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PROCEDURES FOR TERMINATING SMALL TRUSTS*

EDITOR'S SYNOPSIS: *Trusts sometimes become too small for effective administration. This article discusses various provisions—statutory, common law, and drafting—for terminating them.*

I. INTRODUCTION

Irrevocable trusts, whether *inter vivos* or testamentary, often become too small to administer efficiently and effectively. A trust, for example, with a small corpus which was deemed adequate twenty years ago may no longer be sufficiently large to justify the costs of administration. Perhaps the value of the assets in the trust has declined over the years. In other situations, a portion of the trust may have been distributed on the occurrence of a particular event and the balance remaining is too small to administer economically. Where there is a corporate fiduciary, perhaps applicable minimum fee standards make the cost of administration prohibitive given the corpus remaining in the trust. Many such trusts no longer serve the intended purpose of the grantor or testator, yet there is often no statutory mechanism, and in some cases no equitable jurisdiction of the court, to terminate such trusts.

The Committee on Formation, Administration and Distribution of Trusts has conducted a survey to determine which of the fifty states and the District of Columbia have specific statutes authorizing termination of such trusts. Only six states presently have such statutes. The Committee recommends that other jurisdictions enact an appropriate statute for termination of small trusts.

II. STATUTORY PROVISIONS

A. Statutory Small Trust Termination by Court

Some states have enacted specific statutes allowing termination of small trusts.

For example, Wisconsin¹ provides for court termination of a living trust where the settlor is deceased, or termination of any testamentary trust as follows:

In the case of a living trust where the settlor is deceased and in the case of any testamentary trust, regardless in either case of spendthrift or similar protective provisions, a court with consent of the trustee may order termination of the trust, in whole or in part, and such distribution of the assets as it

considers appropriate if the court is satisfied that because of any substantial reason existing at the inception of a testamentary trust, or in the case of any trust, arising from a subsequent change in circumstances (including, but not limited to the amount of principal in the trust, income produced by the trust and the cost of administering the trust) continuation of the trust, in whole or in part, is impractical. In any event, if the trust property is valued at less than \$5,000, the court may order termination of the trust and such distribution of the assets as it considers appropriate.

Kentucky allows direct distribution from a probate estate to beneficiaries or termination of a trust if the principal thereof is \$15,000 or less. This statute² provides:

(1) Whenever a trustee or personal representative holds and controls an amount, exclusive of income, of fifteen thousand dollars (\$15,000) or less or the will directs that such an amount be placed in a trust, the fiduciary may petition the district court having jurisdiction of the trust or estate, for an order authorizing the fiduciary to distribute the amount held, plus income available, less fees chargeable, to the appropriate beneficiary or beneficiaries, legal representatives thereof, or other appropriate persons or institutions responsible for the object of the trust, who shall be under a duty to use the funds for the purposes of the trust. Upon receipt of said petition by the district court, and accompanying affidavit and/or oral testimony, the court shall order the amount distributed.

(2) When an order to distribute the amount petitioned is granted and entered into the court's records, no bond shall be required of the recipient of said distribution from the trustee or personal representative.

(3) A release of the trustee or personal representative shall be executed by the recipient upon distribution of the amount held, declaring said fiduciary not liable thereafter. The trustee or personal representative shall not be required to look into the application of the amount so distributed.

California has statutory authority for modification or termination of a trust where the corpus is small, applicable to both *inter vivos* and testamentary trusts. This statute³ provides as follows:

(a) If upon petition of the trustee or any beneficiary of a trust, the Superior Court shall at any time determine that the fair market value of the principal of a trust has become so low, in relation to the costs of administration thereof, that continuance of the trust pursuant to its existing terms would defeat or substantially impair the accomplishment of the purposes of the trust, the court may, in its discretion in a manner which conforms as nearly as possible to the intention of the trustor, order that the trustee be changed, that the terms of the trust be modified, or that the trust be terminated, in whole or in part.

(b) If the court orders termination of the trust, in whole or in part, it shall direct that the principal and undistributed income be distributed to the beneficiaries in a manner which conforms as nearly as possible to the intention of the trustor; and may make such other and further orders as it deems necessary or appropriate to protect the interests of the beneficiaries.

*Report of the Committee on Formation, Administration and Distribution of Trusts.

²KY. REV. STAT. § 386.185.

(c) Nothing in this section shall limit any power of the court to permit modification or termination of any trust, as such power existed before the adoption of this section.

(d) The existence of a spendthrift or similar protective provision in the trust shall not make this section inapplicable to such trust.

Connecticut law⁴ provides for the discontinuance of a charitable trust where the value of the principal is less than \$15,000. Florida enacted in 1984 a statute⁵ providing for termination of a trust of \$25,000 or less by a corporate fiduciary.

B. Statutory Termination by Trustee

Oregon added to its version of the Uniform Trustees' Powers Act a section allowing a trustee, when the market value of a trust is below \$10,000 and where the continuance of the trust pursuant to its existing terms would defeat or substantially impair the accomplishment of the purposes of the trust, to terminate the trust and distribute the trust property to the beneficiaries in a manner which will conform as nearly as possible to the intention of the trustor. That statute⁶ provides as follows:

(4) . . . if at any time the trustee has determined that the market value of a trust is below \$10,000 and that, in relation to the costs of administration thereof, the continuance of the trust pursuant to its existing terms, will defeat or substantially impair the accomplishment of the purposes of the trust, the trustee may, in its sole discretion, terminate the trust and distribute the trust property, including principal and undistributed income, to the beneficiaries in a manner which conforms as nearly as possible to the intention of the trustor. The trustee may enter into such an agreement or make such other provisions that it deems necessary or appropriate to protect the interests of the beneficiaries and to carry out the intent and purpose of the trust. The existence of spendthrift or similar protective provisions in the trust shall not make this section inapplicable.

⁴CONN. GEN. STAT. §§ 45-79b.

⁵FLA. STAT. § 737.402. The Florida Statute provides:

. . . (3) The powers created in this subsection apply only if the trustee is a business organization authorized to engage in trust business under chapter 658, chapter 660, or chapter 665. If such a trustee has determined that the market value of a trust is less than \$25,000 and that, in relation to the costs of administration thereof, the continuance of the trust pursuant to its existing terms will defeat or substantially impair the accomplishment of the purposes of the trust, the trustee may, in its sole discretion, terminate the trust and distribute the trust property, including principal and undistributed income, to the beneficiaries in a manner which conforms as nearly as possible to the intention of the settlor. The trustee may enter into an agreement or agreements or make such other provisions that it deems necessary or appropriate to protect the interests of the beneficiaries and the trustee to carry out the intent and purpose of the trust. The existence of a spendthrift or a similar protected provision in the trust shall not make this subsection inapplicable unless the trust instrument expressly provides that the trustee may not terminate the trust pursuant to this subsection.

The committee's research has not located other specific statutes providing for termination of a trust due to its small size.

III. GENERAL POWERS OF TERMINATION

A. Statutes Based Upon Restatement of Trusts

A number of states have followed the rules of *Restatement (Second) of Trusts* relating to termination or modification of trusts. While these rules are not specifically directed to the small trust, they seem broad enough in scope to encompass termination of small trust in appropriate circumstances.

Restatement (Second) of Trusts, Section 335 (1959), provides for termination of a trust where the purpose of the trust has become illegal or impossible of fulfillment. Section 336 provides:

If owing to circumstances not known to the settlor and not anticipated by him the continuance of the trust would defeat or substantially impair the accomplishment of the purposes of the trust, the court will direct or permit termination of the trust.

Some states have enacted statutes which codify those Restatement rules. An Indiana statute,⁷ for example, provides:

- (a) On petition by a trustee or beneficiary, the court may, in its own discretion, terminate the trust:
 - (1) if the purpose of the trust has been fulfilled or has become illegal or impossible of fulfillment; or
 - (2) if, owing to circumstances not known to the settlor and not anticipated by him, the continuance of the trust would defeat or substantially impair the accomplishment of the purpose of the trust.
- (b) The court shall include in its order under subsection (a) of this section a provision making such a distribution of the trust estate as the court deems most nearly in conformance with the settlor's intent.

The Probate, Estates and Fiduciaries Code of the state of Pennsylvania allows a court having jurisdiction, regardless of any spendthrift provision, to terminate a trust where the original purpose of the trust cannot be carried out or is impractical and termination would more closely approximate the intention of the settlor. This section originally was limited to a trust with a principal of \$25,000 or less. That limitation was gradually increased to \$100,000. In 1982, the dollar limit was removed. That statute⁸ provides:

- (a) Failure of original purpose.—The court having jurisdiction of a trust heretofore or hereafter created, regardless of any spendthrift or similar provi-

⁷IND. CODE § 30-4-3-24; see also N. DAK. GEN. CODE § 59-02-17.

sion therein, in its discretion may terminate such trust in whole or in part, or make an allowance from principal to one or more beneficiaries, provided the court after hearing is satisfied that the original purpose of the conveyer cannot be carried out or is impractical of fulfillment and that the termination, partial termination, or allowance more nearly approximates the intention of the conveyer, and notice is given to all parties in interest or to their duly appointed fiduciaries.

(b) Distribution of terminated trust.—Whenever the court shall decree termination or partial termination of a trust under the provisions of this section, it shall thereupon order such distribution of the principal and undistributed income as it deems proper and as nearly as possible in conformity with the conveyer's intention.

(c) Other powers.—Nothing in this section shall limit any power of the court to terminate or reform a trust under existing law.

Restatement (Second) of Trusts, Section 337, provides as follows:

(1) Except as stated in subsection (2), if all of the beneficiaries of a trust consent and none of them is under an incapacity, they can compel the termination of the trust.

(2) If the continuance of the trust is necessary to carry out a material purpose of the trust, the beneficiaries cannot compel its termination.

Missouri in 1983 enacted a new trust statute.⁹ The following provision is of interest:

When all of the adult beneficiaries who are not disabled consent, the court may, upon finding that such variation will benefit the disabled, minor, unborn and unascertained beneficiaries, vary the terms of a private trust so as to reduce or eliminate the interests of some beneficiaries and increase those of others, to change the times or amounts of payments and distributions to beneficiaries, or to provide for termination of the trust at a time earlier or later than that specified by the terms.

Under the Missouri statute, for purposes of consenting to termination or modification of a trust, the holder of a presently exercisable general power of appointment is deemed to act for beneficiaries who would take in default of the exercise of that power.

Where the settlor and all beneficiaries consent to termination of a trust, a trust can be revoked in Wisconsin.¹⁰ A settlor, with the consent of all beneficiaries can alter, amend or revoke a trust in New York.¹¹

The Uniform Trustees' Powers Act, which has been enacted in about ten jurisdictions, has no specific provision allowing a trustee or a court to terminate a small trust as no longer economical to administer.

The Uniform Probate Code, Section 7-201(a)(3), gives a court general jurisdiction over trustees and beneficiaries and is believed to be broad enough in its language to allow a court in a UPC jurisdiction to terminate a trust, but there is no specific provision for termination.

B. Case Law

In some jurisdictions there is no specific statute which allows termination of a small trust but that right is recognized by case law. For example, a trust was terminated in the state of Arizona where its continuance "became peculiarly profitless."¹² In other jurisdictions the court will terminate a trust if all beneficiaries consent,¹³ or where the purpose of the trust cannot be accomplished.¹⁴

C. Provisions in Will or Trust

Practitioners frequently include provisions in a will or *inter vivos* trust allowing termination of a trust when its principal becomes too small in reference to the cost of administration.

A sample clause provides as follows:

If and when the value of any trust has declined to such an amount that the trustees deem it uneconomical or imprudent to continue to retain the principal in trust, the trustees shall have the power to terminate such trust by paying over and delivering the then remaining principal to or for the benefit of the beneficiary or beneficiaries then entitled to receive the income of such trust. If there shall be no beneficiaries then entitled to receive the income of such trust, such principal shall be paid over and delivered to the beneficiary or beneficiaries then entitled to receive distributions therefrom in the discretion of the trustees. Payment shall be made in equal shares or in shares determined by the trustees, in their discretion, by reference to the terms of this instrument. However, no trustee who is also a beneficiary of such trust shall participate in exercising the discretion described in this paragraph.

Another suggested form (proposed by Manufacturers Hanover Trust Company, New York) is as follows:

Anything in this agreement to the contrary notwithstanding, if, at any time after the grantor's death, the principal of any trust or separate share hereunder has a fair market value of less than \$50,000, the corporate trustee may in its sole discretion (but shall not be required to) terminate such trust or separate share and distribute the entire principal thereof and all accrued and undistributed income thereon, outright and free of trust, to the person or persons then entitled to receive the income in the same proportions, if more than one. The trustee shall not be accountable to any persons other than those to whom such distribution is made.

A somewhat more general provision (suggested by First National City Bank of New York) is as follows:

Any provision of this will to the contrary notwithstanding, my trustee may at any time in its discretion terminate any trust hereunder and transfer, pay over and deliver all of the then principal and income of such trust to the person or persons then entitled to income from such trusts, free of trust, if in

⁹MO. REV. STAT. § 456.590, subparagraph 2.

¹⁰WIS. REV. STAT. § 701.12

¹²Fish v. Valley Nat'l Bank of Phoenix, 64 Ariz. 164, 167 P.2d 107 (1946).

its judgment the principal of such trust is so small that it would be inadvisable to continue to hold it in trust.

A variation thereof (suggested by Irving Trust Company of New York) provides the following language for termination of a marital deduction trust:

If the trust fund created by this article shall at any time be of a size which in the sole judgment of trustee shall make it inadvisable or unnecessary to continue such trust, then anything contained in this will and codicil hereto to the contrary notwithstanding, my trustee, in its sole discretion, may pay over and distribute the entire principal of this trust and all accrued and undistributed income then in its hands to my said wife, absolutely.

With reference to the clauses suggested by Manufacturers Hanover Trust Company and First National City Bank of New York, if the trust is a sprinkling trust, additional language is required to specify how the trust corpus is to be distributed among those to whom the income might be sprinkled.

A clause suggested by a California bank, Wells Fargo Bank, provides as follows:

If the value of the assets available to fund any trust or held in any trust hereunder is or becomes, in the absolute discretion of the Trustee, sufficiently small in value that the establishment or continuation thereof is no longer in the best interests of the beneficiary or beneficiaries, the Trustee may refuse to establish or may terminate such trust, in which case, the Trustee shall distribute the property of such trust to the person or persons, and in the proportion, then entitled to receive the income therefrom, insofar as specified in such trust, otherwise in equal shares.

IV. TAX ASPECTS OF TERMINATION

Most trusts which are terminated by the trustee acting alone (Oregon) or by order of court are very small. The tax considerations are, therefore, given little or no attention. However, whenever a trust is terminated, consideration should be given to possible tax aspects of the termination. The power given to a donee or decedent to affect the beneficial enjoyment of a trust by terminating a trust is a power of appointment.¹⁵ Most management powers, however, over a trust, held in a fiduciary capacity do not constitute a power of appointment.¹⁶ If a party is both an income beneficiary and a co-trustee with power to pay a portion of the principal to himself or herself without an ascertainable standard and without a co-trustee having an adverse interest, that power has been held to constitute a general power of appointment.¹⁷ The co-trustee and primary beneficiary of a trust has a general power of appointment where the trustees can termi-

¹⁵Treas. Reg. § 20.2041-1(b); § 25.2514-1(b)(1).

¹⁶Treas. Reg. § 20.2041-1(b)(1).

nate the trust and pay the corpus to him as beneficiary, if local law does not prevent him from participating in that decision.¹⁸ The rights or powers of the trustee depend upon local law. A beneficiary who does not have the absolute power under local law to compel the trustee to make distribution does not have a general power.¹⁹ An independent trustee's power to invade trust principal for the benefit of an income beneficiary in the trustee's sole and unfettered discretion does not impute a general power to the income beneficiary.²⁰ If a trustee-beneficiary has the authority, acting alone, to terminate a trust (when, for example, the value of the corpus falls below a specified dollar amount), then the portion of the income attributable to the trustee-beneficiary's interest in the corpus of the trust presumably would be taxable to such person.²¹ Under most statutes, even if the trustee is the beneficiary, the trust will be terminated only upon petition to an appropriate court, notice to all parties and, in most cases, consent of all parties including income beneficiaries and remaindermen. Such parties obviously have an adverse interest one to another. Termination by order of court in such cases would not appear to involve either a general power of appointment or income tax problems under I.R.C. § 678.

If the trustee is an independent trustee, where termination of the trust cannot benefit the trustee individually or benefit those he or she is legally obligated to support, the power to terminate would by its very nature not be a general power. If the trustee is a beneficiary interested in the trusts, the power to terminate if provided for in the instrument, should be given to the co-trustee, or, if none, to a special trustee to avoid possible tax problems.

V. PROPOSED STATUTE

The Committee recommends that each state which does not now have a specific statute allowing termination of a small irrevocable *inter vivos* or testamentary trusts, enact an appropriate statute to allow such termination. The statutes of Wisconsin, Kentucky and California²² are examples of statutes which are specifically directed to termination of small trusts.

The Committee proposes that any such statute provide the following elements:

- (1) That the trustee or any beneficiary can petition the appropriate court for termination;
- (2) That notice be given to all persons then having an interest in the trust of the proposed termination;

¹⁸Maytag v. United States, 493 F.2d 995 (10th Cir. 1974).

¹⁹Mary Joyce Cox Estate, 59 T.C. 825 (1973).

²⁰Rev. Rul. 76-368, 1976-2 C.B. 271.

²¹I.R.C. 1954, § 678.

²²Wis. REV. STAT. § 701.13(3); KY. REV. STAT. § 386.185; CALIF. CIV. CODE § 2279.1; CALIF. PROB.

(3) That termination be allowed whenever the cost of administration of the trust is such that its continued existence would defeat or substantially impair the accomplishment of the purposes of the trust;

(4) That the trust corpus be distributed to one or more beneficiaries as the court in its discretion determines is appropriate under the circumstances, giving consideration to the terms of the trust and the interests of the income beneficiaries and remaindermen;²³

(5) That the existence of a spendthrift protective provision shall not preclude termination of such trust; and

(6) In the case of property being distributed from a probate estate to a trust, the probate court should have jurisdiction to direct outright distribution of that trust property rather than placing it in trust where the trust is small and termination would not clearly defeat the intent of the trustor.²⁴

In addition, such statute might indicate that a trust of less than a specified dollar amount, such as, for example, \$20,000, is presumed to be too small to continue, and that trusts with a greater value may be terminated if the court deems it appropriate and if all parties then having an interest in the trust consent to termination. If a trust for a minor is terminated, the trust corpus could be transferred to a custodian for the minor pursuant to the Uniform Gifts to Minors Act or the Uniform Transfers to Minors Act.

The Committee suggests the following language for such a statute:

Termination of Small Trust

If upon petition of the trustee, personal representative of the decedent's estate, or any beneficiary, the court having jurisdiction over such trust, regardless of any spendthrift or similar protective provisions, finds that the costs of administration thereof are such that the continuance of the trust, or the establishment of the trust if it is to be established or distribution from a probate estate, would defeat or substantially impair the purposes of the trust, the court, after due notice to all persons then having an interest in the trust, may order distribution of the trust property. The order shall specify the appropriate share of each beneficiary who is to share in the proceeds of the trust, taking into account the interests of income beneficiaries and remaindermen so as to conform as nearly as possible to the intention of the trustor or testator. The order may direct that the interest of a minor beneficiary, or any portion thereof, be converted into qualifying property and distributed to a custodian pursuant to the Uniform Gifts to Minors Act of The Uniform Transfers to Minors Act.²⁵ The court in addition may make such other and further

²³Division of the trust corpus between the income beneficiaries and remaindermen, based upon the IRS tables for valuing life estates and remainders, Treas. Reg. § 20.2031-10(f), may often be appropriate.

²⁴See KY. REV. STAT. § 386.185 for an example of this type of statute.

²⁵If property held in trust is not the type of property that can be held under the Uniform Gifts to Minors Act, it may be necessary to convert property to qualifying property. The Uniform Transfers to Minors Act is much less restrictive. Certain types of property, such as an

orders as it deems proper or necessary to protect the interests of the beneficiaries and of the trustee.

This section shall not limit the right of a trustee, acting alone, to terminate a small trust without order of court in accordance with applicable provisions of the governing instrument.

VI. CONCLUSION

The Committee strongly recommends that each jurisdiction enact a statute allowing court termination of small trusts where the purposes for which the trust was created can best be served by terminating the trust and distributing the assets among those interested, thereby eliminating costs of administration which become excessive in relation to the corpus of the trust.

Respectfully submitted,

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