Fixing Irrevocable Trust Problems

By Edward F. Reilly and Keith A. Herman

The concept of the trust as a vehicle for wealth management and transmission is relatively old in Anglo-American law, yet until fairly recently most irrevocable trusts did not continue for much longer than two generations. In large part, the Rule Against Perpetuities (hereafter the "RAP") served to terminate most irrevocable trusts within a period of time not longer than the "lives in being" when the trust became irrevocable, plus the proverbial 21 years. Problems with such trusts, arising out of drafting errors or simply the failure to anticipate changes in family circumstances, the tax laws, state trust law, investment practices and vehicles, or economic circumstances in general, could be or had to be tolerated, but usually only for some finite period of time.

The recent trend toward abolition of the RAP (Missouri has abolished the RAP for trusts becoming irrevocable after August 28, 2001[1]), together with the increased use of generation-skipping transfer tax planning opportunities[2] and creditor protection aspects of trusts,[3] means that estate planning attorneys are more likely to encounter a situation in which an irrevocable trust needs to be modified in some fashion or even terminated, where no mechanism exists under the terms of the governing instrument to make the desired change. This article will present various methods that are available in Missouri to fix irrevocable trust problems. Current Missouri statutory and case law will be examined as well as the current draft of the Missouri Uniform Trust Code (hereafter the "MUTC").[4]

I. Common Problems with Irrevocable Trusts

Clients often assume that it is a simple matter to "break" a trust that is perceived to have outlived its utility or otherwise imposes unwarranted restrictions (from a beneficiary's perspective). A wide range of circumstances may give rise to the need for a modification or termination of an irrevocable trust. For example, the beneficiaries may become dissatisfied with trustee decisions concerning discretionary distributions or investment performance. A trust may have been drafted with certain provisions that cause unanticipated tax consequences to the beneficiaries, settlor or trustee, or may contain provisions limiting permissible investments or prohibiting certain actions (such as sale or retention of specific property). The allocation of estate taxes among the beneficiaries may not comply with the intent of the settlor. The trustee may not be able to satisfy his duty to comply with the prudent investor rule without violating the trustee's duty of impartiality. The beneficial interests granted by the trust may disqualify a disabled beneficiary for government assistance. There may have been a scrivenor's error. A change in trustee may be desired by the beneficiaries, or the trustee may want to resign. The courts and legislatures have devised several mechanisms to deal with many of these problems in the absence of language in the trust instrument that provides a solution.

II. Alternatives for Dealing with Irrevocable Trust Problems

A. "Informal" Action by Interested Parties

The parties responsible for enforcement of a private trust generally consist of the trustee and the beneficiaries (and in some cases, those claiming through the beneficiaries, such as their legal representatives, heirs and creditors). Typically, no other third parties have standing to become involved with a private trust, except in cases where

1. § 456.236, Mo. Rev. Stat.

2. IRC Section 2631.

3. *See* § 456.080, Mo. Rev. Stat.; Charles D. Fox, IV and Michael J. Huft, *Asset Protection and Dynasty Trusts*, 37 Real Prop. Prob. and Tr. J. 287 (Summer 2002).

4. The MUTC is the Missouri Bar Probate and Trust Law Committee's current draft of the Uniform Trust Code. The MUTC is expected to be introduced in the Missouri legislature in the near future. The MUTC was last revised on April 14, 2003. Applicable sections of the MUTC will be summarized in this article. For the complete text of the MUTC or for other information on the MUTC, consult the Missouri Bar web site at http://www.mobar.org/member/probatcm.htm.

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the State Attorney General steps in to protect a charity's interest in a trust or where the IRS enforces the consequences of compliance with the terms of a trust (or deviation from those terms). If all persons with standing are willing to agree to a modification or termination in a fashion that will bind them and their successors from later challenge, an irrevocable trust can be modified by an agreement that is similar to a trust amendment.[5]

However, obtaining the necessary consents of *all* interested parties may be difficult. Problems arise with such actions where one of the parties objects. If the trustee alone objects, Professor Scott argues persuasively that no good reason exists to prevent the settlor and the beneficiaries from modifying or terminating an irrevocable trust; they may, however, have to seek court approval to require the trustee to comply with their agreement. If a living settlor objects to an agreement for termination or modification (assuming that one or more of the material purposes of the trust remain unaccomplished), it appears unlikely that a reasonable trustee will comply with a request by the beneficiaries for a non-judicially sanctioned modification or termination simply because of the potential for liability to the settlor.

If the settlor is deceased and all the beneficiaries consent (assuming all of the beneficiaries *sui juris*), then generally the beneficiaries can compel a modification or termination of that trust if no material purpose remains to be accomplished.[6] The most common situation occurs when the settlor is deceased and the beneficiaries seeking a modification or termination are not all *sui juris* (there may be disabled, minor, unborn, or otherwise contingent remainder beneficiaries). Sometimes an informal modification or termination can be accomplished by agreement between the trustee and those beneficiaries who are *sui juris*, if the trustee can be convinced that: (1) no material purpose of the trust remains unaccomplished, (2) the beneficiaries seeking such action either have the functional equivalent of "virtual representation" of all other vested or contingent remaindermen or otherwise have the ability to eliminate the interests of such persons[7], and (3) other adequate protections exist to deal with the possibility that a current or future beneficiary might someday challenge the action (perhaps by agreements to exonerate and indemnify the trustee from such liability).

Obviously, because of the difficulties inherit in meeting these criteria, such informal modifications or terminations are difficult to implement. The trustee, and even the beneficiaries seeking such action, must be absolutely confident that the modification sought would be approved if reviewed by a court and that the protections available to them (by way of exculpation and indemnification) are adequate. For these reasons, and because of the enactment of § 456.590.2, many trustees will now insist on modification pursuant to court decree under that statute.

B. Modification of Administrative Terms

There are several Missouri statutes that deal with administrative modifications to a trust. Some of the statutes provide for private action (i.e., without court approval) by the trustee acting alone and other statutes grant a court the authority to authorize a modification. Two important statutes allowing modifications without court approval provide that: (1) if the trustee resigns and no successor is able to act, then a majority of the income beneficiaries may appoint a successor trustee;[8] and (2) a trustee can divide a single trust into separate trusts before or after the initial funding.[9] Several statutes allowing a modification only *with court approval* provide that a court: (1) may reform the trust to avoid violation of the rule against perpetuities[10] (assuming that is still an issue for trusts that became irrevocable prior to August 28, 2001); (2) may relieve a trustee from restrictions on his powers;[11] (3) may authorize a trustee holding a life estate, determinable or defeasible fee to mortgage, to convey, lease or improve the interest;[12] and (4) may confer any other power upon a trustee if it would be expedient.[13]

C. Statutory Modification of Dispositive Terms (Section 456.590.2)

In 1983, the General Assembly enacted § 456.590.2, Mo. Rev. Stat.[14] This statute currently is the optimum way to deal with irrevocable trust problems. The statute allows a trustee or beneficiary to, in essence, rewrite the trust agreement, subject only to obtaining the consent of the then living adult beneficiaries and a court ruling that the nonadult beneficiaries will benefit from the modification. A trustee or any other person beneficially interested in the

5. Scott, *The Law of Trusts*, § 338 (4th ed. 1989).

6. See Scott, § 337 (4th ed. 1989).

7. A beneficiary may have the ability to eliminate a contingent beneficiary's interest by the exercise of a power of appointment.

8. § 456.185, Mo. Rev. Stat. See further discussion *infra*.

9. § 456.520.3(29), Mo. Rev. Stat. Such divisions are often desirable for purposes of GST planning. Currently there is no Missouri statute authorizing a trustee, without court approval, to combine multiple trusts into a single trust. But see MUTC Section 456.4-417, discussed *infra*.

10. § 442.555.2, Mo. Rev. Stat.

11. § 456.570, Mo. Rev. Stat.

12. § 456.580, Mo. Rev. Stat.

13. § 456.590.1, Mo. Rev. Stat.

14. For a more detailed discussion of § 456.590.2, see Peter J. Wiedenbeck, *Missouri's Repeal of the Claflin Doctrine—New View of the Policy Against Perpetuities*, 50 Mo. L. Rev. 805 (1985); Julia C. Walker, *Law Summary: Get Your Dead Hands Off Me: Beneficiaries' Right to Terminate or Modify a Trust Under the Uniform Trust Code*, 67 Mo. L. Rev. 443 (2002); and Scot Boulton, *How Uniform Will the Uniform Trust Code Be: Vagaries of Missouri Trust Law Versus Desires for Conformity*, 67 Mo. L. Rev. 361 (2002).

trust may petition the court for the modification.[15] A modification will only be allowed if two conditions are met: (1) all of the adult "beneficiaries" who are not disabled consent, and (2) the court finds that the modification "will benefit the disabled, minor, unborn and unascertained beneficiaries." Section 456.590.2 is contrary to the rule in the majority of states that only allows a modification if it would not violate a material purpose of the settlor.[16]

As of the date of this article, there have only been two cases interpreting § 456.590.2. The first case was *Hamerstrom*.[17] In *Hamerstrom*, the settlor established a testamentary trust for Elizabeth Hamerstrom. Elizabeth would receive $150 a month until her death or until the trust assets were depleted. Upon Elizabeth's death, the remaining trust assets were to be distributed to Elizabeth's husband, if living, otherwise to Elizabeth's two sons, in equal shares or all to the survivor. The trust agreement was silent as to what would happen if Elizabeth's husband and both of her sons predeceased Elizabeth.[18] Elizabeth, her husband, and her two sons, consented to a petition to modify the trust to allow Elizabeth to receive $2,000 a month. The court found that the term "beneficiaries," as used in the statute, refers to "those persons, including unborn and unascertained issue, individually named, or who are included in a named class, identified by the settlor in the testamentary trust and for whom the settlor expressed an intent to make the provision." The court found that Elizabeth, her husband, and her two sons were the only "beneficiaries." Therefore their consents were sufficient to allow a modification as there were no unnamed or unascertained beneficiaries.

The only other case to interpret § 456.590.2 was *Nitsche*.[19] In *Nitsche*, the income beneficiary petitioned the court for early termination of a trust "[b]ecause of the cost of administration and the low yield being earned on trust assets, and because of the desires of all of the adult beneficiaries of the trust to benefit" the income beneficiary. The court found that there was insufficient evidence to determine whether all of the adult beneficiaries consented to early termination and sustained the trial court's denial of the petition for modification.

There are several interpretative issues regarding § 456.590.2 that have not been resolved, including whether a guardian ad litem[20] must be appointed to represent the interests of the unborn and unascertained beneficiaries.[21] However, these issues may never be resolved if the MUTC is enacted.

D. Other Court Sanctioned Modifications

Missouri courts have long exercised their equitable powers to alter or modify trusts. Prior to enactment of § 456.590, these powers were often invoked to justify changes in trust administration. However, a court of equity has other powers to modify an irrevocable trust going beyond a mere change of administrative powers.

1. *Reformation and Rescission.* A distinction has been made between reformations and modifications.[22] A reformation is the applicable remedy where there has been a scrivenor's error, fraud, or a mistake. With a reformation the court partially rewrites the trust to conform to the original intent of the settlor. Missouri courts sometimes refer to reformations as "construction" cases.[23]

"Rescission" of a trust is a judicial act of undoing a trust, "rescinding" the trust by returning the property of an irrevocable trust to the settlor and setting aside the entire transaction.[24] Rescission may be granted where the creation of the trust was the result of fraud, the settlor's mental incapacity, undue influence, or mistake. There is some authority to the effect that a rescission based upon a mistake of law may actually undo the tax consequences of the original (mistaken) transfer[25].

2. *Cy Pres.* Another remedy, cy pres, is only applicable to charitable trusts. In Missouri the doctrine of cy pres has been stated as follows.

If property is given in trust to be applied to a particular charitable purpose, and it is or becomes impossible or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, the trust will not fail but the court will direct the

15. § 456.590.2 is silent as to the role of the settlor in a modification. It would appear, under the express terms of the statute, that it is irrelevant whether the settlor is dead or alive, and also irrelevant whether the settlor consents to the modification or opposes the modification. However, it has been suggested that a court in its exercise of judicial discretion should refuse to vary a trust where the settlor is still on the scene but does not consent. *See* Wiedenbeck, *supra* at note 14.

16. *See* Wiedenbeck, *supra* note 14; and Walker, *supra* note 14.

17. *Hamerstrom v. Commerce Bank of Kansas City, N.A.*, 808 S.W.2d 434 (Mo. Ct. App. 1991).

18. *See* Walker, *supra* note 14.

19. *In re Trust of Nitsche*, 46 S.W.3d 682 (Mo. Ct. App. 2001).

20. *See* Walker, *supra* note 14.

21. Wiedenbeck, *supra* note 14, points out the following three issues: (1) whether the court has the power to authorize a modification if there are no disabled, minor, unborn, or unascertained beneficiaries; (2) what is meant by the term "benefit;" and (3) the extent to which the court must consider the settlor's material purpose. Issues (1) and (3) appear to have been resolved by *Hamerstrom*.

22. See MoBar: Trusts, Powers of Atty., Custodianships and Nonprobate Matters, § 5.14.

23. *Id.*

24. Scott, § 333.

25. *See Neal v. U.S.*, 98-2 USTC Par. 60,318; see other cases discussed in Scott at § 333.4.

application of the property to some charitable purpose which falls within the general charitable intention of the settlor.[26]

Cy pres may be useful when a particular charitable purpose becomes impossible, where there are more than sufficient funds to accomplish the original purpose, or where unanticipated circumstances would otherwise defeat or impair the purposes of the trust.[27] The attorney general is a necessary party to a cy pres action.[28] Section 456.590.2 has not altered the existing case law on cy pres, as § 456.590.2 expressly applies only to "private trusts" and is therefore not applicable to charitable trusts.[29]

3. *Removal of Restrictions on Charities.* Section 402.040 of the Missouri Revised Statutes provides a procedure for charities to seek court removal of restrictions on funds received from donors.[30] Trust agreements sometimes provide that a distribution is to be made to a charity, subject to a restriction on how the funds may be used. After distribution to the charity, the funds are no longer an asset of the trust and enforcement of the restriction is generally the duty of the attorney general.[31] In this regard, removing the restriction is not, per se, an action to modify a trust in the usual sense. However, such an action is relevant in the context of this article because the trustee making the distributions would have at least a theoretical duty to stop making distributions.[32]

A restriction may be released if the donor consents to the release in writing.[33] If (1) the consent of the donor cannot be obtained (due to death, disability, incapacity, unavailability, or impossibility of identification), or (2) the gift instrument does not give the institution the right to exercise the power of cy pres, *then* the institution may apply to the circuit court for release of the restriction.[34] The attorney general must be notified and given an opportunity to be heard. If the court finds the restriction obsolete, inappropriate, or impracticable, it may release the restriction in whole or in part. Section 401.040 does not limit the application of cy pres.[35]

4. *Change of Trustees.* Chapter 456 offers several mechanisms to permit a change of trustees where the terms of an irrevocable trust are silent. Under §§ 456.183 and 456.185, if a serving trustee resigns, the remaining trustees continue to serve; if there are no remaining co-trustees (and presumably, no successor trustee designated to serve by the terms of the trust), a successor trustee may be designated by a majority in interest of the trust income beneficiaries. Such a procedure does not require court approval.

If court approval is desired, § 456.190 provides that the resigning trustee or a beneficiary, or a beneficiary's heirs, legal representative or assigns, can present an affidavit to the circuit court in which the trust property is situated or in which a will creating the trust was proved or recorded. If all the beneficiaries having capacity to contract (e.g., non-disabled adult income and remainder beneficiaries) consent to the appointment of a designated successor trustee, the circuit court can (and usually will) appoint that successor as provided in § 456.200. If there is less than unanimous consent, the court is to set the matter for hearing and require notice to all "interested persons" as defined in § 472.300.

In the experience of the authors, changes of trustees will most often occur under §§ 456.190 and 456.200, where non-family trustees (such as corporate trustees) are involved because of the perception that the court's order can be structured to eliminate potential future claims against the resigning trustees. Note, however, that under either statutory approach, the resigning trustee must be willing to resign.

E. MUTC Provisions

The current draft of the MUTC would completely repeal[36] § 456.590 and replace it (and, arguably, may supersede much of the common law in this area) with a more complete set of statutes concerning modifications, terminations, reformations, and cy pres.[37] A detailed discussion

26. *Levings v. Danforth*, 512 S.W.2d 207 (Mo. Ct. App. 1974).

27. See MoBar: Trusts, Powers of Atty., Custodianships and Nonprobate Matters, § 7.12.

28. *Thatcher v. City of St. Louis*, 122 S.W.2d 915 (Mo. 1938).

29. In some situations it may be unclear what is a charitable trust and what is a private trust. For example, if a private trust has several beneficiaries, one of which is a charity, it is unclear whether the charitable interest must be modified under cy pres or by § 456.590.2. An assistant Missouri Attorney General explained to one of the authors, in an informal discussion, that cy pres (not § 456.590.2) would be applicable in such a situation.

30. § 402.040 was enacted in 1976 and is based on the Uniform Management of Institutional Funds Act that was approved by the National Conference of Commissioners on Uniform State Laws in 1972.

31. *See* Ronald Chester, *Grantor Standing to Enforce Charitable Transfers Under Section 405(c) of the Uniform Trust Code and Related Law: How Important is it and How Extensive Should it be?*, 37 Real Prop., Prob. & Tr. J. No. 4 (Winter 2003).

32. § 402.040 applies to restrictions placed on an organization by a "gift instrument." A trust should fall within the definition of a gift instrument as an "agreement" or as a "writing." § 402.010, Mo. Rev. Stat. It is peculiar that the definition does not specifically include a trust in the definition of gift instrument.

33. § 402.040.1, Mo. Rev. Stat.

34. § 402.040.2, Mo. Rev. Stat.

35. Cy pres may be applicable in such a situation as courts often apply trust principles to restrictions placed on a charity. See *Restatement (Second) of Trusts* § 348, comment (f) (1959).

36. The substance of § 456.590.2 will be retained and clarified in MUTC 456.4-411B.

37. However, the MUTC makes no change to § 402.040.

of this draft legislation is beyond the scope of this article. However, set out below is a brief summary of the MUTC statutes that are most relevant to this article.

1. MUTC 456.4-411A (Modification or Termination of NonCharitable Irrevocable Trust with Consent of Settlor). Without court approval, a trust may be modified or terminated (even if inconsistent with a material purpose of the settlor) if the settlor and all of the beneficiaries consent. If all of the beneficiaries do not consent, the trust may still be modified/terminated if a court finds that the interests of the non-consenting beneficiaries will be adequately protected.

2. MUTC 456.4-411B (Modification or Termination of NonCharitable Irrevocable Trust by Consent of Adult Beneficiaries). If all of the adult beneficiaries consent, the court may modify or terminate the trust (even if inconsistent with a material purpose of the settlor) if the court finds the interests of the non-consenting beneficiaries will be adequately protected. If all of the adult beneficiaries do not consent, then the court may modify or terminate the trust if the modification is not inconsistent with a material purpose of the trust (or in the case of a termination, continuance of the trust is not necessary to achieve any material purpose of the trust). A spendthrift provision is not presumed to be a material purpose.

3. MUTC 456.4-412 (Modification or Termination because of Unanticipated Circumstances or Inability to Administer Trust Effectively or in Furtherance of a Trust Purpose). A court may modify or terminate the *dispositive* terms of a trust if, because of circumstances not anticipated by the settlor, the modification/termination will further the purposes of the trust. A court may modify the *administrative* provisions of the trust if it will further the purposes of the trust.

4. MUTC 456.4-413 (Cy Pres). The court may modify or terminate a trust (in a manner consistent with the settlor's charitable purposes) if a particular charitable purpose becomes unlawful, impracticable, impossible to achieve, or wasteful.

5. MUTC 456.4-414 (Termination of Uneconomic Trust). A *trustee* may terminate a trust (after notice to qualified beneficiaries) without court approval if the value of the trust is less than $100,000 and is insufficient to justify the cost of administration. A *court* may modify or terminate a trust, or replace a trustee with a new trustee, if the value of the trust is insufficient to justify the cost of administration.

6. MUTC 456.4-415 (Reformation to Correct Mistakes). A court may reform a trust to conform to the settlor's intentions if the terms were affected by a mistake of fact or law in expression or inducement.

7. MUTC 456.4-416 (Modification to Achieve Settlor's Tax Objectives). A court may modify a trust to achieve the settlor's tax objectives if the modification is not contrary to the settlor's probable intention.

8. MUTC 456.4-417 (Combination and Division of Trusts). Without court approval (after notice to qualified beneficiaries), the trustee may combine two or more trusts or divide one trust into two or more trusts if the result does not impair the rights of any beneficiary or adversely affect achievement of the purposes of the trust.

9. MUTC 456.7-706 (Removal of Trustee): Another provision of the MUTC will make a significant change in Missouri trust law dealing with removal of Trustees. MUTC 456.7-706 states four grounds for removal of a trustee. The first three grounds — that the trustee has committed a serious breach of trust, that "lack of cooperation among co-trustees substantially impairs the administration of the trust," and that "because of unfitness, unwillingness, or persistent failure of the trustee to administer the trust effectively . . . removal of the trustee best serves the interests of the beneficiaries," — all appear consistent with prior Missouri law. However, the fourth ground for removal would allow a court to remove a trustee if: (1) "there has been a substantial change of circumstances *or* (2) removal is requested by all of the qualified beneficiaries" *and* (in either case) the court finds that removal of the trustee best serves the interests of all of the beneficiaries, removal of the trustee is not inconsistent with a material purpose of the trust, and a suitable co-trustee or successor trustee is available (meeting all three of these latter requirements is necessary). Enactment of this statute would render a change of trustees relatively easier than such a change appears to be under current law. Until now, beneficiaries seeking to remove a trustee often found that the principles set out in *Sternberg*[38] and *Vest*,[39] to the effect that "personal hostility between a trustee and the trust beneficiaries did not suffice to justify removal of a trust," prevented or at least hampered a change of trustees.

F. Commutation (Prepayment)

Often a beneficiary would rather have a lump sum payment of the value of his interest in a trust rather than ongoing payments pursuant to the distribution standards of the trust. This can be accomplished by commuting (or prepaying) the beneficiary's interest. Commuting, in the context of a trust, is not specifically addressed in any Missouri statutes or case law. However, as a commutation is a transfer of the beneficiary's interest, it should be

38. *Sternberg v. St. Louis Union Trust Co.*, 163 F. 2d 714 (8th Cir. 1947), *cert. denied*, 68 S. Ct. 267.

39. *Vest v. Bialson*, 293 S.W.2d 369 (Mo. 1956).

allowed under the same circumstances as any sale, assignment or transfer of a beneficiary's interest in a trust, unless the trust contains a prohibition on voluntary transfers in a spendthrift clause.[40] If there is a valid spendthrift clause that prohibits a voluntary transfer, then the beneficiary should not be able to commute (or transfer) his interest without court approval pursuant to § 456.590.2.[41]

A reverse commutation is another possible way to terminate a trust without a spendthrift restraint on voluntary transfers. If the current beneficiary purchases the remainder beneficiary's interest, then the trust may terminate if *all* remainder interests (including contingent remainder interests) can be purchased and the doctrine of "merger" would operate to terminate the trust. Such a transaction may have federal transfer tax consequences.[42]

G. Disclaimer/Renunciation

Disclaimers are another powerful weapon to deal with irrevocable trust problems.[43] A disclaimer (or renunciation) is a refusal to accept a property right.[44] Disclaimers may be used to modify an irrevocable trust by accelerating future interests or eliminating powers exercisable in favor of a beneficiary that might have adverse tax consequences. In 1997, §§ 469.010 through 469.120 of the Missouri Revised Statutes codified the rules on disclaimers and provided uniformity with the internal revenue code "qualified disclaimer" rules.[45] However, chapter 469 does not affect a person's right to "transfer, release, disclaim or renounce any property, interest or power . . . under any other statute or under the common law."[46] Prior to enactment of § 469.010 a beneficiary could renounce his interest in a trust (notwithstanding a spendthrift restraint) within a reasonable time if the beneficiary had not accepted the benefits of the trust.[47]

H. Power to Adjust/Unitrust Election

In order to allow a trustee to comply with the prudent investor rule[48] without violating the trustee's duty of impartiality,[49] in certain situations a trustee has the discretion (or, arguably, the duty) to adjust receipts between income and principal[50] or elect to treat a trust as a unitrust.[51] In most cases, these provisions are only needed if the trustee does *not* have the authority to distribute principal to the current beneficiary. The power to adjust allows a trustee to administer the trust in a way that would otherwise violate the terms of the trust (or statutory law) allocating receipts between income and principal. The unitrust election allows the trustee to rewrite the trust, replacing the term "income" with a percentage of the fair market value of the trust.

III. Potential Tax Issues

Unforeseen federal transfer tax issues may lurk in any modification of an irrevocable trust. For example, a judicially sanctioned or "informal" modification of an irrevocable trust that is GST exempt that changes the quality, timing or value of the beneficial interests of "skip persons," may be a constructive addition that changes the GST exempt status of the trust.[52] Similarly, a nonqualified disclaimer or other modification of a beneficiary's income interest may be a gift by the disclaimant to the other trust beneficiaries[53], or possibly even a sale of the income interest.

Conclusion

A variety of tools and techniques are available to legal counsel to "fix" problems with irrevocable trusts. However, in closing, a word of caution is in order. Just because a modification or termination of an irrevocable trust is feasible does not always mean that it is desirable in light of current or potential circumstances that may affect the trust or its beneficiaries. Attorneys advising trustees and/or trust beneficiaries need to give careful thought, not only to the techniques to accomplish such changes, but also to the consequences of any change. ❑

40. *See* Wiedenbeck, *supra* note 14 at 811. ("Absent spendthrift restraint, a beneficiary can always accelerate or anticipate his interest by sale, notwithstanding the settlor's purpose to postpone enjoyment or withhold management.")

41. Stated another way, if there is a spendthrift clause, then the trustee may not prepay the beneficiary's interest.

42. *See Wheeler v. U.S.*, 116 F.3d 749 (5th Cir. 1997); *Estate of Cyril I. Magnin*, 184 F.3d 1074 (9th Cir. 1999); TC Memo 2001-38.

43. *See* Jerry A. Kasner, *Cleaning Up The Mess And Rewriting The Estate Plan: Post Mortem Disclaimers And Reformation*, 2002 Annual Notre Dame Tax and Estate Planning Institute, chapter 28.

44. Missouri cases used the term "renounce" before enactment of chapter 469 of the Missouri Revised Statutes.

45. See IRC Section 2518.

46. § 469.110, Mo. Rev. Stat.

47. *Sanders v. Jones*, 147 S.W.2d 424 (Mo. 1940); *Commerce Trust Company v. Fast*, 396 S.W.2d 683 (Mo. 1965); *Cavers v. St. Louis Union Trust Company*, 531 S.W.2d 526 (Mo. Ct. App. 1975) (court confuses a renunciation with an assignment).

48. § 456.901.1, Mo. Rev. Stat.

49. § 456.906, Mo. Rev. Stat.

50. § 469.405, Mo. Rev. Stat.

51. § 469.411, Mo. Rev. Stat. As of the date of publication of this article, the unitrust election deadline has passed. Unless the technical corrections to the Revised Missouri Principal and Income Act become law, a conversion to a unitrust would have to be pursued under § 456.590.2.

52. See regulations under IRC Section 2601; PLR 9620019.

53. *See Estate of Ruth B. Regester v. Commissioner of Internal Revenue Code*, 83 T.C. 1 (1984); IRC Section 1001(e).