



SIMMONS PERRINE MOYER BERGMAN PLC

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## Special Considerations When Lending to Trusts

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# Presenter:



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# Growing Popularity of Trusts

- Trusts used to be a financial planning vehicle reserved for the extremely wealthy, but friendly enactments by state legislatures have made trust creation easier and accessible to more individuals
- Living trusts (created during the grantor's life) have become increasingly particularly popular with small businesses and family farms
- Aside from probate avoidance, trusts can also manage millions of dollars in trust property, making them lucrative partners for financial institutions

# Trust Basics – Who is Who

- Settlor (Grantor): creates the trust and funds it with property
- Trustee: administrator, invests the trust property, signs on behalf of the trust (i.e. loan documents)
  - Trust property is titled in the trustee's name
  - If a Grantor names him/herself trustee, it is called a self-settled trust
- Beneficiary: holder of an equitable interest in the trust property, including to profits and eventual ownership

# Pledgeable Trust Assets



Securities



Equipment



Crops/Livestock



Real Property



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# Trust Identity

- Irrevocable Trust: grantor forfeits all claims to ownership of property, possibly shielding it from creditors
  - Risks associated with irrevocable trusts dissuade most financial institutions from lending to them
- Revocable Trust: pledged assets can readily be removed from the trust and re-titled in the grantor's name
  - Settlor is typically the initial trustee and the lifetime beneficiary (i.e. self-settled trust)
  - **Revocable trusts still pose risks that lenders need to be cognizant of**

# Use EIN or SSN?

- Revocable trust:
  - Use the social security number of the grantor, as nearly all states recognize the revocable trust as the alter ego of the grantor and any trust income is taxed to the grantor
- Other Trusts:
  - Irrevocable trusts or business trusts (e.g. Employee Share Ownership Trusts)
  - use an employer identification number, as any derived income is not attributed to the grantor's income



# Certificate of Trust

- A certificate of trust can be used in lieu of reviewing the entire trust instrument
  - Provides the essential details to verify the existence of the trust and scope of the trustee's authority
  - Retains privacy of the trust distribution scheme or other sensitive information
- Unreasonable Request: A lender can face financial penalties for *unreasonably* requesting the entire trust instrument after receiving the certificate of trust
- Liability Protection: lender has no liability to third-parties if the lender reasonable relies on a certificate of trust





"1135"

### TRUST CERTIFICATE

Principal	Loan Date	Maturity	Loan No.	Call Coll.	Account	Officer	Initial
\$100,000.00	11-13-2020	On Demand	LOC TEST				

References in the boxes above are for Lender's use only and do not limit the applicability of this document to any particular loan or item.  
Any item above containing \*\*\*\*\* has been omitted due to text length limitations.

Trust: SMITH FAMILY REVOCABLE TRUST  
123 FIRST AVENUE  
DUBUQUE, IA 52001

Lender:

**I, THE UNDERSIGNED, DO HEREBY CERTIFY THAT:**

**CERTIFICATION OF TRUST.** This Trust Certificate is given by the sole currently acting Trustee voluntarily, pursuant to the Iowa Trust Code and is sworn and subscribed under penalty of perjury before a notary public, intending that the facts set forth in this Certificate be relied upon by Lender as true and correct.

- (A) Trust is in existence as of this date and is evidenced by a Trust Instrument executed on January 1, 2000.
- (B) The name and address of the Trustee is: JOHN SMITH, 123 FIRST AVENUE, DUBUQUE, IA, 52001.
- (C) The name of the Trust Settlor is:
- (D) The powers of Trustee include the power to do or perform, all of the acts and things on behalf of Trust set forth in this Certificate.
- (E) Trust is revocable, and the name of the person holding any power to revoke the trust is: JOHN SMITH.
- (F) The trust instrument requires the signature of any 1 Trustee to exercise any powers of the Trustee.
- (G) Trustee hereby certifies that Trust has not been revoked, modified, or amended in any manner which would cause the representations contained in this Certificate to be incorrect and this Certificate is being signed by all of the currently acting Trustees of Trust. Trustee acknowledges and agrees that Lender may require Trustee to provide copies of excerpts from the trust instrument and amendments which designate the Trustee and confer upon the Trustee the power to act in these transactions and that Lender may require such further identification or legal opinion supporting the Trustee's authority and power as Lender shall deem necessary and prudent.

**BORROWING CERTIFICATE.** Trustee, for and on behalf of Trust, is authorized and empowered on behalf of Trust

**Borrow Money.** To borrow, as a cosigner or otherwise, from time to time from Lender, on such terms as may be agreed upon between Trust and Lender, such sum or sums of money as in his or her judgment should be borrowed, without limitation.

**Execute Notes.** To execute and deliver to Lender the promissory note or notes, or other evidence of Trust's credit accommodations, on Lender's forms, at such rates of interest and on such terms as may be agreed upon, evidencing the sums of money so borrowed or any of Trust's indebtedness to Lender, and also to execute and deliver to Lender one or more renewals, extensions, modifications, refinancings, consolidations, or substitutions for one or more of the notes, any portion of the notes, or any other evidence of credit accommodations.

**Grant Security.** To mortgage, pledge, transfer, endorse, hypothecate, or otherwise encumber and deliver to Lender any property now or hereafter belonging to Trust or in which Trust now or hereafter may have an interest, including without limitation all of Trust's real property and all of Trust's personal property (tangible or intangible), as security for the payment of any loans or credit accommodations so obtained, any promissory notes so executed (including any amendments to or modifications, renewals, and extensions of such promissory notes), or any other or further indebtedness of Trust to Lender at any time owing, however the same may be evidenced. Such property may be mortgaged, pledged, transferred, endorsed, hypothecated or encumbered at the time such loans are obtained or such indebtedness is incurred, or at any other time or times, and may be either in addition to or in lieu of any property theretofore mortgaged, pledged, transferred, endorsed, hypothecated or encumbered.

**Execute Security Documents.** To execute and deliver to Lender the forms of mortgage, deed of trust, pledge agreement, hypothecation agreement, and other security agreements and financing statements which Lender may require and which shall evidence the terms and conditions under and pursuant to which such liens and encumbrances, or any of them, are given; and also to execute and deliver to Lender any other written instruments, any chattel paper, or any other collateral, of any kind or nature, which Lender may deem necessary or proper in connection with or pertaining to the giving of the loans and encumbrances.

**Subordination.** To subordinate, in all respects, any and all present and future indebtedness, obligations, liabilities, claims, rights, and demands of any kind which may be owed, now or hereafter, from any person or entity to Trust to all present and future indebtedness, obligations, liabilities, claims, rights, and demands of any kind which may be owed, now or hereafter, from such person or entity to Lender ("Subordinated Indebtedness"), together with subordination by Trust of any and all security interests of any kind, whether now existing or hereafter acquired, securing payment or performance of the Subordinated Indebtedness; all on such subordination terms as may be agreed upon between Trust's Trustees and Lender and in such amounts as in his or her judgment should be subordinated.

**Negotiate Items.** To draw, endorse, and discount with Lender all drafts, trade acceptances, promissory notes, or other evidences of indebtedness payable to or belonging to Trust or in which Trust may have an interest, and either to receive cash for the same or to cause such proceeds to be credited to Trust's account with Lender, or to cause such other disposition of the proceeds derived therefrom as he or she may deem advisable.

**Further Acts.** In the case of lines of credit, to designate additional or alternate individuals as being authorized to request advances under such lines, and in all cases, to do and perform such other acts and things, to pay any and all fees and costs, and to execute and deliver such other documents and agreements, including agreements waiving the right to a trial by jury, as the Trustee may in his or her discretion deem reasonably necessary or proper in order to carry into effect the provisions of this Certificate.

**TERMINATION OR TRANSFER.** Trustees agree that the Trustees will provide to Lender written notice prior to any termination or revocation of Trust or prior to the transfer from Trust of any Trust asset upon which Lender may be relying for repayment of Trust's indebtedness to Lender.

# Certificate of Trust – State by State

- A certificate of trust is statutorily permitted in all of the following states :
  - Arizona – Ariz. Rev. Stat. § 14-11013
  - California – Cal. Prob. Code § 18100.5
  - Colorado – Colo. Rev. Stat. § 15-5-1013
  - Illinois – 760 Ill. Comp. Stat. 3/§ 1013
  - Iowa – Iowa Code § 633A.4604
  - Kansas – Kan. Stat. Ann. § 58a-1013
  - Minnesota – Minn. Stat. § 501c.1013
  - Montana – Mont. Code. Ann. § 72-38-1013
  - New Mexico – N.M. Stat. Ann. § 46A-10-1013
  - Texas – Tex. Prop. Code. Ann. § 114.086
  - Wisconsin – Wis. Stat. § 701.1013

# Notable State Differences

- Extent of information statutorily required
  - **Low End:** must state if trust has been changed or revoked (Iowa)
  - **Middle Ground:** State name of trust and trust instrument, names and power of trustees, if trust has been revoked (Minnesota)
  - **High End:** State date of creation, identify all trust parties, powers of trustees, who has power to revoke, and name in which trust property it taken (Colorado, Arizona, Texas)
  - **Unique Disclosures:**
    - A legal description of any real property held in the trust must be included (California)
    - Identify governing law of the trust (Montana)
    - Trust taxpayer's identification number (New Mexico)
- Boilerplate certificate of trust form included in the statute (Illinois)
- **Takeaway:** Each state had different requirements, so a lender should look to a particular state's code when using a certificate in lieu of the trust instrument

# Authority of the Trust

- Is the trust permitted to enter into lending contracts?
  - Borrower – ensure trust is permitted to borrow capital and use trust assets as collateral
  - Guarantor – ensure trust can pledge trust assets against a debt guaranty
- What power is given to the trustee?
  - Example:
    - **Powers of Trustee.** All powers of the Trustee are fully set forth as Exhibit A. While **John Smith** and **Jane Smith** are serving together as Co-Trustees of this Trust, each of them shall have the authority to act alone as Administrative Trustee (on behalf of both of them) in administering this Trust, provided that neither shall have the power or authority to sell, purchase, liquidate, exchange, encumber, dissolve, distribute, transfer, or otherwise dispose of interests in **Trust Assets** without obtaining the written consent of Grantor.



# Trustee's Signature

- Correct: *John Smith, Trustee of the John and Jane Smith Revocable Trust, Dated 11/13/20*
- **NOT:**
  - *Trustee John Smith; or*
  - *Trustee for John and Jane Smith Revocable Trust Dated 11/13/20*
- Trustee's signature should: (1) include name of trustee and (2) recognize their capacity as a trustee with a particular named trust

# UCC Article 9 – Proper Naming of the Trust

- When filing a financing statement for assets held by a revocable trust, the name that should be used is the name identified within the certificate of trust or trust instrument
  - Example: “John Smith Revocable Trust” should be used if the trust name is contained in the following provision:
    - *1.1 Name of Trust. The name of this Trust shall be the John Smith Revocable Trust.*
- If the trust name is not explicitly stated, then the name that appears on the title page of the trust certificate or instrument AND the name of the grantor should be used:
  - Example: “John Smith” and “John Smith Revocable Trust” should both be used if the trust document contains the following name:
    - *John A. Smith Revocable Trust Agreement*

# Titling of Property

- Real property placed in a trust must be titled to the trustee
  - e.g.: *John Smith, Trustee of the John and Jane Smith Revocable Trust, Dated 11/13/20*
- Recording of the trust instrument not required to make revocable trust effective but deed with proper trustee titling needs to be recorded
- Title Insurance: Make sure to obtain title opinion or title insurance showing the real property is titled in the name of the trust

# Lend to the Asset Holder

- Assets held in trust
  - Trust: Borrower
  - Grantor: Guarantor
- Some assets in the individual's name and other assets held in trust
  - Trust: Guarantor
  - Grantor: Borrower



# Power to Revoke

- The grantor's power to freely add or remove property from the trust distinguishes a revocable trust
- When lending to a revocable trust always take a secured guaranty or security agreement from the grantor and the trust
  - If trust is revoked, lender is covered



# Revocable Becomes Irrevocable

- Death of grantor of a revocable trust:
  - New beneficiaries and a new trustee(s)
  - Power to revoke is lost, so trust becomes irrevocable
- Creditor's Rights:
  - Generally, to the extent a grantor's estate is unable to satisfy the claims of creditors, the assets in the deceased's revocable trust may be reached
- Timing:
  - in most states a trustee must give notice of the grantor's death, if not the creditor should file their claim against trust within a certain specified window (i.e. 1 year)

# Bankruptcy – Business Trust

- A business trust is recognized as a “person” under the Bankruptcy Code and is eligible to declare (11 U.S.C. § 101(9)(A)(v)
  - However, there is no clear definition as to what qualifies as a “business trust”
- Examples:
  - Employee Share Ownership Trusts (ESOTs)
  - Employee Pension Trusts
    - *Catholic Sch. Emps. Pension Trust*, 599 B.R. 634 (BAP 1st Cir. 2019)
  - Personal trusts with no perceivable business purpose do not qualify
    - *In re Blanche Zwerdling Revocable Living Trust*, 531 B.R. 537 (Bankr. D.N.J. 2015)

# Bankruptcy – Non-Business Trusts

- Revocable trust assets typically cannot be shielded from creditors in a bankruptcy proceeding
- In many states, the power to revoke is considered a property interest and the Bankruptcy Code requires a debtor's estate to include all legal and equitable interests

# How to Assure a Spouse's Interest in a Trust is Waived or Pledged

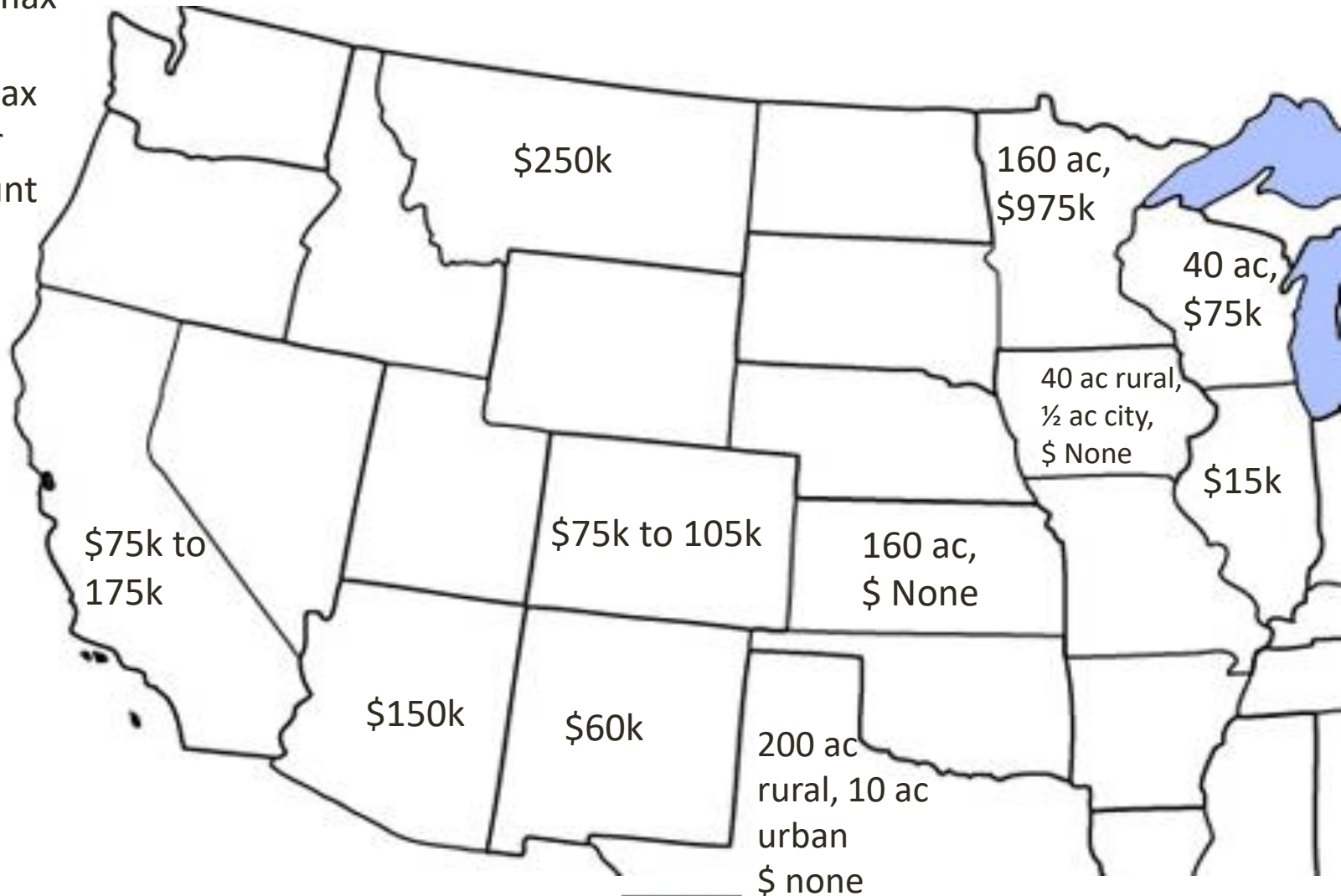
- Elective Share: the surviving spouse of a grantor may be entitled to claim a portion of the revocable trust assets
  - The portion differs from state to state
- Waiver of Spousal Interest:
  - A surviving spouse must sign a waiver explicitly disclaiming having the trust property factored into the elective share amount
  - If a spouse signed the deed that was transferred to a trust, ensure the spouse waived their election share
    - If spouse did not sign, have them sign a mortgage to waive spousal rights and elective share
- Best Practice: Spouse signs a mortgage in all cases so lender is protected

# Homestead Exemption

- The homestead exemption protects a debtor's home from being reached by creditors
  - Extent and amount of exemption varies by state
- Waiver:
  - If the homestead of a grantor is pledged, most states will require BOTH spouses to sign a waiver for the homestead to be subjected to claims
- Bankruptcy:
  - In most states the homestead exemption will apply *even* if the property is tilted to a revocable trust\*
- Best Practice: whether the homestead is titled to the grantor or the trust, both the grantor and their spouse should sign a clause in a mortgage waiving their rights to the exemption

# Limits of the Homestead Exemption

Ac = max  
acres  
\$ = max  
dollar  
amount



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# Fraud - *Veбелиunas*

*In re Veбелиunas*, 332 F.3d 85 (2d. Cir. 2003)

- Vytautas Veбелиunas created a revocable trust in 1983 and an irrevocable trust in 1985. A property, called the Lattingtown Estate, was deeded to the irrevocable trust
  - Vanda Veбелиunas, Vytautas' wife, was named the trustee of the irrevocable trust while Veбелиunas was a beneficiary
- In 1987, Veбелиunas obtained a \$1,000,000 loan from Chase bank and a \$700,000 loan from Citibank, pledging the Lattingtown Estate and falsely claiming it was owned by the *revocable* trust
  - During the transaction period, both banks discovered discrepancies with Veбелиunas' claims but still decided to lend
- Despite the apparent fraud, the court refused to allow the banks to reach the Lattingtown Estate as creditors in Veбелиunas' later bankruptcy proceeding, because “[w]hile the banks had title insurance, we are hesitant to say that they exercised due diligence in this case, as both Chase and Citibank knew when they extended the loans that neither debtor nor the Revocable Vart Trust, of which debtor was the trustee, owned Lattingtown Estate”





# Substance over Form - *Brooks*

*In re Brooks*, 217 B.R. 98 (Bankr. D. Conn. 1998)

- Unlike for a LLC or a corporation, state laws do not require a trust to give notice before offloading assets
  - A grantor of a revocable trust could remove the assets and transfer them to a third party
- Background: In *Brooks*, a debtor, before having an involuntary bankruptcy petition filed against him, transferred stock certificates to his wife who proceeded to create irrevocable trusts in two offshore countries
  - The debtor was named as a beneficiary of the trusts but he was not a trustee nor did he have any power of revocation
- Result: the court held, under state law, that while the trust in form was “irrevocable” in substance it was a self-settled trust and that trust assets were still accessible to creditors



# Case Study of Agricultural Trusts – *In re Clark*

525 B.R. 107 (Bankr. D. Idaho 2014)

- Jay Clark (“Debtor”) was a farmer and attorney in Idaho who filed for a voluntary chapter 12 bankruptcy but was later modified to chapter 7 because of the Debtor’s fraudulent actions
- Debtor created a trust, with himself as trustee and lifetime beneficiary, and two weeks later created an LLC that only had the trust as a member
- Over the course of several years, Debtor entirely disregarded corporate and trust formalities, commingled funds between the LLC, trust, and his personal bank accounts, and failed to keep accurate books
- As to the trust itself, the court noted:
  - “The formation documents for the Trust are flawed, incomplete and inconsistent. There was no proof the Trust was initially funded”



## *In re Clark* cont'd

- Debtor's LLC was structured to hold title to farm equipment, the right to crop insurance payments, and certain crops
- In the bankruptcy proceedings, Debtor claimed that "he did not have personal farming operations" and that the farmland he worked was leased to the LLC, but in various affidavits he admitted to being personally leased thousands of acres
  - This made allocating ownership of crops to the LLC difficult
- Debtor used capital loaned to the trust and LLC to pay off his "student loan; his personal credit card; . . . personal travel expenses;" education and travel expenses to a former employee Debtor had a relationship with; medical care; mortgage payments; rent on a different residence; costs related to a second marriage; and a wedding ring



## *In re Clark* cont'd

- At the time of the bankruptcy, Debtor owed \$676,796.98 to a multitude of creditors, including lenders like \_\_\_\_\_ and \_\_\_\_\_ Credit
- The court also referenced the role of lenders in transacting with Debtor, stating many did not “g[i]ve much, if any, regard to the Trust and the Trust's position as the sole member of the LLC”
  - Debtor was forthcoming about the trifecta of himself, the LLC, and the trust “only when required by diligent or careful lenders”
- Resolution: ultimately, the creditors were able to reach the assets of the trust and the LLC because of the extent to how Debtor operated the trust and LLC as functionally a consolidated entity
- Takeaway: lenders are advised when transacting with a revocable trust that pledges agricultural assets to determine if a farm LLC or another entity is related to the activity of the trust and to ensure trust formalities have been observed



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