

Evolution of Trust Adaptability

A fundamental concept of property law in America is that the owner has the right to control its transfer upon her death. A trust is the legal mechanism that allows a property owner to exercise this right by leaving guidelines for how the property will be managed, who will receive or benefit from it, and under what circumstances. These trusts may last for many years after the original property owner's lifetime.¹

The legal rule that places a limit on the number of years a trust can last is called the “rule against perpetuities.” The traditional version of this rule allows a trust to last for up to twenty-one years after the death of the longest living person who is identifiable at the time the trust became irrevocable. A more straightforward, modern version allows a trust to last for ninety years. The time limit for trusts in Massachusetts is based on a combination of these two formulations.

A recent trend in the law has been to lengthen the time limit for trusts, and a number of states have modified their rule against perpetuities accordingly. For example, under Florida law trusts may last for 360 years. Other states, like New Hampshire, have to a significant extent abolished the rule and made it possible to create trusts that can last forever. These trusts are commonly referred to as “dynasty trusts.”

¹ See generally Ray D. Madoff, *Immortality and the Law* 57-85 (2010).



Learn More:

For more information on Fiduciary Trust visit:

www.FidTrustCo.com

or contact:

Sid Queler

queler@fiduciary-trust.com

617-292-6799



It is impossible to anticipate every circumstance that might arise over time

Benefits of Long Term Trusts: Individuals may have important reasons for wanting to create long-term, or even perpetual, trusts in their estate plans. These reasons can include:

- **Saving taxes** by “skipping” generations
- **Protecting offspring** from creditors, ex-spouses, or from themselves
- **Installing a sound investment management infrastructure**
- **Providing for family members who have special needs**
- **Encouraging certain behaviors** and discouraging others
- **Continuing to exercise control** and steer the ship as they did during their lifetimes

Those who contemplate creating long-term trusts in their estate plans should acknowledge the reality that it is impossible to anticipate every circumstance that might arise over time. They should have a meaningful dialog with their advisors and closest loved ones, and think carefully about the pros and cons of building flexibility into their trusts. This necessarily will involve weighing: 1) including in the trust mechanisms for adaptability against 2) ceding some degree of control in the future to trustees. There are two long-standing and limited mechanisms for making trusts adaptable—giving the trustee the power to make administrative amendments and the power to change the trust’s “situs,” meaning the state and applicable laws governing the trust. A newer and more expansive mechanism is called trust “decanting.”

Adaptability Option 1: Administrative Amendments and Situs Changes

Administrative Power Changes: Many long-term trusts expressly give the trustee the power to make administrative amendments. This power may be exercised by an independent, disinterested trustee to clarify the meaning of language in the trust instrument or to better conform to the requirements of federal or state tax laws. The language granting this power typically states that it cannot be used to materially change the interests of beneficiaries in the trust. In the tax context, the power to amend has been used to ensure that a marital trust qualifies for the marital deduction or to reform a charitable trust to comply with IRS requirements.

Situs Changes: Many trusts also give the trustee the power to change the state and applicable law under which the trust is to be administered. This is referred to as the trust’s “situs.” A trustee might exercise this power to take advantage of tax or other favorable laws in another state. Changing the situs of a trust also may make sense if family members or beneficiaries have relocated over time.

These powers to make administrative amendments and to change situs can provide a degree of adaptability for a trust while ceding little control. Thus, most individuals planning for long-term trusts will find it an easy decision to include them in the trust instrument.

Adaptability Option 2: Decanting

In the context of irrevocable trusts, decanting involves a distribution by the trustee of assets from one trust into one or more other trusts. The receiving trusts usually are newly created and differ from the original trust in some intended way. In essence, decanting amends an otherwise unamendable trust. Decanting must be consistent with authority of the trustee to make distributions and with the intentions of the person who created the original trust.

Decanting might be used to address a wide array of unanticipated circumstances. Examples could include:

- **Restructuring one trust into separate trust shares** to accommodate changes in dynamics and lifestyles among younger generation family members
- **Changing the distribution terms** of a trust to provide more effective protection from the claims of a beneficiary's creditors, or to make it easier for a beneficiary who has special needs to qualify for public assistance
- **Pursuing unique, innovative, or unconventional investment opportunities**
- **Avoiding the imposition of a generation-skipping tax** that would frustrate the original purpose of the trust by removing beneficiaries who are "skip persons"

In some states, including Massachusetts, the legal support for a trustee to decant a trust comes from court decisions that establish legal precedent based on the facts of specific cases. This is referred to as "common law." In a growing number of other states, including New Hampshire, legislatures have passed statutes authorizing trustees to decant trusts and define the parameters within which it may be accomplished.

Massachusetts: The *Kraft* Case

In July 2013, the Supreme Judicial Court of Massachusetts (the "SJC") addressed the issue of decanting in the case of *Morse v. Kraft*. The case dealt with the question of whether the disinterested trustee of the Kraft Irrevocable Family Trust had the power to distribute the property held in trust to a new trust for the benefit of the same beneficiaries without the approval of any beneficiary or a court.

The Kraft Irrevocable Family Trust was created by Robert Kraft, the owner of the New England Patriots. Under the Kraft Trust, four separate sub-trusts were established, one for the benefit of each of Robert Kraft's sons and their children. Richard Morse served as a disinterested trustee of the trusts, meaning he had no beneficial interest in the trusts. Morse was eighty-one years old at the time the *Kraft* case was brought before the SJC. Intending to retire, Morse believed that each Kraft son was capable of serving as successor trustee for his own trust. The trusts however permitted only a disinterested trustee to make decisions regarding distributions to beneficiaries. Since the sons were eligible to receive current distributions from their respective trusts, they did not qualify as disinterested trustees. As a result, Morse sought to "decant" the subtrusts into new trusts, with terms that would enable each of the sons to serve as successor trustees and exercise distributive powers over their own trusts.

Decanting involves a distribution by the trustee of assets from one trust into one or more other trusts

Following Kraft, settlors in Massachusetts who want their trustees to have the power to decant should expressly provide for it in the terms of the trust instrument

The Kraft Irrevocable Family Trust did not include a specific decanting power. Therefore, Morse sought a direct ruling from the SJC on whether the disinterested trustee's general power to distribute property to *or for the benefit of* the sons, included an inherent power to transfer the property to new trusts with terms permitting the sons to serve as trustees of their respective trusts. Robert Kraft and his attorney who drafted the Kraft Trust each submitted an affidavit stating that it was the settlor's intent to give the trustee the power to decant.

Court allows decanting in *Kraft*: The SJC held that the power to decant was inherent in the terms of the trust. However, the SJC's ruling was specific to the *Kraft* case, and the court expressly declined to hold that every disinterested trustee with distribution authority has an inherent power to decant trust assets into other trusts. In rejecting the more expansive ruling, the SJC noted that trust and estate practitioners are including decanting provisions in trust agreements with increasing frequency and suggested that a failure to do so might indicate "an intent to preclude decanting."

Implications of the *Kraft* Case: Following *Kraft*, settlors in Massachusetts who want their trustees to have the power to decant should expressly provide for it in the terms of the trust instrument. A decanting power in a trust instrument should specifically provide that a disinterested trustee has the right (but not the duty) to exercise the power to distribute income and principal to or for the benefit of the beneficiary of any trust by distributing a portion or all of the trust assets to the trustees of any other trust for the benefit of such beneficiary. While granting the trustee the power to decant in a trust instrument permits the trustee to make changes from the original trust, the trustee can only exercise a decanting power in keeping with its fiduciary obligations. It is also important to note that there are some limitations on the decanting power, such as a trustee may not extend the term of the trust beyond the maximum period allowed by law or make a change that may affect the gift tax or generation-skipping transfer tax exclusion claimed with regard to any trust property.

New Hampshire: A Contemporary Trust Environment

Over the last decade, New Hampshire has steadily revised its trust and tax laws to be more accommodating to settlors and beneficiaries of trusts that are administered there. New Hampshire now has statutes that allow for modification of trusts by trustees, including one that permits decanting. NH RSA Section 564-B:4-418 allows a trust to be decanted into another trust "unless the terms of the trust expressly provide otherwise" so long as certain conditions are met. For example, the second trust cannot add a new beneficiary, nor can the second trust reduce any current fixed income interest, annuity interest, or unitrust interest of a beneficiary of the first trust. Through decanting, however, a trust with outdated or impractical provisions can be modified and updated, thus allowing for a more efficient and proper administration of the trust.

Benefit of Decanting Statutes: Many trustees prefer to utilize decanting statutes whenever possible, as opposed to common law, because the rules and requirements are clearer when laid out in a formal statute. In addition, because a statute is crafted through the legislative process, many of the potential problems that may arise have been considered and are addressed in the language. A trustee

can therefore be relatively confident that the decanting will be effective as long as the rules and restrictions set forth in the statute are followed.

NH Allows Trust Modifications: As of July 1, 2014, there is another statute in New Hampshire which allows trustees to modify trusts without decanting in certain circumstances. Under NH RSA Section 564-B:4-419(a), as long as a trust does not expressly prohibit it, a trustee can modify a trust without consent of the beneficiaries for any reason, including:

- Furthering the settlor's intent or a material purpose of the trust
- Preserving favorable tax treatment of the trust
- Providing for more efficient administration of the trust
- Reducing the costs of administration

Similar to the decanting statute, there are reasonable restrictions on a trustee's exercise of this power. For example, a trustee modification cannot be inconsistent with the settlor's intent or a material purpose of the trust, it cannot reduce or eliminate a beneficiary's vested interest in the trust, nor can it alter any right or power that the settlor has under the terms of the trust. But a trustee can make many of the same changes to a trust's administrative provisions that it would with a decanting without transferring the trust assets to a completely different trust. This is just one of a number of options for modernizing trusts which are created by statute and which exist under New Hampshire law.

Determining the Right Approach to Trust Adaptability

Individuals in the planning stage who want to consider long-term trusts should think carefully about the trade-offs between adaptability and control. If they opt for adaptability, they should consider including an express power to decant in the instrument or creating their trust under the law of a state that has decanting and other favorable statutes, such as New Hampshire.

Decanting and the other mechanisms discussed in this article may apply to trusts in a variety of ways. In one complex situation, we saw a power to amend used to add a power to change a trust's situs and applicable law, which then was used to relocate the trust to a state having a decanting statute, under which the trust was then decanted!

Please feel free to contact your officer at Fiduciary Trust if you are planning to create a long-term trust or are involved with an existing irrevocable trust and would like to discuss the subject of trust adaptability in greater detail. Due to our long history of serving as a trustee and our more recent experience with Fiduciary Trust Company of New England in administering trusts in New Hampshire, we are uniquely qualified to advise on all aspects of adaptability for long-term trusts.

Issue Date: January, 2016

© Copyright 2020 by Fiduciary Trust Company
All Rights Reserved

Disclosure: The opinions expressed in this article are as of the date issued and subject to change at any time. Nothing contained herein is intended to constitute investment, legal, tax or accounting advice, and clients should discuss any proposed arrangement or transaction with their investment, legal or tax advisers.