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MODIFICATION OF IRREVOCABLE TRUSTS

A revocable trust can be revoked at any time, usually by the grantor or creator of the trust. An irrevocable trust cannot simply be revoked by the grantor. Historically, irrevocable trusts have been considered etched in stone—unchangeable, immovable. The enactment of the Maine Uniform Trust Code changed this. Under current Maine law, there are circumstances under which an irrevocable trust can be modified or terminated. The type of trust, the purpose of the trust, and whether the beneficiaries of the trust consent to the changes are some of the most significant factors in determining whether a particular trust can be modified or terminated.

Modification or Termination Without Beneficiary Consent

The consent of the beneficiaries is not always required in order to modify or terminate an irrevocable trust. Some changes can be made by the trustee alone or by the court upon request of the trustee, even if the beneficiaries have not agreed to the changes.

1. Unanticipated Circumstances

Even with careful planning and drafting, circumstances not foreseen by the settlor of the trust may arise. When such unanticipated events occur and modifying or terminating the trust would further the purposes of that trust, the court may make changes to the trust to account for the change in circumstances. In doing so the court must consider the settlor's probable intentions (i.e. how the settlor would have addressed the situation had the settlor foreseen the occurrence of such circumstances) and make modifications accordingly.

2. Uneconomic Trusts

On occasion, the value of trust assets diminish to an extent that the cost of managing the trust exceeds the income of the trust and the continued existence of the trust incurs a net loss of trust assets. Although the law strives to uphold the intentions of settlors who create trusts, there are times when the cost of administering a trust becomes unreasonable when compared to the value of the trust itself. When that happens, the trustee may terminate the trust after notifying the beneficiaries.

In order for a trustee to terminate a trust on this basis, the trust property must have a value of less than \$100,000.00. In addition, the trustee must make a good faith determination that the value of the trust property is insufficient to justify the costs of administering the trust. If the value of the trust property is greater than \$100,000.00, but the trustee determines that the costs of administration outweigh the trust's value, the trust may still be modified or terminated. Under those circumstances, however, the trustee cannot modify or terminate the trust without the approval of the court.

3. Mistake of Law or Fact

Sometimes, the settlor drafts the terms of a trust a particular way because the settlor mistakenly believes that a specific fact is true, or that a law operates a certain way. When this occurs, the court may reform the terms of the trust to match what the court determines the settlor would have done had he or she not been mistaken. A petitioner asking the court to make such a change must demonstrate to the court that the settlor was mistaken and that the mistake affected the terms of the trust. The court will modify the trust only if the petitioner proves by clear and convincing evidence that a mistake was made that affected the way the settlor chose to draft the terms of the trust. This requirement is designed to protect the settlor by ensuring that a trust is not changed based purely on allegations that the settlor was mistaken—there must be proof of the mistake, and the court must be satisfied that the settlor did, in fact, make a mistake.

4. Achievement of Tax Objectives

Settlors often create trusts with certain tax objectives in mind. A court may modify the terms of a trust to achieve the settlor's tax goals so long as the modification is not contrary to the other purposes of the trust or the intentions of the settlor.

Modification to achieve tax objectives has become a popular tool given the recent increases to the federal estate tax exemption and the recoupling of the Maine estate tax exemption with the federal scheme. Many irrevocable trusts established based on prudent tax planning through the years are now inefficient under current tax laws, and have been funded with assets that have grown significantly in value and that will, upon termination, be subject to capital gains tax, rather than estate tax. These trusts can be modified to provide a step up in cost basis at termination, avoiding capital gains and estate tax.

5. Combination or Division of Trusts

One individual may serve as the trustee for multiple irrevocable trusts. When that is the case, the trustee may decide that it is most efficient to combine two or more trusts to reduce the costs of administration, or to increase the income earned by the trust. Alternatively, there may be times when a single trust has multiple beneficiaries who have very different needs or objectives than what the shared distribution terms of the trust would support. Under those circumstances, a trustee might decide that it is best to divide the trust into two trusts to better achieve the settlor's goals. Whether a trustee is attempting to combine or divide trusts, he or she may only do so if it will not impair the rights of the beneficiaries or adversely affect the purposes of the trust or trusts. The Trustee must notify the beneficiaries before taking action to combine or divide trusts.

Modification or Termination by Consent of the Beneficiaries

If the proposed changes to a trust do not fall into one of the above categories, then consent by all beneficiaries of the trust is required in order to modify or terminate the trust. In some instances, the consent of the settlor will be required as well. The determination of whose consent is required depends on whether the trust is being terminated or simply modified, and whether the proposed changes are consistent with the trust's purposes.

1. Modification or Termination Inconsistent with Trust Purposes

If the settlor, a trustee, or a beneficiary asks the court to make a modification that is inconsistent with a material purpose of the trust, the consent of the settlor and all beneficiaries is required to make the change. The court can approve such a change only upon a finding that the change is in the best interests of the beneficiaries.

2. Modification Consistent with Trust Purposes

If all beneficiaries, including the remainder beneficiaries, agree, the court may modify a trust absent the consent of the settlor, provided that the change is consistent with the material purposes of the trust. Because such modifications are often requested after the death of a settlor, where consent of the settlor would be impossible, the court will oversee and determine the propriety of the modification. The court retains the discretion to deny the request for modification if the court finds the modification would violate a material purpose of the trust, or for any similar reason.

3. Termination Consistent with Trust Purposes

If the court determines that continuance of the trust is not necessary in order to achieve any material purpose of the trust, then the court may terminate the trust without the settlor's consent, so long as all of the beneficiaries of the trust consent to the termination. A petition for termination is typically brought by the beneficiaries and/or the trustee. The consent of the remainder beneficiaries is required as well. These remainder beneficiaries may be minor children, or even unborn children, of current beneficiaries. In some situations, the court will appoint representatives for minor and unborn children to represent their interests independent of their parents, who may have a conflict of interest in consenting to termination of a trust that will provide a distribution to the parent, rather than the child as a final remainder beneficiary of the trust.

4. The Exception

Although the Maine Uniform Trust Code requires unanimous consent of the beneficiaries or of the beneficiaries and the settlor to make certain changes, the court may nevertheless modify or terminate a trust without obtaining such consent under some circumstances. The court may only approve a modification or termination without unanimous consent if the court, after considering the circumstances, is satisfied that the proposed change could have been made had the required consent been provided, and that the interests of any beneficiary who did not consent would be adequately protected even if the change were approved.