2 Role of the Trustee

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The contributions of John J. Casey and William H. Pokorny, Jr., to previous editions of this chapter are gratefully acknowledged.

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I. [2.1] SCOPE OF CHAPTER

This chapter is addressed to management and administrative questions that commonly confront the trustee and trustee's attorney. It covers the basic duties and powers of the trustee and the sources to which the trustee should look to be assured of the propriety of an act. Compensation of the trustee and the trustee's agents is also considered. Finally, the chapter also discusses the related problems of cotrusteeship situations and the termination of trusteeships.

The dividing line between the duties and powers of a trustee is by no means always clear; some topics may require discussion in each part of this chapter, as well as in Chapters 6 and 9 of this handbook.

Special attention should be given to investment standards and practices permitted to the trustee under the prudent investor rule and the portfolio test that are part of the Trusts and Trustees Act, 760 ILCS 5/1, *et seq.* (see especially 760 ILCS 5/5, *et seq.*). In addition, the Principal and Income Act, 760 ILCS 15/1, *et seq.,* was extensively revised in 1992 and should be reviewed in characterizing any receipts by the trust. A development of particular importance in light of the extreme financial market volatility experienced several years ago was the enactment in 2002 of §5.3 of the Trusts and Trustees Act, 760 ILCS 5/5.3, which authorized the conversion of a trust to a total return trust, as discussed in §2.64 below. Other significant developments include the enactment of the directed trusts statute, §16.3 of the Trusts and Trustees Act, 760 ILCS 5/16.3, discussed in §2.61 below, and the decanting statute, §16.4 of the Trusts and Trustees Act, 760 ILCS 5/16.4, discussed in §2.65 – 2.69 below.

II. DUTIES OF THE TRUSTEE

A. [2.2] In General

It is the fundamental duty of the trustee to hold the trust assets, to administer them solely in the interests of the trust beneficiaries (guarding against the intrusion of interests of any third parties or even the trustee), and to carry out the terms of the trust. Once the trustee has accepted the position, the trustee becomes bound to administer the trust by its terms in accordance with the desires and intentions of the settlor, except (1) in the case of impossibility or illegality or (2) unless circumstances have so changed since the execution of the trust that adherence to its terms would go against the settlor's intentions. The trustee must continue to act as such and, except as the terms of the trust provide otherwise, can be relieved of the duties only with the consent of a court of competent jurisdiction or with the consent of all of the beneficiaries. The sphere of duties of a trustee must be known to that trustee, and the trustee cannot insulate himself or herself from liability by indicating to the beneficiaries that they must set out the trustee's duties. Except as noted in this chapter, the duties and responsibilities of the trustee are generally not specifically fixed by statute, and the trustee does not need the sanction of, and neither is the trustee insulated from liability because of the absence of, any statutes or court orders specifically delineating the trustee's duties. Of course, there is no duty to administer the trust until the trustee has received notice of the trust's creation and has accepted the designation as trustee. *Elkind v. Chase National Bank of City of New York,* 259 A.D. 661, 20 N.Y.S.2d 213, *aff'd,* 284 N.Y. 726 (1940).

One development in Illinois caselaw and local practice has resulted in the dilution of the representative capacity of the trustee, to some extent, in connection with estate administration so that, at least in Cook County, a mere trustee's receipt or acknowledgment is no longer sufficient for an executor delivering property to the trust. In *Norris v. Estate of Norris,* 143 Ill.App.3d 741, 493 N.E.2d 121, 97 Ill.Dec. 639 (1st Dist. 1986), the beneficiaries of a testamentary trust sought to reopen an estate, alleging that the trustee (who was also the executor) had failed to obtain a proper accounting of the estate and that the executor had failed to give them notice of estate accounts. The trial court dismissed the action, holding that under §1-2.11 of the Probate Act of 1975, 755 ILCS 5/1-1, *et seq.* (defining "interested person"), only the trustee of the trust was entitled to notice. The appellate court reversed and, without any reference to §1-2.11, held that, although the trustee was the nominal distributee, the beneficiaries were the actual parties in interest and, since the trust was to pay income to the beneficiaries for their care and maintenance, that income interest constituted a "share of the estate" entitling them to notice as "interested parties." 493 N.E.2d at 126.

The Probate Act was subsequently amended in 1988 to emphasize that *Norris* is not valid law. Section 1-2.11 of the Act was changed to define an "interested person" entitled to notice or accounting, "including without limitation [notice under] Sections 24-2 and 28-11 of this Act," as the trustee and not the trust beneficiaries. 755 ILCS 5/1-2.11. Moreover, §24-2 of the Act, 755 ILCS 5/24-2, was amended to provide that in supervised administration no notice of any accounting is required to be given to a trust beneficiary when the trustee is an interested person. Finally, §28-11 of the Act was amended to provide that notice of the filing of the final report by an independent representative need not be given "[w]henever a trustee of a trust is an interested person, [to] beneficiaries of the trust by reason of the beneficiaries' interest in the trust." 755 ILCS 5/28-11(c)(3).

Nevertheless, in Cook County, when the executor and the trustee are the same person, notice is still required to be given to the income and remainder beneficiaries of the trust, and the estate may not be closed without receipts from the trust beneficiaries. Cook County Circuit Court Rule 12.13(c)(iii). A trustee should beware of accepting trust assets without notice to the beneficiaries, as the transfer may be subject to later attack.

In *Schlosser v. Schlosser,* 218 Ill.App.3d 943, 578 N.E.2d 1203, 161 Ill.Dec. 557 (1st Dist. 1991) (*Schlosser I*), when the attorney for the trustee failed to defend the trust against a suit alleging a lack of mental capacity and undue influence on the settlor and the time for vacating a default judgment had passed, the court found that the trust beneficiaries (who were not named in the suit) did not receive actual effective representation from the attorney for the trustee. The court found that the beneficiaries were necessary parties to the suit and vacated the default. The determination of when the trust beneficiaries are necessary parties is, apparently, to be made on a case-by-case basis. On subsequent remand and appeal, the appellate court held that (1) an interest in a discretionary support provision of a *previous trust* was not sufficient to confer standing and (2) contingent remainder interests were not sufficient to confer standing as to a subsequent trust. *Schlosser v. Schlosser,* 247 Ill.App.3d 1044, 618 N.E.2d 360, 187 Ill.Dec. 769 (1st Dist.) (*Schlosser II*), *appeal denied,* 152 Ill.2d 580 (1993). *See also In re Estate of Vogt,* 249 Ill.App.3d 282, 618 N.E.2d 1141, 188 Ill.Dec. 571 (1st Dist. 1993); Rebecca S. Larson, *Who Is a Necessary Party to a Declaratory Judgment Action? An Appeal for Direction,* 85 Ill.B.J. 536 (1997).

Schlosser II was distinguished by *In re Estate of Michalak,* 404 Ill.App.3d 75, 934 N.E.2d 697, 707, 343 Ill.Dec. 373 (1st Dist. 2010), in which the court held that beneficiaries with an "equitable remainder interest, which vested immediately upon the creation of the trust . . . have standing to appeal the circuit court's order."

Similarly, in *In re Estate of Ostern,* 2014 IL App (2d) 131236, 23 N.E.3d 391, 387 Ill.Dec. 699, the guardians of a disabled ward's person and estate filed a motion to create a trust for the ward but did not notify beneficiaries under the ward's preexisting will and trust. The ward's existing will and trust provided that, upon the ward's death, the estate would be distributed in equal shares among the two guardians (who were daughters of the ward), the ward's third daughter, and the daughter of the ward's deceased spouse from a prior marriage. The preexisting will and trust provided that if a daughter predeceased the ward, her share would be distributed equally to the daughter's then living issue per stirpes. The guardians sought to create a trust that eliminated the interest of the third daughter because she had been found guilty of financial exploitation of the ward and was therefore treated as having predeceased the ward pursuant to state statute. The new trust provided for the distribution of the ward's estate in equal shares among the two guardians. The trial court granted the motion to create the trust, but the children of the third daughter filed a motion to vacate the order and to dissolve the new trust. The children of the third daughter argued that they had not been given notice of the motion to create the new trust and that they were necessary parties because they were beneficiaries of the ward's preexisting will and trust as living issue of the ward's third daughter. The trial court denied the petition of the children of the third daughter, but the appellate court reversed, finding that the children of the third daughter were entitled to notice and that notice to their mother was insufficient.

1. [2.3] Terms of Trust

Ordinarily, the duties of the trustee can be determined by examining the terms of the trust instrument itself. The instrument should disclose both the affirmative duties of the trustee and any restrictions on the trustee's powers. Courts of equity will, of course, (a) prohibit the trustee from carrying out express duties or (b) set aside prohibitions that either are contrary to public policy or are illegal. To the extent that duties are imposed on a trustee that require or authorize the trustee to go beyond or against general equitable principles, those duties must be set forth in language that is correspondingly clear and appropriate. When the trustee feels that specific duties set out in the instrument may be illegal or contrary to public policy, the trustee likely will have a duty to seek instructions from the court.

When the terms of the trust are not contrary to public policy or illegal, the trustee is required to act in accordance with the terms of the trust. In *Dillard v. Dillard,* 2016 IL App (5th) 140441-U, the grantor created a trust instrument that provided that all real estate owned by the trust would continue to be held in trust for a term of ten years following the death of the grantor unless the grantor's two sons, Jimmy and Gary, agreed or directed otherwise. Jimmy and Gary were entitled to the income from the real estate during the ten-year term following the grantor's death. In addition, the trustee was given the power to sell convey, release, mortgage, encumber, lease, partition, improve, manage, protect, and subdivide any real estate and to partition or to exchange the real estate or any part thereof for any real or personal property. Upon the grantor's death, Gary became trustee of the original trust and trustee of a separate trust created thereunder for Jimmy. Five and one-half years later, Gary's son was serving as trustee of both trusts and transferred real estate from the original trust to new trusts created for Gary and his wife (*i.e.,* the trustee's parents). The trustee then made an equalization payment to the trust for Jimmy in an amount equal to the appraised value of his interest in the real estate. Jimmy filed a motion for summary judgment arguing that the trustee breached his fiduciary duty by implementing the land swap because the land swap violated the express terms of the grantor's trust. The trial court denied the motion, but the appellate court reversed, finding that the terms of the trust clearly indicated the grantor's intent that the real estate be retained in the trust for ten years following the grantor's death and that the trustee's powers to deal with real estate did not modify the express language contained in the trust regarding the retention of real estate and that there had been no change in circumstances necessitating the land swap.

A trustee may sometimes have a duty to contest the trust, the express terms of the trust, or a portion of the trust. For example, one court found that when settlors had created a joint and mutual trust, a purported amendment of the trust after the death of one of the settlors was void because the trust instrument was silent on the right of one settlor to amend the trust; that silence implied that any amendment must be made jointly. *Williams v. Springfield Marine Bank,* 131 Ill.App.3d 417, 475 N.E.2d 1122, 86 Ill.Dec. 743 (4th Dist. 1985). *But see Northern Trust Co. v. Tarre,* 86 Ill.2d 441, 427 N.E.2d 1217, 56 Ill.Dec. 671 (1981), in which (a) nothing in the trust agreement limited the exercise of that power, (b) nothing indicated that the power could be exercised only during the time that both settlors were living, and (c) the trust agreement did not require the consent of one settlor to an exercise of power by the other.

In analyzing the terms of the trust instrument, one "is limited to establishing not what the settlor meant to say, but what was meant by what he did say." *Northern Illinois Medical Center v. Home State Bank of Crystal Lake,* 136 Ill.App.3d 129, 482 N.E.2d 1085, 1098, 90 Ill.Dec. 802 (2d Dist. 1985). In *Northern Illinois Medical Center,* the settlor had established a testamentary trust for building and operating a "hospital in or near the city of Crystal Lake." 482 N.E.2d at 1089. The court rejected the competing claims of an existing hospital (because the settlor meant to benefit a new hospital), an outpatient clinic (because it was not a hospital), and a new nearby hospital (because it was not in or principally identified with Crystal Lake). *See also Durdle v. Durdle,* 223 Ill.App.3d 964, 585 N.E.2d 1171, 166 Ill.Dec. 149 (4th Dist. 1992); *Barry v. Carr,* 277 Ill.App.3d 232, 660 N.E.2d 29, 213 Ill.Dec. 772 (1st Dist. 1995).

In *Gwinn v. Gwinn,* 2016 IL App (2d) 150851, 60 N.E.3d 890, 406 Ill. Dec. 339, in an appeal of a motion to dismiss, the court found that the judgment to dismiss should be reversed and the case remanded for further proceedings when trust beneficiaries asserted that the trustee violated the trust agreement and breached a fiduciary duty by making an improper gift of trust assets to his wife. In *Gwinn,* the trust agreement created by the settlor provided for the creation of the family trust upon her death for the primary benefit of her husband during his lifetime and for the remainder to be distributed to their children. Specifically, the terms of the family trust provided that the settlor's husband was entitled to "any part or all of the net income" from the trust and "such sums from principal as the trustee deems necessary or advisable from time to time for his health, support and maintenance in reasonable comfort." 2016 IL App (2d) 150851 at ¶6. The trustee was also authorized to "pay so much or all of the trust's income and principal not distributed [to the settlor's husband to their] children, as the trustee determines to be required or desirable for their health, maintenance in reasonable comfort, education and best interests individually and as a family group." *Id.* In addition, the trustee was authorized to make gifts from the trust to the settlor's descendants. The settlor's husband was appointed as trustee of the family trust. Following the settlor's death, the husband remarried. As trustee, the husband made distributions from the trust to himself of at least $425,000 for the construction of a custom-built house in Colorado that he titled in the name of his new wife alone (and the husband already had a residence for himself in Illinois). The court analyzed the trust agreement and determined that the settlor intended to provide for her children in addition to her husband and that the purposes of the trust did not include buying a house for the husband's new wife. Specifically, the court concluded that the language contained in the trust agreement did not give the trustee the discretion to do whatever he wanted with trust property but limited the trustee in making distributions that were "necessary or *advisable*" for his "health, support and maintenance." [Emphasis in original.] 2016 IL App (2d) 150851 at ¶19. Moreover, given that the trust agreement specifically provided that the trustee could make gifts from the trust for the settlor's descendants, the court interpreted the trust agreement as impliedly denying the trustee the power to make gifts to anyone else. As a result, the court reversed the trial court's dismissal of the children's complaints and remanded the case for further proceedings.

Further, when the trustee believes that subsequent events have changed the interpretation of the trust from that intended by the settlor, the trustee actually may have a duty to seek court amendment of the trust to prevent the implementation of the original terms. In *Department of Mental Health & Developmental Disabilities v. Phillips,* 133 Ill.App.3d 337, 478 N.E.2d 1052, 88 Ill.Dec. 444 (1st Dist. 1985), *aff'd in part, rev'd in part,* 114 Ill.2d 85 (1986), the court permitted an amendment of a trust to prohibit invasion of the trust to reimburse the state for the costs of the support of an institutionalized beneficiary. The state's request amounted to a confiscation of the trust corpus that was held for the beneficiary on a non-ascertainable standard of "education . . . maintenance, medical care, support, general welfare and comfortable living." 478 N.E.2d at 1054. At the beneficiary's death, the trust corpus was to be distributed to the descendants of the beneficiary's father. The trustee's motion to reform the trust was denied at the trial court level, but the appellate court found that, in extreme cases, a trust may be modified to carry out the intentions of the settlor if unforeseen events occur that would otherwise frustrate the settlor's intentions. The court found that the intent of the trust was not to reimburse the state, which would have exhausted the trust corpus, but to provide care for the beneficiary that the state was unable to provide. The trust was reformed to clarify that the fund was to be used at the trustee's discretion for the trust purposes stated but only to provide services that the state could not or would not provide. The Illinois Supreme Court found reformation unnecessary, determining from other evidence that the intent of the settlor was to provide for the trust beneficiary beyond what the state was able to provide for the beneficiary. The result of *Phillips* would indicate that a trustee, in not seeking such reformation even when the trust provisions are not ambiguous, would be at his or her own peril in failing to act since a trust beneficiary might claim that the inaction was tantamount to a failure to protect the beneficiary's interests. *But see In re Estate of McInerny,* 289 Ill.App.3d 589, 682 N.E.2d 284, 224 Ill.Dec. 723 (1st Dist. 1997).

Phillips, supra, does not insulate spendthrift trusts from attack by the state. In *Button v. Elmhurst National Bank,* 169 Ill.App.3d 28, 522 N.E.2d 1368, 119 Ill.Dec. 509 (2d Dist.), *appeal denied,* 122 Ill.2d 570 (1988), the state was allowed to invade a trust to provide for the care of an incompetent beneficiary even though the trustee had absolute discretion to disburse money either to the incompetent or to another trust beneficiary. The court in *Button* stated that the settlor's intent must be determined from the trust instrument, but if an ambiguity exists, the court may consider surrounding circumstances at the time of execution. The court found that the trust was designed as a spendthrift trust primarily for the benefit of the disabled child and directed that the trust reimburse the state for the expenses of the care of the incompetent. The court also directed the trustee to continue to administer the trust for the benefit of both beneficiaries. The trustee was permitted to expend up to $1,000 per month for the benefit of the competent beneficiary without court order and directed to seek leave of the court for amounts over $1,000 per month.

Note that the spendthrift trust problem exemplified in *Phillips, supra,* and *Button* has been addressed by statute in Illinois. 760 ILCS 5/15.1 provides that a discretionary trust for a beneficiary with a disability "shall not be liable to pay or reimburse the State or any public agency for financial aid or services to the individual except to the extent the trust was created by the individual or trust property has been distributed directly to or is otherwise under the control of the individual." When the trust is not discretionary, there still may be an attempt by the state to attach the trust assets.

Supplemental-needs trusts continue to be attacked by public agencies on the basis that the trust actually was created by the individual who has a disability or is needy and so is not supplemental. *See, e.g., In re Estate of Hickey,* 263 Ill.App.3d 658, 635 N.E.2d 853, 200 Ill.Dec. 514 (1st Dist.), *appeal denied,* 157 Ill.2d 502 (1994). *But see In re Estate of Calhoun,* 291 Ill.App.3d 839, 684 N.E.2d 842, 225 Ill.Dec. 851 (1st Dist. 1997).

Just as a trustee has a duty to enforce the terms of the trust, a trustee also has a duty to ensure that powers of appointment are not improperly exercised. *BMO Harris Bank N.A. v. Towers,* 2015 IL App (1st) 133351, 43 N.E.3d 1131, 398 Ill. Dec. 221. This case involved a son's attempted exercise of limited testamentary powers of appointment granted to him under two trusts established by his mother and father, respectively. These trusts provided that if the son failed to effectively exercise his limited testamentary powers of appointment, the remaining property of each trust would be distributed per stirpes to the son's surviving children. In his revocable trust, the son sought to disinherit two of his children. In furtherance of this plan, by his will, the son attempted to exercise his limited testamentary powers of appointment over both trusts in favor of his revocable trust. The trustee sought instructions from the court regarding the validity of the son's action. The son argued that his exercise was permissible since he was allowed to exclude from benefit one or more of his descendants pursuant to the language of the powers of appointment. The court disagreed, noting that "the plain language controlling the powers of appointment for both [parents'] trusts establishes that [the son] could not exercise the powers of appointment in favor of himself because he was not within the class of permissible beneficiaries designated by his parents." 2015 IL App (1st) 133351 at ¶29. The court also found that the revocable trust provided for payment of all debts from the property of the revocable trust, and that the revocable trust contained no language for segregation of the appointed assets from the other assets of his revocable trust. Thus, the son had impermissibly blended his own property with the appointed property, and his creditors could have used the commingled assets to satisfy the son's debts. The court found the son's purported exercise void and affirmed the trial court's instruction to the trustee to distribute the appointed property to the son's four surviving children as directed by the terms of his parents' trusts.

2. [2.4] Implied Duties

The trustee acting under an express trust or implied trust has additional duties that are based on equitable principles. With respect to resulting or constructive trusts, the trustee generally has a duty only to preserve the trust property and to surrender it to the appropriate person or persons when required or requested to do so. There are no specific duties and no purposes to carry out other than preserving the property. In an express trust, in addition to the duty to protect and preserve the trust estate, the trustee has the duty of representing the interests of beneficiaries under a standard of reasonable care, common skills, and prudence.

B. [2.5] Specific Duties

The subject of the trustee's duties may be divided into two separate, broad periods of the existence of the trust: (1) during the actual administration of the trust; and (2) during the termination and distribution of the trust. Duties during administration are discussed in §§2.7 – 2.20 below, and duties during termination and distribution are discussed in §§2.21 – 2.23 below. Duties of the attorney for the trust are discussed in §2.24 below.

1. [2.6] Duties During Administration

During the actual administration of the trust, the duties set out in §§2.7 – 2.20 below must be discharged by the trustee.

a. [2.7] Duty of Loyalty

The paramount duty of the trustee is the duty of loyalty to the trust's beneficiaries that arises, as do the other implied duties, out of the relationship resulting from the creation of the trust. The trustee must administer the trust solely in the interests of the beneficiaries and may not place himself or herself in a position so that the performance of any of the duties can be affected by the trustee's personal interests. The trustee may not sell property to himself or herself as an individual, or generally even in a different fiduciary capacity, regardless of whether the price involved is fair or whether the trust would make a profit from the sale. See §2.46 below. The trustee may not acquire any interest in trust property even when that person as trustee does not directly make the sale, as, for example, when trust assets are sold at a public sale. *Thorp v. McCullum,* 6 Ill. (1 Gilm.) 614 (1844). However, when (1) all beneficiaries are in being, (2) none is under legal disability, and (3) all consent, the sale cannot be set aside if the trustee makes a full disclosure of all relevant facts to the beneficiaries, the trustee does not induce the sale by taking advantage of the fiduciary relationship, and in all other respects the sale is fair and reasonable.

Even a gift of trust property to the trustee by the beneficiaries may be set aside if the gift was induced by undue influence or improper conduct of the trustee. In all such cases, the trustee has the burden of proof in showing that he or she did not engage in improper conduct or take advantage of the relationship with the beneficiaries.

The trustee may breach the duty of loyalty to the beneficiaries by selling trust property to a corporation, partnership, or other entity in which the trustee has a substantial interest. Trust provisions specifically permitting such actions do not preclude scrutiny of the terms of the transaction. Critical factors in this type of sale are whether the personal interest of the trustee is such that it might affect the trustee's judgment in making the sale and whether there has been full disclosure of the personal interest to trust beneficiaries whose interests can be affected by the transaction. *Wallace v. Malooly,* 4 Ill.2d 86, 122 N.E.2d 275 (1954). For an example of a court's finding fraud in connection with the breach of the duty of loyalty, *see Obermaier v. Obermaier,* 128 Ill.App.3d 602, 470 N.E.2d 1047, 83 Ill.Dec. 627 (1st Dist. 1984), in which a trustee was surcharged for actions inducing a sale of corporate shares held by the trust back to a corporation that the trustee controlled and for which the trustee had negotiated a sales price for personal shares higher than the price afforded to the trust. *See also Smith v. First National Bank of Danville,* 254 Ill.App.3d 251, 624 N.E.2d 899, 191 Ill.Dec. 711 (4th Dist. 1993).

A sale of trust property to a third party with the understanding that reconveyance is to be made to the trustee in an individual capacity also constitutes a breach of the trustee's duty of loyalty. In the absence of any agreement, the repurchase by the trustee from the third party is not a breach. However, the fact that the trustee subsequently acquired the property for himself or herself greatly strengthens the inference that the trustee may have been engaged in self-dealing.

A sale of the trustee's own property to the trust also can be considered a breach of the duty of loyalty regardless of the fact that the trustee may be acting in good faith and that a fair price has been paid. So, also, a sale of property to the trust from an entity in which the trustee individually has a substantial interest can be considered a breach; again, the standard is whether the interest of the trustee is sufficient to affect the trustee's judgment in entering into the transaction. *Schmitt v. Wright,* 317 Ill.App. 384, 46 N.E.2d 184 (1st Dist. 1943). The trustee may not purchase for himself or herself any portion of any interest that is held in the trust, such as a leasehold in real estate held in the trust or shares of a corporation controlled by the trust. However, the trustee does not have a duty to dispose of corporate stock held individually before the trust was created merely because stock of the same corporation is included in the trust corpus.

The trustee also violates the duty of loyalty by purchasing for his or her own account property that should have been purchased for the trust. *Bakalis v. Bressler,* 1 Ill.2d 72, 115 N.E.2d 323 (1953); *Hand v. Allen,* 294 Ill. 35, 128 N.E. 305 (1920); *Cushman v. Bonfield,* 139 Ill. 219, 28 N.E. 937 (1891). *But see Gifford v. Gallano Farms, LLC,* No. 2-10-0055, 2011 WL 10109462 (2d Dist. May 18, 2011).

The court may impose a duty of loyalty when the benefit to the trustee is indirect but clear. In *Smith, supra,* the court distinguished the line of cases in which the courts have found that transactions between the trustee and the beneficiary that are unrelated to the trust are not part of the fiduciary relationship.

In *Smith,* the court found that the defendant bank had been involved with the plaintiff's family for several generations, had managed real property for her, was the trustee of her own revocable living trust, made periodic loans to her, and had prepared her income tax returns for several years. In 1983, the bank initiated foreclosure proceedings against other bank customers who owned a tavern. The bank solicited offers to buy the tavern for $65,000 to $85,000. The plaintiff visited the bank about this time to arrange for a car loan, and the loan officer suggested that she might be interested in a business opportunity to become the owner of the tavern. After conferring with her bankers, the plaintiff decided to buy the tavern for $190,000. The bank did not advise her of the lower appraisals or lower offers for the tavern. By reason of the plaintiff's purchase, most of the other customers' indebtedness to the bank was paid. The bank lent the plaintiff the entire purchase price of the tavern, taking as security a mortgage on the property and a security interest in the plaintiff's living trust; thereafter, the bank also loaned the plaintiff another $250,000 for renovations. The plaintiff was unable to make a go of the tavern and eventually sold it at a loss. The plaintiff sued the bank, alleging that it had breached its fiduciary duty to her by persuading her to buy the tavern. The bank in turn sued for the balance of the loan and accrued interest. Although the tavern was not owned in any trust, the court decided that the bank had a fiduciary duty to the plaintiff to disclose the relevant facts to her with respect to a transaction proposed by the bank in which the bank (1) was made whole on a prior bad loan, (2) became a creditor of the plaintiff, and (3) gained a security interest in the plaintiff's trust.

A trustee also can violate the duty to the beneficiaries by using trust property for his or her own purposes. Thus, the trustee may not make loans to himself or herself, use trust money in his or her individual business, or lease trust property to himself or herself. *In re Last Will & Testament of Gleeson,* 5 Ill.App.2d 61, 124 N.E.2d 624 (3d Dist. 1955); *Campbell v. Albers,* 313 Ill.App. 152, 39 N.E.2d 672 (2d Dist. 1942). *See also In re Estate of Hawley,* 183 Ill.App.3d 107, 538 N.E.2d 1220, 131 Ill.Dec. 664 (5th Dist. 1989); *In re Estate of Allison,* 140 Ill.App.3d 183, 488 N.E.2d 1035, 94 Ill.Dec. 788 (3d Dist. 1986). *But see Bracken v. Block,* 204 Ill.App.3d 23, 561 N.E.2d 1273, 149 Ill.Dec. 577 (3d Dist. 1990).

The trustee may not, without violating the duty of loyalty, accept a bonus, commission, or other compensation from any outside party for performing any acts or duties as trustee. This is so even if the acts or duties for which the bonus, commission, or compensation was given were in the best interests of the beneficiaries, were performed pursuant to express provisions in the trust, and were otherwise fair and reasonable with respect to the beneficiaries. Any compensation taken by the trustee under these circumstances must be held for the benefit of the beneficiaries. *White v. Sherman,* 168 Ill. 589, 48 N.E. 128 (1897). *But see Northern Trust Co. v. Thompson,* 336 Ill. 137, 168 N.E. 116 (1929), in which a trustee was allowed to retain a fee paid by a lessee of trust property reimbursing the trustee for its costs in altering lease provisions.

In *Greene v. First National Bank of Chicago,* 162 Ill.App.3d 914, 516 N.E.2d 311, 114 Ill.Dec. 156 (1st Dist. 1987), *appeal denied,* 119 Ill.2d 556 (1988), the court found that, before the death of the donee of a testamentary power of appointment, a trustee has no fiduciary duty to disclose terms of a will or trust to a potential beneficiary. The plaintiff was also the beneficiary of a different trust account created by her deceased father and maintained by the same corporate trustee. She alleged that because of that relationship, the trustee owed her a duty of disclosure of the terms of her mother's trust. The court refused to "impose an intolerable burden on a trustee to make disclosures to a beneficiary of one trust account about transactions in another account." 516 N.E.2d at 314 – 315. As the bank trustee owed the plaintiff no duty, it could not have breached any duty in the administration of the trust.

Note that the Illinois Power of Attorney Act, 755 ILCS 45/1-1, *et seq.,* provides that an agent under the Act is charged with the duty of preserving the principal's estate plan. 755 ILCS 45/2-9. To this end, the "agent shall have access to and the right to copy (but not to hold) the principal's will, trusts and other personal papers and records," and a trustee is obligated accordingly to furnish such documents pursuant to a valid request from such an agent. *Id.*

The trustee may not compete with any of the interests of the beneficiaries, as, for example, when the management of an insurance agency is taken over by the trustee and the trustee individually has an interest in a competing agency. The trustee will not necessarily be required to divest the interest in any business that engages in the same or a similar type of activity. However, the trustee may be enjoined from either commencing an activity in or expanding his or her own business interests into an area that would lead to competition with the business of the trust. *Sauvage v. Gallaway,* 329 Ill.App. 38, 66 N.E.2d 740 (4th Dist. 1946). Therefore, a trustee also is forbidden to take any action that would benefit a third party at the possible expense of a trust beneficiary, especially when a preexisting relationship exists between the trustee and the third party. *City of Chicago v. Tribune Co.,* 248 Ill. 242, 93 N.E. 757 (1910); *Holyoke v. Continental Illinois Nat. Bank & Trust Co.,* 346 Ill.App. 284, 104 N.E.2d 838 (1st Dist. 1952). *See also Rennacker v. Rennacker,* 156 Ill.App.3d 712, 509 N.E.2d 798, 109 Ill.Dec. 137 (3d Dist. 1987); *In re Estate of Muppavarapu,* 359 Ill.App.3d 925, 836 N.E.2d 74, 296 Ill.Dec. 659 (3d Dist. 2005).

The trustee of two separate trusts may sell assets from one trust to the other on terms that are reasonable and fair to all beneficiaries involved. However, if the interests of the beneficiaries of the separate trusts are conflicting, it may be impossible to effect a sale that is fair to all concerned. Then court approval of the transaction should be requested, even though the transaction would appear to be permissible on its face because of the terms of each of the trusts.

No information concerning the assets or activities of the trust should be disclosed to third parties by the trustee if the results of the disclosure would be detrimental to the beneficiaries. An exception to this duty is, of course, when disclosures are required by law, such as information concerning building code violations of trust real property or information required to determine a beneficiary's income tax liability. However, the trustee should be certain that the party requesting any trust information has, in fact, the authority to receive it. No such information generally should be volunteered unless the party requesting it has made clear that the request is pursuant to a grant of legal authority.

In *Mucci v. Stobbs,* 281 Ill.App.3d 22, 666 N.E.2d 50, 216 Ill.Dec. 882 (5th Dist.), *appeal denied,* 168 Ill.2d 598 (1996), the appellate court held that an attorney acting as a trustee breached the duty of loyalty (1) by refusing to accept the appointment by an income beneficiary of a bank as a successor trustee, (2) because a legal malpractice suit by a beneficiary of the trust against the attorney gave rise to a conflict of interest that justified removal of the attorney as trustee, and (3) because the attorney's drafting of trusts that named the attorney as successor trustee and also gave the attorney the power to remove other trustees also created a conflict of interest that justified removal of the attorney as trustee.

Exceptions to all of the above examples of the trustee's duty of loyalty may be created by express provisions in the trust instrument. No grant of authority to the trustee, however, can be made that can excuse the trustee from the basic duty of dealing in good faith with the beneficiaries, and neither can any grant of authority permitting the trustee to engage in self-dealing be so broad as to allow the trustee to take undue advantage of the relationship with the beneficiaries in dealing with trust property for his or her own account.

The effect of express provisions in a trust instrument authorizing self-dealing is illustrated in *Durdle v. Durdle,* 141 Ill.App.3d 12, 489 N.E.2d 1142, 95 Ill.Dec. 414 (4th Dist. 1986). In *Durdle,* the decedent's will left his residuary estate in trust, instructed the trustee to hire the trustee's "son to farm the trust land 'on the customary crop share basis,' " and accorded the trustee a number of powers to farm the land and continue the trust, including the power "[t]o deal with the fiduciary or any other estate or trust, even though the fiduciary is a trustee hereunder." 489 N.E.2d at 1143 – 1144. The trustee (1) continued to manage the land in the same manner it had been managed before the decedent's death; (2) purchased supplies from a cooperative of which the trustee was a director (and of which the decedent had been a member); (3) combined the farm (as he had done before the decedent's death), charging the trust for his work; and (4) borrowed money to continue the farming operations. When the trustee filed his first account showing no income paid to the beneficiaries, a beneficiary objected both to the trustee's payment of combining expenses and to his purchase of farm supplies from the cooperative and further requested removal of the trustee. The trial court approved the first account as filed, awarded the trustee fees for himself and his attorney, and refused to remove the trustee. The appellate court affirmed the basic decision of the trial court, noting that nothing in the record suggested that trust assets had been misspent by the trustee in purchasing the farm supplies. Although troubled by the combining charges (even though there was uncontradicted evidence that the charges were at a rate equal to only 50 percent of the normal charge for such work), the court nevertheless found that the language of the trust permitted this particular self-dealing. *See also Durdle v. Durdle,* 223 Ill.App.3d 964, 585 N.E.2d 1171, 166 Ill.Dec. 149 (4th Dist. 1992); *Laubner v. JP Morgan Chase Bank, N.A.,* 386 Ill.App.3d 457, 898 N.E.2d 744, 325 Ill.Dec. 697 (4th Dist. 2008).

In *Dick v. Peoples Mid-Illinois Corp.,* 242 Ill.App.3d 297, 609 N.E.2d 997, 182 Ill.Dec. 463 (4th Dist. 1993), the court discussed fiduciary conflict of interest to the effect that the settlor of a trust may waive the duty of undivided loyalty, by implication, in knowingly placing a trustee in a position that might conflict with the interests of certain beneficiaries. If the conflict is either created or approved by the settlor, the fiduciary is not to be held liable unless he or she acted dishonestly or in bad faith or abused his or her discretion. A successor trustee — while entitled to the rights, powers, and duties of the predecessor — does not take on liabilities incurred by the predecessor unless the successor trustee is itself guilty of a continuing breach of duty to the beneficiaries. *See also Giagnorio v. Emmett C. Torkelson Trust,* 292 Ill.App.3d 318, 686 N.E.2d 42, 226 Ill.Dec. 693 (2d Dist. 1997).

The profits earned by a fiduciary as the result of a self-interested transaction belong to the beneficiaries. In *Allison, supra,* the court ruled that profits earned by a longtime farm tenant who, because of the decedent's death, was also executor had to be accounted for and returned. The windfall profit enjoyed by the tenant farmer as a result of the payment in kind (PIK) program was not impliedly sanctioned by the decedent, who appointed him executor, when the will also contained a direction to sell the farm. It must be emphasized that the decision to participate in the PIK program was in the best interests of the estate and that, had another executor elected to participate in the program or had court approval or the agreement of the beneficiaries been sought, the tenant would have been entitled to the profit. *See Smith, supra.*

Limited self-dealing by a corporate fiduciary is permitted under the Trusts and Trustees Act. A 1988 amendment to the Act provided that the trustee has the power to enter into agreements for bank or deposit accounts and investments, "including agreements for such services provided by a bank operated by or affiliated with the trustee." 760 ILCS 5/4.06.

The remedies of the beneficiaries for a breach of the trustee's duty of loyalty in matters of self-dealing are varied and may differ slightly depending on the type of property involved in a particular transaction or on the beneficiaries' knowledge of or consent to the transaction. The most common remedies of the beneficiaries are to charge the trustee for (1) any loss or depreciation in value of the trust property resulting from the breach, (2) any profit received by the trustee in connection with the breach, or (3) profits that would have accrued to the trust had there been no breach. For a detailed treatment of various beneficiary remedies available for the breach of the duty of loyalty, see 2A Austin Wakeman Scott and William Franklin Fratcher, THE LAW OF TRUSTS §§170.2 – 170.25 (4th ed. 1987) (multivolume set, year varies by volume).

Even when a sales transaction entered into by a fiduciary appears to be highly favorable to the interests of the beneficiaries, the fiduciary does breach the duty of loyalty when

1. the party to whom the corporate fiduciary is making the sale is receiving its financing from the banking division of the fiduciary; and

2. the fiduciary used the same attorney as another party who joined in the sale when the other seller's activities in the transaction should have raised concerns on the part of the fiduciary regarding warranties and representations made by the fiduciary to the buyer.

See the discussion of *NC Illinois Trust Co. v. First Illini Bancorp, Inc.,* 323 Ill.App.3d 254, 752 N.E.2d 1167, 256 Ill.Dec. 925 (3d Dist.), *appeal denied,* 196 Ill.2d 546 (2001), in §2.9 below.

A trustee who performs service of a personal nature to a trust grantor is not entitled to have the trustees' fees increased to include the value of these personal services. Further, even though the trust instrument authorizes the trustee to apply trust assets for the grantor's welfare and comfort, and even authorizes the trustee to employ someone to attend to these needs, the trust instrument will not be interpreted as authorizing compensation to the trustee for these personal services to the grantor, even if the trustee attempts to hire himself or herself to provide the services. *Lampe v. Pawlarczyk,* 314 Ill.App.3d 455, 731 N.E.2d 867, 247 Ill.Dec. 94 (1st Dist. 2000). Although the trustee in *Lampe* was removed from office pursuant to a petition by the trust's beneficiaries, the trustee was entitled to recover compensation for services that were directly related to her duties as trustee. *See also In re Estate of Russell,* 372 Ill.App.3d 591, 866 N.E.2d 604, 310 Ill.Dec. 443 (2d Dist. 2007).

b. [2.8] Duty To Account

It is the trustee's duty to keep clear, current, and accurate records of dealings with the trust property, showing in detail the nature and the amount of the property and all transactions that have taken place. Any loss that results from the failure of the trustee to keep records is charged against the trustee. Further, any questions concerning the propriety of the trustee's actions that could have been resolved by reference to the accounts are resolved against the trustee to the extent that accounts are not available. *Lehman v. Rothbarth,* 159 Ill. 270, 42 N.E. 777 (1896). The trustee must render an accounting at least annually to trust beneficiaries then entitled to receive income or receiving income from the trust or, if none, to those beneficiaries eligible to receive income. 760 ILCS 5/11(a). *See Sanders v. Stasi,* 2011 IL App (4th) 100750, 951 N.E.2d 1274, 351 Ill.Dec. 610 (focusing on rights of income beneficiary to receive accounting, even during periods of trust when there was no trust income that could have been distributed to beneficiary). *See also In re Estate of Lee,* 2017 IL App (3d) 150651, 83 N.E.3d 570, 416 Ill. Dec. 72.

A current account is binding on the beneficiaries and their heirs and assigns within three years from the date the current account is furnished. 760 ILCS 5/11(a); *Lehman, supra. See also Brown Brothers Harriman Trust Co. v. Bennett,* 357 Ill.App.3d 399, 827 N.E.2d 1101, 293 Ill.Dec. 220 (1st Dist. 2005). Receipt of an account by a beneficiary (or other person on behalf of a beneficiary) is presumed if the trustee has in place procedures requiring the mailing or delivery of the account. 760 ILCS 5/11(g). *See also Williams v. Lindblom,* 163 Ill. 346, 45 N.E. 245, 246 (1896).

Barring provisions in the trust instrument to the contrary, the accounts must be available for inspection at the request of any beneficiary even if that beneficiary has only a future or contingent interest. For example, in *Whalen v. Whalen,* 217 Ill.App.3d 557, 577 N.E.2d 859, 160 Ill.Dec. 534 (3d Dist. 1991), the children of the decedent (their mother) were vested remainderpersons who successfully sued their father (the income beneficiary and trustee) for an accounting. *See also Sanders, supra.* If a request for an accounting appears unreasonable or involves unnecessary expense to the trust, the trustee's compliance may be made contingent on the beneficiary's bearing the expense of any such production.

A beneficiary's receipt and release of a trustee with respect to an accounting does not necessarily foreclose the beneficiary from pursuing an action against the trustee for claims arising from the trustee's fiduciary relationship with the beneficiary when such claims are based on the trustee's alleged breach of his or her duties as a fiduciary to the beneficiary and his or her commission of fraud. *Janowiak v. Tiesi,* 402 Ill.App.3d 997, 932 N.E.2d 569, 342 Ill.Dec. 442 (1st Dist. 2010).

The right to request an accounting is enforceable in a court of equity, but a beneficiary does not have to obtain a court order before making the request. *People v. Bordeaux,* 242 Ill. 327, 89 N.E. 971 (1909); *Nevitt v. Woodburn,* 190 Ill. 283, 60 N.E. 500 (1901). Even when the terms of the trust expressly relieve the trustee of a duty to account, the court may require an accounting if it appears that the trustee may have breached any duties.

Rights of contingent and remainder beneficiaries are a moving target, with the scope of these rights apparently ever increasing. See, *e.g.,* Philip J. Ruce, *The Trustee And The Remainderman: The Trustee's Duty To Inform,* 46 Real Prop.Tr. & Est.L.J. 173 (2011).

c. [2.9] Duty To Exercise Reasonable Care

Illinois amended the Trusts and Trustees Act in 1992 to change the rules governing investments by a trustee. The standard under which the soundness of a trustee's investments is evaluated was changed to the prudent investor rule. See 760 ILCS 5/5.

A trustee has a reasonable period to review the investments of the trust upon initially taking office; §5 of the Trusts and Trustees Act imposes a strict diversification requirement but does permit the settlor to alter that requirement by express language in the trust. Note that if the settlor does wish the trustee to retain an asset that would violate principles of diversification — such as a large interest in a family farm or business — the settlor must add language to the trust instrument empowering the trustee to violate the diversification requirement. See 760 ILCS 5/5(a), 5/5(b).

The prudence of the trustee's investments is to be judged by assessing the entire trust portfolio rather than by looking at whether each individual investment by itself is prudent. More specifically, the Trusts and Trustees Act provides:

> **The trustee has a duty to invest and manage trust assets as a prudent investor would considering the purposes, terms, distribution requirements, and other circumstances of the trust. This standard requires the exercise of reasonable care, skill, and caution and is to be applied to investments not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy that should incorporate risk and return objectives reasonably suitable to the trust.** 760 ILCS 5/5(a)(1).

Additionally, the Act states:

> **The circumstances that the trustee may consider in making investment decisions include, without limitation, the general economic conditions, the possible effect of inflation, the expected tax consequences of investment decisions or strategies, the role each investment or course of action plays within the overall portfolio, the expected total return (including both income yield and appreciation of capital), and the duty to incur only reasonable and appropriate costs.** 760 ILCS 5/5(a)(6).

The 1992 amendments were designed to give the trustee more flexibility in making investments and to design a strategy that may reduce current income in favor of enhancement of the remainderpersons' share. However, the Trusts and Trustees Act imposes duties with which old-time trustees may not be familiar, such as requiring an investment program that carefully balances the demands of the income beneficiary with the duty to preserve (and, arguably, to enhance) the trust assets for the remainderpersons. Compare the level of care of an executor under the prudent man standard, which was contrasted with the prudent investor standard by the court in *In re Estate of Pirie,* 141 Ill.App.3d 750, 492 N.E.2d 884, 890, 97 Ill.Dec. 225 (2d Dist. 1986), in absolving an executor of the duty to liquidate a large block of stock. *See also NC Illinois Trust Co. v. First Illini Bancorp, Inc.,* 323 Ill.App.3d 254, 752 N.E.2d 1167, 256 Ill.Dec. 925 (3d Dist.), *appeal denied,* 196 Ill.2d 546 (2001). 760 ILCS 5/5(a)(2) further states that the investment decisions and actions are to be based on the "trustee's reasonable business judgment" and that "[t]he prudent investor rule is a test of conduct and not of resulting performance." *See also Carter v. Carter,* 2012 IL App (1st) 110855, 965 N.E.2d 1146, 358 Ill.Dec. 667, in which the court held that a trustee of a marital trust, who was also an income beneficiary, did not breach the prudent investor rule when the trustee invested solely in tax-free municipal bonds, that the trustee did not breach the trustee's fiduciary duties of impartiality and prudence by knowingly engaging in an investment strategy that maximized income while damaging the remainder of the beneficiary interest, and that a trustee who is granted authority in a trust document to make investment decisions regardless of diversification is not necessarily still required under the prudent investor rule to diversify those investments.

The 1992 amendments apply to all existing and future trusts after their effective date (January 1, 1992), but only as to actions or inactions occurring after that date. 760 ILCS 5/5(e). (Note that the amendments became effective under legislation passed on February 5, 1992. There may be an argument that February 5, rather than January 1, is the effective date of these amendments.)

In *Herget National Bank of Pekin v. Lampitt,* 133 Ill.App.3d 418, 478 N.E.2d 904, 88 Ill.Dec. 413 (3d Dist. 1985), a corporate trustee was surcharged in excess of $170,400 for losses to the trust caused by the sale of stock in another bank. In deciding to surcharge the trustee, the court found that the trustee (1) failed to attend any of the shareholders' meetings of the bank whose stock was sold, (2) made no effort to have the stock appraised, (3) failed to investigate a beneficiary's expressed concern that the stock value might have decreased, (4) failed to seek court approval of its decision to retain the stock in light of a possible conflict in the desires of various beneficiaries, and (5) made no effort to discover what other trades took place during any period between the trust's creation and the sale of the stock and at what prices those trades were made. The trustee's reliance on a trust provision requiring retention of the stock was brushed aside by the court, which noted that the trustee had previously acted inconsistently with this provision (including the sale in question) and that the trust also gave the trustee broad power to conserve and manage the trust estate, including the power to sell any trust assets. Thus, the evidence was sufficient to show a breach of the trustee's duty. Note that under the Trusts and Trustees Act as subsequently amended, if the trustee can show that the overall mix and return on the portfolio are enhanced, the result may be different. *See also Kremer v. Harris Trust & Savings Bank,* No. 91 C 6382, 1994 WL 411394 (N.D.Ill. Aug. 3, 1994).

While the touchstone of care and skill involved is that of the prudent investor rule, the trustee does have a duty to use a higher degree of skill if he or she has represented himself or herself as having a higher degree of expertise in procuring the appointment as trustee. *In re Busby's Estate,* 288 Ill.App. 500, 6 N.E.2d 451 (1st Dist. 1937). Note that this standard has often been applied to corporate trustees, but, in light of the statutory amendments, it probably has less general applicability to them. *See also Estate of Lindberg,* 98 Ill.App.3d 212, 424 N.E.2d 1161, 54 Ill.Dec. 258 (1st Dist. 1981).

There is an increasing number of comments on the duty of the trustee to minimize tax exposure for the trust. This duty usually is discussed along with the investment duties of the trustee, although it also, obviously, is related to the duty to preserve trust property discussed in §2.10 below. Because trusts are subject to income taxation at unfavorable rates, at least as compared to individuals, a trustee needs to be alert to the possibilities of shifting taxes (thereby saving principal). However, a trustee should keep in mind that the nontax considerations of fulfilling a trust purpose should outweigh the duty to save taxes. Most often, a trustee's duty is not to make current distributions but instead to preserve trust principal and accrued income (albeit heavily taxed) to fulfill a future trust purpose, such as sending a beneficiary to college. See, *e.g.,* Mark L. Ascher, *The Fiduciary Duty to Minimize Taxes,* 20 Real Prop.Prob. & Tr.J. 663 (1985); William V.A. Zorn and Christine S. Anderson, *Shifting Assets to Trusts for Minors After RRA '93 Requires Changes in Focus,* 79 J. Tax'n 352 (1993).

In re Janice Galloway Nonexempt Marital Trust, No. 62-C5-04-200042 (Minn.Dist. 2007), involved a complaint filed by surviving children on the death of the surviving spouse and parent. The complaint was against the corporate trustee for a breach of trust for a failure by the trustee to form a family limited partnership (FLP) with qualified terminable interest property marital trust assets for reducing estate tax liability on the death of the surviving spouse. The trial court ruled in favor of the trustee, holding that

1. although FLPs were a permissible investment under the trust instrument, they were not a mandatory investment;

2. the trust instrument did not evince tax minimization as the manifest purpose of the trust; and

3. the trustee did not have a duty to engage in complex, aggressive, and questionable estate planning techniques required in the creation of an FLP.

The authors understand that no appeal has been taken in *Galloway.*

The trustee's ignorance of the terms of the trust do not insulate the trustee from liability because one of the trustee's first duties is to become thoroughly acquainted with all provisions of the trust. On the other hand, the provisions may relax the degree of attention the trustee must give to the trust. *Hatfield v. First Nat. Bank of Danville,* 317 Ill.App. 169, 46 N.E.2d 94 (3d Dist. 1942). However, these provisions are not to be construed as allowing the trustee to act in bad faith or to take undue advantage of the relationship with the beneficiaries; the provisions generally are strictly construed against the trustee. *See also McCormick v. McCormick,* 180 Ill.App.3d 184, 536 N.E.2d 419, 129 Ill.Dec. 579 (1st Dist. 1988).

A fiduciary may be found to have breached the duty to exercise reasonable care even in a transaction that initially appears to be extremely favorable to the beneficiaries. In *NC Illinois Trust, supra,* the executor, a bank, was held to have breached its fiduciary duties in a sale of closely held business interests owned by the estate. The sale resulted in a successful lawsuit in federal court by the purchaser, who claimed breach of warranty and securities violations.

The defendant bank

1. did not scrutinize financial information that became part of its representations in the sale contract;

2. used this financial information even though it was supplied by another selling party that the bank knew had previously been convicted of perjury;

3. had been advised by beneficiaries of the estate that the financial information that the bank was representing to be accurate was in fact false;

4. had been given a letter from an independent firm that indicated that if the financial information supplied by the other selling party had been prepared in accordance with generally accepted accounting principles, the purchase price would have been decreased by over $189,000;

5. permitted the other selling party to play the principal role in setting the sales price even though the bank had no information as to whether that party was qualified to do so;

6. was financing the purchaser of the business interests at the same time that it was negotiating the purchase price for the estate; and

7. used estate assets to pay the settlement for the bank’s liability under the federal lawsuit as well as to pay for the bank’s defense attorney.

The bank was removed as executor and found liable for (1) prejudgment interest based on profits and interest it gained by use of the estate’s assets, (2) compensatory damages of $242,443, and (3) punitive damages of $1,375,232.

The trustee’s duty of care was extended in a Wisconsin case that was somewhat startling in that the court held against both a corporate trustee and an individual trust officer employed by the corporate trustee. In *Hatleberg v. Norwest Bank Wisconsin,* 271 Wis.2d 225, 678 N.W.2d 302 (App. 2004), the Wisconsin court of appeals found a breach of fiduciary duty when additional estate tax was assessed in a decedent’s estate because an irrevocable trust created by the decedent did not contain *Crummey* withdrawal rights (*see Crummey v. Commissioner,* 397 F.2d 82 (9th Cir. 1968)) that would allow annual contributions to the trust to be sheltered by the decedent’s annual gift tax exclusions. The *Hatleberg* court noted that (1) the trust instrument was drafted by an attorney not selected by the defendants and not under their control and (2) the drafting attorney was advised by the defendants of defects in the trust instrument shortly after it was executed. (The decedent’s estate separately settled with the drafting attorney.) The corporate defendant was named as, and accepted the office of, initial trustee of the trust and was acting as such when the decedent died. The appellate court found the defendants liable because the drafting attorney was no longer retained by the decedent when the defendants discovered the defect and the defendants, having made their discovery, had a duty to take “meaningful action” to remedy the problem. 678 N.W.2d at 310. The Wisconsin Supreme Court affirmed the decision on other grounds. *Hatleberg v. Norwest Bank Wisconsin,* 283 Wis.2d 234, 700 N.W.2d 15 (Wis. 2005).

d. [2.10] Duty To Preserve Trust Property

The trustee is under a duty to use reasonable care and diligence in preserving and protecting the trust property for the benefit of the beneficiaries. Subject to the terms of the trust instrument, the degree of care to which the trustee is held is that of a prudent investor dealing with the investor's own property. See the discussion in §2.9 above. The trustee is under a duty to expend trust funds to ensure that trust assets are not lost or destroyed, to keep buildings in repair, and to avoid any forfeitures of trust property to governmental bodies or creditors. A prudent trustee would insure buildings and other property against fire and other casualty loss. To the extent that the trustee fails to do so and trust property is damaged, the trustee probably will be liable. However, when there is no duty for the trustee to partake in active management of trust assets subject to this type of loss, there would appear to be no duty on the part of the trustee to carry insurance. The trustee is under a duty to exercise stock options, subscription rights, and warrants before their expiration date if it would be to the advantage of the beneficiaries to do so.

When liquid assets are not available for use in preserving and protecting the property, the trustee may be under a duty to sell or mortgage trust assets if there is that power or, in the absence of that power, to apply to the court for permission to sell or mortgage. While the trustee has no obligation to use personal funds to preserve and protect trust assets when trust funds are not available, the trustee may be under a duty to notify beneficiaries of the lack of funds so that they may have the opportunity to supply their own funds for these purposes. To the extent that trust property is being used or occupied by beneficiaries, when an interest in the same property is to pass to successive beneficiaries, the trustee is under an obligation to ensure that the current beneficiaries do not unduly depreciate the value of the property. Again, however, the express terms of the trust instrument may diminish the trustee's duties in this area.

Concerns and discussions about the duty to preserve trust assets have focused on environmentally damaged or contaminated real property. *See, e.g., Quadion Corp. v. Mache,* 738 F.Supp. 270 (N.D.Ill. 1990). Federal and state laws impose joint and several liability on owners, tenants, and anyone who may have dumped contaminants on the property, as well as on any persons claiming through them. The costs of cleanup — even if a trustee is innocent of the dumping, did not authorize the dumping, and had no idea that the contamination took place — can be enormous. The cost of making a remediation study to determine the best course of action also may be very large. Because the trust assets may be liable for the cleanup costs of property in an amount that could exhaust the trust fund, the prudent trustee should investigate the environmental history of any real property before accepting it into the trust portfolio. The trustee may even have a duty to abandon or refuse to accept property to limit exposure to environmental liability to preserve the trust's other assets.

Developments in fiduciary liability for environmental cleanup impose onerous and far-reaching duties on a trustee. The developments seem to suggest that the prudent trustee should take care not to involve the trust in hazardous activities because the liability imposed may not be limited to the trust assets. In particular, corporate trustees are concerned that cleanup costs may be imposed on their assets if the trust assets are insufficient. How much more does the individual fiduciary have to lose?

In *City of Phoenix, Arizona v. Garbage Services Co.,* 827 F.Supp. 600 (D.Ariz. 1993), the court found that a bank that, as testamentary trustee, exercised the decedent's option to reacquire a landfill site might be liable for cleanup costs of the environmentally damaged site. The court announced a broad rule of fiduciary liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), Pub.L. No. 96-510, 94 Stat. 2767: (1) if the trustee's sole liability was because it was an owner (in the chain of title), the trustee would not be liable in an amount in excess of the trust funds; but (2) if hazardous activities occurred while the trustee held title to the property, the trustee's liability as an owner would extend beyond the value of the available trust assets if the trustee had the power to control the use of the property and knowingly allowed the property to be used for the disposal of hazardous substances. In *City of Phoenix,* the bank made a decision to purchase the site as a trust asset and continued to lease the landfill to a corporation (wholly owned by the decedent) for use as a hazardous disposal site. The court held that if the city could prove at trial that hazardous substances were disposed of at the landfill during the time the bank owned it, the bank would be treated under CERCLA as an operator and be held liable for cleanup costs, not only to the extent of the trust's assets but also to the extent of its own. 827 F.Supp. at 607.

Most commentators believe that toxic issues demand strict monitoring by the trustee before the trusteeship is undertaken and before any land is purchased. The innocent purchaser defense (under the reasoning of the court in *City of Phoenix, supra*) should be available if (1) the contamination was caused by a third party, (2) the property was assessed for environmental problems before its acquisition, (3) no hazardous substances were disposed of on the property after its acquisition, and (4) due care was exercised after the property was acquired to manage it — including environmental audits and, perhaps, private remediation. Fiduciaries face claims from two directions in this area: from the government, which might hold the trustee liable for costs of cleanup; and from the beneficiaries, who could allege mismanagement and breach of duty to the extent that a fiduciary exposes the trust assets to cleanup assessments (or who alternatively could complain of the costs of private remediation). See John C. Dorsey and Walter H. Nunnallee, *A "Shell" Corp. May Be a Good Devisee of Contaminated Realty,* 20 Est.Plan. 283 (1993) (noting that a trustee also may consider severing trusts to possibly insulate "clean" trust assets); *United States v. Forester,* No. 88-CV-70613 (E.D.Mich. 1988) (Environmental Protection Agency permitted to seek cleanup costs from decedent's estate).

In 1996, Congress enacted the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996, Pub.L. No. 104-208, Div. A, Title II, Subtitle E, 110 Stat. 3009-462, which altered the "hold everyone liable" approach with respect to fiduciaries by providing that a fiduciary is liable for environmental contamination only up to the value of the assets held in the trust or estate. 42 U.S.C. §9607(n). Further, a fiduciary does not lose its protection from liability by (1) undertaking or directing lawful cleanups; (2) administering property that was contaminated before the fiduciary relationship was begun; (3) providing financial advice to a settlor or beneficiary of the trust; or (4) restructuring, renegotiating, or terminating the fiduciary relationship. The fiduciary must meet the following requirements to take advantage of this protection:

1. The fiduciary cannot also be the beneficiary under the trust.

2. The fiduciary cannot receive benefits that exceed customary or reasonable compensation.

3. The fiduciary cannot have caused or contributed to the contamination.

4. The trust cannot be organized for the primary purpose of, or engaged in, a trade or business for profit.

5. There must be a bona fide fiduciary relationship. The fiduciary cannot be one who acquires ownership or control of the property with the objective of avoiding liability. See Baxter Dunaway and Andrew C. Cooper, *Good News for Lenders and Fiduciaries Under Superfund,* 11 Prob. & Prop., No. 3, 49 (May/June 1997).

e. [2.11] Duty To Defend Actions

A trustee is under a duty to defend the trust assets against all unfounded claims of third parties and to take whatever steps are reasonable with that defense. If the trustee loses at the trial court level, that trustee may also be under a duty to appeal. *Tree v. Continental Ill. Nat. Bank & Trust Co. of Chicago,* 346 Ill.App. 509, 105 N.E.2d 324 (1st Dist. 1952). If it appears that it is more advantageous to the interests of the beneficiaries that a claim of a third party be compromised, a compromise may properly be entered into by the trustee. *Levi v. Stern,* 324 Ill.App. 82, 57 N.E.2d 228 (1st Dist. 1944) (abst.). Inasmuch as the primary concern of the trustee must be the interests of the beneficiaries, the trustee may compromise even an unenforceable claim if it appears certain that the claim can be prosecuted and the cost of defending against it will be greater than the cost of compromising it. *Selleck v. Hawley,* 331 Mo. 1038, 56 S.W.2d 387 (1932). In any situation involving lawsuits affecting trust property, if the trustee is uncertain of what actions should be taken to defend, the trustee should seek instructions from the court.

A trustee should not incur trust expenses in contesting legitimate claims against the trust. A trust is liable for claims against a deceased grantor even when collection efforts against the trust do not commence for more than two years after the grantor’s death when

1. the trust instrument contains language directing the trustee to pay the grantor’s “legally enforceable debts”; and

2. the claims against the grantor were reduced to judgment against the grantor before the grantor’s death. *Society of Lloyd’s v. Estate of McMurray,* 274 F.3d 1133, 1136 (7th Cir. 2001).

The *McMurray* court noted that the trustee “had a duty to pay” the creditor upon the grantor’s death once a court of competent jurisdiction entered judgment against the grantor. *Id.* The debt became legally enforceable at that point, and the trustee ignored its duty to pay.

A trustee may not agree to a premature termination of a trust pursuant to a family settlement agreement when no bona fide dispute exists that would support this termination. *Fleisch v. First American Bank,* 305 Ill.App.3d 105, 710 N.E.2d 1281, 238 Ill.Dec. 179 (3d Dist. 1999).

f. [2.12] Duty To Enforce Claims

The trustee is under a duty to enforce any claims that the trust may have, whether against a predecessor trustee, against executors (in the case of a testamentary trust), or against any other outside parties. Just as the trustee may properly compromise even an unenforceable claim against the trust if it is in the best interests of the beneficiaries to do so, the trustee also has a duty to compromise any claim that the trust may have against another party under similar circumstances. See §§2.11 above and 2.42 below. The trustee is not under a duty to institute a suit to attempt to collect on a claim of questionable enforceability. Even when a suit has been brought to enforce a claim and a favorable judgment is obtained, the trustee is under a duty to defend an appeal only if it would be unreasonable not to do so. For a discussion on obtaining court assistance, see Chapter 9 of this handbook.

A fiduciary entitled to assets of a grantor at the grantor's death should make claims for any of the grantor's assets that may have been the subject of an incomplete gift, especially when the delivery component of the gift may be defective. When a decedent properly executed and had acknowledged a quitclaim deed to a private land trustee, but then for privacy reasons lodged the deed with a land trust beneficiary instead of delivering it to the land trustee, the transfer was held to be incomplete and the real estate subject to the deed held to be part of the grantor's probate estate. *In re Estate of Wittmond,* 314 Ill.App.3d 720, 732 N.E.2d 659, 247 Ill.Dec. 604 (4th Dist.), *appeal denied,* 191 Ill.2d 531 (2000). *See also Albrecht v. Brais,* 324 Ill.App.3d 188, 754 N.E.2d 396, 257 Ill.Dec. 738 (3d Dist. 2001).

g. [2.13] Duty Not To Delegate

The trustee has a duty to perform those acts that he or she can reasonably perform and may not delegate them to others. Acts that the trustee should not reasonably be required to perform personally, however, may be delegated. Since the trustee is operating under the prudent investor rule in determining whether particular acts may be delegated, the trustee must determine whether a prudent investor would perform them personally. Helpful factors to consider in ascertaining whether a delegation is reasonable or unreasonable are (1) the amount of discretion involved in performing the delegated act; (2) the value and character of the property affected; (3) whether the delegated act can affect principal or income of the trust; (4) whether it can affect, directly or indirectly, trust assets or trust beneficiaries; and (5) whether it calls for a professional skill that the trustee does or does not possess. The trustee may, of course, consult with professionals and consider their advice when taking action in matters that cannot be delegated. Agents may also be retained to handle minor portions of a major transaction that cannot itself be delegated, such as securing offers for the sale or lease of real estate, with the trustee personally completing the transaction or allowing an agent to carry out the terms of a contract after the trustee has fixed its terms and provisions.

The 1992 amendments to the investment standards discussed in §2.9 above included an amendment of the duty not to delegate. 760 ILCS 5/5.1(a) provides:

> **The trustee has a duty not to delegate to others the performance of any acts involving the exercise of judgment and discretion, except acts constituting investment functions that a prudent investor of comparable skills might delegate under the circumstances.**

Section 5.1(b) further describes how the delegation of the investment functions may be accomplished. First, the trustee must exercise reasonable care and caution in selecting an investment agent, including reviewing the agent's financial stability, professional licensing status, and performance history. 760 ILCS 5/5.1(b)(1), 5/5.1(b)(2). Only an agent subject to the jurisdiction of the Illinois courts may be selected. 760 ILCS 5/5.1(b)(3). The agent is subject to the same prudent investor rule as the trustee and must be liable under the same fiduciary standards as the trustee to the beneficiaries of the trust. 760 ILCS 5/5.1(b)(4), 5/5.1(b)(5). Written notice of any delegation to an investment agent must be sent to the income beneficiaries 30 days before the delegation takes place. 760 ILCS 5/5.1(b)(6). Many trust instruments authorize the trustee to appoint agents, but the trustee must follow this stricter standard in appointing an investment advisor or agent.

In *William J. O'Neill, Jr. Irrevocable Trust v. Commissioner,* 994 F.2d 302 (6th Cir. 1993), *nonacq.,* 1994-2 Cum.Bull. 1, the Sixth Circuit reversed the Tax Court, finding that the investment advisors' fees were not subject to the two-percent floor and that the fees were available as deductions unique to the trust because the trustees, who were not used to managing large sums of money, were compelled to hire investment advisors to fulfill their fiduciary duties. In *Knight v. Commissioner,* 552 U.S. 181, 169 L.Ed.2d 652, 128 S.Ct. 782 (2008), the United States Supreme Court was faced with deciding a split among the appellate circuits. As stated above, the Sixth Circuit found that "investment advisory fees [are fully] deductible." *O'Neill, supra,* 994 F.2d at 303. However, the Fourth and Federal Circuits found that investment advisory fees "are subject to the 2% floor" because they are commonly or customarily incurred outside of trusts. *See Scott v. United States,* 328 F.3d 132, 140 (4th Cir. 2003). The Supreme Court's decision in *Knight, supra,* abrogated *O'Neill, supra,* by deciding "that the investment advisory fees incurred by the Trust are subject to the 2% floor." 128 S.Ct. at 791. On May 9, 2014, the Internal Revenue Service published Treas.Reg. §1.67-4, prescribing when costs incurred by estates or nongrantor trusts are subject to the two-percent floor for miscellaneous itemized deductions under §67(a) of the Internal Revenue Code, 26 U.S.C. §1, *et seq*. The final regulations were effective May 9, 2014.

The terms of the trust instrument may permit delegation in areas in which the trustee ordinarily would have to act, although in this situation, as well as in the normal situation in which there is not an expanded power of delegation, the trustee has the additional duty of supervising those to whom any acts have been delegated.

One Illinois court has held that when trustees of a pension fund entered into an agency agreement with a bank for the bank to control the investment of the fund's assets, the bank had no duty to follow the instructions of the trustees with respect to the investment of the assets; instead, if the trustees were dissatisfied with the bank's handling of the assets, the trustees should have terminated the agency relationship. *See Local Union No. 422, U.A. of Joliet, Illinois v. First National Bank of Joliet,* 93 Ill.App.3d 890, 417 N.E.2d 1077, 49 Ill.Dec. 250 (3d Dist. 1981). *See also Mason & Dixon Lines, Inc. v. Glover,* 975 F.2d 1298 (7th Cir. 1992), discussing the delegation of trustee authority to an agent, also in a pension context, and determining that the agent has authority to bind the principal even when that principal is a trustee.

In *Metz v. Independent Trust Corp.,* 994 F.2d 395 (7th Cir. 1993), a disgruntled individual retirement account (IRA) settlor-beneficiary sued the IRA trustee for following the settlor's instructions in making a loan to a friend. The trustee had questioned the settlor regarding his direction but followed his instructions anyway. When the friend absconded with the money, the settlor sued the trustee, alleging a breach of fiduciary duty under the then applicable prudent person rule because the trustee had failed to advise the settlor of the friend's shady background. The trustee prevailed on a motion for summary judgment, which was affirmed by the Seventh Circuit. Similarly, *see Mahle v. First National Bank of Peoria,* 241 Ill.App.3d 672, 610 N.E.2d 115, 182 Ill.Dec. 691 (3d Dist. 1993), in which a settlor sued the trustee for following the settlor's instructions (over the trustee's express objections) to pledge trust assets to secure a loan for $100,000 to the settlor's nephew. When the money was lost, the settlor sued the trustee for failing to disclose all material facts to him. The court concluded that the trustee had not breached any fiduciary duty.

h. [2.14] Duty To Take and Keep Control

The trustee is under a duty to the beneficiaries to take control and retain possession of any tangible items that may comprise a portion of the trust assets. The trustee is also under a duty to control the physical evidence of intangible assets, such as stock certificates, bonds, and deeds to real estate and to have this property designated as trust property. The obligor under any such chose in action should be notified of the identity of the trustee, as owner, and the trustee should ensure that payments of income, if any, are made and that any matured notes are collected. Actual possession of the trust assets may be entrusted to agents or custodians acting on behalf of the trustee, but the trustee must act in good faith and with reasonable care in selecting any such custodians and must exercise supervision over the custodians to the extent required. Special care should be taken to determine that sufficient insurance coverage exists before entrusting securities, especially in bearer form, to brokerage houses, banks, or other custodians to protect against the possibility of institutional failure.

i. [2.15] Duty To Keep Trust Property Separate

The trustee is under a duty (1) to keep trust property separate from individual property, (2) to keep trust property separate from any other property not subject to the trust whenever possible, and (3) to ensure that trust property is designated as such. If a trustee mingles trust funds with personal assets, the trustee is guilty of a breach of trust even though the trust assets are not used for the trustee's own purposes. *See In re Estate of Lee,* 2017 IL App (3d) 150651, 83 N.E.3d 570, 416 Ill.Dec. 72, in which the court found that the trustee was not entitled to reimbursement for personal funds expended on trust beneficiaries when the trustee had commingled funds from the trust account with funds from her personal account and failed to keep adequate records of the funds spent on the beneficiaries. Trust funds so mingled become more difficult to trace and also may become subject to possible claims of the trustee's personal creditors. There is also the danger that the trustee may become unable to ascertain which assets belong to the trustee and which belong to the trust. The trustee may have to surrender personal assets, invested more successfully than those of the trust, if there is doubt of ownership. Trust assets should not be placed in the trustee's personal safe-deposit box even if they are identified as trust assets.

The trustee should not commingle assets of separate and distinct trusts even if the same settlor and beneficiaries are involved and their interests are alike unless permitted to do so by the terms of the trusts. If it is contemplated that additions to the trust corpus are to be made at a later date by the settlor or third parties, the trust instrument should provide that the additions are permitted (qualified as is deemed necessary, as for example, by a provision that additions may be made only on the same terms and conditions and only if the trustee's duties are not substantially increased without the trustee's permission). If the terms of the trust allow commingling or if the trustee has obtained leave of court to pool assets of separate trusts, then the trustee has a duty to maintain accurate records of the interests of the separate trusts with respect to the total property held.

An attorney who receives funds in a capacity as trustee or in a capacity as attorney for the trustee must maintain a separate trust account for these funds. Illinois Rule of Professional Conduct of 2010 1.15(a).

j. [2.16] Duty To Make Trust Productive

The trustee is under a duty to use the reasonable business judgment of a prudent investor in investing trust property in a productive manner. See the discussion in §2.9 above. The trustee may take a reasonable amount of time to decide which types of investments are to be acquired for the trust, but the trustee has a duty to avoid any delay that would unreasonably reduce the amount of the return of the trust. The trustee may have a duty to make trust real estate productive depending on the terms of the trust and the type of property held. If the trustee is not directed to sell the land or does not have the power to do so, the trustee is generally under a duty to lease the property. As an alternative to leasing, the trustee may use the property directly so that it produces income, as in the case of a farm or a parking lot. A trustee who is authorized to manage the property is not under a duty to lease it, and a trustee who is directed to manage it is not necessarily empowered to lease it. If the terms of the trust indicate that one or more beneficiaries are entitled to possession of the land, the trustee has no duty to make the land productive.

With respect to chattel property (except that used to produce income, such as farm machinery), the trustee is ordinarily under a duty to sell the chattel and invest the proceeds. However, the trustee may be authorized to hold chattel property until a beneficiary reaches a certain age or until the beneficiaries decide the manner of its distribution, in which case the trustee usually has no duty to make the property productive.

In *Rubin v. Laser,* 301 Ill.App.3d 60, 703 N.E.2d 453, 234 Ill.Dec. 592 (1st Dist. 1998), the court held that a trustee is not liable for a breach of fiduciary duty to the trust because of a failure to purchase additional shares of stock in a company whose stock the trust already holds merely because the initial investment turns out to be profitable.

k. [2.17] Duty To Pay Income to Beneficiary

When an income beneficiary is designated in a trust, the trustee has a duty to pay income in accordance with the terms of the instrument. A portion of the income may be withheld by the trustee to meet present or anticipated expenses that are properly chargeable to income. If the terms of the trust do not specify the frequency with which income is to be paid to the beneficiary, the trustee has a duty to make distributions at reasonable intervals, usually at least annually, and more probably semiannually or quarterly. *De Haan v. De Haan,* 309 Ill. 323, 141 N.E. 184 (1923); *Orr v. Yates,* 209 Ill. 222, 70 N.E. 731 (1904).

The trustee also must consider any spendthrift clause in the trust instrument, as some Illinois courts have eroded the validity of these clauses designed to shield the trust from invasion by creditors of a beneficiary. The Illinois Supreme Court, in *In re Support of Matt,* 105 Ill.2d 330, 473 N.E.2d 1310, 85 Ill.Dec. 505 (1985), reversed the appellate court, which had prohibited the garnishment of trust income for payment of arrearages in child support. The Supreme Court found that the long-standing policy of protecting spendthrift trusts from invasion should yield to Illinois public policy requiring that support judgments be enforced by all available means. A further example of this erosion may be found in *LaSalle National Bank v. United States,* 636 F.Supp. 874 (N.D.Ill. 1986), in which the federal district court ordered a trustee to pay the tax liability of the beneficiary — a tax liability that was largely caused by distributions to the beneficiary from the trust. The settlor stated that his primary intent was to provide adequate care, support, and maintenance for the beneficiary during the latter's lifetime. In connection with distributions of income and principal, the settlor employed the phrase "the trustee shall use," which the court interpreted as limiting the trustee's discretion and imposing on the trustee an obligation to pay. 636 F.Supp. at 876. The court found that, pursuant to Illinois caselaw and the settlor's intent, the trust beneficiary's interest constituted "property or right to property" that was subject to lien rights of the federal government for tax liability. *Id.*

The decision in *Support of Matt, supra,* has been codified and expanded. Section 2-1403 of the Code of Civil Procedure, 735 ILCS 5/1-101, *et seq.,* provides that income or principal of a trust is "subject to withholding for the purpose of securing collection of unpaid child support obligations owed by the beneficiary." 735 ILCS 5/2-1403. Income may be withheld if the beneficiary is the sole income beneficiary of the trust or if the beneficiary is entitled to a specific amount or percentage of the income. Principal may be withheld in the amount of the beneficiary's withdrawal rights "or if the beneficiary is the only beneficiary to whom discretionary payments of principal may be made." 735 ILCS 5/2-1403(2).

If a beneficiary is under legal disability, the trustee has a duty to apply the income for the benefit of the beneficiary if authorized by the instrument. If the trustee is to apply the income in that manner, then the trustee is under a duty to do so and may not delegate that duty by making unsupervised payments of income to the beneficiary's guardian. If the trustee is not authorized to apply the income for the benefit of the beneficiary, then the trustee has the duty to pay the income to the beneficiary or to the beneficiary's guardian. To the extent that the trustee has discretion to withhold income distributions, the income not required for the beneficiary's needs properly may be accumulated for the benefit of the beneficiary, to be distributed at a later date if required.

The trustee's duty to pay income to a spendthrift beneficiary may be affected by the actual wording of the spendthrift clause. For example, in *Domo v. McCarthy,* 66 Ohio St.3d 312, 612 N.E.2d 706 (1993), the court found that a bankrupt beneficiary's interest in a trust, which was to terminate and distribute to him, was beyond the reach of his creditors because the spendthrift clause provided that if someone other than the beneficiary were to attempt to reach the trust, the trust was to convert to a discretionary trust, rather than a mandatory income and principal trust. The court found that the trustee's obligations continued once the creditor attempted to reach the trust assets and that the trustee had an obligation not to distribute the trust but to continue it as a discretionary trust. Thus, the wording of the spendthrift clause affects the trustee's duties.

The trustee's duty to pay income to the beneficiary may be modified in certain situations. Section 11a-18(d) of the Probate Act overrules *In re Estate of Roberts,* 99 Ill.App.3d 993, 426 N.E.2d 269, 55 Ill.Dec. 294 (5th Dist. 1981), in which the court required the trustee of an inter vivos trust to pay the trust income to the guardian of an incompetent beneficiary even though the trust instrument gave the trustee discretion to apply the trust income for the benefit of the beneficiary himself. The Act states that the "trustee shall not be required to distribute any of the income or principal to the guardian of" the ward if the trust instrument provides that the trustee has the power to apply income or principal for the ward's benefit. 755 ILCS 5/11a-18(d). Further, the Act makes clear that an adjudication of disability does not revoke a living trust and that the guardian of the ward does not have the power to revoke or amend the trust. *Id.* Similarly, the Illinois Power of Attorney Act provides that an agent may neither revoke nor amend a trust revocable or amendable by the principal nor require the trustee of any trust for the benefit of the agent's principal to pay income or principal to the agent unless there is specific authority and specific reference to the trust in the written agency instrument. 755 ILCS 45/2-9, 45/3-4(n). Note also that the agent may create for the sole benefit of the principal a revocable trust that terminates at the death of the principal and is paid to the principal's estate. The Illinois Uniform Transfers to Minors Act, 760 ILCS 20/1, *et seq.,* permits and, in some cases, may require the trustee to appoint a custodian for a minor and to make transfers to a custodian appointed by the settlor or by the trustee for the benefit of a minor.

Finally, under 760 ILCS 15/3, the trustee has reasonable discretion concerning the identification of trust receipts as income or principal if the trust instrument is silent.

l. [2.18] Duty To Deal Impartially

The trustee is under a duty to deal impartially with all beneficiaries of the trust, whether their interests are simultaneous or successive. A common situation involves the conflicting interests of successive beneficiaries. Although the trustee has a duty to serve the interests of present income beneficiaries, the trustee must also ensure that they are not enjoying benefits from trust property in such a way as to reduce the principal value ultimately to be received by remainderperson beneficiaries. The terms of the instrument can alter the trustee's duties in this regard, and in the absence of any abuse by the trustee, a court will not prevent the trustee from exercising an express grant of discretion to favor one beneficiary over another.

In *Bornstein v. First United,* 232 Ill.App.3d 623, 597 N.E.2d 870, 173 Ill.Dec. 896 (1st Dist. 1992), the court found that a land trustee, having been given a series of conflicting and confusing instructions by different beneficiaries of the same trust, acted properly in refusing to honor a direction to convey and in filing an interpleader offering to deliver the land in the trust as the court felt proper. When faced with conflicting claims, a trustee who ignores the claim of one beneficiary in favor of another can be held liable for any damages that may result and should file an interpleader. Arguably, this rationale is applicable to a petition for instructions when faced with competing interpretations of a trust instrument.

In *Karpf v. Karpf,* 240 Neb. 302, 481 N.W.2d 891, 896 (1992), the first reported state court opinion involving a *Crummey* trust (*see Crummey v. Commissioner,* 397 F.2d 82 (9th Cir. 1968)), the court, quoting *St. Paul Fire & Marine Insurance Co. v. Truesdell Distributing Corp.,* 207 Neb. 153, 296 N.W.2d 479, 482 (1980), purported to be interpreting a line of Nebraska cases in which the courts had found that a trustee has a duty to inform the beneficiaries of a trust's existence and "of all material facts" concerning the trust. In *Karpf,* the former wife of one of the trust beneficiaries sued because she did not know about the trust and argued that had she known she might have exercised her son's (the settlor's great-grandchild's) withdrawal rights as well as withdrawal rights she had as a grandchild's spouse. Because the trustee did not inform certain of the trust's beneficiaries of their withdrawal rights, the court found that the trustee had breached that duty. Arguably, this conduct would be a breach of the Illinois duty of impartiality, as the failure to exercise withdrawal rights enhanced the shares held in the trust for the primary benefit of another beneficiary. However, the Nebraska court found (as should an Illinois court under the same circumstances) that there were no damages because the beneficiaries were unlikely to have exercised their withdrawal rights, even had they known about them, for fear of antagonizing the settlor.

m. [2.19] Duty with Respect to Cotrustees

Each trustee is under a duty to the beneficiaries to participate actively in the administration of the trust, to prevent a cotrustee from breaching the trust, and to compel a cotrustee to make restitution in case the trust is breached. A cotrustee should not be allowed to take control of the trust property to an extent that would permit the cotrustee to misappropriate the property. The trustee is under a duty not to delegate to a cotrustee those duties that may not be delegated to others. See §2.13 above. However, the terms of the trust instrument may specifically authorize one trustee to take over certain of the trustees' functions, duties, or powers, such as managing investments or exercising discretion with respect to distributions, to a greater extent than, or to the exclusion of, the other trustee. The trustee is under a duty to disclose any breach of trust by a cotrustee and to review the actions of a cotrustee if the trustee believes that there may be a breach. If the trustee fails to take any action with respect to a cotrustee's breach, the trustee can be presumed to have approved it. *Warner v. Rogers,* 255 Ill.App. 78 (3d Dist. 1929). *See also David v. Russo,* 119 Ill.App.3d 290, 456 N.E.2d 342, 74 Ill.Dec. 840 (1st Dist. 1983); *Hopkins v. Loeber,* 329 Ill.App. 423, 69 N.E.2d 104 (1st Dist. 1946).

n. [2.20] Duty to Person Holding Power of Control

Many trust instruments contain provisions granting to a third party the power to direct the trustee in the administration of the trust. Except as noted below, the trustee has the duty to comply with directions given. *Weber v. Chicago & W.I.R. Co.,* 246 Ill. 464, 92 N.E. 931 (1910). The relationship to the trust of the person holding the power is generally irrelevant except for purposes of alerting the trustee when that person may be more likely to abuse third-party power (as, for example, when the holder is a beneficiary who might derive personal gain through the exercise of third-party power). In all cases, the trustee has an obligation to ensure as far as possible that the holder of the power does not violate either the terms of the trust or any fiduciary duty the holder may have. When the power is held solely for the benefit of the person holding it, the trustee's primary duty is only to ensure that the power is being exercised in accordance with the terms of the trust. If, however, the power is for the benefit of persons other than or in addition to the holder, the trustee generally has the same duties that he or she would have with respect to the actions of a cotrustee. If, from the terms of the trust, it is not clear for whose benefit the power is held, the trustee should be especially careful, for conflicting interests may arise depending on the facts and circumstances of each exercise of the power. *Clayton v. James B. Clow & Sons,* 154 F.Supp. 108 (N.D.Ill. 1957), *distinguished by Tri-State National Bank v. Western Gateway Storage Co.,* 92 Idaho 543, 447 P.2d 409 (1968). In some circumstances, the holder of the power may deal through the trustee, directing the trustee when and how to act. Ordinarily, the trustee is justified in doing nothing until a direction is given unless that trustee can reasonably determine that the holder's inaction in a particular circumstance is in violation of the terms of the trust or of a duty to beneficiaries. In that case, the trustee must take steps to see that the power is exercised, and in the event of the holder's refusal to do so, the trustee should apply to the court for instructions. For a related discussion on the enactment of the directed trusts statute, 760 ILCS 5/16.3, see §2.61 below. There are currently no reported cases analyzing the substance of §16.3.

In *Progressive Land Developers, Inc. v. Exchange National Bank of Chicago,* 266 Ill.App.3d 934, 641 N.E.2d 608, 204 Ill.Dec. 384 (1st Dist. 1994), a land trustee was held liable for following a direction to convey. The property held in the land trust was the subject of litigation in a probate proceeding of which the trustee had notice because of citation proceedings that involved the trustee. The court held that the trustee was negligent in honoring the power of direction of the new officers of the corporate beneficiary of the trust because the citation proceedings (together with a letter of inquiry from attorneys regarding assets held by the trust) were sufficient to put the trustee on notice of an adverse claim to the trust assets. The court held that the trustee, after having received such notice, should have refrained from acting, notified the probate court of the requests for conveyances pursuant to the power of direction, and awaited court instructions. The trustee apparently also violated its own internal procedures by failing to obtain an incumbency certificate verifying the status of the new officers of the corporate beneficiary.

2. Termination of the Trust

a. [2.21] General Powers

At the time for the termination of the trust, the trustee may exercise whatever powers are necessary to wind up the administration and effect distribution in accordance with the terms of the instrument. Ordinarily, the trust terminates at a period stated within the trust instrument itself. In certain cases, however, termination may depend on outside facts and circumstances that may or may not be brought to the attention of the trustee. To the extent that the trust may terminate on the occurrence or nonoccurrence of an event or incident, the trustee has a duty to attempt to acquire information from time to time that would enable the trustee to determine whether the trust should be terminated.

When the time for termination has been reached, the trustee has a duty to wind up the affairs of the trust and make distributions within a reasonable period of time. During this period, the trustee has the same duties and responsibilities as during the administration of the trust, in addition to any specific or implied duties entailed in the winding up. *Wayman v. Follansbee,* 253 Ill. 602, 98 N.E. 21 (1912); *Wood v. Continental Illinois Nat. Bank & Trust Co. of Chicago,* 411 Ill. 345, 104 N.E.2d 246 (1952); *Outhet v. Follansbee,* 218 Ill.App. 512 (1st Dist. 1920).

See §2.17 above for a discussion of *Domo v. McCarthy,* 66 Ohio St.3d 312, 612 N.E.2d 706 (1993), in which the court held that the trustee's duties may be different if there is an unusual spendthrift clause.

Conversely, the trustee may oppose a family settlement agreement between beneficiaries of a trust that would provide for the termination of the trust and be highly beneficial to all of the beneficiaries when there is no bona fide family dispute. *See In re Estate of Siaw,* 2015 IL App (1st) 141070-U. In *Estate of Siaw,* two siblings entered into a family settlement agreement to resolve which of the two wills executed by the decedent controlled the distribution of his assets. The trustee, as a legatee under one of the wills, filed a response opposing the family settlement agreement. The trial court entered an order approving the family settlement agreement, but the appellate court reversed, holding that a bona fide dispute between the beneficiaries must exist to justify modification of the settlor's intent and that such a dispute did not exist. The appellate court reasoned that the only reason for bypassing the decedent's estate plan was to accelerate the passage of assets to his children and that such acceleration was contrary to the decedent's intent as expressed in the provisions of his trust.

b. [2.22] Duty To Transfer Title or Possession

With the termination of the trust, the trustee is under a duty to transfer title and distribute assets to the beneficiaries. If the termination does not automatically vest the beneficiaries with title, the trustee must take the steps necessary to pass title and possession. The trustee is under a duty to make distribution with as little delay as possible, although distribution must not be made in such a way as to cause a breach of the trustee's duty to preserve and protect the title to trust property. The trustee is not under a duty to make a distribution until the trustee has had reasonable opportunity to assemble a final accounting and have it approved by the beneficiaries or by the court, if required. However, to the extent that a partial distribution can be made without jeopardizing the interests of the beneficiaries or unduly subjecting the trustee to liability, such distribution should be made. The trustee has no duty to make any distribution whatsoever if the trustee has a reasonable doubt of either the identity of the beneficiaries or the respective interests that they have in the trust property.

c. [2.23] Duty To Account on Termination

The Trusts and Trustees Act provides a procedure by which a trustee may furnish a final accounting to the residuary beneficiaries and be discharged from any further duty to account. See 760 ILCS 5/11. If the trustee complies with the Act and furnishes all necessary documentation to the beneficiaries, the trustee's account is "binding on the beneficiaries receiving the same and all persons claiming by or through them" three years after the date the final accounting is furnished (unless there is fraud in accounting). 760 ILCS 5/11(b). Note that the final accounting does not form the basis for a discharge if the trustee does not "make available to such beneficiaries copies of prior accounts not theretofore furnished." *Id.*

For trusts that terminated and were distributed ten years or less prior to January 1, 1988, the trustee's accounting similarly must be binding within five years from January 1, 1988, or within ten years from the date the final accounting was furnished, whichever is longer. 760 ILCS 5/11(c).

For trusts that terminated and were distributed more than ten years prior to January 1, 1988, the trustee's accounting similarly must be binding within two years from January 1, 1988. 760 ILCS 5/11(d).

In the case of a beneficiary under a legal disability, the trustee should deliver the accounting to the beneficiary's estate, or, if no representative for the estate of a beneficiary under legal disability has been appointed, the accounting shall be binding if delivered to a spouse, parent, adult child, or guardian of the person of the beneficiary. 760 ILCS 5/11(e).

The Trusts and Trustees Act's discharge provision applies to all Illinois trusts, even those created before the first effective date of the Act. 760 ILCS 5/3(2).

Again, however, note the limitations on any accounting approval by a beneficiary, with respect to claims by the beneficiary of fraud on the part of the trustee. *Janowiak v. Tiesi,* 402 Ill.App.3d 997, 932 N.E.2d 569, 342 Ill.Dec. 442 (1st Dist. 2010).

3. [2.24] Duties of the Attorneys for the Trust

Illinois courts express and impose separate duties of loyalty and good faith on attorneys representing a trust. At least two cases in which the courts discuss these duties have arisen in the context of the common practice of representing the family in trust administration matters, and they serve to highlight the fact that the attorney's chief duty — like the trustee's first duty — is owed to the trust. Attorneys practicing in this area should be aware of these duties; a failure to perform them may result in harsh penalties.

The court in *Greene v. First National Bank of Chicago,* 162 Ill.App.3d 914, 516 N.E.2d 311, 114 Ill.Dec. 156 (1st Dist. 1987), *appeal denied,* 119 Ill.2d 556 (1988), found that the attorney for the settlor owed a duty of loyalty to her not only to draft an estate plan properly expressing her wishes but also not to make disclosures to third parties concerning the estate plan. In *Greene* (discussed in §2.7 above in the context of the trustee's duty to preserve the confidence of the plan), the plaintiff complained that the attorney, who had drafted a power of appointment over a trust for the decedent and who, at the same time, represented other members of the family, including the plaintiff, owed the plaintiff a duty to disclose her mother's plan to her. The court found that the attorney owed the plaintiff no such duty and that discussing the plan with her would have violated the attorney's duty to the settlor.

In *In re Estate of Halas,* 159 Ill.App.3d 818, 512 N.E.2d 1276, 111 Ill.Dec. 639 (1st Dist. 1987), *appeal denied,* 119 Ill.2d 557 (1988), *distinguished by In re Estate of Halas,* 209 Ill.App.3d 333, 568 N.E.2d 170, 154 Ill.Dec. 170 (1st Dist. 1991), the attorneys representing the executors of the estate and the trustees of the residuary testamentary trust were removed and their fees for work done during the first several years of administering a multimillion dollar estate were halved when the court found that they acted in bad faith and breached both their independent fiduciary duty to the trust beneficiaries and their derivative fiduciary duty (derived from the attorneys' duty to the trustee) to the beneficiaries. The court found that the attorneys had "failed to protect the best interests of the beneficiaries" by overstaffing the matter, by duplication of effort, and by using inexperienced attorneys to research settled points of law. 512 N.E.2d at 1283.

Further, in direct violation of a court order, the attorneys had effected a corporate reorganization of the major asset of the estate (a minority interest in the Chicago Bears professional football team) without informing the guardian of the beneficiaries. During the reorganization, the attorneys represented other family members as well as the corporation. As a result of the reorganization, the court found that other family members had benefited while the minority position of the estate was damaged by the corporate change. The attorneys filed accountings for the estate that were deceptively timed to avoid revealing the reorganization to the beneficiaries or the court. (The first accounting was filed several months after the reorganization took place but was only for the period through the day before the reorganization; the next accounting was delayed for almost 17 months.) The attorneys had represented to the court that the executors were agreed on certain actions when, in fact, one of the executors had never been consulted and refused to take the action the attorneys suggested to him.

Emphasizing the independent nature of the duty owed by an attorney, the *Halas* court found that the duty had been breached even though the executors-trustees had not acted improperly or imprudently. "The attorney . . . must act with due care and protect the interests of the beneficiaries." 512 N.E.2d at 1280. However, over the objections of the beneficiaries, the attorneys were allowed approximately half of the fees they sought because their actions were done merely in bad faith and not "with malice." 512 N.E.2d at 1285 – 1286. *See also In re Estate of Bitoy,* 395 Ill.App.3d 262, 917 N.E.2d 74, 334 Ill.Dec. 477 (1st Dist. 2009).

In connection with the allocation of attorneys' fees against particular trust shares (and some complications that may arise because the court overruled the beneficiaries' agreement on how the attorneys' fees should be charged), *see Continental Illinois National Bank & Trust Company of Chicago v. Sax,* 199 Ill.App.3d 685, 557 N.E.2d 475, 145 Ill.Dec. 705 (1st Dist. 1990).

The attorney for the fiduciary has a duty of loyalty to the estate and the beneficiaries, derived from the fiduciary's duty of loyalty. For a review and commentary on some of the ethical guidelines to be applied in an estate planning context, see American College of Trust and Estate Counsel (ACTEC), *ACTEC Commentaries on the Model Rules of Professional Conduct,* 28 Real Prop.Prob. & Tr.J. 865 (1994), which offers the following example of the attorney's duty to inform the beneficiaries of the fiduciary's breach of duty:

> **Trustee asked Lawyer about the propriety of speculating in commodity futures with trust assets. Lawyer advised that such speculation was not permitted under local law or the trust instrument. Trustee speculated nevertheless, and the trust suffered a serious loss. However, Lawyer was not required under the terms of the representation to monitor the Trustee's investments.**
>
> **If Trustee prepares an accounting that is misleading, in an attempt to hide the loss, Lawyer must not participate in the accounting. Lawyer should attempt to convince Trustee to make an honest accounting. In some states Lawyer may be required to take unilateral action to inform the beneficiaries of the situation. In any event if Lawyer cannot persuade Trustee to make a proper accounting, he or she should probably withdraw.**

Even if Trustee had not initially made an improper accounting to hide the problem, in some jurisdictions Lawyer might yet have to call the breach of duty in managing the investments to the attention of the beneficiaries. He or she may not offer the beneficiaries legal advice but may recommend that they obtain independent counsel.

Consistent with this ACTEC example, *see Pierce v. Lyman,* 1 Cal.App.4th 1093, 3 Cal.Rptr.2d 236 (1991), in which beneficiaries sued the trustees and their attorneys, alleging that (a) the trustees had breached their fiduciary duties by making risky and imprudent investments so that the value of the trust declined by more than $2 million and (b) the attorneys for the trustees had deliberately prepared and filed annual accountings with the probate court designed to conceal the losses. The trial court dismissed the complaint against the attorneys because of a lack of privity. The appellate court reversed, holding that, while under California law an attorney for a trust normally would have no liability to beneficiaries for advice given to the trustee, if an attorney assisted the trustee in breaching the trustee's fiduciary duty to the beneficiaries, then the beneficiaries would have a cause of action against the attorney. (Nevertheless, see Cal.Civ. Code §1714.10, concerning actions against an attorney for civil conspiracy, which was enacted after this case was decided.)

Beneficiaries can sue for injuries to a trust when the trustee is itself involved in culpable misconduct against the trust, necessitating the bringing of an action by the beneficiaries. *Basista v. Alms,* 2015 IL App (1st) 142114-U. In *Basista,* the plaintiff, who was the parent and legal guardian of the minor beneficiaries of the trust, alleged that the beneficiaries had been deprived of their share of the trust as a result of the attorney's negligent advice to his client, the executor and trustee of the trust, who converted trust assets to her own use. The appellate court reversed the trial court's order dismissing the plaintiff's complaint in order to allow the plaintiff to amend the complaint to plead a legal malpractice claim against the attorney on behalf of the trust.

In *Jewish Hospital of St. Louis, Missouri v. Boatmen's National Bank of Belleville,* 261 Ill.App.3d 750, 633 N.E.2d 1267, 1271, 199 Ill.Dec. 276 (5th Dist.), *appeal denied,* 157 Ill.2d 503 (1994), the charitable beneficiaries of a trust sued the bank executor and its attorney and accountant because more than $800,000 of the trust principal had been "unnecessarily" paid in estate tax when the decedent's plan included a nonqualifying charitable split-interest trust and the executor failed to file a timely petition to reform the trust. The bank's attorney also was the decedent's attorney and drafted the defective trust. The trial court granted summary judgment for all defendants. The appellate court (a) reversed summary judgment as to the attorney and accountant and found that an action might be maintained against them because of the improper estate planning advice given the decedent but (b) held that no action could be maintained against the bank. The bank reasonably relied on the attorney. The court found that the bank had no duty to give the beneficiaries "options" concerning the trust and tax liability because the reformation had differing impacts on the different beneficiaries — possibly reducing the interests of the noncharitable beneficiaries while enhancing the interests of the charitable remainder beneficiaries. 633 N.E.2d at 1281. *See also Grimes v. Saikley,* 388 Ill.App.3d 802, 904 N.E.2d 183, 328 Ill.Dec. 421 (4th Dist. 2009); *Estate of Lis,* 365 Ill.App.3d 1, 847 N.E.2d 879, 301 Ill.Dec. 869 (1st Dist. 2006).

In *Hagney v. Lopeman,* 147 Ill.2d 458, 590 N.E.2d 466, 168 Ill.Dec. 829 (1992), the trial court imposed a constructive trust on the remainder interests purchased by an attorney from an estate while he was in a fiduciary relationship with the trust's life beneficiary. The attorney raised the statute of limitations as a bar to the imposition of a constructive trust. The appellate court reversed the constructive trust, finding that it was barred by the statute of limitations. The Illinois Supreme Court reversed both lower courts and remanded the case for trial. The Supreme Court ruled that more information was needed on the attorney's actions to conceal his purchase. The court found that silence on the part of the fiduciary (the attorney) when he had a duty to disclose relevant facts could amount to fraudulent concealment for purposes of the statute of limitations and that this fraud had to be specifically pleaded. *See also DeLuna v. Burciaga,* 223 Ill.2d 49, 857 N.E.2d 229, 306 Ill.Dec. 136 (2006); Todd A. Fuller, *Attorney Liability to Estate Beneficiaries: The Privity Passes Through,* 100 Dick.L.Rev. 29, 64 (1995).

4. [2.25] Power but No Duty To Decant

On January 1, 2013, the power to decant a trust became effective in Illinois. A trustee can decant by removing the assets of a trust with problematic terms and distributing them to a new trust created with more favorable terms. This power is applicable to any trust regulated under Illinois law, unless the terms of the trust prohibit the power to decant. The language of the statute provides for different distribution requirements based on the trustee's mandated discretion. If the trustee has absolute discretion, he or she is able to alter the interests of the current and successor beneficiary's distributions in the new trust. If his or her discretion is not absolute, the new trust must maintain the original distribution requirements. Although this may be a useful planning option in certain situations, the trustee does not have a duty to decant a trust and make a distribution to a new trust. 760 ILCS 5/16.4(*l*) states:

> **Notwithstanding any other provision of this Section, a trustee has no duty to inform beneficiaries about the availability of this Section and no duty to review the trust to determine whether any action should be taken under this Section.**

There are currently no cases regarding §16.4.

C. Liability of the Trustee

1. [2.26] Generally: What Constitutes a Breach?

A trustee breaches the trust when the trustee violates a duty, whether in bad faith, in good faith, negligently, or because of a mistake as to the extent of trustee duties. This is true with respect to express and implied duties set out in the trust, provided by statute, or grounded in common law. The trustee is not protected from liability because he or she acts in good faith or secures the opinion of counsel. However, the mere fact that a trustee has made a mistake in ascertaining or carrying out trust duties does not automatically make the trustee liable for a breach of trust, for the trustee is protected if he or she has acted with proper care and caution. See William K. Stevens, *Administration of a Trust,* 41 Ill.B.J. 354 (1953).

A critical question in an alleged breach of fiduciary duty is whether the trustee may use trust assets in defending against the allegation. The basic rule is that the trustee should not expect that the trust pays unless the trustee prevails and that the trustee should be careful of using or relying on trust assets until a court order is entered approving the use and amount of trust assets. In *Greenspan v. Mesirow,* 138 Ill.App.3d 294, 485 N.E.2d 1196, 92 Ill.Dec. 953 (1st Dist. 1985), nonfamily trustees, charged with serious misconduct as fiduciaries by the family beneficiaries — from the beginning of the controversy — had used trust assets to pay their litigation expenses. The plaintiffs' motion that the trustees be prohibited from using trust assets to defend the plaintiffs' action was denied by the trial court. The appellate court reversed and remanded, stating that indemnification pendente lite of the trustees from trust assets, when the fiduciaries have been accused of serious misconduct in their capacities as representatives of the same trust, is not permitted by law or public policy.

Additionally, if a trustee does not prevail, the trustee may be surcharged on any of the three theories of beneficiary remedies in connection with the breach of the duty of loyalty discussed in §2.7 above. Thus, in *Herget National Bank of Pekin v. Lampitt,* 133 Ill.App.3d 418, 478 N.E.2d 904, 88 Ill.Dec. 413 (3d Dist. 1985), discussed in §2.9 above, the trustee was surcharged for the devaluation in bank stock occurring between the time the stock was valued by the trustee and the time it was sold four years later.

On the other hand, if a beneficiary's suit is groundless, the trustee may succeed in (and can probably be charged with a duty to pursue) surcharging the beneficiary's share of the trust assets for the costs of defending against the charges raised by that particular beneficiary. *Spiegel v. Continental Illinois National Bank,* 790 F.2d 638, 650 (7th Cir. 1986) (trust beneficiary's complaint under Racketeer Influenced and Corrupt Organizations Act (RICO), Pub.L. No. 91-452, Title IX, §901(a), 84 Stat. 941 (1970), against corporate trustee, in part, based on corporate trustee's use of trust assets to defend against RICO suit, was "frivolous" and justified imposition of sanctions in amount of double attorneys' fees against plaintiff); *Webbe v. First National Bank & Trust Company of Barrington,* 139 Ill.App.3d 806, 487 N.E.2d 711, 93 Ill.Dec. 886 (2d Dist. 1985) (beneficiary's trust share was charged with expenses of other beneficiaries in connection with suit). *But see Chicago City Bank & Trust Co. v. Pick,* 235 Ill.App.3d 252, 602 N.E.2d 484, 176 Ill.Dec. 830 (1st Dist. 1992), in which such fees were not allowed. *See also Heritage Pullman Bank & Trust Co. v. Carr,* 283 Ill.App.3d 472, 670 N.E.2d 814, 219 Ill.Dec. 136 (1st Dist. 1996).

Finally, when in doubt, the trustee should seek court construction of the instrument. The court in *Comtrade, Inc. v. First National Bank of Highland Park,* 146 Ill.App.3d 1069, 497 N.E.2d 527, 100 Ill.Dec. 549 (2d Dist. 1986), found no breach of trust when the trustee filed an interpleader action to determine the proper method of winding up a trust, as the beneficiaries disagreed on how the trust fund should be distributed and the trust instrument was silent. *See also Bornstein v. First United,* 232 Ill.App.3d 623, 597 N.E.2d 870, 173 Ill.Dec. 896 (1st Dist. 1992); *Northern Trust Co. v. Heuer,* 202 Ill.App.3d 1066, 560 N.E.2d 961, 148 Ill.Dec. 364 (1st Dist. 1990); *Bangert v. Northern Trust Co.,* 362 Ill.App.3d 402, 839 N.E.2d 640, 298 Ill.Dec. 317 (1st Dist. 2005), *appeal denied,* 218 Ill.2d 535 (2006); *Cartwright v. Moore,* 394 Ill.App.3d 1, 913 N.E.2d 1163, 332 Ill.Dec. 873 (1st Dist. 2009); *Grate v. Grzetich,* 373 Ill.App.3d 228, 867 N.E.2d 577, 310 Ill.Dec. 886 (3d Dist. 2007).

2. [2.27] Exoneration Provisions

The terms of the trust instrument (a) may authorize the trustee to take actions that would normally constitute a breach or (b) may generally purport to relieve the trustee from liabilities resulting from certain breaches of the trust. The exculpatory language of these exoneration provisions has been given effect in Illinois. *Axelrod v. Giambalvo,* 129 Ill.App.3d 512, 472 N.E.2d 840, 84 Ill.Dec. 703 (1st Dist. 1984); *MAJS Investment, Inc. v. Albany Bank & Trust Co.,* 175 Ill.App.3d 478, 529 N.E.2d 1035, 124 Ill.Dec. 918 (1st Dist. 1988).

A typical provision in the first category of exoneration may authorize the trustee to take specific actions that would otherwise be construed as a breach, such as favoring one beneficiary over another or retaining unproductive or otherwise improper trust investments.

The second and more common type of provision is an exoneration of the trustee from liability for any actions he or she has taken or not taken as long as the trustee was acting in good faith or as long as the actions did not constitute gross negligence or an intentional breach of the trust.

Either type of provision may be ineffective to relieve the trustee from liability in certain instances, such as when the breach was not within the scope of the limiting provision or when the limiting provision was void as against public policy or was improperly inserted in the trust instrument. *See Stiles v. Whalen,* No. 13 C 3516, 2013 WL 6730797 (N.D.Ill. Dec. 20, 2013) (denying trustee's motion to dismiss claims of breach of fiduciary duty despite exculpatory clause in trust when plaintiff alleged trustee breached his fiduciary duties by not administering trust according to its terms, by failing to collect interest on loans made to certain beneficiaries, by allowing cotrustee to make unauthorized distributions from trust, by paying himself excessive fees, by employing unqualified appraiser to value properties, and by misappropriating funds from trust).

The distinction between the two types of provisions is important because the latter category of exoneration clauses (relieving the trustee from liability) is more prone to attack by the court and by trust beneficiaries. As an example, if the trustee is expressly permitted by the trust instrument to invest in a manner that is otherwise prohibited under the statute, it is fairly clear that such an investment is not a breach of trust. *But see Herget National Bank of Pekin v. Lampitt,* 133 Ill.App.3d 418, 478 N.E.2d 904, 88 Ill.Dec. 413 (3d Dist. 1985) (discussed in §2.9 above). However, if the trust merely contains a provision relieving the trustee from liability for acts constituting only ordinary negligence, then the action of the trustee in making improper investments clearly is a breach, and the trustee is protected, if at all, only to the extent that the trustee's liability can be deemed restricted.

It would be expected that a trustee insulated from liability because of an exculpation provision contained in the trust instrument (or separate agreement entered into with the trust's beneficiaries) would be challenged on the right to receive compensation from actions that constituted the breach. *Sauvage v. Gallaway,* 335 Ill.App. 35, 80 N.E.2d 553 (4th Dist. 1948); *Continental Illinois Nat. Bank & Trust Co. of Chicago v. Kelley,* 333 Ill.App. 119, 76 N.E.2d 820 (1st Dist. 1948); *Jarrett v. Johnson,* 116 Ill.App. 592 (1st Dist. 1904), *aff'd,* 216 Ill. 212 (1905); *Jones v. Heritage Pullman Bank & Trust Co.,* 164 Ill.App.3d 596, 518 N.E.2d 178, 115 Ill.Dec. 653 (1st Dist. 1987).

Trust provisions relieving a trustee from liability, as opposed to those expanding a trustee's powers, are more strictly construed against the trustee and are given effect only to the extent that it is clear that the trustee should be relieved from liability. Thus, in *Tuttle v. Gilmore,* 36 N.J.Eq. 617 (N.J. 1883), the court held that when a trustee breached the trust by investing in unauthorized assets, the trustee was liable for the breach even though there was a provision limiting liability to those cases in which there was a willful and intentional breach. The trustee was able to show that no personal benefit was derived from investing in the assets and that the motives were solely in the best interests of the beneficiaries. The court, however, held that since the trustee knew the investments were unauthorized, the limitation clause was ineffective to insulate the trustee from liability. The facts that there was no personal benefit to the trustee and that the trustee's primary concern was for the beneficiaries were irrelevant.

Provisions relieving a trustee from liability also may be subject to attack on the ground that they are void as against public policy. No matter how broad an exoneration provision may be, the trustee is liable if he or she breaches the trust in bad faith, intentionally, or in a grossly negligent manner or has profited personally through the breach of the trust. *Countiss v. Whiting,* 306 Ill.App. 548, 29 N.E.2d 277 (1st Dist. 1940) (cited in *Johnson v. Moon,* 3 Ill.2d 561, 121 N.E.2d 774, 776 (1954), *Health Cost Controls v. Sevilla,* 307 Ill.App.3d 582, 718 N.E.2d 558, 564, 240 Ill.Dec. 925 (1st Dist. 1999), and *Axelrod, supra,* 472 N.E.2d at 844).

As one court has stated,

> **the law . . . determines a point beyond which the parties cannot agree to relieve a trustee from liability for breach of a trust duty. For instance, a trustee cannot contract for immunity from liability for acts of gross negligence or for acts done in bad faith. Such contracts are invalid because repugnant to law.** *Browning v. Fidelity Trust Co.,* 250 F. 321, 325 (3d Cir.), *cert. denied,* 39 S.Ct. 9 (1918).

Finally, exculpatory provisions are ineffective to protect a trustee from liability when the provisions have been inserted in the trust instrument because of the undue influence of the trustee or because the trustee violated or abused a confidential or fiduciary relationship with the settlor. Thus, if an attorney names himself or herself as trustee and inserts an exculpation clause relieving the attorney from liability for ordinary negligence and the clause is not pointed out and explained to the settlor, the clause probably will be ineffective. *In re Will of Putnam,* 257 N.Y. 140, 177 N.E. 399 (1931). The same rule would seem to apply if the trustee requested that the settlor's attorney include an exculpation clause to protect the trustee and the settlor was unaware of the existence of the clause or did not understand it or did not know that it was inserted at the request of the trustee.

III. POWERS OF THE TRUSTEE

A. [2.28] In General

The powers of the trustee are derived primarily from two sources: the terms of the trust instrument and the provisions of the applicable state statutes. Normally, it should be unnecessary to seek court authorization or direction when confronted with a question of whether a certain power may be exercised by the trustee.

1. [2.29] Terms of the Trust

In determining the extent to which the trust instrument grants authority to the trustee to exercise various powers, it is appropriate to consider not only the plain meaning of the language used but also the apparent overall intent of the settlor. If the terms of the trust are not entirely specific as to a given power but it appears from a reading of the entire trust instrument that the exercise of that power would be consistent with the objectives of the trust, the trustee should feel justified in proceeding accordingly. Thus, if an act is deemed necessary or appropriate to carrying out the purposes of the trust and is not actually prohibited by its terms, then the act should be permissible.

Even if the terms of the instrument prohibit a certain act, it may be concluded that, in view of a change in circumstances since the establishment of the trust, a deviation from the terms can be justified as being in the best interests of the beneficiaries. In that case, however, it is not advisable to proceed without obtaining court authorization first.

A trust instrument also may restrict a trustee's powers. For example, in *Metz v. Independent Trust Corp.,* 994 F.2d 395 (7th Cir. 1993), the Seventh Circuit denied the grantor-beneficiary's claim against the trustee, in part due to the grantor's retention of sole authority to direct the investment of the trust account. The grantor had directed the trustee to invest the trust account with a designated investment advisor, who subsequently absconded with the trust funds. The grantor sought to recover from the trustee, asserting in part that exculpatory language in the trust agreement violated federal and Illinois public policy. The Seventh Circuit rejected these arguments, characterizing the trustee's powers as nondiscretionary and passive and finding that exculpatory protection of a trustee is enforceable absent bad faith or reckless indifference on the part of the trustee. *See also Walker v. Northern Trust Co.,* No. 06 C 4901, 2008 WL 191182 (N.D.Ill. Jan. 22, 2008) (holding that summary judgment was appropriate in favor of trustee faced with claim by beneficiary for denying discretionary distributions when trust instrument clearly granted such discretion to advisory committee). Similarly, in *Woolard v. Woolard,* 547 F.3d 755 (7th Cir. 2008), the Seventh Circuit held that distributions made by a trustee to a beneficiary's father, purportedly for the benefit of the minor beneficiary, was a breach of the express terms of the trust because the trust agreement allowed for distributions only directly to the beneficiary, to the legally appointed guardian of the beneficiary, or to a custodian under the Illinois Uniform Transfers to Minors Act.

As discussed in §§2.30 and 2.61 below, §16.3 of the Trusts and Trustees Act codifies the concept of the directed trust, in which the powers of the trustee may be carefully circumscribed by the trust instrument. For example, the trust instrument may provide that an individual other than the trustee (a directing party) shall direct the trustee with respect to the purchase, sale, or encumbrance of trust assets. In that case, the trustee (an excluded fiduciary) shall have no liability as a fiduciary for following the direction of the directing party, except in cases of willful misconduct. 760 ILCS 5/16.3(f). At the same time, the Act provides that the directing party shall be considered a fiduciary subject to the same duties and standards applicable to a trustee unless the governing instrument provides otherwise. 760 ILCS 5/16.3(e). While it has long been common for trust instruments to unbundle the powers of the trustee by giving one or more parties other than the trustee the power to make specified decisions or direct the trustee with respect to investments or distributions, §16.3 of the Act defines the division of duties and liabilities of the trustee and other parties in such arrangements. In that regard, the Act's imposition of order on the interactions of multi-participant trusts is a welcome development, especially from the perspective of the trustee, who may be relieved to follow directions from another party as to the management of a particular asset. For an overview of the problems and opportunities inherent in modern, multi-participant trusts, see John P.C. Duncan and Anita M. Sarafa, *Achieve the Promise — and Limit the Risk — of Multi-Participant Trusts,* 36 ACTEC L.J. 769 (2011).

2. [2.30] Effect of Statutes

The Trusts and Trustees Act contains an enumeration of statutory powers granted to trustees. Sections 4.01 – 4.08, 4.10 – 4.12, and 4.14 – 4.24 of the Act apply only to trusts executed on or after October 1, 1973. 760 ILCS 5/3(2). Section 17 of the Act, 760 ILCS 5/17, applies only to orders entered on or after October 1, 1973, that pertain to eminent domain or partition proceedings. 760 ILCS 5/3(2). Other provisions of the Act apparently apply to all Illinois trusts without regard to the date on which the trust instrument was executed. For example, §16.3 of the Act, 760 ILCS 5/16.3, governing directed trusts, applies to all trusts in existence on January 1, 2013, or created after that date. 760 ILCS 5/16.7. Section 16.3 of the Act pertains to the administration of a trust administered in Illinois under Illinois law or that is governed by Illinois law with respect to the meaning and effect of its terms, except to the extent that the governing instrument expressly prohibits §16.3 from applying to the trust by specifically referencing §16.3. 760 ILCS 5/16.7.

The Trusts and Trustees Act recites that its provisions are applicable to a trust only "to the extent that they are not inconsistent with the provisions of the instrument." 760 ILCS 5/3(1). Illinois courts have held that the "Act merely establishes a set of default rules applicable when not in conflict with the terms of a trust agreement." *Woolard v. Woolard,* 547 F.3d 755, 759 (7th Cir. 2008). Accordingly, reference should be made to the Act only after it is determined that the trust instrument neither grants nor prohibits a given power. However, the terms of the instrument must be carefully reviewed in making such a determination and in deciding whether the Act may be relied on to expand on the terms. For example, the Act gives the trustee power to make distributions in a number of alternative ways if certain circumstances exist. See 760 ILCS 5/4.20, quoted in §2.51 below. If the trust instrument authorizes distributions in some but not all of the ways set forth in the Act, a determination must be made as to whether the settlor intended to limit the grant of power in the instrument, thus precluding reliance on the Act to expand on that power. For example, in *Woolard,* a trustee could not rely on the fact that the Act authorized distributions to an adult relative of a minor beneficiary because — although the trust did not specifically prohibit such distributions — by mirroring other sections of the Act regarding distributions, it was held that the grantor intentionally excluded such power from the trust agreement.

B. [2.31] Statutory Powers

The powers discussed in §§2.32 – 2.58 below are set forth in the order of their appearance in the Trusts and Trustees Act. The discussion in each section is addressed to documents not specifically governed by the Act or by previous statutory provisions and is accompanied by either a quotation or a summary of the specific provision in the Act.

1. [2.32] Selling Trust Property

The trustee may properly sell trust property if (a) the trustee has the power to do so under the terms of the instrument or (b) it is necessary or appropriate to sell to carry out the purposes of the trust.

First, the intention of the settlor, as manifested by the language of the trust and the circumstances surrounding its establishment, must be ascertained to determine whether the trustee is authorized to sell trust property. Words of similar import, such as the power to "dispose of" or to "invest and reinvest" trust property, may be relied on in most circumstances as being tantamount to a power to sell.

The terms of the instrument must be followed if they expressly require or expressly prohibit the sale of trust assets or provide for sales only under certain circumstances. However, there are occasions when the court may permit a deviation from the terms, particularly if compliance would defeat the purposes of the trust. Early caselaw suggested that only in extreme cases would it be permissible for a court of chancery to deviate from the terms of a trust and that the exercise of the power must be based on facts showing that conditions had arisen or exigencies had developed that could not have been foreseen by the donor and that, as a result of the unforeseen conditions, the beneficiaries would suffer loss. The mere fact that a sale of trust property might benefit the beneficiaries was an insufficient basis for authorizing the sale. *See, e.g., Johns v. Johns,* 172 Ill. 472, 50 N.E. 337 (1898); *Gavin v. Curtin,* 171 Ill. 640, 49 N.E. 523 (1898); *Curtiss v. Brown,* 29 Ill. 201 (1862). In 1929, however, the legislature amended §50 of the former Chancery Act (now codified at §17.1 of the Trusts and Trustees Act) to permit the court to order the sale of trust property if

> **it is made to appear that such lands or estate are liable to waste or depreciation in value, or that the sale thereof and the safe and proper investment of the proceeds will inure to the benefit and advantage of the persons entitled thereto, or that it is otherwise necessary for the conservation, preservation or protection of the property or estate or of any present or future interest therein.** 760 ILCS 5/17.1.

Subsequent caselaw interpreting this portion of the statute suggests that the statute was intended to liberalize the common law and that the court clearly has the power to order a sale if the sale inures to the benefit of the trust beneficiaries without the necessity of showing that the sale is required to protect the trust estate from loss or to prevent a total loss of the trust estate. However, even under the more liberal statutory standard, before the court authorizes a sale when no power of sale is contained in the trust instrument, it will seek to determine that the main object of the trust is best served by that action and that the intent of the trust is carried out. *American State Bank v. Kupfer,* 114 Ill.App.3d 760, 449 N.E.2d 1024, 70 Ill.Dec. 677 (4th Dist. 1983); *Shamel v. Shamel,* 3 Ill.2d 425, 121 N.E.2d 819 (1954). For the same reasons, the court may permit retention of property that has been directed to be sold by the terms of the instrument.

In *Durdle v. Durdle,* 223 Ill.App.3d 964, 585 N.E.2d 1171, 166 Ill.Dec. 149 (4th Dist. 1992), the appellate court declined to order a sale of trust real estate at the behest of certain trust beneficiaries. The court found that a court-ordered sale is appropriate only in the event of a change in circumstances that was not foreseen by the grantor. In *Durdle,* the court found no such change in circumstances, such as waste or depreciation in value. In addition, the court clearly was perturbed by the beneficiaries' repeated legal attacks against the trustee, which the court characterized as "legal-expense blackmail." 585 N.E.2d at 1175.

If the language of the instrument is inconclusive, or in the absence of any language relating to the sale of trust assets, consideration should be given to the purposes for which the trust was established. A power of sale can be implied if the trust purposes require it. Thus, if the trust provides for the payment of a certain annuity or for the support of the beneficiary and the only way to obtain funds for required payments is by a sale of trust property, then the trustee is justified in making a sale. *Cherry v. Greene,* 115 Ill. 591, 4 N.E. 257 (1886).

Also to be considered is the type of trust property in question. When a trust holds an improper investment, such as unproductive property, there is a power, if not a duty, to sell it and invest the proceeds in income-producing property.

The trustee also may consider obtaining the approval of beneficiaries for a sale of trust assets. The consent of a beneficiary, as long as the beneficiary is legally competent, is aware of all relevant facts, and has not been improperly induced to give the consent, can preclude the beneficiary from having a trust sale set aside. Proceeding in this manner requires careful consideration by the trustee, for the trustee should consider the possible objections of all present and future beneficiaries. The terms of the trust may, of course, provide that a beneficiary's consent is a necessary prerequisite to any sale of trust assets.

Any method of sale may be used by the trustee as long as it is reasonably necessary and results in a prudent handling of the transaction. Thus, it is not necessarily improper to sell to a beneficiary, to sell on credit (if the property is of sufficient value and that is the only way the sale can be advantageously made), or to exchange trust property for other property. Granting options to purchase trust property normally is not considered proper in that it involves giving up the trustee's discretion before the time of sale. However, it may be permissible if it is considered prudent in light of the circumstances and if a sale cannot be effected otherwise.

760 ILCS 5/4.01 gives the trustee power "[t]o sell, contract to sell and grant options to purchase any part or all of the trust estate at public or private sale, for cash or on credit, and to exchange any part or all of the trust estate for other property."

2. [2.33] Leasing Trust Property

Generally, the trustee has the duty to make trust property productive. See §2.16 above. The trustee thus may have an implied power to enter into leases of property that is currently producing no income even though there may be no provision in the instrument for making leases. However, the trustee must comply with the terms of the trust if the terms expressly prohibit leasing trust property unless the trustee believes that doing so is detrimental to the interests of the beneficiaries, in which case the trustee should seek court direction. The court has the power to authorize leases but does not exercise that power if the trustee already has appropriate authority under the terms of the instrument.

The provisions of a lease should be considered in light of all relevant circumstances. Its terms should be of a length considered necessary to secure a good tenant. Other considerations in determining the propriety of a lease are the purposes of the trust, the interests of the beneficiaries, the value of the property, and the normal methods of dealing with the property in the community.

Normally, a power to lease includes an authority to enter into leases that begin in the future, but only to an extent not inconsistent with the best interests of the trust. For instance, it may be considered imprudent for the trustee to bind himself or herself to a lease far in advance of the time of its commencement. On the other hand, there should be no objection to the execution of a renewal of a current lease to take effect in a relatively short period of time.

With regard to leases of oil, gas, and other minerals, as well as participation in mineral development generally, see §2.53 below and Chapter 6 of this handbook. Regarding leases of farm property, see §2.52 below.

760 ILCS 5/4.02 gives the trustee power "[t]o enter into leases for any period of time, though extending beyond the termination of the trust." Additionally, if a trust has a sole beneficiary and that beneficiary authorizes the trustee to enter into a lease that extends beyond the term of the trust, the resulting lease cannot be held invalid. *LaSalle National Bank v. Khan,* 191 Ill.App.3d 41, 547 N.E.2d 472, 138 Ill.Dec. 305 (1st Dist. 1989). See §§2.21 – 2.23 above for a discussion of the trustee's general duties at the termination of the trust.

3. [2.34] Borrowing and Mortgaging Trust Property

The power to mortgage rests on the same general considerations as the power of sale, although there is a greater risk involved in mortgaging trust property in that the trustee receives less than its full value at the time of the transaction and runs the risk of subsequently losing the property. If the power to mortgage is not specifically expressed in the instrument, that power may be implied when there is a necessity to improve trust property to make it income productive. However, if there is no power granted and the trust purposes do not justify a mortgage, the trustee breaches his or her duty by mortgaging trust property. Accordingly, in situations not covered by the Trusts and Trustees Act, consideration should be given to seeking court authorization.

The power to purchase property subject to a mortgage or to give a purchase-money mortgage should be viewed in the same light as the power to mortgage property. These are not normally considered proper acts and should be undertaken only with express authority from the terms of the trust, the Trusts and Trustees Act, or a court order.

The court may permit deviations from the terms of the instrument if there are circumstances not originally anticipated by the settlor and strict adherence to trust terms would defeat the overall objectives of the trust. *Johns v. Montgomery,* 265 Ill. 21, 106 N.E. 497 (1914). Thus, when there is an express prohibition against mortgaging, the court may permit a mortgage if it is necessary to prevent a sacrifice of the trust property. The objective, however, must be to prevent disaster. If the power to mortgage is not expressly or impliedly granted by the terms of the instrument, a court will not be inclined to approve a mortgage if there is no emergency involved and the mortgage is desired merely to improve the value of trust property.

The trustee may have the power to borrow money without security if that action is necessary to accomplish the purposes of the trust even if the terms of the instrument do not specifically empower the trustee to do so. If the trustee has borrowed funds and used them for the benefit of the trust, the lender may reach the trust assets to the extent of this benefit. This is true even when the trustee has exceeded his or her powers.

The trustee's power to pledge trust assets may not be exercised by an attorney-in-fact acting pursuant to a durable power of attorney executed by the grantor that does not expressly authorize the attorney-in-fact to sign loan guaranties on behalf of the trust. *See Amcore Bank, N.A. v. Hahnaman-Albrecht, Inc.,* 326 Ill.App.3d 126, 759 N.E.2d 174, 259 Ill.Dec. 694 (2d Dist. 2001). The court in *Amcore Bank* observed that a general grant of agency, such as that contained in a broad, catchall provision in a durable power of attorney, does not give the attorney-in-fact the authority to execute loan guaranties in general, let alone on behalf of a trust. 759 N.E.2d at 182. In *Amcore Bank,* the grantor created a trust that specifically gave the trustee the power to pledge trust assets for the debts of any business in which the grantor owned at least a five-percent interest. The grantor later executed a durable power of attorney naming both his wife and his son "each individually and not jointly" as his attorney-in-fact. 759 N.E.2d at 179. The durable power of attorney was not meant to change the trust provision giving the trustee the authority to pledge trust assets and did not expressly give the attorney-in-fact the authority to sign loan guaranties, either in general or on the trust's behalf. Sometime thereafter, the grantor, who also served as the original trustee of the trust, became disabled and was replaced by a corporate successor trustee. When one of the grantor's businesses sought a line of credit for its operations, the grantor's son signed a guaranty for the loan as attorney-in-fact on the trust's behalf pursuant to the durable power of attorney. The court found that while the grantor specifically gave the trustee the power to pledge trust assets for the grantor's business debts, the grantor never expressly gave his attorney-in-fact the power to sign debt guaranties. The court further found that the general grant of agency in the durable power of attorney's catchall paragraph did not give the attorney-in-fact the authority to make contracts of guaranty. Therefore, the court held that the attorney-in-fact had no authority to sign loan guaranties, whether in general or on the trust's behalf.

760 ILCS 5/4.03 gives the trustee power "[t]o borrow money and to mortgage, pledge or otherwise encumber any part or all of the trust estate."

4. [2.35] Dealing with Real Estate

760 ILCS 5/4.04 gives the trustee power "[t]o grant easements, subdivide, improve, give consents and enter into contracts relating to real estate or its use and to dedicate any interest in real estate."

This provision serves to expand other specific powers on which the trustee may rely in dealing with real property comprising a portion of the trust. See Chapter 6 of this handbook for a general discussion of real estate as a trust investment. The provision giving the trustee power to grant easements may be useful in taking advantage of the federal estate tax benefits available for conservation easements granted upon or after death. See 26 U.S.C. §§2055(a), 2055(f), and 2031(c). Internal Revenue Code §2031(c)(9) contemplates the grant of a conservation easement after the decedent's death (*i.e.,* during the estate administration), provided that an appropriate election is made on the decedent's timely filed federal estate tax return.

5. [2.36] Appointing Trustees To Deal in Other Jurisdictions

760 ILCS 5/4.05 gives the trustee power

[t]**o designate or appoint a trustee to act in any other jurisdiction as sole trustee or co-trustee of any part or all of the trust estate located in such other jurisdiction; to confer upon the appointed trustee any or all of the rights, powers and duties of the appointing trustee; and to remove the appointed trustee.**

To the extent that the exercise of this power becomes necessary or desirable, the trustee should consider carefully not only the identity of the appointee but also the extent to which the trustee feels justified in delegating rights, powers, and duties. In a typical case, it may be prudent to limit as fully as possible the discretion conferred. See §2.13 above.

6. [2.37] Entering into Agreements for Deposit and Custody Accounts

760 ILCS 5/4.06 gives the trustee power

[t]**o enter into agreements for bank or other deposit accounts, safe deposit boxes, custodian, agency or depositary arrangements for all or any part of the trust estate, including agreements for such services provided by a bank operated by or affiliated with the trustee, and to pay reasonable compensation for those services, including compensation to the bank operated by or affiliated with the trustee, except that nothing in this Section shall be construed as removing any depositary arrangements from the requirements of the prudent person rule.**

See §§2.14 and 2.15 above for further discussion relative to this power.

7. [2.38] Dealing with Investment Securities

In voting corporate shares, the trustee has the duty to promote the interests of the beneficiaries. When the trustee is required by the terms of the instrument to vote at the direction of the settlor or a beneficiary or third party, the trustee may be compelled to give a proxy. The trustee must comply and transfer the legal power to vote the shares. However, if the trustee believes that his or her duty to the beneficiaries requires seeking the assistance of the court to prevent a consequent action detrimental to the beneficiaries, then the trustee should do so.

The trustee may properly grant proxies to vote shares of stock held in the trust, particularly when the shares involved represent an insignificant percentage of the outstanding shares of the corporation. This would not necessarily be an improper delegation, particularly when routine corporate matters are under consideration. However, if the trust owns a large or controlling interest in the corporation and the vote more directly affects the interests of the beneficiaries of the trust, the trustee should not give a proxy to vote the trust's shares unless in doing so the trustee can exercise control effectively, such as by giving a special proxy in advance with specific directions for how the votes are to be cast.

The trustee owes the same duty of loyalty to the beneficiaries in voting shares of stock held in the trust as in the exercise of any other powers. See §2.7 above. The trustee is accountable if he or she acts in a self-interested manner rather than in the interests of the beneficiaries. If the trustee is also an officer or director of the corporation, the trustee has additional fiduciary obligations to the trust beneficiaries in that capacity. If the trustee is guilty of a misdeed as a corporate officer but makes good to the corporation with no loss resulting to the trust, then the trustee has no liability to the beneficiaries. If the trustee fails to make good a loss to the corporation, however, the trustee may be held liable to the beneficiaries by reason of a breach of duty, even though the breach occurred in the trustee's capacity as officer or director of the corporation rather than as trustee.

760 ILCS 5/4.07 gives the trustee the following powers:

> **(a) To exercise all the rights and powers of an individual owner with respect to shares of stock, bonds or other securities in the trust estate, including, but not by way of limitation, voting, giving proxies, participating in voting trusts, mergers, consolidations, foreclosures, reorganizations or liquidations, and exercising or selling subscription or conversion rights;**
>
> **(b) If the provisions of the trust instrument direct that the trust estate be invested in obligations issued or guaranteed by the United States or any instrumentality or agency thereof, the trustee, if he does not make such investment directly, may invest the trust estate in interests in any open-end or closed-end management type investment company or investment trust registered under the Investment Company Act of 1940, as from time to time amended, provided that the portfolio of such investment company or investment trust is limited to obligations of the United States hereinabove described and to agreements to repurchase such obligations, which agreements, with respect to principal and interest, are at least 100% collateralized by such obligations marked to market on a daily basis, if the investment company or investment trust takes delivery of such obligations either directly or through an independent custodian designated in accordance with the Investment Company Act of 1940, as from time to time amended. Nothing in this subsection (b) shall be construed as removing any such investment from the requirements of the prudent man rule.**

8. [2.39] Incurring Expenses

It is proper for the trustee to incur expenses and pay expenses out of trust assets whenever they are reasonably necessary in the administration of the trust. Thus, expenses are properly incurred when they are either (a) authorized by the terms of the instrument or (b) necessary or appropriate to carry out the purposes of the trust.

Certain expenses consistently are deemed as reasonable and necessary and appropriate charges against the trust estate, such as expenses incurred in exercising other trustees' powers (*e.g.,* expenses of sales of assets), expenses for the preservation of trust assets (*e.g.,* insurance premiums and the rental of safe-deposit boxes for securities), expenses of management, and, in most cases, expenses for repairs of trust property. Repairs, however, should be distinguished carefully from improvements to trust property. In general, repairs usually can be found to be necessary when there is an objective of maintaining income-producing assets. Improvements, on the other hand, have as their goal the enhancement of property values. Prior to embarking on a program of improvements, the trustee should determine whether there is express authority in the instrument or whether authority may be gleaned from the general intent and objectives of the trust. If it may be said that the trust's net income is not presently at a level where it should be and that improvements, in all likelihood, can result in an increase of net income, then the incurring of improvement expenses should be deemed reasonable and in the best interests of the beneficiaries.

There may be a question whether certain services fall within the purview of what would be considered the duties of the trustee and thus whether expenses are proper. It is not proper for a trustee to incur expenses in any area in which the trustee would be expected to have the appropriate skill to perform the duty in question on his or her own, as trustee, without additional compensation. See §§2.40 (appointment of agents), 2.73 (compensation of agents), and 2.76 (extra compensation) below. In all events, the expense should be of definite benefit to the trust estate.

If an expense is found to have been incurred improperly, the trustee is not entitled to reimbursement from the trust assets. Thus, the payment of improper or excessive compensation to agents or of penalties on taxes that should have been timely paid can be chargeable to the trustee individually and not reimbursable to the trustee from trust assets.

760 ILCS 5/4.08 gives the trustee power "[t]o pay taxes and reasonable expenses incurred in administering the trust estate."

In addition to the general grant of power set forth above, there is a further provision in 760 ILCS 5/7 that "[t]he trustee shall be reimbursed for all proper expenses incurred in the management and protection of the trust."

While the definition of "proper expenses" for purposes of §7 of the Trusts and Trustees Act may not always be clear, the court in *Lampe v. Pawlarczyk,* 314 Ill.App.3d 455, 731 N.E.2d 867, 247 Ill.Dec. 94 (1st Dist. 2000), highlighted certain expenses that, in the absence of express authority in the trust document, definitely are not proper. In *Lampe,* the trustee, in addition to performing certain ministerial duties, such as bookkeeping and accounting, to protect the trust assets, also performed various personal services for the grantor. The court concluded that taking the grantor grocery shopping, coordinating her medical and dental care, and performing certain household chores for her were personal services and not services performed “in the management and protection of the trust.” 731 N.E.2d at 875, quoting 760 ILCS 5/7. Accordingly, the court held that compensation for the personal services performed for the grantor was not a proper expense incurred under §7.

Just as the *Lampe* court clarified that, in the absence of express authority in the trust instrument, the trust estate may not be used to reimburse the trustee’s expenditures for the grantor’s personal benefit, neither may the trustee be reimbursed for expenses deemed to benefit the trustee rather than the trust he or she is charged to protect. In *NC Illinois Trust Co. v. Madigan,* 351 Ill.App.3d 311, 812 N.E.2d 1038, 286 Ill.Dec. 23 (4th Dist. 2004), the court denied the trustee’s request that its attorneys’ fees incurred in appealing an adverse decision related to a will construction be paid from the trust estate. In addition, the court reversed an order of the circuit court that allowed the trustee to keep trust moneys for attorneys’ fees that the trustee had already paid to a consulting attorney. See §2.40 below for a discussion of *NC Illinois Trust* with respect to using trust funds to pay a consulting attorney.

9. [2.40] Appointing Agents

Other proper expenses chargeable to the trust include payments for the service of attorneys, brokers, or other agents when the services are reasonably necessary to the administration of the trust. However, those expenses are not proper trust charges if they constitute services the trustee ought to perform personally or if they are normally covered by the trustee’s compensation, in which case there is no additional benefit to the trust. If the act consists of a proper delegation and is not otherwise being paid for as a part of the trustee’s compensation, then its payment may properly be charged against the trust assets. For further discussion of compensation to attorneys and agents, see §2.76 below.

760 ILCS 5/4.09 gives the trustee power “[t]o appoint attorneys, auditors, financial advisers and other agents and to pay reasonable compensation to such appointees.” Section 4.09 further provides:

> **If the trustee uses reasonable care, skill, and caution in the selection of the agent, the trustee may rely upon the advice or recommendation of the agent without further investigation and, except as may otherwise be provided in subsection (b) of Section 5.1 with respect to investment agents, shall have no responsibility for actions taken or omitted upon the advice or recommendation of the agent.** *Id.*

Section 4.09 applies to all Illinois trusts and trustee actions, regardless of when the trust in question was executed or the action at issue was taken. See 760 ILCS 5/3(2).

In *NC Illinois Trust Co. v. Madigan,* 351 Ill.App.3d 311, 812 N.E.2d 1038, 286 Ill.Dec. 23 (4th Dist. 2004), the court denied payment of a consulting attorney’s fee from the trust estate. *NC Illinois Trust* involved a trustee’s unsuccessful appeal from a circuit court order that terminated a charitable trust. The trustee petitioned to recover certain attorneys’ and administrative fees from the trust estate. While not granting the trustee's fee petition in full, the circuit court allowed the trustee to be reimbursed for its prior payment to an attorney for advice on whether to appeal the order terminating the trust. The trustee appealed the partial denial of its fee petition. The appellate court reversed the portion of the order of the circuit court that allowed the trustee to be reimbursed from the trust for payment of the consulting attorney's fee. The appellate court reasoned that because the appeal served only the trustee's interest in maintaining the charitable trust, the trustee could not therefore use trust assets to pay the consulting attorney.

10. [2.41] Delegating Rights, Powers, or Duties to Cotrustee

Historically, delegation of any of the trustee's duties or powers, even to a cotrustee, was improper. See §§2.13 (duty not to delegate) and 2.19 (duty with respect to cotrustees) above and 2.63 (statutory provisions relating to cotrustees) below. However, if a trustee delegates purely ministerial acts not calling for the exercise of judgment or discretion, then delegation is permissible. *See In re Trusteeship Under Last Will & Testament of Hartzell,* 43 Ill.App.2d 118, 192 N.E.2d 697 (2d Dist. 1963). In *Janowiak v. Tiesi,* 402 Ill.App.3d 997, 932 N.E.2d 569, 342 Ill.Dec. 442 (1st Dist. 2010), the court, citing *Hartzell, supra,* found that the duty to provide information to a beneficiary was not a ministerial act that could be delegated. See also 760 ILCS 5/5.1, which permits delegation of certain investment functions.

760 ILCS 5/4.10 gives the trustee power "[t]o delegate to a co-trustee for any period of time any or all of the trustee's rights, powers and duties."

11. [2.42] Compromising and Abandoning Claims

The trustee has the power to take all reasonable steps to realize on claims held by the trust. Unless all other viable alternatives have been exhausted, this power does not necessarily mean that the trustee has an obligation to bring court actions. If it is prudent to compromise claims, the trustee has the power, if not the duty, to do so. If the trustee's actions are prudent in light of all circumstances, the trustee may also justifiably submit a claim to arbitration or even abandon it if it is considered too futile, too expensive to pursue, or actually worthless.

As far as claims against the trust are concerned, the trustee has a duty to resist if they are known or believed to be unfounded. Again, the trustee may submit claims to arbitration or may compromise them if these courses are prudent under the circumstances. The trustee may, of course, apply to a court for instructions in a questionable case. See §§2.11 and 2.12 above.

With some exceptions, only the current trustee has standing to pursue claims on behalf of the trust against a third party for injury to the trust. *See, e.g., Godfrey v. Kamin,* No. 99 C 3230, 2000 WL 1847768 (N.D.Ill. Dec. 14, 2000) (dismissing contingent remainder beneficiary plaintiffs' claims because current trustees who had standing to pursue these claims were not parties to lawsuit and had not improperly refused or neglected to bring suit), *aff'd,* 19 Fed.Appx. 435 (7th Cir. 2001). *See also In re Sharif,* 446 B.R. 870, 882 (Bankr. N.D.Ill. 2011) ("The trustee, not the beneficiaries, has the exclusive authority to sue third parties who injure the beneficiaries' interest in the trust."). Beneficiaries may pursue claims against third parties when the trustee improperly refuses or neglects to bring an action against a third party, when the trustee cannot be subjected to the court's jurisdiction, or when there is no trustee and such a lawsuit is necessary to protect the interest of the beneficiary. See RESTATEMENT (SECOND) OF TRUSTS §§282(2), 282(3) (1959). *See also Tipsword v. I.F.D.A. Services, Inc.,* Civil No. 09-390-GPM, 2011 WL 2470705, *3 (S.D.Ill. June 21, 2011) ("[T]here is an exception to the general rule that beneficiaries cannot sue for injuries to a trust where . . . the trustee of a trust is itself involved in culpable misconduct against the trust, necessitating the bringing of an action by a beneficiary of the trust."). These exceptions did not apply in *Godfrey, supra,* in which the contingent remainder beneficiaries of the estate of their late father sued the former trustees of a marital trust for breach of fiduciary duties in administering the portfolio of investments held by the trust. The plaintiffs were contingent remainder beneficiaries because their mother was the sole income beneficiary of the marital trust during her lifetime, with the remainder of the trust estate to pass, upon her death per stirpes, to her then living descendants (including the plaintiffs). The court in *Godfrey* found that the defendants, as past trustees, were third parties in relationship to the trust. As a result, only the current trustees had standing to pursue claims against third parties for injury to the trust. Because the current trustees of the trust were not parties to the lawsuit and the contingent remainder beneficiary plaintiffs had failed to allege that the current trustees had improperly refused or neglected to bring suit or could not be subjected to the jurisdiction of the court, the court dismissed the lawsuit.

760 ILCS 5/4.11 gives the trustee power "[t]o compromise, contest, prosecute or abandon claims or other charges in favor of or against the trust estate."

12. [2.43] Executing Contracts and Other Documents

Contracts, notes, deeds, and other documents are generally binding on the trustee individually; the trustee does have personal liability. However, in modern times, there has been a greater tendency to permit the trustee's liability to be limited to the trustee's representative capacity. The trust may specifically limit or entirely exclude personal liability and restrict liability to trust assets. To do so effectively, however, the document must state the restrictions clearly.

760 ILCS 5/4.12 gives the trustee power

> [t]**o execute contracts, notes, conveyances and other instruments, whether or not containing covenants and warranties binding upon and creating a charge against the trust estate or excluding personal liability.**

13. [2.44] Receiving Additional Property

760 ILCS 5/4.13 gives the trustee power "[t]o receive and administer additional property as part of the trust estate or as a separate trust having terms identical to the terms of the existing trust." Section 4.13 applies to all Illinois trusts and trustee actions, regardless of when the trust in question was executed or the action at issue was taken.

See §2.15 above for a discussion of the requirement for the trustee to segregate property.

14. [2.45] Dealing with Undivided Interests in Property

In making any investment for the trust estate, the trustee should take care not to place himself or herself in the position of being unable to exercise control over that investment. The acquisition of an undivided interest in property should be made only when the trustee has an effective voice in controlling the investment and has the ability to dispose of it readily. See Chapter 6 of this handbook for a complete discussion of trust investments.

760 ILCS 5/4.14 gives the trustee power "[t]o invest in or hold undivided interests in property."

15. [2.46] Dealing with Other Trusts or Estates

The trustee has a duty to refrain from any act that may not be in the best interests of the beneficiaries. A trustee dealing with himself or herself as fiduciary of another trust or estate runs the risk, in numerous situations, of being placed in a position of not being able to serve faithfully the beneficiaries of both. 760 ILCS 5/4.15 gives the trustee power

> [t]**o deal with the executor, trustee or other representative of any other trust or estate in which a beneficiary of the trust estate has an interest, notwithstanding the fact that the trustee is an executor, trustee or other representative of the other trust or estate.**

Although §4.15 refers to situations in which a beneficiary has an interest in another trust or estate, the trustee should proceed cautiously in any situation in which fewer than all the beneficiaries of each trust are identical.

16. [2.47] Making Distributions in Cash or Kind

In determining the manner in which to allocate, divide, or distribute property to or among several beneficiaries, the trustee should consider discretionary powers contained in the instrument and the provisions of the Trusts and Trustees Act, when applicable. In all cases, consideration should be given to (a) the types of property involved and (b) whether and the extent to which it is practicable to make distributions in kind. An awareness of the income tax basis of each asset, and thus the capital gain or loss consequences of its sale, may be an important consideration in determining whether to sell or distribute an asset. Obtaining the agreement of all beneficiaries is, of course, the most satisfactory method of finalizing a plan of distribution.

760 ILCS 5/4.16 gives the trustee power "[t]o make equitable division or distribution in cash or in kind, or both, and for that purpose to value any property divided or distributed in kind." See also Chapter 8 of this handbook.

17. [2.48] Acting in Reliance on Affidavits

760 ILCS 5/4.17 gives the trustee power

> [t]**o rely upon an affidavit, certificate, letter or other evidence reasonably believed to be genuine and on the basis of any such evidence to make any payment or distribution in good faith without liability.**

The trustee has the power and duty to take whatever steps are necessary to be assured of the correct identity of beneficiaries or of the authority on which he or she is requested or directed to make payments or distributions of trust assets.

18. [2.49] Continuing All Rights, Powers, and Duties After Termination or During Pending Litigation

760 ILCS 5/4.18 gives the trustee power

> [t]**o have all of the rights, powers and duties given to or imposed upon the trustee by law and the provisions of the trust instrument during the period between the termination of the trust and the distribution thereof and during any period in which any litigation is pending which may void or invalidate the trust in whole or in part or affect the rights, powers, duties or discretions of the trustee except as otherwise directed by the court.**

The pendency of litigation affecting the trust does not impede the exercise by the trustee of powers otherwise granted to him or her. Thus, for example, a trustee may recover reasonable post-termination expenses incurred due to litigation. *Leigh v. Engle,* 714 F.Supp. 1465, *modified on other grounds,* 723 F.Supp. 1272 (N.D.Ill. 1989). In any area of doubt, court direction should be requested. *But see NC Illinois Trust Co. v. Madigan,* 351 Ill.App.3d 311, 812 N.E.2d 1038, 286 Ill.Dec. 23 (4th Dist. 2004) — discussed in §§2.39 and 2.40 above — denying reimbursement of the attorneys' fees incurred by the trustee to appeal a determination that the trust was invalid.

Upon the occurrence of the event or time when the trust is to terminate, the trustee retains the duties and powers previously held by the trustee until the trust is fully wound up. However, the trustee should limit his or her activities to working toward final distribution. See §§2.21 – 2.23 above and Chapter 8 of this handbook.

19. [2.50] Obtaining and Maintaining Insurance for the Trust

760 ILCS 5/4.19 allows the trustee "[t]o purchase and keep in force insurance of an appropriate nature and form and in a reasonable amount for the protection of the trust estate or the ownership thereof."

See §2.10 above for a discussion of insuring trust property.

20. [2.51] Distributing Income and Principal

760 ILCS 5/4.20 gives the trustee power

[t]**o distribute income and amounts of principal in such one or more of the following ways as the trustee believes to be for the best interests of any beneficiary who at the time of distribution is under legal disability or in the opinion of the trustee is unable properly to manage his affairs because of illness, physical or mental disability or any other cause:**

(a) directly to the beneficiary;

(b) to a duly appointed guardian of the beneficiary;

(c) to a custodian for the beneficiary under the Uniform Transfers to Minors Act;

(d) to an adult relative of the beneficiary;

(e) by expending the money or using the property directly for the benefit of the beneficiary; and the trustee is not required to see to the application of any distribution so made; and

(f) to a trust, created prior to the time the distribution becomes payable, for the sole benefit of the beneficiary and those dependent upon the beneficiary during his or her lifetime, to be administered as a part thereof, except that any amounts distributed to the trust pursuant to this paragraph (f) shall be separately accounted for by the trustee of the trust and shall be indefeasibly vested in the beneficiary so that if the beneficiary dies prior to complete distribution of such amounts, the amounts and the accretions, earnings, and income thereon, if any, shall be paid to the beneficiary's estate; provided, however, that this paragraph (f) shall not apply to the extent that it would cause a trust otherwise qualifying for the federal estate tax marital deduction not to so qualify.

See Chapter 5 of this handbook for a complete discussion of this provision and facility of payment clauses generally.

21. [2.52] Dealing with Farm Property

760 ILCS 5/4.21 gives the trustee power

[t]**o plant and harvest crops; to breed, raise, purchase and sell livestock; to lease land, equipment or livestock for cash or on shares, to purchase and sell, exchange or otherwise acquire or dispose of farm equipment and farm produce of all kinds; to make improvements, construct, repair, or demolish and remove any buildings, structures or fences, to engage agents, managers and employees and delegate powers to them; to engage in drainage and conservation programs; to terrace, clear, ditch**

and drain lands and install irrigation systems; to replace improvements and equipment; to fertilize and improve the soil; to engage in the growing, improvement, and sale of trees and other forest crops; to participate or decline to participate in governmental agricultural or land programs; and to perform such acts as the trustee deems appropriate, using such methods as are commonly employed by other farm owners in the community in which the farm property is located.

22. [2.53] Pursuing Oil, Gas, and Other Mineral Development

760 ILCS 5/4.22 gives the trustee power

[t]**o drill, mine and otherwise operate for the development of oil, gas and other minerals; to enter into contracts relating to the installation and operation of absorption and repressuring plants; to enter into unitization or pooling agreements for any purpose including primary, secondary or tertiary recovery; to place and maintain pipe lines; to execute oil, gas and mineral leases, division and transfer orders, grants, deeds, releases and assignments and other instruments; to participate in a cooperative coal marketing association or similar entity; and to perform such other acts as the trustee deems appropriate, using such methods as are commonly employed by owners of such interests in the community in which the interests are located.**

This section is discussed further in Chapter 6 of this handbook.

23. [2.54] Continuing an Unincorporated Business

760 ILCS 5/4.23 gives the trustee power

[t]**o continue an unincorporated business and participate in its management by having the trustee or one or more agents of the trustee act as a manager with appropriate compensation from the business and to incorporate the business.**

This section is discussed further in Chapter 6 of this handbook.

24. [2.55] Continuing a Partnership

760 ILCS 5/4.24 gives the trustee power

[t]**o continue a business in the partnership form and participate in its management by having the trustee or one or more agents of the trustee act as a partner, limited partner or employee with appropriate compensation from the business; to enter into new partnership agreements; and to incorporate the business; and with respect to the foregoing activities, the trustee or the agent or agents of the trustee shall not be personally liable to third persons with respect to actions, not sounding in tort, unless he fails to identify the trust estate and reveal that he is acting in a representative**

capacity. Provided, however, that nothing in this Section shall impair in any way the liability of the trust estate with respect to the foregoing activities to the extent of the assets of the trust estate.

This section is discussed further in Chapter 6 of this handbook. A trustee who succeeds a decedent as the successor trustee of the decedent's formerly revocable trust should carefully evaluate partnership or limited liability company agreements to which the decedent, as trustee of his or her revocable trust, was a party during the decedent's life, as these agreements may provide that the partnership or company must be dissolved in the event of a partner's death unless continued by the partners. In such a case, this provision gives the trustee the power to continue the partnership if the trust instrument is otherwise silent.

25. [2.56] Severing and Consolidating Trusts

760 ILCS 5/4.25 gives the trustee power

[t]**o sever any trust estate on a fractional basis into 2 or more separate trusts for any reason; to segregate by allocation to a separate account or trust a specific amount or gift made from any trust to reflect a partial disclaimer, to reflect or result in differences in federal tax attributes, to satisfy any federal tax requirement or election, or to reduce potential generation-skipping transfer tax liability, in a manner consistent with the rules governing disclaimers, such federal tax attributes, such requirements or elections, or any applicable tax rules or regulations, and income earned on a segregated amount or gift after segregation occurs shall pass to the designated take of such amount or gift; and to consolidate 2 or more trusts having substantially similar terms into a single trust. In managing, investing, administering, and distributing the trust property of any separate account or trust and in making applicable tax elections, the trustee may consider the differences in federal tax attributes and all other factors the trustee believes pertinent and may make disproportionate distributions from the separate trusts created. A separate account or trust created by severance or segregation shall be treated as a separate trust for all purposes from and after the date on which the severance or segregation is effective, and shall be held on terms and conditions that are substantially equivalent to the terms of the trust from which it was severed or segregated so that the aggregate interests of each beneficiary in the several trusts are substantially equivalent to the beneficiary's interests in the trust before severance, provided, however, that any terms of the trust before severance that would affect qualification of the trust for any federal tax deduction, exclusion, election, exemption, or other special federal tax status must remain identical in each of the separate trusts created.**

This section could be used, for example, to sever a trust into two or more separate trusts to make a more efficient allocation of federal generation-skipping transfer (GST) tax exemptions. Section 4.25 provides that it applies to all Illinois trusts and all trustee actions regardless of when the trust in question was executed or when the action at issue was taken.

The Internal Revenue Code specifically provides for the severance of trusts to allocate the federal GST tax exemption. Specifically, Code §2642(a)(3)(A) permits the trustee to sever a single trust into two or more trusts if such severance is a "qualified severance." A "qualified severance" is the division of a trust and the creation (by any means available under the governing instrument or under applicable state law) of two or more trusts, provided that the original trust is divided on a fractional basis and the newly created trusts provide for the same succession of interests of beneficiaries as the original trust. 26 U.S.C. §2642(a)(3)(B)(i). For a trust that is only partially exempt from GST tax, a severance would be a qualified severance only if it met the criteria discussed above and produced two trusts, one of which was totally exempt from GST tax and the other of which was totally subject to GST tax. 26 U.S.C. §2642(a)(3)(B)(ii).

26. [2.57] Small Trust Termination

760 ILCS 5/4.26 gives the trustee power

> [t]**o terminate the trust and distribute the trust estate, including principal and accrued and undistributed income, if the trustee determines, in the trustee's sole discretion with the consent of the recipients, that the market value of a trust is less than $100,000 and that the costs of continuing the trust will substantially impair accomplishment of the purpose of the trust.**

Section 4.26 became effective June 1, 2008, and applies to all trusts created before, on, or after that date, other than trusts for domestic or pet animals created pursuant to 760 ILCS 5/15.2. See also §§2.21 – 2.23 above regarding the trustee's duties when terminating a trust.

Section 4.26 further provides:

> **Distribution** [on termination] **shall be made to the persons then entitled to receive or eligible to have the benefit of the income from the trust in the proportions in which they are entitled thereto, or if their interests are indefinite, to those persons per stirpes if they have a common ancestor, or if not, then in equal shares. The trustee shall give notice to the persons at least 30 days prior to the effective date of the termination.**
>
> **If a particular trustee is an income beneficiary of the trust or is legally obligated to an income beneficiary, then that particular trustee may not participate as a trustee in the exercise of this termination power; provided, however, that if the trust has one or more co-trustees who are not so disqualified from participating, the co-trustee or co-trustees may exercise this power.** 760 ILCS 5/4.26.

While §4.26 authorizes a trustee to determine, in the trustee's sole discretion, that a trust with a market value of less than $100,000 should terminate, the trustee should not terminate a trust unless the trustee also determines that the cost of continuing the trust can "substantially impair [the] accomplishment of the purpose of the trust." *Id.* In addition, the trustee must obtain the "consent of the recipients" of the trust property if the trust were to terminate. *Id*. The Trusts and Trustees Act determines who must be a recipient, based on the nature of the beneficial interests involved. Therefore, the determination of who is a recipient must be based in part on the terms of the trusts and the description of the beneficial interests. Assuming that the trustee has obtained the consent of the recipients, the trustee must give notice to these persons at least 30 days before the effective date of the trust's termination. Note that if a trustee is an income beneficiary of the trust or is legally obligated to an income beneficiary, such as a minor child of the trustee, that trustee may not participate as trustee in exercising the termination power.

Lastly, §4.26 provides that it "shall not apply to the extent that it would cause a trust otherwise qualifying for a federal or State tax benefit or other benefit not to so qualify." *Id.*

27. [2.58] Investing in Mutual Funds

760 ILCS 5/5.2 gives the trustee, including a trustee of a common trust fund, power to invest and reinvest the trust estate in mutual funds, including unregistered funds. It provides that investments will not be prohibited solely because the trustee or an affiliate provides management or advisor services to the fund (or acts in any other role) and receives reasonable compensation for these services.

C. [2.59] Certification of Trust

Instead of providing a full coy of the trust instrument, 760 ILCS 5/8.5 gives the trustee the ability to furnish a certification of trust to any person other than the beneficiary. The statute provides specific information about the trust that must be included in the certification, as well as execution requirements. Third parties who rely in good faith on a trustee's certification (1) are not liable for their actions made in such reliance and (2) may enforce transactions entered into in such reliance. 760 ILCS 5/8.5(g), 5/8.5(h).

D. [2.60] Other Powers — Discretionary Acts

One of the more difficult areas in trust administration is that of dealing with the exercise or non-exercise of powers that are left, by the terms of the instrument, to the sole discretion of the trustee. Discretionary powers are those granted to the trustee giving the trustee the privilege, but not the duty, to do or refrain from doing an act. Discretionary provisions may relate to the business management of trust assets or to the allocation of income or principal to or among beneficiaries. Most difficulties arise either when the trustee does not exercise powers in a manner in which he or she has been authorized or when the trustee exercises these powers on behalf of one or more, but not all, of the beneficiaries.

Generally, a court does not interfere with the trustee's exercise of discretionary powers unless it can be shown that the trustee has (1) exceeded the limits of the discretion or in any other manner abused the discretion, (2) failed to exercise the discretion, or (3) failed to use judgment in its exercise. In determining whether the trustee has acted properly, the court does consider a combination of factors, including the nature of the power and the extent of the discretion, the terms of the trust and its purposes, any external standards mentioned in the trust, the circumstances surrounding the present controversy, the motives of the trustee, and whether there may be any conflict of interest on the part of the trustee.

If the trustee has conscientiously considered the question at hand, inquired into the circumstances, and used reasonable judgment, the court is not inclined to interfere with the trustee's final decision. For example, in *Rubinson v. Rubinson,* 250 Ill.App.3d 206, 620 N.E.2d 1271, 190 Ill.Dec. 10 (1st Dist.), *appeal denied,* 153 Ill.2d 569 (1993), the appellate court did not disturb the trustees' decision to amend the trust by divesting a trust beneficiary of her interest. The trust instrument had given the trustees unfettered discretion to distribute or retain trust principal and income and to amend the trust subject to several enumerated restrictions, but it did not give the trustees the express authority to divest a beneficiary. Nevertheless, the court interpreted the power of amendment to include the "power to extinguish absolutely the interest of a named beneficiary." 620 N.E.2d at 1279.

In other cases, the court may (1) direct the trustee to act when a failure to do so may constitute an abuse of the trustee's discretion, (2) enjoin the trustee from acting when the act would be an abuse, (3) hold the trustee liable when the discretion has been abused, or (4) remove the trustee from office or deny or diminish the trustee's compensation.

The laws of most states, including Illinois, do not expressly permit a trustee to change the situs and governing law of a trust to that of another jurisdiction. Note, however, that Illinois law now contemplates that a trust's governing instrument may authorize a trust protector to change the situs of the trust, the governing law, or both. 760 ILCS 5/16.3(d)(6). Many practitioners include language in their standard trust forms that would allow a trustee, in his or her discretion, to change a trust's situs. As a general rule, the trust should have some connection to the situs chosen (*e.g.,* a trustee or beneficiary resides there or a substantial portion of the trust corpus is located there). A change-of-situs clause may be advisable, for example, to take advantage of another jurisdiction's more favorable creditor protection laws or its repeal of the common-law rule against perpetuities. Caution should be exercised, however, to ensure that a change of situs does not cause a trust that is grandfathered from federal generation-skipping transfer tax to lose its exempt status. See 26 C.F.R. §26.2601-1(b)(4)(i)(E), Example 4.

IV. [2.61] DIRECTED TRUSTS

To understand why the trustee of a modern, multi-participant trust might welcome the enactment of §16.3 of the Trusts and Trustees Act, one only need review *Walker v. Northern Trust Co.,* No. 06 C 4901, 2008 WL 191182 (N.D.Ill. Jan. 22, 2008) (*Walker II*), and its prior history, *Walker v. Northern Trust Co.,* No. 06 C 4901, 2007 WL 178392 (N.D.Ill. Jan. 18, 2007) (*Walker I*). *Walker II,* also discussed in §§2.29 above and 2.76 below, demonstrates in stark terms the risks trustees face when acting at the direction of another party as to certain trust decisions. The directed trust statute, 760 ILCS 5/16.3, clarifies the duties, responsibilities, and liabilities of the trustee and other advisers and protectors who, regardless of their title, wield authority under the trust instrument to direct the trustee.

Under the *Walker* trust instrument, powers and responsibilities were divided between the trustee and the advisory committee. The advisory committee was composed of certain of the settlor's family members and a friend. The trustee's powers included the traditional fiduciary powers of managing and investing trust assets, voting, allocating receipts and expenses, determining whether distributions are made in cash or in kind, settling claims, and keeping accounts. However, the trustee's powers of sale, investment, reinvestment, and voting of trust assets were subject to the written direction of the advisory committee. Moreover, the trustee's power to distribute income or principal to the beneficiaries could be exercised only in accordance with the advisory committee's written directions, and the trustee could not question or override the advisory committee's direction as to distributions. *See Walker II, supra,* 2008 WL 191182 at *1. The *Walker* trust instrument also authorized the advisory committee to direct the distribution of certain portions of the trust assets to the primary beneficiary of the trust, the settlor's daughter, once she attained certain ages, including a potential terminating distribution of the trust assets at age 40. The trust instrument provided that the distributions at certain ages "were discretionary and that the 'Advisory Committee . . . shall not under any circumstances be compelled' to direct that the distributions be made." *Id.* While certain distributions were made to the primary beneficiary's spouse and son, the vast majority of distribution requests, including two age-based distribution requests by the primary beneficiary, were denied by the advisory committee. 2008 WL 191182 at *9.

The primary beneficiary sued, inter alia, taking issue with the advisory committee's denials of discretionary distributions and the trustee's actions in accordance with the advisory committee's directions. She alleged that the advisory committee and the trustee breached their fiduciary duties by failing to act in her best interests by denying distributions despite her repeated requests for funds to pay for her housing, medical expenses, education, and the care of her special-needs child. The plaintiff prevailed on the separate motions to dismiss of both the trustee and the advisory committee. *See Walker I, supra.*

In the later action, the trustee moved for summary judgment on the primary beneficiary's claim regarding the denial of discretionary distributions on the ground that the governing instrument conferred no discretion on the trustee as to distribution decisions. *See Walker II, supra,* 2008 WL 191182 at *9. The court agreed with the trustee that the governing instrument clearly provided that while the advisory committee was in existence, the advisory committee's decision was final as to discretionary distributions. The court found that the trustee had no veto power over the decisions of the advisory committee; thus, the trustee had no fiduciary duty to the primary beneficiary with respect to discretionary distributions, and the trustee prevailed on its motion for summary judgment. *Id.* Notably, the advisory committee, which the court found stood in a fiduciary relationship to the primary beneficiary, lost its motion for summary judgment with respect to certain denials of discretionary distributions. 2008 WL 191182 at **9 – 10.

Had the directed trust statute been applicable to the trust instrument in *Walker,* the trustee would have been considered an excluded fiduciary acting at the direction of the advisory committee, defined as a "distribution trust advisor" (also a "directing party") under §16.3 of the Trusts and Trustees Act, and thus would not have been liable for following the direction of the advisory committee as to distributions. 760 ILCS 5/16.3(f). Moreover, absent a direction in the trust instrument to the contrary, the advisory committee would have been considered a fiduciary subject to the same duties and standards applicable to a trustee. 760 ILCS 5/16.3(e). That is, whether the advisory committee stood in a fiduciary relationship to the primary beneficiary would not have been a subject of litigation. Thus, the directed trust statute brings a measure of clarity to Illinois law regarding the roles, powers, and relationships of the trustee and other involved parties.

Importantly, as noted in §2.30 above, §16.7 of the Trusts and Trustees Act, 760 ILCS 5/16.7, allows the drafter to preclude the application of §16.3 to a given trust instrument.

V. HOW TO HANDLE COTRUSTEESHIPS

A. [2.62] In General

At common law, all acting trustees must concur in the exercise of trust powers. The terms of a trust may dispense with the common-law requirement of unanimity in any number of ways. The instrument may authorize a majority of the trustees to bind the trust, one of several trustees to exercise certain powers, or one trustee to act in the absence of others. Any such language contained in the trust properly may be relied on if the intended division of authority is clearly spelled out.

A provision in the trust instrument governing the conduct of cotrustees does not deprive a court of its power to supervise a trust. Thus, in *Taxy v. Worden,* 181 Ill.App.3d 97, 536 N.E.2d 901, 129 Ill.Dec. 851 (1st Dist. 1989), a court's supervisory order setting forth certain procedural requirements for trustee meetings and giving a cotrustee authority to examine trust and corporate documents was not at variance with the trust instrument in view of the historic hostility among the trustees.

In *Rubinson v. Rubinson,* 250 Ill.App.3d 206, 620 N.E.2d 1271, 190 Ill.Dec. 10 (1st Dist.), *appeal denied,* 153 Ill.2d 569 (1993), a beneficiary alleged that one of two acting trustees was ineligible to act in that capacity. Because the trust instrument contained several provisions requiring joint trustee action, the complaining beneficiary asserted that the sole eligible trustee could not take action alone to divest her of her beneficial interest in the trust. The court rejected this assertion, finding that "Illinois law creates a presumption that a trust which initially names two trustees authorizes the surviving co-trustee to act alone." 620 N.E.2d at 1278, citing *Golder v. Bressler,* 105 Ill. 419 (1883). The *Rubinson* court found that this presumption was not rebutted under the circumstances presented because the instrument did not "create an imperative of multiple trustees before a surviving trustee would be deemed powerless to act alone." *Id.*

B. [2.63] Statutory Provisions

In the absence of specific provisions in the trust instrument, reference should be made to applicable statutes. In Illinois, trust instruments are governed by 760 ILCS 5/10, which provides:

> **If there are 3 or more trustees of a trust, a majority of the trustees are competent to act in all cases after prior written notice to, or written waiver of notice by, each other trustee, but a dissenting trustee has no liability for the acts of the majority.**

The effect and the construction of cotrustee provisions are discussed extensively in *Stuart v. Continental Illinois National Bank & Trust Company of Chicago,* 68 Ill.2d 502, 369 N.E.2d 1262, 12 Ill.Dec. 248 (1977).

VI. [2.64] TRUSTEE'S POWER TO CONVERT TO TOTAL RETURN TRUST

760 ILCS 5/5.3 gives the trustee an elective power to convert an Illinois trust into a total return trust. Following such a conversion, the trust's annual income will consist of a percentage of the net fair market value of the trust's assets. That percentage can be neither less than three percent nor more than five percent. 760 ILCS 5/5.3(b). To properly elect to convert the trust to a total return trust, the trustee must determine that the conversion "will enable the trustee to better carry out the purposes of the trust and the conversion is in the best interests of the beneficiaries." 760 ILCS 5/5.3(a)(1). Once the trust is converted, the trustee must invest and manage the trust assets to maximize the trust's "total return without regard to whether that return is from income or appreciation of principal." 760 ILCS 5/5.3(a)(2). While the trustee has no duty to inform the beneficiaries about the availability of converting to a total return trust, once the trustee has determined that it would be proper to convert, the trustee must give notice of that decision and specify an effective date for the conversion. Proper notice must include a copy of §5.3 of the Trusts and Trustees Act and must be directed to (a) all legally competent beneficiaries who are currently receiving (or eligible to receive) income from the trust and (b) all legally competent beneficiaries who would receive (or be eligible to receive) a distribution of principal or income if the current interests of beneficiaries currently receiving (or eligible to receive) income ended. 760 ILCS 5/5.3(a)(3). The statutory authority to establish a total return trust became effective August 22, 2002, and applies to all trusts in existence on, or established after, that date. 760 ILCS 5/5.3(*l*).

To comport with final regulations issued under Internal Revenue Code §643, the Trusts and Trustees Act was amended by P.A. 93-991 (eff. Aug. 23, 2004) by adding the following:

> **a change in the method of determining a reasonable current return by converting to a total return trust in accordance with this Section and substituting the distribution amount for net trust accounting income is a proper change in the definition of trust income notwithstanding any contrary provision of the Principal and Income Act, and the distribution amount shall be deemed a reasonable current return that fairly apportions the total return of a total return trust.** 760 ILCS 5/5.3(d)(5).

VII. [2.65] TRUSTEE'S POWER TO DECANT

On August 10, 2012, Illinois signed into law P.A. 97-920 (eff. Jan. 1, 2013), which amended the Trusts and Trustees Act by adding §16.4, "Distribution of trust principal in further trust," or the so-called "decanting statute." Section 16.4 provides that

> [a]**n authorized trustee who has the absolute discretion to distribute the principal of a trust may distribute part or all of the principal of the trust in favor of a trustee of a second trust for the benefit of one, more than one, or all of the current beneficiaries of the first trust and for the benefit of one, more than one, or all of the successor and remainder beneficiaries of the first trust.**
>
> * * *

> **. . . An authorized trustee who has the power to distribute the principal of a trust but does not have the absolute discretion to distribute the principal of the trust may distribute part or all of the principal of the first trust in favor of a trustee of a second trust, provided that the current beneficiaries of the second trust shall be the same as the current beneficiaries of the first trust and the successor and remainder beneficiaries of the second trust shall be the same as the successor and remainder beneficiaries of the first trust.** 760 ILCS 5/16.4(c), 5/16.4(d).

The idea behind decanting is that if a trustee has the power to make distributions of trust principal to a beneficiary outright (from a first trust), inherent in that power is the ability to make a distribution of trust principal from the first trust to another trust (a second trust). This distribution to a second trust is known as a "decanting distribution." As described above, the statute distinguishes between a trustee who has absolute discretion to make distributions of principal and a trustee who has less than absolute discretion. "Absolute discretion" is defined as "the right to distribute principal that is not limited or modified in any manner to or for the benefit of one or more beneficiaries of the trust, whether or not the term 'absolute' is used." 760 ILCS 5/16.4(a). The statute specifically provides that a distribution standard "that includes purposes such as best interests, welfare, or happiness" is considered absolute discretion for purposes of the decanting statute. *Id.* On the other hand, a discretionary distribution standard limited to the ascertainable standard of health, education, support, and maintenance would be considered non-absolute.

A. [2.66] Absolute vs. Non-Absolute Discretion

A trustee who has absolute discretion to make principal distributions has much more flexibility than a trustee without absolute discretion in how the second trust may differ from the first trust. If the trustee has absolute discretion, the second trust does not need to include all of the beneficiaries of the first trust, though new beneficiaries may not be added (the second trust must be "for the benefit of one, more than one, or all of the current beneficiaries of the first trust and for the benefit of one, more than one, or all of the successor and remainder beneficiaries of the first trust"). 760 ILCS 5/16.4(c). A trustee with absolute discretion may grant, in the second trust, a lifetime or testamentary power of appointment to one or more of the current beneficiaries of the first trust, even if such power of appointment did not exist in the first trust, provided that the beneficiary to whom the power of appointment is granted in the second trust could receive an outright distribution of principal under the terms of the first trust. 760 ILCS 5/16.4(c)(1). In addition, the class of permissible appointees in favor of whom a beneficiary may exercise a newly granted power of appointment over the principal of the "second trust may be broader than or otherwise different from the current, successor, and presumptive remainder beneficiaries of the first trust." 760 ILCS 5/16.4(c)(2). Finally, if the beneficiaries of the first trust are described as a class of individuals, the beneficiaries of the second trust may (but not must) include individuals who become members of the class after the decanting distribution is made.

A trustee without absolute discretion is much more limited in its ability to alter the dispositive provisions of the first trust when making a decanting distribution to a second trust. First, the current beneficiaries of the first trust must be identical to the current beneficiaries of the second trust. 760 ILCS 5/16.4(d). Similarly, the successor and remainder beneficiaries of the first trust must be identical to the successor and remainder beneficiaries of the second trust. *Id.* The language describing the trustee's distribution standard in the first trust must be the same as in the second trust. 760 ILCS 5/16.4(d)(1). If the beneficiaries of the first trust are described as a class of individuals, the beneficiaries of the second trust must include individuals who become members of the class after the trust is decanted. 760 ILCS 5/16.4(d)(2). Any power of appointment granted in the second trust must mirror a power granted in the first trust. 760 ILCS 5/16.4(d)(3).

An exception is made for a trustee without absolute discretion who distributes all or a portion of the interest of a beneficiary who has a disability in a first trust to a second trust that is a supplemental-needs trust, provided that the trustee determines that such an action would be in the best interests of the beneficiary who has a disability. 760 ILCS 5/16.4(d)(4). The statute defines a "beneficiary who has a disability" as a beneficiary who "has a disability that substantially impairs the beneficiary's ability to provide for his or her own care or custody and that constitutes a substantial handicap, whether or not the beneficiary has been adjudicated a 'person with a disability.' " 760 ILCS 5/16.4(d)(4)(ii). The statute provides additional considerations for the creation of a supplemental-needs second trust that should be reviewed by any trustee considering this option. See 760 ILCS 5/16.4(d)(4).

B. [2.67] Procedure

A trustee may exercise its ability to decant all or a portion of a first trust to a second trust without the express approval of the settlor, the beneficiaries, or the court, provided that (1) the trustee sends written notice of its intent to decant to all of the legally competent current and presumptive remainder beneficiaries of the trust at least 60 days prior to the effective date of the decanting distribution, (2) such notice specifies the manner in which the trustee intends to exercise its power to decant and the effective date of the decanting distribution, and (3) no beneficiary to whom notice was sent objects within the 60-day period. 760 ILCS 5/16.4(e). If a charity is a current or presumptive remainder beneficiary of the trust, the trustee must also provide notice to the Illinois Attorney General's Charitable Trust Bureau. *Id*. A trustee need not provide notice to a beneficiary who cannot be located after reasonable diligence or is not known to the trustee. *Id*.

A trustee must obtain court approval to decant if (1) none of the current beneficiaries of the trust are legally competent, (2) none of the presumptive remainder beneficiaries of the trust are legally competent, or (3) any of the beneficiaries files a written objection to the decanting distribution with the trustee within the 60-day notice period. 760 ILCS 5/16.4(f).

A trustee may also decant the property of a first trust to a second trust by written agreement with all of the primary beneficiaries of the first trust, acting either individually or by their respective representatives under the virtual representation statute, 760 ILCS 5/16.1. 760 ILCS 5/16.4(j).

C. [2.68] Restrictions

Regardless of whether the trustee's discretionary power is absolute or non-absolute, some restrictions apply on a trustee's ability to decant. First and foremost, a trustee may not decant if the terms of the first trust specify that decanting is specifically prohibited. 760 ILCS 5/16.4(m). A general prohibition stating that a trust may not be amended or revoked or a spendthrift clause in a trust does not warrant the specific prohibition required to disallow decanting. *Id*.

The trustee may extend the term of a trust, but may not extend the term longer than the perpetuities period provided in the first trust unless the terms of the first trust expressly authorize such an extension. 760 ILCS 5/16.4(g). In addition, the perpetuities provision of the first trust may not be reduced, limited, or modified in the second trust unless specifically authorized by the terms of the first trust. 760 ILCS 5/16.4(n)(4).

The terms of the second trust may not reduce, limit, or modify any beneficiary's current right to mandatory distributions from the trust or withdrawal rights that have come into effect, unless the second trust is a supplemental-needs trust. 760 ILCS 5/16.4(n)(1).

The terms of the second trust may not extinguish the overall fiduciary duties of a trustee; however, the terms of the second trust may shift such liability to another individual. 760 ILCS 5/16.4(n)(2). The statute specifically authorizes a decanting "distribution that unbundles the governance structure of a trust to divide and separate fiduciary and nonfiduciary responsibilities among several parties." *Id*. For example, if a first trust provides that the trustee make all investment and distribution decisions, a second trust may provide that the trustee make only distribution decisions and rely on the direction of an investment advisor to make investment decisions. However, if the second trust provides that the investment advisor has no liability for his or her negligent actions and the first trust contains no such exoneration provision, the decanting distribution to the second trust would not be allowed.

The terms of the second trust may not eliminate a provision in the first trust granting another person the right to remove or replace the trustee making the decanting distribution, unless such power is granted in the second trust to "a separate independent, non-subservient individual or entity." 760 ILCS 5/16.4(n)(3).

A trustee may not decant to a second trust for the sole purpose of changing the trustee compensation provisions of the trust, but if the trustee is decanting for other valid reasons, these provisions may be adjusted in the second trust "to bring the trustee's compensation into accord with reasonable limits in accord with Illinois law in effect at the time of the exercise." 760 ILCS 5/16.4(q)(1). In addition, the trustee may not be compensated for the act of decanting. 760 ILCS 5/16.4(q)(2).

A trustee also may not decant to a second trust if the decanting distribution would result in any of the following:

1. The property of the second trust would become subject to the claims of reimbursement by any private or governmental body or interfere with an individual's entitlement to government benefits. 760 ILCS 5/16.4(*o*).

2. The minimum distribution period under Internal Revenue Code §401(a)(9) applicable to property in the first trust would be shortened in the second trust. 760 ILCS 5/16.4(p)(3).

3. The second trust would not qualify as an S corporation shareholder if the first trust holds shares in an S corporation. 760 ILCS 5/16.4(p)(2).

D. [2.69] Tax Considerations

The statute provides some guidance to the many tax questions surrounding decanting, though several questions remain unanswered.

A trustee is specifically prohibited from making a decanting distribution to a second trust if a tax benefit would be lost as a result of the decanting. 760 ILCS 5/16.4(p). Specifically, the statute provides:

> **If any contribution to the first trust qualified for the annual exclusion under Section 2503(b) of the Code, the marital deduction under Section 2056(a) or 2523(a) of the Code, or the charitable deduction under Section 170(a), 642(c), 2055(a) or 2522(a) of the Code, is a direct skip qualifying for treatment under Section 2642(c) of the Code, or qualified for any other specific tax benefit that would be lost by the existence of the authorized trustee's authority under subsection (c) or (d) for income, gift, estate, or generation-skipping transfer tax purposes under the Code, then the authorized trustee shall not have the power to distribute the principal of a trust pursuant to subsection (c) or (d) in a manner that would prevent the contribution to the first trust from qualifying for or would reduce the exclusion, deduction, or other tax benefit that was originally claimed with respect to that contribution.** *Id.*

In addition, the statute specifically provides that a trustee may decant from a grantor trust to a nongrantor trust or vice versa. 760 ILCS 5/16.4(p)(1).

A number of additional tax issues should be considered before the decision to exercise a trustee's decanting power is made. In 2011, the IRS announced that it would no longer issue Private Letter Rulings in the area of decanting while it studied the related tax implications. IRS Notice 2011-101, 2011-52 Int.Rev.Bull. 932. There is much uncertainty regarding the income, gift, estate, and generation-skipping transfer tax treatment of a second trust receiving property from a first trust, including the following:

1. Does the decanting distribution carry out distributable net income to the second trust?

2. Does the decanting distribution trigger gain recognition under Internal Revenue Code §1001?

3. If all assets are distributed from the first trust to the second trust, will the second trust benefit from the carryover losses, net operating losses, or deductions in excess of income of the first trust?

4. If a beneficiary does not object to a proposed decanting that limits his or her beneficial interest, was a taxable gift made by that beneficiary? Did the acquiescing beneficiary make a transfer that would trigger estate tax inclusion under Code §2036 or §2038?

5. If the second trust arguably shifts beneficial interests to a lower generation than the first trust, is this a modification that would jeopardize the first trust's GST-exempt or grandfathered status?

If these or other tax considerations are of concern with a particular trust, the trustee should consider waiting to decant until more guidance is issued by the IRS.

VIII. DIGITAL ASSETS

A. [2.70] Purpose and Definitions

On August 12, 2016, Illinois adopted the Revised Uniform Fiduciary Access to Digital Assets Act (2015) (RUFADAA), 755 ILCS 70/1, *et seq.* The purpose of RUFADAA is to provide clarity on when fiduciaries may receive access to the digital assets of a deceased or incompetent individual.

RUFADAA defines a "digital asset" as "an electronic record in which an individual has a right or interest," excluding "an underlying asset or liability unless the asset or liability is itself an electronic record." 755 ILCS 70/2(10). "Electronic" is defined as "relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities," and "record" is defined as "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form." 755 ILCS 70/2(11), 70/2(22). Practically speaking, this definition of "digital asset" includes all forms of electronically stored information, whether such information is stored on a computer's hard drive, on a mobile device, through cloud-based storage, on a social media platform, or in another electronic fashion. Excluded from the definition are assets that are themselves an electronic record, which includes digital currency and Internet domain names.

B. [2.71] Direction for Disclosure of Digital Assets

755 ILCS 70/4 establishes a hierarchy for what governs the disclosure of an individual's digital asset to a fiduciary. Of highest priority is a direction by an individual in an "online tool" established by a custodian of digital assets. 755 ILCS 70/4(a). If the online tool allows the individual to modify or delete the direction at any time, then any such direction trumps a contrary provision in an estate planning document (such as a will, trust, power of attorney, or "other record"). 755 ILCS 70/4(b). If an online tool is not used, a direction in an individual's estate planning documents will govern. Finally, if no online tool is used and no direction is made in a relevant estate planning document, the terms-of-service agreement controlling the digital asset will govern a fiduciary's access to those assets.

Terms-of-service agreements typically greatly restrict or completely prohibit access to an individual's digital assets by a fiduciary. Accordingly, in order to ensure that a fiduciary has access to an individual's digital assets after his or her death or incapacity, it is important to include an express grant of such authority in all of the individual's estate planning documents. Alternatively, if an individual does not want any fiduciary to be able to access his or her digital assets, that intent should be made clear as well.

C. [2.72] Ability of Custodian To Seek or Require a Court Order

Even if an individual grants express authority to a fiduciary to access his or her digital assets, the custodian of those assets has broad deference under the Revised Uniform Fiduciary Access to Digital Assets Act (2015) to seek court approval of a requested disclosure. Specifically, if a custodian feels a request to disclose only some, but not all, of an individual's digital assets "imposes an undue burden" on the custodian, the custodian may seek a court order for instruction. 755 ILCS 70/6(d). Moreover, 755 ILCS 70/16(e) provides that RUFADAA "does not limit a custodian's ability to obtain or require a fiduciary . . . to obtain a court order" that authorizes the disclosure.

IX. COMPENSATION

A. Trustees

1. [2.73] General Law Regarding Compensation

It is well settled in Illinois that trustees are entitled to compensation for the fair value of their services. However, there is no statute fixing trustees' fees, nor is there any set method to determine what is reasonable in a given case. Factors to be considered are the quantity of services rendered, the risks involved, the responsibilities undertaken, the degree of difficulty, and the knowledge and skill required, as well as the size of the trust and the amounts of income received and disbursed. A fairly common practice is to base compensation on a fixed percentage of either the annual gross income or the principal value of the trust or both.

Usually, the approximate range of reasonable compensation of the trustee may be determined by comparison with the known compensation of trustees in similar situations. If a trustee is to operate an ongoing business concern, for instance, one may consider the amount and type of work involved and compare this trustee's situation with that of a trustee with similar duties, as distinguished from that of a trustee who, although responsible for a trust of equal total value and income, is required to expend much less effort.

The compensation of the trustee may be determined by agreement with the settlor before the establishment of the trust even though the compensation agreement may not be reflected in the trust instrument itself or by agreement with the beneficiaries. If the established amount is greater than would be considered normal, it is nevertheless properly payable unless the trustee abused his or her fiduciary position to induce the agreement. The beneficiaries must, of course, have the legal capacity to make any such agreement, and if fewer than all beneficiaries enter into it, it is binding only on those who do. Moreover, the trustee must make full disclosure of all relevant facts and circumstances to the beneficiaries for the agreement to have binding effect. As for consideration, the trustee's undertaking to administer the trust is deemed sufficient as long as the trustee is not already under a duty to administer the trust.

The trustee may voluntarily waive compensation for services, although a waiver for a period of time does not necessarily preclude the trustee from claiming fees at a later date. The right to compensation is personal; it can be waived by a trustee for himself or herself but not for cotrustees. *See Gorin v. McFarland,* 80 Ill.App.2d 398, 224 N.E.2d 615 (4th Dist. 1967).

For general considerations to be taken into account in determining trustees' fees, *see Rogers v. Belt,* 317 Ill.App. 81, 45 N.E.2d 511 (2d Dist. 1942).

2. [2.74] Statute

Unlike some states, Illinois has no fixed compensation statute. The statutory coverage in Illinois extends merely to an affirmation that trustees' fees are allowable. 760 ILCS 5/7 provides that "[t]he trustee shall be reimbursed for all proper expenses incurred in the management and protection of the trust and shall be entitled to reasonable compensation for services rendered."

3. [2.75] Terms of the Trust

If the trust instrument provides for payment of trustees' fees in a certain amount or prohibits the taking of fees, the trustee is bound to adhere to the instrument. *Johnson v. Sarver,* 350 Ill.App. 565, 113 N.E.2d 578 (2d Dist. 1953). In a case in which the stated amount is inadequate, however, a court may award a greater amount if it can be determined that the present circumstances were not anticipated when the trust was established. Such an increase in fees would be granted on the theory that it would defeat or impair the accomplishment of the purposes of the trust to limit the compensation of the trustee and thereby discourage competent trustees from undertaking to administer the trust. *Smith v. Stover,* 15 Ill.App.2d 78, 145 N.E.2d 515 (2d Dist. 1957); *Smith v. Stover,* 262 Ill.App. 440 (2d Dist. 1931). As in the case of compensation agreements with the settlor or beneficiaries, the amount stated in the trust is payable even though it may be greater than fees ordinarily chargeable in similar situations, unless the trustee is guilty of having wrongfully procured the insertion of the provision.

If the instrument provides that the trustee is to receive a certain benefit, such as a stated legacy, it is strictly a question of interpretation whether the compensation as trustee is to be in addition to that benefit. In the absence of evidence to the contrary, the legacy normally is considered a gift, with compensation allowable over and above that amount. It is also a question of interpretation of the trust whether language relating to compensation is applicable only to the original trustee or also to successor trustees.

In *Schroeder v. Sullivan,* 2018 IL App (1st) 163210, 104 N.E.2d 460, 422 Ill.Dec. 893, the court interpreted trust language that provided for reimbursement of reasonable expenses and compensation for services performed by a corporate trustee. Based on this language, the lower court held that "by implication" a noncorporate trustee was not entitled to compensation. 2018 IL App (1st) 163210 at ¶19. The appellate court reversed on the issue, holding that the language of the trust did not prohibit compensation to a noncorporate trustee, and remanded the case to determine the appropriate amount of compensation.

4. [2.76] Extra Compensation

In many jurisdictions, a trustee who, in addition to normal services as trustee renders professional services that are not usually performed by a trustee, is entitled to additional compensation. However, *see Hough v. Harvey,* 71 Ill. 72 (1873), in which an Illinois attorney-trustee was denied additional compensation. *See also Bennett v. Weber,* 323 Ill. 283, 154 N.E. 105 (1926). A principal reason for denying additional compensation is to discourage a potential tendency for the trustee to create employment for himself or herself as a professional. Nevertheless, the trend of Illinois caselaw as to executors would seem to support extra compensation for a trustee who performs additional services as an attorney. *Cf. In re Estate of Hackett,* 51 Ill.App.3d 474, 366 N.E.2d 1103, 9 Ill.Dec. 592 (4th Dist. 1977) (personal representative awarded compensation for both legal services and services as representative); Illinois State Bar Association Advisory Opinion on Professional Conduct No. 520 (Oct. 1975) (stating that an executor or administrator who is also an attorney is entitled to compensation for services in both capacities). However, double compensation is not permissible if the efforts as attorney and as executor are duplicative. *Estate of Brown,* 58 Ill.App.3d 697, 374 N.E.2d 699, 15 Ill.Dec. 916 (1st Dist. 1978). *Cf. In re Estate of Weeks,* 409 Ill.App.3d 1101, 950 N.E.2d 280, 351 Ill.Dec. 124 (4th Dist. 2011) (affirming reduction in lawyer's and executor's fees for performing duplicative services).

Apparently, there have been no Illinois cases in which the court has had to deal with a trustee or an executor being allowed credit for payment for legal services rendered by a firm of which the trustee is a member. In cases involving executors who are also attorneys, the courts have allowed executors' fees, taking into account the benefit of the legal services rendered. *In re Estate of McCalmont,* 16 Ill.App.2d 246, 148 N.E.2d 23 (2d Dist. 1958); *In re Edwards' Estate,* 312 Ill.App. 645, 39 N.E.2d 72 (2d Dist. 1942). In some jurisdictions, the court has held that a trustee cannot employ and pay money to a firm of which he or she is a member unless the trustee receives no part of the consideration received by the firm.

For ethical considerations, see ISBA Advisory Op. No. 526 (Jan. 1976); ABA Comm. on Prof'l Ethics & Grievances, Formal Op. 271 (1946). These opinions state that it is not improper for a trustee in bankruptcy to be represented by his or her own firm. It should be noted that both of these opinions deal with situations in which the proceeding is already subject to the jurisdiction and supervision of a court. However, the ABA Committee on Professional Ethics and Grievances stated that since fees of attorneys for all fiduciaries may be questioned by any party and be subject to the approval of court, "there is no ethical impropriety in a trustee in bankruptcy being represented by the firm of which he is a member and . . . the same principle applies to executors, administrators, guardians, etc. and other similar fiduciaries." ABA Formal Op. 271, p. 564. In the long run, the trustee can recover only amounts that the court deems reasonable and justified. If the services are not necessary or the necessity for the services arose because of the trustee's own fault, then no additional compensation should be payable to the trustee.

However, a trustee may obtain an award of attorneys' fees if legal services rendered by independent counsel directly relate to and are reasonably incurred in the performance of the trustee's duties under the trust instrument. *Northern Trust Co. v. Continental Illinois National Bank & Trust Company of Chicago,* 43 Ill.App.3d 169, 356 N.E.2d 1049, 1 Ill.Dec. 767 (1st Dist.

1976), *aff'd in part, rev'd in part on other grounds sub nom. Stuart v. Continental Illinois National Bank & Trust Company of Chicago,* 68 Ill.2d 502 (1977). *But see NC Illinois Trust Co. v. Madigan,* 351 Ill.App.3d 311, 812 N.E.2d 1038, 286 Ill.Dec. 23 (4th Dist. 2004), discussed in §§2.39 and 2.40 above. Similarly, a fiduciary other than a trustee, such as a member of an advisory committee that directs the trustee on distributions to beneficiaries, may be reimbursed from the trust estate for attorneys' fees "for things done in good faith in litigation that is not hostile to the trust estate or the beneficiary." *Walker v. Northern Trust Co.,* No. 06 C 4901, 2008 WL 191182, *8 (N.D.Ill. Jan. 22, 2008). The *Walker* court noted that when members of the advisory committee act in a fiduciary capacity and are designated as fiduciaries in the trust instrument, they should "be afforded protection commensurate with that provided to the Trustee." 2008 WL 191182 at *7. Nevertheless, any such legal fees paid from the trust estate on behalf of an advisory committee member are subject to the same test of reasonableness; a trustee may be found to have breached a duty to a beneficiary if such fees are found to be unreasonable. *Id.*

5. [2.77] Several Trustees

The practice with respect to payments of fees to several trustees varies widely. While in theory the total amount of compensation payable should not be any different if several trustees act than if only one is acting, each case must be viewed separately, and a number of factors may be involved. A relatively common payment concern arises when one or more individual trustees are named to serve with a corporate trustee. It may be shown that the settlor was aware of the existence of a published fee schedule of the corporate fiduciary and, therefore, contemplated the possible payment of greater than normal fees to the trustees as a group. In each cotrustee situation, the logical approach would be to allow each trustee reasonable compensation for the services rendered. This may result in a greater total amount being paid than when only one trustee acts.

With respect to the question of compensation payable to successive trustees, unless the terms of the trust provide otherwise, a trustee is not entitled to full compensation if the trustee does not complete the administration of the trust. An award of reasonable compensation should be made to the retiring trustee or his or her estate. In determining a retiring trustee's total compensation, among the factors to be considered are how near completion the trust administration is, what services were rendered by the retiring trustee, and what remains to be done to complete the administration of the trust.

6. [2.78] Effect of Breach

There is no definite rule regarding the effect that a trustee's breach of the trust may have on the trustee's compensation. The trustee certainly may be liable to the beneficiaries for losses resulting from a breach; a simple offsetting of the trustee's compensation or withholding of it until the loss is made good is a convenient way of making satisfaction.

The courts typically do not refuse or deny compensation as a penalty. Rather, when compensation has been reduced or denied because of a breach, it generally has been on the basis that the trustee's services were not performed properly.

Compensation may be (a) diminished if the trustee's breach was not serious or (b) denied if the trustee has misappropriated trust property or has been guilty of gross negligence. In some cases, the trustee has been allowed full compensation in spite of the breach but has been held liable for the loss resulting from the breach. *See Craven v. Craven,* 407 Ill. 252, 95 N.E.2d 489 (1950); *Conant v. Lansden,* 341 Ill.App. 488, 94 N.E.2d 594 (4th Dist. 1950), *aff'd in part, rev'd in part,* 409 Ill. 149 (1951); RESTATEMENT (SECOND) OF TRUSTS §243, cmt. c (1959).

B. [2.79] Attorneys, Agents, and Investment Counsel

As discussed in §2.40 above, 760 ILCS 5/4.09 gives the trustee power to "appoint attorneys, auditors, financial advisers and other agents and to pay reasonable compensation to such appointees." In determining whether the amount of compensation paid to agents is deemed reasonable in light of all circumstances, the trustee should be guided by the same general considerations that are taken into account in determining the compensation of the trustee. Thus, the complexity of the services performed, the responsibility assumed, and the amount of expertise required by and brought to the task are aspects to be reviewed. The trustee is well-advised first to consider the typical charges in the marketplace for these services. If the trustee has conscientiously considered these factors, then the trustee may proceed safely under authority of §4.09 unless the terms of the instrument prohibit or restrict this outside employment.

In addition to the statutory provision authorizing the appointment of agents, the trust instrument itself may provide a basis for incurring expenses relating to the appointments. Thus, a trust instrument's instruction that "the Trustee shall first pay all necessary costs and expenses of administering and protecting the Trust" was considered a sound basis for the award of attorneys' fees in a suit brought by the trustee for instructions. *Chicago City Bank & Trust Co. v. Lesman,* 186 Ill.App.3d 697, 542 N.E.2d 824, 828, 134 Ill.Dec. 478 (1st Dist. 1989). In appropriate circumstances, fees, along with a trustee's extraordinary expenses, may be charged against the share of beneficiaries who initiate groundless litigation. *Continental Illinois National Bank & Trust Company of Chicago v. Sax,* 199 Ill.App.3d 685, 557 N.E.2d 475, 145 Ill.Dec. 705 (1st Dist. 1990).

X. CHANGE OF TRUSTEES

A. [2.80] In General

Sections 2.81 – 2.87 below are devoted to the subject of termination of the role of trustee and the effect it has on the administration of the trust by surviving or successor trustees. These sections are not concerned with the termination of the trust itself, which is discussed in Chapter 8 of this handbook.

As with any other subject in this field, reference should be made first to the terms of the trust to determine carefully whether a procedure has been established for the termination of a trusteeship. All such trust provisions, whether dealing with (1) the death, resignation, or removal of a trustee; (2) the appointment of successor trustees; or (3) the exercise of powers generally by existing and successor trustees, should be reviewed carefully. Sections 2.81 – 2.87 below deal with situations in which the terms of the trust instrument do not provide a satisfactory answer.

B. Termination of the Role of Trustee

1. [2.81] Disclaimer

A disclaimer to act as trustee is not technically a termination of the role of trustee. It is actually a refusal to accept the office of trustee. To be effective, a disclaimer must be made prior to acceptance of the trust. If a trustee has indicated acceptance of the office, the trustee may not thereafter disclaim.

There is no particular formality involved in either accepting or disclaiming a trust. A disclaimer may be indicated in any manner sufficient to show a refusal to act as trustee. For instance, under given circumstances, a long delay in assuming control over trust property normally indicates a disclaimer. However, the best practice is to disclaim formally, in writing, any interest in the trust.

A disclaimer automatically divests the proposed trustee of any title to property intended to be conveyed to the trustee in trust. Title to such property does vest automatically in the remaining named trustees, if any. In the absence of other named trustees, it revests in the settlor or the settlor's estate.

2. [2.82] Death

Joint trustees hold legal title to all trust property as joint tenants with the right of survivorship. 765 ILCS 1005/1. Accordingly, upon the death of one of several trustees, the legal title to trust property automatically passes to the surviving trustees. *Reichert v. Missouri & Illinois Coal Co.,* 231 Ill. 238, 83 N.E. 166 (1907). This is true even if a corporation and an individual are cotrustees. Upon the individual's death, the corporation becomes the sole trustee and sole legal owner of the trust property.

Upon the death of a sole trustee, legal title to trust property technically passes to the trustee's heir or estate, but it is held for the benefit of the trust pending the appointment of a new trustee.

3. [2.83] Resignation

760 ILCS 5/12 provides that, except as otherwise provided in the trust instrument,

> [a] **trustee may resign at any time by written notice of the resignation to the settlor, if living, to a co-trustee, if any, and to the beneficiaries then entitled to receive or eligible to have the benefit of the income from the trust estate.**

Absent the applicability of this statutory provision, a trustee who has accepted the trust may not resign except (a) in accordance with the terms of the trust allowing him or her to do so, (b) with the permission of a court, or (c) with the consent of all beneficiaries, provided they are all ascertained and all have legal capacity to give consent. Any other attempts to resign are ineffective to relieve the trustee of his or her duties, responsibilities, and liabilities. *Sauvage v. Gallaway,* 329 Ill.App. 38, 66 N.E.2d 740 (4th Dist. 1946).

Generally, a court does permit resignation if there is good reason for it, but a court does not permit resignation if the result can be disadvantageous to the trust. In all events, permission is not granted until a successor is appointed and until an accounting is rendered by the resigning trustee.

4. [2.84] Removal

Removal of a trustee may be accomplished in accordance with the terms of the trust when the instrument grants to one or more individuals the power to remove. Removal may be made without application to the court as long as it is done in proper exercise of the power and in full compliance with the terms of the trust. If the power may be exercised only under certain circumstances, then those circumstances must be present. If the power is unlimited, then there is no necessity to show cause unless, upon application to a court, it can be shown that removal can prejudice the rights of beneficiaries.

Aside from removal provisions that may be contained in the trust instrument, a court has discretionary power to remove a trustee for proper cause. Grounds for removal, always relating to the protection of the interest of the beneficiaries, are numerous. They include legal incapacity of the trustee, refusal to account, dishonesty, any unreasonable failure to cooperate with cotrustees, and serious breach of fiduciary duties. It is generally held that friction or hostility between the trustee and the beneficiaries does not constitute grounds for removal unless there is a showing of something more. Thus, the trustee may be properly removed if these feelings impede the effective administration of the trust, especially when the trustee is at fault.

C. [2.85] Appointment of New Trustee

760 ILCS 5/13(2) provides that, except as otherwise provided in the trust instrument, in the event of the death, resignation, refusal, or inability to act of any trustee,

> **if there is no remaining trustee, a successor trustee may be appointed by a majority in interest if the beneficiaries then entitled to receive the income from the trust estate or, if the interest of the income beneficiaries are indefinite, by a majority in number of the beneficiaries then eligible to have the benefit of the income of the trust estate, by an instrument in writing delivered to the successor, who shall become a successor trustee upon written acceptance of the appointment, but no beneficiary who is appointed as a successor trustee shall have any discretion to determine the propriety or amount of any distribution of income or principal to himself or to any person to whom he is legally obligated.**

The terms of the trust may provide for the appointment of a successor trustee by (1) the settlor; (2) one, some, or all of the beneficiaries; (3) existing or surviving trustees; or (4) third persons unrelated to the trust. A court does not interfere with the exercise of this power except when the appointing party abuses the discretionary power by appointing an unfit trustee.

In the absence of specific provisions in the trust instrument providing for filling vacancies, a court has wide discretion in determining whether there is a necessity to appoint a new trustee as well as the identity of that trustee. Whether it is necessary to appoint a new trustee to fill a vacancy depends on the objectives of the trust and on the circumstances. If it is apparent that the settlor intended that a certain number of trustees always be in office, then a new one should be appointed when a vacancy occurs. *Barnhart v. Barnhart,* 415 Ill. 303, 114 N.E.2d 378 (1953). Even in the absence of this intention, the court does fill a vacancy if it appears that an additional trustee will be more conducive to the proper administration of the trust.

Title to trust assets does vest automatically in a new trustee regardless of whether the trustee assumes office by an appointment of a court or by the exercise of a power of appointment pursuant to the terms of the trust.

It is important to note that the appointment of a successor trustee, whether by the terms of the trust instrument or by 760 ILCS 5/13(2), is applicable only when an actual vacancy exists in the office of trustee. In *Spencer v. Di Cola,* 2014 IL App (1st) 121585, 16 N.E.3d 1, 383 Ill.Dec. 819, beneficiaries of a trust unsuccessfully attempted to replace the trustee by relying only on their ability to appoint a successor trustee.

D. Effect on Other Trustees' Powers

1. [2.86] Surviving Trustee

Absent contrary indications in the trust instrument, the statutory provisions with respect to powers of the surviving trustees control. 760 ILCS 5/13 provides:

> **In the event of the death, resignation, refusal or inability to act of any trustee:**
>
> **(1) the remaining trustee, if any, shall continue to act, with all the rights, powers and duties, of all of the trustees.**

2. [2.87] Successor Trustee

760 ILCS 5/14 provides:

> **(1) A successor trustee shall have all the rights, powers and duties, which are granted to or imposed on the predecessor. (2) A successor trustee shall be under no duty to inquire into the acts or doings of a predecessor trustee, and is not liable for any act or failure to act of a predecessor trustee. (3) With the approval of a majority in interest of the beneficiaries then entitled to receive or eligible to have the benefit of the income from the trust, a successor trustee may accept the account rendered and the property received as a full and complete discharge to the predecessor trustee without incurring any liability for so doing.**

Even absent this statutory provision, the courts generally hold that a successor trustee may exercise all powers granted to the original trustee unless otherwise provided in the trust instrument.

As with the question of powers of surviving trustees, the intent of the settlor should be ascertained carefully with respect to powers of successor trustees. If the instrument is explicit, it should be followed strictly. If there are no express provisions, the settlor’s intent should be ascertained by reference to the overall objectives of the trust. Among the factors to be considered are (a) the nature of the power and the extent to which it is discretionary; (b) whether the original trustee was individual or corporate; (c) the time when the power is to be exercised; (d) the relationship among the settlor, the trustees, and the beneficiaries; and (e) whether the power was conferred on the original trustee by name.

In the case of successor trustees, particularly those not originally named by the settlor but appointed after the establishment of the trust, the answer should be determined after a somewhat more careful consideration than that given to the question of the exercise of powers by surviving trustees who were originally named by the settlor.

When dealing with business administration powers or other essential powers, successors generally may exercise the same powers granted to the original trustees, whether directed or authorized. Broad discretionary powers, on the other hand, more likely may be found to have been meant only for the original trustee. If the instrument contains a standard on which the trustee is to base the exercise of discretion, it is easier to assume intent on the part of a settlor that the successor may exercise the power. In the absence of a standard, the inference that the successor may exercise a power is not as strong. However, the successor may be deemed to have the power in any event unless it appears that the settlor intended to limit the discretion to the original trustee.

Among other considerations is the question of whether the situation at hand was likely to have arisen after the originally named trustee had ceased to act. If so, and if it is likely that the settlor foresaw or could have foreseen the present set of circumstances, then it may be assumed that the settlor intended the successor to have the same powers as the originally named trustee. Thus, for instance, when the settlor names a trustee who is considerably older than the beneficiaries, it is likely that the settlor contemplated that successor trustees would be acting and presumably exercising the same powers granted to the original trustee.

Also to be considered is the relationship of the settlor and the beneficiaries. For instance, a power granted to the original trustee to invade principal for the benefit of a close relative of the settlor presumably would be deemed to survive to successor trustees.

Finally, the relationship of the settlor to the trustee also may be of importance. If it was a nonfamily relationship at the outset, it is easier to conclude that a successor nonfamily trustee has the same powers. This should also be true in the case of a corporate trustee. *City Nat. Bank & Trust Co. of Chicago v. Bairstow,* 319 Ill.App. 632, 50 N.E.2d 111 (1st Dist. 1943).

XI. TAX PROVISIONS AFFECTING THE TRUSTEE

A. [2.88] In General

A trustee faces a variety of duties and obligations under federal and state tax law. Sections 2.89 – 2.94 below highlight certain estate tax and generation-skipping transfer tax provisions that significantly affect the trustee. For a more extensive treatment of tax issues, particularly income tax issues, affecting trusts and trustees, see Chapters 5 and 7 of this handbook.

B. [2.89] Obligation To File Estate Tax Returns

Under certain circumstances, the trustee may be required to file a federal estate tax return on behalf of the estate of the grantor of the trust under which the trustee is acting. The executor of a decedent's estate has primary responsibility for filing the federal estate tax return and for paying any tax due. Under Internal Revenue Code §2203, if no executor or administrator is appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any of the decedent's property is treated as the decedent's executor for the purpose of return requirements. In many cases, the person in possession of all or a portion of the decedent's property may be the trustee. For example, the decedent may have transferred all personal assets to a living trust during his or her lifetime. If no executor for the decedent is appointed, the trustee of the living trust has primary responsibility for filing the federal estate tax return.

C. Trustee Responsibilities When Filing Federal Estate Tax Returns

1. [2.90] Prior Gifts

A single, unified rate schedule applies for gift and estate tax purposes, with progressive rates based on cumulative transfers during life and at death. Under this unified tax structure, the aggregate amount of lifetime taxable gifts made after 1976 is added to the donor's gross estate at the time of his or her death. 26 U.S.C. §2101(c)(1).

When a trustee is responsible for filing a federal estate tax return, it is critical that a complete list of all post-1976 adjusted taxable gifts be obtained to compute the federal estate tax properly. If the decedent's gift tax records are not available to the trustee, they should be requested from the IRS. Under Internal Revenue Code §2204(d), a fiduciary who in good faith relies on gift tax returns supplied by the IRS is not personally liable for any estate tax deficiency due to adjusted taxable gifts made more than three years before the decedent's death that are not shown on these returns. If the fiduciary fails to request returns from the IRS, the fiduciary is personally liable for any such estate tax deficiency. It is not clear what recourse a trustee has if the IRS cannot supply the information in time for filing the return (if it can be supplied at all) or if the information supplied is discovered later to be incorrect. Although a trustee cannot be held personally liable by the IRS for a tax deficiency that resulted from erroneous information supplied by the IRS, the trustee's liability to the beneficiaries is certainly open to question.

The trustee also should ascertain whether the decedent made gifts between September 8, 1976, and January 1, 1977. Tax Reform Act of 1976 (TRA ’76), Pub.L. No. 94-455, 90 Stat. 1520. Transition rules under TRA ’76 provide that the use of all or a portion of the $30,000 lifetime exemption then available reduces the applicable credit amount now available to offset gift and estate taxes. The applicable credit amount reduction is 20 percent of the lifetime exemption so used, thus leading to a potential underpayment of taxes by as much as $6,000 if the existence of a gift using the full exemption available during that period is not reported properly.

2. [2.91] Gifts in Contemplation of Death

For the estate of a decedent dying after December 31, 1981, the value of most transfers of property made within three years of death is not includable in the decedent’s gross estate. This rule, contained in Internal Revenue Code §2035(a), does not apply to transfers of life insurance under Code §2042 or transfers of interests that are otherwise includable in the gross estate under Code §2036, §2037, or §2038. Notwithstanding the foregoing, certain lifetime transfers may be includable in the gross estate for determining whether the estate qualifies for special-use valuation under Code §2032A, deferral of estate taxes under Code §6166, and Code §303 redemptions of stock and to identify property that may be subject to estate tax liens. 26 U.S.C. §2035. See also the Economic Recovery Tax Act of 1981 (ERTA), Pub.L. No. 97-34, 95 Stat. 172.

A trustee who is responsible for filing a federal estate tax return must search carefully for any transfers made within three years of death that are includable in the decedent’s gross estate. These transfers are essential to the correct computation of estate tax liability (as are any gift taxes paid), and the transferee’s basis in the property must be communicated to both the IRS and the transferee.

D. [2.92] Generation-Skipping Transfer Tax

In addition to gift and estate taxes, a third type of transfer tax is imposed on transfers to grandchildren and other persons who are two or more generations younger than the transferor — the generation-skipping transfer tax. If there was no GST tax, property transferred directly to one’s grandchildren (or to a trust in which no child of the transferor possesses a general power of appointment) would escape transfer tax at the death of the transferor’s children. Congress believes that this ability to skip a generation without paying transfer tax is unfair. The GST tax prevents this result by imposing a second level of tax (in addition to gift or estate tax) on transfers to grandchildren at a flat rate equal to the highest marginal estate and gift tax rate. In the absence of further changes to the Internal Revenue Code, the GST tax rate (along with the highest marginal estate and gift tax rate) was decreased gradually to 45 percent by 2007, and the tax rate was zero in 2010 under §302(c) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA), Pub.L. No. 111-312, 124 Stat. 3296. See also §901 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub.L. No. 107-16, 115 Stat. 38. For 2011 and 2012, the tax rate was 35 percent, the highest marginal estate tax rate under Code §2001. See 26 U.S.C. §2641; Pub.L. No. 107-16, §901. On January 1, 2013, Congress approved the American Taxpayer Relief Act of 2012 (ATRA), Pub.L. No. 112-240, 126 Stat. 2313, which permanently extended certain GST tax provisions introduced in 2001 by deleting the sunset of those provisions scheduled to take effect after 2012. See Pub.L. No. 112-240, §101. ATRA permanently maintained the GST exemption (along with the estate and gift tax exemptions) at $5 million, indexed for inflation with 2011 as the base year, but increased the top tax rate on transfers in excess of the relevant exemptions to 40 percent for 2013 and forward. *Id.* The Tax Cuts and Jobs Act of 2017 (TCJA), Pub.L. No. 115-97, §11061, 131 Stat. 2054, 2091, doubled the gift, estate, and GST tax exemption base to $10 million and provided a new measure to calculate the annual inflation adjustment known as the "chained consumer price index" (chained CPI). Pub.L. No. 115-97, §11002. With the increased base exemption amount and using chained CPI, all three of these exemption amounts were increased to $11.18 million in 2018 and to $11.4 million in 2019. Rev.Proc. 2018-18, 2018-10 Int.Rev.Bull. 392; Rev.Proc. 2018-57, 2018-49 Int.Rev.Bull. 827. Under TCJA, however, all three exemptions are scheduled to revert back to pre-2018 levels beginning in 2026. See Pub.L. No. 115-97, §11061.

There are two significant exclusions from GST tax:

1. As of the date of this writing, a person may give up to $15,000 of property annually to a grandchild or other individual who is two or more generations younger than the donor free of GST tax. 26 U.S.C. §2503(b); Rev.Proc. 2018-57, 2018-49 Int.Rev.Bull. 827. To qualify for the GST tax annual exclusion, however, the gift must be made either directly to the grandchild or to a trust of which the grandchild is the only beneficiary. See 26 U.S.C. §2642(c).

2. All medical and tuition expenses paid on behalf of a grandchild directly to the healthcare provider or school are not subject to GST tax. 26 U.S.C. §2503(e).

To the extent that GST tax exemption is not allocated to a particular trust, and unless the governing instrument provides otherwise, the trustee is responsible for paying, from the property constituting the transfer, the GST tax attributable to certain actual and constructive distributions from the trust. See 26 U.S.C. §2603(a)(2) (relating to taxable terminations and to direct skips that are made from a trust). In these cases, the trustee must file a federal gift or estate tax return to report the GST.

In certain cases, a trust is not entirely exempt from GST tax, which can add considerable complexity to the administration of the trust. However, the trust instrument may authorize the trustee to sever a partially GST tax-exempt trust into two separate trusts, one of which is entirely exempt from GST tax and one of which is entirely nonexempt. If the instrument does not contain such an express power, the trustee ordinarily is able to sever the trust under the authority granted in 760 ILCS 5/4.25. See §2.56 above for a discussion of the trustee's severance powers and potential limitations imposed by the issuance of final regulations governing qualified severances under Code §2642(a)(3).

For an excellent discussion of the effect of the GST tax on estate planning generally, and on trust administration in particular, see Jon J. Gallo, *Estate Planning and the Generation-Skipping Tax,* 33 Real Prop.Prob. & Tr.J. 457 (1998).

E. [2.93] Adjustments to Basis

A trustee should determine whether the trust holds any assets received by the decedent by gift within one year of death. An adjustment to basis, pursuant to Internal Revenue Code §1014(e), is not allowed when appreciated property is acquired by a decedent by gift within one year of death and the property passes, upon the decedent's death, to the original donor or the donor's spouse. The same rule applies if a trustee sells appreciated property acquired by the decedent by gift within one year of death and the original donor receives the sale proceeds.

F. [2.94] Chapter 14 Special Valuation Rules

The Revenue Reconciliation Act of 1990, Pub.L. No. 101-508, Title XI, 104 Stat. 1388-400, retroactively repealed the controversial anti-freeze provisions of former Internal Revenue Code §2036(c) and replaced them with Chapter 14 of the Code, comprised of Code §§2701 – 2704. Two provisions of the Code (Code §§2701 and 2702) contain a series of valuation rules that apply for gift tax purposes to the types of interests normally transferred and retained in freeze and value-shifting transactions. Additional rules govern the impact of options and other restrictions commonly found in buy-sell agreements (Code §2703) and certain lapsing rights and restrictions (Code §2704) on the valuation of assets that are subject to these restrictions. The provisions of Chapter 14 apply generally to transfers occurring, agreements entered into, and restrictions or limitations created after October 8, 1990. Pub.L. No. 101-508, §11602(e)(1). The trustee may need to be aware of Chapter 14 restrictions if the trustee wishes to participate in certain estate planning techniques (*e.g.,* the creation of a family limited partnership or family limited liability company).

One of the planning techniques that has been endorsed by the Tax Court in spite of the Chapter 14 restrictions is the fixed-term, zeroed-out grantor retained annuity trust (GRAT). This technique, approved by a unanimous decision of the Tax Court in *Walton v. Commissioner,* 115 T.C. 589 (2000), *acq.,* IRS Notice 2003-72, 2003-2 Cum.Bull. 964, allows the grantor to set up a GRAT in which the grantor's right to receive a fixed sum for a term of years can be valued at zero for gift tax purposes under Code §7520 if the right is a qualified interest within the meaning of Code §2702(b). Under *Walton,* such a valuation would be permissible regardless of the life expectancy of the grantor. See Carlyn S. McCaffrey et al., *The Aftermath of* Walton: *The Rehabilitation of the Fixed-Term, Zeroed-Out GRAT,* 95 J. Tax'n 325 (2001). In *Walton,* the grantor funded each of two GRATs with stock valued at approximately $100 million for a term of two years each. Under the terms of each GRAT, the grantor was to receive an annuity of 49.35 percent of the trust's initial value in Year 1 and 59.22 percent in Year 2. At the end of the two-year term, the remainder, if any, was to pass to a child of the grantor. The GRATs were irrevocable, prohibited additional contributions, and otherwise met the requirements of a qualified annuity interest under Treas.Reg. §25.2702-3. The grantor valued the remainder interest of each GRAT at zero on a timely filed gift tax return because the grantor's annuity interest in each GRAT was equal to 100 percent of the value of the assets originally transferred. The IRS contended that because the annuity was payable to the grantor's estate if the grantor failed to survive the term of the GRAT, the portion that might pass to the grantor's estate was not a qualified interest under Code §2702. The Tax Court disagreed with the IRS and concluded that the right to the annuity during life and the contingent annuity payable to the grantor's estate constituted only one retained interest, which was therefore a qualified retained interest under Code §2702. The IRS has acquiesced in the Tax Court's decision in *Walton* and has revised the applicable regulations. See IRS Notice 2003-72, *supra* (invalidating former 26 C.F.R. §25.2702-3(e), Example 5); T.D. 9181, 2005-1 Cum.Bull. 717.