

## LexisNexis® Emerging Issues Analysis

**Stephanie G. Rapkin on  
Pet Trusts - The How to Guide**

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Clients of all incomes and all net worths are interested in pet trusts. Irrespective of the news headlines, pet trusts are not just for the very rich or the terribly eccentric. The first pet trust I created many years ago was for a young single woman with limited financial resources, but she was concerned that her two-year-old retriever was not adoptable as he required regular veterinarian care and medications. Fortunately, the state where I practice has for decades had a provision for honorary trusts that allows for the creation and recognition of a pet trust.<sup>1</sup>

Today, there has been a societal shift to recognizing the importance of caring for pets after the death of the owner. The ability for practitioners in a variety of jurisdictions to create a pet trust has expanded due to many states incorporating Uniform State Laws in their legislation. Both the Uniform Trust Act and Uniform Probate Code have created provisions legitimizing trusts for the care of an animal after the owner's death. Nearly 40 states have adopted one or the other, either as proposed by the National Conference of Commissioners on Uniform State Laws, or modified.<sup>2</sup> Section 2-907 of the Uniform Probate Code (1990)<sup>3</sup> provides for a governing instrument caring for a pet to be liberally

1. [Wis. Stat. § 701.11](#)(1) states in part, "where the owner of property makes a testamentary transfer in trust for a specific non-charitable purpose, and there is no definite or definitely ascertainable human beneficiary designated, no enforceable trust is created; but the transferee has power to apply the property to the designated purpose, unless the purpose is capricious."
2. The Uniform Probate Code Section 2-907, or a version thereof, has been adopted by: Alaska, Arizona, Colorado, Hawaii, Illinois, Michigan, Montana, North Carolina, South Dakota and Utah. The Uniform Trust Act Section 408, or a version thereof, has been adopted by: Alabama, Arkansas, District of Columbia, Florida, Kansas, Maine, Maryland, Missouri, Nebraska, New Hampshire, New Mexico, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Virginia and Wyoming. States adopting another approach are: California, Idaho, Indiana, Iowa, Nevada, New Jersey, New York, Rhode Island and Texas. Connecticut has also just adopted its own version effective October 1, 2009.
3. Section 2-907. Honorary Trusts; Trusts for Pets.
  - (a) [Honorary Trust.] Subject to subsection (c), if (i) a trust is for a specific lawful noncharitable purpose or for lawful noncharitable purposes to be selected by the trustee and (ii) there is no definite or definitely ascertainable beneficiary designated, the trust may be performed by the trustee for [21] years but no longer, whether or not the terms of the trust contemplate a longer duration.
  - (b) [Trust for Pets.] Subject to this subsection and subsection (c), a trust for the care of a designated domestic or pet animal is valid. The trust terminates when no living animal is covered by the trust. A governing instrument must be liberally construed to bring the transfer within this subsection, to presume against the merely precatory or honorary nature of the disposition, and to carry out the general intent of the transferor. Extrinsic evidence is admissible in determining the transferor's intent.

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construed and enforced as opposed to a precatory or honorary request of the governing instrument, while Section 408 of the Uniform Trust Act<sup>4</sup> provides for legitimizing a trust (or portion thereof) specifically designed for an animal.

(c) [Additional Provisions Applicable to Honorary Trusts and Trusts for Pets.] In addition to the provisions of subsection (a) or (b), a trust covered by either of those subsections is subject to the following provisions:

- (1) Except as expressly provided otherwise in the trust instrument, no portion of the principal or income may be converted to the use of the trustee or to any use other than for the trust's purposes or for the benefit of a covered animal.
- (2) Upon termination, the trustee shall transfer the unexpended trust property in the following order:
  - (i) as directed in the trust instrument;
  - (ii) if the trust was created in a nonresiduary clause in the transferor's will or in a codicil to the transferor's will, under the residuary clause in the transferor's will; and
  - (iii) if no taker is produced by the application of subparagraph (i) or (ii), to the transferor's heirs under Section 2-711.
- (3) For the purposes of Section 2-707, the residuary clause is treated as creating a future interest under the terms of a trust.
- (4) The intended use of the principal or income can be enforced by an individual designated for that purpose in the trust instrument or, if none, by an individual appointed by a court upon application to it by an individual.
- (5) Except as ordered by the Court or required by the trust instrument, no filing, report, registration, periodic accounting, separate maintenance of funds, appointment, or fee is required by reason of the existence of the fiduciary relationship of the trustee.
- (6) A Court may reduce the amount of the property transferred, if it determines that that amount substantially exceeds the amount required for the intended use. The amount of the reduction, if any, passes as unexpended trust property under subsection (c)(2).
- (7) If no trustee is designated or no designated trustee is willing or able to serve, a Court shall name a trustee. A Court may order the transfer of the property to another trustee, if required to assure that the intended use is carried out and if no successor trustee is designated in the trust instrument or if no designated successor trustee agrees to serve or is able to serve. A Court may also make such other orders and determinations as shall be advisable to carry out the intent of the transferor and the purpose of this section.

#### 4. The Uniform Trust Act

- (a) A trust may be created to provide for the care of an animal alive during the settlor's lifetime. The trust terminates upon the death of the animal or, if the trust was created to provide for the care of more than one animal alive during the settlor's lifetime, upon the death of the last surviving animal.
- (b) A trust authorized by this section may be enforced by a person appointed in the terms of the trust or, if no person is so appointed, by a person appointed by the court. A person having an interest in the welfare of the animal may request the court to appoint a person to enforce the trust or to remove a person appointed.

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The statutes were intended to honor the legality of a bequest to a pet by giving a bequest of this nature both the recognition and enforcement of a court. The statutes do not provide the provisions required for personalization or customization, but rather are simply a framework for the drafter to be comfortable with when developing the appropriate vehicle, be it an inter vivos trust or a testamentary trust.

Naturally, it is incumbent on the practitioner to comply with the rules of the state where they are drafting. But if the state rules are unfavorable there is also a possibility of creating a trust in a different (more favorable) jurisdiction. Changing the situs of an existing trust is also a viable option.

To create a trust in another jurisdiction the document should name a trustee in the selected jurisdiction along with instructions that the funds be held and administered in that jurisdiction, or, prior to death, there should be at least some property held in that selected jurisdiction providing some nexus to the favored state.

Changing the situs from one state to another might be accomplished through an express provision in the trust instrument, a pertinent statute, or a court petition. Generally, the courts have permitted the transfer of a trust when: (1) there is no contrary intent expressed in the trust instrument; (2) the administration of the trust will be effectuated similarly to that of the original state; and (3) the interests of the beneficiaries will be honored as intended.<sup>5</sup>

Regardless of whether the trust situs is to be changed or an alternative state originally selected, the governing instrument should contain a provision and designation of which selected state will govern both matters of construction and administration to help alleviate any questions that may block the situs selection or change.

**Testamentary Trusts.** There is still much to consider when determining the type and style of trust which is appropriate for the situation. Either a Will or a codicil to a Will may be used to create a pet trust. A Will may be structured as a pour over Will providing for funds to pass to a stand alone trust which benefits the pet while the Will simply gifts the

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(c) Property of a trust authorized by this section may be applied only to its intended use, except to the extent the court determines that the value of the trust property exceeds the amount required for the intended use. Except as otherwise provided in the terms of the trust, property not required for the intended use must be distributed to the settlor, if then living, otherwise to the settlors successors in interest.

5. For a more complete discussion of changing or selecting alternative situs of a trust See R. Nenno, *Choosing and Rechoosing the Jurisdiction for a Trust*, 40 U. Miami Heckerling Institute on Est. Plan. Ch. 4 (2006).

animal to a person. On the other hand, the Will may do both; create a trust and provide for the residence of the pet.

If a testamentary instrument is used to create a trust there may be an added measure of comfort in that there is from the very start a court to oversee the funding as well as the regular continued outside supervision as needed. This checks and balances system is particularly advantageous if an individual trustee is selected. For those states which have adopted Section (5) of the UPC, courts can waive the annual accounting, reports and fees. The benefit of eliminating an annual accounting is that it may reduce the administrative duties and costs associated with such. The elimination of the automatic court review does not mean that there is no opportunity for review; it just means that there must be a discretionary decision by the court to require such filings. This does, however, negate the primary advantage of the automatic oversight on the financial matters.

There are clearly some drawbacks with a testamentary trust that would not be associated with an inter vivos trust. There could be a delay in both effectuating the trust and the transition of the pet to the caretaker. There is a normal delay associated with probate proceedings. Such a delay may range from weeks to month depending both on how soon after death the Will is submitted for probate and how quickly the county holds hearings on admission of a Will. Of course, any objections to the Will might delay matters further. To alleviate this problem the document could provide that pending the probate process the pet could be allowed to live with the caretaker on a temporary basis. It may also be possible that a special administration proceeding could be opened for purposes of caring for the pet immediately. Two other drawbacks of a testamentary trust are that the trust contained in the Will is public record and that a Will is more susceptible to challenge: both are common complaints to the usage of any Will.

**Inter Vivos Trusts.** A pet trust may be established as part of a multifaceted trust or as a stand-alone pet trust. The trust may be revocable or irrevocable. Consideration might also be given to the use of an irrevocable life insurance trust.

If an irrevocable life insurance trust is used, unknown is whether the pet would be deemed to have an insurable interest in the trust. Traditionally an insurable interest is found if there is: (1) one so closely related by blood or affinity that he or she wants the other to continue to live, irrespective of monetary considerations; (2) a creditor; and (3) one having a reasonable expectation of pecuniary benefit or advantage from the continued life of another. State statutes and case law have modified the definition of an insurable interest expanding it so that it may be feasible in certain locales for a policy to be

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purchased which names the trust as the owner and the beneficiary, even if the ultimate beneficiaries of the trust are pets, without running afoul of the insurable interest rule. Assuming that an insurance institution will issue such a policy and after issuance they challenge the policy by claiming that there is not an insurable interest, the policy may be treated by the court as a voidable contract. However, in some states, the insurance policy is not invalid merely because the policyholder lacks an insurable interest. A court with appropriate jurisdiction may order the policy paid to someone else who is equitably entitled or may create a constructive trust thereby saving the policy for the pet.<sup>6</sup> For those who are not comfortable with assuming that a pet has an insurable interest (or if the insurance company will not issue the policy) the alternative is to purchase insurance directly. As a general rule, if the initial owner is the insured, he or she always has an insurable interest in his or her own life. The insured can then assign the policy to anyone he or she wishes, whether or not the assignee otherwise has an insurable interest and, thus, can subsequently transfer the policy to an irrevocable life insurance trust. Obviously, this approach of transferring an insurance policy to a trust after the initial owner-insured purchases it exposes the estate to estate taxation if the insured dies within three years after the assignment. But the use of life insurance to fund a pet trust is certainly worth considering.

One of the major advantages of using an inter vivos trust, regardless of the type of trust, is that there is no delay between the date of death and the establishment of the trust. On the other hand, in the event that the funds are improperly being used or that the trustee is not properly supervising the caretaker there is no outside supervision without affirmative action being taken by a third party to bring the matter to the court's attention.

An inter vivos trust has an added benefit in that it can also name a pet guardian or agent and provide funds for the care of a pet while the owner is incapacitated just as trusts do for a human who is incapacitated.

**The Trust Corpus and Distribution.** The corpus of the trust can be funded with anything from cash, investment assets, and retirement benefits to life insurance - either employer sponsored or purchased independently. The only limitation on funding the trust is that large sums of funds may be prohibited from being transferred to the pet trust in those states which have adopted a prohibition on excess funding. What exactly is "excess funding" is unanswered, but there may be some guidance for establishing the

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6. [Wis. Stat. § 631.07.](#)

amount of funds required by knowing the life expectancy of the pet and the average cost of maintenance for that type of animal. Furthermore, drafting the trust with a discussion of the specific needs of the pet and the pet's lifestyle will also help to establish for a court what the amount of appropriate funds required is.

How a trust is to work for distribution purposes is as varied as the funding mechanism. It is limited by only the client's imagination and the drafter's creativity. Some suggestions are as follows: The grantor's home and/or household furnishings pass to the trust. They remain in the trust as long as there is a pet alive. The caretaker moves into the home and lives there rent free. One of the obvious benefits to this is that the pet is not uprooted from its home. The caretaker may or may not be financially responsible for the food and pet supplies. Depending on the amount of funds available for the trust or lack thereof, the caretaker may also be financially responsible for household maintenance, utilities and professional services related to the maintenance of the home. It is important in this type of trust that the caretaker is given instructions or told of the responsibilities with regards to maintaining the home. Generally this might be in a similar manner to that of a renter or tenant of a residential lease. The trust may also be funded with sufficient cash that will pay for major repairs, replace appliances as needed, and pay the property taxes. If funds are available it also pays for all the veterinarian bills. At the death of the pet the acting caretaker is allowed to purchase the house and furnishings from the trust for a specified amount or percentage of the fair market value as appraised at the time of the death of the pet. The longer the pet lives the greater the benefit to the caretaker as they are living in the house for a nominal amount. Thus, there is motivation to properly care for the pet and ensure that they are protected. The trustee receives fees for services rendered, or if a corporate trustee, in accordance with the fee schedule of the institution. The remainder of the trust, including the proceeds from the "sale" of the house upon the trust's termination, can be distributed as desired. [This should not be to the caretaker as it may undercut the motivation to care for the pet].

Another variation is to have a trust directly financially benefiting the caretaker of the pet via a set amount or salary from either income, principal or both. The fee of the caretaker for the services may be static or adjustable. The adjustable fee for services takes into account a reflection of the ravages of inflation on the caretaker's salary, and it may also provide greater financial incentive as a pet gets older and perhaps needs additional care and services from the caretaker. This type of trust may also provide for distributions to the caretaker to reimburse the caretaker for expenses incurred such as veterinarian expenses, food, grooming and the like or pay those expenses directly.

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There also can be a combination of the two methods of caretaker incentive - income for services and a residence in which to live.

There is also the trust where the pet was an outright gift to the human and only the pet's needs are met by the trust. That is, the trust pays for the pet's care and provides no compensation of any manner to an individual.

**Drafting Considerations.** In general, some considerations, no matter what type of trust instrument is selected are drafting so that there is a means of identifying the pet; identifying the circumstances for removal of the caretaker; providing for a named successor caretaker; and using an independent monitor to oversee the care of the pet - most likely the pet's veterinarian. The independent monitor may not only have the final say on how the pet is being cared for, but also the final word on medical and end of life decisions. Include whether the caretaker can or cannot have other pets, and if so what type and/or how many. Such mundane and routine things as specific care of the pet (for example, type of food, grooming and where to obtain grooming, or not allowing a cat outside); grounds for the caretaker's removal (for example, failing to take the pet for annual checkups, failing to cooperate with the trustee, or allowing a cat outside); or the use of a pet sitter or boarding facility when the caretaker is on vacation or temporally unavailable should also be included. There should be a provision which provides that the trustee is authorized to have regular communication with the independent monitor and the right to randomly check on the pet. With the growing use of pet health insurance, the trustee should have the ability to purchase such insurance at their discretion particularly if the corpus of the trust is limited. Liability insurance and/or an umbrella policy should also be a consideration, particularly for an animal that will interact with other animals or humans. The trustee can either purchase such insurance or may be authorized to reimburse the caretaker for the purchase of such. There should also be a provision for where the funds go in the event a court deems that the funds for the pet trust are in excess of the amount reasonably necessary for the care of the pet. Other provisions in this type of trust would be similar to any other trust such as providing for a successor trustee, limiting the liability of trustee and trustee's fees. There may also be directions on what type of documentation is required for reimbursement to the caretaker for out-of-pocket expenses paid by the caretaker or a provision on how the trust should be billed directly by providers. Do not omit trustee investment choices, standard of care, accounting and bond clauses.

Selection of a trustee may be predicated upon the amount of funds available for funding the trust. Naturally, if the resources are quite large, an institutional trustee is a viable op-

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tion. If drafting in such a manner that the trustee is to actually have contact with the pet a local institution or one with branch offices in the place where the pet resides might be a better choice so that regular visits can be arranged.

As an aside, make sure the caretaker understands his or her responsibilities and duties. This should be clearly spelled out even before undertaking the trust drafting and perhaps even put in writing.

**Taxation.** As with all types of trusts, income, gift and estate taxes are all a consideration to be factored into the decision making process. Income taxes are probably the most encompassing taxes to deal with. Taxes may be imposed on not only the income generated by the trust, but additional taxes may be due as a result of the type of assets used to fund the trust. For example, retirement benefits, such as an IRA, will trigger an income tax on the corpus by December 31 of the calendar year that contains the fifth anniversary of the date of death as there is no designated human beneficiary.<sup>7</sup>

If the trust beneficiary is the pet, such as under the types of trust created by the UPC or UTA (i.e. I leave my cat, Charlie, \$100,000 in trust), all of the income, whether distributed or not in any give year, is taxed at the trust rate. This is the approach to be taken by the Service in [Revenue Ruling 76-486](#), 1976-2 C.B. 192. However, if the trust holds an asset that requires repairs or maintenance, such as the residence, then the payments for repairs or maintenance of the trust asset should be deemed to be an administrative cost or expense. Arguably this payment would then in fact be a deductible administrative cost.

Care must be paid to the overall amount of taxes paid as a result of the steep bracket climb of a trust versus the slower bracket climb imposed on an individual.<sup>8</sup>

If the trust is designed to distribute funds to the caretaker who is also a beneficiary, the caretaker will pay the taxes on the income distributed while the trust receives a corresponding deduction. The income to the caretaker-beneficiary is reported to them on a K-1. Although the overall income taxes paid may be lower in this type of a trust this may

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7. [I.R.C. § 401\(a\)\(9\)\(B\)\(ii\)](#); [Treas. Reg. § 1.401\(a\)\(9\)-3](#), Q&A-2.

8. In 2009, personal income of less than \$8,350 was taxed at a 10% marginal rate. At \$8,350, but less than \$33,950, the tax was imposed at a 15% marginal rate. In a trust, the marginal tax rate of 15% applied to income of less than \$2,300. Once a trust reached income of \$11,501 the marginal rate jumped to 35%.



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result in a fiscally unsound position for the caretaker. If the caretaker must also use the funds distributed to pay for the pet's care for such items as food, grooming and veterinarian bills, the net amount to them is significantly reduced. In addition, the caretaker may be in a tax bracket where the income received places them in a higher overall bracket diminishing any benefit they would receive. The trust could provide additional sums to make up for that dilemma.

The next tax issue raised is the gift tax question: both the federal and state gift tax. (Note: today only a very few states have a state gift tax). Accordingly a grantor trust is the preferred method as such a design eliminates an imposition of gift taxes. However, if there is a gift tax, such as the tax, which occurs with an insurance trust, the federal applicable credit may be applied to the transfer to eliminate the federal gift tax. It is pretty clear that the federal gift tax annual exclusion would not be available for a gift to a pet.

More likely to occur are estate or inheritance taxes. Consequently, if the estate is sufficiently large so as to incur an estate tax or an inheritance tax, a tax apportionment clause in the estate planning documents is imperative to ensure that the pet trust is not eviscerated by the estate or inheritance taxes imposed.

Creative planning, and possibly a device which would appeal to clients who are interested in a pet trust, would be the use of a charitable remainder trust. Unfortunately a trust for a pet with the remainder to charity does not qualify as a charitable split interest trust for purposes of an estate tax or income tax charitable deduction.<sup>9</sup> There has been some public discussion of amending or changing the Code to allow for a charitable deduction for a split interest pet trust and perhaps that will come to fruition in the not too distant future.

To summarize, a pet trust is not an unusual request from a client in this day and age nor is it a difficult document to draft. There are however so many variables and ways to structure it that it takes some thought and thorough discussions with the client so as to incorporate all of the technical and nontechnical factors to ensure its viability.

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9. [Rev. Rul 78-105](#), 1978-1 C.B. 295.

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taxation in 1990. In addition to her practice, she is an adjunct professor at the University of Wisconsin-Milwaukee. She has also written numerous articles on estate planning and taxation for national legal publications, including *Trusts & Estates*, *The Journal of Taxation of Investments* and *Taxes: The Tax Magazine*. In addition to writing on these topics, Stephanie frequently lectures for continuing education programs both locally and nationally. Stephanie is the update author of *Planning for Large Estates* (LexisNexis Matthew Bender).

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