#L-1020 2/15/85

First Supplement to Memorandum 85-13

Subject: Study L-1020 - Probate Code (Power of Personal Representative to Accept Pour-up from Trust)

Mr. Irving Kellogg has written the Commission with a suggestion that the Probate Code make clear that the executor may receive assets from a trust where the trustee is authorized or directed to pour up to the estate. A copy of Mr. Kellogg's letter is attached hereto as Exhibit 1. Included with his letter is a detailed analysis of this issue from Mr. Frederick R. Keydel, a Michigan attorney, whose views were solicited by Mr. Kellogg.

Mr. Kellogg is concerned that a probate court in California might refuse to permit a pour-up from the trust to the estate and thereby foil a carefully drawn estate plan. Hence, Mr. Kellogg suggests that the question be settled by statute in advance of any problems developing. Mr. Keydel, on the other hand, is "astounded" at the suggestion that a statute is necessary. He believes there is no reason to think an executor could refuse a distribution from a trust and no basis for a probate court to refuse acceptance.

If the Commission agrees with Mr. Kellogg that there is a need for statutory clarification, draft Section 7551 (a) (attached to Memorandum 85-13) could be revised as follows:

> 7551. (a) Subject to subdivisions (c) and (d), the personal representative:
>
> . . . .
>
> (3) May accept assets transferred to the probate estate from a living trust of which the decedent was a trustor or a beneficiary or both.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

EXHIBIT 1

LAW OFFICES
IRVING KELLOGG
A LAW CORPORATION

January 3, 1985

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LOS ANGELES, CALIFORNIA 90067
(213) 203-8807

John DeMoully
Law Revision Commission
4000 Middlefield Road
Palo Alto, CA 94306

Dear John:

Apropos of my previous correspondence with you about the pour up aspects of the revocable trust, I enclose a copy of the letter and material Fred Keydel, Esq. of Detroit sent me a few weeks ago.

I did not want to send it before now because of the holiday interval.

As you can gather from Fred's letter and the copy of his article, the pour up is a significant estate planning and decedent administration planning device.

In the light of this material, I think the subject is worthy of further consideration. However, as Fred notes in his letter to me, there is no reason for a statutory effort in the matter. However, my concern is that a probate court in California might refuse to acknowledge or approve the pour up, and the results would be costly to the decedent's estate.

So, I ask you to renew your review of this problem. I think a statutory clarification would help the estate planning and probate bars and be beneficial to the estates of decedents whose documents were planned with the pour up option in them.

Cordially,

Irving Kellogg

IK/bc
Enclosures

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June 26, 1984

Mr. Irving Kellogg
188 Century Park East
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Los Angeles, California 90067

Re: Discretionary "Pourups" from Revocable Trusts to Settlor's Probate Estate

Dear Irving:

I am simply astounded that anyone would have to suggest the need for legislation permitting an executor to accept a distribution, whether mandatory or in the discretion of the trustee, made by a trust, whether revocable or irrevocable, to a probate estate.

1. How can anyone think that the fiduciary of an estate could reject such a benefit? Whether or not it is taxable for income tax purposes, such a distribution of assets is, at least to some extent, a benefit to the estate.

2. What logical or reasonable basis would a fiduciary of any estate or a probate court judge give for refusing to permit a benefit to be received by the estate?

It is laughable that someone might suggest that, absent express statutory authorization, such a benefit to the estate must be rejected on "general principals"!

3. It is certainly common to have:

   (a) Revocable trusts that, on the settlor's death, mandatorily pourover 100% to the settlor's probate estate,

   (b) So called "estate trusts" that, on the beneficiary's death, mandatorily pourover 100% to the beneficiary's probate estate - these are a well recognized form of marital deduction trust that can permit income accumulations throughout the surviving spouse's lifetime,

   (c) Qualified employee benefit plan and IRA beneficiary designations calling for distributions from those trust funds to the probate estate of the plan participant or accountowner on his or her death, and

   (d) Exercises of powers of appointment over a trust's assets to the trust beneficiary's probate estate (especially in the context of the traditional form of income/general power of appointment type marital deduction trust).

   Is some express statutory authority required in each of these cases in order for the estate's fiduciary to accept the benefit?

4. From the point of view of creditors of the deceased settlor of a revocable trust, under the laws of many states (such as Michigan, MCLA section 556.128), the assets of the revocable trust are subject to probate estate creditor claims if the assets of the probate estate are insufficient to pay all such claims.

(a) This is true whether or not the revocable trust makes any provision for mandatory or discretionary "pourup" distributions of trust assets to the decedent's estate.

(b) The decedent's creditors cannot successfully make claims directly against the revocable trust but must first present their claims in the probate estate. If no probate estate exists, the creditors have standing to petition for the probate of the estate as the first step in enforcing collection from the revocable trust assets.

In my firm's practice here in Michigan, we frequently use "pourups" from a revocable trust to the settlor's probate estate. Obviously, in all of these cases the residuary beneficiary of the probate estate is the revocable trust itself. Good practice dictates, in order to avoid contests as to the validity of the trust after the settlor's death, that in the typical revocable trust type estate plan a will pouring over the residue of the probate estate to the trust is essential.

A. Although pourup distributions from the trust to the estate are normally made for the purpose of shifting the trust's taxable income (DNI) to the estate (which is not subject to the throwback rules on trust accumulations), we have never had such trust tax returns taking those distribution deductions contested in any way by the IRS.

B. On the contrary, we first got the idea of using pourups as a means of shifting the taxable income of the trust to the

estate when an IRS agent on audit of one of our local bank's trust income tax returns required that a discretionary distribution (of money to pay the estate tax) made by a revocable trust to the settlor's probate estate be treated as moving the DNI of the trust to the estate - in that case, the trust and estate tax returns had not treated the transfer of assets from the revocable trust to the probate estate as a DNI moving distribution.

C. In many of the cases where we have wanted to use a pourup for tax purposes, no probate estate has actually existed. Under those circumstances we have petitioned for belated probate on the basis of a few dollars in cash allegedly found in the possession of the decedent (e.g., in the wallet, purse, or hospital table drawer). That has typically been the only probate inventory asset. The distribution made from the revocable trust to the probate estate is then later reported in the probate estate accounting simply as a "receipt" of the estate.

D. The income tax aspects of pourups from revocable trusts to the settlor's probate estate have been written about in a number of scholarly publications - for instance:

(1) The Real Property, Probate & Trust Law Journal (Fall, 1969),

(2) The Tenth University of Miami Institute on Estate Planning (1976) - Malcolm Moore's article on "The Advantages of Probate",

(3) The Fourteenth University of Miami Estate Planning Institute (1980) - Dave Cornfeld's article on "Trapping Distributions", and

(4) The Eighteenth University of Miami Institute on Estate Planning (1984) - my article on "Revocable Trusts Revisited" (a few pages from the printer's proofs dealing with the subject of pourups are enclosed).

As I said earlier, there should be no need for specific enabling legislation to permit a fiduciary to accept what is clearly a benefit to the estate involved. In fact, I find it hard to imagine just how the question would arise. Would some probate court analyst or judge see the receipt of a distribution from the trust on the estate's accounting and raise objection that somehow the executor was wrong in accepting such a benefit? Can the executor be surcharged for "improperly" accepting such a benefit? That seems ridiculous to me.

If there are those in California who for some reason do not want pourups to be permitted from revocable trusts to probate estates, it would seem that they should have to enact specific legislation prohibiting it (rather than the other way around).

Good luck on getting this fiasco straightened out.

Sincerely,

Frederick R. Keydel

FRK:mw
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Enclosures