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# Wills, Trusts, Guardianships, and Fiduciary Administration

by Mary F. Radford\*

This Article examines the major cases decided and legislation enacted during the period from June 1, 2004 through May 31, 2005. The cases and statutes discussed cover the substantive law relating to decedents' estates, trusts, and guardianships, and to the fiduciaries who administer these entities.

## I. 2004-05 CASES OF NOTE

### A. *Trust Cases: Discerning the Settlor's Intent*

A basic tenet of wills and trust law is that in construing a will or trust instrument, "the court shall seek diligently for the intention of the testator" or settlor.<sup>1</sup> In *SunTrust Bank v. Merritt*,<sup>2</sup> the court of appeals stated that "[t]he cardinal rule in construing a trust instrument involves discerning 'the intent of the settlor and [effectuating] that intent within the language used and within what the law will permit.'"<sup>3</sup> Courts may

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1. O.C.G.A. § 53-4-55 (1997). This statute relates to wills, but the courts have used the same rule in the construction of trusts. See, e.g., *Miller v. Walker*, 270 Ga. 811, 815, 514 S.E.2d 22, 25 (1999); *Perling v. C & S Nat'l Bank*, 250 Ga. 674, 676, 300 S.E.2d 649, 651 (1983); *Thomas v. Trust Co. Bank*, 247 Ga. 693, 693, 279 S.E.2d 440, 441 (1981).

2. 272 Ga. App. 485, 612 S.E.2d 818 (2005).

3. *Id.* at 488, 612 S.E.2d at 821 (citing *Miller*, 270 Ga. at 815, 514 S.E.2d at 25) (brackets in original). The Restatement (Third) of Trusts section 4 defines "terms of the trust" as "the manifestation of intention of the settlor with respect to the trust provisions." RESTATEMENT (THIRD) OF TRUSTS § 4 (2003). In Georgia, all wills and express trusts are

only resort to parol or extrinsic evidence to discern intent regarding matters on which the written instrument is silent or ambiguous.<sup>4</sup> In two cases decided during the reporting period, the Georgia appellate courts engaged in rather lengthy interpretations of language that appeared in trust instruments, and in one case, in an extrinsic document in an effort to glean the intent of the settlor of the trust.<sup>5</sup> Both cases interpret language commonly used in trusts, and the results in both cases are, in this author's view, puzzling and troubling.

The first of these cases is *Namik v. Wachovia Bank of Georgia*.<sup>6</sup> The court of appeals decision in this case was discussed previously in this author's article in the 2004 *Annual Survey of Georgia Law*.<sup>7</sup> In the 2004-05 reporting period, the Georgia Supreme Court reversed the court of appeals decision and held that the bank had breached its fiduciary and contractual duties.<sup>8</sup>

Briefly, the facts of *Namik* are that a retired Iraqi army officer, General Ali, while visiting his son in Atlanta, deposited \$2.65 million at the bank in a certificate of deposit scheduled to mature in six months. The next day, Ali and a bank trust officer discussed placing this property in trust. Ali signed the bank's Revocable Trust Agreement form and left the bank. He returned to Iraq, and some years later, his son revealed to the bank that Ali had been arrested upon his return to Iraq and died in prison. When the six-month certificate of deposit matured, the trust officer, whose name was Tom Slaughter, wrote a memorandum (the "Slaughter Memo") that indicated Ali wanted to fund the trust with the money from the matured certificate. The memo also indicated that Ali orally mentioned to the trust officer that he wanted "no market risks" and that he would like to have the funds invested "only in U.S. Government issues."<sup>9</sup> Neither of these instructions were embodied in the written trust agreement, which authorized the trustee to "hold, manage, invest, and reinvest the said property in its discretion."<sup>10</sup> The

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required to be in writing. O.C.G.A. §§ 53-4-20, 53-12-20 (1997).

4. *Ovrevik v. Ovrevik*, 242 Ga. App. 95, 97, 527 S.E.2d 586, 588 (2000) (stating that a court will "turn to parol evidence only if the trust agreement is ambiguous . . ."); see also O.C.G.A. § 53-4-56 (1997); *SunTrust Bank*, 272 Ga. App. at 487, 612 S.E.2d at 820.

5. *Namik v. Wachovia Bank of Georgia*, 279 Ga. 250, 251-52, 612 S.E.2d 270, 272-73 (2005), *rev'g* *Wachovia Bank of Georgia v. Namik*, 265 Ga. App. 80, 593 S.E.2d 35 (2003); *SunTrust Bank v. Merritt*, 272 Ga. App. 485, 612 S.E.2d 818 (2005).

6. 279 Ga. 250, 612 S.E.2d 270 (2005).

7. See Mary F. Radford, *Wills, Trusts, Guardianships, and Fiduciary Administration*, 56 MERCER L. REV. 457, 472-75 (2004).

8. *Namik*, 279 Ga. at 252-53, 612 S.E.2d at 273.

9. *Namik*, 265 Ga. App. at 80-81, 593 S.E.2d at 36.

10. *Id.* at 83, 593 S.E.2d at 38.

trust agreement also incorporated by reference the trustee powers that appear in Official Code of Georgia Annotated ("O.C.G.A.") section 53-12-232.<sup>11</sup> The agreement directed that the funds were to be used for the benefit of the settlor during his life and, at his death, be paid over to the personal representative of his estate.<sup>12</sup>

At the time the trust was established, the bank officers made several unsuccessful attempts to contact Ali. Unsure of Ali's tax status (that is, whether he was a citizen, nonresident alien, etc.), the bank invested the trust funds in tax-free municipal bonds. After Ali's death was discovered, the funds were paid over to the bank as administrator of Ali's estate. The estate tax laws and regulations in effect at the time of Ali's death caused the entire value of the trust fund to be included in his estate as U.S. situs property, and the estate paid tax in the amount of \$933,248.49. His son Namik sued, claiming the bank was responsible for subjecting his father's estate to those taxes. Namik pointed out that the Internal Revenue Code<sup>13</sup> lists certain types of property that are not considered to be situated in the United States when calculating the estates of nonresident aliens.<sup>14</sup> These types of property include proceeds of life insurance policies, certain bank deposits, and other debt obligations, including U.S. debt obligations.<sup>15</sup> However, as noted by the court of appeals, prior to an amendment in 1997, this law was "obscure . . . 'not perspicuous, not clearly expressed, vague, hard to understand.'"<sup>16</sup> The obscure rule that was in effect in 1990 would have excluded from the nonresident alien's gross estate only investments in U.S. government issues with a maturity greater than 183 days.<sup>17</sup> The court of appeals concluded that the bank could not be held liable for not knowing this obscure rule; the supreme court held that it could.<sup>18</sup>

However, the key factor that differentiated the court of appeals decision in favor of the bank from the supreme court's holding against the bank was the admissibility of the Slaughter Memo as evidence of the

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11. O.C.G.A. § 53-12-232 (1997); *See Namik*, 265 Ga. App. at 80-81, 593 S.E.2d at 36. According to O.C.G.A. section 53-12-231, a settlor may incorporate by reference into the trust agreement any or all of the extensive trustee powers that are listed in O.C.G.A. section 53-12-232. O.C.G.A. § 53-12-231; O.C.G.A. § 53-12-232.

12. *Namik*, 265 Ga. App. at 81, 593 S.E.2d at 37.

13. 26 U.S.C. §§ 1-9833 (2000).

14. *Namik*, 265 Ga. App. at 83, 593 S.E.2d at 38.

15. 26 U.S.C. §§ 2105, 2106 (2000).

16. *Namik*, 265 Ga. App. at 84, 593 S.E.2d at 39 (quoting BLACK'S LAW DICTIONARY 971 (5th ed. 1979)).

17. *Id.*

18. *Id.* at 83-84, 593 S.E.2d at 38; 279 Ga. at 253, 612 S.E.2d at 274.

settlor's intent.<sup>19</sup> If the memo were admissible, and thus incorporated into the trust agreement, then the theory was that the bank should have followed Ali's instructions "to invest only in U.S. government issues."<sup>20</sup> The court of appeals held that the Slaughter Memo was admissible for the purpose of showing how the trust was to be funded, but not for the purpose of showing Ali's intention to invest the funds.<sup>21</sup> The court of appeals concluded that no ambiguity existed in the investment directions that appeared in Ali's trust agreement.<sup>22</sup> This decision was based on the general rule that intent is inferred in the language of the trust agreement and resort will be made to oral evidence only if the agreement is ambiguous.<sup>23</sup> The court of appeals noted that Ali easily could have inserted his own investment directives into the written instrument if he desired.<sup>24</sup> The court of appeals held that the Slaughter Memo "should not have been admitted to vary the terms of the Trust Agreement because it constitutes parol evidence inadmissible under Georgia law."<sup>25</sup> According to this court, the memo did not explain any ambiguities in the agreement and, instead, "would completely change the discretion provided in the Trust Agreement."<sup>26</sup>

The supreme court, on the other hand, concluded that the Slaughter Memo was admissible to explain General Ali's investment desires because the memo had been admitted to show the source of the trust funds, indicating that the written trust agreement did not constitute the entire agreement between Ali and the bank.<sup>27</sup> The supreme court went on to say that "[o]ne topic on which the trust agreement was silent was Ali's instructions regarding the specific types of investment vehicles in which he wanted his money invested."<sup>28</sup> The court stated that the clause granting the trustee complete discretion in investing the funds was "not a statement of investment preference[s]," nor was the

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19. *Namik*, 279 Ga. at 252, 612 S.E.2d at 273.

20. *Namik*, 265 Ga. App. at 84, 593 S.E.2d at 39. The court of appeals noted that even if the bank had invested in U.S. government securities, there was still no evidence that the bank would have chosen to invest in securities with a maturity greater than 183 days. *Id.*

21. *Id.* at 85-86, 593 S.E.2d at 40.

22. *Id.* at 84-85, 593 S.E.2d at 39.

23. *Id.* at 84, 593 S.E.2d at 39.

24. *Id.*

25. *Id.* at 84-85, 593 S.E.2d at 39 (citing O.C.G.A. §§ 13-2-2, 24-6-1 (1997)).

26. *Id.* at 85, 593 S.E.2d at 39 (citing *Redfearn v. C & S Nat'l Bank*, 122 Ga. App. 282, 285, 176 S.E.2d 627, 629 (1970)).

27. *Namik*, 279 Ga. at 252, 612 S.E.2d at 273. The supreme court also noted that the court of appeals inappropriately held that the Slaughter Memo was not admissible because it represented an agreement arrived at subsequent to the writing. The supreme court concluded that the Slaughter Memo and the agreement were contemporaneous. *Id.*

28. *Id.* at 251, 612 S.E.2d at 273.

incorporation by reference of the statutory trustee powers.<sup>29</sup> Thus, the supreme court held that the Slaughter Memo was admissible to explain the so-called ambiguity caused by the trust's "silence" on the question of investment vehicles.<sup>30</sup>

The supreme court's reasoning that the Slaughter Memo was admissible is puzzling. The supreme court's conclusion that the trust was silent as to the specific type of investment vehicles that Ali desired is belied by the fact that the trust agreement gave the trustee complete discretion in making investing decisions and incorporated by reference the trustee powers contained in O.C.G.A. section 53-12-232.<sup>31</sup> These powers include a very explicit and broad listing of the types of vehicles in which a trustee is allowed to invest.<sup>32</sup> Section 53-12-232(3) describes the investment power as follows:

To invest and reinvest, as the fiduciary shall deem advisable, in common or preferred stocks, bonds, debentures, notes, mortgages, or other securities, in or outside the United States; in insurance contracts on the life of any beneficiary or of any person in whom a beneficiary has an insurable interest or in annuity contracts for any beneficiary; in any real or personal property; in investment trusts, including the securities of or other interests in any open-end or closed-end management investment company or investment trust registered under the Investment Company Act of 1940, as from time to time amended; in participations in common trust funds; and, generally, in such property as the fiduciary shall deem advisable even though the investment is not of the character approved by applicable law but for this paragraph  
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<sup>33</sup>

This language has probably been incorporated over the years into thousands of trust instruments. Settlers and trustees will be surprised to find that their trust instruments are "silent" and "ambiguous" as to what investment vehicles should be used.<sup>34</sup>

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29. *Id.*

30. *Id.* at 252, 612 S.E.2d at 273.

31. *See* O.C.G.A. § 53-12-232.

32. *See id.*

33. *Id.* § 53-12-232(3).

34. Interestingly, the supreme court issued an initial opinion in this case in February 2005, but then granted a motion for reconsideration. On reconsideration, the court did not change its ultimate finding, but vacated its first opinion and replaced it with a new one. In that original opinion, the supreme court apparently did not notice that the trust instrument incorporated the Georgia trustee powers by reference. The opinion in the initial case said that the trust was silent and ambiguous as to the investment vehicles and then proceeded to state that this "incomplete provision" could be contrasted to that in *Thomas v. Wood*, 228 Ga. 206, 184 S.E.2d 561 (1971), where a trustee

In *SunTrust Bank v. Merritt*,<sup>35</sup> the court of appeals interpreted language in a testamentary trust that was to pay “the entire net income” to Mr. Merritt for life, and then pay the remainder to his descendants.<sup>36</sup> The trust also included the following language:

If at any time [William Merritt] is in actual need of support and has no other adequate means of support, including the income from this trust and any other means of support, then the Trustees shall be authorized to encroach on the corpus of the property in such amounts as in the judgment of the corporate Trustee is absolutely necessary to provide for his actual and essential support. I do not intend that the Trustees encroach on the corpus in order to provide a standard of living equal to that to which he may have been accustomed, but I intend the power of encroachment to be exercised only in case of absolute necessity. The judgment of the corporate Trustee shall be final and conclusive.<sup>37</sup>

Mr. Merritt served as co-trustee with the bank.<sup>38</sup> At his insistence, the trust invested in tax-free assets in order to “maximize tax-free income.” The corpus of his trust was valued at \$675,000 at the initiation of the trust and \$732,000 when he died in 2000, but its growth had not kept pace with inflation. Two other similar trusts, which were set up for his sisters and their families, had been invested primarily in stocks over the same time period and had tripled in value. Mr. Merritt’s children, who were the remainder beneficiaries under his trust, claimed that the bank had breached its duty to administer the trust in a manner that balanced the interests of the income beneficiary against the remainder beneficiaries by favoring the interest of the income beneficiary rather than the remainder beneficiaries.<sup>39</sup> The trial court found that “the interests of the remainder beneficiaries were secondary to those of the income beneficiary.”<sup>40</sup>

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was empowered to sell, exchange or otherwise dispose of the trust property at public or private sale for cash or on terms; to retain, sell, invest and reinvest in any stocks, bonds, securities or other property, real or personal, which he deemed proper, necessary or expedient, without any responsibility for the exercise of his discretion except that of using ordinary care and without being confined to legal investments.

228 Ga. at 209, 184 S.E.2d at 564. The court’s language bore a striking resemblance to the language in O.C.G.A. section 53-12-232(3) (original opinion on file with author).

35. 272 Ga. App. 485, 612 S.E.2d 818 (2005).

36. *Id.* at 486, 612 S.E.2d at 820.

37. *Id.* (brackets in original).

38. *Id.* at 487 n.5, 612 S.E.2d at 820 n.5.

39. *Id.*, 612 S.E.2d at 821. This duty is discussed in the context of Georgia’s new Trust Flexible Income Legislation at *infra* Part II.B.

40. *Merritt*, 272 Ga. App. at 487, 612 S.E.2d at 821.

The court of appeals agreed, and although its opinion is not completely clear, the court apparently relied on the rule that a trustee must treat beneficiaries who have different interests in an impartial manner unless the trust provisions give the trustee the discretion or direction to favor one or more beneficiaries over the other.<sup>41</sup> The court analyzed the words of the trust to discern whether it gave the trustee the discretion to favor Mr. Merritt's interest over that of his descendants.<sup>42</sup> Finding no Georgia cases on point, the court turned to cases from two other jurisdictions to support its holding that the trust language indicated that the trustee's only duty was to preserve the corpus, not increase it.<sup>43</sup> The court cited an Arizona case, *Tovrea v. Nolan*,<sup>44</sup> for the proposition that the primary purpose of the Merritt trust was to provide a lifetime income for Mr. Merritt.<sup>45</sup> However, a close examination of the language of the *Tovrea* trust reveals that the two trusts differ in terms of the settlor's intent toward the income beneficiary. The Merritt trust's invasion clause, quoted above, was narrow and not in the least generous toward the income beneficiary. The *Tovrea* trust, on the other hand, included broad language that showed an intent to use trust assets to favor the income beneficiary. The trust in *Tovrea* explicitly allowed the trustee to invade the trust corpus for the income beneficiary "at such times and in such amounts as they shall determine, in their sole and absolute discretion, that she may benefit from additional funds to maintain her health, education and general welfare."<sup>46</sup> The Arizona court concluded that "[c]learly, [the settlor] intended that the trust provide for [the income beneficiary], even at the expense of principal."<sup>47</sup> The language in the Merritt trust did not exhibit such clear intent. If anything, the Merritt trust indicated that the remainder beneficiaries' interest was not to be sacrificed in favor of the income beneficiary's interest except in the most dire circumstances.<sup>48</sup>

Perhaps most troubling about *Merritt* is the court's seemingly blanket conclusion that because the trust was set up to pay income to Mr.

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41. *Id.* at 488, 612 S.E.2d at 821. See RESTATEMENT (THIRD) OF TRUSTS § 183 cmt. a (1997).

42. *Merritt*, 272 Ga. App. at 489, 612 S.E.2d at 822. The court engaged in this examination in the process of deciding that the trustee had no duty to meet or exceed inflation when investing the trust corpus. *Id.*

43. *Id.* at 490, 612 S.E.2d at 822 (citing *In re Trust Created by Martin*, 266 Neb. 353, 664 N.W.2d 923 (2003); *Tovrea v. Nolan*, 178 Ariz. 485, 875 P.2d 144 (1993)).

44. 178 Ariz. 485, 875 P.2d 144 (1993).

45. *Merritt*, 272 Ga. App. at 489, 612 S.E.2d at 822.

46. 178 Ariz. at 490, 875 P.2d at 149.

47. *Id.*

48. *Merritt*, 272 Ga. App. at 490, 612 S.E.2d at 822.



Merritt for his life, the settlor clearly intended to favor the income beneficiary over the remainder beneficiaries.<sup>49</sup> From this conclusion, the court extrapolates its holding that the trial court should have granted summary judgment in the trustee's favor on the issue of whether the trustee breached its fiduciary duty to the remainder beneficiaries by not investing to keep pace with inflation.<sup>50</sup> Discerning the court's intent is difficult. The court may be making a blunt statement that, as a matter of law, the duty to "preserve and protect"<sup>51</sup> the trust corpus in a trust with an income beneficiary does not include a duty to keep pace with inflation. On the other hand, the court may be saying that the particular language of the Merritt trust indicates a clear intent to favor the income beneficiary, and thus precludes any need to keep up with inflation. Because trusts with bifurcated interests between income beneficiaries and remainder beneficiaries are quite common, either interpretation leaves trustees in a quandary as to exactly when the rule of impartial treatment of different classes of trust beneficiaries would be applicable.

#### B. *Will Revocation: Which Law Applies*

Effective January 1, 1998, Georgia enacted a complete revision of the Georgia Probate Code.<sup>52</sup> The new code sections apply to all cases decided on or after that date, "provided, however, that no vested rights of title, year's support, succession, or inheritance shall be impaired."<sup>53</sup> The transition from the old code to the revised code raised some questions about whether the revised law applied to determine the legal effect of actions that occurred prior to January 1, 1998. In *Colella v. Coutu*,<sup>54</sup> a 2004 case, the Georgia Supreme Court applied the new law to determine whether a testator's pre-1998 divorce had revoked his pre-1998 will.<sup>55</sup> At the time of the testator's divorce, under the former Probate Code, a divorce caused the complete revocation of a will by operation of law.<sup>56</sup> The testator died in 2000 and his executor argued that the Revised Probate Code of 1998 applied.<sup>57</sup> Under the revised

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49. *Id.*

50. *Id.*

51. *Id.* The court refers to this duty earlier in the opinion. *Id.* at 489, 612 S.E.2d at 822.

52. O.C.G.A. §§ 53-2-1 to 53-11-11 (1997) (revised Jan. 1, 1998).

53. O.C.G.A. § 53-1-1 (1997 & Supp. 1998).

54. 278 Ga. 440, 603 S.E.2d 296 (2004).

55. *Id.* at 441, 603 S.E.2d at 297.

56. O.C.G.A. § 53-2-76 (repealed 1998).

57. *Colella*, 278 Ga. at 441, 603 S.E.2d at 297.

Code, O.C.G.A. section 53-4-49<sup>58</sup> does not cause a total revocation of a will upon divorce, but merely causes the former spouse to be treated as if she had predeceased the testator.<sup>59</sup> In *Colella* the testator's will made no provision for the former spouse, and application of the new statute would result in the will remaining intact as written.<sup>60</sup> The supreme court agreed with the probate and superior court findings that the law in effect at the time of the testator's death controlled and thus allowed the admission of the will to probate.<sup>61</sup> The caveators argued that the 1994 divorce revoked the will so there "was simply no will to which the 1998 law could be applied . . ."<sup>62</sup> The court, however, insisted that because the will had no operative effect until the testator died, nothing existed upon which the statutory rules of revocation could operate.<sup>63</sup>

### C. Supreme Court Reverses the 2004 Court of Appeals Decision on Advancements

Last year this author reported on *Walters v. Stewart*,<sup>64</sup> in which the court of appeals examined whether an executor who may have received an advancement from a testator during the testator's life is obliged to acknowledge that advancement by virtue of his status as a fiduciary.<sup>65</sup> In *Walters* a testator's son received a transfer from the testator that arguably could be deemed an "advancement" to the son to be charged off against the share he was to receive under his father's estate. The applicable law required an advancement to be evidenced by a writing, and the same law indicated that the writing could be signed by the transferor within thirty days of the transfer or "signed by the recipient at any time."<sup>66</sup> The father had not signed any such acknowledgment. When the father died, his son qualified as executor and refused his sibling's request that he sign a written acknowledgment that the transfer was an advancement. The court of appeals held that the son had "the sacred duty as executor to acknowledge the transfer as an advancement, if that was in fact his father's intention."<sup>67</sup> The following

58. O.C.G.A. § 53-4-49 (1997).

59. *Id.*

60. *See Colella*, 278 Ga. at 440, 603 S.E.2d at 297.

61. *Id.*

62. *Id.* at 441, 603 S.E.2d at 298.

63. *Id.*

64. 263 Ga. App. 475, 588 S.E.2d 248 (2003), *rev'd*, 278 Ga. 374, 602 S.E.2d 642 (2004).

65. Radford, *supra* note 7, at 470-72.

66. O.C.G.A. § 53-1-10(c) (1997). The court of appeals decided the new law should apply to this transfer. *Walters*, 263 Ga. App. at 475-76, 588 S.E.2d at 249-50.

67. *Walters*, 263 Ga. App. at 477, 588 S.E.2d at 250.

year, the supreme court reversed this decision by the court of appeals.<sup>68</sup> The supreme court held that an individual who received a transfer of money or property from the testator prior to being qualified as executor of the testator's estate is not subject to any fiduciary duties regarding that transfer.<sup>69</sup> The imposition of such a requirement on a transferee "unduly penalizes the transferee who assumes this service [as executor], with the consequence that nominated executors may be forced to decline the position thereby thwarting the expressed desires of the testator."<sup>70</sup>

## II. 2005 LEGISLATION

### A. *Guardianship and Conservatorship Code: Title 29*

In 2004 the Georgia General Assembly enacted a total revision of Title 29 of the O.C.G.A.,<sup>71</sup> which governs guardianships and conservatorships of minors and incapacitated adults. This revision became effective on July 1, 2005, and was discussed in this author's article in the 2004 *Annual Survey of Georgia Law*.<sup>72</sup>

### B. *"Flexible Income" Trust Legislation*

In 2005 the Georgia General Assembly enacted House Bill 406,<sup>73</sup> which revised those sections of Chapter 12 of Title 53 (the "Georgia Trust Act")<sup>74</sup> that describe a trustee's powers in relation to the allocation of trust receipts and disbursements between income and principal. The legislation intends to incorporate flexibility into a trust structured to pay income to a person or persons for a period of time, followed by a distribution of the principal to one or more remainder beneficiaries.<sup>75</sup> In such a trust, tension exists between the income beneficiaries, who typically desire high-yield, potentially risky investments, and the

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68. *Stewart v. Walters*, 278 Ga. 374, 602 S.E.2d 642 (2004).

69. *Id.* at 376, 602 S.E.2d at 644.

70. *Id.*

71. Georgia Guardianship and Conservatorship Code, O.C.G.A. § 29-1-1 to 29-10-11 (2004).

72. Radford, *supra* note 7, at 477-78.

73. Ga. H.R. Bill 406, Reg. Sess. (2005). See Donna Barwick, *House Bill 406: Georgia Flexible Income Trust Legislation*, 22 GA. PROBATE NOTES 9, at 1-5, May-June 2005.

74. O.C.G.A. Title 53, Chapter 12, which is known as the Georgia Trust Act, was enacted in 1991. O.C.G.A. § 53-12-1 (1997).

75. See Barwick, *supra* note 73, at 1. The new Georgia statute is not necessary or applicable if the trust instrument gives the trustee discretionary powers relating to income and principal, such as the power to encroach upon the principal for the benefit of the income beneficiary. See O.C.G.A. § 53-12-211(a) (1997).

remainder beneficiaries, who prefer investment for growth.<sup>76</sup> Unless the trust instrument states otherwise, the trustee is required to deal with all of these beneficiaries with impartiality.<sup>77</sup> The new legislation allows the trustee to invest to achieve the best total return for the trust assets without having to focus on the dichotomy between the traditional accounting definitions of “income” and “principal.”

The Georgia legislation was the work product of a subcommittee of the Fiduciary Law Section of the State Bar of Georgia, chaired by Donna Barwick.<sup>78</sup> The subcommittee’s work was prompted by the growing emphasis in the trust field on the concept of investing for total return regardless of whether the return takes the form of traditional accounting income or appreciation of capital assets.<sup>79</sup> This emphasis, in turn, resulted in the adoption by many states of the 1994 Uniform Prudent Investor Act<sup>80</sup> and the 1997 revisions to the Uniform Principal and Income Act.<sup>81</sup> Additionally, effective January 2, 2004, the Internal Revenue Service finalized regulations under Internal Revenue Code (“IRC”) § 643<sup>82</sup> that refine the definition of “income” for a variety of tax purposes.<sup>83</sup> The regulations provide that a definition of income acceptable under applicable state law will also be acceptable for tax

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76. One commentator has described the problem as follows:

The income beneficiaries of a trust, however, usually have a different goal than the remainder beneficiaries of the trust for the type of investments they want to see. Income beneficiaries prefer investments providing for a higher current yield, but remainder beneficiaries want investments that will appreciate in value over time. Satisfying these conflicting desires has become increasingly difficult for trustees, particularly when current yields are at historic lows.

Louis A. Mezzulo, *Final Regulations on the Definition of Fiduciary Income*, 19 PROB. & PROP. 26, 27, March/April 2005. See also Byrle M. Abbin, *Interaction of Total Return Trusts and the Definition of Income Regs.*, 32 EST. PLAN. 3, August 2005.

77. See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 227 (1990). This rule was at issue in *SunTrust Bank v. Merritt*, which is discussed *supra* at text accompanying note 2. The amended Georgia statute requires the trustee to “administer a trust impartially based on what is fair and reasonable to all the beneficiaries, except to the extent that the governing instrument clearly manifests an intention that the trustee shall or may favor one or more of the beneficiaries.” O.C.G.A. § 53-12-211(b) (Supp. 2005).

78. For a detailed description of this new legislation, see Barwick, *supra* note 73, at 1-5.

79. See Prefatory Note, Uniform Principal and Income Act (1997).

80. Unif. Prudent Investor Act, 7B U.L.A. 16 (1994).

81. Unif. Principal and Income Act, 7B U.L.A. 131 (1997).

82. 26 U.S.C. § 643 (2000).

83. Treas. Reg. § 1.643(b)(1) (2005). There are a number of tax provisions in which the definition of income is important. For example, to receive the marital deduction for estate tax purposes for property that is devised to the surviving spouse in a qualified terminable interest (“QTIP”) trust, the spouse must receive all of the income from the trust, payable at least annually. 26 U.S.C. § 2056 (2000) (I.R.C.). For a description of this and other tax provisions that involve a definition of income, see Mezzulo, *supra* note 76, at 28-29.

purposes.<sup>84</sup> Additionally, the regulations discuss two types of state laws that define income differently from traditional accounting definitions: (1) laws that give the trustee power to adjust receipts and disbursements between income and principal; and (2) laws that allow a trust to be converted to a unitrust.<sup>85</sup> The Georgia legislation adopts both of these types of laws.

The first type of state statute recognized by the Treasury Regulations is "the power to adjust."<sup>86</sup> The amended O.C.G.A. section 53-12-220<sup>87</sup> gives this power to trustees.<sup>88</sup> Basically, the trustee can "adjust between principal and income by allocating an amount of income to principal or an amount of principal to income to the extent the trustee considers appropriate . . ." to carry out the trustee's overall duty of fairness to all beneficiaries.<sup>89</sup> The statute includes a nonexclusive list of factors that the trustee may consider in making an adjustment.<sup>90</sup>

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84. Treas. Reg. § 1.643(b)(1).

85. *Id.*

86. *Id.* The power to adjust is incorporated into section 104 of the 1997 Revised Uniform Principal and Income Act.

87. O.C.G.A. § 53-12-220 (1997 & Supp. 2005).

88. *Id.* § 53-12-220(a).

89. *Id.*

90. See O.C.G.A. § 53-12-220(b) (1997 & Supp. 2005). These factors are:

- (1) The size of the trust;
- (2) The nature and estimated duration of the trust;
- (3) The liquidity and distribution requirements of the trust;
- (4) The needs for regular distributions and preservation and appreciation of capital;
- (5) The expected tax consequences of an adjustment;
- (6) The net amount allocated to income under this chapter and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;
- (7) The assets held in the trust; the extent to which they consist of financial assets, interests in closely held enterprises, and tangible and intangible personal property or real property; the extent to which an asset is used by a beneficiary; and whether an asset was purchased by the trustee or received from the settlor or testator;
- (8) To the extent reasonably known to the trustee, the needs of the beneficiaries for present and future distributions authorized or required by the governing instrument;
- (9) Whether and to what extent the governing instrument gives the trustee the power to invade principal or accumulate income or prohibits the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income;
- (10) The intent of the settlor or testator; and
- (11) The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation on the trust.

*Id.*

The statute also contains prohibitions against making an adjustment in certain circumstances, primarily if the adjustment would cause one or more of the beneficiaries or the trust to lose a tax advantage.<sup>91</sup> A trustee cannot exercise the power to adjust if the trustee is a beneficiary of the trust,<sup>92</sup> but a disinterested co-trustee is allowed to exercise the power.<sup>93</sup>

The second type of statute contemplated in the Treasury Regulations and incorporated into the Georgia legislation is the power to convert the trust to a "unitrust."<sup>94</sup> A unitrust is a trust in which the annual payout is a fixed percentage of the total trust assets (the "unitrust rate"), regardless of whether that amount represents more or less than the actual accounting income earned by the trust in that year.<sup>95</sup> The Treasury Regulations accept any statutorily-mandated unitrust rate that falls within three to five percent.<sup>96</sup> The Georgia statute specifies that the unitrust rate shall be four percent,<sup>97</sup> unless the court allows a different payout rate.<sup>98</sup>

Unlike the power to adjust, the power to convert into a unitrust may not be exercised by the trustee unilaterally. First, the trustee must release the power to adjust.<sup>99</sup> Second, the trustee must then give notice

91. These circumstances are described in O.C.G.A. section 53-12-220(c).

92. O.C.G.A. § 53-12-220(c)(7).

93. *Id.* § 53-12-220(d).

94. Treas. Regs. § 1.643(b)(1) (2005).

95. See Abbin, *supra* note 76, at 10. Some states have adopted unitrust statutes that define the distributable amount as the greater of the actual accounting income or the unitrust amount. Georgia did not adopt this variation. However, the Georgia statute allows the court to authorize a payment of net income even if it would exceed the unitrust amount if needed to preserve a tax benefit. O.C.G.A. § 53-12-221(g)(2). The Georgia statute also contains a rule that dictates the order in which actual income and principal amounts will be charged off to pay the unitrust amount:

Unless otherwise provided by the governing instrument, the unitrust distribution shall be paid from net income, as such term would be determined if the trust were not a unitrust. To the extent net income is insufficient, the unitrust distribution shall be paid from net realized short-term capital gains. To the extent income and net realized short-term capital gains are insufficient, the unitrust distribution shall be paid from net realized long-term capital gains. To the extent income and net realized short-term and long-term capital gains are insufficient, the unitrust distribution shall be paid from the principal of the trust.

O.C.G.A. § 53-12-221(f)(2).

96. Treas. Regs. § 1.643(b)(1) (2005).

97. O.C.G.A. § 53-12-221(d)(3). The rate is actually "4 percent of the net fair market value of the trust's assets . . . averaged over the lesser of: (A) The three preceding years; or (B) The period during which the trust has been in existence." *Id.*

98. O.C.G.A. § 53-12-221(g)(1).

99. *Id.* § 53-12-221(a).

of its intent to convert the trust to "all the sui juris beneficiaries who: (A) Are currently eligible to receive income from the trust; and (B) Would receive, if no power of appointment were exercised, a distribution of principal if the trust were to terminate immediately prior to the giving of notice."<sup>100</sup> If the beneficiaries do not object, the trustee may then convert the trust.<sup>101</sup> Alternatively, the trust or a beneficiary may petition the court to approve the conversion of a trust to a unitrust.<sup>102</sup> The statute contains a list of factors to be taken into account when determining whether to convert a trust that is substantially similar to those listed in the adjustment statute.<sup>103</sup> The unitrust statute also contains prohibitions against conversion to a unitrust that, similar to those prohibitions in the adjustment statute, are designed primarily to prevent a conversion that would jeopardize a tax advantage enjoyed by one of the beneficiaries or the trust.<sup>104</sup>

The new legislation also contains a remedy for situations where a trustee abuses its discretion by exercising or failing to exercise the power to either adjust or convert.<sup>105</sup> The remedy is simply "to restore the income and remainder beneficiaries to the positions they would have occupied if the trustee had not abused its discretion . . ."<sup>106</sup> If a beneficiary receives a distribution that is too small, the trustee in subsequent years will distribute to that beneficiary the amount needed to restore the deficiency.<sup>107</sup> If a beneficiary receives a distribution that is too large, the trustee will withhold future distributions to that beneficiary in order to make up for that overpayment.<sup>108</sup> If a trustee's abuse is related to the power to convert to a unitrust, the court will order either a conversion to a unitrust or a reconversion from a unitrust as appropriate.<sup>109</sup> The trustee must use its own funds to restore

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100. *Id.* § 53-12-221(a)(2). The trustee must give notice of (1) its intent to release the power to adjust and to convert the trust, (2) notice of how the unitrust will operate, and (3) notice of when the trust assets will be valued. *Id.*

101. *Id.* § 53-12-221(a)(3)-(4). At least one sui juris beneficiary must exist in each of the two categories, or the trustee may not convert without court permission. *Id.* § 53-12-221(b)(1)-(3).

102. *Id.* § 53-12-221(b). A beneficiary must first request that the trustee make the conversion and may only petition the court if the trustee refuses the request. *Id.*

103. *Id.* § 53-12-221. See *supra* note 90.

104. O.C.G.A. § 53-12-221.

105. O.C.G.A. § 53-12-222.

106. *Id.* § 53-12-222(c).

107. *Id.* § 53-12-222(c)(1).

108. *Id.* § 53-12-222(c)(2).

109. *Id.* § 53-12-222(c)(3).

beneficiaries only if the court cannot use any of the three above described methods to restore them and the trust.<sup>110</sup>

### C. *Voluntary Legitimation of a Parent-Child Relationship*

Both the Georgia Probate Code<sup>111</sup> and the Georgia Guardianship and Conservatorship Code<sup>112</sup> contain provisions that contemplate the legitimation of a father-child relationship in order for the father to be legally recognized as the parent of the child. Under O.C.G.A. sections 53-2-3<sup>113</sup> and 53-2-4,<sup>114</sup> inheritance rights between a father and a child born out of wedlock may be established in a number of different ways. Two of these methods are: (1) if “[a] court of competent jurisdiction has entered an order declaring the child to be legitimate, under the authority of Code Section 19-7-22 or such other authority as may be provided by law;”<sup>115</sup> or (2) if “[t]he father has executed a sworn statement signed by him attesting to the parent-child relationship . . . .”<sup>116</sup> The 2005 Guardianship and Conservatorship Code defines a “parent” as

a biological or adoptive father or mother whose parental rights have not been surrendered or terminated and, in the case of a child born out of wedlock, the individual or individuals who are entitled to have custody of and exercise parental power over the child pursuant to Code Section 19-7-25.<sup>117</sup>

If the parent of a child—the mother in the case of a nonlegitimated child born out of wedlock—is dead and a third party petitions to become the child’s guardian, the code requires that the biological father be given both notice of the petition and thirty days “to file a petition to legitimize the minor pursuant to Code Section 19-7-22.”<sup>118</sup>

Traditionally, as these laws reflect, the parent-child relationship between a father and his nonmarital offspring could be legitimated only through a formalized court proceeding. In 2005 the O.C.G.A. was amended to add a new way to legitimize the parent-child relationship

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110. *Id.* § 53-12-222(c)(4).

111. O.C.G.A. §§ 53-2-1 to 53-11-11 (1997) (revised Jan. 1, 1998).

112. O.C.G.A. §§ 29-1-1 to 29-10-11.

113. O.C.G.A. § 53-2-3.

114. O.C.G.A. § 53-2-4.

115. O.C.G.A. § 53-2-3(2)(A)(I); O.C.G.A. § 53-2-4(b)(1)(A). O.C.G.A. section 19-7-22 (2004 & Supp. 2005) describes the method by which a father of a child born out of wedlock may petition a court to render legitimate his relationship with his child.

116. O.C.G.A. § 53-2-3(2)(A)(iii); O.C.G.A. § 53-2-4(b)(1)(C).

117. O.C.G.A. § 29-1-1(13).

118. O.C.G.A. § 29-2-15(c) (Supp. 2004).



between a father and a child born out of wedlock.<sup>119</sup> Under the amended O.C.G.A. section 19-7-22, a mother and father can legitimate the relationship by signing a “voluntary acknowledgment of paternity” to which “both the mother and father freely agree and consent,” in which case “the child may be legitimated by the inclusion of a statement indicating a voluntary acknowledgment of legitimation.”<sup>120</sup> To date, neither the Probate Code nor the Guardianship Code contemplate the use of this voluntary acknowledgment of legitimation. Conceivably, the acknowledgment could establish the relationship under those sections of the Probate Code that allow paternity to be proven by a “sworn statement,”<sup>121</sup> but no requirement exists in Title 19 that the “voluntary acknowledgment of paternity” be a *sworn* statement.<sup>122</sup>

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119. O.C.G.A. § 19-7-22(g)(2) (2004 & Supp. 2005).

120. *Id.* Under O.C.G.A. sections 19-7-46.1 and 19-7-51, the signature of a mother and father on a voluntary acknowledgment of paternity, combined with the filing of the acknowledgment in the putative father registry, will establish paternity for the purposes of matters such as child support. O.C.G.A. § 19-7-46.1 (2004); O.C.G.A. § 19-7-51 (2004).

121. O.C.G.A. § 53-2-3(2)(A)(iii); O.C.G.A. § 53-2-4(b)(1)(C).

122. O.C.G.A. § 53-2-3(2)(A)(iii); O.C.G.A. § 53-2-4(b)(1)(C).