Modifying Trusts in Georgia

Southeast Fellows Institute

Session I

Charlotte, North Carolina

September 2022

James D. Spratt, Jr.

Djuric Spratt P.A.

Atlanta, Georgia

Table of Contents

A. Introduction

The 2018 amendments to the Georgia Trust Code introduced a number of new concepts to Georgia trust and estate lawyers (*e.g.,* decanting, nonjudicial settlement agreements and trust directors) and transformed some existing concepts significantly (*e.g.,* trust modifications and representation). The 2018 amendments left a number of questions unanswered. Amendments to the Georgia Trust Code in 2020 answered many of these questions. The 2020 amendments became effective on January 1, 2021. The purpose of this paper is to illustrate how the 2018 and 2020 amendments work in practice.

Alternate versions of this paper illustrating tools to alter the outcomes under irrevocable trusts in various contexts have been presented by the author and his colleague, Cynthia A. Duncan, and former colleague, Jessica Cohan, at a number of seminars. The author gratefully acknowledges the contribution of his colleague, Christa R. Boyd, in the preparation of prior versions of this paper.

To illustrate the material, this paper uses Bob and Jane, a fictional couple, as a case study.

B. Background — Bob and Jane

Bob and Jane live in Georgia and have been married for 35 years. They have three grown children — Bobby, Janie, and Wendy. Bobby is married with three young children. Janie is divorced with one child. Her former husband is a problem. Wendy is the youngest. After graduating from college, she moved away, and most of the time she is difficult to locate.

Bob and Jane built a construction supply business from the ground up that they recently sold to a larger competitor. None of the children were actively engaged in the business and, while

Bob and Jane have been planning for the sale of the business for the past 5 years, they never dreamed the business would sell for what it did.

Over the years, Bob and Jane have engaged in extensive estate planning and have undertaken numerous wealth transfer strategies. As a result of those strategies, Bob and Jane were able to transfer a significant percentage of the business to generation-skipping trusts prior to the sale of the business. In addition, they made large gifts to those same trusts recently to take advantage of the increase in their gift and generation-skipping transfer tax exemptions. They now consider themselves set for life. They also feel like they have accomplished what they wanted to accomplish from a wealth transfer standpoint. At this point, they are looking to "turn-off the spigot" and "declare victory."

The following is a review of the wealth transfer strategies that Bob and Jane have undertaken over the years, some of the ways that they might be able to alter or modify the outcomes of those strategies, and the tax issues that may arise if they choose to modify the various trusts they have created over the years or redirect the assets of those trusts to new trusts.

References herein to the "IRC" are to the Internal Revenue Code of 1986, as amended. References herein to the "Service" are to the Internal Revenue Service. References herein to the "O.C.G.A." are to the Official Code of Georgia Annotated as amended through July 1, 2020.

C. Hypotheticals

1. Hypothetical One — Trusts for the Benefit of Descendants

a. Facts

In 2012, Bob created two generation-skipping trusts, one for the benefit of Bobby and his descendants and one for the benefit of Janie and her descendants ("Bob's 2012 Trusts"). Jane is the trustee of both trusts. If Jane ceases to serve as trustee, then Bob's brother is named as

successor. If Bob's brother ceases to serve, he has the power to name a string of successors. If he fails to do so or if his last-named successor fails or ceases to serve, a corporate successor trustee is named in the trust instrument.

The trustee has broad distribution discretion with respect to both trusts. Bob retained the power in a nonfiduciary capacity to reacquire the trust property of each trust by substituting property of equivalent value. The trust instruments provide that Bob may renounce this power by delivering written notice of his renunciation to the trustee.

Bobby and Janie both have limited powers of appointment over their respective trusts exercisable in favor of Bob's descendants in a lower generation than Bobby and Janie. Bobby's trust provides that in the event his family line dies out, the trust property passes to Janie's trust. Janie's trust has a reciprocal provision. If both Bobby's and Janie's family lines die out, the remote takers are Bob's heirs at law if he died intestate and unmarried at that time.

The trust instruments contain rule against perpetuities savings provisions that require the trust property to vest 21 years after the death of the last surviving descendant of Bob who was living on the date the 2012 Trusts were created. All of the grandchildren were born prior to the creation of the Bob's 2012 Trusts.

Bob's 2012 Trusts are grantor trusts with respect to Bob. After paying a very significant capital gains tax in connection with the sale of the business, Bob would like to terminate the grantor trust status of Bob's 2012 Trusts. Since Bob's 2012 Trusts now hold liquid assets, Bob would also like Bob's 2012 Trusts to provide for an investment advisor to bifurcate investment decisions and distribution decisions. Ideally, Bob would like to serve as the investment advisor of Bob's 2012 Trusts. If Bob is not serving as the investment advisor, he would also like to give someone the ability to remove and replace that investment advisor.

b. Discussion

To determine the steps necessary to "toggle out" of grantor trust status, Bob's 2012 Trusts must be analyzed to determine which powers or beneficial interests are causing them to be grantor trusts. Bob retained a corpus substitution power over each trust. A corpus substitution power is an administrative power under IRC § 675(4)(C),[1] which causes each trust to be a wholly grantor trust[2] with respect to Bob. Fortunately for Bob, he can relinquish the corpus substitution powers, and the trusts will no longer be grantor trusts with respect to him because of this administrative power. As a result, Bob is in the driver's seat with respect to this attribute of grantor trust status.[3]

The corpus substitution powers, however, are not the only trust attributes that cause the trusts to be grantor trusts. Jane is the trustee of each trust. Her distribution authority is not limited by a reasonably definite standard such as a HEMS standard. Consequently, the trusts are wholly grantor trusts with respect to Bob under IRC § 674. Jane has the power to control beneficial enjoyment under IRC § 674(a),[4] and none of the exceptions of IRC § 674(b)[5] or 674(d)[6] apply, which means Jane will also need to resign as trustee of Bob's 2012 trusts.

---

[1] IRC § 675 provides: "The grantor shall be treated as the owner of any portion of a trust in respect of which… (4) [a] power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity." A power to reacquire trust corpus by substituting other property of an equivalent value is a power of administration. *See* IRC § 675(4)(C).

[2] A wholly grantor trust is a trust with respect to which the grantor is deemed to be the owner of both the income and principal of the trust for income tax purposes.

[3] If the trust instrument is silent as to whether the grantor may renounce a corpus substitution power, then state law controls.

[4] IRC § 674(a) provides: "The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party."

[5] IRC § 674(b)(5) provides an exception for a "power to distribute corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries provided that the power is limited by a reasonably definite standard which is set forth in the trust instrument."

[6] IRC § 674(d) provides an exception for "a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries… if such power is limited by a reasonably definite external standard which is set forth in the trust instrument."

If Jane resigns, then Bob's brother will succeed her as trustee of both trusts. Because his distribution discretion is not limited by a reasonably definite standard and he is related to Bob, none of the exceptions under IRC § 674(b), 674(c)[7] or 674(d) would apply, so the trusts would remain grantor trusts with respect to Bob. Bob needs his brother's cooperation. His brother could resign and appoint successor trustees who are not related or subordinate to Bob.[8] This would disengage grantor trust status because the exception under IRC § 674(c) would apply. He also could appoint Bobby as trustee of his family's trust and Janie as trustee of her family's trust. This would terminate grantor trust status because Bobby and Janie are adverse parties[9] with respect to their respective trusts. IRC § 674(a) applies only if the power to control beneficial enjoyment is exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Bob would not want grantor trust status to depend upon who was serving as trustee. He would be concerned that the identity of a future trustee would reengage grantor trust status. Bob would want Bob's 2012 Trusts to be modified to provide that the distribution discretion of any trustee who is related or subordinate to him and who is nonadverse would be subject to a HEMS standard during his lifetime. He also would want the trust agreements scrubbed of any other provisions that could trigger grantor trust status.

---

[7] IRC § 674(c) provides an exception for a power "solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties whom are subservient to the wishes of the grantor — (1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries; or (2) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries)."

[8] IRC § 672(c) defines the term "related or subordinate" to mean "any nonadverse party who is — (1) the grantor's spouse if living with the grantor; (2) any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive."

[9] Treas. Reg. § 672(a)-(1) defines the term "adverse party" to mean "any person having a substantial beneficial interest in a trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust."

O.C.G.A. § 53-12-61(b) provides a statutory mechanism for a settlor and qualified beneficiaries of an irrevocable trust to amend the trust, even if the modification is inconsistent with a material purpose of the trust if the settlor and all qualified beneficiaries consent to such modification. Although a petition must be filed in court, the court's approval is not discretionary. If it finds that the settlor and all qualified beneficiaries approve the modification, the court *shall* approve the modification.[10] A proceeding to approve a modification under this section may be commenced by a trustee, trust director, beneficiary, or settlor.[11] The trustee's consent is not required, the statute merely requires that notice be given to the trustee.[12]

Through this statutory process, Bob and the qualified beneficiaries should be able to modify the trusts. Who are the qualified beneficiaries? "Qualified beneficiaries" are living individuals or other existing persons who, on the date of determination of beneficiary status, are current beneficiaries of the trust (i.e., permissible distributees of the trust income and principal), those who would become beneficiaries if the interests of the current beneficiaries terminated without the trust terminating, and those who would become beneficiaries if the trust terminated.[13] So the qualified beneficiaries of the trusts are Bobby, Janie, their living descendants, all of whom are current beneficiaries, and Bob's heirs at law.

For the purpose of determining the qualified beneficiaries of Bob's 2012 Trusts, who are Bob's heirs at law if he died intestate and unmarried? The 2020 amendments make it clear that this determination is a snapshot that applies only to individuals living at the time of determination

[10] O.C.G.A. § 53-12-61(b) states, in part, that "[d]uring the settlor's lifetime, the court shall approve a petition to modify or terminate an irrevocable trust, even if the modification or termination is inconsistent with a material purpose of the trust, if the settlor and all qualified beneficiaries consent to such modification or termination and the trustee has received notice of the proposed modification or termination."
[11] O.C.G.A. § 53-12-61(e).
[12] Notice must be given to the trustee "by delivery of a copy of the petition by certified or registered mail or statutory overnight delivery with return receipt requested and with delivery restricted to addressee at least 31 days before entry of an order granting the petition." O.C.G.A. § 53-12-61(m)(1)(A)(ii).
[13] O.C.G.A. § 53-12-2(10).

of beneficiary status. If Bob died today, his heirs at law if he died intestate and unmarried would be Bobby, Janie and Wendy.[14] However, the heirs at law provisions of Bob's 2012 Trusts only come into play if Bobby, Janie and all of their descendants are deceased. This would leave Wendy as Bob's sole heir at law if he died intestate and unmarried today.

The consents of the minor descendants of Bob would need to be obtained through "representation." If Wendy cannot be located, her consent would need to be obtained through representation as well. This is the subject of O.C.G.A. § 53-12-8. Under O.C.G.A. § 53-12-8(f)(8), Bobby and Janie should be able to represent their minor and unborn descendants as long as there is no conflict of interest with respect to the subject matter of the modification.[15]

With respect to Wendy, O.C.G.A. § 53-12-8(e) and (h) appear to provide a method for Bobby and Janie to represent Wendy. O.C.G.A. § 53-12-8(e) allows the holder of a power of appointment to represent persons whose interests are as permissible appointees, as takers in default, or are otherwise subject to the power as long as there is no conflict of interest with respect to the particular question. Bobby and Janie have powers of appointment over their respective trusts and should be able to represent all takers in default, which would be Wendy.

O.C.G.A. § 53-12-8(h) permits a person who would be eligible to receive distributions of income or principal from the trust upon the termination of the interests of all persons then currently eligible to receive distributions of income or principal to represent contingent successor remainder beneficiaries as long as there is no conflict of interest with respect to the particular question. Bobby and his descendants are the persons currently eligible to receive distributions of income or

[14] *See* O.C.G.A. § 53-2-1(c).
[15] O.C.G.A. § 53-12-8(f)(8) provides: "To the extent there is no conflict of interest between the representative and the person represented or among those being represented with respect to a particular question or dispute…[a]n ancestor may represent and bind an ancestor's minor or unborn descendant if a conservator or guardian for such descendant has not been appointed."

principal from his trust. Janie, as a beneficiary of her trust, would be a person eligible to receive distributions of income or principal upon the termination of the interests of Bobby and his descendants. Therefore, with respect to Bobby's trust, Janie should be able to represent Wendy as the contingent successor remainder beneficiary. The same would be true with respect to Bobby for Janie's trust.

If Bobby and Janie were satisfied that there were no conflicts of interest in their representation of their minor descendants and Wendy, then Bob, Bobby, and Janie could petition the court to make the necessary modifications to the trusts and the court would have no discretion. Under O.C.G.A. § 53-12-61(b), it would be required to approve the modifications.

The termination of grantor trust status for a trust has a significant impact on current and future beneficiaries. Bob may be concerned that Janie's former husband might dream up some conflict of interest that would nullify Janie's representation of her minor descendants. If Janie were unwilling or unable to serve in a representative capacity for her minor descendants, then not all beneficiaries would be consenting to the modifications, so O.C.G.A. § 53-12-61(b) would not apply. Janie could ask the court to appoint a representative to represent her minor descendants, but that could raise questions from the court as to why Bobby's minor descendants would not similarly need an appointed representative.[16] Modification might be possible, however, under

[16] O.C.G.A. § 53-12-8(i) provides: "If the court determines that an interest is not represented under this Code section, or that the otherwise available representation might be inadequate, the court may appoint a representative to receive notice, give consent, and otherwise represent, bind, and act on behalf of a minor, incapacitated, or unborn individual, or a person whose identity or location is unknown and not reasonably ascertainable. A representative may be appointed to represent several persons or interests. A representative may act on behalf of the individual represented with respect to any matter arising under this chapter, regardless of whether a judicial proceeding concerning the trust is pending. In making decisions, a representative may consider the general benefit accruing to the living members of the individual's family."

O.C.G.A. § 53-12-61(d)(1) and/or (4).[17] This would require court approval, which would be discretionary.

An action under O.C.G.A. § 53-12-61(d) may be commenced by a trustee, trust director, or beneficiary.[18] This could require the appointment of a representative for the minor beneficiaries. Whether that representative or the court would go along with such a modification is by no means certain. Bob and Jane could decide that the judicial modification process is too complicated, and the outcome is too uncertain.

As noted above, a modification of Bob's 2012 Trusts under O.C.G.A. § 53-12-61(b) would not require Jane's participation as trustee, the trustee is simply required to be notified. If Jane were worried that Wendy or Janie's former husband might claim that she breached a fiduciary duty by going along with trust modifications that terminated grantor trust status, she would have some protection in the fact that her consent would not be required under O.C.G.A. § 53-12-61(b). She would be a bystander.

If Jane were not worried about a breach of fiduciary duty claim, or if she were willing to take the risk, then in lieu of the judicial route the modifications could instead be accomplished through the exercise of her decanting power. Under O.C.G.A. § 53-12-62, a trustee with authority to invade the principal of an "original trust"[19] to make distributions to or for the benefit of one or more of the beneficiaries may also, independently or with court approval, exercise such authority by distributing all or part of the principal of the original trust to a trustee of a "second trust,"[20]

---

[17] O.C.G.A. § 53-12-61(d)(1) provides: "The court may, upon petition…[m]odify the trust if, owning to circumstances not anticipated by the settlor, modification would further the purposes of such trust." O.C.G.A. § 53-12-61(d)(4) provides: "The court may, upon petition…[m]odify the trust to achieve the settlor's tax objectives, with such modification to have either prospective or retroactive effect."

[18] O.C.G.A. § 53-12-61(e).

[19] O.C.G.A. § 53-12-62(a)(1) defines the term "original trust" to mean the trust from which principal is being distributed.

[20] O.C.G.A. § 53-12-62(a)(2) defines the term "second trust" to mean the trust to which assets are being distributed from the original trust, whether a separate trust or an amended version of the original trust.

whether a separate trust or an amended version of the original trust. Accordingly, Jane could exercise her decanting power to modify Bob's 2012 Trusts or transfer the assets of Bob's 2012 Trusts to new trusts that have the desired modifications.[21]

In exercising this decanting power, however, the second trust may not (1) include as a "current beneficiary"[22] a person who is not a current beneficiary of income or principal of the original trust or (2) include as a beneficiary, as defined in O.C.G.A. § 53-12-2(2), any person that is not a beneficiary of the original trust.[23] So Jane may not add beneficiaries in the exercise of her decanting power, but note that she may remove beneficiaries. The second trust may also confer a power of appointment upon a beneficiary of the original trust to whom or for the benefit of whom the trustee has the power to distribute the principal of such original trust.[24] The permissible appointees of the power of appointment conferred upon a beneficiary may include persons who are not beneficiaries of the original trust or second trust.[25] So if Bob and Jane wanted to give Bobby and Janie the ability to reduce the amount of property that passes in trust for his or her children upon his or her death, the second trusts could expand the scope of Bobby's and Janie's limited powers of appointment by including charities in the class of permissible appointees. It is

[21] The trustee has broad distribution discretion with respect to Bob's 2012 Trusts. If the trustee's distribution discretion were limited to an ascertainable standard, such as a HEMS standard, would Jane's authority to exercise her decanting power be limited in some manner? Under O.C.G.A. § 53-12-62(b)(2), a trustee with authority to invade the principal of the original trust to make distributions to or for the benefit of one or more of the beneficiaries may also exercise *such* authority by distributing all or part of the principal of the original trust to a trustee of a second trust. While not explicit, this seems to imply that the decanting authority is limited to the scope of the trustee's authority to invade principal under the original trust. Does this mean the trustee is limited to distributing the amount the trustee could have distributed to the beneficiaries under the HEMS standard to the second trust? Alternatively, would the trustee be permitted to distribute all of the trust property to a second trust where distributions are limited to the same HEMS standard as the original trust? These are open questions under O.C.G.A. § 53-12-62(b)(2).

[22] O.C.G.A. § 53-12-62(b)(1) defines the term "current beneficiary" to mean a person who, on the date of distribution to the second trust, is a distributee or permissible distribute of trust income or principal.

[23] O.C.G.A. § 53-12-62(b)(2).

[24] O.C.G.A. § 53-12-62(h).

[25] O.C.G.A. § 53-12-62(h).

also clear under the statute that the second trusts created as the result of Jane exercising her decanting power need not qualify as grantor trusts for federal income tax purposes.[26]

Jane would be able to exercise her decanting power without the consent of any person and without court approval.[27] She would, however, need to satisfy the notice provisions of O.C.G.A. § 53-12-62(c).[28] The notice must be delivered 30 days before the proposed distribution to the second trust and would need to describe the manner in which Jane intended to exercise the decanting power and the proposed effective date for the exercise of the power. In accordance with the provisions of the statute, the notice would need to be sent to Bob, as the settlor of Bob's 2012 Trusts, and to the persons entitled to annual reports under the trust instruments. Under the terms of the trust instruments, each adult person who is eligible to receive income from the subject trust is entitled to an annual report, so the notice would need to be sent to Bobby and Janie as well. Is the notice requirement waivable by the persons entitled to notice or would Jane need to wait 30 days after providing notice to Bob, Bobby and Janie? There is nothing in the Georgia statute explicitly allowing a trustee to exercise his or her decanting power before the expiration of the 30-day period if waived by those entitled to notice,[29] but if Bob, Bobby and Janie all waive the notice provisions, it is hard to see anyone else with reason to complain. Moreover, Jane could argue that she has the right to decant under Georgia common law with no notice requirements.[30]

---

[26] O.C.G.A. § 53-12-62(j)(1).
[27] O.C.G.A. § 53-12-62(c).
[28] O.C.G.A. § 53-12-62(c) provides, in part: "Except as provided in this Code section, a trustee may exercise the power to invade the principal of the original trust under subsection (b) of this Code section without the consent of the settlor or the beneficiaries of the original trust if such trustee provides written notice of such trustee's decision to exercise the power to such settlor, if living, any trust director, and those persons then entitled to annual reports from the trustee of the original trust."
[29] Section 7(f) of the Uniform Trust Decanting Act provides: "The decanting power may be exercised before expiration of the notice period under subsection (a) if all persons entitled to receive notice waive the period in a signed record."
[30] O.C.G.A. § 53-12-62(g) provides: "This Code section shall not be construed to abridge the right of any trustee who has a power of invasion to distribute property in further trust that arises under any other law or under common law, and nothing in this Code section shall be construed to imply that the common law does not permit the exercise of a power to invade the principal of a trust in the manner authorized under subsection (b) of this Code section."

Jane's compliance with the notice requirements would not alter the rights of the beneficiaries to petition a court asserting that the exercise of the decanting power was ineffective because it did not comply with the statute, it was an abuse of discretion, or otherwise a breach of fiduciary duty. While there is statutory authority for Jane to remove beneficiaries, include permissible appointees under powers of appointment who are not beneficiaries of the original trust or decant from a grantor trust to a non-grantor trust, the exercise of any such authority will still be subject to Jane's fiduciary duties as trustee. Thus, the question is not "can" Jane exercise her authority, but rather, "should" Jane exercise her authority. If Jane were uncomfortable proceeding with the exercise of her decanting power without court approval, then she could petition the court to provide instructions on whether the proposed exercise of her decanting power is permitted under the statute and consistent with her fiduciary duties.

Is there another way Bob's 2012 Trusts could be modified without a judicial action? Under Georgia common law and since July 1, 2018, under the Georgia Trust Code, "the trustee, any trust director, and all other persons whose interests would be affected may enter into a binding nonjudicial settlement agreement with respect to any matter involving the trust."[31] Under O.C.G.A. § 53-12-9(b), a nonjudicial settlement agreement is (i) valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court under the Georgia Trust Code or other applicable law and (ii) not valid with respect to any modification or termination of an irrevocable trust when the settlor's consent would be required in a proceeding to approve such modification or termination under subsection (b) of Code Section 53-12-61. Thus, a modification under O.C.G.A. § 53-12-61(b) may not be

[31] O.C.G.A. § 53-12-9(a).

accomplished via a nonjudicial settlement agreement because the settlor's consent (along with qualified beneficiaries) is required under O.C.G.A. § 53-12-61(b).

A modification under O.C.G.A. § 53-12-61(d), however, may be possible via a nonjudicial settlement agreement. A nonjudicial settlement agreement is "final and binding on all parties to such agreement, including individuals not sui juris, unborn beneficiaries, and persons unknown who are represented by a person who may represent and bind such parties under Code Section 53-12-8, as if ordered by a court with competent jurisdiction over the trust, the trust property, and the parties."[32]

The necessary parties to the nonjudicial settlement agreement would be the qualified beneficiaries (Bobby, Janie, their born descendants, and Wendy), Bobby and Janie's unborn descendants, and Bob's heirs at law assuming Wendy predeceased the last to survive of Bobby, Janie, and their descendants. Bobby and Janie should be able to represent their unborn descendants under Code Section 52-12-8(f)(8). Because of their powers of appointment, Bobby and Janie should be able to represent Bob's unknown heirs at law under Code Section 53-12-8(e).

Regardless of the method by which Bob and Jane choose to modify Bob's 2012 Trusts, the modified trusts (or second trusts in a decanting) should be able to provide for the investment advisor Bob desires. The 2018 amendments to the Georgia Trust Code added Article 18, providing for trust directors and directed trustees.[33] O.C.G.A. § 53-12-500(4) defines a trust director as "a person that is granted a power of direction by a trust to the extent the power is exercisable while the person is not serving as a trustee, regardless of how the trust instrument refers to such person and regardless of whether the person is a beneficiary or settlor of the trust."

[32] O.C.G.A. § 53-12-9(d).
[33] O.C.G.A. § 53-12-500, *et seq*. The Georgia provisions are a modified version of the Uniform Directed Trust Act.

O.C.G.A. § 53-12-500(3) defines a power of direction as "a power over a trust granted to a person by the trust instrument to the extent the power is exercisable while the person is not serving as a trustee." A power of direction includes a power over the administration of the trust or the investment, management, or distribution of the trust property; a power to consent to a trustee's actions, whether through exercise of an affirmative power to consent or through nonexercise of a veto power over a trustee's actions, when a trustee may not act without such consent; and, all further powers appropriate to the exercise or nonexercise of such powers held by the trust director described in subsection (b) of Code Section 53-12-502. Under O.C.G.A. § 53-12-500(1), a directed trustee is a trustee that is subject to a trust director's power of direction.

A power of direction specifically does not include (i) a power of appointment; (ii) a power to appoint or remove a trustee or trust director; (iii) a power of a settlor to revoke the trust or amend the trust instrument; (iv) a power of a beneficiary over a trust to the extent the exercise or nonexercise of the power affects the beneficial interest of the beneficiary or a person represented by the beneficiary under O.C.G.A. § 53-12-8 with respect to the exercise or nonexercise of the power; or (v) a power over a trust if (A) the terms of the trust provide such power is held in a nonfiduciary capacity and (B) such power must be held in a nonfiduciary capacity to achieve the settlor's tax objectives.[34]

Thus, an investment advisor with authority over the investments in Bob's 2012 Trusts would be a trust director, regardless of the fact that the trust agreements call such person an investment advisor, rather than a trust director. Additionally, if Bob's 2012 Trusts are modified to provide for an investment advisor and also to give a person the ability to remove that investment

[34] O.C.G.A. § 53-12-501(b).

advisor, the person holding the power to remove the investment advisor will not hold a power of direction, and thus will not be a trust director.

O.C.G.A. § 53-12-502(a) provides the authority for a trust instrument to grant powers of direction to a trust director. O.C.G.A. § 53-12-503(a) makes clear that with respect to a power of direction, a trust director has the same fiduciary duty and liability in the exercise or nonexercise of the power of direction as a trustee in a like position and under similar circumstances, and that the trust instrument may vary the trust director's duty or liability to the same extent the trust instrument could vary the duty or liability of a trustee in a like position and under similar circumstances. A trust director acting in reliance on information provided by a trustee or another trust director is not liable for a breach of trust to the extent the breach resulted from such reliance, unless the trust director engages in bad faith.[35] Bob's 2012 Trusts could thus not relieve the investment advisor of liability for a breach of trust committed in bad faith or with reckless indifference to the interests of the beneficiaries.[36]

A trust director does not have a duty to monitor a trustee or another trust director regarding matters outside the scope of the trust director's powers of direction, or inform or give advice to a settlor, beneficiary, trustee, or another trust director concerning an instance in which the director might have acted differently than a trustee or another trust director.[37] A trust director does, however, have a duty to keep trustees and other trust directors reasonably informed of the exercise or nonexercise of the trust director's power of direction to the extent such exercise or nonexercise is relevant to the trustee's or other trust director's powers and duties regarding the trust, and to respond to reasonable requests from trustees and other trust directors for information to the extent

[35] O.C.G.A. § 53-12-503(h).
[36] *See* O.C.G.A. § 53-12-303(a).
[37] O.C.G.A. § 53-12-503(j)(1).

such information is relevant to the trustee's or other trust director's powers and duties regarding the trust.[38]

A directed trustee is required to take reasonable action to comply with a trust director's exercise or nonexercise of a power of direction and is not liable for such action unless compliance would clearly constitute willful misconduct on the part of the directed trustee.[39] A directed trustee acting in reliance on information provided by a trust director is not be liable for a breach of trust to the extent the breach resulted from such reliance, unless the directed trustee acts in bad faith.[40]

A directed trustee is required to account at least annually to a trust director as if the trust director were a qualified beneficiary of an irrevocable trust to whom income is required or authorized in the trustee's discretion to be distributed and to respond to reasonable requests from a trust director for information to the extent such information is relevant to the trust director's interest in or trust director's powers and duties regarding the trust.[41] A directed trustee does not, however, have a duty to (i) monitor, investigate, review, or evaluate a trust director, including a trust director's actions or inactions; (ii) provide any accountings, reports, or other information to a trust director beyond that required by subsection (b) of O.C.G.A. § 53-12-504(c); (iii) advise a trust director regarding the scope, nature, execution, standard of care, potential liability, or other aspects of their status as trust director; (iv) take any action in response to willful misconduct by the trust director other than the refusal to comply with such direction; (v) attempt to compel a trust director to act or not act; (vi) petition the court regarding a trust director's action, inaction, capacity, or any similar matter; or (vii) inform or give advice to a settlor, beneficiary, trustee, or

[38] O.C.G.A. § 53-12-503(g).
[39] O.C.G.A. § 53-12-504(a).
[40] O.C.G.A. § 53-12-504(d).
[41] O.C.G.A. § 53-12-504(c).

trust director concerning an instance in which the trustee might have acted differently than the trust director.[42]

2. Hypothetical Two — Spousal Access Trust

a. Facts

In 2012, Jane created a trust for the benefit of Bob and their descendants ("Jane's 2012 Trust"). Bob is the trustee of the trust. He has the authority to name a string of successors. With respect to distributions to descendants, Bob has broad discretion, but with respect to distributions to himself, his discretion is limited by a HEMS standard. In exercising this standard, Bob, as trustee, is required to take into account other resources available to him.

Bob has lifetime and testamentary limited powers of appointment in favor of Jane's descendants and trusts for their benefit. Upon Bob's death, the trust will divide into separate trusts for Bobby and Janie and their respective descendants. The terms of these separate trusts are identical to the terms of Bob's 2012 Trusts, except the remote taker is Jane's sister, if then living, and otherwise Jane's sister's descendants then living.

The trust contains a rule against perpetuities savings provision that requires the trust property to vest 21 years after the death of the survivor of Bob and the last surviving descendant of Jane's who was living on the date the trust was created. The trust is exempt from the generation-skipping transfer tax because sufficient GST exemption was allocated to the trust to cause it to have an inclusion ratio of zero.

Jane retained a corpus substitution power over the trust property. The trust instrument provides that Jane may renounce this power by delivering written notice of her renunciation to the trustee.

[42] O.C.G.A. § 53-12-504(f)(1).

The trust is a grantor trust with respect to Jane. After paying a very significant capital gains tax in connection with the sale of the business, Jane would like to terminate the grantor trust status of Jane's 2012 Trust.

b. Discussion

To determine the steps necessary to toggle out of grantor trust status, Jane's 2012 Trust must be analyzed to determine which powers or beneficial interests are causing the trust to be a grantor trust with respect to Jane. The trust has the same attributes that cause Bob's 2012 Trusts to be grantor trusts with respect to him. Jane retained a corpus substitution power over the property of Jane's 2012 Trust, and Bob is trustee. To terminate grantor trust status, Jane would need to renounce her corpus substitution power, Bob would need to resign as trustee and appoint a trustee that did not trigger grantor trust status under Section 674, and the trust would need the same modifications that Bob's 2012 Trusts need. But these actions would not be sufficient because there are two additional attributes that cause Jane's 2012 Trust to be a wholly grantor trust with respect to her.

First, Bob has lifetime and testamentary limited powers of appointment. These are powers to control beneficial enjoyment under IRC § 674(a),[43] and none of the exceptions under IRC § 674(b), 674(c) or 674(d) apply.[44] These powers would be attributed to Jane under IRC § 672(e). Bob would need to renounce his lifetime and testamentary limited powers of appointment.

[43] Although Bob is a beneficiary of Jane's 2012 Trust, he is not considered an adverse party because under IRC § 672(e) the interest that would otherwise make him an adverse party is attributed to Jane.

[44] IRC § 674(b)(3) provides an exception for a power exercisable only by will, which would include Bob's testamentary limited power of appointment. This exception, however, does not apply to "a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party." It would seem that under IRC § 672(e), Bob's testamentary power of appointment would be attributed to Jane, the grantor, and the income of Jane's 2012 Trust may be accumulated in the discretion of the trustee. Because there is no way to ensure that there will always be an adverse party willing and able to serve as trustee, there is no way to ensure that the IRC § 674(b)(3) exception would always apply.

Second, Bob is a beneficiary of the trust. The trust is thus a wholly grantor trust with respect to Jane under IRC § 677(a)(1).[45] Bob's beneficial interest in the trust triggers grantor trust status under IRC § 677(a)(1) unless an adverse party is serving as trustee. Because there is no way to ensure that there will always be an adverse party willing and able to serve as trustee, Bob would need to relinquish his beneficial interest in the trust.

There are several actions that Bob and others could take to eliminate his powers and beneficial interest with respect to Jane's 2012 Trust, thus terminating grantor trust status. First, Bob could exercise his lifetime limited power of appointment in favor of trusts for Bobby, Janie, and their respective descendants. If the new trusts had no attributes that would cause them to be grantor trusts with respect to Jane, this would work.

Second, Jane, as settlor, and Bob and the other qualified beneficiaries of Jane's 2012 Trust could modify and divide the trust under O.C.G.A. § 53-12-61(b).[46] As noted above, under O.C.G.A. § 53-12-61(b), the settlor and all qualified beneficiaries may modify or terminate a trust even if the modification or termination is inconsistent with a material purpose of the trust. So, it would not matter whether Bob's beneficial interest in Jane's 2012 Trust was a material purpose.

Modifying Jane's 2012 Trust under O.C.G.A. § 53-12-61(b) would raise some of the same representation issues as the modifications of Bob's 2012 Trusts. Since Bob and Jane file join income tax returns, Bob likely has a conflict of interest with respect to the other beneficiaries, so he could not represent the takers in default of the exercise of his power of appointment under O.C.G.A. § 53-12-8(e).

---

[45] IRC § 677(a) provides: "The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be – (1) distributed to the grantor or the grantor's spouse…."

[46] O.C.G.A. § 53-12-61(j) provides that modification of a trust includes the consolidation or division of a trust.

Additionally, it is unclear whether Bobby and Janie could represent contingent successor remainder beneficiaries under O.C.G.A. § 53-12-8(h). As noted above, Bob and Bob and Jane's descendants are currently eligible to receive distributions of income and principal from Jane's 2012 Trust. O.C.G.A. § 53-12-8(h) permits a person who would be eligible to receive distributions of income or principal from the trust upon the termination of the interests of all persons then currently eligible to receive distributions of income or principal to represent contingent successor remainder beneficiaries as long as there is no conflict of interest with respect to the particular question. If Bob's and Bob and Jane's descendants' interests in Jane's 2012 Trust all terminate, Jane's sister would the person eligible to receive distributions of income or principal from the trust, so Bobby and Janie could not represent the contingent successor remainder beneficiaries under O.C.G.A. § 53-12-8(h).

Because of this uncertainty, Bob and Jane would want Jane's sister to consent to the modification as well as the person who would be eligible to receive distributions of income or principal from the trust upon the termination of all persons then currently eligible to distributions of income and principal. If Jane's sister would agree to consent to the modification, she could represent her descendants under O.C.G.A. § 53-12-8(h) as well because they are contingent successor beneficiaries.[47] If Jane's sister would not consent or if Bob and Jane do not want to inform Jane's sister regarding Jane's 2012 Trust, Bob and Jane could take an alternative and

[47]To illustrate a circumstance that was clarified by the 2020 amendments, assume that the remote taker provision of Jane's 2012 Trust does not include Jane's sister, and if Jane has no living descendants, the property will go to Wendy. Assume also that Jane's sister's then living descendants are all minors. Jane's sister should be able to represent her minor descendants under O.C.G. A. § 53-12-8(f)(8) and represent Wendy also as a contingent successor remainder beneficiary under O.C.G.A. § 53-12-8(h). O.C.G.A. § 53-12-8(j) provides that "the representative of a person represented under this Code section may represent and bind any other person who could be represented under this Code section by the person being represented by the representative if the person being represented were living and sui juris but only to the extent there is no conflict of interest between the representative and such other person or among those being represented with respect to the a particular question or dispute." This allows for "piggy back" representation.

perhaps more nuanced position with respect to O.C.G.A. § 53-12-8(h) and decide that "termination of the interests of all persons then currently eligible to receive distributions of income or principal" means interests in Jane's 2012 Trust as it exists now. Each current beneficiary's interest in that trust terminates upon Bob's death and that trust splits into separate trusts for Bobby and Janie. Bobby and Janie would then be eligible to receive distributions of income or principal and could represent the contingent successor remainder beneficiaries of Jane's 2012 Trust. Bobby and Janie may be less concerned about serving as representatives in this case than in the case of Bob's 2012 Trusts because all of the beneficiaries are benefiting from the termination of Bob's beneficial interest and lifetime and testamentary limited powers of appointment. To the remaining beneficiaries of Jane's 2012 Trust, this benefit might be worth the loss of grantor trust status.

In exercising his lifetime limited power of appointment or in consenting to a modification, Bob would be participating in an action that would result in the termination of his beneficial interest in the trust. Would either action be considered a gift? In *Regester v. Commissioner,*[48] the Tax Court held that the exercise of a limited power of appointment over the corpus of a trust by the income beneficiary was a taxable gift of the income interest in the property appointed.[49] Bob's consent to a modification that would terminate his beneficial interest in Jane's 2012 Trust also would be a gift. [50]

---

[48] 83 T.C. 1 (1984).

[49] This was contrary to the decision of the Court of Claims in *Self v. United States,* 142 F. Supp. 939 (1956). In Rev. Rul. 79-327, 1979-2 C.B. 342, the Service stated that it would not follow *Self* to the extent it would be contrary to the Regulations. Here the Service was referring to Treas. Reg. § 25.2514-1(b)(2), which states that the exercise of a limited power of appointment by an income interest holder is a taxable gift under IRC § 2511(a).

[50] IRC § 2511 provides that the gift tax imposed by IRC § 2501 shall apply whether the transfer is "in trust or otherwise," whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Treas. Reg. § 25.2511-2(a) provides that the gift tax is "not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon the ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable." Therefore, it is not necessary to identify a donee in order to determine that a gift has been made.

The value of Bob's gift would be very hard to determine. IRC § 7520 provides that the value of an annuity, any interest for life or a term of years, or any remainder or reversionary interest shall be determined under tables prescribed by the Secretary. Thus, a beneficiary's interest in a trust typically is not valued with reference to the willing seller-willing buyer standard, but rather is valued in accordance with actuarial tables prescribed by the regulations. The use of the actuarial tables provides a mechanical approach to valuation that avoids the need to examine the facts and circumstances of every case.

The value of Bob's beneficial interest in Jane's 2012 Trust, however, would not be determined under IRC § 7520 because his beneficial interest in the trust is not an "ordinary income interest."[51] So how would the value of Bob's beneficial interest be determined? He is a discretionary beneficiary, the distribution discretion is subject to a HEMS standard, the trustee is required to take into account his other resources, and the trustee has broad discretion to distribute trust income and corpus to other beneficiaries. Bob's other resources are significant, so it is unlikely that he would ever receive a distribution of income or principal from Jane's 2012 Trust.

[51] Treas. Reg. § 20.7520-3(b)(1)(i)(B) provides: "An *ordinary income interest* is the right to receive the income from or the use of property during one or more measuring lives or for some other defined period. A standard section 7520 income factor for an ordinary income interest represents the present worth of the right to receive the use of $1.00 for a defined period, using the interest rate prescribed under section 7520 for the appropriate month." Treas. Reg. § 20.7520-3(b)(2)(ii)(B) provides that "a standard Section 7520 income factor" may not be used to value a term income interest or life interest if the governing instrument "permits the beneficiary's income or other enjoyment to be withheld, diverted, or accumulated for another person's benefit without the consent of the income beneficiary," or if the governing instrument "permits the trust corpus to be withdrawn from the trust for another person's benefit without the consent of the income beneficiary…." Treas. Reg. § 20.7520-3(b)(2)(iv), Example 3 describes a trust created by decedent, A, in which all income is paid to A's child for life with remainder to grandchild. The trust instrument authorizes the trustee to distribute corpus to A's surviving spouse for the spouse's "comfort and happiness." Because the trustee's power to invade trust corpus in unrestricted, the exercise of the power could result in the termination of the income interest at any time. Thus, the income interest would not be considered an ordinary income interest and may not be valued under Section 7520.

Prior to the enactment of IRC § 7520, the Service issued Rev. Rul. 70-292[52] and Rev. Rul. 75-550,[53] which could be relevant to the valuation of Bob's beneficial interest.[54] In each of these rulings, the Service ruled that the income interest of a beneficiary was susceptible to valuation even though the trustee had discretion to distribute income to another beneficiary because the discretion to distribute income to the other beneficiary was subject to an ascertainable standard. The authority of the trustee of Jane's 2012 Trust to distribute income or principal to beneficiaries other than Bob is not limited by an ascertainable standard. These rulings imply that Bob's beneficial interest would not be susceptible to valuation because the discretion of the trustee of Jane's 2012 Trust to distribute income or principal to beneficiaries other than Bob is not limited by an ascertainable standard.

Notwithstanding the foregoing, Bob may not be comfortable exercising his power of appointment or consenting to the modification because he is not willing to take on any exposure to gift tax liability, then he may wish to consider a third alternative — the exercise of his decanting

---

[52] 1970-1 C.B. 187. In Rev. Rul. 70-292, a transferor created a trust in which his daughter held a life income interest. The trustee had the authority to use income for the benefit of the transferor's spouse. Under state law, this authority was determined to be limited by an ascertainable standard. The Service held that because the power to divert income was limited by an ascertainable standard, the income interest was susceptible of valuation. It went on to state that under the facts of the ruling, the likelihood that the trustee would exercise this power was so remote as to be negligible. This ruling dealt with the credit under Section 2013 for previously taxed property, which requires that the interest in the trust be ascertainable.

[53] 1975-2 C.B. 357. In Rev. Rul. 75-550, the Service dealt with a similar issue under Section 2013 in valuing an income interest subject to an encroachment power "for the comfort, support, hospital or medical expenses" of the children of the beneficiary of the income interest. This was deemed to be an ascertainable standard. It was determined that the children needed $100,000 per year in support based on prior experience, so the Service valued the income interest assuming an annual encroachment of $100,000. *See also* PLR 9451049, in which the Service ruled that the exercise of a limited power of appointment over a trust in which the powerholder had the right to periodic distributions of income and principal to provide for health, support and maintenance in the standard of living to which the powerholder was accustomed was a taxable gift under both Treas. Reg. § 25.2514-1(b)(2) and IRC § 2511(a), the value of which was readily ascertainable. Presumably the powerholder was entitled to trust distributions. The ruling cited Rev. Rul. 75-550 for guidance on valuing the taxable gift. The Service concluded that the present value of all possible distributions to the donee annually was the basis for determining the value of the taxable gift.

[54] There may be some question whether these rulings apply after the enactment of Section 7520 and the regulations thereunder or in a context other than Section 2013, but note the reference to Rev. Rul. 75-550 in PLR 200243026, which deals with the GST tax and gift tax consequences of the exercise of a power of appointment in which the powerholder had an income interest in the trust.

power under O.C.G.A. § 53-12-62. Bob's exercise of his decanting power may not have gift tax implications because he is exercising his distribution power as a fiduciary.[55] If there were any doubts about that, Bob could resign, name a successor trustee who does not have a beneficial interest in the trust, and the successor trustee could exercise the decanting power.

Exercising the decanting power might be the best alternative from a gift tax perspective. It would be the best alternative from a generation-skipping transfer tax ("GSTT") standpoint as well. Jane's 2012 Trust is exempt from the GSTT because GST exemption was allocated on a timely basis to all transfers to the trust. Bob and Jane would not want to jeopardize the GSTT exempt status of the trust.

[55] Treas. Reg. § 25.2511-1(g)(2) provides: "If a trustee has a beneficial interest in trust property, a transfer of the property by the trustee is not a taxable transfer if it is made pursuant to a fiduciary power the exercise or nonexercise of which is limited by a reasonably fixed or ascertainable standard which is set forth in the trust instrument. A clearly measurable standard under which the holder of a power is legally accountable is such a standard for this purpose. For instance, a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; to enable him to maintain his accustomed standard of living; or to meet an emergency, would be such a standard. However, a power to distribute corpus for the pleasure, desire, or happiness of a beneficiary is not such a standard. The entire context of a provision of a trust instrument granting a power must be considered in determining whether the power is limited by a reasonably definite standard. For example, if a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or nonexercise of a power, the power is not limited by a reasonably definite standard. However, the fact that the governing instrument is phrased in discretionary terms is not in itself an indication that no such standard exists." Bob's discretion to distribute to beneficiaries other than himself is not limited to a reasonably fixed or ascertainable standard, so the exercise of his decanting power would not fall within this "safe harbor." The author is not aware of any case where the Service has argued that a trustee with a beneficial interest in a trust made a gift by exercising a distribution power that was not limited by a reasonably fixed or ascertainable standard.

The regulations under IRC § 2601 provide rules for determining when the exercise of a discretionary power, modification, judicial construction, or settlement agreement with respect to a grandfathered trust[56] will not result in the loss of the trust's GSTT exempt status.[57]

With respect to an exercise of a discretionary power over a trust, the regulations provide that the distribution of trust principal from an exempt trust to a new trust will not cause the new trust to lose its GSTT exempt status if (1) either the terms of the trust instrument authorize such action, or at the time the exempt trust became irrevocable, state law authorized such action,[58] without the consent or approval of any beneficiary or court, and (2) the terms of the governing instrument of the new trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years.[59]

With respect to a modification of a trust, the regulations provide that a modification by judicial reformation, or nonjudicial reformation that is valid under state law, will not cause the

---

[56] No precedential guidance has been issued concerning changes that may affect the status of a trust that is exempt from the GSTT not because of its effective date but because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. The Service has noted in multiple private letter rulings that at a minimum, a change that would not affect the GSTT status of a trust that was irrevocable on September 25, 1985, should similarly not affect the GSTT status of a trust that is exempt from GSTT because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. *See e.g.*, PLR 201138027, PLR 201418001, and PLR 201604001. As a practicing lawyer, defaulting to this "safe harbor" is clearly the safest position to take. From an academic perspective, however, there is a compelling argument that the rules applicable to grandfathered trusts should not and do not apply to trusts that are exempt from the GSTT as a result of the allocation of GST exemption. *See* James P. Spica, *Means to an End: Electively Forcing Vesting to Suit Tax Rules Against Perpetuities*, 40 ACTEC L.J. 347, 356-59 (2014).

[57] Treas. Reg. § 26.2601-1(b)(4)(i).

[58] For purposes of this discussion, it is assumed that prior to the enactment of O.C.G.A. § 53-12-62, Georgia common law would have allowed the exercise of Bob's decanting power. *See* O.C.G.A. § 53-12-62(f).

[59] Treas. Reg. § 26.2601-1(b)(4)(i)(A). For purposes of (b)(4)(i)(A), the exercise of a trustee's distributive power that validly postpones or suspends the vesting, absolute ownership, or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date the original trust became irrevocable) will not be considered an exercise that postpones or suspends vesting, absolute ownership, or the power of alienation beyond the perpetuities period.

trust to lose its GSTT exempt status if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.[60]

The termination of Bob's beneficial interest in Jane's 2012 Trust could be viewed as a shift of his beneficial interest to his children and more remote descendants. Accordingly, a modification and division under O.C.G.A. § 53-12-61 could jeopardize the GSTT exempt status of Jane's 2012 Trust. The exercise of Bob's decanting power would be a better option because under the regulations an exercise of a discretionary power may shift a beneficial interest to lower generations as long as the vesting period is not extended.[61]

Whether the modification and division of Jane's 2012 Trust are accomplished through a judicial modification or a decanting, the effect is the same in that Bobby and Janie (and the other beneficiaries) are each giving up a beneficial interest in one trust in exchange for a beneficial interest in another. If this is treated as an exchange, could this result in gain recognition under IRC § 1001? This depends upon whether the beneficial interests are materially different. In *Cottage Savings Association v. Commissioner*,[62] the Supreme Court considered what "materially different"

[60] Treas. Reg. § 26.2601-1(b)(4)(i)(D). This regulation provides that "a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification."

[61] The Service has announced that it will no longer issue rulings in factual situations similar to those set forth in the examples contained in Treas. Reg. § 26.2601-1(b)(4)(i)(E). Rev. Proc. 2019-3, § 3.01(108).

[62] 499 U.S. 554 (1991).

means for purposes of IRC § 1001. The Court held that interests are materially different if they involve legal entitlements that are different in kind or extent.[63]

The Service has discussed the application of *Cottage Savings* in numerous private letter rulings. Although the Service's view as to what constitutes an exchange for purposes of IRC § 1001 has evolved, it now takes the position that an action taken by the trustee or a beneficiary which is authorized (1) under the terms of the trust instrument; (2) by a state statute;[64] or (3) pursuant to a court approved settlement agreement in connection with a bona fide dispute between the parties does not result in a sale or exchange for purposes of IRC § 1001.[65] Although the private letter rulings are numerous, none appear to address precisely the fact pattern of the proposed modification of Jane's 2012 Trust.

Bobby and Janie are permissive beneficiaries of Janie's 2012 Trust along with their father and their descendants. After their father's death, the trust divides into separate trusts for each of them and their respective descendants. Thereafter, they are permissive beneficiaries of their family's trust along with their descendants. They are permissive beneficiaries before and after the

---

[63] 499 U.S. at 564-566.

[64] A number of commenters have noted that if state law requires the consent of the beneficiaries for a decanting, the Service could disregard the state statute exception and hold that a taxable exchange occurs as a result of the decanting. Since a modification under O.C.G.A. § 53-12-61(b) requires the consent of all qualified beneficiaries, decanting under O.C.G.A. § 53-12-62 seems to be the best alternative for Bob and Jane from an income tax perspective.

[65] *See, e.g.,* PLRs 20010037 (trustee had discretionary power to divide the trust and Service concluded that trustee's division of the trust into 3 trusts, one for each child and that child's issue, was not an exchange), 200116016 and 200210056 (trustee's exercise of a power to divide trusts granted to the trustee under the terms of the trust instrument was not an exchange of interests and did not result in a realization of gain under Section 1001), 200207018 (trustee had broad discretion to distribute income and principal outright, or in further trust, among several beneficiaries and Service recognized that the beneficiaries of the new trust and the original trust did not acquire their interests in such trusts as a result of an exchange of their respective interests, but rather by reason of the authority granted to the trustee of the original trust to make distributions in further trust), 200112038 (exercise of a power of appointment granted in the instrument to the beneficiary was not an exchange and thus, did not result in a sale or exchange under the Cottage Savings doctrine, noting that the beneficiary was simply exercising the authority granted to such beneficiary under the governing instrument), 200135007 (partition did not result in a sale, exchange or other disposition because the beneficiaries did not receive their interests in the individual trusts as a result of an exchange of their interests in the original trust, but rather by reason of the authority granted under Georgia law), and 200119047 (court approved settlement agreement of a bona fide dispute between parties did not result in an exchange).

modification and division. The only difference is that after the modification and division each trust has fewer current beneficiaries. Even if there is an exchange, it is hard to see how their beneficial interests would be materially different in kind. But would they be materially different in extent? Does the fact that after the modification and division each would be a permissive beneficiary of a trust with fewer current beneficiaries mean that their beneficial interests would be materially different in extent?

3. Hypothetical Three — Pot Trust for the Benefit of Bob's Father's Descendants

a. Facts

Under the terms of his Will, Bob's father created a generation-skipping trust for the benefit of Bob's father's descendants. The trust is somewhat unique in that it remains a pot trust for Bob's father's descendants until the death of the survivor of Bob's father's children, Bob and his brother. Upon the death of the survivor of Bob and his brother, the trust property is distributed outright to Bob's father's then living descendants, per stirpes. Until the trust terminates, the trustee has discretion to distribute income and principal to Bob's father's descendants. The trust agreement named a corporate trustee as the initial trustee. While the beneficiaries of the trust have no ability to remove a trustee, in the event of a resignation, a majority of the adult beneficiaries has the ability to name a successor trustee or co-trustees. Bob and his brother have differing investment objectives and would like to divide the trust into two separate trusts, one for Bob's family line and one for his brother's family line. Bob and his brother would each like to serve as sole trustee of the trust for his respective family line. Bob's brother has two adult children, neither of whom have any children. The corporate trustee has no other relationship with the family and is not keen on administering a pot trust for multiple family lines. The corporate trustee has agreed in concept to do whatever is necessary to achieve the family's goals.

b. Discussion

Because Bob's father, who was the settlor of the trust, has passed away, the qualified beneficiaries cannot pursue a modification under O.C.G.A. § 53-12-61(b), but they could petition the court to modify the trust pursuant to O.C.G.A. § 53-12-61(c), which provides a statutory mechanism for the beneficiaries of an irrevocable trust to amend the trust after the settlor's death if all of the qualified beneficiaries consent, the trustee has received notice of the proposed modification, and the court concludes that the modification is not inconsistent with any material purpose of the trust. While not inconceivable, it would be hard to imagine that the court would consider the division of the trust and allowing Bob and his brother to serve as sole trustees of their respective trusts inconsistent with any material purpose of the trust.

The qualified beneficiaries of the trust are Bob, Bob's brother, Bobby, Janie, Wendy, Bob's brother's children and the minor descendants of Bob's father. The consent of the minor descendants of Bob's father would need to be obtained through representation, as would the consent of Wendy. O.C.G.A. § 53-12-8(f)(8) would allow Bobby and Janie to represent their minor descendants as long as there is no conflict of interest with respect to the subject matter of the modification. Similarly, Bob's brother's children should be able to represent their minor descendants under O.C.G.A. § 53-12-8(f)(8). While Bob and his brother could arguably represent their minor descendants under O.C.G.A. § 53-12-8(f)(8), the fact that each will serve as sole trustee of the discretionary trust created for his family line could be perceived as a conflict of interest. This should not matter because Bobby, Janie, or Bob's brother's children should also be able to represent Wendy under O.C.G.A. § 53-12-8(g), which enables a minor, incapacitated or unborn individual or a person whose identity or location is unknown and not reasonably ascertainable to be represented by another having a substantially identical interest with respect to a particular

question or dispute, but only to the extent there is no conflict of interest between the representative and the person represented with respect to such particular question or dispute. As mere permissible beneficiaries of a pot trust, the interests of Bob's father's descendants in the trust, whether born or unborn, would appear to be substantially identical.

The proceeding could be commenced by Bob and his brother in their capacities as beneficiaries of the trust and would not require the consent of the trustee.[66]

Since the corporate trustee has agreed to do whatever is necessary to achieve the family's goals and the settlor of the trust is deceased, to avoid a court proceeding, the trustee and all of the beneficiaries (including beneficiaries represented pursuant to O.C.G.A. § 53-12-8) could divide and modify the trust under the authority of O.C.G.A. § 53-12-61(c) by entering into a nonjudicial settlement agreement pursuant to O.C.G.A. § 53-12-9(b). In this case, the unborn descendants would need to be represented, but they could be parties to the agreement would be able to represent them under some combination of representation under O.C.G.A. § 53-12-8.

The trustee would have the authority to contest the modification under O.C.G.A. § 53-12-61(m)(1)(A)(ii) if it had grounds to allege that representation was improper or in the case of a modification under O.C.G.A. § 53-12-61(c), the modification violated a material purpose of the trust. Interestingly, the Georgia Court of Appeals has held that a trust can be modified by consent of the beneficiaries to provide for a nonjudicial mechanism for removing a trustee, even when the trustee objected to the modification and there was no cause shown for removal. The court held that the modification statute was not inconsistent with the trustee removal statute.[67]

[66] O.C.G.A. § 53-12-61(c), (e).
[67] Glass v. Faircloth, 354 Ga. App. 326, 840 S.E.2d 724 (2020).

Four years down the road…

4. Hypothetical Four — Charitable Remainder Trust

a. Facts

In 2004, Bob and Jane created a charitable remainder unitrust (the "CRT") and contributed assets from a joint account to the trust. Each of them is entitled to one-half of the unitrust amount for life. The survivor is entitled to the entire unitrust amount for life. Upon the death of the survivor, the trust assets pass to their donor advised fund at their community foundation. Bob and Jane are co-trustees of the CRT. We are now 4 years down the road — and Bob and Jane have decided to get a divorce.

If possible, as a part of the divorce settlement, Bob and Jane would like to terminate the CRT by dividing the trust assets among themselves and the community foundation based on the actuarial value of the interests of the beneficiaries. If this is not possible, because they have different investment objectives, Bob and Jane would like to divide the CRT into separate and equal CRTs one with Jane as the unitrust beneficiary and the other with Bob as the unitrust beneficiary. Each would like to have a survivorship interest over the other's CRT.

b. Discussion

At one time, the Service was willing to rule favorably on the early termination of a charitable remainder trust and the division of trust assets between the noncharitable beneficiaries and the charitable remainder beneficiary based on the actual values of their interests.[68] In 2008, however, the Service announced that it would no longer rule on whether the termination of a charitable remainder trust before the end of its term as defined in the trust instrument, in a

[68] *E.g.*, PLR 200304025.

transaction giving the beneficiaries their actuarial shares of the value of the trust, would cause the trust to lose its qualification as a charitable remainder trust.[69] This remains a no ruling issue.[70]

Terminating the CRT would be risky because Bob and Jane would not be able to obtain a private letter ruling, and the fact that the Service will not issue rulings in this area suggests that it takes a dim view of such terminations. Bob and Jane, however, should be able to divide it.

Dividing a charitable remainder trust can be a high-risk endeavor. Fortunately, for Bob and Jane, there is useful guidance from the Service. Rev. Rul. 2008-41 addressed the division of a charitable remainder trust with attributes similar to the CRT.[71] This ruling would provide authority for Bob and Jane to modify and divide the CRT in the manner they wish as long as they do not retain survivorship interests over each other's CRTs.

Specifically, the ruling provided that (i) the division of the charitable remainder trust would not cause the original trust or the post-division trusts to fail to qualify as charitable

---

[69] Rev. Proc. 2008-3, § 5.10.

[70] Rev. Proc. 2019-3, § 3.01(77).

[71] 2008-30 I.R.B. 170. In Situation 2 described in the ruling, a charitable remainder trust has two noncharitable recipients who are married to each other but in the process of obtaining a divorce, and under the charitable remainder trust terms, each of them is entitled to an equal share of the unitrust or annuity amount and upon the death of one recipient, the surviving recipient becomes entitled to the entire annuity or unitrust amount for life. At the death of the last surviving recipient, the trust assets are distributed to the charity. A state court approves a pro rata division of the charitable remainder trust into two separate and equal charitable remainder trusts of the same type as the charitable remainder trust being divided ($e.g.$, annuity trust, unitrust, net income unitrust with make-up provision). The order incorporates the provisions for the new trusts. The trusts may have different trustees. Each asset of the original trust is divided equally between the two new trusts. Each separate charitable remainder trust has the same provisions as the original charitable remainder trust, except that (i) each trust has only one noncharitable recipient, *i.e.*, husband or wife as the case may be, (ii) each trust is administered and invested independently by its trustee, and (iii) upon the death of husband or wife, his or her separate charitable remainder trust terminates and its assets are distributed to the charity. The charitable remainder beneficiaries of the new charitable remainder trusts are the same as those of the original charitable remainder trust. Each of husband and wife is entitled to receive from his or her separate charitable remainder trust the same annuity amount or unitrust percentage that he or she was entitled to receive under the original charitable remainder trust, except that each has in effect relinquished the interest to which he or she would have been entitled by reason of surviving the other. The ruling observes that because the charity will receive the assets of one charitable remainder trust upon the death of the first spouse to die and the assets of the other charitable remainder trust upon the death of the surviving spouse (as opposed to receiving a distribution only at the death of the survivor, as would have been the case under the original charitable remainder trust), the value of the charitable remainder interest as a result of the trust division may be larger than the value of the remainder as computed at the creation of the original CRT.

remainder trusts under IRC § 664(d); (ii) the pro rata division of assets between the trusts would not be a disposition producing gain or loss, the basis of each new charitable remainder trust's share of each asset post-division would be the same share of the basis of that asset in the hands of the original charitable remainder trust pre-division, and the new charitable remainder trusts would tack the holding periods of the original charitable remainder trust; (iii) the IRC § 507(c) termination excise tax would not apply; (iv) the division of the charitable remainder trust would not be a self-dealing transaction under IRC § 4941; and (v) the division would not be a taxable expenditure under IRC § 4945.

O.C.G.A. § 53-12-61(k) provides that subsections (b) and (c) of this Code section shall not apply to charitable trusts. Since the CRT has a remainder beneficiary that is a charity, is it a "charitable trust" for purposes of O.C.G.A. § 53-12-61(b)? O.C.G.A. § 53-12 170(a) defines the term "charitable trust" to mean a trust in which the settlor provides that the trust property shall be used for charitable purposes. O.C.G.A. § 53-12 170(b) defines "charitable purposes" as: (1) the relief of poverty; (2) the advancement of religion; (3) the advancement of ethics and religion; (4) the advancement of health; (5) the advancement of science and the arts and humanities; (6) the protection and preservation of the environment; (7) the improvement, maintenance, or repair of cemeteries, other places of disposition of human remains, and memorials; (8) the prevention of cruelty to animals; (9) governmental purposes; and (10) other similar subjects having for their object the relief of human suffering or the promotion of human civilization.

If the CRT is a charitable trust, then the Attorney General has the rights of a qualified beneficiary. A good argument can be made that a trust that merely has a charity as a remainder beneficiary (or even as a current permissible beneficiary) is not a charitable trust because the

purpose of the trust itself is not charitable.[72] However, in two cases interpreting Kansas law,[73] both the Kansas Supreme Court and the Missouri Court of Appeals held that a charitable remainder trust is a "charitable trust."[74]

Bob, Jane, and the community foundation could take the position that the CRT is not a charitable trust as such term is used in O.C.G.A. § 53-12-170 and petition the court to modify and divide the CRT pursuant O.C.G.A. § 53-12-61(b). Alternatively, Bob, Jane, and the community foundation could take no position with respect to whether the CRT is a charitable trust and petition the court to modify and divide the CRT pursuant to O.C.G.A. § 53-12-61(d)(5), but they would have to show that the division would be helpful to the administration of the CRT. Finally , Bob, Jane, and the community foundation may be able to modify and divide the CRT by entering into a nonjudicial settlement agreement pursuant to O.C.G.A. § 52-12-9 and O.C.G.A. § 53-12-61(d) as discussed above.

D. Conclusion

Bob and Jane have a number of tools at their disposal to accomplish their objectives. They could relinquish powers, exercise powers of appointment, change trustees, modify trusts under O.C.G.A. § 53-12-61, exercise decanting powers under O.C.G.A. § 53-12-62, or enter into nonjudicial settlement agreements pursuant to O.C.G.A. § 53-12-9. A number of factors determine

---

[72] *See Green v. Austin*, 222 Ga. 409, 414-15 (1966) (holding, in the context of the rule against perpetuities, that where a trust has charitable and noncharitable provisions that are inseparable, such "mixed trusts" are governed by the rules and laws of noncharitable trusts).

[73] The Kansas statutes defining charitable trusts are similar to the Georgia statutes. K.S.A. 58a-103(3) provides: "'Charitable trust' means a trust, or portion of a trust, created for a charitable purpose described in subsection (a) of K.S.A. 58a-405, and amendments thereto." K.S.A. 58a-405(a) provides: "A charitable trust may be created for the relief of poverty, the advancement of education or religion, the promotion of health, governmental or municipal purposes, or other purposes the achievement of which is beneficial to the community."

[74] *In re Estate of Somers*, 277 Kan. 761 (2004); *Hudson v. UMB Bank, N.A.*, 447 S.W.3d 714 (Mo. Ct. App. 2014). Based in part on *Somers*, *Hudson* held that a charitable remainder trust could not be modified under K.S.A. 58a-411(b), which provides that a noncharitable irrevocable trust may be modified upon consent of all of the qualified beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust.

which tool is best suited for the specific objective. Some could be implemented by Bob or Jane; others would require cooperation. Some tools would involve the exercise of fiduciary duties; others would not. Some would raise income, gift, and generation-skipping transfer tax issues that others would not. For each objective, Bob and Jane would want to select the tool that is the safest — the one with the fewest tax and fiduciary issues.