

Just When You Thought an Irrevocable Trust Couldn't Be Changed: 5 Ways to Modify an Irrevocable Trust

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Irrevocable trusts shouldn't be left to languish as the years go by. In this issue, we'll show you why and how an old or out-of-date irrevocable trust can be modified to benefit you, your clients, their spouses, or other beneficiaries. And, of course, it's all totally legal.

How Trust Modifications Benefit Your Book of Business

Here's a list of reasons why updating an old and stale trust will benefit your clients and strengthen your business relationship with them:

- Tax-related complexities of outdated or poorly worded irrevocable trusts—such as high tax rates on capital gains or undistributed income in such trusts, or the forfeited opportunity for a step-up in basis at a second death—may now be at odds with your clients' goals and circumstances. An up-to-date trust can take advantage of opportunities to save taxes.
- Old trusts may limit your ability to wisely manage assets inside such trusts as part of an integrated total portfolio approach. This may mean poorer investment and tax outcomes for your client and more time-consuming management approaches for you, perhaps without compensation for that extra customization. An up-to-date trust can make management easier for you and more productive for your clients.
- In some cases, your clients may have declined your offers to manage assets in such trusts, since making any changes to the existing holdings would trigger income and/or capital gains taxes and surtaxes in the context of aggressively accelerated trust tax-rate schedules. But, if you could show them strategies for getting rid of these restrictions, not only might your clients value the improved flexibility and diversification, but you might win the opportunity to manage those assets.
- The beneficiaries, trustees, and your clients' other advisors will appreciate your insight, strengthening their desire to look to you for additional services.

Signals that an Irrevocable Trust Should Be Modified

After a trust becomes irrevocable, family circumstances, finances, and laws will undoubtedly change. As such, the trust may need to be modified to:

- Obtain a step-up in basis
- Minimize income taxes or estate taxes
- Qualify a beneficiary for government benefits
- Change the trustee, the provisions governing the trustee, or the trustee's powers
- Modify the distribution terms or pattern
- Adjust or remove a power of appointment
- Add or remove beneficiaries
- Move the trust to a new jurisdiction
- Change the governing law
- Add or remove a trust protector or advisor.

How Irrevocable Trusts Can Be Modified

The appropriate modification method depends on many factors, including trust agreement terms, length of irrevocability, identity of current and remainder beneficiaries, and governing laws. All that being said, an irrevocable trust can be changed by:

1. Judicial Reformation: Reformation consists of going to court and asking a judge to determine that the trust maker's intent has been frustrated and to restate the trust to meet that intent.
2. Judicial or Non-Judicial Conversion: Conversion involves invoking the provisions of the trust agreement or state law to convert a discretionary income and principal trust into a mandatory unitrust or vice versa.
3. Judicial or Non-Judicial Modification: Modification refers to changing the terms of the trust by agreement or a court order to meet the trust maker's intent, such as tax-saving objectives. One must show that an unforeseen change of circumstance has frustrate the trust maker's intent.
4. Invoking the Trust Protector: Trust protector provisions allow a third-party trust protector to step in and exercise specific modification powers as defined in the trust agreement.
5. Decanting the Trust: Decanting is the process of taking the funds from an existing trust and distributing them into a new trust with more favorable terms.

WARNING: Changing an Irrevocable Trust Isn't Easy and May Not Be the Best Choice



An irrevocable trust that no longer makes practical or economic sense is a prime target for change; however, despite a trust's shortcomings, it may be impossible to change. Sometimes, the best option may be to terminate the trust altogether and distribute what's left to the beneficiaries.

Let's Work Together

We are happy to talk you through the options and pros and cons of trust modification or termination, the steps that would be required, how much it would cost, and how much it could benefit your clients. We are always here to help add value to your client relationships and convert prospects into clients. Call us today.