Presentation on the Most Common Trusts in American Law

Solution Notaire Hebdo / March 21, 2019 / No.10 / pg 16-18

by Michael W. Galligan[4] et Caroline Deneuville[5]

Translated by Michael W. Galligan

During the International Practice breakfast held at the Chamber of Notaries in Paris on September 25, 2018, Michael W. Galligan discussed the main characteristics of a trust and the different types of trusts. His remarks were complemented by those of Caroline Deneuville. The reception of trusts and their effects, under the regime of the European Succession Regulation, will be the subject of a second article.

Preamble

We must demystify the trust, an instrument found in many areas of life, particularly for civil and commercial matters in the Anglo-American world or in countries who have drawn from the common law tradition. That is the goal we have set for ourselves. We will focus mainly on the trust in the framework of the family and, more particularly, on the administration of an estate. Even limited to this aspect, this article is only an initial approach to the question. Certain points of the presentation (in particular, on American taxation) will not be considered; they require separate treatment.

The parts in italics represent Caroline Deneuville's comments inserted in the presentation by Michael Galligan.

The characteristics of the trust

1. **Definition**. As stated in the 1985 Hague Convention, still not applicable in France, the trust "covers the legal relations created by a person, the settlor – during life or upon death - when property has been placed under the control of a trustee in the interest of a beneficiary or for a specific purpose." (Hague Convention of July 1, 1985 on the Law Applicable to Trusts and Their Recognition, Article 2)

The property held in trust constitutes a fund separate from the personal patrimony of the trustee. Title to the property (in the American sense of the term) is held by the trustee.

The trustee has the power and the duty to administer the property of the trust, and to dispose of such property according to the terms of the trust instrument and the rules that govern trusts

[4] Attorney admitted to the bar of New York State, Partner Trusts & Estates, Department, Phillips Nizer LLP
[5] Notary in Paris, coordinator for International Programs related to the English speaking world, of the Chamber of Notaries in Paris

2. **The actors**. The settlor is the founder or grantor who transferred the property to a trustee with the intention of creating a trust.

It should be noted that the settlor has no donative intention with regard to the trustee (unless the Trustee is also an express beneficiary), whereas an intention to make a gift ("animus donandi") is an essential element in French law of the transfer of property without consideration, whether by gift or legacy.

The beneficiaries are those who are entitled to current or future distributions of income or capital, all under the terms of the trust.

The trustee is the person who holds the title (in the American sense of the term) over the assets of the trust and who has the obligation to administer them and distribute them for the benefit of the beneficiaries.

The trustee has title to the property within the meaning of American law, but there is no transfer of the property for the trustee's personal benefit in the way we would expect under French law. We could say that the trustee holds a box which contains a gift for the beneficiary.

And the judge has the power to supervise, to regulate the conduct of the trustees, to dismiss them, to replace them if necessary. The judge ensures that the economic benefits of the trust are preserved until the assets of the trust are ultimately distributed to the beneficiaries. *As in many other legal situations, when a person acts on account of another, whether for an incapable adult, or for a beneficiary of the Trust, or on behalf of creditors, for example, in a succession accepted to the extent of net assets, a judge may intervene or be accorded jurisdiction over the matter. He acts like a guardrail, protecting all the interests involved.*

3. **What the trust is not**. The trust itself is not an independent legal entity, it is not a corporation and does not have legal personality. Nor is it an agency ("mandat"). The settlor no longer holds the property when it has been transferred to the trust and the trustee's main task is to serve the interests of the beneficiaries and not the interests of the settlor. But the settlor could create a trust for the settlor's own benefit.

4. **The conduct of the trustee, and the trustee's obligations**. It must be stressed that the trustee must be accountable to the beneficiaries and must never lose sight of the trustee's obligations, responsibilities and duties. The trustee must behave in an disinterested manner that is solicitous of the interests in the trust, in accordance with the directions made by the settlor. *This is the counterpart to the confidence that the settlor has expressed in choosing the trustee. It does not matter whether the trustee is paid or not, this expression of confidence comports with these duties.*

We find the same idea in many cases of administration of property for a third party, for example in our concept of mandate for the future protection of another or even for oneself (“mandat de protection future autrui ou mandat de protection pour soi-même”).

In the modern conception of management of trusts, no investment is forbidden whereas traditional rules discouraged investments in risky or speculative businesses. Diversification across asset classes and types of investments is generally preferred. The trustee must make prudent decisions but is not required to guarantee a good result. The trustee must keep an accounting distinguishing principal and income.

The main types of trusts

5. **Trusts may be revocable or irrevocable**. If the settlor can unilaterally take back the property transferred to the trustee, the trust is considered revocable.

In English law, only irrevocable trusts would be considered as valid trusts.

In the United States, revocable trusts play an important role in inheritance. In most states, they avoid the "probate" procedure. For this reason, they are very common, especially in California and Florida. *In this case, the transfer of property is made during the lifetime of the settlor, by an “intervivos” trust, which is revocable. The settlor may revoke the trust, but if he does not do so, the trust will become an irrevocable trust upon the settlor’s death. The trust instrument directs the disposition of the property in the case of death, which the trustee must then execute when the time comes.*

A trust established in a will is necessarily irrevocable since the settlor is the decedent, who, by definition, cannot take back the property of the trust.

In practice, we often have both instruments:

- a revocable trust created during the settlor’s lifetime by the deceased settlor,

- a will by which the same person bequeaths and transfers their property (those items of property that have not already been transferred to the “intervivos” trust) to the trustee of the same trust.

The property left at death will therefore be joined to the property held by the trustee of the revocable trust (which has become irrevocable at death). The dispositions that become effective at the death of the settlor can be found in this revocable trust to which the Will also refers.

An irrevocable trust can also be a classic gift trust established by the settlor during his lifetime by which he unconditionally transfers property to a trustee (inter vivos gift).

6. **Some purposes of the trust**. The trust may have be established to:

- protect beneficiaries in the event of lack of financial experience or an inability to manage their assets. *In such cases, in French law, we use the gift or bequest under the condition that the property be administered by a third party, or again with a prohibition on transferring the property without the consent of a third party, both on the alienation as well as the use of its income;*

- protect the property, that is to say, the property of the beneficiary against the claims of creditors. *We have equivalent mechanisms with the conventional escrow, the acceptance of an estate up to the net assets which entails separation of the assets, etc. ;*

- *organize the succession.*

One may be concerned with protecting the property transmitted to the descendants of a first marriage of the settlor while the settlor is remarried. *In such a case, we would make a division of property by leaving the second spouse the "usufruct" of the property. It may also be to pass the property on over several generations. Without being able to go out several generations, we can nevertheless come close to this approach using "residual" and "gradual" gifts.*

7. **The phases of a trust**. A trust always counts at least two time phases: a current phase and a future phase. Except for certain states such as Delaware, Alaska and New Jersey where there is no limit in time, the trust cannot continue indefinitely. Thus, in New York, the testamentary trust cannot continue beyond 21 years after the death of a survivor of a group of people alive at the death of the testator (for example, 21 years after the last death of all the descendants of the settlor's parents alive on the day of the settlor's death). At the end of this period and if the trust is still being administered, the property is held outside the trust, that is to say, the trust ends, and title to the property and the interests of the beneficiaries are no longer separated.

8. **Income or capital distributions**. The trust may provide for distributions directed by the settlor or left to the discretion (total or subject to standards) of the trustee.

In conclusion: To fully understand these concepts about the trust, to perceive their nuances in order to transpose them to the closest equivalent in our French law – this is what Article 31 of the Succession Regulation provides for when it proposes the adaptation of a real right not known to our law. We do not know this division between title and beneficial interest, between "legal ownership" and "beneficiary ownership," but we have, for the most part, similar purposes to achieve.[6]

[6] Article 31 provides what "[w]here a person invokes a right in rem …under the law applicable to the succession and the law of the Member State in which the right is invoked does not know the right in rem in question, that right shall, if necessary and to the extent possible, be adapted to the closest equivalent right in rem under the law of That State, taking into account the aims and the interests pursued by the specific right in rem and the effects attached to it"

EXAMPLE:

Trust having a current phase and a future phase: trust in favor of A, and on the death of A or at the end of a certain period, the goods are transferred to B.

Here we find an analogy with the transfer in division of property if A is only entitled to fruits, or with a residual donation if A can claim a part of the capital.

The trust may have several future phases: trust in favor of A, and on the death of A, the trust is maintained in favor of B, and on the death of B, the trust is maintained for C, and so on.

EXAMPLES OF INCOME DISTRIBUTION:

- “I instruct the trustee to distribute the net income of the trust to A by quarterly (or more frequent) payments throughout life”;

- or “I instruct the trustee to distribute as much or all of the net income of the trust, as my trustee deems desirable in my trustee’s absolute discretion”;

- or "I instruct the trustee to distribute as much or all of the net income of the trust, as my trustee deems it desirable to provide for A, that is, if A’s health so requires, or for A’s education and maintenance.

EXAMPLES OF PRINCIPAL DISTRIBUTION:

- the trust deed may prohibit the distribution of principal. *Thus A is only entitled to income, the principal having to remain intact for B who will receive it upon the death of A, unless the principal remains in trust for B after this event*;

- the trust deed may provide for the distribution of the principal at the discretion of the trustee or determined by a standard as described above for income;

- it may provide for the distribution of capital to one or the other of the designated beneficiaries (class of beneficiaries): "I authorize my trustee to distribute all or part of the principal at any time for the benefit of one and/or either of A, B and C who would be alive from time to time at trustee’s absolute discretion". *One is not far from a limited power of appointment conferred on a fiduciary [such as an executor under a Will], which would be prohibited under French law but probably allowed if the succession is governed by American law.*

- the causes of distribution can be framed as already indicated: for example, “I authorize my trustee to distribute [same provision as above up to ... A, B and C], to provide for their needs with regard to health, education or maintenance or support”. *The discretionary power of the trustee is limited; the legacy is almost conditional;*

- the provision may provide for a straightforward termination: "upon the death of A, the trust will end and my trustee will distribute the remaining principal of the trust to B, and in the case that B has predeceased A, to C, and in the case that C has predeceased A, to the children of C then alive";

- the trust deed may also provide that the first beneficiary may appoint in his own will the successive beneficiary(s): "upon the death of A, my trustee will distribute the principal amount remaining in trust, outright or in further trust, for the benefit of one or more of the descendants of A, as A shall appoint in his will, and failing that, to the descendants of A, per stirpes."