May 13, 2021

UNDERSTANDING OBSCURE TRUSTS

A. INTRODUCCTION

As the landscape of the corporate fiduciary world continues to evolve; and as the demands to increase revenue continue to mount; trust companies may be tempted to expand their offerings and venture into less well-known areas of trust administration. Although there can be economic benefits of engaging in obscure trusts; it is wise to understand some of the pitfalls that might also occur.

B. PET TRUSTS

Although surveys differ, up to 68% of households in the United States are thought to contain one or more animal considered to be a pet.[1] And it doesn't take an overly astute observer to notice that many pet owners consider their pets to be more than animals. Rather, they are members of the family. And like other loved ones, many Americans want to ensure that their furry, feathery, or scaly friends are cared for should the owner die first.

A. State Laws:

Currently, all fifty states and the District of Columbia have some type of Pet Trust Statute. Minnesota was the last to enact one in 2016. That statute allows for the pet trust to be in existence until the death of the animal, or, if the trust was created to provide for the care of more than one animal alive during the settlor's lifetime, upon the death of the last surviving animal. Notwithstanding the foregoing, the trust may not be enforced for more than 90 years.[2]

The length for which Pet Trusts are allowed to remain in existence varies from state to state. Many state statutes simply require trusts to terminate with the last surviving animal passes away. Others, like the Minnesota statute, cap the trust term by a certain number of years. Some limit the trust to twenty-one

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[1] Kain Brulliard and Scott Clement, "How many Americans have pets? An investigation of fuzzy statistics," The Washington Post, Jan. 31, 2019, https://www.washingtonpost.com/science/2019/01/31/how-many-americans-have-pets-an-investigation-into-fuzzy-statistics.

[2] Sec. 501C.0408 MN Statutes.

years, such as Alaska[3] and Michigan,[4] while others go out much longer. For example, the State of Washington applies its general rule against perpetuities which is one hundred fifty years following the effective date of the instrument.[5]

The limits on duration imposed by statues that define a specific number of years can create a problem when it comes to Pet Trust. What happens if someone in Michigan creates a trust for a young cockatoo? Cockatoos generally have a lifespan of sixty years. However, in captivity they can live much longer. For instance, Fred, a sulfur-crested cockatoo in Tasmania, Australia lived to be at least 104. Not to be out done, Cocky Bennet, another Australian cockatoo, also of sulfur-crested variety, reported lived to be 120.[6] And cockatoos aren't the only exotic animals kept as pets with a lifespan that wreaks havoc with perpetuity limitations. Henry the tuatara, a New Zealand reptile that closely resembles a lizard, was at least 120 years old in April of 2019 and is presumably still going strong.[7] But Henry is nothing compared to Jonathan, the giant tortoise. As of this past April he was a whopping 187 years old and designated as the world's oldest living land animal by Guinness World Records.[8]

B. How much is too much? (Matter of Abels, 44 Misc. 3rd 485)

OPINION OF THE COURT

ANTHONY A. SCARPING, S.

In this miscellaneous proceeding, Richard M. Copland (Copland), as co-executor of the estate of Lenore Lewis Abels (the decedent), petitions the court for a decree in accordance with EPTL 7-8.1 (d) reducing the amount of money to be transferred from the estate to the trustees of a testamentary pet trust established under the decedent's will. Issue has been joined, and a stipulation was entered into between the interested parties which provides that discovery is waived, and the matter is to be submitted on the pleadings.

The decedent was married to Joel Abels (Joel), and they lived at 22 Normandy Lane, New Rochelle, New York (the home). They had a daughter who predeceased them on August 8, 2000 at the age of 46 years.

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[3] AS 13.12.907.
[4] MCLS 700.2722.
[5] RCW 11.98.130.
[6] Zoe Miller, "11 of the oldest animals ever, ranked by age," Business Insider, Apr. 23, 2019, https://www.elephants.com/news/the-sanctuary-in-the-news/posts/11-of-the-oldest-animals-ever-ranked-by-age.
[7] Ibid.
[8] Ibid.

On February 16, 2003, the decedent executed an instrument which provided $115,000 in cash bequests to various charities for the care of animals and the rest of her assets in trust for Joel. If Joel did not survive her, all of her property (with the exception of the home) was to be sold and distributed to her named trustees to be used as follows: $35,000 in salary and a $5,000 bonus per year to Eugenia Chodnicka (Eugenia) (who was the decedent's housekeeper); funds were allotted for Eugenia to maintain the home and care for her cats;[1] and when the last cat died, the home and its contents were to be sold, and the remainder distributed to 33 animal oriented charities in the percentages set forth in the instrument plus a $50,000 bonus to Eugenia. On that same day, Joel executed an instrument, which other than certain different general bequests, contained the same pet trust with remainder to charities if the decedent should predecease him.

On January 24, 2007 Joel died. Sixteen days later, the decedent died. On August 13, 2007 letters testamentary and letters of trusteeship issued in Joel's estate to Copland and co-fiduciary Michael Maino (Maino) (collectively, the co-executors), and on October 15, 2007 letters testamentary and letters of trusteeship issued in the decedent's estate to Copland and Maino. An inventory of assets filed in 2007 reflected assets in the decedent's estate totaling $4,761,346.[2]

Copland filed this proceeding and then an amended petition. His amended petition requests that the court (1) reduce the amount to be transferred to the trustees to either $440,000 or $1,000,000 minus $628,000 (the amount already expended) for an amount of $372,000 and (2) permit the sale of the home. In support of his amended petition, Copland asserts that the co-executors have been fulfilling the terms of the trust with estate funds because funds have never been transferred to the trust for the life beneficiaries. As to the decedent's cats, he alleges that Gindy is seven years old and can be expected to live another 5 to 11 years, and Poke-A-Dot is nine years old and can be expected to live another three to nine years. Copland also states that the home needs significant repairs, the taxes and upkeep on the home are very expensive, and Eugenia has indicated a willingness to leave the home and have the co-executors find and pay for a suitable new place for her and the cats to live.

In response to the amended petition, Maino filed an amended answer, containing a host of extraneous information and then generally admitting most of the allegations and requesting that the court grant the relief requested by Copland.

People for the Ethical Treatment of Animals (PETA), Bide-A-Wee Home Association, Fund for Animals and Doris Day Animal League, several of the charitable trust remainder beneficiaries, filed an answer which denied knowledge or information sufficient to form a belief as to the bulk of the allegations in the petition and asserted an "affirmative defense" which stated that, while the petition alleges that the estate assets exceed $3.6 million, it fails to set forth the liabilities and assets on hand, making it impossible to determine what would remain in the estate should the proposed reduction be granted and that the co-executors have failed to file state and federal tax returns. The pleading further prays that the court make a determination in the proceeding.

Eugenia filed an answer generally denying the allegations in the petition. She also asserted various "affirmative defenses" which included that the petition is based on misinformation that an agreement is in place for Eugenia to relocate with the decedent's cats and the co-executors, having failed to timely file tax returns, are now hoping to reduce the pet trust so that the taxing authorities might consider a charitable deduction, thus perhaps minimizing tax liability. The answer further requests that the court deny the petition.

As a preliminary matter, in every proceeding before this court, the clear expression of the decedent's intent is to be given effect (*see Wager v Wager,* 96 N.Y. 164 [1884]). EPTL 7-8.1 (a) authorizes the establishment of a trust for the care of a pet animal and the use of principal or income to be enforced by an individual designated for that purpose in the trust instrument or, if none, by an individual appointed by the court. The McKinney's Commentary to the statute provides that, prior to its enactment, New Yorkers had to provide for their pets in less ideal ways which would not always ensure that their wishes would be carried out regarding their animals. For example, a pet owner could give money to a person with an unenforceable request that he care for the pet, he could make a gift to a person contingent on his care of the pet, or he could give the pet and money to a humane society (Margaret Valentine Turano, Practice Commentaries, McKinney's Cons Laws of NY, EPTL 7-8.1). The statute also provides that a court may reduce the amount of the property transferred to a pet trust if the court determines that the amount substantially exceeds the amount required for the intended use (EPTL 7-8.1 [d]).

Copland argues that the pet trust can be reduced if the home is sold, and Eugenia moved to a less expensive residence. Copland arrives at a sum certain by approximating the life expectancy of the cats and Eugenia's monthly costs to take care of them.[3] He urges that this would be beneficial because the remainder of the trust would then be accelerated, the estate could possibly qualify for a charitable trust exemption, potentially reducing estate tax liability, and dispositions could be made to the 33 charitable remainder beneficiaries rather than when the last cat dies. He further argues that the reduction is necessary to meet the decedent's wishes to benefit the charities as well as her cats.

In actuality, Copland's prayer casts aside the decedent's wishes. The decedent gave very specific instructions as to how she wanted her cats to be cared for. That care included Eugenia, her home, a salary and bonus to Eugenia, maintenance for the home and a stipend for the cats.[4]

Furthermore, after the decedent's daughter and her husband predeceased her, her instrument makes clear that the primary object of her bounty became her cats (and not the charities). If she had wanted to dispose of her assets to give more money to the charities right away, she could have. Indeed, she gave $115,000 in cash bequests to the charities (including $25,000 to PETA). The face of the instrument makes plain that she knew that choice was available to her. She also could have chosen a less expensive option for the care of her pets. But she did not. Instead, as evidenced by article FIFTH of her will, she painstakingly planned out the care for her pets and set forth that the charities were to take only on the death of her last cat. Again, if she intended to benefit the charities over her pets, and create a charitable deduction, the instrument would have been drafted differently.[5]

In essence, Copland is asking for this court to rewrite the decedent's will. The court may not override the expressed intention of a testator (*see Matter of Knapp,* 41 Misc.3d 1202[A], 2013 NY Slip Op 51556[U] [Sur Ct, NY County 2013]; *Matter of Kastin,* NYLJ, Aug. 1, 2013 at 30 [Sur Ct, NY County 2013]). Similarly, the very purpose of the statute was to provide certainty to a pet owner regarding the care of her animals. Given the existence of the statute and the facts present, the court could not sanction the premature termination of this trust.

Additionally, Copland's petition is largely speculative. There is no guarantee that Copland is correct in his estimates as to the life span of the cats[6] or his assessment as to the cost of alternative living arrangements for Eugenia and the cats, there has been no determination made on the accuracy of the assets and liabilities in this estate, and there is no guarantee that the IRS will agree that the estate will qualify for a charitable deduction.

Indeed, Copland offers no authority for the proposition that the IRS would offer a charitable estate tax deduction based on the facts present here where (1) the estate is seven years delinquent in filing a return and (2) there has been a de facto formation of the trust since the life beneficiaries have been receiving benefits for seven years.

Matter of Helmsley, (31 Misc.3d 1233[A], 2009 NY Slip Op 52802[U] [Sur Ct, NY County 2009]), cited by Copland, had a very different set of facts and is distinguishable. In *Helmsley,* the pet trust was reduced from $12 million to $2 million because the trust was overfunded for the carrying out of the decedent's wishes. Unlike Copland's prayer for relief here, the petitioner in *Matter of Helmsley* did not seek to alter Mrs. Helmsley's wishes and arrangements for her dog, Trouble. Simply put, Mrs. Helmsley had made a disposition to the trust greater than what was required to carry out her intentions.

This matter is more akin to *Matter of Duke,* (NYLJ, Aug. 6, 1997 at 24, col 6 [Sur Ct, NY County 1997]), which was decided prior to the enactment of EPTL 7-8.1, which fact makes the case at bar even stronger against the reduction.
In *Duke,* the court upheld the validity of a trust under Ms. Duke's will for the benefit of her dog against a challenge by the Doris Duke Charitable Foundation, the residuary beneficiary of the estate, to invalidate it. In doing so, the court stated:

In reaching the foregoing conclusion, the [c]ourt is cognizant of the tax and non-tax savings that would accrue to the Doris Duke Charitable Foundation if the trust were held to be invalid; the willingness of the Doris Duke Foundation for the Preservation of Endangered Wildlife and the Doris Duke Foundation for the Preservation of New Jersey Farmland and Farm Animals to care for the dog; and the possibility of future litigation arising with respect to the trust. These factors, however, cannot justify invalidating an otherwise proper disposition. (Duke at 25, col 1; see generally Matter of Kastin [refusing to apply anti-lapse statute and thus disinheriting children of predeceased sibling where decedent's intent from plain language of instrument was clear, and objective was to identify and honor testamentary intent, and not further societal benefit].)

Based on the above, the prayers for relief requested in the amended petition are denied in their entirety.

Case Foot Notes

1. Copland alleges that, of the several cats which belonged to the decedent at the time of her death, only two remain.

2. In his petition, Copland alleges that the value of the estate at the decedent's death was $3,600,000 and that the home is worth about $300,000 to $500,000. On the inventory of assets, the home was valued at $1,000,000.

3. In a conference before the court, there was also a suggestion made that Eugenia could return to Poland (her homeland) with the cats.

4. One commentator has noted that planners often recommend that testators place their residences and farms in trust to properly care for the animals and to insure a vehicle for their intention that the "animals remain together in familiar

surroundings" (see Frances Carlisle, Helmsley's Pet Trust Raises Issues for Owners of All Income Levels, NYLJ, May 28, 2009 at 4, col 3).

5. This same commentator has said that the "primary concern of a client when creating a pet trust is usually the animals and not the remainderman" (see Frances Carlisle, Remember the Family Pet in Estate Planning, NYLJ, July 16, 2004 at 5, col 3).

6. If the cats live longer, there may be increased financial burdens on Eugenia which the decedent did not contemplate. [9]

C. Which pets are the beneficiary?

Hahn v. Estate of Stange, 2008 Tex. App. LEXIS 1027

Procedural Posture
Appellant designated caretaker challenged the judgment of the Probate Court No. 2 for Bexar County, Texas, declaring that all of the testatrix's real and personal property passed to the residuary beneficiaries under her will, in the action with appellee estate administrator.

Overview
The administrator filed a declaratory judgment action to determine the beneficiaries under the testatrix's holographic will. The probate court determined that the will created a pet trust for the benefit of the testatrix's cats, but that the pet trust failed because there were no ascertainable beneficiaries. The probate court also determined that the designated caretaker for the cats was not a beneficiary under the will because his health issues prevented him from carrying out the purpose of the trust. The probate court found that the designated caretaker's heath issues rendered him unable to stay in the home and care for any cats. The appellate court ruled that there was sufficient evidence to support the finding of the probate court, that the pet trust failed because no beneficiary cat was identified or located, as none of the testatrix's cats could be accounted for. Also, because the testatrix's will made it clear that the primary purpose of her estate plan was to provide above all for the care of the cats, the will was not ambiguous about the creation of the trust.

D. Who will care for the pet?

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[9] 988 N.Y.S.2d 458

i. What happens when the designated caregiver says “no”?

Although the pet trust created by Leona Helmsley for her Maltese named *Trouble* was infamous for many reasons, one of the less publicized facts concerned the caregiver. Mrs. Helmsley appointed her brother to care for *Trouble,* but he refused to accept the role. Luckily for the dog, Carl Lekic, the general manager of the Helmsley Sandcastle Hotel in Sarasota, Florida accepted the role.[10]

ii. What does the trustee do when the trust fails to name a caregiver?

E. Examples of the good and the bad

i. The Good - Taffy the Cat

The trustee shall set aside the sum of $100,000.00 for the loving care and maintenance of my loving cat, Taffy. I recommend my trustee pay an amount up to $500.00 per month as a gift to the caretaker of my pet, to include food, shelter, medical care and such other necessaries as pet ownership requires. Further providing:

- *Taffy be delivered to the possession of my friend and personal caregiver, (specifically named person), to care for Taffy as her own for the life of Taffy. During such time as Taffy resides with the caregiver, I request that she provide Taffy with healthcare through (a particular animal hospital) on, at least, a semi-annual basis; and*

- *If the caregiver shall be unable to provide such care, or if, for any other reason Taffy shall cease to reside in the possession of the caregiver, then, I recommend that my trustee seek the assistance of (specifically named veterinarians) to aid in placement of my pet with another home.*

[10] Cara Buckley, Cosseted Life and Secret End of a Millionaire Maltese, June 9, 2011, The New York Times, www.nytimes.com/2011/06/10/nyregion/leona-helmsleys-millionaire-dog-trouble-is-dead.

- *My trustee shall make inquiry from time to time form both the caretaker and the veterinarians concerning the wellbeing of Taffy.*

Upon the death of my pet, the remainder shall be divided among the residuary beneficiaries listed below.

ii. The Bad - Bridgett the dog

My Trustee shall retain in trust enough assets to take care of all of my pet(s) for the remaining portion of my pets' life. The amount my trustee retains in trust for the benefit of my pet(s) may not be challenged by anyone. Any assets remaining after the death of my pets will be administered pursuant to the following section (Gifts to Charity).

C. LAND TRUSTS

A. The Basics

A land trust is an agreement established between a grantor and a trustee to bifurcate legal title from the use and oversite of property. In essence, title to a property vests in the trustee while the beneficiary (usually the grantor) retains control of the use and sale of the property. The land trust beneficiary receives all the tax benefits and property appreciation. However, the recorded deed indicates only the trustee and trust as the owner of the property, the trust beneficiaries are not disclosed. Furthermore, the trust is usually named only with a sequence of numbers and letters such as LT12345.

In addition to privacy, one of the other benefits of a land trust is the ease of conveyance in terms of both succession of ownership and disposing of part interests. Upon the death of the original beneficiary, property held in a land trust passes to the contingent beneficiaries indicated in the trust agreement on file with the trustee. This means that probating the property is not necessary. The interest passes immediately enabling the new beneficiary to enjoy the property instead of having to wait a substantial amount of time for probate to close.[11] Likewise, should the original beneficiary choose to change the person or

[11] Michael Brennan, "Illinois Land Trust Explained," The Virtual Attorney, Dec. 18, 2017, www.thevirtualattorney.com/blog/illinois-land-trusts-explained.

persons to receive the share upon passing, he or she need only amend the contingent beneficiary form. And, since interests in real estate held in a land trust are deemed to be personal property interests, they may be assigned to other individuals, in whole or in part without the need for a new deed. The original beneficiary simply modifies the trust agreement.[12]

B. State Laws

Although the concept of a land trust dates back many centuries in common law and was at its height during the period of European feudalism. However, King Henry of England felt he was suffering revenue shortages among other grievances and introduced several bills to the House of Commons in the early 1500s. In 1535 the English Parliament finally passed the Statute of Uses.[13] This statute was interpreted over the subsequent years by the courts to mean that if a trustee didn't do anything but hold title to land, legal title vested in the beneficiary.

However, in 1921 the Supreme Court of Illinois upheld the concept of the land trust in Jennings v. Kotz.[14] Thus was born the Illinois Land trust. Although not formally recognized in every state (Illinois, Florida and Hawaii are a few that have statutes on the books regarding land trusts), many other states are using such trust arrangement arrangements. Colorado and California are two such states.

C. Issues with serving as Land Trust Trustee

While the land trust trustee role sounds fairly straightforward and risk free, there are several issues that can arise during administration which should be considered before entering this line of business.

i. Legal fee examples

A. Case #1

B. Case #2

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[12] Ibid.
[13] David T. Smith, "The Statute of Uses: A Look at Its Historical Evolution and Demise," Case Western Reserve Law Review, Volume 18, Issue 1, 1966, scholarlycommons.law.case.edu/cgi/viewcontent.cgi?article=4446&context=caselrev.
[14] *Jennings v. Kotz* 132 N.E. 625 ILL Oct. 22, 1921.

ii. Trustee Fees

Typically land trusts charge a higher fee in year one (acceptance and first year fee) with a nominal annual fee in subsequent years. (the fees for commercial property are usually higher than for residential property which is typically defined as a primary residence or second/vacation home occupied by the beneficiary.)

In additional to the annual fees, additional charges are typically charged for executing a deed, accepting in additional parcels, adding or changing beneficiaries, or closing the account.

Although the initial fee is generally received with the opening documents, the ongoing annual fees are invoiced as land trusts don't hold cash, just title to the property. While many clients pay their fees, it is usual to have a sizable account receivable which must be accounted for. This also then requires the company to have a system in place to attempt to collect the fees and ultimately invoke a collection agency process at times. This is time consuming and often fruitless, therefore fee write-offs are a regular occurance.

iii. Incapacitation

iv. Refinancing the Property

v. Trustee Resignation

4. QUALIFIED SETTLEMENT FUND TRUSTS

A. The Basics

The qualified settlement fund (QSF) is a common vehicle used by plaintiff and defense attorneys when settling cases. QSFs were created by the Tax Reform act of 1986 to answer questions surrounding the income tax treatment of settlement funds and answer questions related to when a tax deduction for payments made to the fund could be taken by the defendants.[15]

A QSF is a fund, account, or trust that satisfies each of the following:

i. It is established pursuant to an order of, or is approved by, the United States, any state (including the district of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority;

ii. It is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability –

    a. Under the Comprehensive Environmental Response, Compensation and Liability Act of 19880 (CERCLA), as amended or

    b. Arising out of a tort, breach, or contract, or violation of law; or

    c. Designated by the Commissioner in a revenue ruling or revenue procedure and

iii. The fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor and related persons.[16]

iv. After a QSF has been established, the trustee or fund administrator must apply for a TIN, potentially make certain tax elections for the defendants to receive a timely deduction and ensure all tax reporting requirements are met.[17]

B. Issues with serving as QSF Trust or Fund Administrator

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[15] Edward Radetich, "Pitfalls of the Improper election of Qualified Settlement Funds," Heffler Claims Group, July 27, 2018, https://www.hefflerclaims.com/tax-posts/pitfalls-of-the-improper-election-of-qualified-settlement-funds.

[16] 26 CFR § 1.468B-1.

[17] Edward Radetich, "Pitfalls of the Improper election of Qualified Settlement Funds," Heffler Claims Group, July 27, 2018, https://www.hefflerclaims.com/tax-posts/pitfalls-of-the-improper-election-of-qualified-settlement-funds.

i. The tax penalties for not filing correctly or timely can be substantial. Not all states have the same tax treatment of QSFs so it is very important to have a relationship with a tax firm that understands these unique tax issues.

ii. The trustee or fund administrator must make sure that in the case of a personal injury class action claim, all the required paybacks are fulfilled for any Medicare, Medicaid or other liens.

iii. Some QSFs contain a clawback provision within the agreement whereby the defendant in a case can pull back funds within the QSF based upon certain criteria or events. It is incumbent on the trustee to ensure the specific terms of the document are known and followed.

iv. QSFs may be funded with a structured settlement. This can cause the QSF to remain in effect for a long period of time. The trustee must keep in touch with the beneficiary to ensure funds are being distributed to the correct location. Often, there are foreign beneficiaries (particularly in the event of a plane crash) and the trustee must deal with sending out annuity payments to beneficiaries all over the world. Minor beneficiaries can cause even further complications as the trustee must deal with the guardian representing a minor in a foreign land.

5. LIFE INSURANCE TRUSTS (ILITS)

A. The Basics

i. Review of Policy and Insurance Company (Pre-Acceptance and Annual)

Unless the trust is directed or state statute says otherwise, regular Reg 9 Reviews apply but are often overlooked. The following should be included in such a review:

a. Funding adequacy
b. Review of existing loans
c. Carrier strength/rating
d. Life Expectancies
e. Survival Probabilities
f. Asset Allocation (variable policies)
g. Track policy changes

ii. Sending Annual Gifting Notices

iii. Send and Trust Crummy Notices

iv. Payment of Insurance Premium monitoring and tracking

v. Track 5x5 and hanging powers

Using an outside company to help oversee the process and provide administrative and regulatory review support can be a very good way to ensure that all aspects of the ILIT administration are covered.

B. What happens when the grantor no longer funds the policy?

There are many reasons why grantors decide they no longer want to fund the life insurance within their trust. Sometimes the grantor's financial circumstances change, and the premiums are no longer affordable. At other times, family situations may change, and the intended beneficiaries may no longer need or be alive to receive the funds. And sometimes, as in recent years, the tax laws change and those creating the trust may no longer need to plan for estate tax liability following death. In those cases, what should the trustee do?

i. Analyze the circumstances of the grantor and beneficiaries. The trustee should review in totality the financial, tax, insurability and any other relevant facts.[18]

ii. Review the Insurance Policy to determine the various payment options available including reduced premiums; using built up cash value to cover the premium; doing a conversion or exchange for revised coverage or premiums; or surrendering of the policy completely.[19]

iii. Analyze the provisions within the trust to determine what options are available for distributions or even premature termination of the trust. If provisions are presently in the document, consideration can be given to reforming the document under a nonjudicial settlement agreement with virtual representation or even court modification.[20]

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[18] Kevin Rack, "ILITs, Insureds and the Extreme Estate Tax Exemption: A Solutions Methodology," Virginia State Bar, Trusts and Estates Section Newsletter, Vol. 22, No. 9, Fall 2013, https://www.vsb.org/docs/sections/trustsandestates/fall2013.pdf.
[19] Ibid
[20] Ibid

No matter what the decision, the trustee needs to ensure that the file is properly documented to show that the grantor no longer intends to fund the policy by making additional payments and that the considerations in i – iii above were fully considered.

6. RABBI TRUSTS

A. The Basics

i. A rabbi trust is a grantor trust established by a company or organization to fund a nonqualified deferred compensation plan, generally for a highly compensated employee or employees. It allows for the assets to be secured at present but not paid out until a later date. Because of its grantor trust status, the taxability flows to the company rather than the tax payer. Although a grantor trust, the agreement is irrevocable and unamendable and therefore secures the assets for the beneficiary or beneficiaries should the employer be sold or management change. As a grantor trust, however, the trust assets are still subject to the claims of the employer's creditors.

ii. The term "Rabbi Trust" dates back to a Private Letter Ruling (PLR) issued by the IRS in 1980. The IRS was replying to a letter submitted by a congregation requesting a ruling on the federal income tax liability to a rabbi upon the funding of a trust by the congregation for the rabbi's benefit. The trust was structured so that the trustee was to invest and manage the trust estate, pay net income generated in the trust to the rabbi at least quarter annually and upon the rabbi's death, disability, retirement , or termination of his services, receive the principal and income as directed in the trust agreement. The IRS concluded although the congregation could not alter, amend, revoke, change, or annual any provision that because the assets in the trust were subject to the claims of the congregation's creditors and were not paid or made available per the terms of Section 451 of the Code, the funding of the trust was not deemed as a taxable event in the year the funds were transferred to the trust. Rather payments of principal and income paid to the rabbi would be included in his tax liability only in the year they were received or made available.[21]

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[21] P.L.R. 8113107, 1980 WL 137740, misc.taxes.com/rFCTuJmv/plr-8113107-rabbi-trusts.

iii. In 1992, the IRS issues Revenue Procedure 92-64 created a model Rabbi Trust. In Section 2, the IRS stated that it receives and responds to many requests for rulings on the federal income tax consequences of trusts established in connection in unfunded deferred compensation arrangements. It noted that many of the requests utilized similar instruments and consequently, to aid the taxpayer and to expedite the process of ruling on each request, the procedure provides a model trust for plan sponsors to use.[22]

iv. Further IRS guidance was given in 2000 when IRS Notice 2000-56. The notice provided guidance on which entity is treated as a grantor and owner of the rabbi trust when a parent company contributes assets to a trust for the benefit of a subsidiary. The IRS concluded that the parent company will be treated as the grantor and owner of the assets in the trust if the assets are both subject to the claims of the creditors of the parent corporation and subject to the requirement that any such assets not transferred to the subsidiary employees will revert to the parent on termination of the trust, even though such assets are also subject to the claims of the creditors of the subsidiary.[23]

B. What to watch out for when administering a rabbi trust.

i. Master Trust/Sub Accounting

ii. Insolvency of Employer

iii. Taxation

7. PRE-NEED FUNERAL AND CEMETERY TRUSTS

A. The Basics

The fundamental purpose of pre-need funeral and cemetery trusts is to protect consumers when arranging for funeral services, cemetery merchandise or perpetual care of their final resting place. Unlike most trust arrangements, these trusts involve three parties, the consumer, the funeral home and the trustee. Most states

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[22] Rabbi Trusts, I.R.S. Notice 2000-56, https://www.irs.gov/pub/irs-drop/n-00-56.pdf.
[23] Ibid.

have laws governing the investment of pre-need funeral and cemetery trusts as well as the amount required to be funded in the trusts and the distributions that can be made from them. Furthermore, most states also have requirements for annual reporting to both the consumer and the state.

B. Pre-Need Funeral Trusts

Generally, there are two different contracts that govern this relationship. There is a contract between the consumer and the funeral home outlining the arrangements to be provided by the funeral home at the consumer's death. Many states require that the funds collected by the funeral homes be deposited into a trust account. Therefore, in most cases, there is a master trust agreement between a trust company and the funeral home outlining when the funds will be released and to whom. If the contract runs until the consumer passes, the funds are distributed to the funeral home providing the services. If the consumer cancels the contact (or there are excess funds left after the services are provided), the funds pay out to the consumer (or the consumer's estate). In addition, statements must be provided to the funeral home and the consumer based on individual state law. In addition, the funeral home, in most states, will be required to provide an annual report to the state and the trustee will be required to attest to the information.[24]

C. Cemetery Trusts

There are two kinds of cemetery trusts:

i. Endowment or perpetual care trusts are trusts created to provide for the ongoing maintenance of grave sites, common areas, roads, etc., within the cemetery. Most states require that these trusts be maintained separately from other funds held by the cemetery and are often required to be managed by an institution.[25]

ii. Service or Merchandise trusts are trusts created to hold the funds that consumers pay a funeral home or cemetery for headstones, burial vaults, etc. These trusts ae usually of nominal amount and held in the name of the purchaser.[26]

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[24] Office of Thrift Supervision, "Pre-Need Funeral and Cemetery Trusts," R.B. 38-02, O.T.S. Handbook, Trust and Asset Management, Sec. 150, Feb. 25, 2010.
[25] Ibid.
[26] Ibid.

D. Reporting, recordkeeping, and reputational risk are the primary downsides to administering these types of trust relationships. Care should be taken to fully understand the nuances of the state regulations governing the relationship as well as the reputation of the funeral home or cemetery.