LEGAL UPDATES

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Options for Changing an Irrevocable Trust

Service

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As its name implies, an irrevocable trust cannot be revoked by the person who establishes the trust. Typically, an irrevocable trust also cannot be changed by a trustee or beneficiary. The irrevocable nature makes the trust a vehicle for a variety of purposes: estate and gift tax planning, and asset protection being two of the most notable. However, the irrevocable nature of the trust also limits its flexibility and the ability to address changes in circumstances involving the trust beneficiaries and tax laws, for example. Requesting that a court modify a trust has always been an option, but this is an expensive and cumbersome procedure. Over the years, different options have developed to allow certain changes to be made to irrevocable trusts without court intervention. These include the use of a trust protector, decanting, and nonjudicial settlement and modification agreements. These options vary from state to state, and they are not the only options available; however, they have become popular topics of discussion in recent years.

What follows is a brief description of each of these options. Irrevocable trusts and the circumstances in which they operate are inherently different. Importantly, any change made to a trust has estate, gift, generation-skipping transfer, and income tax consequences that need to be carefully considered. If you believe that changes to an irrevocable trust with which you are involved should be considered, please reach out to our Private Wealth team and we will analyze your options and any potential tax implications. This article should not be relied upon as legal advice, but we look forward to discussing your particular circumstances and advising as appropriate.

Trust protector

A trust protector is an individual other than the trustee or a beneficiary who is given special powers over the trust agreement. The powers of a trust protector are typically defined in the trust agreement. Some states regulate the powers a

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trust protector may have and how these powers are exercised. For example, a state statute may provide that a trust protector appointed by the trust instrument has the powers, delegations, and functions conferred on the trust protector by the trust instrument, which may include the power to: (1) remove and appoint a trustee; (2) modify or amend the trust instrument for any valid purpose or reason, including to achieve a favorable tax status or to respond to changes in the internal revenue code or state law, or the ruling and regulations under such code or law; (3) increase, decrease, modify, or restrict the interests of any beneficiary of the trust; (4) modify the terms of a power of appointment granted by the trust; and (5) change the applicable law governing the trust.

By way of example, we have seen trust protectors take action in the following circumstances and more: (i) removing and replacing a trustee who is not complying with proper accounting requirements, (ii) expanding a beneficiary's power of appointment to give the beneficiary more flexibility, and (iii) amending a trust agreement to respond to new legislation either to take advantage of new benefits provided by the legislation or to avoid negative consequences of the legislation.

Trust protectors typically can take action without the consent of any trustee, beneficiary, or settlor of the trust agreement. However, notice is typically required to be given to one or all of the aforementioned parties, in order to give such party, the opportunity to object to the proposed action.

Decanting

The term decanting refers to the process of a trustee "pouring" the assets of one trust into another trust, much like decanting wine from the bottle to another vessel. In many states, the trustee may distribute the trust assets to a different trust agreement if the trustee decides that this is in the best interest of the beneficiaries. Typically, the trustee may decant trust assets without prior court approval but may seek court approval in the trustee's discretion.

Under the law of many states, a trustee meeting certain requirements may distribute (decant) the assets of one trust to another, as long as the new trust (1) does not reduce any fixed nondiscretionary income payments; (2) does not alter any nondiscretionary annuity or unitrust payments; (3) is in favor of the beneficiaries of the trust; (4) results in any ascertainable standard applicable for distributions from the trust being the same or more restrictive standard applicable for distributions from the recipient trust when the trustee exercising the power described in this subsection is a possible beneficiary under the standard; (5) does not adversely affect the tax treatment of the trust, the trustee, the settlor, or the beneficiaries; and (6) does not violate the limitations on validity of vesting interests.

Furthermore, state law may allow the resulting trust agreement to (1) change the order of trustee succession; (2) expand or restrict powers of appointment held by beneficiaries; or (3) add a trust protector for additional future flexibility. As an additional benefit, many states allow a trustee to

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accomplish a decanting by *restating* the original trust agreement rather than creating an entirely new, separate trust agreement to govern the original trust assets. The restatement method avoids the administrative burden of needing to re-title all assets of the trust in the name of the new trust.

Nonjudicial settlement and modification agreements

Many states provide a statutory structure whereby certain parties interested in an irrevocable trust may join together and agree to amend certain provisions in the trust agreement. These are commonly known as nonjudicial settlement or nonjudicial modification agreements. Generally, the trustee and the current and remainder beneficiaries are the parties who are required to agree on the amendment to the irrevocable trust agreement. Some states require the settlors to consent to any such amendment. As the name indicates, nonjudicial settlement and modification agreements do not require court approval, but interested persons typically have the right to ask a court to approve the agreement.

Under the law of many states, interested persons may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust, provided it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by a court or other applicable law. While the specific rules will vary based on state statutes, the following are examples of trust provisions that can often be amended through a nonjudicial settlement agreement: (1) the interpretation or construction of the terms of the trust; (2) the approval of a trustee's report or accounting; (3) direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power; (4) the resignation or appointment of a trustee and the determination of a trustee's compensation; (5) the transfer of a trust's principal place of administration; and (6) the liability of a trustee for an action relating to the trust.

There are many situations that can arise where a nonjudicial settlement agreement would be useful to the parties to a trust. For example, if a trustee is hesitant to exercise or refrain from exercising a particular discretionary power, the trustee may seek approval from the beneficiaries through a nonjudicial settlement agreement. The trustee and beneficiaries may also utilize a nonjudicial settlement agreement to transfer trust situs to a different state or provide for an alternate successor trustee.

Conclusion

Irrevocable trusts are incredibly useful tools for protecting assets from creditors and shielding them from estate taxes. The provisions of an irrevocable trust should be carefully considered when creating the trust. However, it is difficult to predict the future and try to account for all possible future changes in circumstances. Knowing that there are tools and techniques available to allow the parties to a trust

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to react and adapt to ever-changing tax laws and unforeseen changes in family circumstances should help alleviate some concerns with creating a trust that is irrevocable.

Contact us

For questions or guidance about irrevocable trusts or the contents of this update, please contact Jill Palmquist, Thomas Durrant, or your Husch Blackwell attorney.

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