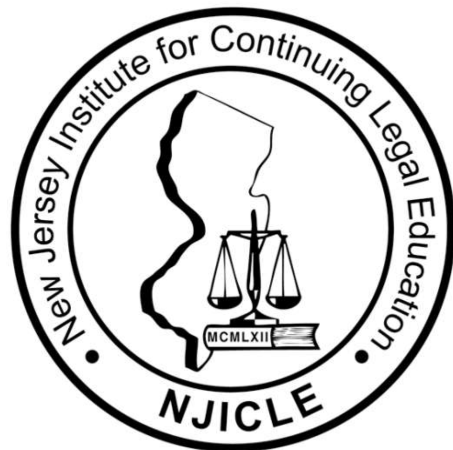
ESTATE PLANNING AND ADMINISTRATION INSTITUTE PART 2

2024 Seminar Material

MI0282.242

New Jersey Institute for
Continuing Legal Education

A Division of the State Bar Association
NJICLE.com



This page intentionally left blank

ESTATE PLANNING AND ADMINISTRATION INSTITUTE PART 2

Moderators

Robert D. Borteck, Esq.
Borteck & Czapek, P.C.
(Florham Park)

Gerard G. Brew, Esq.
McCarter & English, LLP
(Newark)

Speakers

Robert I. Aufseeser, Esq.
Law Office of Robert Aufseeser LLC
(East Brunswick)

Daniela P. Catrocho, Esq.
Day Pitney, LLP
(Parsippany)

Christine Socha Czapek, Esq.
Borteck & Czapek, P.C.
(Florham Park)

Crystal West Edwards, Esq.
Certified as an Elder Law Attorney by the National Elder Law Foundation
Porzio, Bromberg & Newman P.C.
(Morristown)

Timothy M. Ferges, Esq.
McCarter & English, LLP
(Newark; New York City)

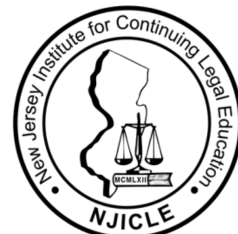
Laura A. Kelly, Esq.
McCarter & English, LLP
(Newark)

Tara S. Sinha, Esq.
Witman Stadtmauer, P.A.
(Florham Park)

Leonard J. Witman, Esq.
Witman Stadtmauer, P.A.
(Florham Park)

In cooperation with the New Jersey State Bar Association **Real Property, Trust and Estate Law Section**

MI0282.242



© 2024 New Jersey State Bar Association. All rights reserved. Any copying of material herein, in whole or in part, and by any means without written permission is prohibited. Requests for such permission should be sent to NJICLE, a Division of the New Jersey State Bar Association, New Jersey Law Center, One Constitution Square, New Brunswick, New Jersey 08901-1520.

Table of Contents

	Page
Creditor Claims in the Administration of Estates Timothy M. Ferges	1
Creditor Claims Against Estates	1
Current New Jersey State Law Governing Notice by Creditors of Their Claims Against the Estate	1
Old Repealed Law (Repealed Notice Procedures That Previously Governed Estates of Decedents Who Died Prior to February 24, 2005)	5
Untimely Claims Against the Estate	7
Untimely Claims Against Devisees or Heirs	9
Statute of Limitations Governing Creditor Claims	10
Order of Priority of Claims	11
Abatement	15
Creditor's Rights in Multi-State Administrations	16
Real Property	17
Sale of Property Subject to Escheat to Pay Debts	20
Insolvent Estates	21
Liability of Heirs and Devisees	23
Administering Retirement Assets After Death Under the SECURE Acts PowerPoint Presentation Leonard J. Witman, Esq. Tara S. Sinha, Esq.	25
Decanting, Modifying and Terminating Irrevocable Trusts Daniela P. Catrocho, Esq.	51
Common Reasons to Decant, Modify or Terminate an Irrevocable Trust	51
Decanting an Irrevocable Trust	51
Modifying and Terminating an Irrevocable Trust	55
Tax Implications of Decanting, Modifying or Terminating an Irrevocable Trust	60
Recovery of Attorney's Fees When Defending the Decanting, Modification or Termination of a Trust	72
Recent Relevant Cases Arising in States That Have Implemented the UTC	72
Decanting, Modifying, and Terminating Trusts PowerPoint Presentation Daniela P. Catrocho, Esq.	75
Adventures in Generation Skipping Laura A. Kelly	91

Generation-Skipping (*Very* Generally) 93
Section 2601 of the Internal Revenue Code (the "Code") Imposes a Tax on "Every Generation-Skipping Transfer" 93
What is a Generation-Skipping Transfer? Section 2611 of the Code Defines It 93
Who is the Transferor? 94
Notes 95
Help – I Think a Generation-Skip Just Occurred! 96
Are You Sure It's a Problem? 96
Calculation of Tax 101
Liability for Tax 103
GST Reporting Requirements 104
How Do I Fix a Trust That is *Partially* GST-Exempt? 107
If the Goal is to Avoid Having to Pay Generation-Skipping Tax, Every Effort Should Be Made So That a Trust is Either Entirely Exempt or Entirely Non-Exempt from Generation-Skipping Tax 107
Qualified Severance 108

About the Panelists… 115

Creditor Claims in the Administration of Estates

by

© Timothy M. Ferges
McCarter & English, LLP
Telephone: (973) 639-2022
E-mail: tferges@mccarter.com

Creditor Claims Against Estates

The claims of one's creditors do not typically expire solely as a result of his or her death. A personal representative must be mindful of those claims and take them into account when making decisions regarding the distribution of assets. On the other hand, the creditor is also governed by New Jersey statutory law imposing certain procedures on the creditor that must be fulfilled. The following is an outline of those procedures and other applicable law.

I. Current New Jersey Law Governing Notice by Creditors of Their Claims Against the Estate – New Jersey currently has a "self-executing" statutory scheme that runs from the date of the decedent's death governing creditor claims. In other words, a personal representative does not have to notify the creditor of the debtor's death. The law instead places the onus on the creditor to serve notice of his or her claim. If the claim is presented within the statutory period (nine months of death), the creditor's claim will be preserved and the personal representative may be held personally liable if assets are distributed from the estate without satisfaction of the claim. The following statutory provisions govern that procedure:

a. **Nine Month Limitation** – creditors of the decedent must present their claim (called a "proof of claim") to the personal representative within nine months of the date of the decedent's death. *N.J.S.A.* 3B:22-4.

   1. **Untimely Proofs of Claim** – If a proof of claim is not timely presented within the nine month deadline, the personal representative is not liable to the creditor with respect to any assets the personal representative delivered or paid to satisfy any lawful claims, devises or distributive shares before the presentation of the claim. *N.J.S.A.* 3B:22-4.

b. **Required Format of Proof of Claim:**

   1. **In Writing** – the proof of claim must be presented in writing. *N.J.S.A.* 3B:22-4.

2. **Verified –** the proof of claim presented must be signed by the creditor under oath. *N.J.S.A.* 3B:22-4.

   a. **Payment of *Unverified* Claims if Estate is Solvent** – Nonetheless, if a personal representative pays a claim that is not verified on or before final accounting, that payment will be allowed if: (i) he or she made the payment in good faith, (ii) the claim is proven to be valid, and (iii) the estate was sufficient to pay the debt. *N.J.S.A.* 3B:22-6.

      - **Note:** This law suggests that if a personal representative pays an unverified claim and it ends up that the unverified claim was not valid, the personal representative could potentially be held liable for his or her payment of same.

   b. **Payment of *Unverified* Claim if Estate is Insolvent** - If a personal representative pays a claim that is not verified and the estate is not sufficient to pay the debt, the payment will still be allowed in the pro rata amount the creditor would have been entitled to receive if the claim had been presented verified as required so long as (i) he or she made the payment in good faith and (ii) the claim is proven valid. *N.J.S.A.* 3B:22-6.

      - **Note:** This means that the personal representative could be held liable for a portion of the payment. (Payment of verified claims with respect to insolvent estates is covered in more detail below.)

c. **Claims Payable in the Future Treated the Same** – if a claim payable in the future is a liquidated claim (i.e., the claim is ascertainable in amount), it may be presented to the personal representative and is subject to the same protections as claims that are currently payable. A creditor of a liquidated claim payable in the future is also entitled to "a reasonable rebate of interest." *N.J.S.A.* 3B:22-5.

d. **Treatment of Timely Presented Proof of Claim:**

1. **Personal Representative's Three Month Deadline to Dispute** – If the Proof of Claim is timely presented, the personal representative is to give the creditor notice within 3 months of the presentation of the claim that the claim is allowed, disputed, or allowed and disputed in part. *N.J.S.A.* 3B:22-7.

2. **If Claim is Disputed** –

   a. **Creditor's Three Month Deadline to File an Action That Precludes Distributions -** Within 3 months of receiving notice that the claim is disputed, the creditor must commence an action to recover on the disputed claim. *N.J.S.A.* 3B:22-8.

b. **If No Action Within Three Month Deadline -** If the creditor does not commence that action within 3 months, the personal representative is not liable with respect to any assets he or she has delivered or paid in satisfaction of any lawful claims, devises or distributive shares before the commencement of the action. *N.J.S.A.* 3B:22-8.

e. **IRS Appears to be Exempt From This Procedure –** *US v. Summerlin*, 310 U.S. 414, 418 (1940) (US Supreme Court holding "that the [Florida] statute in this instance requiring claims to be filed within eight months[1] cannot deprive the United States of its right to enforce its claim; that the United States still has its right of action against the administrator, even though the probate court is to be regarded as having no jurisdiction to receive a claim after the expiration of the specified period"); *accord Matter of Estate of Moc*k, 2012 WL 8415852, *4 (Del. Ch. Feb. 27, 2012) (Delaware Court of Chancery ruling that Delaware's eight-month statutory period to present a proof of claim did not apply against the IRS as the "United States [was] asserting a right created by a federal statute [IRC 6321[2]] and proceeding in its sovereign capacity by requesting that its tax lien be satisfied first . . . [Delaware's] eight-month statutory period for filing claims [therefore] does not bar the United States from enforcing its claim")

f. **Obligation to Set-Off Claims –** Personal representatives are obligated to ensure that a debt that the decedent owes to a creditor is set off against any debt that the creditor may owe to the decedent. *Terhune v. Oldis*, 44 N.J.Eq. 146, 153, 14 A. 638, 641, 642 (Prerog.1888).

g. **Personal Representative Has Authority to Compromise a Claim –** Rather than pay a claim in full or reject a claim in full, there is a third option. Unless his or her authority is limited under a Will or if his or unless his or her authority is limited by court order, a personal representative has authority to compromise a claim against the estate. *N.J.S.A.* 3B:23-14(m).

1. **Fiduciary Duties –** In compromising a claim, the personal representative must, of course, act in good faith and with due care.

2. **Instructions -** If concerned regarding the possibility that a beneficiary could later dispute the compromise, the personal representative can always bring an

---

[1] This Florida statute imposed an absolute bar if claims are not presented within eight months (unlike the current governing New Jersey statute).

[2] Under I.R.C. § 6321, "(i)f any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

application for instructions from the court regarding the proposed compromise. *Rule* 4:95-2; *N.J.S.A.* 2A:16-55

h. **Personal Representative Right of Subrogation if He or She Personally Pays Claim –** A personal representative who advances funds to pay a creditor claim has a right of subrogation and the right to be reimbursed by the estate. *Suydam v. Voorhees*, 58 N.J.Eq. 157, 43 A. 4 (Ch.1899).

1. **Exception –** If the estate was insolvent, the personal representative may only be reimbursed to the extent of the pro rata amount that the creditor otherwise would have been paid from the estate. *First National Bank v. Thompson*, 61 N.J.Eq. 188 (Ch.1901).

II. Old Repealed Law (Repealed Notice Procedures That Previously Governed Estates of Decedents Who Died Prior to February 27, 2005) – New Jersey did not always have a self-executing statute. New Jersey law previously put the onus on the personal representative to notify creditors of the decedent's death and the right to bring a claim. That prior New Jersey law governed decedents who died *prior to February 27, 2005*.

a. Specifically, under the prior version of N.J.S.A. 3B:22-4, which governed the estates of decedents who died prior to February 27, 2005, "at any time after granting letters testamentary or of administration, the Superior Court, or surrogate, as the case may be, may, whether the estate be solvent or not, order the personal representative to give public notice to creditors to present to [the personal representative] their claims".

    i. "If an order [was] entered under N.J.S.A. 3B:22-4, a notice stating the entry, the date thereof, on whose application, and what directions are thereby given,:

        1. [was required to] be mailed by the [personal representative] to each creditor of the estate of which the [personal representative] knows or which can be ascertained by reasonable inquiry, by ordinary mail directed to the creditor's last known address, and

        2. [was to] be published once in such one or more newspapers of this State as may be directed in the order, the publication to be made within 20 days after the date of the order. Such further notice shall be given as the court directs." *Rule* 4:80-8 (repealed).

    ii. The creditor then had to present the creditor's claim to the personal representative "in writing and under oath, specifying the amount claimed, and the particulars of the claim, within 6 months from the date of the order." *N.J.S.A.* 3B:22-4.

    iii. If the creditor did not present such claim within that six month period, the personal representative would not be liable with respect to any assets he may have delivered or paid in satisfaction of any lawful claims, devises or distributive shares, before the presentation of the claim. *N.J.S.A.* 3B:22-9 (repealed).

b. With respect to that prior law (and in jurisdictions that still apply notice procedures like this), there are due process considerations. *Tulsa Professional Collection Services, Inc. v. Pope*, 485 U.S. 478, 485 (1988). In *Tulsa*, the United States Supreme Court considered an Oklahoma "notice claim" statute. The Court found the Fourteenth Amendment's procedural due process protections require that a "reasonably ascertainable" creditor receive actual notice and that notice by publication is only sufficient for creditors that are not reasonably ascertainable. *Id*. at 491. But creditors with mere "conjectural" claims – claims that can be discovered only after investigation of the personal representative -- are not entitled to actual notice. *Id* (citing *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 317

(1950)). The Court held personal representatives need only make "reasonably diligent efforts" to discern a creditor's identity. *Id*.

c. Some states have held *Pope* inapplicable "to self-executing statutes of limitation on creditor's claims that begin running at the time of decedent's death." *See, e.g., State ex rel. Houska v. Dickhaner*, 323 S.W. 3d 29, 33 (Mo. 2010); *In re Estate of Ongaro*, 998 P.2d 1097, 1105-06 (Colo. 2000); *Estate of Decker v. Farm Credit Services*, 684 N.E. 2d 1137, 1139 (Ind. 1997) (holding that because the governing statute "is self-executing, the federal Due Process Clause is not implicated").

III. Untimely Claims Against the Estate – While under current New Jersey law, creditors are no longer provided notice of their right to bring claims upon a decedent's death, a creditor's claim against the estate may not be absolutely barred despite that the creditor does not serve a proof of claim within the above-described nine month period under the current version of N.J.S.A. 3B:22-4. In other words, presenting an untimely proof of claim against an estate is of no great consequence unless the estate turns out to be insolvent (more on that below). 7 *NJPRAC* § 1327.

Absent insolvency, the creditor can recover against the balance of the estate assets remaining after the creditors who have duly presented claims are paid. *Id*. If the personal representative has already distributed the estate assets, the creditor may sue the beneficiaries for recovery of the estates assets that they received. *Id*. (That procedure is also discussed further below.)

a. **Creditor May be Able to Present an Untimely Proof of Claim to the Personal Representative** – If a creditor does not present a written claim that is verified within the requisite nine month period under N.J.S.A. 3B:22-4, the creditor may still be able to present a verified claim at any time before the remaining estate assets have been distributed or paid subject to the below condition. *N.J.S.A.* 3B:22-10.

    i. **Condition –** However, this procedure is not permitted unless the assets of the estate exceed the amount needed to pay the claims that were timely presented within nine months pursuant to N.J.S.A. 3B:22-4, *N.J.S.A.* 3B:22-10. In other words, the estate must be solvent and able to pay all timely presented claims in full. If there is anything then remaining, then the creditor's untimely claim against the estate can be protected and will be governed by the following procedure.

    ii. **Exception –** If an estate is adjudged insolvent, a creditor who fails to present his claim to the personal representative within nine months from the date of decedent's death (as provided in N.J.S.A. 3B:22-4) "shall be forever barred from prosecuting or recovering thereon" unless sufficient assets remain after all timely presented claims are satisfied. *N.J.S.A.* 3B:22-33.

b. **Acceptance of Untimely Claim** – Assuming the above condition is met, a personal representative is to pay the untimely claim if satisfied it is correct to the extent there are assets available to pay it. *N.J.S.A.* 3B:22-11.

    i. **Timing of Payment of Untimely Claim** – A personal representative does not need to pay a claim brought under N.J.S.A. 3B:22-10 until (a) the personal representative's account has been settled and the court has authorized him or her to make payment or (b) the court otherwise directs that it be paid. *N.J.S.A.* 3B:22-14.

    ii. **Action in Any Court to Recover if Not Rejected –** If a claim brought under N.J.S.A. 3B:22-10 is not rejected, but the personal representative fails to pay it,

the creditor may also bring an action against the personal representative to recover on his claim in any court of competent jurisdiction. *N.J.S.A.* 3B:22-12.

c. **Rejection of Untimely Claim** – If the personal representative is not satisfied the claim is correct, the personal representative is to notify the creditor that the creditor is to establish the disputed claim by judgment. *N.J.S.A.* 3B:22-11. Note that this statute does not seem to impose a time limitation by when the personal representative must reject the untimely claim. (Compare that to the deadline above under which a personal representative must reject a timely presented claim within three months of its presentation.)

   i. **Required Retention of Assets Upon Rejection -** The personal representative is to retain assets sufficient to pay the claim together with interests and costs until the claimant has the opportunity to establish the claim by judgment. *N.J.S.A.* 3B:22-11.

   ii. **One Month to Bring Action Upon Rejection** – If the creditor fails to bring an action within one month after being notified to establish the claim by judgment, the creditor is forever barred from any action against the personal representative to recover on the claim. *N.J.S.A.* 3B:22-13.

d. **Rebuttable Presumption That Devise Remains Unpaid** – In an action by a creditor for payment of the creditor's ratable proportion of the creditor's debt, it is presumed that a distribution to a devisee or heir has not been made if no refunding bond has been filed. However, that presumption may be rebutted by proof that the devise or distributive share was actually paid over to the devisee or heir. N.J.S.A. 3B:22-15.

IV. **<u>Untimely Claims Against Devisees or Heirs</u>** – With respect to untimely claims, rather than bring a claim against the estate (or if bringing a claim against the estate will prove fruitless due to the estate's insolvency or because the estate assets have been distributed already), a creditor may bring a claim directly against a devisee or heir to recover under a refunding bond.

a. **Refunding Bond Requirement** – Upon distributing estate assets, the personal representative is to take a refunding bond from the devisee/distributee. That refunding bond is to then be filed in the Surrogate's Court. *N.J.S.A.* 3B:23-4.

b. **Action Against a Devisee or Heir on a Refunding Bond** – A claimant against an estate who has failed to present his or her claim in due form within the time required, may bring an action in his own name without leave of court <u>on a refunding bond</u> given by a devisee or heir and recover the proportion of his claim which ought to be paid out of the devise or distributive share for which the bond was given. N.J.S.A. 3B:22-16.

c. **Limited to Amount Received by Devisee or Heir** - Recovery on a refunding bond shall in no case exceed the amount actually received by the devisee or heir furnishing the bond. *N.J.S.A.* 3B:22-16.

d. **Intermediate Fiduciaries**:

    i. **Defense of an Intermediary Fiduciary Who Has Received a Devise or Distributive Share from the Personal Representative** – A fiduciary (e.g. a trustee) who has given a refunding bond in connection with a devise or distributive share that fiduciary received from the personal representative may bar the action by establishing that (a) the fiduciary has in turn distributed the assets "to the person entitled thereto" (e.g. the beneficiary of the trust) and (b) the fiduciary has also taken a refunding bond in connection with that distribution. *N.J.S.A.* 3B:22-17.

        1. **Defense if Only Part Distributed** – if that intermediary fiduciary has distributed only part of the devise or distributive share, but a refunding bond has been taken in connection with that partial distribution, the fiduciary may assert the same defense with respect to the portion distributed. N.J.S.A. 3B:22-17.

    ii. **Creditor Can Pursue the Ultimate Devisee or Heir** – notwithstanding the intermediary fiduciary's defense, the creditor can pursue an action on a refunding bond taken by that fiduciary against the ultimate devisee or heir as if the personal representative had made the distribution directly and had taken the bond himself. N.J.S.A. 3B:22-18.

V. Statute of Limitations Governing Creditor Claims – A creditor may be subject to a statute of limitations governing the creditor's claim. For example, under New Jersey law, contractual claims are generally governed by a six year limitations period running from the date upon which the action accrued. *N.J.S.A.* 2A:14-1. (But note that an unexpired limitations period will be extended by the period of six months where the debtor/decedent dies. *N.J.S.A.* 2A:14-23.)

a. The mere service of a proof of claim does not suspend the running of a statute of limitations, at least with respect to a solvent estate. *Smith v. Dowden*, 92 N.J.L. 317 (Sup.1919); cf. *Smith v. Crate*r, 43 N.J.Eq. 636 (E. & A.1888) ("The presentation of a claim to an administrator after he has initiated proceedings to declare the estate insolvent suspends the running of the statute of limitations").

b. **Waiver of Statute of Limitations** – Subject to the below requirements, a personal representative may waive any defense of limitations available to the estate. *N.J.S.A.* 3B:22-1.

    a. **Requirements:**

        i. The estate must be solvent; and

        ii. The personal representative must first obtain the consent of all "successors" (i.e., heirs or devisees). *N.J.S.A.* 3B:22-1.

c. **The Statute of Limitations Otherwise Prevents Time-Barred Claims** - If the defense is not waived (or cannot be waived as set forth above), no claim which was barred by any statute of limitations at the time of the decedent's death shall be allowed or paid. *N.J.S.A.* 3B:22-1.

d. **Six Month Tolling Upon Death** – Unexpired statutes of limitations with respect to claims against a decedent are tolled for a period of six months after death. *N.J.S.A.* 2A:14-23.

    a. Moreover, no action can in fact be brought against a personal representative within six months after letters are issued except for (a) funeral expenses or (b) by special leave of the court. *N.J.S.A.* 3B:14-40.

VI. <u>Order of Priority of Claims</u> – Where an estate is insolvent (i.e., its liabilities are in excess of its assets), the personal representative may have to consider which claims are to be prioritized as there may be insufficient assets to pay all creditor claims.

a. **Priority of Payments –** Under *N.J.S.A.* 3B:22-2, if the assets of the estate are insufficient to pay all claims in full, the personal representative is to pay claims in this order:

i. **Reasonable Funeral Expenses;**

1. **"Reasonable" Requirement** – If the estate is insolvent, the personal representative cannot expend all of the estate assets on the funeral, to the detriment of the other creditors, if the cost of the funeral is "unreasonable." The cost of the funeral "should correspond with the circumstances and social conditions [of the decedent], including his station in life and the value of his estate." *Quinn v. Koeck*, 95 N.J.Super. 467, 470, 231 A.2d 822–824 (App.Div.1967).

ii. **Administration Costs/Expenses;**

1. **Includes Allowed Expenses:** commissions of the personal representative, legal fees (including to himself or herself if he/she is an attorney), accounting fees, travel expenses, premium on a surety bond, and other reasonable expenses that a court would allow in a formal accounting matter.

   a. RPC 1.5 governs reasonableness of counsel fees.

2. **Does Not Include Disallowed Expenses:** *personal* expenses of the personal representative (for example, the personal representative's meals). *In re Linn*, 124 N.J.Eq. 65, 199 A. 396 (E. & A.1938) ("Executor was not entitled to an allowance for lunches and like personal expense, but was entitled to reimbursement for reasonable traveling expenses incurred in traveling between his home and office from which estate's business was administered").

iii. **Debts Owed to Office of the Public Guardian for Elderly Adults;**

iv. **Debts and taxes that have preference under federal law or the laws of New Jersey;**

1. **Federal Tax Debt (Including Federal Estate Tax) Has Priority Over New Jersey Tax Debt (Including New Jersey Inheritance Tax) -** where estate assets insufficient to satisfy both liens. *Matter of Kurth's Estate*, 185 N.J. Super. 443 (App. Div. 1982) (citing 31 *U.S.C.A.* §§ 191 and 192, which were the predecessors of 31 *U.S.C.A.* § 3713); 26 *U.S.C.A.* § 6324; *N.J.S.A.* 54:35–5.

a. **Personal Liability of Personal Representative to Federal Government -** Under federal law, a personal representative is personally liable to the federal government if he or she pays a debt subordinate to a debt owed to the federal government where the estate is insolvent. The personal representative is liable to the extent of the amount paid. 31 *U.S.C.A.* § 3713(b); *IRC* § 6901(a) (fiduciary personally liable under 31 *U.S.C.A.* § 3713(b) for income, estate, and gift taxes); Treas. Reg. § 301.6901-1(a) (providing for assessment and collection of the fiduciary's personal liability with respect to an income tax).

2. **New Jersey Tax Debt Take Priority Over Municipal Tax Debt** - *Bowes v. United States*, 127 N.J.Eq. 132 (Ch.1940) ("Executor, in paying claims against deceased's estate, was required to pay claims for administration expenses first, then claims for estate taxes due the United States, then claims for inheritance taxes due the state, then claims for municipal taxes, and finally claims of general creditors.").

   a. But note that a recorded property tax lien may be satisfied from real estate specifically (as opposed to other assets of estate). See below.

v. **Reasonable medical and hospital expenses of the <u>last</u> illness of the decedent, including compensation of persons attending him;**

1. **"Last Illness" –** Refers to "the period to be preferred is the interval commencing when a patient is permanently stricken and does not recover from the ravages of a long-standing condition, and not the treatment over a long period covering months or years." *In re Estate of Carpentiero*, 102 N.J.Super. 395, 404 (Cty.Ct.1968). "Any other construction would lead to extremely large medical claims prejudicial to other worthy claims, and would favor dilatory practices on the part of medical claimants." *Id* (holding hospital bill was incurred during decedent's "last illness" despite that death occurred three months after his discharge from the hospital as the proximate cause of death was the condition for which decedent was treated at hospital and the three month period was "not so inordinate as to require denial of a preference).

vi. **Judgments entered against the <u>decedent</u> according to the priorities of their entries respectively; and**

1. **Judgments Only Granted Priority if Against *Decedent* (Not Against Estate)** – *Ward v. Kaycoff*, 9 N.J.Misc. 498 (Sup.1931) ("judgments to be preferred must be actually entered of record

during the lifetime of defendant"); *Matter of Estate of Forgett*, 2019 WL 4165062 (App. Div. 2019) ("a judgment against an executor or administrator . . . unlike a judgment against a decedent in his lifetime, is not entitled to a preference over other claims payable out of the assets of the decedent's estate") (citing 7 N.J. Practice, Wills and Administration § 1283).

a. **Judgments Against Personal Representative Not Entitled to Preference –** On the other hand, a judgment, after death, entered against the personal representative (or against an heir, devisee, or legatee) is not entitled to preference over other claims payable out of the estate. *Ryan v. Van Arx*, 46 N.J.L. 531, 531 (E. & A.1884) (judgment entered against personal representative "will not be entitled to be paid in preference to other creditors").

2. **Liens Under Judgments Entered Against Decedent Create Secured Claims –** If, under a judgment against a *decedent*, a lien has been acquired, then:

a. to the extent of the lien, the judgment creditor's claim is a secured claim (*Wright v. Wright*, 70 N.J.Eq. 407 (Ch.1905)); and

b. for the balance, it is just a preferred claim.

vii. **All other claims.**

1. **Secured Claims Are Superior to Preferred Creditors** – 7 N.J. Prac., Wills And Administration § 1280.

b. **Above Order of Priority Does Not Govern Real Estate Encumbered by Mortgages and Tax Liens –** Above order of priority will not trump a lien that attaches to real estate to the extent it is <u>not the personal liability</u> of the decedent who is the owner of the real estate:

i. **Mortgages Recorded on Real Estate Are Not Subject to N.J.S.A. 3B:22-2 –** "[W]hether an estate is insolvent or not, payment of the mortgage debt on real property is to be satisfied primarily from the property itself, not from the assets of the estate." *Investors Savings Bank, Inc. v. Sitzman*, 2010 WL 2471122, *3 (App. Div. 2010). Thus a personal representative "cannot invoke the provisions of N.J.S.A. 3B:22-2 to defeat [a mortgagee's] foreclosure action." *Id*. Moreover, the failure of a mortgagee or its assignee to present a claim for the mortgage debt will in no way prejudice it when it comes to foreclose the mortgage. *Slack v. Emery*, 30 N.J.Eq. 458, 462 (Ch.1879).

ii. **Property Tax Liens Recorded on Real Estate, Including Tax Sale Certificates, Are Not Subject to N.J.S.A. 3B:22-2 –** In *In the Matter of Pryo*r, 366 N.J. Super. 545 (App .Div. 2004), cert. denied, 181 N.J. 545 (2004), the Appellate Division considered property tax liens that attach to land and are not assessed against a property owner (i.e., property owners have no personal liability for property taxes). *Id* at 552. The *Pryor* Court determined that those municipal tax liens, including those incorporated in tax sale certificates, have first lien status and are to be paid prior to any other claims against an insolvent estate, including, for example, Medicaid and Public Guardian liens. *Id* at 553-54 (citing N.J.S.A. 54:5-9).

c. **No Preference to Any Claim of the Same Class of Another Claim -** No preference shall be given in the payment of any claim over any other claim of the same class. *N.J.S.A.* 3B:22-2.

d. **Claims Due and Payable Not Given Priority -** A claim due and payable shall not be entitled to a preference over claims not due. *N.J.S.A.* 3B:22-2.

e. **Commencement of an Action Does Not Give a Creditor Priority -** The mere commencement of an action against the personal representative in which the creditor seeks (a) recovery of a debt or claim or (b) entry of a judgment thereon against the personal representative shall not entitle such debt or claim to preference over others of the same class. *N.J.S.A.* 3B:22-2.

VII. **<u>Abatement</u>** – What if the assets of the estate residue are insufficient to pay debts? It may be the case that specifically devised assets are then necessary to satisfy a claim. But, in that case, how does the personal representative determine which assets should be used to satisfy the claim? The law below provides guidance.

a. **Abatement of Estate Assets to Pay Creditor Claims** - Estate assets abate in accordance with N.J.S.A. 3B:23-12 in order to satisfy debts or claims. *N.J.S.A.* 3B:22-3.

b. **Order of Abatement** – Distributive shares generally abate (regardless of whether they consist of real or personal property) in the following order:

   i. Property passing by intestacy;

   ii. Residuary devises;

   iii. General devises (i.e., a bequest of "$20,000 to my daughter"); and

   iv. Specific devises (i.e., a bequest of "my diamond ring to my daughter"). *N.J.S.A.* 3B:23-12.

c. **Proportional Reductions in Each Classification -** Abatement within each above classification is in proportion to the amount of property each of the beneficiaries would have received if full distribution of the property had been made in accordance with the terms of the will. *N.J.S.A.* 3B:23-12

d. **Exceptions Where Abatement Statute (3B:23-12) Doesn't Apply:**

   i. **Share of Spouse Who Elects to Take Elective Share** – The share of a surviving spouse who elects to take an elective share is not affected by abatement. *N.J.S.A.* 23-12.

   ii. **Terms of Will Override the Above Order** - If the will expresses an order of abatement, the shares abate in accordance with the Will. *N.J.S.A*. 3B:23-14.

   iii. **If Purpose of Devise Would be Defeated by Abatement Statute -** if the testamentary plan or the express or implied purpose of the devise would be defeated by the order of abatement stated in N.J.S.A 3B:23-12, shares of the distributees abate as may be found necessary to give effect to the intention of the testator. *N.J.S.A*. 3B:23-14.

VIII. <u>Creditor's Rights in Multi-State Administrations</u> – It may be the case that the decedent died domiciled in another jurisdiction, but left New Jersey assets (in which case there could be ancillary probate or administration in New Jersey). The New Jersey statutory law governing creditor claims considers this scenario:

a. **New Jersey Estate Assets are Subject to Claims Against Personal Representatives Even if Not Appointed in New Jersey** – If estate assets are administered in New Jersey, they are subject to all claims against a personal representative even if the personal representative was not appointed in New Jersey. *N.J.S.A.* 3B:22-19.

b. **Payment of Claims Allowed in Outside Jurisdictions Where Estate Insolvent** – If the estate (within New Jersey or as a whole) is insufficient to cover all claims, <u>each creditor</u> (whether the creditor's claim has been allowed <u>in New Jersey or</u> in an estate administration in <u>another state</u> of which the personal representative is aware) is entitled to receive payment of an equal proportion of his or her claim. *N.J.S.A.* 3B:22-20.

    i. **Preference or Security in Another State** – If a preference or security in regard to a claim is allowed in another jurisdiction but not in New Jersey, the creditor so benefited is to receive dividends from New Jersey assets only upon the balance of the creditor's claim after deducting the amount of the benefit (i.e., after deducting the amount of the foreign preference or security). *N.J.S.A.* 3B:22-20.

c. **Estate of Decedent Not Domiciled in New Jersey, Who Died With New Jersey Assets** (N.J.S.A. 3B:22-21) - If (a) the claims against the entire estate exceed the total value of <u>all</u> estate assets (including both the estate assets administered in New Jersey and the assets administered outside New Jersey) <u>and</u> (b) the decedent was not domiciled in New Jersey upon his or her death:

    i. **If Possible, New Jersey Assets Used to Make Proportionate Payment -** A proportionate payment of the claims allowed in New Jersey shall be made if the New Jersey assets are sufficient for this purpose; and

        1. **Remaining New Jersey Assets -** The balance of the New Jersey assets shall be transferred to the personal representative appointed in New Jersey.

    ii. **If New Jersey Assets Insufficient -** If New Jersey assets are insufficient to pay all claims allowed in New Jersey, New Jersey assets are to be marshaled so that each claim allowed in New Jersey is paid its proportion as far as possible, after taking into account all dividends on claims allowed in New Jersey from assets in other jurisdictions.

IX. Real Property

a. A personal representative must take possession of a decedent's real property and manage it for the benefit of creditors and other interested parties. *N.J.S.A.* 3B:10-29 and 3B:10-30. The personal representative will also have the power to sell the property if such power is conferred by will or by N.J.S.A. 3B:14-23.

b. **Personal Representative's Action for Permission to Sell Real Estate -** Personal representative can file an action before the Probate Part for permission to sell real estate where he or she believes that the remaining assets of the estate are insufficient to pay creditor claims. *Rule* 4:90-1.

   i. **Unnecessary if Personal Representative Has Authority -** If, however, the personal representative has authority to sell real estate (either under the Will or under N.J.S.A. 3B:14-23), such an action may be unnecessary.

   ii. **Specifically Devised Real Estate -** Under N.J.S.A. 3B:14-23(e), a personal representative can sell real estate owned by an estate at public or private sale *"except where the property or an interest therein is specifically disposed of.*" Thus if a personal representative determines he or she must sell specifically devised real estate, it seems he or she may need to bring a court application for permission to do the same.

c. **Creditor's Action to Compel Sale of Real Estate** – After securing a judgment against the personal representative, a creditor can bring an action before the Probate Part to compel the sale of real estate to satisfy its judgment debt.

   i. **Requirements** – Creditor's verified complaint must confirm:

      1. **Judgment -** "the creditor has reduced his claim against the executor or administrator to judgment" [*Rule* 4:90-2(a)];

      2. **Unsatisfied -** "the judgment remains partly or wholly unsatisfied for want of personal assets" [*Rule* 4:90-2(b)];

      3. **Real Estate -** "there is real estate, specifying its description, location, character, condition and value, as near as may be" [*Rule* 4:90-2(c)]; and

      4. **No Action by Personal Representative for Permission to Sell -** "the executor or administrator, notwithstanding that demand has been made upon him more than one month previously, has failed to commence an action for the sale of the real estate." [*Rule* 4:90-2(d)].

d. **Bond of Heir or Devisee to Prevent Sale of Real Estate** – Heirs or devisees can prevent a sale by furnishing a bond with sureties binding themselves to pay all unpaid debts and administration expenses. *Rule* 4:90-6. If the heir or devisee then fails to pay such debt or expense, upon the personal representative's application, the Probate

Part can then direct that either the surety bond be enforced or that the personal representative be permitted to proceed with selling the real estate. *Id*.

e. **Mortgages and Other Recorded Liens** - As addressed further above, real property cannot be sold free of a mortgage or other lien that encumbers the property. *See*, *e.g.*, *Investors Savings Bank, Inc. v. Sitzman*, 2010 WL 2471122, *3 (App. Div. 2010) ("whether an estate is insolvent or not, payment of the mortgage debt on real property is to be satisfied primarily from the property itself, not from the assets of the estate"); *In the Matter of Pryo*r, 366 N.J. Super. 545, 552 (App .Div. 2004), cert. denied, 181 N.J. 545 (2004) (holding that property owners have no personal liability for property taxes and thus the property tax lien is paid from the proceeds of the real property).

f. **One-Year Statutory Lien on Decedent's Real Property** – In addition to mortgages and recorded liens, for a limited period of one year from the date of the decedent's death, a decedent's real property also remains susceptible to his or her other creditor claims. *N.J.S.A.* 3B:22-22 (real property of "any person" is liable for the payment of the decedent's debts for only one year after his date of death). In other words, N.J.S.A. 3B:22-22 creates a statutory lien in favor of all creditors (including unsecured creditors) that encumbers the real estate for a period of one year.

   i. **Title Company Upon Sale –** Because of the statutory lien, if the property is being sold within one year of the decedent's death, the buyer's title company might require information concerning the assets and debts of the estate and a bond from the executor before agreeing to insure the property. (Some title companies may require that proceeds be held in escrow until that one year period elapses.)

   ii. **Creditor's Court Action to Compel Sale in Order to Enforce Statutory Lien Must be Brought Within One Year –** A creditor can, in a sense, enforce that statutory lien by bringing an action, within that one-year period, pursuant to *Rule* 4:90-2 to compel the sale of real estate. *Mott v. German Hosp.*, 55 N.J. Eq. 722 (Ch. 1897) ("a creditor of the testator has no lien as against an incumbrance created by the devisee unless he enforces his remedy within the year"). If the action is not brought within that one-year period, the statutory lien is then lifted.

   iii. **Personal Representative's Court Action to Sell Prior to Expiration of One-Year Statutory Lien** – Nonetheless, during that one year period, the personal representative may sell the real property free of this statutory lien if the sale is approved by the court. *N.J.S.A.* 3B:22-22.

      1. **Condition –** Upon such an application, the court must approve the sale "upon terms and conditions as the court may direct for the protection of creditors" (notwithstanding any alienation or encumbrance made or attempted to be made by the heirs or devisee to the contrary). *N.J.S.A.* 3B:22-22.

iv. **One Year Limitation Period Can Only be Extended by Will if the Will Provides for a Lien** – In order to extend the one year limitation under N.J.S.A. 3B:22-22, the decedent's Will must contain "express language to the effect that the debts shall remain a lien upon the real property for a longer period." *N.J.S.A.* 3B:22-23 (emphasis added).

1. **Absent the Imposition of Lien, Other Language in the Will is Insufficient to Extend the One Year Period** – The one year period "shall not be deemed to be extended by any directions in a will that just debts be paid. Any charge upon real property created by any directions in a will that just debts be paid shall not attach to the real property beyond the period of 1 year fixed in [N.J.S.A. 3B:22-22]. . ." *N.J.S.A.* 3B:22-23.

g. **After One Year, Personal Representative Still Obligated to Satisfy Creditor Claims Pursuant to the Above-Described Procedure –** Even after the one-year statutory lien expires, the personal representative is not absolved of the obligation to pay creditor claims, including applying the proceeds of a sale of the property toward creditor claims.

h. **Heirs and Devisees Still Liable After One Year –** In addition, despite that the real property itself is not subject to the statutory lien for the payment of debts after one year, the expiration of the one year period will not affect any liability of heirs of devisees under N.J.S.A. 3B:22-39 *et seq*. *N.J.S.A.* 3B:22-24. So, in other words, if heirs or devises receive real property from an estate, they are still liable for the unsatisfied debt to the extent of the real property they receive. *N.J.S.A.* 3B:22-40 (this statute is discussed in more detail below).

X. Sale of Property Subject to Escheat to Pay Debts

a. **Court Order to Sell Property Subject to Escheat to New Jersey –** If property of the estate is to escheat to the State of New Jersey, but it is necessary to sell that property in order to pay the decedent's debts, the court "shall" direct the personal representative to sell that property sufficient for that purpose. *N.J.S.A.* 3B:22-26.

b. **All of Property Sold Vests in Purchaser** – When the personal representative, pursuant to court order (as provided in N.J.S.A. 3B:22-26), sells property that was to escheat to New Jersey, title to that property vests entirely in the purchaser of that property. *N.J.S.A.* 3B:22-27.

c. **Court Order Confirming Sale** – The judgment or order directing the sale is "conclusive evidence in all courts of the validity of the proceedings for sale and of the fulfillment of statutory requirements." *N.J.S.A.* 3B:22-28.

    i. **Setting Aside the Order** – The judgment or order can be set aside or reversed in an appropriate proceeding, but such a proceeding does not affect a bona fide purchaser, who (along with his heirs and assigns) holds the property despite that a court may set aside the Order confirming the sale and notwithstanding any defect in the proceedings for sale. *N.J.S.A.* 3B:22-28.

d. **Surplus Payable to State Treasurer** – After debts and administration expenses paid, if there are no heirs, the court shall order the surplus be paid to the State Treasurer and the personal representative shall have no further obligation regarding the surplus. *N.J.S.A.* 3B:22-29.

XI. Insolvent Estates

a. **Preferred Expenses and Debts Satisfied First From Insolvent Estate** – In the case of an insolvent estate, the estate is first applied to the preferred expenses and debts in accordance with N.J.S.A. 3B:22-2 (see above). *N.J.S.A.* 3B:22-32.

b. **Once Preferred Expenses and Debts are Satisfied, Pro Rata Distribution of Balance to Creditors** – Once preferred expenses and debts are satisfied in accordance with N.J.S.A. 3B:22-2, the balance of the assets of the insolvent estate are to be distributed among the decedent's creditors in proportion to the sum due to each. *N.J.S.A.* 3B:22-32.

c. **In Case of Adjudged Insolvent Estate, Untimely Claim is "Forever Barred"** – If an estate is adjudged insolvent, a creditor who fails to present his claim to the personal representative within nine months from the date of decedent's death (as provided in N.J.S.A. 3B:22-4) "shall be forever barred from prosecuting or recovering thereon." *N.J.S.A.* 3B:22-33.

   i. **Exception –** If all exhibited and allowed claims are fully satisfied and assets remain in the estate, or the creditors find some other unaccounted for asset, the creditor shall receive his ratable proportion therefrom. *N.J.S.A.* 3B:22-33.

   ii. **Extension of Time Limitation** – Before distribution is made, upon application of any creditor, the court may extend the time under which creditors may present claims. *N.J.S.A.* 3B:22-33.

d. **Action to Have an Estate Adjudged Insolvent** – In an action to have an estate adjudged insolvent, the court may adjudicate upon and determine the amount and value of the estate and the liability of the estate on claims made against it. *N.J.S.A.* 3B:22-34; *Rule* 4:91-1 et seq. (describing procedure for bringing such action by Order to Show Cause and Verified Complaint).

   i. **Accounting** – "The executor or administrator shall also file with the complaint an account in the form required by R. 4:87-3." *Rule* 4:91-1(b).

   ii. **Judgment of Insolvency** – the court may enter a judgment adjudging an estate insolvent if it appears the estate is insufficient to pay debts and direct the personal representative to proceed as if the estate were insolvent, and to make sale of the whole or any part of the estate of his decedent, from time to time, as may appear expedient. *N.J.S.A.* 3B:22-35; *Rule* 4:91-1(c).

e. **Distribution of Proceeds of Insolvent Estate** - Proceeds of the insolvent estate which come to the hands of the personal representative shall be distributed under direction of the court, from time to time, as may be found convenient and just. *N.J.S.A.* 3B:22-36.

f. **Residue After Payment of All Debts and Claims** – If any residue remains after full payment of all debts and claims, it is to be divided among the heirs or devisees as provided by law or by will, respectively. *N.J.S.A.* 3B:22-37.

g. **Actions Against a Personal Representative of an Insolvent Estate Allowed** - Nothing precludes an action against the personal representative of an insolvent estate for waste or misapplication of the estate of his decedent. *N.J.S.A.* 3B:22-38.

XII. Liability of Heirs and Devisees

a. **Heirs and devisees liable for debt of decedent** – Every creditor may maintain an action against the heirs and devisees of his deceased debtor. The heirs or devisees are liable to pay the debt by reason of the descent or devise of the real or personal property to them. In all actions creditors shall be preferred as in actions against personal representatives. *N.J.S.A.* 3B:22-40; *N.J.S.A.* 3B:23-24 (refunding bond requirement).

b. **Joinder of Parties** – The creditor's action against heirs or devisees is to be brought against all of the heirs and devisees of the deceased debtor who can be "found within [New Jersey]."[3] *N.J.S.A.* 3B:22-41.

c. **General Judgment** – Generally, a judgment against an heir or devisee is "general" such that it will be entered against the heir or devisee *personally* for the full amount due and collectible from any assets of the heir or devisee (as if it was the heir or devisee's own personal debt). *N.J.S.A.* 3B:22-42.

  i. The judgment against the heir or devisee will be "general" if the "judgment goes against the heir or devisee by default or after a trial on an answer which does not admit the inheritance or devise of the property or if the answer has been struck out entirely." 7 *NJPRAC* § 1312.

  ii. **Exception: Special Judgment** – If, however, the heir or devisee admits in the action the descent or devise to him or her, specifically describing it, then judgment is then instead "special" and is limited to only the specific property that the heir or devisee received such that only that specific asset (or assets) received can be pursued. *N.J.S.A.* 3B:22-42.

d. **Descended or Devised Property Thereafter Sold** – In the event an asset was distributed to an heir or devisee and was thereafter sold or transferred in a bona fide transaction prior to the commencement of the creditor's action against the heir or devisee, the property that was sold or transferred is not liable for the debt (even if the judgment would have otherwise been "special" under N.J.S.A. 3B:22-42). *N.J.S.A.* 3B:22-43.

  i. **General Judgment Against Heir or Devisee for Total Amount Received in Sale** - In the event of such a sale or transfer, the judgment against the heir or devisee is instead a "general" judgment and the heir or devisee is personally liable for "the full amount thereof." *N.J.S.A.* 3B:22-43.

    1. This general rule will apply "(i)f the heir or devisee files no answer or does not admit in his answer the devise or descent, or if his

---

[3] N.J.S.A. 3B:22-41 does not explain its use of the phrase "found within the State" and there do not appear to be reported decisions in New Jersey explaining this language.

answer is struck out entirely, a general judgment will be entered for the amount of the debt." 7 *NJPRAC* § 1314.

2. **Exception: Limited General Judgment** – If, however, the heir or devisee admits in the action the descent or devise to him, specifically describing it, the judgment remains "general"[4], but that general judgment will then be limited to the value of the asset that was descended or devised. *N.J.S.A.* 3B:22-43. That limited general judgment will not include the value of any improvements made on the descended or devised property that was sold or transferred. 7 *NJPRAC* § 1314 (if the heir or devisee "pleads the alienation (or sale), admits the descent or devise of the land (or personal property) and specifically describes the land (or other property), he is liable at law to the creditor to the extent of the value of the land (or other property) in the condition in which it stood at the decedent's death, but not for improvements made by him").

e. **Contribution** – an heir or devisee may pursue a claim for contribution from the other heirs and devisees who are also liable for the debt. *N.J.S.A.* 3B:22-44.

[4] It remains "general" because the specific descended/devised property no longer is in the hands of the heir/devisee such that the execution of the judgment "is collectible out of the property of the heir or devisee generally." 7 NJPRAC § 1314.

ADMINISTERING RETIREMENT ASSETS AFTER DEATH UNDER THE SECURE ACTS

Leonard J. Witman, Esq.
Tara S. Sinha, Esq.
Witman Stadtmauer, P.A.
26 Columbia Turnpike, Suite 100
Florham Park, NJ 07932
(973) 822-0220

Who does an IRA pay to?

- Individual Retirement Accounts ("IRAs") are non-probate assets
- IRA is governed by beneficiary designation form ("BDF"), not by decedent's Will or Revocable Trust
- Unlike many pension accounts, IRAs are generally not required to be paid to an account holder's spouse.

Who does an IRA pay to?

- If IRA did not designate a beneficiary, have to look at master plan document to determine beneficiary; if owner was married, may be spouse; otherwise, typically the estate.
- If account pays to estate, must be distributed within 5 years, unless "ghost" rule applies if owner was in distribution status. This rule also applies for any non-"designated beneficiary" – i.e. charities, non-qualified trusts (trusts discussed later).

How are IRAs taxed?

Estate/inheritance tax – IRAs are included in the deceased account holder's estate and are subject to federal and state (if applicable) estate tax and inheritance tax (if applicable). NOTE: 691(c) deduction will apply if federal estate tax is incurred.
NJ inheritance tax – beneficiary gets a tax basis equal to value of account reported on Form IT-R (if subject to tax)

How are IRAs taxed?

Income tax – Income taxation of an IRA depends if the account is a traditional or Roth IRA. Federal and state laws differ. Roth IRA distributions are generally income tax free. Distributions from a traditional IRA are taxed as ordinary income (federal, states vary). Therefore, the law imposes withdrawal requirements upon IRA holders during life and beneficiaries after death.

Post-SECURE Administration

- SECURE has three categories of beneficiaries --

  (1) Designated beneficiaries (DB) – with certain exceptions (below), individuals and certain types of trusts, which must receive all distributions from the IRA by the end of the 10th year after the IRA holder's death.

Post-SECURE Administration

(2) Eligible designated beneficiaries (EDB) – special exceptions to the DB rules that are still allowed to take a form of life expectancy payouts

(3) Non-designated beneficiary – an estate, charity, or non-qualified trust. For a non-DB, the 5-year rule still applies, unless the account holder was in distribution status, then you can apply the owner's remaining life expectancy (ghost rule)

Post-SECURE Administration

5 types of Eligible Designated Beneficiaries –

(1) Surviving spouse
(2) Minor child (not grandchild) – 10-year rule applies upon reaching majority
(3) Disabled beneficiary
(4) Chronically ill beneficiary
(5) Less then 10 years younger beneficiary

Post-SECURE Administration

In 2022, the Treasury Dept. issued Proposed Regulations to the SECURE Act that SIGNIFICANTLY changed how we understand SECURE and how payments are to be made to beneficiaries, making it clear that a defining line is drawn whether an account holder dies before or after his/her

REQUIRED BEGINNING DATE (RBD)!

SECURE 2.0 – Required Beginning Date

- Required beginning date increased to age 73 starting in 2023
- Required beginning date increased to age 75 beginning in year 2033
- Born before 1951 – no effect

  1951-1959 – RMD at age 73

  1960 and later – RMD at age 75

Post-SECURE Administration

Type of Beneficiary	Death Before Required Beginning Date (RBD)	Death After Required Beginning Date (RBD)
Eligible Designated Beneficiary (EDB)	EDB can "stretch" using own life expectancy OR (in limited circumstances) EDB can elect 10-year rule (plan allows account holder or beneficiary to elect 10-year rule) **NOTE: default rule for EDB is life expectancy payout**	Life expectancy distributions over the longer of the EDB's life expectancy or the account holder's life expectancy (ghost rule) (be careful for older beneficiaries!); spouse can still rollover; no option for 10-year rule
Designated Beneficiary (DB)	10-year rule – no distributions required until end of year 10	Annual distributions based on longer of account holder or DB's life expectancy but whole account must come out by year 10!
Non-Designated Beneficiary	5-year rule – no distributions required until end of year 5	Ghost rule – continue RMDs based on decedent's life expectancy, finish distributions within 5 years

Post-SECURE Administration

- Surviving spouse – Most post-death planning for surviving spouse remains the same.
- Spouse can still roll decedent's IRA to his/her own IRA.
- A conduit trust for the surviving spouse is still eligible for lifetime RMDs. Accumulation trust does not work and 10-year rule applies.
- Upon spouse's death, 10-year rule applies.

Post-SECURE Administration

Disabled beneficiaries- definitions coincide with Social Security definition; Section 72(m) of the Code relating to early distributions defines disabled as “unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or be of long-continued and indefinite duration…”

Post-SECURE Administration

Chronically-ill beneficiaries – utilizes long-term care insurance definitions. Looks at inability to perform at least two activities of daily living for a period of at least 90 days due to a loss of functional capacity or presence of a disability or requirement of substantial supervision to protect individual's health and safety due to cognitive impairment.

Post-SECURE Administration

- Less than 10 years younger beneficiary – i.e. siblings, unmarried partner, friend
- Proposed Regulations make it clear that look to exact birthdate (i.e. month/day), not just year, to determine if <10 years younger
- After death of 10 year younger EDB, subsequent beneficiaries have 10-year rule.

Post-SECURE Administration

- Proposed Regulations clarify – age of majority for children is **21**; take RMDs based on life expectancy
- After reaching majority, 10-year rule applies; but, they still must continue to take RMDs based on life expectancy until 31, by which time full balance of account must have paid out
- REMEMBER – tolling to age of majority is for CHILDREN only, not GRANDCHILDREN

Post-SECURE – Tax and Timing

So, you inherit an IRA and you fall within the 10-year rule – what does this mean?

- First issue - Was the decedent before or after RBD? Will determine distribution options
- Timing – All distributions must be made by 12/31 of the year that marks the 10th anniversary of the account holder's death.

Post-SECURE – Tax and Timing

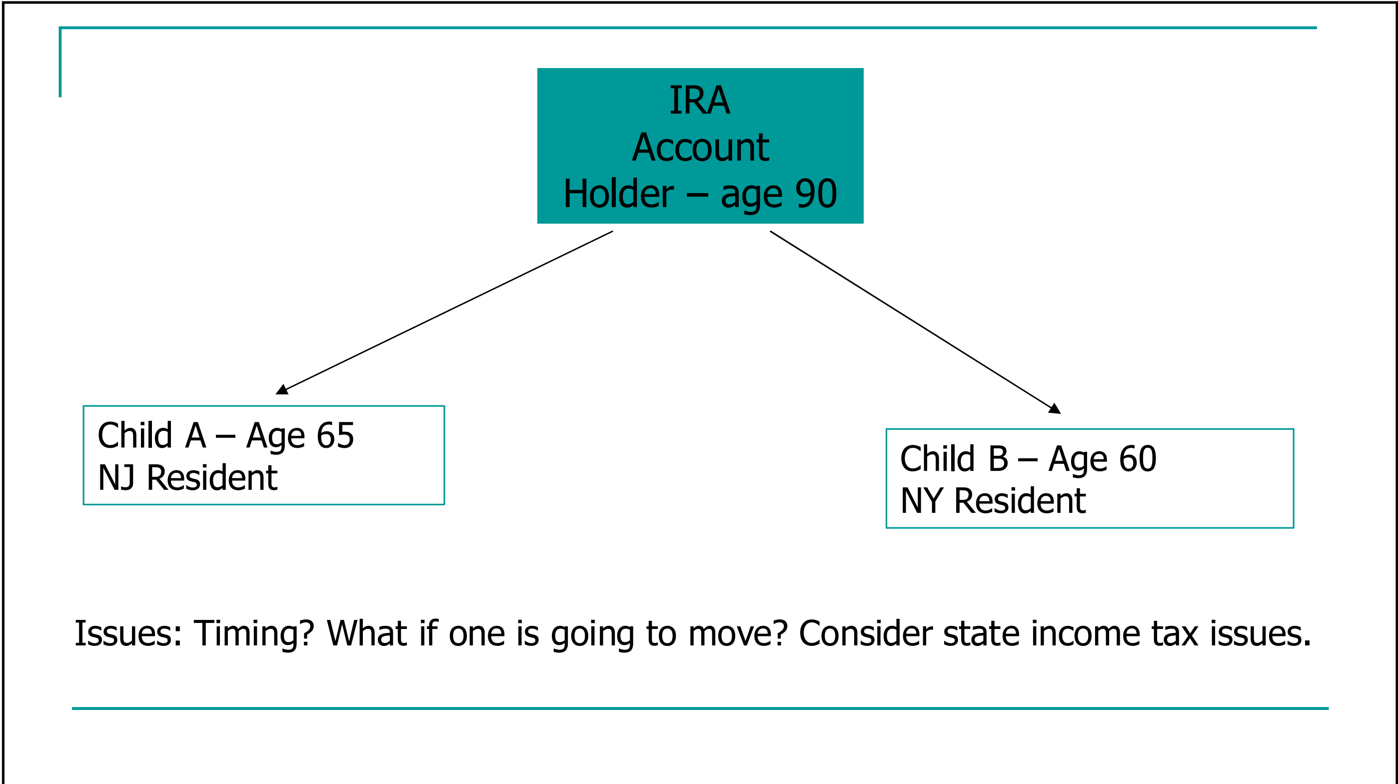
- Income Tax Considerations – Unless the IRA is a Roth, the distributions will be taxed as ordinary income (remember, states and fed differ). Therefore, timing of distributions have important income tax consequences. Must consider both federal and state income tax implications.

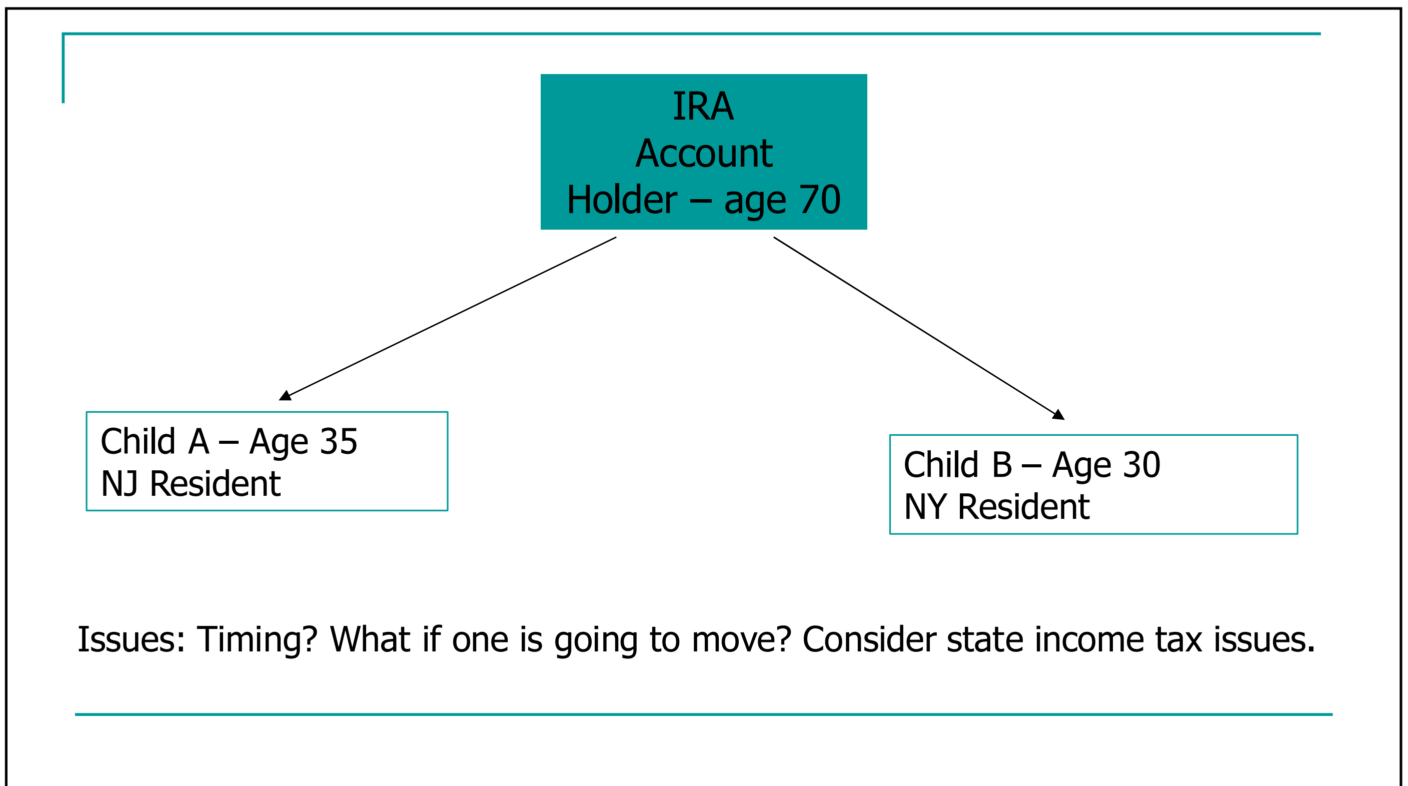
Post-SECURE – Tax and Timing

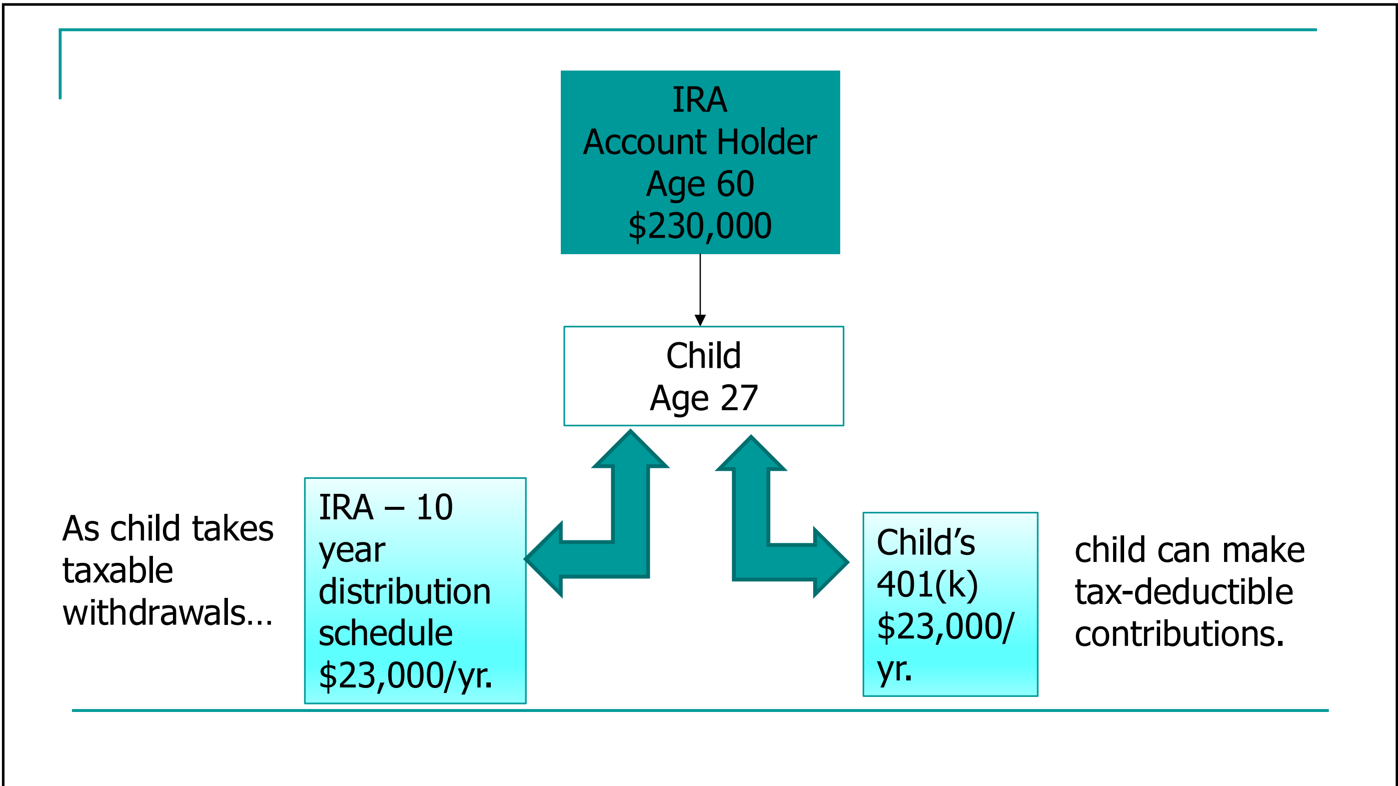
- Things to consider when timing distributions:
  - Market conditions
  - Income taxation of individual beneficiaries
  - Income taxation of trusts and whether trusts pass through benefit to individual (assuming accumulation)
  - Can you defer larger distributions to Year 10 to maximize growth in IRA? Bigger tax bill? What if a Roth?
  - Creditors
  - Beneficiary's estate planning – contribute to 401(k), Roth?

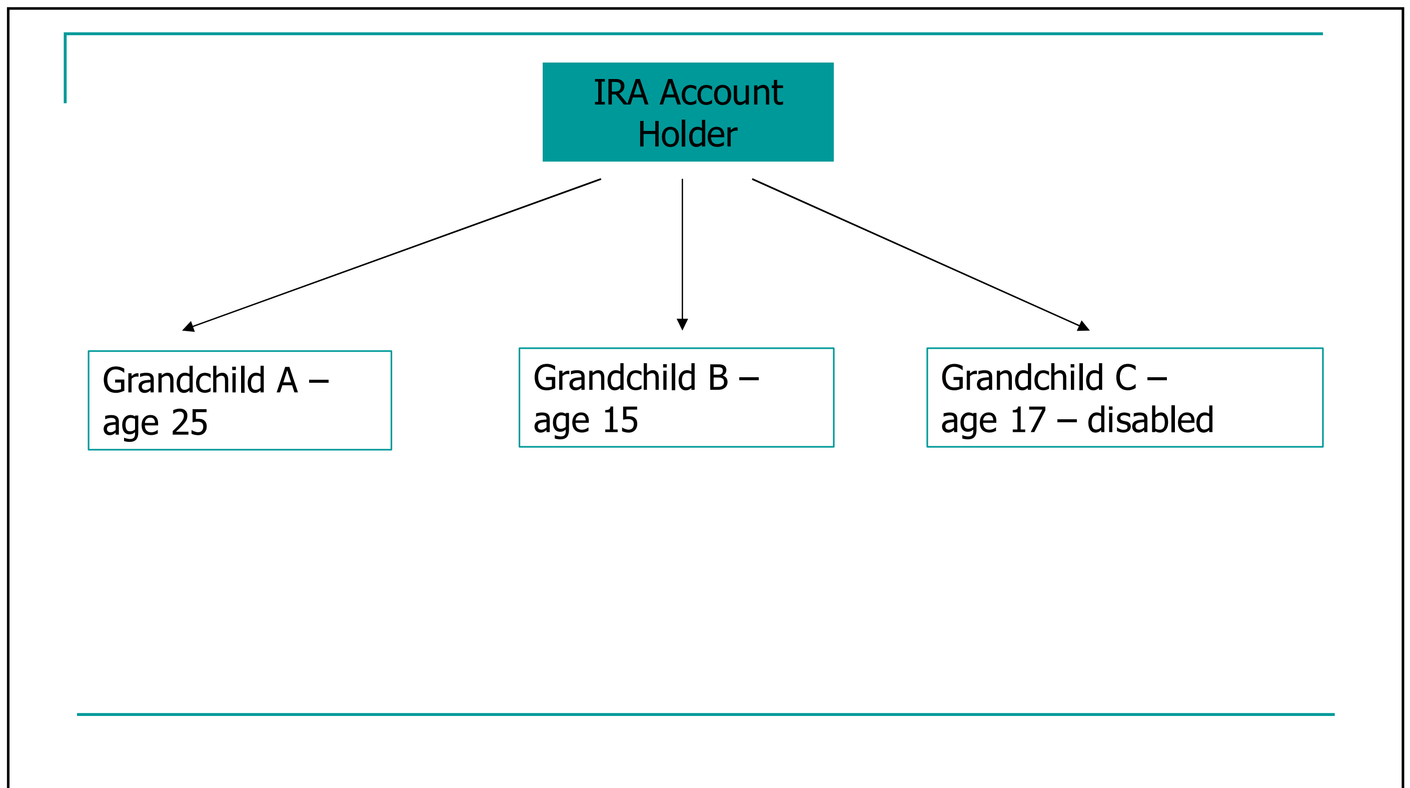
SECURE 2.0 – Excise Tax Rates

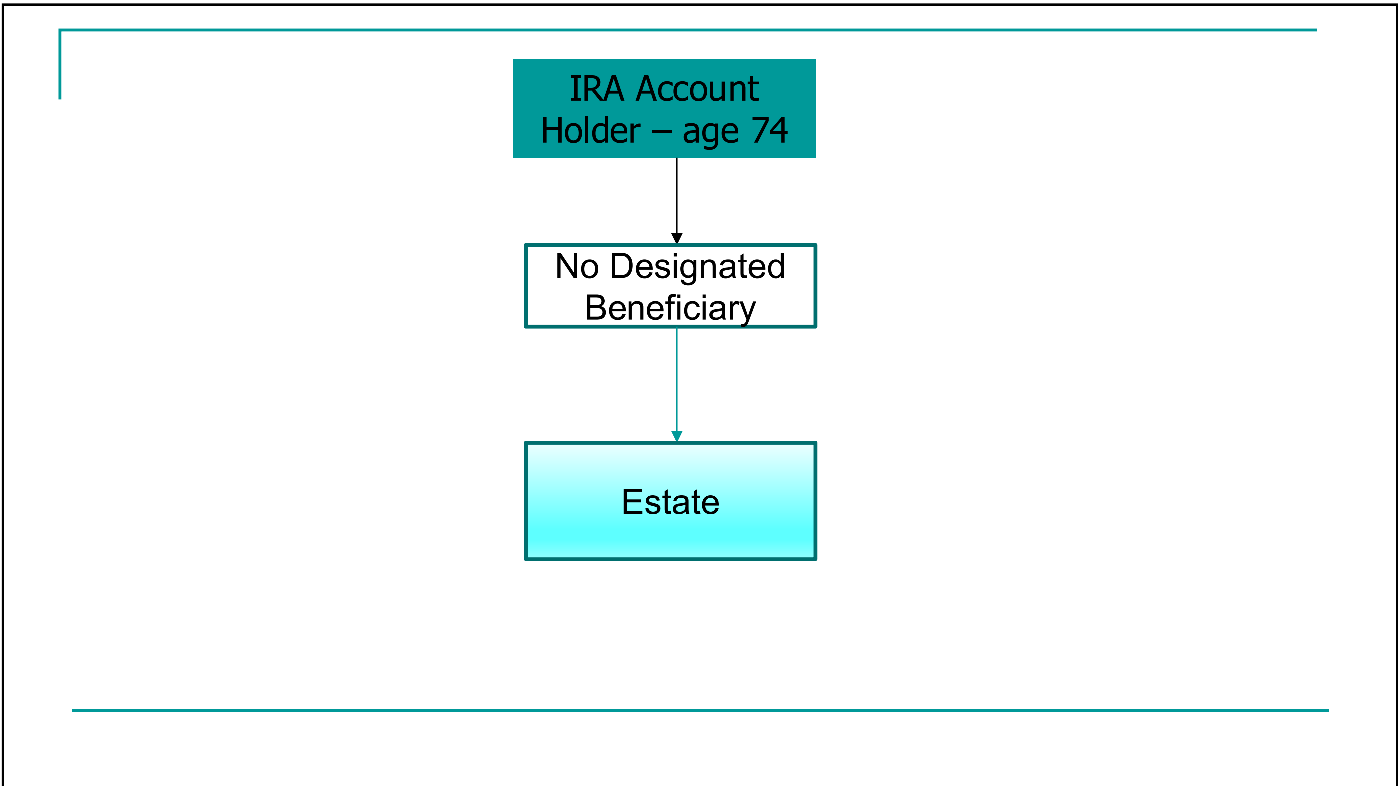
- Starting in 2023, the § 4974 excise tax rate for failure to withdraw RMDs was decreased to 25%
- This rate is reduced to 10% if the failure to withdraw is corrected and return is filed within 2 years and before deficiency notice is issued or assessment at 25%
- Query: will these new rates change IRS policy on waiver?
- Consider IRS Notice 2024-35 regarding RMDs


IRA
Account
Holder – age 90
Child A – Age 65
NJ Resident
Child B – Age 60
NY Resident
Issues: Timing? What if one is going to move? Consider state income tax issues.


IRA
Account
Holder – age 70
Child A – Age 35
NJ Resident
Child B – Age 30
NY Resident
Issues: Timing? What if one is going to move? Consider state income tax issues.


IRA
Account Holder
Age 60
$230,000
Child
Age 27
As child takes taxable withdrawals…
IRA – 10 year distribution schedule $23,000/yr.
Child's 401(k) $23,000/ yr.
child can make tax-deductible contributions.


IRA Account Holder
Grandchild A – age 25
Grandchild B – age 15
Grandchild C – age 17 – disabled


IRA Account
Holder – age 74
No Designated
Beneficiary
Estate

This page intentionally left blank

DECANTING, MODIFYING AND TERMINATING IRREVOCABLE TRUSTS

By Daniela P. Catrocho, Esquire

I. Common reasons to decant, modify or terminate an irrevocable trust:

A. Effectuate beneficial tax consequences

B. Grant, remove or refine powers of appointment

C. Change administrative provisions

D. Modify trustee provisions

E. Divide trusts or permit mergers thereof

F. Change situs or governing law

G. Change trust terms

H. Eliminate beneficial enjoyment

II. Decanting an Irrevocable Trust

A. Decanting is the act of transferring the assets from an existing trust to a new trust when a Trustee is permitted to make principal distributions.

1. Typically, the existing trust contains undesirable terms or lacks provisions that the new trust corrects.

2. Does not generally require the consent of a beneficiary or the court, as it is typically effectuated by the Trustee exercising its discretion to make principal distributions.

B. Decanting options:

1. The trust instrument may contain a decanting power. If so, the ability to decant will be limited to that provision.

2. Absent an express decanting power, the trustee may move the trust situs to a jurisdiction containing a decanting statute (i.e., New York's EPTL 10-6.6).

3. Alternatively, the trustee may employ common law decanting in the jurisdiction governing the trust's administration. *See Phipps v. Palm Beach Trust Co.*, 142 Fla. 782, 196 So. 299 (1940); *Wiedenmayer v.*

Johnson, 106 N.J. Super. 161 (App. Div. 1969), *aff'd sub nom. Wiedenmayer v. Villanueva*, 55 N.J. 81 (1969).

a) *Phipps* is the landmark case validating a Trustee's decanting power. In *Phipps,* the settlor created a trust from which the Trustees had the power to distribute principal in such shares among (and even to the exclusion of any one of) the settlor's spouse and descendants as the individual Trustee (who was also the settlor's spouse) determined in his sole and absolute discretion. The Trustee/spouse exercised this power by directing the property in further trust with terms slightly different from the original trust. The Florida Supreme Court held that a Trustee's discretionary power to distribute is akin to a special power of appointment, and if the Trustee may distribute the trust outright to a beneficiary, the Trustee may create a lesser estate for that beneficiary's benefit.

b) *Wiedenmayer* is the leading case in New Jersey to support a Trustee's power to decant.

C. *Wiedenmayer v. Johnson*

1. Facts: Trust authorized Trustees to distribute "from time to time and whenever in their absolute and uncontrolled discretion they deem it to be for his best interests, to use for or to distribute and pay over to John Seward Johnson, Jr…to be his absolutely, outright and forever, any or all of the Trust Property." Trustees determined to distribute the Trust Property to John on the condition that he immediately transfer the funds to a successor Trust, which eliminated two of his descendants.

2. Court holdings:

a) If the Trustees could distribute trust property outright to the beneficiary, it is "logical to conclude that the trustees could, to safeguard the son's best interests, condition the distribution upon his setting up a substituted trust." *Id.* at 164-165.

b) "Best interests" are not limited to financial interests, but they may also "be served by the peace of mind." *Id.* at 165.

c) The trust creator was concerned with his son's best interests, and the interests of others were only secondary in relation thereto.

d) "Courts may not substitute their opinions as to the son's 'best interests,' as opposed to the opinion of the trustees vested by the creator of the trust with the 'absolute and uncontrolled discretion' to make that determination." *Id.* Thus, absent a showing of an abuse of discretion (i.e., that the Trustee's decision was not "made in good faith, after consideration of all the facts and attendant

circumstances, and for reasonably valid reasons"), the court will not substitute its judgment for that of the trustees. *Id.*

D. Can/should the Trustee decant?

1. Analyze the trust instrument: Is there a provision that permits decanting? If so, what is the breadth of the decanting that is permitted?

2. If there is no express power, is there sufficient discretion of the Trustee to justify decanting?

   a) Sole and absolute power is typically required, and is what existed in both of *Wiedenmayer* and *Phipps*.

3. Evaluate possible breach of trust claims.

   a) Trustees, even those granted absolute and sole discretion, are still obligated to administer the trust for the beneficiary's best interests.

   b) Abuse of discretion. Was there sufficient discretion in the trust to permit decanting? If not, the Trustee may be deemed to have exceeded the scope of its discretion.

4. Breach of duty of impartiality?

   a) Eliminating one or more trust beneficiaries. Although eliminating trust beneficiaries through a decanting is permissible, it may be interpreted as a violation of the trustee's duty of impartiality.

   b) The New Hampshire Supreme Court invalidated a decanting that eliminated beneficiaries due to a breach of duty of impartiality. The fiduciary failed to consider the financial interests of beneficiaries whose future remainder interests were eliminated by decanting. *Hodges v. Johnson*, 177 A.3d 86 (N.H. 2017).

E. If the Trustee determines to decant, how should it be accomplished?

1. The Trustees in the *Wiedenmayer* case distributed the corpus to the beneficiary who agreed to immediately contribute it back to a new trust. The Trustees were permitted "to use for or distribute and pay over to" the beneficiary. The outright distribution to the beneficiary and contribution over may create creditor concerns (if state law permits creditor access to self-settled trusts) or tax implications.

2. Directly to the Trustee of the new Trust. Permissible if the trust permits the Trustee to distribute corpus "in trust for" or to "apply" corpus.

Arguably, the Trustees in the *Wiedenmayer* could have employed this alternative as well.

F. Great care should be taken when drafting the new trust to which the assets of the existing trust will be transferred, including close analysis of provisions that could result in adverse tax implications.

G. Other decanting case law:

1. *HUNY & BH Assocs., Inc. v. Silberberg*, No. BERL1067715, 2017 WL 6627701 (N.J. Super. Ct. L. Div. Oct. 23, 2017) affirmed in part, reversed in part by *HUNY & BH Associates, Inc. v. Silberberg*, No. A-1696-17, 2021 WL 6109385 (N.J.Super.A.D., Dec. 27, 2021) (ruling that the lower court erred in ruling that plaintiff's claim was barred by the statute of limitations as there was no indication that plaintiff knew or should have known that her 21st birthday triggered her right to the custodial property in trust and in ruling that all deposits in such trust after plaintiff turned 21 were not intended to be gifts).

2. *In re 2008 Tr.*, No. ESXCP2482014, 2016 WL 8453570 (N.J. Ch. Div. Mar. 22, 2016).

3. *Ferri v. Powell-Ferri*, 476 Mass. 651 (Mar. 20, 2017); *Ferri v. Powell-Ferri*, 326 Conn. 438 (Aug. 8, 2017).

4. *Morse v. Kraft*, 992 N.E.2d 1021 (Mass. 2013).

5. *Tannen v. Tannen*, 205 N.J. 80 (2011).

6. *In re Spencer's Estate*, 232 N.W.2d 491 (Iowa 1975).

7. *Harrell v. Badger*, 171 So. 3d 764 (Fla. Dist. Ct. App. 2015).

H. Uniform Law Commission's Trust Decanting Act (UTDA).

1. Completed in 2015. As of September 2024, the UTDA has been enacted by 18 states (Alabama, California, Colorado, Connecticut, Illinois, Indiana, Kansas, Maine, Maryland, Montana, Nebraska, New Mexico, North Carolina, Vermont, Virginia, Washington, West Virginia and Wisconsin), and legislation has been introduced in two others (Massachusetts and District of Columbia). However, other states have had statutes in place prior to the enactment of UTDA, such as Delaware, Alaska, Nevada and South Dakota, or afford a Trustee with a "power of

appointment" to effectuate a decanting, such as New York, Arizona and Florida. In all, 39 jurisdictions have laws permitting decanting.[1]

2. Affords different rules depending upon the extent of the Trustee's discretion:

a) If the Trustee has limited discretion to make distributions (referred to as a distribution that is subject to an "ascertainable standard" or is a "reasonably definite standard"), a Trustee may decant for administrative or tax purposes, but the beneficial interests of the recipient trust must be "substantially similar" to the beneficial interests of the original trust.

b) If the Trustee has "expanded distributive discretion," the Trustee may decant to a new trust that alters the beneficial enjoyment, limited only to protect (i) current, noncontingent or vested remainder interests, (ii) qualification for tax benefits, and (iii) charitable interests.

3. Special rules exist for decanting to create a third party special needs trust for a beneficiary whose qualification for needs-based governmental benefits could be impacted by his or her beneficial interest in the trust.

4. Affords a "check and balance" to preclude abuses by requiring notice to qualified beneficiaries who may petition a court for a number of enumerated reasons and by listing various instances in which decanting is limited. Of the jurisdictions that permit decanting, Arizona, Delaware, Nevada, South Dakota, Tennessee and Wyoming do not require notice to be sent to beneficiaries, and New Hampshire only requires notice for charitable trusts).

III. Modifying and Terminating an Irrevocable Trust

A. Express authority is located within the New Jersey Uniform Trust Code ("UTC") effective July 17, 2016, at *N.J.S.A.* § 3B:31-26 through § 3B:31-33. These rules apply to all trusts in existence on or created after the effective date.

B. Pursuant to *N.J.S.A.* § 3B:31-6, common law supplements the UTC except to the extent that the UTC or other statute modifies the common law. Thus, existing

[1] Alabama, Alaska, Arizona, California, Colorado, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Ohio, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

case law, including that addressing trust reformation, may continue to apply to the extent not inconsistent with provisions of the UTC.

1. *See e.g., In re Tr. Of Nelson*, 454 N.J. Super. 151 (App. Div. 2018). Holding that the court may look beyond the governing instrument, even if unambiguous on its face, to determine the settlor's probable intent. The court declined to determine whether *N.J.S.A.* § 3B:31-31 and -32 applied to permit the court to modify the trust to effectuate the settlor's intent.

C. Under *N.J.S.A.* § 3B:31-27, a noncharitable, irrevocable trust may be modified or terminated:

1. Upon consent of the trustee and all beneficiaries if the modification or termination is not inconsistent with a material purpose of the trust. § 3B:31-27(a).

2. By a court upon consent of all of the beneficiaries if the court concludes that, in the case of a termination, continuance is not necessary to achieve any material purpose of the trust, or, in the case of a modification, the modification is not inconsistent with a material purpose of the trust. § 3B:31-27(b).

3. By a court upon the request of a beneficiary or trustee if the court determines that, had all of the beneficiaries consented, the trust could have been modified or terminated, and that the interests of a beneficiary not consenting will be adequately protected. § 3B:31-27(e).

4. No modification or termination is permitted if it is inconsistent with a material purpose of the trust.

a) A spendthrift provision in the trust is not presumed to constitute a material purpose of the trust. § 3B:31-27(c).

b) What constitutes a "material purpose" is a subjective determination of the settlor's intent. *See Fidelity Union Trust Co. v. Margetts*, 7 N.J. 556, 566 (1951) and *In re Estate of Bonardi*, 376 N.J.Super. 508 (App. Div. 2005) (holding that the testator's intent to create a trust for his wife was a material purpose frustrated by the beneficiaries' consent to otherwise terminate it).

c) *See e.g., Trust Under Agreement of Taylor*, 164 A.3d 1147 (Pa. 2017) (modification to change the terms for removal of trustee is precluded where a specific statute already exists for same).

(1) But See *In re Tr. Under Deed of Walter R. Garrison*, 288 A.3d 866 (Pa. 2023), which distinguished its decision in Taylor. In Garrison, the court clarified that its decision in Taylor stemmed from a need to give priority to two seemingly conflicting statutory provisions (one found within the uniform act and the other in other trust law predating the uniform act), whereas in Garrison, (i) all parties involved in the trust, including the settlor and trustees, (ii) court approval is not required under the particular uniform law provisioni at issue and (iii) the settlor's intent did not require protection since the settlor was a participant to the modification. Thus, Garrison supports that trusts could be modified by consent of settlor and all beneficiaries to allow for replacement of trustees by a majority of beneficiaries after settlor's death.

d) *See also N.J.S.A.* § 3B:31-11(f) ("a nonjudicial settlement may not be used to produce a result that is contrary to other sections of Title 3B of the New Jersey Statutes, including, but not limited to, terminating or modifying a trust in an impermissible manner").

e) A recent New Jersey case illustrates that the courts consider the purpose of a trust when terminating (see *Matter of David H. Kato Spec. Needs Tr., Dated December 11, 2018*, No. A-0414-22, 2024 WL 762246, at *3 (N.J. Super. App. Div. Feb. 26, 2024), at *3 (considering the purpose of the trust when terminating a special needs trust where the beneficiary was no longer eligible for Medicaid).

f) Recent cases in other jurisdictions suggest that courts may be taking a closer look at the settlor's intent when terminating or modifying a trust.

(1) *Demircan v. Mikhaylov*, 306 So.3d 142 (Fla. Dist. Ct. App. 2020) (Florida appellate court allowing trust modification under common law where living settlor and beneficiaries of a trust consent to its modification, whether or not the modification satisfies Fla. Stat. requirements regarding materiality of the trust's purpose).

(2) *Horgan v. Cosden*, 249 So.3d 683 (Fla. Dist. Ct. App. 2018) (Holding that termination of a trust was improper because it would frustrate the purpose of the trust to provide income distributions to the settlor's son for life with a remainder to three educational institutions despite all beneficiaries agreeing to the termination).

(3) *In re McGregor*, 308 Neb. 405 (2021) (Supreme Court of Nebraska holding that a spendthrift provision was a

material purpose of the trust, disallowing a nonjudicial settlement agreement that distributed assets outright to beneficiaries rather than in trust).

(4) *In re Trust of Jennie Shire*, 299 Neb. 25 (2018) (Considering the settlor's intent in denying modification request to increase trust distributions even though the trust had grown substantially since its creation 70 years prior).

(5) *In re Trust under Will of Flint for the benefit of Shadek*, 118 A.3d 182 (Del. Ch. 2015) (the Delaware Chancery Court refusing to modify a trust to a directed trust where such modification ran contrary to the settlor's intent).

(6) *Matters of Estate & Tr. of Kalil*, 11047-MZ, 2018 WL 793718 (Del. Ch. Feb. 7, 2018), appeal dismissed sub nom. Kalil v. Kalil, 182 A.3d 114 (Del. 2018), as corrected (Mar. 13, 2018) (Refusing to reform a trust where reformation would not remedy the settlor's mistake in failing to retitle an investment account because that mistake did not affect specific terms in the trust; the party seeking reformation is seeking to establish that a donative document does not reflect the donor's intention).

(7) *In re Sukenik*, 75 N.Y.S.3d 422 (2018) (Trust and IRA beneficiary designation can be reformed to designate charity as beneficiary of IRA rather than spouse and afford spouse a specific pecuniary bequest in trust equal to value of IRA, finding settlor's intent to effectuate tax savings).

(8) *In re Tr. Created by Augustin*, 935 N.W.2d 493 (Neb. Ct. App. 2019) (The objective of the rule allowing judicial modification or deviation and the intended consequences of its application are not to disregard the intention of a settlor. The objective is to give effect to what the settlor's intent probably would have been had the circumstances in question been anticipated," but finding that modification was not permitted since the trusts at issue terminated by their terms).

(9) *In re Gale L. Tuttle Revocable Trust, Harshman Land Company, et. al. v. B&B Family Farms, LLC*, A-19-841, 2020 WL 3526129, at *4 (Neb. Ct. App. June 30, 2020) (declining to modify a trust where the terms of the trust manifested the settlor's intent that modification was not required).

(10) *In re Special Needs Tr. for Moss*, No. 357836, 2022 WL 2760235 (Mich. Ct. App. July 14, 2022) (affirming that termination of trust furthered settlor's intent of supplementing quality of beneficiary's life and that living settlor's objection to termination did not preclude determination that statute permitted termination).

(11) *Martin v. Paul*, No. 944 MDA 2021, 2023 WL 2681889, at *1 (Pa. Super. Ct. Mar. 29, 2023) (affirming in part the modification of a trust to allow for the sale of property in furtherance of settlor's intent).

(12) *In re Tr. B Under Agreement of Richard H. Wells Dated September 28, 1956*, 311 A.3d 1057, 1074 (Pa. 2024) (reversing a trust termination in furtherance of the settlor's intent for assets to remain in trust).

D. Provisions of the UTC that permit modification of termination for certain reasons:

1. Due to unanticipated circumstances or the inability to administer the trust effectively. § 3B:31-28.

a) Requires court approval.

b) Court may modify administrative or dispositive terms or terminate if because of unanticipated circumstances, the purposes of the trust will be furthered by doing so.

c) Court may modify administrative terms if administration under current terms would be impracticable or wasteful or would impair the administration.

d) If terminated, the property is to be distributed in a manner consistent with the purposes of the trust.

2. Charitable trust modification or termination (cy pres). § 3B:31-29.

a) With one exception, where a particular charitable purpose becomes unlawful, impracticable, impossible to achieve, or wasteful:

(1) the trust does not fail,

(2) the trust property does not revert to the settlor or the settlor's estate and

(3) the court may modify or terminate by directing the property to be applied or distributed in a manner consistent with the settlor's charitable purposes.

b) The exception – if the trust instrument would distribute the property to a noncharitable beneficiary in such instance, that takes priority.

3. Uneconomical Trust. § 3B:31-30.

a) By the Trustee upon notice to qualified beneficiaries for trusts less than $100,000 in value.

b) By the court if it determines that the value of the trust is insufficient to justify the costs of administration.

4. To achieve the settlor's tax objectives. § 3B:31-33.

a) Could be made retroactively.

5. To correct a mistake of fact or law. § 3B:31-31.

a) Does not require the trust to be ambiguous – settlor's intent would permit the court to review extrinsic evidence even where the trust terms are otherwise unambiguous.

6. To conform the trust to the settlor's probable intent. § 3B:31-32.

a) *See generally, Matter of Trust of Nelson*, 454 N.J.Super. 151 (App. Div. 2018).

7. Combination and Division § 3B:31-34.

a) Combination even where Settlors, Governing instruments and Trustees are different

b) Must not impair rights of any beneficiary or adversely affect the achievement of the purposes of the trust.

E. Typically, except for court applications, a modification or termination is effectuated by way of nonjudicial settlement agreement pursuant to *N.J.S.A.* §3B:31-11, which may implicate representation of relevant parties under the rules set forth in *N.J.S.A.* § 3B:31-13 through § 3B:31-17.

IV. Tax Implications of Decanting, Modifying or Terminating a Trust

A. Notice 2011-101 requested comments on the tax implications of decanting.

1. Review the April 2, 2012 letter from the American College of Trust and Estate Counsel to the Internal Revenue Service providing comments for a comprehensive discussion and a proposed Revenue Ruling: https://www.actec.org/assets/1/6/Mezzullo_Comments_04_02_12.pdf.

B. Rev. Proc. 2024-3. To date, the IRS has not issued any technical guidance, but has listed the tax implications of decanting as an area under study in which rulings or determination letters will not be issued until the service resolves the issue through publication of a revenue ruling, a revenue procedure, regulations, or otherwise. See specifically the following excerpts from Rev. Proc. 2024-3:

1. (8) Sections 661 and 662.—Deduction for Estates and Trusts Accumulating Income or Distributing Corpus; Inclusion of Amounts in Gross Income of Beneficiaries of Estates and Trusts Accumulating Income or Distributing Corpus.—Whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a "“decanting") resulting in a change in beneficial interests is a distribution for which a deduction is allowable under § 661 or which requires an amount to be included in the gross income of any person under § 662.

2. (16) Section 2501.—Imposition of Tax.—Whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is a gift under § 2501. There was legislation introduced in Congress, the "Flat Tax Act" in February 2023 that would have repealed Section 2501, which is still pending

3. (19) Sections 2601 and 2663.—Tax Imposed; Regulations.—Whether the distribution of property by a trustee from an irrevocable generation-skipping transfer tax (GST) exempt trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is the loss of GST exempt status or constitutes a taxable termination or taxable distribution under § 2612.

4. See also the following section under "Areas in which rules or determination letters will not be issued:"

   (117) Section 2601.—Tax Imposed.— Whether 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).

C. Income tax implications.

1. Unless a new trust is created by a beneficiary's exercising a power of appointment, there will be no change to the identity of the grantor.

2. There should be no deemed sale resulting in the recognition of capital gain or loss.

3. Make sure the recipient trust would not qualify as a foreign trust.

D. Gift tax implications.

1. Generally, there would be no gift tax implications if the modification applies only to administrative, and not dispositive, provisions. *But See* Chief Counsel Advice Memorandum (CCA) 202352018 issued December 29, 2023 (IRS concluded that the beneficiaries of a grantor trust made a taxable gift to the grantor as a result of a trust modification to add a provision in the trust that would permit the trustee to reimburse the grantor for income taxes attributable to the trust).

2. Who is the trustee that will effectuate the decanting, modification or termination? If the trustee is a beneficiary of the old trust, the action may be deemed a gift by the beneficiary/trustee.

3. Does a beneficiary (who may not be the trustee) have an exercisable power of withdrawal, general power of appointment, or right to object to the action impacting the beneficiary's interest? If so, the action may trigger a gift by the beneficiary.

4. If the beneficiary does not consent to the action, will a gift be avoided?

5. Consider the "Delaware Tax Trap," which occurs if new interests created by exercising a power of appointment postpone the vesting of an interest in property beyond the date determined by the original trust (or whether triggering it may be desirable).

E. Estate tax implications.

1. What powers did the grantor have in the old trust and what powers might the grantor have in the new trust? Is the grantor participating in the action? "Yes" answers may suggest that the grantor has retained sufficient control so as to cause inclusion in the grantor's estate.

2. Does the beneficiary have a general power of appointment in the new trust? If so, the assets of the new trust would be included in the beneficiary's estate.

3. Did the action result in the beneficiary's making a gift? Did the beneficiary have the ability to prevent the action and fail to do so? If so, the trust may be included in the beneficiary's estate.

F. Generation-Skipping Transfer Tax implications.

1. Is the existing trust exempt from generation-skipping transfer tax, and if so, will the assets in the new trust likewise be tax exempt?

2. The rules may be different for "grandfathered" trusts (i.e., those in existence on September 26, 1985) and trusts to which a person's GST exemption is allocated. The Service appears to take the position that the rules apply similarly to both. See, e.g., PLR 201820007 & 201820008.

3. Generally, GST exemption will not be lost provided that the action does not delay the vesting of the ownership of the original trust property beyond the vesting date of the original trust. For grandfathered trusts, the action must also be completed pursuant to state law in effect when the trust became irrevocable or a power contained within the trust instrument.

4. A loss of GST exempt status may result from the decanting if beneficial interests are affected.

5. The regulations may treat decanting differently from modification. For instance, Treas. Reg. § 26.2601-1(b)(4)(i)(A)-(D) contains four "safe harbors" to confirm when a modification will not result in a loss of GST exemption (note, (A) is really decanting):

   (A) Discretionary Powers – no loss if (1) either (i) old trust instrument authorizes distribution to a new trust without consent of a beneficiary or court or (ii) at time trust became irrevocable, state law did, and (2) new trust instrument does not extend the time for vesting of any beneficial interest

   (B) Settlement – a court approved settlement of a bona fide issue regarding the administration of a trust or the construction of the terms of a trust will not result in a loss if (1) the settlement results from arm's length negotiations and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable law

   (C) Judicial construction – a judicial construction to resolve an ambiguity or correct a scrivener's error results in no loss if (1) the action involves a bona fide issue and (2) the construction is consistent with applicable law that would be applied by the highest court of the state

   (D) Other changes – no loss by judicial or nonjudicial means if the modification will not shift a beneficial interest to a beneficiary in a lower generation than the person who held the beneficial interest prior to the modification and the modification does not extend the time for vesting of a beneficial interest beyond the original term.

6. Treas. Reg. § 26.2601-1(b)(4)(i) states: "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."

G. Some recent Private Letter Rulings:

1. PLRs 201814001 & 201814002

a) Supports justification for obtaining a judicial construction rather than a modification or decanting to avoid adverse tax consequences.

b) Held - Construction of ambiguous terms in grandfathered GST trust has no adverse GST, gift or income tax consequences.

c) These PLRs address a purported ambiguity in the meaning of "descendants" and whether it included adopted descendants. Trustees petitioned the state court for a judgment that the term did not include adopted descendants, which the court conditionally granted on obtaining a favorable IRS ruling of no adverse GST, gift or income tax consequences.

d) IRS ruled that the court's order was consistent with applicable state law that the highest court of the state would apply, and pursuant to Treas. Reg. § 26.2601-1(b)(4)(i)(C), the judicial construction to resolve an ambiguity to correct a scrivener's error does not result in loss of GST exemption.

e) Moreover, because the ambiguity was resolved by a court, no transfer occurred for gift tax purposes.

f) Last, because the ambiguity related to the construction of the trust to carry out the settlor's intent, there was no disposition of an interest and consequently no realization of gain or loss.

g) The decanting or modification to change the definition of descendant would have modified the class of beneficiaries and resulted in the loss of GST exemption.

2. PLRs 201820007 & 201820008 (PLRs for trusts for sons created under same instrument)

a) Involved decanting to a new trust that granted a beneficiary a general power of appointment to preclude adverse GST consequences.

b) Held – under Treas. Reg. § 26.2601-1(b)(4)(i)(D)(2), "modifications that are administrative in nature that only indirectly

increase the amount transferred will not be considered to shift a beneficial interest in the trust. See Example 10 of § 26.2601-1(b)(4)(i)(E)."

c) In this case, the grant of a testamentary general power of appointment is the functional equivalent of granting outright ownership, causing the trust property to be included in the estate of the beneficiary, and therefore, does not result in the shift of beneficial interest to a lower generation or extend the time for vesting.

d) Gift and income tax consequences were not addressed.

3. PLR 201818005

a) Analyzes a way to sever trusts without affecting GST grandfathered status.

b) Prior partition proceeding divided original trust into five separate trusts, at which time the IRS ruled that there was no realization of gain/loss for income tax purposes, no transfer by a beneficiary for gift tax purposes, and no loss to the GST exempt status. Second partition order of the court (applicable to only one of the five trusts) included a modification to provide that upon the lifetime beneficiary's death, the trust would be divided equally into separate trusts, one for each of said beneficiary's living children, and one for the descendants of a deceased child of said beneficiary.

c) Held – modification is not an exchange of property resulting in gain or loss for income tax purposes; having no material difference in the position of the beneficiaries before and after partition results in no adverse gift tax consequences; and the action was similar to Example 5 in Treas. Reg. § 26.2601-1(b)(4)(i)(E), where a trust may be divided with court approval into separate equal trusts for the settlor's children, because the division did not shift any beneficial interest to a beneficiary in a lower generation or extend the time for vesting.

4. PLRs 201920001 – 201920003 (May 17, 2019).

a) Held - court reformation and modification of several irrevocable trusts to limit the class of appointees of grandchildren's testamentary power of appointment and limit withdrawal rights (i) did not grant the trusts' beneficiaries with general powers of appointment, and (ii) did not constitute the exercise or release of any general power of appointment resulting in a gift, and that GST tax was automatically allocated to each transfer to the trust.

5. PLR 201938004-201938006 (September 20, 2019)

   a) Involved a court modification of a grandfathered trust where a son was deemed to hold a general power of appointment over the trust, and the issue was whether the distributions upon termination of the modified trust were subject to GST tax.

   b) Held – Because the trust assets are to be included in the son's gross estate, the son is treated as the owner for GST purposes. After judicial construction and modifications to the administration and dispositive provisions of the trust, the trust remained exempt from GST tax upon termination.

6. PLR 202011001, PLR 202011002, PLR 202011003, PLR 202011004, and PLR 202011005 (March 13, 2020).

   a) Held –a state court modification of an irrevocable trust to have the remainder interest after child's death held in continued trust for the grandchildren, but giving each grandchild a testamentary general power of appointment over his or her separate share trust, did not deprive the trust of its effective date protection from the GST tax.

7. PLR 201947001-201947006 (November 22, 2019)

   a) Modification of an irrevocable grandfathered trust extending it for the life of a beneficiary pursuant to a state statute (i) would not cause the trust to lose its exempt status for purposes of the GST tax, (ii) would not result in the inclusion of the trust in the grantor's estate, and (iii) would not cause the grantor or any beneficiary to have made a gift.

   b) Held – the proposed modification would not cause the trust to lose its GST exempt status because there is no shift in beneficial interests; modification will not result in inclusion in the grantor's estate because the grantor did not retain any interests or power over the trust, and the modification will not result in any change to the beneficial interests of any of the contingent or non-contingent beneficiaries of the trust, so the modification is not subject to gift tax by the grantor or any of the trust beneficiaries.

   c) **NOTE**: The IRS reversed its position in this PLR in a footnote of Chief Counsel Advice Memorandum (CCA) 202352018 issued December 29, 2023. The IRS concluded that the beneficiaries of a grantor trust made a taxable gift to the grantor as a result of a trust modification to add a provision in the trust that would permit the trustee to reimburse the grantor for income taxes attributable to the trust.

8. PLR 201932010 (August 9, 2019)

    a) Termination of a trust by court approval if the continuation of the trust is not necessary to achieve any material purpose.

    b) Held – (i) termination of the trust will not be subject to GST tax as it does not cause a shift in beneficial interests to a lower generation than those beneficiaries with interests prior to the termination, nor extend the time for vesting of any beneficial interest beyond the period provided in the original trust (based on the actuarial values presented); (ii) no deemed transfer of property (for gift tax purposes) since the beneficial interests, rights and expectancies of the beneficiaries will be substantially the same before and after termination and the proposed distribution.

9. PLRs 201941012-201941023 (October 11, 2019)

    a) Held - The reformation of an irrevocable trust (i) would not cause any child of the settlor to have released a general power of appointment by reason of the lapse of a withdrawal right, and (ii) would not cause anyone other than the settlor, the settlor's spouse, and the settlor's parents to be transferors of the trust for GST tax purposes.

10. PLR 202013001, PLR 202013002, PLR 202013003 & PLR 202013004 (October 7, 2019)

    a) Held – the proposed court modification, which included creating continuing trusts with general powers of appointment, of a grandfathered trust does not cause the trust to lose its exemption from GST tax because the continuing beneficiary's trust will be includable in the beneficiary's estate at death, and each continuing beneficiary will be treated as transferor for GST purposes. No shift in beneficial interests to a lower generation that persons holding those interests, and the modification will not extend the vesting for any beneficial interest.

11. PLR 202009012 (February 28, 2020)

    a) Court reformation and modification of revocable trust after the settlor's death to correct several scrivener's errors and proration of federal estate tax, and ruling on spouse's exercise of testamentary power of appointment, as reformed, over the Marital Trust.

    b) Held – (i) spouse's exercise of power of appointment, as reformed, is not exercise of a general power of appointment; (ii) the Marital Trust qualifies as QTIP; (iii) the reverse QTIP election for the GST exempt Marital Trust was valid; (iv) spouse did not possess any

general power of appointment over the Family Trust as this was never intended and subsequently corrected by the court's reformation, and the Family Trust will not be included in the spouse's estate; (v) the waiver of the trustee of a separate survivor's trust, of the right of reimbursement for estate taxes due from the GST exempt Marital Trust was valid, and the spouse did not make a constructive addition to the GST exempt Marital Trust and thus, will not be deemed the transferor with respect to any portion of this trust for GST tax purposes at her death.

12. PLR 202108001, PLR 202108002, PLR 202108003, PLR 202108004, PLR 202108005, PLR 202108006 (February 26, 2021)

    a) Held – State court orders modifying administrative provisions of trust and declaratory judgment will not affect trust's exempt status under Treas. Reg. 26.2601-1(b)(4)(i)(C), and declaratory judgment will not cause stated trusts to lose grandfathered exempt status for GSTT purposes. Also, declaratory judgment will not result in gift by trust beneficiary under I.R.C. §2501 and will not cause trust to be included in trust beneficiary's gross estate under I.R.C. §2001. There was a bill introduced in the Senate on April 20, 2023 that would amend I.R.C. §2001.

13. PLR 202133005 (August 20, 2021) and PLR 202134003 (August 27, 2021)

    a) Held – A proportional division of one trust into several new trusts for Grantor's children, is not considered a sale or exchange of property under §1001(a), results in no gain or loss under §61(a)(3) or §1001 (a), and the transfer of assets are not included in the gross income of the beneficiary of a new trust under §662. If each trust is managed and administered separately, they are treated as separate trusts for federal income tax purposes. The new trusts will keep the same tax basis and holding period of assets of the original trust as they are not considered a sale or exchange of property under §1001. Also, the new trusts will take upon any net capital and operating losses, as well as any other tax attributes of the original trust. If no beneficial interest is transferred to the any beneficiary of a lower generation under §2651, the exemption status from GST tax from the original trust will also apply to the new trusts.

14. PLR 202134004 (August 27, 2021)

    a) Held – Neither modifying a trust to assign a successor trustee nor dividing a trust into two equal trusts for the Grantor's grandchildren and their descendants affects GST exemption status

when the modifications do not result in a shift of any beneficial interest to a beneficiary of a lower generation and do not extend the vesting time of any beneficial interest. As the beneficial interests of the beneficiaries are not changed, no transfer of property is deemed to have occurred, and there will be no federal gift tax applied under § 512(b). Also, this will not result in the assets of the trust or of the beneficiaries being included in the gross estate of the beneficiaries for §2035-2038 federal estate tax purposes. Moreover, if the will of the Grantor authorizes non-pro rata allocations of the trust and the allocations are made with assets of equal value while the trust receives nothing in exchange for this allocation, while no beneficial interests are transferred to beneficiaries, no gain or loss from a sale of trust assets is recognized under §61 and §1001. This distribution is also not considered to be a distribution under §661 or §1.661(a)-2(f) nor causes any trusts or beneficiaries to recognize any income, gain, or loss under §662. As §1001 does not apply, the transferred assets retain the holding period assigned in the original trust under §1223(2) and the basis of each asset is unchanged under §1015.

15. PLR 202145026 (November 12, 2021)

a) Court's prior judicial modification of irrevocable trust to comply with §664(d)(2)-(3) was otherwise valid but inadvertently changed the valuation date of trust.

b) Held – A modification of the charitable interest of an irrevocable trust that does not change the actuarial value of an ascertainable and reformable interest, doles out payments in specified dollar amounts or through a fixed percentage, and does not change the termination or effect date of the trust satisfies the requirements of §2055(e)(3)(C).

16. PLR 202215015 (April 15, 2022)

a) Held –Merger of several GST trusts for Grantor's descendants into a single existing trust is held to not affect the GST tax exempt status of the trusts. As the beneficiaries, distribution provision, trustee power provision, dispositive provision, and termination provision of the trust are all substantially similar or identical, no beneficial interest in the trusts are shifted to a beneficiary occupying a lower generation. This, coupled with the modification not extending the vesting time of beneficial interest in the trust beyond the original period, satisfies Section 26.2601 requirements to retain the original GST tax exempt statuses of all trusts and trusts and beneficiaries.

17. PLR 202216001-202216006 (April 22, 2022)

    a) This PLR addresses the potential tax implications of judicial modification of decanted irrevocable trusts. The trust in question was decanted from one original trust to six individual trusts for the Grantor's individual children.

    b) Held – Judicial modification of new trust's termination date provisions to correct scrivener's errors in order to effectuate the Grantor's original intent does not result in any change to a beneficiary's taxable income. A modification of a trust to ensure that a new trust does not extend the vesting interest beyond that of the original trust will not alter the inclusion ratio of the new trust nor result in the application of additional gift tax. Such modification also does not constitute a transfer and therefore the property of the new trust is not included in the beneficiary's gross estate.

18. PLR 202224008 (June 17, 2022)

    a) Held – Judicial modification of a trust for several generations of decedent's family to alter the distribution method of such trust such that certain beneficiaries will receive their shares in a separate trust instead of directly does not shift a beneficial interest in the trusts to any beneficiary of a lower generation than provided in the original trust. Thus, there is no loss of GST tax exempt status.

19. PLR 202301001 (January 6, 2023)

    a) Held – Proposed distribution of trust's assets to successor trust satisfies Reg. 26.2601-1(b)(4)(i)(D) and won't cause either trust to lose their exempt status from GSTT. Also, each named beneficiary of stated trust will possess general power of appointment under Code Sec. 2041(b)(1) with respect to property subject to this power and value of this property at time of beneficiary's death will be includible in beneficiary's gross estate under Code Sec. 2041(a)(2).

20. PLR 202317010 (April 28, 2023)

    a) Held - Court-approved settlement agreement, court order, implementation of settlement agreement, and distributions upon trust termination won't cause trust to lose its exempt status for GSTT purposes or otherwise become subject to GSTT under Code Sec. 2601 and Code Sec. 2603. (See PLR 202317001, PLR 202317010, PLR 202317011)

21. PLR 202318014 (May 5, 2023)

    a) Held - Court-approved settlement agreement, court order, implementation of settlement agreement, and distributions upon trust termination won't cause trust to lose its exempt status for GSTT purposes or otherwise become subject to GSTT under Code Sec. 2601; and Code Sec. 2603.

22. PLR 202432012 (August 9, 2024)

    a) Held – Modification of grandchildren's trust dividing trust into two equal trusts will not cause trust to lose GST exempt status or otherwise become subject to GST tax, does not constitute a transfer by a beneficiary for gift tax purposes and will not cause beneficiary to recognize gain or loss of sale or disposition of trust property.

23. PLR 202432016 (August 9, 2024)

    a) Held – Modification of children's trust by state court will not result in a transfer of property subject to GST tax under Code Sec. 2601, and will not cause the trust to lose its GST tax exempt status.

H. Decanting and modification treated as continuation of trust?

1. Several private letter rulings have treated trust decanting and modification as a continuation of the original trust, retaining the same tax attributes of the original trust.

    a) PLR 200607015 (Finding that where state law permitted a trustee to exercise a limited power of appointment and distribute trust principal to separate trusts, the new trusts should be treated as a continuation of the original trust).

    b) PLR 200736002 (Stating that no gain or loss is recognized on the partition of Trust for purposes of § 61(a)(3) or § 1001(a) by Trust, by any of the three successor trusts, or by any beneficiary of those trusts).

    c) PLR 200832020 (Modification by trustees to divide and change administrative provisions of trust authorized under state law was treated as continuation of trust for federal income tax purposes).

    d) PLR 9330008 (Extension of trust resulting from exercise of special power of appointment granted in grandfathered trust was treated as continuation of grandfathered trust).

2. Whether a trust is treated as a continuation may still present a taxable event under certain circumstances, and would likely be fact dependent.

a) It is possible for a recognition event to occur through a decanting that requires beneficiary approval, where a beneficiary's interests in the new trust are materially different from the original.

b) Special consideration should be given to change in situs of the trust (possible state tax implications), and negative basis assets held in trust (possibly triggering gain).

V. Recovery of Attorney's Fees when Defending the Decanting, Modification or Termination of a Trust

A. Generally, a trustee can be reimbursed out of trust property for reasonable attorney's fees and other costs in bringing, defending, or settling litigation as appropriate to proper administration or performance of the trustee's duties.

1. *Bronstein v. Bronstein*, 332 So.3d 510 (District Court of Appeal of FL Dec. 22, 2021) (holding that while a trustee may pay costs and attorney's fees in any proceeding in which they prove the expense was reasonably necessary and for the benefit of the trust, beneficiaries may challenge those costs and fees).

B. If a decanting, modification or termination is deemed to be a breach of trust, however, a trustee may be liable for the attorney's fees incurred to defend the improper action. *See, e.g.*, *Hodges v. Johnson*, 173 N.H. 595 (2020).

1. The New Hampshire Supreme Court held that trustees were liable for attorney's fees incurred by a trust in litigation arising from a series of decantings. The decantings constituted a breach of the trustees' duty of impartiality because the trustees failed to consider the beneficiaries' interests. The absence of case law governing decantings did not excuse the trustees' actions, as they could have retained independent counsel or sought instructions from a court.

VI. Recent Relevant Cases Arising in States that Have Implemented the UTC

A. *Connary v. Shea*, 2024 ME 57 (Supreme Judicial Court of ME August 6, 2024) (affirming no evidence that one of two settlors of a trust mistakenly believed the trust provided for beneficiary to receive proceeds from any future recall of bank stock with which trust was funded in part, as could support beneficiary's claim for reformation after bank stock was recalled).

B. *In re Revocable Trust of David Rothstein*, 272 A.3d 471 (Superior Court of PA Jan 12, 2022) (accepting a modification of a trust which changed the beneficiaries of

such trust even though it did not follow the proper procedure because the Grantor showed his intent to do so).

C. *Ex parte Scoggins*, 2021 WL 4024376 (Supreme Court of Alabama Sep. 3, 2021) (permitting emergency termination of irrevocable trust upon finding that trustee had misappropriated funds in direct violation of previous court orders).

D. *Skarsten-Dinerman v. Milton Skarsten Living Trust*, 2021 WL 6109571 (Court of Appeals of MN Dec. 27, 2021) (affirming decision to deny modification of a trust to allow distribution and sale of farmland as Grantor's intent was to keep land intact as a source of income for the beneficiaries and such modification would be inconsistent with this intent. The court was not convinced by the beneficiaries' argument that falling rent prices have decreased the value of the land to the extent that it was no longer a feasible source of income).

E. *In re Trust B Created Under Karam Family Trust*, 2021 WL 6013442 (Court of Appeals of AZ Dec. 20, 2021) (upholding decision that allowed trustee of irrevocable trust to terminate trust without the approval of one of the Settlor's children. The court looked specifically to the power of appointment that was granted to the trustee and deemed that the Settlor's intent was to give trustee discretion in deciding who the beneficiaries of trust would be).

This page intentionally left blank

Decanting, Modifying, and Terminating Trusts

Daniela P. Catrocho, Esq.

© 2024 Day Pitney LLP

Why Decant, Modify or Terminate a Trust?

- Effectuate beneficial tax consequences
- Grant, remove or refine powers of appointment
- Change administrative provisions
- Modify Trustee provisions
- Divide trust or permit mergers thereof
- Change situs or governing law
- Change trust terms
- Eliminate or expand beneficial enjoyment

Decanting

- Transfer assets from existing trust to a new trust
- Authority to Decant
  - Trust provision
  - Statutory authority
  - Common law

Decanting

- *Wiedenmayer v. Johnson*
  - Trustee power to distribute outright
  - For beneficiary's "best interests"
  - In Trustee's "absolute and uncontrolled discretion"
- Good faith decisions made after consideration of all relevant facts and attendant circumstances and for reasonably valid reasons will defeat abuse of discretion claims

Decanting

- Can/Should Trustee Decant
- Analyze Trust instrument
  - Evaluate other applicable law
  - Evaluate Breach of Trust potential
    - Breach of Duty of Impartiality
    - Attorney's Fees
- How to Decant
- Drafting Considerations for the new Trust

Decanting

- Uniform Trust Decanting Act
  - Completed 2015
  - Different rules for different discretion
    - "Ascertainable standard" or "reasonably definite standard"
    - "Expanded distributive discretion"
  - Special rules for decanting to a special needs trust
  - Notice requirements
  - Limitations

Trust Modification & Termination

Modifying and Terminating

- New Jersey Uniform Trust Code, *N.J.S.A.* § 3B:31-26 through § 3B:31-33
- § 3B:31-6: common law supplements the UTC where it is not inconsistent
- Trustee or beneficiary may seek court approval or denial. § 3B:31-26(b)

Modifying and Terminating

- Non-charitable, irrevocable trust with some consent. § 3B:31-27
  - By nonjudicial settlement agreement with consent of trustee and all beneficiaries
    - § 3B:31-11
    - Not just qualified beneficiaries – all beneficiaries
    - Representation issues. § 3B:31-13 through -17
  - With court approval upon consent of all beneficiaries
  - With court approval upon request of one beneficiary
- No modification or termination if inconsistent with a material purpose of the trust

Modifying and Terminating

- What is a material purpose
  - Spendthrift provision is no longer presumed to be
  - Settlor's intent considered
- Cannot modify to get around other applicable law
  - § 3B:31-11(f)
  - *Trust Under Agreement of Taylor*, 164 A.3d 1147 (Pa. 2017); *In re Tr. Under Deed of Walter R. Garrison*, 288 A.3d 866 (Pa. 2023)

Modifying and Termination

- Modifying or Terminating for specific reasons:
  - Expires per terms, no purpose remains, or purposes are unlawful, contrary to public policy, impossible to achieve
  - Unanticipated circumstances
  - Inability to administer effectively
  - Cy pres
  - Uneconomical
  - Achieve tax objectives
- Reformation to Correct a mistake of fact or law
- Construction to Conform to probable intent
- Combination and Division

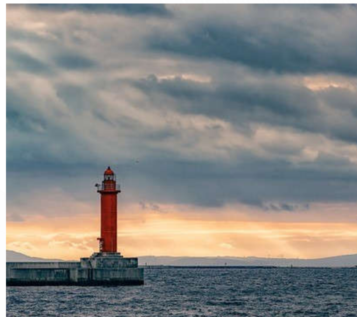
Tax Implications of Decanting,
Modifying & Terminating Trusts

Tax Implications

- Income Tax
- Gift Tax
  - Historically, none if it’s a modification of administrative provisions only*
  - Beware of Trustee/beneficiary actions
  - Beware of Beneficiary rights
- Estate Tax
  - To Grantor
  - To Beneficiary

Tax Implications

- Generation-Skipping Transfer Tax
  - Possible loss of exemption
  - Four safe harbors - Treas. Reg. § 26.2601-1(b)(4)(i)(A)-(D)



GST Tax Safe Harbors

- Four safe harbors - Treas. Reg. § 26.2601-1(b)(4)(i)(A)-(D)
  - Decanting – ok if old trust or state law permitted without consent of beneficiary or court and new trust does not extend the time for vesting of a beneficial interest
  - Modification - ok where
    - Court approved arm's length negotiated settlement within range of reasonable outcomes
    - Judicial construction of a bona fide issue consistent with applicable state law (i.e., correcting scrivener errors)
    - Judicial or nonjudicial action that neither shifts a beneficial interest to a lower generation nor extends the vesting of a beneficial interest

IRS Guidance

- No Rulings or Determination Letters – Rev. Proc. 2024-3
- Chief Counsel Advice Memorandum (CCA) 202352018 issued December 29, 2023
- Also check PLRs for guidance!

Adventures in Generation Skipping

Laura A. Kelly
McCarter & English, LLP
Newark, New Jersey

This page intentionally left blank

I. Generation-Skipping (*Very* Generally)

A. Section 2601 of the Internal Revenue Code (the "Code") imposes a tax on "every generation-skipping transfer."

B. What is a generation-skipping transfer? Section 2611 of the Code defines it as a:

1. Direct Skip – a transfer to a skip person that is subject to gift or estate tax.[1]

a. Who is a skip person? A natural person who is two or more generations below the generation assignment of the transferor.[2]

Example: Elizabeth gives a house to her grandson William.

b. A trust can also be a skip person, if all of the interests in the trust are held by skip persons[3] or if no one has an interest in the trust, but at no time after the transfer may a distribution be made to anyone other than a skip person.[4]

Example: Elizabeth gives a house to a trust for the benefit of her grandchildren William, Harry, Beatrice, and Eugenie.

2. Taxable Termination - the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless (i) immediately after such termination, a non-skip person has an interest in such property, or (ii) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.[5]

a. Example: Elizabeth creates an irrevocable trust. The trustees have discretion to pay income and principal to Elizabeth's son Charles and her grandson William. If Charles dies, a taxable termination would occur because the only beneficiary at that point would be a skip person (William).

b. Compare: Elizabeth creates an irrevocable trust. The trustees have discretion to pay income and principal to Elizabeth's son Charles, her daughter Anne, and her grandson William. If Charles dies, a taxable termination would NOT occur because Anne (a non-skip person) still has an interest in the trust.

---

[1] Internal Revenue Code §2612(c)(1).
[2] IRC §2613(a)(1).
[3] IRC §2613(a)(2)(A).
[4] IRC §2613(a)(2)(B).
[5] IRC §2612(a).

3. Taxable Distribution – any distribution from a trust to a skip person unless the distribution is a direct skip or a taxable termination.[6]

   Example: Elizabeth creates an irrevocable trust. The trustees have discretion to pay income and principal to Elizabeth's son Charles and her grandson William. If the trustees make a distribution to William, this is a taxable distribution.

C. Who is the transferor?

1. Look to the most recent transfer subject to federal gift or estate tax.[7] For a lifetime gift, the transferor is the donor.[8] For a gift at death, the transferor is usually the decedent.[9]

2. However, a QTIP trust is included in the gross estate of the surviving spouse under Section 2044 of the Code. This would make the surviving spouse the transferor.

   a. For this reason, a "reverse QTIP election" is sometimes made in order to allocate to the QTIP trust the generation-skipping tax exemption of the first spouse to die.[10]

   b. The effect *for generation-skipping tax purposes* is that the QTIP election was not made (preventing the transferor switch when the surviving spouse dies).[11]

3. Property over which someone holds a general power of appointment is included in that person's gross estate for estate tax purposes under Section 2041 of the Code. The power holder becomes the new transferor of the property.

   a. Example: Elizabeth creates an irrevocable trust. The trustees have discretion to pay income and principal to Elizabeth's son Charles for his life. Charles is given a testamentary limited power of appointment over the trust property. At Charles's death, unless he exercises the limited power of appointment, the trust property will pass to Elizabeth's grandson William.

      Property subject to a limited power of appointment is not included in the holder's gross estate. Elizabeth, as the person most recently

[6] IRC §2612(b).
[7] Treasury Regulations §26.2611-1.
[8] IRC §2652(a)(1)(B).
[9] IRC §2652(a)(1)(A).
[10] IRC §2652(a)(3).
[11] IRC §2652(a)(3).

subject to gift tax in connection with the property, remains the transferor. A taxable termination occurs at Charles's death.

b. Example: Elizabeth creates an irrevocable trust. The trustees have discretion to pay income and principal to Elizabeth's son Charles for his life. Charles is given a testamentary general power of appointment over the trust property. At Charles's death, unless he exercises the general power of appointment, the trust property will pass to Elizabeth's grandson William.

Property subject to a general power of appointment is included in the holder's gross estate. The transferor switches from Elizabeth to Charles, and no generation-skipping transfer is deemed to have occurred.

If the terms of the trust permit it, granting a general power of appointment to a non-skip person could be a good way of preventing a generation-skipping tax that might occur in a non-GST exempt trust.

D. Notes

1. Any transfer that, if made during life by an individual, would not be treated as a taxable gift under section 2503(e) (certain transfers for educational or medical expenses), is not a "generation-skipping transfer."[12]

2. Any transfer to the extent the transferred property previously was subject to generation-skipping tax, the transferee in the prior transfer was the same generation (or a lower one) than the current transfer, and the transfers don't have the effect of avoiding tax, also isn't considered a "generation-skipping transfer."[13]

Example: Elizabeth creates an irrevocable trust. The trustees have discretion to pay income and principal to Elizabeth's son Charles and her grandson William. If Charles dies, a taxable termination would occur because the only beneficiary at that point would be a skip person (William). After that tax, the trustees decide to make a distribution to William. This distribution isn't considered a generation-skipping transfer under the "previously-taxed" exception.

[12] IRC §2611(b)(1).
[13] IRC §2611(b)(2).

3. Only one direct skip occurs when a single transfer of property skips two or more generations.[14]

II. Help - I think a generation-skip just occurred!

A. Are you sure it's a problem?

1. Is the trust "grandfathered"? If the trust was irrevocable on September 25, 1985 and no additions were made to the trust after that date, the trust is exempt from generation-skipping tax.[15]

a. The general rule is that any trust in existence on that date is considered to be irrevocable,[16] BUT:

i. If the grantor retained a power that would cause the trust to be included in his or her gross estate under Section 2038 of the Code (to alter, amend, revoke, or terminate, to add beneficiaries etc.), it is not irrevocable.[17]

ii. If the trust held life insurance and the grantor possessed any incidents of ownership over that policy that would have caused inclusion in the grantor's estate under Section 2042 of the Code, the trust is not irrevocable.[18]

b. Special situations

i. QTIP Trusts – Trusts for which a qualified terminable interest property election was made prior to September 25, 1985 are not subject to generation-skipping tax.[19] The trust is treated as if a reverse QTIP election were made under Section 2652(a)(3) of the Code, treating the grantor/ decedent as the transferor.

ii. Transition Rule #1 - Generation-skipping tax will not apply to a revocable trust that (i) was in existence on October 21, 1986 and was not amended at any time after October 21, 1986 in any way that results in the creation of, or an increase in the amount of, a generation-skipping transfer, and (ii) had no additions made to it after October 21, 1986, that results in the creation of, or an increase in the amount

---

[14] Regs §26.2612-1(a).
[15] Regs §26.2601-1(b)(i).
[16] Regs §26.2601-1(b)(ii).
[17] Regs §26.2601-1(b)(ii)(B).
[18] Regs §26.2601-1(b)(ii)(C).
[19] Regs §26.2601-1(b)(iii).

of, a generation-skipping transfer, IF the decedent dies before January 1, 1987.[20]

iii. Transition Rule #2 - If the person was unable to change the disposition of his or her property because of a mental disability from October 22, 1986 that continued until death, no generation-skip will be deemed to have occurred (i) from a trust that is included in the decedent's gross estate, or (ii) in connection with a direct skip that happens at the decedent's death.[21]

When claiming this exception in connection with direct skips that happen at a decedent's death, the instructions for Form 706 state that if the decedent had been adjudged mentally incompetent, a copy of the judgment or decree must be filed with the return. If the decedent had not been adjudged mentally incompetent, the executor must file with Form 706 a certification from a qualified physician stating that in the physician's opinion the decedent had been mentally incompetent at all times on and after October 22, 1986, and that the decedent had not regained the competence to modify or revoke the terms of the trust or will prior to the decedent's death.

c. Were any additions made to the grandfathered trust?

i. If an addition is made to a grandfathered trust after September 25, 1985, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to generation-skipping tax. *See* Regs §26.2601-1(b)(1)(iv) for the mechanics of this.

ii. The post-September 25, 1985, release, exercise, or lapse of a general power of appointment over a grandfathered trust is considered to be a constructive addition.[22] The value of the trust property subject to the power is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

iii. The post-September 25, 1985, release, exercise, or lapse of a limited power of appointment over a grandfathered trust is not considered to be a constructive addition as long as the exercise does not postpone the vesting of the interest

[20] Regs §26.2601-1(b)(2)(i).
[21] Regs §26.2601-1(b)(3).
[22] Regs §26.2601-1(b)(1)(v)(A).

beyond the rule against perpetuities.[23] If the limited power is exercised in a way that creates a second power, no constructive addition will occur as long as the second power may not be exercised in a way that could postpone the vesting of the interest beyond the perpetuities period of the original trust.[24]

2. Was GST exemption affirmatively allocated to the trust on a timely-filed gift or estate tax return? Obtain copies of gift and estate tax returns filed in connection with transfers to the trust.

   a. Schedule D of Form 709 is where the donor's GST exemption is allocated in connection with lifetime gifts. Make sure that the GST exemption was allocated correctly.

      i. In general, an annual exclusion gift made to an individual also will qualify for the GST annual exclusion.[25]

      ii. However, a gift to a trust that may qualify for the gift tax annual exclusion (because of the presence of a Crummey withdrawal power, for example) will not qualify for the GST annual exclusion unless the trust is a "2642(c) trust": a trust (i) for a single beneficiary and, (ii) the terms of which, if the trust continues until the beneficiary's death, would include the trust property in the beneficiary's estate.[26] A gift tax return preparer may have claimed the GST annual exclusion where it isn't permitted and under-allocated the donor's GST exemption to the transfer.

   b. A decedent's GST exemption is allocated on Schedule R of Form 706.

   Remember to look for the "reverse QTIP election" made under Section 2652(a)(3) of the Code for a QTIP trust, which will result in the first spouse being treated as the transferor for GST purposes (not the surviving spouse). There used to be a box to check for this. Now, if a qualifying interest is listed in Part 1, Line 9 of Schedule R, you're deemed to have made a reverse QTIP election.

---

[23] Regs §26.2601-1(b)(1)(v)(B).
[24] Regs §26.2601-1(b)(1)(v)(B).
[25] IRC §2642(c)(1).
[26] IRC §2642(c)(2).

3. No return? No affirmative election? – Was GST exemption automatically allocated?

   a. If any individual makes a direct skip during life, his or her unused GST exemption will be allocated to the property transferred so that the property is exempt from generation-skipping tax.[27]

   b. If any individual makes an indirect skip during life to a "GST trust", his or her unused GST exemption will be allocated to the property transferred so that the property is exempt from generation-skipping tax.[28]

      A "GST trust" is a trust that could have a taxable distribution or taxable termination in the future, unless it falls into one of the following exceptions:[29]

      i. The trust provides that more than 25% of the principal must be distributed to or may be withdrawn by one or more individuals who are non-skip persons (i) before the date that the individual attains age 46, (ii) on or before one or more dates specified in the trust that will occur before the date that such individual attains age 46, or (iii) upon the occurrence of an event that may reasonably be expected to occur before the date that such individual attains age 46.

      ii. The trust provides that more than 25% of the principal must be distributed to or may be withdrawn by one or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals.

      iii. The trust instrument provides that, if one or more individuals who are non-skip persons die on or before a date or event described in (i) or (ii) above, more than 25 percent of the principal either must be distributed to the estate or estates of one or more of such individuals or is subject to a general power of appointment exercisable by one or more of such individuals.

---

[27] IRC §2632(b)(1).
[28] IRC §2632(c)(1).
[29] IRC §2632(c)(3)(B).

iv. The trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer.

v. The trust is a charitable lead annuity trust, a charitable remainder annuity trust, or a charitable remainder unitrust, or

vi. The trust is a charitable lead unitrust that is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

c. If you do have a gift tax return, the donor will have claimed the automatic allocation of GST exemption on Schedule A, Part 3 of Form 709. One of the options is for the automatic allocation of GST exemption to apply to that year's gift and all subsequent transfers to the trust.[30]

d. Regs §26.2632-1(d)(2) provides that, after someone dies, his or her unused GST exemption is automatically allocated on the due date for filing the decedent's federal estate tax return to the extent not otherwise allocated by the decedent's executor on or before that date. The automatic allocation occurs whether or not a return is actually required to be filed.

i. Unused GST exemption is allocated:

First, pro rata, on the basis of the value of the property as finally determined for federal estate tax purposes, to direct skips treated as occurring at the transferor's death.

The balance (if any), pro rata, on the basis of the federal estate tax value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made.[31]

[30] Regs §26.2632-1(b)(3)(i).
[31] Regs §26.2632-1(d)(2).

ii. The automatic allocation of GST exemption is irrevocable, and an allocation made by the executor after the automatic allocation is made is ineffective. [32]

iii. No automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the trust.[33]

B. Calculation of Tax

1. GST Exemption

a. Every individual is allowed a generation-skipping transfer tax ("GST") exemption amount which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.[34]

b. The amount of the GST exemption is equal to the basic exclusion amount for federal estate tax purposes.[35] Until 2026, this amount is $10 million, indexed for inflation (in 2024, $13.61 million).[36] On January 1, 2026, the amount is scheduled to revert to $5 million, indexed for inflation.[37]

2. Applicable Fraction / Inclusion Ratio

a. The applicable fraction is a fraction in which the numerator of the applicable fraction is the amount of GST exemption allocated to the trust (or to the transferred property in the case of a direct skip that isn't to a trust), and the denominator of the applicable fraction is the value of the property transferred to the trust (or transferred in a direct skip that isn't to a trust) reduced by the sum of (i) any Federal estate tax and any State death tax incurred by reason of the transfer that is chargeable to the trust and is actually recovered from the trust, (ii) the amount of any charitable deduction allowed with respect to the transfer, and (iii) in the case of a direct skip, the value of the portion of the transfer that is a nontaxable gift. [38]

---

[32] Regs §26.2632-1(d)(2).
[33] Regs §26.2632-1(d)(2).
[34] IRC §2631(a).
[35] IRC §2631(c).
[36] IRC §2010(c)(3).
[37] IRC §2010(c)(3).
[38] IRC §2642(a)(2).

b. The inclusion ratio is the excess of 1 over the applicable fraction.[39] A transfer with an inclusion ratio of zero is completely exempt from generation-skipping tax. A transfer with an inclusion ratio of one is completely non-exempt from generation-skipping tax.

c. Generation-skipping tax is imposed at an applicable rate that is equal to the maximum federal estate tax rate (at the time of the generation-skip) multiplied by the inclusion ratio.[40] In 2024 the maximum federal estate tax rate is 40%.

3. Examples

a. Elizabeth makes a gift of $117,000 to her grandson William. $17,000 of this gift qualifies for the generation-skipping tax annual exclusion. Elizabeth allocates $100,000 of her GST exemption to the transfer.

i. The applicable fraction is $100,000 / $100,000 = 1.

ii. The inclusion ratio is zero (1 – the applicable fraction). No generation-skipping tax is due in connection with this direct skip.

b. Elizabeth makes a gift of $117,000 to a trust for her grandson William, her granddaughter Beatrice, and her granddaughter Eugenie. This gift does not qualify for the generation-skipping tax annual exclusion. Elizabeth allocates $117,000 of her GST exemption to the transfer.

i. The applicable fraction is $117,000 / $117,000 = 1.

ii. The inclusion ratio is zero (1 – the applicable fraction). No generation-skipping tax is due in connection with this direct skip.

c. Elizabeth makes a gift of $117,000 to a trust for her grandson William, her granddaughter Beatrice, and her granddaughter Eugenie. This gift does not qualify for the generation-skipping tax annual exclusion. Due to a mix-up, Elizabeth's accountant makes an affirmative election NOT to apply any of Elizabeth's GST exemption to the transfer.

i. The applicable fraction is $0 / $117,000 = 0.

---

[39] IRC §2642(a)(1).
[40] IRC §2641(a).

ii. The inclusion ratio is 1 (1 – the applicable fraction). Generation-skipping tax is due in connection with this direct skip. The applicable rate of tax is 40% (the maximum federal estate tax rate) x 1 (the inclusion ratio) = 40%.

d. Elizabeth makes a gift of $117,000 to a trust for her grandson William, her granddaughter Beatrice, and her granddaughter Eugenie. This gift does not qualify for the generation-skipping tax annual exclusion. Elizabeth's accountant thinks it does, however, and allocates $100,000 of her GST exemption to the transfer.

i. The applicable fraction is $100,000 / $117,000 = 0.855.

ii. The inclusion ratio is 0.145 (1 – the applicable fraction). Generation-skipping tax is due in connection with this direct skip. The applicable rate of tax is 40% (the maximum federal estate tax rate) x 0.145 (the inclusion ratio) = 5.8%.

C. Liability for Tax

1. The transferee pays the generation-skipping tax on a taxable distribution.[41]

Example: William will pay the generation-skipping tax in connection with a distribution to him from a non-GST exempt trust created by his grandmother Elizabeth.

2. The trustee pays the generation-skipping tax on a taxable termination or a direct skip from a trust.[42]

Example: The trustee of a non-GST exempt trust created by Elizabeth for the benefit of her son Charles and his descendants will pay the generation-skipping tax on the taxable termination that will occur at Charles's death.

3. The transferor pays the generation-skipping tax on a direct skip.[43]

Example: Elizabeth will pay any generation-skipping tax due in connection with a gift she makes to her grandson William.

4. Unless the governing instrument otherwise directs, the tax is paid out of the transferred property itself.[44]

---

[41] IRC §2603(a)(1).
[42] IRC §2603(a)(2).
[43] IRC §2603(a)(3).
[44] IRC §2603(b).

D. GST Reporting Requirements

1. Direct skips made during life

a. An individual reports direct skips made during his life on Schedule A, Part 2 of Form 709. These gifts are then carried over to Schedule D, Part 1 of Form 709, where the net transfer is determined.

b. The net transfer is then carried over to Schedule D, Part 3 of Form 709, where the amount of generation-skipping tax is calculated or a portion of the donor's exemption is allocated to the transfer so that no tax is due.

2. Direct skips at the death of a decedent.

a. Form 706, Schedule R is used to determine the generation-skipping tax on direct skips that is payable by the decedent's estate. Schedule R-1 is used to determine the generation-skipping tax on direct skips that is payable by a trust that is included in the decedent's estate.

b. Recall that the trustee pays the generation-skipping tax on a direct skip from a trust. [45] Schedule R-1 is the notice from the executor to the trustee that the tax is due. The executor completes Schedule R-1, files one copy with Form 706, and gives the trustee two copies – one to be used as a payment voucher for the IRS, and one to be kept with the trust's files.

c. If any of the executors is also one of the trustees of the trust, the direct skip is reported on Schedule R (not Schedule R-1). This makes sense: there is no need to provide Schedule R-1's notification.

d. Schedule R – Part 2 or Part 3

i. Part 2 calculates the generation-skipping tax on transfers in which the property interests transferred are to bear the generation-skipping tax on the transfers. (This is the default rule.)

ii. Part 3 calculates the generation-skipping tax on transfers in which the property interests transferred do <u>not</u> bear the generation-skipping tax on the transfers (because the will or trust specifically directs).

---

[45] IRC §2603(a)(2).

3. Taxable Distributions

a. Recall that the transferee pays the generation-skipping tax on a taxable distribution.[46]

b. The trustee notifies the IRS and the distributee of the taxable distribution on Form 706-GS(D-1).

i. Form 706-GS(D-1) must be filed even in connection with taxable distributions from GST-exempt trusts (i.e., trusts with a zero inclusion ratio).

ii. Part A of the form is filed with the IRS and includes a section to remind the preparer that the inclusion ratio must be recalculated when assets are transferred to a pre-existing trust. Part B of the form serves as notice to the distributee of the transfer and the trust's inclusion ratio.

Note: Consider documenting the automatic allocation of GST exemption if a federal estate tax return is not required to be filed, so that the reporting of future taxable distributions or taxable terminations is simplified.

Example: Philip created an irrevocable trust for the benefit of his son Charles and his descendants ("Charles's Trust"). The trust is GST-exempt. When Philip's wife, Elizabeth, dies, she leaves her estate to Charles's Trust. Elizabeth's estate is not required to file a federal estate tax return. She has more than enough GST exemption remaining to make her gift to Charles's Trust exempt from generation-skipping tax, and the automatic allocation rules would apply.

Several years after Elizabeth's death, a distribution is made from Charles's Trust to Elizabeth and Philip's grandson William. This is a taxable distribution that must be reported on Form 706-GS(D-1), even though Charles's Trust is GST exempt. If Elizabeth's executor had the foresight to prepare a document by which (i) the trustee of Charles's Trust acknowledged Elizabeth's gift to the trust, and (ii) the application of the automatic allocation rules to the gift is recited, it will be much easier for the trustee of Charles's Trust to substantiate how Charles's Trust still has an inclusion ratio of zero (i.e. is completely GST exempt) even after Elizabeth's subsequent gift to an existing GST exempt trust.

[46] IRC §2603(a)(1).

iii. The form is filed with the IRS and given to the distributee by April 15th of the year following the taxable distribution.

iv. If the trust pays the generation-skipping tax on a taxable distribution, the tax paid is treated as an additional taxable distribution.[47]

c. If the distributee receives Form 706-GS(D-1) from the trustee and the listed inclusion ratio is higher than zero, the distributee files Form 706-GS(D).

i. Form 706-GS(D) is used to calculate and report the tax due on distributions from a trust that are subject to the generation-skipping tax.

ii. The form is due by April 15th of the year following the distribution. An automatic six-month extension of time to file is available.

iii. The distributee does not need to file Form 706-GS(D) if the form he received from the trustee shows that the trust has a zero inclusion ratio.

4. Taxable Terminations

a. Recall that the trustee pays the generation-skipping tax on a taxable termination.[48]

b. The trustee reports the taxable termination by filing Form 706-GS(T) no later than April 15th of the year following the taxable termination. An automatic extension of time to file is available by filing Form 7004, Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns.

i. Part I and II of the form require information about the trust and its inclusion ratio.

ii. Schedule A requires information about the identity of the skip people and a description for the reason the taxable termination has occurred.

iii. Property subject to the taxable termination is listed on Schedule A and valued. If the taxable termination occurs because of the death of an individual, the trustee may elect alternate valuation under section 2032. If the trustee elects

[47] Regs §26.2612-1(c)(1).
[48] IRC §2603(a)(2).

alternate valuation, the trustee must use it to value all property included in the termination. Alternate value is not allowed unless the election will decrease both the total value of the property interests that were subject to the termination and the total net GST tax due.

iv. The form permits deductions (trustee's fees, administrative expenses, financial advisor's fees, accounting fees, attorney fees, the cost of selling the trust property), which are listed on Schedule B.

III. How do I fix a trust that is *partially* GST-Exempt?

A. If the goal is to avoid having to pay generation-skipping tax, every effort should be made so that a trust is either entirely exempt or entirely non-exempt from generation-skipping tax.

Example: Elizabeth creates an irrevocable trust for the benefit of her son Andrew and his two daughters, Beatrice and Eugenie, and their descendants ("Andrew's Trust").

1. GST-exempt trusts have an inclusion ratio of zero. If a trust is entirely GST-exempt, distributions to skip people can be prioritized – and distributions can be made as sparingly as possible – to maximize the generation-skipping potential of the trust.

   Example: If Elizabeth allocated GST exemption to Andrew's Trust so that it is entirely GST-exempt, the trustee can focus on distributions to Beatrice and Eugenie (and their respective children).

2. GST non-exempt trusts have an inclusion ratio of one. If a trust is entirely GST non-exempt, distributions to non-skip people can be prioritized – and distributions can be made as liberally as the trust terms permit – to minimize any eventual generation-skipping tax. The trustee could consider whether it is possible to grant a general power of appointment to a non-skip person, who may have unused estate tax exemption of his or her own, in order to halt the progress of a generation-skip.

   Example: If Elizabeth did not allocate GST exemption to Andrew's Trust, it will be entirely GST non-exempt. The trustees can make any distributions that Andrew might need from this trust but will refrain from any distributions to Beatrice and Eugenie that would incur generation-skipping tax as taxable distributions. If the trust terms allow the trustees to grant Andrew a testamentary general power of appointment, after his death distributions may be made to Beatrice and Eugenie (and their children) without triggering a generation-skipping tax.

3. Partially GST-exempt trusts have an inclusion ratio of something between zero (exempt) and one (non-exempt). A partially GST-exempt trust is in limbo; every taxable distribution or termination will trigger some amount of generation-skipping tax.

   Example: If Elizabeth did not allocate enough GST exemption to Andrew's Trust, it will be only partially exempt from generation-skipping tax. Elizabeth's allocation resulted in an inclusion ratio of 0.6. The trust is only 40% GST-exempt. The trustees can make any distributions that Andrew might need from this trust, but each distribution to Beatrice and Eugenie (or their respective issue) would trigger generation-skipping tax. The applicable rate of tax is 40% (the maximum federal estate tax rate) x 0.6 (the inclusion ratio) = 24%.

   Granting Andrew a testamentary general power of appointment would be inefficient. The entire trust would be included in Andrew's gross estate for federal estate tax purposes, which would be a waste of the 40% of Elizabeth's GST exemption that was allocated to Andrew's Trust.

B. Qualified Severance

1. Regs. Section 26.2642-6 describes a "qualified severance" – a way to divide an existing trust into two or more trusts so that the separate trusts resulting from the severance are treated as separate trusts for generation-skipping tax purposes and the inclusion ratio of each new resulting trust may be different from the inclusion ratio of the original trust.

   Example: Andrew's Trust has an inclusion ratio of 0.6; it is partially GST exempt. A qualified severance could divide Andrew's Trust into two separate trusts for GST purposes: one that is entirely GST-exempt, and one that is entirely GST non-exempt.

2. Requirements of a qualified severance:

   a. The single trust must be severed pursuant to the terms of the governing instrument, or pursuant to applicable local law.[49] The severance must be effective under local law.[50]

      If the result does not impair rights of any beneficiary or adversely affect the achievement of the purposes of the trust, the trustees of a single trust may divide the trust into two or more separate trusts, in which case distributions provided by the governing instrument may be made from one or more of the separate trusts. N.J.S.A. 3B:31-34.

[49] Regs §26.2642-6(d)(1).
[50] Regs §26.2642-6(d)(2).

b. The date of severance must be either (i) the date selected by the trustee as of which the trust assets are to be valued in order to determine the funding of the resulting trusts, or (ii) the court-imposed date of funding in the case of an order of the local court with jurisdiction over the trust ordering the trustee to fund the resulting trusts on or as of a specific date.[51]

c. The funding must be commenced immediately upon, and funding must occur within a reasonable time (but in no event more than 90 days) after, the selected valuation date.[52]

d. The single trust (original trust) must be severed on a fractional basis, such that each new trust (resulting trust) is funded with a fraction or percentage of the original trust, and the sum of those fractions or percentages is one or one hundred percent, respectively.[53]

i. The fraction may be expressed as a formula, "for example, that fraction of the trust the numerator of which is equal to the transferor's unused GST tax exemption, and the denominator of which is the fair market value of the original trust's assets on the date of severance."[54]

ii. A pecuniary division will not result in a qualified severance.[55]

iii. Example: Andrew's Trust has an inclusion ratio of 0.6; it is partially GST exempt. The trust holds assets valued at $10 million on January 1st. The trustees may sever Andrew's Trust into a new GST-Exempt Andrew's Trust and a new GST Non-Exempt Andrew's Trust.

Funding GST-Exempt Andrew's Trust with 40% of the trust assets valued on January 1st and funding GST Non-Exempt Andrew's Trust with 60% of the trust assets valued on January 1st would satisfy this requirement.

Funding GST-Exempt Andrew's Trust with $4 million and funding GST Non-Exempt Andrew's Trust with $6 million would not satisfy this requirement.

---

[51] Regs §26.2642-6(d)(3).
[52] Regs §26.2642-6(d)(3).
[53] Regs §26.2642-6(d)(4).
[54] Regs §26.2642-6(d)(4).
[55] Regs §26.2642-6(d)(4).

e. Funding. Either:

i. Each of the new separate trusts may be funded with a pro rata share of each asset held by the original trust;[56] or

ii. The assets of the original trust may be divided between the two new trusts on a non-pro rata basis BUT each asset must be valued by multiplying the fair market value of the asset held in the original trust as of the date of severance by the fraction of that asset received by that resulting trust.[57] No discounts may be claimed because one of the new trusts receives less than the entire interest held by the original trust.

i. Example: Andrew's Trust has an inclusion ratio of 0.6; it is partially GST exempt. The trust holds assets valued at \$10 million on January 1st: \$4 million in cash, and a 22% interest in York, Inc. – a closely-held corporation – valued at \$6 million on January 1st. The trustees may sever Andrew's Trust into a new GST-Exempt Andrew's Trust and a new GST Non-Exempt Andrew's Trust.

Funding GST-Exempt Andrew's Trust with \$1.6 million of cash (40% of the \$4 million) and 8.8% of York, Inc. valued at \$2.4 million (40% of the 22% of York, Inc. owned by the original trust) and funding GST Non-Exempt Andrew's Trust with \$2.4 million of cash (60% of the \$4 million) and 13.2% of York, Inc. valued at \$3.6 million (60% of the 22% of York, Inc. owned by the original trust) would satisfy this requirement. (pro-rata funding)

Funding GST-Exempt Andrew's Trust with \$4 million of cash (40% of the value of the original trust on the date of severance) and funding GST Non-Exempt Andrew's Trust with 22% of York, Inc. valued at \$6 million (60% of the value of the original trust on the date of severance) would satisfy this requirement. (non-pro rata funding)

The trustees decide to split the original trust's interest in York, Inc. equally between the two new trusts. Funding GST-Exempt Andrew's Trust with \$1 million of cash and 11% of York, Inc. valued at \$3 million (40% of the value of the original trust on the date of severance, not claiming any discount because of the division in the ownership of the

[56] Regs §26.2642-6(d)(4).
[57] Regs §26.2642-6(d)(4).

York, Inc. holding) and funding GST Non-Exempt Andrew's Trust with $3 million of cash and 11% of York, Inc. valued at $3 million (60% of the value of the original trust on the date of severance, not claiming any discount because of the division in the ownership of the York, Inc. holding) would satisfy this requirement. (non-pro rata funding)

f. The terms of the resulting trusts must provide, in the aggregate, for the same succession of interests of beneficiaries as are provided in the original trust.[58]

g. What about trusts where discretionary distributions may be made to one or more of the current beneficiaries? A qualified severance requires:

i. The terms of each of the new trusts to be the same as the terms of the original trust. Each permissible beneficiary of the original trust doesn't need to be a beneficiary of all of the new trusts.[59]

ii. Each beneficiary's interest in the new trusts (collectively) to equal the beneficiary's interest in the original trust, determined by the terms of the trust instrument or, if none, on a per-capita basis.[60]

iii. No shift of a beneficial interest in the trust to any beneficiary in a lower generation than the beneficiaries of the original trust.[61]

iv. No extension of the vesting of any beneficial interest in the trust beyond the period provided for in the original trust.[62]

v. Example: Elizabeth creates an irrevocable trust for the benefit of her son Charles, her daughter Anne, her son Andrew, and her son Edward, and their respective descendants. Upon the last to die of Elizabeth's children, the trust is to terminate, and the remaining trust property will be distributed in four equal shares, one share to the descendants of each of Elizabeth's children, per stirpes.

[58] Regs §26.2642-6(d)(5).
[59] Regs §26.2642-6(d)(5)(i).
[60] Regs §26.2642-6(d)(5)(ii).
[61] Regs §26.2642-6(d)(5)(iii).
[62] Regs §26.2642-6(d)(5)(iv).

The trust has an inclusion ratio of 1 (completely GST non-exempt).

The trustees sever the original trust into four equal new trusts, one for each child. Each of the new trusts also has an inclusion ratio of 1. During a child's life, he or she is the beneficiary. At a child's death, the remaining property of the child's separate trust will be distributed to the child's descendants or, if none, will be added to the separate trusts for the child's siblings.

In the aggregate, the new trusts provide for the same beneficiaries and the same succession of interests as provided in the original trust. The severance does not shift any beneficial interest to a beneficiary who occupies a lower generation than the beneficiary in the original trust.

h. When dividing a trust with an inclusion ratio of either one or zero, the new trusts must also have an inclusion ratio of one or zero.[63] When dividing a partially exempt trust (i.e., one with an inclusion ratio equal to something between one and zero), either:

i. The trust must be severed initially into only two new trusts: one funded with a fractional share equal to the applicable fraction used to determine the inclusion ratio (which will be entirely GST-exempt), and one funded with a fractional share equal to the excess of one over the applicable fraction (which will be entirely GST non-exempt).[64] Each new trust may then be further divided in a second qualified severance, if desired.

Example: Elizabeth creates an irrevocable trust for the benefit of her son Charles, her daughter Anne, her son Andrew, and her son Edward, and their respective descendants (the "Family Trust"). Upon the last to die of Elizabeth's children, the Family Trust is to terminate, and the remaining trust property will be distributed in four equal shares, one share to the descendants of each of Elizabeth's children, per stirpes. The Family Trust has an inclusion ratio of .7 (partially GST-exempt). The Family Trust holds assets valued at $100 million on January 1st.

The trustees first sever the Family Trust into a new GST-Exempt Family Trust and a new GST Non-Exempt Family

[63] Regs §26.2642-6(d)(6).
[64] Regs §26.2642-6(d)(7)(ii).

Trust. They fund the GST-Exempt Family Trust with 30% of the trust assets valued on January 1st. They fund the GST Non-Exempt Family Trust with 70% of the trust assets valued on January 1st.

After this qualified severance, the trustees may decide to further divide the Family Trust by a qualified severance into four new trusts, one for each child (as described above).

ii. The trust is severed initially into more than two new trusts. One or more of the resulting trusts *in the aggregate* must be funded with a fractional share that is equal to the applicable fraction used to determine the inclusion ratio of the original trust (both of which will be entirely GST-exempt). Each of the other new trust or trusts will have an inclusion ratio of one.[65]

iii. Example: Elizabeth creates an irrevocable trust during her life. During the ten-year trust term, income is payable to Elizabeth's children Charles and Anne. The trustees have discretion to pay principal to Charles or Anne without charging that person's ultimate share. At the end of the term, the trust property is to be divided into as many shares as are necessary to allocate and distribute one share to each child who is then living, and one share per stirpes to the descendants of each child who is not then living leaving living descendants. The trust has an inclusion ratio of 0.75.

The trustees divide the trust into three new trusts. Trust 1, for the benefit of Charles and his descendants, will receive 50% of the original trust's assets and will have an inclusion ratio of 1. Trust 2, for the benefit of Anne and her descendants, will receive 25% of the original trust's assets and will have an inclusion ratio of 1. Trust 3, for the benefit of Anne and her descendants, will receive 25% of the original trust's assets and will have an inclusion ratio of 0.

3. Reporting a qualified severance

a. When - A qualified severance of a trust may be made at any time prior to the termination of the trust.[66] It must be reported to the Internal Revenue Service no later than April 15th of the year

[65] Regs §26.2642-6(d)(7)(iii).
[66] Regs §26.2642-6(f).

immediately following the year during which the severance occurred (or by the last day of the period covered by an extension of time, if an extension of time is granted, to file the notice).[67]

b. How

i. A qualified severance is reported by filing Form 706-GS(T). The filer must write "Qualified Severance" at the top of the form and attach a Notice of Qualified Severance (Notice).[68]

ii. The Notice must provide information about the original trust:[69]

The name of the transferor;

The name and date of creation of the original trust;

The tax identification number of the original trust; and

The inclusion ratio before the severance.

iii. The Notice must also provide information about each of the new trusts created by the qualified severance:[70]

The name and tax identification number of the trust;

The date of severance;

The fraction of the total assets of the original trust received by the resulting trust;

Other details explaining the basis for the funding of the resulting trust (a fraction of the total fair market value of the assets on the date of severance, or a fraction of each asset); and

The inclusion ratio.

---

[67] Regs §26.2642-6(e)(1).
[68] Regs §26.2642-6(e)(1).
[69] Regs §26.2642-6(e)(2).
[70] Regs §26.2642-6(e)(3).

About the Panelists…

Robert I. Aufseeser is a solo practitioner in East Brunswick, New Jersey. His practice includes estate and trust planning, closely-held businesses, probate and related litigation.

Mr. Aufseeser is admitted to practice in New Jersey and New York, and before the United States District Court for the District of New Jersey and the United States Tax Court. He has been a member of the New Jersey State and New York State Bar Associations, as well as an Adjunct Professor of Business Law at Union County College. He has written and lectured extensively on aspects of trust and estate administration including probate proceedings, formal and informal fiduciary accountings, the inheritance rights of children, insolvent estates and creditor disputes; and his article "New Jersey Child Support Liens: Who is Liable for Distributions to Beneficiaries" appeared in the *New Jersey Law Journal*.

Mr. Aufseeser received his B.A. from Rutgers University, his J.D. from Syracuse University College of Law and his LL.M. in Taxation from New York Law School.

Robert D. Borteck, Borteck & Czapek, P.C. in Florham Park, New Jersey, concentrates his practice in estate and tax planning matters, estate administration and contested probate matters, and handles individual financial and business planning as well as trust department work for leading financial institutions in New Jersey. He has been designated as an Accredited Estate Planner by the National Association of Estate Planners and often serves as an expert witness in contested probate matters.

Admitted to practice in New Jersey, New York and the District of Columbia, and before the United States District Court for the District of New Jersey, the United States Tax Court and the United States Supreme Court, Mr. Borteck is a Fellow of the American College of Trust & Estate Counsel (ACTEC), a member of the organization's Fiduciary Litigation Committee and is a former New Jersey State Chair and Mid-Atlantic Representative. He is a former Co-Chair of the New Jersey Practice and Procedure Committee and the NJSBA Death Tax Committee, and serves as Chair of the New Jersey State Bar Association Real Property, Probate and Trust Section's Inheritance Tax Rules and Regulations Committee. Mr. Borteck is also a past President and Director of the Northwestern New Jersey Estate Planning Council and has been a member of the American Bar Association's Real Property, Probate and Trust Law Section. A Life Member of the National Registry of *Who's Who*, he is a frequent lecturer on estate and tax planning topics for ICLE, ACTEC and other private and professional groups.

Mr. Borteck attended Colby College and Hebrew University, and received his B.A. from New York University, where he was elected to *Omicron Delta Epsilon*. He received his J.D. from New York University School of Law, where he was Editor of the *New York University Journal of International Law and Politics* and a participant in the Moot Court Competition.

Gerard G. Brew is a Partner in McCarter & English, LLP in Newark, New Jersey. He concentrates his practice in the representation of clients in disputed matters involving estates, trusts, fiduciaries, family issues and small businesses (partnerships and closely-held corporations). Handling numerous litigated and non-litigated family disputes, he has been

appointed by courts to mediate disputes related to these issues, represents clients in litigation and handles estate planning and administration matters.

Admitted to practice in New Jersey and New York, Mr. Brew is a Fellow, Past New Jersey State Chair and Mid-Atlantic Regional Chair of the American College of Trust and Estate Counsel (ACTEC) and a member of ACTEC's Planning Committee. He is also a member of the American Bar Association's Section on Real Property & Trust and Estate Law, where he has served on its governing Council and as Group Chair and Vice Chair of the Estate and Fiduciary Litigation and the Ethics and Malpractice Group and its committees.

Mr. Brew is the author of the *New Jersey Probate Procedures Manual* (ICLE 2008) and a contributing editor to the *New Jersey Estate Litigation Manual* (ICLE 2006, authored by Steven K. Mignogna, Esq.) and the *New Jersey Estate Planning Manual* (ICLE 2007, authored by Glenn A. Henkel, Esq.). He has also been an Adjunct Professor of Law at New York Law School, where he has taught New Jersey estate administration. In 2014 he received the New Jersey State Bar Association *Pro Bono* Award and he is the recipient of several other honors.

Mr. Brew received his B.A. from Rutgers College and his J.D. from Rutgers University School of Law, where he was Managing Research Editor for the *Rutgers Computer & Technology Law Journal*. He served as Law Clerk to the Honorable Nicholas Scalera, Superior Court of New Jersey, Appellate Division.

Daniela P. Catrocho is a senior associate with Day Pitney, LLP in Parsippany, New Jersey, where she assists high-net-worth individuals and families in trust and estate law, including trust and estate planning, administration and litigation. She advises individuals and families on succession planning, lifetime giving, and estate and income taxation issues.

Ms. Catrocho is admitted to practice in New Jersey and New York. She is a member of the New Jersey State and New York State Bar Associations, the Estate Planning Council of Northern New Jersey and the Mid-Atlantic Fellows Institute of the American College of Trust and Estate Counsel (ACTEC), Class II. Ms. Catrocho is the co-author of "Retroactive Tax Legislation and Gift Planning in 2021" (*New Jersey Law Journal*, 3/25/21) and several other journal articles. Prior to attending law school, she spent several years in business management and administration in public higher education and in the private sector.

Ms. Catrocho received her B.F.A. from Rutgers University and her J.D., *cum laude*, from Seton Hall University School of Law, where she was Notes Editor for the *Seton Hall Legislative Bureau Journal*. She was a judicial law clerk to the Honorable Walter Koprowski, Jr., Presiding Judge, Chancery Division, Probate and General Equity Parts.

Christine Socha Czapek is a Partner in Borteck & Czapek, P.C. in Florham Park, New Jersey, where she concentrates her practice in estate and probate litigation, estate planning and administration, and guardianships.

Admitted to practice in New Jersey and New York, and before the United States District Court for the District of New Jersey, Ms. Czapek is a member of the Board of Consultors of the New Jersey State Bar Association Real Property, Trust & Estate Law Section, Treasurer of the Estate Planning Council of Northern New Jersey and a Fellow of the American College of Trust and Estate Counsel (ACTEC). She has been a member of the Morris County Bar Association and is a former

Co-Chair of the Somerset County Bar Association's Estate and Trust Practice Subsection. She is the recipient of several honors, including the Professional Service Award bestowed by the Raritan Valley Chapter of Habitat for Humanity.

Ms. Czapek received her B.A., *magna cum laude*, from Lafayette College and her J.D., *cum laude*, from Seton Hall University School of Law. She served as Judicial Law Clerk to the Honorable Peter E. Doyne, P.J.Ch. (Ret.), Bergen County.

Crystal West Edwards, Certified as an Elder Law Attorney by the ABA-accredited National Elder Law Foundation, is a Principal of Porzio, Bromberg & Newman P.C. in Morristown, New Jersey. She primarily focuses her practice in elder law, special needs planning and advocacy, estate planning and estate administration. She assists seniors, individuals with special needs and their families with complex estate and tax planning, asset preservation, eligibility for means-tested government benefits, fiduciary appointments, and representation and advocacy.

Ms. Edwards is admitted to practice in New Jersey and Pennsylvania, and before the United States District Court for the District of New Jersey and the United States Court of Appeals for Veterans' Claims. A Fellow of the American College of Trust and Estate Counsel (ACTEC), she has been a member of the New Jersey State Bar Association Elder and Disability Law Section and Diversity Committee, and is a former member of the Board of Directors of the National Academy of Elder Law Attorneys (NAELA) and Past President of the Garden State Bar Association. She is Past President of the New Jersey Chapter of NAELA and has served on the Young Lawyers and Associates Committee of the NJSBA Elder and Disability Law Section.

A former adjunct faculty member at Kean University, Ms. Edwards was honored by the State of New Jersey with a Senate Resolution for "her meritorious history of professional leadership and exemplary dedication." She has lectured statewide on elder law topics and was the recipient of ICLE's Distinguished Service Award and the 2014 Young Lawyer Award from the Garden State Bar Association for her "exceptional commitment to the GSBA, the Community & the Elder and Disability Law Bar."

Ms. Edwards received her B.S., *cum laude*, from the University of North Carolina at Charlotte and her J.D. from Pennsylvania State University's Dickinson School of Law.

Timothy M. Ferges is a Partner in McCarter & English, LLP in the firm's Newark, New Jersey, and New York City offices, where he concentrates his practice in trust and estate law, including trust and estate litigation, estate planning, and trust and estate administration. Mr. Ferges brings and defends breach of fiduciary duty claims and handles contested accounting proceedings, Will and trust construction matters, and other fiduciary disputes; and represents beneficiaries, individual fiduciaries, and large institutional trust companies as well as charitable and non-profit organizations in those disputes. He also counsels high-net-worth individuals and families in estate planning goals while integrating asset protection and minimizing exposure to income and transfer taxes.

Admitted to practice in New Jersey and New York, and before the United States District Court for the District of New Jersey, Mr. Ferges is a member of the American Academy of Attorney—CPAs and the American Bar Association Section of Real Property, Trust and Estate Law, where he has served as Vice Chair of a committee in the Trust & Estates Litigation Group. He is a member of the Mid-Atlantic Fellows Institute of the American College of Trust & Estate Counsel (ACTEC) and

the New Jersey State Bar Association Real Property, Trust and Estate Law Section and the New York State Bar Association's Trusts and Estates Law Section, where he has served as Vice Chair of the Estate Litigation Committee. In addition to being an attorney, he is also a Certified Public Accountant and a member of the Board of Trustees of the Springpoint Senior Living Foundation.

Mr. Ferges has lectured for ICLE, the National Business Institute and other organizations, and his articles have appeared in the *New Jersey Law Journal* and other publications. He is the recipient of several honors.

Mr. Ferges received his B.S. from Rutgers University; his M.B.A. from Rutgers Business School; his J.D. from Seton Hall University School of Law, where he served as Director of the Appellate Advocacy Moot Court Board and as a member of the Interscholastic Moot Court Board; and his LL.M. in Taxation from New York University School of Law. He was Law Clerk to the Honorable Walter Koprowski, Jr. and the Honorable Renee Jones Weeks, Probate Part, Chancery Division, Superior Court of New Jersey.

Laura A. Kelly is a Partner in McCarter & English, LLP in the firm's Newark, New Jersey, office, where she concentrates her practice in trust and estate matters. She drafts Wills and trusts, administers trusts and estates, and advises high-net-worth clients regarding sophisticated estate planning, with an emphasis on estate, gift, generation-skipping transfer and income tax planning. She also assists clients with the planning and implementation of lifetime transfers of property, including the management of transfers of real estate, life insurance and business interests.

Admitted to practice in New Jersey, New York and Massachusetts, Ms. Kelly is a Fellow of the American College of Trust and Estate Counsel (ACTEC) and a member of the American, New Jersey State and Boston Bar Associations. She was a member of the inaugural class of Bergen LEADS, a class of 30 acknowledged leaders of Bergen County, and has served on its Steering and Selection Committees. She was appointed to the Board of Consultors of the New Jersey State Bar Association Real Property, Trust and Estates Section and is a past President and Sustaining Member of the Junior League of Bergen County.

Ms. Kelly has lectured on a variety of estate planning topics and previously taught the estate planning course for ICLE's *Skills and Methods* Series. She has also been a guest lecturer at New York Law School's LL.M. program on the topic of estate taxes. She is a contributing author to *Understanding and Using Trusts* and *Breaking the Code of Wealth Management*, and has been published in *Garden State Woman* Magazine.

Ms. Kelly received her B.A., *magna cum laude*, from Wellesley College, where she was elected to *Phi Beta Kappa*, and her J.D. from the University of Virginia School of Law.

Tara S. Sinha is a Partner in Witman Stadtmauer, P.A. in Florham Park, New Jersey, and concentrates her practice in estate planning and administration, estate and probate litigation, and federal and state taxation.

Admitted to practice in New Jersey and New York, and before the United States District Court for the District of New Jersey, Ms. Sinha is a Fellow of the American College of Trust and Estate Counsel (ACTEC) and serves on the Board of Consultors of the New Jersey State Bar

Association Real Property, Trust and Estate Law Section. She is a member of the New Jersey State, New York State and Morris County Bar Associations.

Ms. Sinha has been a member of the Worrall F. Mountain American Inn of Court and her articles have appeared in the *New Jersey Law Journal*. She has lectured for ICLE, the New York City Bar Association, the Practising Law Institute and other organizations.

Ms. Sinha received her B.S. from Rutgers College and her J.D. from Rutgers School of Law-Newark, where she was Senior Articles Editor of the *Women's Rights Law Reporter* and a Teaching Assistant for the Legal Research and Writing program. She was Law Clerk to the Honorable Walter R. Barisonek, J.S.C., Superior Court of New Jersey, Union County.

Leonard J. Witman is the Senior Tax Partner in Witman Stadtmauer, P.A. in Florham Park, New Jersey, and a nationally-noted lecturer and author in the tax, estate and elder law planning and deferred compensation fields.

Admitted to practice in New Jersey and New York, Mr. Witman is a Fellow of and former New Jersey State Chair of the American College of Trust and Estate Counsel (ACTEC) and a Fellow of the American College of Employee Benefit Counsel. He is Past Chair of the New Jersey State Bar Association Taxation Committee and a former tax law specialist, instructor and lecturer with the Internal Revenue Service in the Employee Plans and Exempt Organizations Division.

An adjunct professor of law at Seton Hall Law School and Rutgers University Graduate Business School, Mr. Witman is a frequent lecturer and author whose articles have appeared in the *Journal of Taxation*, *CLU Journal* and *Medical Economics*. He is the author of *A Retirement Planning Techniques Book* (10th Edition) and *Roth IRAs*, and has been a member of the editorial board of the *Practical Accountant*. He has been quoted in financial columns in *The New York Times* and *The Wall Street Journal*, and on CNBC and CBS News, and is the recipient of the Dorothy G. Black Distinguished Service Award for his contributions to trust and estate law in New Jersey.

Mr. Witman is a graduate of Rutgers College and New York Law School.

This page intentionally left blank

PORZIO
Implementation of Elder Law Planning
Through the Benefits Qualification Process
Crystal West Edwards, Esq.
cwedwards@pbnlaw.com
973-889-4263

Care Considerations

- Home Care
  - Caregiver Agreements
  - Government Benefits Options
- Assisted Living
  - Admissions agreements
  - Private pay periods
  - Government Benefits Options
- Skilled Nursing
  - Asset Protection Planning
  - Government Benefits Options

Estate Planning Considerations

- Last Will and Testament
  - Possibility of assets passing to institutionalized spouse

- Advance Directives for Healthcare

- Power of Attorney
  - Make gifts
  - Establish trusts
  - Fund trusts

Estate Planning Considerations

See DMAHS Memo to Banks regarding trust needed for high income individuals to establish income eligibility for Medicaid, *https://www.nj.gov/humanservices/dmahs/clients/QIT_Memo_to_NJ_Banks.pdf*

"The individual, their Power of Attorney, legal guardian or conservator can act on behalf of the individual, consistent with New Jersey law, to establish a QIT. **If a Power of Attorney document grants general authority to handle the financial or health care affairs of an individual, this should be sufficient to allow the Power of Attorney to establish a QIT for that individual."**

General Medicaid Eligibility

Applicant must be:

- Aged (65 years or older), Blind or Disabled AND
- U.S. citizen OR resident alien AND
- State resident AND
- Eligible both financially and medically

Medical Eligibility

- Applicant must require assistance with at least three activities of daily living
- Such as eating, dressing, bathing, toileting, transferring, self-medicating, cooking, etc.

Financial Eligiblity

MANAGED LONG-TERM SERVICES AND SUPPORTS (MLTSS) PROGRAM

- Resource Allowance for Individual: $2,000
- Resource Allowance for Applicant Couple: $3,000
- Income cap: $2,829 for 2024

Financial Eligiblity

SPOUSE'S INCOME

- In spousal situations, the applicant's income is tested alone
- Applicant's resources are pooled with spouse's resources
- Resource allowance is provided to non-applicant spouse from combined resources

RESOURCE ALLOWANCE

- Min. Community Spouse Resource Allowance: $30,828 in 2024
- Max. Community Spouse Resource Allowance: $154,140 in 2024

Financial Eligiblity

MAINTENANCE (INCOME) ALLOWANCE

- Minimum Monthly Maintenance Allowance: $2,465 in 2024
- Maximum Monthly Maintenance Allowance: $3,853.50 in 2024

Financial Eligiblity

COUNTABLE RESOURCES

- Includes any assets that are not specifically excludable.
- Differs among states
  - i.e. NY and PA exempt the community spouse's pension plan, IRAs and 401(k)s, while NJ considers such assets "available" to the institutionalized spouse.

Financial Eligibility

EXCLUDABLE RESOURCES

- An automobile
- Personal effects and household goods less than $2,000
- $1,500 burial fund or reasonable amount an Irrevocable Prepaid Funeral Trust Fund.
- Life Insurance
  - Policies with $0 cash surrender value, such as term policies
  - Cash value insurance with face value of no more than $1,500
  - If aggregate face value exceeds $1,500, the combined cash surrender value is available.

Financial Eligibility

TRANSFER OF ASSETS

- 60 month look-back period.
- Uncompensated transfers (gifts) will be aggregated and a penalty period imposed
- Penalty period begins to run after the applicant is institutionalized and has run out of money.
- Penalty period calculated by dividing the gifts by the "average" cost of nursing home care in New Jersey (**$440.10 per day or $13,386.38 per month in 2024**). This created a period of months that the applicant will be ineligible for Medicaid
- In other words, there is a one-month penalty imposed for every $13,386.38 transferred or otherwise given away.

Financial Eligibility

EXEMPT TRANSFER OF ASSETS

- Transfers to community spouse
- Transfers to a child with disabilities or to trust for benefit of an individual with disabilities
- Real Estate Transfers to...
  - A spouse
  - A child under the age of 21
  - "Disabled child"
  - Caregiver child
  - Sibling with an equity interest

Elder Law Case Study (Married)

- What are our planning options if Spouse One is the Institutionalized Spouse? Are our planning options impacted by where Spouse One receives care?

JOINT	SPOUSE ONE	SPOUSE TWO
Primary Residence $500,000	IRA $250,000	IRA $125,000
Cash $125,000	Income $3,000 monthly	Income $500 monthly

- What are our planning options if Spouse Two is the Institutionalized Spouse? Are our planning options impacted by where Spouse Two receives care?

Elder Law Case Study (Single)

- What are our planning options? Are our planning options impacted by where the client receives care?

ASSET	VALUE
Primary Residence	$500,000
Cash	$125,000
IRA	$250,000
Life Insurance	$ 3,300
Income (monthly)	$ 3,000 ($2,700/$300)

PORZIO
Questions?
Crystal West Edwards, Esq.
cwedwards@pbnlaw.com
973-889-4263

DECANTING, MODIFYING AND TERMINATING IRREVOCABLE TRUSTS

By Daniela P. Catrocho, Esquire

I. Common reasons to decant, modify or terminate an irrevocable trust:

A. Effectuate beneficial tax consequences

B. Grant, remove or refine powers of appointment

C. Change administrative provisions

D. Modify trustee provisions

E. Divide trusts or permit mergers thereof

F. Change situs or governing law

G. Change trust terms

H. Eliminate beneficial enjoyment

II. Decanting an Irrevocable Trust

A. Decanting is the act of transferring the assets from an existing trust to a new trust when a Trustee is permitted to make principal distributions.

1. Typically, the existing trust contains undesirable terms or lacks provisions that the new trust corrects.

2. Does not generally require the consent of a beneficiary or the court, as it is typically effectuated by the Trustee exercising its discretion to make principal distributions.

B. Decanting options:

1. The trust instrument may contain a decanting power. If so, the ability to decant will be limited to that provision.

2. Absent an express decanting power, the trustee may move the trust situs to a jurisdiction containing a decanting statute (i.e., New York's EPTL 10-6.6).

3. Alternatively, the trustee may employ common law decanting in the jurisdiction governing the trust's administration. *See Phipps v. Palm Beach Trust Co.*, 142 Fla. 782, 196 So. 299 (1940); *Wiedenmayer v.*

Johnson, 106 N.J. Super. 161 (App. Div. 1969), *aff'd sub nom. Wiedenmayer v. Villanueva*, 55 N.J. 81 (1969).

a) *Phipps* is the landmark case validating a Trustee's decanting power. In *Phipps,* the settlor created a trust from which the Trustees had the power to distribute principal in such shares among (and even to the exclusion of any one of) the settlor's spouse and descendants as the individual Trustee (who was also the settlor's spouse) determined in his sole and absolute discretion. The Trustee/spouse exercised this power by directing the property in further trust with terms slightly different from the original trust. The Florida Supreme Court held that a Trustee's discretionary power to distribute is akin to a special power of appointment, and if the Trustee may distribute the trust outright to a beneficiary, the Trustee may create a lesser estate for that beneficiary's benefit.

b) *Wiedenmayer* is the leading case in New Jersey to support a Trustee's power to decant.

C. *Wiedenmayer v. Johnson*

1. Facts: Trust authorized Trustees to distribute "from time to time and whenever in their absolute and uncontrolled discretion they deem it to be for his best interests, to use for or to distribute and pay over to John Seward Johnson, Jr…to be his absolutely, outright and forever, any or all of the Trust Property." Trustees determined to distribute the Trust Property to John on the condition that he immediately transfer the funds to a successor Trust, which eliminated two of his descendants.

2. Court holdings:

a) If the Trustees could distribute trust property outright to the beneficiary, it is "logical to conclude that the trustees could, to safeguard the son's best interests, condition the distribution upon his setting up a substituted trust." *Id.* at 164-165.

b) "Best interests" are not limited to financial interests, but they may also "be served by the peace of mind." *Id.* at 165.

c) The trust creator was concerned with his son's best interests, and the interests of others were only secondary in relation thereto.

d) "Courts may not substitute their opinions as to the son's 'best interests,' as opposed to the opinion of the trustees vested by the creator of the trust with the 'absolute and uncontrolled discretion' to make that determination." *Id.* Thus, absent a showing of an abuse of discretion (i.e., that the Trustee's decision was not "made in good faith, after consideration of all the facts and attendant

circumstances, and for reasonably valid reasons"), the court will not substitute its judgment for that of the trustees. *Id.*

D. Can/should the Trustee decant?

1. Analyze the trust instrument: Is there a provision that permits decanting? If so, what is the breadth of the decanting that is permitted?

2. If there is no express power, is there sufficient discretion of the Trustee to justify decanting?

   a) Sole and absolute power is typically required, and is what existed in both of *Wiedenmayer* and *Phipps*.

3. Evaluate possible breach of trust claims.

   a) Trustees, even those granted absolute and sole discretion, are still obligated to administer the trust for the beneficiary's best interests.

   b) Abuse of discretion. Was there sufficient discretion in the trust to permit decanting? If not, the Trustee may be deemed to have exceeded the scope of its discretion.

4. Breach of duty of impartiality?

   a) Eliminating one or more trust beneficiaries. Although eliminating trust beneficiaries through a decanting is permissible, it may be interpreted as a violation of the trustee's duty of impartiality.

   b) The New Hampshire Supreme Court invalidated a decanting that eliminated beneficiaries due to a breach of duty of impartiality. The fiduciary failed to consider the financial interests of beneficiaries whose future remainder interests were eliminated by decanting. *Hodges v. Johnson*, 177 A.3d 86 (N.H. 2017).

E. If the Trustee determines to decant, how should it be accomplished?

1. The Trustees in the *Wiedenmayer* case distributed the corpus to the beneficiary who agreed to immediately contribute it back to a new trust. The Trustees were permitted "to use for or distribute and pay over to" the beneficiary. The outright distribution to the beneficiary and contribution over may create creditor concerns (if state law permits creditor access to self-settled trusts) or tax implications.

2. Directly to the Trustee of the new Trust. Permissible if the trust permits the Trustee to distribute corpus "in trust for" or to "apply" corpus.

Arguably, the Trustees in the *Wiedenmayer* could have employed this alternative as well.

F. Great care should be taken when drafting the new trust to which the assets of the existing trust will be transferred, including close analysis of provisions that could result in adverse tax implications.

G. Other decanting case law:

1. *HUNY & BH Assocs., Inc. v. Silberberg*, No. BERL1067715, 2017 WL 6627701 (N.J. Super. Ct. L. Div. Oct. 23, 2017) affirmed in part, reversed in part by *HUNY & BH Associates, Inc. v. Silberberg*, No. A-1696-17, 2021 WL 6109385 (N.J.Super.A.D., Dec. 27, 2021) (ruling that the lower court erred in ruling that plaintiff's claim was barred by the statute of limitations as there was no indication that plaintiff knew or should have known that her 21st birthday triggered her right to the custodial property in trust and in ruling that all deposits in such trust after plaintiff turned 21 were not intended to be gifts).

2. *In re 2008 Tr.*, No. ESXCP2482014, 2016 WL 8453570 (N.J. Ch. Div. Mar. 22, 2016).

3. *Ferri v. Powell-Ferri*, 476 Mass. 651 (Mar. 20, 2017); *Ferri v. Powell-Ferri*, 326 Conn. 438 (Aug. 8, 2017).

4. *Morse v. Kraft*, 992 N.E.2d 1021 (Mass. 2013).

5. *Tannen v. Tannen*, 205 N.J. 80 (2011).

6. *In re Spencer's Estate*, 232 N.W.2d 491 (Iowa 1975).

7. *Harrell v. Badger*, 171 So. 3d 764 (Fla. Dist. Ct. App. 2015).

H. Uniform Law Commission's Trust Decanting Act (UTDA).

1. Completed in 2015. As of September 2024, the UTDA has been enacted by 18 states (Alabama, California, Colorado, Connecticut, Illinois, Indiana, Kansas, Maine, Maryland, Montana, Nebraska, New Mexico, North Carolina, Vermont, Virginia, Washington, West Virginia and Wisconsin), and legislation has been introduced in two others (Massachusetts and District of Columbia). However, other states have had statutes in place prior to the enactment of UTDA, such as Delaware, Alaska, Nevada and South Dakota, or afford a Trustee with a "power of

appointment" to effectuate a decanting, such as New York, Arizona and Florida. In all, 39 jurisdictions have laws permitting decanting.[1]

2. Affords different rules depending upon the extent of the Trustee's discretion:

a) If the Trustee has limited discretion to make distributions (referred to as a distribution that is subject to an "ascertainable standard" or is a "reasonably definite standard"), a Trustee may decant for administrative or tax purposes, but the beneficial interests of the recipient trust must be "substantially similar" to the beneficial interests of the original trust.

b) If the Trustee has "expanded distributive discretion," the Trustee may decant to a new trust that alters the beneficial enjoyment, limited only to protect (i) current, noncontingent or vested remainder interests, (ii) qualification for tax benefits, and (iii) charitable interests.

3. Special rules exist for decanting to create a third party special needs trust for a beneficiary whose qualification for needs-based governmental benefits could be impacted by his or her beneficial interest in the trust.

4. Affords a "check and balance" to preclude abuses by requiring notice to qualified beneficiaries who may petition a court for a number of enumerated reasons and by listing various instances in which decanting is limited. Of the jurisdictions that permit decanting, Arizona, Delaware, Nevada, South Dakota, Tennessee and Wyoming do not require notice to be sent to beneficiaries, and New Hampshire only requires notice for charitable trusts).

III. Modifying and Terminating an Irrevocable Trust

A. Express authority is located within the New Jersey Uniform Trust Code ("UTC") effective July 17, 2016, at *N.J.S.A.* § 3B:31-26 through § 3B:31-33. These rules apply to all trusts in existence on or created after the effective date.

B. Pursuant to *N.J.S.A.* § 3B:31-6, common law supplements the UTC except to the extent that the UTC or other statute modifies the common law. Thus, existing

---

[1] Alabama, Alaska, Arizona, California, Colorado, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Ohio, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

case law, including that addressing trust reformation, may continue to apply to the extent not inconsistent with provisions of the UTC.

1. *See e.g., In re Tr. Of Nelson*, 454 N.J. Super. 151 (App. Div. 2018). Holding that the court may look beyond the governing instrument, even if unambiguous on its face, to determine the settlor's probable intent. The court declined to determine whether *N.J.S.A.* § 3B:31-31 and -32 applied to permit the court to modify the trust to effectuate the settlor's intent.

C. Under *N.J.S.A.* § 3B:31-27, a noncharitable, irrevocable trust may be modified or terminated:

1. Upon consent of the trustee and all beneficiaries if the modification or termination is not inconsistent with a material purpose of the trust. § 3B:31-27(a).

2. By a court upon consent of all of the beneficiaries if the court concludes that, in the case of a termination, continuance is not necessary to achieve any material purpose of the trust, or, in the case of a modification, the modification is not inconsistent with a material purpose of the trust. § 3B:31-27(b).

3. By a court upon the request of a beneficiary or trustee if the court determines that, had all of the beneficiaries consented, the trust could have been modified or terminated, and that the interests of a beneficiary not consenting will be adequately protected. § 3B:31-27(e).

4. No modification or termination is permitted if it is inconsistent with a material purpose of the trust.

a) A spendthrift provision in the trust is not presumed to constitute a material purpose of the trust. § 3B:31-27(c).

b) What constitutes a "material purpose" is a subjective determination of the settlor's intent. *See Fidelity Union Trust Co. v. Margetts*, 7 N.J. 556, 566 (1951) and *In re Estate of Bonardi*, 376 N.J.Super. 508 (App. Div. 2005) (holding that the testator's intent to create a trust for his wife was a material purpose frustrated by the beneficiaries' consent to otherwise terminate it).

c) *See e.g., Trust Under Agreement of Taylor*, 164 A.3d 1147 (Pa. 2017) (modification to change the terms for removal of trustee is precluded where a specific statute already exists for same).

(1) But See *In re Tr. Under Deed of Walter R. Garrison*, 288 A.3d 866 (Pa. 2023), which distinguished its decision in Taylor. In Garrison, the court clarified that its decision in Taylor stemmed from a need to give priority to two seemingly conflicting statutory provisions (one found within the uniform act and the other in other trust law predating the uniform act), whereas in Garrison, (i) all parties involved in the trust, including the settlor and trustees, (ii) court approval is not required under the particular uniform law provisioni at issue and (iii) the settlor's intent did not require protection since the settlor was a participant to the modification. Thus, Garrison supports that trusts could be modified by consent of settlor and all beneficiaries to allow for replacement of trustees by a majority of beneficiaries after settlor's death.

d) *See also N.J.S.A.* § 3B:31-11(f) ("a nonjudicial settlement may not be used to produce a result that is contrary to other sections of Title 3B of the New Jersey Statutes, including, but not limited to, terminating or modifying a trust in an impermissible manner").

e) A recent New Jersey case illustrates that the courts consider the purpose of a trust when terminating (see *Matter of David H. Kato Spec. Needs Tr., Dated December 11, 2018*, No. A-0414-22, 2024 WL 762246, at *3 (N.J. Super. App. Div. Feb. 26, 2024), at *3 (considering the purpose of the trust when terminating a special needs trust where the beneficiary was no longer eligible for Medicaid).

f) Recent cases in other jurisdictions suggest that courts may be taking a closer look at the settlor's intent when terminating or modifying a trust.

(1) *Demircan v. Mikhaylov*, 306 So.3d 142 (Fla. Dist. Ct. App. 2020) (Florida appellate court allowing trust modification under common law where living settlor and beneficiaries of a trust consent to its modification, whether or not the modification satisfies Fla. Stat. requirements regarding materiality of the trust's purpose).

(2) *Horgan v. Cosden*, 249 So.3d 683 (Fla. Dist. Ct. App. 2018) (Holding that termination of a trust was improper because it would frustrate the purpose of the trust to provide income distributions to the settlor's son for life with a remainder to three educational institutions despite all beneficiaries agreeing to the termination).

(3) *In re McGregor*, 308 Neb. 405 (2021) (Supreme Court of Nebraska holding that a spendthrift provision was a

material purpose of the trust, disallowing a nonjudicial settlement agreement that distributed assets outright to beneficiaries rather than in trust).

(4) *In re Trust of Jennie Shire*, 299 Neb. 25 (2018) (Considering the settlor's intent in denying modification request to increase trust distributions even though the trust had grown substantially since its creation 70 years prior).

(5) *In re Trust under Will of Flint for the benefit of Shadek*, 118 A.3d 182 (Del. Ch. 2015) (the Delaware Chancery Court refusing to modify a trust to a directed trust where such modification ran contrary to the settlor's intent).

(6) *Matters of Estate & Tr. of Kalil*, 11047-MZ, 2018 WL 793718 (Del. Ch. Feb. 7, 2018), appeal dismissed sub nom. Kalil v. Kalil, 182 A.3d 114 (Del. 2018), as corrected (Mar. 13, 2018) (Refusing to reform a trust where reformation would not remedy the settlor's mistake in failing to retitle an investment account because that mistake did not affect specific terms in the trust; the party seeking reformation is seeking to establish that a donative document does not reflect the donor's intention).

(7) *In re Sukenik*, 75 N.Y.S.3d 422 (2018) (Trust and IRA beneficiary designation can be reformed to designate charity as beneficiary of IRA rather than spouse and afford spouse a specific pecuniary bequest in trust equal to value of IRA, finding settlor's intent to effectuate tax savings).

(8) *In re Tr. Created by Augustin*, 935 N.W.2d 493 (Neb. Ct. App. 2019) (The objective of the rule allowing judicial modification or deviation and the intended consequences of its application are not to disregard the intention of a settlor. The objective is to give effect to what the settlor's intent probably would have been had the circumstances in question been anticipated," but finding that modification was not permitted since the trusts at issue terminated by their terms).

(9) *In re Gale L. Tuttle Revocable Trust, Harshman Land Company, et. al. v. B&B Family Farms, LLC*, A-19-841, 2020 WL 3526129, at *4 (Neb. Ct. App. June 30, 2020) (declining to modify a trust where the terms of the trust manifested the settlor's intent that modification was not required).

(10) *In re Special Needs Tr. for Moss*, No. 357836, 2022 WL 2760235 (Mich. Ct. App. July 14, 2022) (affirming that termination of trust furthered settlor's intent of supplementing quality of beneficiary's life and that living settlor's objection to termination did not preclude determination that statute permitted termination).

(11) *Martin v. Paul*, No. 944 MDA 2021, 2023 WL 2681889, at *1 (Pa. Super. Ct. Mar. 29, 2023) (affirming in part the modification of a trust to allow for the sale of property in furtherance of settlor's intent).

(12) *In re Tr. B Under Agreement of Richard H. Wells Dated September 28, 1956*, 311 A.3d 1057, 1074 (Pa. 2024) (reversing a trust termination in furtherance of the settlor's intent for assets to remain in trust).

D. Provisions of the UTC that permit modification of termination for certain reasons:

1. Due to unanticipated circumstances or the inability to administer the trust effectively. § 3B:31-28.

a) Requires court approval.

b) Court may modify administrative or dispositive terms or terminate if because of unanticipated circumstances, the purposes of the trust will be furthered by doing so.

c) Court may modify administrative terms if administration under current terms would be impracticable or wasteful or would impair the administration.

d) If terminated, the property is to be distributed in a manner consistent with the purposes of the trust.

2. Charitable trust modification or termination (cy pres). § 3B:31-29.

a) With one exception, where a particular charitable purpose becomes unlawful, impracticable, impossible to achieve, or wasteful:

(1) the trust does not fail,

(2) the trust property does not revert to the settlor or the settlor's estate and

(3) the court may modify or terminate by directing the property to be applied or distributed in a manner consistent with the settlor's charitable purposes.

b) The exception – if the trust instrument would distribute the property to a noncharitable beneficiary in such instance, that takes priority.

3. Uneconomical Trust. § 3B:31-30.

a) By the Trustee upon notice to qualified beneficiaries for trusts less than $100,000 in value.

b) By the court if it determines that the value of the trust is insufficient to justify the costs of administration.

4. To achieve the settlor's tax objectives. § 3B:31-33.

a) Could be made retroactively.

5. To correct a mistake of fact or law. § 3B:31-31.

a) Does not require the trust to be ambiguous – settlor's intent would permit the court to review extrinsic evidence even where the trust terms are otherwise unambiguous.

6. To conform the trust to the settlor's probable intent. § 3B:31-32.

a) *See generally, Matter of Trust of Nelson*, 454 N.J.Super. 151 (App. Div. 2018).

7. Combination and Division § 3B:31-34.

a) Combination even where Settlors, Governing instruments and Trustees are different

b) Must not impair rights of any beneficiary or adversely affect the achievement of the purposes of the trust.

E. Typically, except for court applications, a modification or termination is effectuated by way of nonjudicial settlement agreement pursuant to *N.J.S.A.* §3B:31-11, which may implicate representation of relevant parties under the rules set forth in *N.J.S.A.* § 3B:31-13 through § 3B:31-17.

IV. Tax Implications of Decanting, Modifying or Terminating a Trust

A. Notice 2011-101 requested comments on the tax implications of decanting.

1. Review the April 2, 2012 letter from the American College of Trust and Estate Counsel to the Internal Revenue Service providing comments for a comprehensive discussion and a proposed Revenue Ruling: https://www.actec.org/assets/1/6/Mezzullo_Comments_04_02_12.pdf.

B. Rev. Proc. 2024-3. To date, the IRS has not issued any technical guidance, but has listed the tax implications of decanting as an area under study in which rulings or determination letters will not be issued until the service resolves the issue through publication of a revenue ruling, a revenue procedure, regulations, or otherwise. See specifically the following excerpts from Rev. Proc. 2024-3:

1. (8) Sections 661 and 662.—Deduction for Estates and Trusts Accumulating Income or Distributing Corpus; Inclusion of Amounts in Gross Income of Beneficiaries of Estates and Trusts Accumulating Income or Distributing Corpus.—Whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a ""decanting") resulting in a change in beneficial interests is a distribution for which a deduction is allowable under § 661 or which requires an amount to be included in the gross income of any person under § 662.

2. (16) Section 2501.—Imposition of Tax.—Whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is a gift under § 2501. There was legislation introduced in Congress, the "Flat Tax Act" in February 2023 that would have repealed Section 2501, which is still pending

3. (19) Sections 2601 and 2663.—Tax Imposed; Regulations.—Whether the distribution of property by a trustee from an irrevocable generation-skipping transfer tax (GST) exempt trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is the loss of GST exempt status or constitutes a taxable termination or taxable distribution under § 2612.

4. See also the following section under "Areas in which rules or determination letters will not be issued:"

   (117) Section 2601.—Tax Imposed.— Whether 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).

C. Income tax implications.

1. Unless a new trust is created by a beneficiary's exercising a power of appointment, there will be no change to the identity of the grantor.

2. There should be no deemed sale resulting in the recognition of capital gain or loss.

3. Make sure the recipient trust would not qualify as a foreign trust.

D. Gift tax implications.

1. Generally, there would be no gift tax implications if the modification applies only to administrative, and not dispositive, provisions. *But See* Chief Counsel Advice Memorandum (CCA) 202352018 issued December 29, 2023 (IRS concluded that the beneficiaries of a grantor trust made a taxable gift to the grantor as a result of a trust modification to add a provision in the trust that would permit the trustee to reimburse the grantor for income taxes attributable to the trust).

2. Who is the trustee that will effectuate the decanting, modification or termination? If the trustee is a beneficiary of the old trust, the action may be deemed a gift by the beneficiary/trustee.

3. Does a beneficiary (who may not be the trustee) have an exercisable power of withdrawal, general power of appointment, or right to object to the action impacting the beneficiary's interest? If so, the action may trigger a gift by the beneficiary.

4. If the beneficiary does not consent to the action, will a gift be avoided?

5. Consider the "Delaware Tax Trap," which occurs if new interests created by exercising a power of appointment postpone the vesting of an interest in property beyond the date determined by the original trust (or whether triggering it may be desirable).

E. Estate tax implications.

1. What powers did the grantor have in the old trust and what powers might the grantor have in the new trust? Is the grantor participating in the action? "Yes" answers may suggest that the grantor has retained sufficient control so as to cause inclusion in the grantor's estate.

2. Does the beneficiary have a general power of appointment in the new trust? If so, the assets of the new trust would be included in the beneficiary's estate.

3. Did the action result in the beneficiary's making a gift? Did the beneficiary have the ability to prevent the action and fail to do so? If so, the trust may be included in the beneficiary's estate.

F. Generation-Skipping Transfer Tax implications.

1. Is the existing trust exempt from generation-skipping transfer tax, and if so, will the assets in the new trust likewise be tax exempt?

2. The rules may be different for "grandfathered" trusts (i.e., those in existence on September 26, 1985) and trusts to which a person's GST exemption is allocated. The Service appears to take the position that the rules apply similarly to both. See, e.g., PLR 201820007 & 201820008.

3. Generally, GST exemption will not be lost provided that the action does not delay the vesting of the ownership of the original trust property beyond the vesting date of the original trust. For grandfathered trusts, the action must also be completed pursuant to state law in effect when the trust became irrevocable or a power contained within the trust instrument.

4. A loss of GST exempt status may result from the decanting if beneficial interests are affected.

5. The regulations may treat decanting differently from modification. For instance, Treas. Reg. § 26.2601-1(b)(4)(i)(A)-(D) contains four "safe harbors" to confirm when a modification will not result in a loss of GST exemption (note, (A) is really decanting):

   (A) Discretionary Powers – no loss if (1) either (i) old trust instrument authorizes distribution to a new trust without consent of a beneficiary or court or (ii) at time trust became irrevocable, state law did, and (2) new trust instrument does not extend the time for vesting of any beneficial interest

   (B) Settlement – a court approved settlement of a bona fide issue regarding the administration of a trust or the construction of the terms of a trust will not result in a loss if (1) the settlement results from arm's length negotiations and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable law

   (C) Judicial construction – a judicial construction to resolve an ambiguity or correct a scrivener's error results in no loss if (1) the action involves a bona fide issue and (2) the construction is consistent with applicable law that would be applied by the highest court of the state

   (D) Other changes – no loss by judicial or nonjudicial means if the modification will not shift a beneficial interest to a beneficiary in a lower generation than the person who held the beneficial interest prior to the modification and the modification does not extend the time for vesting of a beneficial interest beyond the original term.

6. Treas. Reg. § 26.2601-1(b)(4)(i) states: "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."

G. Some recent Private Letter Rulings:

1. PLR 201647001 (November 18, 2016)

a) Held – court-approved modification of a trust to add a tax reimbursement clause (by an independent trustee to the grantor) and other administrative provisions did not result in change in beneficial interests in the trust, and therefore, no gift tax consequences to the beneficiaries.

b) **NOTE**: The IRS reversed its position in this PLR in a footnote of Chief Counsel Advice Memorandum (CCA) 202352018 issued December 29, 2023. The IRS concluded that the beneficiaries of a grantor trust made a taxable gift to the grantor as a result of a trust modification to add a provision in the trust that would permit the trustee to reimburse the grantor for income taxes attributable to the trust.

2. PLRs 201814001 & 201814002

a) Supports justification for obtaining a judicial construction rather than a modification or decanting to avoid adverse tax consequences.

b) Held - Construction of ambiguous terms in grandfathered GST trust has no adverse GST, gift or income tax consequences.

c) These PLRs address a purported ambiguity in the meaning of "descendants" and whether it included adopted descendants. Trustees petitioned the state court for a judgment that the term did not include adopted descendants, which the court conditionally granted on obtaining a favorable IRS ruling of no adverse GST, gift or income tax consequences.

d) IRS ruled that the court's order was consistent with applicable state law that the highest court of the state would apply, and pursuant to Treas. Reg. § 26.2601-1(b)(4)(i)(C), the judicial construction to resolve an ambiguity to correct a scrivener's error does not result in loss of GST exemption.

e) Moreover, because the ambiguity was resolved by a court, no transfer occurred for gift tax purposes.

f) Last, because the ambiguity related to the construction of the trust to carry out the settlor's intent, there was no disposition of an interest and consequently no realization of gain or loss.

g) The decanting or modification to change the definition of descendant would have modified the class of beneficiaries and resulted in the loss of GST exemption.

3. PLRs 201820007 & 201820008 (PLRs for trusts for sons created under same instrument)

a) Involved decanting to a new trust that granted a beneficiary a general power of appointment to preclude adverse GST consequences.

b) Held – under Treas. Reg. § 26.2601-1(b)(4)(i)(D)(2), "modifications that are administrative in nature that only indirectly increase the amount transferred will not be considered to shift a beneficial interest in the trust. See Example 10 of § 26.2601-1(b)(4)(i)(E)."

c) In this case, the grant of a testamentary general power of appointment is the functional equivalent of granting outright ownership, causing the trust property to be included in the estate of the beneficiary, and therefore, does not result in the shift of beneficial interest to a lower generation or extend the time for vesting.

d) Gift and income tax consequences were not addressed.

4. PLR 201818005

a) Analyzes a way to sever trusts without affecting GST grandfathered status.

b) Prior partition proceeding divided original trust into five separate trusts, at which time the IRS ruled that there was no realization of gain/loss for income tax purposes, no transfer by a beneficiary for gift tax purposes, and no loss to the GST exempt status. Second partition order of the court (applicable to only one of the five trusts) included a modification to provide that upon the lifetime beneficiary's death, the trust would be divided equally into separate trusts, one for each of said beneficiary's living children, and one for the descendants of a deceased child of said beneficiary.

c) Held – modification is not an exchange of property resulting in gain or loss for income tax purposes; having no material difference in the position of the beneficiaries before and after partition results

in no adverse gift tax consequences; and the action was similar to Example 5 in Treas. Reg. § 26.2601-1(b)(4)(i)(E), where a trust may be divided with court approval into separate equal trusts for the settlor's children, because the division did not shift any beneficial interest to a beneficiary in a lower generation or extend the time for vesting.

5. PLRs 201920001 – 201920003 (May 17, 2019).

   a) Held - court reformation and modification of several irrevocable trusts to limit the class of appointees of grandchildren's testamentary power of appointment and limit withdrawal rights (i) did not grant the trusts' beneficiaries with general powers of appointment, and (ii) did not constitute the exercise or release of any general power of appointment resulting in a gift, and that GST tax was automatically allocated to each transfer to the trust.

6. PLR 201938004-201938006 (September 20, 2019)

   a) Involved a court modification of a grandfathered trust where a son was deemed to hold a general power of appointment over the trust, and the issue was whether the distributions upon termination of the modified trust were subject to GST tax.

   b) Held – Because the trust assets are to be included in the son's gross estate, the son is treated as the owner for GST purposes. After judicial construction and modifications to the administration and dispositive provisions of the trust, the trust remained exempt from GST tax upon termination.

7. PLR 202011001, PLR 202011002, PLR 202011003, PLR 202011004, and PLR 202011005 (March 13, 2020).

   a) Held –a state court modification of an irrevocable trust to have the remainder interest after child's death held in continued trust for the grandchildren, but giving each grandchild a testamentary general power of appointment over his or her separate share trust, did not deprive the trust of its effective date protection from the GST tax.

8. PLR 201947001-201947006 (November 22, 2019)

   a) Modification of an irrevocable grandfathered trust extending it for the life of a beneficiary pursuant to a state statute (i) would not cause the trust to lose its exempt status for purposes of the GST tax, (ii) would not result in the inclusion of the trust in the grantor's estate, and (iii) would not cause the grantor or any beneficiary to have made a gift.

b) Held – the proposed modification would not cause the trust to lose its GST exempt status because there is no shift in beneficial interests; modification will not result in inclusion in the grantor's estate because the grantor did not retain any interests or power over the trust, and the modification will not result in any change to the beneficial interests of any of the contingent or non-contingent beneficiaries of the trust, so the modification is not subject to gift tax by the grantor or any of the trust beneficiaries.

9. PLR 201932010 (August 9, 2019)

a) Termination of a trust by court approval if the continuation of the trust is not necessary to achieve any material purpose.

b) Held – (i) termination of the trust will not be subject to GST tax as it does not cause a shift in beneficial interests to a lower generation than those beneficiaries with interests prior to the termination, nor extend the time for vesting of any beneficial interest beyond the period provided in the original trust (based on the actuarial values presented); (ii) no deemed transfer of property (for gift tax purposes) since the beneficial interests, rights and expectancies of the beneficiaries will be substantially the same before and after termination and the proposed distribution.

10. PLRs 201941012-201941023 (October 11, 2019)

a) Held - The reformation of an irrevocable trust (i) would not cause any child of the settlor to have released a general power of appointment by reason of the lapse of a withdrawal right, and (ii) would not cause anyone other than the settlor, the settlor's spouse, and the settlor's parents to be transferors of the trust for GST tax purposes.

11. PLR 202013001, PLR 202013002, PLR 202013003 & PLR 202013004 (October 7, 2019)

a) Held – the proposed court modification, which included creating continuing trusts with general powers of appointment, of a grandfathered trust does not cause the trust to lose its exemption from GST tax because the continuing beneficiary's trust will be includable in the beneficiary's estate at death, and each continuing beneficiary will be treated as transferor for GST purposes. No shift in beneficial interests to a lower generation that persons holding those interests, and the modification will not extend the vesting for any beneficial interest.

12. PLR 202009012 (February 28, 2020)

a) Court reformation and modification of revocable trust after the settlor's death to correct several scrivener's errors and proration of federal estate tax, and ruling on spouse's exercise of testamentary power of appointment, as reformed, over the Marital Trust.

b) Held – (i) spouse's exercise of power of appointment, as reformed, is not exercise of a general power of appointment; (ii) the Marital Trust qualifies as QTIP; (iii) the reverse QTIP election for the GST exempt Marital Trust was valid; (iv) spouse did not possess any general power of appointment over the Family Trust as this was never intended and subsequently corrected by the court's reformation, and the Family Trust will not be included in the spouse's estate; (v) the waiver of the trustee of a separate survivor's trust, of the right of reimbursement for estate taxes due from the GST exempt Marital Trust was valid, and the spouse did not make a constructive addition to the GST exempt Marital Trust and thus, will not be deemed the transferor with respect to any portion of this trust for GST tax purposes at her death.

13. PLR 202108001, PLR 202108002, PLR 202108003, PLR 202108004, PLR 202108005, PLR 202108006 (February 26, 2021)

a) Held – State court orders modifying administrative provisions of trust and declaratory judgment will not affect trust's exempt status under Treas. Reg. 26.2601-1(b)(4)(i)(C), and declaratory judgment will not cause stated trusts to lose grandfathered exempt status for GSTT purposes. Also, declaratory judgment will not result in gift by trust beneficiary under I.R.C. §2501 and will not cause trust to be included in trust beneficiary's gross estate under I.R.C. §2001. There was a bill introduced in the Senate on April 20, 2023 that would amend I.R.C. §2001.

14. PLR 202133005 (August 20, 2021) and PLR 202134003 (August 27, 2021)

a) Held – A proportional division of one trust into several new trusts for Grantor's children, is not considered a sale or exchange of property under §1001(a), results in no gain or loss under §61(a)(3) or §1001 (a), and the transfer of assets are not included in the gross income of the beneficiary of a new trust under §662. If each trust is managed and administered separately, they are treated as separate trusts for federal income tax purposes. The new trusts will keep the same tax basis and holding period of assets of the original trust as they are not considered a sale or exchange of property under §1001. Also, the new trusts will take upon any net capital and operating losses, as well as any other tax attributes of the original trust. If no beneficial interest is transferred to the any

beneficiary of a lower generation under §2651, the exemption status from GST tax from the original trust will also apply to the new trusts.

15. PLR 202134004 (August 27, 2021)

    a) Held – Neither modifying a trust to assign a successor trustee nor dividing a trust into two equal trusts for the Grantor's grandchildren and their descendants affects GST exemption status when the modifications do not result in a shift of any beneficial interest to a beneficiary of a lower generation and do not extend the vesting time of any beneficial interest. As the beneficial interests of the beneficiaries are not changed, no transfer of property is deemed to have occurred, and there will be no federal gift tax applied under § 512(b). Also, this will not result in the assets of the trust or of the beneficiaries being included in the gross estate of the beneficiaries for §2035-2038 federal estate tax purposes. Moreover, if the will of the Grantor authorizes non-pro rata allocations of the trust and the allocations are made with assets of equal value while the trust receives nothing in exchange for this allocation, while no beneficial interests are transferred to beneficiaries, no gain or loss from a sale of trust assets is recognized under §61 and §1001. This distribution is also not considered to be a distribution under §661 or §1.661(a)-2(f) nor causes any trusts or beneficiaries to recognize any income, gain, or loss under §662. As §1001 does not apply, the transferred assets retain the holding period assigned in the original trust under §1223(2) and the basis of each asset is unchanged under §1015.

16. PLR 202145026 (November 12, 2021)

    a) Court's prior judicial modification of irrevocable trust to comply with §664(d)(2)-(3) was otherwise valid but inadvertently changed the valuation date of trust.

    b) Held – A modification of the charitable interest of an irrevocable trust that does not change the actuarial value of an ascertainable and reformable interest, doles out payments in specified dollar amounts or through a fixed percentage, and does not change the termination or effect date of the trust satisfies the requirements of §2055(e)(3)(C).

17. PLR 202215015 (April 15, 2022)

    a) Held –Merger of several GST trusts for Grantor's descendants into a single existing trust is held to not affect the GST tax exempt status of the trusts. As the beneficiaries, distribution provision,

trustee power provision, dispositive provision, and termination provision of the trust are all substantially similar or identical, no beneficial interest in the trusts are shifted to a beneficiary occupying a lower generation. This, coupled with the modification not extending the vesting time of beneficial interest in the trust beyond the original period, satisfies Section 26.2601 requirements to retain the original GST tax exempt statuses of all trusts and trusts and beneficiaries.

18. PLR 202216001-202216006 (April 22, 2022)

    a) This PLR addresses the potential tax implications of judicial modification of decanted irrevocable trusts. The trust in question was decanted from one original trust to six individual trusts for the Grantor's individual children.

    b) Held – Judicial modification of new trust's termination date provisions to correct scrivener's errors in order to effectuate the Grantor's original intent does not result in any change to a beneficiary's taxable income. A modification of a trust to ensure that a new trust does not extend the vesting interest beyond that of the original trust will not alter the inclusion ratio of the new trust nor result in the application of additional gift tax. Such modification also does not constitute a transfer and therefore the property of the new trust is not included in the beneficiary's gross estate.

19. PLR 202224008 (June 17, 2022)

    a) Held – Judicial modification of a trust for several generations of decedent's family to alter the distribution method of such trust such that certain beneficiaries will receive their shares in a separate trust instead of directly does not shift a beneficial interest in the trusts to any beneficiary of a lower generation than provided in the original trust. Thus, there is no loss of GST tax exempt status.

20. PLR 202301001 (January 6, 2023)

    a) Held – Proposed distribution of trust's assets to successor trust satisfies Reg. 26.2601-1(b)(4)(i)(D) and won't cause either trust to lose their exempt status from GSTT. Also, each named beneficiary of stated trust will possess general power of appointment under Code Sec. 2041(b)(1) with respect to property subject to this power and value of this property at time of beneficiary's death will be includible in beneficiary's gross estate under Code Sec. 2041(a)(2).

21. PLR 202317010 (April 28, 2023)

a) Held - Court-approved settlement agreement, court order, implementation of settlement agreement, and distributions upon trust termination won't cause trust to lose its exempt status for GSTT purposes or otherwise become subject to GSTT under Code Sec. 2601 and Code Sec. 2603. (See PLR 202317001, PLR 202317010, PLR 202317011)

22. PLR 202318014 (May 5, 2023)

a) Held - Court-approved settlement agreement, court order, implementation of settlement agreement, and distributions upon trust termination won't cause trust to lose its exempt status for GSTT purposes or otherwise become subject to GSTT under Code Sec. 2601; and Code Sec. 2603.

23. PLR 202432012 (August 9, 2024)

a) Held – Modification of grandchildren's trust dividing trust into two equal trusts will not cause trust to lose GST exempt status or otherwise become subject to GST tax, does not constitute a transfer by a beneficiary for gift tax purposes and will not cause beneficiary to recognize gain or loss of sale or disposition of trust property.

24. PLR 202432016 (August 9, 2024)

a) Held – Modification of children's trust by state court will not result in a transfer of property subject to GST tax under Code Sec. 2601, and will not cause the trust to lose its GST tax exempt status.

H. Decanting and modification treated as continuation of trust?

1. Several private letter rulings have treated trust decanting and modification as a continuation of the original trust, retaining the same tax attributes of the original trust.

a) PLR 200607015 (Finding that where state law permitted a trustee to exercise a limited power of appointment and distribute trust principal to separate trusts, the new trusts should be treated as a continuation of the original trust).

b) PLR 200736002 (Stating that no gain or loss is recognized on the partition of Trust for purposes of § 61(a)(3) or § 1001(a) by Trust, by any of the three successor trusts, or by any beneficiary of those trusts).

c) PLR 200832020 (Modification by trustees to divide and change administrative provisions of trust authorized under state law was treated as continuation of trust for federal income tax purposes).

d) PLR 9330008 (Extension of trust resulting from exercise of special power of appointment granted in grandfathered trust was treated as continuation of grandfathered trust).

2. Whether a trust is treated as a continuation may still present a taxable event under certain circumstances, and would likely be fact dependent.

a) It is possible for a recognition event to occur through a decanting that requires beneficiary approval, where a beneficiary's interests in the new trust are materially different from the original.

b) Special consideration should be given to change in situs of the trust (possible state tax implications), and negative basis assets held in trust (possibly triggering gain).

V. Recovery of Attorney's Fees when Defending the Decanting, Modification or Termination of a Trust

A. Generally, a trustee can be reimbursed out of trust property for reasonable attorney's fees and other costs in bringing, defending, or settling litigation as appropriate to proper administration or performance of the trustee's duties.

1. *Bronstein v. Bronstein*, 332 So.3d 510 (District Court of Appeal of FL Dec. 22, 2021) (holding that while a trustee may pay costs and attorney's fees in any proceeding in which they prove the expense was reasonably necessary and for the benefit of the trust, beneficiaries may challenge those costs and fees).

B. If a decanting, modification or termination is deemed to be a breach of trust, however, a trustee may be liable for the attorney's fees incurred to defend the improper action. *See, e.g.*, *Hodges v. Johnson*, 173 N.H. 595 (2020).

1. The New Hampshire Supreme Court held that trustees were liable for attorney's fees incurred by a trust in litigation arising from a series of decantings. The decantings constituted a breach of the trustees' duty of impartiality because the trustees failed to consider the beneficiaries' interests. The absence of case law governing decantings did not excuse the trustees' actions, as they could have retained independent counsel or sought instructions from a court.

VI. Recent Relevant Cases Arising in States that Have Implemented the UTC

A. *Connary v. Shea*, 2024 ME 57 (Supreme Judicial Court of ME August 6, 2024) (affirming no evidence that one of two settlors of a trust mistakenly believed the trust provided for beneficiary to receive proceeds from any future recall of bank stock with which trust was funded in part, as could support beneficiary's claim for reformation after bank stock was recalled).

B. *In re Revocable Trust of David Rothstein*, 272 A.3d 471 (Superior Court of PA Jan 12, 2022) (accepting a modification of a trust which changed the beneficiaries of such trust even though it did not follow the proper procedure because the Grantor showed his intent to do so).

C. *Ex parte Scoggins*, 2021 WL 4024376 (Supreme Court of Alabama Sep. 3, 2021) (permitting emergency termination of irrevocable trust upon finding that trustee had misappropriated funds in direct violation of previous court orders).

D. *Skarsten-Dinerman v. Milton Skarsten Living Trust*, 2021 WL 6109571 (Court of Appeals of MN Dec. 27, 2021) (affirming decision to deny modification of a trust to allow distribution and sale of farmland as Grantor's intent was to keep land intact as a source of income for the beneficiaries and such modification would be inconsistent with this intent. The court was not convinced by the beneficiaries' argument that falling rent prices have decreased the value of the land to the extent that it was no longer a feasible source of income).

E. *In re Trust B Created Under Karam Family Trust*, 2021 WL 6013442 (Court of Appeals of AZ Dec. 20, 2021) (upholding decision that allowed trustee of irrevocable trust to terminate trust without the approval of one of the Settlor's children. The court looked specifically to the power of appointment that was granted to the trustee and deemed that the Settlor's intent was to give trustee discretion in deciding who the beneficiaries of trust would be).