

THE COMPLETE TRUST GUIDE

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CHAPTER I

IT'S A MATTER OF TRUST (NATURE OF A TRUST)

I. Ancient Common Law Arrangement

A. Local Law Controls Formation and Validity

1. Most states have left in place common law

a. Statutory definitions are not always helpful:

- (1) **Restatement of Trusts:** “A trust . . . is a fiduciary relationship with respect to property, subjecting the person by whom the titles to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.” Restatement Second, Trusts §2.
- (2) **Federal tax law:** “The term ‘trust’ includes any arrangement (other than an estate) which, although not a trust, has substantially the same effect as a trust.” [and] “Arrangements to which this [definition] applies include arrangements involving life estates and remainders, estates for years, and insurance and annuity contracts.” Internal Revenue Code of 1986, as amended, (hereinafter IRC, Code, Section or §, without other modification) §2652(b)(1) and (3).

2. Statutes modify many aspects of common law trusts

a. Trustee powers and duties

b. Allocation of principal and income—huge new area of change (see below)

c. Beneficiary and creditor rights

d. Amendment and revocation

e. Court supervision

3. Federal tax law dictates many considerations

a. Who gets taxed on income?

- (1) Grantor or fiduciary or beneficiary

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- (2) Mandatory or discretionary
 - b. In whose taxable estate is corpus?
 - c. Who can be the trustee?
- B. “Contract” Requires Three Parties
- 1. Original property owner creating trust—typically, the client (settlor/trustor/grantor)
 - 2. Legal owner charged with duties (trustee)
 - 3. Parties to benefit (beneficiaries)
 - 4. *See* Section II. below for detailed discussion of these three roles
- C. Why Use Trusts?
- 1. “The purposes for which trusts can be created are as unlimited as the imagination of lawyers . . . Through the trust it is possible to separate the benefits of ownership from the burdens of ownership.” 1 A. Scott, *Trusts*, §1 at 2 (4th Ed. 1987).
 - 2. Tax motivations
 - a. Remove assets from grantor’s and/or beneficiary’s taxable estates
 - (1) Credit shelter/bypass trusts, life insurance trusts
 - (2) Only trusts allow this division of ownership from beneficial interest
 - b. Control disposition after qualifying for tax benefits.
 - (1) Certain marital trusts (QTIP, “estate” trust, GPOA trust, and QDOT, for example) qualify for the unlimited marital deduction, while ultimate disposition of the property is controlled by decedent.
 - (2) This “time line” division of assets and post-mortem control is generally only possible through trusts.
 - c. Create transfer of ownership without loss of control.
 - (1) Removing assets from Senior generation without letting Junior generation actually get the goods.
 - (2) Trusts are one mechanism of accomplishing this goal, but must be compared to other arrangements, such as limited partnership interests and non-voting corporate stock which may work as well or better.
 - d. Transfer partial interests while achieving other goals.

- (1) Benefit charities while saving income and estate taxes and increasing income (CRAT or CRUT).
- (2) Benefit beneficiaries by saving estate taxes while creating income for charity (CLAT or CLUT).
- (3) Save estate taxes while retaining economic benefits for a term (QPRT, GRAT or GRUT).
- (4) Increase benefits to beneficiaries without further tax (defective grantor trust).
- (5) Avoid estate taxes for generations (GSTT dynasty trust).

3. Non-tax motivations

a. Protection of Surviving Spouse and Children

- (1) *Predator deterrence*—future ex-spouses, in-laws, out-laws and others who may notice an heir is now worth millions; trusts generally get future victim out of the middle; controlled release of family wealth; more difficult for even non-malicious predator to spend someone else's children's inheritance.
- (2) *Creditor protection*—third party trusts (*i.e.*, not self-settled) and testamentary trusts are excellent asset-protection devices; state law or trust agreements usually contain “spendthrift provisions,” barring beneficiaries from pledging or borrowing against their trust interest as collateral.
 - (a) For example, New York generally makes all trusts “spendthrift” unless otherwise provided by grantor, NY EPTL §7-1.5; *but see NY EPTL §7-1.6 for court discretion unless barred by grantor*. However, in other jurisdictions trusts may not have spendthrift protection unless the settlor inserts a spendthrift provision. *See*, Anne S. Emanuel, *Spendthrift Trusts: It's Time to Codify the Compromise*, 72 Neb. L. Rev. 179 (1993).
 - (b) Creditor remedies usually limited to minor partial levies/charging orders against trust income. *See, e.g., NY CPLR §5205(c) and (d)*, exempting 100% of trust *corpus*, except not from QDROs and not for additions to trusts within 90 days of the claim and not for fraudulent conveyances; and exempting 90% of trust income unless court finds the exemption unnecessary for the reasonable requirements of the debtor and his dependents; and exempting 100% of income from all qualified retirement plans.
 - (c) Family law interface. *See In re Balanson*, 25 P3d 28 (Colo., 2001), where the Colorado Supreme Court had to reverse a trial court which had held that although a wife's support trust from her parent was “separate” property, the appreciation in value during her marriage was marital property, available for a property settlement.
 - (d) Tort Feasor Interface. What happens when the trust beneficiary is an active tort-feasor of the worst sort? Will courts carve out an exception to the generally strong

spendthrift protection under current state statutes? So far, the answer (in a non-child support setting) is no. *See Scheffel v. Krueger*, 782 A.2d 410 (N.H., 2001), one of the few cases on point. Here, the New Hampshire Supreme Court upheld the trial court's refusal to attach defendant's trust to satisfy a civil judgment obtained by plaintiff, who was a victim of sexual assault by defendant. Defendant was a trust beneficiary from his grandmother with typical spendthrift protections. The New Hampshire statute recognized only two exceptions to spendthrift protection: self-settled trusts and fraudulent conveyances. Tort creditors were not listed, and could thus not reach the trust assets.

- (3) *Disability of beneficiary*—trustee managed funds are not affected by beneficiary's health or mental capacity; avoids "Groucho Marx" living probate scenario; avoids financial guardianship proceedings, delays and costs; avoids loss of control to spouse or more remote family member who may win contested guardianship/conservatorship battle.
 - (4) *Inability to manage wealth*—trustees control investment, reporting and distribution of trust income and corpus; trustees must follow trust document and state law. Relative abilities of beneficiaries are irrelevant.
- b. Divide benefits of ownership among multiple parties with centralized control
- (1) Some assets, like a vacation compound, may be intended to benefit a group of families while remaining outside of anyone's estate and under centralized control.
 - (2) In other cases, a business interest may be intended for non-participating children while managed by active children, again while minimizing estate tax inclusions.

D. The Fiduciary Relationship

1. Highest standard of conduct

- a. Trustee must strictly observe state and common law fiduciary standards in performing duties under the trust instrument.
- b. State law frequently mandates high standards of responsibility that cannot be modified by trust creator.
 - (1) Common law dictated complete fidelity and avoidance of conflicts of interest.
 - (2) Statutory law frequently goes further, invalidating exculpatory clauses found to be contrary to public policy. Exculpatory clauses will not be given effect if constructed in such a manner as to allow trustee to act in bad faith or without reasonable care. *See, Rippey v. Denver United States National Bank*, 273 F. Supp. 718 (D. Colo. 1967). New York law, for example, forbids the following for executors and testamentary trustees:
 - (a) Exonerating them from common law duties of reasonable care, diligence and prudence; or

- (b) The power to fix the value of any asset for distribution, allocation or other purposes (NY EPTL §11-1.7(a)).
- (c) The above statutory limitations may be pursued by beneficiaries without regard to any *in terrorem* or no-contest provision in a will. NY EPTL §11-1.7(c).

2. Statutory rules govern behavior

- a. State law generally provides a long list of powers that trustees are authorized to hold without further court approval. *See*, II A. Scott, Trusts, §164 (4th Ed. 1987); Uniform Trustees Powers Act, Uniform Laws Annotated Business & Financial Laws, Vol. 7B §2-§3 (Act has been adopted by 16 states).
- b. Grantors should add to list for greater flexibility, depending on state law limitations; should also modify and eliminate any powers not desired.
- c. Income and principal rules (*i.e.*, “who gets what”) will be controlled by state law unless modified by grantor. *See* The Revised Uniform Principal and Income Act (Revised 1962 Act), Uniform Laws Annotated Business & Financial Laws, Vol. 7B §3 *et. seq.* (the Act or its predecessor has been adopted in some form by 41 states); *see also*, III A. Scott, Trusts, §235 (discussion on apportionment of income).
- d. *Future Shock Is Here*: Note that a new model act, The Uniform Principal and Income Act of 1997, which was passed by the National Conference of Commissioners on Uniform State Laws in that year, and approved by the American Bar Association in 1998, embraces radically different concepts. Ignoring the traditional differences between income and principal transactions, instead the act mandates a uniform percentage of the trust’s total return to be treated as income, and the balance as principal. Known as a unitrust approach, this concept is already statutory for charitable remainder trusts (§664(d)—*see* Chapter VIII). The new model act has been adopted in 24 states as of February, 2002.
 - (1) IRS helped facilitate rapid passage of the new uniform act by enacting proposed regulations that show that such state schemes would not adversely affect marital deductions, GSTT grandfathering, or QDOT qualifications, among other concepts vitally concerned with “accounting income” under state law. *See* proposed amendments to §§1.642(c)-2, 1.643(a)-3, 1.643(b)-1, 1.651(a)-2, 1.661(a)-2, 1.664-3, 20.2056(b)-5, 20.2056(b)-7, 20.2056(b)-10, 20.2056A-5, 20.2056A-13, 25.2523(e)-1, 25.2523(h)-2 *and* 26.2601-1, published in Federal Register February 15, 2001 (REG-106513-00)
 - (2) For example, “income” is now defined to include capital gains if “local law provides for a reasonable apportionment between income and remainder beneficiaries of the total return of the trust for the year . . . a unitrust amount of between 3% and 5% of the annual fair market value of the trust assets is a reasonable apportionment . . .” Prop. Reg. §1.643(b)-1.
 - (3) Equitable adjustments permitted under state law will also be deemed to be reasonable if the trustee is investing and managing the assets under the state’s prudent investor standard, the trust refers to mandatory “income” to be distributed, and the trustee cannot otherwise administer the trust impartially. *Id.*

- (4) Distribution in kind to satisfy a requirement to distribute income will be treated as a gain realized by the trust; this is in addition to any voluntary gain recognized by election under §643(e) upon other distributions in kind. Prop. Reg. §1.651(a)-2 and 1.661(a)-2.
- (5) Estate tax marital deduction will not be lost if a state statute defines “income” as a reasonable apportionment between income and remainder beneficiaries of the total return of the trust. Prop. Reg. §20.2056(b)(5)(f)(1).
- (6) State statutes vary in how the 1997 act has been implemented. Look for:
 - (a) Total Return Unitrust (TRU) provisions, usually with a set rate of 3% to 5%, giving deference to the IRS regulations.
 - i) Missouri has no upper limit;
 - ii) New Jersey allows increases to income beneficiaries up to 4%, decreases down to 6%;
 - iii) Delaware allows trustees to choose between 3% and 5%;
 - iv) New York, Pennsylvania (pending) chose 4%, allowing court relief and a power to adjust (see below).
 - (b) Power to adjust, allowing trustees to allocate to or from income and capital gains to allow income beneficiaries a fair share of the total return.
 - i) Some states provide for a separate power to adjust, wherein the trustee can exercise this right to allocate short and long term capital gains to the income beneficiaries;
 - ii) This power is usually an alternative to the TRU approach;
 - iii) Delaware, by allowing trustees to choose a TRU from 3% to 5% has an integrated approach, with no separate power to adjust;
 - iv) New York, Missouri and Pennsylvania (pending) have TRUs and powers to adjust as separate concepts, with the idea that no solution is ideal for all trusts;
 - v) New Jersey has opted for a TRU safe harbor within the power to adjust.
 - (c) Ordering Rules. Many statutes contemplate an ordering procedure so that short- and long-term capital gains are deemed paid out explicitly in the TRU or power to adjust setting. Some states have omitted this from their statutes (*i.e.*, New York).
 - i) States without an ordering rule will have to resort to IRS regulatory positions that allow a “consistent practice” of paying out gains; otherwise gains continue to be taxed to trust.

- ii) Ordering rules in statute should be conclusive under the new proposed regs.
 - e. See state supplement, Chapter IA, on principal and income act, if applicable
 - f. Investment powers and duties usually critical
 - (1) Old law frequently provided for an approved list of types of investments
 - (2) Modern statutes established “prudent man [person]” rules with some investment restrictions. “Prudent man [person]” standards are governed by state statute. The Uniform Prudent Investor Act has been adopted by 37 states, with 2 pending at February, 2002. *See*, Uniform Prudent Investor Act 1994, Uniform Laws Annotated Business & Financial Laws, Vol. 7B at pg. 18 *et. seq.* (Supp. 1997) (discussion of Act and adopting jurisdictions’ variations).
 - (3) For example, the Prudent Investor Act in New York, as in many recently adopting states and modeled on the uniform act, creates a sophisticated approach.
 - (a) Fiduciary must adhere to the prudent investor standard
 - i) Adopt an overall investment strategy;
 - ii) Consider size, duration, and liquidity needs of portfolio, general economic conditions, effects of inflation, tax considerations, expected returns and present and future needs of beneficiaries;
 - iii) Diversify, unless reasonable not to under document; and
 - iv) Determine within reasonable time whether to retain initial assets. (NY EPTL §11.2-3(b)).
 - (b) No investments are inherently good or bad.
 - (c) Detailed record keeping required to show that fiduciary has acted in accordance with overall investment strategy.
3. Multiple opportunities for personal liability
 - a. State law violations of conduct or rules
 - (1) Erroneous distributions under principal and income acts
 - (2) Not meeting investment standards
 - (3) Failure to identify and satisfy legal claims within time limits
 - b. Federal and state tax law
 - (1) Premature distribution of assets before tax liabilities are settled

- (2) Failure to pay GST, estate taxes
 - (3) Missed elections and return deadlines
 - (4) Beneficiary induced fraudulent behavior
- c. Numerous statutes provide for personal liability of fiduciaries for violations; re estate tax, *see* 31 U.S.C. §3713 and *IRC* §2204; for two recent cases under the former statute, *see U.S. v. Bartlett*, No. 99-2060 (C.D. Ill. 2/19/02) and *U.S. v. First Midwest Bank/Illinois, N.A.*, 1997 WL 675192 (N.D. Ill. 1997); trustee as transferee under estate tax (§6324(a)(2)) or gift tax (§6324(b)); for investing, *see Uniform Prudent Investor Act 1994, Uniform Laws Annotated Business and Financial Laws*, Vol. 7B at pg. 18 *et. seq.* (Supp. 1997); II A. Scott, *Trusts*, § 170-170.23 (4th Ed. 1987).
- d. State law also controls when and how fiduciaries are sued and defended, and to what extent income or principal can be used to defend fiduciaries.

E. Advantages and Disadvantages of Trusts

1. Advantages

- a. Control over property (including post-mortem)
- b. Restrict access to property
- c. Provide professional management/investment
- d. Responsibility and accountability
- e. Remove from estate taxation (donor and heirs)
- f. Qualify for tax benefits (*e.g.*, QTIP)
- g. Flexibility and discretion
- h. Asset protection (other than donor)
- i. Avoidance of probate administration
- j. Multiple state tax planning
- k. Family privacy
- l. Many more

2. Disadvantages

- a. Cost of formation (legal and tax advice)
- b. Cost of operation (trustee's commissions, return preparation, court supervision)

- c. Loss of unrestricted access and freedom
- d. Tailoring personal goals with tax objectives
- e. Administrative inconvenience (*Crummey* notices, retitling of assets, extra checkbook, etc.)
- f. Income tax rate increase on accumulations
- g. Local law requirements, such as periodic accountings, filings, waivers
- h. Local law limitations on ownership of assets, activities, ability to sue, etc.
- i. Many more

F. Types of Trusts

1. In general

- a. A trust may be created for any lawful purpose. I A. Scott, *Trusts* §59 (4th Ed. 1987).
 - (1) The particular type of trust to be created will be dependent upon the grantor's objectives including personal, non-tax objectives and tax objectives.
 - (2) Focus on objectives before looking at trust techniques
- b. Objectives must be carefully considered by the grantor and his estate planning advisor before deciding upon the type of trust to be used.
- c. Clients are often confused by trusts and may think that one type of trust may solve their particular concerns while the actual results will be much different.
 - (1) On more than one occasion we have heard clients explain to us that they need a revocable living trust because it will avoid probate, save estate taxes, and protect their assets from nursing home costs. As you will see in later materials, these are erroneous assumptions.
 - (2) Marketing of trusts creates confusion
- d. Educating the client regarding the different types of trusts and their uses is essential in all cases.

2. Common Examples. Several transactions from everyday life are actually trusts of some kind.

- a. "In Trust for" bank accounts, also known as "Totten Trusts." Persons who designate a death beneficiary for bank accounts are actually creating a type of revocable trust. The "in trust for" designation is usually completely revocable and gives the beneficiary no rights during the life of the depositor. The depositor can freely revoke the designation during life or at death through a will. Always check state trust and banking law. *See*, I A. Scott, *Trusts*, §58.3 (4th Ed. 1987).

- b. Qualified education savings programs (529 Plans). Almost all states offer §529 plans in concert with brokerage houses or other investment firms.
 - (1) These programs enable parents to save for a child's college education by transferring annual amounts or a lump sum to a "trust" (an account held by the state or brokerage company) and naming the child as the beneficiary.
 - (2) Income tax is now avoided if the funds are spent on education. *See* §529(c)(3)(B), *as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001*, P.L. 107-16, hereinafter, the 2001 Act.
 - (3) Completed gift treatment and removal from donor's estate are provided by statute despite substantial retained control. §529(c)(2)(A) and §529(c)(4)(A).
 - (4) These plans are essentially irrevocable trusts with special tax treatment authorized by §529.
 - (5) Many states' programs have been launched nationally in a competition among the states to attract plan dollars, and taxpayers can pick and choose benefits and participate in most states' plans without regard to residency.
 - c. UGMA/UTMA accounts. These custodial arrangements for minors are actually irrevocable trusts of the minor's property subject to the custodianship of a trustee. To govern the procedures for gifts to minors, every state has enacted either the Uniform Transfers to Minors Act (1983) or the Uniform Gifts to Minors Act (1956, revised 1966).
 - d. Qualified pension and profit-sharing plans. Retirement benefits are generally required to be held in trust under ERISA. Counting such trusts, virtually every American has been a trust beneficiary of some kind at one point in his or her life.
3. The various types of trusts can initially be divided into two broad categories—"inter vivos" or "lifetime" trusts and testamentary trusts.
- a. An inter vivos trust is one that is created during the grantor's life by execution of a trust agreement and transfer of property by the grantor to the trustee of the trust to hold in accordance with the trust terms.
 - (1) Although an inter vivos trust is usually created at the express direction of a grantor, implied trusts (also referred to as resulting or constructive trusts) also exist.
 - (2) These trusts generally come about when title to property is transferred to someone else but that person is not intended to benefit from the property. Restatement Second, Trusts §440.
 - (3) Other trusts may arise by operation of law. Taxes withheld from employees' incomes by employers are deemed to be held in trust for the government. *See* §§7501 and 7512(b). *See also* special state rules for sales taxes and other collected or withheld funds.

- (4) There are, generally, two types of inter vivos or living trusts—revocable and irrevocable. These are more fully discussed below.
- b. A testamentary trust is one that is created at the grantor's death usually pursuant to the terms of a grantor's will.
 - (1) Such a trust, because it is created at the grantor's death, by its very nature is an irrevocable trust.
 - (2) May be used for tax savings purposes such as utilizing the estate tax marital deduction or the applicable exclusion amount (more fully discussed below)
 - (3) For non-tax reasons such as protecting assets for the benefit of minor or disabled beneficiaries.

G. Inter Vivos (Living) Trusts

1. Revocable—A revocable trust is one in which the grantor retains the power to amend or revoke the trust in the manner defined in the trust agreement. The power to revoke must be expressly reserved in the trust agreement in order to be recognized (in most states).
 - a. Because the grantor retains the power to revoke the trust and take back the trust property, the grantor is generally treated as the owner of the income and assets of the trust for income, gift and estate tax purposes. IRC §§676(a), 2038.
 - (1) There are no tax advantages of a revocable trust.
 - (2) However, a grantor may create tax advantaged trusts such as a marital deduction trust or credit shelter trust within the terms of a revocable trust the same as he could in a will.
 - (3) From that respect, the revocable trust can provide similar estate tax advantages to a will but no more so than a will.
 - b. Revocable trusts are generally recommended, however, not for tax purposes, but for non-tax reasons:
 - (1) Asset management;
 - (2) Probate avoidance (incl. ancillary administration); and
 - (3) Privacy.
 - c. An exhaustive discussion of the principal advantages and disadvantages of revocable trusts can be found in Chapter XI.
2. Irrevocable—An irrevocable trust, whether created during life or at death, is generally characterized by the fact that the grantor cannot change its terms once it is created. As a result, it is essential that the grantor and his advisor verify that the trust will fully accomplish the

grantor's objectives—both tax and non-tax—prior to executing the trust agreement and transferring assets to the trust.

- a. The tax consequences of an irrevocable trust will generally be very different than with a revocable trust.
 - (1) Based on the trust terms, the income generated by trust assets will be either taxed to the trust or the beneficiaries of the trust.
 - (2) In some cases, however, trust income may be taxed to the grantor.
 - (3) Because the trust is irrevocable, a gift tax may be payable on the transfers to the trust.
 - (4) One common reason for creating an irrevocable trust is to remove assets from the grantor's taxable estate. With careful drafting, this result can be accomplished.
- b. Although the trust is irrevocable, state law may provide a mechanism for changing or revoking such a trust. *See*, IV Scott, Trusts, §331 at 383 (4th Ed. 1987).
- c. "Private" trusts are created to benefit private individuals such as the grantor or the grantor's family, including spouse, children, grandchildren, siblings, etc. The benefits of such a trust may include:
 - (1) Estate tax savings;
 - (2) Continued management of trust assets for those otherwise not capable of managing assets; and
 - (3) Protection of trust assets from creditors of the beneficiaries.
- d. "Charitable" trusts are created with the idea that the trust assets will currently or ultimately benefit a tax qualified charity.
 - (1) The charitable interest may be a current benefit such as with an endowment fund or a charitable lead (income) trust
 - (2) Future benefit may come from a charitable remainder trust.
 - (3) Significant income, gift and estate tax benefits can be garnered by utilizing charitable trusts in estate planning, as will be discussed in Chapter VIII.

H. Testamentary

1. Tax related—Usually a primary reason to include trust language in a will is to protect some major estate tax benefit such as the marital deduction or the unified credit. Careful drafting is essential, as these areas are fraught with pitfalls that can trip up the inexperienced practitioner.

2. Non-tax related—Many personal objectives can also be accomplished by including trust language in a will, including:
 - a. Protecting assets for and from minor, disabled and/or spendthrift beneficiaries;
 - b. Providing for a surviving spouse who is otherwise unable to manage those assets; and
 - c. Providing for a surviving spouse while also preserving trust assets for the ultimate benefit of children from a previous marriage.

II. Parties to a Trust

A. In General

1. A trust is generally a three party arrangement. There are three key persons who play a part in establishing and operating a trust—the grantor, the trustee and the beneficiary.
2. One person may play multiple roles and can have powers in certain roles, and not in others.

B. The Grantor

1. The grantor (sometimes also referred to as the settlor or trustor) is the person who is creating the trust and whose property will generally be transferred to the trust. The grantor has the opportunity to dictate how the trust will operate on a day to day and annual basis.
2. The grantor will draft and execute a legal document which will establish the terms of the trust. This agreement, referred to as a trust agreement, declaration or indenture, will define the terms of the trust. Such terms will include, for example:
 - a. The persons or institutions that will benefit from the trust property;
 - b. When and how often distributions of income are made;
 - c. When and how principal should be distributed; and
 - d. Operating rules governing the behavior of the trustee, including:
 - (1) Appropriate investments for the trust;
 - (2) Rules for allocating receipts and disbursements between income and principal; and
 - (3) The powers of the trustee over trust assets.
 - e. Trust language often includes a provision regarding the rights of the beneficiary or beneficiaries, including:
 - (1) Any rights to demand distributions; and
 - (2) Rights to remove and replace a trustee.

3. The language of the written trust agreement should not be ambiguous. Ambiguity will generally result in problems for the trustee in dealing with trust beneficiaries and may ultimately defeat the original objectives of the grantor in establishing the trust.
4. With the new Uniform Principal and Income Act of 1997 being adopted rapidly around the nation, drafters must be careful not to nullify important benefits available to trustees under the Act, unless intended.
5. The grantor may establish the trust during life by executing a trust agreement or declaration of trust and funding that lifetime trust with assets, or at death by including the trust provisions in his will. A trust established and funded during life is generally effective immediately while a trust created by a person's will can only become effective at that individual's death
6. The grantor may, pursuant to the trust terms, retain certain rights to or powers over trust property and income.
 - a. Any such retention of rights or powers will likely have certain income, estate and/or gift tax consequences.
 - b. It is essential that these tax issues be examined when drafting the trust document to be sure that the trust arrangement conforms with the grantor's overall objectives.

C. The Trustee

1. The trustee is the party to whom the trust property has been entrusted to be administered in accordance with the written trust agreement.
 - a. A trustee serves in a "fiduciary capacity" meaning that he must act in a diligent and prudent manner for the benefit of others.
 - b. As a fiduciary, state law will generally impose certain duties on the trustee including:
 - (1) A duty of faithfulness and loyalty to the grantor and the beneficiaries;
 - (2) A duty to avoid self dealing; and
 - (3) A duty to avoid conflicts of interest.
2. By virtue of being named as a trustee under a valid trust agreement, the trustee possesses certain powers which are granted under state law. *See, Uniform Trustees' Powers Act, Uniform Laws Annotated Business & Financial Laws, Vol. 7B §2-§3 at pg. 745 et. seq.; II A. Scott, Trusts §164 (4th. Ed. 1987).*
 - a. The grantor may in the trust agreement, however, eliminate or modify some powers or add certain powers not granted to a trustee under state law.
 - b. It is often advisable for a grantor to provide additional powers to a trustee which powers allow the trustee more flexibility and discretion.

- c. An example of a trust power often added in the trust documents is the following:
“To retain such property for any period, whether or not the same is of the character permissible for investments by fiduciaries under any applicable law, including any interest in a closely held business, and without regard to the effect any such retention may have upon the diversity of investments.”
 - d. With the new principal and income act, Grantors should review every proposed trust to determine whether the power to adjust or TRU should be available to the Trustee, or should be overridden in the agreement.
3. Although the trustee will generally accept legal title to trust property under state law, he does not have ownership in his own right but only on behalf of the equitable owners of the trust—the beneficiary(ies).
 4. The trust agreement may provide for multiple trustees and in such a case, should provide rules for decision making when the trustees disagree on a matter, such as majority or unanimous voting. In addition, the document should provide for successor trustees should an initial trustee be unable to serve.
 5. The grantor’s choice of trustee will depend on a variety of factors including the nature of the trust property, the beneficiaries of the trust and their various needs, and trust objectives. Choice of a trustee may also dictate tax filing exposure in many states.
 6. Trustees are entitled to compensation for their role as trustee either in accordance with the trust agreement or state law.

D. The Beneficiary

1. A trust agreement is generally created to benefit the third party to the arrangement—the beneficiary or beneficiaries.
 - a. There are a variety of interests or levels of interest that a beneficiary may have in a trust arrangement.
 - b. The grantor of the trust may also be a beneficiary of the trust or may have no continuing interest in the trust property after the trust is established and funded.
 - c. There may be multiple beneficiaries, or beneficiaries in different aspects of the trust, *such as* income beneficiaries and principal beneficiaries.
 - d. A beneficiary’s interest in the trust may last for a term of years or for the beneficiary’s lifetime.
 - e. The beneficiary’s interest in the trust may start immediately or begin in the future.
2. Some of the types of beneficial interest in a trust are as follows:
 - a. Life Interest—A life interest is an interest in a trust for a term based on the life of the beneficiary or another person. At the death of the life beneficiary, the trust will either continue for an additional term or terminate and the trust’s assets will be distributed.

- b. **Term Interest**—A term interest is a beneficial interest for a stated term which is generally expressed as a number of years.
 - c. **Remainder Interest**—This interest generally represents a right to receive trust property in the future after the expiration of one or more life or term interests in the trust.
 - d. **Reversionary Interest**—A reversionary interest is an interest of a grantor in the return of the trust property to him after the expiration of a life or term interest in the trust.
- E. **The Role of Financial Institutions**
1. A financial institution, such as a bank, trust company or brokerage company, will often be considered by a grantor as a candidate to serve as a primary trustee, co-trustee or successor trustee of a trust arrangement. A financial institution offers both advantages and disadvantages as a trustee.
 - a. The benefits of naming a financial institution as a trustee include financial expertise in managing assets, continuity of the position and freedom from emotional and beneficiary pressures in making investment and distribution decisions.
 - b. The disadvantages of a corporate trustee include potentially costly fees, generally conservative investment policies and lack of understanding and/or consideration of beneficiary (family) dynamics.
 2. Advisers should be alert to professionals who routinely recommend or name themselves or a specific financial institution for all their client's documents. Usually that means that the best interests of the client may not have been considered and the client may be unaware of the selection.
 3. Trustee choices should carefully weigh the needs of the client, the appropriateness of the available fiduciaries, the term and objectives of the trusts, and the various tax rules that apply to limit fiduciary choices.
 4. The new principal and income act may make it impossible for individuals to serve as trustees without profound personal liability exposure and may require special drafting considerations to meet the enormous demands placed on trustees under the act.

EXHIBIT XV-A

QUALIFIED SUBCHAPTER S TRUST

SKYWALKER FAMILY QUALIFIED SUBCHAPTER S TRUST

On April ____, 2002, **LUKE SKYWALKER**, presently residing at ABC Street, Anywhere, USA (hereinafter "Grantor") entered into this Agreement with **HAN SOLO**, having an address at 123 Street, Anywhere, USA ("Trustee"), as follows:

Article I

Creation and Funding of Trust

A. This instrument creates four separate and independent shares in a trust to be known as **THE SKYWALKER FAMILY QUALIFIED SUBCHAPTER S TRUST** ("Trust"). The assets of the Trust shall include stock of Skywalker, Inc., a New York corporation, that has elected to be taxed under Subchapter S of the Internal Revenue Code.

B. The Grantor transfers to the Trustee the property listed in Schedule A, including stock of Skywalker, Inc., to be held and administered according to the terms of this instrument. The Grantor and anyone else may transfer additional property to the Trustee, to be held and administered according to the terms of this instrument. The Grantor retains no right, title, or interest in any Trust property.

C. It is the intention of all of the parties to create four (4) separate and independent shares of a qualified subchapter S trust under §1361(d)(3) and the separate share rule of §663(c) of the Internal Revenue Code of 1986, as amended, and all Trust provisions shall be interpreted in such a manner as to accomplish the parties' intentions. All trust property shall be separately and independently administered for the exclusive benefit of the current income beneficiary of that share.

D. It is the intention of the Grantor that the Trust created under this Agreement constitute a qualified subchapter S trust (as defined in Code Section 1361) during the period that the Trustee owns any shares of Skywalker, Inc. and Skywalker, Inc. continues to maintain a valid S election; and it is the Grantor's intention that during such period this trust is to be administered in such a manner as to qualify the trust as an eligible shareholder of a Subchapter S corporation under the provisions of said Section.

Article II

Irrevocability

The Trust and all interests in it are irrevocable, and the Grantor has no power to alter, amend, revoke, or terminate any Trust provision or interest, whether under this instrument or any statute or other rule of law.

Article III

Beneficiaries and Term of the Trust

This Trust begins on the date of this instrument and ends as provided in Article VI. The term "Beneficiary" shall refer to the Current Income Beneficiary for each of the four (4) separate and independent shares of this Trust. The following individuals shall be the Current Income Beneficiaries of their respective separate and independent share of this Trust:

1. **COLLIN LUKE SKYWALKER**
ABC Street
Anywhere, USA
2. **CONNOR DANIEL SKYWALKER**
ABC Street
Anywhere, USA
3. **MICHELLE SKYWALKER**
ABC Street
Anywhere, USA
4. **GRACE SKYWALKER**
ABC Street
Anywhere, USA

Except as otherwise provided in this agreement, each Beneficiary shall be allocated a one-fourth (1/4) share of any additional principal contributions, and the trust shall be administered as if it consists of four (4) separate and independent shares of trust corpus.

Article IV

Annual Demand Power

A. Immediately following any contribution to the Trust created hereunder, the Current Income Beneficiary may withdraw his or her full share of the amount of the contribution, except that the total amount of such withdrawals in any calendar year cannot exceed the "annual exclusion amount." The annual exclusion amount shall mean the amount excludible from gifts for gift tax purposes by virtue of Section 2503(b) of the Internal Revenue Code, or any successor thereto, in effect in the year in question (currently \$10,000), provided that during any time the Grantor is married the annual exclusion amount shall mean twice the amount so excludible (currently \$20,000). This demand power takes precedence over any other power or discretion granted the Trustee.

B. The following rules shall apply to the demand powers created under this article.

1. A Beneficiary can exercise this demand power by a written request delivered to the Trustee. If a Beneficiary is unable to exercise this demand power because of a legal disability, including minority, such Beneficiary's parent (if the Beneficiary is a minor), or any other legally authorized personal representative, including (but not limited to), a guardian, committee, or conservator, may make the demand on his or her behalf. However, in no event can the Grantor make a Beneficiary's demand for such Beneficiary, regardless of the Grantor's relationship to the Beneficiary. The Grantor requests, but

does not demand, that no amounts withdrawn by a parent or personal representative be expended in a manner that would discharge or satisfy the Grantor's legal obligation to support a Beneficiary, if any.

2. The Trustee must reasonably notify the person who would exercise each Beneficiary's demand power of the existence of the power and of any contributions made to the Trust subject to the power.

3. The Beneficiary's demand power is cumulative; however, for each calendar year this power is unused it will lapse on the earlier of (a) December 31 or (b) thirty (30) calendar days following the date of the contribution, to the extent of the lesser of (1) the greater of \$5,000 or 5% of the fair market value of the Trust, or (2) the amount of the contribution to the Trust. Any powers remaining unexpired from an earlier calendar year shall lapse in the current year to the extent the greater of \$5,000 or 5% of the fair market value of the Trust exceeds the amount of the current year contributions to the Trust, with the earliest unexpired powers lapsing first. No payment may be made in a subsequent year on account of the Beneficiary's failure to demand a distribution in a prior year, after that demand power has lapsed.

4. The Trustee may satisfy the Beneficiary's demand for a distribution by distributing cash, other assets, or fractional interests in other assets, as the Trustee deems appropriate.

5. "Contribution" means any cash or other assets transferred to the Trustee by the Grantor to be held as part of the Trust funds. The amount of any contribution is its federal gift tax value, as determined by the Trustee at the time of the transfer.

Article V

During the Trust's Term

A. During the term of the Trust, the Trustee shall hold and administer the Trust property remaining after any exercise of the Beneficiary's demand powers under Article IV for the lifetime benefit of the Current Income Beneficiary.

B. During the life of the Current Income Beneficiary, the Trustee shall pay:

1. All of the Trust's income to or for the benefit of the Current Income Beneficiary in convenient installments, but at least annually;

2. So much of the Trust's principal (including all or none) as the Trustee deems appropriate in her sole and absolute discretion, for the Current Income Beneficiary without regard to any existing resources of such Beneficiary;

3. No principal or income may be distributed to any Beneficiary other than the Current Income Beneficiary for whose benefit such share is being held during his or her lifetime.

C. At the death of a Current Income Beneficiary, the Trustee shall pay and distribute to the estate of the deceased Current Income Beneficiary a sum equal to the value of the deceased Current Income Beneficiary's separate and independent share as of the date of death of the income beneficiary. The sum shall be paid to the estate within 120 days of the death of the deceased Current Income Beneficiary.

The amount distributable by the Trustee to the estate of the deceased Current Income Beneficiary shall be reduced by applying against this amount the proceeds from any and all life insurance policies insuring the life of the deceased Current Income Beneficiary the premiums of which are being paid for by the

Trust or Skywalker, Inc. and the beneficiary of which is the family of the Current Income Beneficiary. As used in this Paragraph and throughout this Agreement, the term "family" shall mean the Current Income Beneficiary's spouse and/or issue, including any legally adopted issue.

The balance of the amount distributable to the estate of the deceased Current Income Beneficiary shall be paid and distributed as follows:

1. A down payment equal to the amount of any life insurance proceeds payable to the trust and/or to Skywalker, Inc. on policies on the life of the Current Income Beneficiary.

2. Any remaining value shall be payable in sixty (60) consecutive equal monthly installments of principal and interest commencing no later than one hundred twenty (120) days after the date of death of the Current Income Beneficiary and shall be evidenced by a promissory note. Such note shall provide for interest to accrue at the highest prime rate published by *The Wall Street Journal* in its Money Rates Column on the day such note is executed, or the first business day thereafter, with interest commencing no later than one hundred twenty (120) days after the date of death of the Current Income Beneficiary. The balance of the note may be prepaid at any time without penalty. Such note shall also provide for the acceleration of the entire unpaid principal balance in the event of default in the payment of principal or interest for more than ten (10) days after notice and demand.

Any shares of stock in Skywalker, Inc. held for such deceased Current Income Beneficiary pursuant to this trust shall be allocated equally among the remaining separate and independent shares of this trust.

D. On the date of the death of the last surviving Current Income Beneficiary, this trust shall terminate and any and all accrued income and principal shall be paid and distributed to the issue of the last surviving Current Income Beneficiary, in equal shares *per stirpes*.

E. Notwithstanding any provisions of this instrument, the Trustee shall have no discretion to distribute Skywalker, Inc. stock held by this Trust to any person not a Current Income Beneficiary.

F. The Trustee shall not pay or expend any money in a manner that would discharge the Grantor's legal obligation to support any Beneficiary.

Article VI

When the Trust Ends

The Trust created under this instrument shall end on the earlier of the death of the last Current Income Beneficiary named in Article III or the sale of all of the common stock in Skywalker, Inc. held by the Trust. If the Trust terminates because the last of the Current Income Beneficiaries has died, the Trust principal shall be distributed as directed in Paragraph D., Article V, above. If the Trust terminates upon the sale of all of the common stock of Skywalker, Inc. held by the Trust, the Trustee shall promptly transfer all of the trust funds, including any accumulated income, to the Current Income Beneficiaries, in equal shares *per stirpes*.

Article VII**Spendthrift Clause**

To the extent permitted by law, the Beneficiary's share will not be subject to liabilities or creditor claims or to assignment or anticipation. No Beneficiary shall have the power to assign or pledge his or her share in this Trust, nor shall the Trustee recognize or be bound by any attempted assignment, transfer, pledge, hypothecation or other attempt to collateralize a share in this Trust. No income or principal shall be subject in any manner to any claim of any creditor of any Beneficiary or liable to attachment, execution or other process of law.