

Tuesday, September 28, 2010

Modifying Irrevocable Trusts To Reflect Family Changes

By Bruce Givner and Owen Kaye

Irrevocable trusts are important tools in both estate tax planning and asset protection planning. For example, an irrevocable trust for the benefit of the children can own an insurance policy so that the proceeds are not included in the parents' taxable estates. That same trust can also be a member of an LLC with the parents so that the parents have the benefit of the charging order limit available to members of a multi-member LLC.

Irrevocable trusts of this type are commonly established when the parents create "basic" estate planning documents, e.g., a "pourover" will; "living" (also known as "family" or "revocable") trust; "blanket" assignment of assets; trust certificate; and durable powers of attorney for health care and asset management. And that type of planning - hopefully - takes place when the children are young.

Unfortunately, 20 years later, things have changed. The son has married a woman, whom mom and dad do not approve. The daughter is married to a nice man who cannot earn a decent living. Both parents are uncomfortable with the irrevocable trust, which provides that the assets are distributed outright to their children on their deaths. What can be done?

There are several ways to modify an irrevocable trust directly, and indirectly. The best approach is, of course, to anticipate the need for future flexibility when drafting the trust. However, even if the instrument does not anticipate the need for future flexibility, all hope is not lost due to helpful provisions in California's Probate Code and the ability to change the trust's investments.

One important step in drafting the trust is to provide both parents with the right to remove the trustee and name a new one. To avoid an adverse estate tax result (inclusion of the trust assets in mom and dad's taxable estates), the new trustee must not be "related or subordinate" as defined in Internal Revenue Code Section 672(c). However, that retained power alone is often enough to allow clients to feel comfortable with signing an irrevocable trust.

An option to consider is to name a trust "protector." "Protectors" are commonly used in trusts drafted in foreign, common law, asset protection jurisdictions, such as the Cook Islands. Due to the flexibility offered by "protectors," their use has dramatically expanded in U.S. trusts drafted in the past 20 years. Nevada is one of the few U.S. states to have defined the term in its laws. See Nevada Revised Statutes Sections 163.4437 and 163.5553. Protectors are often given one or more of the following powers: to modify or amend the trust to achieve a more favorable tax status or to respond to changes in federal or state law; modify or amend the trust to take advantage of changes in the rule against perpetuities, restraints on alienation or other state laws restricting the terms of a trust, the distribution of trust property or the administration of the trust; increase or decrease the interests of any beneficiary, and change the manner of distribution to a beneficiary; remove and appoint a trustee, trust adviser, investment committee member or distribution committee member; terminate the trust; direct or veto trust distributions; change the location or governing law of the trust; appoint a successor trust protector or trust adviser; and interpret terms of the instrument at the trustee's request.

There are, of course, other drafting tools available. However, next assume that the parents are in your office 20 years later; you did not draft the trust (so that it does not have the built-in flexibility); and they are unhappy with the fact that the assets will be distributed outright to their children after their deaths. Instead, the parents want the assets to remain in trust for as long as possible. What tools are now available?

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Thursday, May 12, 2011

Discipline

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Health Care & Hospital Law

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The Curse of Chavez Ravine

Are the Dodgers' financial problems a case of delayed retribution for how Dodger Stadium came about? By **Gideon Kanner** of Loyola Law School

International

The Benefits of Bilateral Investment Treaties When Investing in China

Bilateral investment treaties operate as "free insurance" with its minimal costs and direct benefits. By **Allan Marson, Grant Hanessian,** and **Michiel Kloes** of Baker & McKenzie

Construction

What to Do With a Busted Project

Distressed real estate projects are getting a shot of much needed adrenaline from preferred equity. By **Anita F. Sabine** of O'Melveny & Myers LLP

Letter to the Editor

America Is a Fair Country

Leon Snaid responds to "Death of Osama bin Laden: Could There Have Been a Trial?"

Criminal

Panel Lawyers Could Be Curtailed

A committee of federal judges is considering whether to create a new "alternate" public defender's office in the Central District of California that would be independent of the existing institution.

Judge Bars Gang Injunction Enforcement

A federal judge has approved an unusual permanent injunction against the Orange County district attorney, barring him from enforcing a gang injunction won in state court against 48 people.

One possibility is the California Probate Code. Section 15404(a) provides that "If the settlor and all beneficiaries of a trust consent, they may compel the modification or termination of the trust." That solution does not require going to court, a result which the parents will like. However, there is a potential roadblock: why would the son and daughter agree to extend the date of distribution? The answer is simple: coercion. If the son and daughter do not agree to sign the action prepared by their parents' lawyer, then the mom and dad can revise their living trust to leave all of their other assets to their favorite charity. In other words, the parents - can, in the words of Don Vito Corleone, make their son and daughter "an offer that they can't refuse." The grandchildren are also beneficiaries, as defined in Probate Code Section 24(c), because they have a "future interest." A guardian *ad litem* is apparently unnecessary if the Section 15404(a) procedure is followed. See Probate Code Section 15405.

Another possibility is to have the irrevocable trust invest its assets into a limited partnership with the desired party - the one who would be the long-term trustee - as the general partner. The limited partnership agreement can be drafted to continue for a long enough time to satisfy the parents' desire that their children do not have access to the assets immediately upon their deaths.

Clients are often afraid of making "irrevocable" transfers. That fear can prevent them from entering into important estate tax and asset protection planning. Happily, the law has helpful tools that, when properly explained and employed, can alleviate their concerns.

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Judicial Profile Making Her Mark

A framed reproduction of Botticelli's Calumny of Apelles hangs in U.S. Magistrate Judge Jennifer L. Thurston's chambers. The colorful painting, rich in allegory, depicts Slander dragging Innocence - the victim of false accusations by Envy,

Intellectual Property Nevada Newspaper Pursues Copyright Cases

Despite some recent unfavorable court rulings, a Nevada company appears to be doubling down on its bet that suing hundreds of defendants for infringing the copyright of a Las Vegas newspaper is a winning strategy.

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