

IN WITH THE NEW

An examination of Connecticut's new trust law

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ABSTRACT

- *On 1 January 2020, Connecticut's new Public Act No. 19-137 (the Act) came into effect, significantly modernising its trust law. The Act includes changes and additions to substantive trust law, as well as to more procedural matters affecting trusts and their beneficiaries.*
- *Connecticut is the 35th state in the US to enact the Uniform Trust Code in some form. Once approved by the Uniform Law Commission (ULC), it is up to each state to consider and enact the law, often amending the law to comport with its historical jurisprudence or to satisfy the particular needs or desires of its constituents. This article will examine Connecticut's enactment of the Act, which includes variations required by Connecticut's bifurcated court system where courts of limited jurisdiction, called probate courts, control virtually all aspects of administering and managing testamentary trusts.*
- *A key provision of the Act includes an 800-year perpetuity period for trusts. Previously, Connecticut law did not allow for long-term 'dynasty trusts' (trusts that continue for multiple generations) and included the traditional rule against perpetuities (RAP) that requires non-charitable trusts to terminate within approximately 90 years of creation. The Act makes it possible to create a trust in Connecticut that can last up to 800 years, thus providing an opportunity for creating dynasty trusts. As a result, Connecticut residents no longer have to turn to other jurisdictions to create and administer dynasty trusts.*

On 1 January 2020, Connecticut's new *Public Act No. 19-137* (the Act) came into effect adopting the *Connecticut Uniform Trust Code*. It is a long-awaited, sweeping modernisation of Connecticut law concerning the formation, modification, administration and termination of trusts. The Act creating the new law is more than 90 pages long and includes more than 120 sections. Although titled as the *Connecticut Uniform Trust Code*, it actually includes four specific legislative acts that are key updates to existing Connecticut trust law, namely:

- the *Connecticut Uniform Trust Act*;
- the *Connecticut Uniform Directed Trust Act*;
- the *Connecticut Qualified Dispositions in Trust Act* (CQDTA); and
- the *Connecticut Uniform Rule Against Perpetuities Act*.¹

The Act is expected to significantly enhance estate and asset-protection planning opportunities available to Connecticut residents, trustees and beneficiaries and perhaps draw new trust business to the state. Specifically, the new law addresses:

- the trustee's duties, powers and liability;
- the rights of creditors;
- the virtual and designated representation of trust beneficiaries or other parties; and
- the establishment of a trust's principal place of administration.

The law also establishes new standards for the administration of trusts and for individuals serving as trustees or in other fiduciary capacities. Connecticut's new law applies to virtually all trusts with the exception of charitable trusts.

The Act generally allows the terms of a trust to override the statutory provisions, with 14 enumerated exceptions.²

These exceptions include:

- requirements for creating a trust;
- the duty of a trustee to act in good faith and in accordance with the terms and purposes of the trust;
- the power of the court to modify or terminate a trust;
- the duty under the new law to comply with certain notice provisions applicable to the

beneficiaries of irrevocable trusts who have attained 25 years of age; and

- provisions dealing with judicial supervision of testamentary trusts.

Connecticut becomes the 35th state in the US to enact the *Uniform Trust Code* in some form. The Act was adopted in 2000 by the Uniform Law Commission (ULC),³ which was established in 1892 with the goal of providing states with 'non-partisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law'.⁴ Once the ULC approves a uniform law, it is up to each state to consider and enact the law, often amending the law to comport with its historical jurisprudence or to satisfy the particular needs or desires of its constituents. Although the definition of a uniform act is one that seeks to establish the same law on a subject among various jurisdictions, there are marked differences in the Act between the states that have adopted it. For example, the Act includes variations required by Connecticut's bifurcated court system where courts of limited jurisdiction, called probate courts, control virtually all aspects of administering and managing testamentary trusts.

Below are some key highlights of Connecticut's version of the legislation.

DYNASTY TRUST PLANNING

Previously, Connecticut law did not allow for long-term 'dynasty trusts' (trusts that continue for multiple generations) and included the traditional rule against perpetuities (RAP) that requires non-charitable trusts to terminate within approximately 90 years of creation. The possibility of a dynasty trust that extended beyond the lives of the grantor's grandchildren was unachievable. Connecticut's limited trust term often resulted in a grantor's inability to plan for future generations without having to hire an out-of-state trustee. States with more developed trust laws, like Delaware or Florida, became increasingly attractive because they authorised trust terms that could last significantly longer (e.g. 360 years in Florida and in perpetuity in Delaware).

³ Also known as the National Conference of Commissioners on Uniform State Laws.

⁴ www.uniformlaws.org/aboutulc/overview

¹ Public Act 19-137

² s.5(b) of Public Act 19-137

‘Connecticut residents no longer have to turn to other jurisdictions to create and administer dynasty trusts’

The Act makes it possible to create a trust in Connecticut that can last up to 800 years, thus providing an opportunity for creating dynasty trusts. As a result, Connecticut residents no longer have to turn to other jurisdictions to create and administer dynasty trusts. The extended RAP period only applies to trusts created on or after 1 January 2020, meaning the new law will not stretch the vesting period for trusts already in existence in Connecticut or trusts that migrate into the state from elsewhere. However, it presents the opportunity for multi-generational wealth planning going forward.

DIRECTED TRUSTS

Prior to this legislation, trustees in Connecticut retained full responsibility (and liability) over how trust assets were managed, invested and distributed. The new legislation allows a trustee’s duties, and liability for the performance or non-performance of those duties, to be allocated between the trustee and other individuals who may be better able to carry out certain trust objectives. By establishing a directed trust, a grantor can now appoint a trust director, that is, a non-trustee individual with authority to manage a specific part of the trust administration. For example, a grantor can appoint a trusted family member as trustee to oversee distributions and appoint a different individual or a trust company as the trust director to handle investment decisions. This bifurcation of the traditional roles of the trustee is most useful in situations where trusts hold concentrated investments or assets, such as a closely held business or significant amounts of real estate. Professional trustees typically resist accepting investment responsibility for those trusts due to the specialised skills required and the potential

liability associated with managing a closely held business and holding concentrated positions. Notably, trust directors are subject to the same rules and have the same fiduciary duty and exposure to liability as similarly situated trustees.

ASSET PROTECTION TRUSTS

The new law incorporates the CQDTA, which enables the creation of a self-settled asset protection trust; i.e. a trust created by an individual for the benefit of themselves that can shield the individual’s assets from the claims of their creditors. Connecticut is the 19th state to adopt domestic asset protection trust legislation. Although the self-settled asset protection trust is appealing to individuals looking to insulate themselves from potential unknown liabilities, the new law includes stringent requirements that must be met when creating an asset protection trust for the benefit of the grantor, so as not to run afoul of fraudulent transfer laws. Creditors who are not barred by these rules have a ‘clear and convincing’ evidence standard of proof to overcome.

Grantors cannot avoid existing known creditors, and the exemption from the claims of existing unknown creditors applies four years after the creation of the trust or one year after it was reasonable for the creditor to discover the transfer, whichever is later. The CQDTA includes a class of exemption creditors who are not precluded from making claims outside of the four-year and one-year rules. These include a spouse or former spouse who was married to the grantor at or before the time of funding the trust, but only with respect to agreements or support and property orders in place prior to creating the trust. In addition, all children who have a support order in place prior to the transfer of assets to the trust are exception creditors.

Among the other prerequisites to creating an effective asset protection trust under the CQDTA, the trust must:

- be governed under Connecticut law;
- be irrevocable;
- include a spendthrift clause (i.e. a provision that prevents the beneficiary from assigning their interest in the trust); and
- appoint an independent trustee to make distributions to the individual creating the trust.

If done properly, a self-settled asset protection trust will enable individuals to protect their

personal assets in a way similar to how limited liability companies are used to protect business assets.

CREDITOR CLAIMS

In a matter of particular importance to grantors who create long-term trusts for their children and grandchildren, but worry about claims against the trust in the case of divorce, the law prohibits a beneficiary's creditor (e.g. an ex-spouse) from attaching or compelling a distribution of property that is subject to a power, whether mandatory or discretionary, held by the trustee of the trust. This includes a power held by the beneficiary as the sole trustee, or a co-trustee of the trust, to make distributions to or for the benefit of the beneficiary or a person whom the beneficiary has an obligation to support, provided the distribution is for such beneficiary's individual health, education, support or maintenance.⁵ Most practitioners would agree that a true 'spendthrift' trust, with fully discretionary distribution standards in the hands of an independent trustee, should not be subject to division in a divorce under Connecticut law, but the Act makes clear that a beneficiary receives this enhanced protection from creditors even if they are serving as their own trustee, provided the ascertainable standard is used, thereby permitting the beneficiary to maintain control of their own inheritance. The Act also precludes creditors from attaching or compelling a distribution of property that is subject to a limited power of withdrawal. These powers are typically drafted as being limited to the gift tax annual exclusion amount, which is USD15,000 per person for 2020.

INCOME TAX REIMBURSEMENT

Under prior Connecticut law, if a Connecticut trust permits the reimbursement of income taxes to the grantor of the trust, the principal of the trust could be subject to creditor claims. Furthermore, under federal tax law, if a trust is subject to the grantor's creditors, it is included in the grantor's estate for estate tax purposes. The new law makes it explicitly clear that such reimbursement authority does not subject the trust assets to

claims of creditors, as long as the trust agreement expressly provides the trustee with the requisite discretion to reimburse the grantor. Accordingly, an irrevocable trust can permit reimbursement of income taxes to the grantor without jeopardising trust assets or putting them within reach of uninvited creditors.

Highlighted below are various rules from the new law that will impact the future of trust management and administration in Connecticut.

JURISDICTION OF THE PROBATE COURT

Connecticut is somewhat unique in that it has 54 probate courts organised on a regional basis that are often called 'the people's courts' because they are intended to offer more streamlined and direct access to legal proceedings. They are, however, courts of limited jurisdiction and the Act includes specific rules as to the scope of probate court jurisdiction versus superior court jurisdiction, the Connecticut Superior Court (the Superior Court) being the first-level state court. For example, with regard to testamentary trusts, it specifies that probate courts have sole original jurisdiction over matters to:

- determine the validity of the will establishing a trust;
- compel a trustee to account or to approve a trustee's account or proposed final distribution; and
- terminate a charitable trust.

This exclusive jurisdiction is significantly curtailed (and perhaps even rendered moot), however, by the provision giving original jurisdiction to the Superior Court over proceedings relating to another Superior Court action, or if the probate court lacks the power to provide an adequate remedy. Effectively, this brings all contested matters under the jurisdiction of the Superior Court since jury trials are not permitted in probate court, nor are they empowered with a full scope of equitable remedies. Probate courts and superior courts have concurrent original jurisdiction over several matters relating to testamentary trusts, such as to:

- determine title or right of possession and use in property that constitutes or may constitute trust property;
- reform a trust to qualify for the marital deduction or charitable deduction under tax law; and
- modify or terminate a non-charitable trust.

5 The specific statutory language makes reference to the 'ascertainable standard' provisions of ss.2041(b)(1)(A) and 2514(c)(1) of the *Internal Revenue Code of 1986*, which include distributions for a beneficiary's health, education, support or maintenance.

The Superior Court has original jurisdiction over all matters relating to *inter vivos* trusts; however, there are several matters over which the probate court has concurrent original jurisdiction with the Superior Court, such as:

- compelling a trustee to account or approving a trustee's account;
- terminating a charitable trust; or
- determining title or right of possession and use in property that constitutes or may constitute trust property.

The concurrent jurisdiction provisions are welcomed by practitioners in Connecticut since they expand access to the more streamlined process of the probate courts with regard to *inter vivos* trusts.

NON-JUDICIAL SETTLEMENT AGREEMENTS

As enacted, the Act allows interested parties to enter into a binding, non-judicial settlement agreement in matters relating to a trust, such as interpretation of the trust agreement, trustee resignation and appointment, trust accountings and trustee compensation. Notably, the Act prohibits interested parties from modifying or terminating a trust by way of a non-judicial settlement agreement. This provision also only applies to *inter vivos* trusts and not to testamentary trusts. Nevertheless, this is another welcomed change in Connecticut since attorneys have traditionally had to rely upon release agreements to deal with trustee transitions and accountings for *inter vivos* trust matters.

NOTICE TO BENEFICIARIES

The Act imposes new reporting requirements on trustees to give notice of a trust's existence and the grantor's identity to all qualified beneficiaries (defined as beneficiaries currently eligible to receive distributions and the presumptive remaindermen) and to keep them reasonably informed about the trust's administration. Annual reports are required to be provided to all current beneficiaries and any other qualified beneficiary who requests a report. Trustees must also promptly respond to a beneficiary's request for information. Trust agreements cannot waive the notice requirements with respect to qualified beneficiaries over the age of 25. However, the grantor can nominate a 'designated

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representative' to receive notice on behalf of a beneficiary and to bind the beneficiary. The appointment of a designated representative can be particularly useful in situations where the beneficiary is a minor or where the beneficiary lacks capacity. However, there are limitations on when a designated representative can represent and bind another beneficiary if the designated representative is also a beneficiary of the trust. These new notice provisions are required for all irrevocable trusts created on or after 1 January 2020, and revocable trusts that become irrevocable on or after 1 January 2020.

TRUST COMBINATION AND DIVISION

After providing 30 days' notice to all qualified beneficiaries, a trustee of an *inter vivos* trust is permitted to combine the trust with other trusts or to divide the trust as needed. For testamentary trusts, the trustee must seek court approval.

MODIFICATION OF IRREVOCABLE TRUSTS

Irrevocable trusts may now be modified or terminated if the court finds that the grantor, trustees and beneficiaries all consent, even if it is inconsistent with a material purpose of the trust. A grantor's power to consent to the modification or termination may be exercised by an agent under a power of attorney or the grantor's conservator. The court may also approve a modification or termination of a trust without the consent of the grantor if all of the beneficiaries consent and the court concludes that the modification is not inconsistent with a material purpose of the trust or the termination does not thwart a material

purpose of the trust. These provisions under the new law are prospective only; that is, they only apply to irrevocable trusts created after 1 January 2020, or to trusts that become irrevocable after that date.

POWER TO TERMINATE SMALL TRUSTS

The threshold amount under which a trustee may terminate a non-charitable *inter vivos* trust that is not economical to administer has increased from USD150,000 to USD200,000. A trustee who wishes to exercise this discretion must first give 30 days' notice to the beneficiaries. The power to terminate testamentary trusts still requires court approval. Courts are also now authorised to terminate an *inter vivos* or testamentary trust if it determines that the trust property's value does not justify its costs relative to the trust's material purposes. This latter provision provides some flexibility for trusts above the threshold amount seeking to terminate.

TRANSFERRING TRUSTS OUT OF STATE

The Act also prescribes the requisite process for transferring a Connecticut trust to another jurisdiction. For certain *inter vivos* trusts, the trustees must provide notice to beneficiaries in advance of a transfer and transfers regarding testamentary trusts will require probate court approval. Charitable trusts are prohibited from transferring to another jurisdiction outside of the US.

EFFECTIVE DATE

In general, the Act applies to all Connecticut trusts, even if they were created before the 1 January 2020 effective date. However, as noted in some of the provisions described above, there are specific exceptions to this rule. For example, the requirements relating to enhanced notice and disclosure to trust beneficiaries and the rules governing the modification of irrevocable trusts apply only to irrevocable trusts created on or after 1 January 2020, and to revocable trusts that become irrevocable on or after 1 January 2020. This still means that revocable trusts created before 1 January 2020 will be subject to the new notice and disclosure rules once they become irrevocable. It would be wise to revisit these trusts before they become irrevocable to determine whether amendments are needed or desirable.

Connecticut's enactment of the Act is welcome news in a state with what many view as an antiquated system of trust law. As described above, many of the newly modernised provisions, however, only apply to *inter vivos* trusts, leaving testamentary trusts largely under the control of the courts even in the absence of controversy. Connecticut attorneys will, for this reason, likely continue to avoid the use of testamentary trusts where possible in favour of lifetime planning.

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