



The Wealth Counselor

A monthly newsletter for wealth planning professionals

Trust & Estate Litigation: Its Common Causes

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Mixing family members and money does not always lead to love and happiness. While the work we do is frequently challenging and often rewarding, protecting our clients, our colleagues and ourselves from unnecessary litigation remains a high priority. In many cases, litigation can be avoided with some basic precautionary measures.

This issue of *The Wealth Counselor* explores some of the most common reasons trusts and estates end up in litigation, and some measures the planning team can take to help prevent it.

When litigation ensues regarding an estate plan, it can take two forms. It may be a challenge to an estate plan document, such as whether a will should be admitted to probate. It may also have to do with the administration of an estate, such as who will serve as Executor.

Challenges to the Plan

Challenges to estate planning documents frequently occur when children (and sometimes spouses) are not treated equally as beneficiaries, and especially if someone feels they were not treated "fairly" (a very subjective determination). It is not necessary for someone to be disinherited for litigation to ensue.

Lack of Capacity

That a trustmaker or testator lacked the mental capacity to make a will or create a trust is a common complaint.

Definitions of capacity vary from state to state but, generally speaking, the testator needs to have the ability to understand at the time of making his or her will generally what assets he or she owns, the dispositive provisions of the will, and the testator's relationship

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with those who will benefit from the will.

Every adult who has not been judicially determined incapacitated is presumed to have capacity. Therefore, the burden to prove incapacity is on the contestant. Mere feebleness of the body or mental weakness does not rebut the presumption of competence. Also, the moment at which testamentary capacity is to be tested is the moment of the execution of the document.

Because of these assumptions and requirements, voiding a will on the grounds of testamentary capacity is difficult. However, the prudent course is to take steps to protect yourself and your client as much as possible.

Planning Tip: Know the statutes and/or case law in your state. If there is a concern, have a medical doctor or psychology expert evaluate the client just before signing his or her estate planning documents.

Fraud, Duress and Undue Influence

Fraud, duress and undue influence commonly shortened to simply "undue influence," is statistically the most frequent basis for blocking probate of a will or enforcement of a trust. It can also result in partial invalidity if the remainder of the document is not invalid for other reasons. Simply stated, it is the substitution of another person's will for that of the testator or trustmaker.

A frequent scenario in such cases is this: A family member or caretaker brings in an elderly client, stays with the client during the planning meeting, may even pay for the attorney's or other professional's services, and becomes the main beneficiary or heir. The beneficiary may or may not be related to the client.

When a court makes a determination of whether undue influence has been exercised, it considers a variety of factors, including whether the transaction took place at an appropriate time and in an appropriate setting, and whether the testator was pressured into acting quickly or discouraged from seeking advice from others. Courts also consider the relationship between the parties and the "fairness" of the transaction.

Planning Tip: If you suspect a client is being subjected to undue influence, meeting with the client alone may help to determine the client's capacity, understanding of the events, and even fear of some person in their life.

Revocation of a Will

A third common attack is that the document at issue has been revoked. A testator may completely revoke a will by intentionally destroying it. Complete or partial revocation may also be done by a writing executed under the same formalities of a will or executing a new will.

There is a presumption that a will was revoked if it was in the possession of the testator

and cannot be located upon his/her death. The burden is on the proponent of the will to establish otherwise.

Partial revocation may be desirable, especially in cases of undue influence when only certain provisions of the will might be affected by the person(s) who stand to benefit from the undue influence, and other provisions pertaining to innocent beneficiaries are unaffected.

Planning Tip: Many practitioners mistakenly assume that, in case of the invalidity of the last document, the prior document is automatically revived, but this may be rebutted by evidence to the contrary. If the subsequent will shows a radical departure from the prior plan, the drafting attorney should explain in the document itself the reason for the departure. If a will is being revoked by a written instrument, include an explanation of the purposes for the revocation and that the testator would prefer intestacy over the revival of the prior will.

Prenuptial and Postnuptial Agreements

These, if valid, can affect the surviving spouse's elective share or intestate share of an estate, rights to homestead, exempt property, family allowance and preference on appointment as personal representative of an intestate estate. Prenuptial and postnuptial agreements are often challenged when a marriage ends by death or divorce.

Planning Tip: Creating a valid prenuptial or postnuptial agreement requires care. In some states fair disclosure of assets is required for both prenuptial and postnuptial agreements. It is more likely to be upheld if each party has their own lawyer.

Matters Affecting Administration

Creditors' Claims

Litigated matters in an estate may relate to creditors' claims. Some of the grounds include that the claim may be challenged as not valid or coming too late. So, too, an objection to a claim may be challenged as coming too late.

Removal of Personal Representative

Again, there will be variations in state probate laws but, in general, a personal representative may be removed for various causes, which may include:

- physical or mental incapacity;
- failure to comply with a court order;
- failure to account for sale or real property or to produce the estate assets for inspection;
- wasting or other maladministration of the estate;
- failure to give bond or security;
- conviction of a felony;
- conflicting or adverse interests against the estate;

- revocation of probate of a will in which he/she is named as personal representative;
- lack of present ability to qualify for appointment.

Simple disagreement between beneficiaries and the personal representative is not likely to support removal.

Planning Tip: Because a court is bound to follow the statutory preference of who should serve as personal representative (absent that person's proven unfitness), the client must act to prevent that person serving.

Removal of Trustee

The general rule is a court can remove a trustee only for incapacity or on a clear showing of abuse or wrongdoing in the actual administration of the trust. It is not enough to show that there is a potential for mismanagement or conflict of interest by the trustee; the party seeking removal must allege and prove actual conduct by the trustee amounting to a breach of trust. However, the court should allow for removal for unfitness when the likelihood of harm to the trust can be demonstrated, such as from habitual substance abuse or lack of ability.

Where there is hostility and disharmony between co-trustees that impedes administration of the trust and unnecessarily depletes the trust's assets, a court can remove the trustee determined to be the cause of the disharmony.

Planning Tip: Removal of a trustee may be authorized by the trust document itself. Clients should include such a removal clause if they want certain persons (possibly beneficiaries) to have the power of removal without the necessity of going to court. To avoid later concerns by third parties regarding the successor trustee's legitimacy or challenge by the removed trustee, the removal should be accomplished in strict accordance with any procedural requirements contained in the trust document.

Breach of Fiduciary Duty

A trustee, whether a professional or a family member, has certain fiduciary responsibilities under the law, including:

- To follow the instructions in the trust document.
- To not mix trust assets with his/her own. Bank accounts and investments must be kept separate.
- To not use trust assets for his/her own benefit.
- The trustee or executor must treat all beneficiaries the same. One beneficiary cannot be favored over another unless the will or trust says otherwise.
- To invest trust or estate assets in a prudent (conservative) manner, in a way that will result in reasonable growth with minimum risk.
- To keep accurate records, file tax returns, and report to the beneficiaries as the

law or the trust requires.

Planning Tip: A family member who takes on the responsibility of being an executor or trustee must be educated about these fiduciary responsibilities, estate or trust administration and the terms of the will or trust itself. Rarely is a family member fully qualified to act as sole trustee.

Avoiding Litigation

Exploring litigation risks and how to minimize them creates an excellent opportunity to suggest and put together a qualified team of advisors who can ensure proper trust administration. However, even professionals are at risk when helping administer a trust for the beneficiaries. Here are some areas of concern:

Understanding the Terms of the Trust

The risk of litigation may be reduced by making sure all parties to the trust understand what the trust says: who will receive distributions from the trust, how much they will receive and when they will receive it; the fact that debts and taxes will need to be paid, how much they will be, and when they must be paid; who the trustee(s) and successor trustee(s) are, their responsibilities, and how they are to be compensated; what services from professionals will be secured and how they will be compensated; etc.

Administrative Issues of an Established Trust

At the incapacity or death of the grantor, there are many administrative tasks, issues and decisions to face. Frequently, the grantor's accounting records are not up to date, especially if the person was ill or losing mental capacity. Bills may be past due and tax returns may not have been filed. The trustee may need to be brought up to speed quickly and, if a family member, may not be emotionally ready to do so.

If the grantor has died, there may be several trusts with their own administrative needs depending on the family and financial situation. For example, there may be blended families; younger and older children; irrevocable trusts for tax planning; charitable planning; provisions for a surviving spouse; IRAs, 401(k)s, and annuities; life insurance; etc. Also, a well-intentioned but uninformed or unsuitable trustee may make costly mistakes without careful oversight and instruction by a professional who understands the required accounting.

Distribution Standards and Decisions

When drafting a trust that will give the trustee discretion in providing for a beneficiary, the estate planner will often use the accepted standards of "health, education, maintenance and support." Generally these are interpreted to mean that a beneficiary can receive distributions that will maintain his or her accustomed standard of living. But does that mean providing unlimited funds to maintain that standard of living at the risk of depleting the trust assets? If the beneficiary is receiving income from other sources, should that income be taken into consideration? If the trust does not provide more explicit

instructions, the trustee can be put in an awkward situation, pitted between the beneficiary who is to receive the support and other beneficiaries who are expecting to receive the trust assets after the supported beneficiary dies.

Balancing the Interests of Income Beneficiaries vs. Remainder Beneficiaries

Many ongoing trusts give one beneficiary (typically, a surviving spouse) the right to receive all of the income from the trust. After this beneficiary dies, another beneficiary (often an adult child or children) will be entitled to receive the trust principal. This can frequently lead to conflicts between the income beneficiary, who wants as much income as possible, and the remainder beneficiary, who wants the principal to grow as much as possible. The trustee and the investment advisor will need to work together carefully to create as much balance as possible to provide for both.

Suitability of Investments

Each beneficiary of the trust may have different risk tolerance levels. Some may want to be more aggressive, others more cautious. Some may want the trust to invest in their business or buy them a house. Remember, the trustee, working with the investment advisor, is responsible for handling the trust assets in a prudent (conservative) manner for the benefit of all beneficiaries, not just one particular beneficiary.

Insurance Reviews

Regular reviews of the amount of life insurance and policies are a must. The amount of insurance may need to be adjusted up or down. If the individual is in good health, a different policy may be more suitable. Should irrevocable life insurance trusts own the policies? Is there a desire to establish trusts for grandchildren, charitable causes, or a special needs child? There are many valuable uses for life insurance in estate planning and, if done properly, the proceeds will be free of estate taxes, income taxes, and probate fees.

Planning Tip: Professionals who work with trusts often forget that a trust document and its administration are foreign to the family members. Hopefully, the more they understand them and the resulting benefits, the more likely you will ease any frustration and avoid a court battle. Periodic updates and open communication to all involved parties, including other members of the advisory team, are essential.

Conclusion

Not all trust and estate litigation can be avoided or is, in fact, bad. There are times when it is necessary to protect the innocent or wronged. What you want to do is to protect yourself, your clients, and your colleagues from *unnecessary and avoidable* litigation, and there are steps you can take to do that. All members of the advisory team need to be familiar with and understand legal issues that may arise in probate and trust administration. Don't assume the family has any correct information about either of these subjects. Do what you do in a professional, ethical and conscientious manner. And communicate often and well to all involved.

To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from their tax adviser based on the taxpayer's particular circumstances.

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