


## A Presentation For The 2011 Delaware Trust Conference



### Options for Managing Trust Transfer Risk: A Practical Discussion on the Risks Involved in Determining Whether to Reform, Decant or Amend an Existing Trust when Moving it to Delaware

Michael M. Gordon, J.D., LL.M.  
Gordon, Fournaris & Mammarella, P.A.  
1925 Lovering Avenue  
Wilmington, DE 19806  
[mgordon@gfmlaw.com](mailto:mgordon@gfmlaw.com)

William H. Lunger, Esquire  
Martin & Lunger, P.A.  
1020 N. Bancroft Parkway, Suite 100  
Wilmington, DE 19805  
[whlunger@mcl-law.com](mailto:whlunger@mcl-law.com)

Melinda Merk  
Senior Vice President and  
Regional Trust Advisor  
Private Wealth Management  
SunTrust Bank  
8330 Boone Boulevard, 2<sup>nd</sup> Floor  
Vienna, VA 22182  
[Melinda.merk@suntrust.com](mailto:Melinda.merk@suntrust.com)

Seane Baylor  
UBS Trust Company, N.A.  
500 Delaware Avenue, Suite 900  
Wilmington, DE 19801  
[Seane.baylor@ubs.com](mailto:Seane.baylor@ubs.com)

# IRS Circular 230

---

To ensure compliance with IRS requirements, I must inform you that any U.S. federal tax advice contained herein is not intended or written to be used, and cannot be used, for the purpose of avoiding any penalties that may be imposed under the Internal Revenue Code or for the purpose of promoting, marketing, or recommending any transaction or matter addressed herein.

# Methods for Reforming Irrevocable Trusts Under Delaware Law

---

There are two ways that an Irrevocable Trust may be modified under Delaware law:

1. Through a judicial reformation; and
2. Through the use of Delaware's decanting statute (12 Del. C. § 3528).

# The Delaware Court of Chancery

---

1. The Delaware Court of Chancery is comprised of one Chancellor, four Vice Chancellors and two Masters in Chancery.
2. Every new matter is filed to the attention of the Chancellor, who then assigns it within the Court.
3. The Delaware Court of Chancery has specialized jurisdiction over business and corporate law matters.

# The Delaware Court of Chancery

---

4. The Delaware Court of Chancery also has exclusive jurisdiction over all matters and causes in equity, including Delaware trust administration and trust interpretation cases. 10 Del. C. § 341.
5. Generally, the Delaware Court of Chancery will accept jurisdiction over a Consent Petition if a trust has a Delaware trustee, or will have a Delaware trustee upon the effective date of the order (i.e., if the order itself causes a conditional acceptance of appointment of a Delaware trustee to become effective).
6. There is no jury participation for proceedings in the Delaware Court of Chancery and cases are handled in a timely and efficient manner.

# Consent Petitions

---

The Court of Chancery has worked closely with the Estates and Trusts Section of the Delaware Bar Association to allow “Consent Petitions” for purposes of reforming irrevocable trusts. If all parties interested in the trust agree (or for tax reasons state their non-objection or take no position), the trust may be reformed for a proper purpose. The process continues to evolve.

# Requirements for Filing Consent Petitions

---

There are several requirements for filing Consent Petitions with the Register in Chancery relating to trust matters:

1. The Petition must fully disclose all facts and circumstances related to the Trust and the relief requested.
2. The Petitioner can be anyone with an interest (beneficial or fiduciary) in the trust.
3. The Petition must be accompanied by an explanatory cover letter from the filing attorney stating the material purpose of the Petition and summarizing the relief requested in the Petition.
4. The Petition must have attached to it as an exhibit a copy of the trust instrument, amendments thereto and any Orders relating to the trust instrument.

# Requirements for Filing Consent Petitions

---

5. Unless the relationship of those with a beneficial interest in the trust to the grantor is self-evident, the filing attorney must enclose with the cover letter accompanying the Petition or attached as an exhibit to the Petition a family tree or other document showing the relationship of those having a beneficial interest in the trust to the grantor.

6. The Petition must include, as exhibits, consents, notices of non-objection or statements of no position (“Consents”) to the relief requested in the Petition from all interested parties. This may include, but is not limited to, (i) trustees and other fiduciaries (unless they have otherwise signified their consent to the Petition by acting as a Petitioner or accepting a fiduciary position); (ii) the trust beneficiaries; and (iii) all other persons having an interest in the trust pursuant to the express terms of the trust instrument (such as, but not limited to, power holders and persons having other rights and powers, held in a non-fiduciary capacity, with respect to trust property).



# Requirements for Filing Consent Petitions

---

7. For purposes of filing Consent Petitions, trust beneficiaries are defined as those with a present interest in the trust and those whose interest in the trust would vest, without regard to the exercise or non-exercise of a power of appointment, if the present interest in the trust terminated on the date the Petition is filed.

8. A trust beneficiary's Consent must be executed by (i) the beneficiary personally; (ii) the beneficiary's attorney ad litem; (iii) a person authorized to virtually represent the beneficiary pursuant to 12 Del. C. § 3547 or any successor statute; or (iv) a person authorized by applicable law to represent the beneficiary with respect to the Petition (such as, but not limited to, the beneficiary's attorney-in-fact or the Attorney General in the case of certain charitable beneficiaries).

# Requirements for Filing Consent Petitions

---

9. Consents executed pursuant to 12 Del. C. § 3547 (Delaware's virtual representation statute) must include reference to the statute, state the relationship of the person signing the Consent to those virtually represented and include in the signature block the name of the person signing the Consent and the class of those virtually represented.

10. All Consents must be notarized unless there is justifiable cause why the Consent cannot be notarized and the Court waives the requirement.

11. All Consents must have a signature line with the name of the individual signing the consent typed or printed below the signature.

# Confidentiality of Consent Petitions

---

All Consent Petitions are filed in the Court of Chancery as Civil Miscellaneous Matters (C.M.) and are not matters of public record even absent a court order sealing the record. The Court is currently holding closed hearings for all Petitions.

In the event all of the Consents may not be obtained, the Petition must be filed as a Civil Action (C.A.) and set down for a hearing, meaning that the matter will be open to the public. However, when issues of confidentiality and privacy are paramount to the parties in a Civil Action, it is possible to obtain a court order to seal the record thereby keeping the trust agreement, the parties and their dispute private. Chancery Court Rule 5(g)(3).

# Delaware's Decanting Statute

## 12 Del. C. § 3528

---

Delaware law authorizes a trustee that has authority under the terms of the trust instrument (the first trust) to invade principal for the benefit of one or more of the beneficiaries, to exercise such authority by appointing all or a portion of the principal subject to the power of invasion in favor of a trustee of a trust created pursuant to a separate instrument (a second trust). 12 Del. C. § 3528(a). Implicit in the statute is the concept that, if a trustee may invade principal for a beneficiary under the terms of a trust agreement, the trustee may, in the exercise of its principal invasion power, appoint the principal to a new trust for the benefit of some or all of the beneficiaries of the first trust.

# Requirements for Use of Decanting Statute

---

1. The trust instrument must not prohibit the trustee from distributing assets in further trust for a beneficiary. 12 Del. C. § 3528(a).
2. The trustee must have the ability to invade principal for the benefit of one or more of the beneficiaries of the trust. 12 Del. C. § 3528(a).
3. The beneficiaries of the second trust must also be beneficiaries of the first trust. 12 Del. C. § 3528(a)(1).
4. The second trust may not alter the beneficial interests of beneficiaries of the first trust that are not proper objects of the exercise of the power of invasion. 12 Del. C. § 3528(a)(1).

# Requirements for Use of Decanting Statute

---

5. The second trust must comply with any standard that limits the trustee's authority to make distributions from the first trust (i.e., if the first trust provides that distributions to the beneficiaries can only be made pursuant to an ascertainable standard the second trust cannot provide that distributions can be made to the beneficiaries for any purpose). 12 Del. C. § 3528(a)(5).

6. The first trust must be administered in Delaware. 12 Del. C. § 3528(f).

7. A written "decanting instrument" must be signed and acknowledged by the trustee and filed with the records of the trust. 12 Del. C. § 3528(b).

# Other Aspects of Decanting Statute

---

1. The trustee does not need the consent of the beneficiaries or any other interested party to exercise its decanting power. However, it is common practice to have the beneficiaries consent to the decanting and release and indemnify the trustee from any liability in connection with the decanting.

2. While the second trust may not have beneficiaries who are not also beneficiaries of the first trust, the decanting statute specifically permits the second trust to grant a beneficiary of the first trust a limited or general power of appointment thereby allowing a beneficiary to appoint trust property to a person who is not a beneficiary of the first trust. 12 Del. C. § 3528(a).

3. A trustee's exercise of its decanting power is considered the exercise of a power of appointment and is subject to the provisions of Chapter 5 of Title 25 of the Delaware Code relating to the time at which the permissible period of the rule against perpetuities begins and the law which determines the permissible period of the rule against perpetuities. 12 Del. C. § 3528(c).

# Common Reformation Accomplished Through Consent Petitions and/or Decanting

---

1. Acceptance of jurisdiction over a trust so that Delaware is the situs of the trust and reformation of the trust so that Delaware law will thereafter govern the administration of the trust.
2. Ratification of prior trust acts by trustees and other advisors.
3. Bifurcation of trustee responsibilities through the appointment of advisers in accordance with 12 Del. C. § 3313 (i.e., Investment Direction Advisers, Distribution Advisers and Trust Protectors).
4. Modification of other administrative provisions of a trust (i.e., succession of trustee provisions, accounting provisions, trustee powers, etc.).



# Common Reformation Accomplished Through Consent Petitions and/or Decanting

---

5. Modification to beneficial terms of trust (i.e., removing beneficiary withdrawal rights at certain ages so trust assets stay in further trust for beneficiary's lifetime as opposed to being distributed at specified ages).
6. Conversion of grantor trust to non-grantor trust for income tax purposes.
7. Division of a pot trust into separate trusts for the benefit of a sole beneficiary.
8. Correction of mistake or ambiguity contained in trust agreement.

# Modifying a Trust under the UTC

---

- ❑ To date, the Uniform Trust Code (UTC) has been adopted in 26 states
- ❑ The UTC can provide authority for modifying a trust, particularly in states that have not enacted a decanting statute (e.g., VA, DC, PA) and the governing document does not explicitly provide authority for the desired modification
- ❑ Judicial Modification or Termination
  - Section 411 – Consent (Non-Charitable Trusts)
    - ❑ Upon the consent of the Grantor and all beneficiaries, even if inconsistent with a material purpose of the trust
    - ❑ Upon the consent of all beneficiaries, if not inconsistent with a material purpose of the trust
    - ❑ Without unanimous consent of the beneficiaries, if the court determines the interest of any non-consenting beneficiary will be adequately protected
  - Section 412 – Unanticipated circumstances
  - Section 414 – Uneconomic trust
  - Section 415 – Correct mistake of law or fact
  - Section 416 – Achieve Grantor’s tax objectives

# Modifying a Trust under the UTC

---

- Non-Judicial Modification
  - Section 111 permits “interested persons” to enter into binding non-judicial settlement agreement for certain matters that do not violate a material purpose of the trust (as set forth in Section 411), including:
    - Resignation or appointment of a trustee
    - Transfer of principal place of administration
    - Grant any necessary or desirable powers to trustee
  - Section 417 – permits trustee to merge or divide a trust, after notice to the beneficiaries
- Consider including express provisions in the governing document to avoid reliance on the UTC or decanting statute
  - Power to modify trust granted to trust protector or independent trustee (can be limited to certain circumstances, such as for tax purposes or to remove/replace trustee)
  - Power to change situs, and to merge or divide trust

# Modifying a Trust under the UTC

---

- ❑ Power to make distributions in further trust, on such terms as the independent trustee may deem to be in the best interests of the beneficiary (provided this does not have the effect of divesting any vested interest of a beneficiary)