

Lewis Rice Presents: Advanced Estate Planning Techniques for 2016 and Beyond

September 27, 2016

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The New Section 2704(b) Proposed Regulations: Insights & Planning Implications

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September 27, 2016

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History of the § 2704 Regulations

The § 2704(b) Proposed Regulations

The Proposed Regulations

IRC § 2704(b)

- Section 25.2704-2: Transfers subject to “applicable restrictions”
- NEW Section 25.2704-3: Transfers subject to “disregarded restrictions”
- Section 25.2701-2: Definition of “controlled entity” expanded
- Section 25.2704-1: Lapse of certain rights
- Section 25.2704-4: Effective Date

§ 2704(b)– Transfers Subject to Applicable Restrictions

- (1) Any **applicable restriction** shall be disregarded in determining the value of a transferred interest.
- (2) An “**applicable restriction**” is any restriction:
 - (A) which effectively limits the ability of the corporation or partnership to liquidate, and
 - (B) which the transferor or any member of the transferor’s family, either alone or collectively, has the right remove, in whole or in part, after such transfer.
-
- (4) The Secretary may by regulations provide that **other restrictions** shall be disregarded in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor’s family **if such restriction has the effect of reducing the value of the transferred interest for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee.**

Proposed Reg. § 25.2704-3– Disregarded Restrictions

- When a partnership interest is transferred to a family member, certain restrictions will be disregarded in valuing the interest, for transfer tax purposes.
- A “**disregarded restriction**” is a restriction that:
 - **limits** the ability of an interest holder to
 - **compel** liquidation or redemption **of that interest**
 - on **no more than six months’ notice**
 - for **cash or property**
 - equal to at least “**minimum value.**”

Prop. Reg. § 25.2704-3(b)(1)(i)-(iii).

Disregarded Restrictions

Minimum Value

- **“Minimum Value”** is an interest’s pro rata share of the net fair market value of the entity’s assets.

Minimum Value = (fair market value of entity’s assets — entity’s debts*) x share represented by interest.

Prop. Reg. § 25.2704-3(b)(1)(ii).

*Only reduced by entity’s debts to the extent that the debts would be deductible under IRC § 2053 if they had been claims against a decedent’s estate.

Disregarded Restrictions

“Cash or Property”

- Interest holder must receive cash or property in exchange for his interest
- Interest may **not** be redeemed for an **intra-family promissory note** (i.e., a note issued by an entity, its owners, or a related person), ***unless***:
 - Entity is engaged in an **active trade or business**;
 - At least **60% of the entity’s value** consists of **non-passive trade/business assets**;
 - **Liquidation proceeds** (i.e., payments on the note) are **not** attributable to **§ 6166(b)(9)(B) passive assets**;
 - The note is **adequately secured**;
 - The note requires **periodic payments** on a non-deferred basis;
 - The note is issued at **market interest rates** (not AFRs); and,
 - The note has a **fair market value** on the date of liquidation **equal to the liquidation proceeds**.

Disregarded Restrictions

Family Control

- A restriction is only a “**disregarded restriction**” if, after the transfer, the restriction will lapse or can be removed by the transferor or any member of the transferor’s family.
- An interest held by a nonfamily member that gives the nonfamily member the power to prevent the removal of the restriction is also disregarded, **unless** the interest:
 - Has been held by that nonfamily member for **at least 3 years**;
 - Represents **at least a 10% interest** in the entity;
 - Represents **at least a 20% interest** in the entity, when **aggregated** with other nonfamily members; and,
 - Can be redeemed by the nonfamily holder on **no more than 6 months’ notice**, for **cash or other property**.

Exceptions – Restrictions that Will Not be Disregarded

- Commercially reasonable restrictions imposed by unrelated investors.
- Restrictions that are mandatory and unavoidable under federal or state law.
 - This includes “a limitation on the ability to liquidate the entity (in whole or in part) that is more restrictive than the limitations that would apply under the state law generally applicable to the entity in the absence of the restriction.”
- Safe Harbor: No restriction will be disregarded if every holder of an interest in the entity has the power to redeem his/her interest on no more than 6 months’ notice, for cash or other property.
 - Not a “deemed put.”

Effect of Disregarded Restriction

- If a restriction is disregarded under Section 25.2704-3(b)(1), the fair market value of the transferred interest is determined under generally applicable valuation principles, including any appropriate discounts or premiums, as if the disregarded restriction did not exist.

“Controlled Entity”

Expanded Definition

- Current regulations apply to **corporations** and **partnerships**.
- Proposed regulations stat that § 2704 applies to **corporations, partnerships, LLCs** and “**any other entity or arrangement** that is a “**business entity**” within the meaning of [Treas. Reg.] § 301.7701-2(a).”

Lapse of Certain Rights

Expanded Meaning of “Voting Right”

- **Assignee Interests**
 - Proposed regulations clarify that “the transfer of a partnership interest to an assignee that neither has nor may exercise the voting or liquidation rights of a partner is a lapse of the voting and liquidation rights associated with the transferred interest.”
- Expanded Meaning of “**Voting Right**”
 - Proposed regulations provide that “In the case of a limited liability company, the right of a member to participate in company management is a voting right.”

Lapse of Certain Rights

New Three-Year Rule

- Lapse of voting or liquidation right in family-owned entity is transfer by individual who held right if entity is controlled by transferor and members of transferor's family immediately before and after lapse.
 - Family control includes all descendants of parents of transferor or transferor's spouse.
 - But does not apply if rights with respect to transferred interest are not restricted or eliminated. Reg. § 25.2704-1(c)(1).
 - Proposed regulations would deny exception for transfers occurring **within three years before transferor's death** [described in preamble as "bright-line test"].
 - "The lapse ... is treated as a lapse occurring **on the transferor's date of death**, includible in the gross estate pursuant to section 2704(a)."

Effective Dates

- Provisions of proposed regulations applicable to voting and liquidation rights are proposed to apply to rights and restrictions created after October 8, 1990, but only to transfers occurring after date regulations are published as final.
- New rules for “Disregarding Certain Restrictions on Redemption or Liquidation” (Prop. Reg. § 25.2704-3) will not take effect until 30 days after date regulations are published as final.
 - See 5 U.S.C. § 553(d) (provision of Administrative Procedure Act rule applicable to “legislative” regulations).
- Public comments due November 2.
- Public hearing to be held on December 1.
- Regulations could be finalized any time thereafter.

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Practical Considerations in Sale of Business Entity to IDIT

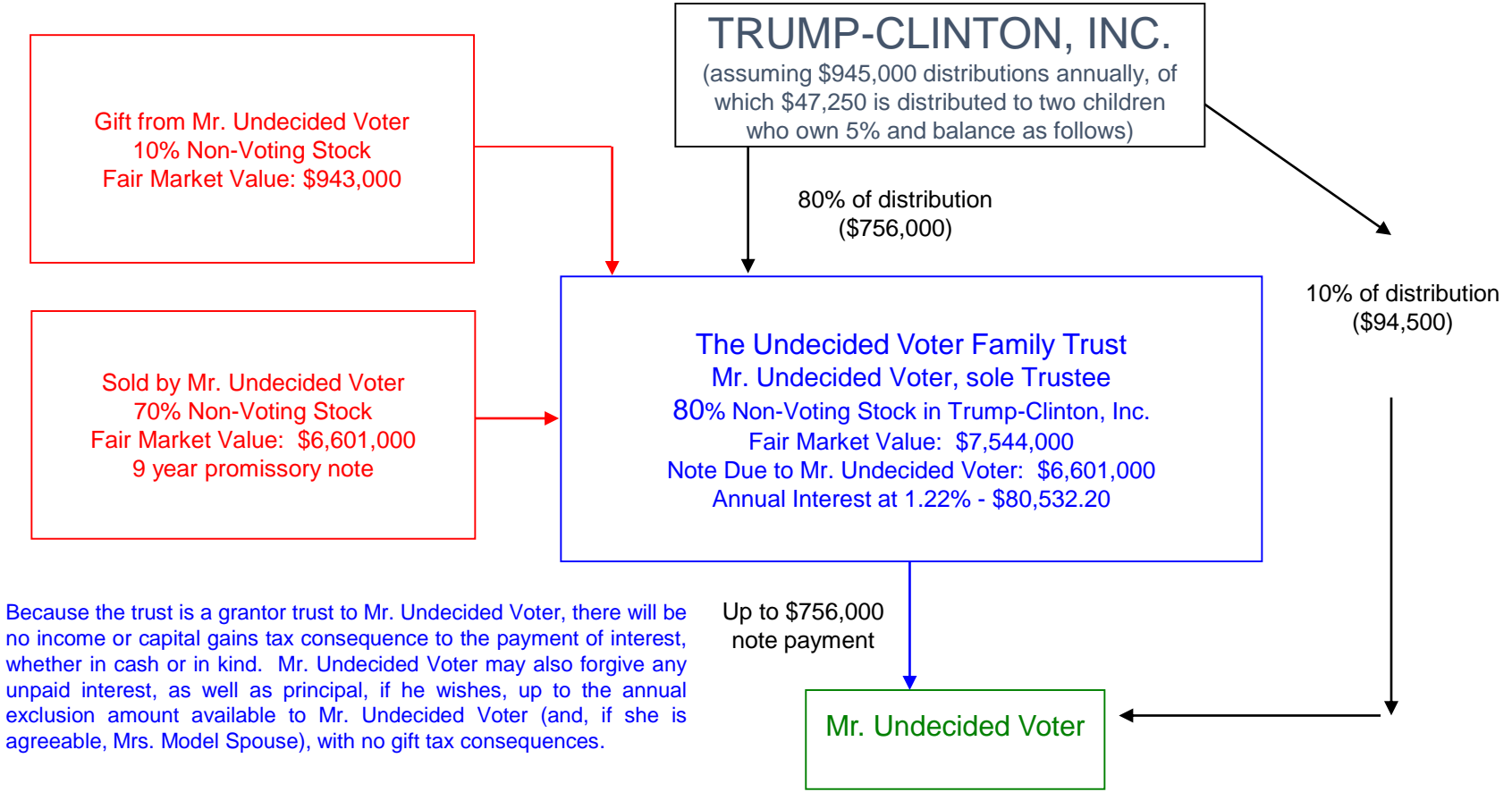
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September 27, 2016

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Structure of Sale Transaction

MR. AND MRS. UNDECIDED VOTER



1. Mr. Undecided Voter owned 90% of the Company prior to the transaction – 10% (all) of the voting stock and 80% of the non-voting stock. Each of his two children owns 5% of the non-voting stock prior to and after the transaction.
2. An appraisal was obtained, which resulted in the value of 1% of non-voting stock equaling \$94,300.

Intentionally Defective Irrevocable Trust

- Grantor trust during Mr. Undecided Voter's lifetime
 - Permissible S corporation shareholder during Mr. Undecided Voter's lifetime
 - After Mr. Undecided Voter's death, IDIT drafted to qualify as ESBT or QSST
- During Mr. Undecided Voter's life, he pays income taxes on assets of IDIT, increasing assets passing to IDIT beneficiaries
- Assets sold or gifted to IDIT without recognizing taxable gain
- Assets sold or gifted to IDIT no longer included in Mr. Undecided Voter's estate
- Mr. Undecided Voter cannot be a beneficiary but spouse can be beneficiary
- Mr. Undecided Voter may act as Trustee (unless voting stock is owned by IDIT or Mr. Undecided Voter transfers stock possessing at least 20% of total combined voting power of all classes of stock to IDIT)

Ways Grantor is Protected Financially

Number 1: Repayment of the Promissory Note

- The promissory note given by the IDIT can be structured to provide regular payments of interest or interest and principal
- If cash flow is insufficient to repay the note, renegotiate the terms of the note. Document the renegotiation with an amended and restated promissory note using the then current Applicable Federal Rate

Ways Grantor is Protected Financially

Number 2: Swap Assets

- Mr. Undecided Voter can swap liquid assets owned by the IDIT for illiquid assets owned by the Mr. Undecided Voter if of equivalent value
- Use power to swap assets to move low basis assets from the IDIT to Mr. Undecided Voter's estate in exchange for higher basis assets
- Written memorialization of swap and gift tax return

Ways Grantor is Protected Financially

Number 3: Spouse as Beneficiary of IDIT

- Model Spouse could be named as a beneficiary of the IDIT at the outset
- If Mr. Undecided Voter is uncomfortable naming Model Spouse as an IDIT beneficiary at the outset, a third party (not Mr. Undecided Voter, Model Spouse or any descendant) can be given the ability to add Model Spouse as a beneficiary in the future
- Once promissory note is repaid, if Model Spouse is a beneficiary and living, Trustees of IDIT can make distributions to Model Spouse from the IDIT for health, support and maintenance (best to use other estate taxable assets first)

Ways Grantor is Protected Financially

Number 4: Borrow

- If Model Spouse is not beneficiary of IDIT and/or promissory note given in connection with the sale has been fully repaid, Mr. Undecided Voter can borrow funds from the IDIT
- Document with promissory note using at least Applicable Federal Rate for interest, which is typically lower than market rate
- Required annual interest payments may evidence a loan that more closely resembles a third party loan

Ways Grantor is Protected Financially

Number 5: Grantor Trust Status

- Turn off grantor trust status
- IDIT must pay income taxes on assets owned by IDIT
- Model Spouse can no longer be beneficiary of IDIT
- Mr. Undecided Voter can no longer have power to borrow from IDIT
- Neither Mr. Undecided Voter nor Model Spouse can serve as Trustee once grantor trust status is switched off

IDIT Cash Flow Analysis

September 2016

Before Transfer

Shareholder	Voting	Non-Voting	Total	Percent
Dad	10	80	90	90.00%
Son	0	5	5	5.00%
Daughter	0	5	5	5.00%
Totals	10	90	100	100.00%

Transfer of Non-Voting Shares to IDIT

	IDIT	Per Share	Total Value
Gift	10	94,300	943,000
Sale	70	94,300	6,601,000
	80		7,544,000

After Transfer

Shareholder	Voting	Non-Voting	Total	Percent
Dad	10	0	10	10.00%
IDIT	0	80	80	80.00%
Son	0	5	5	5.00%
Daughter	0	5	5	5.00%
Totals	10	90	100	100.00%

Year	Company Taxable Income	Taxable Income Dad	Taxable Income IDIT	Taxable Income Dad+IDIT	Taxes at 45%	Distrib. to Dad+IDIT	Distrib. to Dad	Distrib. to IDIT	IDIT Cash Req. to Pay Taxes	Note Pmt = Tax Req. +\$50G	IDIT Cash Balance	Note Interest (1.22%)	Principal Payment	Note Balance 6,601,000	
1	2016	1,500,000	150,000	1,200,000	1,350,000	607,500	850,500	94,500	756,000	513,000	563,000	193,000	80,532	482,468	6,118,532
2	2017	1,500,000	150,000	1,200,000	1,350,000	607,500	850,500	94,500	756,000	513,000	563,000	386,000	74,646	488,354	5,630,178
3	2018	2,500,000	250,000	2,000,000	2,250,000	1,012,500	1,417,500	157,500	1,260,000	855,000	905,000	741,000	68,688	836,312	4,793,866
4	2019	2,500,000	250,000	2,000,000	2,250,000	1,012,500	1,417,500	157,500	1,260,000	855,000	905,000	1,096,000	58,485	846,515	3,947,352
5	2020	2,500,000	250,000	2,000,000	2,250,000	1,012,500	1,417,500	157,500	1,260,000	855,000	905,000	1,451,000	48,158	856,842	3,090,509
6	2021	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	734,000	1,725,000	37,704	696,296	2,394,214
7	2022	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	734,000	1,999,000	29,209	704,791	1,689,423
8	2023	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	734,000	2,273,000	20,611	713,389	976,034
9	2024	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	734,000	2,547,000	11,908	722,092	253,942
10	2025	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	257,040	3,297,960	3,098	253,942	0
11	2026	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	4,305,960	0	0	0
12	2027	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	5,313,960	0	0	0
13	2028	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	6,321,960	0	0	0
14	2029	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	7,329,960	0	0	0
15	2030	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	8,337,960	0	0	0
16	2031	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	9,345,960	0	0	0
17	2032	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	10,353,960	0	0	0
18	2033	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	11,361,960	0	0	0
19	2034	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	12,369,960	0	0	0
20	2035	2,000,000	200,000	1,600,000	1,800,000	810,000	1,134,000	126,000	1,008,000	684,000	0	13,377,960	0	0	0

**MR. AND MRS. UNDECIDED VOTER
ESTATE TAX FOCUSED BALANCE SHEET**

Asset or Liability	AVAILABLE TO MR. UNDECIDED VOTER AND MODEL SPOUSE			AVAILABLE TO MODEL SPOUSE		AVAILABLE TO MR. UNDECIDED VOTER		TOTAL
	Estate Taxable			Non-Estate Taxable		Non-Estate Taxable		
	Mr. Undecided Voter's Revocable Trust	Retirement Assets	Model Spouse's Revocable Trust	Undecided Voter Family Trust	Insurance Trust	Fun Money Trust	House Trust*	
Cash & Cash Equivalents								\$ 950,000.00
Washington Lobbyist Bank								
Politico Bank & Trust	\$ 500,000.00							
Bank of Freedom			450,000.00					
Marketable Securities								5,000,000.00
Risky Investment Account	1,500,000.00							
Rainy Day Fund			1,000,000.00			\$ 2,500,000.00		
Trump-Clinton, Inc. Stock	943,000.00			7,544,000.00	**			8,487,000.00
Promissory Note From Family Trust	6,601,000.00							6,601,000.00
Real Estate								2,300,000.00
Main Residence - St. Louis, MO							\$ 1,500,000.00	
Vacation Home in Florida			800,000.00					
Retirement Accounts								
Life Insurance (Death Benefit)								
Subtotals	\$ 9,544,000.00	-	2,250,000.00	7,544,000.00	-	2,500,000.00	1,500,000.00	\$ 23,338,000.00
Subtotal - Mr. Undecided Voter and Model Spouse (Taxable)								11,794,000.00
Subtotal - Mr. Undecided Voter and Model Spouse (Taxable; assuming note repaid and spent)								5,193,000.00
Available to Model Spouse (as Survivor)								12,737,000.00
Available to Mr. Undecided Voter (as Survivor; assume note repaid and spent)								9,193,000.00
Subtotal - Left to Charity (Non-Taxable)								-
*If grantor dies prior to end of term of House Trust, assets are included in grantor's estate.								
**Please note that until note is repaid in full, promissory note due Mr. Undecided Voter reduces net value of assets in Family Trust.								
Red numbers are estate taxable.								

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Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

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September 27, 2016

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Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

Key Financial Data

Fair Market Value Less Commission	20,000,000
Debt on Contributed Property	9,300,000
Total Accumulated Depreciation	4,700,000
Total Adjusted Basis in Contributed Property	2,800,000
Estimated Tax Rate on Gain Subject to Depreciation Recapture	33.1%
Estimated Tax Rate on Gain in Excess of Depreciation Recapture	28.4%
Estimated Ordinary Tax Rate	43.2%

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

A Few Key Tax Issues for Donor

- FMV deduction based on value of real estate
- Qualified Appraisal Rules
- What about discounts for real estate owned by an LLC or other entity?
 - Put option as a consideration
 - Mismatch with estate/gift values under proposed 2704 regs.
- Deduction reduces income at top brackets and works it way down
- Deduction excess over AGI limits carried over up to 5 years and unused carryover expires with the donor

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

A Few Key Tax Issues for Donor

- Relief of Indebtedness = Bargain Sale
 - Apportionment of basis to sale and charitable portions
 - Adjusted basis allocated to sale in example is \$1,302,000
 - Taxation of sale portion will trigger recapture of depreciation at a special 25% rate and depreciation in excess of straight-line depreciation will reduce the charitable contribution deduction
 - Depreciation recapture allocated to sale in example is \$2,185,500
- How Late is Too Late – Assignment of Income Doctrine
- Sale of Property by Charity within 3 Years (special reporting on IRS Form 8282)

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

A Few Key Tax Issues for the Charity

- Debt Raises Issue of Unrelated Business Taxable Income
 - Interesting UBIT exception for certain debts – IRC Sec. 514(c)(2)(B)
 - UBIT and impact on support test for publicly supported charities
 - UBIT and impact on 501(c)(3) status of any charitable organization
- Excess Business Holdings Issues for Real Estate Owned in an Entity if Charity is a Donor Advised Fund, Private Foundation or Certain Supporting Organizations
- There several are other due diligence and process issues for the charity which we are not covering in this presentation. Also, for purposes of simplicity, we have ignored the Pease tax and made some general assumptions about applicable federal and state tax rates.

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

Comparison of Alternatives and How to Think About Outcomes

- Option 1: Pre-Sale Charitable Gift of Real Estate (or LLC that owns Real Estate)
- Option 2: Post-Sale Charitable Gift of Cash Proceeds from Sale
- Option 3: Charitable Gift of Appreciated Marketable Securities

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

Comparison of Alternatives and How to Think About Outcomes

- Option 1: Pre-Sale Charitable Gift of Real Estate (or LLC that owns Real Estate)
 - Charitable Contribution Deduction = \$6.420M
 - Tax Benefit of Charitable Contribution = \$2.774M
 - Tax on Bargain Sale Element (the debt) = \$1.424M
 - \$434k depreciation recapture
 - \$990k capital gains

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

Comparison of Alternatives and How to Think About Outcomes

- Option 1: Pre-Sale Charitable Gift of Real Estate (or LLC that owns Real Estate)
 - “Cost” to Mr. Real Estate is approximately \$2.007M
 - Benefit to Charity is approximately \$6.420M
 - If no UBIT, approximately \$6.420M
 - If UBIT, approximately \$4.487M
- “Leverage” of gift approximately 3.20

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

Comparison of Alternatives and How to Think About Outcomes

- Option 2: Post-Sale Charitable Gift of Cash Proceeds from Sale
 - Sale nets Mr. Real Estate approximately \$3.357M after income taxes
 - Tax benefit of charitable gift is approximately \$1.450M
 - “Cost” to Mr. Real Estate is the difference of \$1.907M
 - Benefit to Charity is \$3.357M
 - “Leverage” is approximately 1.76

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

Comparison of Alternatives and How to Think About Outcomes

- Option 3: Charitable Gift of Appreciated Marketable Securities
 - Assume same basis in stock as the appreciated real estate on a percentage basis
 - A sale of \$4.441M of stock would net Mr. Real Estate the same \$3.357M he would net from sale of the real estate
 - Tax benefit of charitable gift is approximately \$1.919M
 - “Cost” of gift is approximately \$1.438M
 - Benefit to charity is \$4.441M
 - “Leverage” of gift is approximately 3.09

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

Comparison of Alternatives and How to Think About Outcomes

- A Deeper Look at the Outcomes
 - Option 1 (pre-sale gift) leverage rises from 3.20 to 5.33
 - Option 2 (post-sale gift) leverage rises from 1.76 to 2.93
 - Option 3 (marketable securities gift) leverage rises from 3.09 to 5.15

Mr. Real Estate – Charitable Gift of Debt Financed Depreciated Commercial Real Estate

Comparison of Alternatives and How to Think About Outcomes

- A Deeper Look at the Outcomes
 - Typical family making a charitable gift at this level has a large taxable estate
 - The donor is unlikely to consume the wealth during his lifetime
 - Therefore, the donated wealth would be part of the donor's estate and the next generation would receive \$0.60 on the dollar
 - This increases the “leverage” because it decreases the cost of the gift in the hands of the next generation

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Not So Set In Stone: Modifying Irrevocable Trusts in Missouri and Illinois

Robert J. Will and Timothy D. Yeaglin

September 27, 2016

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Main Avenues of Modification

- Nonjudicial Settlement Agreements
- Nonjudicial Modifications
- Decanting
- Trust Protectors
- Judicial Modifications and Terminations

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Nonjudicial Settlement Agreements

- Interested parties in Missouri and Illinois may enter into a binding agreement with respect to several matters involving a trust.
- The Grantor/Settlor need not be living for the agreement to be effective.
- Such matters include: (i) the interpretation or construction of trust terms; (ii) directions to the trustees to refrain from an act or to grant the trustee powers; (iii) **the resignation or appointment of trustees**; and (iv) the determination of trustee compensation.

Nonjudicial Settlement Agreements

- These agreements cannot be used to terminate a trust or modify dispositive provisions, with or without the concurrence of the Settlor/Grantor.
- Interested parties must sign the agreement. They include the trustees and beneficiaries.
- Virtual Representation can help reduce number of signatures.
- The consent of one person may bind another person in certain circumstances.

Nonjudicial Settlement Agreements

- Parents->Minor or unborn children (if no conflict of interest)
- Holders of broad/special or general powers of appointment->takers in default and potential appointees
- Trustees-> beneficiaries (if no conflict of interest)
- Persons with substantially similar interests -> minors, unborn, incapacitated and those unable to be located (if no conflict of interest) and *in terms of a settlement agreement only, Qualified Beneficiaries can bind any non-qualified beneficiary.*

Nonjudicial Modification Agreements

- Irrevocable Trusts may be modified in Missouri with the consent of the Settlor/Grantor and the beneficiaries, even if the modification is inconsistent with the purpose of the trust.
- Thus, dispositive provisions can be modified in this fashion if all of the beneficiaries agree (or are virtually represented).
- The Settlor cannot bind any beneficiary.
- Qualified Beneficiaries who have substantially similar interests with more remote beneficiaries **cannot** bind known (but remote) beneficiaries with respect to this Agreement.

Nonjudicial Modification Agreements

- Considerations:
 - Are Consents by Beneficiaries considered gifts in certain circumstances?
 - For instance, if a beneficiary consents to changing an outright distribution to a distribution to the beneficiary, subject to a lifetime trust, has a gift been made? Are there GST consequences?
 - Is there a 2036 problem with the Settlor/Grantor assisting in the modification of an irrevocable trust he/she created?
 - Florida does not allow a nonjudicial modification while a Settlor/Grantor is alive due to this concern.

Decanting - Not Just for Wine and Spirits Any More

- This newer modification technique is increasing in popularity.
- It is accomplished by a Trustee transferring assets from the old, less ideal trust to a new trust with better terms.
- To properly decant in Missouri:
 - The original trust must allow the trustee to have at least the discretion to distribute income or principal to beneficiaries, even if that discretion is limited by an applicable standard (health, support, maintenance, etc.)

Decanting - Not Just for Wine and Spirits Any More

- The new trust must only provide for beneficiaries named in the original trust; no new beneficiaries allowed.
- The new trust may provide for fewer original beneficiaries than the original trust.
- Typically, we advise that a third party trustee perform the decanting.
- Income interests in certain trusts (Grantor Retained Annuity Trusts; Charitable Remainder Trusts; Marital Trusts) cannot be reduced.
- The Permissible Beneficiaries of the new trust must be notified 60 days prior to the decanting (unless this is waived).
- Spendthrift clauses do not prevent decanting in Missouri.

Decanting - Not Just for Wine and Spirits Any More

- Decanting is likely preferable to a Nonjudicial Modification.
- Beneficiary consents are not required, thus removing the concern about gifts being made through consents.
- The Settlor is not involved in the decanting process (again, we recommend a third-party Trustee).
- The final product is a newly funded irrevocable trust rather than a “modified irrevocable trust” in terms of “optics.”

Decanting - Not Just for Wine and Spirits Any More

- Illinois decanting is more restrictive. If the document limits the trustee's absolute discretion with an applicable standard (health, support, etc.), then (i) the beneficiaries of the new trust must match the beneficiaries of the old trust and (ii) the distribution language (income/principal) and the powers of appointment must all be the same as the old trust.
- These rules are relaxed in Illinois to allow for decanting into special needs trusts with respect to a disabled beneficiary's interest.
- Florida's law is even more restrictive. Trustees **cannot** decant in Florida if an applicable standard is provided.

Trust Protectors

- Missouri law provides for the role of a Trust Protector, who is someone other than the Settlor/Grantor, Trustee or beneficiary.
- A Trust Protector may have powers that are **expressly described** in the document, including those powers to: (i) modify or amend the trust instrument; (ii) terminate the trust; and/or (iii) increase, decrease, modify, or restrict the interests of the beneficiary or beneficiaries of the trust.

Trust Protectors

- Advantages of Trust Protectors
 - Modifications by Trust Protectors are easier than nonjudicial modifications or judicial modifications because beneficiaries and other parties do not need to agree and no court is involved.
 - It is arguable that Trust Protector modifications are easier than decanting because assets are not transferred between trusts (new accounts are not required, etc.).
 - As with all modification options: flexibility
- Disadvantages of Trust Protectors
 - Finding someone to actually act in the role.
 - Fiduciary duties to Settlor and beneficiaries? Limited case law; potentially volatile area.
 - 2036 argument if evidence that Settlor asks Trust Protector to make changes to irrevocable trust.

Judicial Modifications and Terminations - Bob Will

- Most common when the Settlor is no longer living (otherwise, the nonjudicial route is available) or when not all beneficiaries agree.
- If all adult beneficiaries consent, a court may (if a non-consenting beneficiary's interest is protected):
 - reduce or eliminate the interests of some beneficiaries and increase those of others;
 - change the times or amounts of payments and distributions to beneficiaries;
 - provide for termination of the trust at a time earlier or later than that specified by its term.

Judicial Modifications and Terminations - Bob Will

- If not all adult beneficiaries agree, a court may still modify the trust if the court is:
 - satisfied that the interests of a beneficiary who does not consent will be adequately protected; and,
 - in the case of a termination, the party seeking termination establishes that continuance of the trust is not necessary to achieve any material purpose of the trust; or
 - in the case of a modification, the party seeking modification establishes that the modification is not inconsistent with a material purpose of the trust, and the modification is not specifically prohibited by the terms of the trust.

Judicial Modifications and Terminations – Bob Will

- Work performed for corporate fiduciaries
- Charitable v. non-charitable modifications
- Venue Issues in St. Louis (County vs. City)
- Discussion regarding various scenarios and anecdotal experiences concerning judicial modifications and terminations