Boilerplate Provisions

The Impact of Certain "Standard" Will Provisions

Frederick R. Franke, Jr.

Frederick R. Franke, Jr.

LAW OFFICE OF FREDERICK R. FRANKE, JR.

- Practice areas: Estates/trusts planning and administration, exempt organizations, and fiduciary litigation.

- Past Chair, Estate and Trust Law Section, Maryland State Bar Association.

- Fellow, American College of Trust and Estate Counsel.

- Adjunct Professor of Law at the University of Baltimore, having taught estates and trusts in the evening division.

- Listed in *The Best Lawyers of America* and *Maryland Super Lawyers* (Estate Planning and Probate).

- Frequent lecturer for various continuing education programs for lawyers and accountants, including: Will Drafting (Testamentary Trusts) (MICPEL 2007, 2005, 2003); Asset Protection Planning (MICPEL 2007); Basic Estate Tax Planning (Revocable Trusts) MICPEL 2006, 2004); Advanced Estate Planning Institute (Asset Protection) (MICPEL 2006); Conservation Easements (MET 2005); Disclaimers (AABA 2004); Valuation Discounting (MICPEL 2003; MSBA 2003 and 2002); The 2001 Tax Act (AABA 2002; Univ. Baltimore 2001).

Table of Contents

BOILERPLATE PROVISIONS
The Impact of Certain "Standard" Will Provisions

Frederick R. Franke, Jr.
Law Office of Frederick R. Franke, Jr.
77 Franklin Street
Annapolis, Maryland 21401
410-263-4876

1. Tax Clauses.

1.1. The tax clause as a bequest. In certain circumstances, the tax clause can be the functional equivalence of a bequest. In Fauntleroy v. Blizzard[1], for example, Ms. Jackson's Will contained the "standard" tax clause which directed that the taxes be paid from the residuary estate. The Will provided a specific bequest of her husband's family stock back to his family (to the children of the deceased husband's brother) and the residue to the Fauntleroy heirs who were her family members. The stock was valued at $1.4 Million with her estate apparently consisting of this stock and her farm. The total estate and inheritance taxes tax that was shifted to the residue was $910,000. Probably at least 75% of this amount was attributable to the specific bequest to the collateral family members. In Estate of Boyd[2], the "standard" tax clause wiped out the marital bequest because of a large insurance policy going to the decedent's son, the spouse's stepson. In that case, the son/stepson disclaimed his interest in the probate estate and to the benefit of the tax clause.

1.2. The federal law regarding the tax burden. Generally, the federal law looks to state law to determine tax apportionment. Riggs v. Del Drago: "Congress from 1916

[1] Reported as Noble v. Bruce, 349 Md. 730 (1998) where the Court of Appeals dismissed two malpractice cases due to the heirs lacking standing to sue based on a strict privity theory.
[2] Estate of Boyd, 819 F. 2d 170 (7th Cir. 1987), rev'g 85 T.C. 1056 (1985) held that one may disclaim the benefits of the tax clause which, in that case, resurrected the marital deduction. Presumably, not every family dynamic would permit the use of a disclaimer to fix the result in similar circumstances.

onward has understood local law as governing the distribution of the estate tax after payment of the tax." Also "Congress did not contemplate that the Government would be interested in the distribution of the estate after the tax was paid, and that Congress intended that state law should determine the ultimate thrust of the tax."[3] Also: "If the issue is how to apportion the estate taxes, Riggs v. Del Drago instructs us to look to state law." Estate of Reno v. Comm.[4]

1.2.1. This does not mean that the IRS is restricted in its collection efforts to follow the tax apportionment scheme. Under IRC § 6324, for example, a "secret" estate tax lien attaches to all of a decedent's probate property and the IRS is able to chase that property into the hands of as bone fide purchaser.[5]

1.2.2. Although the general federal law refers to state law, certain provisions of federal law contain special apportionment provisions. IRC § 2603 (b) provides that "Unless otherwise directed pursuant to the governing instrument by specific reference to the tax imposed by this chapter, the tax imposed by this chapter on a generation-skipping transfer shall be charged to the property constituting such transfer." Also, IRC § 2207 provides that unless the decedent provides otherwise, the property subject to a general power of appointment shall bear its share of the estate tax and, similarly, IRC § 2207A provides that QTIP property likewise bears its portion of the tax.

1.3. Maryland Common Law. "Historically, estate taxes were viewed, like other transfer tax or administrative expense, as being part of the cost of administration, and, absent an expression of intent in the will to the contrary, payable from the residuary portion of the estate." Johnson v. Hall, 283 Md. 644, 647 (1978).

---

[3] Riggs v. Del Drago, 317 U.S. 95, at 99 and 98 (1944).
[4] Estate of Reno v. Comm., 945 F. 2d 733, 733 (4th Cir. 1991)(citation omitted)..
[5] Detroit Bank v. U.S., 317 U.S. 329 (1943); U.S. v. Vohland, 675 F2d 1071 (1982 CA9).

1.3.1. "The inequity which frequently resulted from the application of this 'common law' rule, especially when the residue was left to sustain a widow or minor children, spurred many state legislatures to revise that rule through statutory enactment." Id.

1.4. The "Maryland Uniform Estate Tax Apportionment Act."[6]

1.4.1. The Act generally provides that federal (and Maryland) estate tax should be apportioned among all those interested in the estate in the proportion that each person's interest bears to the total estate value.

1.4.2. "Person interested in the estate" includes non-probate legatees and recipients of *inter vivos* gifts where the gift may generate the federal estate tax: "[A]ny person who is entitled to receive or has received, from a decedent while alive or by reason of the death of a decedent, any property or interest in property included in the taxable estate of the decedent." In Shepter v. Johns Hopkins University, 334 Md. 82 (1994), the Court held that this included adjustable taxable gifts that had (or should have) reduced the available credit. In 1995, the General Assembly reenacted § 7-308 to legislatively reverse the result of Shepter. Thus, the apportionment does "not include any interest of the decedent that is not included in the value of the decedent's taxable estate determined under §§ 2001(b)(1)(A) and 2051 of the Internal Revenue Code of 1986." Section 2. ch. 555, Acts 1995.

1.4.3. The statutory apportionment does not apply if a contrary instruction is in the Will. § 7-308(k).

1.4.3.1. In Johnson v. Hall, 283 Md. 644 (1978), the Court of Appeals held that a general direction to pay taxes is not a direction to pay such taxes

[6] § 7-308 of the Tax-General Article, Annotated Code of Maryland.

from the residuary estate. In Johnson, the Will directed that "I direct that … all estate and inheritance taxes, be paid as soon after my death as can lawfully and conveniently be done." The court held that "No magical or mystical word or phrase is required to shift the burden of estate taxes from the legatees and devisees to the residue; however, for us to recognize the testatrix's 'boiler plate' reference to the payment of debts, expenses, and taxes in the first clause of her will states an intent not to apportion would require that we be clairvoyant." (at 655). The purported deficiency in the language was that the personal representative was not directed from where the money was to come. The tax clause should have a direction that the taxes be paid "from my residuary estate."

1.4.3.2. In Pfeufer v. Cyphers, 397 Md. 643 (2007), the will left the entire residuary estate to four people, three of whom were exempt from inheritance tax but one of whom was liable for the inheritance tax. The issue was whether a directive to pay all taxes from the residue meant that the residue was liable for the inheritance tax thereby, in effect, having that tax shifted to the tax-exempt heirs. The Court upheld the clause. Pfeufer has a detailed discussion of Johnson v. Hall and tax clauses in general. The inheritance tax is a tax on the "privilege of receiving property that passes from a decedent." § 7-202 of the Tax-General Article of the Annotated Code of Maryland. The tax is payable by the person to whom property passes and not on the estate of the person from whom it passed. Mercantile-Safe Deposit & Trust Co. v. Register of Wills, 252 Md. 311 (1969). Nevertheless, Pfeufer held that a tax clause can shift the tax to the estate.

1.5. Examples of Tax Clauses.[7]

[7] These examples are from Guttenberg, Maryland Estate Planning, Wills and Trust Library, (DataTrace 2006), reprinted here by the kind permission of Mr. Aryeh Guttenburg. These are illustrative of general

1.5.1. "Standard" Tax Clauses (paid out of residue).

I direct that all inheritance, estate, succession and other transfer taxes occasioned by my death, together with the reasonable expenses of determining the same and any interest of penalties thereon, paid with respect to all probate and nonprobate property includible in my gross estate and taxable by reason of my death (whether payable by my estate or by the recipient of any such property) shall be paid and discharged in full without any apportionment, by my Personal Representative out of my residuary estate.

If my wife shall survive me, I direct that all estate, inheritance, succession, transfer or other death taxes assessed by any taxing authority, whether foreign or domestic, in respect of all property taxable by reason of my death or by reason of the inclusion of such property in my gross estate for estate tax purposes, be paid, without apportionment, out of that portion of my residuary estate not qualifying for he marital deduction. To the extent the nonmarital portion of my residuary estate is insufficient to pay such taxes, I direct that the balance of such taxes be paid from that portion of my residuary estate, if any, which qualifies for the marital deduction, without apportionment. If my wife shall not survive me, I direct that all such taxes shall be paid from my residuary estate without apportionment. However, the aforesaid notwithstanding, if, at the time of my death, I am the beneficiary of a qualified terminable interest property (QTIP) trust, and the principal of that trust is includible in my gross estate for tax purposes, it is my direction, pursuant to the provisions of Internal Revenue Code, Section 2207A, that my Personal Representative or the trustee of such trust withhold from the shares of the remaindermen of such trust an amount by which the estate tax in my estate exceeds the amount of the estate tax which would have been payable had the trust property not been included in my estate for tax purposes.

1.5.2. Apportionment for certain non-probate disposition.

I direct that all estate, legacy, inheritance, succession, transfer, or all other death taxes assessed by any taxing authority, whether foreign or domestic, in respect of all property taxable by reason of my death or by reason of the inclusion of such property in my gross estate for estate tax purposes, whether such property passes under this will or otherwise, whether payable by my estate or by any recipient of such property, shall be paid as follows:

(a) All such taxes attributable to property passing under this will shall be paid out of my residuary estate and charged to the trust created under the [name and date of living trust instrument], as provided in such instrument.

(b) All such taxes which are attributable to the assets of the [name of living trust] shall be allocated and paid as provided in such instrument.

(c) All such taxes which are attributable to any other property shall be apportioned among the persons and entities benefited in the proportion that the taxable value of the property or interest bears to the total taxable value of the property and

principles of law only and <u>not</u> for the purpose of giving advice as to the appropriateness or the use of these forms or the language suggested.

interests received by all persons benefited (the values as finally determined in the respective tax proceedings being the values to be used for the appointment of the respective taxes) and my Personal Representative shall seek reimbursement for such taxes from the persons benefited to the fullest extent permitted by any applicable law.

1.5.3. Apportionment of all dispositions.

I direct that all estate, legacy, inheritance, succession, transfer, or all other death taxes assessed by any taxing authority, whether foreign or domestic, in respect of all property taxable by reason of my death or by reason of the inclusion of such property in my gross estate for estate tax purposes, whether such property passes under this will or otherwise, whether payable by my estate or by any recipient of such property, shall be apportioned among the persons and entities benefited in the proportion that the taxable value of the property or interest bears to the total taxable value of the property and interest received by all persons benefited (the values as finally determined in the respective tax proceedings being the values to be used for the apportionment of the respective taxes) and my Personal Representative shall seek reimbursement for such taxes from the persons benefited to the fullest extent permitted by any applicable law.

2.0. Investment Powers.

2.1. Common Law Rule. "Maryland follows a 'prudent person' standard for investment by fiduciaries." Attorney Grievance Comm’n v. Owrutsky, 322 Md. 334, 350 n. 7 (1991). This means that "in all management of the trust a trustee is required to manifest 'the care, skill, prudence, and diligence of an ordinarily prudent [person] engaged in similar business affairs and with objectives similar to those of the trust in question.' This duty 'is not necessarily to maximize the return on investments but rather to secure a "just" or "reasonable" return while avoiding undue risk.'" Maryland Nat’l Bank v. Cummins, 322 Md. 570, 580 (1991) (citations omitted). In Board of Trustees v. City of Baltimore, 317 Md. 72 (1989), the Court clarified that the prudent investment rule looks to the whole portfolio, not on examination of each investment. This was a challenge by the city pension trustees to ordinances requiring divestiture of its holdings in companies doing business in South Africa. The pension trustees claimed that the ordinances conflicted with the trustees' common law duties of investment prudence and loyalty. The trustees' claimed that prudence of investment was effected "by radically reducing the universe of eligible investments." They claimed to be barred from almost 1/2 of the market capitalization of the S & P 500. (at 103). The Court rejected this argument and held that the "prudent person" rule dictates a "whole portfolio" approach rather than an examination of each investment. (at 104). The "whole portfolio" approach to prudence is particularly useful in defending the performance of one holding by a showing of portfolio balance. In addition to its contention that the ordinances violated rules of prudence, the trustees argued that the ordinances violated the duty of loyalty because they were forced to consider the interests of persons other than the pension beneficiaries. The Court rejected that argument, stating that the cost of considering the social aspects of investments are *de minimis.*

2.2. <u>The Prudent Investor Act.</u>

2.2.1. E&T 15-114 sets out standards for investments. By its terms, the Act covers trust companies and persons who elect into the coverage. It generally covers trustees, guardians, custodian, under the UTMA but not personal representatives.[8] Nevertheless, it is a statutory map as to how any fiduciary should invest and it establishes standards offering more direction and guidance than the Common Law prudent person standard cases.

2.3. <u>The "Legal List" of Investments.</u> E&T § 15-106 sets out "lawful investments" in which a fiduciary may invest. It is not exclusive: "This section shall not be construed to make unlawful any investment not listed in this section." E&T § 15-106(g). Also, investing on the list is not a defense to imprudence. The Henderson

[8] E&T 15-114 contains its own definition of "fiduciary" and "fiduciary assets" that exclude personal representatives. The rest of Title 15, however, includes personal representatives in the definition of fiduciary. E&T § 15-101(g).

Commission recommended abolishing the legal list of fiduciary investments. Notwithstanding this recommendation, the "legal list" remains in the Code but offers no protection to the fiduciary: "The Maryland legislature has interposed what can be characterized as a permissive legal list for most fiduciaries; it has acknowledged, however, that the prudent man rule underlies all fiduciary investment decisions. One is then left to wonder why Maryland's legal lists are necessary ... In essence, Maryland's statutory provisions on investments by fiduciaries generate much heat but little light. The fiduciary is on his own in making decisions, frequently operating under the belief that the law protects him when, in fact, it only creates a presumption in favor of his decisions if he complies with the statutory recommendations." Tralins, *Contemporary Fiduciary Investments: Why Maryland Needs the Prudent Man Rule*, 12 U. Balt. L. Rev. 207, 230-231 (1982).

2.4. Statutory Powers in General. E&T Art. § 7-401 establishes the investment authority for personal representatives. These powers cover personal representatives but no other fiduciaries. Subsection (a) states that the statute enumerates powers that are "in addition to the power or authority contained in the will and other common-law or statutory powers …." Investment authority largely remains an issue dependent on the "prudent person" rule. Even court approval of an investment does not insulate the fiduciary from liability. See, Goldsborough v. DeWitt, 171 Md. 225 (1937).

2.5. The Statutory Enumeration of Powers.

2.5.1. Subsection (b) permits the personal representative to "retain assets owned by the decedent pending distribution or liquidation, including those in which the representative is personally interested or which are otherwise improper for trust investment." The ability to retain investments even when the personal representative is also "personally interested" in the investment parallels, in part, the "implied exemption" to fiduciary conflicts. In Goldman v. Rubin, 292 Md. 693 (1982), the testator was the founder of a clothing business which he ran as a family affair with one son as president, a son-in-law as vice-president, and another son-in-law as secretary and counsel of the business. One daughter, Mrs. Goldman, the Plaintiff, was not involved in the business. The testator named as personal representatives, those family members who were also part owners of the business and who served on its board of directors. The will provided that the taxes, funeral and administrative expenses be paid out of a trust which held all of the testator's stock. The trust was for the benefit of his son who was president and his daughter whose husband was vice-president. The trustees were identical to the board of directors. This arrangement was structured to enable the stock to be redeemed under IRC § 303 to the extent of these expenses, which redemption would get capital gains treatment. Other than the § 303 expenses out of the trust, all remaining expenses were to be paid out of the residuary and the net residuary was to be distributed to all of the children -- including Mrs. Goldman, who was to receive 2/9th. Mrs. Goldman did not have any relationship with the company and was not a trust beneficiary. The Trustees/Directors effectuated the redemption in exchange for a note (the company being apparently short of cash). The note paid 6% interest currently, with principal payments deferred for 10 years. A 2/9th interest in this note was then distributed to Mrs. Goldman. Mrs. Goldman sued charging that the personal representatives had a conflict of interest. The trial court agreed. The Court of Appeals held that because the testator created the conflict of interest, this divided loyalty does not constitute a per se breach of duty. This holding (the so-called "implied exemption" rule) means that the conflict, in itself, is not prohibited. Thus, the trial court should have examined the conduct of the personal representatives to see if they acted prudently in issuing the note. Because the trial court decided the case on a per se basis, it was sent down for a hearing to determine whether the note was a proper exercise of the personal representative's discretion based on a balancing of their duty to the legatees and on the testator's intention (found in the will) to keep his company intact for those of the family who worked in the business.

2.5.2. Subsection (e) permits the personal representative to deposit funds for the account of the estate in checking accounts, in insured interest-bearing accounts, or in short-term loan arrangements. The Court of Appeals has held: "It is the obligation of an attorney upon receiving funds representing the assets of an estate to deposit those funds in a separate estate account clearly identified by the name of the decedent. Such funds should not be commingled in an escrow account, general or otherwise." Attorney Grievance Comm'n v. Kenneth L. Boehm, 293 Md. 476, 479 (1982).

2.5.3. Subsection (n) states that the personal representative "may invest in, sell, mortgage, pledge, exchange, or lease property."

2.5.4. Subsection (s) permits the personal representative to continue an unincorporated business of the decedent for a period of 4 months "where continuation is a reasonable means of preserving the value of the business including goodwill." With Court approval, the unincorporated business may be continued for a longer period. This procedure permits interested persons to object. If the business becomes incorporated after the death by the personal representative, then the business may be continued throughout the period of administration. Subsections (t) and (u) permit the personal representative to incorporate or create an LLC for the sole proprietorship.

2.6. Powers in the Instrument. Generally, the governing instrument may alter restrictions contained in statute or in the Common Law. See, for example E&T Art. § 7-401(a): "[A] personal representative may exercise all the power or authority conferred upon him by statute or in the will, without application to, the approval of, or ratification by the court. Except as validly limited by the will ... a personal representative may" also exercise certain enumerated powers as set forth in the statute. Generally when powers are added in a will they are drafted to apply to both personal representatives (generally a relatively short term or transitional position) and the trustee (generally a longer term position).

2.6.1. One typical provision authorizes a fiduciary to invest in securities that may be too risky to qualify under the "prudent person" rule. If it is anticipated that a major portion of a trust (or estate) is stock or some other ownership interest in one business -- perhaps the testator(rix)'s business -- a provision negating normal diversification rules should be included. Generally, it is a good practice to name the business interest that may comprise a large part of the trust and give authority to continue and perhaps expand such investment.

2.6.2. Another provision may be to permit the fiduciary to invest in non-income producing property -- for example if part of the family home or farm is put into trust. In this situation, additional powers to permit the income beneficiary to reside in the property is advisable. If the trust is a QTIP trust, any power to retain non-income producing property should be contingent on the surviving spouse's explicit permission.

2.6.3. Generally, if a closely held business is part of the assets, it is a good idea to give powers to operate such a business to the fiduciary. Although limited powers are contained in E&T Art. § 7-401(s), these are too limited in purpose (solely to preserve the value of an unincorporated business), time (4 months without a court order), and specifics (continue an unincorporated business) to do the job. In addition, creating a power-to-operate-a-business clause that is tailored to the actual circumstances of the client is a useful way to focus such planning. Some of the areas to discuss include: whether other estate or trust funds may be applied to the running of the business, whether the fiduciary will be paid extra amounts for running the business, power to borrow, power to hire and fire, power to delegate management tasks, etc.

2.6.4. The tension between instructions concerning the retention of particular investments and unforeseen circumstances has produced litigation. One dramatic instance of this tension was Matter of Dumont, 2006 N.Y. Slip Op. 866; 2006 N.Y. App. Div. LEXIS 1301, 2006 WL 259834 (2006). Mr. Dumont wanted to preserve his Eastman Kodak stock for the remaindermen of his trust and so he provided in his will: "It is my desire and hope that [the Kodak stock] will be held by my said Executors and by my said trustee to be distributed to the ultimate beneficiaries under this Will, and neither my Executors nor my said trustee shall dispose of such stock for the purpose of diversification of investment and neither they or it shall be held liable for any diminution in the value of such stock." The Will also provided: "The foregoing provisions shall not prevent my said Executors or my said Trustee from disposing of all or part of the stock in Eastman Kodak Company in case there shall be some compelling reason other than diversification of investment for doing so." The Surrogate surcharged the trustee, J.P. Morgan/Chase, over $24 Million because it failed to timely sell the Eastman Kodak stock. The intermediate appellate court reversed on narrow grounds (the Surrogate based its surcharge on the assumption that the stock should have been sold on a particular date not alleged by the remaindermen). Nevertheless, this case illustrates that care must be used in drafting and implementation of these sort of clauses.

2.7. Deductibility of Investment Advice.

In Knight v. Commissioner, ___ U.S. ___ (January 16, 2008), the Supreme Court decided that the deduction that a trust takes for investment advice is subject to the 2% floor of adjusted gross income. Before this ruling, many trustees deducted the full amount of such expenses on the basis that such advice was a necessary cost arising from its fiduciary duties. The Supreme Court, however, held that because such fees could be incurred if the property was held individually, IRC § 67(e)(1) would not exempt the fee from the 2% floor treatment.

3.0. Spendthrift Provisions.

3.1. In General.

A spendthrift trust may be created when the creator of a trust manifests the intention (expressly or by implication) that the beneficiaries receive an equitable interest in the trust free of the claims of their creditors. Cherbonnier v. Bussey, 92 Md. 413 (1901). No specific language is needed to create a spendthrift trust. The earliest Maryland case, for example, determined that the direction that the trustee make payments "into his (the beneficiary's) hands, and not into another, whether claiming by his authority or otherwise" was an expressed manifestation of such an intent. Smith v. Towers, 69 Md. 77, __ (1888). Other manifestations of an intention to create a spendthrift trust are more elaborate:

> "No interest of any beneficiary of this Will or any rust [sic] created thereby shall be assignable in anticipation of payment thereof in whole or in party by the voluntary or involuntary acts of any such beneficiary or by operation of law. Neither the corpus of any trust created hereby, nor the income resulting therefrom, while in the hands of my fiduciaries, shall be subject to any conveyance, transfer, or assignment, or be pledged as security for any debt or obligation of any beneficiary thereof, and the same shall not be subject to any claim of any creditor of any such beneficiary through legal process or otherwise. Any such attempted sale, anticipation, or pledge of any of the funds or property held in any such trust or will, or the income therefrom, by any beneficiary shall be null and void, and shall not be recognized by my fiduciaries."

Duvall v. McGee, 375 Md. 476 (2003), footnote 5.

3.2. Theoretical Underpinning.

A spendthrift trust has been defined as "a trust that restrains voluntary and involuntary alienation of all or any of the beneficiaries' interests." Restatement of Trusts 3d § 58. "The Validity of Spendthrift Trusts," 34 A.L.R. 2d 1335: "[T]his particular type of trust, created with the view of providing a fund for the maintenance or use of another, and at the same time securing it against his improvidence, incapacity, misfortune, by means of such a restrictive provision, to which the term spendthrift trust was originally and is now generally applied…" Spendthrift trusts are upheld because the donor of the trust has the right to dispose of his or her property:

> "Now common honesty requires, of course, that every one should pay his debts, and the policy of the law for centuries has been to subject the property of a debtor of every kind which he holds in his own right, to the payment of his debts. He has as owner of such property the right to dispose of it as he pleases, and his interest is, therefore, liable for the payment of his debts. But a cestui que trust does not hold the estate or interest in his own right; he has but an equitable and qualified right to the property or to its income, to be held and enjoyed by the beneficiary on certain terms and conditions prescribed by the founder of the trust. The legal title is in the trustee, and the cestui que trust derives his title to the income through the instrument by which the trust is created. The donor or devisor, as the absolute owner of the property, has the right to prescribe the terms on which his bounty shall be enjoyed, unless such terms be repugnant to the law. And it is no answer to say that the gift of an equitable right to income to the

> exclusion of creditors is against the policy of the law. This is begging the question. Why is it against the policy of the law? What sound principle does it violate? The creditors of the beneficiary have no right to complain, because the founder of the trust did not give his bounty to them. And if so, what grounds have they to complain because he has seen proper to give it in trust to be received by the trustee and to be paid to another, and not to be liable while in the hands of the trustee to the creditors of the cestui que trust. All deeds and wills and other instruments by which such trusts are created, are required by law to be recorded in the public offices, and creditors have notice of the terms and conditions on which the beneficiary is entitled to the income of the property. They know that the founder of the trust has declared that this income shall be paid to the object of his bounty to the exclusion of creditors, and if under such circumstances they see proper to give credit to one who has but an equitable and qualified right to the enjoyment of property, they do so with their eyes open. It cannot be said that credit was given upon such a qualified right to the enjoyment of the income of property, or that creditors have been deceived or mislead; and if the beneficiary is dishonest enough not to apply the income when received by him to the payment of his debts, creditors have no right to complain because they cannot subject it in the hands of the trustee to the payment of their claims, against the express terms of the trust."

Smith v. Towers, 69 Md. 77, 88 (1888) (as quoted in DuVall v. McGee, 375 Md. 476 (2003)).

3.3. Special Status Creditors.

Despite the general respect afforded a spendthrift trust, it is not inviolate against certain claims: alimony arrearages, Safe Deposit & Trust Co. v. Robertson, 192 Md. 653 (1949); child support, Zouck v. Zouck, 204 Md. 285 (1954), and federal income taxes, Mercantile Trust Co. v. Hofferbert, 58 F. Supp. 701 (D. Md. 1944). In the case of alimony and child support, the Court has made the distinction that such claims are not for debts of a beneficiary but are rather duties of the beneficiary: "We think the view expressed in the Restatement is sound. The reason for the rejection of the common law rule (prohibiting spendthrift provisions), that a condition restraining alienation by the beneficiary is repugnant to the nature of the estate granted, was simply that persons extending credit to the beneficiary on a voluntary basis are chargeable with notice of the conditions set forth in the instrument…. This reasoning is inapplicable to a claim for alimony which in Maryland at least, is 'an award made by the court for food, clothing, habitation and other necessities for the maintenance of the wife…'. The obligation continues during the joint lives of the parties, and is a duty, not a debt." Robertson, at 662. See also, Prince George's County Police Pension Plan v. Burke, 321 Md. 699 (1991) upholding, as part of a marital property award, a transfer of a partial interest in a county pension plan despite spendthrift protections because the spouse is entitled to her the equitable distribution of her "rightful portion" of the retirement fund. When discussing these cases, the Court of Appeals noted that "none of these cases was premised on there having been a lack of notice given to the claimants as to the trust beneficiary's limited interest in the trust. Rather, the courts recognize a fundamental difference between these obligations and those of ordinary creditors." DuVall at 499-500. This distinction in DuVall is important, of course, as DuVall involved a tort creditor who certainly lacked notice of the debtor/tortfeasor's limited interest in the trust. One could argue that a prospective spouse may have notice when he or she marries a person primarily supported by a trust fund that a subsequent spousal award may be difficult to collect.

Every edition of the Restatement of Trusts has recognized that a spendthrift trust can be reached to satisfy claims "for necessary services rendered to the beneficiary or necessary supplies furnished to him," Restatement § 157 or based on "services or supplies provided for necessities or for the protection of the beneficiary's interest in the trust." Restatement 3d § 59. The Comment to Restatement 3d states:

"Failure to give enforcement to appropriate claims of this type (based on supplying necessities) would tend to undermine the beneficiary's ability to obtain necessary goods and assistance; and a refusal to enforce such claims is not essential to a settlor's purpose of protecting the beneficiary." These rules suggest that the trust in question is either explicitly or implicitly a "support trust." To the extent that the trust is wholly or partially discretionary, of course, no creditor will be able to enforce a judgment for providing necessities. See First Nat. Bank of Maryland v. Dept. Health and Mental Hygiene, 284 Md. 720 (1079): "A support trust, it is generally recognized, is one that provides that 'the trustee shall pay or apply only so much of the income and principal or either as necessary for the education or support of the beneficiary,' thereby barring the beneficiary from transferring his interest and precluding his creditors from reaching it." Id. At 725. The beneficiary of a support trust has enforceable rights to compel the trustee to make appropriate distributions. Offutt v. Offutt, 204 Md. 101 (1954). The First Nat. Bank of Maryland court cited Robertson for the proposition that a creditor of the beneficiary likewise may compel the support distributions. Robertson, 192 Md. 653 (1949). The creditor in Robertson, of course, was a spouse who is afforded super-creditor status.

3.4. Tortfeasor Access.

The Court of Appeals refused to extend the class of claims that may breach a spendthrift trust to include claims by tortfeasors. The facts underlying Duvall v. McGee are egregious. The beneficiary of a spendthrift trust was convicted of felony murder. The estate of the victim brought suit to enforce its judgment against the trust. The Court distinguished "a mere judgment creditor" from a spouse or child to whom a beneficiary owes a "duty" of support: "Indeed, to permit the invasion of the Trust to pay the tort judgments of the beneficiary, in addition to thwarting the trust donor's intent by, in effect, imposing liability on the Trust for the wrongful acts of the trust beneficiary, is, as the appellees argue, to create an exception for "tort victims" or "victims of crimes." Comment a. to Restatement 3d (2003) § 59 takes a different position: "The nature or pattern of tortious conduct by a beneficiary, for example, may on policy grounds justify a court's refusal to allow spendthrift immunity to protect the trust interest and lifestyle of that beneficiary, especially one whose willful or fraudulent conduct or persistently reckless behavior causes serious harm to others." See also, Sligh v. First Nat. Bank of Holmes County, 704 So. 2d 1020 (Miss. 1997) which, as noted in a footnote in DuVall, prompted a legislative reversal so to reinstate immunity from tort claims in 1998. The Commissioners of the Uniform Trust Code (2005) "declined to create an exception for tort claimants" to its exceptions to spendthrift provisions (Section 503).

3.5. Spendthrift Clauses and Trust Termination.

Maryland follows the general American rule that a trust may be terminated when all beneficiaries consent to the termination and when termination is not contrary to the settlor's intention. Probasco v. Clark, 58 Md. App. 683 (1984). When a trust contains a spendthrift provision, however, one of the material purposes of the trust is the protection afforded a beneficiary by that clause. Consequently, a trust containing a spendthrift provision may not be modified by a Maryland Court regardless of whether all beneficiaries consent:

> "These cases and many others in Maryland have upheld the immunity of spendthrift trusts from attempted invasion by creditors of the beneficiaries. A necessary corollary of such a policy is that spendthrift trusts must be immune from attempts by the beneficiaries themselves to reach the corpus. As Dean Griswold has pointed out, to permit premature termination by the beneficiaries, either in whole

> or in *pro tanto*, would amount to an assignment of the corpus, the very thing that a restraint on alienation, such as we have in the case at bar, forbids. Griswold, *'Spendthrift Trusts,'* (2 Ed.) § 517, 517.1. If a beneficiary be forbidden to assign her interest in the trust, should she be allowed to accomplish the same result by termination? We think the answer is apparent. The purpose of the restraint on alienation such as the one in this trust is not only to protect the beneficiaries from the claims of creditors, but also to assure the maximum annual income."

Kirkland v. Mercantile Safe Deposit & Trust Co., 218 Md. 17, 23 (1958). See also Mahan v. Mahan, 320 Md. 262 (1989) ("[W]e hold that paragraph six of Frances's deed of trust created a spendthrift trust, and that a spendthrift trust cannot be terminated by the consent of the beneficiaries, even though all are sui juris and all join in seeking termination.")

The Kirkland case is instructive as to the type of circumstances where a spendthrift clause may, in fact, injure the beneficiary that the trust was presumably established to protect. In Kirkland, a mother established a trust to protect her three daughters. The trust directed 'all income' to go to the daughters but no distributions of corpus. Almost forty years after the mother's death, one of the two remaining daughters suffered a stroke and 'was left in such a condition that she was unable to care for herself, which involved expenses in excess of the income from the trust.' Kirkland at 21. The remaining daughter – who was guardian for the sister – sought a termination of the trust so that principal could be used for her sister. It was under those circumstances that the Court held that the trust could not be terminated. With the addition of § 104 of the new Uniform Principal and Income Act, Maryland law provides a trustee with a partial potential remedy to this sort of situation. E&T Art. §§ 15-502.1-15-502.3.

4.0. Powers of Appointment.

4.1. The Maryland "General" Power.

Maryland has a unique rule that holds that a "general" power of appointment is not really a general power of appointment unless it specifically provides that the donee of the power may appoint to his or her self, creditors, or the creditors of his or her estate. Merely stating that one is granting a "general power of appointment" is insufficient. Bryan v. U.S., 286 Md. 176 (1979) (a power designated "a general power of testamentary disposition" was held not to be a power to appoint to self, creditors, estate or creditors of estate and therefore did not qualify as a general power of appointment marital trust); Pierport v. Comm'n, 336 F. 2d 277 (1964) (no marital deduction under IRC § 2056); but see Guiney v. U.S., 425 F. 2d 145 (1970) (holding that a "general power of appointment" qualified for § 2056 treatment where the Will specifically stated it was a "general power" in order to qualify for the federal marital deduction).

Therefore, in order to create a general power of appointment in Maryland, the donor of the power must specify that the donee may appoint to his or her self, estate, creditors or creditors of his or her estate.

4.2. Creditors and Limited Powers of Appointment.

As a general rule, creditors of the donee of a limited or special power of appointment cannot reach the property. In Mercantile Trust Co. v. Bergdorf & Goodman Co., 167 Md. 158 (1934), a woman created a self settled trust and retained an income interest for life and retained a testamentary power of appointment to heirs. In the absence of a showing of fraud in the inception of the trust, creditors had no recourse against the principal of the trust. In U.S. v. Baldwin, 283 Md. 586 (1978), a settlor retained income for life, could name himself as trustee, and retained a broad (but not general) testamentary power of appointment. The Court held that the principal was beyond the reach of creditors (including the U.S. as creditor based on income tax liability.)

4.3. Creditors and General Powers of Appointment.

The Maryland rule as to *inter vivos* general powers of appointment seems to be that a credit may force exercise. In Brent v. State Cent. Collection Unit, 311 Md. 626 (1988), a beneficiary was given the power to withdraw from her father's spendthrift trust certain percentage amounts of the trust at certain ages (1/2 at age 35, the remainder at age 40). Before reaching these ages, the beneficiary became permanently disabled and unable to direct the trustee to make the distributions. The Court held that regardless of her ability to withdraw funds, the power to withdraw took those funds out of the spendthrift protection and exposed the funds to creditor attachment.[9]

The rule regarding testamentary powers of appointment seems to be very different. In U.S. v. Field, 255 U.S. 257 (1921), the Court held that the existence of the power does not shift the subject property to the donee. If the donee exercises the power, however, then the exercise to someone other than the creditor is deemed a fraudulent conveyance:

> "Where the donee dies indebted, having executed the power in favor of volunteers, the appointed property is treated as equitable, not legal, assets of his estate; *Clapp v. Ingrahm, 126 Massachusetts, 200, 203; Patterson & Co. v. Lawrence, 83 Georgia, 703, 707;* and (in the absence of statute), if it passes to the executor at all, it does so not by virtue of his office but as a matter of convenience and because he represents the rights of creditors. *O'Grady v. Wilmot* [1916] 2 A.C.

[9] Interestingly, the Court held that the beneficiary's competence could have been made a condition precedent of her withdrawal right: "As the Court of Special Appeals indicated, the settlor in the case *sub judice* used no words which even intimated that the distribution of the principal upon demand be deferred for any reason. He showed no interest whatsoever in the preservation of the corpus intact upon demand to distribute it. He did not see fit to direct postponement of the distribution of the principal in the unhappy event of the legal disability of the beneficiary. *See La Salle Nat. Bank v. MacDonald*, 2 Ill.2d 581, 119 N.E.2d 266. Had the settlor intended to these ends, he could have easily so provided in the agreement." Brent, *supra*. at 640-641.

231, 248-257; *Smith v. Garey, 2 Dev. & Bat. Eq. (N.C.) 42, 49; Olney v. Balch, 154 Massachusetts, 318, 322; Emmons v. Shaw, 171 Massachusetts, 410, 411; Hill v. Treasurer, 229 Massachusetts, 474, 477.*

Where the power is executed, creditors of the donee can lay claim to the appointed estate only to the extent that the donee's own estate is insufficient to satisfy their demands. *Patterson & Co. v. Lawrence, 83 Georgia, 703, 708; Walker v. Treasurer, 221, Massachusetts, 600, 602-603; Shattuck v. Burrage, 229 Massachusetts, 448, 452.*

It is settled that (in the absence of statute) creditors have no redress in case of a failure to execute the power."

The rule has been repeated (and, perhaps expanded, albeit in dicta) in various Maryland decisions. See, for example, Frank v. Frank, 253 Md. 413 (1969):

"In *Connor v. O'Hara, 188 Md. 527*, in holding that for purposes of the Maryland inheritance tax laws, property passing by exercise of a testamentary power of appointment is regarded as passing not from the donee of the power but from the donor, Judge Markell, for the Court, said that this theory of passage not only is as fully applicable in Maryland as elsewhere but has been carried further here than in many other jurisdictions, and continued:

"In England, and generally but not universally in this country, this rule is qualified by a rule that when a general power of appointment is exercised, equity will regard the property appointed as part of the donee's assets for the payment of his creditors in preference to the claims of his voluntary appointees. In such cases the appointed property is treated as equitable, not legal, assets of the donee's estate, and may pass to the executor, not by virtue of his office but as a matter of convenience and because he represents the rights of creditors. *United States v. Field, 1921, 255 U.S. 257, 262, 263, 41 S. Ct. 256, 65 L. Ed. 617, 18 A.L.R. 1461*. In Maryland this English rule has been rejected. Decisions of dicta of this court indicate that a donee has no power (unless expressly conferred) to appoint for payment of his own debts. *Balls v. Dampman, 69 Md. 390, 16 A. 16, 1 L.R.A. 545; Price v. Cherbonnier, 103 Md. 107, 110, 111, 63 A. 209; cf. Wyeth v. Safe Deposit & Trust Co., 176 Md. 369, 376, 4 A. 2d 753;* appointed property is not part of the donee's estate, not subject to the jurisdiction of the Orphans' Court, and not subject to payment of the donee's debts. *Prince de Bearn v. Winans, 111 Md. 434, 472, 74 A. 626." [188 Md. At 530-531]*"

Indeed, the Conner decision continued to reference O'Hare v. O'Hare, 185 Md. 321 for the proposition that a donee of a testamentary power could not during his life bind himself by contract as to the exercise of the power and that the subject matter of the power was not the donee's property but that of the donor. Connor did not involve a creditor claiming against the donee of a power so its pronouncements are dicta. It is not fully clear which English rule has been rejected by Maryland but the passage strongly suggests that it is the rule pertaining to exercised powers. It may, however, merely be a reference to the restrictive nature of a Maryland general power of appointment without explicit authority to appoint to creditors, etc. See Rolling-Tarbox, "Powers of Appointment Under the Bankruptcy Code: A Focus on General Testamentary Powers," 72 Iowa L. Rev. 1041 (1987) (a discussion of the potential inclusion of a general power in the bankruptcy estate. Even if included, the court should not have the authority to trigger exercise absent a specific statute under state law authorizing same).

5.0. Exculpatory Clauses.

5.1. Validity in general. The Court of Appeals "has held that exculpatory clauses are valid, and will be enforced according to their tenor, with certain limitations." Attorney Grievance Comm'n v. Owrutsky, 322 Md. 334, 350 (1991) (Citing Sullivan v. Mosner, 266 Md. 479 (1972)).

5.1.1. In Helman v. Mendelson, 138 Md. App. 29, 37 (2001), the Court recognized that an exculpatory clause is a restriction on the rights of beneficiaries in favor of the trustee: "Although Alfred did not specifically authorize loans to trustees who were also beneficiaries of the trust, he explicitly elevated the beneficiaries' interests over the rules governing trust investment by the exculpatory provision of the trust. This form of exculpatory clause is designed to protect the trustees who act in the interests of the beneficiaries when that act may be contrary to the law of trust governing certain types of investment. In Maryland, exculpatory clauses are generally deemed to be valid and enforceable."

5.1.2. An exculpatory clause limits a fiduciaries personal liability: “Exculpatory clauses are different from provisions in a will that enlarge upon the general powers of a personal representative … For example, a testator may wish to authorize a personal representative or a testamentary trustee to invest in securities that might be too risky to qualify under the “prudent person” rule … Such a clause would enlarge the powers of the personal representative beyond those specified by statute and thereby prevent the exercise of such powers from resulting in a breach of fiduciary duty. In contrast, an exculpatory clause relieves a personal representative from breaches of duty, however narrowly or broadly defined.” Godette v. Estate of Cox, 592 A.2d 1028, 1033 in Note 11 (D.C. App. 1991).

5.2. Limits to exculpatory clauses. There are limits on exculpatory clauses: "There are circumstances, however, under which the public interest will not permit an exculpatory clause in a contract; these have often been grouped into three general exceptions to the rule. First, a party will not be permitted to excuse its liability for intentional harms or for the more extreme forms of negligence, i.e., reckless, wanton, or gross. *Winterstein*, 16 Md. App. At 136, 293 A.2d at 824; Restatement, Second, Contracts § 195(1); Keeton, *supra*. Second, the contract cannot be the product of grossly unequal bargaining power. 'When one party is at such an obvious disadvantage in bargaining power that the effect of the contract is to put him at the mercy of the other's negligence, the agreement is void as against public policy.' *Winterstein*, 16 Md. App. At 135-36, 293 A.2d at 824; Keeton, *supra*. Third, public policy will not permit exculpatory agreements in transactions affecting the public interest. *Winterstein*, 16 Md. App. 136, 293 A.2d at 824. The last category includes the performance of a public service obligation, e.g., public utilities, common carriers, innkeepers, and public warehousemen. It also includes these transactions, not readily susceptible to definition or broad categorization, that are so important to the public good that an exculpatory clause would be 'patently offensive,' such that 'the common sense of the entire community would … pronounce it' invalid." *Md. Nat'l Cap. P. & P. v. Wash. Nat'l Arena*, 282 Md. 588, 606, 386 A.2d 1216, 1228 (1978), quoting *Estate of Woods, Weeks & Co.,* 52 Md. 520, 536 (1879). This standard is a strict one, in keeping with our general reluctance to invoke the nebulous public interest to disturb private contracts."

Wolf v. Ford, 335 Md. 525, 531-532 (1994).

5.2.1. Whether an exculpatory clause will protect the scrivener/attorney/fiduciary is highly problematic: "The legal profession, with its ability to influence all aspects of citizens' lives, public and private, cannot be separated from the concept of ordered liberty. Thus, the attorney-client relationship is one that is so affected with public interest that generally an attorney cannot require a client to release him or her from liability for future negligence. *See* Rule 1.8(h) of the Rules of Professional Conduct." Wolf, *supra*. at footnote 6.