PLANNING AND DRAFTING

FOR THE NON-PROFESSIONAL FAMILY FIDUCIARY

(Some Will and Trust Provisions You Might Find Useful and May Not Find In the Form Books)

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PLANNING AND DRAFTING FOR THE NON-PROFESSIONAL FAMILY FIDUCIARY[1]

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I. INTRODUCTION

The purpose of this paper is to highlight some problems, opportunities, and techniques for using non-professionals -- especially, family members -- as "boss" of the entrusted family venture. It contemplates most of the usual property transfer and tax issues, but applies a do-it-yourself approach that lacks the steadiness, continuity, training and resources of the professional corporate trustee.

Now, don't get me wrong. I *like* trust officers. "Some of my best friends are trust officers." Really. I have never met a trust officer (well, very few at least) who did not want to do a good, conscientious job; to be responsive to their beneficiaries; to be professional, impartial, thoughtful and effective. But trust officers are not free agents: they work for the trust department, which in turn is a division of some other financial services enterprise, which exists to make money for its owners/stockholders (and those owners can change quickly and unpredictably.) Making money for the owners is not always consistent with providing the hands-on service that was the hallmark of the loss-leading trust departments of yore – and few will argue that the trend is to provide more wealth

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These materials represent excerpts from previous projects and the author's sometimes futile attempts to find solutions to some particularly troublesome problems. While every effort has been made to assure the reasonable accuracy of the analysis and suggestions included in these materials, the author cannot assume responsibility for the contents beyond their use as a general teaching and reference guide. Any person engaged in the tax, business or estate planning process, and in particular one whose efforts involve the practical application of strategies pertaining to marital deduction planning, the generation skipping transfer of property, annual exclusion gifts, fiduciary duties, dispute resolution, or the prospective insulation of property from the claims of creditors must independently verify the accuracy and applicability of the law to each particular circumstance, and in turn satisfy himself or herself as to the consequences that may occur.

This paper is dedicated to Ortheldo A. Peithmann – an extraordinary Christian man, a superb real estate lawyer, and the very model of the small town general practitioner. A lot of what is discussed here was implemented in his estate plan.

management (i.e., investment and financial services) than beneficiary services, and that the standard of training and experience is shifting away from the law and in favor of business and accounting backgrounds. In some of the more drastic cases, the trust departments have become aggressive profit centers where fewer and fewer services are being performed by fewer and fewer people with lesser and lesser training – and the highest fees the market will bear. (And those are the ones the public hears about, too.)

Contrast that with our increasingly more informed and more highly-educated client base. These new folks -- the Gen-Xers and Gen-Y/Millenials who often are the ultimate objects of our clients' bounty -- are inculcated to believe in themselves and their inherent abilities, and fluent in research methods that some of us find a little astonishing. These client/beneficiaries want to be in charge; they do not want to pay for services and information that should be "for free"; and, they expect us to structure the family succession plan accordingly.

So, in the first case, you have traditional trust departments, that:

* Don't die or divorce or disappear
* Don't steal the money, or lose the assets
* Have experience and skills
* Are "disinterested" -- which can be very important for tax thinking
* Have access to outside advisers, including legal counsel, who can help implement and interpret in the face of changing circumstances, and manage or defuse disputes, and
* Generally administer the entrustment in a competent, professional way.

There will never be a shortage of need for those virtues. There will always be complex situations and family dynamics that require them; and, even in the most tightly structured family plans, there will almost always be a role for a corporate trustee as a backstop.

In contrast, you can have family members running their own show, who:

* Frequently die, divorce, or disappear -- and rarely do so at the most convenient moment
* Statistically, a few will steal or lose something sooner or later
* Often lack necessary experience, skills – and sometimes, good sense
* Are far from "disinterested" -- which means that, in addition to being willing to

occasionally indulge in retributive mischief, they are at risk of countless tax potholes

*. May or may not choose to consult business, financial, or legal counsel when prudent or necessary (they cost money), and

*. May or may not administer the fiefdom competently or wisely.

So, in the absence of institutional strength and tax insulation, the drafting in favor of the family fiduciary requires all that more thought, to provide:

* Guidance and advice on what to do when – largely in the forms of clearly worded mandates, supplemented by equally precise precatory explanations and statements of purpose and desires

* Insulation from unwanted tax events, which means the very careful use of special and general power of appointment principles

* Conflict management, including defining what is and is not a conflict of interest; who gets the ultimate benefit and makes the ultimate decisions among competing authorities and interest holders; addressing unmet expectations; mediation, as a means of conflict avoidance; arbitration and litigation, as a means of conflict resolution; and, the consequences of intransigence

* Reformation in the event of radically changed circumstances.

Irrespective of the nightmare mess of the federal/Illinois transfer tax system -- which we all have to live with, but really can't do anything about -- there are still powerful reasons for forming long-term trusts along the following lines:

* Assuring all income for family members, including surviving spouses, descendants, and options for descendants' spouses

* Wiggle room to invade principal for real needs

* Protecting an"active" farmer child's right to farm ground while preserving the other, non-farming descendants' right to the landlord's share of the income, or protecting a small business manager's prerogatives to run things for the benefit of all

* Applying the suitable (complex) tax/funding formulae to assure the best advantage of marital deduction, credit shelter and GST exemption amounts for maximum transfer tax avoidance and principal enhancement

* Insulating the trust property from the claims and demands of predators

Planning to avoid risks, while preserving benefit, access, and control in each immediately successive generation, and without undue taxation, can include procedures that:

* Names spouses/children as Trustees or Co-Trustees, or each child as Trustee or Co-Trustee of his or her own portion (a sub-divided trust)[2]

* Allows an interested Trustee/beneficiary access to principal for health, education, maintenance and support (the "ascertainable standard" safe harbor afforded under Internal Revenue Code Sections 2041 and 2514.)[3] This standard is very broad in practice, but insulates the interested Trustee's access from being taxable as a general power of appointment.

* Gives each child/beneficiary a *limited* power of appointment to end the trust or continue it on – or to redirect it – as he or she thinks best.

  This option extends planning discretion to each successor generation and preserves priceless flexibility; however, this flexibility can also be limited by terms restricting the class of permissible appointees and other terms of appointment.

The net effect is to give each tier of beneficiaries -- spouses, then children, appointees and/or grandchildren -- substantially all of the practical benefit of outright ownership without the tax burdens or risks of loss. Since the beneficiary is not the outright owner:

* The trust assets can't be reached by the beneficiary's personal creditors.

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Choosing the initial and successor Trustee -- a crucial control feature -- requires a lot of thought: naming family members -- surviving spouse, child or children, grandchild or grandchildren -- as Trustee or Co-Trustee preserves family control, and can balance personal interests with the control features. *The single most important criterion is character*: someone who is well intended and conscientious. Education, training, geography, even age don't matter so much as an honest disposition and a willingness to seek advice and listen to it.

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A power of appointment is the power to direct the disposition or use of property that belongs to someone else. These tax power of appointment rules, complex in their own right, create a legislative fiction that certain general powers of appointment shall be construed as if the power holder actually owned the subject property. Possession, exercise, release or the mere lapse of a general power can thereby trigger the gift and estate tax. Of course, both Code Sections contain broad exemptions from tax for more narrow powers, most importantly those known as "limited" or "special" powers that are limited by an **ascertainable standard.** The ascertainable standard is defined under Code Sections 2041 and 2514 as relating to the "health, education, support, or maintenance" of the eligible distributee(s). Treas. Reg. §25.2514-1(c)(2) and 20.2041-1(c)(2) include the following specific qualifiers: "support"; "support in reasonable comfort"; "support in his accustomed manner of living"; "education, including college and professional education"; "health"; "medical, dental, hospital, and nursing expenses, and expenses of invalidism".

These standards are in fact more generous and less restrictive than may first appear. The terms "support" and "maintenance" are not limited to the bare necessities of life, and it is immaterial whether the beneficiary is required to exhaust other income before the power can be exercised. Treas. Reg. Sections 25.2514-1(c); 20.2041-1(c)(2). The ascertainable standard exception prevents the subject property from being included in the beneficiary holder's estate yet places little practical restraint on the beneficiary's access.

* The descendant's spouses will normally not have a marital interest in the trust assets, which are thus exempt from divorce property settlements.

* GST-exempt trust assets are not included in the child's (or grandchildren's) taxable estates, thereby avoiding duplicate taxation.

Conceptually, the trust can endure indefinitely; however, even if the trust does not qualify as a perpetual interest trust[4], it may endure for "lives in being plus 21 years", which under existing facts should be sufficient to cover two, three, four or more generations after creator's death -- an ample term. It is your author's experience that once these advantages are explained and considered, the children are often the most enthusiastic advocates of the plan.

II. SELECT PROVISIONS

The following provisions have resulted from your author's peculiar preference for these long term, tax-advantaged and asset-protected trusts, and some of the methods necessary for making them work. As will always be the case, there is no substitute for careful, even detailed planning and drafting when putting these complex estate plans together. The following provisions represent only a few of countless possible approaches that might be suitable in select instances where family member fiduciaries are running the show:

A. The GST Apportionment. There are two kinds of generation skipping trusts[5]: (i) those that are intended to be wholly exempt, and thus insulated from GST tax and estate tax for more than one generation; and (ii) those that are not.

* Exempt trusts will have an inclusion ratio of "0", and remain exempt so long as no beneficiary is charged with gift or estate tax during its term.

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765 ILCS 305/3(a-5). A simple opt-out from the RAP will do, if desired:

This trust is a Qualified Perpetual Trust as defined and provided by 765 ILCS (a-5), and by these specific terms the rule against perpetuities does not apply. No Trustee's power to sell trust property shall be construed to the contrary.

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The generation skipping transfer tax scheme is found in Chapter 13 of the Internal Revenue Code (Sections 2001-2210), and has been part of the law since 1986. The theory is deceivingly simple: **Except as exempted, property not subject to gift or estate tax in each successive generation must face its own GST tax.** But in implementing this theory Congress adopted concepts, terms, and definitions which differ dramatically from the familiar gift and estate tax rules. Unintended GST events can result from any number of traditional estate planning techniques, triggering hefty unexpected tax. Any advisor planning for multi-generational transfers in trust has no choice but to master the GST fundamentals.

* Non-exempt trusts will have an inclusion ratio of "1", and each taxable distribution and taxable termination will subject the fund to the maximum (currently, 45%) tax. Such non-exempt trusts are employed more for their asset protection features than for tax planning, and need to be protected from the GST tax by applying a taxable general power of appointment upon each successor beneficiary.

Here is a living trust formula for a non-married grantor that is intended to allow the surviving trustee to divide the common fund into exempt and non-exempt portions to maximum advantage[6]. Note the very broad precatory tax instructions in Paragraph F:

<u>ARTICLE SEVEN</u>: Disposition Upon Grantor's Death.

This Agreement, as amended from time to time, shall become irrevocable upon Grantor's death. At such time the Trustee shall collect any property directed to pass to the Trust as a result of Grantor's death, whether under Grantor's Will or otherwise, and shall thenceforth hold, administer and distribute the Trust Estate according to the following provisions:

A. [debts]

B. [taxes and costs]

C. [personal effects]

D. Subject to the foregoing, the Trustee shall then divide the Trust Estate then remaining (the "Net Trust Estate") into two portions, hereinafter referred to as the "Non-Exempt Portion" and the "Exempt Portion".

1. The Trustee shall allocate to the Non-Exempt Portion a pecuniary amount equal to the amount, if any, by which the value of Grantor's Trust Estate (as finally determined for federal estate tax purposes) exceeds the "GST Exempt Amount".

2. The Trustee shall allocate the balance and remainder of the Net Trust Estate to the Exempt Portion.

3. Any property allocated in kind to the Non-Exempt Portion shall be valued for the purpose of satisfying the pecuniary amount required at its fair market value as of the actual date of allocation.

4. To the extent possible while consistent with the preceding requirements of this Paragraph D., Grantor's "Farm Property" (as hereinafter defined) shall be allocated to the Exempt Portion.

5. The "GST Exempt Amount" described in Subparagraph D.1. above means the unused portion of Grantor's generation skipping tax exemption allowable to Grantor under Internal Revenue Code Section 2631, reduced by the aggregate amount of

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6 Commonly known as a "qualified severance"; Code Section 2642(a)(3). Final GST qualified severance regulations were issued in August, 2007 as Treas. Reg. 26.2642-6. At the same time, final regulations under Code Section 1001 (pertaining to taxable gains and losses upon the exchange of property) were also issued as Treas. Reg. 1.1001-1. The new GST regulations are beyond the scope of this article, but the options provided in this proposed formula language comply.

allocations of such exemption before or after Grantor's death <u>other than</u> any allocations to the Exempt Portion.

E. Both the "Non-Exempt Portion" and the "Exempt Portion" shall pass to the "Descendants' Trusts", to be further divided, held, administered and distributed pursuant to Article Eight below.

F. In furtherance of the foregoing provisions, and not in derogation thereof, it is the Grantor's intention that the Trustee shall not be required to administer any Trust Estate that is only partially exempt from generation skipping taxes, but instead shall monitor the Trust Estates throughout the term of the Trust(s) provided for herein so as always to provide that: (i) the "Exempt Portion" shall consist of that portion of a Trust Estate to which sufficient generation skipping transfer tax exemption (as that term is defined under Internal Revenue Code Section 2631 and supporting regulations) has been allocated by the Transferor of that property (whether the Grantor as aforesaid, or some successor interest holder in the manner hereinafter provided) so as to produce an inclusion ratio of zero for that Portion; and, (ii) that the "Non-Exempt Portion" shall consist of all that part of a Trust Estate other than the Exempt Portion. It is the Grantor's desire, which is not binding on any beneficiary hereunder, that a taxable general power of appointment will be kept in effect over the Non-Exempt Portion property when the beneficiary believes that the inclusion of the property subject thereto in such beneficiary's gross estate for federal estate tax purposes may achieve a significant savings in transfer taxes by subjecting the property to the federal estate tax rather than a generation skipping transfer tax imposed under Chapter 13 of the Internal Revenue Code; and, that by providing for the creation of taxable general powers of appointment by certain beneficiaries as hereinafter provided the beneficiaries may make optimum use of the generation skipping transfer tax exemption (as that term is defined under Internal Revenue Code Section 2631 and supporting regulations) available to each such beneficiary, so that property previously held as part of the "Non-Exempt Portion" might thereafter be held as part of the "Exempt Portion." In apportioning property between the Non-Exempt Portion and the Exempt Portion:

1. The Trustee may rely upon the allocations of generation skipping transfer tax exemption made by the Transferor of the property to the Trust, and shall adjust the apportionments to conform with any later allocations, or revisions to allocations or values upon audit, in order always to maintain a zero inclusion ratio for the Exempt Portion; and,

2. If any such property was valued for the purposes of allocating generation skipping transfer tax exemption at a value other than the fair market value as of the date of the transfer (or deemed transfer), any property so apportioned to one or another Portion to maintain the zero inclusion ratio shall be selected in such manner that such property shall have an aggregate fair market value fairly representative of the appreciation and depreciation in fair market value since the date of the original transfer of all property available for apportionment on each date of apportionment (or re-apportionment).

G. All references herein to the administration or distribution of Trust property or to a "Trust Estate" (whether one or more) shall apply to both the Non-Exempt Portion and the Exempt Portion unless otherwise stated; provided, however, that each such Portion, and any subdivision of each such Portion, shall at all times be segregated from the other as distinct Trust Estates.

B. The Descendant's Trust(s). These provisions supplement the division/disposition terms of the preceding Article, and govern the transition into the long term trust or trusts. Both parents are gone, and the property that has made its way to this stage is now net of estate tax and segregated for GST tax purposes. One of two things can now occur: the Descendants' Trust can become a functional single entity, in which the children (or a predeceased child's descendants) have undivided interests[7], or the Trustee may, after gathering things together, promptly disperse them again by creating separate "Descendant's Trusts" for each beneficiary.

What to do at this point is a crucial ultimate decision for the family, and deserves a lot of consideration of all the factors mentioned earlier, and then some: the degree of family cooperation; who's in charge; the desire to hold a single asset or business together; the relative competence or special needs of the family; and so forth. On balance, however, experience seems to show that most first-generation beneficiaries -- those who are being skipped for tax benefit and asset protection purposes -- will more readily accept the totality of the plan if each feels that he or she is in nominal control of his or her own inheritance and its destiny, since expectations of fairness count. More often than not this will mean forming separate trusts , and probably naming each adult beneficiary as at least a Co-Trustee. Here is one approach suitable to a farming family context:

<u>ARTICLE EIGHT</u>: The Descendants' Trusts Provisions.

The Trustee shall divide all of the "Exempt Portion" and "Non-Exempt Portion" property directed to pass to the Descendants' Trusts (while maintaining the distinction between the Exempt Portions and Non-Exempt Portions) pursuant to the foregoing into equal shares of each such Portion. One share of the Exempt Portion and one share of the Non-Exempt Portion shall be created for each of HARD LEE FARMING and DUTIFUL LEE FARMING, (the "Grantor's Children" or "Child") living at that time, and one share of the Exempt Portion and one share of the Non-Exempt Portion shall be created for each deceased Child of Grantor who has one or more descendants then living, which shares shall be further divided into shares for such descendants, per stirpes. Each resulting share of the Non-Exempt Portion and the Exempt Portion shall be named for the Child or other descendant beneficiary for whom it was created and thereafter held and administered as a separate Descendant's Trust for his or her benefit according to the following provisions:

How liberal or tight the beneficial terms should be during the children's lives is another hot topic. Most parents (and the skippee children) will want the kids to have rather broad access because, after all, "it's their inheritance." Many GST planners recommend discretionary, as opposed to mandatory income distributions, to avoid leakage and to facilitate greater trust appreciation. But while that is undoubtedly true in principle, the reality is that undistributed income now hits a 35% income tax threshold at only $10,700.00. Moreover, if the trust mandates annual income distribution the first generation beneficiaries

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[7] Thus invoking the "substantially separate and independent share" requirements of Code Section 2654 and Treas. Reg. 26.2654-1(a).

often feel more comfortable taking their full income share without worrying about generational equity. In short, from an accounting, tax, and psychological perspective, providing for mandatory income distribution is the easiest way to go.

Similarly, access to principal must be limited only by an "ascertainable standard". More broadly drawn instruments may even include a "5 and 5" power. Consider this treatment for the kids:

A. The Trustee shall pay to or for the benefit of the beneficiary all of the net income of the Trust in regular monthly or other convenient installments, and at least annually.

B. The Trustee shall also pay to or for the benefit of the beneficiary so much of the Trust principal (other than "Farm Property", as hereinafter defined) as may be required from time to time to provide for his or her health, education, maintenance and support in reasonable comfort only. Grantor's primary concern during the life of each Descendant's Trust's current beneficiary is for the support in reasonable comfort of that current beneficiary, without regard to that beneficiary's other assets or income, and in priority over the interest of any potential successor beneficiary; provided, that all such distributions of principal pursuant to this Paragraph shall always adhere to this ascertainable standard.

C. In addition, and during the month of June of each calendar year only, the beneficiary shall have the right to withdraw or demand distribution, free of trust, an amount of Trust principal (other than "Farm Property", as hereinafter defined) that does not exceed the greater of: (i) FIVE THOUSAND DOLLARS ($5,000.00); or (ii) FIVE PERCENT (5%) of the value of the Descendant's Trust on June 1 of each year. This right of withdrawal shall be non-cumulative, may be exercised only by a signed written instrument delivered to the Trustee during the month of June each calendar year, and shall lapse if not exercised on or before June 30 of each year.[8]

D. Notwithstanding the provisions of Paragraphs A. - C. above, all distributions of income and/or principal from each Descendant's Trust, however or whenever created, shall be subject to the specific restrictions that apply in the event of the disability of a beneficiary that are hereinafter provided.

E. It is Grantor's expectation that no distribution of principal shall be made from any Exempt Portion until substantially all of the Non-Exempt Portion of that Descendant's Trust has been exhausted.

F. Upon the death of each Descendant's Trust beneficiary his or her Descendant's Trust Estate shall pass as follows:

1. Each such beneficiary shall have the limited testamentary power to appoint the entitlement to all the annual income from any specific part, or all, of the Non-Exempt Portion of his or her Trust Estate, to or for the exclusive benefit of his or her spouse, for the term of the beneficiary's spouse's entire life only. This power may be exercised by a Will which specifically refers to this limited power of appointment; provided, however, that the exercise of this limited power of appointment shall not be effective unless it creates in the

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8 See, Code Sections 2514(e) and 2041(b)(2). The price of this flexible access is that the 5% value of the trust will be includible in the beneficiary's estate if he or she dies before the power lapses. That is why the window is open for just one month during the year.

beneficiary's spouse the additional general testamentary power to appoint the property from which the income entitlement flows to the beneficiary's spouse's estate.

2. Subject to the foregoing, each such beneficiary shall also have the general testamentary power to appoint any specific portion, or all, of the "Non-Exempt Portion" of the Trust Estate, not effectively appointed pursuant to Paragraph F.1. above, to or for the benefit of the creditors of his or her estate, but only by a Will which specifically refers to this general power of appointment.

3. Subject to the foregoing, each such beneficiary shall also have the limited testamentary powers:

a. To appoint the right to receive any part or all of the income from the "Exempt Portion" of his or her Trust Estate to or for the benefit of his or her spouse for any period of time not to exceed the spouse's lifetime.

b. To appoint all, any portion of, or any beneficial interest in the Exempt Portion, and that part of the Non-Exempt Portion not effectively appointed pursuant to Subparagraph F.2. above, of his or her Trust Estate (including principal, income, the power to appoint successor interests or successor Trustees, the power to create successive limited or general powers of appointment, and any other right, prerogative or privilege not elsewhere restricted by this instrument), outright or in trust, but only to or for the benefit of such one or more of Grantor's descendants (other than the beneficiary/power holder) then living or thereafter born.

c. In each case these powers may be exercised in such portions, amounts or manner as that beneficiary may appoint by a Will which specifically refers to the power of appointment being exercised; provided, however, that no exercise of a limited power of appointment shall be effective:

i. to appoint the Exempt Portion of the Trust property in a manner resulting in any trust having a federal generation-skipping transfer tax inclusion ratio greater than zero;

ii. to allow the distribution of Trust principal free of trust to any person who has not attained the age of 25 years;

iii. to direct the sale, partition, distribution free of trust, or other disposition of any separate parcel of "Farm Property" (as that term is hereinafter defined) except in strict compliance with the provisions therefor that are hereinafter provided; or,

iv. to create in any appointee a taxable general power of appointment over the Exempt Portion of a Trust Estate or Trust property (although the limited power may be exercised to create in the appointee a general power of appointment over any Non-Exempt Portion so appointed).

4. Except as otherwise effectively appointed, then upon the death of: (i) the beneficiary; and/or (ii) the death of the last to die of the beneficiary and the beneficiary's spouse, to the extent that an interest in property appointed for the lifetime benefit of the beneficiary's spouse should inure to the Descendant's Trust upon the death of the beneficiary's spouse, the Trustee shall collect all the property remaining in or passing to the Descendant's Trust pursuant to the foregoing; reapportion the Exempt Portion and Non-Exempt Portion property to reflect any allocations of generation skipping transfer tax exemption taking effect upon the death of the beneficiary and/or the beneficiary's spouse, if any; and then divide all the Exempt Portion and Non-Exempt Portion property (while maintaining the distinction between the Exempt Portions and Non-Exempt Portions) into equal shares of each Portion so as to provide:

a. One such share of the Exempt Portion and one such share of the Non-Exempt Portion for each living child of the deceased beneficiary, and one such share of each Portion for each deceased child of the deceased beneficiary who has one or more living descendants, which shares shall be further divided into similar shares for such descendants, per stirpes; or

b. If the beneficiary is not survived by any descendants, then to provide one such share of the Exempt Portion and one such share of the Non-Exempt Portion for each surviving sibling of the beneficiary, and one such share of each Portion for each deceased sibling who has one or more living descendants, which shares shall be further divided into similar shares for such descendants, per stirpes.

c. If the beneficiary is not survived by any descendants or siblings, then to provide shares of each such portion for those persons who would inherit from the beneficiary's intestate estate, in the manner and proportions prescribed by the Illinois rules of descent and distribution, but: (i) assuming that all of the Grantor's descendant's spouses were then deceased; and (ii) subject to the definition of "descendants" hereinafter provided.

d. Each share allocated to one of the Grantor's descendants for whom a Descendant's Trust then exists shall be added to his or her Trust Estate. Each share allocated to a new descendant beneficiary shall thereafter be held and administered as a new Descendant's Trust. The Trustee shall administer the Exempt Portion and Non-Exempt Portion of that new Descendant's Trust, and shall distribute the income and principal thereof to or for the benefit of that beneficiary in the same portions, amounts or manner, and subject to the same restrictions, prerogatives and powers of appointment (including specifically the defined general power of appointment over the Non-Exempt Portion and the defined limited powers of appointment over the Exempt Portion) accorded by this instrument to each of the Descendant's Trust's beneficiaries initially.

G. Each Descendant's Trust, however and whenever created pursuant to or as a result of this instrument shall terminate at the end of twenty-one (21) years after the death of the last to die of all of Grantor's descendants who are living at the date this instrument becomes irrevocable. Upon such termination, and except as otherwise effectively appointed, each Trust Estate shall vest in those descendants of the Grantor then entitled to or eligible to receive or have the benefit of its income in proportion to his or her fractional income interest(s), per stirpes and not per capita; provided, that with regard to any interest in a Trust Estate which is subject to a then-current entitlement of the income in a spouse of a descendant created through the exercise of a power of appointment, then that interest shall vest, subject to such current income entitlement, in those persons entitled to or eligible to receive or have the benefit of its income immediately upon the death of the entitled spouse, in proportion to his or her fractional income interest(s), per stirpes and not per capita.[9]

Paragraph A., of course, is a QTIP-type mandatory income requirement. But Paragraph B. is a discretionary option creating a power of withdrawal over principal that is subject to an ascertainable standard, suitable for a descendant beneficiary acting as his or her own trustee (but note the limitation on withdrawal of "Farm Property" principal.) The statement of the grantor's priority of purposes instructs the trustee to be generous within the confines of this standard, and provides the interested trustee some shelter from any

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This Paragraph G. assumes the client did *not* opt out from RAP treatment, as provided under 765 ILCS 305/3(a-5). See note 4 above.

remainderman's impatience to get his or her hands on his ancestor's money.

Paragraph C. is intended to strike a compromise between the grantor's desire to provide generous access, while limiting the period during which the 5 and 5 amount will be vulnerable to inclusion in the survivor's gross estate. In targeting the mid-year, 30-day term of June, the thought is that the survivor can plan for this withdrawal if he or she wants some extra cash,[10] or let it lapse (with relief) on July 1 if not.

Paragraph D makes all payments of both income and principal subject to the self-amending disability provisions that will convert each Descendant's Trust into a special needs trust if necessary.

The layered testamentary powers of appointment in Sub-paragraphs F.1 - F.3 provide a dispositional control mechanism while also assuring that the unused Non-Exempt Portion will be subject to transfer tax in the estate of the beneficiary, and thereby avoid any GST tax. These powers will afford each child the opportunity, presumably many years after the death of the grantor, to reconsider the needs, desires and deserts of the family, and to adjust the distribution of the fund as circumstances may then indicate. The limitation on the class of permissible appointees is inserted as an example, and need not be so limited; it would be equally effective (for tax purposes, if not family sociology) to limit the class to "such persons or entities other than [the beneficiary], his or her estate, his or her creditors, or the creditors of his or her estate".[11]

Finally, Subparagraph F.4 provides one of many possible alternatives for distribution in default of appointment. The fact is that the vast majority of powers are never exercised, and a clear statement of who takes in default of appointment is always desirable.

C. Farm Property and Management. These provisions allow the family to make critical non-tax administrative decisions, such as: (i) the scope of the continued farm operation; (ii) the degree of control to be afforded the continuing farm operator; (iii) the

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10 The grantor trust income tax rules cannot be ignored for this period, but since the survivor has a mandatory income right anyway it would seem that in all but the very largest trusts that burden can be handled with skilled tax reporting on the fiduciary income tax return.

11 The broadest drafting possible to avoid general power treatment. Note that another advantage of placing this power in the first tier beneficiary -- whether a child or a surviving spouse -- is to encourage the children and grand children to be kind to the power holder. Cynics can have a field day with this one, but there are plenty of times when the first spouse's primary purpose is to extract that very contribution -- of kindness and attention -- from the potential takers.

restrictions – if any – that should apply on the disposition of "Farm Property" (a carefully defined term); and, (iv) the source of payments that cannot practically be charged to trust principal. The provisions of this Article are limited in the main only by the family's intentions and imagination; and, for those practitioners who rarely advise farm operators, imagine a widget factory instead, and how these principles can be turned to other uses:

ARTICLE NINE: Farm Property and Management.

The Grantor is convinced that the Farming family has been blessed with the fruits of the land - land which has passed to her upon the strength of several lifetime's worth of hard work, frugality, and foresight. Preserving that land intact for the benefit of her descendants is of utmost importance to Grantor and shall be a primary objective of the Trustee. Accordingly, the Grantor hereby declares and directs:

A. That she considers the Farming family farmland and any and all other agricultural real estate held at any time by any one or more Trusts created by or as a result of this instrument, however acquired and wherever situated, (including, without limitation, the real estate described on Exhibit A hereto; that portion dedicated to residences, sheds, bins, and other agricultural support facilities without the requirement that said agricultural real estate actually be dedicated to producing crops; and, including specifically any interest in any business or other legal entity that owns an interest in the Farming family farmland or other agricultural real estate including without limitation shares in a corporation, a partnership interest in any limited or general partnership, a beneficial interest in or power of direction over a land trust, a membership interest in any limited liability company, or otherwise, all of which being referred to herein for convenience as "Farm Property"), to be a sound and proper investment and, subject to the following provisions, expressly authorizes the Trustee to invest in or retain indefinitely any part or all of any Trust Estate in Farm Property, to the exclusion of all other investments if necessary.

B. That in supplement to the foregoing statements of purpose and declarations and directions, and not in limitation thereof, the Grantor also imposes the following restrictions upon the sale, partition, mortgage and/or distribution of said Farm Property, which restrictions shall be immune from revision through the exercise of any power of appointment otherwise conferred by this instrument:

1. For so long as the Grantor and any of the Grantor's three Children is living, no beneficiary shall have the right to demand or withdraw and no Trustee shall have the power to sell, mortgage, petition for partition, or distribute as principal free from trust any portion of the Farm Property except:

a. As may prove actually necessary to discharge any federal or state death taxes remaining due upon the death of the Grantor after all other assets available for that purpose have been exhausted; or,

b. In compliance with or upon the untaxed release of any Internal Revenue Code Section 2032A lien pertaining to such Farm Property; and

c. Upon the request by or prior written consent of all persons having a current income interest in said portion of Farm Property (and in the event any said beneficiary has not attained the age of majority, said consent or withholding of said consent may be made conclusively by his or her legal guardian); or,

d. Upon the order of any court of competent jurisdiction having

first made its finding that such is in the best interest of all the beneficiaries of all Trust Estates generally.

2. Following the death of the last to die of the Grantor and all three of the Grantor's Children, no beneficiary shall have the right to demand or withdraw and no Trustee shall have the power to sell, mortgage, petition for partition, or distribute as principal free from trust any portion of the Farm Property except:

a. In compliance with or upon the untaxed release of any Internal Revenue Code Section 2032A lien pertaining to such Farm Property; and

b. Upon the request by or prior written consent of all persons having a current income interest in said portion of Farm Property (and in the event any said beneficiary has not attained the age of majority, said consent or withholding of said consent may be made conclusively by his or her legal guardian); or,

c. Having first offered the subject portion of Farm Property for sale and purchase by any one or more of the Grantor's descendants who, as a condition of such purchase will agree not to reconvey said portion of the Farm Property without first offering it for purchase by another descendant of Grantor. (The preferred right of purchase shall be for a purchase price equal to an average of two appraisals prepared by licensed Illinois land appraisers familiar with farm values in Sangamon County. The terms of sale shall be those prevailing for similar sales of farm land on an "arms length" basis within the area. If more than one descendant of Grantor wishes to exercise the preferred right to purchase then each shall be allowed to do so in fractional proportions equivalent to the number participating in the purchase.); or,

d. Upon the order of any court of competent jurisdiction having first made its finding that such is in the best interest of all the beneficiaries of all Trust Estates generally.

3. The restrictions of Subparagraphs B.1. and B.2. immediately above shall not apply, however, to that portion of Farm Property constituting a natural, separate residential homestead. In the event any such residential homestead passes into Trust hereunder, the Trustee shall at any time have the power, but not the obligation, to survey, partition, and set aside any said farm homestead (including houses, support buildings, storage facilities and land traditionally not employed for growing crops, and as may otherwise be required by state or local zoning or land use authorities) and offer it for sale at its then-current value upon such terms and conditions as may then be in the best interest of the Trust(s), giving preference to any adult descendant of Grantor who may wish to buy it at its then-current value; or in the alternative, the Trustee may maintain and preserve said homestead for any beneficiary's residential use or as an income-producing property.

4. The restrictions of Subparagraphs B.1. and B.2. immediately above shall also not apply to prevent the Trustee from exchanging one or another tract of Farm Property for another, similar tract (or tracts) if the Trustee believes such an exchange would benefit the Trust Estate(s) generally.

C. That the Grantor's sons, Hard Lee Farming and Dutiful Lee Farming , shall have the right and opportunity to tenant-farm the Farm Property as long as either or both desires or is capable of doing so, in accordance with the crop-share lease arrangement now existing between them and the Grantor. This right to farm the Farm Property shall not disqualify either or both from serving as a Trustee or Co-Trustee; but to the contrary, the Grantor emphasizes her intention that each may serve in the multiple capacities of Trustee, farm tenant and/or farm manager, none of which shall be construed or interpreted as an actual or potential conflict of interest, nor limited by any duty that either disgorge his individual tenant's share of the profits according to said lease arrangement. At such time as both of the Grantor's sons shall cease to farm the Farm Property, the Trustee shall give

preference to such person or entity as the last of them to farm the land may designate in writing to be the next farm tenant; and if no such person or entity is designated, then to an adult descendant of the Grantor (or spouse of a descendant of Grantor) who is capable of farming the land properly.

D. That in addition, the Grantor's sons, Hard Lee Farming and Dutiful Lee Farming , or the survivor of them, shall serve as farm manager for all Trusts created pursuant to or as a result of this instrument. When selecting a successor farm manager each Trustee shall give preference to a "qualified heir" of the Grantor, as that term is defined and applied by Internal Revenue Code Sections 2032A and/or 2057.

E. That the Trustee is specifically authorized and directed to continue to engage in farm operations and the production, harvesting and marketing of farm products; to retain farm management consultants; to enter into farm programs; to purchase or rent and operate farm machinery and equipment; to improve the Farm Property, and to repair, improve, and construct farm buildings, fences, and drainage facilities; to develop, lease, or otherwise dispose of any mineral, oil, or gas property or rights; to borrow money for any of the purposes described in this Article; and in general to do all things customary or desirable in farm operations; provided, however, that the Trustee shall at all times conduct its farm management in compliance with any Internal Revenue Code Section 2032A Special Use Election at any time made.

F. That, because of the illiquid nature of the Farm Property, the Trustee shall first pay currently from gross income all of the expenses of holding and administering the Trust, including by way of example but not limitation: any taxes; special assessments; insurance payments; costs of preserving productivity; reasonable cash reserves for depreciation and repairs; costs of administration of the Trust; and all other necessary and reasonable expenses, all of which costs shall be borne by the income beneficiaries without contribution from principal.

G. That the Trustee shall pay all taxes and special assessments which may be levied against Farm Property in a timely manner, and before penalty may accrue; keep the buildings and improvements thereon insured for their fair insurable value; keep the buildings, waterways, and drainage thereon and easements appurtenant thereto in a reasonable state of repair and upkeep; and, use reasonable efforts to maintain the fertility of the soil; however, the Trustee shall not be required to maintain or insure improvements that become unproductive due to changing circumstances.

H. That the Trustee may consent to special use valuation of Farm Property for death tax purposes or a deferral of payment of federal estate tax or state death taxes, and may accept property which is subject to a lien for the payment of deferred death taxes or which has been specially valued; and, accordingly, the Trustee may take any action consistent with such consent or acceptance including execution of any agreement, consent to imposition of any lien, substitution of any security, acceleration of any payment, assessment of any tax or any other proceedings pertaining to special valuation, in each case without regard to the effect on the relative interests of any beneficiary.

D. Disability Provisions and the Special Needs Conversion: Long term trusts require looking out for the unforeseeable, even the unimaginable, including the possibility that a tall strong healthy child or grandchild may fall victim to accident and permanent disability. Rather than cringe from the thought, we should address the problem by availing the "special needs and comforts" trusts for loved ones without exposing trust principal to seizure for reimbursement by public aid agencies that may have provided basic shelter, sustenance and medical care. Volumes have been written on the subject of drafting trusts for the benefit of third parties that can be used for special needs, and while Congress (and the assorted state agencies) are growing ever more aggressive in seeking recovery of assistance payments, it makes sense to at least try to anticipate the problem with self-amending disability provisions:

<u>ARTICLE TWELVE</u>: Disability.

A. Wherever used in this instrument the term "disability" means any legal, mental or physical condition which renders a person less than fully able to manage his or her person or estate, or his or her medical, personal or financial affairs.

1. The term shall include, but is not limited to, the stricter standard of "a medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months"; or, "any condition of comparable severity evidenced by marked functional limitations." Any person who has been determined to be disabled: (i) in the manner provided by Illinois statutes governing adjudication of disability [e.g., Article XIa of the Illinois Probate Act; 755 ILCS 5/11a-1 through 11a-23, or any similar or successor provision governing the same substantive topic]; (ii) for any purpose by the Social Security Administration; and/or, (iii) who has been determined (by any federal or state agency) to be disabled for Medicaid purposes, shall during the term of such determination be deemed to be disabled for the purposes of this instrument. Any person who has suffered a medically determinable condition of such severity as to be sufficient, in the judgement of his or her attending physician or physicians to require his or her institutionalization as a long-term resident of a nursing home or other health care facility, or require long-term nursing or other professional health care on an "in-home" basis, shall during the term of such condition be deemed to be disabled for the purposes of this instrument.

2. To the extent a disability is not established by the findings set forth in Subparagraph A.1. immediately above, then:

a. The determination of a present disability, or the recovery from a past disability, affecting the Grantor or any person who is serving as Trustee shall be made in a signed writing by that person's attending physician after a personal examination. That written determination shall contain: (i) a description of the nature and type of the disability and an assessment of how the disability impacts on the ability of the person to make decisions; (ii) an analysis and results of evaluations of the person's mental and physical condition, and immediately apparent prospects for recovery; (iii) a statement expressing an opinion on whether the person shall require institutionalization as a long-term resident of a nursing home or other health care facility, or require long-term nursing or other professional health care on an "in-home" basis; and, (iv) a conclusion and opinion on whether that person is disabled on the basis of the criteria herein provided. This written determination shall be delivered to the current and successor beneficiaries and, if applicable, to any person nominated as successor Trustee hereunder, who shall then assume the office of Trustee in the manner provided elsewhere in this instrument.

b. The determination of a present disability, or the recovery from a past disability, affecting any beneficiary other than the Grantor or a person who is serving as Trustee hereunder shall be made by the Trustee in his, her, or its sole discretion on the basis of the criteria herein provided and such reasonable inquiry as the Trustee deems appropriate in the circumstances.

B. Notwithstanding anything in this instrument to the contrary, in the event any beneficiary (other than Grantor) suffers a disability then the Trustee's powers, discretions and obligations under this instrument with respect to the disabled beneficiary shall thenceforth, immediately, and without further acts in furtherance be amended, restricted, and governed by the following provisions:

1. In the event that the disabled beneficiary is then serving as Trustee, he or she shall immediately, and for the remaining term of that disability be disqualified to serve as Trustee. This disqualification shall endure through the entire period of disability, but shall end when the disabling condition ends, at which time the beneficiary may be restored as Trustee. The successor Trustee shall be as elsewhere provided in this instrument.

2. Commencing immediately upon the disabling event, the Trustee shall withhold payment of Trust principal or income for basic support requirements such as food, clothing, medical care and shelter which the disabled beneficiary is able to receive from any local, state or federal government agency or agencies or any other source, whether public or private, and the beneficiary's power to withdraw, and the Trustee's discretion to distribute principal from any Trust shall thenceforth be limited accordingly.

3. During such period as the disabled beneficiary is receiving or eligible to receive assistance from local, state or federal government sources, or from private agencies, Trust principal or income shall be distributed to or for the benefit of the disabled beneficiary, if at all, only for the special needs, comforts or luxuries suitable for the beneficiary's happiness (including but not limited to travel, expenses for travelling companions if requested or necessary, entertainment, supplemental medical and dental expenses, social services, and transportation) which will not otherwise be provided by any local, state or federal government agency or agencies, and no distribution shall be made for the basic support and care of the disabled beneficiary.

4. In no event may Trust principal or income be paid to, on the demand of, or for the benefit of any governmental agency or department and the Trustee shall do all things reasonable or necessary to at all times preserve the Trust Estate free of the claims of such governmental bodies.

C. The entitlement, discretion, privilege or interest of any beneficiary to make discretionary withdrawals or distributions of the principal of any Trust Estate during his or her lifetime is contingent upon the restrictions hereinabove set forth. In the event any proceeding is initiated by any governmental agency to breach, set aside, avoid, or otherwise revise these restrictions on any beneficiary's interest for the purpose of seeking reimbursement from the principal of any Trust Estate for goods, care, or services provided by or at the expense of any governmental body, private agency, or individual, or for any other purpose, then in such event the Trustee's power to distribute principal of the Trust to or for the benefit of the disabled beneficiary at any time during the period of disability shall immediately and without further action by any person terminate, and in such event all provisions for the demand or distribution of principal free of trust to, on account for, or for the benefit of the disabled beneficiary (other than the provision pertaining to termination of the trust in compliance with the Illinois "Rule Against Perpetuities") shall be suspended during the period of disability. If the disability endures until the beneficiary's death, then the beneficiary shall be deemed to have predeceased the date stated for distribution of principal free of trust.

D. Except as necessary to preserve the federal estate tax marital deduction anticipated elsewhere in this instrument (which requirements, including any requirement for the annual distribution of income to my spouse, shall supersede this Article), the interest of any discretionary beneficiary to receive income from any Trust Estate during his or her lifetime is contingent upon the restrictions hereinabove set forth. Any trust income which the Trustee does not distribute pursuant to the foregoing directions and restrictions shall be added to principal, and the Trustee shall pay currently any fiduciary income taxes accruing

on said undistributed income.

E. Notwithstanding the foregoing, the provisions of this Article are subject to the requirements necessary to preserve the federal estate tax marital deduction anticipated elsewhere in this instrument. Those requirements, including the requirement for the annual distribution of the Marital Trust income to Grantor's Spouse, and that no successor beneficiary shall have any right to the principal or income of any Trust created for the exclusive benefit of Grantor's Spouse during the Grantor's Spouse's lifetime, shall supersede these provisions; and, to the extent these provisions are contrary to the requirements of said federal estate tax marital deduction, (but to such extent, only) the same shall, as and with respect to Grantor's Spouse, be deemed void.

E. Administrative Preferences and Additional Authorities.

1. Priority of Benefit and Investment Discretion: If the client's beneficial purpose is to provide each current interested trustee/beneficiary maximum latitude in the administration of his/her separate share, subject only to the tax avoidance and asset protection features built into the plan, it may be worth identifying that priority in concrete terms. The following could be a suitable addition to the Trustee's administrative powers.

No Trustee shall be liable for any mistake in judgment in the making or retaining of investments, or any other discretionary decision made by the Trustee, so long as any such decision is made in good faith. The Trustee shall have maximum latitude in making investments and shall not be bound by any duty to consider both the reasonable production of income and the preservation of capital value. [Optional qualifiers: (i) Subject to the overriding requirements of the marital deduction provisions provided elsewhere in this instrument; (ii) and/or subject further to the limitations to the disposition of "Farm Property" provided elsewhere in this instrument] the Trustee is otherwise specifically authorized to invest the entire Trust Estate: (i) in income producing assets; (ii) in assets selected for the potential of capital growth; (iii) any combination of income and growth investments; or, (iv) assets which neither produce income nor offer potential for capital growth but which the Trustee believes benefit the beneficiary generally. While relying upon the Trustee's fiduciary duties in all other respects as a material term of this Agreement, the Grantor exempts the Trustee from the duties of impartiality in investing with respect to current and successor beneficiaries, it being Grantor's intention to provide maximum benefit to each current beneficiary in priority over the interest of successor beneficiaries. The Trustee may but shall not be required to retain investment advisers, the cost of which shall be borne by the Trust Estate generally. In addition, the Trustee may but is not required to delegate investment functions in any manner consistent with the provisions of the Illinois Trusts and Trustees Act.

It is hard to imagine a more clear cut grant of individual discretion and priority. Nevertheless, note the bracketed optional limitations pertaining to the marital deduction requirements, and the possible application of "Farm Property" limitations.

2. No Conflict of Interest: Similar provision can be made to further head off conflict-of-interest issues while addressing the interested trustee tax problems:

Any individual acting as Trustee who is also a beneficiary of any Trust or Trust Estate created hereunder may deal with any Trust on an "arms-length" basis without obtaining the approval or confirmation of any Court or any other beneficiary, and such dealings made in good faith shall be as binding and conclusive as though no such relationship or possible conflict of interest existed. Any such Trustee shall not be required to account for or disgorge any direct or indirect personal benefit he, she or it receives, or liable for any loss that results, except by reason of gross negligence or willful malfeasance, it being the Grantor's intention to empower as Trustee persons who are the natural objects of his bounty. Any power to make discretionary distributions of Trust principal to or for the benefit of a person who is serving as Trustee of a Trust (including distributions to the person's spouse and distributions in discharge of any legal obligation of the person) or any other discretionary power, the exercise of which could result in distribution of the principal to or for the benefit of such individual, shall be exercisable solely by the Trustee or Trustees other than that person. If no other Trustee is then serving, such power shall not be exercisable; provided, however, that the provisions of this paragraph shall not apply to a power to make distributions which, under this instrument, is limited by an "ascertainable standard" relating to the beneficiary's health, education, support or maintenance as that term is defined and applied by Internal Revenue Code Sections 2511, 2514 and 2041, and supporting regulations.

3. <u>Compensation</u>: All to often, family members are expected to assume these time-devouring, high-maintenance administrative tasks without pay, and in the end they get about what they pay for. If it is the client's intention to keep the fiduciary fully engaged -- instead of shirking trust work in favor of making a living -- then compensation should be discussed and provided for. Illinois' statutory standard of "reasonable compensation" begs the question of what's fair, so tying the pay to an objective, measurable standard might be preferred. Here's one way:

Each person or entity serving as Trustee shall be entitled to a reasonable compensation for his, her, or its services (which, for each, may be equivalent to but shall not exceed the fees charged by First Trust Bank of Post Oak, Illinois, or its corporate successor, according to its fee schedule published from time to time during the term of the Trust) and to reimbursement for actual, reasonable and necessary expenses incurred on behalf of the Trust.

4. <u>Authority to Continue Farming</u>: If the lengthy "Farm Management" article is not used the following briefer alternative could be added:

The Trustee is further authorized to continue to engage in farm operations and the production, harvesting and marketing of farm products; to participate or decline to participate in governmental agricultural or land programs; to retain farm management consultants or advisors and to engage agents, managers and employees and delegate powers to them; to lease land, equipment or livestock for cash or on shares; to purchase and sell, exchange or otherwise acquire or dispose of farm equipment and farm produce of all kinds; to make improvements, construct, repair, or demolish and remove any buildings, structures or fences; to engage in drainage and conservation programs and to terrace, clear, ditch and drain lands and install irrigation systems; to repair, improve, and construct farm buildings, fences, and drainage facilities; to develop, lease, or otherwise dispose of any mineral, oil, or

gas property or rights; to borrow money for any of the purposes described in this paragraph; and in general to do all things customary or desirable in farm operations.

5. Power to Merge Trusts. Left unmentioned in the GST drafting example provided above is the liklihood that upon the death of one or another of the key players two or more trusts of substantially identical beneficial terms -- a Descendant's Trust and a parallel ILIT, for example – could be coming together for the benefit of a single beneficiary. In such event the beneficiary/Trustee should have the specific authority to merge his or her two trusts into one:

The Trustee shall have the power to merge any Trust with any other Trust or trust property held for the benefit of the same beneficiary(ies) (under this or any other instrument) into one single Trust Estate if, in the opinion of the Trustee, the terms and federal transfer tax attributes of such trusts are substantially identical or such a merger can be effected without materially adversely affecting the interests of such beneficiary or beneficiaries.

6. Power to Allot Property. To avoid the administrative headache of fractionalizing property when funding the various trusts, and to take advantage of the latitude afforded by the pecuniary funding formula built into the example, the Trustee should have broad authority to pick and choose assets:

The Trustee shall have the power to allot to any trust an undivided interest in property, make joint investments for two or more trusts hereunder, distribute property in cash or in kind, or partly in each; to allot different kinds or disproportionate shares or undivided interests in property among the distributed shares, without regard to the income tax basis of such property or interest; and, except as specifically required elsewhere in this instrument, to determine the value of any property so allotted or distributed.

7. Tax Elections. This one should be obvious:

The Trustee shall have the power to exercise any discretion, election, or power permitted under any federal or state tax law that the Trustee deems advisable, without regard to its effect on the relative interests of the beneficiaries, and the Trustee shall make no corresponding adjustment between principal and income, or to the relative interests of the beneficiaries to compensate for the effect of the exercise of discretions, elections, or powers.

8. Spendthrift Provisions. These provisions are practically essential if the trust assets are to be insulated from claims:

With respect to each Trust or Trust Estate created by virtue of this instrument, and

notwithstanding any provision herein contained to the contrary:

1. Neither the principal nor the income of any interest in a Trust Estate shall be liable for or charged with any debts, contracts, liabilities or torts of a beneficiary, or for any duty of support that may or may not be owed by a beneficiary, and no interest in a Trust Estate shall be subject to seizure or other process by any creditor of a beneficiary.

2. No beneficiary shall have the power to anticipate, petition for partition, encumber or transfer his or her interest in the Trust Estate in any manner, and any purported anticipation, partition, encumbrance or transfer shall be void.

3. No beneficiary shall have any right to compel any discretionary distribution, or to partition any assets held in trust.

4. Nothing in this Paragraph shall limit the lawful exercise of any power of withdrawal retained by Grantor, or the effectiveness of any disclaimer or release.

F. Conflict Avoidance and Management.

Naturally, if the interested beneficiary is the sole trustee, conflicts should be at a minimum. But since the biblical confrontation of Cain and Abel the potential for family members to fuss – *seriously* fuss – has proven its way. As one prominent Arizona trial lawyer recently warned, we are about to see an explosion in the volume and complexity of trusts-and-estates disputes in the near future:

> **Estates are larger and more complex. An "Entitlement Generation" is coming of age. There's been an influx of more litigious probate lawyers as well as a proliferation of poorly drafted and incomplete trusts. Meanwhile, the majority of Americans are without estate plans even as their family trees grow more complicated and their lifespans get longer.[12]**

Failing to make provision for dealing with this potential is almost asking for it.

1. <u>Alternative Dispute Resolution</u>: Starting with mediation is often a good way to provide interested persons an opportunity to voice their concerns, frustrations, and agendas. Sometimes, just letting people express themselves -- and in a process well short of litigation -- can defuse the situation. Mediation involves the concerned parties meeting with a (hopefully) impartial and person who assists them in addressing their differences. It is not binding and is not a dispute determinant; rather, the mediator acts as a facilitator among the opposing interests and attempts to help them define issues, find

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12 Peace, Kenneth J., *A Call to Mediate* July, 2007, TRUSTS AND ESTATES. A frighteningly thorough examination of the conditions at play.

common themes, and accommodate each other to the extent possible while moderating confrontation and calming ill will. Here is one possibility[13]:

> **Any dispute or controversy of any kind or nature arising under or as a result of this instrument shall be referred and submitted to mediation under the auspices of ___________, and no interested person shall have standing to pursue any action at law until that mediation has been completed, although any party may as necessary proceed in equity to preserve status until mediation has been completed.**

This provision may, of course, be followed with arbitration provisions or, in the alternative, a choice of law or venue, and an attorneys' fees clause.

2. <u>Judicial Confirmation</u>: Frequently, an individual trustee may find it advantageous to anticipate trouble by asking the Court in advance to confirm the trust and provide prior authority for actions that could be controversial.

> **No Trustee shall be personally liable upon any contract, note, or other instrument executed hereunder or for any indebtedness of the Trust Estate. To the extent that Grantor may lawfully waive any such requirements, no Trustee shall ever be required to qualify before, be appointed by, or account to any Court, or obtain the order of or approval of any Court in the exercise of any power of discretion herein given. However, the Trustee is hereby specifically authorized to petition the Circuit Court of the County where any one or another Trustee resides to have any Trust herein created confirmed by Order of Court at any time the Trustee determines such confirmation useful in giving effect to this instrument, to resolving uncertainties, or to protecting the Trustee from inappropriate criticism.**

3. <u>In Terrorem</u>: Some courts disapprove of *in terrorem* clauses, as do some states: in Florida they are generally unenforceable, while California has a distinct body of law recognizing and directing their implementation. However that may be, the following clause successfully staved off a court fight merely because the potential protagnonists simply weren't sure if it was valid, or not, and there was way too much money involved to risk it:

> **Grantor further declares and directs that he/she has created certain preferences for some of his/her children and grandchildren under this agreement that were not extended to others, and that he/she has chosen to exclude some people who might otherwise have had an expectation in his/her property, and the reasons for these decisions are well considered and need not be explained here. However, it is important to Grantor that all his/her children know that these decisions were not made out of any lack of affection or respect for the other children, and that Grantor's love and respect for all his/her children is equal and immeasurable. It is Grantor's most fervent desire that all of his/her children, and their children, will respect the careful planning represented by this instrument; will cooperate in giving effect to these provisions as cheerfully and willingly as each can; and, will also respect each**

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[13] "JAMS" and the American Arbitration Association are both leading voices for alternative dispute resolution methods, and have many representative clauses. www.jamsadr.com and www.adr.org

other's expectations, needs, burdens, and desires over the years to come. The cooperation that each of them extends to the others will demonstrate their appreciation for what Grantor has intended to do for the common benefit of all. Those who choose to cooperate in this manner will be honoring their forebears as well as themselves. Those who choose not to, or who wish in any way to challenge the provisions of this instrument, will be dishonoring their parents or grandparents, and themselves; and, in addition to provoking my eternal condemnation, will be demonstrating themselves unworthy of sharing in the family bounty.

Accordingly, and notwithstanding any beneficial terms contained elsewhere in this instrument, if any beneficiary hereunder, whether one or more, institutes or participates in (except as a party defending this instrument) any proceeding to contest or attack the validity of this instrument or any of the terms or provisions hereof, then any beneficial interest provided for that beneficiary or beneficiaries hereunder shall be revoked, and shall pass as if that beneficiary or beneficiaries, and all of his or her or their descendants, had predeceased Grantor. This provision shall apply regardless of whether such proceedings are instituted in good faith or with probable cause. Grantor has been advised that Illinois law sometimes disfavors provisions such as this, and in response respectfully invokes the protection of the Illinois courts and judiciary to construe this provision as broadly as may be possible or necessary to implement Grantor's carefully articulated purpose herein, to-wit: Grantor expects his family to abide by his wishes and not to fuss, and if they choose to fuss he prays that they take nothing. Amen.

4. Trust Protectors: At first viewed askance, the notion of an outside advisor and helper is becoming more and more common, especially in the context of these long term trusts[14]. The office first developed to enable settlors of offshore asset protection trusts to continue to influence the control of those assets without exposure to creditors. Whether that worked, or not, the notion has expanded to appointing a domestic trust protector whereby the Grantor is, in effect, vesting one or more limited powers of appointment in a disinterested person who may or may not rise to fiduciary status depending on the drafting and scope of the assignment. Among the powers that can and frequently are delegated are the power:

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See, Romanoff, Robert A., Ch. 6, "Drafting Considerations for Trusts", ADVANCED ASSET PROTECTION PLANNING, Illinois Institute for Continuing Legal Education (Spring, 2007), pp. 46 - 50 for a thorough explanation and comprehensive form. Rob and your author have been singing in chorus on these long term trust issues for more than a decade.

* To remove or add trustees
* To amend otherwise irrevocable instruments to comply with stated purposes in the light of changed circumstances
* To approve accountings and certain investment recommendations
* To initiate or supervise mediation or arbitration
* Subject to tax considerations, and the Grantor's intent, -- just about anything else

Which seems to raise the problem of -- just who is the trust protector working for? The settlor, or the beneficiaries? Two superb recent articles in the Cardozo Law Review[15] consider whether in empowering the trust protector you are diminishing the trustee, confusing authority, and perhaps merely exchanging one set of fiduciary/agency problems for another.

Largely out of that concern, and more largely out of intuitive suspicion, your author has limited his use of trust protectors for select purposes. For example, not long ago the question of identity of potential beneficiaries came up, and the following clause resulted:

> **Grantor hereby confers upon her friend and attorney, WILLIAM A. PEITHMANN, if then living, and if not then living to the then-serving President of the First Trust Bank of Post Oak, Illinois, the limited power of appointment to construe the provisions of this Subparagraph, to give it effect, and to determine the correct identity of each of the above-listed charitable organizations and their respective qualification under Internal Revenue Section 501(c) as of the date of Grantor's death, which said powerholder may exercise in writing in his or her absolute discretion, and which shall be binding upon all persons or entities claiming any interest under this instrument.**

III. POST-MORTEM OPTIONS.

A. Disclaimer. A disclaimer is the absolute and irrevocable refusal to accept an interest in property, or power over property, to which the disclaimant is entitled. A valid property law disclaimer causes the interest to pass to those who would have taken had the

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15 Sterk, Stewart E, *Trust Protectors, Agency Costs and Fiduciary Duty*, 27 CARDOZO LAW REVIEW 2761 (2006); and, Alexander, Gregory S., *Trust Protectors: Who Will Watch the Watchmen?*, 27 CARDOZO LAW REVIEW 2807 (2006).

disclaimant predeceased the date of the entitlement. If the property law disclaimer also satisfies somewhat stricter Internal Revenue Code requirements as a "qualified disclaimer," the refusal to accept will also allow the affected property to pass beyond the disclaimant to the next taker without treatment as a separate transaction for estate and gift tax purposes. In effect, a qualified disclaimer collapses the transfer into a single gift from the original owner to the ultimate recipient, bypassing the disclaimant, so that, as between the disclaimant and the next taker, the passing is not a taxable transfer.

A disclaimer can create the opportunity to rewrite estate plans substantially after death; to cure flaws or omissions; to take advantage of newly apparent tax savings; to protect family assets from (some) creditors; or, to secure other benefits. Given the uncertainty of current state and federal transfer tax law, and the public's reluctance to revisit existing estate plans, disclaimers may yet prove to be of even greater importance now, and over the next ten years, than over the last twenty years. The Illinois disclaimer statute can be found at Illinois Probate Act §2-7; 755 ILCS 5/2-7. The rules governing a qualified disclaimer are provided in IRC Section§2518 and its detailed supporting regulations, Treas.Reg. §§25.2518-1, 25.2518-2, and 25.2518-3. The subject is too complex to separately address in the body of this article.

B. Testamentary Exercise of Power of Appointment. Suppose the life-interest beneficiary of one of those foregoing GST trust provisions wants to exercise one or another of his or her powers. A failed exercise is worse than default, and thus great care should be employed to make the election as unmistakable as possible. A suitable will provision could be drafted as follows:

LAST WILL AND TESTAMENT of DUTIFUL LEE FARMING

* * * *

ARTICLE FOUR: I hereby declare that I am the current beneficiary, and the Trustee, of the Dutiful Lee Farming Descendant's Trust (EIN: 45-1234567), which was created under and is governed by ARTICLE EIGHT of the Father Farming Trust Agreement dated October 17, 1997. This Trust consists of two components:

- **An "Exempt Portion", so-called because it is exempt from generation skipping transfer tax; and,**

* **A "Non-Exempt Portion", which is not yet exempt from generation skipping transfer tax.**

Paragraphs F. and G. of said ARTICLE EIGHT of the Father Farming Trust Agreement provide in their entirety as follows:

"F. Upon the death of each Descendant's Trust beneficiary [**i.e., me**] his or her Descendant's Trust Estate shall pass as follows:

[quote termination provisions verbatim]

I hereby exercise, or decline to exercise, the above-described powers of appointment, by specific reference, as follows:

A. I hereby decline to exercise the limited testamentary power of appointment provided in Subparagraph F.1 of said ARTICLE EIGHT of said Father Farming Trust Agreement, with the knowledge that said limited power shall lapse upon my death.

B. I hereby decline to exercise the general testamentary power of appointment provided in Subparagraph F.2 of said ARTICLE EIGHT of said Father Farming Trust Agreement, with the knowledge that said general power shall lapse upon my death; that the lapse of this general power may, under the provisions of Internal Revenue Code Section 2041, cause the value of the Non-Exempt Portion to be includible in my gross estate for federal estate tax purposes as provided by Internal Revenue Code Section 2031; and, that upon my death I may then be deemed to be the "transferor" of the Non-Exempt Portion for the purposes of Internal Revenue Code Section 2652. In such case, I suggest but do not absolutely direct that my Executor first allocate so much of my generation skipping transfer tax exemption remaining at my death to as much of, or if possible all of, said Non-Exempt Portion, in order that as much of or if possible all of said Non-Exempt Portion may be added to the "Exempt Portion" with a continuing inclusion ratio for the Exempt Portion of zero.

C. I hereby exercise the limited power of appointment provided in Subparagraph F.3 of said ARTICLE EIGHT of said Father Farming Trust Agreement as follows:

1. If my daughter, Donna Farming, survives me, then she shall receive all of the income from the "Non-Exempt" Portion and from the "Exempt Portion" of my Descendant's Trust Estate for so long as she may live.

2. During the life of my said daughter, the Trustee of my Descendant's Trust shall be, in the order named:

FIRST, My daughter, Donna Farming;

SECOND, In the event my said daughter should fail to become or cease to serve as Trustee during my daughter's lifetime, then the successor Trustee shall be such: (i) one or more descendant(s) of Donna Farming who has/have attained the age of 30; and/or, (ii) corporate fiduciary, as my said daughter Donna Farming may appoint by a signed instrument (including a Will) specifically referring to this limited power of appointment; and,

THIRD, Upon default of appointment, the successor Trustee shall be the First Community Bank of Post Oak, or its corporate successor.

3. Upon the death of the last to die of my said daughter and me:

a. My Descendant's Trust shall terminate; and,

b. The Trustee shall distribute the Trust Estate then

> **remaining to my daughter's descendants *per stirpes* then living, subject only to the continuing application of the Holdback Trust provisions of Article ____ below.**

C. Except as otherwise effectively appointed by the foregoing, the Dutiful Lee Farming Descendant's Trust shall continue to be administered pursuant to the provisions of the Father Farming Trust Agreement dated October 17, 1997.

C. Preserving the Record – The Detailed Deed in Trust. Sometimes it gets lost in our thinking that the people who are most closely familiar with the multi-generational plan will be dead when the rubber finally hits the road. The first generation beneficiaries will cruise along just fine, but when they leave the scene – then what? Lawyers and accountants will be equally dead, or at least retired, files destroyed and many records may well be lost. Plus, the very flexibility that makes these setups so attractive also makes them mind-numbingly complicated. How do we preserve the record for the next takers when we don't have one of those [awful but] perpetual trust companies? One way, at least for real estate, is to put it all in the deed in trust: everything that might be useful to a distant descendant and that you are not afraid o f disclosing.