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BARRETT, EASTERDAY, CUNNINGHAM & ESELGROTH LLP

BECE Special Edition

Ohio Adopts New Trust Code

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Historically, Ohio has had very few statutory laws that deal with trusts. Most of the statutes dealing with trusts involve only trusts administered through the Probate Court. Instead, Ohio has relied on old common law from England and court decisions. The number of trusts established has increased dramatically over the last decade as more people are using trusts for estate tax savings and probate avoidance. This, in turn, has an impact on many other people, whether they are trustees, beneficiaries, bankers, brokers or real estate professionals.

With so many people impacted by trusts, it should not be any surprise that

Ohio has enacted new statutory laws to address many common trust situations. Ohio adopted a new trust code when Governor Bob Taft signed House Bill 416 into law on June 28, 2006. This new Ohio Trust Code (OTC), will be effective January 1, 2007.

A joint committee of lawyers, bankers, and others used the Uniform Trust Code (UTC) as a basis to form the OTC. The UTC is a model act prepared to give all states guidance in coming up with more uniform laws throughout the country. The new OTC uses many of the UTC provisions, but Ohio also modified the UTC in many ways to make it more consistent with existing Ohio

law. Therefore, Ohio law under the new OTC will in some ways remain the same as the existing trust law, but the OTC will also change or add laws in some areas.

Definitions

"Settlor" or "Grantor" are common terms used to describe the person who is creating the trust either during lifetime or upon that

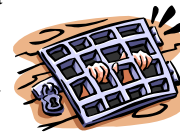
Continued on page 2.

"The new laws are too important to wait for our Holiday Edition!"

New Law Mandates Landlord Registration

Effective September 28, 2006, the owner of any residential rental property must register with the County Auditor. You will need to contact your County Auditor for the appropriate form. Some counties have the forms available online. Failing to register or failing to update

the information within ten days of any changes in the information is a minor misdemeanor. This could become a trap to successor trustees who may not even know the information about rental properties until more



than ten days after a change. Copies of the registrations should be kept with the estate planning documents, so that a successor will know what is required. It would also be helpful for the attorney involved to have a copy of the registration statements.

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Special points of interest:

- Help protect your child's inheritance from creditors
- Override the OTC default provisions
- Direct gifts to charity from IRAs
- Eliminate fighting over funeral arrangements

Ohio Trust Code (cont.)

person's death. Testamentary trusts only come into existence at the death of the settlor, through the Last Will and Testament of the settlor in probate court. Inter vivos, or living trusts, are used more often in Ohio and are established during the settlor's lifetime without any court involvement. The OTC will apply to both testamentary and inter vivos trusts. It also will apply to a great extent to all existing trusts, regardless of whether the trust can be amended or not, as well as to all trusts established after the effective date.

The OTC mainly states default rules that apply to trusts. These default rules can be overridden by the terms of the trust. However, there are 14 mandatory rules given in the OTC that the settlor cannot override. Some of these rules include the requirements for making a trust, the duty of the trustee to follow the terms laid out in the trust, and the requirement that the purpose of a trust be lawful and achievable. However, special provisions, which will be discussed later in this article, can be drafted in the trust to address a couple of the mandatory rules.

It is important to understand both the default and mandatory rules, so that you know whether any existing trust needs modified as a result of the OTC. This will be a personal decision, as some people will like the new provisions while others will not.

In order to understand these rules and how they apply, it is important to understand distinctions the OTC makes with different types of beneficiaries. The OTC recognizes three main types



of beneficiaries: current, qualified, and other. A current beneficiary is a person who is a distributee or permissible distributee of trust income or principal on the date the beneficiary's qualification is determined. A qualified beneficiary is any current beneficiary plus a person who would become a current beneficiary if the interests of the current beneficiary are terminated. Any other beneficiary is a person who has a present or future interest in the trust who is not a current or qualified beneficiary. For example, in a family trust that is set up for a spouse on the occasion of the death of the other spouse, the surviving spouse is the current beneficiary. The children are qualified beneficiaries in the case of the death of the remaining spouse or beneficiary. However, if the child or qualified beneficiary dies before his or her parent, the child's children are beneficiaries.

General Provisions

Often, beneficiaries are unborn, minors, or adults who lack capacity. In this situation, the OTC allows another representative to act on the behalf of the beneficiary. For example, a parent can act on behalf of a minor or unborn child, and people with identical interests can act on behalf of each other.

The OTC allows for any matter involving a trust to be settled in a private settlement agreement (PSA), with four general exceptions. A PSA cannot be used to terminate a trust early or to change the inter-

ests of beneficiaries. There are other provisions that specifically address how and when a trust can be terminated early. Also, PSAs may not be used for certain charitable trusts. Finally, a PSA is only valid if it includes terms and conditions that could be approved by a court. The PSA provisions will eliminate the need for court involvement where all of the parties are able to negotiate a settlement as to how the trust should be administered.

The OTC validates trusts for the care of a pet during the pet's lifetime. The trust may be enforced by a person appointed by the settlor in the trust. If no one is appointed in the trust, the court may appoint someone.

The OTC aims to provide more flexibility to modify trusts than has been previously allowed by law. However, precaution was taken so that the intentions of the settlor were not compromised. The traditional rules on modifying or terminating trusts remain, but they are more relaxed in certain areas. For instance, if there is convincing evidence that a mistake regarding the interests of the settlor was made, modification is possible. Another difference the OTC has from the UTC is allowing a living trust of less than \$100,000 to be terminated by the trustee without court involvement.

Creditor Protection

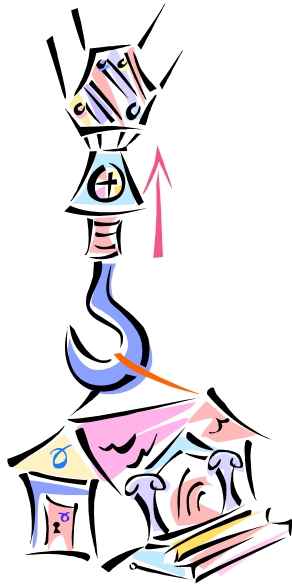
One of the major benefits of establishing a trust for another person is protecting the trust assets from the claims of the beneficiary's creditors. Under the OTC, a creditor of a beneficiary cannot reach the beneficiary's interest or assets of a spendthrift trust unless there is a court order for provision of a child or current spouse. There is also an exception for claims of the State of Ohio and the United States.

"it is important to understand distinctions the OTC makes with different types of beneficiaries"

Ohio Trust Code (cont.)

The statute says that these are the only exceptions, so it is unlikely that a court will be able to create additional exceptions. A spendthrift trust is defined as a trust that says it is subject to spendthrift provisions or contains language limiting both voluntary and involuntary transfers of the beneficiary's interest. The OTC specifically provides that the creditor protection applies even if the beneficiary is the trustee. However, the provisions do not protect the trust assets from claims of the settlor's creditors to the extent of any interest retained in the trust by the settlor.

In addition to spendthrift trusts, no creditor can reach the beneficiary's interests before the beneficiary receives them, as long as the trust is wholly discretionary (WDT). Important requirements for a WDT are that the trustee must have absolute discretion, the beneficiary cannot be a trustee, and the trust cannot have a support standard. If the trust includes a support standard, a beneficiary has the right to distributions from the trust for a necessity, such as a health problem.



these requirements do not apply to a revocable trust during the lifetime of the settlor; however, there does appear to be a requirement to provide information to any beneficiary who requests it. This is a requirement that the settlor can avoid by addressing it in the trust agreement.

The primary duty of the Trustee is to exercise good faith in administering the terms of the trust. This duty is mandatory for all trustees. The trustee also has a duty of loyalty to the beneficiaries. A conflict of interest can often arise between this duty of loyalty and transactions where the trustee is also a beneficiary. A transaction between the trustee on behalf of the trust and the trustee for the trustee's own benefit is generally voidable by the other beneficiaries. The trustee cannot get around this rule by entering the transaction with a related party. This rule also applies if the trustee tries to substitute a spouse, descendant, sibling, parent or agent of the trustee. The exceptions to this general rule are the following: 1) the transaction was authorized by the terms of the trust or by other provisions of Ohio law, 2) the transaction was approved by the court, 3) the beneficiary failed to start a legal action within the appropriate time period, 4) the beneficiary consented or ratified the transaction, and 5) the contract or claim involved arose before the person contemplated being the trustee. The rule also does not apply if the transaction is between two different trusts of which the trustee is acting as the trustee of both.

If you have named family members as trustee and want the trustee to be able to rent land from the trust or otherwise have dealings with the trust, you will need to make sure that the trust expressly authorizes the transactions or you waive this duty of loyalty.

Notices

On and after January 1, 2007, a trustee of any trust that becomes irrevocable will be required within sixty days to provide to the current beneficiaries notice of the existence of the trust, the identity of the settlor, the right to request a copy of the trust agreement and the name, address and telephone number of the trustee. The trustee is also required at least annually to provide to the current beneficiaries, and to other beneficiaries who request it, a report of the trust property, liabilities, receipts and disbursements, the trustee's compensation and a listing of the trust assets, with fair market values if feasible. The trustee must provide notice to the current beneficiaries when there is any change in rate or method of calculation of the trustee's compensation and any change in the location of the administration of the trust to another state. The trustee must provide notice to the qualified beneficiaries upon termination of any trusts under \$100,000, consolidation or division of trusts and upon trustee resignation.

The OTC provides that unless it is unreasonable under the circumstances, the trustee shall promptly respond to any beneficiary's request for information related to the administration of the trust.

Many of these notice provisions may be waived in the trust agreement with two major exceptions contained in the



"you can protect the trust assets from the claims of the beneficiary's creditors"

Ohio Trust Code (cont.)

mandatory requirements. Under the OTC, you may not completely waive the trustee's duty "to notify current beneficiaries of an irrevocable trust who have attained twenty-five years of age of the existence of the trust, of the identity of the trustee, and of their respective right to request trustee's reports" and "to respond to the request of a current beneficiary of an irrevocable trust for trustee's reports and other information reasonably related to the administration of a trust." These duties may be waived or modified as to one or more of the current beneficiaries by creating a beneficiary surrogate to receive the information instead of the beneficiary. The beneficiary surrogate must be someone other than a trustee and is required to use good faith to protect the interests of the beneficiary.

These mandatory notice provisions have the most impact where an irrevocable trust is set up with discretionary powers of distributions to multiple beneficiaries. For example, a husband who has named his wife as the sole current beneficiary and trustee after his death, the mandatory notices do not apply. On the other hand, if the trustee has discretion to make distributions to the spouse and lineal descendants, the wife will be required to provide the notices and reports unless waived by the beneficiaries.

If you are designating a family member as the trustee, you may want to consider waiving the notice and reporting requirements to the greatest extent possible. Some people may want to consider removing children and others as a potential beneficiary during the lifetime of the surviving spouse to avoid the surviving spouse having to comply with the mandatory provisions. A few of you may want to consider adding a beneficiary surrogate so you can keep your children from knowing about the terms or administration of the trust.

"you have the ability to override most of the requirements"

There are situations that may arise where the trustee may want to send a report even if not required. The OTC provides a statute of limitations of two years for claims against the trustee for breach of trust where the trustee provided a report that adequately discloses the existence of a potential claim for breach of trust and informs

the beneficiary of the time in which a claim must be commenced. If this type of report is not provided, the statute of limitations is four years from the first to occur of the following: (1) the removal, resignation, or death of the trustee, (2) the termination of the beneficiary's interest in the trust, (3) the termination of the trust and (4) the time at which the beneficiary knew or should have known of the breach of trust. Therefore, any beneficiary who knows of a breach of trust must commence a legal action within four years or the claim will be lost. Many trustees will begin providing regular reports with a statement that claims must be filed in two years in an attempt to shorten the period even further. The beneficiary will then be in a position of needing to file any claims within two years or argue that the breach of trust was not adequately disclosed in the report.

A trustee can also limit its liability in other ways as well. For example, the trustee may obtain the consent, release or ratification of the beneficiaries. The trustee will also not have any personal liability on any contracts if the trustee discloses the representative capacity. The words "trustee" or "as trustee" following the name or signature of a trustee are sufficient disclosure. This is the same



type of personal protection obtained when you sign in a representative capacity on behalf of a corporation or limited liability company. In either case, it is extremely important to list your representative capacity on behalf of the trust or company.

Certification of Trust

Third parties often ask for a copy of the entire trust document. The OTC provides an alternative, so that you do not have to disclose the beneficiaries. The Certificate is required to include certain information about the trust, the currently serving trustee and the powers of the trustee. The OTC provides protections for third parties who rely on the Certificate in good faith. However, the third party can be liable for damages if they refuse to accept a Certificate and the refusal is not done in good faith.

Conclusion

It is a good idea to review estate planning documents on a regular basis, but the new trust code provides an additional reason to review your existing estate planning documents to see if the documents still accomplish your wishes. If you do not like the new requirements of the trust code, you have the ability to override most of the requirements. If you do like the new provisions, you may not need to make any changes to your documents. If you are administering an existing irrevocable trust as the trustee, you will need to familiarize yourself with the new requirements so that you comply with the new law.

IRA Charitable Rollovers

From now through the end of 2007, IRA owners who have attained 70 ½ years of age have a new planning opportunity. The IRA owner may now make a direct transfer from the IRA to charity in 2006 and 2007 in an amount not to exceed \$100,000 per year.

The main benefit of such a transfer is that it does not end up as reportable income on your federal income tax return. Also, the transfer will qualify for the minimum required distribution for the year. Further, because it is not included in income, there should not be any Ohio income tax on the distribution. These transfers will not be subject to the limitation on charitable gifts of 50% of adjusted gross income and any other deduction limitations. If your minimum required distribution otherwise causes more social security income to be taxed because it raises your taxable income above the relevant

thresholds, this type of transfer may result in less tax being paid on the so-



cial security income. This also will result in less taxes for donors who do not have enough deductions to itemize on their returns. They will get the benefit of the gift to charity and still be

able to take the standard deduction.

In general, the charity must be a public charity and cannot be a supporting organization or a donor advised fund. However, the gift may be made to a particular scholarship fund of a university. In addition, the entire gift must qualify for the charitable deduction, so no benefits may be received from the charity, such as invitations to banquets or preferential seating at athletic events. The new provision does not apply to 401K or other types of retirement accounts.

If you are interested in planning for this type of transfer, it is recommended that you contact both the charity, the IRA custodian and a tax advisor, so that the transfer is appropriately made. You may want to review your taxes before the end of the year to see if this could be beneficial to you and the charity.



Right of Disposition

Effective October 12, 2006, Ohio now permits you to designate an agent to make funeral, burial or cremation arrangements for you after your death. If there are surviving spouses and children who have differing views, whether religious or otherwise, as to how the funeral should be handled, this document will help reduce the fighting after your death. However, the person exercising the right to dispose will be personally liable for any of the expenses. This gives the funeral home greater

assurance of whose direction to follow and of getting paid.

If you do not designate an agent, the statute specifies that a surviving spouse, children (collectively), parents, siblings or grandparents, successively in that order, have the right of disposition.





**BARRETT, EASTERDAY,
CUNNINGHAM & ESELGROTH LLP**

7269 Sawmill Road
Dublin, Ohio 43016

Phone: 614-210-1840

Fax: 614-210-1841

E-mail: info@ohiocounsel.com

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www.ohiocounsel.com

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Direct Attorney Telephone Numbers

We value your call, so please feel free to contact each of us on our direct lines at the following numbers:

Dave Barrett (614)210-1842 Jeff Easterday (614)210-1843 Russell Cunningham (614)210-1844

Carolyn Eselgroth (614)210-1845 Troy Callicot (614)210-1847

If we are not available when you call, your call will roll over to either a receptionist or our voicemail.

If you want any additional information on any of the issues discussed in this newsletter, please contact Carolyn Eselgroth, Jeffrey Easterday or Russell Cunningham.

Russell N. Cunningham is an OSBA Board Certified Specialist in Estate Planning, Trust and Probate Law.

