The State of a Trust’s Situs

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ABSTRACT
A trust’s situs, where the trust is located, is generally assumed to be the state in which the settlor resides. However, that is not always the case. In fact, situs can be claimed by multiple states, depending on the state’s statutory regime as well as the location of the trust parties and its assets. Changing the trust’s situs may result in significant administrative and tax benefits. This presents an opportunity for family and trust advisors to examine and evaluate whether changing the situs to a more favorable trust and taxing state could result in significant savings, from both an administrative and a tax perspective.

Introduction
A trust’s situs often is taken for granted and is assumed to be governed by the laws of the settlor’s domicile. However, that assumption is often not entirely accurate. In fact, during the lifetime of the trust, situs can arguably be claimed by multiple states based on a number of factors, including the settlor’s domicile; where the trust was created; as well as where the current trustee, beneficiaries, and even trust assets reside. The location of the trust’s situs can affect its administrative efficiency as well as taxes, and changing the situs can result in significant savings on both fronts. The situs of a trust and the ability to change it can be a powerful and compelling tool available to the trustee to improve its overall administration and more efficiently achieve the intent and purpose of the trust.

Trust Situs: What Is It?
The situs of a trust, generally speaking, is where a trust is located. A trust that is created, administered, and taxed in one state has situs in that state. However, it is not always that simple. In reality, a trust can have multiple situses and even share situs, depending on the location of the settlor, trustee, beneficiaries, and trust assets. For example, a trust...
may be under the jurisdiction of one state but be administered and taxed under the laws of a different state. Therefore, when determining situs and analyzing whether it would be appropriate and beneficial to move the trust’s situs, one should make such decisions with a firm understanding of this bifurcated trust situs concept. The assumption that the state of the settlor’s domicile is the trust’s situs should not automatically be presumed.

**Types of Situs**

It has been suggested that there are up to four different situses a trust can have.\(^1\) Administrative situs (also referred to as the principal place of administration) refers to where the administration principally occurs; locational situs refers to where the assets are physically located; tax situs refers to the state(s) that have the ability to tax the trust (that is, whether the trust is a resident or nonresident trust for state fiduciary income tax purposes); and jurisdictional situs refers to the state whose courts have jurisdiction to hear matters concerning the trust.\(^2\) Jurisdictional situs may be affected by the other types of situs and is nonexclusive, meaning multiple states could theoretically assert jurisdiction over the trust.\(^3\) For example, a trust could have a tax situs in State A and property in State B, and the trust could designate that the laws of State C govern. In that case, all three states could and may claim jurisdiction. Whether a trust has multiple situses or shares situs depends on the statutes of each state as well as where the various trust parties and trust assets are located.\(^4\)

When contemplating changing situs, it is important to focus on both the administrative and tax situs. The administrative situs is particularly important because that is the trust’s principal place of administration, which will, in turn, determine which state’s laws may govern. An analysis of such laws is necessary in order to determine whether the trust can be moved, and if so, how that should be accomplished. Absent specific language in the trust document, these laws will dictate if the trustee possesses the power to change the trust’s administrative situs, and if so, how.

The tax situs also is important, particularly because tax savings may be one of the driving factors for a situs change. Each state varies in how it taxes trust income. Some states tax trusts based on where they were created or became irrevocable.\(^5\) Others tax based on the location of the trustee or the trust beneficiaries.\(^6\) Still others choose to tax based on where the trust assets are located or where the trust is being administered.\(^7\) Eight states have no trust income tax at all: Alaska, Florida, New Hampshire, Nevada, South Dakota, Texas, Washington, and Wyoming.

Given the discrepancies among states’ trust taxing statutes, it is important to identify the tax laws of the outbound state (current trust situs) as well as the inbound state (proposed new trust situs). It is also possible that a trust could have multiple tax situses. In these situations, the outbound state may still claim tax jurisdiction based on where the trust was created, while the inbound state may assert tax jurisdiction based on where the trustee and/or beneficiaries may reside or where the trust assets are located. This analysis is particularly important for clients who are seeking to change the trust situs in order to gain more favorable tax treatment or are seeking to avoid state income taxes altogether.

This situation can arise when a trust’s situs will be changed from a state that has “long-arm” resident trust taxing statutes. Each state can define a resident trust differently, and these long-arm states seek to tax a trust based solely on the fact that the settlor was a resident of the state at the time of the trust’s creation and/or at the time it became irrevocable. Therefore, regardless of the fact that the settlor, beneficiaries, trustees, or even, in some instances, trust assets no longer have a connection to the state, the state may...
still seek to tax trust income based solely on its creation in that state.

In the states where these statutes have been challenged, such statutes generally have been found to be unconstitutional. In fact, there is a history of case law holding that, under either the due process clause or the commerce clause, a state is not justified in taxing a trust that does not have a significant connection (or substantial nexus) to the state. Therefore, it is likely that these statutes will continue to fall as constitutional challenges are made to them. However, this is an important issue to keep in mind for those considering moving situs to a state where such statutes are still law and challenges have not yet been brought against them. If tax savings are a significant goal, changing the trust’s situs is a calculated risk that the trustee must consider carefully.

Reasons to Change Situs

Despite the inherent complexity of trust laws and trust situs, there are significant benefits that can be gained and money that can be saved by transferring the trust’s situs.

Favorable Trust Laws

While there are many factors that may go into effectuating a change in the trust’s situs, one of the most popular reasons is to take advantage of a state’s more favorable trust laws. The Uniform Trust Code (UTC) was codified in 2000, with subsequent amendments made, the most recent of which passed in 2010. This code seeks to create a uniform standard for trust laws among the states. States have discretion to implement the UTC as adopted by the Uniform Laws Commission. Therefore, states can choose to approve the UTC in its entirety or to pass only selective provisions. The practical effect of this phenomenon is that states compete for trust business by passing more favorable and flexible trust laws when compared with their neighbors.

An argument can be made that states that have adopted the UTC are more attractive inbound states. These states are ideal because their laws have been updated to provide more flexibility to deal with trusts as well as with the practical implications of administering a trust in the modern environment. Among the provisions that are most popular are directed trusts and trust protectors, as well as mechanisms that allow for modifying and amending irrevocable trusts.

Directed trusts are trusts that allow for an advisor to direct the trustee as to how trust assets are invested and managed. This type of trust is particularly important for trusts that are overly concentrated in a single holding; that own and operate family businesses; or that invest in nontraditional or risky investments, such as hedge funds and private equity. Given the nature of such assets, it may be difficult for the trustee to abide by his or her fiduciary duty while also managing these unique assets. A directed trust allows the advisor to take responsibility for investment decisions, thereby reducing the liability of the trustee for retaining such investments.

Another beneficial provision to examine when selecting an inbound state are trust protector provisions. The trust protector is an individual, appointed by the settlor(s), who has the power to either direct or require the trustee to take or refrain from taking certain actions in the administration of the trust. The identity of the trust protector as well as the powers of the trust protector are generally enumerated in the trust instrument itself. This is a powerful mechanism that allows the settlor(s) to provide additional oversight over the trustee.

Perhaps the most important laws to consider are the flexibility a state may provide to modify or reform a “defective” irrevocable trust. Irrevocable trusts, by their very name, are created to be permanent. Yet for various reasons, including changes in the trust and
tax laws, changes in a beneficiary’s situation, and in general, the realities of a modern world, some irrevocable trusts would benefit from having changes made to them. Under the UTC, there are a variety of tools available to allow a settlor (if living), trustee, and beneficiary to make changes to these trusts without needing to resort to court involvement and approval. Among them are nonjudicial settlement agreements (NJSAs), modification or termination agreements, and, as a last resort, decanting.\(^\text{13}\) The nonjudicial modification of irrevocable trusts is one of the hallmarks of the UTC, and states with such statutes are extremely attractive as inbound states because of the flexibility they provide.

An NJSA allows interested parties to agree to modify certain trust provisions, and the UTC specifically contemplates its use for changing trust situs.\(^\text{14}\) Where an NJSA may not be appropriate, the parties can consider an agreement to either modify or terminate an irrevocable trust. In order for this agreement to be implemented outside of the court system, the settlor as well as all beneficiaries must agree and consent to the proposed modification or termination.\(^\text{15}\) Generally, beneficiaries include present and future beneficiaries, regardless of whether their interest is vested or contingent.\(^\text{16}\) However, most state statutes will provide mechanisms for certain individuals to represent and bind the interests of others; for example, parents can represent or bind the interests of their children, even if they are unborn.\(^\text{17}\)

As one can imagine, depending on the trust terms, a modification or termination agreement can involve a wide variety of parties; however, flexibility can be found among the states. For example, the definition of a beneficiary may provide some additional flexibility when determining the parties who must consent. States also differ in terms of which parties are required to consent before court approval is required, as well as which parties may represent and bind other parties in such agreement. If either the settlor or beneficiaries is unwilling or unable to consent, this matter generally will need to be submitted to the court for approval.

Where neither the NJSA nor the modification/termination agreement is appropriate or where all parties cannot or will not consent, the trustee may have the option of decanting the trust. Decanting is the process of transferring trust assets from one irrevocable trust to another.\(^\text{18}\) Essentially, it provides practitioners and clients alike with the unique opportunity to rewrite an irrevocable trust. Authority is granted to the trustee, either under the terms of the original trust or through state statutes, to pour assets from the original trust into a new trust with different provisions, which can include those related to the trust’s situs.\(^\text{19}\) Again, states differ on the flexibility and power granted to a trustee when it comes to decanting authority.

### Fiduciary Income Tax

State income taxes can be a significant expense for nongrantor trusts that do not distribute all of their ordinary income earned and realized capital gains. Therefore, avoiding these taxes can be a significant motivating factor.

As previously discussed, states tax trust income differently, based on where the interested parties (settlor, beneficiaries, trustee, etc.) may reside or where the assets may be located. Obviously, a state with no trust income tax would be preferable. There also will be variety among the states in terms of their trust tax rates, which can range anywhere from 3 percent to upwards of 11 percent.\(^\text{20}\) Moving to a state with a favorable trust tax regime could save a significant amount of money, year after year. In order to realize such savings, it is important to confirm that the trust will escape double taxation under a state’s long-arm taxing authority.
The State of a Trust’s Situs
Kelly Dancy

Convenience

Lastly, the trust situs may be a decision made based solely on convenience. For a variety of reasons, including ease of administration and efficiency, it may be beneficial for the trust to be sitused close to the beneficiaries or trustee. While this may not be the sole reason for moving trust situs, it is certainly an added benefit, the value of which should not be underestimated.

Procedure

Once it has been determined a change of situs is appropriate and the inbound state has been selected, the next step is to determine how to effectuate such a change.21

Authority

State Statutes

A thorough analysis of the outbound state’s trust laws is required, as they will determine the trustee’s authority as well as what mechanisms may be available to effectuate the transfer. Without precluding the other means for establishing a connection with the jurisdiction, the principal place of administration will generally be controlled by the trust instrument. However, states differ in how controlling this language may be. For example, some states may require for the language to be paired with an actual connection to the state, such as the trustee’s principal place of business or the administration of the trust.22 Other states allow the trustee to designate the principal place of administration following a transfer.23 The UTC provides for a trustee to change the trust situs as well, however, the requirements of notice and consent can vary widely from state to state.24 If the language in the trust document is not controlling, the principal place of administration will generally be where the trustee resides.25

Generally, a change in trust situs can also be accomplished through an NJSA. In fact, trust situs is one of the trust provisions explicitly stated in the UTC (and UTC state statutes) that is appropriate for an NJSA.26 Generally, this will require the consent of all interested parties to the trust.27 Interested parties are defined as all parties that would be required for a binding court settlement.28 While not specifically defined—and the comment to the UTC indicates that was by design—this is a more complex step, comparatively, since it will require the agreement of multiple parties. Should circumstances require, a modification agreement or trust decanting are also valid mechanisms to consider.

Trust Instrument

The trust instrument may also provide authority for the trustee to change the situs of the trust instrument. Assuming this authority does not conflict with state law, this provides the settlor with the opportunity to dictate the scope and terms of the trustee’s power to change the situs unilaterally.

Tax Situs

When determining the tax situs of the trust, one must evaluate the tax laws of both the outbound and the inbound state. As previously discussed, an outbound state that has a long-arm taxing regime for resident trusts will not advance the ball forward from a tax perspective. However, if taxes are not the sole reason for the change in situs, this analysis will not be as important.

Assuming avoiding or minimizing fiduciary trust taxes is a motivating factor, the trust tax situs analysis needs to be conducted from the perspective of which trust characteristics need to be changed in order to take the trust outside of the outbound state’s taxation statute and under the jurisdiction of the inbound state’s taxation statute. Therefore, depending on each state’s statutory scheme, it will be necessary
to change the trustee, the location of the trust assets, or the residence of the settlor and/or beneficiaries. In general, it is a combination of these factors that will determine where and how the trust is taxed, if at all.

**Governing Law and Trust Situs**

Governing law generally refers to the laws that will govern the trust. In the context of a trust’s situs and the contemplation of a move, it is important to consider the different types of governing law. Technically speaking, there are three types of laws that can apply to trusts: validity, construction, and administration. The validity of a trust refers to the existence and enforceability of the trust. Construction is the application of rules that determine a trustor’s presumed intent when the settlor’s actual intent cannot be ascertained. The administration of the trust includes any matter relating to the management of the trust and can include, but is not limited to, the duties owed by the trustee to the beneficiaries, the liability of the trustee for breach of trust and the trustee’s right to indemnification for expenses incurred during the administration, the propriety of trust investments, the removal of a trustee and the appointment of a successor, trustee compensation, and the termination or modification of a trust.

An analysis must be conducted as to the outbound and inbound states’ governing law statutes, particularly in terms of the jurisdiction and administration of the trust. As previously discussed, jurisdictional situs can, in theory, be claimed by multiple states based on, among other factors, the governing law of the trust and its principal place of administration. Therefore, it is important to clarify which state’s laws govern and where the principal place of administration is both before and after the proposed change. These answers may affect which state is a leading candidate for the trust’s new situs and how to bring the trust under that state’s more favorable laws.

The governing law will generally be determined by the language in the trust instrument. Although states will differ in their statutory schemes, language in the trust document designating the jurisdiction will generally be conclusive. This allows the settlor to select the law that will govern the meaning and effect of the terms of the trust. The settlor could also give the trustee the ability to change which state’s laws will govern the trust within the trust instrument as well. Providing this authority would give the trustee the flexibility to attempt to align the governing law with the new trust situs. There is also always the option of addressing this issue through an NJSA or similar mechanism. Absent such language or agreement, a state will generally look to the most substantial relationship between the trust and an interested party, generally the trustee, and once determined, where that individual resides. The state’s laws regarding the validity and construction of a trust generally will not change with a change in situs, unless the change is specifically enumerated in either the trust or a statutory agreement, such as an NJSA or a trust modification agreement. However, the governing law regarding administration will generally change with a change in the principal place of administration.

**Favorable States**

**Outbound States**

It generally will be easier to move a trust from a state that taxes based on the location of the trustee and/or trust assets. The trustee and location of the trust and administration of the trust assets are easily changed to take the trust’s income outside of that state’s jurisdiction compared with the trust’s location or the residence of the settlor. If the state taxes based on the trustee’s location, a trust situs can be changed by changing the trustee.
Inbound States

It should come as no surprise that states that do not tax trust income are ripe for consideration as favorable inbound states, particularly if minimizing or avoiding taxes altogether was a goal of the move. In fact, these are some of the most popular states in which to situs a trust. In addition, states that have adopted the UTC and have flexible and modern trust laws are also extremely popular.

Conclusion

Moving the situs of a trust can provide significant benefits not only in its administration but also in the ability to further the purpose and intent of the trust. Changing the trust’s situs may allow the trust to be governed by more modern trust laws, thereby, providing more flexibility for the trust’s administration. The tax savings that could be realized from changing the trust’s situs should not be underestimated. A careful analysis must be undertaken before such change is made to determine how best to effectuate the situs change as well as determine an appropriate inbound state. Regardless of whether any action is taken, it is a worthwhile exercise to examine the trust’s situs periodically and determine whether a change should be considered.

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(2) Ibid.
(3) Ibid.
(4) For a more detailed discussion of the types of situs, see Sager & Terebelo (2013), endnote 1.
(5) See, for example, D.C. Code § 47-1809.01 (District of Columbia); Me. Rev. Stat. Ann. tit. 36, § 5102(4)(B)–(C) (Maine); Neb. Rev. Stat. § 77-7274.01(6)(b)–(c) (Nebraska); Okla. Stat. tit. 68, § 2353(6) (Oklahoma); 72 P.S. §§ 7301(6) (Pennsylvania); and 32 V.S.A. § 5811(11)(B) (Vermont).
(9) Ibid.
(10) For a greater discussion of additional factors to be considered when changing trust situs, see Sager & Terebelo (2013), endnote 1, and Peter S. Gordon, “Trust Adventures in Wonderland—From the Meadow and Through the Looking Glass; Situs and Governing Law” (2012).
(12) Ibid.
(13) Decanting should be seen as a last resort based on the complexity and administrative costs associated with decanting a trust. If there are other options available, such as an NJSA or trust modification agreement, those options should be explored first before considering decanting.
(14) Uniform Tr. Code Section 111 (2000). Other matters that may be agreed to via an NJSA include the interpretation and construction of the terms of the trust; the approval of a trustee’s report or accounting; direction to a trustee to refrain from performing a particular act, or the grant to a trustee of any necessary or desirable power; the resignation or appointment of a trustee and the determination of a trustee’s compensation; transfer of a trust’s principal place of administration; liability to a trustee of an action relating to a trust.
(18) For a more thorough discussion of decanting, see William R. Culp Jr. and Briani Bennett Mellen, “Trust Decanting: An Overview and Introduction to Creative Planning Opportunities,” Real
The State of a Trust’s Situs
Kelly Dancy

(20) Ind. Code §§ 6-3-1-3.5, 6-3-1-12(d), 6-3-1-14, 6-3-2-1(a); Ind. Admin. Code tit. 45, r. 3.1-1-21(d), r. 3.1-1-12; versus Or. Rev. Stat. §§ 316.022(6), 316.037(1), 316.267, 316.282(1)(d), (2).
(21) The procedure for changing trust situs may differ between testamentary and inter vivos trusts. This article generally addresses what is necessary to change the situs of an inter vivos trust.
(22) See Uniform Tr. Code Section 108 (2000), which states, the terms of a trust designating the principal place of administration are valid and controlling if: (a) the Trustee’s principal place of business is located in or a trust is a resident of the designated jurisdiction; or (b) all or part of the administration occurs in the designated jurisdiction.
(23) See, for example, Wis. Stat. § 701.0108, which allows the trustee to designate the principal place of administration as well as transfer the principal place of administration between jurisdictions, with the consent of all interested parties.
(25) Ibid.
(27) Ibid.
(28) Ibid.
(30) Ibid.
(31) Ibid.
(33) Ibid.
(34) See Uniform Tr. Code Section 403, which provides that an inter vivos trust is validly created if its creation complied with the law of the jurisdiction in which it was executed or the law of jurisdiction in which: (a) the settlor was domiciled; (b) the trustee was domiciled or had a place of business; or (c) any trust property was located. See also Uniform Tr. Code Section 107, which states the meaning and effect of the terms of a trust are determined by: (1) the law of the jurisdiction designated in the terms, unless the designation of that jurisdiction’s laws is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue; or (2) in the absence of controlling designations in the terms of the trust, the law of the jurisdiction having the most significant relationship to the matter at hand.