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Fixing a Broken Trust

Posted By *SNA Admin* On January 10, 2023 @ 11:38 am In Government Benefits, Special Needs Trusts, THE VOICE | [No Comments](#)

In many ways, an irrevocable trust is like a house. It is a structure designed to last a long time, to benefit the people who live there (the beneficiaries), and to safeguard property (the trust assets). And, like a house, the components of a trust can sometimes break or become outdated. A trust may have been designed for one purpose, but a change in circumstances might require renovation. Sometimes the parts of the trust (its provisions) become antiquated, or even unsafe, and require modernizing.

When the beneficiary of a trust has a disability, the need to update or fix a trust that no longer works effectively becomes even more important. For example, if a trust contains a provision that allows the beneficiary with a disability to receive all of the income from a trust or gives that beneficiary the right to require the trustee to make distributions to him or her, it could eliminate that person's eligibility for means-tested government benefits such as Supplemental Security Income (SSI) or Medicaid. To keep access to government benefits available, the trust will require alterations.

How do you repair a broken trust?

There are a variety of options, and each will depend on the circumstances of a specific situation, as well as the state law that governs that trust. While this article explores different approaches that may be available, it is best to consult with an attorney experienced in disability law and trust modification options who is licensed to practice in the state where the trust is being administered. It is important to note that this article is focused only on trusts that are irrevocable—meaning those trusts that are designed to be unchangeable from the beginning, irrevocable, or those trusts that have become unchangeable, irrevocable, because the person who created the trust is no longer living.

The first step to fixing a broken trust?

Identify the problem or problems that need to be fixed in the trust.

Suppose that a beneficiary who receives SSI is also entitled to receive regular payments of income from a trust. In this example what should be added to the trust and what should be taken away?

We know from reviewing the SSI rules that after the first \$20 of unearned income, the remaining unearned income offsets the recipient's SSI benefit dollar for dollar. Thus, if a trust beneficiary is receiving \$200 of SSI and is also entitled to receive \$220 of trust income every month, the

beneficiary will lose his or her SSI due to the unearned income rules (because, although the first \$20 of income is disregarded, the remaining \$200 of income will offset the \$200 of SSI, leaving the individual with \$0 SSI). In this case the beneficiary's right to receive income from the trust must be removed so that the beneficiary can continue to receive SSI.

Should anything be added to this trust? If the trust has no other provisions that benefit the beneficiary other than the right to receive income, it may be appropriate to allow the trustee to make discretionary distributions to the beneficiary with a disability. This is likely what the creator of the trust (sometimes called the grantor or settlor of the trust) intended in giving the beneficiary a right to receive income in the first place. However, instead of an income right that could harm the beneficiary's access to government benefits, the trustee could be given the discretionary power to make discretionary distributions to or for the benefit of the beneficiary. This would allow the trustee to pay for goods and services that could benefit the beneficiary with a disability, without triggering the unearned income rules (and jeopardizing access to benefits).

The second step in fixing a broken trust?

Identify solutions.

Now that the problems are clear, the next step is to determine the best way to fix them. This will involve reviewing all the ways the trust can be changed to add needed provisions or take out the problematic ones.

The best place to start is with the trust document itself. Carefully review each word. Does the trust contain any provisions that allow it to be modified? If so, are there any special requirements that must be met? Sometimes a trust will have a provision allowing its terms to be modified for tax purposes or to comply with the intentions of the grantor. If this is the case, consider who has the power to modify. Is it the trustee? A trust protector? Must someone be named to fill this role? Often there are requirements for who can be appointed to modify a trust, and often other beneficiaries or family members of the grantor are excluded from being appointed for tax reasons. Under no circumstances should the person with a disability be appointed to modify the trust, even if the terms of the trust allow this.

If the trust contains terms that allow it to be modified, it is important to make sure that the contemplated changes fit within the scope of the modification power. If the trust only gives the ability to modify to keep up with changes in the tax law, then this provision could not be used for the beneficiary entitled to receive income, since the right to receive income has nothing to do with changes in the tax law. Instead, this situation will require a different method of fixing the trust, such as modification, reformation, or decanting under state law.

How does one modify a trust?

First, the governing law of the trust must be identified.

Each state has laws that govern trusts. A careful review of the trust document will reveal what state's law governs that particular trust. Often, this will be the state where the trust was created, or where the grantor was living at the time he or she signed the trust document. Is the trust being administered in the same state? Many times, the answer is yes, but it is also possible that the trustee lives in another state and is managing the trust there. This may open up the possibility that another state's law could apply for purposes of administering the trust.

Once the applicable state law has been identified, the next step is look at that state's trust law. A majority of states (36 as of the time of this article) have enacted some version of the Uniform Trust Code, or UTC. The UTC allows for a trust to be modified with or without having to go to court, although different standards may apply depending on the state. In states where the UTC has not been adopted there may be written laws that allow trust modification, or the ability to modify the trust may be based on prior case law.

In a state that has adopted the UTC, a trust modification will often require the agreement of all the beneficiaries of a trust or, if all beneficiaries do not agree, a court may have to approve the modification. Beneficiaries are entitled to know about the proposed modification in advance and, in some cases, a court hearing may be required before the modification can be made, even if all beneficiaries agree. Often a modification must further a fundamental purpose of the trust (sometimes called a material purpose), or that particular modification is not allowed. The rules governing trust modifications can be complex, and it is important to understand them and how they apply to each situation before moving forward.

The UTC also allows for a trust to be reformed, which is different from a modification in that a reformation dates back to the original date of the trust while a modification only changes the terms of the trust going forward. The standard of proof is also higher in a trust reformation, in that it must often be proved that the grantor of the trust made a mistake and that the grantor's intent of what the trust should have said can be clearly demonstrated. In the example of the SSI recipient beneficiary who is also entitled to receive all trust income, there is no indication that the grantor made a mistake—he or she just had not anticipated a circumstance where the right to receive income could actually be harmful to the beneficiary. So, it would be unlikely that trust reformation would be an option.

There is also the possibility of decanting the trust. Decanting is a process where the assets of a trust are transferred to a new trust, and that new trust is governed by updated provisions—often in the form of an entirely new trust document. In some states decanting can also be a modification of the original trust. Often, the trust beneficiaries must be notified of a proposed decanting before it can take place, and they have a period of time during which to object. Just over half of the states allow trust decanting, but the rules vary widely among jurisdictions. Some states even have specific decanting rules that allow a trust to be altered to accommodate a person with a disability in order to preserve access to government benefits. Before undertaking a trust decanting it is important to note that the law on this subject can be very complex. Therefore, it is important to partner with an

experienced attorney to make sure that the decanting is done properly and complies with all applicable rules.

Once the best method for fixing the trust is identified, what happens next?

Before moving forward with the selected alteration process, it is best to pause first and ask if any more updates are needed. Going back to the house metaphor at the beginning of this article, if one is remodeling the kitchen, it is probably a good idea to check on the condition of the plumbing and electrical systems too. If more work is needed it is best not to have to go back to the construction phase, but rather, do all the work at one time.

Trusts are no different. In the example where the beneficiary's right to receive income is being removed, it is good practice to ask if there are any other changes that could benefit the trust. Should a distribution standard be rewritten? What if the beneficiary later moves to a different state or the laws regulating government benefit eligibility change? How can the trust keep up without having to be modified (or reformed or decanted) again? One update that almost any trust for a beneficiary with a disability can benefit from is adding a limited power to amend in the future—for the specific purpose of being able to continue to comply with all applicable government benefit rules, no matter where a beneficiary lives or how the federal regulations governing a particular program change.

While the methods of fixing a trust may seem complicated, the steps to get started are relatively simple. Review the trust document carefully, determine what needs to be removed and what needs to be added, and evaluate the different options for altering the trust based on that trust's applicable state law—all while checking if any other provisions of the trust can be improved before getting started. If the design is sound and the work is done well the craftsmanship should last for a long time. And whether it is a trust or a house that receives this attention, both will benefit from the result.

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