New Orleans Estate Planning Council
November 15, 2010

THE LOUISIANA TRUST CODE – CHANGES ENACTED IN 2010

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As we all know the law of trusts in Louisiana is significantly different from the law of the other states. Thanks to our unique civil-law history, a modern trust law was not adopted until the Louisiana Trust Code was enacted in 1964. The Trust Code established rules that are very similar to the law governing trusts in the other states; nevertheless, we preserve unique rules on vesting of beneficial interests that derive from our history.

The Trust Code was drafted by a committee of the Louisiana State Law Institute. The Law Institute, making use of its Trust Code Revision Committee, has continued to oversee the Trust Code, and from time to time recommends legislative changes. In **Act 390 of 2010**, the Legislature adopted several changes recommended by the Law Institute. Two other laws affecting the Trust Code were enacted in 2010 that did *not* originate with the Law Institute. Topics I through VII, below, describe the changes originated by the Law Institute, and included in Act 390. Topics VIII and IX describe the changes that did not originate with the Law Institute. And a Lagniappe item at the end describes an amendment to the Code of Civil Procedure that affects trusts.

All references below to "Sections" are to sections of the Louisiana Trust Code. The Trust Code is found at La. R.S. 9:1721 through 9:2252.

Act 390 was signed by the Governor on June 21, and its effective date is August 15, 2010. Section 2 of Act 390 states that the provisions of the act apply to all trusts, even if created prior to the effective date. The one exception is discussed below at Topic III.

I. "Proper Court"

1. The Trust Code in numerous places states that actions concerning a trust are to be brought in the "proper court." See, for example, Section 2233 (petition for instructions); Section 2208 (relieving trustee of liability); Section 2172 (compelling trustee to furnish security); Section 2160 (authorizing an adjustment between income and principal that benefits the trustee); Section 2088 (approval of trustee accounts); Section 2066 (deviation from terms of the trust instrument); Section 2067 (invasion of principal); Section 2026 (modification as a result of a change in circumstances); Section 1789 (removal of trustee).

2. Other sections of the Trust Code mention actions taken by "the court" rather than "the proper court", but the Trust Code as a whole indicates that any action affecting a Louisiana trust must be brought in a "proper court".

3. The term "proper court" previously was defined at Section 1725(5). The definition was incomplete in that it did not cover all possible situations of inter vivos trusts. It also did not permit all interested parties to agree to use a different court than the one required under that definition.

4. The term "proper court" is now explained in a new section of its own, Section 2235, in Part IX of the Trust Code governing "actions". Section 2235 makes the following changes:

   i. The settlor of an *inter vivos* trust is now able to designate any court as the proper court. Previously the law had restricted the settlor's choices in designating the proper court.

   ii. In the absence of a designation in the trust instrument, there will no longer be a gap in the law as to where a proper court for an *inter vivos* trust can be located. It can be in (a) the parish of the settlor's domicile when the trust was created, (b) the parish in which a trustee in domiciled, (c) the parish in which an agent for service of process of a non-resident trustee is domiciled, and, if all else fails, (d) the 19th Judicial District for the Parish of East Baton Rouge.

   iii. As under prior law, in the case of a testamentary trust the proper court is the court of the parish having jurisdiction over the settlor's succession. However, the settlor now can designate a court in a different parish, to be the proper court after the trustee has been put into possession.

   iv. Furthermore, in the case of either an *inter vivos* or a testamentary trust (after the trustee has been put into possession), if all trustees, beneficiaries and living settlors agree on a different court than a court determined by Section 2235, they may do so.

   v. The law makes it clear, too, that, in the case of an *inter vivos* trust, if a matter has been litigated in a parish's court, that court continues to be the sole proper court absent the agreement referred to in paragraph iv.

   vi. The new law also makes it clear that once an action affecting an *inter vivos* trust has been instituted, a person having the power to amend the trust instrument cannot amend it to change the proper court for that action.

5. The law does not expressly cover the situation where a suit involving a Louisiana trust is brought in another state. However, when the new law

says that "**the proper court shall be any court agreed to by all trustees, beneficiaries and living settlors**", there seems no reason why they cannot select a court in another state.

6. Since the new provisions on "proper court" apply to existing trusts as well as new trusts, it is now possible for all interested parties to agree to a new court in which to litigate matters.

7. In addition, if a trust instrument designated as the proper court a court that was not recognized by prior law, that designation should now be recognized. However, if the matter affecting an inter vivos trust was previously litigated the parties have to continue to use that court unless they agree to use a different court.

II. Class Trusts – Involvement of Non-Class Trust Members

1. Section 1891 authorizes the creation of a class trust for descendants of a settlor or for descendants of a settlor's siblings, provided that at least one member of the class is in being when the trust is created. The members of the class can be as many as 3 generations below the generation of the settlor.

2. The class trust is an exception to the Trust Code's unique vesting rule (see, *e.g.*, Sections 1803, 1971, 1972), that all beneficiaries of the trust must be in being and ascertained as of the date of the creation of the trust, and a principal beneficiary's interest must pass at death to his heirs or legatees. As individuals are born or adopted into the class they become beneficiaries after the creation of the trust. In addition, the trust instrument can substitute other members of the class upon the death of a member of the class during the term of the Trust. Section 1895. See Topic III below.

3. It is obviously necessary that no one who is not a member of the class share in what is provided in trust for that class. Thus Section 1893 has said that "The members of the class must always be the sole beneficiaries of the interest affected, whether income, principal, or both."

4. What if the trust instrument provide benefits both for a class and for a non-class individual? For example, a trust might provide for income to be paid to the settlor's surviving spouse, if needed, and any income not needed would be distributable to the class of the settlor's children and grandchildren. The new law makes it clear that such a mixed class and non-class trust is permitted, by restating the first sentence of Section 1893 to read as follows: "**A class trust may be created with respect to all or a portion of income or principal, or both, but the members of the class must always be the sole beneficiaries of the portion of the trust of which they are beneficiaries**."

5. The rule remains that no person who is not eligible to be included in the class can share in what the class is entitled to.

6. But perhaps some mixture of non-class members with class members should be permitted by future legislation. In particular, should a settlor be allowed to include the surviving spouse of a member of the class as a permitted income beneficiary?

7. The change in Section 1893 is meant to be a clarification not a change in the law. Like all of Act 390, this provision applies to existing trusts.

III. Class Trusts - Substitutions when Class Member dies leaving children.

1. Section 1895 has long provided an exception from the vesting rule: the trust instrument can substitute for a member of the class the other members of the class, when the class member dies intestate and without descendants. That was expanded in 1997 to provide that the substitution can be of other members of the class even if the class member dies testate, provided that he dies without descendants and the property of the trust does not include the deceased beneficiary's legitime.

2. Thus, Section 1895 has allowed substitutions that enable the settlor to cause the trust to continue to benefit only family members when a beneficiary dies without descendants. But if a beneficiary dies with descendants, he has been free to leave his interest in the trust to anyone. While the beneficiary may (and usually will) benefit his own descendants, he doesn't have to (provided that, as in now normally the case, his children are not forced heirs), and thus the settlor's intention of keeping the benefits of the trust in the family can be defeated in that situation.

3. To make it possible for a settlor of a class trust to assure that the trust property remains in the family even when a member of the class dies with descendants, Section 1895 has been amended to allow the trust instrument to provide that, "**except as to the legitime in trust, the interest of a member of the class who dies leaving one or more descendants, vests in the beneficiary's descendant heirs**."

4. This new wording is at Section 1895A(3). Section 1895A has been redesigned to create three paragraphs. The first two paragraphs carry forward the prior rules allowing substitutions when a beneficiary dies without descendants.

5. The following is a sample of a trust provision making full use of the substitutions permitted by Section 1895A, assuming there is no legitime interest:

> If a member of the class dies during the term of the trust without a descendant surviving him, his interest in the trust shall vest in the

other members of the class; but if he dies leaving one or more descendants who survive him, his interest in the trust shall vest in his descendants, equally.

6. In considering how adventurous one can be with Section 1895, one has to take into account that Section 1891B allows the settlor to determine how the members of a class share. Only when the instrument is silent do the default rules apply: if the class consists only of one generation, they share equally by roots from their common ancestor, and if more than one generation, their interests are equal by heads.

7. Suppose a class trust for children, grandchildren and great-grandchildren is created when the only member of the class in being when the trust is created is a child. Does Section 1891B allow the trust instrument to provide that upon the birth of a grandchild the child's interest is reduced to zero? It is no longer necessary to include such a provision, since Section 1895A(3) now allows the child's children to be substituted for him at death.

8. A settlor may want to have interests in a class trust be equal by roots, so that, for example, if a grandchild dies without descendants his interest in the trust vests in his siblings and not in his cousins, but if there is no sibling it would go to the cousins. But do paragraphs (1) and (2) of Section 1895A allow you to go there, when they only authorize the trust instrument to provide that when a member of the class dies without descendants his interest "**vests in the other members of the class**"? Does that wording require some kind of equality among the substituted members of the class? In light of Section 1891B, it is likely that a substitution of only some of the members of the class is permitted.

9. Note that the class can include great-grandchildren and can provide that upon the death of a great-grandchild his children will be substituted for him. This gets the interest down to an additional generation, even though those substituted children cannot be members of the class. It is clear under Section 1895B that such substituted individuals can participate in the class trust and can furthermore share in subsequent substitutions.

10. Under Section 2 of Act 390, a substitution under Section 1895A(3) can occur only after the effective date of the Act. However, if the instrument governing a trust that is in existence on the effective date of the Act provides for such a substitution (which is not likely), a substitution can be made after the effective date.

11. No discussion of class trusts for multiple generations should ignore the possibility of a generation-skipping transfer tax under Sections 2601, *et seq*. of the Internal Revenue Code Section ("IRC"), which are scheduled to go back into effect January 1, 2011.

IV. Substitutions in Revocable Trusts

1. Since the enactment of Section 1973 in 1974, it has been possible to shift an interest in a trust that is not a class trust, if the initial principal beneficiary dies without descendants.

2. Furthermore, since the enactment of Section 2011 in 1988 it has been possible for a revocable trust to defer the ascertainment of beneficiaries until the trust becomes irrevocable. However, the Trust Code has not allowed the trust instrument to provide for substitutions occurring during the time that the trust is revocable. For example, the trust instrument may provide that the beneficiary will be "my son John, but if he dies during the term of the trust the beneficiary will be John's wife if living and not separated from him at the time of his death."

3. Section 1973 is modified to permit such a substitution.

C. The trust instrument may provide that the interest of a designated principal beneficiary of a revocable trust shifts to another person or persons, if the substitution occurs no later than the date when the trust becomes irrevocable.

4. The substitution now permitted under Section 1973C does not necessarily have to apply at the death of the original beneficiary.

5. Note that Section 1973 was not amended to allow substitutions of the children of a designated beneficiary (as permitted in class trusts; see the discussion of modified Section 1895, at Topic III, above). That may be included in subsequent legislation.

6. Thanks to Section 2 of the Act, the change in 1973 validates substitutions in existing trusts. There appears to be no constitutional issue about divesting an interest, since the settlor could amend the trust in any event to change the beneficiary.

V. Protection from Creditors when Beneficiary Fails to Exercise a Withdrawal Right

1. It is standard these days to provide that a trust is a "spendthrift trust", meaning that the beneficiary cannot assign his interest in the trust nor can a creditor (with a few exceptions – see topic VIII, below) seize that interest. Spendthrift trusts are authorized by Section 2001 *et seq*.

2. There are some exceptions. In particular, spendthrift trust protection can not be accorded to a beneficiary to the extent that the beneficiary has donated property to the trust, directly or indirectly. Section 2004(2).

3. Some trusts have withdrawal powers. A beneficiary may be given the right for a limited period of time to withdraw property donated to the trust,

and failing the withdrawal exercise the property remains in trust for a long period of time. Such withdrawal rights are generally given for either of two reasons: (1) the withdrawal power qualifies the gift in trust for the annual exclusion from U.S. gift tax, under IRC Section 2503(b); or (2) the withdrawal power is designed to be a "five and five" power, exempt from U.S. Gift and Estate Tax under IRC Sections 2514(e) and 2041(b)(2).

4. If a beneficiary has a withdrawal power that he does not exercise, does he thereby become an indirect "donor" to the trust of the property that he could have withdrawn, so that his interest in that property of the trust is not exempt from seizure? To assure that property that could have been withdrawn, but is not, is protected from seizure in a spendthrift trust, the following has been added to Section 2004: "**A beneficiary will not be deemed to have donated property to a trust merely because he fails to exercise a right of withdrawal from the trust.**"

VI. Delegation of Right to Amend

1. A longstanding policy of Louisiana law, again derived from our civil-law heritage, is that a person cannot delegate to someone else the right to dispose of his property. Thus, Civil Code Art. 1572 states that "testamentary dispositions committed to the choice of a third party person are null, except as expressly provided by law."

2. Consistent with that provision, Section 2025 states that "a settlor may delegate to another person the right to terminate a trust, or to modify the administrative provisions of the trust, but the right to modify other provisions of the trust may not be delegated."

3. Such a delegation is not uncommon in the other states, where a person can be given a "power of appointment", meaning a power to designate beneficiaries. The power of appointment can either be limited or unlimited.

4. Section 2031 has been added to the trust to provide a very limited form of a power of appointment:

> **A trust instrument may authorize a person other than the settlor to modify the provisions of the trust instrument in order to add or subtract beneficiaries, or modify their rights, if all of the affected beneficiaries are descendants of the person given the power to modify.**

5. Thus, for example, a married person might place property in trust paying income to his surviving spouse with the principal of the trust set aside for their children, equally, and authorize the surviving spouse to change the

percentage interests of the children, or even to add other descendants of theirs.

6. Note that if there is any possibility of adding descendants in a lower generation there could be a generation-skipping transfer tax concern.

7. The form of such a modification is governed by Section 2051. That section provides that such a modification must be "by authentic act or by act under private signature executed in the presence of two witnesses and duly acknowledged by the person who makes the modification," or by testament.

8. Section 2031 appears to be broad enough to allow modification of rights in a class trust.

9. This limited power of appointment may be especially attractive to a married person who would have given everything to his surviving spouse but for the desire to make use of the "applicable credit amount", under IRC Section 2010, in order to minimize the overall U.S. Estate Taxes for the tax estates.

10. Unless the trust instrument provides otherwise, it appears that the person having the limited power of appointment can exercise the power without any fiduciary obligation to any of the beneficiaries, and thus can be completely arbitrary, unfair or mean-spirited.

11. Note that this essentially amounts to the power holder having a right to make a beneficial transfer that is not a donation in itself. There should be no U.S. transfer tax as a result of such an exercise. See IRC Sections 2041 and 2514 (which tax powers of appointment when they are "general", that is, exercisable without restriction). See also Revenue Ruling 79-327 ("non-general, or special powers of appointment, do not usually come within the purview of section 2514(b) as they are powers under which the individual possessing the power can only appoint to a limited class of persons….").

12. Note, however, that if a beneficiary of the trust is a forced heir of the settlor, his interest cannot be modified to the extent of that forced portion. See Section 1841.

13. Section 2 of the Act indicates that Section 2031 applies to existing trusts that authorize limited powers of appointment of the type describing Section 2031, and validates them. Retroactive validation of a provision not valid at the time of the trust's creation could present a Constitutional issue, but it is most unlikely that any existing trusts were drafted in that way.

VII. Delegation of Right to Revoke versus Delegation of Right To Amend

1. As mentioned in preceding Topic VI, with minor exceptions the right to amend a trust cannot be delegated. Section 2025. Section 2045 was amended in 2001 to allow a settlor to delegate the right to revoke a trust. There was no intention by that amendment to give the delegated person the right to amend the trust. However, Section 2022 has always said that "reservation of the right to revoke includes the right to modify the trust."

2. In order to make it clear that the delegated right to revoke does not include the right to modify, Act 309 has amended Section 2045 by adding a sentence reading "**The right to amend may not be delegated except as provided in R.S. 9:2025 and 9:2031**."

3. Note that if a right to revoke is to be authorized by power of attorney, the power of attorney must refer specifically to the trust; apparently it would not suffice to refer to trusts in general.

VIII. Act 457 of 2010, Modifying the Spendthrift Trust Rules

1. The Legislature in 2010 made two changes to the Trust Code that were not submitted by the Law Institute. The first is Act 457, which modifies Section 2005.

2. Section 2005 excepts certain creditors from the general rule that creditors cannot seize the interest of the beneficiary of a spendthrift trust. The existing exceptions were "alimony, or maintenance of a person whom the beneficiary is obligated to support" and "necessary services rendered or necessary supplies furnished to the beneficiary". A new exception is adopted by Act 457: a beneficiary's interest in a spendthrift trust can be seized to collect "**Damages arising from a felony criminal offense committed by the beneficiary which results in a conviction or plea of guilty**".

3. This is a very limited exception requiring a conviction or guilty plea followed by a civil court judgment for damages. The right of the injured party is going to be further limited because all that the creditor can seize is "any portion of the beneficiary's interest in trust income and principal" as the proper court decides in its discretion. For example, if a principal beneficiary is the guilty party and there is an intervening income interest, all that can be seized is the principal beneficiary's ultimate right to receive principal. The assets of the trust cannot be seized.

IX. Act 224 of 2010, Regarding Delegation of Performance

1. Section 2087 provides generally that a trustee cannot delegate his performance of his duties. Section 2087B, as amended by Act 520 of 2001, provided that "a trustee may delegate the performance of acts that

he could not reasonably be required to perform personally." (Section 2087 goes on to provide in Paragraphs C and D that a trustee can delegate by investing in mutual funds or similar pooled investments, and can delegate investment and asset management functions.)

2. Act 224 amended Section 2087B to read as follows: "**A trustee may, by power of attorney, delegate the performance of ministerial duties and acts that he could not reasonably be required to perform personally**."

3. Act 224 seems to place a significant limitation on the ability of the trustee to delegate performance, when it limits the delegation to "ministerial duties". When Section 2116 was repealed by Act 520 of 2001 (as recommended by the Law Institute), with its substance being moved into Section 2087B, the reference to ministerial duties was removed, on the theory that it was sufficient to state that the delegation could be of any act that the trustee could not reasonably be required to perform personally. It is not clear what is gained by returning to the ministerial-duties wording.

4. The change further adds that the delegation must be by power of attorney ("mandate" is the Civil Code term). This seems to impose a much more serious restriction on the ability to delegate. However, it is not at all clear what form the mandate must take and even whether it has to be written. See Civil Code Art. 2993, which states that "the contract of mandate is not required to be in any particular form," unless the law prescribes a certain form for an Act.

Lagniappe

Act 226 of 2010 amended Louisiana Code of Civil Procedure Article 3061 by adding a subsection C which reads as follows:

> **A judgment sending one or more petitioners into possession under a testamentary usufruct or trust automatically incorporates all the terms of the testamentary usufruct or trust without the necessity of stating the terms in the judgment.**

Act 226 legislatively overrules a recent case, *Yokum v. van Calsem*, 981 So.2d 725 and 983 So.2d 1277 (La. 4th Cir. 2008), in which the court held that a usufructuary who was given by the testament the power to sell nonconsumables without the consent of the naked owner, and who tried to exercise that power, was not able to do so because the Judgment of Possession failed to mention the power. Under the logic of that decision, special powers granted to a trustee in the trust instrument would also have to be mentioned in the judgment of possession. Act 226 removes that concern.

Act 226 is procedural, and therefore appears to apply to all transactions, even under judgments ante-dating the Act.