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In North Carolina Irrevocable Trusts May No Longer Be Irrevocable

07.16.2010

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Due to recent changes in North Carolina law, irrevocable trusts are no longer “set in stone.” Irrevocable trusts can now be rewritten for a variety of reasons and in a variety of methods or even terminated. When the terms of an irrevocable trust become troublesome, a beneficiary or trustee of the trust will have the option to remedy a defective or unwanted trust provision or terminate the trust.

Sometimes the best way to fix the trust is simply to replace it. When a beneficiary or trustee experiences trouble in the application of trust terms or becomes aware that the terms are deficient in some respect, the trustee or beneficiary should consider whether tools such as decanting or trust modification may allow trust assets to be administered under different and improved trust terms. When these options are available, they may provide relatively simple, cost-effective ways to modernize an old trust, change a trust’s administrative provisions, improve clarity or correct drafting errors.

Decanting

Decanting refers to the ability of a trustee to appoint the assets of one trust into another trust under the trustee’s discretionary power to make distributions to or for the benefit of one or more beneficiaries. Decanting allows the trustee to create a new trust with more favorable or desirable terms and then “pour over” (decant) the trust assets into the newly established trust. As long as the new trust beneficiaries consist of one or more of the original beneficiaries, decanting may be used to amend administrative terms, update a trust to address changed circumstances, alter the dispositive terms of a trust, and address other issues that may arise during the life of a trust. Often, trust decanting is a process that may not require a judicial hearing or court approval, meaning less hassle and expense for the trust. The list below is a sample of the many situations where trust decanting can prove valuable:

Modernize or improve outdated trust provisions. Trust decanting allows a trustee to incorporate recent changes in the law by adding new Trustee authority or powers not previously available.

Address Changed Circumstances. Quite often a client’s view of the future never materializes as envisioned or an unanticipated series of events creates a situation much different from the client’s original intention. In addition, many of these changes occur after a trust has become irrevocable and the client no longer has the ability to unilaterally

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amend the instrument. Trust decanting provides a valuable way to account for the unforeseen without the need for court approval. Some examples of unforeseen circumstances are:

- **Disabled Beneficiaries.** A beneficiary becomes disabled or has special needs. The Trustee could decant that specific beneficiary's portion into a supplemental needs trust to enable the beneficiary to avoid disqualification for federal or state government benefits.
- **Distributive Provisions.** A Grantor may have set up a trust that is to distribute all trust corpus to a beneficiary at a set age or event, or perhaps in tiers at two or three different ages. If events later occur where that beneficiary, for whatever reason, should not receive a large lump sum of assets upon such age or event, then the Trustee could decant such assets into another trust for the benefit of the same beneficiary, but with a later age distribution or even continuation for the lifetime of the beneficiary.
- **Creditor or Marital issues.** Decanting allows a Trustee to make adjustments for unforeseen creditor or marital problems that could otherwise adversely affect the Grantor's intended use of the trust assets. The decanting power could also include the addition of spendthrift language in the trust.
- **Uneven wealth accumulation.** Should one or more beneficiaries have accumulated assets to the point that they really do not 'need' the assistance the trust provides, the Trustee could use decanting to place the trust assets into another trust to provide greater benefit to those beneficiaries more in need.

Change trust situs. If a trust presently does not allow a change in situs or place of administration, decanting can allow a Trustee to move a trust to another jurisdiction for administration. This might provide tax benefits if the new jurisdiction has more favorable tax laws.

Tax issues. A Trustee may need to correct a Crummey power of withdrawal to qualify for the gift tax annual exclusion. A Trustee may need to make a trust a grantor trust for income tax purposes which would allow for the sale of appreciated assets by the Trust to the Grantor without the recognition of income. As noted above, another state's tax laws may be more beneficial and the Trustee would like to change trust situs to avail itself of these tax benefits. Finally, a Trustee can use decanting to fully maximize the generation skipping transfer tax exemption.

Correct Drafting Errors. Whether substantive or clerical in nature, a variety of drafting errors or omissions may not be discovered until after the trust is irrevocable. Trust decanting can correct these errors.

Trustee or administrative changes. Trust decanting can allow for later alteration to Trustee administration provisions including the number of votes required to act among co-trustees or the order of successor trustees.

Modification or Termination of Trust Under UTC

Another approach to modify or even terminate an irrevocable trust by a grantor, beneficiary or trustee is under the

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North Carolina's Uniform Trust Code (UTC). An irrevocable trust can be modified or terminated if the settlor and all the beneficiaries consent. This type of modification is the only statutory provision under the UTC which does not require a court order to amend an irrevocable trust. This type of modification or termination is available even if the modification or termination is inconsistent with the original purpose of the trust.

The UTC also provides that the court may terminate or modify an irrevocable trust, upon consent by all beneficiaries, if it is determined that the continuation of the trust is not necessary to achieve its original purpose, or the modification is necessary to maintain the trust's original purpose. If one or more beneficiaries do not agree with the proposed modification or termination, the court may still terminate or modify the trust if the trust could have been modified if all of the beneficiaries had consented and the modification or termination will adequately protect the non-consenting beneficiary. The modification or termination of the trust can also be for the following reasons:

- The modification or termination of the trust substantially outweighs the interest in accomplishing the material purpose of the trust.
- Changed circumstances have occurred and the court finds that such modification or termination will further the original purposes of the trust.
- The existing trust terms cause unnecessary waste or strain on the trust's administration.
- To conform to the settlor's original intention if the court finds that the terms of the trust were affected by a mistake of a fact or law or by a drafting error.
- To achieve a settlor's intended tax objectives. Such modification can be applied retroactively if so ordered by the court.
- The trust has a total value of less than \$50,000.

In summary, irrevocable trusts are now not necessarily irrevocable. Objectionable provisions of the trust can now be eliminated and in some situations the trust can be terminated. These trust remedies apply to all trusts regardless of the date that the trust was created.

Circular 230 Disclosure

To ensure compliance with requirements imposed by the IRS, unless specifically indicated otherwise, any tax advice contained in this communication (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of avoiding tax related penalties or promoting, marketing or recommending to another party any tax related matter addressed herein.

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