

Rx for Trusts in Trouble

Remember: 'Irrevocable' Ain't What It Used to Be

By CAROL C. KLYMAN, Esq.

So, who has a trust and why do we care if it's ill?

It turns out that there are more people than you think who have set up or are beneficiaries of irrevocable trusts that, for one reason or another, are no longer desirable.



Maybe the law or the reasons for the trust have changed. Sometimes businesses that have been managed through a trust for a period of time may not currently be operating optimally for tax, business, and/or

family purposes. Perhaps some provisions of the trust that were originally helpful now cause legal or family problems for the beneficiaries. Maybe the trust has simply outlived its usefulness. Perhaps the laws under which the trust was created are no longer in force.

Can you get out, how, and who decides where you end up? What, exactly, does 'irrevocable' mean when applied to a trust?

The Bay State has a long and fairly rich tradition of allowing modification to irrevocable trusts, which now has been amplified by the passage of the Massachusetts Uniform Trust Code in 2012 and a new court decision in 2013. The types of irrevocable trusts that could be affected are, among others, irrevocable trusts holding life insurance, trusts holding businesses for family and/or non-family members, special-needs trusts, and family and revocable trusts that have become irrevocable at the settlor's death. What follows are some of the ways to modify irrevocable trusts under current law.

Pursuant to the Trust Instrument

- **Contingency clauses.** Many well-drafted trusts contain contingency clauses that allow the trustee to terminate the trust, to merge it with similar but not identical trusts, and to amend it to bring it into compliance with tax or other laws.

- **Termination clauses.** These clauses allow the trustee to distribute trust property out to the beneficiaries when it is too small to make trust administration economically viable.

- **Special powers of appointment.** These are powers that can be retained by the settlor

or granted to a beneficiary. They allow trust property to be distributed or held in trust as directed by the person holding the power. This can be very helpful for minor or disabled beneficiaries or those who may have creditor issues, and is an elegant way of amending the trust without recourse to the trustee, the courts, or other beneficiaries.

Under the New Uniform Trust Code

A trust can be modified under the new UTC as follows:

- Without court approval but with the consent of all the beneficiaries and the settlor (M.G.L. c 203E, Section 411);

- With court approval with consent of the all the beneficiaries and with a court determination that modification is not inconsistent with a material purpose of the trust (M.G.L. c 203E, Section 411); and

- By the court where, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust (M.G.L. c 203E, Section 412).

Pursuant to Case Law

The courts in Massachusetts have allowed trust modification in some of the following circumstances:

- To distribute trust property outright or to appoint property in further trust pursuant to a special power retained by the settlor or granted to a beneficiary even though the trust option may not be specifically mentioned (*Loring v. Karri-Davies*, 1976);

- To implement intended planning to reduce estate or generation-skipping taxes (*First Agricultural Bank v. Coxe*, 1990, and its progeny);

- To disclaim a trustee power or beneficiary provision even though there is no express provision in the trust (*McClintock v. Schahill*, 1998); and

- To 'decant' trust property into a successor trust without consent of a court or trust beneficiary under the trustee authority, to distribute to or for the benefit of trust beneficiaries (*Morse v. Kraft*, 2013).

Some Pitfalls

But, beware, there are traps for the unwary! Sometimes changes can trigger tax, creditor, or government eligibility problems that

didn't exist previously, and this can make the cure much worse than the disease. Here are some of the pitfalls:

- **Loss of tax benefits** such as the marital deduction or the generation-skipping tax exemption. Many revocable trusts are set up to maximize the use of the Massachusetts or federal estate-tax exemptions (\$5.25 million and \$1 million, respectively). At the death of the settlor, the trust becomes irrevocable. Any changes made pursuant to any of the methods above must take care not to lose the benefit of these exemptions.

- **Loss of eligibility** for MassHealth or other benefit programs. Supplemental-needs trusts and other discretionary trusts may be designed to allow the beneficiary to maintain eligibility for MassHealth, supplemental security income, Social Security disability insurance, veterans-assistance programs, or some rent-subsidy programs. Any outright distribution or transfers to a successor trust that allows the beneficiary independent access to trust assets or income can result in loss of eligibility for these benefits and a disaster for the affected beneficiary.

- **Exposure to creditors.** Some trusts are designed to shield a beneficiary from the claims of creditors. If these protections are not maintained in the successor trust, the beneficiary may end up with nothing.

Moral of the Story

If you have an irrevocable trust, have it reviewed by a knowledgeable attorney to be sure it meets your needs under your current circumstances, and, if not, ask about using one or more of the above methods to make changes. If you are contemplating creating an irrevocable trust, discuss viable exit strategies as part of your plan.

Remember ... irrevocable just ain't what it used to be! ■

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