Kentucky Legislature Enacts Uniform Trust Code: What You Need to Know Now

The Kentucky Legislature recently enacted, and Governor Beshear signed, House Bill 78 (HB 78) ("Kentucky Uniform Trust Code" or "KUTC"), which makes sweeping changes to various Kentucky statutes relating to the creation and administration of trusts in Kentucky. The KUTC contains a number of innovative provisions and also codifies a variety of common law principles found in the trust and estates area of the law. HB 78 was modeled after the Uniform Trust Code, a version of which is currently adopted in 28 states.

Notwithstanding the broad scope of the KUTC, the terms of a particular trust instrument "trump" its statutory provisions, with a few exceptions.

KUTC is effective July 15, 2014, and most of its provisions apply to existing trusts and trusts executed on or after the effective date. Let’s review how some of its more significant provisions could affect you.

1. Non-Judicial Settlement Agreements
"Interested Persons", defined to mean persons whose consent is required to achieve a binding settlement if the settlement was approved by a court, are permitted to enter into a binding non-judicial (i.e., without court approval) settlement agreement with respect to any matter involving a trust, provided the settlement agreement does not violate a material purpose of the trust.

An interested person may request the District Court to approve the settlement.

Examples of matters that can be resolved by a settlement without incurring the cost of a court appearance include, but are not limited to:

- The interpretation of the terms of the trust;
- Approval of a trustee’s accounting;
- Resignation or appointment of a trustee, and determination of a trustee’s compensation;
- Transfer of a trust’s principal place of administration; and
- Liability of a trustee for an action relating to the trust.

2. Modification/Termination of Uneconomic Trust
To avoid the economic inefficiencies associated with administering a small trust, Kentucky law currently allows a trust with assets of less than $50,000 to be terminated and the trust property distributed to the beneficiaries. The KUTC increases
this amount to $100,000.

A trust with less than $100,000 of assets may be terminated after giving notice to the “qualified beneficiaries”, which generally includes all current permissible income and principal beneficiaries and the persons who receive the trust property upon termination of the trust. The District Court has exclusive jurisdiction over this matter.

If you are the beneficiary (or a trustee) of a small trust having a value of $100,000 or less, a beneficiary or the trustee can now petition the District Court to terminate the trust and to distribute the trust assets to the appropriate beneficiary or beneficiaries.

3. Subject-Matter Jurisdiction
Under current law it is not always clear whether a legal proceeding concerning a trust must be brought in District Court or Circuit Court. The KUTC gives concurrent jurisdiction to the District Court and the Circuit Court, which means that the matter may be brought in either jurisdiction.

If a proceeding is initially brought in District Court, District Court will have exclusive jurisdiction unless within 20 days of receiving notice of the proceeding, a party files an action in Circuit Court relating to the same trust matter, in which event the Circuit Court will have exclusive jurisdiction over the matter.

4. Trust for Care of Animals
Currently, a trust may not be created in Kentucky without a human beneficiary – i.e., a trust for a pet is not permitted.

The KUTC explicitly permits a trust to be created for the care of an animal alive during the lifetime of the person creating the trust (a “Pet Trust”). The Pet Trust terminates at the death of the animal, or if the Pet Trust was created for multiple animals, at the death of the last surviving animal.

A Pet Trust for an animal may be enforced by a person appointed in the trust instrument. If no appointment is made, a person having an interest in the animal's welfare can ask the District Court to appoint (or remove) a person to enforce the trust.

5. Modification/Reformation/Termination of a Trust
The KUTC contains a series of interrelated rules on when a trust may be terminated, reformed or modified other than by its own terms. The goal is to provide flexibility while preserving the settlor’s intention.

In addition to the termination or modification of small trusts described above, under the KUTC the District Court may modify, reform or terminate a trust for the following reason:

- The modification will further the purpose of the trust due to circumstances not anticipated by the settlor. The District Court may also modify the administrative terms of a trust if continuation of the trust under the existing terms would be impracticable or wasteful.
- The court may reform the terms of a trust, even if unambiguous, to correct a mistake to conform to the settlor’s intention. The settlor’s intention must be proved by clear and convincing evidence.
- The District Court may reform the terms of a trust to achieve the settlor’s tax objectives, and this modification can be retroactive. Qualifying for a charitable deduction for estate, gift or income tax purposes where there is a technical flaw in the terms of the trust is an example of when this provision could be used. But whether a modification under this
provision in the KUTC will be recognized by the IRS is a matter of Federal law.

6. Combination and Division of Trusts
It’s not uncommon for the goals and objectives of multiple beneficiaries of a single trust to diverge years after the trust was created. The KUTC adds flexibility to this situation and authorizes the District Court to divide a trust into two or more separate trusts if the division does not impair the rights of any beneficiary or affect the purposes of the trust.

Prior notice must be given to all qualified beneficiaries. A division of a single trust is to be made on a fractional basis and the new, separate trusts may be funded by a non-pro rata distribution of assets from the single trust.

Similarly, a person may be the beneficiary of more than one trust with similar terms, perhaps created by different persons (e.g., parents). To eliminate the administrative inconvenience and added cost of maintaining multiple trusts, the KUTC allows the District Court to combine the two (or more) trusts into a single trust after notice to the qualified beneficiaries.

7. Creditor’s Claims Against Settlor
During a settlor’s lifetime, property titled to a revocable trust is subject to the claims of the settlor’s creditors under Kentucky law.

Many of our clients utilize a “pour over” will in connection with a revocable trust in their estate planning, which means that the terms of the will direct the probate assets in the estate to the trustee of the revocable trust, to be disposed of in accordance with its private terms.

When the settlor’s revocable trust becomes irrevocable at the settlor’s death, to what extent are the assets in the then irrevocable trust subject to creditor claims? After the death of a settlor, the KUTC provides that property held in a revocable trust is subject to the settlor’s creditors, costs of administration of the settlor’s estate, settlor’s funeral expenses, and statutory allowances to the surviving spouse and children to the extent the settlor’s probate estate is inadequate to satisfy these claims.

However, no property added to a revocable trust from a source other than the settlor’s estate (i.e., life insurance or retirement accounts by beneficiary designation) is subject to these claims.

A creditor of a settlor of an irrevocable trust may only reach the maximum amount that could be distributed by the trustee to or for the settlor’s benefit.

8. Limitation on Action Contesting Validity of a Revocable Trust
A person wishing to contest the validity of a trust that was revocable at the settlor’s death must initiate a judicial proceeding no later than the earlier of (1) two years after the settlor’s death or (2) ninety days after the trustee sent the person a copy of the trust and notice informing the person of the trust’s existence, the trustee’s name and address and the time allowed for commencing a proceeding.

A trustee is not liable for distributing property from a revocable trust following the death of a settlor pursuant to the terms of the trust instrument unless the trustee is aware of a pending judicial proceeding to contest the validity of the trust, or the trustee has been notified that someone intends to file such proceeding and it’s actually filed within 60 days of such notice.
9. Distribution of Assets Upon Termination
A trustee may send beneficiaries a proposed distribution upon the termination of a trust, and a beneficiary may not object to the distribution if the beneficiary does not do so within 30 days after the proposal was sent. This addresses the situation where a trustee is reluctant to make a distribution until the beneficiary approves but the beneficiary is reluctant to approve until the assets are in hand.

10. Limitation of Action Against a Trustee
A beneficiary has one year to commence a claim against a trustee for a breach of trust if a beneficiary is given a report that adequately discloses the existence of a potential claim and the beneficiary is informed of the deadline to bring a claim.

If a timely report is not given to a beneficiary with the required information, a beneficiary must make the claim within five years after the first to occur of (i) removal, resignation or death of a trustee, (2) the termination of a beneficiary’s interest in the trust or (iii) the termination of the trust.

11. Certification of Trust
A trustee is sometimes asked to provide a copy of the trust agreement to a third party non-beneficiary, such as when the trustee of an irrevocable trust opens a bank or investment account.

The settlor of such a trust sometimes objects to “making public” the private terms of the trust instrument. Under the KUTC, a trustee is permitted to provide a “certification of trust” to such a third party in lieu of providing the actual trust instrument.

The statute lists certain information that must be contained in the certification, but the dispositive terms of the trust are not required to be disclosed. This provides an extra layer of privacy for a beneficiary when a third party requests a copy of a trust.

A third party is permitted to act in reliance on the certification, and the third party will not be held liable for its actions as long as the third party did not know that a representation in the certification was false. If a third party makes a demand for the trust instrument in addition to a certification, the third party will be held liable for damages (not defined in the KUTC) if the District Court determines the third party was not acting in good faith when demanding the trust instrument.

12. Trustee Investment Standard
There is no longer a separate fiduciary standard for an individual trustee and a corporate trustee. All trustees are now held to the same prudent investor standard, which is the standard currently applicable to corporate fiduciaries found in Section 286.3-277 of the Kentucky Revised Statutes.

A trustee must act as a prudent investor in light of the circumstances, terms and distribution requirements of the trust and exercising reasonable skill, care and caution.

13. Trust Registration
Under current law, a trust created under a Will (a “testamentary trust”) is subject to judicial supervision (e.g., periodic accountings) and requires court approval to appoint a trustee. The KUTC provides that a trust is not subject to continuing judicial supervision unless ordered by a court, and no registration of a trust is required unless the trust instrument specifically provides for registration.
If you are a settlor, trustee or a beneficiary of a trust, the KUTC contains provisions that could have a significant impact on your duties, responsibilities and/or rights with respect to the trust. For those of our readers who have not considered the use of a trust in their estate planning, the KUTC adds an unprecedented degree of flexibility to their use in Kentucky.

14. Delegation by Trustee
The KUTC permits trustees to delegate various aspects of trust administration to agents (e.g., an investment advisor, real estate manager), subject to certain standards of care.

A trustee is permitted to delegate to an agent and to establish the scope of the delegation as long as the trustee uses reasonable care, skill and caution. The delegated duty must be one a prudent trustee of comparable skill could delegate under the circumstances. An agent must exercise reasonable care to comply with the delegation, and a trustee who complies with the above standard is not liable to the beneficiary for an action by an agent.

15. Virtual Representation by Persons Having Substantially Identical Interests
The KUTC permits a minor, incapacitated beneficiary, unborn individual or person whose identity is unknown to be represented by someone having a substantially identical interest in the dispute as long as there is no conflict of interest between the representative and person whose interest is being represented.

This would permit, for example, an adult child who is a beneficiary of a trust created by the child’s parent to represent the child’s minor siblings in a matter involving trust distributions where the trust provides for distribution to the settlor’s children as a class.

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