Unintended Consequences of Naming a Charitable Beneficiary in a Will or Trust

Mark Sales and David Reynolds of Diamond McCarthy LLP
• In 2019, bequests totaled $43.21 billion in charitable giving. This represented 10% of all charitable giving in the US.  
  Giving USA 2020  
  https://www.nptrust.org/philanthropic-resources/charitable-giving-statistics/

• According to the most recent data available, there are more than 1.54 million charitable organizations in the United States.  
  The Urban Institute | National Center for Charitable Statistics 2019

• Approximately 90% of high-net-worth households give to charity.  
  The 2018 U.S. Trust Study of High-Net-Worth Philanthropy conducted in partnership with the Indiana University Lilly School of Philanthropy
Charities are often named as remainder beneficiaries in wills and trusts, and can be included in all types of plans.

For an overview of the many types of plans, see Paul D. Callister, Charitable Remainder Trusts: An Overview, 51 Tax Law. 549 (1998)

One Example of a commonly utilized plan is a CRAT – Charitable Remainder Annuity Trust

REASONS FOR DOING SO INCLUDE, AMONG OTHER REASONS:

• TAX BENEFITS
• PRESERVATION OF WEALTH
• THE NOTION OF GIVING TO ENTITIES THAT ALIGN WITH SETTLORS BELIEFS
Under a CRAT, there are two levels of beneficiaries: the primary beneficiary that receives benefits during their lifetime at a set percentage of the amount initially invested, and the remainder (potentially contingent) beneficiaries that are the charities, which receive funds after the passing of the primary beneficiary.

Both are beneficiaries, and are owed equal duties of loyalty and fair dealing from the trustee.
CRAT
Charitable Annuity Remainder Trust

This is popular because of its versatility. It provides income to an individual chosen by the settlor during that individual’s life, with the remainder of the assets, at that individuals’ death, then going to named beneficiaries.

Provides tangible tax benefits, as it entitles the settlor to an income tax deduction for the present value of the remainder interest (as determined by 26CFR § 1.664-2).

Thus, it provides the settlor a tax break, provides for the interest of an individual important to the settlor, and provides a gift to a charity (or charities) important to the settlor.
Great News!

The rule against perpetuities does not apply to charitable trusts.


“The rule against perpetuities applies to trusts other than charitable trusts.”
Charities are able to accept or refuse such a gift. The repercussions of such declinations can be difficult to anticipate, especially if the asset declined is a piece of a larger donation to the charity.

Referred to as a “qualified disclaimer” under Treasury Regulation § 25-2518-2(d)(1), the asset is to then pass to the “next in line”.

Settlors sometimes choose to name charitable beneficiaries as a way of disposing of property that may be difficult or otherwise hard to maintain or sell.
The Belief Is That It Will Be An Easy Way To Both:

- Give Assets To Important Causes; And
- Avoid Disputes That Could Drain Assets And Become Mentally Taxing To The Settlor And Family Members Who May Serve As Fiduciaries Or Have Competing Beneficial Interests.

Settlors Also Believe That Charities Are Easy To Deal With And Will Not Raise Or Make Much Fuss.
Historically Charities Were Thought Of As Non-Contentious Beneficiaries Who Were Happy Just To Be Included In An Estate Plan.

Times Have Changed And Even The Best Intentions Can Go Wrong.

Many Charities Have Become Much More Sophisticated, Litigation Savvy, And Aggressive In Protecting Their Interests. Many Have In-House Counsel Or Outside Specialists Overseeing The Trusts And Estates In Which They Are Named.

The Texas Attorney General’s Office Also Has Oversight Over Any Litigation Involving Charities In Texas.
There may be situations where, due to internal family dynamics, an estate plan may intentionally include disproportionately small gifts to family members, or even disinherit some or all family members entirely, with assets primarily going to charity.

Those types of plans can be difficult to navigate, and many such issues are discussed in *Planning for the Dysfunctional Family*, by Glan Yale: [http://www.texasbarcelo.com/materials/events/6530/93379_01.pdf](http://www.texasbarcelo.com/materials/events/6530/93379_01.pdf).

Family members may feel cheated if they believe the assets of an estate should have gone to them, but instead went to an outside charity. May feel entitled to the assets, thus raising a tense situation from the outset between a trustee, family members/individual beneficiaries, and charitable beneficiaries.

Ripe for potential litigation.
Other Considerations Before Designating Charities as Beneficiaries

Rights Of A Charitable Beneficiary & Duties Of Trustees

Involvement Of The Texas Attorney General’s Office In Any Potential Litigation

The Fiduciary’s Duty To Consider Rights Of All Beneficiaries Equally
“A trustee shall administer the trust in good faith according to its terms and this subtitle. In the absence of any contrary terms in the trust instrument or contrary provisions of this subtitle, in administering the trust, a trustee shall perform all of the duties imposed on trustees by the common law.”


“The existence of strained relations between parties does not minimize the fiduciary's duty of full and complete disclosure. Montgomery v. Kennedy, 669 S.W.2d 309, 313 (Tex. 1984).
A trustee is required to keep full, accurate, and orderly records concerning the status of the trust estate and all acts performed thereunder.

*Beaty v. Bales*, 677 S.W.2d 750, 753 (Tex. App.—San Antonio 1984, writ refused NRE)

Potentially, a trustee has a duty, upon demand, to allow a beneficiary on a reasonable basis to inspect the non-privileged books and records of the trust.

Restatement of the Law of Trusts 3rd §82.

A trust document may not limit a trustee’s duty to respond to a demand for an accounting if the demand is from a beneficiary who is entitled or permitted to receive distributions or would receive a distribution if the trust terminated at the time of the demand.

 Tex. Prop. Code §111.0035(b)(4)
Texas Law Requires The Involvement Of The Texas Attorney General’s Office For Any Litigation Involving A Charity

Chapter 123 of the Texas Property Code requires notice to the Attorney General by any party initiating a proceeding involving a charitable trust.

“‘Charitable entity’ means a corporation, trust, community chest, fund, foundation, or other entity organized for scientific, educational, philanthropic, or environmental purposes, social welfare, the arts and humanities, or another civic or public purpose described by Section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(c)(3)).” Tex. Prop. Code §123.001.

Several other statutory provisions require notice to the Attorney General as protector of the public interest in charity. Notice under these statutes is often required when there are changes to a charitable trust or when there is a charitable interest but there is no named charity that can be notified of a trust or estate issue or charitable gift.
Can bring more unwanted attention.
Can lead to the Attorney General intervening.
Can lead to investigations by the Attorney General, and a way to get the camel’s nose in the tent.

Potentially, if Attorney General is investigating a charity, they could look to a trust that funds that charity.
• Investigations into Trump Foundation led to its dissolution.
• Investigations into Clinton Foundation lasted more than 5 years and led to subpoenas issued to the charity.
• These investigations can look into what funds the foundations, i.e., a charitable trust.
Settlor may wish for the investments to the lifetime beneficiary to pay tax free dividends, which is possible under both a CRAT and a CRUT (Charitable Remainder Unitrust). But, those generally have lower returns on investments, and that could ultimately reduce the amount paid to the charitable remainder beneficiaries.

Natural conflict between Primary and Remainder Beneficiaries, and they may disagree:

• over how a trustee should invest a trust portfolio;
• over whether to maintain assets that are personally important to Primary Beneficiary and not a remainder charity beneficiary (e.g., family company stock); or
• on whether to focus on more aggressive/conservative investments.
The prudent investor rule provides that “A trustee’s investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.


 “[A] trustee is under a duty to the beneficiary except as otherwise provided by the terms of the trust, to distribute the risk of loss by a reasonable diversification of investments, unless under the circumstances it is prudent not to do so.

How To Avoid The Pitfalls

Need To Choose Wisely

BEST TO INCLUDE CHARITIES THAT THE SETTLOR HAS FAMILIARITY WITH ALREADY

- On boards, prior donations, points of contact, etc.
- Utilizing a service to become familiar with charities may be a way to get to know the charity first

For instance, Communities Foundation of Texas connects individuals with organizations that can best suit their charitable desires.
• Keeping Beneficiaries in the Know Now Will Avoid the Quagmire of Them Later Feeling They Were Intentionally Kept In The Dark

• Ensure Trustee Has Full Information and Provide Necessary Information Timely to All Beneficiaries

• If the Beneficiaries Have a Dispute, Then As Trustee or Trustee’s Attorney, Attempt To Communicate Openly with Beneficiaries
What happens if a successor trustee discovers that more charitable beneficiaries likely exist than have been acknowledged? (e.g., Failed attempt to remove beneficiaries)

**How this was handled to avoid litigation:**

Provided legal opinion memorandum advising trustee that the two previously unacknowledged beneficiaries were beneficiaries.

Developed strategy to advise acknowledged beneficiaries of this analysis, which included the state of the law, as well as the pros and cons of either accepting or rejecting potential beneficiaries.

Reached out to previously unacknowledged beneficiaries as well. Drafted consent agreement between all beneficiaries regarding ineffectiveness of attempt to remove and status of all as beneficiaries.

This process and agreement avoided the need for litigation and demonstrated ability of beneficiaries to rely upon the trustee to look out for all their interests.
May wish to have a “Fresh Start” agreement

Removes duty to investigate the behavior of past trustees

Section 114.002 of the Texas Trust Code imposes a duty on a successor trustee, by shifting liability to a successor trustee, to investigate and seek to compel a redress of a breach of duty by a predecessor trustee

HOWEVER, Section 114.005(a) of the Texas Trust Code provides that: “[a] beneficiary who has full legal capacity and is acting on full information may relieve a trustee from any duty, responsibility, restriction, or liability as to the beneficiary that would otherwise be imposed on the trustee by this subtitle, including liability for past violations.”

FURTHER, Section 114.032(a) of the Texas Trust Code provides that: “[a] written agreement between a trustee and a beneficiary, including a release, consent, or other agreement relating to a trustee’s duty, power, responsibility, restriction, or liability, is final and binding on the beneficiary and any person represented by a beneficiary . . .”
Resolving Disputes Where the Beneficiaries Cannot Agree
- When The Courts Need To Be Involved

DON’T MAKE IT CONTENTIOUS IF POSSIBLE

Keep the communication open

Advise that you will seek the court’s instruction and will keep them up to date on the filing.

**Practice Pointer:**

When dealing with multiple beneficiaries, you could have an instance where only one out of five or six raises an issue. You may believe that the others, based on communications, agrees with the Trustee’s position.

However, once litigation comes, beneficiaries not at center of dispute may lie low. They may not want to spend fees or have the public controversy. Thus, as trustee, ensure that the actions taken and statements made will withstand court scrutiny on their own without the Court becoming aware of the other charitable beneficiaries’ general agreement with the trustee.
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DON’T MAKE IT CONTENTIOUS, IF POSSIBLE

Feel free to advise the charity that, as trustee’s counsel, you have reached a different conclusion, but that you understand the duties owed to them. But, with this type of disagreement, it’s best to get someone to call balls and strikes.

Don’t throw surprises at the charities – Courts will not appreciate this tactic, and it will only increase the animosity.

Don’t be afraid to tell the Court where the trustee stands on the issue, while also advising the Court that, ultimately, the trustee is seeking the court’s instructions (DJ action).
**No appeal agreement**: Agreement that beneficiaries will not appeal decision of trial court, with the carrot being an agreement to pay up to a certain amount of legal fees out of the trust corpus.

**Arbitration provision in the trust agreement itself**: Texas Supreme Court allows arbitration provisions within a trust agreement. *Rachal v. Reitz*, 403 S.W.3d 840, 847 (Tex. 2013) (holding that an arbitration provision in the trust was enforceable against the beneficiary under the Texas Arbitration Act).

**Potentially seek reformation** if a conflict or expense is seen coming that may be avoidable.

Texas Property Code § 112.054

*See also Troublesome Trust Topics*, Moore & Rosenberg, August 13, 2015,

Thank you.