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Spinning straw into gold: Modifying irrevocable trusts

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Irrevocable trusts have been part of estate planning for years. They have been used for a variety of purposes, such as to remove assets from a person's estate in order to reduce taxes, to protect assets from creditors, and to provide management of assets for beneficiaries. Historically, these trusts could run for perhaps 100 years or so, but often terminated much earlier than that. More recently, many states have eliminated or modified their laws so as to allow trusts to run forever, or at least for periods that are, for all practical purposes, forever. In addition, creditor protection has become much more important to some persons given the litigious nature of our society. The larger generation-skipping tax exemption has also fueled an increased interest in keeping assets in trust to avoid future taxes. Thus, there are now many more trusts that will run for very long periods than used to be the case.

Many clients wish to have the benefits of an irrevocable trust but do not like the idea that the trust is actually irrevocable. Estate planners have also sought ways to modify trusts that are irrevocable as a result of changed circumstances or because the planner's client is the beneficiary who objects to the terms of the trust. In response to this, state laws have been evolving over time to permit changes to what were once instruments that could not be modified. These changes raise several issues, both legal and otherwise.

For fiduciaries, this brave new world can be a minefield, exposing the fiduciary to possible litigation for making, or perhaps for not making, a change that state law now permits.

Changing the definition of "income"

Most trusts permit the trustee to distribute both income and principal to the beneficiaries according to some standard. However, a significant number of trusts still provide for a mandatory distribution of net income but no principal. This may especially be true in second-marriage situations. A spouse may want to provide for his or her surviving spouse but is fearful the surviving spouse will spend the trust principal (on himself or herself, or even a future spouse) to the detriment of the decedent spouse's children from a prior marriage.

While the purpose of these trusts may have made sense at inception, the settlor may not have been thinking about a year like 2013 when the S&P 500 Index was up over 30% while yields on corporate and municipal bonds were miniscule. The basic structure of these trusts sets up a conflict between the income beneficiary, who wants investments that will generate income, and the remainder beneficiaries, who are looking for growth. The trustee is placed in the position of having to invest in a way that is seemingly fair to both, leaving the trustee open to being sued by either (or both) party(ies). To address this issue, most states now give a trustee the power to recharacterize principal as income or vice versa, to convert the trust into a unitrust or both.

Adjust allocation of principal and income. The 1997 Revised Uniform Principal and Income Act §104 allows a nonbeneficiary trustee to make an adjustment between principal and income "to the extent the trustee considers necessary" if certain conditions are met:[1]

1. The trustee must invest and manage the trust assets as a prudent investor.
2. Terms of the trust must "describe the amount that may or must be distributed to a beneficiary by referring to the trust's income"

3. The trustee must determine that it can administer the trust impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the trust clearly indicates an intent to favor one or more of the beneficiaries.

Even if these three conditions are met, Section 104(b) contains a laundry list of factors that the trustee must consider before exercising the power. They include such things as the settlor's intent, the nature, purpose and expected duration of the trust, the actual and anticipated effect of economic conditions on principal and income, the effects of inflation and deflation, and the identity and circumstances of the beneficiaries.

The Revised Uniform Principal and Income Act has not been adopted in all states, and some of the states that have adopted it have not adopted §104. California and New York have adopted it, thereby giving trustees a power to adjust. Illinois has not adopted it. Illinois' version of the Principal and Income Act contains a similar provision that relates to the allocation of receipts and expenses by a trustee.[2] It provides that a trustee may make such allocations in a manner that "is reasonable and equitable" in order to avoid a substantial inequity among the beneficiaries, as long as there is nothing in the trust instrument to the contrary.[3]

This power to adjust can be used in a year like 2013 to give the income beneficiary a "fair" return on the trust assets without having to change a total return investment philosophy. Otherwise, in order to generate income, the trustee might have to invest a larger percentage of assets in fixed income than might be considered prudent. The reverse could also be true-in a year like those that occurred in the late 1970s when there was high inflation and rising interest rates, it could be appropriate to reclassify a portion of the income earned by the trust as principal.

Conversion to unitrust. An alternative means of dealing with the inherent conflict between income and remainder beneficiaries is through conversion of a trust to a total return trust (or "unitrust"). A unitrust requires that a specific percentage of the value of the assets of the trust be distributed to the "income" beneficiary each year regardless of the trust accounting income that may be generated during that year. Most states have now adopted statutes that allow a trustee to convert a trust to a unitrust. Illinois and California permit this.[4] New York allows conversions to a unitrust only if the election is made within two years of the date when assets first become subject to the trust.[5] If the state in question does not have a statute allowing for conversion, it still might be possible to petition for a court reformation of the trust.

States have individualized procedures for converting a trust to a unitrust. Generally, some of the issues that will arise include:

1. The appropriate percentage to pay out each year. Under Treas. Reg. 1.643(b)-1, if the trust is to qualify for a marital deduction, the percentage must be between 3% and 5%. Many state statutes have similar limits on the permissible percentage. For example, in Illinois and California, if the trustee converts a trust without the consent of the beneficiaries or a court, the percentage must be 4%, but if the conversion is with the consent of the beneficiaries, it may be between 3% and 5%.[6] New York requires a 4% payout rate.[7]

2. Will the trustee convert without the consent of the beneficiaries or a court?

3. Will the annual percentage be determined on a rolling average basis?

4. Will nonliquid assets be excluded from the unitrust calculation?

5. Will adjustments be made if additional assets are added to the trust or distributed from the trust?

The IRS has dealt with the issue of how conversions to unitrusts and exercises of powers to adjust affect the marital deduction. In order to qualify for the marital deduction, the surviving spouse must generally be entitled to receive all of the trust accounting income of the marital trust at least annually. Reg. 1.643(b)-1 , which defines "income" of a trust, was amended in 2003 to provide that:

…an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains and appreciation. For example, a state statute providing that income is a unitrust amount of no less than 3% and no more than 5% of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis, is a reasonable apportionment of the total return of the trust. Similarly, a state statute that permits the trustee to make adjustments between income and principal to fulfill the trustee's duty of impartiality between the income and remainder beneficiaries is generally a reasonable apportionment of the total return of the trust.

That same regulation states that a switch in methods of determining income authorized by state statute will not be considered an income realization event under IRC Section 1001 nor result in a taxable gift by any of the beneficiaries, but a switch in methods not specifically authorized by state statutes (such as by court order or nonjudicial settlement) may be a recognition event, gift, or both, depending on all facts and circumstances.

Trust protectors

Settlors of irrevocable trusts generally cannot retain rights to change those trusts if they want transfers to the trusts to be completed gifts. Yet, there is no prohibition against giving another person the right to make those changes as long as there is no agreement between them for the person so appointed to carry out directions from the settlor. This person is often referred to as a "trust protector."

The concept of a trust protector has its origins in foreign trusts, especially those set up for asset protection purposes. Although an individual might have needed to use a foreign trustee in order to avail himself or herself of the asset protection laws of an overseas jurisdiction, there was often a reluctance to actually cede authority for distributions to that foreign trustee. To avoid this, foreign trusts would often include the appointment of a trust protector, who was usually a family member, close friend, or trusted advisor, who would have the power to direct the trustee regarding such things as distributions. The trust protector might also have the right to amend the trust and remove the trustee and appoint a successor trustee.

As certain states began to adopt domestic asset protection statutes, the concept of a trust protector became more common in domestic trusts. The Uniform Trust Code (UTC) gave an added boost to the use of trust protectors. UTC §808(b) provides that the settlor of a trust may authorize a third party to direct certain actions of the trustee unless the trustee knows that the direction is manifestly contrary to the terms of the trust or would be a breach of the power that the third party has to the trust beneficiaries. Further, §808(c) permits the settlor to designate a third party to direct modification or termination of the trust. The comments to §808 say that this section ratifies use of a trust protector.

Permissible powers. Some states that are not UTC states have also enacted statutes specifically permitting the use of trust protectors. Neither New York nor California has a statute specifically sanctioning the use of a trust protector. The Illinois statute provides that a trust protector's powers may include (but are not limited to) any one or more of the following powers:

1. Modify or amend the trust instrument to achieve favorable tax status or respond to changes in the Internal Revenue Code, federal laws, state law, or the rulings and regulations under such laws.

2. Increase, decrease, or modify the interests of any beneficiary or beneficiaries of the trust.

3. Modify the terms of any power of appointment granted by the trust; provided, however, such modification or amendment may not grant a beneficial interest to any individual, class of individuals, or other parties not specifically provided for under the trust instrument.

4. Remove, appoint, or remove and appoint, a trustee, investment trust advisor, distribution trust advisor, another directing party, investment committee member, or distribution committee member, including designation of a plan of succession for future holders of any such office.

5. Terminate the trust, including a determination of how the trustee distributes the trust property to be consistent with the purposes of the trust.

6. Change the situs of the trust, the governing law of the trust, or both.

7. Appoint one or more successor trust protectors, including designation of a plan of succession for future trust protectors.

8. Interpret terms of the trust instrument at the request of the trustee.

9. Advise the trustee on matters concerning a beneficiary.

10. Amend or modify the trust instrument to take advantage of laws governing restraints on alienation, distribution of trust property, or to improve the administration of the trust.[8]

As can be seen, a trust protector can be given very broad authority to rewrite a trust. Whether a settlor wishes to give someone this broad right raises a difficult issue. It may be that a settlor is willing to give a trusted friend or advisor this right, but is the settlor willing to let someone he or she does not know make changes many years in the future that will alter the settlor's intent?

Is the trust protector a fiduciary? UTC §808(d) provides that the trust protector is "presumptively" a fiduciary and is liable for any breach of duty. Likewise, the Illinois statute states that a trust protector:

… is a fiduciary of the trust subject to the same duties and standards applicable to a trustee of a trust as provided by applicable law unless the governing instrument provides otherwise, but the governing instrument may not, however, relieve or exonerate a [trust protector] from the duty to act or withhold acting as the [trust protector] in good faith reasonably believes is in the best interests of the trust.[9]

On the other hand, some states, like Alaska, specifically say that the trust protector is not a fiduciary unless the trust agreement provides otherwise.[10] The Alaska statute, the "opt out" provisions of the UTC, and the Illinois statute seem to allow for a trust protector to avoid fiduciary responsibilities even if the protector has what are, in essence, fiduciary powers. How can there be a trust if the trust protector is not a fiduciary and the trust agreement and state law absolve the trustee from liability when a trust protector is directing the trustee's actions? And would a settlor really want a trust drafted that puts the beneficiaries at the whim of the trust protector? If the trust protector is a fiduciary and owes fiduciary duties to the trust beneficiaries, then what standard of care applies? Might it be different for different powers?

If the trust protector is a fiduciary and is potentially liable to the beneficiaries, then under what circumstances will a protector actually exercise his or her powers? If the power is generally administrative, exercising the power may not pose a particular challenge. Even this may result in a suit in the future, though. What if the protector adds a power permitting the trustee to buy stocks on margin and it results in a significant future loss? If the power relates to modifying dispositive provisions of a trust, such as increasing or decreasing a beneficial interest, how can that power ever be exercised without violating a fiduciary duty to a beneficiary or class of beneficiaries?

Standard of care. If a protector is actually named in the trust and fails to monitor the actions of the trustee, might that be enough to result in liability? This question was raised in *Robert T. McLean Irrevocable Trust v. Davis*,[11] one of the few reported U.S. cases dealing with trust protectors.

In *McLean*, the successor trustee of a trust sued the trust protector for alleged breach of his fiduciary duty to remove the former trustees who were improperly spending trust funds. The trial court granted summary judgment for the trust protector, but the appellate court reversed the decision. Missouri law imposed no specific duties on a trust protector, so the appellate court held that those duties could arise only under the terms of the trust instrument. Although the trust did not specify how or when the protector was to carry out his duties, it stated that the trust protector was to act in a fiduciary capacity. It also provided immunity for actions taken by the trust protector in good faith, which the court relied on in stating that there must be some implied duty of care on the trust protector.

The court went on to say that it might be possible to draw the inference that the settlor intended the protector to remove a trustee who was acting against the purpose of the trust. As a result, there was enough of an issue to defeat the summary judgment motion. On remand, the trial court found that the trust protector had no obligation to monitor the activities of the trustee, but a duty to remove the trustee may have arisen if the trust protector was made aware of any bad conduct of the trustee. It ultimately granted the trust protector a directed verdict, which was upheld by the appellate court.[12]

More recently, in a recent unreported 2018 California case, the person named as trust protector did seek to monitor the trust's administration.[13] The trustees refused to provide an accounting and other information. The trust protector sued to get that information, but the California Appellate Court affirmed the trial court's dismissal of the suit. The court said that the trust protector's powers did not include authority to affirmatively seek oversight of the trust.

Court modification

There are other possible ways that irrevocable trusts can be modified. In some cases, a court can change the terms of a trust. In other cases, court involvement may not be necessary.

The Restatement (Third) of Trusts provides for modification of an irrevocable trust by a court in two situations:

1. A court can modify a trust as a result of changed circumstances.[14]
2. The beneficiaries can cause a modification if it is not inconsistent with a material purpose of the trust or if the reasons for the modification outweigh the material purpose of the trust.[15]

The rule in *Restatement (Third) of Trusts* is more lenient than the one in the *Restatement (Second) of Trusts*, which generally allowed modifications only if the settlor of the trust were alive and consented to the modification.[16]

Of course, state law may be more or less restrictive than the *Restatement* rule. For example, in Illinois, beneficiary consent and changed circumstances or an emergency situation will generally be required in order for a court to modify a trust where a nonjudicial settlement (as discussed below) is not used.[17] However, Florida has enacted legislation that will allow for the modification of even an unambiguous will or trust to conform the document to the testator's/settlor's intent.[18]

The UTC also allows for modification of an irrevocable trust either by consent of all of the beneficiaries if a court concludes the modification is not inconsistent with a material purpose of the trust, or without consent because of changed circumstances or if continuation of the trust as is would be impracticable or wasteful or impair the administration of the trust.[19]

Is the trustee under an affirmative duty to seek a trust modification in appropriate cases? Comment e to section 66 of the *Restatement (Third) of Trusts* says that it is if failure to do so would cause harm to the trust or its beneficiaries or would jeopardize the settlor's purpose for the trust. State statutes might eliminate this duty, though.

Nonjudicial settlement agreements

It may also now be possible to modify an irrevocable trust without court involvement. UTC §111 provides for nonjudicial settlement agreements with respect to any matter involving a trust as long as no material purpose of the trust will be violated and the proposed change is something that a court would otherwise be empowered to make. The parties to a nonjudicial settlement agreement must include all parties who would be necessary in a court proceeding to modify a trust.[20] The comment to §111 states that because of the variety of matters for which a nonjudicial settlement agreement can be used, no attempt was made to define what parties would be necessary, but that it would usually include the trustee.

Modifiable items. The nonexclusive list of items that can be the subject of such an agreement include such things as:

1. Construction or interpretation of a trust provision.

2. Resignation and appointment of a trustee.

3. A trustee's compensation.

4. Giving direction to a trustee or the granting to a trustee of any necessary or desirable power.[21]

The comment to §111 states that these agreements cannot be used for things such as what would be an impermissible termination of a trust. The condition that the modification is something that a court would otherwise be able to approve also seems to limit the ability to use these agreements to make changes in dispositive provisions.

Illinois has a similar statute to UTC §111. It provides that any of the following can be addressed in a nonjudicial settlement agreement:

1. Validity, interpretation, or construction of the trust.

2. Approval of a trustee's report or accounting.

3. Exercise or nonexercise of a trustee's power.

4. Granting to the trustee any necessary or desirable administrative power that does not conflict with a clear material purpose of the trust.

5. Questions related to property or an interest in property held by the trust.

6. Removal and appointment of a trustee or others holding fiduciary or nonfiduciary powers.

7. Determination of a trustee's compensation.

8. Transfer of situs and change of governing law.

9. Liability or indemnification of a trustee.

10. Resolution of bona fide disputes.

11. Modification of the administrative terms of the trust.

12. Termination of a trust, but only with court approval.

13. Any other matter that could be approved by a court.[22]

Because minor or unborn beneficiaries will often be necessary parties, these agreements will often require coordination with a "virtual representation" statute.

Both the UTC and the Illinois statute allow any interested party to seek court approval of a nonjudicial settlement agreement.[23] Although the purpose of a nonjudicial settlement agreement is to allow changes without court approval, a trustee may wish to nonetheless seek court approval to minimize the risk of a later lawsuit. The Illinois statute provides another means of protection for a trustee who is contemplating entering into a nonjudicial settlement agreement. A trustee may obtain and rely on an opinion of counsel on any matter relevant to the agreement.[24]

Given these options, unless the proposed modification is noncontroversial, a trustee is likely to want to obtain a court order or at least an opinion of counsel before signing any such agreement. At a minimum, the trustee might seek releases and indemnifications from all of the other signatories to the agreement, especially if any of them will be signed as the virtual representative of a minor or unborn beneficiary.

Neither New York nor California has a nonjudicial settlement statute. Each state does permit an amendment or revocation of a trust under very limited circumstances that include that the settlor of the trust must be living.[25]

Change of trust situs

A backdoor way to modifying an irrevocable trust might be through a change in the situs of the trust's administration. Some trust instruments permit the trustee to move the situs of the trust to another jurisdiction and then adopt the laws of that new jurisdiction for purposes of trust administration. For example, some jurisdictions have directed trustee statutes while others do not. If the beneficiaries wish to use outside investment counsel and the trustee is willing to allow it as long as the trustee is protected from liability, but the trust instrument and state law do not permit directed trustees, then moving the trust to one of the states that has a directed trustee statute would solve the problem.

Delaware has historically been a popular destination for trusts that had been governed under other states' more restrictive laws. In three cases known as the *Peierls* cases, the Delaware Court of Chancery had made it very difficult to bring a foreign trust to Delaware and have Delaware law apply to that trust.[26] However, the Delaware Supreme Court set aside enough of those opinions to allow the practice to continue. According to the court, as long as the trust agreement does not specify that another jurisdiction's laws will always apply, the law governing trust administration will change if a trustee is appointed in a different jurisdiction.[27]

Decanting

Another means of modifying an irrevocable trust is by "decanting" that trust into a new trust that may be set up purely to receive the funds from the old trust. The new trust will have been drafted with the modified terms. The old trust will then be terminated. The theory behind this is that if a trustee has broad enough discretion to make an outright distribution to a beneficiary, then the trustee should be able to make a distribution in trust for that beneficiary.

One of the first examples of decanting was reported in the Florida case of *Phipps v. Palm Beach Trust Company*.[28] In *Phipps*, the Florida Supreme Court held that a trustee with absolute discretion to make distributions could instead make a distribution to a second trust for the benefit of a beneficiary. This was based on common law, not any statutory provision. More recently, the Supreme Judicial Court of Massachusetts held that the trustee of an irrevocable trust may have the power to decant trust property to a new trust, based on the terms of the trust in question and the facts of the particular case.[29] In *Morse*, the trustee had the authority to make distributions to or for the benefit of a beneficiary, limited only by the fact that any distribution had to be for the beneficiary's benefit.

State statutes. Twenty-seven states (including Illinois; New York; and, as of September 2018, California) have enacted statutes as of the date this was written that codify a trustee's right to decant, at least under certain circumstances. As might be expected, the statutory provisions vary from state to state.

In order to decant, the state statute may require that the trustee have very broad discretionary power to make distributions of principal (or, in some states, income or principal), such as distributions for best interests or welfare or in the sole and absolute discretion of the trustee. In some cases, as in Illinois and New York, decanting may be possible even if the standard is more limited, but then the changes to the old trust that may be allowed may also be more limited.[30] The statute also may require that the trustee not be a beneficiary of the trust being decanted.[31]

Most states do not require beneficiary or settlor consent in order to decant, although a beneficiary might go to court to block a trustee from decanting. Regardless of whether it is a requirement, a trustee might want to have all of the beneficiaries consent to a decanting in order to protect itself from a later objection. This could raise gift tax issues, though, so the beneficiaries might not want to consent if that is not required under state law. (The same issues might arise if the beneficiaries fail to object, however.) A settlor probably should not consent for the same reason, though an acknowledgement from the settlor that the decanting is in accordance with his or her intent should not raise gift tax concerns. A trustee could also seek court approval before decanting. Beneficiaries might object to the cost of a court proceeding where the trustee could decant without court approval, so the trustee would have to make a business judgment about the necessity for this.

The power to decant may allow a trustee to entirely rewrite an irrevocable trust. For example, in Illinois and New York, if an independent trustee has absolute discretion to make distributions, then distribution standards can be changed, beneficiaries eliminated, objects of powers of appointment can be broader or otherwise different than under the original trust, and different provisions related to trustees can be included.[32] In Illinois, at least, a trust can also be decanted into a supplemental needs trust under certain circumstances.[33]

Federal tax issues. The IRS has been promising guidance on the tax issues related to decanting but has yet to issue any such help. As a result, there are many unanswered tax questions for a trustee that actually decants a trust, such as:

1. Will converting a grantor trust to a nongrantor trust cause gain recognition if the trust has liabilities in excess of basis? Does the answer to this question change if the beneficiary consents to the decanting?[34]

2. Does mere presence of a decanting power in a trust (or a statute) have consequences under the grantor trust rules?

3. If there is only a partial decanting, is the transfer of assets from the original trust to the new trust a distribution for purposes of Sections 661 and 662?

4. Does the new trust succeed to all of the old tax attributes of the original trust, such as capital losses and net operating losses? Is a new federal employee identification number (FEIN) required?

5. If a beneficiary's interest is reduced as a result of a decanting and the beneficiary fails to object, is there a gift by the beneficiary to the other beneficiaries?

6. Could the existence of a decanting power cause loss of a marital deduction?

7. Can a decanting cause the loss of GST exempt status for a grandfathered trust?

The IRS has indicated that it will no longer issue private letter rulings involving several issues related to decanting until its public guidance is issued, but there may be other areas in which a private letter ruling could be sought as additional protection for the trustee. This is something that a trustee should consider if there is any possibility that the decanting could have adverse tax consequences.

When deciding whether to exercise a power to decant, the trustee must remember that it is probably acting in a fiduciary capacity (unless the trust instrument provides otherwise). For example, the Delaware statute provides that a trustee is held to the same standards of care and liability applicable to a trustee making an outright distribution to a beneficiary.[35] The Illinois and New York statutes provides that the trustee will exercise its discretion to decant in the trustee's fiduciary capacity.[36] An Illinois trustee can decant only to further the purposes of the trust.[37] A New York trustee may not decant "if there is substantial evidence of a contrary intent of the creator and it cannot be established that the creator would be likely to have such intention under the circumstances existing at the time of the exercise of the power."[38]

Although exercising the power to decant is a fiduciary power, many of the state statutes do not hold a trustee liable for not exercising it.[39] Delaware even exonerates a trustee who fails to consider whether the power should be exercised, absent willful misconduct.[40] If there is no state statute but the state's common law would permit decanting, might a trustee be liable for failing to decant in an appropriate situation? Even though the trustee is acting as a fiduciary in exercising the power to decant, its liability may be limited by state statute. Under the Illinois statute, the only remedy available to a beneficiary is to seek a court order directing the trustee to decant, or reverse or modify a previous decanting, unless the action or omission of the trustee is found to be an abuse of discretion.[41]

Severance and merger of trusts

In some cases, a single trust has been created for multiple beneficiaries in several family lines. There is likely to come a time when the interests of the families diverge and the trustee is faced with competing requests for distributions and investment strategies. One option that may be available is a severance of the trust to create separate trusts for each family.

Many trust instruments grant the trustee the power to merge or sever trusts. In addition, most states now have adopted laws that will allow a trustee to sever a trust or merge trusts.[42]

There was a concern among planners that if a trust that was grandfathered from GST tax was severed, the resulting trusts would lose the grandfathered status. However, IRS regulations issued under Section 2601 specifically provide that a severance of a grandfathered trust pursuant to the terms of the governing instrument or state law will not cause a loss of that status as long as the severance does not shift any beneficial interests to lower-generation beneficiaries or extend the time for vesting.[43]

In some situations, a merger of trusts may eliminate a problem provision without the need for a decanting. An irrevocable trust or state law might give the trustee the right to merge the trust into another trust with similar terms. If the proposed change to the trust is rather modest and the trustee believes that the new trust is "similar enough," it might be possible simply to merge the old trust into a new trust that includes the changed provision. The new trust could be an existing trust or one created for the primary purpose of merging the old trust out of existence. Mergers of trusts are granted similar protection from loss of grandfathered GST status as are severed trusts.[44]

Once again, a trustee must be aware that it may have a duty to divide or merge trusts in certain cases. Failure to do so may lead to liability. ("Given the substantial tax benefits often involved, a failure by the trustee to pursue a division might in certain cases be a breach of fiduciary duty. The opposite could also be true if the division is undertaken to increase fees or to fit within the small trust termination provision."[45])

In certain cases, especially when a grantor trust is involved, it may be possible to ameliorate the unwanted provisions of a trust through a sale of the assets to another trust. This might be useful especially if the trust consists of one or more insurance policies, because the policies can likely be purchased for a fraction of their ultimate values. This may still raise fiduciary concerns because a beneficiary might object if he or she has more restricted rights under the new trust.

Planning dilemma

This new flexibility raises serious questions for the estate planner who is trying to draft documents that carry out the intent of his or her client. While most planners view flexibility as a good thing, a client may view these techniques as an end run around his or her intent.

Should or must the estate planner discuss the possibility that unless prohibited in the trust agreement, these new state laws may allow the trust to be changed significantly in the future? For example, most clients grant at least limited powers of appointment that allow for changes to be made through exercise of the powers. Under some states' laws, even a limited power granted to a child to a group such as descendants can become a broader one at the grandchild level if the child exercises it to create a new trust for the grandchild.[46] Will the client, therefore, view this as no different than a decanting to a new trust that has a broad power of appointment for the child? On the other hand, what planner has not had a settlor of an irrevocable trust who wished that the trust could be changed?

If planners begin to use trust protectors as standard parts of their plans, it is important that the powers of those protectors be limited unless the client approves of broader powers. It may be that a client is willing to have a certain individual or individuals that the client knows make substantive changes in a trust if it becomes desirable to do so, but may be less willing (or unwilling) to leave it up to some unknown person in the future.
If planners fail to raise these issues and either do or do not preclude possible changes in the future to an irrevocable trust, are they potentially subjecting themselves to liability for their actions or inactions?

Protecting the trustee

As should be clear, given the new range of tools available, trustees will be called on increasingly to make changes to irrevocable trusts. Most of the time, these changes will come from beneficiaries of the trust who object to some of the trust terms. What should control the trust's administration-the settlor's intent or the interests of the beneficiaries?

Trustees should also be mindful of the fact that just because they may have a power does not mean it should be exercised. If a requested change is primarily administrative, the potential exposure of the trustee will likely be less than if the change is substantive. Any change that will affect the rights of different beneficiaries opens up the possibility of being sued at a later date.

In almost every case, a trustee will be better protected if a court approves a change or the beneficiaries consent at the time of the change. In many cases, beneficiaries may object to the cost and delay that might be involved with a court proceeding. It becomes a matter of business judgment in what situations a trustee will require court approval before acting.

Conclusion

Like modern-day Rumpelstiltskins, lawyers and trustees may now have the opportunity to spin straw into gold by taking what was an irrevocable trust and changing it into a more desirable vehicle. But there are pitfalls to this new flexibility that need to be considered before any such changes are made. As more modifications are made, it is a certainty that some of them will lead to disgruntled beneficiaries and lawsuits. Planners and trustees should be cautious about using these powers so as to avoid creating more problems instead of solving them.

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1. 1997 Revised Uniform Principal and Income Act § 104(a).
2. 760 Ill. Comp. Stat. Ann. 15/3.
3. 760 Ill. Comp. Stat. Ann. 15/3(b)(2).
4. 760 Ill. Comp. Stat. Ann. 5/5.3; West's Ann. Cal. Prob. Code §16336.5.
5. .Y. Est. Powers & Trusts Law §11-2.4(e)(1)(B)(ii) (McKinney).
6. 760 Ill. Comp. Stat. Ann. 5/5.3; West's Ann. Cal. Prob. Code §16336.5.
7. N.Y. Est. Powers & Trusts Law §11-2.4(b).
8. 760 Ill. Comp. Stat. Ann. 5/16.3.
9. 760 Ill. Comp. Stat. Ann. 5/16.3(e).
10. Alaska Stat. Ann. § 13.36.370(d) (West).
11. 283 S.W.3d 786 (Mo. Ct. App. 2009)
12. Robert T. McLean Irrevocable Tr. u/a/d Mar. 31, 1999 ex rel. *McLean v. Ponder*, 418 S.W.3d 482 , 486 (Mo. Ct. App. 2013).
13. *Carberry v. Kaltschmid*, No. A150675, 2018 WL 2731898 , at *1 (Cal. Ct. App. 6/7/2018).
14. Restatement (Third) of Trusts §66.
15. Restatement (Third) of Trusts §65.
16. Restatement (Second) of Trusts §338.
17. *Curtiss v. Brown*, 29 Ill. 201 (1862); *Stough v. Brach*, 395 IL 544 (1946).
18. Fla. Stat. Ann. §§732.615 and 736.0415 (West).
19. Unif.Trust Code §§411(b) and 412.
20. Unif. Trust Code §111(a).
21. Unif. Trust Code §111(d).

22. 760 Ill. Comp. Stat. Ann. 5/16.1(d)(4). ↩

23. Unif. Trust Code §111(e); 760 Ill. Comp. Stat. Ann. 5/16.1(d)(5). ↩

24. 760 Ill. Comp. Stat. Ann. 5/16.1(d)(7). ↩

25. N.Y. Est. Powers & Trusts Law §7-1.9 (McKinney); Cal. Prob. Code §15404(a) (West). ↩

26. In Re The Ethel F. Peierls Charitable Lead Unitrust, C.M. No. 16811-N-VCL (12/10/2012); In Re The Peierls Family Inter Vivos Trusts, Consolidated C.M. No. 16812-N-VCL (12/10/2012); In Re The Peierls Family Testamentary Trusts, Consolidated C.M. No. 16810-N-VCL (12/11/2012). ↩

27. I*n re Peierls Family Inter Vivos Trusts*, 77 A.3d 249 , 259 (Del. 2013). ↩

28. 196 So. 2d 299 (Fla. 1940). ↩

29. *Morse v. Kraft*, 992 N.E.2d 1021 (2013). ↩

30. 760 Ill. Stat. Ann. 5/16.4(d); N.Y. Est. Powers & Trusts Law §10-6.6(c) (McKinney). ↩

31. See, e.g., N.Y. Est. Powers & Trusts Law §10-6.6(s)(2). ↩

32. 760 Ill. Stat. Ann. 5/16.4(c); N.Y. Est. Power & Trusts Law §10-6.6(b). ↩

33. 760 Ill. Stat. Ann. 5/16.4(d)(4). ↩

34. See., e.g., Cottage Savings Association, 499 U.S. 554 (1991). ↩

35. Del. Code. Ann. tit. 12, §3528(e) (West). ↩

36. 760 Ill. Stat. Ann. 5/16.4(b); N.Y. Est. Power & Trusts Law § 10-6.6(h). ↩

37. 760 Ill. Stat. Ann. 5/16.4(b). ↩

38. N.Y. Est. Power & Trusts Law §10-6.6(h). ↩

39. See, e.g., 760 Ill. Stat. Ann. 5/16.4(u). ↩

40. Del. Code. Ann. tit. 12 §3528(e) (West). ↩

41. 760 Ill. Stat. Ann. 5/16.4(u). ↩

42. See, e.g., 760 Ill. Stat. Ann. 5/4.25. ↩

43. Reg. 26.2601-1(b)(4)(i)(E), Example 5. ↩

44. Reg. 26.2601-1(b)(4)(i)(E), Example 6. ↩

45. Unif. Trust Code § 417, cmt. ↩

46. For example, this is the law in Illinois, which adapted the Uniform Powers of Appointment Act effective 1/1/2019, but modified Section 305 to permit this result. ↩

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