
# Grantor Trust Reimbursement Statutes: A Magic Wand to Allay the Woes of Grumpy Trustors

**May 14, 2022 10:30-11:30 am**

# The Panel

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Jenny is a founding partner of MDSU and practices in the areas of estate planning, estate and trust administration, tax planning, wealth preservation, and fiduciary litigation. She advises clients on all aspects of estates and trusts, including wills, powers of attorney, probate and estate administration, and guardianships. In addition, Jenny advises individual trustees, banks, and trust companies regarding trust modifications, terminations, mergers, decantings, nonjudicial settlements, and trust situs changes.

Jenny is a published author and frequent speaker on issues and developments related to trusts and estates. She has presented nationally on various topics, including directed trusts, nonjudicial methods of modification, and recent developments to state and federal trust law.

Jenny has been recognized by Chambers – High Net Worth since 2018, she is certified as an Accredited Estate Planner® by the National Association of Estate Planners & Councils, and is the recipient of a Powerwomen Award for business growth.

# The Panel

## Kristen A. Curatolo
## Kirkland & Ellis LLP

Kristen A. Curatolo is a partner in the Trusts and Estates Practice Group of Kirkland & Ellis LLP. Kristen works closely with a diverse clientele to create custom estate plans and implement sophisticated wealth transfer techniques. Her clients include multiple generations of ultra-high net worth families, private equity fund principals, and leaders in the financial industry. She advises individuals, institutions and family offices regarding the administration of complex trusts and estates. She has developed particular experience working with principals of private equity funds and venture capital firms to transfer interests in investment funds in a tax efficient manner.

She is also experienced with modifying, consolidating, terminating, and “decanting” existing trusts, as well as transferring the situs of trusts for tax and non-tax purposes. Kristen regularly counsels clients on nonprofit formation (public charities and private foundations), grant-making, board fiduciary duties, corporate governance and compliance issues. She also assists clients with structured charitable giving, including restricted gift agreements and charitable trusts.

# Overview

1. Benefits of Grantor Trust Status
2. Revenue Ruling 2004-64
3. Current State of Affairs
4. Comparison of the Six Statutes
5. Moving or Modifying Trusts
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# Benefits of a Grantor Trust Status

- A trust that qualifies for grantor trust status means the creator of the trust (the trustor) will be responsible for payment of the income tax liability associated with the trust during the trustor's lifetime.
- The beneficiaries are relieved of the tax burden
- Growth of trust property is enhanced

# Benefits of a Grantor Trust Status

- Payment of the trust's income taxes reduces the trustor's estate
- Does not require any additional allocation of the trustor's unified lifetime gift and estate exemption or generation-skipping transfer (GST) tax exemption

# Revenue Ruling 2004-64

- What happens when the trustor gets hit with a huge tax bill and has a serious case of buyer’s remorse?
- Revenue Ruling 2004-64 is the muse that inspired grantor trust reimbursement legislation.
- Created an opportunity for trustors to transfer more wealth (and thereby reduce their taxable estate) without impacting their available gift tax or GST tax exemptions.

# Revenue Ruling 2004-64

- Held that no gift is made by the trustor when the trust's income is included in the trustor's taxable income.
- Further held that if the trust's governing instrument or applicable local law gives the trustee the discretion to reimburse the trustor for that portion of the trustor's income tax liability, the existence of that discretion, by itself (whether or not exercised) won't cause the value of the trust's assets to be includible in the trustor's gross estate.

# Current State of Affairs

- Connecticut, Florida, Colorado, Delaware, New Hampshire and New York have all enacted legislation that expressly authorizes reimbursement of taxes paid by the trustor from the trust.
- Numerous states have enacted statutes stating the inclusion of the reimbursement power in an irrevocable trust won't make the trust's assets subject to the claims of the trustor's creditors.

# Current State of Affairs

Let's compare and contrast the reimbursement statutes of the six jurisdictions that have enacted reimbursement statutes.

- ►Colorado: C.R.S. § 15-5-818
- ►Connecticut: C.G.S. § 45a-499fff
- ►Delaware: 12 Del. C. § 3344
- ►Florida: Fla. Stat. § 736.08145
- ►New Hampshire: N.H. Rev. Stat. § 564-B:8-816
- ►New York: EPTL § 7-1.11

# States That Do Not Expressly Authorize Reimbursement But Provide Creditor Protection

Several states don't expressly authorize the trustee to repay the trustor for the trustor's income tax liability but have statutes that prevent the trustor's creditors from reaching trust property based on a trustee's reimbursement power under the trust agreement.

1. **Arizona (Ariz. Rev. Stat. Section 14-10505)**
2. **Idaho (Idaho Code Ann. Section 15-7-502)**
3. **Illinois (760 ILCS 3/505)**
4. **Iowa (Iowa Code Ann. Section 633A.2304)**
5. **Kentucky (Ky. Rev. Stat. Ann. Section 386B.5-020)**
6. **Maryland (Md. Code Ann., Est. and Trusts Section 14.5-1003)**
7. **Massachusetts (M.G.L.A. 203E Section 505)**
8. **Montana (M.C.A. Section 72-38-505)**
9. **North Carolina (N.C. Gen. Stat. Ann. Section 36C-5-505)**
10. **Pennsylvania (20 Pa.C.S.A. Section 7745)**
11. **Texas (Tex. Prop. Code Ann. Section 112.035)**
12. **Virginia (Va. Code Ann. Section 64.2-747)**

# Colorado

- C.R.S. § 15-5-818 was added to Colorado's Trust Code and became effective on January 1, 2019.
- Permits reimbursement unless the governing instrument provides otherwise, or an independent trustee (under Section 672(c)) of a trust elects otherwise in writing.
- Provides protection of trust assets from creditors of the trustor, even if there is a court order which directs that a creditor can reach the assets.

# Connecticut

- C.G.S. § 45a-499fff became effective Jan. 1, 2020
- Focus is creditor protection
- Does not permit reimbursement unless the trust agreement or "any other provision of law" authorizes such reimbursement
- Statute does not serve as an independent basis on which reimbursement can be sought

# Delaware

- The original version of 12 *Del. C*. § 3344, enacted on June 19, 2019, allowed the trustee to reimburse the trustor's personal federal or state income tax liability attributable to the trust.
- An amendment to the Delaware reimbursement statute, which became effective on June 30, 2021, expanded the types of income tax liabilities reimbursable by the trustee and provides further exceptions to the statute's application when it would negatively affect tax deductions.
- Permits the trustee to reimburse any county, metropolitan-region, city, local, foreign or other income tax liability.

# Florida

- Fla. Stat. § 736.08145 became effective July 1, 2020
- Similar to Delaware's statute
- Reimbursement may only be made if the trustee isn't a beneficiary of the trust or an individual who's related or subordinate to the trustor under Section 672(c)
- Permits a trustee to irrevocably elect out of its application by providing written notice to the trustor and any other person who has the ability to remove and replace the trustee within 60 days of such election taking effect

# New Hampshire

- N.H. Rev. Stat. § 564-B:8-816 became effective on October 1, 2004. It has been amended 5 times since its enactment. The amendments became effective on September 20, 2005, September 9, 2008, July 1, 2014, July 27, 2015, and September 10, 2019.
- Subsection (c), which provides for trustor reimbursement, was added in the July 1, 2014 amendment.
- It grants the trustee the power to reimburse the grantor for income tax liability "under Section 671 of the Internal Revenue Code or any similar law."

# New York

- EPTL § 7-1.11 became effective on May 21, 1969
- Similar to the Colorado Statute, in that the trustee is permitted to reimburse the trustor for tax liabilities unless the governing instrument provides otherwise. However, there is no provision that an independent trustee can elect otherwise in writing.
- No reference to creditor protection.
- This was addressed in EPTL § 7-3.1(d), which was added by amendment in 2005.

# Moving or Modifying Trusts

- It's possible to move or modify a trust to get the benefits of a reimbursement statute.
- For example, say your client created an irrevocable trust in a jurisdiction that doesn't allow the trustee to reimburse the trustor for income taxes paid. The trust has a considerable income tax bill, but the trustor doesn't want to toggle off grantor trust status.
- There are a few ways to help your client, which may include migrating the trust to a favorable jurisdiction, decanting the trust to another trust with desirable terms or using a state's trust amendment or non-judicial settlement agreement statute to update the terms of the trust.

# Migrating to a Favorable Jurisdiction

- Review the trust agreement to see if the governing law or situs of the trust may be changed.
- If the governing instrument allows the situs of the trust to be changed, it may be possible to appoint a trustee (or an administrative trustee) in the favorable jurisdiction to avail the trust of that jurisdiction's trust laws.
- Example: Appointing a Delaware trustee of a California trust to invoke 12 *Del. C.* § 3332(b).

# Decanting a Trust in the Wrong Place to a Trust in the Right One

- It may be possible to decant a trust that was established in one state into a new trust established in a different state.
- Example: A trust established in Wisconsin (which has no reimbursement statute but has a decanting statute) may be decanted to a Florida trust that allows the trustor to be reimbursed for income taxes.
- However, consider the state income tax consequences of such transfer.

# Amending the Trust

- Consider whether the trust may be amended under state law.
- Example: If the trustor is living and all beneficiaries are adults, New York allows a trust agreement to be modified by the written agreement of the trustor and beneficiaries (and trustee consent isn't required).
- Using this amendment statute (or a similar one), a trust may be modified to include reimbursement language.

# Non-Judicial Settlement Agreement

- Consider whether the trust's governing law and/or situs may be changed to a favorable jurisdiction pursuant to a non-judicial settlement agreement.
- Non-judicial settlement agreements are permitted under the Uniform Trust Code.
- Under a non-judicial settlement agreement, the parties interested in the trust agreement may agree to transfer a trust's principal place of administration or to change the law governing administration of the trust to a state authorizing reimbursement of the trustor's income taxes.

# Planning for a Better Day

- Consider including flexible “catch-all” language when drafting irrevocable trusts to allow for the possibility that your state may adopt grantor trust reimbursement legislation in the future.
- See the sample “Income Tax Reimbursement” language in the materials. It may obviate the need to amend or decant such trust if state law changes.
- The sample language could be included in all irrevocable grantor trust agreements, regardless of whether the state currently has a grantor trust reimbursement statute.

# Trustee's Fiduciary Duty

- If the trustee holds the power to reimburse the trustor, arguably, the exercise of such a power is a breach of the trustee's fiduciary duty to the beneficiaries, because it benefits the trustor to the detriment of the beneficiaries.
- Include exculpatory language specifically in the context of the exercise of the reimbursement power.

# Trustee's Fiduciary Duty

- Grant the reimbursement power to an individual designated in the trust agreement who can exercise the power in a nonfiduciary capacity.
- Before exercising the reimbursement power, the trustee could request that the beneficiaries execute a release agreement, releasing the trustee from any liability for breach of fiduciary duty associated with the exercise of the power.

# Words of Caution

- Be careful to provide that such reimbursement is within the trustee's *discretion* and isn't mandatory, or will cause gross estate inclusion for the trustor under Section 2036(a)(1).
- No written agreement or other pre-existing arrangement between the trustee and trustor about reimbursement.

# Words of Caution

- Reimbursement is moving money in the wrong direction.
- If the trustee's discretion to reimburse the trustor for income taxes paid is exercised too often, the trustor may risk creditor protection issues.

# Questions?

# Contact Information

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