

# Trusts & Estates

The newsletter of the Illinois State Bar Association's Section on Trusts & Estates

## Grantor trust administration in Illinois: A primer—part 3

BY COLLEEN L. SAHLAS AND EMILY VIVIAN

This is the final article in a 3-part series.

This article, published in three installments, outlines the roles and duties of the acting successor trustee in Illinois trust administration of a self-declaration of trust where the grantor/settlor has become disabled or is deceased. Accordingly, it instructs you as the attorney on how to advise and assist the trustee in carrying out those duties.

The two previous installments covered the major aspects of trust administration in Illinois. This section covers the tax timeline, written by Emily R. Vivian, and optional actions in trust administration, written by Colleen L. Sahlas.

**Note that this article series is based upon current Illinois law, which may be subject to change when the Illinois Trust Code at HB1471 takes effect on January 1, 2020.**

### Tax Filings and Issues in Trust Administration

By Emily R. Vivian

Fiduciaries, whether they be executors, trustees or administrators, are often surprised to learn that they are required to file income tax returns for the entities that they represent (*i.e.*, estates and trusts). While a fiduciary can often get by with filing a single trust income tax return, in many

cases a fiduciary is required to file several trust income tax returns. Specifically, if the trust administration is relatively simple, straightforward and can be wrapped up in a single tax year, the fiduciary may only need to file one trust income tax return. However, if the trust is complicated or is structured to last for multiple years, the fiduciary will need to file multiple trust income tax returns. Accordingly, there are many different tax matters to consider when representing fiduciaries.

#### Tax Returns in Trust Administration

So what types of tax returns are fiduciaries required to file when administering a trust? And when are such tax returns due?

#### Decedent's Final Income Tax

The tax year for a decedent closes as of the date of his or her death. Obviously, the decedent cannot file his or her own final income tax return, so someone else must handle that responsibility. It makes sense that the responsibility would fall to the executor of the decedent's estate, as the executor is already responsible for managing the decedent's assets and liabilities. However, many times when a decedent dies and the bulk of his or her assets are titled in the name of his or her trust, a probate estate is not required to be opened and no executor is appointed. Rather, the decedent's financial affairs are handled strictly through trust

administration. Because taxes are considered a debt of a decedent and tax refunds are considered an asset of the decedent, the trustee is required to satisfy any outstanding taxes and collect any potential tax refunds.

The due date for the decedent's final income tax return is April 15 following the year in which the decedent died. For example, if the decedent died March 20, 2019, his or her final income tax return will be due April 15, 2020, and will cover the period of January 1, 2019, to March 20, 2019. If the decedent died November 2, 2019, his or her final income tax return will be due April 15, 2020, and will cover the period January 1, 2019, to November 2, 2019.

Also, if the decedent was married at the time of his or her death, the surviving spouse can file as married filing jointly for the year in which the decedent died. So, if Johnny and June are married and Johnny dies on January 2, 2019, June can file as married filing jointly for 2019 (the returns for which will be due April 15, 2020).

#### Fiduciary Tax Return

As Colleen L. Sahlas pointed out in part 1 of this primer, a trust becomes a separate taxpaying entity as of the date of the decedent's death (or earlier if the decedent ceases being a trustee of his or her trust). So, in addition to taking responsibility for decedent's final income tax return, the

trustee is also responsible for filing the fiduciary (*i.e.*, the trust) income tax return.

### **Calendar Year vs. Fiscal Year**

An estate may choose either a calendar tax year or a fiscal tax year. If an executor or administrator elects a fiscal year, he or she may choose to end the tax year on the last day of any month, as long as such tax year ends on or before the last day of the month immediately preceding the month in which the decedent died. For example, if a decedent died on June 16, the estate could elect to have a fiscal year ending May 31, in which case the fiduciary income tax return would be due on September 15 (as a fiduciary income tax return is due on the 15<sup>th</sup> day of the fourth month following the fiscal year end).

There are several advantages to choosing a fiscal year end as opposed to a calendar year end. For one, the representative is granted flexibility in allocating losses/gains and income/expenses among beneficiaries by considering different tax years. In addition, if the estate is fairly simple and can be closed within a relatively short period of time, an estate may be able to file just one fiduciary income tax return. For example, assume a decedent dies November 6. The 6-month claims period does not end until at least May. If the estate fails to elect a fiscal year, the representative would have to file two income tax returns, one with a tax year ending December 31 of the year in which the decedent died, and one with a tax year ending December 31 of the following year. If, however, the estate elects a fiscal year ending October 31, the representative may only need to file one income tax return.

This discussion is beneficial if we are representing the representative of *an estate*, but what if we are representing the trustee of *a trust*?

### **Election to Treat Trust as an Estate**

In general, a trust's tax year is a calendar year. However, pursuant to Code § 645, a qualified revocable trust may elect to be treated as part of the decedent's estate for income tax purposes, and, thus, can elect a fiscal year.<sup>1</sup> As with an estate, the first day of the tax year begins the day after the decedent's death and ends on the last of a month, so long as such month is not more than eleven months following the decedent's

death.

A "qualified revocable trust" is a trust (or any portion thereof) which was treated as owned by the decedent by reason of a power in the grantor, (this includes most revocable living trusts).

To elect to treat the estate and trust as a single taxpayer, the trustee should file Form 8855, Election to Treat a Qualified Revocable Trust as Part of an Estate, with the IRS. This election must be made no later than the due date of the first federal income tax return (including extensions), and once the election made, it is irrevocable.

### **Who Is a Fiduciary?**

Generally, responsibility for filing income tax returns in estate administration falls on the fiduciary. This term is broadly defined in Code § 7701(a)(6) to include "a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in a fiduciary capacity for any person."<sup>2</sup> (Although the subject for a different article, when the administration of a decedent's estate involves responsibility for filing an estate tax return, Code § 2203 defines "executor" as "the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.")<sup>3</sup>

## **Options to Consider in Trust Administration**

### **By Colleen L. Sahlas**

#### **DECLINING TO SERVE AS TRUSTEE**

The trustee may decline to serve. In that event, the vacancy must be filled as follows:

Sec. 13. Vacancy - Successor Trustee.

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; or

(2) if there is no remaining trustee, a successor trustee may be appointed by a majority in interest of the beneficiaries then entitled to receive the income from the trust estate or, if the interests 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.<sup>4</sup>

#### **TRUSTEE RESIGNATION**

The trustee can choose at any time to resign but must do so in writing.

Sec. 12. Resignation. 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.<sup>5</sup>

#### **APPOINT A CO-TRUSTEE**

The Trustee may choose to appoint a co-trustee as appropriate unless the trust forbids it.

Sec. 4.05. To 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.<sup>6</sup>

Sec. 4.10. To delegate to a co-trustee for any period of time any or all of the trustee's rights, powers and duties.<sup>7</sup>

#### **SEVER THE TRUST**

Sec. 4.25. Severance and consolidation. To 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. The provisions of this amendatory Act of 1993 apply to all trusts created, and actions taken before, on, or after the effective date of this amendatory Act of 1993.<sup>8</sup>

#### TERMINATE A SMALL TRUST

Sec. 4.26. Small trust termination. To 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.

Distribution 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.

This Section 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, nor shall it apply to trusts for domestic or pet animals.

The provisions of this amendatory Act of the 95th General Assembly apply to all trusts created before, on, or after its effective date.<sup>9</sup>  
DELEGATE INVESTMENT FUNCTIONS TO AN INVESTMENT AGENT

It is prudent for the trustee to delegate investment functions to an investment agent, and thereby shift the liability onto the investment agent. The trustee must conduct an investigation of the investment agent and send written notice to the beneficiaries of the same, and it shall take effect 30 days thereafter.

- Conduct an investigation of the investment agent:
  - For an overview, check out the U.S. Securities & Exchange Commission website. SEC's website says, "Before you invest or pay for any investment advice, make sure your brokers, investment advisers, and investment adviser representatives have not had disciplinary problems or been in trouble with regulators or other investors. You also should check to see whether they are registered or licensed. This is very important, because if you do business with an unregistered securities broker or a firm that later goes out of business, there may be no way for you to recover your money — even if an arbitrator or a court rules in your favor. . . To find out about an investment adviser and whether it is properly registered, read its registration form, called 'Form ADV.' Form ADV has two parts. Part 1 contains information about the

adviser's business and whether the adviser has had problems with regulators or clients. Part 2 sets out the minimum requirements for a written disclosure statement, commonly referred to as the "brochure," which advisers must provide to prospective clients initially and to existing clients annually. The brochure describes, in a narrative format, the adviser's business practices, fees, conflicts of interest, and disciplinary information. Before you hire an investment adviser, always ask for and carefully read both parts of the Form ADV.<sup>10</sup>

"You can view an adviser's most recent Form ADV online by visiting the Investment Adviser Public Disclosure (IAPD) website.<sup>11</sup> You can also obtain copies of Form ADV for individual advisers and firms from the investment adviser, your state securities regulator, or the SEC, depending on the size of the adviser. You'll find contact information for your state securities regulator on the website of the North American Securities Administrators Association."<sup>12</sup>

- Conduct a search on the SEC's Investment Adviser Public Disclosure website.<sup>13</sup>
- If some advisors are also brokers, conduct a search with Brokercheck website.<sup>14</sup>
- Conduct a search to see if the brokerage firm is a member of the Securities Investor Protection Corporation (SIPC): The SEC's website states, "If your brokerage firm goes out of business and is a member of the Securities Investor Protection Corporation (SIPC), then your cash and securities held by the brokerage firm may be protected up to \$500,000, including a \$250,000 limit for cash. When a SIPC member becomes insolvent, SIPC will ask a court to appoint a trustee to supervise the firm's

liquidation and to process investors' claims. SIPC covers most types of securities, such as stocks, bonds, and mutual funds. But SIPC does not protect you against losses caused by a decline in the market value of your securities. And it does not provide protection for investment contracts not registered with the SEC.<sup>15</sup>

- Send Written notice to the beneficiaries
- A sample written notice is included at the end of this article. Sec. 5.1. Duty not to delegate.
  - (a) 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. The trustee may delegate those investment functions to an investment agent as provided in subsection (b).
  - (b) For a trustee to properly delegate investment functions under subsection (a), all of the following

requirements apply:

- (1) The trustee must exercise reasonable care, skill, and caution in selecting the investment agent, in establishing the scope and specific terms of any delegation, and in periodically reviewing the agent's actions in order to monitor overall performance and compliance with the scope and specific terms of the delegation.
- (2) The trustee must conduct an inquiry into the experience, performance history, professional licensing or registration, if any, and financial stability of the investment agent.
- (3) The investment agent shall be subject to the jurisdiction of the courts of the State of Illinois.
- (4) The investment agent shall be subject to the same standards that are applicable to the trustee.
- (5) The investment agent shall be liable to the beneficiaries of the trust and to the designated trustee to the same extent as if the investment agent were a designated trustee in relation to the exercise or nonexercise of the investment

function.

- (6) The trustee shall send written notice of its intention to begin delegating investment functions under this Section to the beneficiaries eligible to receive income from the trust on the date of initial delegation at least 30 days before the delegation. This notice shall thereafter, until or unless the beneficiaries eligible to receive income from the trust at the time are notified to the contrary, authorize the trustee to delegate investment functions pursuant to this Section
  - (c) If all requirements of subsection (b) are satisfied, the trustee shall not otherwise be responsible for the investment decisions or actions of the investment agent to which the investment functions are delegated.
  - (d) On and after July 1, 1992, this Section applies to all existing and future trusts, but only as to actions or inactions occurring after that date.<sup>16</sup>

(SAMPLE DELEGATION FORM BELOW)

#### DELEGATION OF INVESTMENT FUNCTIONS BY TRUSTEE TO INVESTMENT ADVISOR

Pursuant to 760 ILCS 5/5.1 (b), \_\_\_\_\_ (name), Trustee of The \_\_\_\_\_ Trust dated \_\_\_\_\_, hereby notifies you, \_\_\_\_\_, as income beneficiary and principal beneficiary of the aforementioned Trust, of the Trustee's intention to begin delegating investment functions under this Section to \_\_\_\_\_ (name of investment advisor) of \_\_\_\_\_ (investment broker firm name).

\_\_\_\_\_ (investment advisor) of \_\_\_\_\_ (investment broker firm name) was the trusted financial investor and advisor to the Settlor(s) of the aforementioned trust, \_\_\_\_\_ (Settlor's name), and therefore for the sake of continuity of the assets and retention of the same trusted advisor, all investment functions shall be delegated to \_\_\_\_\_ (investment advisor). The scope of his/her functions shall be those outlined in 760 ILCS 5/5 concerning Securities and the Prudent Investor Rule (see below). The Trustee, \_\_\_\_\_, has investigated the investment advisor's professional experience, licenses, and performance history and has attached a detailed Broker Report consisting of \_\_\_ pages for your review.

In 30 days, this notice shall thereafter, until or unless the beneficiaries eligible to receive income from the trust at the time are notified to the contrary, authorize the trustee to delegate investment functions pursuant to 760 ILCS 5/5.1 (b) (statute recited below).

Date: \_\_\_\_\_

Signed: \_\_\_\_\_

#### Recitation of Statute

Sec. 5.1. Duty not to delegate.

(a) 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. **The trustee may delegate those investment functions to an investment agent as provided in subsection (b).**

(b) For a trustee to properly delegate investment functions under subsection (a), all of the following requirements apply:

(1) The trustee must exercise reasonable care, skill, and caution in selecting the investment agent, in establishing the scope

and specific terms of any delegation, and in periodically reviewing the agent's actions in order to monitor overall performance and compliance with the scope and specific terms of the delegation.

(2) The trustee must conduct an inquiry into the experience, performance history, professional licensing or registration, if any, and financial stability of the investment agent.

(3) The investment agent shall be subject to the jurisdiction of the courts of the State of Illinois.

(4) The investment agent shall be subject to the same standards that are applicable to the trustee.

(5) The investment agent shall be liable to the beneficiaries of the trust and to the designated trustee to the same extent as if the investment agent were a designated trustee in relation to the exercise or nonexercise of the investment function.

(6) The trustee shall send written

notice of its intention to begin delegating investment functions under this Section to the beneficiaries eligible to receive income from the trust on the date of initial delegation at least 30 days before the delegation. This notice shall thereafter, until or unless the beneficiaries eligible to receive income from the trust at the time are notified to the contrary, authorize the trustee to delegate investment functions pursuant to this Section.

(c) If all requirements of subsection (b) are satisfied, the trustee shall not otherwise be responsible for the investment decisions or actions of the investment agent to which the investment functions are delegated.

(d) On and after July 1, 1992, this Section applies to all existing and future trusts, but only as to actions or inactions occurring after that date. ■

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1. 26 US Code 645.
2. 26 US Code 7701(a)(6).
3. 26 US Code 2203.
4. 760 ILCS 5/13 (Source: P.A. 78-625).
5. 760 ILCS 5/12 (Source: P.A. 78-625).
6. 760 ILCS 5/4.05 (Source: P.A. 86-1475).
7. 760 ILCS 5/4.10 (Source: P.A. 86-1475).
8. 760 ILCS 5/4.25.
9. 760 ILCS 5/4.26 (Source: P.A. 95-605).
10. <https://www.sec.gov/reportspubs/investor-publications/investor-brokershtm.html>
11. <https://www.adviserinfo.sec.gov/>
12. <http://www.nasaa.org/about-us/contact-us/contact-your-regulator/>
13. <https://www.adviserinfo.sec.gov/>
14. <https://brokercheck.finra.org/>
15. <https://www.sec.gov/fast-answers/werssipchtm.html>
16. 760 ILCS 5/5.1 (Source: P.A. 87-715; 87-895).