

IRREVOCABLE TRUST REBOOT: BRINGING A FRESH SCRIPT TO AN OLD SHOW

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Introduction

- Many uses of trusts**
- Revocable v. Irrevocable Trusts**
- Change is the only constant (e.g., tax law, state law, investment environment, family financial and behavioral circumstances)**
- UTC Flexibility**
- Modification v. Decanting**
- Judicial v. Nonjudicial**



Reasons to Modify/Decant

- Extend the trust term
- Converting a support trust into a discretionary trust
- Fixing drafting errors or resolving ambiguity
- Moving the trust to a state with more favorable laws



Reasons to Modify/Decant

- Adjusting powers of appointment
- Changing trustee provisions
- Combining or separating trusts
- Drafting a special needs trust
- Qualifying the trust to hold Sub S stock




Parties to Modification Actions

- Grantor/Settlor
- Beneficiaries v. Qualified Beneficiaries
- Representation
 - Someone speaks for and binds someone else
 - Conflict of interests eliminate power




Parties -- Representation

- Guardian (general or of the estate)
- POA – “with authority to act with respect to the particular question or dispute”
- Trustee – “unless the question or dispute involves the internal affairs of the trust”
- PR of an estate




Parties -- Representation

- Parent of a minor child
- Unborn issue
- Substantially identical interest



Nonjudicial Trust Modification

- Nonjudicial settlement agreements under NCGS 36C-1-111
 - In NC, essentially for administrative matters where all “interested persons” are willing to sign (not substantive or dispositive issues)
 - Approve trustee reports
 - Direct trustee to perform or refrain administrative act
 - Resignation/appointment/compensation
 - Transfer place of administration
 - Address liability for other items in the list



Nonjudicial Trust Modification

- Modification by consent of settlor and beneficiaries under NCGS 36C-4-411(a)**
 - Permitted even if the proposed change is inconsistent with a material purpose of the trust
 - Does not require court approval (but may seek)
 - All beneficiaries (not just “qualified”)



Nonjudicial Modification (Cont.)

- Modification of uneconomic trusts (NCGS 36C-4-414)**
 - No court required
 - Under \$50K if trustee determines insufficient to justify costs
 - Beneficiary consent not required, but notice to qualified beneficiaries is



Judicial Modification

- Compelled modification by consent of all beneficiaries (NCGS 36C-4-411(b))**
 - “Material purpose”



Judicial Modification

- Requested modification by consent of all beneficiaries (NCGS 36C-4-411(c))
 - "Substantially outweigh trust's material purpose"



Judicial Modification

- Modification without consent of beneficiaries (NCGS 36C-4-411(d))
 - Adequate protection for nonconsenting beneficiaries



Judicial Modification

- Modification due to unanticipated circumstances (NCGS 36C-4-412)



Judicial Modification

- Modification to achieve settlor's tax objectives (NCGS 36C-4-416)**
 - Not contrary to the settlor's probable intention**
 - May have retroactive effect**



Judicial Modification (Cont.)

- Modification to correct drafting errors (NCGS 36C-4-415)**
 - clear and convincing extrinsic evidence**
 - mistake of fact or law**
 - expression or inducement**




Judicial Modification (Cont.)

- Modification of charitable trusts (NCGS 36C-4-413)**
 - Cy pres**
 - Becomes unlawful, impracticable, impossible to achieve, or wasteful**
 - Modify or terminate in a manner consistent with the settlor's charitable purposes**




Trust Decanting

- **Decanting procedure in NCGS 36C-8-816.1**
 - **Definitions: “original trust”, “second trust”, “current beneficiary”**
 - **Trustee exercises power to distribute assets from original trust to second trust (which may be created by trustee)**
 - **Notice and waiver**




Trust Decanting

- **Modification v. Decanting**
- **Limitations:**
 - **Cannot add beneficiaries**
 - **Cannot accelerate a beneficiary’s interest**
 - **Dispositive terms of the new trust must adhere to specific requirements**




Trust Decanting

- **Limitations on Dispositive Terms**
 - **Cannot reduce a fixed income, annuity or unitrust interest (that has come into effect)**
 - **Marital or charitable deduction savings**
 - **2503(b) and (c) gifts**
 - **Withdrawal rights preserved**




Trust Decanting

- **Limitations on Dispositive Terms**
 - ▣ **Ascertainable standard (HEMS) must be maintained**
 - ▣ **Second trust may grant new power of appointment**
 - **Note: permissible appointees may include persons not beneficiaries of the original trust**
 - **Perpetuities/Alienation savings**




Trust Decanting (Cont.)

- **Concerns regarding fiduciary liability**
 - ▣ **Trustee's exercise of discretionary power to distribute trust property**
 - ▣ **Failure to decant does not give rise to fiduciary liability**
- **Uniform Law Commission Trust Decanting Act**




Tax Concerns – Income tax

- **Subchapter S stock – avoid changes that jeopardize the S election**
- **Grantor trust status – be careful about accidentally causing grantor or nongrantor trust status**
- **Uncertainties re decanting and divisions**




Tax Concerns – Estate and Gift Tax

- Estate and gift tax consequences of settlor’s consent**
- Gift tax consequences of beneficiaries’ consent**


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Tax Concerns – GST Tax

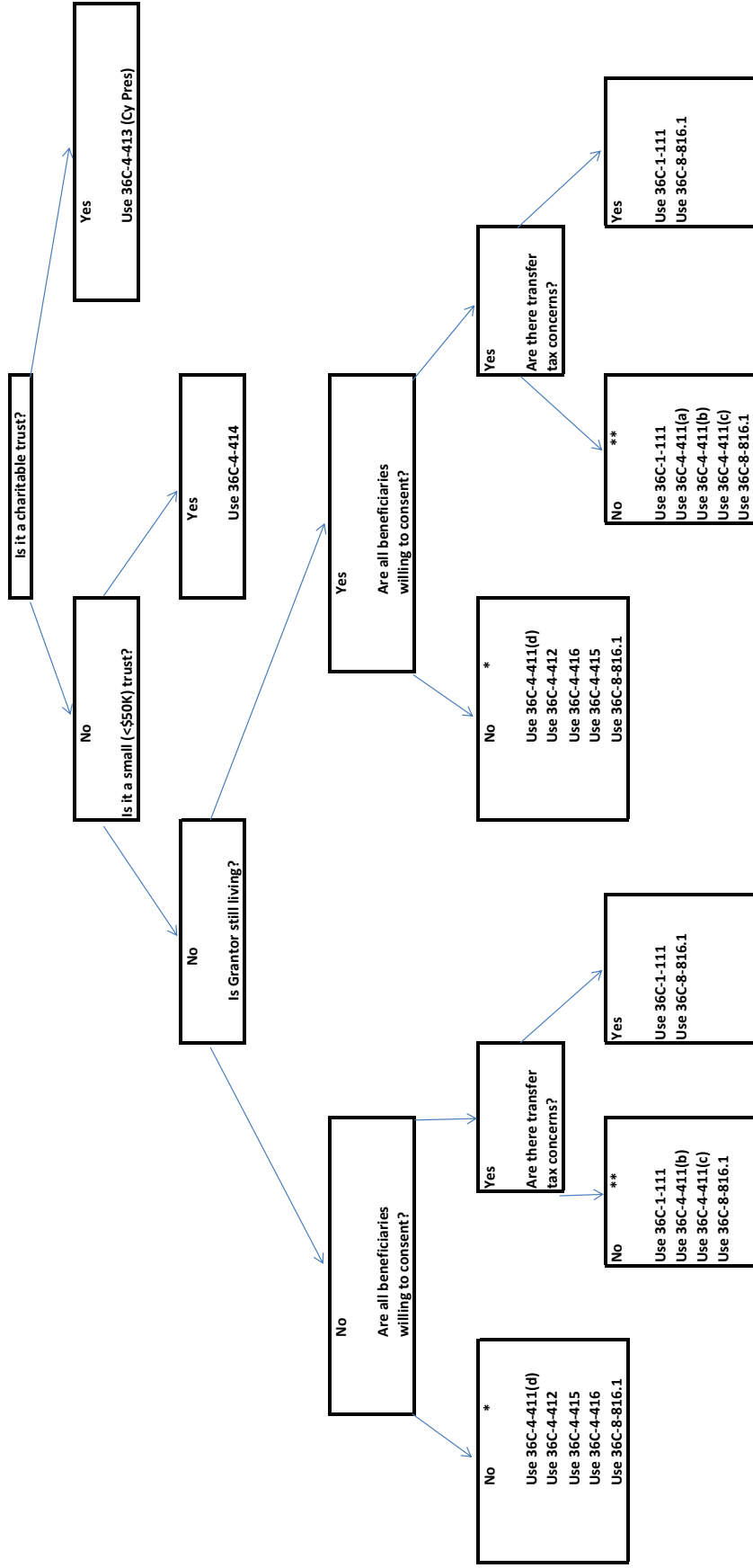
- Discretionary distribution safe harbor under Treas. Reg. Sec. 26.2601-1(b)(4)(i)(A)**
- Catch-all safe harbor under Treas. Reg. Sec. 26.2601-1(b)(4)(i)(D)**


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How to Modify An Irrevocable Trust



* Note that the statutes listed in this box may also be available even when all of the beneficiaries will consent.

** Note that the statutes listed in this box may also be used when there are transfer tax returns, but should only be used with caution.

36C-1-111 Nonjudicial settlement agreements (administrative matters)

36C-4-411(a) Modification by consent (grantor and all beneficiaries consent)

36C-4-411(b) Modification by consent (beneficiaries consent and material purpose consistency)

36C-4-411(c) Modification by consent (beneficiaries consent and proposed change outweighs material purpose)

36C-4-411(d) Modification by consent (not all beneficiaries consent and could have been modified with consent/beneficiary protection)

36C-4-412 Unanticipated circumstances

36C-4-413 Cy pres

36C-4-414 Uneconomic trust

36C-4-415 Reformation to correct mistakes

36C-4-416 Achieve settlor's tax objectives

36C-8-816.1 Decanting