Just Say No to Overbroad Trust and Estate Waivers: Part II

BY REYNOLDS T. CAFFERATA AND CATHERINE ANNE KARAYAN

Protect your rights.

Step-by-Step Protecting Your Rights

Beneficiaries can protect themselves from overbroad waiver with the following steps:

1. Review the information provided by the fiduciary to see if there is any reason for concern.
2. Review waivers and edit forms so that they do not provide fiduciaries with greater protections than they would have with the accounting, including:
   a. Describe or identify the information provided by the fiduciary;
   b. Limit waiver to the acts of the fiduciary disclosed in information provided by the fiduciary;
   c. Limit the indemnity to claims that are not the fault of the fiduciary;
   d. Limit the indemnity to the beneficiary's share of the claim;
   e. Limit the indemnity to amount that the beneficiary received from the estate or trust; and
   f. Eliminate joint and several liability for the indemnity.
3. Send the edited waiver with an explanation of changes back to the fiduciary.
4. Hold firm.
5. If necessary, send a letter to the other beneficiaries to diffuse the peer pressure.
6. When all else fails, let the fiduciary file the accounting.

Editing the Waiver

Generally, the beneficiary should be willing to enter into releases with the following terms:

1. The beneficiary will release the fiduciary for acts that have been disclosed in an accounting or other report that the beneficiary has reviewed.
2. The beneficiary will not release unknown claims.
3. The beneficiary will agree to refund a distribution for the beneficiary's pro-rata share of later discovered lawful liabilities of the fiduciary up to the amount distributed to the beneficiary.
4. The beneficiary will indemnify the fiduciary for the beneficiary's pro-rata share of claims against the fiduciary not due to the fiduciary's negligent or willful acts up to the amount distributed to the beneficiary.
5. The beneficiary will not indemnify for the fiduciary's negligence. In limited circumstances, the beneficiary may accept gross negligence as the standard.

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Revisions to Receipts or Releases

The following are specific revisions that often need to be made to receipts or releases. Common inserts and examples are underlined, and deletions are stricken.

Entity. The receipt may imply that an individual is giving a release when in the case of a charity, an entity is giving the release. The party giving the release should be clearly identified as an entity when the entity is the beneficiary.

Defining the Accounting. The receipt may reference information given to the beneficiary or, in fact, statements or other information were given to the beneficiary. Generally, it is necessary to make sure the receipt has described the documents given to the beneficiary and has a short title such as the "Accounting." Example:

The Trustee has provided the beneficiary with monthly statements of its administration from July 21, 2020, to present (the "Accounting").

Limit any release to actions shown in the Accounting. Release language needs to be edited to remove provisions that imply that the beneficiary is releasing unknown claims and to limit the release to actions disclosed in the accounting. Example:

Beneficiary releases and forever discharges Bank, individually and as

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IRA, this would equate to annual withdrawals from the IRA of approximately $127,000 over the 10-year period, for ages 55-65, which withdrawals will likely be taxed during Sam's peak tax bracket years. What's more, no portion of the IRA receipts will be entitled to the benefit of lower "capital gains" tax rates or to tax-exempt income treatment.

As an alternative to this "direct IRA beneficiary" plan, assume that Sam's parents instead designate a 20-year tax-exempt charitable remainder annuity trust with Sam as beneficiary of their $1 million IRA. Sam's parents structure the trust so that charity will receive, actuarially, the minimum 10 percent of the initial trust assets, which, with 5 percent compound growth, works out to $265,000 in 20 years. Applying the Internal Revenue Service's so-called "Section 7520 rate," which has risen from a low of 0.4 percent in November 2020 to 5 percent for April 2023, Sam will receive an annuity of $72,000 per year, for 20 years (using the April rate). Compare this number to the above-mentioned $127,000 figure Sam would receive each year, for 10 years, as direct beneficiary of the IRA, and remember that the additional annual amount under the direct IRA beneficiary plan, or $55,000, will be received during years when Sam is likely to be in a higher income tax bracket.

By contrast, during the four years (Years 11-14) under the "IRA/charitable remainder trust" alternative, or years when Sam is likely to be retired but not yet required to take benefits under his own IRA and/or 401k plan account at age 75, the $72,000 annuity payments will be taxed as ordinary income. However, this likely will be at much lower income tax rates than the payments during Years 1-10, when Sam was still working. Furthermore, *and if structured properly*, during Years 15-20, also years in which Sam is likely to be retired but not yet required to take benefits under his own IRA or 401k plan account at age 75, the annuity payments to Sam will enjoy the benefits of the lower capital gains income tax rates. And, to the extent the trust invests in tax-exempt securities, the payments may not even be subject to federal income tax.

A Zero-Cost Planned Gift. From the above example, we already know that charity will receive an estimated $265,000 on a $1 million initial value charitable remainder trust when the trust terminates after 20 years. But how do Sam and his spouse fare? The answer depends, in part, on how old Sam is when his parents die. If he is 55 and, along with his spouse, is enjoying the couple's peak earning years, he and his spouse would actually fare somewhat better than if the IRA/charitable remainder trust not been utilized. If Sam is 65 and retired when his parents die, he and his spouse would fare slightly worse than if the IRA/charitable remainder trust not been utilized. This is because the IRA/charitable remainder trust alternative would not be benefiting by partially avoiding the higher income tax rates while Sam is in his peak earning years. If Sam is somewhere in between, say age 60, Sam and his spouse would be in "break-even" territory, i.e., neither profiting nor losing as a consequence of the IRA/charitable remainder trust plan. Despite the fact that Sam basically receives the same after-tax amount under either form of IRA disposition, the charity receives $265,000 at the end of Year 20 under the IRA/charitable remainder trust alternative (assuming 5 percent income tax-free compound growth rate and a 5 percent Section 7520 rate), while it obviously would receive $0 under the direct IRA beneficiary plan. How can this possibly be?

There are at least six reasons. First, approximately 50 percent less money is paid out during the first 10 years after the account owner's death under the IRA/charitable remainder trust plan, years in which the child beneficiary is likely to be in his or her peak income tax brackets. Second, by spreading the income from the IRA over 20 years as opposed to only 10, the income from

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Zero-cost planning.

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trustee of the Trust, and its employees, officers, directors, shareholders, attorneys, agents, predecessors, successors and assigns, from and against any and all claims, damages, liabilities, losses, and expenses of any kind, in connection with the administration of the Trust, with respect to Bank's acts and transactions and Bank's omissions, if any, from any and all claims~~, known or unknown, suspected or unsuspected~~, which Beneficiary may have for those acts or omissions of Bank disclosed in the Accounting, and hereby discharges Bank as trustee of the Trust for all acts and omissions disclosed in the Accounting upon distribution of the Distribution to Beneficiary.

Consider key terms.

Limit Indemnity to Pro Rata Share, Distribution Amount and to Lawful Claims. Indemnity and refunding terms should be limited to the beneficiary's prorated share of the liability and to the amount that the beneficiary received from the trust or estate. Example:

Beneficiary further agrees, to the extent of the Distribution, ~~jointly and severally with the other Beneficiaries,~~ to indemnify, exonerate and hold harmless Bank, individually and as trustee of the Trust, and its employees, officers, directors, shareholders, attorneys, agents, predecessors, successors, and assigns, from and against any and all taxes, expenses, liabilities, losses, claims, demands, or charges of any kind or nature whatsoever, which Bank may at any time have incurred, or which at any time may be asserted by anyone against it in consequence of its administration of the Trust that is not due to the negligence or willfulness of Bank.

Beneficiary agrees to refund up to the entire amount of the Distribution to Bank (a) to the extent that such distributions may ultimately be determined to have been in excess of the amounts properly distributable to it, (b) to the extent of any additional federal, state, or local tax which may be due by reason of an audit but that are not attributable to Bank's negligence or willfulness, and (c) to the extent necessary to pay the amount of any expense, claim, damage, liability, loss, demand, or charge of any kind or nature whatsoever which may be incurred or which may be payable to Bank because of, in respect of, or in connection with its acts, omissions, transactions, duties, obligations, or responsibilities that are not the result of Bank's negligence or willfulness; provided, however, that Beneficiary's liability pursuant to this paragraph shall not exceed the amount of the Distribution. Further, Beneficiary's obligation to indemnify or refund to Bank shall not exceed the Beneficiary's pro-rata share of the obligation.

Delete Civil Code Section 1542 Waiver. California Civil Code Section 1542 provides that if a party signs a release of claims, the release does not extend to claims that party did know existed. In California, fiduciaries often ask beneficiaries to waive Civil Code Section 1542, which is just another way of asking the beneficiary to waive unknown claims. If the fiduciary's release includes a waiver of Civil Code Section 1542, the waiver should be removed in its entirety. Example:

~~Waiver of Civil Code Section 1542. The Parties acknowledge that their legal counsel have advised them of and they are familiar with the provisions of California Civil Code section 1542. That statute reads as follows:~~

~~"A general release does not extend to claims that the creditor or releasing party does not know or suspect to exist in his or her favor at the time of executing the release and that, if known by him or her, would have materially affected his or her settlement with the debtor or released party."~~

~~The Parties acknowledge that facts, in addition to or different from those which are now known or believed by them to be true, may hereafter be discovered with respect to the subject matter of the Released Claims. The Parties hereby accept and assume the risk that the facts may turn out to be different and agree that the releases given hereunder will remain fully enforceable and not subject to termination or rescission, notwithstanding any such difference in the facts. Each Party hereto waives and relinquishes any and all rights and benefits which he/it presently has or may have or at any time in the future, will or may have under and pursuant to the above statute, and any and all similar provisions contained in the law of any jurisdiction(s), whether within or outside the United States,~~

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~~to the full extent that such Party may lawfully waive such rights with respect to the subject matter of the releases contained in this Agreement.~~

Delete Probate Code Section 16464 Waiver. A waiver of California Probate Code Section 16464 should be deleted in its entirety, or at least with respect to Section 16464(b)(2), relating to undisclosed information. Example:

The Beneficiary expressly waives the benefit of the following portions of subsection (b) of Section 16464 of the California Probate Code~~, which provides as follows~~: "(b) A release or contract is not effective to discharge the trustee's liability for a breach of trust in any of the following circumstances: (1) Where the beneficiary was under an incapacity at the time of making the release or contract; [...] ~~(2) Where the beneficiary did not know of his or her rights and the material facts (a) that the trustee knew or reasonably should have known and (b) that the trustee did not reasonably believe that the beneficiary knew;~~ (3) Where the release or contract of the beneficiary was induced by improper conduct of the trustee; (4) Where the transaction involved a bargain with the trustee that was not fair and reasonable." The Beneficiary, however, does not waive paragraph (2) of subsection (b) of Section 16464 of the California Probate Code.

Delete Penalty of Perjury Declaration Statement. A penalty of perjury declaration statement should be deleted in its entirety or at least modified so that the declaration is limited only to being true and correct to the best of the beneficiary's knowledge. Example:

Beneficiary declares under penalty of perjury under the laws of the State of California that the foregoing is true and correct to the best of Beneficiary's knowledge.

Editor's Note: In Part III in the September issue, a cover letter template to explain the edits will be shared along with additional final recommendations.

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the IRA/charitable remainder trust is likely to be taxed to the child beneficiary in lower marginal income tax brackets, generally. Third, the funds which were not paid out of the charitable remainder trust during the first 10 years after the parents pass have the ability to grow and compound, unreduced by income taxes, inside the tax-exempt IRA/charitable remainder trust, thus increasing the annual annuity amount payable to the child beneficiary. Fourth, the federal income tax rate to the child beneficiary on the last six years' worth of annuity payments (or the years after the initial $1 million deposit has been distributed to the child beneficiary) from the IRA/charitable remainder trust, or 30 percent of the overall payments, can be as low as 0 percent. Fifth, because the IRA/charitable remainder trust is income tax-exempt, the $100,000 (or 10 percent) portion of the initial value of the trust corpus compounds, income tax-free, inside of the trust before it eventually passes to charity, unreduced by income or estate taxes. Finally, because the IRS' Section 7520 rate has risen at least tenfold from its low of 0.4 percent in November of 2020, the permissible annual annuity payable to the children under the IRA/charitable remainder trust has likewise risen.

Impact of 7520 rate.

Each donor's individual financial and family situation, as well as the IRS' Section 7520 rate at the time, will determine the ultimate tax benefits to be derived from the IRA/charitable remainder trust alternative. Donors should therefore consult with their tax advisors before drawing any conclusions regarding the merits of the plan as applied to specific cases. Given today's higher Section 7520 rates, however, the average family will suffer little, if at all, financially by choosing the IRA/charitable remainder trust alternative over the direct IRA beneficiary plan, while the charity will benefit significantly. Donors who have been fortunate enough to accumulate significant taxable IRA and/or 401k plan accounts will therefore want to consider the IRA/charitable remainder trust as part of their overall estate plan.