



What if beneficiaries and a trustee are the victims of the trust from hell? Suppose that in the jurisdiction where the trust currently has its situs

- the state updates its trust laws every 25 years, whether they need it or not,
- the trust annually must pay a 10% state income tax on its accumulated ordinary income and realized capital gains,
- the spendthrift clause is as leaky as a sieve,
- the trustee must file costly and unproductive court accountings every two years, and
- the auditing judge is in jail by the time of the next accounting.

Can the trust be moved to a more favorable jurisdiction? The answer is an emphatic—it depends!

This article begins by listing reasons why beneficiaries might want to change the trustee, governing law, or situs of a trust and the potential roadblocks. Next, it discusses which state's law governs various issues affecting trusts, describes how the relocation of a trust might be accomplished, and focuses on particular issues that might cause beneficiaries to explore moving a trust. Finally, it alerts attorneys to some federal transfer-tax pitfalls.

Reasons to Move and Roadblocks to Moving a Trust

For the 2006 Heckerling Institute, the author assembled a panel that consisted of Carol A. Johnston, Los Angeles, California; Joshua S. Rubenstein, New York, New York; and W. Donald Sparks II, Wilmington, Delaware, to discuss "The Nuts and Bolts of Changing the Situs of a Trust." With input from the other panelists, Sparks compiled a list of the top 10 (actually 13) reasons why trust beneficiaries investigate moving a trust and a list of the top 10 roadblocks to such a move. In descending order of frequency, the most common

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Andrew O. Alcalá

The Trust *from* **HELL** Can It Be Moved to a Celestial Jurisdiction?

By Richard W. Nenno

reasons why beneficiaries explore moving a trust are

- to address dissatisfaction with the current corporate trustee (whether or not a purported breach of trust is involved),
- to avoid state income tax on the trust's accumulated ordinary income and capital gains,
- to improve the trust's investment performance (because a new trustee will provide better investment results, for example, or because a change of governing law will enable a co-trustee or adviser to direct investments),
- to reduce fees and administrative costs (including accounting costs),
- to consolidate trusts at a single location,
- to reform the terms of the trust,
- to convert an income trust to a total-return unitrust,
- to obtain more effective creditor protection for beneficiaries,
- to extend the trust's duration,
- to avoid burdensome state regulatory requirements (usually on charitable trusts),
- to take advantage of a virtual-representation statute to avoid the appointment of a guardian or trustee ad litem to represent unknown or minor beneficiaries in a court proceeding,
- to use a statute that offers more grounds for removing a trustee, or
- to qualify for diversity jurisdiction so that a dispute may be litigated in federal district court.

In descending order of frequency, the most common roadblocks to moving a trust are

- lack of agreement among the beneficiaries,
- lack of appropriate language in the governing instrument,
- court intervention (refusal of a court to permit the move, for example, or excessive cost of a court proceeding),
- fee issues (for example, principal termination fee for current trustee, excessive fees of new trustee),
- uncooperative co-trustees,

- accounting requirements and liability issues (releases and indemnifications, for example),
- choice-of-law issues,
- conflict-of-interest issues,
- involvement of guardian or trustee ad litem who objects to the move, or
- inability to terminate all ties to the original jurisdiction.

What Law Applies?

Moving the situs or place of administration of a trust from one state to another does *not* automatically result in a change in the law that applies. Thus, if the governing instrument provides that the validity, construction, and administration of the trust will be governed by the law of a specific state, moving the trust will not change the applicable law. But if the governing instrument provides that the trust will be governed by the law of the state where the trust is administered or has its situs, moving the trust is worth exploring.

If the governing instrument is silent regarding the law that will apply if the trust is moved, then a conflict-of-laws analysis must be performed. According to sections 267 to 282 of the *Restatement (Second) of Conflict of Laws*, that analysis depends on whether the question at issue involves trust validity, construction, or administration; whether the trust is an inter vivos trust or a testamentary trust; and whether the issue involves personal property or real property. Questions involving the "validity" of trust provisions relate to matters such as whether the trust violates the rule against perpetuities or the rule against accumulations. Questions involving the "construction" of a trust relate to matters such as the identity of the beneficiaries, their respective interests, and, in most cases, allocations between principal and income. Questions of trust "administration" involve matters such as the powers and duties of the trustee, trust investments, compensation of the trustee and its right to indemnity, liability for breach of trust, and the power of the beneficiaries to terminate the trust.

If the governing instrument is silent and if the question involves personal property:

- matters of validity typically are determined, in the case of a testamentary trust, by the law of the state of the testator's domicile at death and, in the case of an inter vivos trust, by the law of the state with which, for the matter at issue, the trust has its most significant relationship;
- matters of construction typically are determined, in the case of a testamentary trust or an inter vivos trust, by the law of the state that the client probably would have desired to be applicable; and
- matters of administration typically are determined, in the case of a testamentary trust, by the law of the state in which the trust is to be administered and, in the case of an inter vivos trust, by the law of the state to which the administration of the trust is most substantially related.

If the governing instrument is silent and if the question involves an interest in real property, questions involving the validity, construction, and administration of a trust, testamentary or inter vivos, generally are resolved under the law that would be applied by the courts of the state where the real property is located.

Delaware courts have looked to a number of factors to determine what governing law should apply in interpreting or administering trusts. These factors include the location of the trustee, the place where the assets in the trust are held, any governing law provisions set forth in the trust instrument, the domicile of the testator (in the case of a testamentary trust) or the domicile of the trustor (in the case of an inter vivos trust), and the location of the beneficiaries of the trust. In Delaware cases that involve inter vivos trusts, in the absence of an explicit governing law provision, courts have tended to emphasize the location of the trustee and the location

of the administration of the trust as the most significant factors in determining the nexus for the application of the appropriate governing law. See *Lewis v. Hanson*, 128 A.2d 819, 826 (Del. 1957), *aff'd sub nom. Hanson v. Denckla*, 357 U.S. 235 (1958).

Section 615 of the Scott treatise describes the effect of a trust move that brings about a change in the law that governs its administration:

Although a change in the place of administration is authorized, any resulting change in the applicable law will presumably include only matters of administration. The law of the new place of administration will probably be applicable to the compensation of the trustee, the scope of permissible investments, and the powers and duties of the trustee. On the other hand, the change in the place of administration will not affect those matters that pertain to the disposition of the trust property. Thus the change in the place of administration will not affect the determination of who are the beneficiaries of the trust or probably the allocation of receipts and expenses to income or principal. Presumably as to these matters the settlor or testator did not intend to make applicable the law of the place of administration nor did he intend to change the applicable law merely because he permitted a change in the place of administration.

Effecting the Move

The transfer of a trust's situs or place of administration from one state to another might be accomplished through an express provision in the trust instrument, a pertinent statute, or a court petition. If the governing instrument provides for the removal and replacement of the trustee without the necessity of a court proceeding, the nomination of a trustee in the more favorable state might be sufficient in itself to accomplish the transfer of the situs. Similarly, the governing instrument might confer powers of appointment that the beneficiaries

may exercise in a way that will accomplish the transfer of situs without court intervention. Frequently, however, the governing instrument is silent on the issues of removal, resignation, and replacement or does not contain powers of appointment. In such a case, the beneficiaries must either obtain the trustee's agreement to resign or convince the local probate court to remove the trustee. In this connection, a local statute (such as one based on Uniform Trust Code (UTC) § 706) might provide a court with a basis for removing a trustee.

To move a trust in conjunction with the resignation or removal of a trustee, the beneficiaries or the trustee must file a petition (often accompanied by an accounting) in the local probate court. In many instances, it also is necessary to file a petition in a court in the new state seeking the court's approval of the transfer of situs and acceptance of jurisdiction over the trust before the proceeding in the local probate court. Thus, the local court knows of the new trustee's willingness to serve and the new court's acceptance of jurisdiction on the local court's approval of transfer.

The means by which the trust is moved may have a bearing on which of the more favorable state's benefits can be made available. Thus, in one case, it might be possible to get perpetual duration, no state income taxation, avoidance of accounting requirements, effective spendthrift protection, a favorable total-return unitrust law, reduction in administrative costs, and a direction investment adviser. In another case, however, it might not be possible to get one or more of these benefits.

Generally, courts will permit a trust to be moved if the trust instrument does not express a contrary intent, the administration of the trust will be facilitated, and the interests of the beneficiaries will be promoted. See *In re Estate of McComas*, 165 Misc. 2d 947, 948 (Surr. Ct. 1995). Trustees and beneficiaries should not assume, though, that courts automatically will grant petitions to transfer situs. For example, courts have denied such petitions

when the accomplishment of the stated objective—the avoidance of New York income tax—did not require the change. See *In re Bush*, 2 Misc. 3d 744 (Surr. Ct. 2003).

Some states facilitate the application of their laws to the administration of trusts moved from other states. For example, according to a Delaware statute, Delaware law governs the administration of a trust unless the governing instrument or a court order expressly provides otherwise. 12 Del. Code Ann. § 3332(b).

Moving to Enjoy a Favorable Trust Climate

Beneficiaries might want to relocate a trust simply to obtain the benefits of being in a trust-friendly jurisdiction. Such a jurisdiction should have a well-thought-out body of trust statutes; an ongoing commitment to update those statutes to respond to changing federal tax laws, financial conditions, and other circumstances; a competent judiciary; a supportive legislature, executive branch, and legal and banking communities; and several financial institutions that compete for trust business. Delaware developed such a system early in the 20th century. See Max M. Schanzenbach & Robert H. Sitkoff, *Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust*, 27 *Cardozo L. Rev.* 2465, 2495–96 (2006); see Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 *Yale L.J.* 356, 375 n.62, 393–94 (2005). South Dakota did so starting in about 1983. Since 1997, states such as Alaska, Florida, Nevada, New Hampshire, and Wyoming have taken steps to attract trust business.

Moving to Carry Out Clients' Objectives or to Facilitate Amendment or Termination of a Trust

States vary on the degree to which they will honor a client's wishes. Thus, if a trustee is concerned that the client's objectives might be better accomplished in another state, it might investigate moving the trust. But the trustee and the beneficiaries might want to amend or terminate a trust, in which case they should explore moving the trust to a state where this can

be accomplished readily. Washington's statutory scheme is worth investigating in such a case. See Wash. Rev. Code §§ 11.96A.210–11.96A.250.

Moving to Create a Perpetual Trust

A provocative question is whether a trust created in a state that does not countenance perpetual trusts may be moved to another state and become a perpetual trust. The determination of how long a trust may last is a matter of validity, and the law that governs such matters rarely changes on moving a trust. The author is aware of an instance, however, in which the trust instrument expressed the client's intent that the trust be perpetual and encouraged the trustee to move the trust to achieve this objective.

Converting a trust into a perpetual trust should be easier if the trust confers powers of appointment. Thus, based on Delaware cases decided in the 1940s, it might be possible to turn a trust into a perpetual trust if the trust were written with sufficient flexibility and if it confers a limited power of appointment on a beneficiary.

In discussing this subject, section 635 of the Scott treatise states:

Even though a testamentary trust is created to be administered at the outset in the state in which the testator is domiciled at his death, he may confer a power to appoint a substitute trustee in another state. If this power is exercised, the trust is presumably to be administered thereafter in the second state. If so, the exercise of a power of appointment contained in the trust is valid, if valid under the law of the second state. The result is the same where a trust is created inter vivos and there is a subsequent change in the place of administration.

In support of these conclusions, it discusses *Wilmington Trust Co. v. Wilmington Trust Co.*, 24 A.2d 309 (Del. 1942):

In *Wilmington Trust Co. v. Wilmington Trust Co.* a resident of New York executed a deed of trust, conveying to his wife shares of stock in trust for her and for his children for their lives. The

children were given a general power of appointment. By the terms of the trust the adult beneficiaries, with the approval of the trustee, were authorized to substitute as trustee a trust company of any state, which should then hold the trust estate with the same effect as though it were named as the original trustee. In pursuance of this power, they named the Wilmington Trust Company of Delaware as trustee in place of the wife. The securities were delivered to it and the trust was thereafter administered by it in Delaware. One of the children executed an instrument appointing his share to the Wilmington Trust Company in trust for his two children for life and on their death as they might appoint. The Delaware court held that the validity of the exercise of the power of appointment was governed by the law of Delaware and not by that of New York and that the exercise of the power was valid under the law of Delaware, although it would have been invalid under the law of New York because not limited in duration to two lives.

Five years later, the Delaware Court of Chancery followed that decision in *Wilmington Trust Co. v. Sloane*, 54 A.2d 544 (Del. Ch. 1947).

Consequently, a beneficiary who possesses a limited power of appointment over an irrevocable trust that is governed by the common-law rule against perpetuities or the Uniform Statutory Rule Against Perpetuities (USRAP) should be able to move the trust to a state, in certain circumstances, that has abolished the rule against perpetuities so that he or she can exercise the power to make it possible for the trust to last forever.

Moving to Avoid State Income Tax

Taking action (moving a trust out of a state, for example, or changing the trustee) might make it possible for a trust to stop paying an income tax. If a state assesses a tax if the trustee is

located or resides in that state or if the trust is administered there, moving the trust should terminate liability for the tax. If a state imposes its tax if the client lived in that state when he or she created the trust, however, whether or not that tax will continue to apply if the trust is moved raises complex constitutional issues. The constitutional issues involve whether the state statute creating the basis on which the income tax is imposed violates various federal and state constitutional mandates, including the Commerce Clause and the Due Process Clause of the U.S. Constitution, and therefore can be safely ignored in the absence of any continuing nexus between the trust and the original state.

Trustees and beneficiaries should consider whether they can save state tax by moving a trust to another state or taking other steps. At the same time, they must make sure that such a change will not subject the trust to taxation in one or more other states. If the trustee discovers that tax has been paid erroneously or that it can be escaped, the trustee should consider filing a "final" return in the year before the occurrence of a major transaction (the sale of a large block of low-basis stock, for example). In some states, the attorney might consider petitioning a court to transfer the trust's situs to a new state. Wisconsin recognizes that a change of situs in this manner will end a testamentary trust's liability for tax. A legal letter ruling from the Pennsylvania Department of Revenue also found that a trust with a situs outside Pennsylvania was not subject to Pennsylvania income tax. No. PIT-01-040 (July 27, 2001).

Moving to Provide More Investment Flexibility

A state's explicit recognition of the "directed trust" (an irrevocable trust in which a co-trustee, adviser, committee, or protector named in the governing instrument directs the trustee on investment and/or distribution decisions) might, by itself, be a sufficient reason to move a trust. This fea-

ture might be particularly attractive to trustees and beneficiaries of trusts that hold closely held business interests, lack diversification of assets, or invest in assets (limited partnerships, for example) that traditionally were viewed as inappropriate because of the trustee's deemed delegation of its investment responsibility. See Richard W. Nenno, *Directed Trusts: Can Directed Trustees Limit Their Liability?*, Prob. & Prop. 45 (Nov./Dec. 2007).

Moving to Provide Greater Protection from Creditor Claims

Some states provide more protection than other states against creditor claims for the beneficiaries of a third-party trust (a trust that a client creates for beneficiaries except himself or herself), and some states offer protection from creditor claims for the trustor-beneficiary of a self-settled trust (a trust that a client creates for beneficiaries including himself or herself). Because section 176 of the *Restatement (Second) of Trusts* says that a trustee has a fundamental duty to use reasonable care to protect a trust from unnecessary exposure to risk of loss, trustees of certain third-party and self-settled trusts might have an obligation to explore moving them to more protective jurisdictions. See *In re Joseph Heller Inter Vivos Trust*, 613 N.Y.S.2d 809 (Surr. Ct. 1994).

Moving to Avoid Accounting Requirements and Administrative Costs

Moving a trust might avoid court-accounting requirements in the original state. If the trust to be moved is an inter vivos trust, it should be possible to avoid future court accountings. Even if the trust to be moved is a testamentary trust for which judicial accountings are required, it might be possible to avoid court accountings if the governing instrument contains language waiving the requirement. For example, the Delaware courts have demonstrated some flexibility in interpreting governing instruments to avoid the necessity for judicial intervention.

Moving to Use the Power to Adjust or to Convert to a Total-Return Unitrust

Trustees and beneficiaries might want to move a trust to take advantage of a state's total-return unitrust statutes or statutory power to adjust, particularly because there is greater assurance regarding the tax consequences of actions taken under such a statute than there is for actions taken without statutory authority. Several states' unitrust conversion statutes and a few states' power to adjust statutes provide that conversion of a trust to a total-return unitrust or the exercise of the power to adjust is a matter of trust administration and that the statute is available to trusts administered in that state under that state's law. Thus, if moving a trust changes the law that governs its administration, the trust will be able to take advantage of such a statute. Nevertheless, changing the situs of a trust will *not* automatically change the law that governs its administration. Consequently, absent an applicable statute in the new jurisdiction or specific language in the court order or the trust instrument stating that the laws governing the administration of the trust will be those of the new situs, the governing law of the original state might still apply. See Richard W. Nenno, *The Power to Adjust and Total-Return Unitrust Statutes: State Developments and Tax Considerations*, 42 Real Prop., Prob. & Tr. J. 657 (2008).

Federal Transfer-tax Consequences of Moving

The attorney should confirm that moving the trust will not produce adverse federal transfer-tax consequences.

Unless or until the federal generation-skipping transfer tax ("GST tax") is repealed, great care should be taken in moving a trust that is grandfathered for GST-tax purposes (a trust that was irrevocable on September 25, 1985, and to which later additions have not been made) because the IRS takes the position that a trust will lose its grandfathered status if it is moved to lengthen its duration. Treas. Reg. § 26.2601-1(b)(4)(i)(E), ex. 4. As noted

above, moving a trust to a state that has a longer perpetuities period than that of the original state will not lengthen a trust's duration if the trust instrument specifies that the trust must terminate on a particular date (at the end of the USRAP period, for example, or the common-law perpetuities period). A Delaware statute provides that the duration of a trust does not change merely because it is moved to Delaware. 12 Del. Code Ann. § 3332(a). In addition, a beneficiary of a grandfathered trust may not exercise a limited power of appointment to create a perpetual trust and preserve the trust's grandfathered status. Treas. Reg. § 26.2601-1(b)(1)(v)(B). The IRS takes the position that moving a grandfathered trust to avoid state income tax (Treas. Reg. § 26.2601-1(b)(4)(i)(D)) or to use (or to avoid) another state's total-return unitrust-conversion law (Treas. Reg. § 26.2601-1(b)(4)(i)(E), ex. 11) or power to adjust statute (Treas. Reg. § 26.2601-1(b)(4)(i)(E), ex. 12) will not cost the trust its grandfathered status.

The IRS has applied the rules for grandfathered trusts to exempt trusts (trusts to which GST exemption has been allocated). Therefore, an exempt trust may be moved safely for GST-tax purposes if the change would have been acceptable for a grandfathered trust. See PLR 200714016.

Conclusion

Although beneficiaries might have valid reasons to move a trust, one or more roadblocks might make it impossible or impracticable to make the change. Accordingly, it is essential in the creation of a new trust to select the right trustees, situs, and governing law and to include appropriate language in case a change is needed in the future.

Nevertheless, if the beneficiaries of an existing trust are clamoring for a change, the attorney should examine the governing instrument carefully and investigate applicable local law to determine whether he or she can accommodate their wishes. In many instances, the attorney will be pleasantly surprised to discover that the requested change is possible. Even if moving the trust cannot be accomplished, it's certainly worth a look. ■