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How Irrevocable Is an Irrevocable Trust?

How to break or at least bend them.

Geoffrey N. Taylor | Nov 20, 2018

With the federal estate tax exemption now set at a robust $11,180,000 per person (thank you Tax Cuts and Jobs Act), the estate tax in its current form applies to very few individuals and families. This means that much of the estate tax reduction planning that has been put in place over the years (together with its inherent inflexibility) is no longer needed. With revocable trusts, making changes as a result of the higher exemption is

simple, provided that the grantor is alive and competent. With irrevocable trusts, not so much.

Irrevocable trusts have been a hallmark of gift and estate tax planning since, well, there have been gift and estate taxes. In setting up an irrevocable trust, the grantor creates a plan of disposition, contributes assets to the trust and thereby gives up all control over the assets contributed and any ability to change that plan of disposition. If the grantor's gaze into the crystal ball is accurate, such as how mature his children become in the years following funding, the loss of control is no problem. But people and circumstances change. What if the grantor's financial situation changes such that he wants (or even needs) the assets back? What if the grantor wants to remove a beneficiary, such as an ex-spouse or estranged child? What if the grantor's children are not as mature as he thought they'd be a decade or two after creating the trust? What if there has been a falling out with the trustee? Just how irrevocable is irrevocable?

I get these questions all the time, and my initial response is always the same: "I need to read the trust agreement." "Oh, this is just your standard trust agreement.""That's nice. I need to read the trust agreement." "But everyone agrees that we should make this one change." "Terrific! I need to read the trust agreement." Sometimes the provisions of the trust agreement allow for some flexibility. A power of appointment often allows the powerholder, such as the grantor's spouse, to add, remove and change the beneficiaries of the trust, their share of the trust assets, and the timing and standards of distribution. A "trustee appointer" can often remove and replace trustees. A "trust protector" can often amend the trust agreement.

If the trust agreement isn't helpful, the next step is to look to state law. Depending on the desired change, the interested persons may be able to enter into a nonjudicial settlement agreement. This avoids court involvement, but it can only be used with respect to administrative matters, such as (i) interpreting the terms of the trust, (ii) approving a trustee's accounting, and (iii) filling a trustee vacancy. It cannot be used to

(i) violate a material purpose of the trust, (ii) modify the trust, or (iii) terminate the trust. Its application is therefore fairly limited.

Decanting the assets of the trust into a second trust is another possibility. However, like the nonjudicial modification, its application is somewhat limited in that the terms of the second trust cannot "materially change the beneficial interests of the beneficiaries of the first trust." This is normally exactly what the parties want to do.

As a last resort, the parties pursue a judicial modification by petitioning the probate court. This can be expensive and unpredictable. Will the court "rubber stamp" a modification if the grantor, trustee and all trust beneficiaries agree? What if less than all beneficiaries agree? Note that the statute requires the court to conclude that the modification is consistent with the material purposes of the trust, so even if all the beneficiaries agree, there's no guarantee the court will approve the modification.

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