

Trust Terminations: Settling Accounts & Fiduciary Release

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In the most simple of terms, individuals, referred to as settlors, establish trusts to protect the settlor's property. A trustee who accepts property, subject to a trust, accepts the duty and responsibility to administer and protect the property according to the terms the settlor instructed in the trust instrument.¹ The trustee's fiduciary duty to protect the trust property creates risks of liability for breach of trust during the term of the trust and for generally up to three years following the trust's termination.

Indiana's Trust Code allows trustees to settle all risks and liabilities with respect to its administration of the trust prior to making final distribution of the trust's property. The kinds of risks and liabilities a trustee would want to settle include allegations of breach of trust that cause a loss or depreciation to the value of the trust property, or a breach that allows the trustee to generate a profit outside the trust.² A trustee may also be liability for the beneficiary's reasonable attorney fees incurred in bringing an successful action.³ This article will discuss how a trustee can obtain settlement of all these potential liability risks at the time the trust is terminated and trust property finally distributed.

Trusts Generally

The written trust document⁴ is the settlor's instructions to the trustee on how the trustee is to hold, distribute and care for and protect the property held in trust. Through the trust instrument, the settlor tells the trustee how long the property is to be held in trust, how *income* generated on the trust property is to be distributed and to whom, when and to whom trust *principal* is to be distributed and who receives the trust property upon termination of the trust. The settlor may also alter trustee's duties and responsibilities, as outlined in Indiana's Trust Code, including such matters as changing the trustee's investment duties, reporting duties and provide limitations on the trustee's liability to the trust's beneficiaries. When the trust is silent on certain fiduciary duties, Indiana's Trust Code completes the gaps to impose statutory duties on the trustee.

When the trust is silent, the trustee has statutorily imposed fiduciary duties, including:

- The duty to take control of property, and preserve and make the trust property productive for both the income and remainder beneficiary⁵

¹ Ind. Code §30-4-3-6(a)

² Ind. Code 30-4-3-11(b)

³ *Id.*

⁴ Indiana requires that trusts be in writing bearing the settlor's signature; *see* Ind. Code §30-4-2-1(a).

⁵ Ind. Code 30-4-3-6(b)(1)-(4), although the trust's terms may alter the investment standards.

- The duty to keep the trust property separate from the trustee's individual property as well as from property subject to another trust⁶
- The duty to maintain clear and accurate accounts of the trust's principal and income⁷
- The duty to give the beneficiary complete and accurate information concerning any matter relating the trust's administration, and allow the beneficiary, or the beneficiary's agent the right to inspect trust property, accounts and other documents concerning the trust's administration upon the beneficiary's reasonable request⁸
- The duty to take any reasonable action to realize on claims that are part of trust property⁹
- The duty to defend actions involving the trust estate¹⁰
- The duty to supervise anyone to whom authority has been delegated¹¹
- The duty to determine the trust beneficiaries¹²

Statute of limitations upon trust termination

Indiana's Trust Code has a three year statute of limitations for a breach of trust, provided the beneficiary has received a final account or other statement fully disclosing the matter and showing a termination of the trust relationship between the trustee and the beneficiary.¹³ However, this three year statute of limitations for a beneficiary to commence a breach of trust against a trustee can be barred by previous adjudication, *consent* or limitation".¹⁴

All Persons Interested in the Trust

The first inquiry is determining all those possible persons who have an interest in the trust at the time of the trust's termination. This includes determining all those persons who would have any right of action against the trustee, now or in the future, for its administration of the trust. This is usually a straightforward exercise when a trust terminates according to its terms.

Consider, for instance, a trust that provides all income distributed to X for life, with all the rest and remainder of trust property distributed outright to X's descendants, *per stirpes*, following X's death. At the time of X's death, X is survived by two children, A and B, and one

⁶ Ind. Code 30-4-3-6(b)(5)

⁷ Ind. Code 30-4-3-6(b)(6)

⁸ Ind. Code 30-4-3-6(b)(7)

⁹ Ind. Code 30-4-3-6(b)(8)

¹⁰ Ind. Code 30-4-3-6(b)(9)

¹¹ Ind. Code 30-4-3-6(b)(10)

¹² Ind. Code 30-4-3-6(b)(11)

¹³ Ind. Code §30-4-6-12.

¹⁴ *Id.* (*emphasis added*).

child, C, predeceased X, leaving two children, D and E, a minor, who survived X. All the persons interested in the trust would be: X, deceased, A, B, D and E, a minor. Because two of the persons interested in the trust are incapacitated or deceased, X, deceased and E, a minor, a representative with authority to bind their interests are necessary.

Virtual Representation

Indiana's Trust Code provides rules regarding who can represent another in a trust matter, unless the terms of the trust provide otherwise.¹⁵ Barring a conflict between the representative and the person represented, the following persons can represent and bind a person interested in the trust:

- A guardian for a person protected under the guardianship
- An attorney-in-fact with authority to act for the principal
- A trustee for the trust's beneficiaries
- A personal representative of a decedent's estate for those interested in the estate
- A parent for the parent's minor, unborn or not yet adopted child

In addition, holders of a general power of appointment over trust property, including testamentary powers, may represent and bind all persons whose interest are subject to the holder's power.¹⁶ And unless otherwise represented, a person with a substantially identical interest with respect to the trust property and provided there is no conflict, can represent a minor, an incapacitated person, an unborn or not yet adopted child or a person whose identity is unknown and not reasonably ascertainable.¹⁷ In the event that this leaves any interest unrepresented or such representation is inadequate, the court may appoint a guardian ad litem to receive notice, give consent and otherwise bind such persons.¹⁸

When a trust is terminating according to its terms, determining all interested persons is usually a straightforward exercise. The event has occurred, being in this case, the income beneficiary's death, at which time you can determine who are the surviving beneficiaries, *per stirpes*. But consider the same situation involving a trust terminating because the value of its property is under \$75,000. With the trust terminating before the end of X's life, settlement of the issues by the current persons interested may be simplified by resorting to the virtual representation rules with careful review of whether a conflict exists between the representative and the person represented.

¹⁵ Ind Code §30-4-6-10.5.

¹⁶ Ind. Code §30-4-6-10.5(b).

¹⁷ Ind. Code §30-4-6-10.5(c).

¹⁸ Ind. Code §30-4-6-10.5(d).

Adequate disclosure

Once all the interested persons in the trust are determined, the next step is to determine what information must be provided to get full settlement on all the trustee's accounts at the time of termination.

A trustee may request a judicial settlement of all its accounts.¹⁹ In its court petition for settlement, the trustee is required to file a verified statement of accounts showing:

- The period covered by the account;
- The total principal which the trustee is chargeable since last account settlement, or if none, the trust's beginning inventory;
- An itemized schedule of all principal cash and property received and disbursed, distributed or otherwise disposed of during the period;
- An itemized schedule of income received and disbursed, distributed, or otherwise disposed of during the period;
- The balance of principal and income remaining at the close of the period, how it is invested and both its inventory value and current fair market value;
- A statement that the trust has been administered according to its terms.
- The names and addresses of all living beneficiaries and a statement of any beneficiary under legal disability;
- A description of any possible unborn or unascertainable beneficiary and his interest in the trust; and
- The business addresses, if any, or the residence address of all the trustees.²⁰

For a complete judicial release of the trustee's accounts that have not previously been settled by the court, a trustee should file an accounting beginning from first acceptance of trust property through the current period. If the trustee is seeking an out of court settlement from the beneficiaries, the beneficiaries can waive a full accounting and provide consents based on statements or other financial data available.

Court proceedings

When resorting to the court remedy to settle a trustee's accounts, the trust must first be docketed and made a part of the court's records.²¹ Notice must be served on all persons whose rights may be effected by the court's settlement of the accounts, which would be all those persons determined to have an interest in the trust.²² Notice would include a copy of the Trustee's

¹⁹ Ind. Code §30-4-3-18.

²⁰ Ind. Code §30-4-5-13.

²¹ Ind. Code §30-4-6-4.

²² Ind. Code §30-4-6-6(a).

petition along with the trust's final account along with a notice of by what date any written objections must be filed with the court. Those persons whose rights would be affected are given an opportunity to review the trust's accounts and file with the court specific objections he or she may have with respect to the trustee's accounts.²³ When objections are filed, the court conducts a hearing to determine the correctness of the trustee's accounts and the validity and propriety of all actions of the trustee described in its statement and the court generally has broad discretion to determine what action it determines is necessary to settle the trustee's accounts.²⁴

Court proceedings to settle accounts are available to the trustee to get a full release on its accounts at the time of trust termination and final distribution. It is a right granted under Indiana's Trust Code that may not be modified by the settlor in the trust agreement.²⁵ Although the trust may provide nonjudicial settlement of the trustee's accounts by certain designated individuals, a final court order on the account is unquestionably final.

Settlement by Agreement

In lieu of obtaining a costly judicial settlement of its accounts, a trustee may settle its liability with respect to the trust by obtaining the consent of all those persons interested in the trust. This is particularly useful and less expensive method than a judicial proceeding, provided all those persons interested in the trust and the trustee agree.

Situations that tend to lend itself to settlement by consent of all interested persons, would include those situations where the trust has been professionally managed by a corporate fiduciary, who has regularly sent trust statements over the term of the trust as provided under the trust instrument or Indiana law and has professionally managed the trust property along the way. Also, a settlement by agreement requires that all interested persons be able to give consent, or if he or she are unable to give consent, must have his or her interests represented by another who can consent and bind that interested person.

In consent by agreement, all the interested persons can waive the trustee's formal accounting prepared in the manner the court would require, and can instead accept other financial statements that are readily available, thereby minimizing additional administrative expense on the trust. Because obtaining binding consents from interested persons can depend on the adequacy of disclosures received, the interested person should acknowledge that the information the trustee provided is sufficient to allow him or her to give consent. If the interested person believes that information provided is inadequate, he or she can request additional information, which upon receipt, may resolve this issue.

²³ Ind. Code §30-4-5-14 (b) and (c).

²⁴ Ind. Code §30-4-5-14(d).

²⁵ See Ind. Code §30-4-3-18 (the statutory right for judicial settlement of accounts does not contain provision allowing the trust to alter this statutory remedy by providing otherwise)

In addition to adequate disclosure of financial or other information, an interested person should understand the terms of the trust arrangement in order to be able to give a binding consent to the settlement. Because trusts are usually written by lawyers and in a way that is difficult for a person (who is not a lawyer) to understand, the settlement agreement should contain a written narrative of how the trust was created, when and how the trustee accepted to serve, a summary of the trust's dispositive provisions, identify its beneficiaries and identify who is to receive the trust property upon termination. A complete copy of the trust should be referenced and attached to the settlement agreement. The beneficiary should acknowledge that these facts are true.

At the time of final distribution, the trustee should review all liabilities and expenses it may incur and settle all those liabilities and expenses prior to making final distribution. However, because of the unknown; in making final distribution by consent of all the interested persons, the trustee should obtain an indemnity from the remainder beneficiaries for any liabilities and expenses of administration that may arise after the trust property is distributed. The indemnity for administrative expenses merely represents what a trustee would have the right to recover from a beneficiary through a judicial proceeding.

The trustee should also obtain an agreement by those interested persons to refund any distribution that is later determined to have been distributed in error to him or her. Again, a trustee should exercise caution in its administration and distribution so that it is not later recouping a prior distribution, but the refund agreement is simply an agreement to avoid a subsequent judicial proceeding by the trustee against the beneficiary.

With a summary of the trust's terms (including a copy of the trust instrument), full and adequate financial disclosures of the trust's administration and a proposed schedule of final distribution, all interested persons can provide a binding consent to the distribution and waive formal court accountings under conditions that put the trustee in substantially the same position that the trustee would have been in an uncontested judicial proceeding, and at a lower cost to the trust.

Conclusion

In this increasing litigious environment, having settlement of all risks and liabilities associated with the trustee's administration of the trust is recommended before making final distribution of trust property. Because the voluntary settlement approach by all persons interested in the trust generally minimizes the trust's settlement costs for the benefit of the remainder beneficiaries, if the circumstances warrant, the trustee can consider giving the interested persons the opportunity to settle the accounts by agreement. Otherwise, the trustee may rely on the court system for account settlement and discharge upon the trust's termination.