Is the Irrevocable Trust Really Irrevocable?

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This article discusses the modification of irrevocable trusts, including the recently enacted Colorado Uniform Trust Code.

While its name suggests that an irrevocable trust cannot be changed, it is all too common for a change to such a trust to be desired any number of years after its creation. Historically, trust modifications have been accomplished either through the terms of a trust or pursuant to a court order. Today there is greater flexibility to modify irrevocable trusts through decanting under the Colorado Uniform Trust Decanting Act (UTDA), and when the Colorado Uniform Trust Code becomes effective on January 1, 2019, even more nonjudicial modification options will be available.

This article identifies common reasons to modify irrevocable trusts and various options available to accomplish modifications.

Why Change an Irrevocable Trust?

Common reasons for amending irrevocable trusts after their creation include changes in circumstances, the need for updated tax planning provisions, and administrative provisions that no longer work.

Family Changes and Unforeseen Circumstances

It is impossible for the settlor of an irrevocable or dynasty trust to predict all future events, including the needs of and issues confronting future beneficiaries. Distribution provisions may need to be changed for a beneficiary with substance abuse problems or a spendthrift beneficiary so that trust funds are not dissipated for purposes the settlor did not intend. Similarly, it may be wise to limit distribution provisions for a beneficiary with creditor problems. In a divorce context, mandatory distributions to a beneficiary's spouse could result in additional marital property that is subject to division.[1] If the settlor failed to anticipate the needs of omitted successor beneficiaries, the addition of a power of appointment can allow the powerholder to provide for new beneficiaries in trust after the original beneficiary's death.

In a blended family situation, there may be tension between income and remainder beneficiaries of a marital trust that puts a family member trustee in a difficult position. In addition, a selected trustee may not work well with beneficiaries who have no power to remove and replace the trustee. Due to tension

between current beneficiaries of a pot trust created for multiple beneficiaries, typically the settlor's descendants or children, the trustee may desire to split the pot trust into a separate trust for each beneficiary. In addition, due to changed circumstances, it may make sense to remove a beneficiary as a co-trustee.

It is also difficult for a settlor to anticipate the costs of administration, and at some point in time the costs may outweigh the benefits of continuing the trust. The trust purpose may cease to exist, for example, when a trust was created solely for the educational needs of a beneficiary who is now a 50-year-old practicing physician. And it is all too common that the terms of a trust for a beneficiary who is either on government benefits or may need government benefits in the future should be changed to prevent the trust assets from being counted as resources of the beneficiary and thus disqualifying the beneficiary for government benefits.

Updated Tax Planning

With respect to a credit shelter trust, if the surviving spouse is not expected to have a taxable estate, it may make more sense to have the trust assets included in the surviving spouse's taxable estate to achieve a step-up in basis at the death of the surviving spouse. A settlor may want to convert a grantor trust to a non-grantor trust or a non-grantor trust to a grantor trust if the trust instrument contains no toggle provision. Significant income tax savings can also often be achieved with a change in trust situs.

It may be wise to extend the duration of a trust exempt from generation-skipping transfer (GST) tax to maximize the tax benefits. In some circumstances, it may be best for a beneficiary if a general power of appointment is converted into a nongeneral power of appointment. In other circumstances, a general power of appointment could be added to a GST exempt trust to obtain a step-up in basis for the trust assets at the death of the beneficiary with the general power of appointment. A trust with a mixed GST inclusion ratio could be severed into GST exempt and non-exempt trusts so that distributions can be made to skip beneficiaries from the GST exempt trust without paying GST tax.

Administrative Provisions

Trustee restrictions, such as a mandatory corporate trustee, may cease to make sense economically, particularly if the trust holds an interest in a closely held business or the trust assets have diminished in value. A recent development in trust administration is the desire to bifurcate trustee responsibilities, such as with a directed trust, where provisions allowing for bifurcation were not included in the original document. A bifurcation may also be helpful if the trust holds an interest in a closely held business or substantial real estate holdings. On the other hand, a trust may not permit a trustee to hold an interest in a closely held business or may direct a trustee to retain such an interest that should be sold due to changes in the financial condition of the business.

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It may be desirable to move a trust to a jurisdiction permitting "silent trusts" or appoint a trust protector or director to receive accountings and trust information to avoid notifications to certain beneficiaries if the trustee believes the beneficiaries, contrary to the settlor's wishes, would become overly dependent on the trust.

A trust may contain unclear provisions regarding resignation, removal, and appointment of trustees, or may contain no provision whatsoever regarding appointment of a successor trustee in the event no named trustee is able to serve. Finally, a trust may merely contain outdated administrative provisions, or scrivener's errors may need to be addressed.

Current Nonjudicial Methods for Changing the Irrevocable Trust

Multiple nonjudicial tools are available to enable changes to irrevocable trusts. A few examples of such tools are discussed below.

Authorization Granted in the Trust Instrument

The first step in selecting the appropriate method for modifying an irrevocable trust is to carefully review the trust's terms. The trust may already contain terms that allow desired changes to be made. The trust protector or trustee may have the power to make certain changes to the trust, such as consolidating or dividing trusts, and changing the trust situs and governing law. Beneficiaries may be able to accomplish desired changes to future beneficiaries through the exercise of powers of appointment granted in the trust document.

If the settlor wants to make the trust even more flexible in the future, the drafting attorney should consider

- stating the settlor's intent as clearly as possible in the trust document;
- providing expanded distributive discretion to an independent trustee who is not related or subordinate to the beneficiaries under the provisions of Internal Revenue Code (IRC) § 672(c), to more thoroughly use decanting to modify the trust in the future;
- granting an independent trustee the ability to grant a general power of appointment

(to create estate tax inclusion and the corresponding step-up in basis);
- adding flexible trust termination provisions for the trustee or trust protector, such as in the best interest of the beneficiaries; and
- granting the trustee the ability to distribute trust principal to trust beneficiaries to allow the beneficiaries to use the basis increase under IRC § 1014, if distribution otherwise makes sense (for instance, taking into account the possible dissipation of the trust assets by a spendthrift beneficiary and the possibility of a future divorce).

Decanting under the Colorado Uniform Trust Decanting Act

In general, the goal of decanting is to make trusts more flexible to achieve the settlor's material purposes or probable intent if the settlor could have foreseen the changed circumstances that now make modification desirable.[2] Decanting is a fiduciary power exercisable only by a fiduciary, typically the trustee.[3] A trust director under a directed trust act may also be able to decant if the trust director is acting in a fiduciary capacity.[4] Decanting is premised on the trustee's ability to make discretionary principal distributions to or for the benefit of the beneficiaries and cannot be accomplished if the fiduciary has no power to distribute principal.[5]

Decanting does not usually require court approval or beneficiary approval.[6] Because decanting is viewed as a fiduciary power to modify the first trust, it can be accomplished either by modifying the terms of the first trust or by distributing trust assets to a new trust (the second trust).[7] A trustee cannot decant a wholly charitable trust or a revocable trust (unless the revocable trust can only be revoked by the settlor with the consent of the trustee or someone holding an adverse interest).[8] A power to decant set forth in the trust instrument does not supplant or prohibit decanting under the UTDA.[9]

Notice of a proposed decanting must be given to each living settlor of the first trust, each qualified beneficiary of the first trust, each holder of a presently exercisable power of appointment over any property of the first trust, each person who has the current right to remove or replace the authorized fiduciary, all other fiduciaries of the first trust, all fiduciaries of the second trust, and the attorney general (if there is a determinable charitable interest).[10] Any person entitled to notice of a proposed decanting, any beneficiary, or any person with standing to enforce a charitable interest can apply to the court for a determination of whether the proposed decanting is permitted under the UTDA and is consistent with the relevant fiduciary duties.[11] The UTDA contains flexible representation provisions, including the ability of a parent to represent a minor or unborn child.[12]

The UTDA contains protective provisions that prohibit the authorized fiduciary from decanting if the terms of the second trust would negate a tax benefit contained in the first trust, such as a charitable or marital deduction.[13] However, a future tax benefit, such as the original goal of exclusion of a credit shelter trust from the surviving spouse's taxable estate, can be changed. Accordingly, decanting can be used to grant a general power of appointment to the surviving spouse to cause estate tax inclusion and the corresponding step-up in basis.[14] Decanting can also be used to change a grantor trust (a trust for which the settlor is considered the owner for income tax purposes pursuant to IRC §§ 671 to 677) to a nongrantor trust (if the settlor no longer wants to pay income tax on the trust income) or a nongrantor trust to a grantor trust.[15] If the first trust is an electing small business trust that is qualified to own S corporation stock, the authorized fiduciary can decant into a second trust that qualifies as a qualified subchapter S trust to hold S corporation stock.[16]

One goal of the UTDA is to prevent unintended transfer tax consequences that may arise from using another method whereby the parties involved must consent to the modification. For instance, under certain circumstances, a beneficiary receiving a reduced interest pursuant to a nonjudicial settlement to which he or she has consented may be deemed to have made a taxable gift to the other beneficiaries, but it may be possible to achieve the same result using decanting without resulting gift tax consequences due to the lack of beneficiary consent.

Decanting under Limited Distributive Discretion. "Limited distributive discretion" is a power of principal distribution that is limited to an "ascertainable" or a "reasonably definite standard."[17] An "ascertainable standard" means a standard relating to an individual's health, education, support, or maintenance as defined in specific IRC sections and applicable regulations.[18] Other examples of an "ascertainable standard" include "support in reasonable comfort"; "maintenance in health and reasonable comfort"; "support in the beneficiary's accustomed manner of living"; "education, including college and professional education"; and "medical, dental, hospital and nursing expenses and expenses of invalidism."[19] "A power to make distributions for comfort, welfare, happiness or best interests is not limited to an ascertainable standard."[20] In determining whether a distribution power is limited by an ascertainable standard, a requirement that the trustee first exhaust other income or resources is irrelevant.[21] A power to make distributions in the trustee's "sole and absolute discretion" or "as the trustee deems advisable" without any further limitation is not an "ascertainable standard."[22] A "reasonably definite standard" is a clearly measurable standard under which a holder of a power of distribution must act under IRC § 674(b)(5)(A) and applicable regulations.[23] When decanting with limited distributive discretion, "the second trusts, in the aggregate, must grant each beneficiary of the first trust beneficial interests which are *substantially similar* to the beneficial interests of the beneficiary in the first trust."[24] Accordingly, the authorized fiduciary may not materially change the dispositive provisions of the first trust.[25] If, as is common, the trust instrument provides for expanded distributive discretion for a disinterested or independent trustee, the trustee limited to ascertainable distribution standards could ask the court to appoint a disinterested or independent special fiduciary who is authorized to decant under CRS § 15-16-911 with expanded distributive discretion.[26]

Examples of administrative modifications achievable under limited distributive discretion include
- changes in trustee succession provisions.
- a change from mandatory distribution

provisions to a beneficiary at certain ages (such as a certain percentage when the beneficiary reaches the first age and the remainder when he or she reaches the second age) to permissive withdrawal provisions, so that a beneficiary with creditor problems or a beneficiary who does not want to manage the funds can choose to retain the assets in trust. The second trust cannot, however, change the ages of distribution.

- changes to a fiduciary's administrative or investment powers, including the addition of directed trust provisions.
- changes in a fiduciary.
- changes in jurisdiction or the state law governing the administration of the trust.
- trust severances, such as modifying a pot trust for children to provide for separate trusts for each child (with the same distribution standards).[27]

Decanting under Expanded Distributive Discretion. Expanded distributive discretion is "the power of distribution that is not limited to an ascertainable standard or a reasonably definite standard."[28] The authorized fiduciary has broad discretion to decant.[29] The second trust may not, however, add a new current beneficiary who is not already a current beneficiary of the first trust.[30] The second trust also cannot include a "presumptive remainder beneficiary" (sometimes referred to as a first-in-line remainder beneficiary), nor can it include a "successor beneficiary" (a beneficiary whose interest follows the interest of the presumptive remainder beneficiary) who is not a current beneficiary, a "presumptive remainder beneficiary," or a "successor beneficiary" of the first trust.[31] In addition, the second trust cannot reduce or eliminate a "vested interest."[32] "Vested interests" include a right to a mandatory distribution that is noncontingent on the date the decanting is effective; a current and noncontingent right to a mandatory distribution of income, a specified amount, or a percentage of all or a portion of the trust property; a current and noncontingent right to withdraw income, a specified amount, or a percentage of all or a portion of the trust property; a currently exercisable general power of appointment; and a right to receive a determinable portion of the trust property upon termination of the trust that is not subject to the exercise of discretion or the occurrence of a specified event that is not certain to occur.[33] "Vested interests" do not, however, include a mandatory income interest if the authorized fiduciary has the power to distribute trust principal to a different beneficiary; a mandatory right to receive payments less frequently than annually; the right to receive a principal distribution if the time for the distribution has not occurred, such as the right to distribute one-fourth of the principal to a beneficiary upon turning 35, where the beneficiary at the time of the decanting is 29; or a distribution to a remainder beneficiary if the beneficiary must survive.[34]

By way of illustration, the authorized fiduciary of the first trust can decant to

- eliminate beneficiaries.
- make a current beneficiary a "presumptive remainder beneficiary" or a "successor beneficiary."
- eliminate presumptive remainder beneficiaries and successor beneficiaries.
- make a "presumptive remainder beneficiary" a "successor beneficiary" or vice versa.
- alter or eliminate rights that are not vested.
- change the distribution standard.
- add or eliminate a spendthrift provision.
- extend the duration of the trust, subject to the applicable rule against perpetuities.
- change the jurisdiction of the trust and the law governing the administration of the trust.
- eliminate, modify, or add powers of appointment (the class of permissible appointees can be different from the beneficiaries of the first trust). A general power of appointment added to a credit shelter trust or a GST-exempt trust can be used to generate a step-up in basis if the original desired federal transfer tax savings of either type of trust is no longer needed.
- change the trustee or trustee succession provisions.
- change the trustee's powers.
- change the administrative provisions of the trust.
- add investment advisors, trust protectors, trust directors, or other fiduciaries.
- divide a trust into more than one trust.
- consolidate trusts.[35]

In addition, an authorized fiduciary with either expanded distributive discretion or limited distributive discretion, or even no ability to distribute principal, can decant into a special needs trust for a beneficiary if the authorized fiduciary believes the beneficiary may qualify for government benefits in the future based on a disability and that such an exercise of decanting power would further the purposes of the first trust. However, the second trust cannot change the remainder beneficiaries.[36]

Don't Overlook Disclaimers

For a "disclaimer funded" estate plan, consider carefully the ability of the surviving spouse to disclaim certain assets or interests to fund a credit shelter trust. One downside to this approach is the loss of step-up in basis at the death of the surviving spouse. For an estate plan with a credit shelter trust created by a mandatory marital formula, consider having the surviving spouse disclaim his or her interest in the credit shelter trust to accelerate distribution to the remainder beneficiaries.

Note that the use of disclaimers is limited in the context of many powers of appointment granted in irrevocable trusts because all of the powerholders, permissible appointees, and takers in default of appointment must disclaim within nine months after the original transfer that created the power.[37] Many permissible appointees and takers in default are not even aware of the power within nine months of the creation of the trust.

In addition, a disclaimer of an interest in a trust may not result in the interest passing to the desired beneficiary. Multiple disclaimers may be needed for the interest to pass to the desired beneficiary. And, in some circumstances, the proposed disclaimer may never achieve the desired result and thus should not take place.

Judicial Modification of Trusts

A tried and true method of modifying an irrevocable trust is obtaining court approval for the proposed modification. While there are

certainly drawbacks to seeking court approval, including time, expense, and hesitation on the part of clients (and sometimes counsel) to involve the court, there are also benefits to proceeding in this way. For example, a court order approving a modification adds certainty that the modification is valid and effective, may be necessary for tax purposes, and will help shield the trustee from breach of fiduciary duty claims stemming from the modification. And in some cases, going to court may be the only way to achieve the desired result.

Modification under the Colorado Uniform Trust Code

The following sections discuss various aspects of trust modifications and terminations under the Colorado Uniform Trust Code (CUTC), most of which require court approval. The grounds for modification and procedural considerations related to modification actions are addressed.

The CUTC Framework

The CUTC, signed into law on April 25, 2018 and effective January 1, 2019, sets forth multiple grounds for modifying irrevocable trusts. Some of these grounds currently exist in the Colorado Probate Code, and others are codified for the first time in Colorado law, including certain grounds from the common law that have long been relied on by Colorado practitioners. The grounds for modification discussed below are all found in Part 4 of the CUTC, which contains most of the provisions directly addressing trust modification, the majority of which require court approval.

In addition to grounds for modification, the CUTC contains multiple other provisions relating to trust modification and trust modification actions, including provisions addressing virtual representation, notice, jurisdiction and venue, definitions of relevant terms, and nonjudicial settlement agreements. While some of these provisions are addressed below, discussion of all of them is beyond the scope of this article, which focuses primarily on the grounds for modification found in the CUTC because the grounds are arguably the most important consideration in a modification action. After all, one of the first steps in any modification action is ensuring that there is a legal basis for the court to approve the proposed modification.

CRS § 15-5-410: Modification or Termination of Trust—Proceedings for Approval or Disapproval

CRS § 15-5-410 provides that, in addition to the other methods and grounds for modification provided for in the CUTC, a trust will terminate to the extent that (1) it is revoked or expires by its terms; (2) no purpose remains to be achieved; or (3) its purposes have become unlawful, contrary to public policy, or impossible to achieve. The comments to the Uniform Trust Code (UTC) clarify that trust terminations under this section can be either in whole or in part.[38] In addition, the withdrawal of all property from a trust is not an event of termination under this section. Instead, the trust will continue even though the trustee will not have any duties unless and until additional property is added to the trust.[39]

This section also provides that a proceeding to approve or object to a proposed trust termination or modification under Part 4 of the CUTC may be brought by either a trustee or a beneficiary of the trust and may be brought even if court approval is not required under the CUTC.[40]

This section is new and does not have a corresponding section in the Colorado Probate Code.

CRS § 15-5-411: Modification or Termination of Noncharitable Irrevocable Trust by Consent

CRS § 15-5-411 allows the court to approve a modification or termination of a trust both where the modification or termination is inconsistent with a material purpose of the trust and where it is not inconsistent with a material purpose.

While what constitutes a material purpose depends on the trust at issue, a material purpose must be something of significance, and a finding that a trust no longer serves a material purpose does not mean that the trust has no remaining purpose. As explained in the *Restatement (Third) of Trusts* § 65 cmt. d, finding a material purpose of a trust "generally requires some showing of a particular concern or objective on the part of the settlor, such as concern with regard to the beneficiary's management skills, judgment, or level of maturity." A court, therefore, "may look for some circumstantial or other evidence indicating that the trust arrangement represented to the settlor more than a method of allocating the benefits of property among multiple beneficiaries, or a means of offering to the beneficiaries . . . a particular advantage. Sometimes, of course, the very nature or design of a trust suggests its protective nature or some other material purpose."[41] Under CRS § 15-5-411, a spendthrift clause is not per se a material purpose of a trust.

When the proposed modification or termination is inconsistent with a material purpose, the court shall nonetheless approve the modification or termination if the settlor and all beneficiaries consent. The settlor's consent may be given by (1) the settlor himself or herself; (2) the settlor's agent under a power of attorney, if expressly authorized by the power of attorney or trust agreement; (3) the settlor's conservator, where there is no agent who is authorized to give consent, if approved by the court; or (4) the settlor's guardian, where there is no agent or conservator, if approved by the court. While the comments to this section explain that the settlor's participation in modification or termination under this section is not considered a taxable power under Treasury Regulation 20-2038-1(a)(2),[42] this view may not be universally shared by practitioners. Were it to become an issue with respect to a given modification, the tax impacts of the settlor's actions would be decided as a matter of federal tax law, not Colorado trust law.

When the court concludes that the proposed modification is not inconsistent with a material purpose, the court may approve the modification if it finds that all beneficiaries have consented, regardless of whether the settlor has also consented. Similarly, a trust may be terminated with the consent of all beneficiaries (regardless of settlor involvement) if the court concludes that continuation of the trust is not necessary to achieve a material purpose. Although settlor consent is not required under these circumstances, a court might nonetheless consider a settlor's objection to the proposed modification or termination to be significant when determining whether to approve the modification.

If not all beneficiaries consent to a proposed modification or termination, either because a beneficiary objects or because consent is otherwise unable to be obtained, the court may still approve the modification or termination if it is satisfied that the trust could have been modified or terminated if all beneficiaries had consented and the interests of a non-consenting beneficiary are adequately protected. In protecting the interests of non-consenting beneficiaries, the court has a number of options available to it, for example, entering an order that requires the partial continuation of the trust, the purchase of an annuity, or the valuation and pay out of the beneficiary's interest in the trust.[43]

Upon termination under this section, the trust property shall be distributed as agreed by the beneficiaries. There will be no gift tax consequences from the termination if the beneficiaries agree to distribute the property in accordance with the value of their proportionate interests in the trust.[44]

This section is new and does not have a corresponding section in the Colorado Probate Code. However, it does codify principles from the *Restatement* that practitioners commonly use to achieve trust modifications and terminations. The provisions addressing modifications and terminations that are inconsistent with a trust's material purpose are similar to *Restatement (Second) of Trusts* § 338(2) and *Restatement (Third) of Trusts* § 65(2). The provisions addressing modifications and terminations that are not inconsistent with a material purpose are similar to *Restatement (Third) of Trusts* § 65(2), although the *Restatement* goes further: The *Restatement* also allows beneficiaries to compel termination of a trust that still serves a material purpose if the reasons for termination outweigh the material purpose, and it allows the beneficiaries to remove the trustee by way of trust modification if the removal is not inconsistent with a material purpose of the trust.[45]

Although the grounds for modification in this section are not new to Colorado practitioners, the codification of them in the CUTC provides certainty that they are proper grounds for modification and termination of irrevocable trusts and also answers procedural questions about their use. For example, while the *Restatement* is silent on this point, it is now clear that court approval is required for modifications and terminations on the basis of beneficiary consent.

> "In addition to grounds for modification, the CUTC contains multiple other provisions relating to trust modification and trust modification actions, including provisions addressing virtual representation, notice, jurisdiction and venue, definitions of relevant terms, and nonjudicial settlement agreements."

CRS § 15-5-412: Modification or Termination Because of Unanticipated Circumstances or Inability to Administer Trust Effectively

Under CRS § 15-5-412, the court may terminate a trust or modify its administrative or dispositive provisions if modification or termination will further the purposes of the trust because of circumstances not anticipated by the settlor. To the extent practicable, a modification under this section must be in accordance with the settlor's probable intention. The court may also modify a trust's administrative terms if continuation of the trust on the existing terms would be impracticable, wasteful, or impair the administration. Upon termination under this section, the trust property shall be distributed in a matter that is consistent with the purposes of the trust.

As with CRS § 15-5-411, while this section is new and does not have a corresponding section in the Colorado Probate Code, it does codify principles that practitioners already commonly use to achieve trust modifications and terminations. In particular, this section codifies the doctrine of equitable deviation and is similar to *Restatement (Third) of Trusts* § 66(1). The provisions allowing for modification because a trust's existing terms are impracticable, wasteful, or would impair the administration of the trust are similar to modification under the cy pres doctrine.[46] Both *Restatement* § 66 and the cy pres doctrine have been discussed with approval by Colorado courts.[47]

Modification or termination under the doctrine of equitable deviation is allowed to effectuate the settlor's intent and purpose, not to disregard it. For example, a beneficiary's financial circumstances or health may have changed, or a beneficiary may have become incapacitated, and modification of the dispositive provisions may be appropriate to better carry out the settlor's intent with respect to support of that beneficiary. The *Restatement* provides many other examples of circumstances where equitable deviation may be appropriate.[48] For this section to apply, the circumstances justifying termination or modification under equitable deviation do not have to be completely new and may have been in existence at the time the trust was

created, but they nonetheless must not have been anticipated by the settlor.[49]

CRS § 15-5-413: Cy Pres

CRS § 15-5-413 gives the court the power to modify or terminate a charitable trust if a particular charitable purpose of the trust becomes unlawful, impracticable, impossible to achieve, or wasteful. In the event that it does, the trust will not fail and the property will not revert to the settlor; instead, the court may use cy pres to modify or terminate the trust by directing that all or a portion of the property be applied or distributed in a manner consistent with the settlor's charitable purposes. This section presumes that the settlor had a general charitable intent that can be fulfilled even if the trust's particular charitable purpose becomes impracticable or impossible to achieve.[50] "Charitable purpose" is defined in CRS § 15-5-405(1) as "the relief of poverty; the advancement of education or religion; the promotion of health, governmental or municipal purposes; or other purposes the achievement of which is beneficial to the community."

To the extent that the trust includes a provision that would result in the distribution of property to a noncharitable beneficiary, this section provides that such a provision prevails over the court's power to modify or terminate the trust only if when the provision takes effect, the property is to revert to the settlor, the settlor is still living, and the trust has been in existence for less than 21 years.

While the cy pres doctrine was not codified in the Colorado Probate Code, as discussed above, it has previously been recognized by Colorado courts and is regularly used by Colorado practitioners.

CRS § 15-5-414: Modification or Termination of an Uneconomic Trust

CRS § 15-5-414 allows for the modification or termination of a trust, either with or without court involvement, if the value of the trust is insufficient to justify the cost of administration.

The trustee may terminate a trust with a total value of less than $100,000 if he or she determines that the value of the property is insufficient to justify the cost of administration and after notice to qualified beneficiaries.[51] However, simply because the trustee may terminate the trust under this section doesn't mean that he or she must. Even if the value of the trust is less than $100,000, continuation of the trust may be prudent given the trust's purposes, for example, to protect the assets from mismanagement by a beneficiary.[52] The settlor may also specify a value other than $100,000 at which the trust becomes uneconomic and may also prohibit termination without a court order.[53]

This section also provides that the court may modify or terminate the trust, or remove the trustee and appoint a different trustee, if it determines that the value of the trust is insufficient to justify the cost of continued administration. Court termination under this section may be used even if the value of the trust is larger than $100,000 if the settlor provides for a different threshold in the trust agreement.[54]

This section is new and does not have a corresponding section in the Colorado Probate Code.

CRS § 15-5-415: Reformation to Correct Mistakes

Under CRS § 15-5-415, the court may reform the terms of a trust to conform to the settlor's intent if it is proved by clear and convincing evidence that the settlor's intent and the terms of the trust were affected by a mistake of fact, whether in expression or inducement. Reformation is allowed under this section even if the terms of the trust are unambiguous.

A mistake in expression is often caused by a scrivener's error and is one in which the terms of the trust misstate the settlor's intent, do not include a term that was intended to be included, or include a term that was not intended to be included. A mistake in inducement, on the other hand, is one in which the terms of the trust accurately express what the settlor intended, but the settlor's intent was based on a mistake of fact or law. This type of error is often caused by the settlor, not the scrivener.[55]

Reformation of a trust under this section is not the same as interpretation of an ambiguous trust. Whereas an interpretation action involves interpreting the language of the trust as written, a reformation action may involve adding new language to the trust or deleting existing language to conform the trust to the settlor's intent.[56] As a result, the use of extrinsic evidence of the settlor's intent is essential even if it is contrary to the plain meaning of the trust terms, as the action may result in the trust terms being changed. The higher standard of clear and convincing evidence, as opposed to the preponderance of the evidence standard that typically applies in civil actions, must be met before the trust terms can be changed to help guard against unreliable or untrustworthy evidence.[57]

This section is substantially identical to CRS § 15-11-806 of the Colorado Probate Code, and that section will no longer apply to trusts once the CUTC is effective. Current CRS § 15-11-806 has been discussed in three Colorado appellate decisions,[58] and those decisions will remain useful in interpreting new CRS § 15-5-415. The new section, along with the current section, is based on *Restatement (Third) of Property: Donative Transfers* § 12.1, which provides multiple examples of cases where reformation was used.[59]

CRS § 15-5-416: Modification to Achieve Settlor's Tax Objective

CRS § 15-5-416 allows a court to modify a trust in a manner that is not contrary to the settlor's probable intention to achieve the settlor's tax objectives. The court may provide that the modification is effective retroactively. While the modification of a trust under this section is a question of state law, whether the modifications will be recognized for federal tax purposes is a question of federal law.[60]

This section is substantially identical to CRS § 15-11-807 of the Colorado Probate Code, and that section will no longer apply to trusts once the CUTC is effective. There are currently no published Colorado opinions discussing CRS § 15-11-807. The new section, along with the current section, is based on *Restatement (Third) of Property: Donative Transfers* § 12.2, which provides multiple examples of cases where modification to achieve tax objectives was used.[61]

CRS § 15-5-417: Combination and Division of Trusts

As with the termination of an uneconomic trust under CRS § 15-5-414, CRS § 15-5-417 also allows

a trustee to act without court involvement to modify a trust. This section provides that, after notice to qualified beneficiaries, the trustee may either combine two or more trusts into a single trust or divide a single trust into two or more trusts if the result does not impair the rights of any beneficiary or adversely affect the achievement of the trust's purposes. The rule in this section is a default rule that may be overridden by the trust's terms.[62]

Combining trusts under this section may promote efficiencies in the administration of the trusts, for example, by reducing the total amount of administration and trustee fees incurred for the trusts.[63] Dividing a trust may also promote efficiencies and reduce conflict in the administration of the trust, for example, by allowing for different investment strategies for different groups of beneficiaries or addressing the different distribution needs of beneficiaries of a pot trust. Division may also allow the trustee to maximize exemptions available under federal generation-skipping transfer tax rules.[64]

While the terms of the combined and divided trusts do not have to be identical, significant differences may make it more likely that the combination or division will either impair the rights of a beneficiary or adversely affect the achievement of one of the trust's purposes, and thus not be allowed. This is particularly true when there are significant differences in the dispositive provisions.[65]

Although approval by the qualified beneficiaries or the court is not required under this section (only notice to the beneficiaries is required), obtaining consent from either the court or the beneficiaries or both may nonetheless be prudent. This is particularly true the more differences there are in the terms of the combined or divided trusts. Obtaining such consent will help ensure that the combination or division is proper and help guard against breach of fiduciary duty claims.[66]

The Colorado Probate Code currently provides for the combination and division of trusts in CRS § 15-16-401, and the current section is repealed once the CUTC is effective. While similar to the new section, the current section differs in that it requires court approval of the proposed combination or division after notice and a hearing and for good cause shown. In considering whether good cause exists, the court will look at whether the combination or division (1) is consistent with the settlor's intent, (2) would facilitate administration of each trust, and (3) would be in the best interests of the beneficiaries and would not materially impair their interests.[67] There are currently no published Colorado opinions discussing CRS § 15-16-401. The new section is similar to *Restatement (Third) of Trusts* § 68, which provides examples of cases addressing the combination and division of trusts.[68]

Procedural Considerations

A court action to approve the modification or termination of an irrevocable trust must be filed in a court with jurisdiction over the matter and in a county where venue is proper. Part 2 of the CUTC governs judicial proceedings in trust matters and sets forth the rules for jurisdiction and venue. The jurisdiction and venue provisions in the CUTC will, in the large majority of cases, lead to the same result as the jurisdiction and venue provisions currently in the Colorado Probate Code.[69]

With respect to jurisdiction, the CUTC provides that the Denver Probate Court and the district court in counties other than Denver County have subject matter jurisdiction over, among other things, trust modification and termination matters.[70] The courts also generally have personal jurisdiction over the trustees and beneficiaries of a trust with its principal place of administration in Colorado.[71] With respect to venue, the CUTC sets forth the rules for determining where the action should be brought.[72] Venue will generally lie first in the county specified in the trust, if that county has a substantial relationship to the trust administration. If no county is specified, venue will lie in the county in which the trust is registered. If the trust is not registered, venue will lie in the county of the principal place of administration. And if the trust was created by a will, venue will lie in the county in which the decedent's estate is administered.

Another important consideration in any trust modification matter is ensuring that all of the necessary parties are before the court and have received notice. In a court action to approve a trust modification, notice must be provided to interested persons pursuant to CRS § 15-10-401 or, if applicable, the Colorado Rules of Civil Procedure. Typically, notice is provided directly to the interested person by mail or to the interested person's attorney either by mail or through the Colorado Courts E-Filing system. If notice of a proceeding is not properly given to the correct persons, grounds may exist to object to or set aside the modification.

One important change to current law under the CUTC is to the class of persons who must be provided notice of a trust modification proceeding.[73] As mentioned above, certain grounds for modification require notice to qualified beneficiaries rather than to all beneficiaries.[74] Under CRS § 15-5-103(16), a "qualified beneficiary" is one who, on the relevant date, is a distributee or permissible distributee of the trust or who would be next in line if the interests of the current distributees terminated. The definition of "interested person" in the CUTC also incorporates the qualified beneficiary concept, defining "interested person" to include qualified beneficiaries and others with a property right in or claim against the trust that may reasonably and materially be affected by the proceeding. Interested persons under the CUTC also include the trustee and others with authority to act under the trust.[75] The CUTC definition of interested person and its qualified beneficiary concept narrows the class of persons who are entitled to notice from the broader class of beneficiaries under current law. Under CRS § 15-10-201(27), the definition of "interested person" includes all beneficiaries, not just qualified beneficiaries, and others with a property right in or claim against the trust that may be affected by the proceeding, not just those whose rights or interests will be affected in a reasonable and material way.[76]

In connection with ensuring that all interested persons are provided notice and are before the court, practitioners should also consider whether any interested person is unable to receive notice of or consent to the modification proceeding and, as a result, needs a representative to represent his or her interests. Because notice to or consent by beneficiaries is required in trust modification proceedings

under Part 4 of the CUTC, it is not uncommon for this issue to arise, particularly because many trusts have minor beneficiaries or a class of remainder beneficiaries that includes minor, unborn, or unascertained beneficiaries who are unable to receive notice or give consent on their own. When representation is required, practitioners should consult Part 3 of the CUTC, which sets forth the relevant provisions. One important change to the current law is that virtual representation is binding under the CUTC even without a court order,[77] whereas a court order is currently required for virtual representation to be binding in trust modification actions brought under the Colorado Probate Code.[78]

Under certain circumstances, a petition or motion to approve a trust modification may be set on the court's nonappearance docket pursuant to Colorado Rule of Probate Procedure 8.8. If set on the nonappearance docket, the time to object is shortened to 14 days and, assuming no objections are filed and the court is in agreement, the court may approve the modification without a hearing. Generally speaking, use of the nonappearance docket is appropriate when the action is routine and expected to be unopposed, for example, when all of the beneficiaries have consented to the modification.[79]

> "The CUTC definition of interested person and its qualified beneficiary concept narrows the class of persons who are entitled to notice from the broader class of beneficiaries under current law."

Modification of Trusts Using Settlement Agreements

Another common method to achieve a trust modification or termination is through a settlement agreement. The parties to a dispute may agree to modify the terms of a trust as part of a settlement of the dispute. While the parties have significant leeway to craft a settlement that best meets their needs, a trust modification included as part of a settlement agreement should be one that is otherwise allowable.

If a trust modification is included as part of a settlement, care should be taken to ensure that all persons whose interests are impacted by the modification are parties to the settlement agreement, even if they are not otherwise parties to the dispute. The persons who must be parties to the settlement agreement will depend on the specific matters covered by the agreement and the terms of the agreement. As a general rule, those persons will almost certainly include the trustee, and possibly a successor trustee depending on the terms, and the beneficiaries. However, depending on the specifics of the agreement, some beneficiaries may not need to be parties, for example, if the trust has multiple shares and the settlement agreement only concerns one of the separate shares. Ensuring that all necessary persons are parties to a settlement agreement is similar to ensuring that all necessary parties receive notice of a court action to approve a modification, and the considerations involving interested persons and representation discussed above also apply here.

Although not required for the agreement to be valid and binding, the parties may wish to seek court approval of the settlement agreement. Advantages to seeking court approval include (1) the order approving the agreement is, like any other court order, binding on all persons who receive notice of the proceeding to approve the agreement; (2) the court can order that virtual representation applies to the agreement to the extent applicable;[80] and (3) a settlement agreement approved as a court order will have the same force and effect as any other court order.

Nonjudicial Settlement Agreements

After the effective date of the CUTC, nonjudicial settlement agreements may also be used to effectuate a trust modification.

Nonjudicial settlement agreements are addressed in CRS § 15-5-111 of the CUTC, which provides that any person may enter into a nonjudicial settlement agreement with respect to any matter involving a trust. Unlike with a typical settlement agreement, this section provides that a nonjudicial settlement agreement does not have to be supported by consideration to be valid.

A nonjudicial settlement agreement entered into under CRS § 15-5-111 may address a variety of matters, including

- trust interpretation and construction;
- approval of an accounting or trustee's report;
- directions to the trustee, including directing the trustee to refrain from performing a power, or granting the trustee a necessary or desirable power;
- a trustee's resignation or appointment;
- trustee compensation; and
- the trustee's liability for an action relating to the trust.

While trust modification is not specifically enumerated in this list, the list is not intended to be exhaustive. The language of the section itself and the comments to the corresponding UTC section suggest that a trust modification or termination can be achieved using a nonjudicial settlement agreement so long as it is otherwise proper and allowable. For example, CRS § 15-5-111(3) provides that a valid nonjudicial settlement agreement is one that does not violate a material purpose of the trust and includes terms and conditions that could properly be approved by the court. Similarly, the comments to UTC § 111 explain that a nonjudicial settle-

ment agreement cannot be used to achieve a result that is not otherwise authorized by law, for example, a modification or termination of a trust on impermissible grounds.

As with other settlement agreements, care should be taken to ensure that the necessary persons are parties to the nonjudicial settlement agreement. CRS § 15-5-111 provides that the parties to a nonjudicial settlement agreement must include those persons whose interests in the trust would be materially affected by the agreement if the agreement were to be approved by the court at the time it was entered into. As a general rule, and as with other settlement agreements, those persons will almost certainly include the trustee, and possibly a successor trustee depending on the terms, and the beneficiaries. However, depending on the specific terms of the agreement, some of the beneficiaries may not need to be parties, for example, if the trust has multiple shares and the settlement agreement only concerns one of the separate shares. If any of the necessary persons are minors, unborns, or unascertained persons, they may be bound to the agreement by virtual representation, consent of a guardian ad litem, and similar concepts of representation set forth in Part 3 of the CUTC. As discussed above, such representation is binding under the CUTC even without court approval.[81]

As the name suggests, court approval is not required for a nonjudicial settlement agreement to be valid and binding. However, CRS § 15-5-111 specifically provides that any person whose interest in the trust may be affected by the agreement may bring the agreement to the court and ask the court to (1) approve or disapprove the agreement, (2) determine whether any virtual representation or other representation (for example, by a conservator or guardian) was adequate, or (3) determine whether the agreement contains terms and conditions that the court could have properly approved. In addition, court approval may be desirable for the same reasons that court approval of other settlement agreements may be desirable.

Protecting the Irrevocable Trust from Future Changes

Some settlors of irrevocable trusts desire to limit future changes to the trust rather than providing for future flexibility. A clear expression of the settlor's intent can limit the ability of the trustee and beneficiaries to modify the trust in the future. Some settlors may even choose to make a strong statement in the trust instrument against modification, regardless of what can be accomplished under state law. For instance, the settlor may choose to expressly prohibit

decanting to avoid application of any state decanting statute or common law. The settlor may also choose to expressly prohibit a nonjudicial settlement without court approval. Even if such restrictions on the trustee's or beneficiaries' ability to make changes are contained in the trust document, the settlor may nonetheless include a reference to a "letter of wishes" in the document to make suggestions to the trustee regarding future distribution goals.

Conclusion

The term "irrevocable trust" is something of a misnomer because irrevocable trusts are capable of relatively routine modification. And with the enactment of the UTDA and CUTC, the trend in Colorado, as elsewhere, is toward allowing even more flexibility with irrevocable trusts. Practitioners should therefore keep the options for modification in mind at all stages of working with trusts, including when advising settlors on the creation of the trust and when advising trustees and beneficiaries on matters of trust administration. CL

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NOTES

1. *But see* CRS § 15-16-903(6).
2. UTDA Prefatory Note (Unif. Law Comm'n, 2015), www.uniformlaws.org/shared/docs/trustdecanting/UTDA_Final%20Act.pdf.
3. *See, e.g.*, CRS §§ 15-16-902(3) and -904(1); UTDA Prefatory Note; and UTDA § 4 cmt.
4. *See, e.g.*, CRS § 15-16-902(3); UTDA Prefatory Note.
5. CRS §§ 15-16-902(3)(a), -911(2), and -912(1) to (2).
6. CRS §§ 15-16-907(2) and -909.
7. CRS § 15-16-902(10).
8. CRS § 15-16-903(1)(b) and (2).
9. CRS § 15-16-903(4) and (5).
10. CRS § 15-16-907(3).
11. CRS § 15-16-909(1).
12. CRS § 15-16-908.
13. CRS § 15-16-919(2).
14. *See* CRS § 15-16-919(2)(h); UTDA § 19 cmt.
15. CRS § 15-16-919(2)(i).
16. CRS § 15-16-919(2)(d).
17. CRS § 15-16-912(1).
18. CRS § 15-16-902(2).
19. UTDA § 2 cmt.
20. *Id.*
21. *Id.*
22. *Id.*
23. CRS § 15-16-902(21).
24. CRS § 15-16-912(3) (emphasis added).
25. UTDA § 12 cmt.
26. CRS § 15-16-909; UTDA § 9 cmt.
27. *See* CRS § 15-16-912; UTDA § 12 cmt.
28. CRS § 15-16-902(11).
29. CRS § 15-16-911(2).
30. CRS § 15-16-911(3)(a).
31. CRS § 15-16-911(3)(b).
32. CRS § 15-16-911(3)(c).
33. CRS § 15-16-911(1)(d).
34. *See* CRS § 15-16-911(1)(d); UTDA § 11 cmt.
35. *See* CRS §§ 15-16-911(2) and (6); UTDA § 11 cmt.
36. CRS § 15-16-913(2).
37. Treas. Reg. § 25.2518-2(c)(3).
38. UTC § 410 cmt.
39. *Id.*
40. *Id.*
41. *Restatement (Third) of Trusts* § 65 cmt. d; UTC § 411 cmt.
42. UTC § 411 cmt.
43. *Id.*
44. *Id.*
45. *Id.*
46. UTC § 412 cmt.
47. *See, e.g., Saunders v. Muratori*, 251 P.3d 550 (Colo.App. 2010); *Denver Found. v. Wells Fargo Bank, N.A.*, 140 P.3d 78 (Colo.App. 2005); *In re Estate of Vallery*, 883 P.2d 24 (Colo.App. 1993).
48. UTC § 412 cmt.
49. *Id.*
50. UTC § 413 cmt.
51. While the concept of qualified beneficiaries is also used in the UTDA, it is relatively new to Colorado law and is discussed in more detail below.
52. UTC § 414 cmt.
53. *Id.*
54. *Id.*
55. UTC § 415 cmt.
56. *Id.*
57. *Id.*
58. *Baker v. Wood, Ris & Hames, P.C.*, 364 P.3d 872 (Colo. 2016); *In re Estate of Ramstetter*, 411 P.3d 1043 (Colo.App. 2016); *In re Estate of Johnson*, 304 P.3d 614 (Colo.App. 2012).
59. UTC § 415 cmt.
60. UTC § 416 cmt.
61. *Id.*
62. UTC § 417 cmt.
63. *Id.*
64. *Id.*
65. *Id.*
66. *Id.*
67. CRS § 15-16-401.
68. UTC § 417 cmt.
69. *See* CRS §§ 15-10-201(10), 15-16-201, and 15-16-202.
70. CRS §§ 15-5-201 and -203.
71. CRS § 15-5-202.
72. CRS § 15-5-204.
73. Although the CUTC does not specifically provide that the definition of "interested person" contained therein supersedes the Colorado Probate Code's current definition of "interested person" for purposes of trust modification proceedings, CRS § 15-5-106 provides that, in the absence of a contrary provision in the CUTC, the principles of equity, the common law, and other state statutes continue to apply. Because the CUTC does provide a definition of "interested person," the implication of CRS § 15-5-106 is that this definition applies to proceedings under the CUTC.
74. *See* the discussion of decanting under the UTDA and CRS §§ 15-5-414 and -417.
75. CRS § 15-5-103(10).
76. The definition of "interested person" in CRS § 15-10-201(27) will continue to apply to proceedings that are not governed by the CUTC.
77. CRS § 15-5-301.5.
78. CRS § 15-10-403.
79. CRPP 8.8.
80. As noted above, the CUTC provides that virtual representation is binding in trust actions even without court approval.
81. UTC § 111 cmt.