

## **BILL ANALYSIS**

C.S.H.B. 1190  
By: Hartnett  
Judiciary  
Committee Report (Substituted)

### **BACKGROUND AND PURPOSE**

The Real Estate, Probate and Trust Law Section of the State Bar of Texas conducted a multi-year study of the Uniform Trust Code (2000) promulgated by the National Conference of Commissioners of Uniform State Laws (NCCUSL). It concluded that Texas should not adopt the Uniform Trust Code (UTC) in full, but that various provisions of the UTC should be included in the Texas Trust Code to improve it. Most of the changes below derive from the UTC.

### **RULEMAKING AUTHORITY**

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

### **ANALYSIS**

**Section 1.** Section 1 amends Section 111.002 of the Texas Trust Code by repealing subsection (a). Subsection (a) is repealed here, but its essence is included in new Section 111.0035 (see Section 2 below).

**Section 2.** Section 2 adds new Section 111.0035 to the Texas Trust Code. This section is modeled on Section 105 of the Uniform Trust Code. It collects provisions previously found in Section 111.002 and Section 113.059 and adds to the list of “mandatory” trust provisions, borrowing from UTC concepts. This change is necessary in light of *Texas Commerce Bank v. Grizzle*, 96 S. W. 3d 240 (Tex. 2002).

**Section 3.** Section 3 amends Section 111.004 of the Texas Trust Code – the definitions section. The changes to the definition of “settlor” are derived from the definition of “settlor” found in the UTC. The term “breach of trust” is used elsewhere in the Trust Code, and its definition here is derived from the UTC.

**Section 4.** Section 4 amends Section 112.009(a) of the Texas Trust Code. This change is drawn from Section 701 of the Uniform Trust Code.

**Section 5.** Section 5 amends Section 112.035 of the Texas Trust Code. This change addresses problems resulting from the publication in 2003 of Volumes 1 and 2 of the Restatement, Third, of Trusts, by the American Law Institute (ALI). ALI occasionally publishes restatements of the law on various subjects, and Texas appellate courts often cite the restatements as authority for positions taken. Section 60 of the Restatement, Third, of Trusts and the comments and examples related thereto call into question the protection from creditors of a spendthrift trust in situations where the trustee also is a beneficiary of the trust, even if the trustee’s authority to make distributions is limited to an ascertainable standard such as the health, education, maintenance and support of the beneficiary.

It is common practice in Texas to establish trusts with one of the beneficiaries as trustee. For example, a husband, seeking to avail himself of certain tax benefits permitted under federal tax law, may provide in his will that one or more trusts will be established for the benefit of his wife after his death and name his wife as trustee. If these trusts contain a “spendthrift” clause (a clause barring the premature alienation of the trust property and protecting the trust property from the beneficiary’s creditors) and limit the trustee’s authority to make distributions to an

ascertainable standard – as virtually all such trusts do – then significant tax savings may be achieved on the death of the wife.

Trusts are drafted this way in Texas because it has long been the predominant view in Texas that spendthrift protection is not lost because a beneficiary is a trustee of the trust, so long as there are ascertainable restrictions on the trustee/beneficiary's authority to make distributions to himself or herself. Section 60 of Restatement, Third, of Trusts, calls this into question. If Texas courts follow the Restatement approach and disallow spendthrift protection from these trusts, thousands of existing trusts in Texas and their beneficiaries may suffer devastating tax and non-tax consequences.

This change clarifies existing law to assure that spendthrift trusts do not lose spendthrift protection because the trustee also is a beneficiary of the trust, so long as the authority to make distributions to a beneficiary is limited to an ascertainable standard such as health, education, maintenance and support. It also clarifies existing law regarding spendthrift protection as it relates to certain powers of appointment.

Adoption of this change is urgent, given the large number of trusts in existence which would be affected by judicial adoption of the Restatement, Third, position.

**Section 6.** Section 6 adds Section 112.037 to the Texas Trust Code. This new section permits trusts for care of animals. It is based on Section 408 of the UTC.

**Section 7.** Section 7 amends Section 112.054 of the Texas Trust Code. These changes are derived from Sections 411,412 and 416 of the Uniform Trust Code.

**Sections 8 and 9.** Section 8 amends the heading of Section 112.057 of the Texas Trust Code. Section 9 amends Section 112.057. The changes to this section are based on Section 417 of the Uniform Trust Code.

**Section 10.** Section 10 adds Section 113.003 to the Texas Trust Code. This change is based on Section 816 of the Uniform Trust Code.

**Section 11.** Section 11 amends Section 113.021(a) of the Texas Trust Code. The change to subsection (4) updates an outdated reference to the Uniform Gifts to Minors Act. The change to subsection (6) is taken from Section 816 of the Uniform Trust Code.

**Section 12.** Section 12 adds Section 113.027 to the Texas Trust Code. This change is derived from Section 816 of the Uniform Trust Code.

**Section 13.** Section 13 amends Section 113.051 of the Texas Trust Code. The good faith requirement is taken from Section 801 of the Uniform Trust Code.

**Section 14.** Section 14 amends Section 113.058(b) of the Texas Trust Code. This is derived from Section 702 of the Uniform Trust Code.

**Section 15.** Section 15 adds a new Section 113.060 to the Texas Trust Code regarding a trustees duties to supply information to beneficiaries.

**Section 16.** Section 16 amends Section 113.082(a) of the Texas Trust Code. This change clarifies this section, eliminating an outdated reference to "incompetent" an cleaning up the language.

**Section 17.** Section 17 amends Section 113.085 of the Texas Trust Code. This change is taken from Section 703 of the Uniform Trust Code.

**Section 18.** Section 18 amends Section 113.171(a) of the Texas Trust Code to update an outdated reference to the Uniform Gift to Minor's Act.

**Section 19.** Section 19 amends Section 114.003 of the Texas Trust Code. This is taken from Section 808 of the Uniform Trust Code.

**Section 20.** Section 20 amends Section 114.006 of the Texas Trust Code. This change is taken from Section 703 of the Uniform Trust Code.

**Section 21.** Section 21 adds Section 114.007 and 114.008 to the Texas Trust Code.

With respect to Section 114.007, the substance of subsections (b) and (c) used to be in Section 113.059. This was in Subchapter B of Chapter 113, entitled "Duties of Trustee." The section was entitled "Power of Settlor to Alter Trustee's Responsibilities." The parts of the former section dealing with mandatory and default terms were moved to new Section 111.0035. The parts of the former section dealing with exculpation of trustee were moved to this new section, since they dealt with the liability of the trustee and not the duty of the trustee. Subsection (c) was added to clarify that there is a difference between a provision relieving a trustee from liability and a provision which relieves a trustee from a duty imposed by the Trust Code or common law. No substantive change is intended with respect to exculpation provisions.

With respect to Section 114.008, this change is taken from Section 1001 of the Uniform Trust Code.

**Section 22.** Section 22 amends Section 115.001 of the Texas Trust Code. The change to Subsection (c) is taken from Section 201 of the Uniform Trust Code. The change to Subsection (d) is necessary to clarify that county courts at law may create trusts for incapacitated persons under Section 142.005 of the Property Code in light of *Texas Commerce Bank v. Grizzle*, 96 S. W. 3d 240 (Tex. 2002), and HB 3503 from the 2003 regular session.

**Section 23.** Section 23 amends Section 115.011(b) of the Texas Trust Code. This change makes it unnecessary for a person named in a trust instrument other than a beneficiary of the trust to be a party to a proceeding involving the trust. This will exclude the settlor of an irrevocable trust (unless the settlor is a beneficiary), persons named as trustee who are not then serving as trustee, and persons named in the instrument creating the trust which have nothing to do with the trust (such as beneficiaries of unrelated gifts under a will which creates a testamentary trust). This change also makes the trustee a necessary party, assuming that a trustee is serving. The requirement that the trustee must be serving in order to be a necessary party permits beneficiaries of a trust where no trustee is serving to petition the court for appointment of a trustee.

**Section 24.** Section 24 amends Section 115.014 of the Texas Trust Code. This change is taken from Section 305 of the Uniform Trust Code.

**Section 25.** Section 25 amends Section 116.005(c) of the Texas Trust Code. When it was enacted, Section 116.005(c)(1) was necessary because a power to adjust that could reduce income jeopardized the qualified terminable interest property (QTIP) status of a marital trust for federal estate tax purposes. Since enactment, Treasury Regulation 1.643(b)-1 (effective January 2, 2004) makes it clear that an adjustment meeting the regulation's requirements that reduces income in a QTIP trust does not disqualify the trust. Repeal of subsection (c)(1) gives the trustee greater flexibility in administering QTIP trusts.

**Section 26.** Section 26 amends Section 116.172 of the Texas Trust Code. The above change fixes a problem caused by Legislative Council's rewrite of REPTL's Uniform Principal and Income Act bill (HB 2241 in the 2003 regular session). The current provision makes no sense. This clarifies what was intended in the 2003 legislation.

**Section 27.** Section 27 amends Section 121.003 of the Texas Property Code. This change updates an outdated reference to the Texas Trust Act.

**Section 28.** Section 28 amends Section 142.005 of the Texas Property Code. These changes are necessary to clarify that county courts at law may create trusts for incapacitated persons under Section 142.005 of the Property Code in light of *Texas Commerce Bank v. Grizzle*, 96 S. W. 3d 240 (Tex. 2002), and HB 3503 from the 2003 regular session.

**Section 29.** Section 29 repeals Section 113.059 of the Texas Trust Code. The substance of subsections (a) and (b) of Section 113.059 was moved to new Section 111.0035. The substance of subsections (c) and (d) of Section 113.059 was moved to new Section 114.007.

### **EFFECTIVE DATE**

September 1, 2006

### **COMPARISON OF ORIGINAL TO SUBSTITUTE**

In section 2 of the original bill, the text of new Section 111.0035 (b) (5)(C) of the Property Code reads: "under Section 113.060 to a beneficiary described by Paragraph (A) that is 25 years of age or older; or", and the text of this provision in the substituted bill reads: "of full disclosure without demand to a settler of a revocable trust or a beneficiary described by Paragraph (A); and".

The substitute bill adds a new section 15 which amends the Property Code by adding a Section 113.060 which requires trustees to keep beneficiaries reasonably informed of material facts regarding their trusts.

Section 17 of the substitute bill changes the text of Section 113.085(c)(2) of the Property Code (in Section 16 of the original bill) regarding delegation of duties by a cotrustee by deleting the word "properly".

In section 20 of the substitute bill (section 19 of the original) a new proviso has been added to Section 114.006(c) of the Property Code reading: "Subject to Subsection (b),". Also, the final words: "unless the action is a serious breach of trust" have been deleted from this section.

In section 21 of the substitute bill, a new proviso "subject to Subsection (b)," has been added to the amended language of Section 115.001(c)(9).

Section 21 of the original bill amending Section 114.032(a) of the Property Code does not appear in the substitute bill.

Section 29 of the original bill amending Section 5(e) of the Probate Code has not been included in the substitute bill.

The original bill repeals Section 114.005 of the Property Code while the substitute does not.

The original bill states that Sections 26 and 29 of the Act are intended to clarify existing law and the substitute bill mentions only Section 26.

The substitute bill changes the effective date of the act and the new provisions to September 1, 2006 from 2005.