

PROBATE LAW JOURNAL OF OHIO

JULY/AUGUST 2016 | VOLUME 26 | ISSUE 6

EDITOR'S MESSAGE

The General Assembly is now in recess until fall. There are three bills of interest to PLJO that appear to be on track for enactment then:

SB 165, the MOLST (medical order life sustaining treatment) bill has passed the Senate and awaits House action

SB 232, effect of divorce on TOD real estate and inheritance through artificial reproduction technology, has passed the Senate, has been reported out by the House Judiciary Committee and awaits House floor action

HB 432, the omnibus T&E bill, has passed the House and awaits Senate action

For further details see the Legislative Scorecard.

CORRIGAN V. TESTA AND AVOIDING OHIO INCOME TAX ON SOURCE INCOME

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Despite a clear Ohio statute that would have taxed the sale of an LLC interest by a non-resident where the LLC conducted an Ohio-situated business, the Ohio Supreme Court in *Corrigan v. Testa* unanimously held that Ohio's statute as applied against the non-resident owner violated the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution.

The immediate impact of the decision is to encourage out of state residents to invest in Ohio businesses without fear of Ohio income tax on the capital gain upon sale, if structured correctly. Conversely, it may encourage Ohio residents to either move to a lower tax state or transfer any large gain-producing entities to non-resident non-grantor trusts prior to sale, even where the entity conducts business or owns assets primarily in Ohio.

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²⁶Id. Section 9.

²⁷Id. Section 10.

²⁸Id. Section 4 & Section 5.

²⁹Id.

³⁰Id.

³¹Copy of the final version available from <http://netchoice.org/library/privacy-expectation-after-life-choices-act-peace/>.

A COMPARISON OF THE KENTUCKY TRUST CODE AND THE OHIO TRUST CODE: WHAT YOU NEED TO KNOW BEFORE CROSSING THE RIVER

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Based on a presentation by the author at the Cincinnati Estate Planning Institute on Feb. 19, 2016

As Ohio practitioners, we have been utilizing the provisions of the Ohio Trust Code for nearly ten years. With Kentucky's enactment of the Kentucky Trust Code in 2014, it is tempting to assume that the provisions of the two codes are in fact uniform. However, as each state has enacted the Uniform Trust Code, each state has incorporated its own nuances into its respective trust statutes, and the Commonwealth of Kentucky has continued this trend. This article will highlight several important differences between the Kentucky Trust Code and the Ohio Trust Code that a practitioner should consider when drafting or administering Kentucky trusts or when changing the governing law of a trust from Ohio law to Kentucky law.

The Kentucky Uniform Trust Code ("KYUTC") was effective on July 15, 2014, and it applies to all trusts created on or after the effective date and all judicial proceedings commenced on or after the effective date.¹ The KYUTC also applies to trusts created before the effective date with certain exceptions: (i) the presumption that a trust which does not expressly state that it is irrevocable may be amended or revoked does not apply to trusts created before the effective date² and (ii) the duty to inform and report does not apply to trusteeships accepted or to trusts that became irrevocable before the effective date.³

This article will focus on the substantive differences between KYUTC and the Ohio Uniform Trust Code in the following areas: non-judicial settlement agreements, modification or termination of irrevocable trusts, claims of creditors against revocable trust assets, the trustee's duty to inform and report, the power to direct, distributions upon termination, and applicable statutes of limitation.

NONJUDICIAL SETTLEMENT AGREEMENTS

With the adoption of the KYUTC, the Kentucky legislature created a statutory framework for nonjudicial settlement agreements ("NJSA") in K.R.S. Section 386B.1-090. This section is relatively sparse when compared to the Ohio counterpart provision set forth in Ohio Revised Code Section 5801.10. Under the KYUTC, interested persons may enter into a NJSA with respect to any matter involving a trust, provided that the agreement does not violate a material purpose of the trust and contains provisions that could be properly approved by the court.⁴ The statute sets forth the following non-exclusive list of issues which may be resolved by a NJSA: (i) the interpretation or construction of the terms of the trust; (ii) the approval of a trustee's report or accounting; (iii) direction to a trustee to refrain from performing a particular act or to grant a trustee a necessary or desirable power; (iv) the resignation or appointment of a trustee and the determination of the trustee's compensation; (v) the transfer of a trust's principal place of administration; and (vi) the liability of a trustee for an action relating to the trust.⁵

"Interested persons" are those persons whose consent would be required to achieve a binding settlement were the agreement to be approved by the court.⁶ Accordingly, all beneficiaries (individually or by representation) and the trustee would need to be parties to this agreement. Contrast this with Ohio's private settlement agreement statute which permits any two or more parties to enter into a binding settlement agreement.⁷

Any interested person may ask the court to approve the agreement and to determine whether the representation of the beneficiaries is adequate and that the agreement contains terms that could be properly approved by the court.⁸

MODIFICATION/TERMINATION OF AN IRREVOCABLE TRUST

Like the Ohio Trust Code, the KYUTC contains several alternatives for parties who desire to modify or terminate a trust.⁹ These provisions are very similar to the provisions set forth in the Ohio Trust Code with one major substantive difference. The KYUTC grants the parties the statutory power to terminate an irrevocable trust without the court's involvement.

Kentucky Revised Statutes Section 386B.4-110(1) provides as follows:

Except as otherwise provided by the terms of the trust, a noncharitable irrevocable trust may be modified or terminated upon consent of the settlor and all beneficiaries, without court approval, even if it is inconsistent with a material purpose of the trust.¹⁰

Accordingly, if the settlor is still living and the beneficiaries consent, an irrevocable trust may be modified or terminated without court involvement and without the consent of the trustee. A settlor's power to consent to the modification or termination may also be exercised by an agent under a power of attorney (to the extent authorized in the power of attorney and not prohibited by the trust).¹¹ This section provides a statutory framework for the termination of an irrevocable life insurance trust that is no longer needed for estate tax purposes.

CLAIMS OF CREDITORS

An important change to Kentucky's common law occurred with the enactment of K.R.S. Section 386B.5-040. This provision allows creditors of a decedent's estate to reach assets held in the decedent's revocable trust. After the settlor's death, to the extent that the settlor's probate estate is insufficient, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of a settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children.¹² When Ohio enacted the Uniform Trust Code, this provision was not incorporated into Ohio's Trust Code.¹³

Based upon this change to Kentucky law, trustees of Kentucky trusts should postpone distribution

of trust assets until the creditor's claims period has passed.¹⁴

DUTY TO INFORM AND REPORT

The KYUTC statute governing the trustee's duty to inform and report broadens the scope of the trustee's duty by requiring the trustee to provide information to all qualified beneficiaries and not just current beneficiaries, but the statute also allows the trust instrument to curtail the beneficiary's rights to information.¹⁵ Kentucky Revised Statutes Section 386B.8-130 contains the expected directions to the trustee with respect to keeping the beneficiaries reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests, but it is important to note that these directions are subject to the following qualifying language: "*Except as otherwise provided in the terms of the trust.*"¹⁶ Despite this language, the KYUTC does not permit the trust instrument to completely abrogate the trustee's duty to inform and report to the beneficiaries. Regardless of the terms of the trust, the trustee shall have a duty to notify and to report to at least one qualified beneficiary of an irrevocable trust who has attained age 25, or a designated person having a fiduciary relationship to the qualified beneficiary, of the existence of the trust, of the identity of the trustee, and of his or her right to request trustee's reports.¹⁷ If the trust directs the trustee not to notify any beneficiaries, the trustee may still designate a qualified beneficiary or person having a fiduciary relationship with a qualified beneficiary to notify and report to and the trustee shall not be subject to liability for breach of trust for such action.¹⁸

This ability to limit the information that must be provided to beneficiaries may appeal to many settlors, but the long statute of limitations period applicable to actions of a trustee that are not disclosed to the beneficiaries may make trustees unwilling to accept trusts which incorporate these provisions.

POWER TO DIRECT

In many trust agreements, third party decision makers, such as trust protectors, investment advisors, and distribution advisors, are granted the

power to direct certain actions of the trustee. Kentucky and Ohio have adopted a provision governing these third parties' powers to direct the trustee, but the two states have taken opposite approaches to the ongoing responsibilities of the trustee. Both states presume that a person who holds the power to direct the trustee is a fiduciary who is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries.¹⁹ In Kentucky, if the terms of a trust confer upon a third party the power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.²⁰ Kentucky law requires the trustee to oversee and monitor the actions of a third party fiduciary in order to prevent a breach of trust. In Ohio, a trustee is not liable for losses resulting from actions or failures to act when other persons are granted certain powers with respect to the administration of the trust.²¹ Under Ohio law, the trustee is not required to oversee and monitor the actions of the third party and has no responsibility for such third party's actions.

DISTRIBUTIONS UPON TERMINATION

The KYUTC contains two provisions regarding distributions upon termination of a trust. The first provision, K.R.S. § 386B.8-170, is similar to O.R.C. § 5808.17 and provides that a trustee may send a distribution proposal to the beneficiaries of the trust, and the beneficiary's right to object to the proposed distribution terminates if the beneficiary does not notify the trustee of the objection within 30 days.

The second provision, K.R.S. § 386B.8-180, allows the trustee to accelerate the limitations periods for contesting the validity of a revocable trust and for actions against a trustee. In order to accelerate these limitations periods, the trustee must provide a statement to the qualified beneficiaries showing the fair market value of the net assets to be distributed, a trust accounting for the prior five years, an estimate of any items reasonably anticipated but not yet received or disbursed,

the amount of any fees remaining to be paid, and notice that the trust is terminating.²² This notice must clearly warn the beneficiary of the impending bar of claims that will result if an objection is not timely made.²³ The trustee shall distribute the trust assets within 45 days after sending the trust information and notice unless within such time the trustee receives a written objection from a person receiving notice.²⁴ If the trustee receives an objection, then the trustee may file an accounting with the court or the trustee may enter into a nonjudicial settlement agreement with the beneficiary and charge the expenses of such accounting or agreement to the trust.²⁵ If no objections are made, each person who received notice and either consented or failed to object is barred from bringing a claim against the trustee for breach of trust or challenging the validity of the trust to the same extent and with the same effect as if the court had entered a final order approving the trustee's final account.²⁶ This provision grants Kentucky trustees confidence regarding the cessation of their potential liability without the cost and publicity of a court accounting.

STATUTES OF LIMITATION

Kentucky law provides for shorter statute of limitations periods than Ohio law when the beneficiary receives notice of the relevant action. In Kentucky, an action to contest the validity of a trust that was revocable at the Settlor's death must be brought within the earlier of: (i) two years after the settlor's death or (ii) *ninety days* after the trustee sent the person a copy of the trust instrument, notice of the trust's existence, of the trustee's name and address, and the time for commencing a proceeding.²⁷ In Ohio, the action must be brought within the earlier of (i) two years after the settlor's death or (ii) *six months* from the date on which the trustee sends the trust document and other required information.²⁸

In Kentucky, a beneficiary may not commence an action against a trustee for breach of trust more than *one year* after the date the beneficiary was sent a report that adequately disclosed the existence of a potential claim and informed the beneficiary of the time allowed for commencing a claim.²⁹ In Ohio, the beneficiary has *two years* in which to bring this type of claim.³⁰

For any actions of the trustee which are not disclosed in a report as described above, in Kentucky the beneficiary must commence the proceeding against the trustee within *5 years after the discovery* of an injury by a trustee to the rights of the beneficiary.³¹ In contrast, Ohio law requires a judicial proceeding against a trustee for breach of trust for an action not disclosed in a report to the beneficiary to be brought within *four years after the first to occur* of (i) the removal, resignation or death of the trustee, (ii) the termination of the beneficiary's interest in the trust; (iii) the termination of the trust; or (iv) the time at which the beneficiary knew or should have known of the breach of the trust.

CONCLUSION

As explained above, there are many important substantive differences between the Uniform Trust Code as adopted in Ohio and in Kentucky. These differences should be reviewed and considered before drafting or administering a Kentucky trust or when changing the law that will govern your client's trust.

ENDNOTES:

¹K.R.S. § 386B.11-040.

²K.R.S. § 386B.6-020.

³K.R.S. § 386B.8-130.

⁴K.R.S. § 386B.1-090.

⁵Id.

⁶Id.

⁷O.R.C. § 5801.10.

⁸K.R.S. § 386B.1-090.

⁹See K.R.S. Chapter 386B, subchapter 4.

¹⁰K.R.S. § 386B.4-110(1).

¹¹Id. Further, the settlor's conservator or guardian may consent on the settlor's behalf, but only after obtaining the court's approval. Id.

¹²K.R.S. § 386B.5-040.

¹³See. O.R.C. § 5805.06.

¹⁴Generally, claims against a decedent's estate which arose before the death of the decedent are barred unless presented within six months after the appointment of the personal representative or, where no personal representative has been appointed, within two (2) years after the decedent's

death. K.R.S. § 396.011.

¹⁵K.R.S. § 386B.8-130. Unlike the Ohio Trust Code, the KYUTC does not include a definition for current beneficiaries. See K.R.S. § 386B.1-010.

¹⁶K.R.S. § 386B.8-130. Except as otherwise provided in the terms of the trust, the trustee shall (i) notify the qualified beneficiaries of the trustee's acceptance and of the trustee's contact information, (ii) notify the qualified beneficiaries of an irrevocable trust of the trust's existence, the identity of the settlor, the right to request a copy of the trust, and of the right to a trustee's report; and (iii) notify the qualified beneficiaries of any change in the method or rate of the trustee's compensation. Further, except as otherwise provided in the terms of the trust, the trustee, upon request, shall (i) furnish a copy of the trust instrument; and (ii) send, at least annually and at the termination of the trust, a report of the trust property, liabilities, receipts, and disbursements, a listing of the trust assets and, if possible, their respective market values. Id.

¹⁷Id.

¹⁸Id.

¹⁹K.R.S. § 386B.8-080 and O.R.C. § 5808.08.

²⁰K.R.S. § 386B.8-080.

²¹O.R.C. § 5808.08.

²²K.R.S. § 386B.8-180.

²³Id.

²⁴Id.

²⁵Id.

²⁶Id.

²⁷K.R.S. § 386B.6-040. But see K.R.S. § 386B.8-180

²⁸O.R.C. § 5806.04.

²⁹K.R.S. § 386B.10-050.

³⁰O.R.C. § 5810.05.

³¹K.R.S. § 386B.10-050.

OHIO CREDITORS' CLAIMS IN THE CONTEXT OF PROBATE AND NON-PROBATE TRANSFERS

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This article relates to a continuing legal education presentation by the author at the Ohio State Bar Association convention in Cincinnati on April 29, 2016.

INTRODUCTION

Ohio law is not without its quirks when it comes to the enforcement of creditors' claims. Estate plan-