



TRUST MODIFICATIONS

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WAYS TO MODIFY AN IRREVOCABLE TRUST

- Non-Judicial Settlement Agreement (“NJSA”). This is a Uniform Trust Code (“UTC”) concept that is now available in most states. R.S.Mo. Section 456.1-111
- Trust Amendment by Settlor and All Beneficiaries, R.S.Mo. Section 456.4A-411
- Court action to Reform Trust, R.S.Mo. Section 456.4B-411
- Authorization Provided in Trust Instrument
- Decanting Transaction, R.S.Mo. Section 456.4-419

What is Decanting?

- A distribution of assets from one trust to another trust as a result of the exercise of a trustee's power to distribute income or principal
- The rationale with decanting is that a trustee who has the discretion to make an outright distribution of assets to or for a beneficiary, the trustee has a special power of appointment over the assets of the trust, allowing the trustee to distribute the assets to another trust for the benefit of the beneficiary
- Trustee's power to decant can be given by statute, common law, or in the governing instrument
- Beneficiaries can be removed but not added

2017 Tax Cuts Act and Possible Need to Modify Irrevocable Trust

- Gift, Estate and Generation-skipping tax exemptions temporarily doubled until 2026 when it sunsets (or sooner if legislation changes)
- In 2021 exemption is \$11,700,000 per person, \$23,400,000 per couple
- Indexed annually for inflation
- Absent future legislation, in 2026 reverts to \$5,000,000, as indexed for inflation through 2025 (approx. \$5,500,000)

2017 Tax Cuts Act and Possible Need to Modify Irrevocable Trust

- 2017 Tax Cuts Act did not change the basis rules
- Step-up basis – increase to fair market value at date of death
- Step-up basis can occur only if the assets are in taxable estate for estate tax purposes

2017 Tax Cuts Act and Possible Need to Modify Irrevocable Trust

- Trust was drafted to avoid estate tax at beneficiary's death
- But, if on beneficiary's death, estate would not exceed the estate exemption amount even with the addition of the trust assets, then is the transfer tax planning needed?
- If Trust assets are not in beneficiary's taxable estate for estate tax purposes then no basis step-up
- Carry-over basis rules apply

2017 Tax Cuts Act and Possible Need to Modify Irrevocable Trust

- Consequence is loss of basis step-up and income tax on future capital gains
- How do avoid this result?
- Modify the Trust so that the assets are in beneficiary's taxable estate at death

Testamentary Power of Appointment

- Power to direct disposition of assets held in trust at death
- Limited (or special) power if cannot exercise to himself, his estate, creditors, or creditors of estate
- Having a limited power of appointment does not cause inclusion of assets in taxable estate

Testamentary Power of Appointment

- Conversely, a general power of appointment exists if can exercise to one of (i) himself, (ii) his estate, (iii) creditors, or (iv) creditors of estate
- Having a general power of appointment does cause inclusion of assets in taxable estate
- So modifying the trust to add a general power of appointment will allow step-up in basis

Testamentary Power of Appointment

- General power to appoint to creditors of estate is unlikely to alter the disposition scheme
- Mere existence of power causes tax inclusion
- If the power is testamentary (not presently exercisable), under current law the creditor has no rights to compel exercise

2017 Tax Cuts Act and Possible Need to Modify Irrevocable Trust – Temporary Law

- The 2017 Act is temporary
- Absent future legislation the exemption will revert back to \$5,000,000 as indexed for inflation through 2025
- How to draft?

2017 Tax Cuts Act and Possible Need to Modify Irrevocable Trust – Temporary Law

- Since the 2017 Act is temporary, the general power can be a formula
- Power would apply only if the beneficiary does not have a taxable estate at death

Other Considerations

- What if the beneficiary has creditors?
- What if the beneficiary moves to a state that gives creditors rights as permissible appointees?
- What if the law changes in Missouri?
- Trust Protector (not a fiduciary) can be given the ability to add the general power of appointment (and later remove the general power of appointment if necessary)
- Question arises whether the Trust Protector should have the ability to just remove a general power of appointment that is provided for in the Trust instrument

A Non-Judicial Settlement Agreement to Modify?

- This trust modification will require the ability to add a General Power of Appointment
- A non-judicial settlement agreement (NJSA) does not require court approval and can be entered into by the interested persons
- An NJSA is valid only if it does not violate a material purpose, but for administrative matters and to consent to a trustee's action regarding distributions, this technique works
- Potentially adding a General Power of Appointment changes the disposition and thus will violate a material purpose so an NJSA cannot be used for this modification

Trust Amendment by Settlor and All Beneficiaries to Modify?

- This trust modification will require the ability to add a General Power of Appointment
- A Trust Amendment by Settlor and All Beneficiaries does not require court approval
- A Trust Amendment by Settlor and All Beneficiaries can change the disposition
- This will not work if the Settlor is not alive or if unable to obtain the signatures of all beneficiaries (including the contingent beneficiaries); the Settlor can't bind any beneficiary under the virtual representation statutes

Decanting To A Separate Trust to Modify?

- This trust modification will require the ability to add a General Power of Appointment
- A Decanting to a new trust by the Trustee does not require court approval and beneficiaries do not have to consent
- Missouri law is unclear whether the addition of a general power of appointment is considered the addition of a beneficiary. This issue will be clarified in Missouri legislation, hopefully soon.