



TRUST MODIFICATION

Overview of Methods to Modify Trusts

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A. GENERALLY

A.1 Types of Changes. There are a number of changes that may be desired. The changes that are often desired include:

- (a) Changing the trustee or successor trustee;
- (b) Changing advisors, such as an investment advisor or “trust protector;”
- (c) Adding or removing beneficiaries;
- (d) Changing the assets or share allocated to beneficiaries or the timing and nature of distributions to beneficiaries;
- (e) Changing applicable law; and/or
- (f) Adding administrative provisions that can affect a beneficiary’s share, such as a no-contest clause, a provision requiring a property agreement with a spouse or significant other, a clause allowing the trustee to require drug testing of beneficiaries, a provision allowing the trustee to delay a distribution to a beneficiary who is under threat of a lawsuit, who is in bankruptcy, or going through a divorce, etc.

A.2 Modifications Allowed. What changes can be made to a trust depend on the type of trust, the language of the trust instrument, and the laws of the state that govern the trust. The trust instrument is the first place to look for a power to make a change, but if the trust does not contain specific language allowing a change, it is possible that the governing law will permit the change. The trust instrument should specify the person or persons who have the power to make specific changes. For example, some trusts allow the settlor to make some changes, the trustee to make other changes, and other designated advisors to make even more changes.

A.3 Types of Trusts. A testamentary trust is created as part of a last will and testament. A “living trust” (also known as an “*inter vivos* trust” or a “nontestamentary trust”) is created under a written document that is usually called a “trust agreement” or under a “declaration of trust.” For the purposes of this memo, the term “trust instrument” will be used to refer to any of the above.

A.4 Revocable or Irrevocable. Most living trusts are revocable because the trust instrument contains a provision that expressly allows the settlor¹ to amend or revoke the trust. A trust that is revocable can be freely changed by the person having the power to amend or revoke. When the last person having a power to amend or revoke dies, the trust becomes irrevocable. For that reason, a testamentary trust cannot be revoked by the settlor because it does not come into effect until the settlor is deceased. Under Nevada law, a trust is irrevocable by the settlor unless there is a provision in the trust instrument that says otherwise, and the changes that can be made to an irrevocable trust can be very limited.

¹The “settlor” is the creator of the trust. Synonyms include “grantor”, “trustor”, and “trust maker.”

B. METHODS OF CHANGE

B.1 Amendment. The easiest method to make a change is to amend the trust to the extent allowed by the trust instrument. Irrevocable trusts cannot usually be amended; however, some irrevocable trusts permit administrative amendments, which do not change beneficiaries but simply change some of the trust's administrative provisions.

(a) The simplest amendment simply modifies or replaces a few provisions of the trust, and the trustee is required to refer to both the original trust instrument and the amendment.

(b) If the changes to the trust are significant, it is often better to amend the trust by completely replacing the original trust agreement. This is done by "restating" the trust. A trust restatement is sometimes called an "*in toto* amendment" because it replaces the trust instrument "in total." Sometimes a restatement is more cost effective because patching up an old trust can actually be more work. Even if it is more costly, a restatement can update antiquated provisions and eliminate the confusion of having multiple documents to refer to.

(c) Some people prepare multiple amendments to their documents, but the more amendments that are in effect, the more confusing the document becomes. The better practice is to have the latest amendment replace all prior amendments so that there are, at the most, only two documents (e.g., the current amendment and the original trust or the most recent restatement) that have to be referred to by the trustee.

B.2 Power to Change Trustees. If the trust instrument of an irrevocable trust gives the settlor or someone else the power to change trustees, that power can be exercised without amending the provisions of the trust.

B.3 Power of Appointment. In addition, an irrevocable trust may provide for one or more persons to have the power to change beneficiaries. This called a "power of appointment."

(a) Sometimes a power of appointment can allow someone to change the beneficiaries of a trust (or of a specific share of a trust) that is effective while person holding the power is living. This is an "*inter vivos* power of appointment." A trust for the benefit of a settlor's spouse may, for example, give the spouse the power to appoint part of a trust to posterity and/or to charitable organizations.

(b) Sometimes a power of appointment can only become effective after the power holder's death. This is called a "testamentary power of appointment." It is often exercisable under the power holder's last will and testament, but it is common to provide that it can be done in another written instrument as well. It is common, for example, for a trust for the benefit of a settlor's child to allow the child to specify the beneficiary or beneficiaries of the child's share after the child's death.

(c) A power of appointment may allow the power holder to specify any beneficiaries or it may be restricted to a limited group of potential beneficiaries.

B.4 Decanting. In recent years, many states, including Nevada, allow a trustee who has discretion to make distributions to various beneficiaries to create and transfer assets to a second trust with somewhat different terms. The process of "pouring" assets from the original trust to a new trust is referred to as "decanting."

(a) It is sometimes used to split a trust for different persons into separate trusts, and it is sometimes used to replace the original trust entirely. If the trustee has the power to make unequal distributions to the exclusion of one or more beneficiaries, the second trust can exclude one or more beneficiaries.

(b) The power to “decant” is part of a trustee’s discretion and does not require approval by the trust’s beneficiaries or by a court, but the law permits the trustee to seek either.

(c) Decanting may not be appropriate to accomplish some objectives. The key rule is that a decanting cannot deprive a beneficiary of a legally enforceable right. In addition, the Internal Revenue Service (IRS) is not bound by state law, and there can be unintended tax consequences if the decanting is done without keeping tax laws in mind.

B.5 Judicial Reformation. When the trust, as written, has errors or provisions that are unworkable, inapplicable, or unjust in light of current circumstances, the trustee or beneficiaries can petition a court to reform the trust. For example, when the language of a trust instrument is poorly written so that the intended tax objectives are not achieved (such as qualifying for a marital or charitable deduction), the trust can be reformed by the court so that those objective are met. The IRS is not generally bound by a state court ruling, but the IRS will respect a reformation if it is done timely and in such a way that is not intended to circumvent applicable tax law.

B.6 Nonjudicial Reformation. Many states, including Nevada, allow the beneficiaries to agree on a reformation of the trust without having to go to court.

C. CONCLUSION

C.1 Read the Trust Instrument. The first step in modifying a trust is to read the trust instrument and to see what that documents permits to be changed and who has the power to make that change.

C.2 Get Legal and Tax Advice. Before making a change, it is best to seek legal counsel to make sure the changes you want are allowed and advisable. Sometimes changes made to trusts have triggered unanticipated consequences that could have been avoided with sound legal advice. If there are tax issues involved, a certified public accountant or other qualified tax advisor may also need to be consultant.

NOTE: This memo provides general information only and does not contain legal, accounting, or tax advice. For brevity, this memo is oversimplified and should not be relied on for any particular situation. Nothing in this memo can be relied upon for any specific individual’s estate plan or to avoid any tax penalties.

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