Southern Arizona Estate Planning Council

Just Like Starting Over – Decanting Trusts

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I. What is Decanting?

A. Modifying Irrevocable Trusts.

1. On its face, the idea of modifying or changing a trust that, by its terms, is irrevocable seems difficult, if not impossible and potentially contrary to the settlor's intent.

2. Irrevocable trusts are often required to achieve the settlor's tax objectives.

3. In many cases, it may be necessary to modify or change the terms of the trust to more accurately reflect the settlor's intent, to respond to beneficiary needs and circumstances, to address changes in law, to optimize tax consequences, or to correct errors in the trust instrument.

4. There are a number of mechanisms to modify an irrevocable trust, including judicial reformation and modification, trust combinations and divisions, removal and substitution of trustees, non-judicial settlement agreements, the use of "trust protectors" or "trust advisors" to modify the terms of a trust, and now, with increasing popularity, decanting.

B. Decanting.

1. When wine is decanted, it's poured from a bottle into another vessel, usually called the "decanter," to leave the sediment in the bottle while pouring off the pure liquid into the decanter. In addition to leaving the sediment behind, decanting also allows the wine to aerate or to breathe. Decanting a trust is very similar. The assets of the old trust are poured into or transferred to a new trust which is free from the sediment of the old trust that might be preventing it from effectively and efficiently achieving its purposes. Decanting can modify trustee and administrative provisions and also change dispositive provisions of the trust, breathing

new air into the trust.

2. Decanting is the act of a trustee exercising its power to distribute trust principal to or for the benefit of a beneficiary by distributing the assets to a new trust.

3. A decanting power is often thought of as the exercise of a special power of appointment, held by the trustee, to distribute assets for the benefit of a beneficiary. However, when exercising the decanting power, the trustee is subject to its fiduciary duties (including, for example, the duty to act in good faith and in the interest of the beneficiaries), whereas the holder of a power of appointment usually is not acting in a fiduciary capacity, or subject to fiduciary duties when exercising the power.[1]

4. An exercise of a decanting power should be consistent with the purposes of the original trust.

   a. The purpose of decanting is not to disregard the settlor's intent, but to modify the trust to effectuate better the settlor's broader purposes, or the settlor's probable intent, if the settlor had anticipated the circumstances in place at the time of the decanting.

   b. The settlor's purposes generally include the efficient administration of the trust.

   c. The settlor's purposes also may include achieving certain tax objectives, or generally minimizing overall tax liabilities.

C. Theory of Decanting.

1. The theory underlying decanting is that if a trustee has the discretionary power to distribute property to one or more current beneficiaries, then the trustee should have the power to distribute the property to a second trust for the benefit of such beneficiaries. Wine is decanted to bring out the best nose and flavor the grape offers; trusts should be decanted only in furtherance of the purposes of the trust.

2. Some states now allow a trustee to decant even if the trustee has no discretion over making distributions (i.e., the trustee's power to distribute is subject to a standard, or the trustee is required to distribute trust property to a beneficiary).

[1] See RESTATEMENT (THIRD) OF PROPERTY (WILLS AND OTHER DONATIVE TRANSFERS) (Tent. Draft. No. 5, March 27, 2006), §17.1 ("Power of Appointment Defined").

D. Evolution of Decanting.

1. Common Law.

a. The existence of a common law power in a trustee to distribute in further trust is significant from a GST tax perspective even in a state that has enacted a decanting statute. Modification via decanting of a GST exempt trust could destroy the exempt status if the modification fails to comply with one of the safe harbors set out in the GST grandfathering regulations. The safe harbor with the most flexibility applies where decanting is done pursuant to a decanting law that was in effect at the time the trust became irrevocable.

b. The courts of several states have authorized trustees to decant to new trusts pursuant to their exercise of a broad discretionary power of distribution. A trustee's decanting power was first recognized in the Florida case of Phipps v. Palm Beach Trust Co.

c. Phipps v. Palm Beach Trust Co., 142 Fla. 782, 196 So. 299 (1940).

(i) The case involved a Florida inter vivos trust established for the benefit of the settlor's children and more remote descendants, but primarily for the benefit of one child. The trust conferred on the settlor's husband, in his capacity as individual trustee (there was also a corporate trustee), the power to direct distribution of the trust property at any time to any one or more of the beneficiaries. Although granted in a fiduciary capacity, the power was exercisable during the trustee's lifetime and by will. The individual trustee purported to exercise the power by directing that all of the trust property be distributed to the same trustees to be held on similar terms for the benefit of the same beneficiaries, except that the new trust conferred upon the primary beneficiary a limited power to appoint an income interest to the beneficiary's wife. The corporate trustee brought an action to determine whether this purported exercise of the individual trustee's power of distribution was within the powers granted by the trust instrument.

(ii) The court viewed the individual's trustee power as a special power of appointment, and focused on whether the power conferred upon him included the power to appoint in further trust. Analyzing several cases from other states involving powers of appointment held in a non-

fiduciary capacity, the court concluded:

"The general rule gleaned from the foregoing and other cases of similar import is that the power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent.

An examination of the original trust indenture...discloses that the donor reposed unlimited confidence and discretion in the individual trustee and clothed him with absolute power to administer and dispose of the trust estate to any one of the named beneficiaries to the exclusion of the others. He was further vested with unlimited discretion as to the time, amount, manner, and condition any sums should be paid to the beneficiaries. This being the case, there can be no question of the power of the individual trustee to create the second trust estate for the benefit of the class named in the original trust indenture."

142 Fla. at 785, 196 So. at 301.

Although the terms of the trust were important to the court's decision, the crucial point appears to be lack of any expressed intent to prohibit distributions in further trust.

d. Wiedenmayer v. Johnson, 106 N.J. Super. 161, 254 A.2d 534 (App. Div.), *aff'd sub nom.* Wiedenmayer v. Villaneuva, 55 N.J. 81, 259 A.2d 465 (1969).

(i) This case involved one of six inter vivos trusts established with Johnson & Johnson stock by John Seward Johnson for each of his six children. The trust authorized the trustees "from time to time and whenever in their absolute and uncontrolled discretion they deem it to be for his best interests, to use for or distribute and pay over to John Seward Johnson, Jr…to be his absolutely, outright and forever, any or all of the Trust Property." 106 N.J. Super. at 164, 254 A.2d at 535. The trustees proposed to exercise their distribution power to distribute all of the trust property to the beneficiary on the condition that he simultaneously place the distributed property in trust with the same trustees. The terms of the new trust eliminated the contingent remainder interests of two of the beneficiary's children, and the guardian *ad litem*

representing the children objected.

(ii) The court held that the trustees' power to distribute the property outright permitted them to distribute it to the beneficiary on the condition that he establish a substituted trust.

"If they could make that distribution to the end, as the trust indenture clearly stated, that the trust property would be the son's 'absolutely, outright and forever,' it seems logical to conclude that the trustees could, to safeguard the son's best interests, condition the distribution upon his setting up a substituted trust."

106 N.J. Super. at 164-65, 254 A.2d at 536.

Although the distribution in trust eliminated the contingent remainder interests of two of the beneficiary's children, the court reasoned that an outright distribution to the beneficiary would have had the same effect.

e. In Morse v. Kraft, 992 NE2d 1021 (2013), the Massachusetts Supreme Judicial Court approved the decanting of a trust under the common law.[2]

(i) The trust at issue was the Kraft Irrevocable Family Trust, which was established in 1982 by Robert Kraft. The trust agreement established four separate trusts, one for each son of Robert and Myra Kraft. Robert Kraft funded the

[2] In 2017, the Massachusetts Supreme Judicial Court ("SJC") decided another decanting case, and based its decision in large part on the reasoning of the Kraft case. See Ferri v. Powell-Ferri, 72 N.E.3d 541 (Mass. 2017). In Ferri, a trust created in 1983 by the father of the sole beneficiary (Ferri, Jr.) gave the trustees broad discretion to distribute trust property to Ferri, Jr. It also gave Ferri, Jr. the right to withdraw the trust property in stages over time (25% at age 35, 50% at age 39, 75% at age 43, and the balance at age 47). In 2010, Ferri, Jr.'s wife filed an action for divorce. At the time, Ferri, Jr. was 45 years old, and thus had the right to withdraw 75% of the trust property. In 2011, the trustees decanted the trust property to a new trust that eliminated Ferri Jr.'s withdrawal rights. In a convoluted explanation that did not mention §603 of the Massachusetts Uniform Trust Code, or recognize that Ferri, Jr.'s right to withdraw 75% of the trust principal was a general power of appointment, the SJC held the trustees were authorized to decant to the new trust and thus eliminate Ferri, Jr.'s vested withdrawal rights (§603 provides: "…the holder of a non-lapsing power of withdrawal shall be treated…as if the holder of the non-lapsing power of withdrawal were the settlor of a revocable trust to the extent of the property subject to the power." §505(a)(1) of the Massachusetts UTC provides: "During the lifetime of the settlor, the property of a revocable trust shall be subject to the claims of the settlor's creditors."). In August 2017, the Connecticut Supreme Court issued two opinions in the Ferri matters. In one, the court: (i) adopted the opinion of the Massachusetts Supreme Judicial Court, and held that decanting was proper, and (ii) held that the decanted trust was not self-settled. Ferri v. Powell-Ferri, 326 Conn. 438 (2017). In the other, the court held that the assets of the decanted trust could not be considered for equitable distribution purposes, but could be considered when creating alimony orders. Powell-Ferri v. Ferri, 326 Conn. 457 (2017).

1982 Trust. The trust agreement stated: "The Trustees shall pay to such child from time to time such portion or portions of the net income and principal thereof as the disinterested Trustee shall deem desirable for the benefit of such child, accumulating and adding to principal from time to time any income not so paid." The 1982 Trust also provided: "Whenever provision is made hereunder for payment of principal or income to a beneficiary, the same may instead be applied for his or her benefit."

(ii) Richard Morse was the sole trustee and qualified as the disinterested Trustee. Each child's trust terminated upon the child's death, at which time the property was subject to the child's limited power of appointment. In default of appointment, the property was to be distributed by right of representation to the child's then living issue, subject to being held in trust until age 25.

(iii) The disinterested Trustee proposed distributing all of the property of each trust for the benefit of a Kraft child to a new trust for the benefit of the same child to be established under a new declaration of trust, the Kraft Irrevocable Family Trust – 2012. The new trust would allow each of the Kraft sons to serve as trustee of his own trust. The new trust would not automatically have each son as trustee, but would enable Robert Kraft to appoint the sons in the future.

(iv) The court's analysis began with a discussion of trust decanting, noting that common law potentially provides authority for decanting, and also that such authority may be provided by statute. It recognized that decanting allows a trustee to amend an irrevocable trust, but that a decanting power must be exercised in keeping with fiduciary obligations. The opinion stated: "Although we look to precedent for interpretative guidance, it is nevertheless clear that a trustee's decanting authority 'turn[s] on the facts of the particular case and the terms of the instrument creating the trust. There is no fixed rule by which all are determined.'" 922 NE2d at 1025 (*quoting* Phipps).

(v) The court focused in on three key provisions of the original trust agreement:

(a) The trustee's unlimited discretion to pay net income and principal to each son.

(b) The trustee's power to apply principal or income for the benefit of a beneficiary.

(c) The instrument's broad grant of powers to the trustee in the introduction to the trustee powers article.

(vi) The court held that the original trust could be decanted, stating:

"We conclude that the terms of the 1982 Trust authorize the plaintiff to transfer property in the subtrusts to new subtrusts without the consent of the beneficiaries or a court. As did the trust in Wiedenmayer, supra, [the 1982 Trust gives] the disinterested trustee discretion to distribute property directly to, or applied for the benefit of, the trust beneficiaries, limited only in that such distributions must be 'for the benefit of' such beneficiaries. We regard this broad grant of almost unlimited discretion as evidence of the settlor's intent that the disinterested trustee have the authority to distribute assets in further trust for the beneficiaries' benefit."

(vii) The Boston Bar Association submitted an amicus brief that asked the court to declare that a broad discretionary distribution power included the power to distribute in trust, regardless of whether the governing instrument specifically included "to or for the benefit of" language. The argument was premised on the holdings of Phipps and Wiedenmayer, and sought to extend the holding of Loring v. Karri-Davies to powers of appointment held in a fiduciary capacity. The brief noted the importance of a common law decanting principle for GST tax purposes, and argued that such a rule should not, like the holding in Loring v. Karri-Davies,[3] be applied only prospectively.

[3] In Loring v. Karri-Davies, 357 NE2d 11 (1976), the court considered whether a limited power of appointment exercisable by its terms to distribute property outright could be exercised to direct that the appointive property be held in further trust. The court had held that such a power could not be so exercised in Hooper v. Hooper, 89 N.E. 161 (Mass. 1909), but was being urged to modernize the rule in light of the subsequently released Restatement of Property, which authorized appointment in further trust on the facts before the court. Although the court declined to apply the new rule in the case before it, the court reviewed scholarly discussions of the issue and concluded its

(viii) The court declined the BBA's invitation, stating,

> "Although we recognize a trustee's decanting power given the trust language and the circumstances here, we nevertheless recognize the trend toward State Legislatures enacting decanting statutes…Indeed, 'it may be preferable for the [L]egislature of a [S]tate to adopt a decanting statute rather than rely on general principles of property law.' For this reason, we decline to adopt the request of the Boston Bar Association, in its amicus brief, that we recognize an inherent power of trustees of irrevocable trusts to exercise their distribution authority by distributing trust property in further trust, irrespective of the language of the trust. In the absence of express authorizing legislation…practitioners are including express decanting provisions in standard trust agreements with increasing frequency…In light of the increased awareness, and indeed practice, of decanting, we expect that settlors in the future who wish to give trustees a decanting power will do so expressly. We will then consider whether the failure to expressly grant this power suggests an intent to preclude decanting."

(ix) The Morse decision has established common law trust decanting in Massachusetts. Although the decision is limited in scope to trust instruments that include language authorizing decanting, that language may be as broad as an application provision directing that discretionary distributions may be applied for the benefit of a beneficiary. However, given the importance under the GST grandfathering regulations of the state law to have authorized decanting at the time the trust was created, practitioners would have preferred a broader decision authorizing decanting any time a trustee had a broad discretionary power of distribution.

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opinion as follows: "[W]e believe it would be helpful if the law of this Commonwealth corresponded with the provision of the Restatement of Property § 358(e) (1940) to the effect that '[i]f, but only if, the donor does not manifest a contrary intent, the donee of a special power can effectively . . . (e) appoint interests to trustees for the benefit of objects.' Accordingly we declare to be our present intention to apply that rule of construction to special powers of appointment granted in instruments executed by the donors *after the date of this opinion*. This proposed change in the law of this Commonwealth would not thwart or otherwise interfere with the presumed intention of donors of powers of appointment contained in instruments executed by them before the date of this opinion." (emphasis added).

2. Statutory Decanting.

a. Approximately thirty states have enacted decanting statutes. Although the details vary greatly among the states with decanting statutes, the basic premise is the same: a trustee's discretion or ability to make distributions includes the lesser power to move the trust assets to a second trust.

b. The Uniform Trust Code (the "UTC"), which has been enacted in over thirty states, does not have a decanting provision. The UTC contains provisions permitting modifications of trusts, reformations to correct mistakes, and combinations and divisions of trusts. About half of the states that have adopted decanting statutes also have adopted the UTC.

3. Decanting Authorized by the Trust Agreement. Even if neither the common nor statutory law that applies to a particular trust permits decanting, the trust agreement itself could confer upon the trustee the authority to decant, under whatever terms and conditions the settlor specifies.

E. Uniform Law. The National Conference of Commissioners on Uniform State Laws completed its Uniform Trust Decanting Act (the "UTDA") in July 2015, and amended the UTDA on May 17, 2018. As of the date of these materials, twelve states have adopted the uniform act, and legislation to adopt the act has been introduced in Massachusetts. The UTDA is intended to eliminate conflicts between different state statutes, protect trustees who decant under one state's statute, when more than one state's statute might apply, and protect trustees who reasonably rely on a prior decanting.

II. Tax Considerations.

A. Income Taxes. In most cases, there should be no income tax consequences associated with the transfer of assets from one trust to another through the process of decanting. It is important, however, to consider the capital gain implications of Cottage Savings Ass'n v. Comm'r., 499 U.S. 554 (1991), and the negative basis implications of Crane v. Comm'r., 331 U.S. 1 (1947). It also is important to consider whether the tax attributes of the old trust are carried forward into the new trust under the distributable net income (DNI) rules.

B. Federal Wealth Transfer Taxes. It is important to consider whether a taxable gift occurs when assets are transferred from one trust to another, and whether there is estate inclusion with respect to the decanted assets. In addition, it is important to consider the generation skipping transfer (GST) tax consequences of decanting a "grandfathered" GST exempt trust or decanting a non-

grandfathered trust that is exempt by reason of the allocation of GST exemption.

C. IRS Places Decanting on "No-Ruling" List. Given the increased legislative activity by states in enacting decanting statutes and the need to provide definitive guidance, in 2011 the IRS placed decanting on its no-ruling list. Until the IRS publishes a more definitive revenue ruling, revenue procedure, regulation, or other publication, it will not issue determination letters or rule on the following matters:

1. Whether decanting gives rise to a Code §661 deduction or results in inclusion in gross income under Code §662;

2. Whether decanting results in a taxable gift being made under Code §2501; and

3. Whether decanting causes the loss of GST exempt status or constitutes a taxable termination or taxable distribution under Code §2612.

The IRS may issue private rulings with respect to decantings that do not result in changes in any beneficial interests, and do not involve the question of whether a decanting from a GST-grandfathered trust satisfies the regulatory safe harbors for GST purposes.

See Rev. Proc. 2022-3, 2022-01 I.R.B. 144 (Jan. 3, 2022).

D. IRS Places Decanting on, and then Removes Decanting from, Its Priority Guidance Plan. After placing decanting on its no-ruling list, the IRS placed decanting on its 2011-2012 Priority Guidance Plan.[4]

1. The IRS said it intended to issue a "Notice on decanting of trusts under §§2501 and 2601."

2. Interestingly, while the IRS has targeted the gift and GST tax consequences of decanting, it did not include the income or estate tax consequences of decanting in its 2011-2012 Priority Guidance Plan.

3. After placing decanting on its 2011-2012 Priority Guidance Plan, decanting has been omitted from all of the IRS's subsequent Priority Guidance Plans.

[4] The Priority Guidance Plan lists those projects that are priorities for the allocation of resources of the IRS and the Treasury Department during a twelve month period (July 1st through June 30th). The Plan identifies and prioritizes the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance.

E. IRS Requests Comments on Decanting.

1. In December 2011, the IRS issued Notice 2011-101 (2011-52 I.R.B. 932), in which it requested comments regarding when decanting that results in a change in the beneficial interests are not subject to income, gift, estate, and/or GST taxes. The American College of Trust and Estate Counsel (ACTEC) submitted comments, including a proposed revenue ruling, on April 2, 2012.

2. According to Notice 2011-101, the IRS is studying the tax implications of decanting and considering approaches to addressing some or all of the relevant tax issues in published guidance.

III. Uses of Decanting.

A. Change of Administrative Provisions.

1. Change of situs of trust administration.

2. Change of law governing the administration of the trust.

3. Provide for the resignation, removal, and appointment of trustees without court approval.

4. Expand powers of trustee to engage in sophisticated financial transactions, such as derivatives and options, make or guarantee loans, adjust between income and principal, or participate in an initial public offering.

5. Provide for the division of trustee roles and responsibilities through the use of investment advisors, distribution advisors, trust protectors, or special asset direction advisors.

6. Address issues related to trustee compensation, which may be too high or too low.

7. Address trustee liability (and indemnification) for failure to diversify under the prudent investor rule with respect to an over-concentration of investment (typically closely-held business) assets.

8. Convert a foreign trust to a domestic trust or vice versa.

9. Consolidate trusts for administrative efficiency.

B. Beneficiary-Related Change of Circumstances.

1. Limit distributions to beneficiaries with substance abuse problems or those engaging in other unproductive behaviors.

2. Transfer of assets to a special needs trust for a disabled beneficiary.

3. Limit beneficiary rights to obtain information about the nature and extent of their interests in a trust by moving assets to a state where the trustee's duty to provide such information can be restricted.

4. Divide single "pot" sprinkle trusts into separate trusts for each branch of the family.

5. Eliminate a beneficiary altogether.

6. Transfer a self-settled irrevocable trust to a jurisdiction that recognizes asset protection for self-settled spendthrift trusts.

C. Changes Related to Federal or State Tax Planning.

1. Mitigate state income taxation of a trust by moving assets to a new trust in a jurisdiction that does not subject the trust to income taxation based on the location of the trustee or the grantor.

2. Convert a non-grantor trust to a grantor trust or vice versa.

3. Maximize GST planning for assets being distributed to a beneficiary outright (or over which the beneficiary has a general power) by decanting to another trust to make use of the beneficiary's and the grantor's available GST exemption.

4. Division of trusts for GST or marital deduction planning purposes.

D. Changes to Correct Errors or Address Ambiguities.

1. Correct a scrivener's error.[5]

2. Address ambiguities in the original trust instrument.

3. Add a spendthrift clause to a trust that does not contain such a provision.

IV. Is Decanting Permitted under a Particular State Statute?

A. Terminology: First and Second Trust. Under some statutes, the term "first trust" refers to the original trust, and the trust into which the first trust is being decanted is referred to as the "second trust." Thus the first trust is akin to the original bottle of the wine, and the second trust is the decanter. In other state statutes, the "first trust" may be referred to as the "old trust," the "invaded trust" or the "original trust," and the "second trust" may be referred to as the "new trust" or the "appointed trust."

B. Applicability of State Statute. In order to determine whether the decanting statute of a particular state can be used, first the statute should be reviewed to see if it contains specific provisions defining the trusts to which it applies. For example, the statute may require that its state law govern the administration of the trust or the construction of its terms. Generally, decanting is available to trusts regardless of whether they were established before or after the enactment of the decanting statute.

C. What Trusts May Be Decanted? Generally, the state statutes will apply to irrevocable, but not revocable trusts.[6] Some statutes may make a distinction between inter vivos and testamentary trusts. Typically, the second trust may be either a trust already in existence or a new trust created for purposes of decanting. Commonly, a trust may be decanted in whole or in part and may be decanted to more than one trust.

[5] Note that state law determines property rights, and federal law determines how those rights are taxed. See, e.g., U.S. v. Rogers, 461 U.S. 677, 689 (1983); Morgan v. Commissioner, 309 U.S. 78 (1940). A decanting (or other trust modification mechanism) that changes the property rights of the beneficiaries of a trust might not operate to change the federal tax consequences of a completed transaction. See e.g., Estate of La Meres v. Commissioner, 98 T.C. 294 (1992) (trustee's retroactive modification of trust agreement, pursuant to order of state probate court, six years after grantor's death, was not respected because the only reason for the modification was to circumvent the requirements of the split interest trust rules after the government had acquired rights to tax revenues under the terms of the trust agreement). See also Commissioner v. Estate of Bosch, 387 U.S. 456 (1967) (when the application of a federal statute is involved, the decision of a state trial court as to the underlying issue of state law should not be conclusively controlling; that state law as announced by the highest court of the state is to be followed in federal cases).

[6] In Delaware, the trustee may decant a revocable trust if the settlor does not have the capacity to amend the trust agreement. See Del. Code Ann., title 12, §3528 (eff. August 1, 2015).

D. Trust Prohibitions.

1. A trust may expressly prohibit decanting or prohibit certain modifications through decanting. Some state statutes expressly prohibit decanting to the extent prohibited by the trust instrument.

2. Generally, a spendthrift provision, a provision prohibiting amendment, or a provision stating that a trust is irrevocable will not be construed as prohibiting decanting. The South Carolina statute permits decanting even if the trust prohibits decanting, with court approval.[7]

E. Trust Modifications of Decanting Statute. In general, a trust instrument may expressly grant the trustee a power to decant even in the absence of a decanting statute or on terms different than those provided in the decanting statute. For example, state law may provide that the original trust may modify or waive notice requirements, reduce or increase restrictions on altering the interests of beneficiaries, or otherwise contain provisions inconsistent with the statute.

F. Who Needs to Participate? Generally, decanting is performed by one or more of the trustees. In some states notice is required to be given to certain beneficiaries (and sometimes other parties). Generally, court approval is permitted but not required except under certain circumstances.

G. Grantor's Intent and Trust Purposes. State law may require that the exercise of the decanting power be exercised in furtherance of the purposes of the trust, or that the trustee take into account the purposes of the trust when decanting. The trustee also may be required to consider the interests of the beneficiaries and the intent of the settlor (including, for example) how changes in circumstances might have changed the settlor's intent.

H. Discretionary Distribution Authority. Generally, the trustee must have the power to make discretionary distributions to decant. Some statutes require that the power be over principal, some require only a power over income or principal.

1. Some statutes require that the power be an "absolute power" or that the trustee have "*absolute discretion*"; other statutes permit decanting even if the discretion is not absolute. The definition of "absolute discretion" varies by state (e.g., in some states, "absolute discretion" means discretion not limited or modified by the terms of the trust in any way, while in other states, "absolute discretion" means any discretion that is not limited by an ascertainable standard).

[7] S.C. Code Ann. §62-7-816A(a).

2. Some statutes have *bifurcated standards*[8] that require absolute discretion for some modifications (generally changes to beneficial interests) but permit decanting for other purposes (e.g., administrative modifications) even when the discretion is not absolute. The trend of the newer statutes is to use a bifurcated standard.

3. At least one state (New Hampshire) allows a trustee to decant even if the trustee has no discretion in making distributions of income or principal from the first trust.

I. Restrictions on Trustees.

1. Decanting Prohibited. Some statutes prohibit certain interested trustees from decanting. If only interested trustees are acting, decanting may be prohibited. In some states, if all trustees are beneficiaries, the court may appoint a special fiduciary with authority to decant.

2. Decanting Limited. Other statutes address the potential adverse tax consequences of an interested trustee modifying a trust by limiting the types of modifications that can be made by an interested trustee. For example, Wisconsin allows an interested trustee to decant to a trust for a disabled beneficiary if the trustee's only interest in the first trust is as a remainder beneficiary and the second trust does not increase the trustee's interest.[9]

J. Court Approval. Court approval is generally not required to decant, but usually the trustee is free to obtain court approval. Court approval may be required in certain circumstances (e.g., to change a trustee compensation or removal provision).

V. What Changes Are Permitted to Beneficial Interests?

A. Changing Beneficiaries.

1. Adding a Beneficiary. Generally, the decanting statutes do not permit a new beneficiary to be added directly. In some cases it may be possible to give an existing beneficiary a new power of appointment or a broader power of appointment than the beneficiary currently holds that would permit the beneficiary to appoint to persons who are not existing trust beneficiaries or potential appointees of the existing power of

[8] Michigan actually has two statutes, one of which applies when the trustee has absolute discretion and the other of which applies when the trustee has discretion (but not necessarily absolute discretion). See Mich. Comp. Laws §556.115a and §700.7820a.
[9] Wis. Stat. §701.0418(3).

appointment.

2. Eliminating a Beneficiary. Generally, statutes requiring a trustee to have absolute discretion to decant will not require that all of the beneficiaries of the old trust be beneficiaries of the new trust, thus allowing beneficiaries to be eliminated. Some statutes implicitly permit a beneficiary to be eliminated by permitting the decanting power to be exercised in favor of "one or more of" the existing beneficiaries.

3. Keeping the Beneficiaries the Same. Some states explicitly require that the new and old beneficiaries remain the same. Generally in the bifurcated states, if the trustee does not have absolute discretion the beneficiaries must remain the same.

B. Changing the Standard for Distributions.

1. States with bifurcated statutes will generally permit the standard for distributions to change if the trustee has absolute discretion, but require the standard to stay the same where the trustee does not have absolute discretion.

2. Some states require that the distribution standard remain the same.

3. Other states permit the new trust to have a different distribution standard, with certain exceptions (especially when the trustee is a beneficiary). The New Hampshire statute allows a trustee to decant even if the trustee has no discretion over distributions of income or principal from the original trust, and provides: "…the terms of the second trust may impose a standard or no standard on the trustee's discretion, regardless of whether the terms of the first trust imposed a standard on the trustee's discretion to distribute income or principal."

C. Changing Mandatory Distribution or Withdrawal Rights.

1. Some statutes prohibit eliminating an existing mandatory right to income, or an income, annuity or unitrust interest, or all mandatory rights. Other states do not have such a prohibition. Further, if the right to an income, annuity or unitrust interest is necessary to qualify the trust for certain tax benefits, then other provisions of the decanting statute may prohibit eliminating those rights.

2. Some, but not all, states prohibit eliminating or restricting an existing withdrawal right. Michigan prohibits eliminating currently exercisable withdrawal rights if the beneficiary is the sole beneficiary, but not

otherwise.[10] If a mandatory withdrawal or distribution right qualifies a trust for a particular tax benefit, then other provisions of the decanting statute may prohibit its elimination.

3. Many states, however, would permit a future distribution or withdrawal right to be eliminated or restricted. This would permit the trustee to eliminate a beneficiary's staged withdrawal rights if the beneficiary has not yet reached the age at which he or she can withdraw assets from the trust.

D. Granting Powers of Appointment.

1. Commonly, decanting statutes explicitly permit the trustee to grant a power of appointment to one or more of the existing beneficiaries of the original trust. Generally, this power of appointment may be a special or general power of appointment and may permit appointment to anyone, including persons who are not trust beneficiaries.

2. If the old trust contains a power of appointment, generally the new trust need not retain the same power of appointment, except where the decanting statute does not permit changes in beneficial interests. For example, in the bifurcated states if the trustee does not have absolute discretion, the trustee generally cannot eliminate beneficiaries or change the distribution standard, and the new trust must contain the same power of appointment as in the old trust. This may be explicit in the statute, or implicit in the requirement that the decanting not materially change the beneficial interests.

3. Granting a beneficiary of a new trust a power of appointment may have tax consequences.

E. Are Beneficiaries of New Trust Limited to Current Beneficiaries of Old Trust?

1. Limited to Current Beneficiaries.

a. The narrowest theory of decanting permits decanting only to a trust for the benefit of the current beneficiaries (those who could receive a discretionary distribution) of the old trust. In that case, the remainder beneficiaries who are not also current beneficiaries must be deprived of their interest if the trust is decanted.

b. This restriction may be mitigated in states that have a "*boomerang provision*." A "boomerang provision" permits the new trust to provide that at some future time the beneficial

[10] Mich. Comp. Laws §556.115a(1)(d).

provisions of the new trust revert to the beneficial provisions of the old trust, including the provisions regarding remainder beneficiaries.

2. Not Limited to Current Beneficiaries. In some states, remainder beneficiaries of the old trust may be, or under some statutes must be, beneficiaries of the new trust.

a. Remainder Beneficiaries of Old Trust May Be Beneficiaries. The decanting statutes of some states appear to permit, but not require, that remainder beneficiaries of the old trust be remainder beneficiaries of the new trust. Generally, in these states the new trust could eliminate one or more of the remainder beneficiaries.

b. Remainder Beneficiaries Must Remain the Same. Other statutes explicitly require that all remainder beneficiaries of the new trust be the same as the remainder beneficiaries of the old trust. Statutes that require the beneficial interests of the new trust to be the same as the beneficial interests of the old trust implicitly require the remainder beneficiaries of the old trust to remain remainder beneficiaries of the new trust.

F. Acceleration of Future Interests.

1. In General.

a. In a few states, it appears that decanting can be used to accelerate a remainder interest in the old trust to a present interest. Other states explicitly prohibit an acceleration of a remainder interest, or are silent about the acceleration of a future interest.

b. The issue of accelerating a remainder interest does not arise in states that permit only current beneficiaries of the old trust to be beneficiaries of the new trust or that only permit remainder beneficiaries of the old trust to be beneficiaries of the new trust under a boomerang provision.

2. Danger of Permitting Acceleration.

a. Obviously, a statute that permits the acceleration of a remainder interest to a present interest has more flexibility. There may be, however, an income tax risk with respect to trusts that are not intended to be grantor trusts. Several of the exceptions to the

grantor trust rules do not apply if the trustee has the ability to add a beneficiary (i.e., the ability to add a beneficiary will cause the trust to be a grantor trust). See, e.g., Internal Revenue Code (the "Code") §§674(b)(5), (b)(6), (b)(7); and Code §§674(c) and (d).

b. Under the grantor trust rules, the power to add a beneficiary includes the power to make a remainder beneficiary a current beneficiary. Treas. Reg. §1.674(d)-(2)(b) provides that the "exceptions described in Section 674(b)(5), (6) and (7), (c) and (d) are not applicable if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where the action is to provide for after-born or after-adopted children." (Note that the power to add beneficiaries refers to a power to add to the class of beneficiaries who can receive "income or corpus.")

c. It is possible to construct an argument that if the trustee of the trust has the power to decant, and if the trustee by decanting could accelerate a remainder interest to a present interest, then the trustee has a power to add beneficiaries within the meaning of the grantor trust rules. Under the grantor trust rules, the mere fact that a trustee holds this power, whether or not ever exercised, is sufficient to make the trust a grantor trust (or more precisely, to make certain exceptions to the grantor trust rules inapplicable). Thus the possible risk is that the mere existence of a decanting statute that permits the acceleration of a future interest to a present interest causes trusts potentially subject to such statute to unintentionally become grantor trusts.

3. Circumventing a Prohibition on Acceleration. Even in a state that explicitly prohibits the acceleration of a future interest to a present interest, it may be possible to effectively accelerate a future interest by decanting to a trust in which the interests of the current beneficiaries last for only a limited period of time, such as six months.

4. Meaning of "Acceleration". Even in states that prohibit the acceleration of a remainder interest to a present interest, decanting might still result in the remainder interest taking effect more quickly because the decanting restricted or shortened the interests of the current beneficiaries. For example, if a trust provided that the trustee could make discretionary distributions among the grantor's children, A, B and C, and then provided that at the death of such children the remainder of the trust should be distributed to grandchildren, and the trustee decanted to

eliminate the interests of children B and C, such a decanting might result in a remainder interest taking effect more quickly because the remainder beneficiaries then only have to survive A as opposed to the survivor of A, B and C.

G. Supplemental Needs Trusts.

1. Creating a Supplemental Needs Trust. Where the statute permits a change in beneficial interests, the trustee can decant a trust into a supplemental needs trust that limits the beneficiary's interest in a manner that will permit the beneficiary to qualify for governmental benefits. See In the Matter of Kroll, 971 N.Y.S.2d 863 (Surrogate's Court 2013) (upholding a decanting to a special needs trust five days before the beneficiary would have obtained a right of withdrawal over the trust). Generally, however, the decanting statutes will not permit decanting to a pay-back trust, because such a trust would essentially add the government as an additional beneficiary of the trust. The Illinois statute, however, explicitly permits decanting to a pay-back trust or to a "pooled trust" if the first trust was created by or is under the control of, the disabled beneficiary.[11]

2. Existing Trust is a Supplemental Needs Trust. There may be a risk that the existence of a decanting power could inadvertently affect the protection from governmental claims of an existing supplemental needs trust. Some statutes expressly protect existing supplemental needs trusts from any argument that the decanting power permits the trustee to change the provisions that make the trust a supplemental needs trust.

3. Conversion to Supplemental Needs Trust. Some statutes create exceptions to permit a trustee of a trust who does not have absolute discretion to decant into a supplemental needs trust under some circumstances.

VI. Other Restrictions on Decanting.

A. Rule Against Perpetuities. An exercise of a decanting power could inadvertently violate a rule against perpetuities period applicable to the old trust if the new trust does not comply with the same rule against perpetuities period. Even in states that have abolished the rule against perpetuities, the trust being decanted may still be subject to a rule against perpetuities under prior law or may be subject to a rule against perpetuities under the law of a different state. Further, if a trust is grandfathered from generation-skipping transfer ("GST") tax or has an exclusion ratio of less than one, decanting to a trust that does not comply with

[11] Ill. Rev. Stat. Ch. 760, §1213(c).

the same rule against perpetuities period (or a federal rule against perpetuities period) may have adverse GST consequences.

1. Restrictions Protecting Rule Against Perpetuities. Most of the decanting statutes expressly state that the decanting power may not be exercised in a manner that violates the rule against perpetuities period and/or the restriction against alienation that applied to the old trust. The statutes in some states provide that for purposes of abiding by the rule against perpetuities, an exercise of the power to decant will be treated as an exercise of a power of appointment under their rule against perpetuities statutes.

2. Delaware Tax Trap. The Delaware tax trap could be triggered if the new trust conferred upon a beneficiary a power of appointment that could be exercised in a manner that violated the rule against perpetuities period of the original trust. A number of the decanting statutes expressly require that any power of appointment granted to a beneficiary is subject to the original rule against perpetuities.

3. Shorter Rule Against Perpetuities. Presumably, the new trust could adopt a shorter rule against perpetuities term and possibly could select a different class of measuring lives so long as they were in existence at the time the rule against perpetuities period began under the old trust. However, some statutes provide that the new trust may not reduce, limit or modify the rule against perpetuities period, in which case the new trust could not adopt a shorter rule against perpetuities period; this restricts the ability to use the decanting statute to merge two trusts, one of which has a shorter rule against perpetuities period.

4. Longer Term. Some states, such as New Hampshire, explicitly allow the new trust to have a term that is longer than the term of the original trust, and make no mention of the rule against perpetuities or GST issues that may arise as a result of making the term of the new trust longer than that of the first.

B. Tax Restrictions.

1. In General. Certain tax benefits granted under the Code depend upon a trust containing specific provisions. For example, a qualified terminable interest property (QTIP) marital trust or general power of appointment marital trust requires that the surviving spouse be entitled for life to all income, and a general power of appointment marital trust also requires that the surviving spouse have a general power of appointment. If a trustee had the power to decant the old trust in a manner that deprived the surviving spouse of the requisite income interest, or in the case of a

general power of appointment marital trust, the requisite general power of appointment, then arguably the old trust would not qualify for the marital deduction from the inception of the trust. Most state statutes have attempted to avoid adverse tax results by imposing certain tax restrictions on decanting. The state statutes, however, are very erratic regarding which tax provisions of the Internal Revenue Code they address (e.g. marital deduction, charitable deduction, gift tax annual exclusion, GRATs, etc.).

2. Catchall Provisions. Several states, anticipating the difficulty of identifying all tax benefits that might possibly be adversely affected by a decanting power, have inserted catchall tax-savings provisions in their statutes. For example, the Ohio statute provides[12]:

> If the trust instrument for the first trust expressly indicates an intention to qualify for any tax benefit or if the terms of the trust instrument for the first trust are clearly designed to enable the first trust to qualify for a tax benefit, and if the first trust did qualify, or if not for the provisions of division (A) or (B) of this section would have qualified, for any tax benefit, the governing instrument for the second trust shall not include or omit any term that, if included in or omitted from the trust instrument for the first trust, would have prevented the first trust from qualifying for that tax benefit.

C. Subchapter S Qualification. Only certain types of trust qualify to hold subchapter S stock. These trusts are wholly grantor trusts, qualified subchapter S trusts ("QSSTs") and electing small business trusts ("ESBTs"). There is a risk that a trustee might inadvertently decant from a trust that qualified as an S corporation shareholder to a trust that does not so qualify. Some statutes attempt to prevent an inadvertent decanting from a qualified S corporation shareholder to a trust that does not qualify as an S corporation shareholder.

D. Change of Grantor Trust Treatment. Can a trustee decant a non-grantor trust to a grantor trust in order to permit the grantor to pay the income taxes for the trust? Alternatively, can the trustee of a grantor trust convert it to a non-grantor trust to eliminate the grantor's liability for the trust's income taxes?

1. Conversion of Non-Grantor Trust to Grantor Trust.

a. A decanting statute that permits the conversion of a non-grantor trust to a grantor trust is potentially troubling in at least two respects: (i) it allows a trustee to impose on the grantor of the trust a tax liability that the grantor did not voluntarily accept and

[12] Ohio Rev. Code Ann. §5808.18.

that the grantor may not have the ability to eliminate; and (ii) a trustee does not owe fiduciary duties to the grantor, so how does a trustee resist a beneficiary request to benefit the beneficiaries by converting the trust to a grantor trust? Most of the state decanting statutes are silent on this point, which presumably means that such a conversion is permitted.

b. The Arizona statute probably prohibits such a conversion, because it requires that any decanting "not adversely affect the tax treatment of the trust, the trustee, the settlor or the beneficiaries."[13] In contrast, the Illinois and Texas statutes explicitly permit a decanting from a non-grantor trust to a grantor trust.[14]

2. Conversion of Grantor Trust to Non-Grantor Trust.

a. Generally a trustee may decant a trust in a manner that converts a grantor trust to a non-grantor trust either as an incidental result of changing the terms of such trust (for example, to eliminate the interest of a spouse as a beneficiary) or as a primary purpose of the decanting.

b. In states that have catchall tax savings provisions, the catchall provision might prohibit a decanting that would eliminate the grantor trust treatment.

c. Fiduciary liability issues may arise as a result of such conversion, by shifting the income tax burden from the grantor to the beneficiaries.

E. Restrictions on Trustee Mischief. Although, as discussed below, trustees must exercise the decanting power only with due regard to the trustee's fiduciary duties, some statutes contain specific provisions restricting a trustee's ability to decant in a manner that might benefit the trustee as a fiduciary, for example, by allowing for increased trustee fees.

1. Trustee Compensation. Some states allow the trustee to decant to change trustee compensation provisions only with court approval, or with the consent of the current beneficiaries of the second trust. However, most of the state decanting statutes are silent on the issue of trustee compensation.

[13] Ariz. Rev. Stat. Ann. §14-10819.A.
[14] Ill. Rev. Stat. Ch. 760, §1219(b)(9) and Tex. Prop. Code Ann. §112.086(b).

2. Trustee Fee for Decanting. Some states prohibit the trustee from receiving a special fee for decanting. Alaska's statute, however, permits a trustee to be "compensated at a reasonable rate for time spent considering and implementing the exercise of a power to appoint."[15]

3. Trustee Liability. Some statutes prohibit decanting to decrease or indemnify against a trustee's liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence and prudence. Michigan prohibits a reduction in the standard of care applicable to the trustee or an expansion of the exoneration of the trusts, but allows the terms of the second trust to indemnify the trustee of the first trust[16] (subject to the trustee exculpation provisions of the Michigan Trust Code[17]).

4. Trustee Removal Provisions. Several statutes prohibit decanting to eliminate a provision granting a person a right to remove or replace the trustee. For example, Michigan prohibits a diminution in the authority of a person who has a power exercisable in a fiduciary capacity to direct or remove the trustee.[18]

VII. Notice.

A. In General. Because the trustee usually is not required to provide notice to beneficiaries prior to exercising a discretionary power, notice should not necessarily be required prior to decanting. Nonetheless, many states do require prior notice to the beneficiaries. This may logically follow from the fact that beneficiaries are entitled to know the terms of the trust and therefore should receive notice of any change in the trust, although this argument would not require prior notice. Requiring prior notice, however, seems reasonable in light of the significant trust modifications that can be made by decanting, and also practical, in that it helps determine if any beneficiaries may challenge the decanting.

B. No Notice Required. A large number of states do not require the trustee to provide notice to the beneficiaries of the old trust before decanting. Some states allow – but do not require – the trustee to give notice to the beneficiaries. In New Hampshire, no notice is required, but notification of the beneficiaries triggers a 60 day objection period, after which the beneficiaries cannot contest the decanting.

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[15] Alaska Stat. §13.36.158(m).

[16] Mich. Comp. Laws §700.7820a(2) and §556.115a(2).

[17] An exculpatory provision is exonerates a fiduciary from liability for certain acts and omissions affecting the estate or trust. If the drafting attorney is also the trustee, an exculpatory clause may be unenforceable. See Model Uniform Trust Code §1008.

[18] Mich. Comp. Laws §700.7820a(2)(d).

C. Notice Required. Other states require notice to certain parties a certain number of days prior to decanting. The notice period is often 30 days, but may be as long as 90 days (e.g., South Carolina[19]). When notice is mandated, the trustee may be required to notify the settlor, the current beneficiaries, some or all of the remainder beneficiaries, the fiduciaries (e.g., trust protectors), and/or the attorney general.

D. Waiver of Notice. Some statutes specifically provide that the beneficiaries who receive notice can waive the notice period to permit the trustee to immediately decant.

E. Effect of Objection. In most states an objection by a beneficiary does not prevent the trustee from decanting. In some jurisdictions, however, a beneficiary's objection prohibits the trustee from decanting without court approval.

VIII. Procedural Issues.

A. Requirements for New Trust.

1. Generally, the new trust may be one already in existence or may be established by the trustee. Some states require that the assets be transferred to a new trust under a separate trust agreement, while others expressly permit a restatement of the old trust.

2. The UTDA expressly permits a decanting to be done as an "amendment" or "restatement" of the first trust, and also defines the "second trust" to include "the first trust as modified to create the second trust."

B. Tax Identification Number.

1. The second trust should not need to obtain a new tax identification number if: (a) the second trust is a grantor trust and is permitted to use the grantor's social security number; or (b) the second trust was a trust that was in existence prior to the decanting and already has a tax identification number.

2. If the second trust was newly created for purposes of decanting, and only a portion of the first trust is decanted to the second trust then presumably the second trust should obtain a new tax identification number. If the second trust, however, was newly created for purposes of decanting and all of the assets of the first trust are decanted to the second trust, then it may be reasonable to treat the second trust as

[19] S.C. Code Ann. §62-7-816A(g)(2).

simply a continuation of the first trust for income tax purposes.[20]

C. Do Assets Need to be Retitled? If the second trust has a different tax identification number, the decanted trust assets should be retitled to reflect the correct tax identification number (and the name of the second trust). If the tax identification number does not change, then the trustee should consider whether the assets should be retitled to reflect the name of the second trust. In some cases a trustee may, for convenience, decide to give the second trust a name identical or similar to the name of the first trust, perhaps adding the phrase "as decanted on [DATE]," or "as modified on [DATE]."

D. Distribution Plan for Later Discovered Assets. Some statutes specifically address the disposition of after-discovered assets. If the entire trust was decanted, they are part of the new trust. If only part of the old trust was decanted, they are part of the old trust. It would be wise to address this issue in the decanting document.

E. Trust Code Notification Provisions. The trust code of a particular state (including UTC states) may have particular provisions requiring that notification be given to certain beneficiaries when a trust is created or when the trustee changes. The decanting statutes may specify whether a decanting is intended to trigger these modification provisions.

IX. Multi-State Issues.

A. Application of Decanting Statute.

1. When can a trustee utilize the decanting statute of a particular state? Many of the decanting statutes are silent. A few provide that the decanting statute may be used when the trust is governed by the laws of the particular state (see, e.g., Arizona and Missouri)[21], but are not specific about whether the trust must be governed by the relevant state's law for purposes of validity and construction or for purposes of administration. For many trusts, different states' laws may apply to the trust for different purposes (e.g., validity, construction and administration).

2. Other states (e.g., South Dakota, Delaware and New Hampshire) provide that their decanting statutes apply when a trust is administered in or under the laws of the subject state, even if another jurisdiction's laws

[20] See, e.g., N.H. Rev. Stat. Ann. §546-B:4-418(a-1)(2); the comment to Section 2 of the UDTA; and PLR 200736002 (May 22, 2007).
[21] Ariz. Rev. Stat. Ann. §14-10819.B, and Mo. Rev. Stat. §456.4-419(6).

govern with respect to the validity and construction of the trust.[22]

B. Recognition of Out-of-State Decanting. The UTDA expressly recognizes a decanting validly made under another state's law, even if the law of the state that adopted the UTDA also could have applied to the decanting.

X. Other Issues.

A. Jurisdiction of New Trust. Some of the decanting statutes expressly permit the new trust to be under the law of a new jurisdiction. See, e.g., Kentucky. In fact, the Kentucky statute provides that the second trust, "may be a trust created or administered under the laws of any jurisdiction, within or without the United States."[23]

B. Settlor. Generally, the person who contributes property to a trust is considered the settlor of the trust. If A is the settlor of Trust 1 and B is the settlor of Trust 2, and Trust 1 is decanted into Trust 2, A will be the settlor of the portion of Trust 2 attributable to the assets of Trust 1. For certain purposes, however, such as determining settlor intent or construing a trust instrument, the settlor should not be determined by a formulaic asset tracing. The UTDA attempts to address the issue of who is the settlor for purposes of determining settlor intent or construing the trust instrument.

C. Non-Compliant Decanting. Is a decanting completely ineffective if it violates any provision of the statute? Can a beneficiary subsequently argue that a decanting is entirely invalid because the trustee inadvertently failed to give a required notice to one party, or because a provision required to be included in the second trust (such as a rule against perpetuities provision) was not so included, or because a provision included in the second trust is not permitted under the statute? The UTDA includes a decanting savings provision.[24]

D. Claims. Decanting a trust should not be a way for the first trust to avoid legitimate claims. Section 27 of the UTDA expressly provides that claims that

[22] The Peierls decisions in Delaware concluded that even if the trust contains a choice of law provision that references "administration", the law governing the administration of the trust will change when the key place of administration changes via a proper appointment of a successor trustee, unless the settlor has specifically stated his intent that a state's laws shall always govern the administration of the trust. See In re Peierls Charitable Lead Unitrust, 77 A.3d 232 (Del. 2013); In re Peierls Family Inter Vivos Trusts, 77 A.3d 249 (Del. 2013); and In re Peierls Family Testamentary Trusts, 77 A.3d 223 (Del. 2013). The concept was codified in Delaware in 2015. Del. Code Ann., title 12, §§3332 and 3340.

[23] Ky. Rev. Stat. Ann. §386.175(3).

[24] The comment to §22 of the UTDA provides: "In order to provide as much certainty as possible to the trustee and the beneficiaries with respect to the operative terms of a trust, an exercise of a decanting power should not be wholly invalid because the second-trust instrument in part violates this act." §22(a) of the UTDA modifies the second trust instrument to delete impermissible provisions in the second trust instrument and to insert required provisions in the second trust instrument.

could have been brought against the first trust can be brought against the second trust.

E. Accounting Requirements. The Virginia statute provides that if the old trust was required to file accountings with the commissioner of accounts, the new trust will be subject to the same requirement.[25]

XI. Beneficiary's Recourse. What recourse does a beneficiary have who objects to a trustee's decanting?

A. Right to Object. As discussed above, certain states not only require notice of a proposed decanting to certain beneficiaries but also prohibit the trustee from proceeding with decanting without court approval if a beneficiary objects within the notice period. Some statutes are silent regarding the effect of a beneficiary's objection, presumably meaning that the trustee can proceed with the decanting even if a beneficiary objects.

B. Abuse of Discretion. As with any exercise of a discretionary fiduciary power, a beneficiary may bring a judicial claim asserting that the exercise of the power was an abuse of the trustee's discretion.

XII. Trustee Liability.

A. No Duty to Decant. Many states, and the UTDA, expressly state that the trustee has no duty to decant. Some statutes, such as New Hampshire, further provide that a trustee has no duty to even consider decanting.[26]

B. Duty to Inform Beneficiaries. Some statutes state that the trustee has no duty to inform beneficiaries about the availability of decanting.[27]

C. Fiduciary Duties.

1. In addition to holding the power to decant trust assets under the terms of the trust or applicable state statute, the trustee must also determine that the decanting is consistent with the discharge of his or her fiduciary duties. The New Hampshire statute provides: "[A] trustee has a duty to exercise the power [to decant] in a manner that is consistent with the settlor's intent as expressed in the terms of the trust, and the trustee shall act in accordance with the trustee's duties under [the New Hampshire trust code] and the terms of the first trust."

[25] Va. Code Ann. §64.2.779.25
[26] N.H. Rev. Stat. Ann. §564-B:4-418(o).
[27] See, e.g., Tex. Prop. Code Ann. §112.083.

2. While the scope of a trustee's fiduciary duties will vary from state to state and trust to trust, a core duty of loyalty transcends individual application. The duty of loyalty requires the trustee to administer the trust solely in the interests of the beneficiaries.[28] In this sense, the trustee must avoid self-dealing and, where appropriate, remain fair and impartial towards all beneficiaries.

3. When a decanting involves only administrative changes, the trustee's duty of loyalty should not be seriously implicated.

4. A decanting could, however, raise duty of loyalty issues when a trustee's discretion shifts beneficial interests in the trust or otherwise exhibits a preference for one individual or class of beneficiary over another. A beneficiary may complain, for instance, because his or her interest in the trust has been reduced. In addition, a living settlor may complain because the decanting does not comport with his or her desires with respect to the trust administration.

5. Because a trustee's fiduciary duties are omnipresent throughout the trust administration, a trustee must always consider the impact a trust decanting would have on his or her duty of loyalty. A few of the decanting statutes explicitly provide that the exercise of a trustee's power to decant is subject to all of the fiduciary duties that otherwise govern the trustee's administration of the trust, whether imposed by the trust instrument or by governing law. The Delaware statute is even more explicit in stating that the standard of care for decanting is the same as the standard of care when making outright distributions.[29]

[28] The duty of loyalty is perhaps the most fundamental duty of the trustee, and is essentially the obligation of the trustee to not place the trustee's own interests before those of the beneficiaries. Note that both the Model UTC (§802) and the Restatement (Third) of Trusts (§78) provide that the duty of loyalty requires the trustee to administer the trust "solely in the interests of the beneficiaries", not in the *best* interests of the beneficiaries. In fact, the Model UTC only explicitly requires the trustee to act in the "best interests" of the beneficiaries when voting shares of stock and electing and appointing directors and managers of business enterprises. See Model UTC §802(g). However, §803 of the Model UTC, and §79 of the Restatement Third impose upon the trustee a duty to treat beneficiaries impartially. §103(8) of the Model UTC defines "interests of the beneficiaries" as "the beneficial interests provided in the terms of the trust." The comment to §103(8) states that this definition "clarifies that the [beneficiaries'] interests are as provided in the terms of the trust and not as determined by the beneficiaries." The comment to §105 of the Model UTC provides that, "absent some other restriction, a settlor is always free to specify the trust's terms to which the trustee must comply…'interests of the beneficiaries' is a defined term in §103(8) meaning the beneficial interests as provided in the terms of the trust, which the settlor is also free to specify."

[29] Del. Code Ann., title 12, §3528(e).

D. Duty of Impartiality.

1. Could a trustee violate its duty of impartiality[30] by decanting? There is very little case law on the propriety of a trustee's exercise of its decanting power.[31]

2. One of the few cases considering the propriety of a trustee's duty to decant is Hodges v. Johnson, 177 A.3d 86 (N.H. 2017).

   a. In Hodges, the grantor in 2004 had created two irrevocable trusts (one GST exempt and one non-GST exempt) for the benefit of the grantor's wife, his children and step-children, and their descendants. The trustee was authorized to distribute income and principal to the beneficiaries, or to trusts for the benefit of one or more of the beneficiaries, in its discretion.

   b. Through a series of decantings that resulted from family discord, the beneficial interests of several of the children and step-children, and the grantor's (now ex-) wife, were eliminated. Several of the eliminated beneficiaries filed a petition requesting that the court to void the decantings *ab initio*, and to remove the trustees.

   c. The trial court voided the decantings because it found that the trustees had accomplished them without considering the interests of the beneficiaries.

   d. On appeal, the New Hampshire Supreme Court, in a divided opinion,[32] affirmed the trial court's result, but not its analysis. The Supreme Court held that the decantings were void because the trustee had violated his duty of impartiality. It is notable that

[30] The duty of impartiality is an extension of the duty of loyalty to beneficiaries but involves, in typical trust situations, unavoidable and thus permissibly conflicting duties to various beneficiaries with their competing economic interests. "Impartiality" is not the same thing as "equality." The duty of impartiality does not require an equal balancing of diverse interests, but a balancing of those interests in a manner that shows due regard for (i.e., is consistent with) the beneficial interests and the terms and purposes of the trust. This includes respecting any ascertainable preferences of the settlor for some beneficiaries over others, such as the priority frequently discernible from language or circumstances for a life beneficiary (e.g., a surviving spouse or a son or daughter) over that beneficiary's descendants or other recipients of future interests. The trustee must make diligent and good-faith efforts to identify, respect, and balance the various beneficial interests when carrying out its fiduciary responsibilities in managing, protecting, and distributing the trust estate, and in other administrative functions. See Restmt. 3d of Trusts, §79 (Duty of Impartiality; Income Productivity).

[31] For a good discussion of this issue, and the Hodges case, see Lapiana, *Balancing the Duty of Impartiality and Decanting to Eliminate an Interest*, 45 TR. & EST. 41 (March 2018).

[32] The New Hampshire Supreme Court has five justices. In Hodges, two of the justices recused themselves, leaving three to decide the case. Chief Justice Dalianis wrote the opinion, and Justice Lynn concurred. Justice Bassett dissented.

the Supreme Court decided this issue, which was one of first impression, on an alternate ground that the trial court did not reach, and that the parties had not briefed (i.e., the court addressed an issue that the lower court and parties themselves did not).

e. In 2020, the New Hampshire Supreme Court ordered the trustees who had been removed to repay attorneys' fees and costs to the trust. Hodges v. Johnson, 244 A.3d 245 (N.H. 2020).

f. The outcome of the Hodges case is notable, because the New Hampshire decanting statute imposes nearly no limitations on a trustee's statutory power to decant, with respect to the dispositive terms of the trust agreement, and specifically states that "the second trust may exclude one or more beneficiaries of the first trust."[33] See RSA 564-B:4-418(a) and 564-B:4-418(b)(2). Nonetheless, both the trial court and Supreme Court superimposed limits from other areas of the New Hampshire trust code onto the decantings in order to reach their conclusions.

E. Standard of Review. Some of the state statutes reference particular standards of review. For example, the South Dakota statute provides that if the trustee's distribution discretion is not subject to a standard or is subject to a standard that does not create a support interest, then the court may review the trustee's act of decanting only for dishonesty, improper motive or failure to act if under a duty to do so.[34] The Ohio statute provides that a trustee who acts reasonably and in good faith is presumed to have acted in accordance with the terms and purposes of the trust and in the interests of the beneficiaries.[35]

F. Trustee Procedures.

1. Because a decanting may lead to the termination of the first trust, a trustee, especially a corporate trustee, may treat a decanting as any other trust termination, and expect the beneficiaries to follow its trust termination procedures, which may include multiple releases and indemnifications, or a court's approval of its final accounting.[36]

[33]It is also worth noting that the trustee was authorized to exercise its discretion to distribute trust property to any "one or more" of the beneficiaries, or to trusts for the benefit of one or more of the beneficiaries. In other words, the trust agreement itself contained an internal decanting provision that authorized the trustee to make unequal distributions to or for the benefit of the beneficiaries.

[34] S.D. Codified Laws Ann. §55-2-15(10).

[35] Ohio Rev. Code Ann. §5808.18(I).

[36] Filmore, *Decanting at 75 – Expanding Utility and Enduring Problems*, ACTEC 2015 Heart of America Regional Meeting (April 26, 2015), at 21.

2. Although it would seem advantageous to obtain a release from all affected beneficiaries, or a court order approving the decanting, these measures could have adverse tax consequences. Similarly, if the grantor signs an indemnification agreement, the IRS may argue that the decanted trust assets should be included in the grantor's estate because the grantor retained implied control under Code §§2036 or 2038.

3. A decanting also could be viewed, from the trustee's perspective, as a removal of the trustee of the first trust and the appointment of a successor trustee. Consequently, it may be advisable to include an indemnification provision in the new (second) trust instrument that runs to the trustee of the original trust, even if the individual or corporate identity of the trustee is the same for both trusts (because the individual or entity will be serving in two different capacities). This satisfies the role of a receipt and refunding agreement that a trustee usually seeks from a successor trustee, so that the outgoing trustee knows that if claims, taxes, fees, liabilities, etc. from the original trust arise in the future, the trustee of the original trust can still have some recourse against the new trust to be reimbursed.[37]

XIII. Tax Issues.

A. Overview.

1. The term "decant" does not appear anywhere in the Code or Treasury Regulations.

2. The IRS, however, has recognized that decanting is an emerging issue with tax consequences that are not entirely clear under current law. For this reason, the IRS, in Rev. Proc. 2011-3, placed decanting on its "no-ruling" list with respect to certain income, gift and GST tax matters. Similarly, the IRS placed decanting on its 2011-2012 Priority Guidance Plan, although only with respect to the gift and GST tax consequences, but decanting has not appeared on any subsequent Priority Guidance Plan.

3. With such minimal guidance from the IRS, it can be hard to analogize a trustee's act of decanting to an act or event explicitly characterized by the Code or Regulations. Nevertheless, most commentators, drawing from origins at common law, have equated decanting with the exercise of a trustee's special power of appointment.

[37] Levin and Flubacher, *Put Decanting to Work to Give Breath to Trust Purpose*, 38 ESTATE PLANNING at 6 (Jan. 2011).

4. Unless and until the IRS issues more definitive guidance on the tax consequences of decanting, it is best to view decanting, from a theoretical perspective, as the trustee's exercise of a special power of appointment. It is important to remain flexible, however, to enable critical evaluation of the actual results that a proposed decanting will yield.

B. Income Tax.

1. In General. As a general matter, decanting assets from one domestic trust to another will generate minimal, if any, income tax consequences for the trust and its beneficiaries. However, when the trust property has a liability against it that exceeds the property's income tax basis (a "negative basis" asset), it is possible that decanting the negative basis assets will result in the recognition of gain. See Blattmachr, Horn and Zeydel, "An Analysis of the Tax Effects of Decanting," 47 *Real Property, Trust and Estate Law Journal* 141 (Spring 2012) (hereafter, "Tax Effects"); Crane v. Comm'r., 331 U.S. 1 (1947) (when a transferee assumes the transferor's liability in connection with a sale or exchange, the transferor must include in his amount realized the liability assumed by the transferee).

2. Decanting Grantor Trust to Grantor Trust. Decanting the assets of a grantor trust to another grantor trust will not result in the recognition of any gain, even if the trust property includes negative basis assets. See Rev. Rul. 85-13, 1985-1 C.B. 184.

3. Conversion of Grantor Trust to Non-Grantor Trust. If a trust owns negative basis assets, a conversion of a grantor trust to a non-grantor trust may cause the grantor to recognize gain to the extent the liabilities exceed the basis. See Madorin v. Comm'r., 84 T.C. 667 (1985). When grantor trust status terminates, the grantor is treated as having transferred the assets to the non-grantor trust, and the grantor is deemed to realize an amount equal to any liabilities held as part of the trust property. See Treas. Reg. §1.1001-2(c), ex. (5) (explaining the tax consequences associated with the termination of grantor trust status for a trust holding a partnership interest with a negative capital account).

4. Conversion of Non-Grantor Trust to Grantor Trust. The conversion of a non-grantor trust to a grantor trust does not appear to have any income tax consequences. See Tax Effects at 159, citing CCM 200923024; Rev. Rul. 2004-64, 2004-2 C.B. 7.

5. Beneficiary Recognition of Gain.

a. The mere act of decanting should constitute a non-recognition event for the beneficiaries. The basic rule under Code §1001 is that a taxpayer only realizes gain or loss when the taxpayer sells or disposes of property in exchange for property that is *materially different* from the property the taxpayer sold or disposed. See Treas. Reg. §1.1001-1(a).

b. In the well-cited case of Cottage Savings Ass'n v. Comm'r., 499 U.S. 554 (1991), the Supreme Court considered whether a financial institution realized a loss when it exchanged its interests in one set of residential mortgage loans for another institution's interests in a different set of residential mortgage loans. The Court found that under Code §1001(a) and Treas. Reg. §1.1001-1(a), a taxpayer realized gain or loss whenever it received property that was "materially different" from the property the taxpayer exchanged. Two items of property are materially different, the Court explained, if their owners possess legal entitlements that differ in kind or extent. Although the financial regulatory agency found the two sets of mortgage interests substantially identical, the Court held the mortgages to be materially different because they were made to different borrowers and secured by different pieces of real property. As a consequence, the exchange of mortgage interests between the institutions constituted a realization event.

c. Following the Court's interpretation of Code §1001(a) in Cottage Savings, the question with respect to decanting was whether the IRS would consider a trustee's distribution in further trust to be a realization event (i.e., a taxable exchange) because each beneficiary's new interest was materially different from his or her old interest. See, e.g., PLR 199951028 (Sept. 28, 1999); see also PLR 200231011 (Aug. 2, 2002) (finding a taxable exchange when a court-approved settlement provided a beneficiary with a unitrust interest instead of an annuity interest); PLR 200736002 (specifying that a beneficiary could realize a taxable gain if his interests in a new trust created under a pro rata trust division were materially different than his interests in the old trust).

d. In private letter rulings, the IRS has confirmed that if a beneficiary's trust interest is subject to the trustee's discretion to decant – either under the terms of the trust or applicable state law – then there is no change in the quality of the beneficiary's

interest (i.e., it is not materially different under Cottage Savings) when the trustee actually exercises that discretion. This is because the beneficiary's interest was always subject to the trustee's decanting authority. *Cf.* Treas. Reg. §1.1001-1(h) (prescribing similar rules for the severance of trusts); PLR 200810019 (Mar. 7, 2008) (finding no adverse income tax consequences when income interest converted to unitrust interest under governing state law); PLR 200010037 (Dec. 13, 1999) (ruling that a taxable exchange would not occur when a trustee partitioned a trust pursuant to partition authority granted in the trust instrument). See PLR 200743022 (Oct. 26, 2007) and 201134017 (May 26, 2011).

e. Importantly, however, if decanting is not authorized by the terms of the trust or local law, the IRS could persuasively argue that a beneficiary's consent to a decanting constitutes a recognition event. See, e.g., Rev. Rul. 69-486, 1969-2 C.B. 159 (finding that a non-pro-rata trust distribution will be treated as a taxable exchange if the trustee lacked authority to make such a distribution). Even if decanting were authorized by the trust instrument or state statute, the IRS could argue that requiring beneficiary consent connotes a change in the quality of the beneficiary's interest, thereby resulting in a recognition event. For this reason, many states have drafted their decanting statutes to require only beneficiary notice, and not consent.

f. Thus, it is possible that under the doctrine of Cottage Savings, the IRS may take the position that a beneficiary recognizes gain if the decanting changes the quality of the beneficiary's interest and the beneficiary's consent (or possibly the court's approval) is required for the decanting. See Tax Effects at 157-159.

6. Conversion of a Domestic Trust to a Foreign Trust. The conversion of a domestic trust to a foreign trust may result in the recognition of gain under Code §684. See Tax Effects at 159.

7. The Accidental Grantor Trust. Several of the exceptions to grantor trust treatment in Code §674, such as the power to distribute corpus subject to an ascertainable standard (Code §674(b)(5)(A)), the power to withhold income during the disability of a beneficiary (Code §674(b)(7)) and the power of an independent trustee to make distributions (Code §674(c)), do not apply if any person has a power to add a beneficiary to the class designated to receive income or corpus.

C. Gift and Estate Tax.

1. Gift Tax.

a. Decanting will not cause a beneficiary to make a taxable gift to the trust unless:

(i) The trustee exercising the discretion to decant is also a trust beneficiary;

(ii) The trustee's ability to decant is contingent on obtaining beneficiary consent (see below); or

(iii) The Delaware tax trap applies.

b. Some decanting statutes allow a trustee who has absolute discretion to decant to a second trust that eliminates, reduces or restricts the interest of a beneficiary. If: (i) under the statute the beneficiary can block the decanting by a timely filed objection; (ii) the beneficiary's interest in the trust will be reduced or eliminated by decanting; and (iii) the beneficiary fails to object, will the beneficiary be treated as making a gift to the trust or the other beneficiaries of the trust? See Tax Effects at 160-164. Although beneficiary consent could very well constitute a gift under appropriate circumstances, beneficiary acquiescence should not. This is because taxable gifts require the transferor to make a voluntary transfer. See Harris v. Comm'r., 340 U.S. 106 (1958); Estate of DiMarco v. Comm'r., 87 T.C. 653 (1986), acq. 1990-2 C.B.1. When a trustee exercises the power to decant in the trustee's sole discretion and without beneficiary intervention, the beneficiary's inaction, as a factual matter, should not constitute a voluntary transfer capable of triggering the gift tax.

c. If the risks of a gift are particularly acute, trustees and their advisors may insulate themselves from gift tax liability by:

(i) Ensuring that an independent trustee who has no beneficial interest in the trust is the only fiduciary who exercises the authority to decant;

(ii) Limiting the decanting to administrative changes only, thereby avoiding the shifting of beneficial interests in trust and the postponement of vesting periods in trust property; and/or

(iii) Giving the beneficiary a testamentary limited power of appointment.

2. Estate Tax.

a. If decanting reduced or eliminated a beneficiary's interest in a manner that resulted in a gift, then the beneficiary's estate might include the trust assets if Code §§2035, 2036, 2037, 2038, 2039 or 2042 applied. See Tax Effects at 164-165. For example, if the beneficiary was the trustee of the second trust with the power to make discretionary distributions, then the decanted property subject to gift tax might be included in the beneficiary's estate under §2036(a).

b. Estate tax inclusion also may result if:

(i) The new trust gives a beneficiary a general power of appointment over trust property that would render the property includible in the beneficiary's gross estate under Code §2041(a)(2);

(ii) The decanting is treated as an incomplete gift pursuant to a beneficiary's testamentary limited power of appointment and the gift becomes complete at the beneficiary's death;

(iii) A grantor's or beneficiary's involvement in the decanting process shows that the grantor or beneficiary had implied control over the trust assets within the meaning of Code §§2036 or 2038; or

(iv) The Delaware tax trap applies.

3. Delaware Tax Trap. The exercise of a power of appointment may be a transfer for gift or estate tax purposes.

a. Code §2514(d), commonly referred to as the "*Delaware tax trap*," provides that the exercise of a power of appointment will be considered a transfer for transfer tax purposes if:

(i) The powerholder, in exercising the power of appointment, grants another person the right to exercise a power of appointment; and

(ii) Under applicable local law, the new powerholder can exercise his power of appointment to postpone the vesting

of any trust interest or suspend the absolute ownership or power of alienation of such property for a period ascertainable without regard to the date that the first power was created.

b. In other words, the exercise of a limited power of appointment to create a new power of appointment that has the effect of postponing the period of the rule against perpetuities converts the limited power of appointment into a taxable power.

c. Importantly, the Delaware tax trap applies whether the second powerholder exercises the power in the prohibited manner or not. In other words, if the second powerholder has the *mere potential* to limit the ownership rights of trust property beyond the time period that such property was limited by the terms of the original trust instrument, then the first powerholder's appointment of the property will result in a taxable gift.

d. If a person exercises a power of appointment as provided in Code §2514(d) during his lifetime, then the exercise is treated as a taxable gift by the powerholder. If the person exercises his power at death, then such exercise will result in estate inclusion.

e. A decanting of trust property to another trust pursuant to state statute, common law, or the trust instrument that validly extends the term of a trust under state law potentially could violate the provisions of §2514(d) and result in a transfer of property by the trustee for gift tax purposes. For example, if the trustee's discretionary power to distribute property under the second trust is viewed as a special power of appointment, the decanting could violate §2514(d) if the term of the second trust extends beyond that of the first trust and the (interested) trustee's discretionary power to distribute may be exercised for a period without regard to the date of the first trust's creation.

f. The Delaware tax trap should not apply to a trust decanting when:

(i) Prohibited by a state's decanting statute; or

(ii) An independent trustee with no beneficial interest in the trust initiates the decanting;[38] or

[38] No cases construe or interpret §2514(d). It is unclear whether a trust decanting that otherwise violates §2514(d) would not result in a taxable gift where the trustee possesses no beneficial interest in the property subject to the

(iii) The second trust includes a provision that prohibits the exercise of a power of appointment in a manner that extends the vesting period or suspends the ownership or alienation of any interest in the first trust.

g. Many state decanting statutes require that if a trustee exercises its power to decant, the permissible period for the postponement of the vesting of interests in trust property, or, if the state's perpetuities period is stated in terms of alienation, the suspension of the power of alienation over trust property, must be determined by reference to the date of creation of the original power of appointment.

h. Despite the protection built into the state decanting statutes, it would be advisable to include a clause in the decanting resolution or the new trust that provides that postponement of vesting of beneficial interests in, or suspension of absolute ownership or power of alienation over, trust property cannot be extended through the trustee's discretionary distribution power or the exercise of a special power of appointment for a period in excess of the governing permissible perpetuities period measured as of the date of creation of the original trust. This would particularly be true where applicable state law may provide that the second power does not relate back to the date of creation of the first power.

D. Generation Skipping Transfer Tax.

1. Background.

a. Generation-skipping transfers made from a non-exempt trust will be subject to GST tax. See Code §2601.

b. Trusts are generally exempt from GST tax if:

(i) They became irrevocable on or before September 25, 1985 (the effective date of the GST statute), or are otherwise subject to certain transition rules associated with the GST effective date regulations ("grandfathered trusts"), see

decanting. Legislative history indicates that, if made in a *fiduciary* capacity, the exercise of a power of appointment should not trigger the Delaware Tax Trap. See S. Rep. No. 82-382, at 1 (1951), as reprinted in 1951 U.S.C.C.A.N. 1535, 1535; see also Spica, *A Trap for the Wary: Delaware's Anti-Delaware-Tax-Trap Statute Is Too Clever by Half (of Infinity)*, 43 REAL. PROP. TR. & EST. L.J. 673, 675 (2009) (discussing the legislative history's indication that the Delaware Tax Trap was not intended to apply to purely fiduciary powers of appointment).

generally Treas. Reg. 26.26011(b); or

(ii) For trusts that were not irrevocable on or before September 25, 1985, the transferor allocated GST exemption to the trust ("non-grandfathered trusts").

c. A grandfathered trust will lose its GST exempt status if an actual or constructive addition is made to the trust after the effective date. Treas. Reg. §26.2601-1(b)(1).

d. Because decanting could be construed as an addition or other modification that causes a trust to lose its GST exempt status, it is important to understand the treatment of decanting under the GST regulations.

2. Grandfathered Trusts – Preserving GST Exempt Status.

a. The Safe Harbors. Decanting will not cause a grandfathered trust to lose its GST exempt status if the decanting satisfies one of two safe harbors in the Regulations: (i) the *discretionary distribution safe harbor*; or (ii) the *trust modification* safe harbor.

b. Discretionary Distribution Safe Harbor. Under the discretionary distribution safe harbor (Treas. Reg. §26.2601-1(b)(4)(i)(A)), decanting will not taint the GST exempt status of a grandfathered trust if the following conditions are satisfied:

(i) When the grandfathered trust became irrevocable, either the terms of the trust instrument or local law (i.e., state statute or common law)[39] authorized the trustee to make distributions to a new trust;

(ii) Neither beneficiary consent nor court approval is required for the trustee to exercise his discretionary authority; and

(iii) The new trust will not suspend or delay the vesting, absolute ownership, or power of alienation of an interest in trust beyond the permissible perpetuities period under federal law (i.e., a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became

[39] The first prong of the discretionary distribution safe harbor requires that decanting be authorized under the terms of the trust instrument or applicable state law. Because no state decanting statute was in existence at the time of the GST's effective date in 1985, a trustee must rely on its inherent ability under common law to decant the trust assets. See Phipps v. Palm Beach Trust Co., 142 Fla. 782 (1940).

irrevocable plus the period of 21 years, or 90 years from the date on which the grandfathered trust became irrevocable).[40] See Treas. Reg. §26.2601-1(b)(4)(i)(A)(2).

c. Trust Modification Safe Harbor. Under the trust modification safe harbor (Treas. Reg. §26.2601-1(b)(4)(i)(D)), decanting will not taint the GST exempt status of a grandfathered trust if the following conditions are satisfied:

(i) The decanting does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons holding the beneficial interest under the terms of the original trust; and

(ii) The decanting does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Unlike the discretionary distribution safe harbor, a decanting will not fail the trust modification safe harbor solely by reason of a beneficiary's consent or a court's approval of the decanting. While these measures may not affect the trust's GST status, they could result in adverse income, gift, or estate tax consequences.

3. Application of the Safe Harbors to Grandfathered Trusts.

a. Decanting to Make Administrative Changes. If a decanting involves only administrative changes, there should be no loss of GST exempt status. See PLR 200607015 (Nov. 4, 2005); see also Treas. Reg. §26.2601-1(b)(4)(i)(E), ex. 6 (trust modification that is merely administrative will not taint GST exempt status even if modification indirectly increases benefits available to beneficiaries); cf. PLR 9737024 (Sept. 12, 1997) (grandfathered status is preserved when trust is modified pursuant to state decanting statute as long as terms of new trust do not adversely affect quality, value, or timing of any beneficial interest in trust). Under the trust modification safe harbor, this is true regardless of

[40] The GST regulations do not characterize decanting as a special power of appointment, although some state decanting statutes specifically refer to the decanting authority as the power to exercise a special power of appointment over the trust assets. There are separate GST regulations that apply to powers of appointment and decanting. The federal perpetuities period in the decanting regulations (Treas. Reg. §26.2601-1(b)(4)(i)(A)(2)) prescribes a different starting point than the period contained in the power of appointment regulations (Treas. Reg. §26.2601-1(b)(1)(v)(B)). The power of appointment regulations measure the perpetuities period (the later of 21 years plus some life in being, or 90 years) from the date of the *creation of the trust*, while the decanting regulations measure the perpetuities period from the date the grandfathered trust *became irrevocable*.

whether state law authorizes the decanting.

b. Extension of Vesting Period.

(i) A trustee may only extend an interest's vesting period beyond the period prescribed in the original trust if the decanting satisfies the *discretionary distribution* safe harbor. Even then, the decanting cannot extend the vesting period beyond the federal perpetuities period.

(ii) A trustee may desire to extend the vesting period, for example, when a beneficiary is scheduled to receive trust principal at a certain age or upon the death of a certain person. When extending the vesting period in these scenarios, it is important to include provisions in the new trust document limiting the vesting period to comply with federal perpetuities period.

c. Shift of Beneficial Interests. Like the extension of vesting periods, a trustee may only shift a beneficial interest in trust down generational lines if the decanting meets the requirements of the *discretionary distribution* safe harbor. Because the trust modification safe harbor only prohibits the shifting of beneficial interests to persons occupying a lower generation, a trustee may still shift beneficial interests up or across generational lines under the trust modification safe harbor.

d. Example. Treas. Reg. §26.2601-1(b)(4)(i)(E), ex. 2, provides a good example of the interaction between the discretionary distribution and trust modification safe harbors.

(i) Under the facts of the example, the grantor established an irrevocable trust for the benefit of the grantor's child "A," A's spouse, and A's issue. When the trust was established, A had two children, "B" and "C." The trust provided for discretionary distributions of income and principal to the beneficiaries. The trust terminated at A's death, with the principal distributed to A's issue, *per stirpes.*

(ii) Pursuant to a state decanting statute enacted after the creation of the trust, the trustee may appoint the assets to a new trust with either the consent of the beneficiaries or court approval. The trustee did not have the authority to decant under state law prior to the enactment of the decanting statute.

(iii) The trustee appointed one-half of the principal to a new trust pursuant to the state decanting statute. The terms of the new trust provide income to A for life, with the remainder passing one-half to B or B's issue and one-half to C or C's issue.

(iv) The decanting does not satisfy the discretionary distribution safe harbor because beneficiary consent or court approval is required.

(v) The decanting does satisfy the trust modification safe harbor, however, because it will not shift a beneficial interest in the trust and it will not extend the vesting period beyond the period prescribed in the original trust.

e. Decanting a Non-Grantor Trust to a Grantor Trust. Care should be taken when converting a grandfathered trust from a non-grantor trust to a grantor trust. The IRS could argue that the conversion constitutes a shift in the beneficial interest of the trust, resulting in a loss of GST exempt status. This argument is unlikely to succeed, however, as Rev. Rul. 2004-64, 2004-2 C.B. 7, confirms that when a grantor pays the income tax liability attributable to a grantor trust, he has not made a gift to the trust or its beneficiaries. If the payment of income taxes by the grantor is not deemed a transfer under Rev. Rul. 2004-64, then a conversion to grantor trust status, in and of itself, should not shift a beneficial interest in the trust

4. GST Exempt Trusts (Non-Grandfathered).

a. Neither the Code nor the Regulations directly address the consequences of decanting the assets of a non-grandfathered, GST exempt trust (i.e., a trust that is exempt from GST tax by reason of an affirmative allocation of GST exemption).

b. The IRS has indicated, however, that the GST Regulations for grandfathered trusts should apply to non-grandfathered trusts. See PLR 201134017 (May 26, 2011) ("At a minimum, a change that would not affect the GST status of a grandfathered trust should similarly not affect the exempt status of such a [non-grandfathered] trust"); PLR 200743028 (May 29, 2007); see also PLR 200919009 (May 8, 2008).

c. If a GST exempt trust was created after the date when the decanting statute became effective, and the decanting did not extend the time for vesting, the decanting should not affect the GST inclusion ratio of the trust (discretionary distribution safe harbor). Alternatively, if the decanting does not shift a beneficial interest in the trust to a beneficiary in a lower generation and does not extend the time for vesting, then the decanting should not change the inclusion ratio of the trust (trustee modification safe harbor). See PLR 201134017 (May 26, 2011). See also PLR 200227020; PLR 9804046; PLR 9737024; PLR 9438023.

5. Severed Trusts. Some decantings may create separate trusts. Thus the issue may arise as to whether the second trusts are treated as separate trusts for GST purposes. Treas. Reg. §26.2642-6 sets forth the rules for a qualified severance. If the severance is not qualified, the GST tax regulations will still treat the trusts as separate if state law recognizes the post-severance trusts as separate trusts. Treas. Reg. §26.2642-6(h).

XIV. Advice to Practitioners and Trustees.

A. In General. It is important to remember that decanting is just one tool in a practitioner's toolbox. Irrevocable trusts can be modified in other ways, such as through a trust modification under the Uniform Trust Code or through other judicial or non-judicial settlement procedures.

B. Steps to Take. A trustee's first step in the decanting process is to determine that it has the authority to decant, either under the trust instrument or applicable state statute.

1. Although trustees arguably have the power to decant under the common law of all states, if decanting authority is not explicitly granted by the trust agreement or state statute, the trustee should change the situs and/or governing law of the trust to a state with a decanting statute in place.

2. Changing trust situs offers the trustee a chance to forum shop based on the individual needs of the beneficiaries and the accessibility of state decanting statutes.[41]

[41] Query whether a dynasty trust that is GST exempt by virtue of grandfathering or allocation of the GST exemption can be moved from a state that does not permit perpetual trusts to a state that does, if the governing instrument expresses the intent that the trust be perpetual. Some commentators believe that it can. See Nenno, *Choosing a Domestic Jurisdiction for a Long-Term Trust*, BNA EST. GIFT & TR. PORTFOLIO #867 at II.F.2.b.(2) (citing PLR 200822008).

3. Any change in trust situs or governing law will be controlled by the procedures set forth in the trust agreement, if any, and applicable choice of law rules.

C. Fiduciary Liability. Once in a jurisdiction with a decanting statute, a trustee should take steps to protect itself from fiduciary liability.

1. As a general matter, a trustee should communicate openly and honestly with the trust beneficiaries and the settlor, if living. The trustee should take care, however, to avoid communications that would seem to indicate a preference for one beneficiary over another or an implied agreement that the settlor reserved the use and control of irrevocable trust assets.

2. The trustee also should ensure that he or she knows and understands the potential tax consequences of the decanting, especially if decanting a GST exempt trust. When the decanting involves shifting beneficial interests in trust, a trustee must proceed with extra caution.

3. Unless a decanting involves purely administrative changes, practitioners should urge clients to rely on independent trustees with no beneficial interests in the trusts. This reduces the risk of both adverse tax consequences and fiduciary liability issues. The use of independent trustees is even more important if the decanting involves the shifting of beneficial interests or extension of vesting periods in trust.

4. It is important to draft a proper decanting instrument. A decanting instrument may be similar to an exercise of a power of appointment, a property distribution agreement, or a trust merger agreement. In any form, a decanting instrument should include appropriate recitals that provide references to:

   a. the terms of the original trust agreement;

   b. the identity of current trustees and beneficiaries;

   c. any relevant background information regarding the trust administration and need for decanting;

   d. the source of the trustee's authority to decant, either under the terms of the trust or applicable state statute; and

   e. identifying information regarding the decanted trust agreement.

5. The trustee must remember to comply with all requirements under state law, including those relating to beneficiary notice.

6. A release and indemnification of the trustee by the beneficiaries may be prudent, although beneficiary consent may be unwise, given the possibility of adverse tax consequences.

7. Finally, a trustee may protect himself or herself by including certain provisions in the decanted trust agreement. These include, but are not limited to:

   a. Expressly prohibiting the extension of the perpetuities period beyond that of the first trust or as otherwise limited by applicable law;

   b. Extending the time period for any trustee indemnification back to the creation of the original trust agreement; and

   c. Giving the trustee of the new trust agreement the express authority to decant.

XV. Partial Checklist for Decanting Instrument.

A. Governing Law.

1. Identify the law governing the construction of the trust,[42] the law governing the administration of the trust and the place of administration.

2. Does the decanting statute apply to the trust?

3. Does the statute permit decanting to achieve the desired result?

B. Trust Provisions.

1. Does the trust contain its own provisions for decanting?

2. Does it expressly prohibit decanting?

C. Trust Purpose.

1. What are the material purposes of the trust?

2. Is the proposed decanting consistent with the material purposes of the trust?

[42] "Construction" is the application of rules that determine a settlor's presumed intent when his actual intent cannot be ascertained, such as with respect to the identity of the beneficiaries, the beneficiaries' respective interests and, in most cases, allocations between principal and income.

3. Are there better alternatives to achieve the desired result?

D. Trustee. Identify the person (usually trustees) with the ability to distribute principal. Is the discretion absolute or not?

E. Beneficiaries.

1. Identify the current beneficiaries and the presumptive remainder beneficiaries, and whether they have legal capacity.

2. What notice is required?

3. If notice isn't required, is it advisable?

4. Is beneficiary consent desirable? Does it increase tax risks?

F. Powers of Appointment. If the first trust grants a power of appointment, address the effect of a purported exercise of the power of appointment over the first trust.

G. Further Decanting. Consider if the second trust should prohibit, authorize, or change the procedure for further decanting. For example, the second trust could permit future decanting but eliminate the right of beneficiaries to object to the decanting without going to court. Alternatively, if the decanting changes an absolute discretion standard to a more restrictive distribution standard, the second trust might permit future decanting as if the trustee had retained absolute discretion.

H. Rule Against Perpetuities. The rule against perpetuities provision in the second trust should be the same period that applied to the first trust, unless the first trust expressly permits a change and the change will not create tax issues. If the first trust is a qualified perpetual trust and is also GST exempt, consider whether the second trust must comply with the federal rule against perpetuities to avoid adverse GST tax consequences.

I. Confirm Tax Risks and Elections.

1. Identify the income, estate, gift or GST tax consequences or risks.

2. If the first trust was a QTIP, QSST or an ESBT, state the intent that the second trust will qualify as such and consider whether a separate election must be made for the second trust.

J. New Trust or Continuation. State whether the second trust is merely a modification and continuation of the first trust, and will continue to use the same tax identification number, or whether the second trust will be a new trust using a separate tax identification number.

K. Severability. Consider including a provision that reads into the second trust any provision required to be included in the second trust that is inadvertently omitted, and that invalidates any provision included in the second trust that is not permitted to be included under the decanting statute.

~END OF MATERIALS~

THE RAINBOWS AND UNICORNS TRUST

Memorandum Evidencing Trustee's Exercise of Power to Decant Trust Assets under RSA 564-B:4-418

1. ELVIS PRESLEY (the "Grantor") established the RAINBOWS AND UNICORNS TRUST (the "Trust") by an agreement dated February 23, 1989 (the "Trust Agreement").

2. The situs and governing law of the Trust was changed from Massachusetts to New Hampshire by a nonjudicial settlement agreement dated October 17, 2015.

3. The Grantor is living.

4. AMY K. KANYUK ("Amy"), a resident of Concord, New Hampshire, is the current sole Trustee of the Trust. AMY is a "Disinterested Trustee", as such term is defined in ARTICLE XII of the Trust Agreement, and has no vested or contingent present or future beneficial interest in the Trust.

5. The current beneficiaries of the Trust are the Grantor's descendants. The Grantor has three adult children, and no grandchildren or further descendants. The names and birthdates of the Grantor's children are:

    a. Elvis Presley, Jr. (March 1, 1987);
    b. Angelina Jolie (August 12, 1992); and
    c. Jennifer Lawrence (June 8, 1994)

6. The property contributed to the Trust has been allocated among separate shares created for the benefit of each of the Grantor's children, such that each child has a separate share that is administered as a separate trust (a "child's trust") under the terms of the Trust Agreement.

7. Paragraph B. of ARTICLE III of the Trust Agreement provides that the Trustee "shall pay to child or the child's issue" income and principal as the Disinterested Trustee deems "desirable for the benefit of" any one or more of the child or the child's issue. Paragraph B. further provides that the child may withdraw the principal of the child's trust in stages over time: one-third when the child reaches the age of thirty-two (32), two-thirds when the child reaches the age of thirty-seven (37), and the balance when the child reaches the age of forty-two (42).

8. As of the date hereof, the Grantor's oldest child, ELVIS PRESLEY, JR., is thirty-five (35) years old, and therefore may withdraw one-third of the principal of the child's trust created in his name.

9. As of the date hereof, neither of the Grantor's other two children (ANGELINA and JENNIFER) has reached the age of thirty-two (32), and therefore neither ANGELINA nor JENNIFER may withdraw any portion of the principal of the child's trust created in her name.

10. New Hampshire RSA 564-B:4-418 (the "Act"), New Hampshire's decanting statute, empowers the trustee of a trust that is administered in New Hampshire (the "first trust") to appoint some or all of the trust property to another trust (the "second trust"), subject to certain restrictions. In particular RSA 564-B:4-418(g) provides that a trustee may not decant to the extent that the terms of the second trust reduce or eliminate a vested interest of a beneficiary of the first trust.

11. ELVIS's right to withdraw one-third of the principal of the child's trust created in his name is a vested interest that cannot be eliminated by decanting. ELVIS's interest in the remaining principal of his child's trust is not a vested interest. See RSA 564-B:4-418(g)(2).

12. The interests of ANGELINA and JENNIFER in the child's trusts created in their names are not vested interests. See RSA 564-B:4-418(g)(2).

13. AMY, in her fiduciary capacity as Trustee, intends to exercise her authority under the decanting statute to decant all of the Trust assets to a second trust declared by AMY as "Declarant" and Trustee under the same terms and conditions as are described in the Trust Agreement (as modified by the nonjudicial settlement agreement), which is attached hereto as Exhibit A and incorporated herein by this reference, as modified by the provisions of this Memorandum. The second trust will continue to be known as the "Rainbows and Unicorns Trust" under the Trust's existing federal taxpayer identification number, except that:

    a. Paragraph B. of ARTICLE III shall be deleted in its entirety, and replaced with the following new Paragraph B.:

    B.1. The Disinterested Trustee may pay out of the net income or principal, or both (other than principal that may be required to satisfy unexpired withdrawal rights in accordance with the foregoing Paragraph A.), such amount or amounts (whether equal or unequal, and whether the whole or a lesser amount) as the Disinterested Trustee, in its sole and absolute discretion, determines to or for the benefit of such one (1) or more persons then living as the Disinterested Trustee, in its sole and absolute discretion, may select out of a class composed of the child and the child's issue. Any net income not so paid shall be added to principal. The interest of the child and the child's issue in the child's trust is neither a property interest nor an enforceable right, but a mere expectancy. The exercise of the Trustee's discretionary power shall be final unless such Trustee has acted in bad faith.

    B.2. In addition, the Trustee shall pay to my son ELVIS one-third of the value of the principal of the child's trust created in ELVIS's name, as ELVIS shall request in writing. For this purpose, the value of such principal shall be the larger of the value thereof on the date that ELVIS's share was set aside by the Trustee for ELVIS, or the value thereof on the date

on which ELVIS makes such written request. Such values shall be determined by the Disinterested Trustee, in its sole and uncontrolled judgment, and the Disinterested Trustee's determinations in this regard shall be final and not subject to question by any person interested in the trust estate.

b. The first Paragraph of ARTICLE IX shall be deleted in its entirety, and replaced with the following new first Paragraph:

A trustee of any trust hereunder may resign by an instrument in writing delivered or mailed to me during my lifetime and, thereafter, to my wife or, if she is not then living, to the accountees of such trust. Upon my death I appoint my wife as a trustee hereof. At least one of the trustees of each trust shall qualify as a Disinterested Trustee, and during my lifetime and my wife's lifetime, at least one-half of the persons serving as Disinterested Trustee of any one trust shall be persons who are not related or subordinate parties to me or to my wife within the meaning of §672 of the Internal Revenue Code of 1986, as amended (the "Code"). I, and following my death, my wife, shall have the power to designate one or more successor trustees (to serve successively or concurrently) by instrument in writing delivered to my Trustees hereunder. In the event there shall be no trustee of a trust serving or designated to succeed as trustee hereunder, or if an additional trustee shall be required by the provisions hereof, a trustee shall be appointed by the following individuals, in the order named: me; my wife; AMY K. KANYUK; and a majority of my then living children who are not incapacitated; provided, however, that any Trustee appointed by my child or children shall be a Disinterested Trustee, as such term is defined herein, who is not a "related or subordinate" party (within the meaning of Code § 672) to any beneficiary of the subject trust.

14. AMY's exercise of her power to decant satisfies all of the requirements of the decanting statute, including the following:

a. The provisions of the Trust, as modified by the decanting (the "New Trust"), do not include any beneficiary who is not a beneficiary of the Trust prior to the decanting.

b. The exercise of the power to decant does not reduce or eliminate a vested interest of a beneficiary of the Trust.

c. The exercise of the power to decant does not jeopardize any deduction, credit, exclusion or exemption for purposes of any income, gift, estate or generation-skipping tax for which a transfer to the Trust may have qualified.

d. The terms of the New Trust are not inconsistent with a material purpose of the Trust.

e. Other than ELVIS's right to withdraw one-third of the principal of the child's trust created in his name, which such withdrawal right shall continue in existence as provided herein, none of the Trust property is subject to a presently exercisable power of withdrawal

held by a beneficiary of the Trust prior to the decanting.

f. After the decanting, the beneficiaries of the New Trust do not have the power to remove and replace the Trustee with any Trustee who is a "related or subordinate" party (within the meaning of Code §672) to any of the beneficiaries.

15. AMY is exercising her power to decant in good faith and solely for the benefit of the beneficiaries of the Trust, having considered the interests of the beneficiaries, as set forth in the Trust Agreement.

NOW, THEREFORE, AMY K. KANYUK, as Trustee of the Trust and declarant and Trustee of the New Trust, hereby exercises her power under the Act to decant the property of the Trust to the New Trust, as hereinabove provided, and AMY K. KANYUK, as continuing Trustee of the New Trust, agrees to administer the Trust property as hereinabove provided.

If the Trustee's exercise of her decanting power would be effective under the Act except that the provisions of the New Trust in part do not comply with the Act, the exercise of the power shall be effective with respect to the principal of the New Trust attributable to the exercise of the power, as follows:

A. A provision in the New Trust that is not permitted under the Act shall be void to the extent necessary to comply with the Act.

B. A provision required by the Act to be in the New Trust that is not contained in the Trust Agreement shall be deemed to be included in the Trust Agreement to the extent necessary to comply with the Act.

_____ _____

Witness Amy K. Kanyuk

March 23, 2022