

COMMITTEE REPORT: ESTATE PLANNING & TAXATION



By **John H. Skarbnik**

Protecting Pets

Issues to consider when drafting a trust

Americans love their pets. The size of the U.S. pet market is a testament to this devotion. The American Pet Products Association estimates that Americans in 2014 spent \$58.04 billion on their pets, which was more than three times the amount spent in 1994. Sixty-five percent of all U.S. households own over 300 million pets.¹

As many of your clients may consider their pets to be valued members of their families, the initial estate-planning conference with a client should include a discussion of who will care for the pet on the client's disability and/or death. Should the disabled or deceased client's assets be used to pay for the care and maintenance of the pets? Should the selected caretaker of the pet(s) be compensated or receive a bequest for the services that he'll render in caring for the pet(s)? For single individuals who don't have family in close proximity, finding a caretaker or organization may be challenging.

Fortunately, the law concerning whether an individual can create a trust for the benefit of an animal has evolved significantly over the past 25 years. Pet trusts are now recognized in 46 states and Washington, D.C. Prior to the enactment of these statutes, individuals couldn't create pet trusts. Pet trusts were unenforceable or were treated as invalid, mainly due to violating the rule against perpetuities (RAP).

RAP

In a 1952 New York case, a testator created a trust to provide funds for the care of her pets. The monies earned on the trust funds were to be paid to the

caretaker of the pets. On the death of all the testator's pets, the remaining property held in the trust was to pass to The New York Women's League for Animals. Notwithstanding the explicit direction of the testator, the court held that the fund should be immediately distributed to the The New York Women's League for Animals. The court stated:

'At the death of all the pets' the trust is to end. No other provision limits its term. Thus the trust was intended to be measured by the lives of animals and not human beings. 'The right of the beneficiary to enforce the performance of a trust to receive the income of personal property, and to apply it to the use of any person, can not be transferred by assignment or otherwise.' Pers. Prop. Law, § 15, subd. 1. Every income trust is thus by statute a spendthrift trust and suspends the 'absolute ownership of personal property,' Pers. Prop. Law, § 11; Real Prop. Law, § 42. The latter statute provides that 'The absolute power of alienation is suspended, when there are no persons in being by whom an absolute fee in possession can be conveyed.' The phrases 'lives in being' and 'persons in being' as used in the statutes of perpetuities refer to human beings. It is, therefore, my opinion that income or rents and profits trusts may only be measured by the life or lives of human beings... The trust provision intended by the testatrix must therefore fail.²

Similarly, a California court held that a trust created for the benefit of an animal violated the California RAP.³ As a result, the assets that were to pass into the trust for the benefit of the decedent's pets directly passed to the residuary beneficiary of the trust, which was the Society for the Prevention of Cruelty to Animals.⁴



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Statutory Changes

Only four states haven't adopted statutes that permit the creation of pet trusts.⁵ The National Conference of Commissioners on Uniform State Laws enacted two uniform acts that recognize the validity of trusts created for the benefit of pets: The Uniform Probate Code (UPC) Section 2-907(c), Honorary Trusts (enacted in 1990) and the Uniform Trust Code (UTC) (enacted in 2000), which provides that a trust can be created for the care of animals.

Although the uniform acts differ in a number of respects, they also have some similarities. Both provide that the trust will terminate when no living animal ben-

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eficiary of the trust is surviving.⁶ Both also provide that certain designated individuals can enforce the terms of the trust. The UPC provides that if no trustee is designated or no designated trustee is willing to serve, a court shall name the trustee. The court can also order the transfer of property to another trustee to ensure that the intended use is carried out.⁷ The UTC provides that the trust will be enforced by the individual appointed under the terms of the trust or if no such individual is appointed, by an individual appointed by the court. Additionally, an individual who has an interest in the welfare of the animal may request that the court appoint an individual to enforce the trust or remove an individual so appointed.⁸

Both uniform acts have provisions that stipulate how property will be distributed on termination of the trust if there's property remaining in the trust. The UPC provides that such property will be distributed as provided in the trust instrument. If the instrument doesn't provide how the remaining property in a testamentary trust is to be distributed on termination, such property shall pass pursuant to the residuary clause in the transferor's will.

If there's no residual disposition clause, then it shall pass to the heirs of the transferor.⁹ The UTC provides that to the extent property isn't required for the intended use, it may be distributed to the settlor, if living, otherwise to the settlor's successors in interest.¹⁰

Both uniform acts provide that a court has the discretion to reduce the amount of property transferred to the trust if it determines that it exceeds the amount required for the intended use.¹¹

Twenty states have passed pet trust statutes that are based on the UPC.¹² However, the state statutes vary. For example, a trust terminates when no living animal beneficiary is alive. The issue may become whether an animal who hasn't yet been born at the time the trust is created is considered living at that time. Colorado's statute addresses this issue by providing that a pet's offspring in gestation may be a beneficiary of the trust.¹³ Although the UPC provides that no portion of principal and income may be converted to the use of the trustee, Massachusetts permits the trustees to be paid a "reasonable trustee fee."¹⁴ The UPC provides that no accounting may be required by statute. Notwithstanding this provision, the California statute provides that annual accountings shall be provided to individuals who would be entitled to the distribution of the trust assets if the animal were deceased.¹⁵ Oklahoma requires an accounting if the value of the trust exceeds \$20,000, unless the court orders otherwise.¹⁶ The Connecticut statute requires a provision within the trust appointing a trust protector.¹⁷

Twenty-six states and Washington, D.C. have adopted statutes based on the UTC.¹⁸ There are variations among states. The New Jersey statute provides that the trust will terminate on the earlier of when no living animal is covered by the trust or at the end of 21 years.¹⁹

Creating the Pet Trust

A pet trust should address a number of issues including:

1. Which pets will be beneficiaries of the trust?
2. Will a pet acquired by a settlor of an inter vivos trust after its execution be added as a beneficiary?
3. How much money should the settlor contribute to the trust?
4. Should the trustee make periodic distributions to the caretaker?
5. Should the caretaker account to the trustee for actual



- expenses? If so, how often?
6. Should the trustee require the caretaker to provide copies of receipts and disbursements?
 7. Who should be the trustee? Ideally, to create checks and balances, the caretaker shouldn't serve as the trustee.
 8. On the termination of the trust, who should the remaining trust assets be distributed to?
 9. Should the trust provide for compensation of the caretaker or trustee?

Review state statutes that are modeled on the UPC because the uniform act provides that “no portion of the principal or income may be converted to the use of the trustee.”²⁰ However, some states have modified this provision to provide that reasonable compensation may be paid to the trustee.²¹

In states that have statutes that don't directly provide that pet trust monies may be distributed to compensate caretakers and/or trustees, the testator or the settlor of an inter vivos trust should consider creating a separate trust that can provide for payments to the caretaker and/or trustees. Or, consider another alternative: Make a specific bequest in the pet owner's last will and testament of monies to the caretaker and/or trustees.

Overfunding a Pet Trust

States may have statutes that empower courts to reduce the amounts passing into a pet trust. The UPC permits a court to reduce the amount of property transferred if it determines that the “amount substantially exceeds the amount required for the intended use.”²² The UTC is similar except it doesn't contain the word “substantial.”

In a 2014 New York case,²³ the decedent died with an estate of \$4.5 million. Other than a bequest of \$115,000, which passed to various charities for the care of animals, the entire balance of the estate, which included the decedent's home, passed into a trust. The decedent's will directed the caretaker of his pets to reside in the home with his pets. The executor of the estate sought to reduce the amount passing into the trust and requested that the house be sold and the caretaker of the pets be moved into a less expensive residence. The executor sought to distribute the excess money to 33 charities that were the residual beneficiaries of the trust. The court refused to make the change. The court distinguished its decision in

Helmsley, whereby the court reduced the amount passing into a pet trust stating:

In *Helmsley*, the pet trust was reduced from \$12 million to \$2 million because the trust was overfunded for carrying out the decedent's wishes. Unlike Copeland's [the executor] prayer for relief here, the petitioner in *Helmsley* did not seek to alter Mrs. Helmsley's wishes and arrangements for her dog, Trouble. Simply put, Mrs. Helmsley had made a disposition to the trust greater than what was required to carry out her intentions.²⁴

When a testator creates a trust for the benefit of his pet(s) and directs the trustees to pay for expenses relating to the care and maintenance of a monument or burial plots, courts may decrease²⁵ or increase²⁶ the amount the testator directed to use for such purpose.

Selecting a Caretaker and Trustees

It's important that a pet owner select a person who's willing to serve as caretaker of his pets in the event of the owner's death or incapacity. The pet owner should speak with the individuals he selects to serve as the caretaker and successor caretaker for his pet(s) to make sure that they're willing to accept this responsibility. If the pet owner creates a pet trust that's directed to pay all expenses relating to the care of the pet(s), this may make it more likely that the caretaker would be willing to take on this responsibility. The caretaker won't have to spend any of his funds caring for the pet(s). Additionally, the pet owner may create a fund to compensate the caretaker for his services. The owner should discuss with the caretaker the amount that he'll be paid for his services.

The trustee selected should be an individual or an organization that will make sure that the money that the settlor places in trust is used as directed in the trust instrument.

Written Directions

To educate the caretaker, a pet owner should prepare a written document that sets forth information about his pet(s). Providing directions and information will assist the caretaker in making the guardian transition easier. For example, if the pet is a dog, how often is the dog walked? How often is the pet fed? What's the pet's favorite



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foods? Are there any foods that should be avoided?

The medical history and the name, address, phone number and email of the pet's veterinarian will be helpful. The pet owner should also provide any other relevant medical information, such as whether the pet has any medical ailments and the medications the pet is taking.

If the caretaker lives in the same neighborhood as the pet owner, the pet owner should provide the names and contact information for dog walkers and the amount of compensation paid to the dog walkers.

If the pet owner has purchased a cemetery plot for the pet, he should advise the caretaker of the name,

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address and contact information of that cemetery. The pet owner should provide copies of the cemetery deed and/or contract and should advise as to whether funeral expenses have been prepaid.

The pet owner should also advise the caretaker as to whether the pet owner has created a trust or a fund of money to pay for the care of the pet, burial and cemetery maintenance. If so, the pet owner should provide the trustee's name and contact information.

Disability of Pet Owner

A pet owner may consider inserting various provisions within his power of attorney (POA) form relating to the care of his pet(s). Within the POA form, the individual may want to provide that in the event of his incapacity, custody of the pet(s) should be delivered to a named individual or facility. If either the designated individual or the facility can't provide custody, he should name a successor. If the named caretakers and successors aren't available, the pet owner can give the attorney-in-fact the authority to find alternative temporary or permanent living arrangements for the pet(s).

The POA form can also direct the attorney-in-fact to use the pet owner's assets to pay all expenses that may be incurred in caring for the pet(s) during the pet owner's disability. Such expenses may include veterinary care, pet hospital stay, pet food, dog walkers and groomers.

Joint Custody

Unrelated individuals living together may purchase or adopt a pet. If they decide that they'll no longer live together, who will obtain custody of the pet?

To avoid issues involving legal ownership in situations in which individuals share joint custody of a pet, the joint owners may want to execute an agreement that acknowledges who should be treated as the owner of the animal. A presumption may be created if the pet is registered to a particular individual or a dog license lists the owner. However, it doesn't necessarily mean that disputes won't arise.²⁷

In a California case, pursuant to a separation agreement, the husband agreed that the dog could temporarily reside with his wife. The California Appeals Court awarded the dog to the husband because he purchased the dog prior to marriage. The court treated the pet as separate community property. States may have statutes that provide who will be treated as the owner of a pet that was lost or stolen and was adopted by a new owner.²⁸

Tax Consequences

Income tax. A settlor creating an inter vivos trust for the benefit of his pet(s) will be able to reduce the income taxes levied on the trust's income if: (1) the trust is classified as a grantor trust, and (2) the settlor isn't in the maximum income and/or Medicare tax bracket. If the trust is a grantor trust, the income it earns is included in the grantor's reportable income and is subject to tax.²⁹ Although the income, deductions and credits are treated as owned by the grantor and reported by the trust on the trust's tax return, the regulations provide that such items are to be shown on a separate statement attached to the tax return.³⁰

The tax saving is achieved as a result of avoiding the high condensed income tax rates that apply to a trust. In 2015, a trust is subject to the maximum 39.6 percent income tax rate on its income that exceeds \$12,300.³¹ Contrast this rate with that of a single individual and



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an individual who's married and files a joint return with his spouse. A single individual will pay tax at the maximum income tax rate only on taxable income in excess of \$413,200. A married couple will be subject to the maximum 39.6 percent tax rate only when their taxable income exceeds \$464,850.³² Additionally, the trust would be subject to the additional 3.8 percent Medicare tax on its undistributed net unearned income, if the trust's adjusted gross income (AGI) in 2015 exceeds \$12,300.³³ Contrast this rate with that of a single individual or an individual who's married and files jointly with his spouse, who won't be subject to the additional 3.8 percent Medicare tax unless his modified AGI exceeded \$200,000 or \$250,000, respectively.³⁴

A valid testamentary pet trust that's funded by a decedent's estate will be treated as a trust and would be subject to the Internal Revenue Code provisions applicable to trusts. As a general rule, the taxable income of a trust is computed in the same manner as that of an individual.³⁵

A trust that distributes all of its current income is generally allowed a deduction equal to its distributable net income (DNI).³⁶ The beneficiary receiving the DNI is generally required to include it in the beneficiary's income whether or not it's distributable.³⁷ When amounts are paid to the caregiver for services, the caretaker will be taxed on the receipt of such money as compensation.³⁸

When a trust is created for a non-human, such as a pet, the issue is whether the pet should be included as the beneficiary of the trust. In Revenue Ruling 76-486,³⁹ the IRS held that no deduction was permitted for the amount paid for the benefit of an animal. The definition of "beneficiary" for the purpose of the distribution rules is an heir, legatee or devisee, who must be an individual.⁴⁰ Assuming the trust is valid and the assets don't pass directly to the residual beneficiary of the trust, the IRS has held that no deduction will be allowed for the amounts paid or distributed for the benefit of the pet. The trust will report all of its income without reduction for any amounts paid to or for the benefit of the pet. As such, the trust will be subject to the condensed estate and trust income tax rates discussed above.

For example, assume a pet trust earns \$40,000 of income on its investments and distributes \$25,000 to the caretaker to reimburse the caretaker for expenses relat-

ing to the care of the animal. The pet trust will report \$40,000 in income and won't be allowed a deduction for the payment of the \$25,000 to the caretaker.

Charitable deduction. A pet trust may provide that on the death of the last surviving pet, the remaining assets in the trust will be paid to a charitable organization. Can the estate of the testator claim a charitable deduction for the amount that passes to the charitable organization?

To claim a deduction, the trust must qualify as a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT).⁴¹ The Treasury regulations provide that a CRAT must distribute an annuity to one or more beneficiaries.⁴² The distribution amount for a CRAT must not be less than 5 percent nor more than 50 percent of the initial fair market value (FMV) of the property placed in trust.⁴³ Similarly, the distribution amount for a CRUT must not be less than 5 percent nor more than 50 percent of the FMV of the property within the CRUT, as valued annually.⁴⁴ Additionally, the CRAT and the CRUT must make current distributions to a beneficiary who's a "named person or persons."⁴⁵

In one revenue ruling,⁴⁶ a testator created a pet trust in a state that had a statute recognizing its validity. The terms of the trust provided for an annuity of "\$10x dollars," which was not less than 5 percent of property placed in trust to pay for the care of the testator's pet. On the termination of the trust, the property was to pass to a specified charity. The IRS ruled that the decedent's estate couldn't claim a charitable deduction for the remainder interest that was to pass to the charity. Although the trust provided for a distribution of an annuity for the care of the pet, because a pet wasn't a person, it wasn't a beneficiary, which includes an "heir, legatee, devisee."⁴⁷ As such, because a distribution wasn't made for the benefit of a person, there was no distribution to a beneficiary. Therefore, the payment to the charity didn't qualify as a charitable remainder annuity.⁴⁸ Similarly, even if under state law the trust was valid but wasn't enforceable, the IRS held that the result would be the same.⁴⁹

If the state where the pet trust was created doesn't recognize its validity, the entire amount passing under the trust would qualify for the charitable deduction. The charity is treated as receiving a present interest, and the rules that apply to



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charitable remainder interests don't apply.⁵⁰ 

Endnotes

1. See American Pet Products Association website, www.americanpetproducts.org/press_industrytrends.asp.
2. *In re Mills Estate*, 111 N.Y.S.2d 622, 625 (N.Y. Sur. Ct. 1952).
3. *Estate of McNeil*, 230 Cal. App.2d 449 (Cal. App. 1963).
4. See also *In re Renner's Estate*, 413 57A.2d 836 (Pa. 1948).
5. Kentucky, Louisiana, Minnesota and Mississippi.
6. Uniform Probate Code (UPC) Section 2-907(b). Uniform Trust Code (UTC) Section 408(a).
7. UPC Section 2-907(c)(4).
8. UTC Section 408(b).
9. UPC Section 2-907(c)(2).
10. UTC Section 408(c).
11. UPC Section 2-907 provides that the amount must substantially exceed the amount required for the intended use; UTC Section 408(c).
12. Alaska Stat. Ann. Section 13.12.907 (2014); Ariz. Rev. Stat. Ann. Section 14-2907 (2014); Cal. Probate Code Section 15212 (2014); Colo. Rev. Stat. Ann. Section 15-11-901 (2014); Conn. Gen. Stat. Section 45a-489(a) (2014); 12 Del. Code. Section 3555(e) (2014); Haw. Rev. Stat. Ann. Section 560:7-501 (2014); 760 Ill. Comp. Stat. Ann. Code Ann. Section 5/15.2 (2014); Annotated laws of Massachusetts-ALM Gl.ch 203E Section 408 (2014); Mich. Comp. Laws Section 700.2722 (2014); Montana Code Ann. Section 72-2-1017 (2013); Nev. Rev. Stat. Ann. Section 163.0075 (2014); New Mexico Stat. Ann. Section 45-2-907 (2013); N.Y. CLS EPTL Section 7-8.1 (2014); N.C. Gen. Stat. Section 36C-4-408 (2013); 60 Okl. St. Section 199 (2014); R.I. Gen. Law Section 4-23-1 (2014); S.D. Codified Laws Section 55-1-21 (2014); Utah Code Ann. Section 75-2-1001 (2014); Rev. Code Wash. Section 11.118.110 (2014).
13. Colo. Rev. Stat. Ann. Section 15-11-901. See also N.C. Gen. Statute Section 36C-4-408.
14. ALM Gl.ch 203E Section 408(b).
15. See California Probate Code Section 15212(e).
16. 60 Okl. St. Section 199(e).
17. Conn. Gen. Stat. Section 45(a)-489a(a) and (e).
18. Code of Ala. Section 19-3B-408 (2014); Ark. Code Ann. Section 28-73-408 (2014); D.C. Code Section 19-1304.08 (2014); Fla. Stat. Section 736.0408 (2014); O.C.G.A. Section 53-12-28 (2014); Burns Ind. Code. Ann. Section 30-4-2-18 (2014); Iowa Code Section 633A.2105 (2013); Kansas Stat. Ann. Section 58a-408 (2013); 18-B M.R.S. Section 408 (2014); Md. Estates and Trusts Code Ann. Section 14-112 (2014); Rev. Stat. Mo. Section 456.4-408 (2014); Neb. Rev. Stat. Ann. Section 30-3834 (2014); New Hampshire Rev. Stat. Ann. Section 564-B:4-408 (2014); N.J. Stat. Section 3B:11-38 (2014); N.D. Cent Code. Section 59-12-08 (2014); Ohio Rev. Code. Ann. Section 5804.08 (2014); ORS Section 10.185 (2013); 20 Pa.C.S. Section 7738 (2014); S.C. Code Ann. Section 62-7-408 (2013); Tenn. Code Ann. Section 35-15-408 (2014); Tex. Prop. Code Section 12.037 (2014); 14A V.S.A. Section 408 (2014); Va. Code Ann. Section 55-544.08; Washington, D.C. Code Section 19-1304.08; W. Va. Code Section 44D-4-408 (2014); Wis. Stat. Section 701.0408 (2014); Wyo. Stat. Section 4-10-409 (2014).
19. N.J. Stat. 3B:11-38.
20. UPC Section 2-907(c)(1).
21. Annotated laws of Massachusetts, ALM Gl.ch 203E Section 408 (2014).
22. UPC Section 2-907(c)(6).
23. *Matter of Abels*, 988 N.Y.S.2d 458 (Surr. Ct. 2014).
24. *Ibid.*, at p. 462.
25. *Fancher v. Fancher*, 103 P. 206 (Cal. 1909); *Bankers Trust Co. v. Hess*, 63 A. 2d 712 (N.J. Super. Ct. 1949); *In re Randolph's Will*, 262 N.Y.S. 868 (Sur. Ct. 1933); *Heinlein v. Elyria Sav. And Trust Co.*, 62 N.E.2d 284 (1945).
26. *In re Greene's Estate*, 104 N.Y.S.2d 954 (Sur. Ct. 1951); *Gafney v. Kenison*, 10 A. 706 (1887).
27. See *Dubin v. Pelletier*, 2012 R.I. Super. LEXIS 175, in which the owner of a championship dog brought an action against the dog's trainer. The court rejected the trainer's argument that the owner gifted the dog to her. The trial court awarded the dog to the owner, as well as stud fees. The trainer was awarded money for his training services.
28. See *Feger v. Warwick Animal Shelter*, 870 N.Y.S.2d 124 (2008), in which the court stated that the identity of adoptive pets shouldn't be disclosed because, "it is likely that others would be less inclined to adopt because of concerns that they could be subjected to harassment or intimidation by prior putative owners."
29. Internal Revenue Code Section 671; Treasury Regulations Section 1.671-2(c).
30. Treas. Regs. Section 1.671-4(a).
31. IRC Section 1(e) and Revenue Procedure 2014-61, Section 3.01 Table 5 2014-47 IRB.
32. Rev. Proc. 2014-61, Sec. 3.01 Table 5 2014-47 IRB.
33. IRC Section 1411(a)(2).
34. IRC Sections 1411(a)(1) and (b).
35. IRC Section 641.
36. IRC Section 651.
37. IRC Section 652(a).
38. IRC Section 61(a)(1).
39. 1976-2 C.B. 192.
40. IRC Section 643(c).
41. IRC Section 2055(e)(2)(a). Distribution under a charitable remainder trust must be made for a fixed term of 20 years or less or for life or lives in being. Treas. Regs. Section 1.664-2(a)(3)(i).
42. Treas. Regs. Section 1.664-1(a)(2).
43. IRC Section 646(d)(1)(A).
44. IRC Section 646(d)(2)(A).
45. Treas. Regs. Sections 1.664-2(a)(3) and 1.664-3(a)(3).
46. See Revenue Ruling 78-105, situation 1.
47. IRC Section 643(c).
48. See Rev. Rul. 78-105, situation 2.
49. See Rev. Rul. 78-15, citing *Burdick v. Commissioner*, 117 F.2d 972 (2d Cir. 1941), Rev. Rul. 55-335.
50. See Rev. Rul. 78-105, situation 3.