TRUSTS & MORTGAGE ISSUE

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New Legislation Affects Trusts

Last year, the Arizona Legislature approved a modified version of the Uniform Trust Code, which it aptly named the Arizona Trust Code (ATC).

The ATC became effective at the beginning of this year, and it contains many provisions affecting Arizona trusts. This article highlights some of the important features of the new law.

Reporting Requirements

The ATC requires the trustee (person who administers a trust) to provide the trust beneficiaries an annual report regarding trust property, which must include information about trust assets, liabilities, and receipts and disbursements (including the source and amount of the trustee's compensation). In addition, the trustee must keep the "qualified beneficiaries" (three types of beneficiaries are defined in the ATC) reasonably informed about the administration of the trust. The ATC specifies the type of information that is required in these reports.

Notice Requirements

The ATC requires that, within 60 days after a trustee acquires knowledge of the creation of an irrevocable trust or that a revocable trust has become irrevocable, the trustee must provide certain notification to the qualified beneficiaries. The notification must inform the beneficiaries of the trust's existence; the identity of the trustor or trustors; the trustee's name, address and telephone number; the right to request a copy of the relevant portions of the trust instrument; and the right to a trustee's report as described above. The notice requirements only apply, however, to: 1) a trustee who accepts appointment on or after January 1, 2009; 2) an irrevocable trust created on or after January 1, 2009; and 3) a revocable trust that becomes irrevocable on or after January 1, 2009. Many revocable family trusts allow for the creation of sub-trusts for federal estate tax purposes. If sub-trusts are created after the death of the first trustor, the surviving trustor must comply with these notification requirements, even if the qualified beneficiaries are children or close family members.

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Tax Relief for Mortgage Debt Forgiveness

Debt forgiveness normally results in taxable income. But under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may exclude debt forgiven on their principal residence if the balance of their loan was less than $2 million. The limit is $1 million for a married person filing a separate return.

This law applies to debt forgiven in calendar years 2007 through 2012. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure or short sale, may qualify for this relief. In most cases, eligible homeowners only need to fill out a few lines on an IRS form.

The debt must have been used to buy, build or substantially improve the taxpayer's principal residence and must have been secured by that residence. Debt used to refinance qualifying debt is also eligible for the exclusion, but only up to the amount of the old mortgage principal, just before the refinancing.

Debt forgiven on second homes, rental property, business property, credit cards or car loans does not qualify for the tax-relief provision. In some cases, however, other kinds of tax relief, based on insolvency, for example, may be available.

For more information, visit the IRS's Web site, *www.irs.gov.*

Waiver of Reporting and Notice Requirements

Notwithstanding the new reporting and notice requirements, the ATC allows a trustor (person who creates a trust) to partially eliminate the reporting requirements and to restrict or remove certain of the notice requirements in a trust created on or after January 1, 2009, or in an amendment to an existing revocable trust.

Investment Rules

The ATC provides that a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the requirements of the so-called Prudent Investor Rule. This means that a trustee must invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust. In complying with this standard, the trustee is required to exercise reasonable care, skill and caution. In family situations, however, a trustor may not wish to hold his trustee to the prudent investor standard of care, especially if the trustee is a spouse, close family member, or friend lacking the expertise and knowledge required of a prudent investor. In certain situations, requiring the trustee to act as a prudent investor could expose the trustee to unnecessary liability. Here, again, the ATC allows the trustor to expand, restrict, eliminate or otherwise alter the Prudent Investor Rule in a trust created on or after January 1, 2009, or in an amendment to an existing revocable trust.

Trust Revisions

Under the ATC, it is much simpler and easier to revise an irrevocable trust. While some revisions still require court approval, the ATC permits non-judicial modification of trusts with respect to a number of revisions. Interested persons may, subject to certain limitations, enter into a written settlement agreement with respect to any matter involving a trust. Under these provisions, it is not necessary for a beneficiary to go to court to modify the trust. The modification provisions apply to a trust that becomes irrevocable on or after January 1, 2009.

Mandatory Arbitration

The ATC further provides that a trust instrument may contain mandatory, exclusive and reasonable procedures to resolve issues between the trustee and interested persons, or among interested persons with regard to the administration or distribution of the trust. This allows a trustor to include provisions in the trust agreement requiring arbitration between the trustee and the beneficiaries under certain circumstances. (Prior to January 1, 2009, a court ruling rendered trust provisions requiring arbitration unenforceable.) The ability to provide for arbitration to resolve certain disputes between the trustee and the beneficiaries is an important tool to preserve trust assets and avoid attorney's fees and court costs relating to litigation.

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Protection for Tenants in Foreclosed Properties

On May 20, 2009, President Obama signed S. 896, the Helping Families Save Their Homes Act (Public Law 111-22). This federal law includes protections for tenants living in foreclosed properties, as well as revisions to the McKinney-Vento homeless assistance programs. The renter protection provisions of the law became effective May 20, 2009, immediately upon enactment.

For renters in foreclosed properties, the new law will require that the "immediate successor in interest," i.e., the person or entity that acquires the title at foreclosure:

- Provide bona fide tenants with 90 days notice prior to eviction, or
- Allow bona fide tenants with leases to occupy the property until the end of the lease term, except the lease can be terminated on 90 days notice if the unit is sold to a purchaser who will occupy the property.

A bona fide lease or tenancy is one in which the tenant is not the mortgagor or a member of the mortgagor's family; the lease or tenancy is the result of an arms-length transaction; and the lease or tenancy requires rent that is not substantially lower than fair market rent, or is reduced or subsidized due to a federal, state or local subsidy.

The new law also provides specific protections for recipients of Section 8 assistance, including the requirement that the person or entity acquiring the property at foreclosure take ownership subject to the lease between the prior owner and the tenant, and subject to the housing assistance payments contract between the prior owner and the public housing agency.

None of theses provisions preempt more protective state and local laws. All the renter protection provisions expire at the end of 2012.

This legislation will have a significant impact in Arizona, which has one of the highest foreclosure rates in the country.

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Case Summaries

The House That Moved

Too-Steep Slope Causes Clients' Dream House to Move; Home Builder Required to Perform Corrective Work to Avoid Catastrophic Failure

This dispute involved a house that moved. Our clients, a retired couple, purchased a new home from a national homebuilder. The house was located at the end of the street, atop a hill with panoramic views of the city below.

Within two years of moving into their beautiful new home, however, cracks started to form in the floors, walls, sidewalks, and surrounding retaining walls. The lot on which our clients' house was situated had been constructed by the homebuilder, using a cut and fill process. The homebuilder also constructed a riprap slope adjacent to our clients' lot, which dropped more than 20 feet into a desert wash. Our clients retained an engineer to investigate the problem. The engineer determined that the homebuilder had failed to construct the slope according to the grading plans, and had made it too steep. In addition, the homebuilder had failed to properly construct the runoff system, designed to divert runoff to the rear of the lot to protect the steepened side slope. As a result, the slope was deteriorating and, unless repaired, would continue to deteriorate. The slope failure caused the house to move toward the slope at an alarming rate.

Despite having knowledge of the engineer's report, the builder contended that the residence and lot had been built to plans and that the slope was stable.

Our clients filed a complaint with the Registrar of Contractors and we filed a lawsuit on their behalf against the homebuilder. The parties agreed to participate in mediation to attempt to resolve their disputes. During mediation, the homebuilder agreed to pay for and perform corrective work to the house and slope, and to monitor any movements in the house or slope for ten years. The corrective work was estimated to cost in excess of $200,000. In addition, the builder agreed to provide our clients ten-year warranties on the work. Our clients, in turn, agreed to dismiss the complaints against the builder.

Company Manager Commits Fraud

Assets Secretly Transferred to Other Companies Controlled by Manager; Client Awarded Damages

We represented one of two members of a real estate-development company in a suit against the company's manager for breach of contract, breach of fiduciary duty, and fraud. The company was engaged in the business of buying houses, fixing them up, and then selling them.

We joined in the suit numerous other business entities controlled by the manager, because it appeared that the manager had fraudulently transferred the company's assets to those entities. The suit sought money damages against the manager and the other entities that he controlled.

The claims against the manager were subject to mandatory binding arbitration. After a three-day arbitration hearing, the arbitrator found that the manager: 1) breached the company's operating agreement by, among other things, wrongfully disposing of the company's assets; 2) breached his fiduciary duty to our client; and 3) defrauded our client.

The arbitrator awarded damages in the amount of $419,980, to which our client was entitled to half, and attorney fees and costs in the amount of $81,963.

The claims against the other parties in the suit were settled before trial, based in part on their agreement to forfeit any interest in a $35,000 cash bond previously posted by our client, and to convey title to four commercial lots to our client having a fair value of approximately $150,000.

The Longest Mile

Nearly a Mile of Curbs and Gutters Removed and Replaced; Dispute Over Which Contractor was at Fault

The dispute in this case involved nearly a mile of improperly installed concrete curbs and gutters in an upscale residential development. We represented the contractor who installed the curbs and gutters. The other party in this matter was the paving contractor. The controversy was over which contractor was at fault for the defective work.

The owner of the project contracted with the paving contractor to build streets, curbs and gutters, in fairly challenging desert terrain. The paving contractor, in turn, subcontracted with our client to build the curbs and gutters. After they were built, it was discovered that several thousand feet of curbs and gutters had been built either too close to the property lines, or too far from them. As a result, the city refused to approve the work, and approximately 4,000 feet of curbs and gutters had to be removed and replaced.

The paving contractor contended that our client did not follow the staking when it built the curbs and gutters and, therefore, it should not have to pay for the work. (The paving contractor itself did the surveying and staking.) Our client contended that it installed the curbs and gutters in accordance with the staking provided by the paving contractor, and that the paving contractor committed errors in surveying and staking.

Our client and the paving contractor agreed to settle their disputes in binding arbitration, as opposed to a lawsuit. After a three-day arbitration hearing, the Arbitrator ruled in favor of our client, and awarded $135,957 in damages, attorney fees and costs.

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Estate Planning in Arizona

What You Need to Know

Estate Planning in Arizona — What You Need to Know — Donald A. Loose, Attorney at Law — a handbook for anyone interested in wealth preservation, family protection, and succession planning

Are you interested in paying the minimum amount of estate and gift taxes? Would you like to avoid probate and keep your financial affairs private? Estate Planning in Arizona is the reference you need. Written for Arizonans with little or no legal experience, this book tells you what you need to know:

- **The basics of wills and trusts**
- **Protecting your assets**
- **Appointing guardians for your children**
- **Taking title to real estate**
  … and much more!

Providing you with a better understanding of the laws and issues involved in estate planning, this comprehensive, easy-to-understand book will help you to preserve wealth, protect your family, and create a winning succession plan.

Praise for *Arizona Laws 101: A Handbook for Non-Lawyers,* by Donald A. Loose

*"Interpreting the legal jargon and navigating the various laws can be a daunting task for even a trained professional. That's why **Arizona Laws 101: A Handbook for Non-Lawyers** is so helpful."*
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*"Cutting through the Latin phrases and complex case law recitations that confuses laypeople…**Arizona Laws 101** will allow you to be much better informed, and it's the sort of reference volume from which anyone can benefit."*
- Tucson Lifestyle Magazine

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