Expand Choices by Creatively Unwinding Irrevocable Trusts

Despite what its name implies, an irrevocable trust may be subject to change or termination through the implementation of various strategies.

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Irrevocable trusts are often viewed as just that, "irrevocable." They are "cast in stone" and cannot be changed, amended, or terminated. The word "irrevocable" is scary, and both clients and practitioners are often reluctant to invoke it. Yet, the initiated know that nothing is irrevocable, if properly structured. Both state law and smart drafting allow attorneys to create irrevocable trusts and then revoke them (at least in some manner, but with that practical effect).

Three considerations are involved in terminating an irrevocable trust, or, to put it another way, in ignoring some of the terms of an irrevocable trust:

1. Does the state law allow for the revocation of a trust, and what rights and remedies does it create if an irrevocable trust is revoked?
2. Ignoring state law, can the trust be drafted in such a way so that it would nominally be irrevocable, but practically revocable?
3. What are the tax consequences of terminating an irrevocable trust?

State law

Courts have always assigned a high degree of importance to the intent and the material purposes of the trust settlor.[1] The settlor transfers his or her own property to the trustee, and can control all aspects of such transfer and set out any restrictions he or she likes.[2] This principle is based on the value our society places on protecting property rights.

If the settlor intended for the trust to be irrevocable, that intent should be carried out. But there are exceptions to every rule, and the settlor's intent will not be carried out when it encourages illegal activity or violates public policy.[3] The law also prefers the living over the dead. The Uniform Trust Code (2000, as amended), the common law, and the various state trust laws (over half of the states have adopted the UTC; several other states follow it in some form) allow for circumstances when an expressly irrevocable trust may be modified, reformed, or terminated.[4]

The express consent of the settlor and of the beneficiaries is the easiest way to revoke an irrevocable trust. For example, the laws of most states, following the UTC, provide that if the settlor and all the beneficiaries of a trust consent, they may compel the modification or termination of the trust.[5] If most of the beneficiaries consent, a trust may still be modified or terminat-

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ed if it does not substantively impair the interests of those beneficiaries that do not consent.[6]

If a beneficiary lacks the ability to provide consent, both the law of most states and the UTC allow for the guardian *ad litem* to provide consent, and for the holder of a testamentary general power of appointment to represent and bind the permissible appointees, allows parents to represent minors, and allows one beneficiary to represent substantially identical interests of others.[7]

When a beneficiary is not able to represent himself, and there is no parent, guardian, or another beneficiary capable of virtual representation, how can consent be obtained? This is especially relevant for remote contingent beneficiaries. The trustee is able to represent remote contingent beneficiaries,[8] but because the trustee owes them a fiduciary duty, he or she may be unable or unwilling to take the necessary action. In these cases, a court would have to appoint a representative for the unrepresented beneficiaries.[9]

Absent the consent of the settlor (e.g., following the death of the settlor), if all the beneficiaries consent, they may compel the modification or termination of the trust with court approval.[10] Per the UTC and most state laws, such modification or termination by the court is possible only if the trust has achieved its material purpose.[11] Some states that have adopted the UTC follow a more liberal interpretation, and will allow for modification or termination if the reason for modification or termination is more important than achieving the material purpose of the trust.[12]

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Understanding what constitutes a "material purpose" of the trust is crucial. Such purpose needs to be identified and handled for the court-approved modification or termination to be possible. Numerous cases explore the definition of "material purpose," and the Restatement of Trusts, 3d, provides that "[a] finding of [material] purpose 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. Thus, a court 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 (but not imposing on them) a particular advantage. Sometimes, of course, the very nature or design of a trust suggests its protective nature or some other material purpose."[13]

Absent the consent of the settlor and the beneficiaries, the court is allowed to modify the administrative or dispositive provisions of the trust or terminate the trust if, owing to the circumstances not anticipated by the settlor, modification or termination would advance the purpose of the trust.[14] This is commonly referred to as equitable deviation, and is often used to modify administrative or dispositive terms of the trust due to a change in economic circumstances or an incapacity of a beneficiary.[15]

The court is also allowed to modify or terminate the trust if the trust is uneconomical (i.e., has few assets left).[16]

Going beyond the law

Assume that the UTC or the statutory and common law discussed above did not exist. Could an irrevocable trust still be revoked? More importantly, given that the law exists, what can be done if the settlor or the beneficiaries would not want to seek the consent of the court to terminate an irrevocable trust?

A trust is a private agreement between the settlor and the trustee that bestows certain equitable rights and interests on the beneficiaries. Suppose the terms of the trust agreement provide that the trust is irrevocable, but the parties to the agree-

[1] In re Sherman Trust, 179 N.W. 109 (Iowa, 1920) (citing Wilberding v. Miller, 106 N.E. 665 (Ohio, 1913)); Edmonson v. First Nat'l Bank, 55 So. 2d 338 (Ala., 1951) (It has been authoritatively stated that the intent and purpose of the settlor of the trust is the law of the trust.); First Nat'l Bank v. Hyde, 363 S.W.2d 647 (Mo., 1962); Durst v. United States, 559 F.2d 910 (CA-3, 1977); Scharlin v. Superior Court, 9 Cal. App. 4th 162 (Cal. App. 4th Dist., 1992).

[2] UTC Section 105 cmt, 7C U.LA. 432 ("Absent some other restriction, a settlor is always free to specify the trust's terms to which the trustee must comply.")

[3] In re Estate of Sage, 412 N.Y.S.2d 764 (N.Y., 1979); Greenwich Trust Co. v. Tyson, 27 A.2d 166 (Conn., 1942).

[4] See UTC section 411(a), Cal. Prob. Code § 15404(a), Fl. Stat. § 736.0412.

[5] See UTC section 411(a), Cal. Prob. Code § 15404(a), Penn. Cons. Stat., Title 20, § 7740.1(a).

[6] Penn. Cons. Stat., Title, 20, § 7740.1(d).

[7] UTC sections 302, 303 and 304, Cal. Prob. Code § 15405, Penn. Cons. Stat., Title, 20, § 7724.

[8] UTC section 303(4).

[9] UTC section 305.

[10] Claflin v. Claflin, 20 N.E. 454 (Mass., 1889), UTC section 411(b), Penn. Cons. Stat., Title, 20, § 7740.1(b), Virg. Code § 55-544.11(B).

[11] *Id.*

[12] Cal. Prob. Code § 15403(b) (even the more liberal California interpretation is available only if the trust does not contain a spendthrift clause).

[13] Rest. 3d Trusts, section 65, comment d. (Tentative draft 3, 2001).

[14] UTC 412(a), Cal. Prob. Code § 15409(a), Fl. Stat. § § 736.04113 and 736.04115, Virg. Code § 55-544.11.

[15] See Rest. 3d Trusts, section 66, comment b (Tentative draft 3, 2001) for examples.

[16] UTC section 412(b), Cal. Prob. Code § 15408(a).

ment breach the terms. The beneficiaries, not being a party to the contract, can chose to do whatever they desire. They are not bound by the provisions of the trust. However, beneficiaries cannot act alone. They would need the consent of the trustee to terminate the trust. Would the trustee expose himself or herself to risk for breaching the terms of the contract?

The trustee actually has no risk exposure. The trustee would be committing a breach of trust if he or she modifies or terminates an irrevocable trust, but no one could complain—all the beneficiaries consented to the act. The only persons who could complain of the trustee's breach of trust acquiesced to it. There is no one left with legal standing to challenge.[17]

Distinguish the above paragraph from the ability the beneficiaries have to modify or terminate the trust under state law (discussed above). Without the settlor's consent, the beneficiaries can modify or terminate the trust only if that would not violate a material purpose of the trust, because that would be the only way to get court consent. With the consent of the trustee, however, the beneficiaries can terminate any trust, for any reason, ignoring the material purpose test. (N.B. This is a practical result, not a legal conclusion.)

Accordingly, for the beneficiaries always to be able to modify or terminate an irrevocable trust without court consent, the trustee must be willing. To assure that result, it may be prudent to allow beneficiaries to change the trustee.

Drafting flexibility into the trust

Trust agreements are essentially private contracts.[18] To a large extent, the terms of the "contract" govern the trust and the rights and the responsibilities of the parties. The terms of the trust express the intent of the settlor, which is always given a great deal of significance by the courts. Consequently, the settlor can structure the trust, in most respects, in any manner he or she desires and be assured that the terms, under most circumstances, will be honored and carried out. Here are some drafting suggestions to make an irrevocable trust flexible.

Discretionary trust. Granting trustee discretion is the simplest and broadest way of maintaining flexibility. A discretionary trust allows the trustee to exercise control over distributions and investments. Distribution discretion may include the ability to decide when to distribute, how much to distribute, and to which beneficiaries.

Such broad discretion really requires the settlor to trust the trustee. As the title implies, that is exactly what every settlor does when transferring legal title of his or her property to a trust. However, the degree of trust varies with each trust agreement. If granting the trustee full unsupervised discretion is undesirable, the trust should either:

1. Provide for a mechanism to remove and replace the trustee.
2. Limit discretion and look for flexibility through other means.

Power to change trustee. The trust agreement can grant the settlor, the beneficiaries, or a trust protector (see below), the power to remove and replace the trustee.

Most settlors want the ability to remove and replace the trustee. Care should be exercised not to allow the settlor the ability to make himself or herself a trustee as that may lead to undesirable estate tax consequences (trust assets may be included in the settlor's estate).[19] The settlor will be deemed to possess all dispositive and administrative powers of the trustee office. The settlor can have the power to remove the trustee and appoint a new trustee who is not related or subordinate to the settlor within the meaning of Section 672(c).[20]

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[17] See UTC 1009; *Scott on Trusts*, § 216 ("a beneficiary who consents to an act or omission by the trustee ... cannot hold him liable. ...")

[18] Unlike other private agreements, trusts create a fiduciary relationship. Rest. 3d Trusts, section 2.

[19] If the trustee is granted the power to make discretionary distributions, including the power to distribute to the settlor or to add the settlor as a beneficiary, then if the settlor is granted the power to appoint himself or herself as the trustee, the settler will be deemed to hold such power. Section 2036(a). The settlor can retain the power to remove and replace the trustee so long as the settlor or his or her agent cannot be such trustee. Byrum, 440 F. 2d 949, 27 AFTR2d 71-1744 (CA-6, 1971), *aff'd* 408 U.S. 125, 30 AFTR2d 72-5811 (1972).

[20] Rev. Rul. 95-58, 1995-2 CB 191.

To avoid inadvertent estate tax inclusion of trust assets, irrevocable trusts often allow beneficiaries, and not the settlor, the power to replace the trustee. To avoid the inclusion of trust assets in the estate of the beneficiary, it is important to avoid giving the beneficiary a power that would be akin to a general power of appointment. To do this, if a beneficiary has the ability to make himself or herself the trustee, the beneficiary's distribution powers should be limited to an ascertainable standard.[21] The power to name the settlor as the trustee may also be conferred on the trust protector.

If the settlor holds the power to amend or revoke the trust, then the assets of the trust are included in the settlor's estate.[22] However, if someone other than the settlor holds such power, the power is not attributed to the settlor. At least two cases, for example, concluded that the power held by the spouse of the settlor to revoke the trust was not attributed to the settlor.[23] The ability of the settlor to persuade the power-holder, does not impute such ability to the settlor.[24] The focus is on the settlor's ability to legally control or direct the power-holder.

Trust protector. Frequently, the power to amend the trust is given to the trust protector. A trust protector (sometimes referred to as a trust advisor) is simply a trusted person who is given certain powers with respect to the trust. Think of the protector as a type of a trustee who holds certain "super" powers and can exercise such powers in a non-fiduciary capacity. These powers usually supersede the powers of the trustee, making the trust protector a much more important appointment.[25] Common powers granted to the protector include:

- Removing and replacing the trustee.
- Adding beneficiaries (including the ability to add the settlor as a beneficiary).
- Removing beneficiaries.
- Amending distribution provisions.
- Amending administrative and investment directive provisions of the trust.[26]

The trust protector should not be allowed to make any changes to the trust that would increase the benefit that the trust protector would otherwise get from the trust.

To remove the temptation that the trust protector may otherwise experience, the trust protector should not be allowed to make any changes to the trust that would increase the benefit that the trust protector would otherwise get from the trust. To prevent the power from being deemed a general power of appointment, language should be included preventing the trust protector from exercising the power to amend the trust for the benefit of the trust protector, trust protector's estate, or creditors.[27]

It is also good practice to include language in the trust acknowledging that the trust protector is acting independently and that the settlor does not retain any right to control the trust protector. Because the protector will not be running the trust on a day-to-day basis, he or she should be absolved of fiduciary obligations by providing that the protector is acting in a non-fiduciary capacity.

Disclaimer clauses. Another means of achieving flexibility is by using disclaimer clauses. A disclaimer is a standard planning tool in many revocable trusts. In a disclaimer trust, assets are left to the surviving spouse, and a distribution scheme is drafted into the trust that provides what would happen to trust assets if the surviving spouse disclaims. This allows some degree of flexibility and control over trust assets by the surviving spouse.

As an example, a disclaimer may be used for A-B trust funding by providing that all assets are left to the surviving spouse in the A trust, but if he or she disclaims, then whatever is disclaimed is used to fund the B trust. This allows the surviving spouse to decide, at the last possible moment, how much to fund each trust. Given the current estate tax uncertainty, this adds a noticeable layer of flexibility to the trust.

Tax consequences of unwinding

The ability to unwind or amend an irrevocable trust is a matter of state law and case law. The tax consequences of such action derive from federal tax law. Unwinding or amending an irrevocable trust should have no income tax consequences (unless the trust is nongrantor and is "unwound" through the sale of its assets to the grantor), but may have gift and estate tax consequences. Such tax consequences, in turn, would depend on the nature of the trust and the nature of the amendment.

21 Section 2041.

22 Section 2038(a).

23 Estate of Ballard, 47 BTA 784 (1942), *aff'd* 138 F.2d 512, 32 AFTR 8 (CA-2, 1943); and Kneeland, 34 BTA 816 (1936).

24 Tully, 528 F.2d 1401, 37 AFTR2d 76-1529 (Ct. Cl., 1976).

25 This may be reflected in the language of the trust agreement, and in local law, if the jurisdiction provides for a trust protector. See Nev. Rev. Stat. § 163.5553.

26 *Id.*

27 The assets of the trust will be included in the protector's estate if he or she holds a general power of appointment. Section 2041(a)(2).

Not all transfers of assets to or from an irrevocable trust implicate transfer tax consequences. For example, an irrevocable trust may be drafted so that any transfer of assets to the trust is incomplete for gift tax purposes and would cause the inclusion of trust assets in the estate of the settlor under Section 2036. Examining the tax consequences of unwinding such trusts is moot, as there are none. Consequently, the following discussion focuses on the tax consequences of unwinding irrevocable trusts commonly used in estate tax planning, like qualified personal residence trust (QPRTs), grantor retained annuity trusts (GRATs), and intentionally defective grantor trusts (IDGTs).

QPRTs

A QPRT is a type of a split-interest trust. A split-interest trust is one set up for the benefit of the grantor (the term federal tax law uses to describe the settlor) and the grantor's family member, with the two sets of interests following each other chronologically. Section 2702 applies to all split-interest trusts, to value the interest retained by the grantor at zero. If the retained interest is valued at zero, then the remainder interest going to the family member has the same value as the asset contributed to the trust, and is fully subject to the gift tax. Tax law carves out exceptions from the above rule for QPRTs, GRATs, and a few other types of trusts.

A typical QPRT structure would have the grantor make a gift of his or her residence to the trust, retain the right to live in the house, rent-free, for a number of years (that is the interest the grantor retains for himself or herself), with children or family members named as the remainder beneficiaries of the trust.

Permissible assets. QPRTs are subject to restrictions on the types of assets they can hold. A QPRT may hold only:

1. Either a personal residence or a vacation home (but only one property in one QPRT).
2. Cash in an amount not to exceed what is reasonably expected to pay current expenses (like property taxes, landscaping, maintenance, mortgage payments, etc.) or to make improvements to the residence within the next six months.[28]

QPRTs are also restricted from selling the residence to the grantor or grantor's spouse,[29] and when the trust fails to be a QPRT, it must either distribute its assets to the term holder or convert into a GRAT.[30] A trust ceases to be a QPRT if (1) the residence is sold or destroyed and the proceeds are not reinvested in another residence within two years, or (2) the grantor stops using the property as his or her residence during the retained term.[31]

Trust modifications. Modifications to QPRTs relate to fixing poor drafting that may lead to adverse tax consequences or changing the remainder beneficiaries. Because the substantive structure and drafting of a QPRT is provided by the IRS, practitioners have little room for making drafting mistakes.[32] The most common one is the appointment of the grantor as the trustee of the trust, or allowing the grantor the power to substitute himself or herself as the trustee of the trust.

If the grantor is the trustee of the QPRT and he or she has the discretion to decide whether to reinvest sale proceeds (on the sale of the residence) in another residence, the grantor has, effectively, the ability to receive the trust assets back (either by terminating the QPRT status of the trust or by converting it into a GRAT). This power vested in the grantor-trustee may result in an incomplete gift to the QPRT (the gift is completed when the power is terminated) or may be treated as a general power of appointment. Both problems are easily fixable by having the grantor resign as the trustee of the trust.

If the grantor "must" be the trustee of the QPRT, then the drafter should simply deprive the trustee of the power to decide what to do with the proceeds received on the sale

[28] Regs. 25.2702-5(c)(2)(ii) and -5(c)(5)(ii).

[29] Reg. 25.2702-5(c)(9).

[30] Reg. 25.2702-5(c)(8).

[31] Reg. 25.2702-5(c)(7)(ii) and -5(c)(2)(iii).

[32] The Service issued Rev. Proc. 2003-42, 2003-1 CB 993, which sets forth a model QPRT form. Any trust agreement that is substantially similar to the model form and is valid under state law is deemed a valid QPRT

of the residence or from insurance payment when the property is destroyed. The QPRT should require that the proceeds be converted into a GRAT, if not reinvested. This way the grantor-trustee will not have the power to re-vest himself or herself in the trust assets nor will he have a general power of appointment. The same objective may be accomplished by requiring the consent of the remainder beneficiaries as to the use of the proceeds.

Change beneficiaries. Because a QPRT is both irrevocable and not subject to amendment, it would not be possible to change the beneficiaries of the QPRT, once appointed. However, if the beneficiary of the QPRT is another trust (typically, an intentionally defective grantor trust, so that the QPRT can be a grantor trust for its entire term of existence), then it may be possible to draft the other trust with the flexibility of changing beneficiaries. The power to change the beneficiaries of the other trust should not be given to the grantor. Instead, it should be held by the protector of the intentionally defective grantor trust. (Theoretically, a QPRT may also incorporate the use of the trust protector. However, that may place the trust outside the bounds of Rev. Proc. 2003-42.[33])

Termination of the QPRT may be desirable when there is a significant shift in either the circumstances of the grantor's life, or tax law. The grantor may fall on hard times following the establishment of the QPRT, or the grantor's life expectancy may diminish, making it unlikely that he or she will outlive the term of the QPRT.[34] The change in tax law (like an increase in the estate tax exemption from $1 million to $5 million) may obviate the estate tax benefit of the QPRT (and may actually create a tax detriment due to the loss of the income tax basis step up of an asset otherwise not subject to the estate tax).

Conversion to GRAT. If the grantor falls on hard times or falls ill and needs access to the assets of the trust (or the grantor can no longer afford to pay rent), the trustee may sell the residence and convert the QPRT into a GRAT, allowing the grantor to receive cash payments from the trust. If a QPRT is converted into a GRAT, the annual payments to the grantor are calculated as if the trust has been a GRAT from its inception (using the Section 7520 rate at the time of the creation of the trust). Conversion to a GRAT reduces the estate tax value of the trust—more money returns to the grantor and less is available to the remainder beneficiaries.

If the grantor falls ill and is unlikely to survive the retained term, there is no reason not to transfer the residence back to the grantor—it would be included in his or her estate in any case. (A rare exception would be a stepped down basis on death.)

The actual termination of the QPRT can be accomplished by allowing the grantor to purchase the remainder interest for its actuarial value (in which case, when drafting the QPRT, forego the spendthrift clause to allow the beneficiaries to sell, or carve out an exception in the spendthrift clause). Because the grantor will hold all beneficial interests, he or she can terminate the trust without court approval (as discussed above). The remainder beneficiaries will likely have income tax consequences on the sale of the interest (similar to the sale of any other capital asset). The purchase of the remainder interest would work when the grantor has money and simply wants the residence back (for whatever reason), or is in poor health.

When the grantor needs money, and needs it faster than a GRAT payout schedule, the grantor's retained interest may be sold to the remainder beneficiaries (if they have the money to purchase it). The grantor will have income tax consequences on the sale, but he or she will also get a lump sum immediately.

A QPRT may also be terminated by gaining the consent of the remainder beneficiaries to terminate the QPRT. This approach results in a taxable gift from the remainder beneficiaries to the grantor. If the grantor dies within one year from the above gift, then the amount gifted does not get a basis step up on death.[35]

GRAT

Similar to a QPRT, a GRAT is a split-interest trust. Unlike a QPRT, a GRAT can hold any asset, not just a residence. In a GRAT, the grantor contributes assets to the trust and retains an annuity for a term of years. The annual annuity amount is determined at the time the GRAT is established, and on the expiration of the term, the remaining assets are distributed to the remainder beneficiaries. A GRAT transfers to the remainder beneficiaries, and out of the grantor's estate, the difference between the appreciation of the assets and the Section 7520 rate. Thus, GRATs work well for assets expected to significantly appreciate in value.

Tax savings clause. GRATs are irrevocable and not subject to amendment. However, it is common to include a tax savings clause in a GRAT (similar to many other irrevocable trusts) to allow an interpretation of the trust that con-

[33] Note 32, *supra*.

[34] Section 2036 provides for the inclusion of the residence in the grantor's estate if the grantor does not outlive the retained term.

[35] Section 1014(e).

forms to an intended tax benefit. The tax savings clause would generally provide that anything else in the trust notwithstanding, the trust agreement should be interpreted to achieve a specific tax result, and any provision of the trust that would prevent that tax goal from being accomplished would either be ignored, adjusted to produce the desired tax result, or give rise to a trustee power to amend specific terms of the trust to accomplish that goal. Similar tax savings language can be used for any other provisions of the GRAT that must be satisfied to achieve the desired tax result.

For example, in a "zeroed-out" GRAT (referring to a GRAT structured to produce a remainder interest resulting in a zero gift), the tax savings clause would provide that the annuity percentage stated in the trust would be the minimum amount necessary to produce a zero value of the remainder interest. Thus, if the specific percentage stated in the trust works, it will be used, and if it is does not work (because of a mistake in the initial calculation, or a scrivener's error), the minimum necessary would be used.

A tax savings clause may be drafted even more broadly, to provide that the trustee does not have any power and shall not take any action that would disqualify the treatment of the trust as a GRAT.

Asset substitution. Another common GRAT problem relates to its assets. The grantor may want the assets out of the trust, or the expectation as to the appreciation of the assets may change, and the assets are no longer expected to outperform the Section 7520 rate, or trust assets well outperform the expectations and too much wealth is shifted to the remainder beneficiaries. In all cases, the grantor should retain a "swap" power in the GRAT, allowing him or her to substitute a different asset of equivalent value. A swap power is commonly used both in GRATs and intentionally defective grantor trusts. The GRAT should also confer on a trust protector (or some other power holder) the ability to add or change trust beneficiaries.

Other provisions that improve the flexibility of a GRAT include the power of the grantor to:

- Purchase GRAT assets.
- Borrow from the GRAT (on market terms).
- Terminate grantor trust status (the grantor will then not be taxed on trust income).

Termination. The tax consequences of an outright termination of a GRAT with the transfer of assets to the grantor are similar to QPRTs. Remainder beneficiaries are deemed to make a taxable gift of the actuarial value of the remainder interest (as of the date of the gift) to the grantor. If the GRAT is terminated and assets are distributed to the remainder beneficiaries (and the grantor therefore foregoes the annuity payments), the grantor is making a taxable gift of the present value of the remaining annuity payments.

IDGTs

IDGTs are irrevocable trusts that are structured to accomplish a completed gift (i.e., trust assets are not included in the grantor's estate), while remaining a grantor trust for income tax purposes. This structure allows the grantor to sell appreciated assets to the trust without income tax consequences and allows the grantor to be taxed on trust income (reducing the grantor's estate). By selling to the trust an asset that is expected to appreciate in value in exchange for a promissory note from the trust (which will not appreciate in value), the grantor removes future appreciation from his or her estate without any income or gift tax consequences today.

IDGTs have a significant advantage over QPRTs and GRATs—they are not subject to the multitude of rules and regulations to which split-interest trusts are subject. So long as an IDGT is drafted as a grantor trust (commonly, by including the power to lend to the grantor at less than market interest rate or without adequate security), and does not contain any powers or reversions that would cause inclusion of trust assets under Section 2036, the trust works.

Trust protectors work well within the IDGT framework. Their greater flexibility with respect to tax law requirements allows an almost unfettered use of trust protector powers to remove and replace the trustee, change trust beneficiaries (including the power to add the settlor as a beneficiary), and modify certain terms of the trust. Care should be exercised not to give the protector a general power of appointment.

Tax consequences of IDGT termination are similar to QPRTs and GRATs.

Conclusion

An irrevocable trust need not, practically speaking, be truly revocable. Creative drafting can increase flexibility, and state law and consenting parties to the trust may provide additional leeway to adapt an irrevocable trust to satisfy current needs. Unwinding or amending an irrevocable trust, however, may have income and transfer tax consequences that should be considered before implementing a change. ■