas, as Trustee, hereunder. If my husband, Walter J. Thomas fails to qualify or ceases to act for any reason, I appoint Mary Monaghan, Trustee in his place. If Mary Monaghan fails to qualify or ceases to act for any reason, I appoint Megan Kelly, Trustee in her place.”

Here is additional sample language:

“D. Each individual Trustee of any trust hereunder, then serving, may unanimously appoint, in writing:

1. An individual to serve with them as co-Trustee;

2. An individual to serve in his or her place; provided that any such appointment shall not supersede any designation made above of a successor Trustee.

E. The individual Trustees, with the written consent of the above described class of persons, may appoint a corporation organized under the laws of the United States or any
State thereof and possessed of trust powers, which has trust assets of at least One Hundred Million Dollars ($100,000,000), as successor corporate Trustee.”

§20.2.3. Acceptance

Under 20 Pa. CSA § 7761 a person designated as trustee accepts the trusteeship by substantially complying with a method of acceptance provided in the trust instrument; or if the trust instrument does not provide a method or the method provided in the trust instrument is not expressly made exclusive, by accepting delivery of the trust property, exercising powers or performing duties as trustee, or by otherwise indicating acceptance of the trusteeship. To avoid any issue as to whether the trustee has accepted the appointment or not the trustee appointed should evidence their acceptance of the trusteeship. Execution of the document by the trustee appointed with language like the following, should be included58:

“The foregoing trust was delivered, and is hereby accepted, in Philadelphia, Pennsylvania on November 15, 2015.

ATTEST: MILTON TRUST OF PENNSYLVANIA, N.A.

___________________________ By __________________________

§20.3 Vacancy in Trusteeship and Appointment of Successor

It is a fundamental principle of trust law that a trust will not fail for lack of a trustee. If there is no trustee appointed or the original or successor trustee or trustees fail to serve without a successor being appointed in the trust agreement, the 20 Pa. CSA § 7764 provides that the vacancy will be filled, first by provisions in the trust document, then by unanimous agreement of the beneficiaries, and in lieu of such agreement by order of the court. Any liability of a resigning trustee or of any sureties on the trustee's bond for acts or omissions of the trustee is not discharged or affected by the trustee's resignation. Whether or not a vacancy in a trusteeship exists or is required to be filled, the court may appoint an additional trustee or special fiduciary, if the court considers the appointment desirable for the administration of the trust.

E. The individual Trustees, with the written consent of the above described class of persons, may appoint a corporation organized under the laws of the United States or any State thereof and possessed of trust powers, which has trust assets of at least One Hundred Million Dollars ($100,000,000), as successor corporate Trustee.

§20.4 Resignation

Under 20 Pa. C.S. § 7765, a trustee once appointed as trustee may resign either as provided in the trust document or if there is at least one co-trustee and all co-trustees consent in

58 Although the execution and acceptance provisions is discussed along with the discussion of introductory provisions this provisions in normally included at the end of the document.
writing to the resignation, and all qualified beneficiaries also consent in writing. 59 A sole trustee of a trust may not resign unless the trust instrument names a successor trustee or provides a method for appointing a successor trustee, and in either case the resignation shall not be effective until the successor trustee accepts the appointment in writing. Otherwise the approval of the court is required. 60 Any liability of a resigning trustee for acts or omissions of the trustee is not discharged or affected by the trustee's resignation. 61

Sample Language:

“H. Any Trustee while serving hereunder may resign without court approval by written notice delivered to the co-Trustee and all sui juris income beneficiaries. If a Trustee ceases to serve, whether by death or resignation, such Trustee shall be relieved of all liability through the delivery of an account (formal or informal) to the sui juris income beneficiaries and by the signature of a release based on said account by such persons.

I. No Trustee taking office shall be liable in any way for the acts or omissions of any Trustee prior to such Trustee's assumption of office and shall have no duty to review the performance of a Trustee prior to that time.”

§20.5 Removal

A trustee can be removed in a manner provided in the trust. 62 The settlor, a co-trustee, or a beneficiary may also request the court to remove a trustee, or a trustee may be removed by the court on its own initiative.

Sample Language

“A. The settlor may at any time revoke the appointment of a Trustee and appoint an individual, and/or a corporate Trustee to serve with or succeed any Trustee hereunder. Such power of removal under this Paragraph shall not be extinguished by a single exercise; provided that the power to remove a corporate Trustee shall not be exercised more frequently than once every five years.”

In drafting a removal provision like the foregoing for an irrevocable trust, the scrivener should be aware that the provision if not carefully drafted may cause the trust to be included in the settlor’s federal gross estate. If a decedent holds the power to appoint himself or herself as successor trustee if the current trustee cease to serve, and if the trustee has powers (such as a discretionary power to distribute income among trust beneficiaries) that would cause the property

59 20 Pa. CSA § 7765(c)(2).
60 20 Pa. CSA § 7765(a).
61 20 Pa. CSA § 7765(d).
62 20 Pa. CSA §7705(a), also Restatement (Third) Trusts at §37. In fashioning a removal provision for an irrevocable trust, the drafter should be cognizant of the danger that the trust may be included in the settlor's federal gross estate if the settlor retains the power to be appointed as trustee or to appoint someone who is not independent. See Rev. Rul. 95-58, 1995-2 C.B. 191.
to be included in the decedent's estate under §2036 if held directly, then the right to remove a 
trustee may result in the inclusion of the trust in the decedent's gross estate, since under §2036, 
the holding of such a power of removal will attribute those discretionary powers to the decedent
In Rev. Rul. 95-58, 1995-2 C.B 191, the IRS ruled however that a reservation of the power to 
remove a trustee and limited by the to appoint a successor trustee who is neither related nor 
subordinate is not a reservation of a power subject to §2036 or §2038. Therefore, inclusion of a 
clause like the following should be considered:

The foregoing notwithstanding no beneficiary of a trust in an individual, Trustee, or 
other capacity, may appoint himself or herself as Trustee or remove a Trustee and 
appoint in place of the Trustee so removed a Trustee who is a related or subordinate 
party within the definition of Sec. 672(c) of the Code to the beneficiary

§20.6 Decision Making - Co-Trustees

20 Pa. CSA § 7763 provides that co-trustees who cannot reach a unanimous decision may 
act by majority decision. When a dispute arises among trustees as to the exercise or non-exercise 
of any of their powers and there is no agreement by a majority of them, unless otherwise 
provided by the trust instrument, the court in its discretion, upon petition filed by any of the 
trustees or any party in interest, aided if necessary by the report of a master, may direct the 
exercise or non-exercise of the power as it deems necessary for the best interest of the trust. How 
decisions are made should be provided in the trust document:

Sample Language

“C. If more than two Trustees are serving hereunder then all decisions shall be as 
agreed by the majority; if two Trustees are serving, then all decisions shall be 
unanimous.”

Additional Sample Language:

“C. Division of Duties/Delegation: My corporate trustee shall be custodian of all the 
securities in my trust, may hold the securities in the name of a nominee, and shall 
maintain the records. Any individual trustee may delegate in writing from time to time to 
my corporate trustee any or all of the individual trustee’s powers and duties. Unless any 
individual trustee otherwise directs in writing,

I authorize my corporate trustee to rely upon any oral instructions or approvals as long 
as my corporate trustee believes in good faith they are genuine.”

§20.7 Compensating the Trustee

Under PUTA § 7768(b), if a trust instrument or written fee agreement signed by the 
settlor or anyone who is authorized by the trust instrument to do so specifies a trustee’s 
compensation, the trustee is generally entitled to the specified compensation. Here is some 
language authorizing the compensation of a corporate trustee.
“Any corporate fiduciary serving hereunder shall receive compensation for its services hereunder in accordance with a fee agreement entered into between it and me during my lifetime, or if there is no such agreement, between it and the individual fiduciaries serving with it, which in no event shall exceed its Schedule of Fees in effect, from time to time during, the period in which its services are performed. In the absence of such an agreement, the corporate fiduciary shall receive compensation in accordance with its Schedule of Fees in effect, from time to time, during, the period in which its services are performed.”

If the trust appoints an individual trustee consider the following sample language:

a. Any individual fiduciary serving hereunder who is related to me by blood or by marriage shall not receive compensation for his or her services, but shall be entitled to be reimbursed for all expenses incurred as a result of so serving.

b. Any individual fiduciary serving hereunder who is not related to me by blood or by marriage shall receive such compensation for his or her services as may be determined to be reasonable and approved by a majority of the income beneficiaries. I suggest, but do not require, that such compensation be set in an amount between one-quarter and one-third of the compensation which would be paid to a corporate fiduciary in accordance with its standard schedule of fees.

c. Regardless of whether or not such individual chooses to accept such compensation, he or she shall be reimbursed for all expenses incurred as a result of so serving.

§20.8 Trust Protectors

The concept of the so-called “trust protector” first developed in the area of “off-shore” trusts, but has been more recently been grafted to more conventional domestic trust, particularly irrevocable trusts. The trust protector may be an individual, a corporation, or sometimes even a committee. A corporate protector might take the form of a small, regulated trust company. An alternative could be a corporate protector organized by the settlor. Alternatively, or in addition, a protectorship committee may be built into the structure. In this case, the language of the trust instrument would call for the appointment of such a committee and empower it to hire and fire the protector (whether individual or corporate). The settlor could staff the committee with a combination of advisors, both domestic and foreign, but limit the candidates who may serve as protector to nonresident aliens.

The “trust protector” generally serves in a non-fiduciary capacity and can be granted broad or narrow authority over the trust depending on the intent and the circumstances surrounding the trust. Examples of the type of authority granted to the protector could include the following:

– The power to change trustees,
The power to change the situs of administration,

- The power to clarify or modify trust terms for purposes,
- The power to add or eliminate beneficiaries or rearranging their rights.
- The power to approve trustee’s decisions in regard to the distribution of income or corpus.
- The power to approve trustee’s decisions in regard to the investment of trust assets.

The question given the broad range of powers which are sometimes vested in the trust protector is just how the courts will view the protector’s standard of conduct in relation to the trust, the grantor, and the beneficiaries. The issue of whether the protector stands in the role of a fiduciary is an interesting question since there is very little in the way of judicial precedent in regard to with the protector concept or other legal development of it. It can be assumed that a trust protector who has been granted powers normally reserved for a trustee will be treated as a trustee by the courts.

The trust agreement should describe the protector's powers in detail. Generally, the protector cannot take action affirmatively (other than to remove and replace the trustee, consent to alter the class of beneficiaries, and change the situs of the trust), but can block certain acts taken, or powers exercised, by the trustee. The following is an example of a protector provision:

“A. Notwithstanding the provisions of Article VII, the Protector shall have the power from time to time and at any time by deed or other written instrument delivered to the Trustee:

1. To remove any Trustee of any trust created by or pursuant to this Agreement;
2. To appoint an additional trustee or additional trustees, whether within or without Country, as Trustee of any trust created by or pursuant to this Agreement;
3. To appoint a successor or successors to any Trustee hereof, whether within or without Country, as Trustee of any trust created by or pursuant to this Agreement (in the event any Trustee is removed, resigns, or otherwise ceases to act); and
4. To designate the law of any jurisdiction (under which the terms of any trust created by or pursuant to this Agreement shall be capable of taking effect) to be the governing law of any trust created by or pursuant to this Agreement, and to declare that such trust shall thereafter be governed by and take effect according to the laws of the jurisdiction so designated. The Protector shall also have the power to declare that the courts of such jurisdiction may or shall become the forum for the administration of such trust. Such a designation
and declaration shall be set forth in a deed or other written instrument that shall contain the powers and provisions that are necessary to enable such trust to be capable of taking effect under the laws of such jurisdiction, and that may also contain such other powers and provisions as the Protector may determine to be in the best interest of the beneficiaries, provided that such powers and provisions do not infringe upon any rule against perpetuities that is applicable to such trust.

B. The Protector shall have the power, exercisable at any time, to demand an accounting by the Trustee, setting forth the receipts, disbursements, and distributions of both principal and income during the period of accounting and the invested and uninvested principal and undistributed income that is in existence at the beginning and at the end of such accounting period.”
CHAPTER TWENTY-ONE
OTHER NECESSARY PROVISIONS

§21.1 Overview

The trust document should also include some additional provisions, including the following provisions:

– A provision stating the term of the trust;
– A spendthrift provision;
– A tax allocation provisions;
– Business provisions;
– A provision establishing the situs of the trust;
– A provision establishing the law governing the trust.

This Chapter will discuss those miscellaneous trust provisions.

§21.2 Term of the Trust

§21.2.1 Overview

The trust instrument can specify the term of the trust.63 That provision will be upheld unless it violates the Rule Against Perpetuities.

§21.2.2 Rule Against Perpetuities

The Rule Against Perpetuities as codified 20 Pa. C.S. § 6104, provides that an interest in a trust is void unless it vests within a life or lives in being plus 21 years. By statute, the common law perpetuities period will operate to void an interest based on actual not potential events.64 In other words, even if an interest will potentially violate the Rule Against Perpetuities, the interest will not be deemed void unless and until actual events cause it to violate the Rule. Under 20 Pa. C.S. § 6105, the default disposition is generally that any void interest vests in the persons entitled to receive income at the expiration of the perpetuities period.65 If the settlor wants a different disposition, language like the following should be consider

Sample Provision:

“If not previously terminated, all trusts created under this agreement shall terminate upon the expiration of the period provided under 20 Pa. C.S. § 6104(a), at which time the trustee shall distribute the remaining principal balance outright and free of trust to my wife, Katherine, if she is then living, and if she is not then living to those same persons

64 20 Pa. CSA §6104
65 20 Pa. CSA §6105
who would be entitled to such balance upon the death, of my wife, Katherine, and on the same terms as provided in section IV, hereof.”

§21.2.3 Termination Under the Trust Terms

20 Pa. C.S. § 7740 (a) provides that a trust terminates to the extent it is revoked or expires pursuant to its terms. Here’s some sample language:

“At each child's death (or at the time for the setting apart of shares in the case of a child who dies before that time), any then remaining principal of his or her trust shall be paid to my then living descendants, per stirpes outright and free of trust.”

The trust instrument can also provide for termination of the trust by the trustee, which will be upheld absent an abuse of discretion by the trustee in terminating the trust. Here is an example:

“(n) Whenever my Trustee determines that the size of any trust does not warrant the cost of continuing it, or that its administration would be impractical for any other reason, to pay the principal without further responsibility (i) as to any trust of which all of the net income is payable to a single income beneficiary, to such income beneficiary, and (ii) as to any other trust, to my then-living descendants, per stirpes, subject to the provisions of subparagraph (m) or the provisions hereunder appointing a Custodian; provided that no Trustee shall participate in any decision to terminate any trust (i) from which current income may or must be paid to such trustee or to a person that such trustee has a legal obligation to support or (ii) from which principal would be payable to such trustee (or to a person he or she has the obligation to support) if such trust should then terminate under the provisions of this subparagraph.”

§21.3 Spendthrift Clause

A spendthrift clause protects the trust assets from creditors of any beneficiary, transferees or others making a claim through or against a beneficiary. A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision. With certain exceptions, a creditor or assignee of the beneficiary of a spendthrift trust may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.

A spendthrift provision is unenforceable against: (a) a beneficiary's child who has a judgment or court order against the beneficiary for support or maintenance, to the extent of the beneficiary's interests in the income and principal of the trust; (b) any other person who has a judgment or court order against the beneficiary for support or maintenance, to the extent of the beneficiary's interest in the trust's income; (c) a judgment creditor who has provided services for the protection of the beneficiary's interest in the trust; and (d) a claim of the United States or the Commonwealth to the extent Federal law or a statute of this Commonwealth provides.

A claimant against whom a spendthrift provision cannot be enforced may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances. Under 20 Pa. CSA § 7742(a) of the PEF Code, a spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest. A trust instrument 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.

A typical spendthrift clause reads as follows:

“Until distributed, no gift or beneficial interest shall be subject to anticipation or to voluntary or involuntary alienation.”

§21.4 Tax Clause

§21.4.1 In General

A tax allocation provision will determine which gifts bear the burden of the death taxes incurred by the estate. Absent such a provision, the PEF Code will dictate the allocation.

§21.4.2 The Statutory Rules

1. Federal Estate Tax

Under PEF Code 20 Pa. CSA § 3701, a testator may direct how the federal estate tax or the federal generation-skipping transfer tax, including interest and penalties, are to be apportioned among the various gifts made under the will. Alternatively, 20 Pa. CSA § 3701 allows the testator to grant the discretionary power to someone else, such as the executor, to make the determination. Absent directions in the will, PEF Code 20 Pa. CSA § 3702 provides that the federal estate tax is to be apportioned equitably among all parties interested in property includible in the gross estate for federal estate tax purposes in proportion to the value of the interest of each party, subject to certain limitations. Under 20 Pa. CSA § 3702, no apportionment is made to pre-residuary gifts, and the tax is allocated to the residue as an administration expense. However, if a gift of a portion of the residue gives rise to a charitable or marital deduction, taxes will not be apportioned to that gift unless the remaining assets are insufficient to pay the taxes.

Example:

The testator dies with a net probate estate of $10,500,000. Bequests under the will include the following: (i) a specific bequest of property with a fair market value of $5,250,000 to the son of the testator, and (ii) the residue of the estate to the daughter of the testator. The federal estate tax incurred by the estate is $2,100,000. Absent a tax allocation provision to the contrary, that tax is apportioned under the PEF Code as follows: (i) no tax is apportioned to the $5,250,000,000 specific bequest distributed to the son, and (ii) the entire $2,100,000 federal estate tax is apportioned against the residue
passing to the daughter. As a result, the testator’s son inherits $5,250,000, and, after the tax bill is paid, the testator’s daughter inherits $3,150,000.

Example:

The testator dies with a net probate estate of $15,750,000. Bequests under the will include the following: a specific bequest of property worth $5,250,000 to the testator’s son, and the residue is to be divided equally between the testator’s spouse and daughter.

Again, the federal estate tax on the estate is $2,100,000, because in this example the one-half of the residue which passes to the spouse qualifies for the federal estate tax marital deduction and will not be subject to the estate tax. Absent a tax allocation provision to the contrary, that tax is apportioned under the PEF Code as follows: (i) again, no tax is apportioned to the $5,250,000, specific bequest distributed to son, and (ii) no tax is apportioned to the portion of the residue which passes to the testator’s spouse, which qualifies for the federal estate tax marital deduction. The entire $2,100,000 of federal estate tax will be apportioned against the residue passing to the daughter. As a result, the testator’s son inherits $5,250,000 and the testator’s spouse inherits $5,250,000, both unreduced by federal estate tax. After the federal estate tax bill is paid, the testator’s daughter inherits $3,150,000.

2. Pennsylvania Death Taxes

Pennsylvania death taxes include both Pennsylvania Inheritance Tax and the Pennsylvania Estate Tax. The testator has the power to apportion both the Inheritance Tax and the Estate Tax as directed by a provision in the will. Absent a contrary intent in the will, the tax on outright pre-residuary gifts falls on the residue as a general administration expense. Liability for tax on non-probate assets rests with the recipient of the property. The apportionment of the Pennsylvania Estate Tax is determined in the same way as the federal estate tax, as discussed previously.

Example:

“The testator dies with a net probate estate of $600,000. Bequests under the will include the following: a specific bequest of $200,000 to the son of the testator, which under the Pennsylvania Inheritance Tax will be taxed at 4.5%; ½ of the residue to the brother of the testator taxed at 12%; and ½ of the residue to the daughter of the testator taxed at 4.5%. The total tax on the estate is $42,000, apportioned under the PEF Code as follows: (i) the $200,000 specific bequest is distributed to son unreduced by tax, (ii) the entire $42,000 of Pennsylvania Inheritance Tax is apportioned against the residue as an administration expense, leaving $358,000, after tax to be divided equally between the testator’s brother and daughter, with each receiving $179,000.”

§21.4.3. Tax Allocation Provisions

1. In General
A tax allocation provision acts to direct the executor in the manner in which death taxes incurred by the estate, both federal and state, are to be charged. In every case, the net after-tax-effect of the tax provision provided in the will on the client’s probate and non-probate dispositions should be reviewed with the client. The question to be answered is “How much is the net-after-tax-gift each heir will receive after the allocation of the estate and inheritance taxes?”


Some alternatives to the allocation provision cited above will be discussed in this section. The following example of a typical tax provision provides that the death taxes incurred are to be paid out of the residuary estate.

“(a) All death taxes (and interest and penalties thereon) imposed as a result of my death shall be paid out of my residuary estate.”

Another way to word this is as follows:

“(a) All death taxes (and interest and penalties thereon) imposed as a result of my death upon property regardless of whether passing under my Will, shall be paid out of the principal of my residuary estate, each share thereof, whether outright or in trust, to bear a pro rata portion of such taxes.”

These provisions result in the taxes generated by both the probate estate and non-probate assets being paid out of the residue of the probate estate. This means that the residuary estate will be reduced by the death taxes generated by the entire estate, and other gifts will pass free of tax. If the following provision were used, a different result would occur:

“(a) All death taxes (and interest and penalties thereon) imposed as a result of my death upon property passing under my Will, shall be paid out of the principal of my residuary estate, each share thereof, whether outright or in trust, to bear a pro rata portion of such taxes.”

(4) Under this provision, a person receiving an IRA distribution would be responsible for the Inheritance Tax incurred by that distribution the balance would fall on the residue. Perhaps a more equitable result could be achieved if the following clause could be employed:

“(a) The death taxes (and interest and penalties thereon) imposed as a result of my death shall be paid follows:(1) the liability for such tax on property passing under this will, to be charged against each such gift in the amount of tax incurred by each such gift; and (2) the liability for tax on non-probate assets shall rest with the recipient of such property.”

3. Consistency with Will
In drafting a tax clause for a trust instrument, it is important that the tax clause in the Trust be consistent with that in the Will. If the intent is that the trust bear all of the death taxes, the following clauses could be considered:

In the Will:

“All "death taxes", as hereinafter defined, incurred by reason of my death shall be paid directly from the principal of the John Doe Revocable Trust as provided in paragraph NINTH of such trust.”

In the Trust:

“NINTH: Upon the Grantor's death, the Trustees shall pay to the grantor's estate an amount equal to the total of all estate, inheritance and other death taxes (including any interest thereon and penalties with respect thereto), federal, state and other, imposed by reason of the Grantor's death in respect of property held by the trust, passing under the terms of the Grantor's will or otherwise.”

If the Trust is only to bear its fair share of the taxes, the following clauses could be provided:

In the Will:

“The “death taxes”, to be paid by the John Doe Revocable Trust by reason of my death shall be paid directly from the principal of the John Doe Revocable Trust as provided in paragraph NINTH of such trust.”

In the Trust:

“NINTH: Upon the Grantor's death, the Trustees shall pay to the grantor's estate an amount equal to the trust's fair share, determined as provided below, of all estate, inheritance and other death taxes (including any interest thereon and penalties with respect thereto), federal, state and other, imposed by reason of the Grantor's death in respect of property held by the trust or otherwise. The trust's fair share of such taxes shall be determined by the executors or administrators for each tax separately and, for each tax, shall be the proportion of the tax which the value of the property held by the trust in respect to which the tax is imposed bears to the value of all property in respect to which the tax is imposed. A tax shall not be considered imposed in respect to property to the extent of any deduction, credit, exemption or exclusion allowed in respect to such property. The determination by the executors or administrators of the amount payable under this article shall be final, and the Trustees shall pay such sums without making inquiry into their accuracy. Upon making payment of the amounts determined, the Trustees shall be discharged from any liability with respect to such payments and from further accountability therefor. Such payments shall be made out of the principal of the trust.”

§21.5 Business Clause
As reviewed in Chapter 19, under 20 Pa.C.S. § 7780.5, a trustee unless limited by the terms of the trust or the trustee’s general fiduciary duty, holds all powers over the trust property which an unmarried competent owner has over individually owned property. By way of illustration of these powers 20 Pa.C.S. § 7780.5 (29), provides that a trustee shall have the power

“To continue or participate in the operation of any business or other enterprise and to effect incorporation, merger, consolidation, dissolution or other change in the form of the organization of the business or enterprise.”

Despite the statutory empowerment of the trustee to carry on a business it is not a bad idea to include a business powers clause in the trust instrument to give the trust the necessary assurance that administration of a business within the trust is consistent with the settlor’s intent. The following is a sample Business Powers Clause:

“Business Powers. With respect to any interest I may have at my death in any closely-held business whether as partner, stockholder or otherwise and any business with which such closely-held business may merge or consolidate, I give my Trustee the authority to deal with any business interest as freely as I could have done during my lifetime. This authority shall be subject to any Agreement binding upon this Trust, which affects such interest. Without limiting the general authority granted under this Paragraph, I give my Trustee the following specific authority:

(a) To do anything my Trustee considers advisable with respect to the incorporation, operation or liquidation of any such business and with respect to any change in its purpose, nature or structure, including but not limited to the following:

1. To enter into partnership agreements and amendments thereto.

2. To organize a corporation, without leave of court, to carry on any business alone or with others, and to contribute all or part of the assets of such business as capital to such corporation and to accept stock in the corporation in exchange therefore.

3. To vote the shares of any closely-held corporate stock and to determine the advisability of, fix the terms of, and participate in, any corporate reorganization, merger, consolidation, dissolution, public offering, pooling of interest, exchange of stock or similar transaction.

(b) To elect or employ as director, officer, employee or agent of any such business, any person, including my Trustee, or any employee of a corporate Trustee, and to delegate authority to, compensate and remove or discharge any such person.

(c) To create or cause to be created within any such business such deferred compensation or other employee benefit plan, as my Trustee considers advisable.
(d) To extend to any employee of any such business an option to participate in the ownership thereof, or profits therefrom, upon such terms and conditions as my Trustee considers advisable.

(e) To cause to be made and to consent to the making or the continuation of any loans to such business, and to pledge assets of such business as collateral therefor, with any bank or other financial institution.

(f) The fact that my Trustee may be an officer, director or employee of any such business and may own an interest in such business in an individual capacity shall not, insofar as this Trust is concerned, constitute an adverse or conflicting interest, and the acts of my Trustee as such shall be considered as if my Trustee owned no stock and did not serve as an officer, director or employee of said business.

(g) I release my Trustee from any liability for any depreciation in value or loss by reason of the retention of any such business interest except for depreciation or loss resulting from fraudulent acts of my Trustee in connection therewith."

§21.6 Preserving the S Election

§21.6.1 Overview

An eligible corporation may elect to be taxed as an S corporation which, with limited exceptions, isn't taxed at the corporate level. Instead, its items of income, loss, deduction and credit are passed through to, and taken into account by, its shareholders in computing their individual tax liabilities. In order to qualify as an S corporation, the corporation must satisfy certain requirements provided in the Internal Revenue Code and make an election to be treated as an S corporation. Under Code, in order to qualify to make an S election, the corporation must be a domestic corporation, may not have more than 100 shareholders, and must have only one class of stock - In addition, and here is where the issue comes in for trusts, all of the shareholders must be "eligible shareholders". Eligible shareholders generally include basically resident individuals, estates during the period of administration; and only certain types of trusts. Therefore, it is important for the trust document to provide the appropriate provisions to allow the trust to qualify as an eligible S corporation shareholder - otherwise S election will be lost.

§21.6.2 Trusts as S Corporation Shareholders

Only five types of trusts are eligible S corporation shareholders: (1) a voting trust; (2) a "grantor" trust (3) a qualified subchapter S trust ("QSST"); (4) a testamentary trust with respect to stock transferred to it pursuant to the terms of a will (a "will recipient trust") or (5) an electing small business trust ("ESBT").

1. Voting Trust – The Regulations define a qualified voting trust that is a permitted S corporation shareholder as a trust that (a) delegates to one or more trustees the right to vote; (b)

---

67 IRC § 1361.
68 IRC §1362(a)
requires that all distributions with respect to the stock owned by the trust be paid to or on behalf of the beneficial owners; (c) requires title and possession of the stock to be transferred to the beneficial owners on the trust's termination; and (d) terminates on or before a specific date or event.

2. **Grantor Trust** - A trust that is treated as wholly owned by one individual who is a U.S. citizen or resident, for purposes of taxing the person on the income of the trust, may be a shareholder of an S corporation. Therefore, the trust may be a shareholder if the person includes all the trust's items in determining his or her taxable income and credits. The deemed owner does not have to be the grantor. To be eligible, the trust must meet the above requirements only during the period it holds S corporation stock.

3. **QSST** - A Qualified Subchapter S Trust is a trust: (a) that distributes (or is required to distribute) all of its income currently to one individual who is a U.S. citizen or resident, (b) that requires that: (i) during the life of the current income beneficiary there will be only one income beneficiary of the trust, (ii) any corpus distributed during the term of the trust must be distributed to the current income beneficiary, (iii) the current income beneficiary's income interest terminates on the earlier of termination of the trust or the death of that income beneficiary, and (iv) upon trust termination during the life of the current income beneficiary all corpus and income must be distributed to that beneficiary.

4. **A Will Recipient Trust** - A testamentary trust, i.e., a trust which receives stock under a will, is allowed to own S corporation stock during the two-year period beginning on the day the S corporation stock is transferred to it. In addition, a trust that receives stock under the terms of an “electing Code Sec. 645 qualified revocable trust” during the election period or is deemed to receive stock at the close of the election period is allowed to own S corporation stock during the two-year period beginning on the day the S corporation stock is transferred or deemed to be distributed. If the trust continues to hold the stock after the two-year period, the corporation's S election will terminate unless the trust otherwise qualifies as a permitted shareholder.

5. **ESBT** - (a) The trust must not have any beneficiaries other than individuals, estates, or charitable organizations described in Code Sec. 170(c)(2), (b) no interest in the trust may have been acquired by purchase; (c) an election to be an ESBT must apply to the trust, (d) A qualified Subchapter S trust (QSST) election must not have been made with respect to any stock held by the trust, and (e) The trust must not be a tax-exempt trust.

§21.5 **Trust Provisions**

A trust provision like the following will allow the trust to qualify as an eligible S corporation shareholder:

"XII. Special Provisions for S Stock."
A. The Trustee may at any time hold stock of an S Corporation as defined in the Internal Revenue Code (hereinafter "S Stock"), make an election to have any corporation treated as an S Corporation, enter into agreements with other shareholders relating to transfers of S Stock or the management of the S Corporation, and allocate amounts received and the tax on undistributed income between income and principal.

B. The Trustee may allocate the tax deductions and credits arising from ownership of S Stock between income and principal. In making any such allocations, the Trustee shall consider that the income beneficiary is to have enjoyment of the property at least equal to that ordinarily associated with an income interest and in all events shall provide the required beneficial enjoyment to the income beneficiary.

C. The Trustee may make an election to have the Trust, or any trust share provided hereunder that is eligible to make an affirmative election to be treated as Electing Small Business Trust as defined in Sec. 1361(e)(1) of the Code.

D. Notwithstanding anything herein to the contrary, as an alternative to subparagraph C, above, the Trustee may at any time divide any trust hereunder which has a single income beneficiary into two separate trusts, one trust consisting of all S Stock and the other trust consisting of the remaining assets.

(1) Each such trust shall be held under the terms hereunder applicable to the trust so divided, except that (i) there shall be no power in the trust consisting of S Stock to make payments of principal during the lifetime of the income beneficiary to any person other than the person then entitled to receive the income, (ii) all income of the trust consisting of S Stock shall be paid to the income beneficiary at least annually and (iii) all income of such trust accrued or undistributed at the death of the income beneficiary shall be payable to his or her estate.

(2) The trust consisting of S Stock shall at all times have only one current beneficiary and shall not be recombined with the other trust upon the exchange of any S Stock for other assets, but shall at all times after its creation permit payments of principal only to the then-current income beneficiary.

E. Any provision of this Agreement which may appear to conflict with my intention that any trust containing S Stock qualify as a Qualified Subchapter S Trust as defined in Sec. 1361(d) of the Internal Revenue Code shall be construed so as to accomplish that intention.

F. If the Trustee, in the Trustee's sole discretion, determines that such intention might not be accomplished, the Trustee shall have the power to amend the trust to accomplish said intention, subject to the following conditions and limitations:

(1) No such amendment shall be made except to accomplish the intentions set forth in this subparagraph F.
(2) All such amendments shall be in the form of a decree of the court having jurisdiction over the trust, upon petition by the Trustee and after such notice to the parties in interest as such court may direct.

(3) The Trustee shall have the power to request that any such amendment take effect as of the effective date of this trust, or any subsequent date, in the Trustee’s sole discretion.”

§ 21.7 Situs Clause.

20 Pa. CSA § 7708, of the PEF Code provides that provisions of a trust instrument designating the situs of the trust are valid and controlling if: (a) a trustee's principal place of business is located in or a trustee is a resident of the designated jurisdiction; (b) all or part of the trust administration occurs in the designated jurisdiction; or (c) one or more of the beneficiaries resides in the designated jurisdiction.

If the trust instrument does not specify a situs the situs of a testamentary trust is in the county where letters were granted to the personal representative if letters have not been granted, in a county where the letters might have been granted. The situs of an inter vivos trust whose settlor is domiciled in this Commonwealth when the trust becomes irrevocable or, in the case of a revocable trust, when the first application is made to a court concerning the trust during the settlor's lifetime, either in the county of the settlor's principal residence or in the county in which any of the trustees resides or has a place of business; and after the settlor's death either; (i) in the county in which letters have been granted to the settlor's personal representative; (ii) in a county in which letters might have been granted; (iii) in a county which is the principal place of the trust's administration; or (iv) in a county in which any trustee resides or has a place of business.

The situs of an inter vivos trust whose settlor either is living and not domiciled in this Commonwealth at the time when the first application is made to a court concerning the trust or was not domiciled in this Commonwealth at the settlor's death after which the first application to a court concerning the trust is made thereafter shall be in a county where: (i) a trustee's principal place of business is located or a trustee is a resident; (ii) all or part of the trust administration occurs; or (iii) one or more of the beneficiaries reside.

Sample language

“This Trust has been accepted by my Trustee in the Commonwealth of Pennsylvania, and except as provided in Paragraph EIGHTEENTH (g), its situs shall be in that Commonwealth, and all questions pertaining to its validity, construction and administration shall be determined in accordance with the laws of that Commonwealth.”

Note: Paragraph Eighteenth (g) could provide that the trustee or trustees has the power to transfer the situs of the trust as follows:

“If any corporate or individual Trustee is located in a State other than the Commonwealth of Pennsylvania, my Trustees acting unanimously may, but are not
required to, direct in writing that the situs of the Trust be transferred to the State in which such Trustee is located. Any such transfer of situs shall be effective only if the court then having jurisdiction over the Trust shall concurrently transfer jurisdiction over the Trust to the appropriate court in said State. In the event of a transfer of situs, all questions subsequently arising pertaining to the construction and administration of the Trust shall be determined in accordance with the laws of the State to which situs and jurisdiction have been transferred.”

§21.8 Posting of a Bond

Under 20 Pa. CSA § 7762, of the PEF Code, a trustee must give a bond to secure performance of the trustee's duties only if the court finds that a bond is needed to protect the interests of the beneficiaries or is required by the provisions of the trust instrument and the court has not dispensed with the requirement. The court may specify the amount of a bond, its liabilities and whether sureties are necessary. The court may modify or terminate a bond at any time. An institution qualified to do trust business in this Commonwealth need not give bond even if required by the trust instrument.

Sample Language

“No Trustee shall be required to furnish any bond, undertaking or other security for the faithful discharge of his duties as Trustee in any court in any jurisdiction in which he may be called upon to act.”

§21.9 Governing Law

Under 20 Pa. CSA § 7707, of the PEF Code the meaning and effect of the provisions of a trust instrument shall be determined by: (a) subject to certain mandatory rules, as provided in 20 Pa. CSA § 7705(b), the law of the jurisdiction designated in the trust instrument governs; or (b) in the absence of an effective designation in the trust instrument, the law of the jurisdiction in which the settlor is domiciled when the trust becomes irrevocable.

Sample Language

“Governing Law - Unless the governing law has been changed by removal of assets to another jurisdiction, this agreement and each trust created hereunder shall be construed and regulated by the laws of the Commonwealth of Pennsylvania.”