LIFE INSURANCE PLANNING AFTER TAX REFORM*

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DEALING WITH EXISTING LIFE INSURANCE POLICIES AFTER TAX REFORM

Let’s be clear about the Issues

- The economic (read ‘low interest’ and “volatile equity markets”) and tax (read “the Tax Cuts and Jobs Act of 2017”) environment that affects why and how life insurance is purchased, owned, paid for and managed has created uncertainty among policyholders and their advisors about:
  - Whether existing policies are needed or wanted for their original purpose, especially given the doubling of the transfer tax exemptions from 2018 to 2026
  - Whether existing policies should be supported and, if so, to what extent
  - How existing policies should be managed economically going forward
  - How existing policies should be supported and managed from a wealth transfer tax perspective going forward

Understanding the situation

- The client's objectives, priorities and constraints, including insurability
- The vintage, type and construct of the policy
  - No, they don't get better with age
- The terms and tax characteristics of the ILIT
  - Do they still make sense in this environment?
- The type and vintage of any split-dollar or other financing arrangement to which the policy is subject
  - Do they still make sense in this environment?

Range of potential outcomes

- Depending on the context and many other factors, the outcome of the discussions might be to:
  - Grin and bear an increased premium to keep the policy in force
  - Surrender the policy
  - Manage it to reduce the outlay, stabilize performance, etc.
  - Redeploy it for investment purposes
  - Replace it with another policy or an annuity
  - Sell it in a life settlement
  - Donate it to charity
  - Leave the policy alone, but fix the ILIT by modification or decanting
  - Some combination of the foregoing

EXPLORING THE OPTIONS

If it's about cash flow

- Determining the cause of the crunch will help determine a solution
  - The client just doesn't have the cash flow or has too many competing needs for the cash and/or,
  - Dividend or crediting rates dropped, thereby requiring increased premiums to support the death benefit or the same premium to be paid for (way) longer than ever anticipated
- If the policy is whole life
  - Get an illustration that shows a change of dividend option from buying paid-up additions to reducing premium. Client will pay the net premium.
    - Can the client change the option back without evidence of insurability?
  - Be sure client understands the long-term impact of this change
  - If the policy is a whole life/term blend, see if payments for cash building riders can be reduced (and then resumed, if and when).
    - Don't be surprised if the premium cannot be reduced for the foreseeable future!

Cash flow (cont.)

- If the policy is current assumption universal life (CAUL)
  - See how much the premium can be reduced by the client and still support the death benefit to a targeted age.
  - See whether a change from an increasing death benefit option to a level death benefit option will make a significant difference in the premium.
- If the policy is guaranteed universal life (GUL)
  - Revisit the duration of the no-lapse guarantee. Does client still need to support the death benefit to that age?
  - Ask the agent to illustrate a cutback in the premium followed by a “catch-up” premium in the future that will restore the guarantee
    - Consider getting a letter from the carrier supporting the illustration

Cash flow (cont.)

- If the policy is variable universal life (VUL)
  - Assume client is still comfortable with VUL as a concept but wants to manage the policy differently (better?) (for the first time?) to reduce some of the volatility in performance.
  - Revisit the asset allocation of the cash value. Then, depending on the policy's features:
    - Reallocate a growth portfolio to either a more balanced fund/portfolio offered by the carrier or constructed by the client.
    - Explore automatic rebalancing feature, if available.
    - Allocate a portion of the cash value to a fixed account from which the carrier will take monthly costs-of-insurance and expenses, rather than taking those charges pro-rata from all of the funds.

Redeployment

- A policy originally purchased for traditional death benefit use can be ‘redeployed’ as an investment/retirement vehicle
  - Depending upon the type of policy and how it’s constructed, it might be an attractive investment vehicle under current tax law.
    - Cash value grows tax-deferred
    - Client can access cash value for income via partial surrenders, withdrawals (up to basis) or loans (even in excess of basis) on a tax-free basis, assuming it is not a MEC
  - Ask the agent to show how the policy can be used for retirement savings/income
    - Might involve, for instance, an increase in the premium, decrease in the death benefit and a carefully calibrated approach to tapping the policy for income.
  - If the policy is owned by an ILIT, consider how (and at what tax cost) it can be owned by the insured.
    - Use of a swap power in the ILIT; if none, will the trustee agree to sell it (within the trustee’s fiduciary duties to the beneficiaries), and, in either case, at what value?

Exploring the redeployment

- If the policy is whole life, there will be little flexibility with regard to the premium or other aspects of policy design.
  - Redeployment will be more a function of the client's thinking about the policy than actually tinkering with it.
  - Exchange?
- If the policy is a whole life/term blend, the client might be able to increase the premium (to build more cash value) without evidence of insurability.
- If the policy is GUL, the client can likely increase the premium (now viewed as an investment contribution) without such evidence.
  - However, depending on its vintage, the policy may not generate robust cash values on a current assumption basis.
  - Exchange?

Exploring the redeployment (cont.)

- If the policy is CAUL or VUL, then more fundamental design changes could be feasible. For example:
  - Consider some combination of increasing the premium for a certain number of years and, within carrier and tax guidelines, reduce the death benefit to reduce the "drag" of the costs-of-insurance on cash value accumulation.
    - Of course, also determine any requirements for underwriting, imposition of surrender charges, possible FOG tax consequences of a death benefit reduction, etc.
  - Illustrate the maximum tax-free cash flow that the policy can generate at retirement by loan and/or withdrawal, tax-free
    - For a given number of years, without requiring more premium to support the death benefit <u>well beyond </u>client's life expectancy
    - And be sure the illustrations show how any loan and loan interest works!

Sweet surrender?

- Ask the carrier for a “surrender quote”
- Cash surrender value in excess of investment in the contract (generally, premiums paid less non-taxable distributions) is ordinary income, not capital gain.
- If the policy is a modified endowment contract, there is also a 10% penalty tax on the amount of income realized, if the “taxpayer” (not necessarily the “insured”) is under 59½.
  - Especially difficult if the owner (“taxpayer”) is a non-grantor ILIT
- If there is an outstanding policy loan at time of surrender, then the policyholder will be taxed on the excess of the gross cash value (which includes the loan amount) over the investment in the contract.
  - Which can mean a little cash but a lot of income!

Exchange the policy

- Assume client still wants the insurance but is unhappy with, for instance, the carrier, the type of policy or the required (and immutable) outlay.
- The client wants to explore an exchange.
  - One rationale for an exchange is that the client wants coverage for potential long-term care costs but doesn't want to take the "gamble" of buying an individual policy that he or she may never need.
- First, some caveats:
  - Presume that the existing policy should be retained, i.e., proposed replacement must show that it can legitimately meet the needs more effectively than the existing policy.
  - Never cancel a policy until its replacement is in force!
  - Be sure to identify and address any ancillary implications of an exchange, e.g., exchange as a possible material modification of a pre-final regulations collateral assignment split-dollar plan, etc.
  - Client must be insurable to do an exchange

Applicable tax law

- If the transaction qualifies under Section 1035, no gain or loss is recognized in an exchange of one life insurance contract for another on the same insured or for an annuity so long as there is no “boot” received in the exchange.
  - Different insurance carriers and types of policies can be involved in the exchange.
- In order to qualify under Section 1035, the policy received in the exchange must be on the same insured or insureds.
  - Basis in the old policy is carried over to the new policy.
    - Therefore, an exchange under Section 1035 may be helpful to preserve basis even if there is no gain in the policy.
  - Be careful! If there is a loan on the current policy that is extinguished in the exchange, that is “boot” and will taxed as ordinary income (without generating any cash).
    - If the loan is carried over to the new policy, there is no boot.

Internal vs. external exchanges

- Internal exchange involves same carrier
- External exchange involves new carrier
- Always start with the existing carrier, which might have an internal exchange program.
  - Even if the carrier is the same, check the illustration to be sure it is coded for an internal exchange.
- Potential benefits of internal exchange
  - Less rigorous underwriting
  - Surrender charge on old policy might be waived
  - Commission on new product reduced or eliminated
  - The sales loads and premium tax may be reduced or eliminated

Trust but verify

- When all of the illustrations and supporting material about the products and carriers have been received:
  - Does an exchange make sense?
  - It depends…
    - Does everyone really understand all of the working parts of the policies?
    - Have the usual “what ifs” been covered?
    - All premiums, cash values and death benefits considered, do they clearly understand what they might be gaining vs. losing?

Exchange for an annuity

- The tax aspects
  - Exchange can be tax-free under Section 1035, assuming again no “boot”.
  - Basis in policy carries over to annuity.
- Exchange for an immediate annuity
  - To guarantee a lifetime income
  - But compare to a systematic approach to taking income from the policy
- Exchange for a deferred annuity
  - Maintains the tax deferral, but does client really understand the key tax differences between cash value life insurance and a deferred annuity?
    - To the owner during lifetime
    - To the beneficiary

Sell the policy

- A life settlement is the sale of a life insurance policy which is past the contestability period issued on the life of a person (who does not have a condition that is likely to result in death within 24 months), for an amount that is less than the policy's face value but more than the cash surrender value.
  - Generally, for older insureds who have had a decline in health
- Based on various criteria for the client/insured, the policy and other factors, the agent can advise:
  - How the marketability of the policy is determined
  - The steps involved in (and after) a life settlement
- Meanwhile, client should see all bids for the policy, the compensation that the agent (and others) will receive, etc.

Some inside baseball

- The best policy for a sale is one in which the premium is not more than 5% of the death benefit and cash value not more than 15-20% of the death benefit
  - The less cash value vis a vis the death benefit, the better
- Insured should be at least 65-70, life expectancy of up to 12-14 years, smoker is better than non-smoker
- Policy issued on a more favorable underwriting basis than warranted and insured's health has since turned for the worse
  - The worse the better (for the sale, not necessarily for the insured)
- Offer will be based on health information provided and the results of a life expectancy study obtained by the purchaser

Taxation of life settlements

- Section 72(e), which applies in context of a surrender, does not apply in the context of a sale of a policy – here it is income tax basis.
- Rev. Rul. 2009-13
  – It held that gain above basis is ordinary to the extent of the amount of 'inside build-up' that would have been ordinary income upon surrender and capital gain thereafter.
    - Based on the "substitution of income" theory.
  – Ruling also held that life insurance policies are capital assets, but that policyholder must reduce basis by the cost of insurance charges.
    - That portion of the ruling was revoked retroactively by the Tax Cuts and Jobs Act of 2017
    - The Jobs Act also made clear that no exception to the transfer for value rule would be available to the purchaser

Does the life settlement make sense?

- It depends…
- If there's a settlement offer on the table, it means that somebody doesn't think the insured will live too long.
  - Will the sale and reinvestment of the after-tax proceeds of sale leave a larger amount of money to the survivors than if the insured had kept (and, if necessary, supported) the policy?
  - Ask the agent to determine the lowest premium outlay projected to support the death benefit to just beyond life expectancy. Then compare on an annual basis, the "premium-cost-adjusted" death benefit from the policy to the after-tax result of investing the (after-tax) proceeds of the life settlement to see the "crossover" year.
  - And then ask the insured again, "What if you were to die shortly after the sale (some settlements provide a portion of the death benefit to the family), are you going to be comfortable with an institution owning your policy, do you understand that this will affect your future insurability, etc.?"

Donate the policy to charity

- Can be a low cost means of making a potentially significant gift to charity.
- But will the charity accept the gift?
  - Need to check the charity’s policy (no pun intended) on acceptance of policies – they vary widely (from no policy on acceptance at all to detailed requirements for the policy and a plan to pay future premiums)
- Might find that the charity is generally willing to accept policies that meet certain criteria regarding:
  - Age or life expectancy of the insured(s)
  - Amount and number of remaining premiums
  - Type of policy
  - Ratings of the insurer
  - Plan by the insured to pay future premiums; charities will generally not use their funds to pay premiums
    - The issue is donor fatigue
- Will this insured/policy meet the criteria of this charity?

Basic tax implications of the gift

- The donor may be entitled to a current income tax deduction for the gift.
- The transfer must include all of the donor's incidents of ownership in the policy, to comply with the partial interest rule.
  - Which, if it is violated, would deny any deduction
- But the amount of the deduction is not necessarily clear

Determining the amount of the deduction

- Section 170(e)(1)(A)
  - If a life insurance policy is “ordinary income property”, then the donor would only be entitled to an immediate income tax deduction equal to the lesser of the insured's income tax basis in the policy or the fair market value of the policy (however determined).
  - But query as to the impact of Rev. Rul. 2009-13 on the character of a life policy – it held a policy is a capital asset with some aspect of ordinary income; the deduction should be FMV minus the ordinary income portion (gain above basis up to cash value).
  - And the impact of the life settlement market
  - In any event, donor must observe applicable reporting requirements, that is, filing Form 8283, obtaining and paying for formal qualified appraisal from a qualified appraiser (both terms of art) if the value exceeds $5,000, etc., to get the deduction.
    - How do we know if it is or isn’t without the appraisal?

DEALING WITH EXISTING ILITs AND CREATING NEW ILITs, AFTER TAX REFORM

Impact of the 2017 Act

- The transfer taxes and step up at death remain, with the exemptions doubled, from 2018 through 2025, when the increases will “sunset”, as indexed from the base year of 2016, using a slightly lower “chained CPI” index - $11,118,000 (which would have been $11,200,000 using the traditional CPI index) per person in 2018, $11,400,000 in 2019, less prior use, doubled for married couples.
  - Unless changed by future legislation
- It provides authority for the IRS to address any possible “claw-back”.
  - For those who die after 2025, when the estate tax exemption increase sunsets, who used the increased gift exemption during life.
- The Act’s corporate tax rate reduction and the pass-through deduction will have indirect effects on business valuations and the use of split-dollar arrangements, of both flavors, going forward.

Dealing with Existing ILITs

- Many clients established ILITs when the estate tax exemption was a fraction of what it is today.
- Now, with an $11,400,000 per person exemption in 2019, doubled for married couples, less prior use (indexed and, barring future legislative changes, in effect through 2025) many who have ILITs no longer see the need for them.
  - Or perhaps the policies which they own.
- Consider “undoing” the ILIT
  - Remembering it is an otherwise irrevocable trust
    - Which generally means what it says

Dealing with Existing ILITs

- Also consider “fixing” an existing ILIT, using the increased exemption(s)
  - Additional gifts now could mean no more premium payments
    - The gifts could go into the policy or could be held in the trust to pay premiums as they come due
    - Care must be taken to avoid unintentionally creating a MEC by putting the gifts into the policy in its early years
  - Or they could be used to terminate old split-dollar or other financing arrangements
    - Pre Reg-equity/economic benefit split-dollar
      - Donor or employer
    - Post Reg-non-equity/economic benefit split-dollar
      - Donor or employer
    - Loan Regime
      - Donor or employer
    - Third party loans
- Or “fixing” it by changing its terms
  - Remembering, again, it is irrevocable
    - And that it generally means what it says

Overview of options for the "undoing" or the "fixing"

- Decanting by the trustee to another "better" ILIT (if and as permitted under local law)
  - Generally requires the trustee have broad discretionary distribution powers
    - May only require a HEMS distribution standard
  - May require notices to the beneficiaries of the old or the new trust (or both), may require both trusts have the same beneficiaries, etc.
  - It cannot be generalized – the power to decant depends exclusively on local law
    - Consider moving the trust situs, if necessary
  - GST issues if the new trust has a longer term than the old trust?
- See Appendix 1 outlining the Missouri decanting statute

Overview of options for the "undoing" or the "fixing"

- Termination or amendment by a non-fiduciary trust protector (if the trust provides for one with this power)
  - Termination would result in a distribution of the policy(ies) to the beneficiaries
    - Taking the policy(ies) out of a creditor, transfer tax and spouse protected entity
      - Except to the extent state law provides creditor protection for insurance
    - And putting the policy(ies) in the hands of a group of beneficiaries, all of whom would have to act together to exercise incidents of ownership
      - Minors
      - Incompetents
      - Spendthrifts
  - Could an amendment change beneficial interests?

Overview of options for the "undoing" or the "fixing"

- Court reformation/non-judicial modification (as and to the extent permitted under local law)
  - Generally requires settlor and beneficiary (and sometimes trustee) consent
    - Again, it depends exclusively on local law
    - Same GST issues
    - Gift issues for beneficiaries who consent, if their interests are diminished?
  - See Appendix 2 outlining the Missouri non-judicial modification statute

Overview of options for the "undoing" or the "fixing" (continued)

- Distribute the policy by the trustee to adult competent beneficiaries (if possible under the trust)
  - Raises fiduciary duty issues for the trustee, without the consent of all beneficiaries
    - Raises the same beneficiary-owned issues described above
- Distribute the policy by the trustee to a new (better) ILIT (if possible under the trust)
  - Raises fiduciary duty issues for the trustee, without the consent of all beneficiaries, unless the new trust has identical beneficiaries
    - Same GST issues

Overview of options for the "undoing" or the "fixing" (continued)

- Sell the policy by the trustee to a new ILIT based on FMV
  - Raises fiduciary duty issues for both trustees, with a similar exception
  - If the buying trust is a grantor trust from the point of view of the insured, there would be no transfer for value
  - If the selling trust were also a grantor trust, there would be no gain on the sale
    - Sales between grantor trusts are ignored under Rev. Rul. 85-13
  - How does the trustee determine FMV?
    - Can the trustee use gift tax value?
      - 712 issues – multiple values
      - Does it depend on the type of policy?
    - Does it require an appraisal?
      - If so, who is available and who pays the appraiser?

Overview of options for the "undoing" or the "fixing" (continued)

- Sell the policy to the grantor, based on FMV
  - Raises fiduciary duty issues for the trustee, with a similar exception
  - How does the trustee determine FMV?
    - Same questions
  - Again, takes the policy(ies) out of a creditor, transfer tax, and spouse protected entity (except to the extent policies are creditor protected under state law)

Overview of options for the "undoing" or the "fixing" (continued)

- Have the settlor enter into a swap for the policy (if possible under the trust), based on FMV
  - Raises a different set of fiduciary duty issues for the trustee, under the Rev. Ruls.
    - There can be no change in beneficial interests and values have to be equivalent
  - How does the trustee determine FMV?
    - Same questions
  - Same creditor protection issues
  - Exempt from transfer for value
  - Estate tax issue for the insured under Sections 2042 and 2035
  - No tax to either party if the trust is a grantor trust

Creating New ILITs After Tax Reform

- Some clients will view the increased gift and GST exemptions under tax reform as a reason to create new ILITs
  - And others will not
- For clients who need insurance for its death benefit, creating and pre-funding an ILIT would make sense, using the increased exemptions before they sunset.
- The ILIT would likely be a dynasty grantor trust, to protect future generations of beneficiaries from creditor and divorcing spouse issues, as well as future transfer tax issues under future laws and to provide flexibility.

APPENDIX A

Missouri - Decanting

- Decanting statute became effective August 28, 2011
- Missouri was the 12th state to enact decanting legislation
- Decanting statute is a codification of common law of Missouri- see RSMo. 456.4-419.6
- Decanting may be viewed as a modification of the terms of a trust and as an alternative to RSMo. 456.1-111 (non-judicial settlement agreements), RSMo. 456.4-411A, and RSMo. 456.4-411B (modification by consent).

RSMo. 456.4-419. 1- Authority

Unless the terms of the trust instrument expressly provide otherwise, a trustee who has <u>discretionary</u> power under the terms of a trust to make a distribution of <u>income or principal</u>, <u>whether or not limited by an ascertainable standard</u>, to or for the benefit of one or more beneficiaries of a trust, the first trust, may instead exercise such discretionary power by appointing all or part of the income or principal subject to such discretionary power in favor of a trustee of a second trust, the second trust, <u>created under either the same or different trust instrument</u> in the event that the trustee of the first trust decides that the appointment is necessary or desirable after taking into account the terms and purposes of the first trust, the terms and purposes of the second trust, and the consequences of the distribution

Authority - Comments

- An exercise of the trustee’s discretionary power to distribute income, principal or both to or for beneficiaries
  - Uniform Trust Decanting Act - the trustee may exercise the decanting power whether or not under the first trust’s discretionary distribution standard, the fiduciary would have made or could have been compelled to make a discretionary distribution of principal at the time of the exercise
- The trustee is subject to fiduciary duties
- Can assets stay in the same trust with modified terms?

RSMo. 456.4-419.2- Restrictions

2. The following provisions apply to any exercise of the authority granted by subsection 1 of this section:

(1) The second trust may have as beneficiaries only one or more of those beneficiaries of the first trust to or for whom any discretionary distribution may be made from the first trust and who are proper objects of the exercise of the power, or one or more of those other beneficiaries of the first trust to or for whom a distribution of income or principal may have been made in the future from the first trust at a time or upon the happening of an event specified under the first trust;

RSMo. 456.4-419.2- Restrictions

(2) Unless the exercise of such power is limited by an ascertainable standard, no trustee of the first trust may exercise such authority to make a distribution from the first trust if:

(a) Such trustee is a beneficiary of the first trust; or

(b) Any beneficiary may remove and replace the trustee of the first trust with a related or subordinate party to such beneficiary within the meaning of Section 672(c) of the Internal Revenue Code

Restrictions - Comments

- Second Trust
  - Must have *one or more* beneficiaries who are proper objects of the trustee's exercise of discretionary distribution
  - Allows for removal of a beneficiary
  - May include future beneficiaries - acceleration of interest

- Discretionary Distribution under First Trust not limited by an ascertainable standard then the following <u>trustees</u> may not decant:
  - A beneficiary serving as a trustee of the First Trust
  - A Trustee who may be removed and replaced by a beneficiary with a related or subordinate party to such beneficiary within the meaning of Section 672(c) of the Internal Revenue Code

RSMo. 456.4-419. 2- Restrictions, Continued

(3) Except if participating in a change that is needed for a distribution to any such beneficiary under an ascertainable standard, no trustee shall exercise such authority to the extent that doing so would have the effect either of:

(a) Increasing the distributions that can be made in the future from the second trust to the trustee of the first trust or to a beneficiary who can remove and replace the trustee of the first trust with a related or subordinate party to such beneficiary within the meaning of Section 672(c) of the Internal Revenue Code; or

(b) Removing restrictions on discretionary distributions imposed by the instrument under which the first trust was created;

RSMo. 456.4-419. 2- Restrictions, Continued

(4) In the case of any trust contributions which have been treated as gifts qualifying for the exclusion from gift tax described in Section 2503(b) of the Internal Revenue Code, by reason of the application of Section 2503(c), the governing instrument for the second trust shall provide that the beneficiary's remainder interest shall vest no later than the date upon which such interest would have vested under the terms of the governing instrument for the first trust;

RSMo. 456.4-419. 2- Restrictions, Continued

(5) The exercise of such authority may not reduce any income interest of any income beneficiary of any of the following trusts:

(a) A trust for which a marital deduction has been taken for federal tax purposes under Section 2056 or 2523 of the Internal Revenue Code or for state tax purposes under any comparable provision of applicable state law;

(b) A charitable remainder trust under Section 664 of the Internal Revenue Code;

(c) A grantor retained annuity trust under Section 2702 of the Internal Revenue Code; or

(d) A trust which has been qualified as a Subchapter S trust under Section 1361(d) of the Internal Revenue Code or an electing small business trust under Section 1361(e) of the Internal Revenue Code

RSMo. 456.4-419. 2- Restrictions, Continued

(6) The exercise of such authority does not apply to trust property subject to a presently exercisable power of withdrawal held by a trust beneficiary to whom, or for the benefit of whom, the trustee has authority to make distributions, unless after the exercise of such authority, such beneficiary's power of withdrawal is unchanged with respect to the trust property; and

Restrictions Continued - Comments

If discretionary Distribution under First Trust is <u>not</u> limited by an ascertainable standard then NO trustee shall decant if decanting either:

- Increases distributions from the Second Trust to the trustee of the First Trust or to a beneficiary who can remove and replace the trustee of the First Trust with a related or subordinate party to such beneficiary within the meaning of Section 672(c) of the Internal Revenue Code
- Removes restrictions on discretionary distributions imposed by the instrument under which the First Trust was created

Restrictions Continued – Comments Continued

- Protection of annual exclusion gifts, marital deduction trusts, GRATs, charitable remainder trusts, ESBTs
- Cannot change a presently exercisable power of withdrawal held by a trust beneficiary to whom, or for the benefit of whom, the trustee has authority to make distributions

RSMo. 456.4-419. 3-Notice Requirement

- 3. At least sixty days prior to making a discretionary distribution under subsection 1 of this section, the trustee of the first trust shall notify the permissible distributees of the second trust, or the qualified beneficiaries of the second trust if there are no permissible distributees of the second trust, of the distribution. A beneficiary may waive the right to the notice required by this subsection and, with respect to future distributions, may withdraw a waiver previously given.

RSMo. 456.4-419. 4-Fiduciary Duty

Trustee remains subject to all fiduciary duties under the trust and Missouri law in exercising the distribution authority.

RSMo. 456.4-419. 5-No Duty to Act

5. This section does not impose on a trustee a duty to exercise the authority granted by subsection 1 of this section in favor of another trust or to consider exercising such authority in favor of another trust

Important Considerations

- An exercise of a trustee power-subject to all fiduciary duties and standards- trustee must act in good faith and in accordance with the purposes of the trust
- RAP period
- Income tax issues
- Estate tax and gift tax issues
- Grandfathered and GST tax exempt trust, must consider possible GST tax implications of decanting
  - Safe harbor rules Treas. Reg. §26.2601-1(b)(4)(i)(A) and/or in Treas. Reg. §26.2601-1(b)(4)(i)(D).

Possible Clarifications/Changes to RSMo. 456.4-419

- A settlor, who is serving as a trustee, may not decant
- Do not need to move assets to a new trust, can modify the current trusts - prevents retitling of assets and possible obtaining a new EIN
- Second trust must have a permissible distributee
- Cannot add a permissible distributee if grantor is living and the trust is not a grantor trust for income tax purposes
- May retain, create or modify powers of appointment
- Specific language regarding Special Needs Trusts
- Tax savings clauses- marital deduction, charitable deduction, annual exclusion, exempt trusts, QSST, RAP provision
- Notice must be given to permissible distributees of the first trust and the second trust

APPENDIX B

Missouri – Modification

Section 456.4A-411

- Modification or termination of non-charitable irrevocable trust by consent
  – A non-charitable irrevocable trust may be modified or terminated by consent of the settlor and all beneficiaries without court approval, even if inconsistent with a material purpose of the trust.

Section 456.4B-411

- Modification or termination of non-charitable irrevocable trust by consent
  - When all competent adult beneficiaries consent, the Court may, upon finding that the interest of any non-consenting beneficiary will be adequately protected, modify the terms of a non-charitable irrevocable to trust to reduce or eliminate the interests of some beneficiaries, change the times or amounts of payments, or provide for termination of the trust.