

## The Alchemy of Revocable Trusts: Creating the Perfect Solution for Each Client's Problem

Presented by:  
Christian S. Kelso, Esq.

Corpus Christy Estate Planning Counsel  
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Corpus Christy, Texas

Farrow-Gillespie Heath Wilmoth LLP  
1900 N. Pearl St. | Suite 2100 | Dallas TX 75201  
phone 214-361-5600 | [Christian.Kelso@fghwlaw.com](mailto:Christian.Kelso@fghwlaw.com)



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## Introduction

- Chefs fall in 2 categories
  - ▣ Non-bakers
  - ▣ Bakers
- Bakers use some sort of magic to create something that bears no resemblance to what went in.
- Bakers have solutions for all sorts of problems
  - ▣ Sweet/savory
  - ▣ Crunchy/chewy
  - ▣ Etc.
- Revocable trust are much the same.



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## Outline

- This talk will focus on 4 questions:
  - ▣ What is a trust?
  - ▣ What is a rev. trust?
  - ▣ What problems are rev. trusts typically used to solve?
  - ▣ What should a drafter consider when crafting a rev. trust?
  - ▣ What do you do with an existing rev. trust?



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### What is a Trust?

- Split of property rights between 3 parties
  - ▣ Settlor
  - ▣ Trustee
  - ▣ Beneficiary
- Trust is a relationship, not a legal entity
  - ▣ Cannot own property, be sued, etc.
  - ▣ Reason it's called a trust
- Trust is abstract and intangible, not a physical thing
  - ▣ Compare with a Will
  - ▣ Distinguish trust from trust instrument



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### What is a Trust?

- Nomenclature
  - ▣ Settlor/Grantor/Trustor
  - ▣ Revocable Living Trust/Revocable Management Trust/Revocable *Inter Vivos* Trust



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### What is a Trust?

- Trusts categorized in various ways:
  - ▣ • Revocable or irrevocable;
  - ▣ • Grantor or non-grantor (also called a "true" trust);
  - ▣ • Simple or complex;
  - ▣ • Express or implied;
  - ▣ • Self-settled or non-self-settled
  - ▣ • Testamentary or *inter vivos*.



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### What is a Rev. Trust?

- Qualities:
  - ▣ Express
  - ▣ Self-settled
    - Effective during his/her/their lifetime
  - ▣ Revocable
  - ▣ Grantor trust for tax purposes
    - (grantor trusts can be neither simple nor complex.)
- Will substitute?



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### Uses

- Elderly Clients
  - ▣ Probate avoidance
  - ▣ Help with managing assets
  - ▣ Smooth transition of control with co-trustee
  - ▣ More effective than powers of attorney, joint accounts, or guardianship
- Characterization of Property
  - ▣ Designate rev. trusts property as settlor's separate property by agreement
  - ▣ Helps with identification issues



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### Uses

- Out-of-State Property
  - ▣ Avoid ancillary probate
- Avoiding Contests
  - ▣ Standing of expectant heirs presents a problem.
  - ▣ Capacity and undue influence harder to argue.
- Privacy
  - ▣ Privacy trusts are in increasing demand.
  - ▣ Appointment of special trustee.



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### Uses

- Limitations
  - ▣ No creditor protection
  - ▣ No tax savings (as compared with Wills)



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### Drafting Considerations

- Community Property
  - ▣ Maintain character
  - ▣ How to track?
  - ▣ How to avoid comingling?
  - ▣ Who holds responsibility?
  - ▣ Solution is often to execute premarital agreement or partition.



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### Drafting Considerations

- When to terminate initial trust?
  - ▣ Second death or first death?
  - ▣ Transfer tax considerations



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### Drafting Considerations

- Powers of Appointment
  - ▣ Special v. limited powers
  - ▣ Potential appointees?
  - ▣ Provide flexibility
  - ▣ Avoid GSTT



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### Drafting Considerations

- Successor Trustees?
  - ▣ Spouse
  - ▣ Children
  - ▣ Parents
  - ▣ Guardians
  - ▣ Other Individuals
  - ▣ Professional Trustees
  - ▣ Corporate Trustees



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### Drafting Considerations

- Independent Trustees?
  - ▣ IRC. §§ 674(c)(1997) and 672(c).
  - ▣ Functions
    - Distributions beyond HEEMS
    - Avoid Upjohn Clause
    - Other?



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### Drafting Considerations

- Trust Protectors/Committee
  - Fiduciary duty?
  - Standing or springing?
  - Flexibility



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### Drafting Considerations

- Trust Protector Powers (That I Like)
  - Removing and replacing trustees
  - Naming new trustees
  - Correcting typos
  - Addressing changes in law, particularly tax laws
  - Converting trust to a supplemental needs trust
  - Changing the governing law applicable to a given trust.



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### Drafting Considerations

- Trustee Comp
  - "Reasonable" is common, but confusing
  - 5 in, 5 out rule
  - Bank models
  - Hourly fees



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### Drafting Considerations

- Trustee Removal
  - Settlers' typically have broad powers
  - Balance flexibility with functionality



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### Drafting Considerations

- Distributions
  - Spectrum of discretion
  - Ascertainable Standards
  - Modifying language
  - Support or supplement?
  - Upjohn clause



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### Drafting Considerations

- In Terrorem* Clause?
  - Applicability/Enforceability?
  - Teeth?
  - Overuse?
- Exclusions
  - Individual or entire line?
  - Indirect benefits?
  - Treat as predeceased



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### Drafting Considerations

- Accountings and Information Sharing
  - ▣ Separate duties to account and inform
  - ▣ Trustee's perspective
  - ▣ Beneficiary's perspective
  - ▣ First-tier beneficiaries
  - ▣ Non-waivable duty (TTC § 111.0035)



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### Drafting Considerations

- Contingent Trusts
  - ▣ Backstop against minor or incapacitated person taking outright
- Retirement Account Considerations
  - ▣ Increasingly important
  - ▣ Beneficiary designations
  - ▣ Requires understanding of tax rules
- Special Assets
  - ▣ How pay for upkeep?
  - ▣ Licensure?
  - ▣ Few forms



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### Existing Trusts

- You can't always revoke, amend, or restate
- But actually, yes you can
  - ▣ Court control is nonwaivable under TTC § 111.0035
  - ▣ Decanting/merger
- Read the trust instrument...and understand it.
  - ▣ Lay people may not understand the language



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### Existing Trusts

- Trust funding
  - To paraphrase Winston Churchill, execution is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning.
  - Assignments, deeds, replating, etc.
  - Blanket transfers
  - Homesteads?
  - Retirement accounts should not be put into rev. trusts



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### Existing Trusts

- Grantor intent
  - 4-corners doctrine
- Communication with Beneficiaries
  - Demands
  - Best practices
- Investments
  - UPIA applies unless waived
  - Ability to deal with related trusts?
  - Ability to hold family business?



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### Existing Trusts

- Self-dealing
  - Non-waivable, but exceptions apply
  - Breadth of duty
  - Loans, purchases, transactions between related trusts
- Considerations Upon Death of Settlor
  - § 665 election?
  - S-corp stock?



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## Questions?

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