



**2019 Federal Tax Institute of New England**

**Tax Considerations in Trust Terminations, Modifications,  
and Decanting Under  
Connecticut's New Uniform Trust Code**

**October 24, 2019**

**11:25 a.m. – 12:25 p.m.**

**Saint Clements Castle**

**Portland, CT**

**CT Bar Institute, Inc.**

CT: 1.0 CLE Credits (General)  
NY: 1.0 CLE Credits (AOP)

## Lawyers' Principles of Professionalism

As a lawyer I must strive to make our system of justice work fairly and efficiently. In order to carry out that responsibility, not only will I comply with the letter and spirit of the disciplinary standards applicable to all lawyers, but I will also conduct myself in accordance with the following Principles of Professionalism when dealing with my client, opposing parties, their counsel, the courts and the general public.

Civility and courtesy are the hallmarks of professionalism and should not be equated with weakness;

I will endeavor to be courteous and civil, both in oral and in written communications;

I will not knowingly make statements of fact or of law that are untrue;

I will agree to reasonable requests for extensions of time or for waiver of procedural formalities when the legitimate interests of my client will not be adversely affected;

I will refrain from causing unreasonable delays;

I will endeavor to consult with opposing counsel before scheduling depositions and meetings and before rescheduling hearings, and I will cooperate with opposing counsel when scheduling changes are requested;

When scheduled hearings or depositions have to be canceled, I will notify opposing counsel, and if appropriate, the court (or other tribunal) as early as possible;

Before dates for hearings or trials are set, or if that is not feasible, immediately after such dates have been set, I will attempt to verify the availability of key participants and witnesses so that I can promptly notify the court (or other tribunal) and opposing counsel of any likely problem in that regard;

I will refrain from utilizing litigation or any other course of conduct to harass the opposing party;

I will refrain from engaging in excessive and abusive discovery, and I will comply with all reasonable discovery requests;

In depositions and other proceedings, and in negotiations, I will conduct myself with dignity, avoid making groundless objections and refrain from engaging in acts of rudeness or disrespect;

I will not serve motions and pleadings on the other party or counsel at such time or in such manner as will unfairly limit the other party's opportunity to respond;

In business transactions I will not quarrel over matters of form or style, but will concentrate on matters of substance and content;

I will be a vigorous and zealous advocate on behalf of my client, while recognizing, as an officer of the court, that excessive zeal may be detrimental to my client's interests as well as to the proper functioning of our system of justice;

While I must consider my client's decision concerning the objectives of the representation, I nevertheless will counsel my client that a willingness to initiate or engage in settlement discussions is consistent with zealous and effective representation;

Where consistent with my client's interests, I will communicate with opposing counsel in an effort to avoid litigation and to resolve litigation that has actually commenced;

I will withdraw voluntarily claims or defense when it becomes apparent that they do not have merit or are superfluous;

I will not file frivolous motions;

I will make every effort to agree with other counsel, as early as possible, on a voluntary exchange of information and on a plan for discovery;

I will attempt to resolve, by agreement, my objections to matters contained in my opponent's pleadings and discovery requests;

In civil matters, I will stipulate to facts as to which there is no genuine dispute;

I will endeavor to be punctual in attending court hearings, conferences, meetings and depositions;

I will at all times be candid with the court and its personnel;

I will remember that, in addition to commitment to my client's cause, my responsibilities as a lawyer include a devotion to the public good;

I will endeavor to keep myself current in the areas in which I practice and when necessary, will associate with, or refer my client to, counsel knowledgeable in another field of practice;

I will be mindful of the fact that, as a member of a self-regulating profession, it is incumbent on me to report violations by fellow lawyers as required by the Rules of Professional Conduct;

I will be mindful of the need to protect the image of the legal profession in the eyes of the public and will be so guided when considering methods and content of advertising;

I will be mindful that the law is a learned profession and that among its desirable goals are devotion to public service, improvement of administration of justice, and the contribution of uncompensated time and civic influence on behalf of those persons who cannot afford adequate legal assistance;

I will endeavor to ensure that all persons, regardless of race, age, gender, disability, national origin, religion, sexual orientation, color, or creed receive fair and equal treatment under the law, and will always conduct myself in such a way as to promote equality and justice for all.

It is understood that nothing in these Principles shall be deemed to supersede, supplement or in any way amend the Rules of Professional Conduct, alter existing standards of conduct against which lawyer conduct might be judged or become a basis for the imposition of civil liability of any kind.

*--Adopted by the Connecticut Bar Association House of Delegates on June 6, 1994*

**Ronald Aucutt Bio:**

Ronald D. Aucutt is a Senior Fiduciary Counsel with Bessemer Trust Company, N.A. Before joining Bessemer in April 2019, Ron practiced law with Miller & Chevalier Chartered in Washington, D.C., for 23 years and with McGuireWoods LLP in the Washington suburb of Tysons, Virginia, for 20 years. Ron's career with those law firms focused on planning and controversy matters involving the estate, gift, and generation-skipping transfer taxes, the income taxation of trusts and estates, and the rules regarding tax-exempt organizations and charitable contributions. He advised lawyers and other professionals on tax planning and controversy issues and was experienced in resolving tax issues through rulings from the Internal Revenue Service's National Office. He contributed to the formation of tax policy through legislation and Treasury regulations. He served on the Internal Revenue Service Advisory Council in 2014 through 2016 and chaired its OPR Subgroup (working with the IRS Office of Professional Responsibility) in 2015 and 2016. In 2015 through 2018 he served as the Reporter for the Uniform Fiduciary Income and Principal Act, which was approved by the Uniform Law Commission in July 2018.

Ron is a Fellow and former President (2003-2004) of The American College of Trust and Estate Counsel, an academician of The International Academy of Estate and Trust Law and former member of its Council (2000-2004), a former Vice Chair (Committee Operations) of the American Bar Association's Section of Taxation (1998-2000), a Fellow of the American College of Tax Counsel and the American Bar Foundation, and a member of the Christian Legal Society. He is also a member of the Advisory Committee of the Philip E. Heckerling Institute on Estate Planning, the Advisory Board of the Florida Tax Institute, and the Bloomberg BNA Estates, Gifts and Trusts Advisory Board.

# Federal Tax Institute of New England 2019

October 24, 2019

## Agenda

8:00 a.m. – 9:00 a.m.

Registration

Prince Edward Grand Foyer

Breakfast

Bridal Foyer

9:00 a.m. – 9:05 a.m.

Introduction and Brief Background on Major Connecticut Law Changes

Waterford Room

9:05 a.m. – 10:05 a.m.

Opening Plenary Session

Waterford Room

**Current Developments and Planning Ideas We Find Fun and Interesting**

**Turney P. Berry**, Wyatt Tarrant & Combs LLP, Louisville, KY

**Charles A. Redd**, Stinson LLP, St. Louis, MO

Attorneys Berry and Redd will review the most interesting recent developments of general interest to estate planners, covering not only wealth transfer taxation but also various state cases and trends that make our planning easier and more challenging. They will take notice of Connecticut's adoption of the Uniform Trust Code and will discuss how the UTC can be used to implement modern estate planning efforts, including some specific pointers regarding changes made from the uniform act by the Connecticut legislature.

10:05 a.m. – 10:15 a.m.

Break

10:15 a.m. – 11:15 a.m.

Concurrent Session 1

**A. Basics of the New Connecticut Uniform Trust Code**

Waterford Room

**Mary M. Ackerly**, Ackerly Brown LLP, Bantam

**John R. Ivimey**, Reid and Riege PC, Hartford

**Edward F. Krzanowski**, Day Pitney LLP, West Hartford

**Kelley G. Peck**, Cummings & Lockwood LLC, West Hartford

**Deborah J. Tedford**, Tedford Law Firm PC, Mystic

**Suzanne Brown Walsh**, Murtha Cullina LLP, Hartford

**B. Tax Issues Affecting Start-up Ventures and Early-stage Companies**

Prince Edward Ballroom A

**Clifford R. Ennico**, Law Offices of Clifford R. Ennico, Fairfield

Representing a tech start-up or other early-stage business requires a special set of skills for practicing attorneys. Issues cannot always be “pigeonholed” into

specialized areas of practice, and counsel is often required to be a “utility infielder” with competence in a number of areas of law including taxation. In this fast-paced, entertaining presentation, business lawyer Cliff Ennico will cover some of the tax issues affecting Connecticut-based start-ups, including Section 199A (the 20 percent small business deduction), the rise of “economic nexus” in New York and other states, compensating “sweat equity” business owners in corporations and LLCs, overseas partners/investors in an LLC or other “pass through” entity, and tax treatment of stock in a failed startup.

**C. Everyday Bias, Everyday Solutions: Advancing Diversity, Equity, and Inclusion in Your World**

Prince Edward Ballroom B/C

**Karen DeMeola**, University of Connecticut School of Law, Hartford

**Cecil J. Thomas**, Vice President, Connecticut Bar Association; Greater Hartford Legal Aid, Hartford

Biases affect our daily interactions, often so seamlessly that we may not even recognize when they manifest. This session will give you the tools to advance diversity, equity, and inclusion in the world immediately around you: your professional dealings with clients and colleagues, your conversations, your workplace systems and policies. In an interactive presentation, you will consider the implications of systemic and personal bias, study some of its routine manifestations, and learn how to disrupt bias toward more equitable and inclusive outcomes.

11:15 a.m. – 11:25 a.m. Break

11:25 a.m. – 12:25 p.m. Concurrent Session 2

**A. Tax Considerations in Trust Terminations, Modifications, and Decanting under Connecticut’s New Uniform Trust Code**

Prince Edward Ballroom A

**Ronald D. Aucutt**, Bessemer Trust, Naples, FL

This presentation will discuss the federal tax issues to be aware of when terminating or modifying a trust under Connecticut’s new Uniform Trust Code, or decanting a trust under Connecticut’s Uniform Trust Code (or taking similar actions under similar statutes of other states). It will review some of the history of the IRS’s view of those issues reflected in regulations and rulings, including letter rulings in which the speaker was directly or indirectly involved. Against that background, the presentation will include predictions of where both formal IRS guidance and informal IRS reactions may go in the future.

**B. Qualified Small Business Stock**

Prince Edward Ballroom B/C

**Daniel L. Gottfried**, Day Pitney LLP, Hartford

**Michael P. Spiro**, Finn Dixon & Herling LLP, Stamford

This session will discuss the tax benefits available for qualified small business stock and will focus on the requirements, gain exclusion and rollover, and planning opportunities and traps for the unwary.

12:25 p.m. – 12:45 p.m. Break

12:45 p.m. – 1:35 p.m. Lunch and Award Session  
Waterford Room

1:35 p.m. – 2:35 p.m. Afternoon Plenary Session  
Waterford Room

**Recent Developments in Asset Protection**

**Gideon Rothschild**, Moses & Singer LLP, New York, NY

Asset protection trusts will arrive in Connecticut effective January 1, 2020. This presentation will review the legislation and planning with such trusts and other strategies for asset protection.

2:35 p.m. – 2:45 p.m. Break

2:45 p.m. – 3:45 p.m. Concurrent Session 3

**A. Connecticut Directed Trusts**

Waterford Room

**Christiana N. Gianopulos**, Day Pitney LLP, West Hartford

The Connecticut Uniform Trust Code includes the new Connecticut Uniform Directed Trust Act. This presentation will review the Directed Trust Act and the options and opportunities it presents. The presentation will also address planning and drafting considerations for practitioners advising clients on the use of Connecticut directed trusts.

**B. Real Estate Tax Planning**

Prince Edward Ballroom B/C

**Stephen A. Baxley**, Bessemer Trust, New York, NY

This presentation will cover topics in real estate tax planning, including itemized deductions, exclusion of gain on sale of principal residence, like-kind exchanges, rental property, passive activity losses, 199A – QBI deduction, qualified opportunity funds, and REITs.

**C. *Kaestner Trust* Decision: The Significance for State Income Taxation of Trusts**

Prince Edward Ballroom A

**Beth Brunalli**, Davidson Dawson & Clark LLP, New Canaan

On June 21, 2019, in an unanimous decision, the United States Supreme Court held that the taxation of undistributed income from a trust by North Carolina,

based solely on the basis of the beneficiaries' residence in the state, violated the Due Process Clause of the Fourteenth Amendment. The opinion, although narrow, is highly significant in being the Supreme Court's first attempt in many decades to address the increasingly important issue of state taxation of trust income. This program will provide an overview of the facts in *Kaestner Trust*, analyze the Supreme Court's decision, and discuss the implications of the decision for state income taxation of trusts.

3:45 p.m. – 3:55 p.m.

Break

3:55 p.m. – 4:55 p.m.

Closing Plenary Session

Waterford Room

**Drafting Trusts under the New Connecticut Uniform Trust Code**

**Mary M. Ackerly**, Ackerly Brown LLP, Bantam

**John R. Ivimey**, Reid and Riege PC, Hartford

**Kelley G. Peck**, Cummings & Lockwood LLC, West Hartford

**Deborah J. Tedford**, Tedford Law Firm PC, Mystic

**Suzanne Brown Walsh**, Murtha Cullina LLP, Hartford

4:55 p.m. – 5:00 p.m.

Raffle Drawing; Closing Remarks

Waterford Room

**Tax Considerations in Trust Terminations,  
Modifications, and Decanting Under Connecticut's  
New Uniform Trust Code**

**By**

**Ronald D. Aucutt, Lakewood Ranch, Florida  
Senior Fiduciary Counsel, Bessemer Trust**

**Prepared for**

**The Federal Tax Institute of New England  
Portland, Connecticut**

**October 24, 2019**



# **Tax Considerations in Trust Terminations, Modifications, and Decanting Under Connecticut’s New Uniform Trust Code**

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# Tax Considerations in Trust Terminations, Modifications, and Decanting Under Connecticut's New Uniform Trust Code

Ronald D. Aucutt, Lakewood Ranch, Florida  
Senior Fiduciary Counsel, Bessemer Trust

## I. Background: Modern Evolution in the Nature and Use of Trusts

### A. "A Quiet Revolution"

1. "A quiet revolution in American trust law is upon us." Thus began Professors Max M. Schanzenbach and Robert H. Sitkoff, in "The Prudent Investor Rule and Trust Asset Allocation: An Empirical Analysis," 35 ACTEC J. 314 (Spring 2010). The article expanded on a portion of Professor Sitkoff's Joseph Trachtman Memorial Lecture, "The Quiet Revolution in American Trust Law: An Empirical Assessment," presented to The American College of Trust and Estate Counsel on March 7, 2009.

2. The authors continued:

Some of the new trust law has been produced top-down by the American Law Institute and the Uniform Law Commission, through the Restatements and Uniform Acts. The top-down process is typified by academic reporters (drafters) and advisors working in concert with practitioner representatives from the American College of Trust and Estate Counsel and the Section on Real Property, Trusts, and Estates of the American Bar Association. In general, the top-down reforms are designed to update the law in view of the transformation of the irrevocable trust into a management device for financial assets, the increasingly common use of the revocable trust as a will substitute, and the rise of the statutory business trust.

Other major changes to the trust law canon have been bottom-up, driven by local lawyers and bankers in response to the increasingly national scope of the competition for trust business. These reforms are implemented through the lobbying efforts of state bar and bankers' associations, spurred on by a desire to attract or retain trust business. As a consequence, the bottom-up reforms tend to promote dead hand control, reflecting the commercial necessity of appealing to apparent donor preferences.

*Id.* at 314-15 (citations omitted).

### B. The Uniform Prudent Investor Act

1. The Uniform Prudent Investor Act was approved by the National Conference of Commissioners on Uniform State Laws ("NCCUSL," but more recently known simply as the "Uniform Law Commission") in 1994. It has been enacted in whole or in part (or with modifications) by almost all states (**including Connecticut in 1997**) and the District of Columbia. The Act undertakes to update trust investment law in recognition of the changes that have occurred in investment practices. The Act thus reflects the "modern portfolio theory" of investments and focuses on total return.

2. The Act makes at least five fundamental changes to the former criteria for prudent investing.
  - a. The standard of prudence is applied to any investment as part of the total portfolio, rather than to investments individually. In the trust setting, the term “portfolio” embraces all the trust assets. In other words, the trustee’s decisions are not looked at on an individual-investment-by-individual-investment basis but rather are evaluated in the context of the trust portfolio as a whole, and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.
  - b. The tradeoff in all investing between risk and return is identified as the fiduciary’s central consideration.
  - c. All categorical restrictions on types of investments are eliminated. The trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and meets the other requirements of prudent investing.
  - d. The familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing. The prudent investor standard requires a trustee to diversify investments, unless, because of special circumstances, the purposes of the trust are better served without diversifying.
  - e. The much-criticized former rule forbidding a trustee to delegate investment and management functions has been reversed. Delegation is now permitted, subject to strict statutory safeguards, which include establishing the scope and terms of the delegation consistently with the purposes and terms of the trust and periodically reviewing the agent’s actions in order to monitor the agent’s performance and compliance with the terms of the delegation.
3. The standard of care is that of a “prudent investor,” who considers the purposes, terms, distribution requirements, and other circumstances of the trust and exercises reasonable care, skill, and caution. Section 2 of the Act sets out a nonexclusive list of considerations a trustee must consider in developing an investment strategy and managing trust assets. These considerations include general economic conditions, effect of inflation or deflation, expected total return from income and the appreciation of capital, other resources of the beneficiaries, and the specific needs of the beneficiaries.
4. A trustee under the Act must consider factors that generally affect the marketplace as a whole in making investment decisions and also the individual characteristics of the trust assets and the trust beneficiaries.
5. The prudent investor standard is the default standard in the absence of contrary language in the governing instrument.

### **C. The Revised Uniform Principal and Income Act**

1. The Revised Uniform Principal and Income Act (“RUPIA”) was approved by the Uniform Law Commission in 1997 and amended in 2008. (Earlier versions had been approved in 1931 and 1962.) RUPIA has been enacted in whole or in part (or with modifications) by nearly all states (**including Connecticut in 1999**) and the

District of Columbia. One of the stated purposes of the 1997 Act was to ease the tension in satisfying both the income and remainder beneficiaries while complying with “modern portfolio theory” under the Uniform Prudent Investor Act.

2. The Act helps a trustee who has made a prudent, modern portfolio-based investment decision that has the initial effect of skewing return from all the assets under management, viewed as a portfolio, as between income and principal beneficiaries.
  3. Among other remedies, Section 104 of RUPIA (not included in the version approved by every state) gives that trustee the power to reallocate the portfolio return by adjusting between income and principal.
    - a. This power is meant to alleviate the situation in which the income beneficiaries or remainder beneficiaries would otherwise be adversely affected by the total return investment strategy. Specifically, the power to reallocate principal to income where certain requirements are met allows the trustee to invest trust assets for total return and discharge the duty of impartiality without investing in assets that produce traditional “income.”
    - b. The trustee typically has the power to adjust under Section 104 of the 1997 RUPIA only when the following three conditions are met:
      - The trustee invests and manages the trust assets as a prudent investor.
      - The terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust’s income.
      - The trustee determines that it cannot administer the trust impartially on the basis of what is fair and reasonable to all of the beneficiaries, unless the trust clearly manifests an intention that the fiduciary shall or may favor one or more beneficiaries.
- (1) The first condition will typically be met, even if the state has not enacted the Uniform Prudent Investor Act or similar legislation, if the prudent investor rule has been approved by the courts or the terms of the trust require it. Further, even if none of these factors can be pointed to, the Restatement establishes the prudent investor rule as an authoritative interpretation of the common law prudent man rule, referring to the prudent investor rule as a “modest reformulation of the Harvard College dictum and the basic rule of prior Restatements.” RESTATEMENT (3D) OF TRUSTS: PRUDENT INVESTOR RULE, Introduction at 5 (1992). *See Harvard College v. Amory*, 9 Pick. (26 Mass.) 446, 461 (1830) (the acknowledged source of the “prudent man” rule); RESTATEMENT (2D) OF TRUSTS §227 (1959). As a result, there is a basis for concluding that the first condition is satisfied in virtually all states except perhaps those states (if any) in which a trustee is permitted to invest only in assets set forth in a statutory “legal list.”
  - (2) The second condition will be met when the terms of the trust require all of the “income” to be distributed at regular intervals; or when the terms of the trust require a trustee to distribute all of the income, but permit the trustee to decide how much to distribute to each member of a class of beneficiaries;

or when the terms of a trust provide that a beneficiary shall receive the greater of the trust accounting income and a fixed dollar amount, or of trust accounting income and a fractional share of the value of the trust assets. If the trust instrument gives the trustee discretion to distribute the trust's income to the beneficiary or to accumulate some or all of the income, the condition will be met if the terms of the trust do not permit the trustee to distribute more than the trust accounting income.

- (3) The third condition will be met if the trustee determines that either it is impossible to administer the trust impartially or that it is impossible to achieve the degree of impartiality required, encouraged, or permitted under the trust agreement.

#### **D. The Uniform Fiduciary Income and Principal Act**

1. The Uniform Fiduciary Income and Principal Act (UFIPA) was approved by the Uniform Law Commission in July 2018. It supersedes RUIA. It has been enacted in 2019 in Utah.
2. UFIPA makes many changes to increase a fiduciary's flexibility, including the availability of the power to adjust. In Section 203 of UFIPA, the power to adjust is not limited to cases where all three of the conditions identified in the bullet points above are met. Instead, it is available "if the fiduciary determines the exercise of the power to adjust will assist the fiduciary to administer the trust or estate impartially." In that way, giving the trustee of a modern trust *more* discretion over distributions of both income and principal will not ironically cause the trustee to have *less* discretion to adjust between income and principal. Therefore, within the bounds of the power to adjust, the trustee will still be able to treat the beneficiaries impartially, while still respecting the simple tradition of "distributing income."
3. Before making an adjustment the trustee still must consider the factors that are relevant to the trust and its beneficiaries, including the following factors set forth in Section 201(e) of UFIPA, which is an updated restatement of RUIA Section 104(b):
  - a. The terms of the trust.
  - b. The nature, distribution standards, and expected duration of the trust.
  - c. The effect of the allocation rules, including specific adjustments between income and principal, under Articles 4 through 7 of UFIPA, which are generally updates of the default allocation rules generally carried over from Articles 2 through 5 of RUIA.
  - d. The desirability of liquidity and regularity of income.
  - e. The desirability of the preservation and appreciation of principal.
  - f. The extent to which an asset is used or may be used by a beneficiary.
  - g. The increase or decrease in the value of principal assets, reasonably determined by the fiduciary.

- h. Whether and to what extent the terms of the trust give the fiduciary power to accumulate income or invade principal or prohibit the fiduciary from accumulating income or invading principal.
  - i. The extent to which the fiduciary has accumulated income or invaded principal in preceding accounting periods.
  - j. The effect of current and reasonably expected economic conditions.
  - k. The reasonably expected tax consequences of the exercise of the power.
4. In addition, like Section 104(c)(7) and (8) of RUIA, Section 203(e)(7) of UFIPA generally prevents the adjustment power from being exercised by a trustee who is also a beneficiary or is otherwise not “independent.” If there are independent cotrustees, they alone should exercise the power. If there are no independent trustees, one should be appointed.
  5. Therefore, under both RUIA and UFIPA, one way to resolve the tension between income and remainder beneficiaries in a low-yield environment is to reallocate principal to income to increase the amount payable to the income beneficiaries each year. In a high-interest rate or high-inflation environment, the opposite might be true, and the trustee might reallocate income to principal to increase the growth of trust.
  6. The power to adjust between income and principal in this way can influence the determination of what is distributable to beneficiaries. Nevertheless, in 2003, the Treasury and IRS finalized Reg. §1.643(b)-1, which, in part, confirms that
 

an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation. For example, ... a state statute that permits the trustee to make adjustments between income and principal to fulfill the trustee’s duty of impartiality between the income and remainder beneficiaries is generally a reasonable apportionment of the total return of the trust. Generally, these adjustments are permitted by state statutes when the trustee invests and manages the trust assets under the state’s prudent investor standard, the trust describes the amount that may or must be distributed to a beneficiary by referring to the trust’s income, and the trustee after applying the state statutory rules regarding the allocation of receipts and disbursements to income and principal, is unable to administer the trust impartially. Allocations pursuant to methods prescribed by such state statutes for apportioning the total return of a trust between income and principal will be respected regardless of whether the trust provides that the income must be distributed to one or more beneficiaries or may be accumulated in whole or in part, and regardless of which alternate permitted method is actually used, provided the trust complies with all requirements of the state statute for switching methods. A switch between methods of determining trust income authorized by state statute will not constitute a recognition event for purposes of section 1001 and will not result in a taxable gift from the trust’s grantor or any of the trust’s beneficiaries.

## E. Conversion to a Total Return Unitrust

1. The word “unitrust” can be traced at least to the literature of the mid-1960s. Lovell, “The Unitrust: A New Concept to Meet an Old Problem,” 105 TRUSTS & ESTATES 215 (1966); Del Cotto & Joyce, “Taxation of the Trust Annuity: The Unitrust Under the Constitution and the Internal Revenue Code,” 23 TAX L. REV. 257 (1968).
  - a. An estate planner’s first reaction to the word is principally influenced, of course, by the use of the term “charitable remainder unitrust” by Congress in section 664, added to the Internal Revenue Code by the Tax Reform Act of 1969.
  - b. The word was reprised following the enactment of section 2702 in Reg. §25.2702-3(c), governing “qualified unitrust interests” in grantor retained unitrusts (“GRUTs”), although GRUTs are hardly ever used, if they are used at all).
  - c. While the precise origin or intent of the word is not totally clear, it appears derived from the notion that the trust consists of a *unified* fund—“a single fund [in which] there would be no distinction between income and principal,” only between “receipts” and “payouts.” Lovell, *supra*. The “unitrust” can be thought of as a trust in which there is a “unity” of interest between the current income beneficiaries and the remainder or successive beneficiaries, because both benefit from a higher value of the trust assets.
2. Thus, in today’s legal usage, a “unitrust” is simply a trust in which the periodic payout to the current income beneficiaries is determined with reference to a percentage of the net value of the trust assets, determined from time to time, regardless of how much income is produced by the trust assets or the growth of the trust assets. As the value of the trust assets increases, the unitrust amount increases. As the value decreases, the unitrust amount decreases.
3. The “unity” of interest between the current income beneficiaries and the remainder or successor beneficiaries will enable the trustee to invest the assets for long-term growth to the benefit of all beneficiaries. This will permit the mission of the trustee and investment team to become more focused. Investment decisions can be based on the needs and risk tolerances of the beneficiaries, and there is less likelihood of dissension between the current and future beneficiaries over investment policy.
4. In addition, to the extent that a unitrust approach makes discretionary invasions of principal unnecessary (or less necessary), the trustee is protected against challenges by the remainder beneficiaries that any discretionary principal distributions were excessive.
5. Similarly, a unitrust approach eliminates the need to make adjustments between income and principal under Section 203 of UFIPA and thus protects the trustee against challenges that such adjustments were improper.
6. Refinements of the unitrust approach can permit a total return unitrust to even better serve the objective of achieving more stability and predictability for the income beneficiaries.

- a. One such refinement is to provide that the trust distribute a percentage of its market value determined on the basis of a two (or more) year rolling average, rather than using the market value in a single year. Twelve quarters (three years) is a common example. This will reduce potential fluctuations in distributions caused by short-swing movements in the stock market. Although the rate of increase in the unitrust distribution to the income beneficiaries will lag the performance of the portfolio, the income beneficiaries will benefit in down years.
  - b. Another similar refinement designed to reduce risk to all the beneficiaries is to place a ceiling and/or a floor on the unitrust payout amount, or a limit on the upward or downward fluctuation of the unitrust amount from year to year.
7. When a multi-generation trust is converted to a unitrust, consideration might be given to whether it is appropriate at the same time to divide the trust among family lines, in order to allow individual family lines to invest as they see fit.
  8. Although RUPA does not provide for conversion of a trust to a unitrust, many states have enacted statutes expressly allowing for conversion, either as part of their Uniform Principal and Income Acts or as separate legislation.
  9. New Article 3 of UFIPA does provide for conversion of a trust to a unitrust. Unlike the statutes in effect in some states, however, it provides broad flexibility in the design of the unitrust provisions, except that in the case of certain tax-advantaged trusts, Section 309(b) of UFIPA limits that flexibility generally to the parameters enacted by those states. Those parameters in UFIPA, and as enacted in those states, mirror what amounts to a safe harbor, again in Reg. §1.643(b)-1 finalized in 2003, which states that

an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation. For example, a state statute providing that income is a unitrust amount of no less than 3% and no more than 5% of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis, is a reasonable apportionment of the total return of the trust.

#### **F. The Uniform Trust Code (with Connecticut Variations)**

1. The Uniform Trust Code (“UTC”) was approved by the Uniform Law Commission in 2000. It has been enacted in various forms in about two-thirds of the states **(including Connecticut in 2019, generally effective January 1, 2020)** and the District of Columbia. It is an ambitious and sometimes controversial blend of codification (distilled from Restatements) and law reform. It recognizes court supervision as the exception and not the norm.
2. Section 304 of the UTC (**section 19(b) of Connecticut’s UTC**) recognizes “virtual representation,” by which a minor, incapacitated, unborn, or unknown person may be represented and legally bound by someone with “a substantially identical interest with respect to the particular question or dispute” unless that would present a conflict of interest. **[Note: All references in this outline to “sections” of**



**Connecticut's Uniform Trust Code are sections of Public Act No. 19-137, as enacted. The act will be placed in Connecticut's general statutes, probably in Title 45a, with section numbering adapted to that context.]**

3. Section 111 of the UTC (**section 11 of Connecticut's UTC**) provides that "interested persons may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust ... to the extent it does not violate a material purpose of the trust."
  - a. The requirement that the action "not violate a material purpose of the trust" codifies the "Claflin Doctrine." *See Claflin v. Claflin*, 20 N.E. 454 (Mass. 1889).
  - b. Matters that may be resolved by a nonjudicial settlement agreement expressly include the interpretation or construction of the terms of the trust, direction to a trustee to refrain from performing a particular act, the grant to a trustee of any necessary or desirable power, and transfer of a trust's principal place of administration.
  - c. The scope of section 111 is generally regarded as rather narrow, limited to the resolution of interpretive and administrative disputes and not necessarily including the substantive modification of the terms of the trust. **Connecticut has added section 11(e) to its version, expressly clarifying that "[a] nonjudicial settlement agreement may not modify or terminate an irrevocable trust."**
4. Section 411 of the UTC (**section 31 of Connecticut's UTC**) is broader than Section 111 in some ways.
  - a. It applies "even if the modification or termination is inconsistent with a material purpose of the trust" and adds for good measure, in subsection (c) (but not in the version enacted by some other states), that "[a] spendthrift provision in the terms of the trust is not presumed to constitute a material purpose of the trust."
  - b. But it contemplates the involvement of the settlor of the trust and, since a 2004 amendment, makes court approval an option, which the comment to Section 411 states was done "on the recommendation of the Estate and Gift Taxation Committee of the American College of Trust and Estate Counsel (ACTEC)" to address a concern that otherwise it "could potentially result in the taxation for federal estate tax purposes of irrevocable trusts created in states which previously required that a court approve a settlor/beneficiary termination or modification." **Connecticut has chosen the court approval option.**
5. Perhaps most broadly of all, Section 412 of the UTC (**section 32 of Connecticut's UTC**) provides: "The court may modify the administrative or dispositive terms of a trust[, subject to sections 33 and 34,] or terminate [a noncharitable] trust if, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust." (**The text in square brackets is added in Connecticut's version.**)
6. Finally, Section 417 of the UTC (**section 38(a) of Connecticut's UTC**) provides that after notice to the beneficiaries "a trustee may combine two or more trusts into a single

trust or divide a trust into two or more separate trusts, if the result does not impair rights of any beneficiary or adversely affect achievement of the purposes of the trust.”

- a. **Connecticut’s version is limited to inter vivos trusts, but section 38(b) of Connecticut’s UTC permits the same actions for testamentary trusts, but with court approval, not notice to the beneficiaries.**
  - b. The comment to UTC Section 417 clarifies that “[t]his section allows a trustee to combine two or more trusts even though their terms are not identical.”
  - c. Historically, the merger of trusts has been a common way trustees have achieved what has come to be called “decanting.” See Part I.H beginning on page 11.
7. With all these relatively new ways to modify a trust, one might question whether and to what extent any trust can still be “irrevocable.” See the analysis, including suggestions for achieving an appropriate balance, in Redd, “Flexibility vs. Certainty – Has the Pendulum Swung Too Far,” TRUSTS & ESTATES (March 2015).
8. In this regard, the Foreword to the RESTATEMENT (3D) OF TRUSTS (2012) states:
- The principles restated in these volumes have two main themes. One is to make it easier to accomplish the settlor’s intentions, so long as those intentions can be reliably established and do not offend public policy. The second is to recognize appropriate authority, through doctrines that include cy pres, to enable the living – especially judges – to adapt the settlor’s expressed purposes to contemporary circumstances. This second purpose is increasingly important because of changes, complexities, and opportunities in tax law, other legal developments, improved life expectancies, and the creation of more trusts that survive long after the settlor expressed her or his intentions.
9. Section 808 of the UTC ratified the role of trust “advisers” and “protectors,” although without using those terms.
- a. As a model for “directed trust” legislation, it ratified the power conferred on a person to direct actions of the trustee and provided, in subsection (b), that “[i]f the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.” See Radigan, “Defining Responsibilities When Multiple Parties Administer Trusts,” 40 ESTATE PLANNING 12, 17-20 (Jan. 2013).
  - b. The comment to Section 808 explained that “[p]owers to direct are most effective when the trustee is not deterred from exercising the power by fear of possible liability. On the other hand, the trustee does have overall responsibility for seeing that the terms of the trust are honored. For this reason, subsection (b) imposes only minimal oversight responsibility on the trustee. A trustee must generally act in accordance with the direction. A trustee may refuse the direction only if the attempted exercise would be manifestly contrary to the

terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty owed by the holder of the power to the beneficiaries of the trust.”

- c. For thoughtful observations, including the answer to the question “once and for all, is the protector a fiduciary?”, see Bove, “The Case Against the Trust Protector,” 37 ACTEC J. 77 (2011); Bove, “The Trust Protector: Friend or Fiduciary?”, published in volume II of ASSET PROTECTION STRATEGIES – WEALTH PRESERVATION PLANNING WITH DOMESTIC AND OFFSHORE ENTITIES (Am. Bar Ass’n 2005, Alexander A. Bove, Jr., ed.), and Bove, “The Trust Protector: Trust(y) Watchdog or Expensive Exotic Pet,” 30 ESTATE PLANNING 390 (Aug. 2003). The author’s answer is yes, by the way.
- d. With the approval of the Uniform Directed Trust Act (discussed next) in 2017, the Uniform Law Commission in 2018 noted that Section 808 “was largely superseded,” removed it from the UTC, and thereafter has identified Section 808 as “reserved.” Section 9(b) of the Uniform Directed Trust Act (2017) changes the “manifestly contrary” standard to “willful misconduct.”

#### **G. The Uniform Directed Trust Act**

- 1. In 2017, the Uniform Law Commission approved the Uniform Directed Trust Act (“UDTA”). It has been enacted by about ten states. **Connecticut enacted it in 2019 as sections 81 through 98 of its Uniform Trust Code.**
- 2. Under UDTA, a power over a trust held by a nontrustee is called a “power of direction,” and the holder of that power is called a “trust director.” A trustee that is subject to a power of direction is called a “directed trustee.”
- 3. As the drafters stated in the Prefatory Note:

By validating terms of a trust that grant a trust director a power of direction, the Uniform Directed Trust Act promotes settlor autonomy in accordance with the principle of freedom of disposition. At the same time, the act imposes a mandatory minimum of fiduciary duty on both a directed trustee and a trust director in accordance with the traditional principle that a trust is a fiduciary relationship. *See, e.g.*, Restatement (Third) of Trusts §96 comment c (2012) (“[F]or reasons of policy trust fiduciary law imposes limitations on the types and degree of misconduct for which the trustee can be excused from liability.”).

- 4. The fiduciary duty and liability of a trust director are addressed in Section 8 of UDTA. Both the fiduciary duty and liability of the trust director (Section 8(a)(1)) and the ability of the terms of the trust to vary that duty and liability (Section 8(a)(2)) are the same as in the case of a trustee “in a like position and under similar circumstances.”
  - a. **Connecticut includes those provisions in section 87(a) of its Uniform Trust Code.**
  - b. But the law varies among states. Alaska Statutes §13.36.370(d), for example, provides:

Subject to the terms of the trust instrument, a trust protector is not liable or accountable as a trustee or fiduciary because of an act or omission of the trust protector taken when performing the function of a trust protector under the trust instrument.

5. Under Section 9 of UDTA (**and section 88 of Connecticut's UTC**), a directed trustee is required to take reasonable action to comply with a trust director's direction, except to the extent that such compliance would be willful misconduct, and may ask a court for instructions if in doubt.
6. For more on UDTA, see Morley & Sitkoff, "Making Directed Trusts Work: The Uniform Directed Trust Act," 44 ACTEC L.J. 3 (Winter 2019); Ditelberg, "Am I My Brother's Keeper: Willful Misconduct and the Directed Trustee under the Uniform Directed Trust Act," 44 ACTEC L.J. 207 (Spring 2019); Spica, "From Strength to Strength: A Comment on Morley and Sitkoff's *Making Directed Trusts Work*," *id.* at 215; Bieber & Chang, "Spinning Straw Into Gold—Modifying Irrevocable Trusts," 46 EST. PLAN. 3, 5-7 (Jan. 2019).

## H. Decanting

1. "Decanting" is generally the discretionary authority to distribute some or all the assets of one trust (a "Distributing Trust") to another (often new) trust (a "Receiving Trust") pursuant to a power of appointment, the governing instrument, or applicable state law, without the need for prior court approval or the prior consent of any beneficiary of the trust. *See generally* Bieber & Chang, *supra* at 9-11; Culp & Mellen, "Trust Decanting: An Overview and Introduction to Creative Planning Opportunities," 45 REAL PROP. TR. & EST. L. J. 1 (2010); Simmons, "Decanting and Its Alternatives, Remodeling and Revamping Irrevocable Trusts," 55 S.D.L. REV. 253 (2010); Skeary, "The Power of Trust Decanting," PROB. & PROP. 22 (Sept.-Oct. 2018); Willms, "Decanting Trusts: Irrevocable, Not Unchangeable," 6 EST. PLAN. & COMMUNITY PROPERTY L.J. 35 (2013).
  - a. Decanting is authorized by statute in about half of the states.
  - b. It is also viewed by many as permitted in many circumstances under the common law first applied (as far as we know) in *Phipps v. Palm Beach Trust Co.*, 142 Fla. 782, 196 So. 299 (1940). Citing RESTATEMENT OF TRUSTS §17, The *Phipps* court concluded that "the power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent."
  - c. To the same effect was *Wiedenmayer v. Johnson*, 106 N.J. Super. 161, 164-65, 254 A.2d 534 (App. Div.), *aff'd sub nom. Wiedenmayer v. Villanueva*, 55 N.J. 81, 259 A.2d 465 (1969), in which the court of appeals states: "If [trustees] could make [a] distribution to the end, as the trust indenture expressly stated, that the trust property would be the son's 'absolutely, outright and forever,' it seems logical to conclude that the trustees could, to safeguard the son's best interests, condition the distribution upon his setting up a substituted trust."
  - d. In contrast, *In re Estate of Spencer*, 232 N.W.2d 491 (Iowa 1975), held that a testamentary power of appointment authorized to be exercised by life estates

for children with the remainders to children's surviving issue could not be exercised in favor of a multi-generation trust that vested later than the children's deaths.

2. RESTATEMENT (2D) OF PROPERTY: DONATIVE TRANSFERS §11.1 comment d (1986) states that "the trustee holding a discretionary power has a power of appointment ...." RESTATEMENT (2D) OF PROPERTY: DONATIVE TRANSFERS §19.4 recognizes that a nongeneral power of appointment may be exercised by creating a general or nongeneral power. And RESTATEMENT (3D) OF PROPERTY: WILLS AND OTHER DONATIVE TRANSFERS §19.14 (2011) clarifies that "[e]xcept to the extent that the donor has manifested a contrary intention, the donee of a nongeneral power is authorized to make an appointment in any form, including one in trust and one that creates a power of appointment in another, that only benefits permissible appointees of the power." Finally, RESTATEMENT (3D) OF PROPERTY: WILLS AND OTHER DONATIVE TRANSFERS §19.14 comment f concludes that "[s]ubject to fiduciary standards and the terms of the power, a trustee or other fiduciary can exercise a fiduciary distributive power such as a power of invasion to create another trust."
3. In *Morse v. Kraft*, 992 N.E.2d 1021 (Mass. 2013), citing a cross-reference in RESTATEMENT (3D) OF PROPERTY: WILLS AND OTHER DONATIVE TRANSFERS §17.1 comment g, but not the clearer conclusion in §19.14 comment f *supra*, the Massachusetts Supreme Judicial Court held that a trust instrument that authorized distributions to a beneficiary or "for his or her benefit" authorized distributions to new trusts.
  - a. The court reasoned simply that the trust provisions in question

give the disinterested trustee discretion to distribute property directly to, or applied for the benefit of, the trust beneficiaries, limited only in that such distributions must be "for the benefit of" such beneficiaries. We regard this broad grant of almost unlimited discretion as evidence of the settlor's intent that the disinterested trustee have the authority to distribute assets in further trust for the beneficiaries' benefit.
  - b. The Boston Bar Association had submitted an amicus brief requesting the court to "extend the decanting power to purely discretionary trusts where the trustee has the power to distribute assets 'to' the beneficiary, but not 'for the benefit of' the beneficiary." Di Cola, "Joan Di Cola on *Morse v. Kraft* – Massachusetts Supreme Judicial Court Allows Decanting," LEIMBERG INFORMATION SERVICES ESTATE PLANNING NEWSLETTER #2125 (Aug. 2, 2013).
    - (1) The court expressly declined to adopt that position of recognizing "an inherent power of trustees of irrevocable trusts to exercise their distribution authority by distributing trust property in further trust, irrespective of the language of the trust."
    - (2) The court viewed the case as a matter of interpreting the trust instrument, and pointed several times in its opinion to the broad discretion of the trustee in making distributions and the specific authorization in the trust instrument that a payment to a beneficiary could be "applied for his or her benefit" and that distributions could be made "for the benefit of" the beneficiaries.

- (3) Many trust instruments merely authorize distributions “to” beneficiaries and do not explicitly include the phrase “for the benefit of” beneficiaries. The case leaves in greater question whether those trusts have a decanting authority without court approval.
- c. If the focus of the analysis is on the specific terms of the trust, there may be more need to obtain a judicial order that the trustee has the authority to make distributions in further trust without court approval in order to be assured that the decanting will not have adverse GST tax consequences, particularly if there is any possibility of shifting benefits to younger generation beneficiaries or any possibility of extending the trust term.
  - d. But for future drafting purposes, the court noted that trusts created in the future may need to authorize decanting specifically if that is intended:

In the absence of express authorizing legislation, practitioners are including express decanting provisions in standard trust agreements with increasing frequency.... The 2012 Trust [*i.e.*, the newly created trust under the decanting power], for example, twice states expressly that the trustee has decanting power. In light of the increased awareness, and indeed practice, of decanting, we expect that settlors in the future who wish to give trustees a decanting power will do so expressly. We will then consider whether the failure to expressly grant this power suggests an intent to preclude decanting.

- e. Other recent cases:

- (1) ***Ferri v. Powell-Ferri*, 72 N.E.3d 541 (Mass. 2017), ruling on issues in a Connecticut case certified from the Supreme Court of Connecticut and citing *Morse v. Kraft*, allowed a trustee to decant a trust in which the beneficiary had a power to withdraw trust corpus at certain ages into a new spendthrift trust in which the beneficiary had no such power.**
- (2) **The Connecticut Supreme Court followed the Massachusetts decision in *Powell-Ferri v. Ferri*, 326 Conn. 457 (2017).**
- (3) *Davidovich v. Hoppenstein*, 162 A.D.3d 512, 79 N.Y.S.3d 133 (N.Y. App. 2018), affirmed the Surrogate Court’s decision allowing a trustee to distribute a life insurance policy to a new trust that excluded one of the settlor’s children from the class of beneficiaries, even though the trustee had allegedly not followed all the requirements of New York’s decanting statute. The rulings confirmed in effect that the decanting statute supplemented, but did not override, the provisions of the trust agreement and the common law.
- (4) Meanwhile, in contrast, the courts in *Hodges v. Johnson*, 177 A.3d 86 (N.H. 2017), declined to allow a decanting that eliminated beneficiaries. The rather extreme facts of the case revealed that the two trustees of the trust resigned, the settlor’s estate planning attorney became the trustee and executed decanting documents, and then the attorney resigned and was replaced by the two original trustees. This happened three times over three years, each time eliminating one or two beneficiaries, apparently reflecting

discord outside the trust: the termination of a stepchild's employment by the family business, the disappointment of a son over the engagement of an outside manager, and finally the settlor's divorce. Each time, the new trusts resulting from the decanting were not funded because the decanting documents deferred that detail until the settlor's death. Although the trust terms clearly allowed unequal distributions, even to the exclusion of some beneficiaries, the courts believed that the trustees had violated their duty of impartiality by failing to consider the interests of all present and future beneficiaries.

4. In early GST tax rulings on decanting transactions, the IRS treated them like any other change to a trust.
  - a. Letter Ruling 9737024 (June 17, 1997) addressed a New York trust, called "Trust II," that had been irrevocable in 1976.

(1) The trustees had

the discretion to pay to the Beneficiary at any time, as much of the current income and principal as they may determine advisable for the "proper support, comfort and welfare of the Beneficiary (without regard to the income or other resources of the Beneficiary)" or the Beneficiary's dependents or to assist the Beneficiary (or the Beneficiary's dependents) in the event of illness, accident or emergency.

- (2) Under New York's decanting statute, N.Y. EST. POWERS & TRUSTS §10-6.6(b)(1), which had become effective in 1992, as quoted by the IRS (including the explanations in square brackets, which the IRS added in the ruling):

A trustee, who has the absolute discretion, under the terms of a[n] ... irrevocable inter vivos trust agreement, to invade the principal of a trust for the benefit of the income beneficiary ... of the trust, may exercise such discretion by appointing so much or all of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument with the consent of all persons interested in the trust but without prior court approval, provided, however, that (A) the exercise of such discretion does not reduce any fixed income interest of any income beneficiary of the trust (B) the exercise of such discretion is in favor of the beneficiaries of the trust, and (C) does not violate the limitations of [E.P.T.L. section] 11-1.7 [which prohibits waivers of liability].

- (3) Under the authority of that statute, the trustees proposed to transfer the assets of Trust II to another trust, which would be identical except for the provisions for trustee succession. The IRS ruled

The substantive and dispositive provisions of the new trust are identical to those of Trust II. Moreover, the new trust, like Trust II, will include Article THIRTEENTH, which provides that the trust will

be administered and regulated in accordance with the laws of New York State.

... [T]he proposed changes in [the trustee succession provisions] of the new trust will be administrative in nature and will not result in any change in the quality, value or timing of any beneficial interest in the trust.

Accordingly, because the substantive and dispositive provisions of Trust II are identical to the new trust, the proposed transfer of the corpus of Trust II to the new trust will not change the quality, value, or timing of any power, beneficial interest, right, or expectancy originally provided for under the terms of Trust II.

... Thus, the new trust will be subject to Chapter 13 to the same extent Trust II was subject to Chapter 13.

- b. Other favorable rulings involving the New York decanting statute include Letter Rulings 9332014 (May 13, 1993), 9450036 (Sept. 20, 1994), 9804046 (Oct. 28, 1997), 9848043 and 9849007 (Sept. 1, 1998), and 200227020 (April 1, 2002). Similar favorable rulings, with no state specified, include Letter Rulings 200520023 (Jan. 28, 2005) (court-approved transfer of three trusts into three similar “Receiving Trusts”), 200607015 (Nov. 4, 2005) (court-approved transfer of nine trusts into nine new trusts), 201133007 (May 17, 2011) (court-approved division of two trusts along family lines into three trusts each after a court-approved change of situs), and 201134017 (May 26, 2011) (distribution from a post-1985 trust to a similar “Receiving Trust” pursuant to specific authority in the trust instrument would not affect the trust’s zero inclusion ratio).
- c. Letter Ruling 200410015 (Oct. 10, 2003), addressing what it called a “restructuring” of 16 separate trusts in a state that apparently did not have a decanting statute or case (*i.e.*, a state other than New York, Alaska, Delaware, Florida, or New Jersey), stated in part (emphasis added):

[The trust instruments provide that] during the existence of the separate trusts, any part or even all of the then net income and/or corpus of the trust ... may, at any time or times, in the sole discretion of the independent trustee of the trust, *be distributed to or for the benefit of* [the beneficiary], or any one or more of [the then beneficiaries], of such separate trust and/or *to or for the benefit of* any one or more of those of the lineal descendants of the beneficiary or beneficiaries who are also lineal descendants of the grantors and who are then living even though not now living, including those whose parent or parents are then living.

...

The current trustees propose to consolidate [certain] trusts .... [Other trusts] will [be] merged and then divided, generally on a per stirpes basis, into four new trusts .... The ... consolidations and the ... division will be achieved *by the independent trustee’s exercise of his distribution discretion* over the sixteen current trusts to appoint their assets to six new trusts, each governed by a new trust agreement.

...



On Date 10, the trustees filed a Petition for Instructions with Probate Court in State 2. Probate Court is the court having jurisdiction over all the trusts that are the subject of this private letter ruling. The Petition for Instructions sought *confirmation* of the independent trustee's authority to exercise his discretionary power of distribution *in favor of further trusts*. On Date 11, Probate Court issued sixteen separate orders (one for each trust) contingent upon a private letter ruling from the Internal Revenue Service regarding the estate and generation-skipping transfer tax consequences of the exercise. The orders stated that the trust instruments grant the independent trustee a discretionary power of distribution that *may be exercised in favor of one or more new trusts created by him* for the benefit of all or any one of the permissible distributees under the original trusts, equally or unequally. The orders further provided that the power could be exercised by the independent trustee without either beneficiary consent or court approval if the new trusts do not benefit anyone who was not a current or future permissible distributee under the relevant original trust and the terms of the new trust do not extend the duration of the trusts beyond the perpetuities period of the relevant original trust.

...

The present transaction is similar to that in Example 1 of [Reg.] §26.2601-1(b)(4)(i)(E). With respect to the original trusts, the independent trustee has the discretion to make the proposed distributions in the respective trust agreements. Furthermore, the terms of the new trust agreements will not extend the time for vesting that was provided for in the original trusts because the individuals used as measuring lives for the new trusts were included as measuring lives under the original trust. Therefore, the new trusts will terminate at the same time the original trusts were to terminate. Accordingly, the terms in the new trust agreements do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property in contradiction to §26.2601-1(b)(4)(A)(2) [*sic*, 1(b)(4)(i)(A)(2)] or §26.2601-1(b)(1)(v)(B). *We therefore conclude that the proposed transaction will not change the status of the trusts as exempt from the generation-skipping transfer tax.*

- d. Letter Ruling 200406041 (Oct. 10, 2003), favorably addressing what was apparently the same or related “restructuring” transactions as in Letter Ruling 200410015, added that “[t]he current independent trustee proposes to distribute the assets of Trust 2 and Trust 3 to two new trusts, Trust 2A and Trust 3A, respectively.”
5. Then, in January 2011, sections 5.09, 5.16, and 5.17 of Rev. Proc. 2011-3, 2011-1 I.R.B. 111, included decanting among the “areas under study in which rulings ... will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations, or otherwise.” This designation was continued in subsequent “-3” Revenue Procedures. *See, e.g.*, sections 5.01(7), (12), and (13) of Rev. Proc. 2019-3, 2019-1 I.R.B. 130.
6. The 2011-2012 Treasury-IRS Priority Guidance Plan, released on September 2, 2011, included, as item 13, “Notice on decanting of trusts under §§2501 and 2601.”

7. On December 20, 2011, the IRS published Notice 2011-101, 2011-52 I.R.B. 932, asking for comments from the public by April 25, 2012, on the tax consequences of decanting transactions. Notice 2011-101 asked for comments on the relevance and effect of the following 13 facts and circumstances (as well as the identification of any other factors that might affect the tax consequences):
  - a. A beneficiary's right to or interest in trust principal or income is changed (including the right or interest of a charitable beneficiary).
  - b. Trust principal and/or income may be used to benefit new (additional) beneficiaries.
  - c. A beneficial interest (including any power to appoint income or corpus, whether general or limited, or other power) is added, deleted, or changed.
  - d. The transfer takes place from a trust treated as partially or wholly owned by a person under sections 671 through 678 of the Internal Revenue Code (a "grantor trust") to one which is not a grantor trust, or vice versa.
  - e. The situs or governing law of the Receiving Trust differs from that of the Distributing Trust, resulting in a termination date of the Receiving Trust that is subsequent to the termination date of the Distributing Trust.
  - f. A court order and/or approval of the state Attorney General is required for the transfer by the terms of the Distributing Trust and/or applicable law.
  - g. The beneficiaries are required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law.
  - h. The beneficiaries are not required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law.
  - i. Consent of the beneficiaries and/or a court order (or approval of the state Attorney General) is not required but is obtained.
  - j. The effect of state law or the silence of state law on any of the above scenarios.
  - k. A change in the identity of a donor or transferor for gift and/or GST tax purposes.
  - l. The Distributing Trust is exempt from GST tax under Reg. §26.2601-1, has an inclusion ratio of zero under section 2632, or is exempt from GST tax under section 2663.
  - m. None of the changes described above are made, but a future power to make any such changes is created.
8. Notice 2011-101 also "encourage[d] the public to suggest a definition for the type of transfer ('decanting') this guidance is intended to address" and encouraged responses to consider the contexts of domestic trusts, the domestication of foreign trusts, and transfers to foreign trusts.
9. Finally, the Notice added that the IRS "generally will continue to issue PLRs with respect to such transfers that do not result in a change to any beneficial interests and do not result in a change in the applicable rule against perpetuities period."

10. That was it!

- a. The Plan predicted a “Notice on decanting,” and the IRS published Notice 2011-101.
- b. Decanting was omitted from the 2012-2013 Plan and has been omitted again from subsequent Plans.
- c. There were extensive public comments in response to the Notice, however, and there is little doubt that the Treasury and IRS will continue to study the issues raised by decanting.

11. Meanwhile, a new Uniform Trust Decanting Act (UTDA) was approved by the Uniform Law Commission in July 2015. It has been enacted in about eight states (**not including Connecticut**). It generally allows decanting whenever the trustee has discretion to make principal distributions, or even if the trustee does not have such discretion if it is appropriate to decant into a special-needs trust.

- a. Generally, under UTDA decanting may not add beneficiaries. Moreover, Section 19 of UTDA includes extensive explicit safeguards, called “tax-related limitations,” to prevent decanting from jeopardizing any intended beneficial tax characteristics of the trust. The beneficial tax characteristics explicitly addressed are the marital deduction, the charitable deduction, the annual gift tax exclusion, the eligibility of the trust to hold S corporation stock, an inclusion ratio of zero for GST tax purposes, preservation of the use of the trust beneficiary’s life expectancy in determining minimum required distributions from a retirement plan or IRA, and the preservation, creation, or termination of grantor trust status as the circumstances might warrant.
- b. UTDA in effect now provides the “definition” Notice 2011-101 asked for, and its publication should now pave the way for the long-awaited tax guidance for decantings done under UTDA or substantially identical statutes. And because of the care to avoid tax problems that UTDA exhibits, that guidance should not be as hard to complete or as harsh in its application as many might have feared.

## **I. The Influence of Tax Law**

- 1. “Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.” Reg. §301.7701-4(a).
  - a. Respect for the essential nature of a trust for income tax purposes has been viewed as requiring that the beneficiaries’ interests be non-transferable and that “the beneficiaries [do] not, qua beneficiaries, control trust affairs.” *Bedell Trust v. Commissioner*, 86 T.C. 1207, 1220 (1986).
  - b. If, for tax purposes, a domestic trust with more than one beneficiary is not treated as a trust, it is likely to be treated as a partnership (Reg. §301.7701-3(b)(1)(i)), creating, among other things, some unpleasant income tax surprises.

- c. This highlights the importance that the trust be administered *by* the trustee *for* the beneficiaries, and that the beneficiaries' rights are to monitor and enforce the discharge of the trustee's duties, not take over.
2. In addition, as seen in the IRS letter rulings discussed in Part H.4, Notice 2011-101 discussed in Part H.7, and Section 19 of the Uniform Trust Decanting Act discussed in Part H.11, it is widely recognized that changes to a trust could jeopardize other helpful tax characteristics of that trust unless care is taken to observe appropriate boundaries.

## II. Importance of the Ability to Change a Trust

### A. Introduction

1. Recall the Foreword to the RESTATEMENT (3D) OF TRUSTS (2012), which states (emphasis added):

The principles restated in these volumes have two main themes. One is to make it easier to accomplish the settlor's intentions, so long as those intentions can be reliably established and do not offend public policy. The second is to recognize appropriate authority, through doctrines that include cy pres, **to enable the living – especially judges – to adapt the settlor's expressed purposes to contemporary circumstances. This second purpose is increasingly important because of changes, complexities, and opportunities in tax law, other legal developments, improved life expectancies, and the creation of more trusts that survive long after the settlor expressed her or his intentions.**

2. History leaves no doubt about the importance of flexibility in designing and administering a trust. Trusts must change because times change, values (personal and property) change, circumstances change, families change, and families grow.

### B. Repeal or Relaxation of the Rule Against Perpetuities

1. Nothing highlights both the growth of families and the need of trusts to change more than the demands of perpetual trusts in jurisdictions that have repealed or relaxed their Rule Against Perpetuities, fueled by increases in the GST exemption.
2. **In connection with its enactment of the Uniform Trust Code, Connecticut amended its statutory rule against perpetuities by extending the fixed period available as an alternative to a lives-in-being test from 90 years to 800 years, unless the terms of the trust expressly require that all beneficial interests in the trust vest or terminate within a lesser period, applicable to trusts created on or after January 1, 2020.**
3. Consider the record-keeping that might be required.
  - a. A “pot” trust, after a century or two, will resemble a publicly owned corporation!
  - b. Individual trusts for each family line, which in turn divide each generation, are appealing, but they may sacrifice flexibility.
  - c. In addition, consider the challenge of determining the disposition of a separate trust if its family line dies out – that is, if the beneficiaries of the trust die without

issue surviving. Where does the trust go? To the descendants of some common ancestor? How far back? Back to the original settlor, if necessary? Back to the original settlor in every case? How is “per stirpes” defined in such a case – *i.e.*, at which generation is the trust divided per capita? Even if the trust instrument or the governing law is clear, who will keep the records?

4. How should standards for the exercise of discretion be written?
5. How will developments in reproductive technology affect the determination and treatment of beneficiaries?
  - a. Is there any doubt that biology will be one of the cutting edges of technology in this century? *See* Stone, “The New Genesis in Estate Planning,” 47TH ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING ch. 8 (2013). *See also* Archer, “Scrambled Eggs: Defining Parenthood and Inheritance Rights of Children Born of Reproductive Technology,” 3 LOYOLA JOURNAL OF PUBLIC INTERNATIONAL LAW 152 (Spring 2002); Campisi, Lowder & Challa, “Heirs in the Freezer: Bronze Age Biology Confronts Biotechnology,” 36 ACTEC L.J. 179 (Summer 2010); Gibson & Michaels, “Determining Heirship In the World of Modern Reproduction,” 40 ESTATE PLANNING 29 (Jan. 2013); Goffe, “Postmortem Conception Quandary: When Must an Heir Be Here?,” 40 ESTATE PLANNING 17 (July 2013); Klein, “The Issue With Issue: Rights of Posthumously Conceived Children,” 41 ESTATE PLANNING 14 (Nov. 2014); McCrimmon, “Gametes, Embryos and the Life in Being: The Impact of Reproductive Technology on the Rule Against Perpetuities,” 34 REAL PROP., PROB. & TRUST J. 697 (Winter 2000); Riedel, “The Impact of Modern Reproductive Technology on the Law of Probate: ‘Frozen Pops’ and Inheritance,” the ACTEC Mary Moers Wenig Writing Competition 2004 3<sup>rd</sup> Place Winner; Shayne & Quigley, “Defining ‘Descendants’: Science Outpaces Traditional Heirship,” 38 ESTATE PLANNING 14 (April 2011).
  - b. In *Astrue v. Capato*, 566 U.S. 541, 132 S. Ct. 2021, No. 11-159 (May 21, 2012), the Supreme Court held that twins posthumously conceived through in vitro fertilization were not “children” for purposes of “child’s insurance benefits” under the Social Security Act. The Court deferred to a Social Security Administration rule that in turn deferred to state intestacy law, and the law of Florida, which applied in that case, treated posthumous children as children only if they were conceived before death. But the Court also appeared to be influenced by the fact that the purpose of the “child’s insurance benefits” was to “provide ... dependent members of [a wage earner’s] family with protection against the hardship occasioned by [the] loss of [the insured’s] earnings.” (citing *Califano v. Jobst*, 434 U.S. 47, 52 (1977)), a purpose not served in a case where the death of the twins’ father before they were even conceived was arguably not a “loss” to the twins.
  - c. But *Capato* and similar rulings should not necessarily govern the administration of trusts or even decedent’s estates, and it is increasingly important that governing documents address such issues themselves or provide the necessary flexibility to permit trustees to do so.

6. Different issues are presented by the evolving diverse understanding of the term “marriage.” *United States v. Windsor*, 570 U.S. 12, 133 S. Ct. 2675 (No. 12-307, June 26, 2013); *Obergefell v. Hodges*, 576 U.S. \_\_\_, 135 S. Ct. 2584 (No. 14-556, June 26, 2015), recognizing the rights of same-sex couples to marry. *See* T.D. 9785 (Sept. 8, 2016), implementing *Obergefell*.
  - a. In addition to the estate tax marital deduction (section 2056 of the Internal Revenue Code), which was the issue in *Windsor*, other notable tax benefits of marriage include gift-splitting (sections 2513(a) and 2652(a)(2)), portability of the estate and gift tax unified credit (section 2010(c)), reverse-QTIP elections (section 2652(a)(3)), *per se* same generation assignment for GST tax purposes (section 2651(c)), the availability of disclaimers even if the property passes for the disclaimant’s benefit (section 2518(b)(4)(A)), non-recognition of gain on transfers between spouses (section 1041(a)), expanded eligibility to exclude gain from the sale of a principal residence (section 121), and treatment as one shareholder of an S corporation (section 1361(c)(1)).
  - b. On the other hand, *not* being married can avoid, where it is unwelcome, “family” treatment for such purposes as the special valuation rules of chapter 14 (sections 2701(e)(1) and 2704(c)(2)), disallowance of losses (section 267(c)(4)), attribution of stock ownership (section 318(a)(1)), exceptions to stepped-up basis (section 1014(e)(1)(B)), and identification of disqualified persons with respect to private foundations (section 4946(d)), as well as the “marriage penalty” of being unable to file income tax returns as single taxpayers when both have significant income.
  - c. Other tax attributes that attach to marriage can be good or bad, depending on the circumstances. This includes the filing of a joint income tax return itself (section 6013), which can be a benefit when one spouse has all or most of the income, but can produce a “marriage penalty” when both have significant income, and married persons in such cases cannot elect the more advantageous filing as single taxpayers. Similarly, married status can make it easier to qualify a trust as a grantor trust (sections 672(e) and 677(a)(1)), whether that is desirable or undesirable.
  - d. Meanwhile, relying on the law might not be enough and this will often be another issue to address in drafting.
    - (1) Some settlors and testators may want to be *more* inclusive than the law requires, allowing their descendants’ unmarried companions (of either sex) to be successive beneficiaries or permissible appointees. That has always been possible and should create no problem or controversy.
    - (2) Others may choose to be *less* inclusive than the law would require in the absence of their direction. For example, some might wish to exclude their descendants’ same-sex companions, even if they are married. Besides being contentious, that could raise justiciable public policy concerns, and it might not be clear for a long time how the balance should be struck between public policy and testamentary freedom. *See, e.g., In re Estate of Feinberg*, 919 N.E.2d 888 (Ill. 2009) (overruling a lower court and honoring a direction in

the exercise of a power of appointment to treat as predeceased any descendant who had married “outside the Jewish faith”), discussed in Horton, “Testation and Speech,” 101 GEORGETOWN L. REV. 61 (2012). The Supreme Court of Illinois acknowledged a “tension between the competing values of freedom of testation on one hand and resistance to ‘dead hand’ control on the other,” but reasoned (somewhat inscrutably) that “there is no ‘dead hand’ control or attempt to control the future conduct of the potential beneficiaries” because the holder of the power of appointment “did not impose a condition intended to control future decisions of their grandchildren regarding marriage or the practice of Judaism; rather, she made a bequest to reward, at the time of her death, those grandchildren whose lives most closely embraced the values she and [her husband] cherished.”

### C. Other Changes in the Family

1. **Dispersion.** As a family trust lasts longer, families can be scattered widely. Maintaining unity and identity, especially through in-person meetings, is hard.
2. **Demographics.** Similarly, over time conventional definitions of generations can break down. Family members who are approximately the same age can actually be in different generations. And family members nominally in the same generation can be of widely different ages.
3. **Diversity.** While diversity is good and can enrich a family and should be celebrated, it is unfortunately true that it can sometimes cause strain. Moreover, diversity in views of wealth and diversity in appreciation of the family values that are even more important than wealth can threaten the foundation on which some trusts are built.
4. **Dissent.** Other differences – even as predictable as having Republicans and Democrats in the same family! – can be troublesome, at least without strict and likely unworkable rules about conversation.

## III. Importance of Keeping Beneficiaries Informed

### A. The Role in Preserving the Fiduciary Relationship

1. The importance, for tax purposes, of maintaining at least minimal fundamental characteristics of the trust relationship is seen, for example, in *Bedell Trust v. Commissioner*, 86 T.C. 1207, 1220 (1986). See Part I.I.1 on page 18.
2. Regarding the ability of the courts to enforce a trustee’s fiduciary duties, Judge Learned Hand summed it up this way:

[N]o language, however strong, will entirely remove any power held in trust from the reach of a court of equity. After allowance has been made for every possible factor which could rationally enter into the trustee’s decision, if it appears that he has utterly disregarded the interests of the beneficiary, the court will intervene. Indeed, were that not true, *the power would not be held in trust at all*; the language would be no more than a precatory admonition.

*Stix v. Commissioner*, 152 F.2d 562, 563 (2d Cir. 1945) (emphasis added).

3. It is difficult to view a trust as administered *by* the trustee *for* the beneficiaries if the beneficiaries do not have enough information to permit them to enforce the trustee's fiduciary duties. A beneficiary cannot challenge a trustee's action the beneficiary does not know about.
4. It is therefore axiomatic – although apparently still controversial – that a beneficiary is entitled to receive regular information from the trustee, to receive additional information on request, and to be notified, promptly or even in advance, of extraordinary events such as amendments, decanting, and the like.

## **B. Recent Treatment of the Beneficiaries' Right To Be Informed**

1. **Section 63(a) through (c) of Connecticut's UTC (closely following Section 813(a) through (c) of the UTC) confirms the following duties of a trustee to keep the trust beneficiaries informed:**

(a) A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for the beneficiaries to protect their interests. A trustee shall promptly respond to a beneficiary's request for information reasonably related to the administration of the trust.

(b) A trustee: (1) Upon request of a beneficiary, shall promptly furnish to the beneficiary a copy of the relevant portions of the trust instrument; (2) within sixty days after accepting a trusteeship, shall notify the qualified beneficiaries of the acceptance and of the trustee's name, address and telephone number; and (3) within sixty days after the date on which the trustee acquires knowledge of the creation of an irrevocable trust, or the date on which the trustee acquires knowledge that a formerly revocable trust has become irrevocable, whether by the death of the settlor or otherwise, shall notify the qualified beneficiaries of the trust's existence, of the identity of the settlor or settlors, of the right to request a copy of the trust instrument, and of the right to a trustee's report as provided in subsection (c) of this section.

(c) A trustee shall send a report to the current beneficiaries, and to other qualified beneficiaries who request it, at least annually and at the termination of the trust. Upon a vacancy in a trusteeship, unless a cotrustee remains in office, the former trustee shall send a report to the current beneficiaries and to other qualified beneficiaries who request it. An executor, administrator or conservator may send the report on behalf of a deceased or incapacitated trustee. The report may be formal or informal, but shall include information relating to the trust property, liabilities, receipts and disbursements, including the amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values.

2. Section 105(b) of the UTC (**section 5(b) of Connecticut's UTC**) provides that the terms of a trust prevail over any provision of the UTC, with certain enumerated exceptions. Among the enumerated exceptions are the duty under Section 813(b)(2) and (3) to notify qualified beneficiaries who have attained 25 years of age of the existence of the trust, the identity of the trustee, and their right to request a trustee's reports, and the duty under Section 813(a) to respond to a request for a trustee's reports and other information reasonably related to the administration of the trust. But the Uniform Law Commission drafting committee placed those two



exceptions in brackets out of what it described as “a recognition that there is a lack of consensus on the extent to which a settlor ought to be able to waive reporting to beneficiaries, and that there is little chance that the states will enact [these two exceptions] with any uniformity.”

- a. The Uniform Law Commission drafting committee was certainly correct in that regard. The versions enacted in the respective states vary greatly.
  - b. **Connecticut’s section 5(b)(7) and (8) retain the exception – that is, preserve the mandatory requirement – for the communication duties in section 63, applicable to beneficiaries who have attained the age of 25 years in the case of the duties to notify under section 63(b)(2) and (3).**
3. The Uniform Law Commission drafting committee went on to quote Joe Kartiganer’s and Ray Young’s summary of the policy debate in Kartiganer & Young, “The UTC: Help for Beneficiaries and Their Attorneys,” *PROB. & PROP.*, March-April 2003, at 18, 19-20:

The beneficiaries’ rights to information and reports are among the most important provisions in the UTC. They also are among the provisions that have attracted the most attention. The UTC provisions reflect a compromise position between opposing viewpoints.

Objections raised to beneficiaries’ rights to information include the wishes of some settlors who believe that knowledge of trust benefits would not be good for younger beneficiaries, encouraging them to take up a life of ease rather than work and be productive citizens. Sometimes trustees themselves desire secrecy and freedom from interference by beneficiaries.

The policy arguments on the other side are: that the essence of the trust relationship is accounting to the beneficiaries; that it is wise administration to account and inform beneficiaries, to avoid the greater danger of the beneficiary learning of a breach or possible breach long after the event; and that there are practical difficulties with secrecy (for example, the trustee must tell a child that he or she is not eligible for financial aid at college because the trust will pay, and must determine whether to accumulate income at high income tax rates or pay it out for inclusion in the beneficiary’s own return). Furthermore, there is the practical advantage of a one-year statute of limitations when the beneficiary is informed of the trust transactions and advised of the bar if no claim is made within the year. UTC §1005. In the absence of notice, the trustee is exposed to liability until five years after the trustee ceases to serve, the interests of beneficiaries end, or the trust terminates. UTC §1005(c).

4. *See also* Fitzsimons, “Navigating the Trustee’s Duty to Disclose,” *PROB. & PROP.*, Jan./Feb. 2009, at 40; Foster, “Privacy and the Elusive Quest for Uniformity in the Law of Trusts,” 38 *ARIZ. ST. L.J.* 713 (2006); Gallanis, “The Trustee’s Duty to Inform,” 85 *N.C.L. REV.* 1595 (2007); Millard, “The Trustee’s Duty to Inform and Report Under the Uniform Trust Code,” 40 *REAL PROP. PROB. & TR. J.* 373 (2005); Ruce, “The Trustee and the Remainderman: The Trustee’s Duty to Inform,” 46 *REAL PROP. TR. & EST. L. J.* 173 (2011).
5. In 2005, the North Carolina General Assembly enacted the Uniform Trust Code with the exceptions discussed above, thus permitting a settlor to override the default

requirements to give notice to qualified beneficiaries and respond to requests from qualified beneficiaries for information. In *Wilson v. Wilson*, 690 S.E.2d 710 (N.C. App. 2010), the Court of Appeals (the single intermediate appellate court in North Carolina) considered two irrevocable trusts created in 1992, in which the settlor had purported to relieve the trustee of any duty to give accounts or reports to any court or beneficiary. Quoting RESTATEMENT (2D) OF TRUSTS §173 comment c (1959), the court noted that “the beneficiary is always entitled to such information as is reasonably necessary to enable him to enforce his rights under the trust or to prevent or redress a breach of trust.” 690 S.E.2d at 715. The court concluded that the statute “does not override the duty of the trustee to act in good faith, nor can it obstruct the power of the court to take such action as may be necessary in the interests of justice.” The court added:

If a fiduciary can be rendered free from the duty of informing the beneficiary concerning matters of which he is entitled to know, and if he can also be made immune from liability resulting from his breach of the trust, equity has been rendered impotent. The present instance would be a humiliating example of the helplessness into which courts could be cast if a provision, placed in a trust instrument through a settlor’s mistaken confidence in a trustee, could relieve the latter of a duty to account. Such a provision would be virtually a license to the trustee to convert the fund to his own use and thereby terminate the trust.

690 S.E.2d at 716, quoting *Wood v. Honeyman*, 178 Or. 484, 169 P.2d 131, 164 (1946). The court got it right.

6. See *Fletcher v. Fletcher*, 480 S.E.2d 488 (Va. 1997) (a trustee has an affirmative duty to disclose the terms of the trust to a beneficiary).
7. The interest in “quiet trusts” is not hard to understand.
  - a. Clients for whom secrecy is a goal typically hold to that goal quite fiercely. If the trust is large, it is understandable that settlors would not want to encourage beneficiaries to become dependent, lazy, entitled, and unproductive.
  - b. But is it really credible that the children or other beneficiaries will not see wealth and guess there is a trust?
  - c. And if the trust is too large to tell the beneficiaries about, when will they be told about it? Ever? And what will they think when they learn about the trust? What message from their parents, or other settlor, will that send?
8. In contrast, involving children early, but in an age-appropriate manner (**the UTC and Connecticut’s section 5(b)(7) use age 25**), can contribute to a dialogue about the trust and about wealth that will foster family unity and the transmission of family values.
  - a. If the trust is viewed as just too large for the beneficiaries to handle, maybe it is.
  - b. Maybe in that case some part of the trust should be devoted to charity instead. And a charitable arrangement that permits the children themselves to be involved, such as a donor-advised fund, will serve the additional purpose of modeling and encouraging stewardship and philanthropy.

#### **IV. Connecticut's New Uniform Trust Code: Tax Implications**

##### **A. Preserving the Fiduciary Relationship**

1. Connecticut's Uniform Trust Code is generally helpful with respect to preserving the fiduciary relationship that is fundamental to the nature of a trust and the predictable tax treatment of a trust, as discussed in Parts I.I.1 and III.A. For example:
  - a. Section 87(a)(1) and (2) confirm that a trust director is a fiduciary subject to fiduciary duty to the beneficiaries. See Part I.G.4.
  - b. Sections 63 and 5(b)(7) and (8) generally prevent the use of controversial and possibly risky "quiet trusts" by affirming the trustee's duty of keeping beneficiaries reasonably informed. See Part III.
2. But section 21 appears to embrace the use of a "designated representative" to avoid giving the required information to the beneficiaries to whom the trustee owes the fiduciary duty. That also seems risky.

##### **B. Achieving a Balance in Trust Modifications**

1. At the same time, Connecticut's Uniform Trust Code does allow trusts to be changed to keep up with modern developments and changed circumstances, including, in section 38 (see Part I.F.6), through merger of trusts that may have different terms, so long as "the result does not impair rights of a beneficiary or adversely affect achievement of the purposes of the trust" (and only with court approval in the case of a testamentary trust).
2. Aside from mergers, changes to a trust are generally limited to nonjudicial settlement agreements that do not "modify or terminate an irrevocable trust" (section 11), modifications that are approved by the court (section 31 and 32), and, where the settlor is not available to consent, modifications made necessary by "circumstances not anticipated by the settlor." See Part I.F.3, 4, and 5.
3. Connecticut's UTC provides flexibility, but does not reflect an "anything goes" attitude.

##### **C. Showing Tax-Sensitivity**

The Uniform Trust Code, including Connecticut's version, does not include such detailed precautions against jeopardizing a tax benefit as, for example, Section 19 of the Uniform Trust Decanting Act (UTDA), discussed in Part I.H.11 and quoted in Part V.B. But, like UTDA, the UTC, including Connecticut's UTC, shows sensitivity to tax issues and demonstrate that being proactive about avoiding tax problems is nothing to be ashamed of. For example:

1. Sections 3(2) (UTC Section 103(2)), 40(a), and 64(b)(1) (in an addition to the UTC) incorporate the meaning of an "ascertainable standard" used in sections 2041(b)(1)(A) and 2514(c)(1) of the Internal Revenue Code.
2. Section 37 (UTC Section 416) allows a court to modify the terms of a trust "[t]o achieve the settlor's tax objectives." (The comment to Section 416 warns:

**“Whether a modification made by the court under this section will be recognized under federal tax law is a matter of federal law.”)**

3. Section 64(d)(1) (UTC Section 814(d)(1)) incorporates the meaning of the marital deduction in sections 2056(b)(5) and 2523(e).
4. Section 84(b)(5) (UDTA Section 5(b)(5)) excludes from the scope of the Connecticut Uniform Directed Trust Act a power that “is held in a nonfiduciary capacity to achieve the settlor’s tax objectives under the Internal Revenue Code.”

## **V. The Roles of Advisors, Drafters, and Trustees**

### **A. The Intent and Purpose of a Trust**

1. When advising clients about trusts and drafting trust instruments, understanding and articulating the intent and purpose of a trust can be important in identifying
  - a. the “duties” owed to beneficiaries that give the trust its very nature (see Parts III.A and IV.A),
  - b. the values, objectives, and priorities that might inform an adjustment, conversion, or other action under modern Prudent Investor and Principal and Income statutes (see Parts I.B and I.C), and
  - c. the “material purposes” of the trust for purposes of a nonjudicial settlement under section 11 (UTC Section 111) (see Part I.F.3).
2. Articulating the intent and purpose of a trust can often be as challenging as drafting the technical terms – sometimes more so, because “forms” don’t work well.

### **B. Sensitivity to Taxes: The Uniform Trust Decanting Act**

Although Connecticut has not enacted the Uniform Trust Decanting Act, Section 19(b) of that Act is very candid and helpful about avoiding actions that would jeopardize tax benefits or create tax problems. Its provisions include good reminders for anyone contemplating a decanting or a trust modification of any kind. Section 19(b) of the Uniform Trust Decanting Act provides as follows:

An exercise of the decanting power is subject to the following limitations:

(1) If a first trust contains property that qualified, or would have qualified but for provisions of this act other than this section, for a marital deduction for purposes of the gift or estate tax under the Internal Revenue Code or a state gift, estate, or inheritance tax, the second-trust instrument must not include or omit any term that, if included in or omitted from the trust instrument for the trust to which the property was transferred, would have prevented the transfer from qualifying for the deduction, or would have reduced the amount of the deduction, under the same provisions of the Internal Revenue Code or state law under which the transfer qualified.

(2) If the first trust contains property that qualified, or would have qualified but for provisions of this act other than this section, for a charitable deduction for purposes of the income, gift, or estate tax under the Internal Revenue Code or a state income, gift, estate, or inheritance tax, the second-trust instrument must not include or omit any term that, if included in or omitted from the trust instrument for the trust to which the property was transferred, would have prevented the transfer from qualifying for the deduction, or would have reduced the amount of the deduction,

under the same provisions of the Internal Revenue Code or state law under which the transfer qualified.

(3) If the first trust contains property that qualified, or would have qualified but for provisions of this act other than this section, for the exclusion from the gift tax described in 26 U.S.C. Section 2503(b), the second-trust instrument must not include or omit a term that, if included in or omitted from the trust instrument for the trust to which the property was transferred, would have prevented the transfer from qualifying under 26 U.S.C. Section 2503(b). If the first trust contains property that qualified, or would have qualified but for provisions of this act other than this section, for the exclusion from the gift tax described in 26 U.S.C. Section 2503(b) by application of 26 U.S.C. Section 2503(c), the second-trust instrument must not include or omit a term that, if included or omitted from the trust instrument for the trust to which the property was transferred, would have prevented the transfer from qualifying under 26 U.S.C. Section 2503(c).

(4) If the property of the first trust includes shares of stock in an S corporation, as defined in 26 U.S.C. Section 1361, and the first trust is, or but for provisions of this act other than this section would be, a permitted shareholder under any provision of 26 U.S.C. Section 1361, an authorized fiduciary may exercise the power with respect to part or all of the S-corporation stock only if any second trust receiving the stock is a permitted shareholder under 26 U.S.C. Section 1361(c)(2). If the property of the first trust includes shares of stock in an S corporation and the first trust is, or but for provisions of this act other than this section would be, a qualified subchapter-S trust within the meaning of 26 U.S.C. Section 1361(d), the second-trust instrument must not include or omit a term that prevents the second trust from qualifying as a qualified subchapter-S trust.

(5) If the first trust contains property that qualified, or would have qualified but for provisions of this act other than this section, for a zero inclusion ratio for purposes of the generation-skipping transfer tax under 26 U.S.C. Section 2642(c), the second-trust instrument must not include or omit a term that, if included in or omitted from the first-trust instrument, would have prevented the transfer to the first trust from qualifying for a zero inclusion ratio under 26 U.S.C. Section 2642(c).

(6) If the first trust is directly or indirectly the beneficiary of qualified benefits property [such as IRAs and other property subject to the minimum distribution requirements of Section 401(a)(9) of the Internal Revenue Code], the second-trust instrument may not include or omit any term that, if included in or omitted from the first-trust instrument, would have increased the minimum distributions required with respect to the qualified benefits property under 26 U.S.C. Section 401(a)(9) and any applicable regulations, or any similar requirements that refer to 26 U.S.C. Section 401(a)(9) or the regulations. If an attempted exercise of the decanting power violates the preceding sentence, the trustee is deemed to have held the qualified benefits property and any reinvested distributions of the property as a separate share from the date of the exercise of the power and Section 22 applies to the separate share.

(7) If the first trust qualifies as a grantor trust because of the application of 26 U.S.C. Section 672(f)(2)(A), the second trust may not include or omit a term that, if included in or omitted from the first-trust instrument, would have prevented the first trust from qualifying under 26 U.S.C. Section 672(f)(2)(A).

(8) In this paragraph, “tax benefit” means a federal or state tax deduction, exemption, exclusion, or other benefit not otherwise listed in this section, except for

a benefit arising from being a grantor trust. Subject to paragraph (9), a second-trust instrument may not include or omit a term that, if included in or omitted from the first-trust instrument, would have prevented qualification for a tax benefit if:

(A) the first-trust instrument expressly indicates an intent to qualify for the benefit or the first-trust instrument clearly is designed to enable the first trust to qualify for the benefit; and

(B) the transfer of property held by the first trust or the first trust qualified, or but for provisions of this act other than this section, would have qualified for the tax benefit.

(9) Subject to paragraph (4):

(A) except as otherwise provided in paragraph (7), the second trust may be a nongrantor trust, even if the first trust is a grantor trust; and

(B) except as otherwise provided in paragraph (10), the second trust may be a grantor trust, even if the first trust is a nongrantor trust.

(10) An authorized fiduciary may not exercise the decanting power if a settlor objects in a signed record delivered to the fiduciary within the notice period and:

(A) the first trust and a second trust are both grantor trusts, in whole or in part, the first trust grants the settlor or another person the power to cause the first trust to cease to be a grantor trust, and the second trust does not grant an equivalent power to the settlor or other person; or

(B) the first trust is a nongrantor trust and a second trust is a grantor trust, in whole or in part, with respect to the settlor, unless:

(i) the settlor has the power at all times to cause the second trust to cease to be a grantor trust; or

(ii) the first-trust instrument contains a provision granting the settlor or another person a power that would cause the first trust to cease to be a grantor trust and the second-trust instrument contains the same provision.

## **C. Sensitivity to Taxes: The GST Tax Regulations**

1. One of the biggest concerns when considering a decanting or other trust modification is the generation-skipping transfer tax. The stakes are high and grow higher with the appreciation of the trust assets, and often there is no way to achieve certainty and finality for – well – generations. Reg. §26.2601-1(b)(4)(i), titled “Retention of trust’s exempt status in the case of modifications, etc. – In general,” provides a helpful view into the concerns and analysis of the IRS and can provide a good road map for many trust modifications:

This paragraph (b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under paragraph (b)(1), (2), or (3) of this section (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Thus (unless specifically noted), the rules do not apply in determining, for example, whether the transaction

results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain for purposes of section 1001.

(A) *Discretionary powers.* The distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the provisions of chapter 13, if—

(1) Either—

(i) The terms of the governing instrument of the exempt trust authorize distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; or

(ii) at the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or court; and

(2) The terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation. For purposes of this paragraph (b)(4)(i)(A), the exercise of a trustee's distributive power that validly postpones or suspends the vesting, absolute ownership, or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date the original trust became irrevocable) will not be considered an exercise that postpones or suspends vesting, absolute ownership, or the power of alienation beyond the perpetuities period. If a distributive power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

(B) *Settlement.* A court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if—

(1) The settlement is the product of arm's length negotiations; and

(2) The settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

(C) *Judicial construction.* A judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the provisions of chapter 13, if—

- (1) The judicial action involves a bona fide issue; and
- (2) The construction is consistent with applicable state law that would be applied by the highest court of the state.

(D) *Other changes.*

(1) A modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraph (b)(4)(i)(A), (B), or (C) of this section) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

(2) For purposes of this section, a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust. In addition, administration of a trust in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust, if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of §1.643(b)-1 of this chapter.

2. The regulation goes on, in Reg. §26.2601-1(b)(4)(i)(E), to provide 12 helpful examples.
3. See the application of this regulation in Letter Ruling 200410015, quoted in Part I.H.4.c.
4. Often the precautions taken to obtain a good result for GST tax purposes prove to be effective in avoiding adverse gift, estate, or income tax consequences as well (despite the last sentence of the first paragraph of Reg. §26.2601-1(b)(4)(i)).
5. Reg. §26.2601-1(b)(4) applies by its terms only to "grandfathered" trusts that are exempt from GST tax because they were irrevocable on September 25, 1985. But



the IRS has informally indicated that the same rules would apply to trusts that have an inclusion ratio of less than one because of the allocation of GST exemption.

#### **D. IRS Letter Rulings**

1. When there is a need or desire for greater or quicker certainty, the option of asking the National Office of the IRS for a letter ruling can serve that purpose.
2. With respect to the GST tax, for many years, currently in section 3.10(108) of Rev. Proc. 2019-3, 2019-1 I.R.B. 130, the IRS has designated “[w]hether a trust exempt from generation-skipping transfer (GST) tax under § 26.2601-1(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in § 26.2601-1(b)(4)(i)(E)” as an area “in which rulings ... will not be issued.” But those examples are very helpful. Often they are cited in support of ruling requests, and then, to avoid this no-rule policy, distinguished as, for example, “applicable and persuasive but not identical.” The IRS has generally been cooperative in distinguishing the no-rule policy in such cases.
3. Occasions for requesting a ruling can include:
  - a. When the law, or the application of the law to a particular transaction, is truly in doubt.
  - b. When you “know” the answer and are prepared to explain it!
  - c. When the stakes are very high. For example, it is often prudent to request a ruling before taking any action with respect to a GST-grandfathered or GST-exempt trust, because a 40 percent GST tax if the grandfathering or exemption is lost could be disastrous.
  - d. When the proposed transaction is flexible and can be altered to meet concerns raised by the Service.
4. Reasons to sometimes not ask for a ruling can include:
  - a. When the transaction is completed and cannot be changed.
  - b. When concerns about confidentiality are great. Although the Service personnel will handle the ruling request in a professional manner and the taxpayer is protected against inappropriate disclosure by section 6110, mistakes sometimes happen, and in any event the mere disclosure of material to the IRS in a ruling request can sometimes constitute a waiver of the attorney-client privilege.
  - c. When the taxpayer is wary about alerting the Service to a potential tax issue presented by a transaction or situation. Even if the ruling request is eventually withdrawn because the Service indicates that it is inclined to rule adversely, “the appropriate Service official in the operating division that has examination jurisdiction of the taxpayer’s tax return” will typically be notified. Section 7.08(2) of Rev. Proc. 2019-1, 2019-1 I.R.B. 1.