

Chicago Estate Planning Council

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Illinois Directed Trusts & Decanting

Panelists:

Benetta P. Jenson

Managing Director

J.P. Morgan Private Bank

312.732.3447

benetta.p.jenson@jpmorgan.com

Rebecca Wallenfelsz

Partner

Chapman & Cutler

312.845.3442

wallen@chapman.com

Lyman W. Welch

Partner

Sidley Austin LLP

312.853.4165

lwelch@sidley.com

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760 ILCS 5/16.3 - Directed Trusts

760 ILCS 5/16.4 - Distribution of Trust Principal in Further Trust (Decanting)

- Signed into law on August 10, 2012
- Effective as of January 1, 2013
- Applicable to existing trusts and those created in the future
- Background: To modernize and clarify Illinois law

760 ILCS 5/16.3 - Directed Trusts

- In General
- Uses of Directed Trusts
- Different Types of Directing Parties
- Investment Trust Advisor
- Distribution Trust Advisor
- Trust Protector
- Duties & Liabilities
- Applicability
- Modification of Trust to Create Directing Party?

760 ILCS 5/16.3 - Directed Trusts

- “Directed Trust”: A trust which separates specified trust functions from the trustee’s administrative duties (*e.g.*, separating investment and distribution decisions that a trustee typically would make and allocating those responsibilities to an “Advisor” or “Trust Protector”, known as a “Directing Party”, who direct the administrative trustee, known as the “Excluded Fiduciary”).
- Background: In the past, when authority was separated, Trustee still was held ultimately responsible for the decisions made by Advisors/Trust Protectors, even though the Advisor/Trust Protector had sole authority to make the decision under the governing instrument.
- Purpose: To specifically identify the liabilities and responsibilities of various parties when trust functions are bifurcated. Directed Trusts allow greater flexibility in trust administration.

Uses of Directed Trusts

- Investments (particularly specialty assets, such as interests in a closely-held business, real estate, life insurance, etc.)
- Distributions
- Valuations
- Tax-related Issues
- Change of Situs and Governing Law
- Appointment/Removal of Officeholders
- Amendment of Trust Instrument
- Other

Different Types of Directing Parties

- Investment Trust Advisor: Any one or more persons given authority by the governing instrument to direct, consent to, veto, or otherwise exercise all or any portion of the investment powers of the trust
- Distribution Trust Advisor: Any one or more persons given authority by the governing instrument to direct, consent to, veto, or otherwise exercise all or any portion of the distribution powers and discretions of the trust, including but not limited to authority to make discretionary distribution of income or principal
- Trust Protector: Any one or more persons given any one or more powers specified in the statute, whether or not designated with the title of trust protector by the governing instrument

760 ILCS 5/16.3(b) - Investment Trust Advisor

If a settlor names an Investment Trust Advisor, unless the governing instrument provides otherwise, Section 16.3(b) provides that the Investment Trust Advisor has the authority to:

- (1) Direct the trustee with respect to the retention, purchase, transfer, assignment, sale, or encumbrance of assets and the investment/reinvestment of principal and income;
- (2) Direct the trustee with respect to all management, control and voting powers (including voting proxies for securities held in trust);
- (3) Select and determine reasonable compensation of advisors, managers, consultants, or counselors, including the trustee, and to delegate to them any of the powers of the Investment Trust Advisor;
- (4) Determine the frequency and methodology for valuing assets with no readily available market value

760 ILCS 5/16.3(c) - Distribution Trust Advisor

If a settlor names a Distribution Trust Advisor, unless the governing instrument provides otherwise, Section 16.3(c) provides that the Distribution Trust Advisor has the authority to:

- “Direct the trustee with regard to all decisions relating directly or indirectly to discretionary distributions to or for one or more beneficiaries”

760 ILCS 5/16.3(d) - Trust Protector

If a settlor names a Trust Protector, unless the governing instrument provides otherwise, Section 16.3(d) provides that powers granted to a Trust Protector may include:

- (1) Modify/amend the trust instrument to achieve favorable tax status or respond to changes in the Internal Revenue Code, federal or state laws, and rules/regulations thereunder;
- (2) Increase, decrease, or modify the interests of any beneficiary(ies);
- (3) Modify the terms of any power of appointment granted by the trust, provided that the modification/amendment may not grant a beneficial interest to parties not specifically provided for under the trust instrument;
- (4) Remove, appoint, or remove and appoint, officeholders (trustees, advisors, etc.) or designate a plan of succession for future officeholders;
- (5) Terminate the trust, including determination of how the trustee will distribute the trust property to be consistent with the purposes of the trust;

760 ILCS 5/16.3(d) - Trust Protector (continued)

If a settlor names a Trust Protector, unless the governing instrument provides otherwise, Section 16.3(d) provides that powers granted to a Trust Protector may include:

- (6) Change the situs of the trust and/or governing law of the trust;
 - (7) Appoint one or more successor trust protectors, including designation of a plan of succession for future trust protectors;
 - (8) Interpret terms of the trust instrument at the request of the trustee;
 - (9) Advise the trustee on matters concerning a beneficiary;
 - (10) Amend/modify the trust instrument to take advantage of laws governing restraints on alienation, distribution of trust property, or to improve the administration of the trust.
- * If a charity is a current or presumptive remainder beneficiary, the Trust Protector must give 60-days notice to the Illinois Attorney General before taking certain of these authorized transactions

Duties & Liabilities

- Of a Directing Party:
 - Directing Party is a fiduciary, subject to same duties and standards applicable to a trustee as provided by applicable law, unless provided otherwise under the governing instrument
 - Governing instrument cannot relieve or exonerate a Directing Party from the duty to act or withhold acting as the Directing Party in good faith reasonably believes is in the best interests of the trust
 - Has duty to keep the Excluded Fiduciary and any other Directing Party reasonably informed regarding the administration of the trust
 - Neither the information nor the acts or inaction of the Directing Party affects the limitation from liability of the excluded fiduciary
 - By accepting appointment, a Directing Party submits to the jurisdiction of Illinois courts, even if other agreements may provide otherwise

Duties & Liabilities (continued)

- Of an Excluded Fiduciary:
 - Unless provided otherwise by the governing instrument, an Excluded Fiduciary has NO duty to monitor, review, inquire, investigate, recommend, evaluate, or warn with respect to the Directing Party's action or inactions relating to powers granted in the governing instrument
 - Excluded Fiduciary will not be liable for such action or inaction, including:
 - For Directions by a Directing Party - Excluded Fiduciary is not liable for any loss resulting directly or indirectly from following the Directing Party's direction except in cases of willful misconduct on the part of the Excluded Fiduciary in complying with the direction (includes complying with the valuation of assets for which there is no readily available market value)
 - For Consents by a Directing Party – Excluded Fiduciary is not liable for any loss resulting directly or indirectly from any act taken or omitted as a result of a Directing Party's failure to provide consent after having been asked to do so by the Excluded Fiduciary
 - If the governing instrument provides that an Excluded Fiduciary has to assume the role or responsibility of a Directing Party or if the Excluded Fiduciary appoints a Directing Party or successor to a Directing Party, then the Excluded Fiduciary will assume the same fiduciary and other duties, standards and liabilities of the Directing Party

Applicability

- On and after January 1, 2013, the Directed Trust statute applies to:
 - All existing and future trusts that appoint or provide for a Directing Party
 - Any existing or future trust that is modified in accordance with applicable law or the terms of the governing instrument to appoint or provide for a Directing Party (the governing instrument is not only the trust instrument, but also includes any court order or non-judicial settlement agreement that establishes, construes, or modifies the terms of the trust (e.g., through decanting, Virtual Representation agreements, etc.))
- Express Prohibitions: A governing instrument may expressly prohibit the use of the Directed Trust statute by using a provision in the form: “The provisions of Section 16.3 of the Trusts and Trustees Act and any corresponding provision of future law may not be used in the administration of this trust” or similar provision demonstrating intent

Modification of Trust to Create Directing Party?

- Standard for Court or VRA Reformation of Trust under Illinois Law - One or more of the following*:
 - For mistake of fact or law or for scrivener’s error
 - For unanticipated change of circumstance that frustrates purpose of trust
 - Generally strict emergency standard (e.g., waste, impossibility, etc.)
 - For illegality or for terms against public policy
- * Standard of proof is clear and convincing
- Standard for Court or VRA Reformation of Administrative Provision under Illinois Law – One or more of the following:
 - Similar to equitable deviation for charitable trusts
 - Only for reformation of administrative provisions of non-charitable trust
 - Compliance with existing terms is impossible, illegal or would defeat or impair purposes of trust
 - An inability to administer trust effectively due to circumstances not known to the settlor or not anticipated by settlor

760 ILCS 5/16.4 - Distribution of Trust Principal in Further Trust (Decanting)

- In General
- Uses of Decanting
- Absolute Discretion vs. No Absolute Discretion
- Supplemental Needs Trusts
- How to Decant
- Restrictions on Decanting
- Trustee Liability and Remedies
- Applicability
- Tax Consequences of Decanting

760 ILCS 5/16.4 - Distribution of Trust Principal in Further Trust (Decanting)

- “Decanting”: Pouring of a liquid, such as wine, from one vessel to another. In the context of trusts, “decanting” refers to the power a trustee may have to invade the principal of one irrevocable trust (the “first trust”) and transfer that property to another irrevocable trust (the “second trust”). The second trust could be a pre-existing trust or a new trust.
- Background/Theory of Decanting:
 - Many trusts permit distributions to *or for the benefit of* a beneficiary. Arguably, that authority allows a distribution to another trust for the benefit of the beneficiary.
 - In addition, a trustee with the absolute power to invade the principal of a trust is similar to the trustee holding a special power of appointment. In general, the holder of a special power of appointment may appoint property in further trust. In the case of decanting, unless the trust instrument provides otherwise, the trustee holds a special power of appointment in favor of the beneficiary or beneficiaries for whom the trust principal may be invaded.
- Purpose: To provide an “authorized trustee” with the ability to effectively modify an existing irrevocable trust through a non-judicial approach *in furtherance of the purposes of the trust* and in order to meet a family’s changing needs, but it also can be used to enable a trustee to maximize liability safeguards within a judicial proceeding. Decanting is a useful and powerful addition to the tools already existing under Illinois law for modifying irrevocable trusts (e.g., Virtual Representation Agreements, trust division and merger).
- “Authorized Trustee”: An entity or individual, other than the settlor, who has authority under the terms of the first trust to distribute principal of the trust for the benefit of one or more current beneficiaries (this could be a Distribution Trust Advisor of a Directed Trust).

Uses of Decanting

- Correct Drafting Errors or Ambiguities without the Necessity to Go to Court
- Update/Modify Administrative Provisions
 - Trustee or Other Officeholder Provisions
 - Provide for or change the provisions regarding the resignation, removal and appointment of trustees without court approval
 - Add Directed Trust provisions (add Investment Trust Advisors, Distribution Trust Advisors or Trust Protector provisions)
 - Supplement trustee provisions (e.g., include trustee deadlock resolution procedures)
 - Modify Investment Provisions
 - Add investment powers to engage in particular financial transactions or strategies
 - Vary the investment strategies for different beneficiaries based on their varying needs
- Change Trust Situs/Principal Place of Administration and/or Governing Law
 - Choose a preferred state's law (e.g., benefit from one state's broader trust investment powers)
 - Facilitate trust administration

Uses of Decanting (continued)

- Address Changes in Circumstances
 - Changes in federal and state tax laws
 - Changes in substantive trust laws
 - Unanticipated changes in a beneficiary's circumstances
 - Extend termination date of trust
 - Add or remove spendthrift provisions
 - Create a supplement needs trust
 - Eliminate mandatory distributions
- Qualify a trust as a S Corporation shareholder
- Other

Absolute Discretion vs. No Absolute Discretion

- “Absolute Discretion”: The right to distribute principal that is not limited or modified in any manner to or for the benefit of one or more beneficiaries of the trust. A power to distribute principal that includes purposes such as best interests, welfare, or happiness constitutes absolute discretion (*i.e.*, for unascertainable standards).
- Section 16.4(c) - If Absolute Discretion:
 - Second trust may be held (1) for the benefit of one, more than one, or all of the current beneficiaries of the first trust and (2) for the benefit of one, more than one, or all of the successor and remainder beneficiaries of the first trust;
 - Second trust may grant to a current beneficiary of the first trust a power of appointment, provided that such beneficiary could receive the principal outright under the first trust; and
 - A power of appointment granted to a beneficiary under the second trust may include a broader or different class of permissible appointees than the beneficiaries of the first trust.
- Section 16.4(d) – If No Absolute Discretion:
 - The current beneficiaries of the second trust must be the same as the current beneficiaries of the first trust;
 - The successor and remainder beneficiaries of the second trust must be the same as the successor and remainder beneficiaries of the first trust;
 - The second trust must include the same language authorizing the trustee to distribute income or principal as was used in the first trust; and
 - If a beneficiary has a power of appointment under the first trust, the beneficiary must have the same power of appointment under the second trust and the class of permissible appointees must be the same.

Supplemental Needs Trusts

- Level of Discretion: Regardless of the level of the trustee's discretion (absolute or not), if the beneficiary of the first trust becomes disabled, then the authorized trustee may decant the disabled beneficiary's interest in favor of a second trust which is a supplemental needs trust if the authorized trustee determines that to do so would be in the best interests of the disabled beneficiary.
- Remainder Beneficiaries: The second trust that is a supplemental needs trust may name remainder and successor beneficiaries other than the disabled beneficiary's estate, provided that the second trust names the same presumptive remainder and successor beneficiaries to the disabled beneficiary's interest, and in the same proportions, as exist in the first trust.
- When Disabled Beneficiary Also Is Grantor or Controls Trust: If the disabled beneficiary also is the grantor of or otherwise controls the first trust, then:
 - The authorized trustee may distribute to a “pooled trust” as defined by federal Medicaid law for the benefit of the disabled beneficiary; or
 - The second trust that is a supplemental needs trust must contain pay-back provisions complying with Medicaid reimbursement requirements.

How to Decant

- In Writing: If the authorized trustee wishes to decant, the exercise must be made by written instrument, signed and acknowledged by the trustee, and filed with the records of the first trust and the second trust.
 - Notice Requirement - Without Settlor & Beneficiary Consent and Without Court Approval: An authorized trustee can decant without consent and court approval if:
 - There are one or more legally competent current and beneficiaries and one or more legally competent presumptive remainder beneficiaries;
 - The authorized trustee sends written notice (specifying the manner in which the trustee intends to exercise the power and the prospective effective date for the distribution) to all legally competent current beneficiaries and presumptive remainder beneficiaries assuming non-exercise of all powers of appointment; and
 - No beneficiary to whom notice was sent objects in writing delivered to the authorized trustee within 60 days after the notice is sent.
- * If a charity is a current or presumptive remainder beneficiary, the notice also must be given to the IL Attorney General's Charitable Trust Bureau.
- Court Involvement: Court approval of a decanting is required:
 - If a beneficiary timely objects (in which case the trustee has the burden of proving that the proposed exercise furthers the purpose of the trust); or
 - If there is no legally competent current beneficiary or no legally competent remainder beneficiary.

A trustee does not violate its duty of impartiality by arguing in favor of decanting unless the court finds that the trustee acted in bad faith.

Restrictions on Decanting

An authorized trustee may not exercise the power to decant to affect any of the following:

- Beneficiary's Current Rights: The authorized trustee may not reduce, limit or modify a beneficiary's current right to mandatory distributions of income or principal, mandatory annuity or unitrust interests, or right to withdraw a specified dollar amount. In each case, provided that such mandatory right has come into effect, except with respect to a second trust which is a supplemental needs trust.
- Trustee's Liability: The authorized trustee may not decrease or indemnify against a trustee's liability or exonerate a trustee from liability or failure to exercise reasonable care, diligence, and prudence; except to separate fiduciary and nonfiduciary responsibilities among several parties (as in a directed trust), provided, however, that such structure may reallocate fiduciary responsibilities from one party to another but may not reduce them.
- Removal/Replacement of Authorized Trustee: In general, the authorized trustee may not eliminate a provision granting another person the right to remove or replace the authorized trustee.
- Perpetuities Period: The authorized trustee may not in the second trust reduce, limit or modify the perpetuities provision of the first trust, unless the first trust expressly permits the trustee to do so.
- Tax Savings Provisions: The authorized trustee may not jeopardize tax treatment of the trust with respect to the marital deduction, charitable deduction, annual exclusion or GST tax.
 - Exception: The authorized trustee is permitted to decant from a grantor trust to a non-grantor trust and is permitted to decant to a grantor trust.

Restrictions on Decanting (continued)

An authorized trustee may not exercise the power to decant to affect any of the following:

- S Corporation Shareholder: When the first trust owns S corporation stock, the authorized trustee may not distribute part or all of such stock to a second trust that is not a permitted S corporation shareholder.
- Minimum Distribution Rules: When the first trust owns an interest in property subject to minimum distribution rules, the authorized trustee may not decant into a second trust which would shorten the minimum distribution period of the first trust.
- Trustee Compensation:
 - In General: The authorized trustee may not decant solely to change the compensation provisions of any trustee.
 - Exception: If a trust is being decanted for “other valid and reasonable purposes”, then the second trust may change trustee compensation “to bring the trustee’s compensation in accord with reasonable limits in accord with Illinois law in effect at the time of exercise.”
 - No Special Fee for Decanting: No trustee may receive a commission or other compensation imposed upon assets distributed due to the decanting.

Trustee Liability and Remedies

- No Duty to Decant: The IL decanting statute states that it does not create or imply a duty to exercise a power to decant, and no inference of impropriety will be made as a result of an authorized trustee not exercising the power.
- Good Faith: The IL decanting statute protects a trustee who reasonably and in good faith takes or omits to take any action and creates a presumption that the trustee acted or omitted to act in good faith unless a court determines that there has been an abuse of discretion.
- Remedies: A person's exclusive remedy is to obtain an order of the court directing the decanting for the proper functioning of the trust.
- Statute of Limitations: There is a 2-year statute of limitations from the time the trustee has sent notice or a report to the person or the person's personal representative. The statute of limitations does not run for a person under a legal disability who did not have a personal representative at the time the notice or report was sent, unless there was a Virtual Representation agreement regarding the decanting.

Applicability

- On and after January 1, 2013, the Decanting statute applies to: All existing and future trusts that are
 - Administered in Illinois under Illinois law; or
 - Governed by Illinois law with respect to the meaning and effect of its terms, including a trust whose governing law has been changed to the law of Illinois

In both cases, unless the governing instrument expressly prohibits the use of this Section.

- Express Prohibitions: A governing instrument may expressly prohibit the use of the Decanting statute by using a provision in the form: “Neither the provisions of Section 16.4 of the Trusts and Trustees Act nor any corresponding provision of future law may be used in the administration of this trust” or similar provision demonstrating intent
 - A general prohibition of the amendment or revocation of the first trust or a spendthrift provision do not preclude decanting

Tax Consequences of Decanting

IRS Actions & Tax Uncertainties of Decanting

- Tax Uncertainty - The IRS has recognized that decanting is an emerging issue with tax consequences that are not completely clear under current law.
- “No Ruling Lists” - In December 2011, the IRS added to its “no ruling list” decantings that result in a change in beneficial interests. (Please note, however, that the IRS indicated that it would continue to issue rulings for decantings that (1) do not change beneficial interests and (2) do not result in a change in the applicable RAP period.)
- Request for Comments – In IRS Notice 2011-101, the IRS also requested comments on the tax implications of a trust decanting that could result in a change in the beneficial interest in the trust. Many bar and other associations have responded. IRS requested comments on GST, gift, estate and income tax issues related to 13 sets of facts and circumstances. A sample of the issues is below:
 - GST Tax: Whether a trust that has received property from another trust that is grandfathered for GST purposes through decanting continues to maintain its grandfathered status
 - Gift Tax: Whether a beneficiary whose interests are diminished as a result of the decanting has made a taxable gift
 - Gift /EstateTax: Whether the existence of a decanting power in a trust that otherwise qualifies for an estate or gift tax marital deduction under IRC §2056(b)(7) will cause the trust to fail to qualify for the marital deduction
 - Income Tax: Whether the existence of a decanting power causes the trust to be treated as a grantor trust under IRC §671

Tax Consequences of Decanting (continued)

Sampling of Federal Tax Consequences

- Federal GST Tax: A common issue is whether a decanting which modifies a GST exempt trust will jeopardize the GST exempt status of a trust.
 - GST-Grandfathered Trusts – These are trusts that were irrevocable on or before September 25, 1985 or a Will or revocable trust executed before October 22, 1986, if the decedent died before January 1, 1987. Grandfathered status is lost if there is an addition or constructive addition to the grandfathered trust.
 - Generally, modifications of administrative provisions are allowed without the loss of grandfathered exempt status but any modification deemed to create a new trust does result in the loss of grandfathered status.
 - 2 of the 4 Safe Harbor Exceptions under Treas. Reg. § 26.2601-1(B)(4)(i)(D) in particular potentially apply to decanting:
 - (1) Exercises of discretionary trustee powers;
 - (2) Modifications that do not (1) shift beneficial interests to any beneficiary occupying a lower generational level; nor (2) extend the time for vesting of any beneficial interest beyond that provided in the original trust.

Tax Consequences of Decanting (continued)

Sampling of Federal Tax Consequences

– GST-Grandfathered Trusts

▪ Discretionary Trustee Powers Safe Harbor:

(1) Treas. Reg. § 26.2601-1(b)(4)(i)(A) – The distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to lose its grandfathered status if 2 elements are satisfied:

(a) Either:

- (i) The terms of the governing instrument of the exempt trust authorize distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; or
- (ii) At the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary of court;

AND

(b) The terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting of any beneficial interest in a trust in a manner that may postpone or suspend vesting beyond 21 years plus a life in being measured from the date the original trust became irrevocable.

Tax Consequences of Decanting (continued)

Sampling of Federal Tax Consequences

– GST-Grandfathered Trusts

▪ Discretionary Trustee Powers Safe Harbor:

(2) Analysis – Assuming that the governing instrument does not include a decanting power, then the question becomes whether, at the time the trust became irrevocable, IL common law permitted the distribution of assets in further trust, which is a bit unclear.

▪ Modifications Safe Harbor:

(1) Treas. Reg. § 26.2601-1(b)(4)(i)(D) – A modification of the governing instrument of an exempt trust will not cause an exempt trust to lose its grandfathered status if:

(a) The modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification; and

(b) The modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

(2) Analysis – The IL decanting statute limits the perpetuities period of the second trust to that of the first trust, unless the first trust expressly permits the trustee to extend or lengthen its perpetuities period. Assuming that the first trust does not expressly authorize an extension of the perpetuities period of the second trust, the perpetuities period should remain the same and, thus, any decanting would have to meet the requirement that the modification does not shift a beneficial interest to any beneficiary in a lower generation.

Tax Consequences of Decanting (continued)

Sampling of Federal Tax Consequences

- Federal GST Tax:
 - Allocated GST Exempt Trusts – These are trusts which are GST exempt as a result of the allocation of GST exemption.
 - There is no Treasury Regulation on point regarding the modification of allocated GST exempt trusts.
 - However, the Treasury Regulations which apply to modifications of GST-grandfathered trusts also should apply to allocated GST exempt trusts by analogy.

Tax Consequences of Decanting (continued)

Sampling of Federal Tax Consequences

- Federal Gift Taxes
 - Modifications to Administrative Provisions – Generally, trust modifications to purely administrative provisions should not be deemed gifts by trust beneficiaries.
 - Modifications Which Shift Beneficial Interests – However, if a decanting results in a shifting or transfer of beneficial interests in a trust, then a taxable gift may result.
 - The gift tax applies to *voluntary* transfers.
 - IRS may argue that an agreement between a beneficiary and trustee to shift interests to one or more beneficiaries generally results in a taxable event for gift tax purposes, unless the change results from the settlement in a contested matter.
 - Thus, if a beneficiary must consent to a decanting that may change beneficial interests, then the IRS could argue that the beneficiary made a gift.

Tax Consequences of Decanting (continued)

Sampling of Federal Tax Consequences

- Federal Gift Taxes

- Modifications Which Shift Beneficial Interests –

- Under the IL Decanting Statute:

- (1) The settlor and beneficiaries do not have to consent to a decanting and the decanting may occur without court approval if the authorized trustee provides written notice of the decanting to all *legally competent* current and presumptive remainder beneficiaries.
- (2) A beneficiary can block the decanting by objecting within the 60-day notice period.
- (3) The question becomes whether a beneficiary, whose interest in the first trust will be reduced or eliminated by the decanting and who fails to object, will be treated as making a gift to the trust or the other beneficiaries.
- (4) Note that a beneficiary who is not legally competent is not required to receive notice. Thus, if an authorized trustee does not provide notice to such beneficiary, then that beneficiary does not have the power to object.

- Granting of a Testamentary Limited Power of Appointment – Some practitioners have suggested that if a beneficiary is given a testamentary limited power of appointment in the second trust, then the purported transfer is an incomplete gift for gift tax purposes. Thus, if the beneficiary is treated as making a gift by failing to object within the 60-day period under the IL decanting statute, then the granting of a testamentary limited power of appointment in the second trust may make the gift incomplete.

Tax Consequences of Decanting (continued)

Sampling of Federal Tax Consequences

- Federal Estate Taxes

- Granting of a Testamentary Limited Power of Appointment – If the beneficiary's failure to object is deemed a gift but the gift is incomplete as a result of the beneficiary's testamentary limited power of appointment in the second trust, then the trust property will be includible in the beneficiary's gross estate for estate tax purposes under IRC §§ 2036(a) and 2038.

Tax Consequences of Decanting (continued)

Sampling of Federal Tax Consequences

- Federal Income Tax

- Decanting from a Non-Grantor Trust to a Grantor Trust: IRS has provided that the mere conversion is not a transfer for income tax purposes and therefore not a taxable event. Chief Counsel Memo. 200923024. However, this is not precedent and the IRS specifically did not address whether such a conversion would trigger any other taxes, such as gift tax.
- Decanting from a Grantor Trust to a Non-Grantor Trust: If a trust owns assets that have liabilities in excess of the asset's income tax basis, a conversion of a grantor trust to a non-grantor trust may cause the grantor to recognize gain to the extent of that excess.
- Possible Beneficiary Recognition of Gain: The IRS could argue that a beneficiary recognizes gain if the decanting changes the quality of the beneficiary's interest and the beneficiary's consent is required for the decanting (the same argument could be made in a court reformation of a trust when the beneficiary is required to consent or has the right to object to the reformation).
 - Under the Illinois decanting statute, a beneficiary's consent is not required (*i.e.*, the power to decant is wholly in the discretion of the trustee). However, if the beneficiary objects to the decanting within the 60-day notice period, the decanting is prohibited unless the trustee obtains court approval. The IRS could argue that the beneficiary's ability to block decanting by objection may rise to the level of consent.

Questions & Answers

Thank you.

Benetta P. Jenson, Managing Director J.P. Morgan Private Bank

A Chicago-based wealth advisor, Benetta assists clients with the development of comprehensive, generational wealth transfer planning strategies. She was previously a partner in the Private Client Department of the law firm of McDermott Will & Emery in Chicago.

Benetta frequently speaks and writes nationally on trust and estate planning topics. She is a member of the Estate and Gift Tax, International Tax Planning (former Vice-Chair), Continuing Legal Education and Community Outreach Committees of the Real Property, Trust & Estate Law Section of the American Bar Association. She also is a member of the Illinois State Bar Association, the Federal Taxation and Trust Law (Chair 2012-2013, Vice Chair 2011-2012) Committees of the Chicago Bar Association, and the Chicago Estate Planning Council. In addition, Benetta is a founding officer and Co-Chair of the Chicago branch of the international organization, Society of Trust and Estate Practitioners (known as STEP), and serves as Secretary of the Executive Board of STEP USA.

She also serves as faculty for various courses at the Illinois Institute for Continuing Legal Education (IICLE) and is an Adjunct Professor at Northwestern University's law school L.L.M. tax program, co-teaching "International Estate Planning."

Benetta currently is a Governing Member and serves on the Planned Giving Advisory Council of the Chicago Symphony Orchestra and is a member of the Young Professional Advisory Council of the Chicago Community Trust. She is also active with family private foundations.

Benetta earned her J.D. from Loyola University Chicago School of Law and her Bachelor of Business Administration degree from the University of Wisconsin at Madison.

Rebecca Wallenfelsz **Chapman and Cutler LLP**

Rebecca Wallenfelsz is a partner in the firm's Trusts and Estates Department, and has been practicing law since 1997. Ms. Wallenfelsz has extensive experience representing individuals and institutions in estate planning and trust and estate matters.

Ms. Wallenfelsz's experience in estate planning matters includes drafting a variety of wills, trusts and premarital agreements, and in planning for and minimizing estate, gift and generation-skipping transfer taxes and related income taxes, including taxes related to retirement plan assets. Her practice includes more sophisticated estate planning devices, such as family limited partnerships, grantor-retained annuity trusts, sales to defective grantor trusts and split-dollar agreements. For the charitably inclined client, Ms. Wallenfelsz has planned for, or assisted in creating, directed funds, charitable remainder trusts and private foundations. In addition, Ms. Wallenfelsz reviews and prepares fiduciary tax returns, private foundation information returns and estate, gift and generation-skipping transfer tax returns.

Ms. Wallenfelsz also represents a variety of fiduciaries and beneficiaries in the administration of estates and trusts, including addressing fiduciary risk issues, tax issues and litigation matters, such as will and trust construction, breach of fiduciary duty and contested probate matters. Ms. Wallenfelsz advises institutions on the creation and administration of Individual Retirement Trust products and on transactions involving trusts or estates.

In 2011, Ms. Wallenfelsz was named to the Law Bulletin Publishing Company's "40 Illinois Attorneys Under Forty to Watch" list of outstanding lawyers. In 2012, Ms. Wallenfelsz was elected to the American College of Trust and Estate Counsel, a prestigious professional organization for skilled and experienced lawyers in the trusts and estates practice.

Lyman W. Welch Sidley Austin LLP

LYMAN W. WELCH has been a partner in the Chicago office since 1994 and concentrates in all phases of trust and estate work, with special interests in advanced estate planning techniques, estate planning for executives and family business owners, counsel to trustees, bank trust departments, closely held corporations and charitable organizations.

Selected by *Worth Magazine* as one of the Nation's Top 100 Attorneys (2005 and 2006). Awarded the Austin Fleming Distinguished Service Award by the Chicago Estate Planning Council (2005). Recognized by Chambers USA *America's Leading Lawyers for Business* (2005 - 2012). Recognized as the principal draftsman of both the Illinois Prudent Investor Act (1992) and the Illinois Total Return Trust Act (2003), and the Illinois Virtual Representation Agreement Legislation (2009). Selected as a Leading Illinois Attorney in Trust and Estate Planning Law (1999). Selected as one of the Best Trusts and Estates Lawyers in America by *Bloomberg Personal Finance* (1999).

Memberships & Affiliations:

- Adviser to Restatement of Trusts (Third) Project of the American Law Institute (2003–)
- Fellow of the American College of Trust and Estate Counsel (1990-)
- Fiduciary Litigation Committee (1992-)
- Chair of Breach of Fiduciary Duty Subcommittee (1992-97)
- The Estate and Gift Tax Committee (1997-)
- American Bar Association [Section of Taxation, Committee on Closely Held Corporations (1982-86); Committee on Income Taxation of Estates and Trusts (1979-82; 1987-); Chair of Subcommittee on Taxation of Revocable Trusts (1987-91); Section of Real Property, Probate and Trust Law (1977-)]
- Illinois State Bar Association [Member, Committee on Legal Technology (1994-1998); Chair, Committee on Computer Technology (1982-84); Estate Planning, Probate and Trust Law Section Council (1985-91; 2003-), Chair (1989-90), Secretary (1987-88); Member Committee on Continuing Legal Education (1990-91); Member of Ad Hoc Committee on Powers of Attorney Legislation (1986-87); Chair of Task Force to Adopt Total Return Legislation (2001-2002); Chair of Task Force to Adopt Illinois Prudent Investor Rule (1988-91)
- Chicago Bar Association [Chair, Trust Law Committee (1995–96); Trust Law Committee (1976-); Secretary Trust Law Committee (1980); Chair Trust Law Committee, Division II (1982-83); Federal Taxation Committee (1976-); Chair of Subcommittee on Valuation; Unauthorized Practice of Law Committee (1971-78)]
- Florida Bar Association (1978-)
- The Lawyers Club of Chicago (1981–)
- The Board of Directors of the Illinois Institute of Technology Center for Entrepreneurship (2005–)