Trust Drafting in 2020

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1. Allocation of trust property at first death

Option	Advantages	Disadvantages
1. Classic A/B trust allocation "To the credit shelter trust allocate the maximum amount or fraction of trust property that can pass free of estate tax; to the marital deduction trust allocate the remaining trust property."	As opposed to an "all marital deduction" allocation and reliance on portability of the estate tax credit under IRC §2010(c)(4), the classic A/B trust allocation allows leveraging of the IRC §2010(a) estate tax credit. Assuming spouses' separate ledgers are adequately funded, the classic A/B trust allocation allows use of both generation-skipping transfer tax exemptions, which are not portable.	Does the client really want the U. S. Congress to determine what is allocated to the credit shelter trust? • If the marital deduction trust and the credit shelter trust have different terms, then the U. S. Congress and the accident of the year of death determine the estate plan. • If the marital deduction trust and the credit shelter trust have the same terms, then why not use a single fund QTIP trust instead? No option to use portability and attain basis adjustment under IRC §1014 of credit shelter trust at second death.

1. Allocation of trust property at first death

Option	Advantages	Disadvantages
2. Single QTIP "All trust property is to be held and administered under Section ___."	Simple to draft Tax flexibility – Decisions postponed until first death • Can make a QTIP election over marital portion only and allow leveraging of estate tax credit or decide to make a QTIP election over the entire trust and rely on estate tax portability. • Allows for use of both GSTT exemptions if ledger of first decedent is sufficiently funded and "reverse QTIP election" under IRC §2652(a)(3) is made.	Given partial elections and reverse QTIP elections, it could end up being as difficult to administer as the classic A/B allocation. Relies on the executor making an election. Requires filing estate tax return. Have you ever met a surviving spouse that likes being the beneficiary of a QTIP trust? Fiduciary responsibility of executor to all beneficiaries? Limited flexibility for planning during surviving spouse's overlife.

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3. Clayton QTIP "To the extent of the QTIP election, trust property is allocated to the marital deduction trust; the remaining trust property is allocated to the credit shelter trust"	As compared to the single QTIP, does not lock to the spouse into QTIP provisions unless the value of the trust property exceeds what can be sheltered by the estate tax credit. Can make a QTIP election over marital portion only and allow leveraging of estate tax credit or decide to make a QTIP election over the entire trust and rely on estate tax portability.	Relies on executor making election. Can spouse be sole executor or is a "special executor" needed to prevent spouse from control over her interest beyond ascertainable standards? Requires filing an estate tax return if QTIP is to be elected If it is desired to rely on portability then spouse is locked into the QTIP provisions Fiduciary responsibility of executor to all beneficiaries? Cannot use the tax on prior transfers credit under IRC §2013 unless non elected portion also has QTIP-like provisions (but, then, no different from single QTIP).

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4. My default – Cascading disclaimers "Trust property to Power of Withdrawal Marital Deduction Trust; disclaimed property to QTIP Marital Deduction Trust; disclaimed property to spray trust for spouse and lineage"	Surviving spouse decides how trust property is allocated and can be given guidance shortly after first death. Surviving spouse can decide, without any fiduciary responsibility, to have complete access, to disclaim to allow reverse QTIP, or to do one disclaimer and partial QTIP or double-disclaimer to leverage estate tax credit.	Requirements of IRC §2518 must be met. Disclaimers must be done before spouse accepts an interest in the property and within 9 months of first decedent's death. Special issues if surviving spouse is incapacitated – importance of authorizing disclaimers in powers of attorney and wills. Do not need estate tax return if spouse wants all in power of withdrawal marital deduction trust unless portability is desired. Cannot insert limited powers of appointment for spouse in QTIP marital deduction trust or credit shelter trust because under IRC §2518(b)(4), "the interest [must pass] without any direction on the part of [the disclaimant]." But … can a disinterested party convey a limited power of appointment to the surviving spouse after the fact.? TR §25.2518-2(e)(2) states: "If the surviving spouse, however, ***retains*** the right to direct the beneficial enjoyment of the disclaimed property in a transfer that is not subject to Federal estate and gift tax (whether as trustee or otherwise), such spouse will be treated as directing the beneficial enjoyment of the disclaimed property, unless such power is limited by an ascertainable standard." Under Example (6) of TR §25.2518-2(e)(5), a trust was funded by a qualified disclaimer even though an independent trustee could make distributions to the spouse other than for an ascertainable standard. If so, then an independent party could arguably give the spouse a limited power of appointment over a trust funded by disclaimer.

2. Flexibility to attain basis adjustment

Drafter wants to plan for the possibility that basis adjustment at death of a beneficiary becomes more valuable than estate tax exclusion.

Sample language

Upon the death of the beneficiary, the Trustee will distribute the trust property in such shares and proportions and on such terms and conditions, as the beneficiary has appointed by will in favor of the "permitted objects," which are determined as set forth in the following two paragraphs. In default of the exercise of the power of appointment, the trust property will be divided into separate shares in respect of the beneficiary's lineal descendants, per stirpes, if any, or if none, the trust property will be divided into separate shares in respect of the lineal descendants, per stirpes, of the nearest ancestor of the beneficiary who is me or a lineal descendant of mine and who has any lineal descendants who survive the beneficiary. Each share so created will be held as a separate trust for the benefit of the lineal descendant in respect of whom the share was created, to be administered under this Part. If there is an existing trust already being administered under this Part which is for the benefit of a lineal descendant in respect of whom a share is created, the Trustee may, in the Trustee's sole discretion, choose to add the share to the existing trust.

So long as the grant of a general power of appointment over any of the trust property would not increase the liability of the beneficiary's estate for federal estate tax (ignoring availability of the estate tax marital and charitable deductions), the "permitted objects" of the power of appointment referred to in the preceding paragraph will be the beneficiary, the beneficiary's creditors, the beneficiary's estate, the creditors of the beneficiary's estate, or any other person, but only with respect to certain of the "appreciated property," that is property having a cost basis, determined before the application of Internal Revenue Code §1014 as a result of the beneficiary's death, which is less than the value of the property as finally determined for federal estate tax purposes, or as would be so determined. If the grant of the foregoing general power of appointment over all of the appreciated property would not increase the liability of the beneficiary's estate for federal estate tax (ignoring availability of the estate tax marital and charitable deductions), then the foregoing general power of appointment will apply with respect to all of the appreciated property. If the grant of the foregoing general power of appointment over all of the appreciated property would increase the liability of the beneficiary's estate for federal estate tax (ignoring availability of the marital and charitable deductions), then the foregoing general power of appointment will apply first to appreciated property having the highest ratio of value, as finally determined for federal estate tax purposes, or as would be so determined, to cost basis, determined before applying Internal Revenue Code §1014 as a result of the beneficiary's death, second to appreciated property having the second-highest ratio, and continuing in order of descending ratio until granting the general power of appointment over any additional appreciated property would increase the liability of the beneficiary's estate for federal estate tax (ignoring availability of the marital and charitable deductions).

With respect to trust property not subject to the general power of appointment as determined under the prior paragraph, the "permitted objects" of the power will be such person or persons (other than the beneficiary or his or her creditors, or the beneficiary's estate or creditors of his or her estate).

2. Flexibility to attain basis adjustment

Question

Do you include the foregoing language in the trust instrument?	Or do you give a disinterested person the power to grant a general power of appointment at any time during the administration of the trust?
Yes, because if the beneficiary dies before the power is conferred, the basis will be adjusted automatically up to the point that estate tax would be incurred.	Yes, for several reasons: • If beneficiary dies before power is conferred then trust property may have recently received an adjustment in cost basis. • Does the grantor really want this power possibly arising in a beneficiary who is cute or unborn now but who turns out to be an addict that would appoint the property to a drug supplier? • This is vastly different from the general power of appointment that arises automatically to prevent a generation-skipping transfer tax. That is because the generation-skipping transfer tax is involuntary; whereas the capital gains tax only arises if an appreciated asset is sold, and then only if the gain cannot be balanced against losses or there cannot be a like-kind exchange. Also, if the general power of appointment arises automatically to prevent a generation-skipping transfer tax, that means the beneficiary has lineage, and the likelihood is that the trust will ultimately find its way to that lineage.

Note – If the general power of appointment cannot be applied to all of the appreciated assets without increasing estate tax, and the family has a highly appreciated asset that they would "never sell," one should adjust the language to skip that special asset and allocate the general power of appointment to an asset that the family is more likely to sell even though it has appreciated less.

3. Ohio Trust Code issues

A. Most Trust Code requirements are waivable in the trust instrument. The ones that are not are listed in Ohio Revised Code §5801.04.

B. Consider the possibility of private settlement agreements in the future. If the taker of last resort, end-taker or "all gone" beneficiary is eighteen different cousins and charities, and the chance of them ever inheriting is infinitesimal, does the grantor really want his anal trustee to seek their permission to alter a trustee power or make some other modification that can be executed by private settlement agreement? I have started including the following in the taker of last resort clause:

Section 2 – Private Settlement Agreements and Other Modifications. Notwithstanding Section 1, after my death and before the operation of Section 1, agreements under ORC §5801.10 may be made, and other modifications to this instrument may be made under ORC Chapter 5804, as though the beneficiaries named in Section 1 were not so named, and each such beneficiary will be bound by such an agreement or modification even though no consent or notice was provided. Any beneficiary under Section 1 challenging this provision or the agreement, lack of notice or modification in any respect will be removed as a beneficiary.

C. Consider if you want to relax the rules for private settlement agreements in the trust instrument. Since Ohio Revised Code § 5801.10 is not written into Ohio Revised Code §5801.04 as not capable of alteration by the trust instrument, one should be able to do this.

D. Consider the grantor's wishes regarding decanting under Ohio Revised Code §5808.18 : Does the grantor want to make it easier or harder? There is much more flexibility to decant a wholly discretionary trust. Therefore, if the grantor wants to make it easier to decant under certain circumstances, consider allowing the trust to be a wholly discretionary trust under these circumstances. For example, I often make the trust wholly discretionary if the trustee is a disinterested individual and is either an original trustee or a successor trustee that is named specifically in the trust instrument (rather than appointed by some person or persons).

4. Directed trust issues

Where the trustee used to do everything (invest trust property, vote stock and make distribution decisions), a recent trend is to allow flexibility to appoint different "officers" for different trust functions. For example, in trusts that are expected to last one or more generations after the grantor's death, I enable the beneficiaries to appoint a "Trust Advisor" who is a disinterested individual and holds no other office with respect to the trust. The thinking for enabling this has two reasons. First, rare is the trustee that can perform all of these services better than anyone else. Second, if the trust is to last more than one generation, the grantor does not know and cannot know who will be managing the trust for his or her beneficiaries. Certainly, none of the individual trustees named will be alive, and personnel may have changed at a corporate trustee, or it may be acquired, etc. The idea is to provide flexibility.

Some sample provisions:

The Trust Advisor may create one or more other offices or remove any offices the Trust Advisor has created. The Trust Advisor may also define or change the powers of such other offices and declare or change whether the officer has merely suggestive powers with respect to the Trustee or the officer may direct the Trustee. The Trust Advisor may also state whether or not such other officer is a fiduciary (or in what respects the officer is a fiduciary), the extent of the officer's liability and compensation and change the status. The Trust Advisor may also set forth whether, or what limitations apply when, the officer may deal, or the officer deals with, another officer. Examples of offices which could be created, without limitation, are an Investment Advisor, a Business Advisor, a Distribution Advisor or a Chemical Dependency Advisor.

The Trust Advisor will act as though the Trust Advisor were a co-officer for the sole purpose of breaking any deadlock.

The Trust Advisor will determine which, if any, officer has a particular power if the possessor of that power is in doubt.

The Trust Advisor may change the situs or law governing various aspects of one or more trusts administered under this instrument.

Any powers possessed by the Trustee under this instrument or applicable law that are not granted to another officer by the Trust Advisor are exercisable by the Trustee.

Ohio Revised Code §5815.25 will apply to all trusts administered under this trust instrument, so that absent evidence of fraud, gross negligence or acting outside of good faith, no officer will be liable for actions taken under authority provided under this instrument or any action taken under the direction of another officer who was acting within the authority provided by the Trust Advisor or under this instrument.

With these provisions, the drafter can relocate in the trust instrument many of the provisions that apply to Trustees to a separate part that applies to officers in general.

5. Secure Act issues.

A . In most cases, at the death of the surviving spouse, the 10-year post-mortem distribution rule of new Internal Revenue Code §401(a)(9)(h)(i)(I) will apply. Pre-Secure Act, when a beneficiary could string out distributions over the beneficiary's lifetime, sound financial planning dictated only withdrawing the minimum distribution and deferring distributions to the extent possible. Bracket creep caused by deferring distributions maximally was not a major concern because the annual distributions were relatively small. Instead, deferring distributions allowed beneficiaries to earn gain on money that would have be used to pay tax had the distributions been accelerated instead. With the changed rules, bracket creep has overtaken this as a major concern. Now sound financial planning will likely dictate that the plan or IRA beneficiary seek to withdraw an equal amount over 10 years rather than face bracket creep toward the end of the 10 year period. This is reminiscent of the calculus behind distribution planning when the now-repealed tax on excess distributions was in effect. At that time one did not want to defer so much that the required minimum distribution rules would force a withdrawal in excess of $150,000 in the future, which would trigger 15% excise tax under Internal Revenue Code §4980A, which was repealed for post-1996 distributions. Instead of the pre-1996 early distribution planning to avoid the 15% excise tax, beneficiaries now should engage in early distribution planning to avoid forcing a future distribution which places them in a higher income tax bracket. Unless a beneficiary knows of abnormally high or low income years over the 10 year period, that would probably dictate amortizing the inherited plan or IRA over 10 years. Accordingly, some of my clients have deferred post-mortem time-based distributions of wealth passing by trust until after the 10-year anniversary of death to level out a beneficiary's cash flow.

B. Naming a trust as beneficiary. I have always tried to avoid this because of the administrative complexity and the need to pay income tax on distributions at the trust rate if the trust is not a conduit trust. Avoiding naming a trust became easier with the advent of portability because there is never a need now to fund a credit shelter trust with a plan or IRA balance. But sometimes naming a trust cannot be avoided; sometimes the non-tax concerns outweigh sound economic planning (think spendthrift beneficiary or beneficiary with a substance abuse problem). I would suggest not naming a trust as beneficiary unless the non-tax concerns outweigh sound economic planning for several reasons.

1. Lack of clarity as to distribution rules. For all but the new categories of eligible designated beneficiaries, the life expectancy of the beneficiary is irrelevant. Yet, the Treasury Regulations have not been amended to keep pace with the law. For example, it ought to be the case that qualifying the trust as a "see-through trust" should not require that it be possible to determine the beneficiary with the shortest life expectancy as of September 30 of the year following death; yet that is precisely what Treasury Regulation §1.401(a)(9)-4, A-1 requires. Knowing if you have a see-through trust is relevant to knowing when plan or IRA distributions must be taken:

	Trust is not a "see-through"	Trust is a "see-through"
Death before required beginning date	5-year rule	10-year rule
Death after required beginning date	Distribution over owner or participant's remaining tabular life expectancy	10-year rule

5. Secure Act issues.

(A) If instead of naming a trust directly the beneficiary can be persuaded to create a management trust, or there is a guardian or conservator involved, an IRA owner or plan participant might be persuaded to leave the IRA or plan to a conduit trust, which we know is a see-through trust and rely on the beneficiary or caretaker to assign net distributions to that trust.

(B) If a spray trust for children is named, it appears that the 10-year rule starts when the oldest child reaches majority. So consider using separate shares.

(C) It is not clear that see-through trust status is available with respect to a trust for an "eligible designated beneficiary" other than a disabled or chronically ill beneficiary unless the trust is a conduit trust, because non-conduit trusts would have one or more beneficiaries who are not "mere potential successors." Non-conduit trusts for disabled and chronically ill beneficiaries appear to be permitted because of a special rule under Internal Revenue Code §401(a)(9)(h)(iv) which treats the trust's beneficiary after the death of the disabled or chronically ill beneficiary as the beneficiary of the disabled or chronically ill beneficiary, thus triggering the 10-year rule at that point.

(i) But the rules are not clear if the disabled or chronically ill beneficiary ceases being disabled or chronically ill but does not die.

(ii) Internal Revenue Code §401(a)(9)(h)(iv) creates a negative inference that non-conduit see-through trusts are not possible for eligible designated beneficiaries other than disabled or chronically ill beneficiaries (i.e., such a trust would not be a see-through trust).

2. Distributions that are earlier than desired. Check all existing trusts having conduit provisions that are named beneficiaries of plans or IRAS. If the client thinks he has left his IRA to a conduit trust for his child's benefit and that the IRA distributions will occur efficiently over the beneficiary's lifetime, think again.

(A) This is especially problematic if the trust <u>directs</u> the trustee to withdraw <u>only</u> the required minimum distribution.

(i) In that case, if the child is a minor, then the trustee will be forced to withdraw based on the child's life expectancy until majority is reached, and then to skip 10 years from that point and withdraw the entire IRA in the tenth year (another problem is the lack of clarity as to when majority is reached).

(ii) If the child is not a minor, or the beneficiary is not the client's child or otherwise not an "eligible designated beneficiary," then the trustee will be forced to defer withdrawals until the tenth year after the IRA owner's death and at that point withdraw the entire amount.

(B) While this is less problematic if the trustee may withdraw more than the required minimum distributions, because bracket creep can be avoided, the client should know what the rules are and make a change in plans if appropriate.

5. Secure Act issues.

(C) For a minor child, consider naming instead a custodian under the Ohio Transfers to Minors Act (which can now go to age 25 in Ohio), which will be far simpler than a trust and also might provide superior economic results.

(D) Consider a charitable remainder trust for an older beneficiary as a way of approaching the effect of old post-mortem distribution rules. Do not commingle plan or IRA with other assets in a charitable remainder trust, or you will cause capital gain from the other assets to be taxed as ordinary income under the "worst-in-first-out" rules of Internal Revenue Code §664(b).

3. Naming a trust is less problematic if a Roth IRA is involved because one does not have to worry about the taxability of distributions at all. However, if required minimum distributions are forced earlier than expected, the income and gains earned on the distributed amounts will be taxed earlier. Therefore, though not as vital as taking care when it is not a Roth IRA, it still has some level of importance.

4. Until there is clear regulatory guidance, I would suggest amending any boilerplate provisions that direct the trustee to withdraw only the required minimum distribution (i.e., change them to allow the trustee to withdraw more in some level of discretion), and understand that conduit trust provisions might be the only way to use a life-expectancy distribution for eligible designated beneficiaries other than the chronically ill and disabled. But better yet, find another arrangement to plan for the post-mortem distribution of a plan or IRA.