

Fixing or Killing Off Broken Trusts

(Including 2017 Statutory Changes)

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“Disclaimers under the New Texas Uniform Disclaimer of Property Interests Act,” (with Thomas M. Featherston, Jr. and Julia E. Jonas), State Bar of Texas Advanced Estate Planning and Probate Course (2015), updated on texasprobate.com.

“Problems with the Texas Disclaimer Statutes and What to Do About Them,” (with Julia E. Jonas), State Bar of Texas Advanced Estate Planning and Probate Course (2014).

“Multi-Party Accounts and Other Non-Probate Assets in Texas,” University of Texas CLE Estate Planning, Guardianship and Elder Law (2011), updated on texasprobate.com.

“Dealing with Dysfunctional Clients,” State Bar of Texas Advanced Estate Planning and Probate Course (2010).

“Bypass Trust Basics,” University of Texas CLE Estate Planning, Guardianship and Elder Law (2010).

“Night of the Living Trust: Living in the World of Non-Probate Assets,” National Committee on Planned Giving (2009).

“Protecting the Surviving Spouse and Protecting Yourself After *Belt v. Oppenheimer*,” State Bar of Texas Advanced Estate Planning and Probate Law Course (2006), updated on texasprobate.com.

“UPIA Handbook,” The Texas Probate Web Site [texasprobate.com] (2003 - 4).

“The New Guardianship Rules Regarding Inventories, Monthly Allowances and Investments,” State Bar of Texas Guardianship Law Course (2004).

“Top Ten Brilliance and Blunders: A View from the Webmaster,” State Bar of Texas Annual Advanced Estate Planning and Probate Course (2002).

“Modifying and Terminating Irrevocable Trusts,” State Bar of Texas Advanced Estate Planning and Probate Law Course (1999), updated on texasprobate.com.

“Court-Created Trusts in Texas,” State Bar of Texas Advanced Drafting: Estate Planning and Probate Law Course (1995), updated on texasprobate.com.

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1. Introduction

One of the ironies of the enactment of the generation-skipping transfer tax (“GST”) in 1986 is that a statute designed to curb using trusts for multigenerational planning actually encouraged multigenerational planning. By taxing generation-skipping transfers to the extent they exceeded the lifetime GST exemption amount, estate planners found a new basis for trust planning: if the government is going to allow generation-skipping planning up to the exemption amount, then families ought to take advantage of it.

For this and other reasons, the use of trusts having long terms has increased dramatically. As these trusts mature, families and estate planners are discovering that the trust terms used at the time the trust was created often fail to address the family’s needs and fail to meet the industry standard of trusts today. This paper calls these “broken trusts.”²

Not coincidentally, as the practice of using long-term trusts has grown, there has been a movement toward finding ways to change or terminate broken trusts. This movement is happening on four fronts:

1. Drafters are including provisions in new trust documents which permit adjustment of trust terms in the future.
2. Statutes are being amended to liberalize modification or termination of trusts.



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² These trusts may have been expertly and correctly drafted. They may have accurately represented the settlors’ intentions at the time they were signed. They are called “broken” in this paper because they have that attribute to the persons desiring to change or terminate them.

3. The legal academic community and the courts have moved the needle in the direction of deviating from the settlor's literal terms in appropriate cases.
4. Attorneys working on broken trusts are becoming craftier at using the available tools to fix or terminate them.

This paper mentions strategies which drafters may use to build flexibility into new trust documents. It then takes a close look at the evolving law of judicially modifying and terminating irrevocable trusts. Finally, it discusses the tools – some old, some new – in the attorney's toolbox to fix or terminate broken trusts without going to court, including decanting and combining trusts.

2. Drafting with the Future in Mind

This paper mostly focuses on fixing or terminating existing broken trusts. Still, it is worth noting some of the things drafters of trusts can do to make it easier to adjust to future events. While these strategies build in flexibility, some of them are inappropriate in specific cases. Still, it is the author's opinion that the default approach of the drafter should be to provide flexibility.

Appendix A contains some sample trust provisions to consider using when maximum flexibility is desired.

2.1. Provide Broad Trustee Discretion and Powers

By far, the best way to provide flexibility in the future is to grant the trustee broad discretion – or, at least, broad discretion to the extent permitted by tax law – and to give the trustee broad powers. A settlor creating a trust which may last 10+ years (especially a multigenerational trust) cannot anticipate all of the circumstances which may arise. If the settlor restricts the trustee as to investments or distributions, modification is much more likely to be necessary. Of course, this approach makes selection of the trustee critical and it will not work in all situations. There may be factors which make wide discretion inappropriate.

Consider the following approaches:

- Use a broad discretionary distribution standard if an ascertainable standard is not required for tax purposes.
 - Precatory advice about details of distribution decisions is preferable to mandatory instructions and helps overcome a corporate trustee's reluctance to be left with broad discretion.
 - A savings provision may be used to convert the trust to an ascertainable standard trust if a beneficiary becomes trustee. Also, Section 113.029(b) of the Texas Trust Code may convert the trust to an ascertainable standard trust if a beneficiary becomes a trustee.

Also available as part of the eCourse

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