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## Trust Modifications in Oregon

by Christopher P. Cline, Riverview Trust Company

Although it is the foundation of much estate planning, the “irrevocable trust” is really not so irrevocable. Many states, including Oregon, provide multiple ways to modify or terminate irrevocable trusts. This article provides an overview of trust modifications. It discusses the mechanisms for modification, focusing on nonjudicial settlement agreements (NJSAs) in particular, and alternatives to modification.

In addition to this article, a very helpful resource is Christine Brown & Valerie Sasaki, *Administering Trusts in Oregon* ch 16 (2018), published by the Oregon State Bar. Specifically, that chapter (in section 16.5) covers trust decanting, which this article does not cover (first, because Oregon does not have a decanting statute, and second, because the author believes that other forms of modification described in this article can achieve the same ends with less risk to the party doing the decanting).

### I. Overview.

Before diving into mechanics, it is important to look at the big picture.

#### A. Why Modify?

Irrevocable trusts are modified for one reason only: to fix a trust problem. This problem can arise due to (a) poor drafting initially; (b) changes in beneficiary circumstance; or (c) changes in the law. It is critical, therefore, to identify the real problem. A beneficiary who wants larger distributions from the trust, for instance, may not be a problem that is appropriate for fixing. That said, some reasons for modifying might include:

- Allowing for distributions to be made directly to service providers and landlords, rather than to a spendthrift beneficiary;
- Relaxing outdated restrictions or adding new ones;
- Terminating the trust altogether;
- Moving a trust from Oregon to Washington (and hiring a Vancouver trustee) to avoid state income tax on the sale of a trust asset (this also requires a change of situs under the Oregon Uniform Trust Code);
- Adding a trust protector to determine when distributions should be made;
- Allowing a trustee to invest in an asset concentration (like an interest in a family business); or
- Indemnifying the trustee for making difficult decisions (like when the beneficiaries want the trustee to invest in that family business).

This list obviously isn’t exhaustive, but it does give a sense of scope. The discussion on NJSAs, below, contains a list of statutory purposes for modification.

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## B. How Can It Be Done?

Modification can happen in a number of different ways:

- First, a trust can be drafted to allow an independent party, like a trust protector, to modify the trust in any number of ways, broad or limited. The document can allow trustees to be removed and replaced, situs and governing law to be changed, distributions to be restricted or expanded, or trust terms to be lengthened or shortened. This list is by no means exhaustive; these are just a few provisions that are commonly included.
- Second, an Oregon trust can be modified under a NJSA (described in Section II, below).
- Third, an Oregon trust can be modified by the court using one of several judicial modification provisions (described in Section III, below).
- Fourth, the definition of “income” can be modified using either the power to adjust or the power to convert to a unitrust (not discussed in this article).

Each of these techniques has advantages and disadvantages. Modification by a trust protector can be the most efficient choice, but only if you have a wise and reliable trust protector, and if only if the trust is drafted to name a trust protector with the necessary powers of amendment. This can be rare. Using the NJSA doesn't rely on one person's or the court's judgment but requires the active participation of all parties. Using one of the judicial remedies allows modification to proceed, but only for prescribed reasons and it requires court involvement, which can be time-consuming and expensive. Finally, changing the definition of “income” is easy, but a very limited remedy.

## C. Possible Complications.

There are three significant possible complications. First, not everyone may agree to the proposed change. In this case, the party seeking modification can use one of the court-authorized procedures. But these procedures are limited in scope and could result in a legal battle if one of the nonparticipating parties decides to formally object.

Second, the trustee might not participate, or might not act in the way that beneficiaries intended even after the modification is complete. There are very good reasons for such reticence. As fiduciaries, trustees are subject to liability, and have in fact been sued, for almost *everything*. And for those acting as trustees or representing them, a healthy skepticism is appropriate. The way to overcome such skepticism is to ensure that the trustee is indemnified and held harmless for participating in the modification and for acting under it.

Finally, often the biggest challenge is to avoid accidentally creating a taxable gift following modification.

Although the tax consequences of modification are beyond the scope of this article, in general if a trust beneficiary agrees to a modification, the result of which is a diminution in value of his or her interest, he or she probably has made a taxable gift to the beneficiary whose interest has increased in value as a result. To take a slightly unrealistic example, assume an elderly woman with a five-year life expectancy is entitled to \$10,000 per year from a trust. At her death, the trust property passes to her daughter. Knowing that her mother needs an extra \$10,000 per year for living expenses, the daughter agrees to a NJSA under which her mother's distribution increases to \$20,000. By not objecting to this increase, it can be argued that the daughter made a gift of \$10,000 per year for five years, reduced to present value, to her mother. Further, because it's not a present interest gift, it can't be offset by the daughter's annual exclusion amount.

Because there is no Oregon gift tax, and because the federal estate and gift tax exemption amount is so high, it may be a nonissue. Further, because the trustee has to agree to the modification as well, it could be argued that it is not a gift at all. Nevertheless, this issue should always be considered when contemplating a modification.

## II. Nonjudicial Settlement Agreements.

Perhaps the most common way of modifying an irrevocable trust in Oregon is to pursue a NJSA under ORS 130.045. It is a relatively easy procedure, but several issues can arise.

### A. Generally.

ORS 130.045(3)(a) states that “interested persons” may enter into a NJSA with respect to *any* matter involving a trust. However, a NJSA is valid only to the extent the agreement (a) does not violate a material purpose of the trust and (b) includes terms and conditions that could be properly approved by the court. ORS 130.045(4).

Although the statute refers to any matter involving a trust, ORS 130.045(5) provides a nonexclusive list of matters that may be resolved by a NJSA:

“(a) The interpretation or construction of the terms of the trust or other writings that affect the trust.

“(b) The approval of a trustee's report or accounting.

“(c) Direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power.

“(d) The resignation or appointment of a trustee or cotrustee and the determination of a trustee's compensation.

- “(e) Transfer of a trust’s principal place of administration.
- “(f) Liability of a trustee for an action or failure to act relating to the trust.
- “(g) Determining classes of creditors, beneficiaries, heirs, next of kin or other persons.
- “(h) Resolving disputes arising out of the administration or distribution of the trust.
- “(i) Modifying the terms of the trust, including extending or reducing the period during which the trust operates.”

## B. Who Has to Participate?

To begin with, we have to define “interested persons.” Under ORS 130.145(1), “interested persons” means: (a) any settlor of a trust who is living; (b) all qualified beneficiaries; (c) any acting trustee of the trust; and (d) the Attorney General if the trust is a charitable trust.

Under ORS 130.145(2), if the trust or a portion of the trust is a charitable trust and is irrevocable, and the settlor retains a power to change the beneficiaries of the charitable trust during the settlor’s lifetime or upon the settlor’s death, the Attorney General shall be substituted as the sole interested person to represent all charitable trust beneficiaries whose beneficial interests are subject to the settlor’s retained power. This provision would come into play, for example, when the settlor created a charitable remainder trust for her lifetime benefit and retained the right to designate the charitable remainder beneficiary.

The terms “qualified beneficiaries” and “charitable trust” are defined in ORS 130.010(14) and 130.170(1), respectively.

It is possible that one or more interested persons are minors, incapacitated persons, or simply not reachable for some reason. In this case a representative may be able to agree on that interested person’s behalf. *See* Section IV, below.

## C. To File or Not to File.

The parties to a NJSA must decide whether to file with the court. If the NJSA isn’t filed with the court, ORS 130.045(3)(b) provides that the agreement is binding on all parties to the agreement. On the other hand, if the NJSA is filed with the court, ORS 130.045(3)(c) provides that the agreement is binding as provided in subsections (6) and (7) (discussed below) unless, after the filing of objections and a hearing, the court does not approve the agreement. If the court does not approve the agreement, the agreement is not binding on any beneficiary or party to the agreement. *Id.*

ORS 130.045(6)(a) provides that any interested person may file a NJSA, or a memorandum summarizing it, with

the circuit court for any county where trust assets are located or where the trustee administers the trust. Within five days after the filing of a NJSA or memorandum, the person making the filing must serve a notice of the filing and a copy of the NJSA or memorandum on each beneficiary of the trust whose address is known at the time of the filing and who is not a party to the agreement. *Id.* Service must be made in the form and following the process described in ORS 130.045(6)(c) and (d). If no objections are filed with the court within 60 days after the filing of the agreement or memorandum, the agreement is effective and binding on all beneficiaries who received notice and all beneficiaries who waived notice. ORS 130.045(6).

On the other hand, if objections are filed with the court within 60 days after the filing, ORS 130.045(7) (a) provides that the court shall fix a time and place for a hearing. The person filing the objections must serve a copy of the objections on all beneficiaries who are parties to the agreement and all beneficiaries who received notice under subsection (6), and give notice to those persons of the time and place fixed by the court for a hearing at least 10 days in advance. *Id.*

- The court shall approve a NJSA after a hearing upon objections unless:
- It does not reflect the signatures of all required persons;
- It is not authorized by ORS 130.045; or
- Its approval would not be equitable to beneficiaries who are not interested persons and who are not parties to the agreement.

ORS 130.045(7)(c). A NJSA approved by the court after a hearing is binding on all beneficiaries and parties to it. ORS 130.045(7)(d). Finally, beneficiaries entitled to notice may waive it. ORS 130.045(7)(e).

As this description makes clear, a NJSA filed with the court can be used to bind parties who are not “interested persons” if those parties are given notice and the opportunity to object, whereas a NJSA that is not filed with the court binds only signatories to the agreement.

*Open Issue:* Does “interested persons” in the statute mean *all* interested persons? Assume that Mom is the settlor and her three daughters are all the qualified beneficiaries. Mom wants to modify an irrevocable trust she’s created, and two of the daughters agree. The third simply won’t respond; she’s not objecting, she’s just not communicating at all (not an uncommon situation). If the third daughter doesn’t participate, does an agreement signed by the other three parties qualify as an NJSA? If it does, then Mom could get the other two daughters to sign the agreement, file it with

the court, and give notice to the third daughter. If the third daughter fails to timely object, then she would be bound. On the other hand, if the third daughter's failure to sign means the agreement doesn't qualify as a NJSA, then Mom would have to use one of the more expensive court proceedings to modify the trust (described below).

### III. Other Statutory Remedies.

Although NJSAs are usually the first form of modification thought of by Oregon lawyers, ORS 130.195-.215 provides grounds for trusts to be modified or terminated—some of which require a court proceeding.

#### A. **The Process.**

The process to obtain court approval of a trust modification or termination is the same whether the court approval is mandatory or optional. Under ORS 130.195, a proceeding to approve or disapprove a proposed modification or termination under ORS 130.045, 130.200, 130.205, 130.210, 130.215, 130.220, and 130.225, or trust combination or division under ORS 130.230, may be commenced by a trustee or beneficiary. A proceeding to approve or disapprove a proposed modification or termination under ORS 130.200 may be commenced by the settlor. The settlor of a charitable trust may maintain a proceeding to modify the trust under ORS 130.210.

#### B. **Consent.**

This provision comes in two parts. Most importantly, ORS 130.200(1) provides that an irrevocable trust may be modified or terminated with approval of the court upon consent of the settlor and all beneficiaries who are not remote interest beneficiaries, even if the modification or termination is inconsistent with a material purpose of the trust. In other words, if the settlor is alive and everyone agrees, the trust gets a complete do-over.

There is an extensive list of the parties who can or must participate:

- The Attorney General must consent to any modification or termination of a charitable trust.
- A settlor's power to consent to a trust's modification or termination may be exercised by:

“(a) An agent or attorney-in-fact under a power of attorney only to the extent expressly authorized by the terms of the trust or the power of attorney;

“(b) The settlor's conservator with the approval of the court supervising the conservatorship if an agent or attorney-in-fact is not authorized by the terms of the trust or a power of attorney; or

“(c) The settlor's guardian with the approval of the court supervising the guardianship if an agent or attorney-in-fact is not authorized by the terms of the trust or a power of attorney and a conservator has not been appointed.”

ORS 130.200(1). Even if the settlor is not alive, all is not lost. Under ORS 130.200(2), an irrevocable trust “may be terminated upon consent of all beneficiaries who are not remote interest beneficiaries if the court concludes that continuance of the trust is not necessary to achieve any material purpose of the trust.” Again, the Attorney General must consent to any modification or termination of a charitable trust. *Id.*

If the settlor is not alive, there is the hurdle that the modification or termination cannot violate a material purpose of the trust. And a spendthrift provision is rebuttably presumed to constitute a material purpose of the trust. This means that the moving party must overcome the presumption and prove that the spendthrift clause was not material.

*Note:* The presumption that a spendthrift provision *does* constitute a material purpose is an Oregon modification to the Uniform Trust Code, which presumes that a spendthrift provision *does not* constitute a material purpose.

Upon termination of a trust under either subsection, the trustee shall distribute the trust property as agreed to by the beneficiaries and, in the case of a charitable trust requiring the Attorney General's consent, as agreed to by the Attorney General.

Under ORS 130.200(5), the court can approve a proposed modification or termination without the consent of all beneficiaries who are not remote interest beneficiaries if the court finds that (1) if all beneficiaries who are not remote interest beneficiaries had consented, the trust could have been modified or terminated under this section; and (2) the interests of any beneficiary who does not consent will be adequately protected.

#### C. **Unanticipated Circumstances.**

Under ORS 130.205(1), the court may modify the administrative or dispositive terms of a trust or terminate the trust if it furthers the purposes of the trust and the modification or termination is requested by reason of circumstances not anticipated by the settlor. To the extent practicable, the modification must be made in accordance with the settlor's probable intention. *Id.*

Further, the court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful, or would impair the trust's administration. ORS 130.205(2).

Finally, a trustee may terminate a trust without court intervention if:

“(a) Termination is appropriate by reason of circumstances not anticipated by the settlor;

“(b) Termination will not be inconsistent with the material purposes of the trust;

“(c) All qualified beneficiaries have consented to the termination;

“(d) The trustee is not a beneficiary of the trust and has no duty of support for any beneficiary of the trust; and

“(e) In the case of a charitable trust, the Attorney General has consented to the termination.”

ORS 130.205(3). Upon termination of a trust under this section, the trustee shall distribute the trust property in a manner consistent with the purposes of the trust.

#### D. Cy Pres.

ORS 130.210 provides that, if a particular charitable purpose of a trust becomes unlawful, impracticable, impossible to achieve, or wasteful, the trust does not fail (in whole or in part), the trust property does not revert to the settlor or the settlor’s successors in interest, and the court may apply cy pres to modify or terminate the trust by directing that the trust property be applied or distributed, in whole or in part, in a manner consistent with the settlor’s charitable purposes.

Note that this relief is not available if a provision in the terms of a charitable trust would result in distribution of the trust property to a noncharitable beneficiary, and if, when the provision takes effect, the trust property is to revert to the settlor and the settlor is still living, or fewer than 50 years have elapsed since the date of the trust’s creation.

#### E. Uneconomic Trust.

ORS 130.215(1) provides that, after notice to the qualified beneficiaries, a trustee may terminate a trust if the trustee concludes that the value of the trust property is insufficient to justify the cost of administration. However, a trustee may not terminate a trust under this section if the trustee is a qualified beneficiary of the trust or has a duty of support for a qualified beneficiary of the trust. *Id.* The ability to terminate an uneconomical trust is available to the trustee without court involvement, but for liability purposes a trustee may be reluctant to do so without first obtaining approval of the beneficiaries through a NJSA or seeking the protection of a court order.

Further, the court may modify or terminate a trust, or remove the trustee and appoint a different trustee, if the

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**Contact:** Chris Cline, Editor-in-Chief  
(360) 759-2478, [chriscline@riverviewbank.com](mailto:chriscline@riverviewbank.com)

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court finds that the value of the trust property is insufficient to justify the cost of administration. ORS 130.215(2).

Upon termination of a trust under this section, the trustee shall distribute the trust property in a manner consistent with the purposes of the trust. ORS 130.215(3). This section does not apply to an easement for conservation or preservation. ORS 130.215(4).

#### F. Correcting Mistakes.

Under 130.220, the court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor’s intention if the person requesting reformation proves by clear and convincing evidence that both the settlor’s intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement.

This can be a particularly useful provision, with the caveat that proving a mistake by clear and convincing evidence often involves an admission by the drafting attorney of a scrivener’s error.

#### G. Achieving Tax Objectives.

Under ORS 130.225, the court may modify the terms of a trust to achieve the settlor’s tax objectives if the

modification is not contrary to the settlor's probable intention. The court may provide that the modification has retroactive effect.

#### H. Catch-All.

In addition to all the preceding remedies, ORS 130.195(1) provides a trust terminates:

- “(a) To the extent the trust is revoked or expires pursuant to the terms of the trust;
- “(b) If no purpose of the trust remains to be achieved; or
- “(c) To the extent one or more of the purposes of the trust have become unlawful, contrary to public policy or impossible to achieve.”

#### IV. Representation.

As this article has shown, consent by beneficiaries is either helpful or necessary to a modification or termination (depending upon the statutory framework used). ORS 130.100-.120 provides the means in certain circumstances for one person to represent another person in a modification or termination.

In general, ORS 130.100 provides that “[n]otice to a person who may represent and bind another person under ORS 130.100 to 130.120 has the same effect as if notice were given directly to the other person,” and “[t]he consent of a person who may represent and bind another person under ORS 130.100 to 130.120 is binding on the person represented unless the person represented objects to the representation before the consent would otherwise have become effective.” ORS 130.100(1)-(2). There are a few caveats to this rule:

- “Notice to a representative must comply with ORS 130.035(4),” ORS 130.100(1);
- “Except as otherwise provided in ORS 130.200 and 130.505, a person who is authorized to represent a financially incapable settlor under ORS 130.100 to 130.120 may receive notice and give binding consent on the settlor's behalf,” ORS 130.100(3); and
- “A settlor may not represent and bind a beneficiary under ORS 130.100 to 130.120 with respect to the termination or modification of an irrevocable trust under ORS 130.200(1) [the termination by consent provision],” ORS 130.100(4).

Further, and most importantly, under all of the following sections, a person cannot represent another if there is a conflict of interest between them with respect to the particular matter at issue.

#### A. Holders of Testamentary Power of Appointment.

Under ORS 130.105, the holder of a testamentary power of appointment “may represent and bind persons

whose interests are subject to the power as permissible appointees, as takers in default or by other reason.”

#### B. Parents and Fiduciaries.

ORS 130.110 provides that:

- “(1) A conservator may represent and bind the estate that the conservator controls;
- “(2) An agent having authority to act with respect to the particular question or dispute may represent and bind the principal;
- “(3) A trustee may represent and bind the beneficiaries of the trust;
- “(4) A personal representative of a decedent's estate may represent and bind persons interested in the estate; and
- “(5) A parent may represent and bind the parent's minor or unborn child [but not a grandchild] if a conservator for the child has not been appointed.”

#### C. Substantially Identical Interests.

Under ORS 130.115, “[u]nless otherwise represented, a minor, financially incapable individual or unborn individual, or a person whose identity or location is unknown and not reasonably ascertainable, may be represented by and bound by another person having a substantially identical interest with respect to the particular question or dispute \*\*\*.”

#### D. Special Representative.

Sometimes none of the statutes above apply to a given situation. In this case, ORS 130.120(1) states that, “[i]f the court determines that the interest of a person is not represented under ORS 130.100 to 130.120, or that the otherwise available representation might be inadequate, the court may appoint a special representative to receive notice, give consent and otherwise represent, bind and act on behalf of a minor, financially incapable individual or unborn individual, or a person whose identity or location is unknown and not reasonably ascertainable.” Such a “special representative” may “represent several persons or interests, if the interests of the persons represented do not conflict.” *Id.*

“A special representative may act on behalf of the individual represented with respect to any matter that the court has authorized, whether or not a judicial proceeding concerning the trust is pending.” ORS 130.120(2).

“In making decisions, a special representative may consider general benefit accruing to the living members of the individual's family.” ORS 130.120(3).

There are requirements for qualifying as a special representative. He or she must have appropriate skills and

experience necessary to adequately represent the individual in the matter. ORS 130.120(4). Further, he or she may not have an interest in the subject trust, and may not be related to a personal representative of an estate with an interest in the trust, or to a trustee, beneficiary, or other person with an interest in the trust. *Id.*

“A person requesting the appointment of a special representative must file a petition with the court describing the proposed special representative, the need for a special representative, the qualifications of the special representative, the person or persons who will be represented, the actions that the special representative will take and the approximate date or event when the authority of the special representative will terminate. The person seeking to serve as special representative must file a consent to serve.” ORS 130.120(5). After completing his or her responsibilities, the special representative must petition the court for an order discharging the special representative. ORS 130.120(6). Upon order of the court, the special representative is discharged from any further responsibility with respect to the trust. *Id.*

Finally, a special representative is entitled to reasonable compensation for services. ORS 130.120(6). “The trustee shall pay compensation to the special representative from the principal of the trust that is attributable to those beneficiaries who are represented. If the beneficiaries who are represented do not have principal that is attributable to them, compensation is an administrative expense of the trust.” *Id.*

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## Events Calendar

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### **Estate and Trust Conference**

June 23, 2020 via Livestream Webcast

*Sponsored by the Oregon Society of CPAs. Please contact the OSCPAs for exact title and location.*

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### **Advanced Estate Planning and Administration CLE program**

November 13, 2020

Multnomah Athletic Club, Portland, OR

*Co-sponsored by the OSB Estate Planning and Administration Section and the OSB CLE Department*

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The Editors want to include announcements of upcoming events that are open to the public and may be of interest to our readers. If you know of an event, please send basic information, including point of contact information to Chris Cline at [chriscline@riverviewbank.com](mailto:chriscline@riverviewbank.com) for inclusion in the next issue of the Newsletter.