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New law will help retool outdated trusts

Effective Jan. 1, House Bill 4662 became law. The legislation amends the Illinois Trusts and Trustees Act to include a “decanting” statute.

In the cocktail party context, decanting of wine refers to the pouring of the liquid from one vessel into another to aerate and remove unwanted sediment. Similarly, this new legislation essentially grants a trustee the authority to pour the assets of an old trust into a new trust to add beneficial provisions (“aerate”) and remove less useful provisions (“unwanted sediment”).

Illinois joins more than 15 other states in enacting this legislation, including some of the most popular trust jurisdictions — Alaska, Delaware, Florida, Nevada and South Dakota.

Estate planning attorneys, trust administrators and trustees often find themselves in a difficult situation when administering an outdated irrevocable trust. Most states allow for the judicial modification of a trust, however in making such a modification, the courts look to respect the intentions of the grantor (or settlor) who created the trust and often require beneficiary consent. The process can be time-consuming and quite costly and a mere modification of a trust due to changed circumstances may be counter to the grantor's original intent.

Other useful tools for estate planning attorneys include the merger or consolidation of two similar trusts, authorized under 760 ILCS 5/4.25, and modification by virtual representation, authorized under 760 ILCS 5/16.1.

The statutory changes address the demand for greater flexibility

in trust administration.

Generally, the decanting power allows a trustee to distribute the trust assets into a second trust that may have different terms. In this way, decanting may be a wonderful solution to many common challenges, including to:

- Minimize taxation or administrative costs of a trust
- Modify the tax treatment of a trust to make it a grantor trust (where all tax attributes flow back to the grantor — or the reverse)
- Modify the trustee provisions
- Change the situs of a trust
- Add a trust adviser, trust, protector or special trustee
- Divide the trust property to create separate trusts for each beneficiary
- Maximize asset protection through spendthrift provisions or special needs language.

The trustee may decant a trust in Illinois without the consent of the grantor (or settlor) or beneficiaries and without court approval by merely sending notice to all legally competent current and remainder beneficiaries.

In addition, if a charity is a current or remainder beneficiary of the trust, notice must also be given to the Illinois attorney general's Charitable Trust Bureau. If no beneficiary objects to the decanting of the trust in writing within the 60-day notice period, the trustee may exercise his or her power and distribute part or all of the principal of the first trust to a second trust. If a beneficiary does object, the trustee may petition the court to order the distribution.

The new Section 16.4 of the Trusts and Trustees Act (760 ILCS 5/16.4) delineates the trustee's power to decant in situ-

THE BUZZ



**LINDSEY
PAIGE
MARKUS**

Lindsey Paige Markus, a principal at Chuhak & Tecson P.C., draws on her early career in business, finance and clinically applied neuroscience to communicate with clients and develop creative solutions to fit their estate planning and asset protection needs. Lindsey was named an Illinois Super Lawyers Rising Star in 2010, 2011 and 2012. She is licensed in Illinois and Florida.

ations based on whether the trustee has “absolute discretion” to distribute trust principal. Where the trustee has absolute discretion to distribute trust principal, the second trust may benefit one, more than one or all of the beneficiaries of the first trust.

In addition, the trustee may also grant a power of appointment in the second trust that may be “broader than or otherwise different from” the remainder beneficiaries of the first trust.

In contrast, where the trustee does not have absolute discretion to distribute trust principal, the following characteristics must be the same in the second trust as those in the first: (i) the current beneficiaries and remainder beneficiaries; (ii) the trustee's authorization to distribute the income or principal; and (iii) the beneficiary's power of appointment.

The new legislation also

provides tremendous protection for beneficiaries with special needs. Specifically, even in circumstances where the trustee does not have absolute discretion to distribute the trust principal, in the case of a disabled beneficiary, the trustee is statutorily authorized to decant the principal of the first trust to a second trust — which is a supplemental needs trust (or special needs trust) — if the trustee determines it to be in the best interests of a beneficiary with special needs.

A supplemental needs trust is a specialized irrevocable trust designed for a beneficiary with special needs. The trust enables a person under physical or mental disability, or an individual with a chronic or acquired illness, to have assets held for the individual's benefit.

When properly drafted, the principal of a special needs trust is not considered “countable assets” for purposes of qualification for specific governmental benefits. The purpose of the trust is to provide “special” or “supplemental” care for the beneficiary over and above that which the government provides.

While rooted in common law, the ability of a trustee to aerate an existing trust and remove excess sediment without court approval, or consent from the grantor or beneficiaries, is truly revolutionary.

The statute will undoubtedly open the door to rewrite outdated trusts to provide increased flexibility. However, with such power comes the potential for abuse. Ultimately, over time, the legislature will need to monitor and possibly amend the statute to ensure that this decanting power is used for good — and not evil.