



EXPERIENCE THE RIGHT PARTNERSHIP

D.C. Estate Planning Council

Grantor Intent & Fiduciary Flexibility: Drafting for the Long Haul

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Northern Trust



Grantor Intent & Fiduciary Flexibility: Drafting for the Long Haul

- I. Trust Duration
- II. Demographic Changes
- III. Trust Design & Grantor Intent
- IV. Trust Design & Beneficial Interests
- V. Trust Management: Planning for Unique Assets
- VI. Trust Management: Selection of Fiduciaries and Advisors
- VII. Trust Modification



Trust Duration





Wealth Transfers After ATRA*

■ Introduction

- ◆ Under current law, 2015 represents a continuing opportunity to transfer substantial wealth by gift to family members, particularly through long term trusts designed to be exempt from the Rule Against Perpetuities.
- ◆ The Tax Reform Act of 2010 unified both exemptions and rates under the Federal Estate, Gift, and Generation Skipping Transfer Taxes. ATRA preserved the unified exemption and rate structure, with a modest marginal rate increase.

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Exemptions	\$5,000,000	\$5,120,000	\$5,250,000	\$5,340,000	\$5,430,000
Rate on Excess	35%	35%	40%	40%	40%

- ◆ Leveraged wealth transfer strategies such as the use of valuation discounts for unmarketable and minority interests, short-term grantor retained annuity trusts, defined value clauses, installment sales, and self-cancelling installment notes, among others.
- ◆ The ability to obtain grantor trust treatment for fiduciary income tax purposes. See Revenue Ruling 85-13, 1985-1 Cum. Bul 184. See also Sections 671 et seq. of the Internal Revenue Code.

*American Taxpayer Relief Act of 2012



Wealth Transfers After ATRA

■ Rule Against Perpetuities

- ◆ Approximately 31 states have either repealed, optioned or extended the permissible period under the common law Rule Against Perpetuities (See Table A) making these states a logical choice for the situs of a long-term family (or “dynasty”) trust. Threats to perpetual trusts exist on several fronts:

- ▶ President Obama has proposed, in the General Explanations of the Administration’s Fiscal Year 2015 Revenue Proposals (commonly referred to as the “Green Book”) that the Federal GST exemption to be limited in duration to a period of ninety years.
- ▶ The American Law Institute’s Restatement Third of Property (Wills and Other Donative Transfers) – Volume 3 proposes limiting long-term trusts to no more than two generations below the transferor. This approach is explained and amplified in the “The American Law Institute Proposes a New Approach to Perpetuities: Limiting The Dead Hand to Two Younger Generations.” Lawrence W.. Waggoner, University of Michigan Law School, Public Law and Legal Theory Working Paper Series, Working Paper 200 (Revised July, 2010).



Wealth Transfers After ATRA

■ Rule Against Perpetuities

(continued)

- ▶ The validity of perpetual, private trusts in states with constitutional bans on perpetuities is uncertain. These states include Arizona, Arkansas, Montana, Nevada, North Carolina, Oklahoma, Tennessee, and Wyoming. Please see Unconstitutional Perpetual Trusts, Vanderbilt Law Review Vol. 67:6:1769



State Perpetuities Statutes

RULE**	STATES
Permit Perpetual Trusts	Delaware (for trusts of personal property), District of Columbia, Hawaii, Idaho, Illinois, Kentucky, Maine, Maryland, Michigan, Missouri, Nebraska, New Hampshire, New Jersey, North Carolina, Ohio, Pennsylvania, Rhode Island, South Dakota, Virginia, and Wisconsin
Permit Very Long Trusts	Alabama (360 years), Alaska (1000 years), Arizona (500 years), Colorado (1,000 years), Florida (360 years), Nevada (365 years), Tennessee (360 years), Utah (1,000 years), Washington (150 years), and Wyoming (1,000 years)
Follows USRAP	Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Indiana, Kansas, Massachusetts, Minnesota, Montana, Nebraska, New Mexico, Nevada, North Carolina, North Dakota, Oregon, South Carolina, South Dakota, Tennessee, U. S. Virgin Islands, Utah, Virginia, Washington and West Virginia
Follows Common-Law RAP	Iowa, Mississippi, New York, Oklahoma, Texas, and Vermont
Termination at Later of Death of Last Income Beneficiary or 20 years after Grantor's Death	Louisiana

**January, 2015



Financial Sustainability

■ Financial Sustainability

◆ Financial Modeling

- ▶ Many financial models used to illustrate the asset accumulation in long-term trusts inadequately assess the impact of the two critical phenomena in trust management:
 - The expansion of beneficial interests through generations
 - The timing and extent of trust distributions tied to beneficiaries' life stages

◆ Reproductive Data

- ▶ The mean age of a mother at first birth is 25.2 years in the United States.
- ▶ Significant differences in age at first birth exist among U. S. States and among racial and ethnic groups:
 - Massachusetts has the highest average maternal age at first birth – 27.7 years
 - Mississippi has the lowest average maternal age at first birth – 22.6 years
 - Asia Pacific Islander women had the oldest maternal age at first birth - 28.5 years
 - Alaskan native women had the youngest maternal age at first birth - 21.9



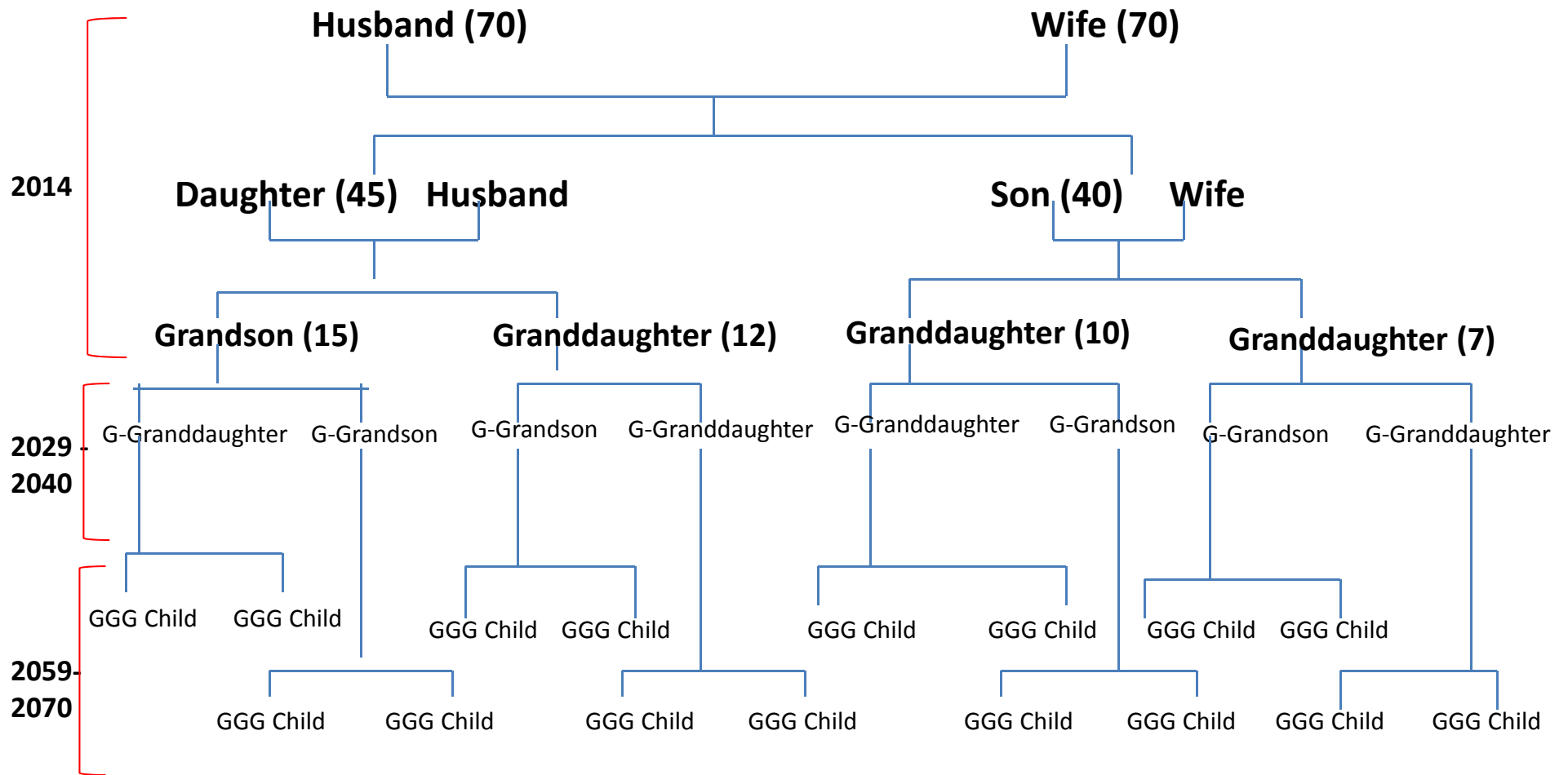
Financial Sustainability

- ▶ Fertility rates in the United States have declined over the last three generations, from a high of 3.0 births per women, for women born in 1935, to 2.0 births per woman, for women born in 1960.
 - The total fertility rate (TFR) for the United States in 2013 was 1.86 births per woman.

- ▶ Statistical data on the average age difference between siblings are difficult to interpolate from census data. I have assumed a three year gap between first and second children for modeling purposes.



Family Tree





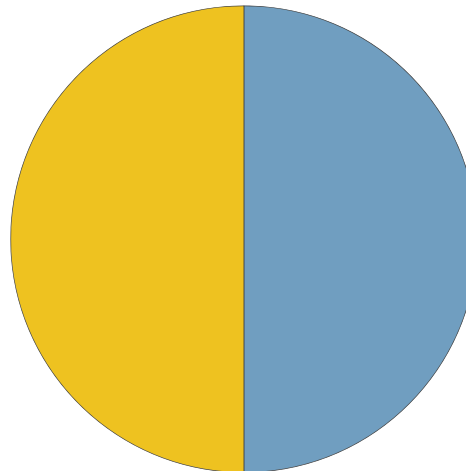
Demographic Changes

- ◆ Increased Life Expectancies
- ◆ Greater Diversity in Domicile
- ◆ Situs Selection & Modification
- ◆ Changes in Family Composition
- ◆ Generational Overlap
- ◆ Expansion of Marriage and Definition of Spouse
- ◆ Diversity of Cultural Perspectives on Estate Planning and Inheritance
- ◆ Changing Economic and Market Conditions: Investment Practices
- ◆ Reproductive Variables



Traditional Trust Portfolio (Pre-Prudent Investor Rule)

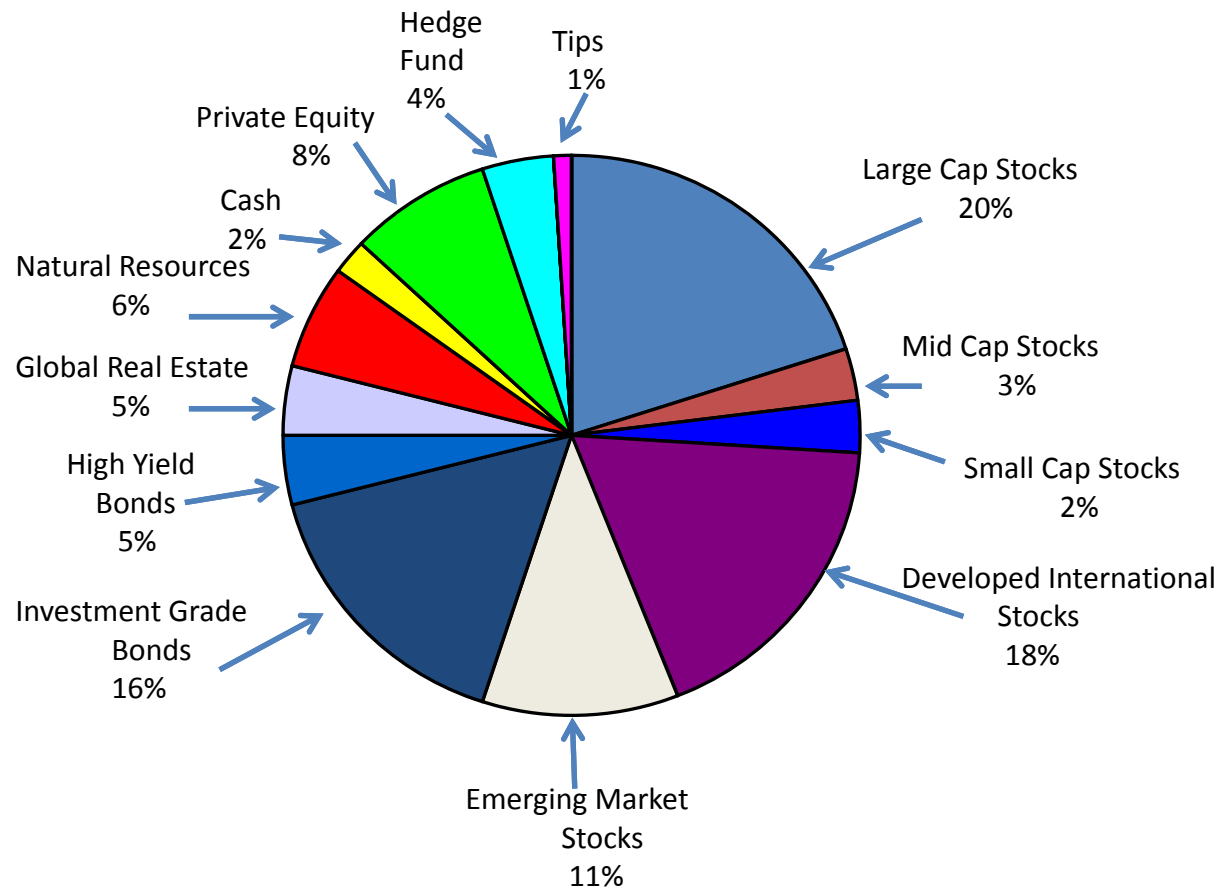
**Large Cap
Domestic Stocks
50%**



**Domestic
Bonds and Cash
50%**



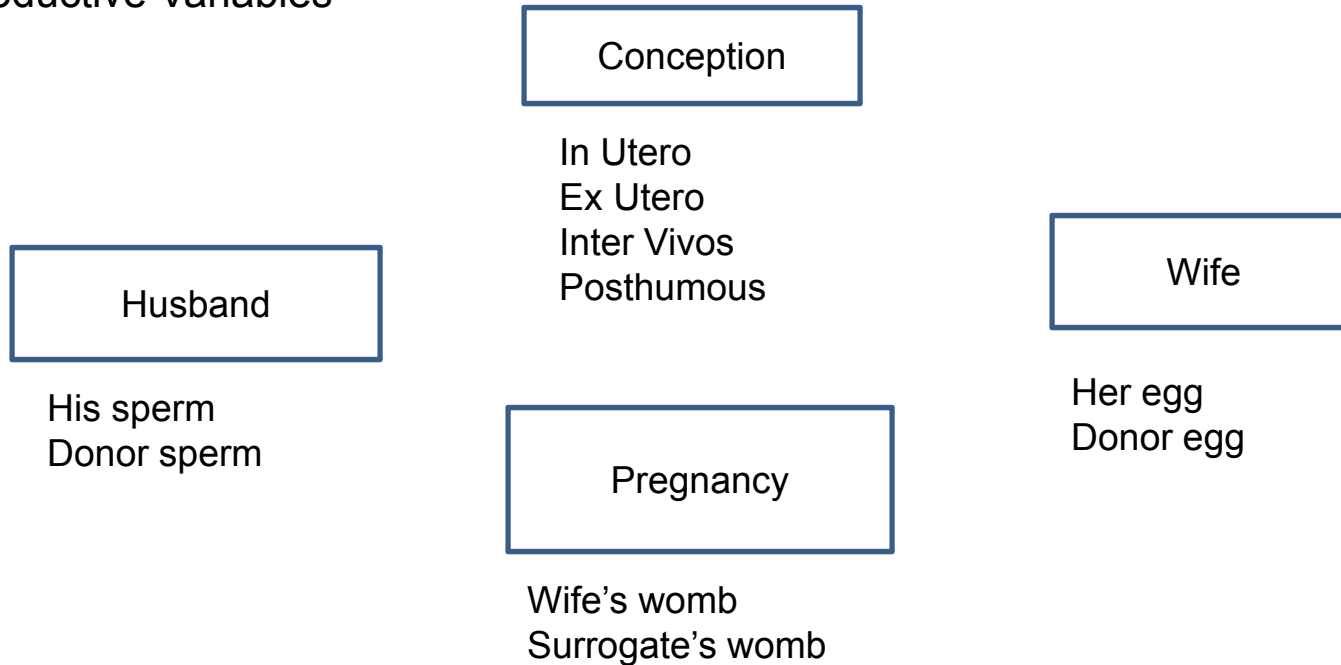
Diversified Trust Portfolio – Post-Prudent Investor Rule*





Demographic Changes

◆ Reproductive Variables



■ ART Children and Inheritance

- Uniform Probate Code §2-120 (As Amended, 2008)
- The New Genesis in Estate Planning, Bruce Stone, Goldman, Felcoski & Stone, P.A. 2013 Heckerling Institute on Estate Planning



Trust Design: Grantor Intent

◆ Tax – Driven Estate Planning Paradigm



Navigating the Estate Planning Minefield

Assets

Family Birth Dates,
Addresses, Marital Status

Grantor Retained
Annuity Trusts

Irrevocable Life
Insurance Trusts

Revocable Trusts

QPRT's

Beneficiary
Designations

CRT'S

QTIP's

Personal Financial
Statements

Family Limited
Partnerships

Charitable
Remainder Trusts

GRAT's

FLP's

Title Insurance
Policies

Qualified Terminable
Interest Property Trusts

Qualified Personal
Residence Trusts

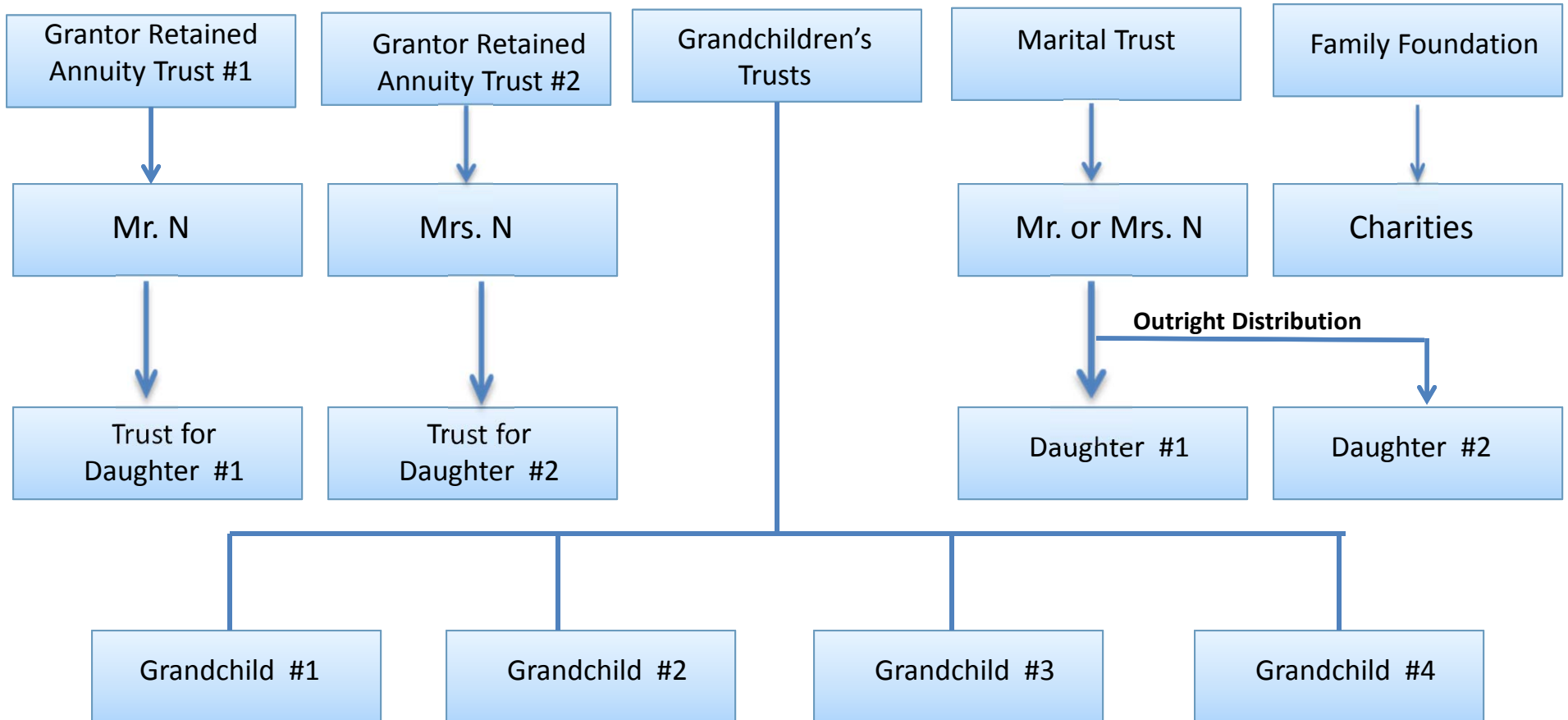
Pour-Over Wills

Liabilities

ILIT's

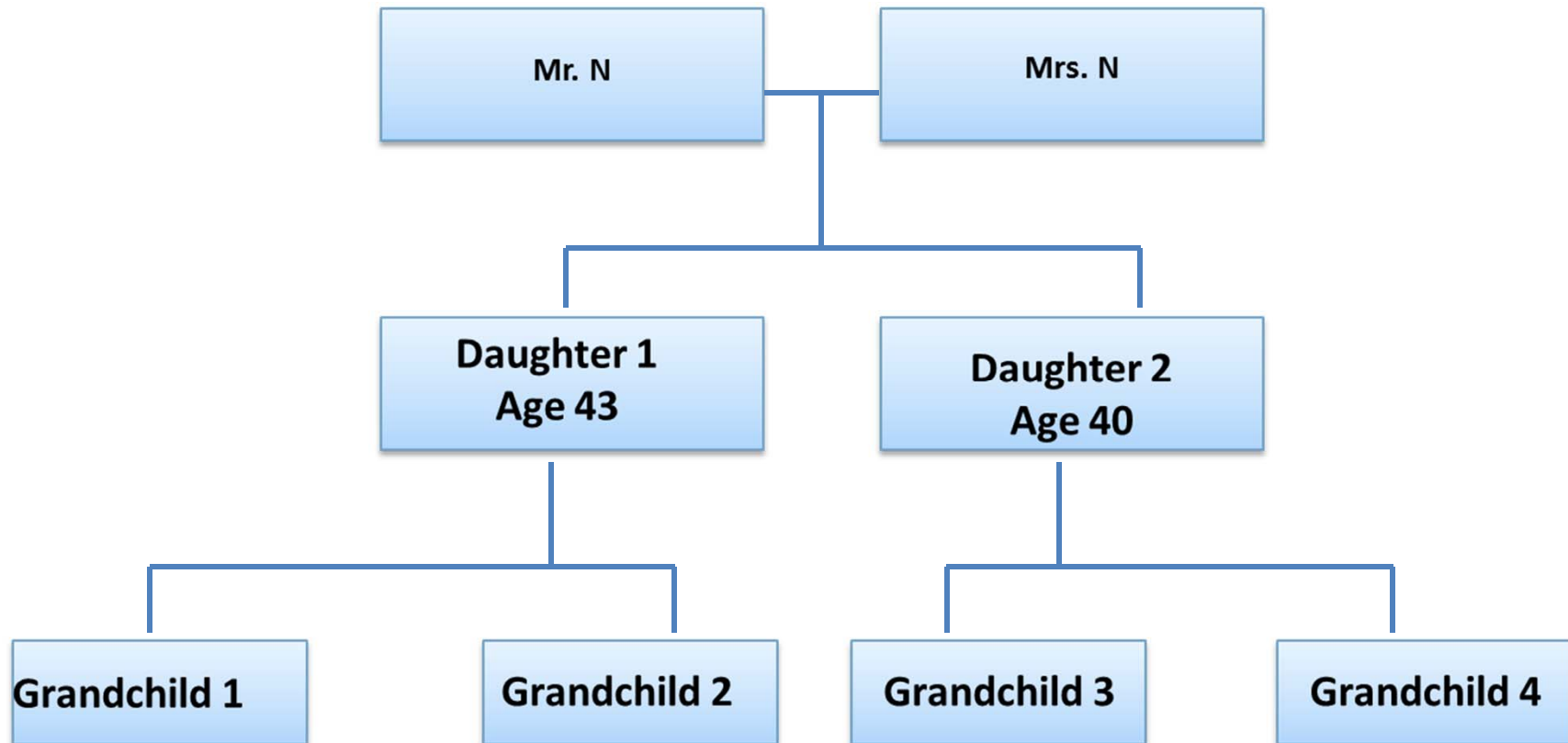


Mr. and Mrs. N. Estate Plan



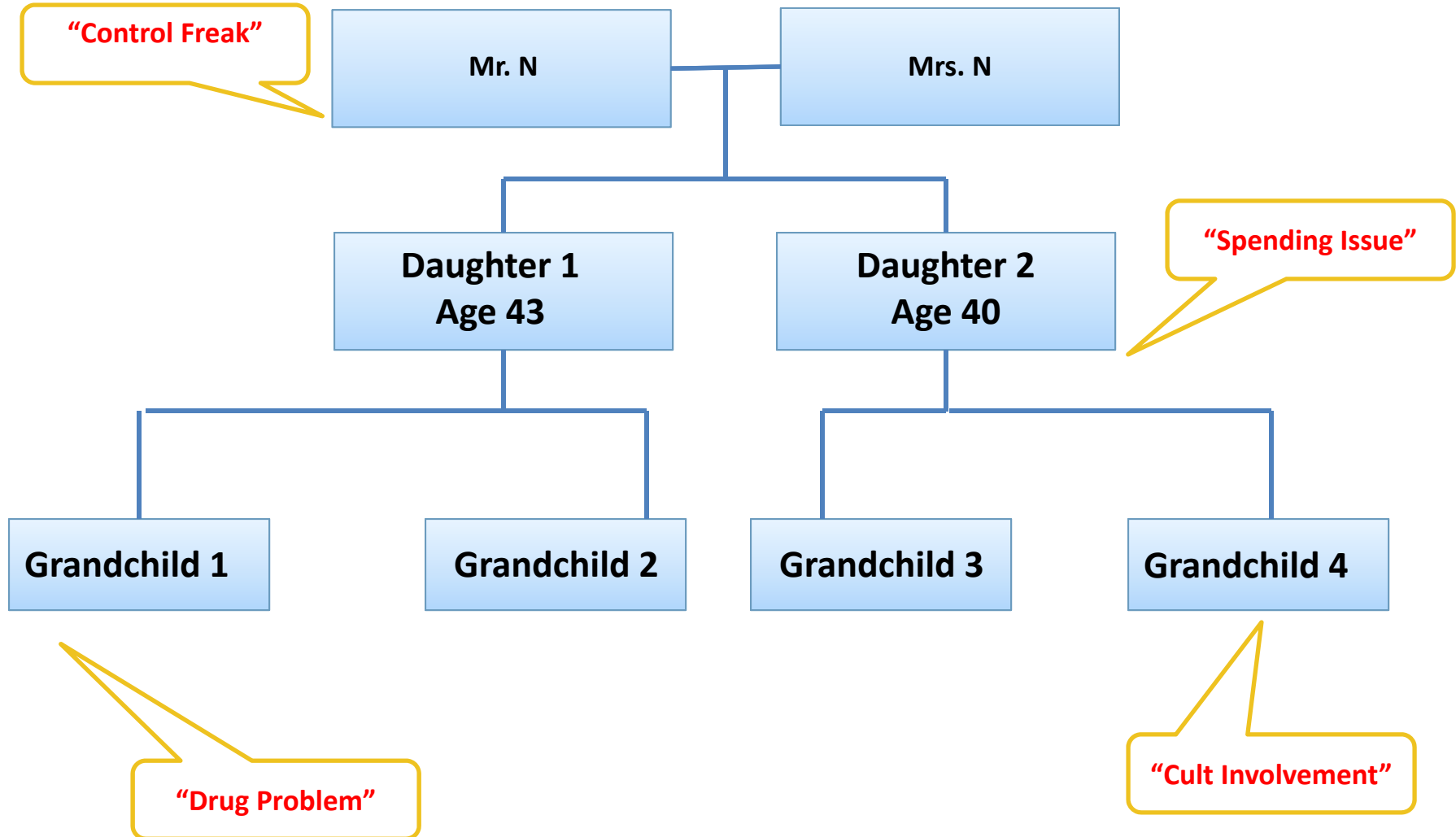


Mr. and Mrs. N. Family





Mr. and Mrs. N. Family Reality





Family Wealth (Redefined*)

- Human Capital
 - ◆ Family members' personalities, gifts, vocations

- Intellectual Capital
 - ◆ Learning, communication, decision making

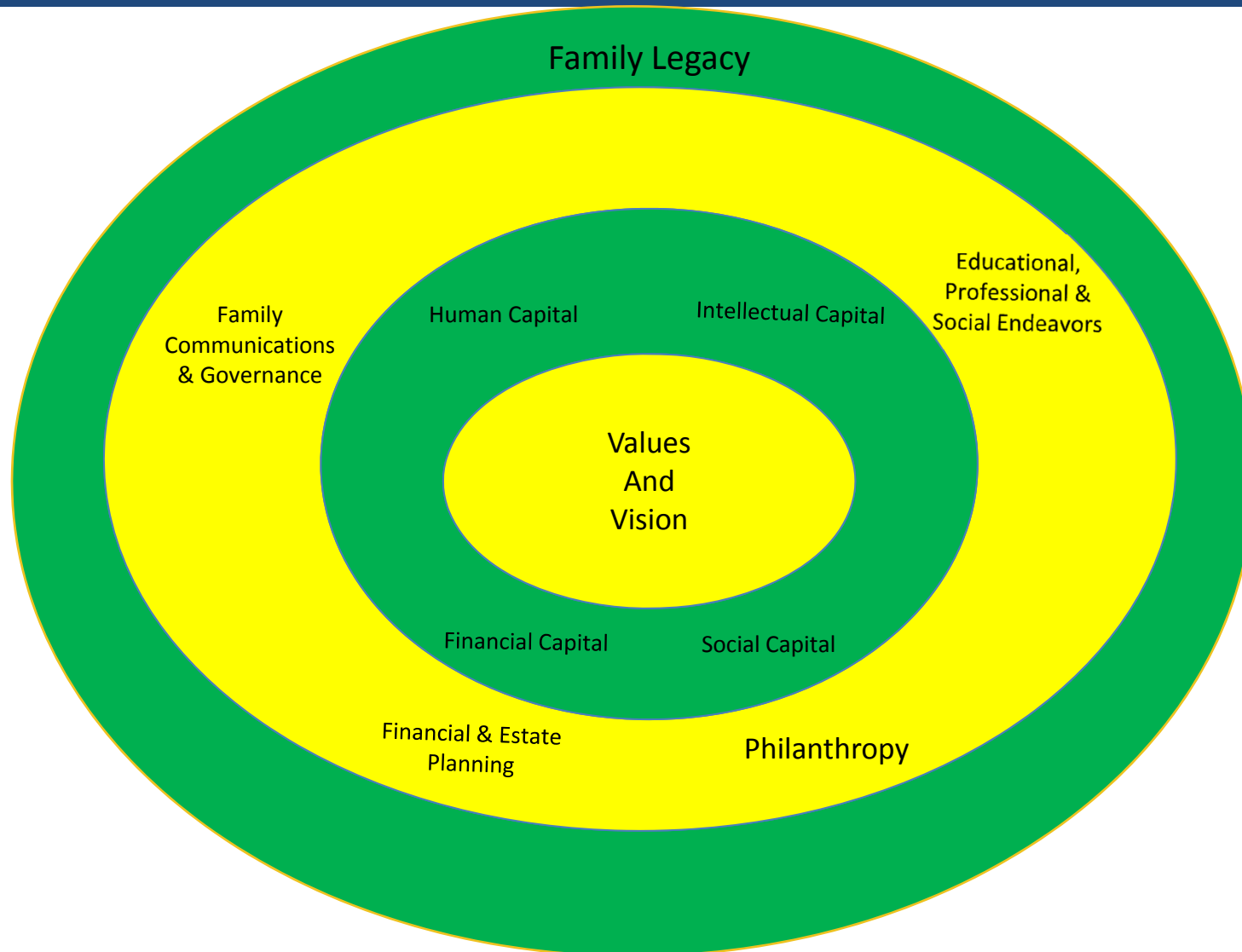
- Social Capital
 - ◆ Family's engagement with society

- Financial Capital
 - ◆ Assets and property

*Wealth in Families, Charles W. Collier, Harvard University, 2006



Wealth Planning (From the Inside Out)





Estate Planning – Essential Questions

- To Whom

- How Much

- When
 - ◆ To Give
 - ◆ To Discuss

- In What Form
 - ◆ Outright or in Trust
 - ◆ Distribution Standards

“Freedom of disposition, or donative freedom, encompasses several distinct yet related ideas – the right to give property away during life and to pass it on at death, the right to choose who gets it, the right to choose the form in which they get it, and the right to give another person the right to make those choices even after your death.”

Thomas P. Gallanis, *Family Property Law: Cases and Materials on Wills, Trusts and Future Interests* 350-351 (5th ed. 2011).



Trust Design: Statements of Intent



Statements of Intent

- Tension Between Settlor Control, Beneficial Interests, and Flexibility
- Evolution of Standards for Early Termination and Trust Modification
 - The Claflin Doctrine: Early termination of a trust may be allowed so long as it does not frustrate a **Material Purpose** of the settlor. Claflin v. Claflin (20 N.E. 454, Mass.1889).
 - Restatement (Third) §65: **Material Purposes** are not readily to be inferred
 - The Uniform Trust Code requires determination of a trust's **Material Purpose** for:
 - §111: Non-Judicial Settlement Agreements
 - §411: Modification or Termination by Consent
 - §412: Modification of Termination Because of Unanticipated Circumstances



Statements of Intent

- Instructions to the Trustee (and Other Fiduciaries)
 - ◆ Letters of Wishes
 - ◆ Precatory Language
 - ◆ Statement of Intent
 - ▶ Demonstrates unique grantor intent
 - ▶ Ties that intent to the trust (material purpose)
 - ▶ Expresses grantor's view on modification and termination
 - ◆ Public Policy Limitations



Statements of Intent

■ Communications to Beneficiaries

- ◆ Wills and Trusts as a Form of Personal Communication
- ◆ Ethical Wills
- ◆ Family Mission Statements
- ◆ Statements of Intent
 - ▶ Formulation
 - Inductive Method
 - Deductive Method
 - ▶ Examples

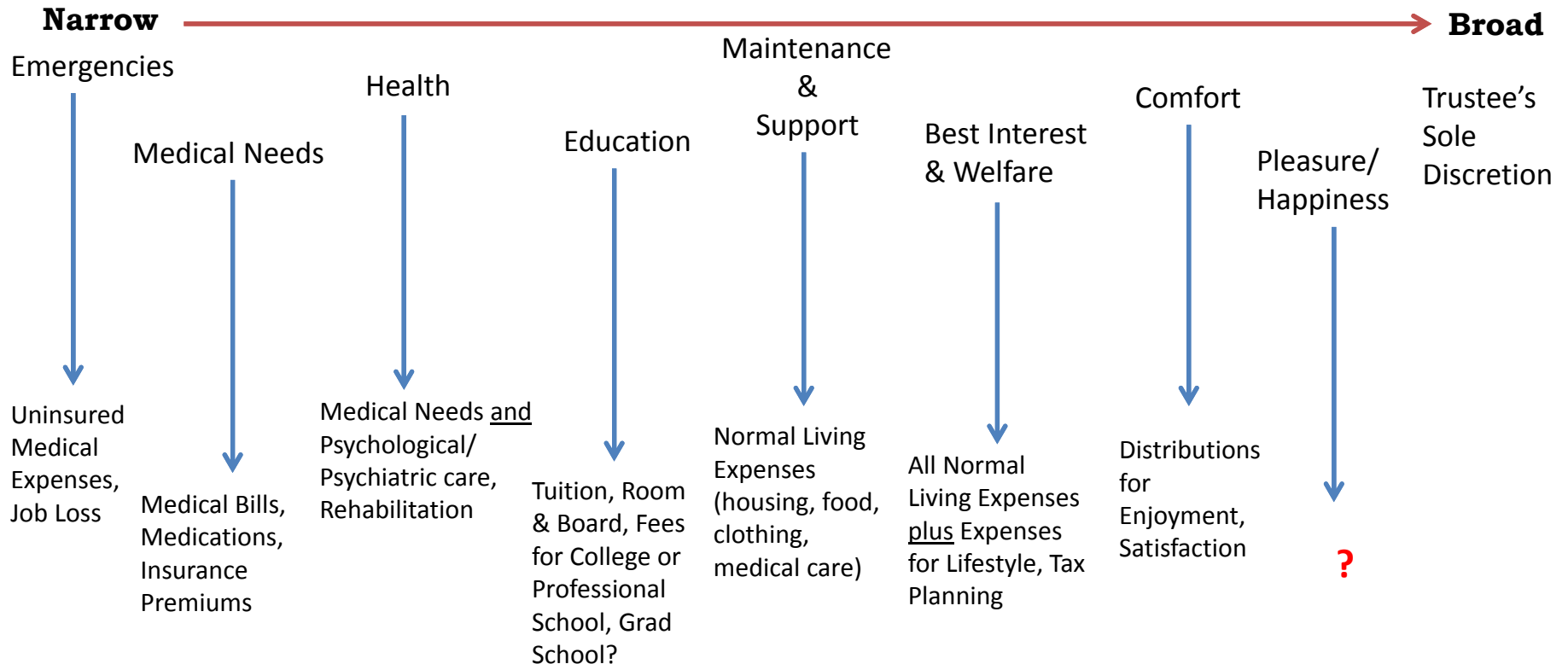


Trust Design: Beneficial Interests

- ◆ Income
- ◆ Discretionary Principal
- ◆ Unitrust Interests
- ◆ Withdrawal Rights
 - Staged
 - 5 x 5 Powers
- ◆ Mandatory Distributions
- ◆ Use of Trust Assets
- ◆ Powers of Appointment
 - Inter-Vivos
 - Testamentary
 - Limited
 - General



Discretionary Distribution Standards





Trust Design: Beneficial Interests & Statements of Intent

◆ Sample Statement of Intent Governing Discretion

In determining whether to distribute or accumulate such income and principal, the Trustee shall take into consideration (a) the income and principal (known to the Trustee) which such child may then have available from all other sources, (b) the tax laws then in effect or about to become in effect, (c) the economics of maintaining the trust created for such child and **(d) what in the opinion of the Trustee will make such child a useful and productive member of society, will encourage such child to realize such child's full potential and will not be detrimental to such child's own sense of self-reliance.**



Trust Management Planning for Unique Assets

- ◆ Liquidity Issues
- ◆ Special Purpose Trusts
- ◆ Asset Concentrations



Liquidity Issues

- Trust Assets Presenting Liquidity/Cash Flow Issues
 - ◆ Real Estate
 - ◆ Venture Capital, Private Equity
 - ◆ Operating Mineral Interests
 - ◆ Non Marketable Entities
 - ◆ Tangible Personalty and Collections
 - ◆ Intellectual Property

- Consider Endowing “Income Consuming” Assets to Facilitate Administration and Management

- Contributions to GST Exempt Trusts to Discharge Expenses of Non-Income Producing Assets Present a Risk of Tainting



Unique Assets: Special Purpose Trusts

- Non-Charitable Purpose Trusts
 - 12 Del. C. §3556
 - Uniform Trust Code §409: Non-charitable Trusts Without Ascertainable Beneficiary

- Examples of Special Purposes
 - Maintaining a Vacation Property
 - Perpetual Care for Family Cemetery
 - Maintaining Control Over a Family Enterprise
 - Maintaining a Collection



Statutory and Judicial Pronouncements on Diversification

■ Uniform Prudent Investor Act, Section 3. Diversification

A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

■ Restatement Third, Trusts §91F

Whether and to what extent a specific investment authorization may affect the normal duty to diversify the trust portfolio (see §90, Comment g) can be a difficult question of interpretation. **Because permissive provisions do not abrogate the trustee's duty to act prudently and because diversification is fundamental to prudent risk management, trust provisions are strictly construed against dispensing with that requirement altogether.** Nevertheless, a relaxation in the degree of diversification may be justified under such an authorization by special opportunities for the trust or by special objectives of the settlor.

■ Wood v. U. S. Bank, N.A. 160 Ohio App 3d 831, 2005

A trustee's duty to diversify may be expanded, restricted, eliminated, or otherwise altered by the terms of the trust. But this statement is true only if the instrument creating the trust clearly indicates an intention to abrogate the common law, now statutory, duty to diversity.



Concerns About Diversification

- Adverse Income Tax Consequences
- Unfamiliarity with Other Asset Classes
- Loss of Control
- Performance Expectations
- Impact on Portfolio Yield
- Legacy Holdings
- Fees



Reasons for Non-Diversification

- Purpose of Trust
- Legacy Holdings
- Termination Date of Trust
 - ◆ Interests of Beneficiaries
 - ◆ Step-Up in Basis
- Illiquidity
- Loss of Controlling Interest
- Related Trusts
- Beneficiaries' Assets
- Adverse Income Tax Consequences



Grantor Intent – Trust Terms on Retention

- Silent Document
- Retention of Assets Acquired from Grantor is Permissible
- Retention of a Particular Asset is Permissible
- Retention of a Particular Asset is Preferred
- Retention of a Particular Asset is Mandatory



Retention Language

- Identify the Asset
- Explicitly Waive the Duty to Diversify
- Articulate the Reasons for Retention
- Address Asset “Conversion” Issues
 - ◆ Equities: Mergers, Acquisitions, Spin-offs
 - ◆ Real Estate: Sale, Reinvestment
- Carefully Consider the Fiduciary’s Standard of Care
 - ◆ Conventional Trusts
 - ◆ Directed Trusts
- Endow Operating/Holding Costs for Non-Income Producing Assets
- Provide a Means for Dispute Resolution
- Protect the Fiduciary



Asset Concentrations: Risk Management Process

- I. **Policy**
Follow trust terms or state Prudent Investor Rule
- II. **Process**
The trustee must have a process for identifying and evaluating concentrations
- III. **Review**
Determine grantor intent and fiduciary responsibility
- IV. **Evaluation**
Evaluate retention and diversification strategies
- V. **Consultation**
Consult with beneficiaries, their counsel, and trustee's counsel
- VI. **Implementation**
Implement appropriate strategies
- VII. **Documentation**
Memorialize the process



Unique Trust Assets - Examples

Bolivian Tin Mine

Bombay Cement Factory

Sewage Plant

Bingo Parlor

Las Vegas Casino

Emu Farm

Llama Farm

Race Horse

½ Race Horse

Animal Reproductive Material

Animal Hospital

Pet Cemetery

Hemp Factory

Methadone Clinic

Nudist Colony

Indonesian Brothel

Motel with Hourly Rates

Las Vegas Wedding Chapel



Trust Management: Selection of Fiduciaries & Advisors



Select Your Advisors and Your Fiduciary With Care

Duty to make
Assets
productive

Duty to
Collect and
Keep control of
the assets

Duty to
Administer trust
according to
Its terms

Duty to
Enforce
claims

Duty to
keep
property
separate

Duty of Loyalty

Duty to
exercise
reasonable
care and skill

Duty to
preserve trust
property

Duty to keep
trust property
separate

Duty to deal
Impartially
with the
beneficiaries

Duty
regarding
delegation

Duty to
furnish
information

Duty to
keep
accounts

Duty to
defend
actions

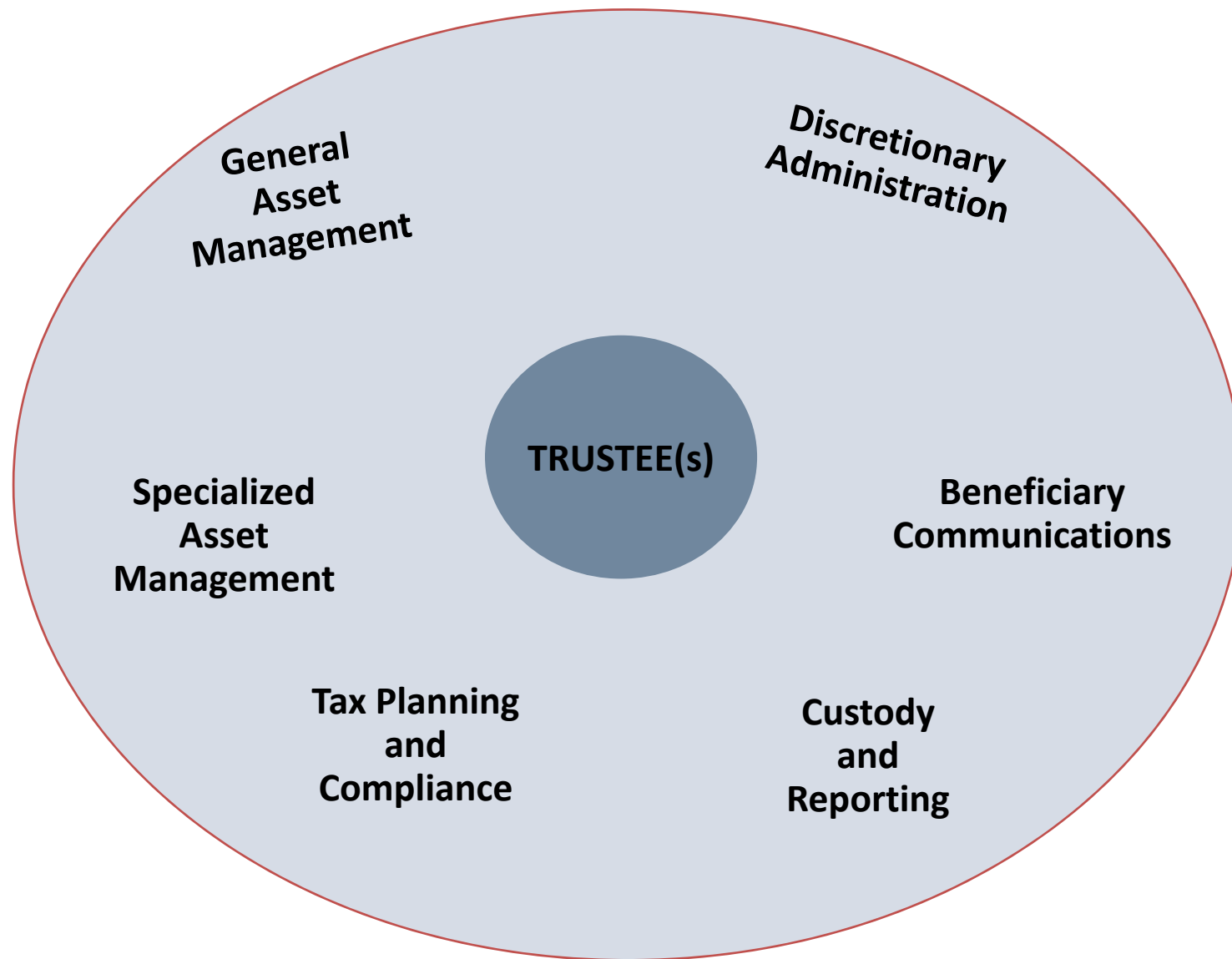


Fiduciary Responsibility

- Conventional Trusts v. Directed (Administrative) Trusts

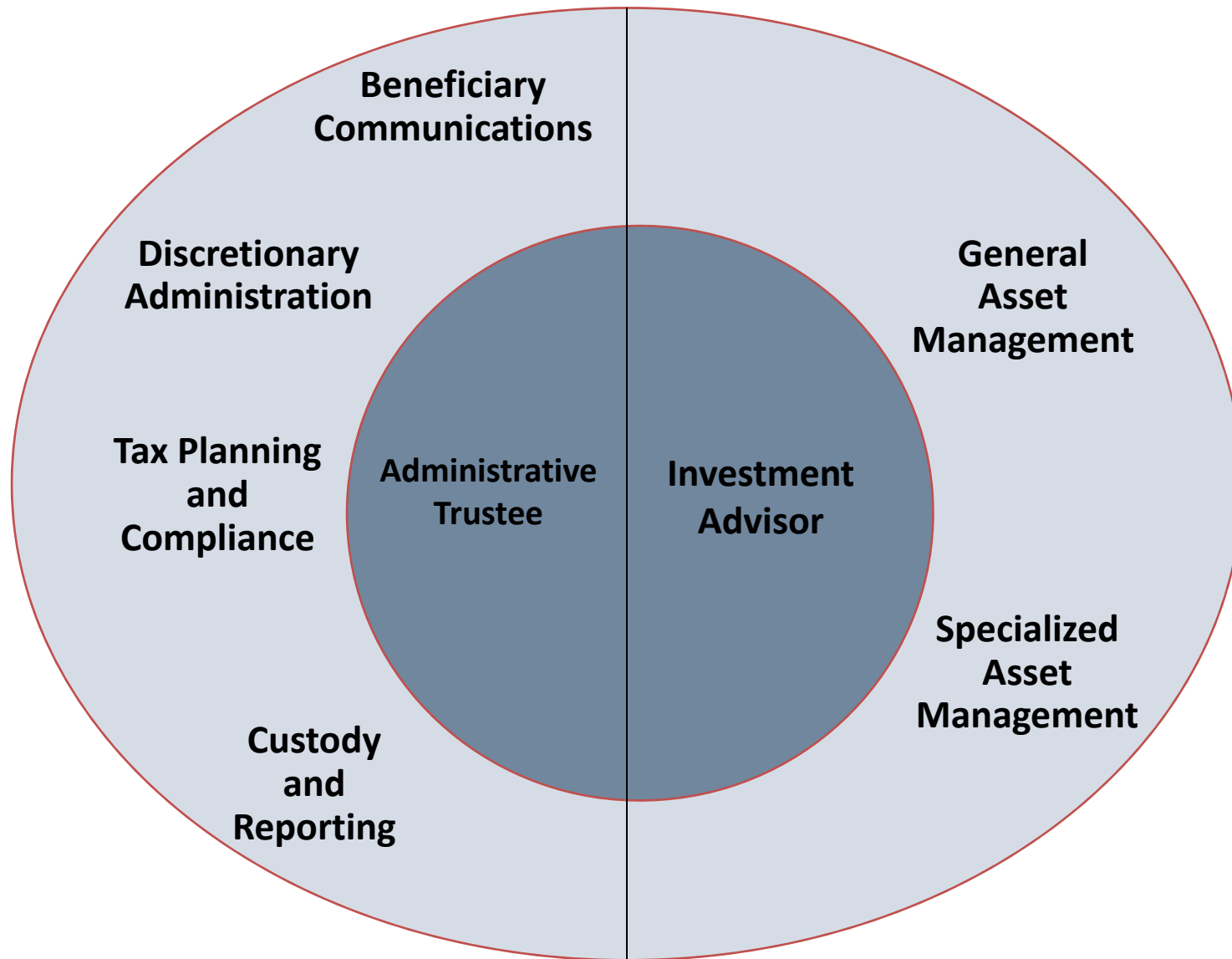


Fiduciary Responsibility – Conventional Trust



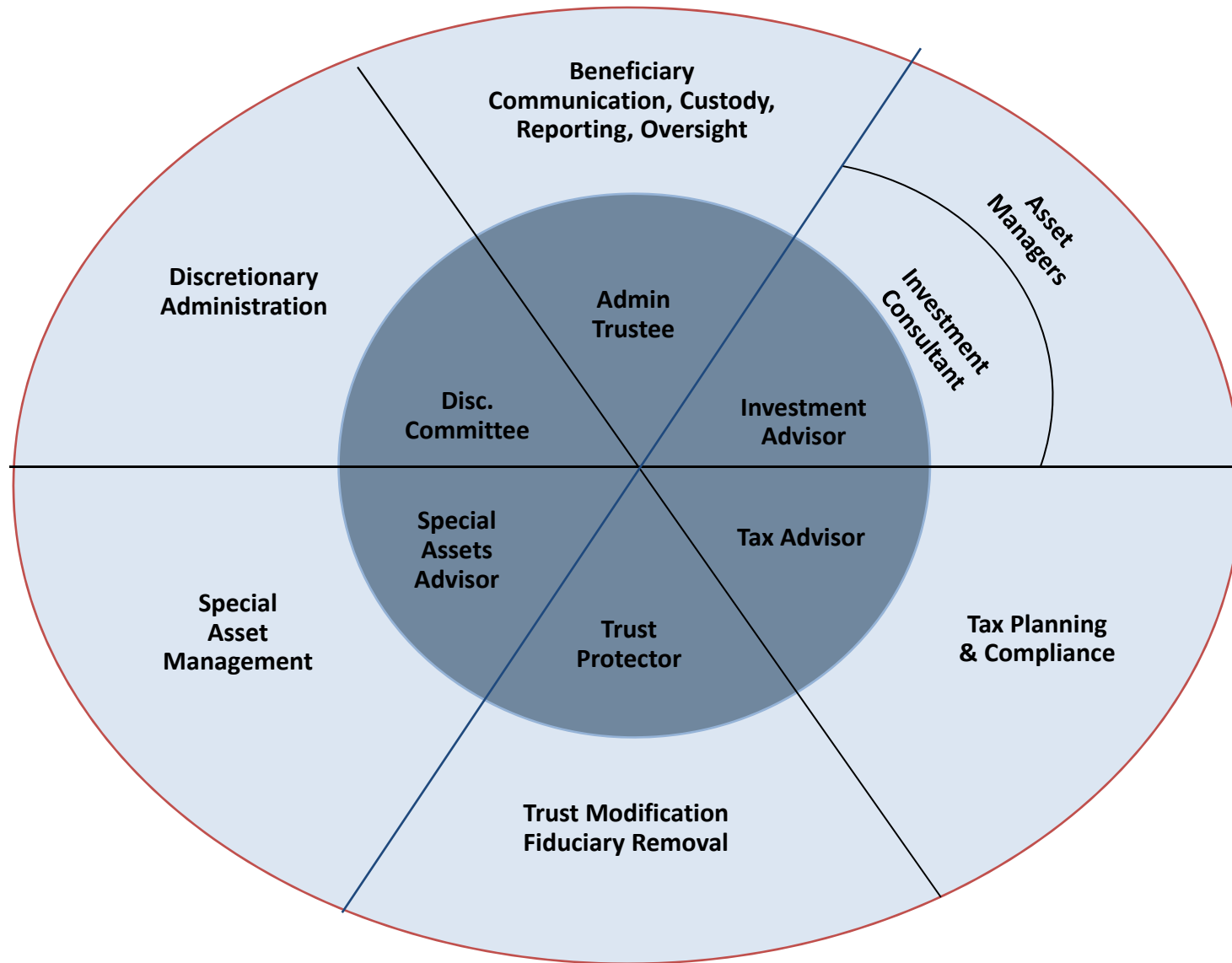


Fiduciary Responsibility – Directed Trust



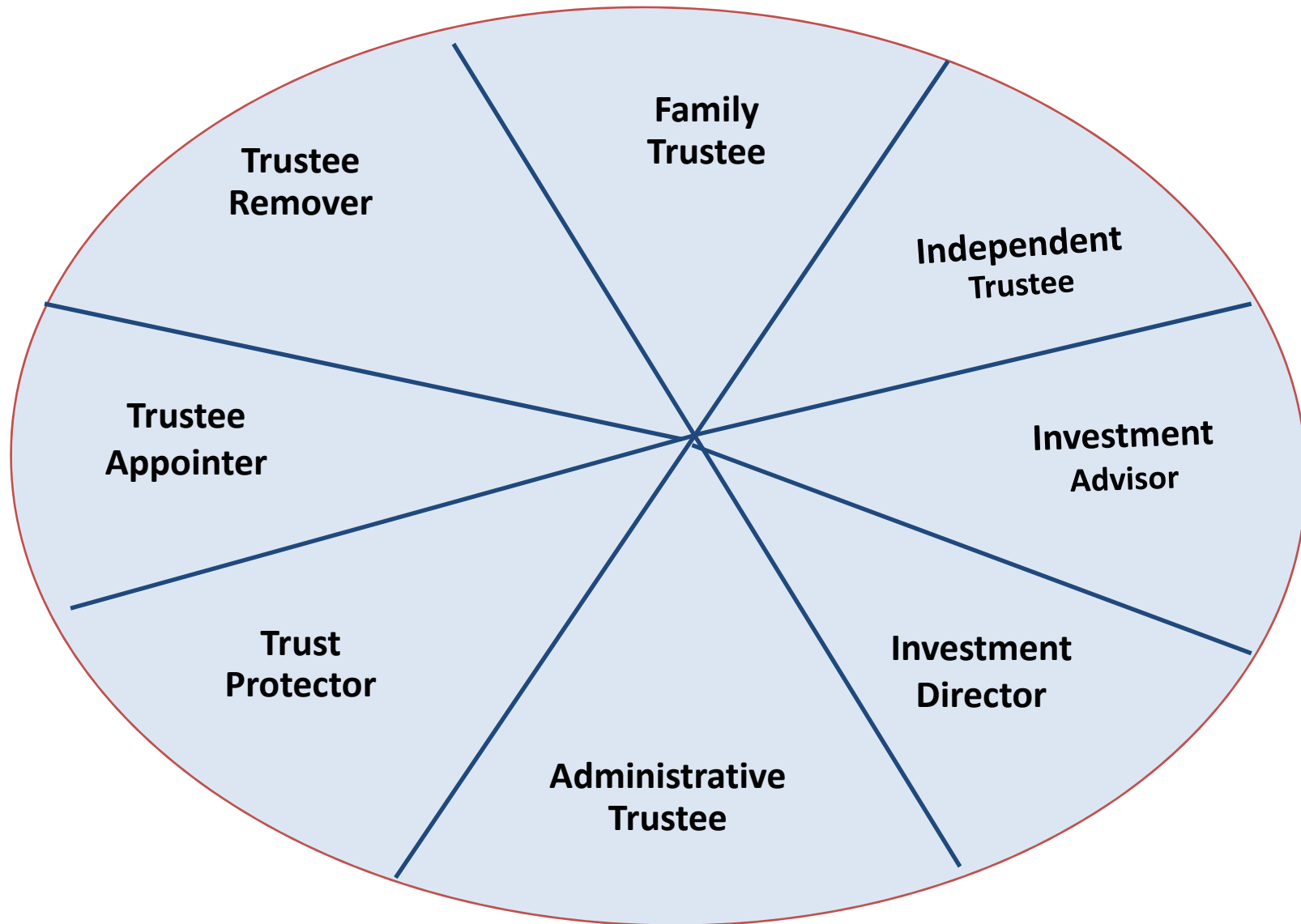


Changes In Trust Design – Enterprise Trust





Changes In Trust Design – The Fractionalized Fiduciary





Fiduciary Responsibility

- Delaware Administrative Trust (12 Del. C. §3313(b) & (e))
 - ◆ The directed trustee under a Delaware administrative trust has no duty to:
 - ▶ Monitor the advisor's conduct;
 - ▶ Provide advice to or consult with the advisor;
 - ▶ Warn or apprise beneficiaries about the advisor's directions

 - ◆ The directed trustee, under the Delaware statute, following an advisor's direction is liable for losses only for the trustee's own "willful misconduct."



Fiduciary Responsibility

■ Directed Trusts Under the Uniform Trust Code

- ◆ Settlers may allocate trust functions among the primary trustee and advisors as they provide in the trust document (UTC §808)
- ◆ The primary trustee's standard for review of the advisor's actions will depend on local law or the trust terms
 - ▶ Uniform Trust Code: the trustee must act as directed unless the advisor's action is:
 - Manifestly contrary to trust terms
 - A serious breach of fiduciary duty

■ Directed Trusts Under the Restatement (Second) of Trusts §185

- ◆ If under the terms of the trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of such power, unless the attempted exercise of the power
 - Violates the terms of the trust
 - Is a violation of a fiduciary duty to which such person is subject in the exercise of the power



Fiduciary Responsibility

■ Drafting to Allocate Responsibility to an Advisor*

- ◆ Define the scope and terms of the advisor's responsibility
- ◆ Set the standard of review to which the advisor's actions will be subjected by the primary trustee
- ◆ Specify whether the advisor's power is fiduciary or personal in nature (if allowed under state law)
- ◆ Specify the standard of care to which the advisor's actions will be subject
- ◆ Specify governing law
- ◆ Address vacancies and succession, mode of decision making for shared powers, compensation for advisors

■ Case Law

- ◆ Rollins v. Branch Banking & Trust Co. of VA (56 VA. Cir 174, 2001)
- ◆ Duemlar v. Wilmington Trust Company (2004 Del. Ch Lexis 2006)
- ◆ Robert T. McLean Irrevocable Trust v Patrick Davis, P.C., (283 S. W. 3d 786 Mo. App. S.D. 2009)

* "The term "adviser" should be used in a trust instrument for the person to whom one or more powers are given to direct the trustee in carrying out the trustee's traditional trustee duties, and the term "trust protector" should be used in the trust instrument for the person to whom one or more powers have been given that relate to one or more specific trust matters but do not involve or infringe on the trustee's performance of traditional trustee duties. In Protectors We Trust: The Nature and Effective Use of "Trust Protectors" as Third Party Decision Makers, Kathleen R. Sherby, 2015 Heckerling Institute on Estate Planning.



Trust Modification

- ◆ Non-Judicial Settlement
- ◆ Court Modification – Equitable Deviation
- ◆ Decanting
- ◆ Role of Protectors



Non-Judicial Settlement Agreements

■ Uniform Trust Code §111:

- Permits interested persons to enter into a binding Non-Judicial Settlement Agreement (“NJSA”) with respect to any matter involving a trust

- Agreement is valid to the extent
 - It does not violate a **material purpose** of the trust
 - It includes terms and conditions that could that could be properly approved by a court

- Matters that may be the object of a NJSA:
 - Interpretation or construction
 - Approval of accountings
 - Directions regarding trustee powers
 - Trustee resignation or appointment
 - Change of trust’s principal place of administration
 - Trustee liability



Modification or Termination by Consent

■ Uniform Trust Code §411:

- (a) “A non-charitable irrevocable trust may be modified or terminated upon consent of the settlor and all beneficiaries, even if...inconsistent with a material purpose of the trust.”
- (b) A non-charitable irrevocable trust may be terminated upon consent of all the beneficiaries if the court concludes that the continuance of the trust is not necessary to achieve any material purpose of the trust.
- (c) A spendthrift provision...is not presumed to constitute a material purpose of the trust.



Modification or Termination Because of Unanticipated Circumstances or Inability to Administer Trust Effectively

■ Uniform Trust Code §412

- (a) The court may modify the administrative or dispositive terms of a trust or terminate the trust if, because circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust.

- (b) The court may modify the administrative terms of a trust if continuation of the trust ...would be impracticable or wasteful or impair the trust's administration.



Statutory Decanting

- 1992 New York Adopts First Decanting Statute
- 2014 The Following Statutes have Adopted Decanting Statutes:

Alaska, Arizona, Delaware, Florida, Illinois, Indiana, Kentucky, Michigan, Missouri, Nevada, New Hampshire, New York, North Carolina, Ohio, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Virginia, Wisconsin, Wyoming

Statutes in effect as of 8/22/2014. See [Summaries of State Decanting Statutes](#), Susan T. Bart, Sidley Austin LLP. 2014



Non-Statutory Decanting

■ Common Law:

- Restatement (Second) of Property: Donative Transfers §11.1

- Restatement (Third) of Property: Wills and Other Donative Transfers §74 (2), Comment g.

- Case Law
 - Phipps v. Palm Beach Trust Co. 196 So. 299 (Fla. 1940)
 - In re Estate of Spencer 232 N.W. 2d 491 (Iowa 1975)
 - Wiedenmayer v. Johnson 254 A. 2d 534 (N.J. Super. Ct. App. Div. 1969)

■ Express Authority in Trust Agreement



Trust Protectors

- Uniform Trust Code §808 (b) – Powers to Direct
 - §808 Comment: “subsections (b)-(d) ratify the use of trust protectors and advisors.”

- Case Law
 - Robert T. McClean Irrevocable Trust v. Davis 283 S. W. 3d 786 (Missouri App. 2009)

- Potential Powers
 - Trustee Supervision or Advice
 - Modification of Trust Terms
 - Discretionary Oversight
 - Dispute Resolution

- Protectors: Fiduciary Duties, Standard of Conduct

Thank You