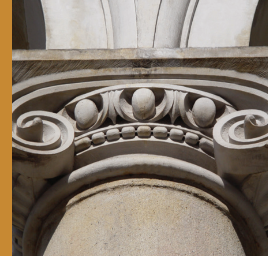


FEATURE:
FIDUCIARY PROFESSIONS

By **Trisha W. Hall**

# Trust Drafting With the End in Mind

Provisions that can complement or crash terminations or modifications

Drafting a trust can be like building an airplane.[1] Each has many components that must be designed to reach the desired result. Some trusts are small crafts; others must be built for long hauls. Most reach their destinations safely. Sadly, however, some don't. Both trusts and airplanes therefore need to be constructed with certain safety features to withstand turbulence.

Modifying a trust may be needed to lower administrative costs, delay outright distributions or reduce friction, whether among beneficiaries or with the trustee. Terminating a trust may be a fiduciary's best option if the costs of administering it outweigh the benefits of its continued existence. As such, modifications and terminations of trusts have proliferated over the last decade. It's not difficult to guess at some of the reasons why.

## Four Reasons

First, since 2001, the only constant about federal transfer tax laws has been change. The Economic Growth and Tax Reconciliation Relief Act, enacted in 2001, created a state of continuous flux, increasing exemption amounts over 10 years, followed by repeal, then a return to the exemption and rates of 2000. A subsequent Congress heightened the suspense in 2010, delaying the law's scheduled sunset until the end of 2012, after which the lifetime exemption would return to $1 million. Taking advantage of the 1-year repeal of estate tax in 2010 and the $5 million estate tax exemption in the two ensuing years, many wealthy citizens established irrevocable trusts, sometimes hastily. Trust officers still tremble when they're reminded of December 2012, when they brought on board a torrent of trusts, after a compressed review, which were followed by grantor's remorse. Like most irrevocable trusts created over the last 15 years, they were primarily motivated by estate tax savings—but with the lifetime estate tax exemption now $11.4 million per individual, grantors and beneficiaries are looking to get out. The vehicle: modification to better reflect current circumstances (for example, obtaining stepped-up basis at the income beneficiary's death) or termination. While some trusts include terms allowing for modification or termination, most trusts' provisions interfere with the interested parties' ability to change and adapt to this "exemption turbulence."

Second, a host of specialized types of irrevocable trusts has developed—asset protection trusts, beneficiary defective inheritance trusts, Delaware incomplete non-grantor trusts and others—whetting clients' demands for irrevocable trusts, whether for tax reduction or protection from creditors. It used to be that an estate-planning attorney would recommend an irrevocable trust as part of a client's overall estate plan. Now, it seems, the situation has reversed, and more clients are telling their attorneys that they need an irrevocable trust. Although clients always profess that they understand what "irrevocability" means, they still want as much control and flexibility in the trust as possible. This has led to a form of modern trust that's drafted to adapt to changes in circumstances by decanting to a new trust, merging into a different trust or being modified by a fiduciary.

Third, a plane with a center of gravity too far forward or aft is difficult to control—just as numerous dynasty trusts have become unwieldy to administer. Each successive generation begets additional beneficiaries.[2] Trustees who must balance the interests of dozens of beneficiaries with identical beneficial interests, but with

**Trisha W. Hall** is a partner at Connolly Gallagher LLP in Wilmington, Del.



varied lifestyles and needs, may look to ways of making the administration more efficient and practical.

Fourth, changes in the law have made modifying irrevocable trusts both more appealing and more attainable. Take, for example, the directed trust. Directed trusts have become all the rage as grantors desire more control over the investments of a trust, lower administrative costs and higher risk assets in a trust's portfolio. Since Delaware first recognized directed trusts in 1985,[3] many states have enacted their own directed trust statutes, and the Uniform Law Commission has recently released the Uniform Directed Trust Act. Fortunately for those who want to modify an old trust, state laws now provide methods to accomplish this modification when the trust instrument is silent. For example, the Uniform Trust Code (UTC), which has been enacted in some form in 33 states, allows for nonjudicial settlement agreements that may modify or terminate a trust,[4] and about 30 states now expressly permit either decanting or merger.

Because of the increased frequency of modifications and terminations of trusts, trust instruments should include not just the authority to modify or terminate a trust but also precautionary features to enable the trustee to safely navigate turbulence and bring a trust in for a safe landing.

The confluence of these developments has brought forth an era of modernizing the irrevocable trust. Numerous tools are available to those wishing to do so, either by the terms of a trust's governing instrument, pursuant to common law or as authorized by statute: small trust termination; termination by agreement of all interested parties; modification by nonjudicial settlement agreement, with or without grantor consent; decanting to a new trust; severance of a trust; merger of a trust into a new or existing trust; a fiduciary with the power to amend a trust's administrative provisions or to adjust to changes in tax law; and garden variety distribution of the trust's principal to one or more beneficiaries.

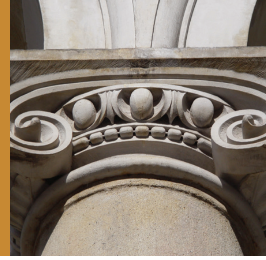
## Fiduciary Duties

The termination or modification of a trust implicates a number of fiduciary duties to beneficiaries, including the duty:

**To inform.** *The Restatement (Third) of Trusts*[5] and the UTC[6] require that a trustee inform beneficiaries of changes involving the trusteeship and other significant developments, especially information that's material in nature needed to protect their interests. This duty requires a trustee to provide notice of or information related to a modification of a trust in most instances. A modification that changes the trustee's role—for example, moving investment responsibility from the trustee to an investment advisor—must be disclosed to all beneficiaries. Likewise, modifying the trust by affecting a beneficiary's rights in the trust or powers over a trustee (adding a provision to authorize removal of a trustee) would require notice to all beneficiaries.

**To act impartially.** The UTC[7] and the Uniform Prudent Investor Act[8] require that a trustee remain impartial in the investment, management and distribution of trust property whenever there are multiple beneficiaries. This duty, arising from principles in the *Restatement (Second) of Trusts*, requires a trustee to treat all beneficiaries equitably in the administration of a trust unless and only to the extent that the trust's terms provide otherwise. This duty, unless waived, could prohibit a trustee from modifying a trust to grant additional administrative rights to one or more beneficiaries, for example, the current income beneficiary becoming the investment advisor or granting the power to replace a trustee to a class of beneficiary (for example, the eldest of each family line).

**Of loyalty.** The duty of loyalty mandates that a trustee set aside any conflict of interest and serve only the interests of the beneficiaries.[9] A unilateral act of a trustee to modify a trust could easily—and inadvertently—breach this duty. For example, merging a trust



into a trust whose governing instrument incorporates a corporate trustee's standard administrative provisions, including the authority to invest in and be compensated on affiliate companies' products, may run afoul of the duty. A decanting to a new trust with the trustee's duties bifurcated among fiduciary advisors may also invoke loyalty concerns because of the resulting shift in liability away from the trustee.

These duties require that trustees participating in a termination or modification of a trust do so cautiously and, in some cases, may pose the potential for such extreme turbulence that the trustee won't proceed at all. Because of the increased frequency of modifications and terminations of trusts, trust instruments should include not just the authority to modify or terminate a trust but also precautionary features to enable the trustee to safely navigate turbulence and bring a trust in for a safe landing.

## Complementing Provisions

Let's now turn our attention to provisions that can complement authorizing language such that a trustee may more confidently engage in changes to a trust. Consider these provisions any time a trust instrument will include the express authority allowing modification or termination. Think of them as the trust equivalent of an airplane's safety belts, oxygen masks and floating seats.

**1. Waiver of duties.** The duties to inform, remain impartial and avoid conflicts of interest may, in some cases, be waived by a trust instrument. The UTC doesn't permit the duty of loyalty (avoid conflicts) to be waived in a trust instrument, but it does permit the other two duties to be limited.[10] The duty to inform the beneficiaries of a trust of the existence of the trust may be waived with respect to beneficiaries under the age of 25.[11]

> *Sample language to waive duty to inform:* Until the death of Grantor, Trustee shall not provide any notice regarding the existence of this trust or the assets thereof to any beneficiary under the age of twenty-five, other than Grantor, or the Trust Protector as representative of such beneficiary.

> *Sample language to waive duty of impartiality:* Trustee shall consider Primary Beneficiary to be the primary beneficiary of this Trust, and I hereby waive the duty of impartiality that the Trustee may otherwise owe to the remainder beneficiaries in favor of Primary Beneficiary.

If the trust instrument includes language waiving the duty of impartiality by stating a preference for the needs of a primary beneficiary, such as a surviving spouse, over those of secondary beneficiaries, then the trustee's exercise of a decanting power granted by the trust instrument to install the primary beneficiary as investment advisor becomes less problematic.

Some states allow a grantor to waive or limit the duty to inform beneficiaries of the existence of a trust. This would necessarily extend to its modification. Trust drafters should consider adding this waiver to a trust instrument any time a trust is intended to benefit one or more beneficiaries over others—for example, a self-settled spendthrift trust or a spousal lifetime access trust. Including such a waiver would eliminate the need to notify the children of the grantor of a self-settled trust or the stepchildren of the surviving spouse of a qualified terminable interest property trust from having to receive information about a trust modification.

**2. Designated representative or trust protector.** When a trust instrument limits information to beneficiaries, it should also designate a person to represent and bind those beneficiaries to whom information will be limited. Having a representative of this type will help ensure the interests of those beneficiaries are protected by receiving notice of a modification or termination or by participating in an agreement to modify the terms of the trust. A trustee may want the trust beneficiaries to consent to or release it from liability associated with a decanting, merger, amendment or termination of a trust before it will proceed (when a non-judicial settlement agreement or modification isn't feasible). If the trust is silent with respect to certain beneficiaries, or if there are minor beneficiaries who can't be virtually represented (due to a conflict of interest, for example), the trustee may move forward with the modification or termination knowing the designated representative or trust protector can consent or release on such beneficiaries' behalf.

> *Sample language:* During the lifetime of the Primary Beneficiary, there shall be a Designated



Representative/Trust Protector to represent the interests of all beneficiaries of the trust other than the Primary Beneficiary. The Designated Representative/Trust Protector shall represent or bind such beneficiaries in connection with a judicial proceeding or any nonjudicial matter, including receipt of accountings and notices regarding the trust.

**3. Virtual representative.** When minor, unborn and unascertainable beneficiaries can be represented by adult beneficiaries, it becomes possible to modify a trust by agreement of all interested persons. If the trust instrument doesn't include a virtual representation clause, and the law governing the administration of the trust doesn't allow for it, a non-judicial settlement agreement may be out of the question.

*Sample language:* As to any trust created hereunder, minor, unborn and unascertainable beneficiaries may for all purposes, including any judicial proceeding or nonjudicial matter, be represented and bound by those with a substantially identical interest, or if none, by his or her parent or guardian, whether or not a conflict of interest exists between them.

**4. Procedure for the release of a fiduciary.** Most beneficiaries are favorably inclined to execute a release if they've received statements during the administration of the trust. Not only does this expedite the process of modifying or terminating a trust, but also, it reduces the costs associated with it.

*Sample language:* A beneficiary may grant a trustee a full and complete release from any and all liability to the beneficiary attributable to any act by or omission of the trustee and may approve any account of the trustee.

**5. Change of situs and law governing administration.** When a trust instrument doesn't include express authority to modify a trust as desired, the next best option may be to change the situs and law governing the administration of the trust to take advantage of a state law with the necessary authority. Having a clause allowing the trustee or other fiduciary to move the trust to another jurisdiction could prove invaluable.

*Sample language:* This agreement creates a Delaware trust, and all matters pertaining to the validity, construction and application of this agreement or to the administration of the trusts created by it shall be governed by Delaware law. The Trust Protector shall have the power to change the situs of administration of the trust from one jurisdiction to another and to elect, by a separate acknowledged instrument filed with the trust records, that the law of such other jurisdiction shall govern the administration of the trust, provided that the Trust Protector shall not make such an election if it would alter any beneficial interest under the trust.

The recommended provisions should be incorporated into a trust instrument with the precision of an aircraft machinist, with attention paid to all other provisions and how they'll work together. I've read trust instruments that require the trustee not to provide information about the trust to beneficiaries under a certain age, only to include another clause that requires the trustee to provide statements to such persons. It's been my experience that including "safety" clauses in trust instruments, such as those described above, will allow the trustee to navigate a modification or termination smoothly and without incident.

## Endnotes

1. The author has never actually been involved with the building of an airplane, but can imagine that it's a highly technical and specialized endeavor much like drafting a trust instrument.
2. *See* Hugh R. Magill, "Estate Planning and Trust Management for a Brave New World: It's All in the Family ... What's a Family?" Heckerling Institute (2019) ("By the fifth generation in a typical American family, their perpetual trust would have 28 living beneficiaries.")
3. 65 Del. Laws, C. 422.
4. Uniform Trust Code (UTC) Section 111.
5. *Restatement (Third) of Trusts* Section 82.
6. UTC Section 813.
7. UTC Section 803, citing *Restatement (Second) of Trusts* Section 183 cmt. A (1959).
8. Uniform Prudent Investor Act Section 6.
9. UTC Section 802.
10. UTC Section 105(b).
11. UTC Section 105(b)(8).