

Trusts & Estates Practice Group

Fixing Irrevocable Trusts

Historically, settlors, trustees, beneficiaries, trust attorneys and even courts have viewed “irrevocable” trusts, to a great extent, as unchangeable. Over the past 15 to 20 years nationally, and over the past 10 years in Missouri, this understanding, at least among trust attorneys, has changed dramatically. There are now multiple methods available for changing the terms of irrevocable trusts with or without court involvement. Because trust law is governed by the states, the methods available for implementing changes can vary widely from state to state. This handout focuses on the methods for changing or terminating irrevocable trusts without court involvement in Missouri. This handout does not address the income or transfer tax consequences — and there are potentially many — of changing the terms of an irrevocable trust by any of the methods discussed below.

Trust Agreement

While this is not a new method for making changes, an irrevocable trust agreement itself may provide some flexibility and other avenues for change to the trustees and beneficiaries. For example, a trust agreement can allow the current trustee to designate co-trustees and successor trustees. A trustee or beneficiary can be granted a specific lifetime or testamentary power of appointment to redirect trust assets in accordance with the terms of such power. The trust agreement may also name a trust protector with authority to make certain changes that the settlor could not or would not grant to the trustee or beneficiaries. Trust attorneys have been using trust protectors for many years, but in 2012, Missouri expressly approved of trust protectors by codifying the powers and duties of the office.

Modification by Agreement Among Settlor and Beneficiaries

The Missouri Uniform Trust Code provides that an irrevocable trust can be modified or terminated upon



consent of the settlor and all beneficiaries, without court approval, even if the modification or termination is inconsistent with a material purpose of the trust. So long as the settlor and beneficiaries of a trust are in agreement, this law essentially gives them complete freedom to rewrite the terms of an irrevocable trust.

The primary difference between this method and the remaining methods discussed in this handout is that the settlor must be living and in agreement with the modification or termination. Practically speaking, if this method is being used to change a trust agreement, the settlor is usually the person leading the charge. If such an agreement is to proceed without court approval, all of the beneficiaries, including all current and remainder beneficiaries, must consent.

While it is sometimes difficult or impossible to get the actual consent of every beneficiary, the Missouri Uniform Trust Code fortunately provides for virtual representation of certain beneficiaries by other persons, including other beneficiaries. The trustee is not a necessary party to such a modification or termination.

Nonjudicial Settlement Agreement Among Interested Persons

The Missouri Uniform Trust Code provides that “interested persons” may enter into a binding nonjudicial settlement agreement on any matter involving a trust, provided that such an agreement is valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be approved by a court under Missouri law. While this is a common method for making changes to an irrevocable trust, the requirements, procedures and limitations of this method are not nearly as clearly defined as are those for modifying an irrevocable trust with the consent of the settlor and the beneficiaries.

First, one must determine who the interested persons are. While they definitely include at least some beneficiaries and the fiduciaries (trustees), others may be interested depending on the purposes of such an agreement and the matter involved. Second, determining what a nonjudicial settlement agreement can do requires analysis of what it cannot do. A nonjudicial settlement agreement cannot do any of the following:

1. Violate a material purpose of the trust;
2. Modify a trust to eliminate or change a beneficiary’s interest or terminate a trust; or
3. Do anything that a Missouri court cannot do.

Fortunately, Missouri law provides some specific examples of matters that may be resolved in a nonjudicial settlement agreement. The examples include interpretation and construction of trust terms, transferring a trust’s principal place of administration and various matters concerning trustees, including resignation, removal, replacement, succession, powers, compensation and liability. These actions are mostly administrative matters rather than dispositive or substantive matters, and these are the primary uses for nonjudicial settlement agreements.

Decanting

Decanting, or the exercise of a trustee’s power to distribute assets from one trust to another trust, is the Missouri trust attorney’s newest tool for assisting a client in changing undesirable terms of an irrevocable trust.

In summary, under Missouri law, a trustee with discretionary power to distribute income or principal of a trust to one or more beneficiaries may instead distribute assets from that trust to another trust held for the benefit of at least one current or remainder beneficiary of the first trust. This may be done if the trustee decides that such a distribution is necessary or desirable after taking into account the terms and purposes of the first trust, the terms and purposes of the second trust, and the consequences of the distribution.

There are certain limitations. For example, a decanting cannot result in the elimination of:

1. A beneficiary’s presently exercisable power of withdrawal from the first trust, or
2. A beneficiary’s income interest that is necessary for a first trust to qualify for certain preferential federal tax treatment, e.g., the marital deduction.

There is also a general limitation: A trustee’s authority to make a decanting distribution shall remain subject to all fiduciary duties otherwise imposed under the trust agreement and Missouri law.

Even considering those limitations, a trustee’s authority to decant to a second trust is, in essence, a power to change the terms of an irrevocable trust. Further, there is no limitation on who can create the second trust, and the trustee of the first trust clearly has the authority to do so.

Lastly, no consent or agreement by the beneficiaries is required. In fact, the trustee is only required to send a notice of a proposed decanting distribution to the current beneficiaries of the second trust, which clearly may exclude some of the beneficiaries of the first trust, 60 days before making the distribution. ■■



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