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Irrevocability in Name Not Practice: Modification and Termination of Irrevocable Trusts in Florida

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Irrevocability in Name Not Practice: Modification and Termination of Irrevocable Trusts in Florida

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Introduction

- This presentation will address options available for trust modification and termination of irrevocable trusts. While the options discussed herein are specific to Florida, counsel, financial advisors, trust officers, amongst many other professionals, should be aware of the options available to them and their clients as we continue to see significant domestic relocation to Florida.

Introduction

- More than 331 million people now live in the U.S. Many Americans are moving to the South, including vast numbers into Florida since 2010, according to the U.S. 2020 census population data released by the U.S. Census Bureau. See U.S News & World Report, 2020 Census Shows Fastest-Growing States. Since 2014, no state has added more new residents from other states on an annual basis than Florida, which has outpaced all other states each year since 2014, averaging over 579,000 new residents per year. See 2019–2014 American Community Survey State-to-State Migration Flows Table.
- While Florida is a desirable landing spot for many domestic relocations for its climate, no state income tax and strong protection against creditors, the Florida legislature has recently enacted amendments to the Florida Trust Code that make Florida a desirable location for flexible estate planning and trust administration. One of the tools available to Trusts and Estates attorneys in Florida is the ability to make changes to an irrevocable trust.

Can Irrevocable Trusts be Modified or Terminated?

- Generally, irrevocable trusts cannot be modified or revoked. While an irrevocable trust, by name and terms, would seem to prohibit amendment of its terms, Florida law provides multiple opportunities for those interested in the trust to make changes—regardless of irrevocability.

Trust Drafting Basics

- When a trust is created the trust document must be drafted and then the trust funded with assets. The person who desires to create the trust, often referred to as the settlor or grantor, will determine things such as how the trust is to be administered, what assets will go into the trust, who will receive those assets and when. If the trust is irrevocable, then it would seem to follow that it cannot be modified or terminated. Often, trust and estate counsel drafting irrevocable trusts will consider and recommend trust provisions that authorize a trustee or beneficiary modification under certain circumstances. Planning ahead, while the preferred option, can be difficult and often times is not done.

Changes in Circumstances

- What if, after making these decisions, it becomes desirable for someone interested in the trust to make changes to its terms but the trust is irrevocable? There are many events that occur throughout life that one may not, or could not, anticipate when creating the trust. A beneficiary's needs may change, the death or birth of family members may necessitate amendment, family circumstances and relationship changes may warrant revised distributive provisions, estate planning goals may change and federal and state inheritance tax laws can change, among many other unforeseen future realities. Fortunately, the flexibility of Florida's Trust Code provides broad opportunity to address the changing needs and desires of trust beneficiaries, trustees and those serving as trust director or trust protector.

Trust Modification and Termination – Tools of Change

- The Florida Trust Code provides four effective paths for making changes to an irrevocable trust:
 - 1) reformation; 2) non-judicial settlement agreements; 3) judicial modification; and 4) decanting. This presentation will address each method in-turn because the availability of a given option requires a fact specific analysis on a case-by-case basis. The available options will involve judicial and non-judicial action as well as agreement among beneficiaries, trustees and/or the settlor.

Reformation

- Reformation allows an interested person, such as a settlor, beneficiary or trustee, the opportunity to correct a mistake in the drafting of an irrevocable trust. FLA. STAT. §736.0415 (2021).
- Reformation requires a judicial action with the narrow goal of fixing mistakes or errors in the trust document that result in a failure to accurately reflect the settlor's intent when creating the trust.

Florida's Liberal Reformation Policy

- Florida has a liberal policy regarding reformation, with the courts acknowledging section 736.0415 as a remedial statute which confers a remedy, and a remedy is the means employed in enforcing a right or in redressing an injury. *Grammer v. Roman*, 174 So. 2d 443, 446 (Fla. 2d DCA 1965).

Florida's Liberal Reformation Policy

- As a remedial statute, section 736.0415 “should be liberally construed in favor of granting access to the remedy provided by the Legislature.” *The Golf Channel, Inc. v. Jenkins*, 752 So. 2d 561, 565–66 (Fla. 2000). Reformation is used to cause the trust to reflect the true intent of the settlor when the terms of the trust have not been clearly expressed in the instrument because of a mutual mistake or inadvertence in law or fact. *Kelly v. Lindenau*, 223 So. 3d 1074, 1077 (Fla. 2d DCA 2017) (citing *Megiel-Rollo v. Megiel*, 162 So. 3d 1088 (Fla. 2d DCA 2015)).

Legal Requirements for Reformation

- Where clear and convincing evidence is presented to the court that the trust as drafted does not reflect the settlor's intent the trust shall be reformed to achieve the settlor's intent. *Megiel*, 162 So. 3d at 1097.
 - Mistake in the trust
 - The mistake does not reflect the settlor's true intention
 - Clear and convincing evidence of the mistake and the settlor's true intent

What if the Challenged Language is Unambiguous?

- Even where the challenged language of the irrevocable trust is unambiguous, reformation is a useful tool if the person seeking reformation can establish the settlor's intent and a drafting mistake that fails to accomplish that intent. §736.0415; *see also Schroeder v. Gebhart*, 825 So. 2d 442 (Fla. 5th DCA 2002).

Key Evidence – Meeting the High Burden

- Counsel will often look to extrinsic evidence to establish the mistake and settlor intent.
 - Earlier drafts of the subject trust
 - Notes from meetings between the drafter, their staff and client intake forms or questionnaires
 - Admission of the mistake by the drafter
 - While not an absolute in meeting the high burden in reformation actions, admission or acknowledgment of the mistake by counsel involved in drafting the trust can be an indicator of a strong reformation action.

Common Examples Indicative of a Proper Reformation Action

- Often times, reformation will be used where a trust includes a term that misstates the settlor's intention, fails to include a term that was intended to be included or includes a term that was not intended to be included. *Lindenau*, 223 So. 3d at 1077.
- Florida appellate decisions have recognized reformation as an available remedy even where the reformation action results in changes to beneficiary designations. *Megiel*, 162 So. 3d at 1097 (citing *Schroeder*, 825 So. 2d at 446 (affirming a trial court order that reformed a trust in order to include as beneficiaries of the trust two of the settlor's grandchildren who had been excluded as the result of a drafting error)).

Limitations of Reformation

- The use of reformation to modify an irrevocable trust has limitations, particularly when compared to other available options.
 - High Burden - The burden of persuasion the court must adhere to “clear and convincing” is a high bar to reach.
 - Limited Flexibility - Reformation is less flexible than other options that may be available because it focuses on remedying a specific error; therefore, it is not a useful tool to address additional modifications, separate from the mistake, that may be warranted in further administration of the irrevocable trust.
 - Privacy Concerns - Client concerns regarding privacy can be difficult to address because of the judicial nature required by a reformation action and the ability of the public to access court records.

Reformation Remains A Powerful Tool of Change

- In spite of its limitations, reformation is an option that should always be given due consideration because it allows for the modification of an irrevocable trust by an interested party *without agreement from other interested parties*, such as a trustee or other beneficiaries, whose interests may be limited as a result of the reformation sought.

Non-Judicial Settlement Agreements

- Non-judicial settlement agreements provide persons interested in an irrevocable trust with the ability to make changes to the trust without commencing a judicial proceeding, subject to statutory restrictions. FLA. STAT. §736.0111 (2021).

Legal Requirements for Non-Judicial Settlement Agreements

- Consent - While consent is required under this method, it is important to determine whether the consent of the settlor is attainable because the scope and flexibility, or lack thereof, provided by a non-judicial settlement agreement depends on whether the settlor consents along with the other interested parties.

Consent Between Trustee and Beneficiaries

- An agreement executed between the trustee and the beneficiaries is only valid where the terms and conditions could be properly approved by the court, if such approval were sought. FLA. STAT. §736.0111(3).
- An agreement executed between the trustee and the beneficiaries may not produce a result that is not authorized under the Florida Trust Code. *Id.*
 - This restriction includes a prohibition on modification or termination of the irrevocable trust that is impermissible under the Florida Trust Code. *Id.*

Consent Between Settlor and Beneficiaries

- An agreement executed between the settlor and the beneficiaries is not subject to the limitations placed upon trustee-beneficiary agreements.
- The added flexibility achieved where the settlor consents acknowledges, impliedly, well-established Florida law that a settlor and all beneficiaries may modify, amend or revoke an irrevocable trust by consent. *Demircan v. Mikhaylov*, 306 So. 3d 142, 148 (Fla. 3d DCA 2020) (holding that settlor and beneficiaries of an irrevocable trust can consent to its modification even over the objection of trustee).
- This common law exception to modification of an irrevocable trust is referred to as the *Preston* exception.

The *Preston* Exception

- The *Preston* exception recognizes the harmony such modification allows by providing for the actual and joint intent of settlors and beneficiaries to be presently realized. *Mikhaylov*, 306 So. 3d at 144. The *Preston* exception acknowledges that neither settlors nor beneficiaries have, by themselves, a right to modify an irrevocable trust, except pursuant to a power identified in the trust. *Id.* at 147. However, “if the settlor and all of the beneficiaries of a trust consent and none of them is under an incapacity, they can compel the termination or modification of the trust, although the purposes of the trust have not been accomplished.” *Mikhaylov*, 306 So. 3d at 147 (quoting *Preston v. City National Bank of Miami*, 294 So. 2d 11, 14 n.6 (Fla. 3d DCA 1974)).

The *Preston* Exception

- The *Preston* exception recognizes a right to the modification or termination of an irrevocable trust by consent of the settlor and beneficiaries even where the purposes of the trust have not been accomplished. This is drastically different from a trustee-beneficiary right to the modification or termination *only where* the purposes of the trust have been accomplished.
 - This distinction makes sense because there is no reason to keep the trust in existence if all those beneficially interested in it, the settlor and the beneficiaries, desire its termination. *Mikhaylov*, 306 So. 3d at 147. Where the settlor does not want the trust provisions to be carried out as drafted, and all the beneficiaries agree, there is no reason for a court to insist on doing so.

Additional Limitations of Non-Judicial Settlement Agreements

- While non-judicial settlement agreements give those interested in an irrevocable trust greater flexibility in seeking to make changes to an irrevocable trust, there are limitations.
- While not a strict limitation, there are specifically authorized changes that can be made under section 736.0111(4). The authorized changes include:
 - 1) interpretation or construction of the terms of the trust; 2) approval of a trustee's report or accounting; 3) direction to a trustee to refrain from performing a particular act; 4) granting a trustee the power to take necessary action; 5) granting a trustee desirable power; 6) resignation or appointment of a trustee; 7) determination of a trustee's compensation; 8) transfer of a trust's principal place of administration; and 9) liability of a trustee for an action relating to the trust.

Additional Limitations of Non-Judicial Settlement Agreements

- While these are not the exclusive matters that may be addressed in a non-judicial settlement agreement, their specific inclusion by the legislature opens the door to attacks on proposed changes that are not specifically authorized.
- In spite of its limitations, Non Judicial Settlement Agreements are an option that should always be given due consideration because they provide an opportunity to avoid the extensive time and litigation costs of formal judicial proceedings.
- Non-judicial settlement agreements are a good option for those clients concerned with privacy because their non-judicial nature prevent public access to information in court records.

Judicial Modification

- Judicial modification provides significant flexibility to make changes to an irrevocable trust after the settlor has died.
- A trustee or beneficiary may commence a judicial modification proceeding to amend or change the terms of the irrevocable trust, terminate the trust, permit the trustee to take action not authorized or explicitly prohibited by the trust, prohibit the trustee from taking actions authorized or specifically required by the trust. FLA. STAT. §736.04113(2).

Legal Requirements for Judicial Modification

- Parties seeking judicial modification must show that the settlor's purpose for creating the irrevocable trust is not being fulfilled, FLA. STAT. §736.04113(1), or;
- The changes sought are in the best interest of the beneficiaries. FLA. STAT. §736.04115(1).
 - Under the “best interest” method, the irrevocable trust must have been created after December 31, 2001, or was a revocable trust that became irrevocable after December 31, 2000, subject to limited restriction. FLA. STAT. §736.04115(3).

Florida Courts Have Broad Discretion in Judicial Modification Actions

- The Florida Trust Code provides the court with broad discretion in judicial modification proceedings.
- In carrying out its broad discretion, the court must consider the terms and purpose of the irrevocable trust, the facts and circumstances surrounding creation of the trust, and evidence relevant to the proposed changes to the irrevocable trust. FLA. STAT. §736.04113(3).
- The court must also consider whether the trust imposes restrictions on the transfer of a beneficiary's interest in the irrevocable trust, commonly referred to as spendthrift provisions. *Id.*
 - It is important to note that the mere existence of a spendthrift provision does not preclude the court from making the changes sought under the judicial modification.

Limitations of Judicial Modification

- While judicial modification is an effective tool in a broader range of factual settings, it does have drawbacks that must be considered.
 - Privacy Concerns - As a judicial proceeding, the privacy concerns of clients are more difficult to address because of public access to court records.
 - Time and Cost - As a judicial proceeding, judicial modification carries with it the likelihood of significant time and legal costs. The increased chances of extensive adversarial litigation among the trustee and beneficiaries heightens this drawback.

Judicial Modification Remains A Powerful Tool of Change

- In spite of its limitations, judicial modification is an option that should always be given due consideration because the Florida Trust Code provides trustees and/or beneficiaries vast flexibility and the court with broad discretion to fashion creative changes to irrevocable trusts when the settlor's purpose for creating the trust is not being fulfilled or where such changes are in the best interest of the beneficiaries.

Decanting

- While the statutory modification and common law remedies previously discussed have been employed by counsel for decades in various forms, recent revisions to Florida's decanting statute have placed a sharper tool in the shed for trust and estate attorneys.
- Decanting allows the trustee to remove assets from an irrevocable trust that has undesirable provisions and distribute them to a new trust that is crafted with desirable terms. *See* FLA. STAT. §736.04117.
- Decanting provides a special class of trustee with great flexibility in making changes to an irrevocable trust.

Decanting is Not Modification

- Decanting, while it provides a trustee with the ability to change the practical effect of an existing trust, is not considered trust modification because it utilizes the trustee's authority to distribute trust assets from an original trust, which terms remain unchanged, to a second trust wherein terms are changed to achieve the trustee's purpose.

How Can Decanting be Used to Achieve a Result Different from the Current Trust

- Practically speaking, decanting allows counsel to address changes to irrevocable trusts that span from what would appear to be mere administrative issues, such as making changes to aged documents that provide more flexibility, to more drastic changes, such as adding powers of appointment that result in changes to the trust's beneficiaries.
- Between these two extremes, the new Florida decanting statute can provide the opportunity to:
 - 1) change trustee compensation;
 - 2) expand the trustee's authority;
 - 3) limit beneficiaries' rights to information concerning the trust;
 - 4) address mistakes in drafting;
 - 5) provide asset protection not contemplated under the initial trust;
 - 6) providing for special needs provisions not contemplated at the time the initial trust was created;
 - 7) severing trusts;
 - and 8) combining trusts.

Legal Requirements for Decanting – The Authorized Trustee

- While decanting provides great flexibility and creativity, it is only available to a trustee that is neither a settlor nor beneficiary, that is authorized to distribute trust principal. This special class of trustee is referred to under the Florida Trust Code as an “authorized trustee.” FLA. STAT. §736.04117(1)(b). However, it is important to note that the restriction placed on a settlor/trustee or beneficiary/trustee does come with a caveat.

Can a Settlor/Trustee or Beneficiary/Trustee Utilize the Decanting Statute?

- Yes. While the decanting statute is clear that a settlor/trustee or beneficiary/trustee are not an authorized trustee, there are steps that can be taken to avail themselves of the statute's flexibility for effectuating change.
- Settlor/Trustee - The settlor, while serving as trustee, may be able to appoint another trustee that qualifies as an authorized trustee. In doing so, the settlor/trustee can place a person of trust and confidence into the shoes of an authorized trustee and effectuate the desired changes through the newly appointed trustee's power to decant.
- Beneficiary/Trustee - The beneficiary, while serving as trustee, may be able to split the original trust, where the original trust has multiple beneficiaries, upon which the beneficiary/trustee may become an authorized trustee as to the severed trusts held for the benefit of *other* beneficiaries.

How Much Flexibility Does the Authorized Trustee Have?

- Regardless of how the trustee qualifies as an authorized trustee, that trustee's flexibility to effectuate changes between terms in the initial irrevocable trust, to those crafted in the second trust, is dependent upon the trustee's power to distribute trust principal under the initial irrevocable trust.
- The key analysis that will determine the authorized trustee's scope of authority to craft new provisions in the second trust is tied to whether that trustee had absolute or limited power to distribute principal under the initial irrevocable trust.

Limited Power vs. Absolute Power

- Limited Power - Where the trustee's authority to distribute principal is limited to a health, education, maintenance and support standard, often referred to as a "HEMS" provision, or similar restrictive language, the trustee's power is limited.
- Absolute Power - Where the trustee's authority to distribute principal is not limited by a "HEMS" provision, but rather provides broader discretion, the authorized trustee's power is absolute.
 - Language indicative of absolute power, but stopping short of using the phrase itself, would likely reference the trustee's authority to distribute principal for the beneficiary's happiness, comfort or best interests.
 - An authorized trustee with absolute power will have great flexibility in crafting terms for the new trust, including drastic changes such as the removal of beneficiaries.

Limitations of Florida's New Decanting Statute

- While the revised Florida decanting statute provides great flexibility it is important to consider its limitations.
- Decanting by an authorized trustee is not available in a number of circumstances, including, but not limited to:
 - 1) where the initial trust prohibits such action; 2) increasing trustee compensation beyond that allowed under the initial trust; 3) indemnifying or limiting a trustee's liability beyond that allowed under the initial trust; 4) changes interfering with federal tax exclusions or deductions.
- In spite of its limitations, decanting is an option that should always be given due consideration because it provides a blend of considerable flexibility to effectuate desired change along with the opportunity to address those clients concerned with privacy interests that is not available in judicial actions.

Conclusion

- Effective use of the tools available to make changes to an irrevocable trust requires in-depth knowledge of the relevant statutory sections and command of Florida common law. The options discussed herein are not available in all circumstances and consideration should be given to client goals that extend beyond the substance of the desired changes themselves, such as a client's privacy interests and willingness to engage in litigation.

Questions?

Please feel free to contact me via email
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