



# WR Marketplace

## *a Finseca Washington Report*

*The WR Marketplace is created exclusively for Finseca members by experts at Baker & Hostetler LLP and the Finseca staff. WR Marketplace #20-21 was written by Michael P. Vito, Counsel, and John F. DeStefano, Associate*

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### **Topic: Zooming into a new age of trust situs**

**Market trend:** The novel coronavirus has led many people – trustees, trust beneficiaries and advisors alike – to relocate their primary workplace or residency for the time being, sometimes across state lines. An irrevocable trust’s situs, or place of administration, may be impacted as this migration continues through the pandemic and likely into the future. The results may be intentional or inadvertent, with each having its own benefits and risks that should be evaluated both opportunistically and out of an abundance of caution.

**Synopsis:** Different jurisdictions invoke different benefits and drawbacks regarding trust administration, state income taxation, creditor protection, and options to modify irrevocable trusts. A situs change might be advantageous or detrimental to both the trust and its beneficiaries depending on the circumstances. Trustees should review potential affirmative steps that may be available to manage the current uncertainty of today’s new environment.

**Take-aways:** In light of increased remote work and voluntary relocation spurred by the COVID-19 pandemic, clients and their advisors should review the current situs of their irrevocable trusts, both to avoid unintended consequences and consider new opportunities. Taking care to review the terms of a trust agreement and develop a strategy designed to manage current circumstances may prove worthwhile.

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### *Has your trust situs changed?*

The original jurisdiction in which a trust was established and administered – the trust’s so-called “**situs**” or “**place of administration**” – may have been applicable and appropriate at the time the trust was created. However, state laws, trust assets, beneficiaries, and trustees change over time, potentially rendering the original situs inapplicable or ineffective.

While such changes are ordinarily anticipated and managed, fallout from the recent health crisis has accelerated the evolution of workplace patterns, creating new day-to-day routines for many. Trust beneficiaries may find themselves living in second homes – either temporarily or longer-term – potentially in a different state than where their trusts were created. Similarly, individual trustees may now find themselves in the unexpected situation of receiving account statements, sending official correspondence, and conducting trust business at their home, as opposed to their traditional office. Institutional trustees are not immune to this trend either as employees continue to work from home.

Practically speaking, a trust’s original situs may be completely disconnected from its current place of administration as a result of such changed circumstances. For example, consider an irrevocable trust created by a New Jersey resident who has since moved to Florida, which was initially managed by a trustee in downtown Manhattan, who as of March of this year has been working remotely full-time at her beach house in Delaware, and whose trust beneficiaries initially lived in New York but fled the city for suburban Connecticut. Which jurisdiction’s law should be applied to the trust’s administration?

### *Different jurisdictions present different options*

More frequently, irrevocable trusts are purposely moved from their original place of creation to a new state that offers more robust trust laws to better serve the trust and its beneficiaries. This trend provides an opportunity for advisors to be proactive by recommending that their clients analyze the current situs of their irrevocable trusts and consider their options. Some key areas where state laws differ include:

- State income tax treatment of undistributed net income;
- Creditor protection for trust beneficiaries;
- Flexibility to divide fiduciary duties among different trustees or directors regarding distributions, investments, and administration;
- Statutory authority to decant an old trust into a new trust with updated provisions that better serve the trust’s overall purpose and the beneficiaries’ best interests;
- Statutory authority to modify a trust agreement by consent of the interested parties for any purpose;

- Latitude for “silent trusts” or the temporary withholding of trust information from beneficiaries until they reach a certain age;
- Ability for the trust to invest in alternative assets not expressly included under the laws of the original jurisdiction or trust agreement;
- Enforcement of a trust’s *in terrorem*, or “no contest clause”; and
- Judicial deference to the settlor’s intent and respect for the trust’s terms as written.

### Case study

**Client Background – Sarah Smith Insurance Trust.** Thirty years ago, Sarah created an irrevocable life insurance trust (“ILIT”) in State A. After Sarah’s passing, the ILIT provides that her children will receive the trust property outright upon attaining age 50. Now in 2020, Sarah has advanced in age and her son may be headed toward divorce. If Sarah were to pass away before a divorce decree were finalized, the life insurance proceeds would pass outright to him and, depending on the jurisdiction, potentially become subject to equitable distribution.

**Legacy Planning Goals.** Before her son’s situation worsens, Sarah would prefer that the trusts stemming from the ILIT not terminate at age 50, but rather, remain in effect for each child’s lifetime. However, the laws of State A do not offer a method to decant or otherwise modify the terms of the trust agreement. The ILIT is silent as to this issue as well. The trustee agrees that it would be in the beneficiaries’ best interests for the trusts to be more protective and has agreed to explore potential strategies to do so. After speaking with fiduciary counsel, the trustee would like to change the trust’s situs and governing law to State B, which provides multiple paths for updating trust provisions, as well as enhanced creditor protection for trust beneficiaries as compared to State A. Upon a successful transition of the situs and governing law to State B, the trustee may utilize State B’s decanting statutes or applicable caselaw to better protect the interests of the beneficiaries and accomplish the settlor’s initial intent that the trust funds remain in the family.

### Relocating the trust to a new situs

**Order of Operations.** First, the trustee should review the trust agreement or other governing instrument. Trusts typically include a governing law provision, including the state in which the trust will be administered, and may authorize the trustee to change the place of administration and/or governing law. Trust agreements drafted more recently tend to include such provisions, but older trusts often do not. If the trust agreement does not include a situs provision, state law may offer alternative avenues, including:

- *Specific Authorization.* A majority of states have adopted a version of the Uniform Trust Code (“UTC”), which authorizes a trust’s situs to be moved to another state. Under the UTC, a trustee may transfer the trust’s principal place of administration to another state if the move is appropriate for the trust’s purposes, its administration, and the interests of the beneficiaries.

Under the UTC formulation, the trustee must give qualified beneficiaries prior notice of the transfer and an opportunity to object.<sup>i</sup>

- *Nonjudicial Settlement Agreement.* The UTC also includes authority for nonjudicial settlement agreements, allowing the trustee and the beneficiaries to enter into a binding agreement over the transfer as long as the agreement does not violate a material purpose of the trust and includes terms and conditions that could be approved by the appropriate court.<sup>ii</sup> The transfer of a trust's principal place of administration is explicitly listed as a matter that may be resolved by a nonjudicial settlement agreement.<sup>iii</sup>
- *Nonjudicial Trust Modification.* States that do not provide specific authorization for changing a trust's situs or permit nonjudicial settlement agreements may allow the trust to be modified by consent of the settlor, trustee, and the beneficiaries.
- *Judicial Modification.* Only a minority of states do not offer statutory authority to change a trust's place of administration without court approval. In these states, if the trust agreement does not authorize the trustee to change situs, the parties must seek a court order. The requirements for judicial modification vary by jurisdiction, and some trust friendly states have adopted procedures easing the process.

**Mechanics.** In addition to following the procedure set forth in the trust agreement or under state law, a trustee also must also sever ties with the prior situs and establish a sufficient nexus (i.e., connection) with the new one.

- *Establishing a Nexus with State B.* State rules vary regarding the minimum ties sufficient to establish a nexus so its laws may govern. These concepts generally involve whether (1) the trust owns property located in the state, (2) the trustee is located in the state, (3) one or more beneficiaries reside in the state, and/or (4) at least part of the trust's administration occurs in the state.
- *Severing Ties with State A.* Although it may not be realistic to cut all ties with the prior state (for example, if the settlor or beneficiaries still live there), some of the following steps should be considered: (1) appointing a trustee located in State B and removing the trustees located in State A (which can be an important element, depending on the income tax laws of State A and B); (2) relocating trust assets to State B; (3) transitioning the trust's investment management, accounting, and record keeping from offices in State A to State B; (4) changing the trust's legal and mailing address to State B; and (5) affirmatively conducting administration and trustee meetings in State B.

### *Once situs has been moved – what law applies?*

The trust agreement itself often provides which state law governs the trust's validity and interpretation as well as the place of administration. Motivation for changing situs often relates to the trust's substantive governing law, such as creditor's rights, decanting statutes, and investment authority.

Often, when a trust's situs is moved, the law applicable to procedure and administration changes, but not necessarily the substantive law governing the trust's "meaning and effect".<sup>iv</sup> While a trust agreement can provide a method for specifying or changing the governing law, some may not. If both state law and the trust agreement do not expressly allow for a change in governing law, the relocation should be accomplished through a trust modification, nonjudicial settlement agreement, or judicial proceeding, as applicable, to be certain the change has the intended effect. Once the governing law and the situs have been changed, the full benefits of the new jurisdiction will be available to the trust, its trustee, and beneficiaries.

### *Taming the uncertainty*

The novel coronavirus has proven itself to be a perpetual wildcard in many areas. Few predicted the pervasiveness of its ripple effects on work and life patterns. Given the abruptness of the pandemic, it is not yet clear how the various jurisdictions will view the current work from home environment, as many individuals still hope to return to their traditional office and primary home on a regular basis. Despite this uncertainty, however, clients can and should take affirmative steps to manage the opportunities or disadvantages presented. For example, if a trustee now finds herself living and working fulltime in an advantageous jurisdiction such as Delaware, this may be the occasion to consider formalizing the new situs. Conversely, to the extent that a trustee has relocated (even temporarily) to state that is potentially problematic with respect to its imposition of income taxes, the trustee may consider either resigning or, depending on the applicable state rules, adopting a strict procedure of conducting trust business elsewhere and ensuring that the record of administration reflects the location of such activities.

***Take-aways:** In light of increased remote work and voluntary relocation spurred by the COVID-19 pandemic, clients and their advisors should review the current situs of their irrevocable trusts, both to avoid unintended consequences and consider new opportunities. Taking care to review the terms of a trust agreement and develop a strategy designed to manage current circumstances may prove worthwhile.*

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<sup>i</sup> See UTC §108. Generally speaking, for purposes of the UTC, a "**qualified beneficiary**" includes (i) a current distributee or permissible distributee of trust income or principal, and (ii) a person who would become a distributee or permissible distributee of trust income or principal if the interests of a person described in (i) terminated or the trust itself terminated. See UTC §103(13).

<sup>ii</sup> UTC § 111(c).

<sup>iii</sup> See UTC §111(d)(5).

<sup>iv</sup> UTC §107.