



WRMarketplace

An AALU Washington Report

The *WRMarketplace* is created exclusively for AALU members by experts at Greenberg Traurig and the AALU staff, led **by Jonathan M. Forster, Steven B. Lapidus, Martin Kalb, Richard A. Sirus, and Rebecca Manicone**. *WRMarketplace* #17-25 was written by Greenberg Traurig **Shareholder Karen D. Yardley**.

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TOPIC: Case Study Series: Location, Location, Location - Changing the Situs of an Irrevocable Trust.

MARKET TREND: As states vie for trust business by offering more exclusive benefits, new life can be given to old trusts by moving to a jurisdiction with more robust trust laws (a so-called “situs change”).

SYNOPSIS: Long-term irrevocable (dynasty) trusts can become inefficient over time. Moving the trust to a new jurisdiction may provide opportunities to refresh the administration of the trust, address state income tax issues, strengthen creditor protection, and decant trust assets to a new trust. The authority to move a trust’s situs may be found in the trust instrument or state law.

TAKE-AWAY: While changing a trust’s situs can be beneficial to both the trust and the trust’s beneficiaries, the process requires careful navigation of, and compliance with, the terms of the trust instrument and the statutes of both the current and proposed places of administration.

PRIOR REPORTS: 17-22; 15-38; 14-21.

Dynasty trusts are intended to continue for long periods of time, but what happens when circumstances change and new opportunities arise? More often than ever, irrevocable trusts are being moved from the original state to a new state with more robust trust laws that protect the trust and its beneficiaries. This trend provides an opportunity for advisors to be proactive by suggesting that the family review the trust and consider their options.

WHY MOVE?

While the original state in which the trust was established and administered (the trust's so-called "**situs**" or "**place of administration**") may have been appropriate at the time the trust was created, state laws, trust assets, beneficiaries, and trustees will change over time, potentially making the original situs and laws less effective. For example, addressing state income tax issues related to undistributed trust income may be a critical fiduciary consideration in moving a trust. Other reasons may include:

- Improved creditor protection for the beneficiaries;
- Enabling the duties of the trustee to be bifurcated into different roles held by different trustees (such as a distribution trustee, investment trustee, and administrative trustee);
- Providing better enforcement of the trust's no contest clause and protection of the trust's terms;
- Permitting the trust to be "silent" (i.e., allowing the existence or other details of the trust to be concealed from certain beneficiaries);
- Enabling the trustee to modify the terms of the trust or decant the trust to a new trust with updated terms better suited to meet the trust's overall goals and the beneficiaries' needs; and
- Permitting the trust to invest in assets not authorized under the laws of the original state (such as a closely held business or private equity fund).

Let's look at a real case that shows these considerations in action.

MOVING A TRUST'S SITUS: CASE STUDY

Client Background – Meet the Smith Irrevocable Trust. In 1995, George Smith created a discretionary irrevocable trust (the "**Smith Irrevocable Trust**") for his descendants under the laws of State A. The trustee of the Smith Irrevocable Trust is a resident of State A, and the trust continues to be administered there. After 22 years, the trust's terms have become outdated, State A has imposed taxes on the trust's undistributed income due to the trustee's residence (even though George and all his descendants now live in other states), and recent changes in State A's laws have made it easier for creditors to reach the trust's assets, despite the trust's spendthrift clause.

The trust agreement also provides for a single, "pot" trust for all George's descendants, which is creating friction among the family branches; however, division of the trust into separate shares for the beneficiaries will not occur until George's death. Unfortunately, the trust is silent on any decanting power that would allow the trust assets to be decanted into separate trusts now, and State A does not have a decanting statute or judicial precedents for trust decanting.

Client Goals. George and the trustee would like to move the trust situs to State B, which has a decanting statute and different state income tax laws that will help the trustee comply with his fiduciary duty to minimize the trust's taxes on undistributed income. The move also allows: (1) prompt decanting of the existing trust assets to a new trust with terms better suited to the beneficiaries' current needs and (2) improved creditor protection for the trust and beneficiaries.

AUTHORITY TO CHANGE SITUS

The trustee must be authorized to move a trust to a new jurisdiction, and such authority may be granted in the trust instrument, pursuant to the original state's statutes, or by obtaining judicial approval for the move.

Trust Terms. The trustee must first review the terms of the trust. Trust instruments typically identify the law that governs the trust and the place where the trust will be administered. The trust instrument also may authorize the trustee to change the place of administration and administrative law. As trusts have become more sophisticated, provisions authorizing a change of situs and administrative law without first obtaining court approval have become commonplace. Older trusts, however, may not contain specific authorization, and the trustee may need to look at other sources of authority to move the trust to State B.

Statutory Authority. If the trust instrument does not authorize the trustee to move the trust, state statutes may offer another approach by providing specific or indirect authority for the move, hopefully without prior judicial approval.

Options:

- *Specific Authorization.* A majority of states have adopted the Uniform Trust Code (“UTC”) or similar statutes authorizing the transfer of a trust's situs to another state. This is, by far, the easiest route. Under the UTC, the trustee may transfer the trust's principal place of administration to another state if the move is appropriate for the trust's purposes, its administration, and the interests of the beneficiaries. The trustee must give qualified beneficiaries prior notice of the transfer and an opportunity to object.¹
- *Nonjudicial Settlement Agreement.* The UTC also includes authority for nonjudicial settlement agreements, allowing the trustee and the beneficiaries to enter into a binding agreement over the transfer as long as the settlement agreement does not violate a material purpose of the trust and includes terms and conditions that could be approved by the appropriate court or other applicable law.² The transfer of a trust's principal place of administration is explicitly listed as a matter that may be resolved by a nonjudicial settlement agreement.³ States that have not adopted the UTC, such as Nevada⁴ and Illinois⁵, have enacted similar statutes authorizing nonjudicial settlement agreements that also would allow the place of administration to be transferred by nonjudicial settlement agreement.

- *Nonjudicial Trust Modification.* States that do not provide specific authorization for changing a trust's situs or permit nonjudicial settlement agreements may provide an indirect method for the transfer without court approval by allowing the trust to be modified by the settlor and the beneficiaries. California law, for example, allows the settlor and all beneficiaries of a California trust to consent to the modification of the trust.⁶ Similarly, an Iowa trust may be modified by written consent of the settlor and all beneficiaries.⁷ Such statutory authority to modify the trust could be used to change the situs of a trust without court approval.

Judicial Proceeding – Path of Most Resistance. A minority of states do not have statutory authority for the nonjudicial transfer of a trust's place of administration. In these states, if the trust does not grant the trustee or another fiduciary the authority to move the place of administration and the trust can't be modified without a court order (such as California and Iowa if the settlor is deceased), it will be necessary to seek court approval for the transfer.

MECHANICS

The trustee will need to follow the steps and procedures dictated by the specific authority relied upon to transfer the trust to State B. The trustee also must determine whether there is an adequate connection to State B that will allow the trust to both sever ties with State A and establish a sufficient nexus (connection) to State B.

Establishing a Nexus with State B. Each state has its own rules regarding the ties that are necessary to establish a sufficient nexus to a state that will allow that state's laws to govern the trust's administration. These rules also can vary with respect to the type of trust that is being transferred. In Nevada, for example, a sufficient nexus is created if (1) the trust owns real estate located in the state, (2) the trustee is located in the state, (3) one or more beneficiaries reside in the state, or (4) at least part of the administration of the trust occurs in the state.⁸

The trustee of the Smith Irrevocable Trust will need to meet State B's statutory requirements for creating a nexus with the state and create as many additional ties as possible with State B. The more ties the trust can establish with State B, the less susceptible the trust will be to claims that the situs has not been transferred from State A. Thus, the Smith family's situation suggests:

- Having at least one trustee located in or a resident of State B. Further, the State A trustee should resign (or be removed).
- Relocating as many of the trust's assets as possible to State B, including:
 - Open new bank and brokerage accounts in State B. Checks for distributions and payment of trust expenses should be issued from a bank located in State B.

- The trustee in State B should have custody of any stocks held in certificate form.
- If feasible, any tangible personal property held as part of the trust should be stored in State B.
- Using financial advisors, accountants, and other advisors located in State B.
- Maintaining the trust's books and records in State B.
- Requiring all correspondence for the trust be sent to and initiated from State B.
- Conducting administration and trustee meetings in State B.

Severing Ties with State A. For the Smith Irrevocable Trust, severing ties with State A also will be important, especially if the trustee, as a fiduciary, is trying to address the trust's state income tax exposure. Some states (such as California, Arizona, and North Carolina)⁹ will tax the trust simply if a trustee or a beneficiary resides in the state.¹⁰ Other states (like Pennsylvania and Oklahoma)¹¹ will tax the trust if the settlor was a resident at the time the trust was created or became irrevocable. While it may not be realistic to sever some ties (such as the residence of the settlor or beneficiaries), other ties can and should be cut as part of moving the trust's situs.

SO THE SITUS HAS BEEN MOVED – WHAT LAW APPLIES?

To successfully move the situs of the Smith Irrevocable Trust, it also will be necessary to identify and change the laws that will govern the trust after the move. As discussed above, the trust instrument generally identifies the law that governs the validity, construction, and administration of the trust. Many of the motivations for relocating a trust (such as better creditor protection, the availability of decanting statutes, the types of investments the trust may make, and the type of information that must be given to the beneficiaries) are dictated by the laws governing administration.

When a trust's situs is moved, the governing law specified in the trust instrument generally continues to govern validity and construction. Most state laws provide that once the situs has been moved, the administration of the trust is governed by the laws of the new situs. The trust instrument also may provide a method for specifying the law that will govern administration. If state law or the trust instrument does not provide for a change in the administrative law, the change should be adopted through a trust modification, nonjudicial settlement agreement, or judicial proceeding, as applicable.

TAKE-AWAY

While changing a trust's situs can be beneficial to both the trust and the trust's beneficiaries, the process requires careful navigation of and compliance with the terms of the trust instrument and the statutes of both the current and proposed place of administration.

DISCLAIMER

This information is intended solely for information and education and is not intended for use as legal or tax advice. Reference herein to any specific tax or other planning strategy, process, product or service does not constitute promotion, endorsement or recommendation by AALU. Persons should consult with their own legal or tax advisors for specific legal or tax advice.

NOTES

¹ See UTC §108. For purposes of the UTC, a “**qualified beneficiary**” means a beneficiary who, on the date the beneficiary’s qualification is determined: (i) is a distributee or permissible distributee of trust income or principal; (ii) would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subparagraph (i) terminated on that date without causing the trust to terminate; or (iii) would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date. See UTC §103(13).

² UTC § 111(c).

³ See UTC §111(d)(5).

⁴ NRS 164.940.

⁵ 760 Ill. Comp. Stat. §5/16.1(d)

⁶ See California Probate Code §15404. If a beneficiary does not consent to the modification, then the other beneficiaries and the settlor may compel a modification of the trust upon petition to the court. If the settlor is deceased, the beneficiaries, acting unanimously, may compel the modification of the trust upon petition to the court. See, California Probate Code §15403.

⁷ Iowa Code §633A.2202.

⁸ NRS 164.045(4).

⁹ See Cal. Rev. & Tax. Code §17742; Ariz. Rev. Stat. § 43-1301(5); N.C. Gen Stat. §105-160.2.

¹⁰ For a discussion regarding the basis for state income taxation of trusts, see WRM# 15-38.

¹¹ See 72 P.S., tit. 61, Sec. 101.1; Okla. Stat. Tit. 68, § 2353.6.