NAEPC
# Journal of Estate & Tax Planning

Click here to view the First Quarter 2014 Issue

# DECANTING: REFINING A VINTAGE TRUST

by
**Susan T. Bart**
Sidley Austin LLP
One South Dearborn Street
Chicago, IL 60603
phone: (312) 853-2075
fax: (312) 853-7036
sbart@sidley.com

**Susan T. Bart** is a partner in the Private Clients, Trusts & Estates Group of the Chicago office of Sidley Austin LLP. In 2013 she was named Reporter to the Uniform Law Commission Decanting Committee. Susan was named the *Best Lawyers'* 2011 Chicago Trusts and Estates Lawyer of the Year. Susan was the recipient of the 2013 Austin Fleming Award from the Chicago Estate Planning Council; this Award is presented annually to a person highly regarded by practicing estate planners for his or her expertise in the field and who has made a significant contribution to the improvement of estate planning practices. In June 2013, Susan was named "Best in Wealth Management" at the Euromoney Legal Media Group's Second Annual Americas Women in Business Law Awards. Susan has been recognized by *Chambers USA* – America's Leading Lawyers for Business (2014) *(fifth consecutive year)*. She is named in the 2013 edition of *The Best Lawyers in America* in the area of Trusts and Estates, was named by *Leading Lawyers Magazine* in 2012 as one of the top ten women attorneys in Illinois in Trust, Will & Estate Planning, one of the top ten women Consumer Lawyers in Illinois, and one of the top 100 women attorneys in Illinois in all areas of practice. She was selected by *Worth* magazine as one of the Nation's Top 100 attorneys (2008-2009 issue) (second consecutive year). She is a Fellow and Regent of The American College of Trust and Estate Counsel (ACTEC), former State Chair for Illinois and a former editor of the ACTEC *Journal*. She authored the book *Education Planning and Gifts to Minors* (Illinois Institute for Continuing Legal Education ("IICLE"), revised 2009), coauthored the award-winning book *Illinois Estate Planning Forms and Commentary* (IICLE, 2$^{nd}$ edition, 2005), and has written numerous articles. Susan received the 2012 Addis Hull Award for her contributions to IICLE's mission and efforts to provide superior legal education to the legal community. Susan writes a column for MorningstarAdvisor.com on their website entitled "529 Advisor." She is also a member of the Board of Trustees, Chair of the Academic Affairs Committee, and a member of the Executive Committee of Roosevelt University, Chicago, Illinois. Ms. Bart earned a Juris Doctor degree, *magna cum laude* (Order of the Coif), in 1985 from the University of Michigan Law School where she was Articles Editor of the *Michigan Law Review*.

Copyright © 2014 by Susan T. Bart. All rights reserved.

*        *        *        *        *        *        *        *

***To comply with certain Treasury regulations, we state that (i) this article is written to support the promotion and marketing of the transactions or matters addressed herein, (ii) this article is not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (iii) each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.***

*        *        *        *        *        *        *        *

***These seminar materials are intended to provide the reader with guidance in estate planning. The materials do not constitute, and should not be treated as, legal advice regarding the use of any particular estate planning technique or the tax consequences associated with any such technique. Although every effort has been made to assure the accuracy of these materials, the author and Sidley Austin LLP do not assume responsibility for any individual's reliance on these materials. The reader should independently verify all statements made in the materials before applying them to a particular fact situation, and should independently determine both the tax and nontax consequences of using any particular estate planning technique before recommending or implementing that technique.***

**DECANTING: REFINING A VINTAGE TRUST**

by
Susan T. Bart
Sidley Austin LLP

**TABLE OF CONTENTS**

I. What is Decanting? ....................................................................................... 1

A. Decanting .......................................................................................................... 1
B. Theory of Decanting .......................................................................................... 1
C. Evolution of Decanting ...................................................................................... 1
D. Uniform Law Project .......................................................................................... 2

II. Uses of Decanting ............................................................................................ 2

A. Administrative Change ...................................................................................... 2
B. Change Investment Limitations, Authorize Acquiring or Retaining an Asset or Permit Lack of Diversification ........................................................................ 2
C. Define (and Limit) Beneficiary Rights to Information ......................................... 2
D. Change Governing Law ..................................................................................... 2
E. Trustee Change .................................................................................................. 2
F. Provide for Advisors, Trust Protectors or Directed Trustees ................................. 2
G. Divide a Trust .................................................................................................... 2
H. Consolidate Trusts .............................................................................................. 2
I. Correct Scrivener's Error or Ambiguity ................................................................. 2
J. Add or Remove Spendthrift Provisions .................................................................. 2
K. Create a Supplemental Needs Trust ...................................................................... 2
L. Limit a Beneficiary's Rights, or Eliminate a Beneficiary ........................................ 2
M. Add a Beneficiary (with a Power of Appointment) ................................................ 2
N. Convert Non-Grantor Trust to Grantor Trust ......................................................... 2
O. Convert Grantor Trust to Non-Grantor Trust ......................................................... 2

III. Is Decanting Permitted Under a Particular State Statute? ...................................... 2

A. Terminology: First and Second Trust .................................................................... 2
B. Applicability of State Statute ................................................................................ 3
C. What Trusts May Be Decanted? ............................................................................ 3
D. Trust Prohibitions ................................................................................................. 3
E. Trust Modifications of Decanting Statute ............................................................... 3
F. Who Needs to Participate? ..................................................................................... 3
G. Grantor's Intent and Trust Purposes ....................................................................... 3
H. Discretionary Distribution Authority ...................................................................... 4
I. Definition of Absolute Discretion ........................................................................... 5

J. Need for Present Distribution ....6
K. Restrictions on Trustees ....6
L. Court Approval ....6

IV. What Changes Are Permitted to Beneficial Interests? ....7

A. Beneficiaries ....7
B. Can You Change the Standard for Distributions? ....7
C. Can You Change Mandatory Distribution or Withdrawal Rights? ....8
D. Powers of Appointment ....8
E. Are Beneficiaries of New Trust Limited to Current Beneficiaries of Old Trust? ....9
F. Acceleration of Future Interests ....10
G. Supplemental Needs Trusts ....11

V. Other Restrictions on Decanting ....12

A. Impairing Beneficiary Rights ....12
B. Treatment of Future Class Members ....13
C. Rule Against Perpetuities ....13
D. Tax Restrictions ....14
E. Subchapter S Qualification ....18
F. Minimum Distribution Rules (Code Section 401(a)(9)) ....19
G. Change of Grantor Trust Treatment ....19
H. Restrictions on Trustee Mischief ....21

VI. Notice ....22

A. No Notice ....22
B. Notice Required ....22
C. Waiver of Notice ....23
D. Effect of Objection ....23

VII. Procedural Issues ....23

A. Requirements for New Trust ....24
B. Tax Identification Number ....24
C. Do Assets Need to be Retitled? ....24
D. Distribution Plan for Later Discovered Assets ....24
E. Trust Code Notification Provisions ....24

VIII. Application of Decanting Statute ....24

IX. Other Issues ....25

A. Accounting Requirements ....25
B. Jurisdiction of New Trust ....25
C. Codification of Common Law ....25

X. Beneficiary's Recourse ....25

A. Right to Object ....25
B. Abuse of Discretion ....25
C. Explicit Remedy....25

XI. Trustee Liability....26

A. No Duty to Decant ....26
B. Duty to Inform Beneficiaries ....26
C. Fiduciary Duties....26
D. Duty of Impartiality ....26
E. Standard of Review....26

XII. Tax Issues....26

A. Income Tax ....26
B. Estate and Gift Tax ....27
C. GST Tax....28

XIII. Considerations....30

A. What state statute(s) applies to the trust?....30
B. Does the applicable state statute permit decanting? ....30
C. Does the applicable state statute permit decanting to achieve the desired result?.30
D. Are there income, estate, gift or GST tax consequences or risks?....30
E. Is the proposed decanting consistent with the material purposes of the trust? ......30
F. Should the trustee decant? ....30
G. What notice is required? Advisable? ....30
H. Is beneficiary consent desirable? Does it increase tax risks? ....30
I. Is court approval required? Desirable? ....30
J. Are there better alternatives to achieve the desired result?....30

XIV. Partial Checklist for Decanting Instrument....30

A. Governing Law ....30
B. Trust Provisions ....30
C. Trust Purpose ....30
D. Trustee....30
E. Beneficiaries ....31
F. Powers of Appointment ....31
G. Further Decanting ....31

H. Rule Against Perpetuities....31
I. Confirm Tax Elections....31
J. New Trust or Continuation....31
K. Future Decanting....31

Bibliography

Appendix I: State Decanting Statutes Passed or Proposed

# DECANTING: REFINING A VINTAGE TRUST

by
Susan T. Bart
Sidley Austin LLP
Chicago, Illinois

---

*From a bottle of Kistler Carneros chardonnay (2005):*

> *"This wine was bottled unfiltered and may therefore develop a natural sediment during its evolution. To prevent the formation of this sediment by filtration or other means would interfere with the natural aging process of the wine and diminish its ultimate quality."*

---

## I. What is Decanting?

A. **Decanting**. 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.

B. **Theory of Decanting**. 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.

C. **Evolution of Decanting**

1. **Common Law**. Some cases have held that decanting is permitted under common law. *Phipps v. Palm Beach Trust Co*., 196 So. 229 (Fla. 1940); *Wiedenmayer v. Johnson*, 254 A.2d 534 (N.J. Super. Ct. App. Div. 1969); *In Re: Estate of Spencer*, 232 N.W.2d 491 (Iowa 1975); *Morse v. Kraft*, SJC 11233 (Supreme Judicial Court, Suffolk County, Massachusetts, July 29, 2013). Some state statutes assert that they are a codification of common law decanting powers.

Copyright © 2014 by Susan T. Bart. All rights reserved.

2. **State Statutes**. Twenty-two states have decanting statutes. See Appendix I.

D. **Uniform Law Project**. The Uniform Law Commission has formed a drafting committee for a Uniform Decanting Statute.

## II. Uses of Decanting

A. Administrative Change

B. Change Investment Limitations, Authorize Acquiring or Retaining an Asset or Permit Lack of Diversification

C. Define (and Limit) Beneficiary Rights to Information

D. Change Governing Law

E. Trustee Change

F. Provide for Advisors, Trust Protectors or Directed Trustees

G. Divide a Trust

H. Consolidate Trusts

I. Correct Scrivener's Error or Ambiguity

J. Add or Remove Spendthrift Provisions

K. Create a Supplemental Needs Trust

L. Limit a Beneficiary's Rights, or Eliminate a Beneficiary

M. Add a Beneficiary (with a Power of Appointment)

N. Convert Non-Grantor Trust to Grantor Trust

O. Convert Grantor Trust to Non-Grantor Trust

## III. 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. See Section VIII. 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. 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.

D. **Trust Prohibitions**. A trust, however, may expressly prohibit decanting or prohibit certain modifications through decanting. Some state statutes expressly prohibit decanting to the extent prohibited by the trust instrument. See, e.g., Delaware, Florida, Illinois, Indiana, Kentucky, New York, South Dakota, Tennessee and Virginia. Generally, a spendthrift provision, provision prohibiting amendment or 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.

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. The Ohio and South Carolina statutes, for example, expressly 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**. The Illinois statute explicitly states that the exercise of the power of decanting must be exercised "in furtherance of the purposes of the trust." The South Dakota statute also directs the trustee to take into account the purposes of the trust:

> Before exercising its discretion to appoint and distribute assets to a second trust, the trustee of the first trust shall determine whether the appointment is necessary or desirable after taking into account the purposes of the first trust, the terms and conditions of the second trust, and the consequences of the distribution.

The New York statute directs the trustee to consider the interests of the beneficiaries as well as the intent of the settlor, including how changes in circumstances might have changed the settlor's intent:

> An authorized trustee exercising the power under this section has a fiduciary duty to exercise the power in the best interests of one or more proper objects of the exercise of the power and as a prudent person would exercise the power under the prevailing circumstances. The authorized trustee may not exercise the power under this section if there is substantial evidence of the contrary intent of the creator and it cannot be established that the creator would be likely to have changed such intention under the circumstances existing at the time of the exercise of the power. The provisions of the invaded trust alone are not to be viewed as substantial evidence of a contrary intent of the creator unless the invaded trust expressly prohibits the exercise of the power in the manner intended by the authorized trustee.

Note that the provisions of the original trust are not to be taken as an indication that the proposed change is contrary to the settlor's intent. The Alaska statute is similar to the New York statute. The Texas statute also directs the trustee to consider the interests of the beneficiaries along with the "terms and purposes" of the trust.

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. 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 New York statute uses the term "unlimited discretion" rather than "absolute discretion.") Some statutes have bifurcated standards 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.

1. **Absolute Discretion Not Required**. The trustee may decant even if the trustee's discretion is not absolute in Arizona, Delaware, Kentucky, Missouri, Nevada, New Hampshire, North Carolina, Rhode Island, South Carolina, South Dakota and Tennessee. Most of these states have restrictions on a beneficiary who is a trustee decanting. Indiana is considering an amendment to its statute to eliminate the requirement that a trustee have absolute discretion to decant.

2. **Bifurcated Standard**. States requiring absolute discretion for some decanting but not others include Alaska, Illinois, Michigan, New York, Ohio, Texas and Virginia. Michigan actually has two statutes, one of which applies when the trustee has absolute discretion (Michigan § 556.115a) and the other of which applies when the trustee has discretion

(but not necessarily absolute discretion) (Michigan § 700.7820a). The trend of the newer statutes is to use a bifurcated standard.

3. **Absolute Discretion**. As of July 1, 2014, when the amendment to the Indiana statute becomes effective, only Florida requires absolute discretion.

4. **Discretion Over Principal**. States that require that the trustee have discretion over *principal* include Alaska, Delaware, Florida, Indiana, New York, Ohio, Rhode Island and Tennessee.

5. **Discretion Over Income or Principal**. States that permit decanting if the trustee has discretion over *income or principal* include Arizona, Kentucky, Michigan, Missouri, Nevada, New Hampshire, North Carolina, South Carolina, South Dakota and Virginia.

## I. Definition of Absolute Discretion

1. **Pure Absolute Discretion**. In some states "absolute discretion" means discretion not limited or modified by the terms of the trust in any way, even by purposes such as best interests, welfare or happiness. See Texas.

2. **"Best Interests" Definition**. A number of states provide that a standard such as best interests or welfare constitutes absolute discretion. For example, the Illinois statute states: "A power to distribute principal that includes purposes such as best interests, welfare, or happiness shall constitute absolute discretion." See also Florida, New York and Ohio. A few statutes explicitly state that a trustee may have absolute discretion even if the trust contains a direction to consider other resources. See, e.g., Michigan § 556.115a.

3. **Anything Beyond Ascertainable Standard**. Some states define "absolute discretion" as any discretion that is not limited to an ascertainable standard. See Florida, Indiana, Michigan § 556.115a. For example, the Florida statute defines "absolute power" as follows:

> (b) For purposes of this subsection, an absolute power to invade principal shall include a power to invade principal that is not limited to specific or ascertainable purposes, such as health, education, maintenance, and support, whether or not the term "absolute" is used. A power to invade principal for purposes such as best interests, welfare, comfort, or happiness shall constitute an absolute power not limited to specific or ascertainable purposes.

FLA. STAT. ANN. § 736.04117(b).

J. **Need for Present Distribution**. Some statutes explicitly state that the trustee may decant even where there is no current need for a distribution. See, e.g., Alaska, Illinois, North Carolina, Ohio and South Carolina.

K. **Restrictions on Trustees**

1. **States Prohibiting Interested Trustee from Decanting**. Some statutes prohibit certain interested trustees from decanting. If only interested trustees are acting, decanting may be prohibited. For example, in Missouri a trustee whose discretion is not limited by an ascertainable standard cannot decant if the trustee is a beneficiary or has certain powers to remove and replace the trustee. See also New Hampshire. In Nevada, a trustee who is a beneficiary may not decant. See also New York, North Carolina, South Carolina and Virginia. In North Carolina, South Carolina and Virginia, if all trustees are beneficiaries, the court may appoint a special fiduciary with authority to decant.

2. **States Limiting Decanting by Interested Trustee**. 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 (see discussion below at Section V, D, 9). For example, see the South Dakota statute, which restricts certain changes to the beneficial interests of a beneficiary acting as trustee or a trustee who may be removed by a beneficiary. Texas provides that an interested trustee may decant only in accordance with the ascertainable standard applicable to the interested trustee. Arguably, a provision in the statute that the power is to be construed as a nongeneral power of appointment is sufficient to impose limits on the powers of a beneficiary acting as a trustee so as to avoid tax issues.

3. **Absolute Discretion or Bifurcated Statutes**. A statute that requires that a trustee have absolute discretion to decant, or a bifurcated statute that requires that a trustee have absolute discretion to make a beneficial change, may not need to include a restriction on an interested trustee decanting. Typically trusts will not give an interested trustee absolute discretion over discretionary distributions because such discretion would create gift and estate tax issues. In the unusual event that a trust does give an interested trustee absolute discretion, the trustee will incur the tax effects of holding a general power of appointment whether or not the trustee also has a decanting power.

L. **Court Approval**. Court approval is generally not required to decant, but usually the trustee is free to obtain court approval. See, e.g., North Carolina and Virginia. Court approval may be required in certain circumstances, for example, in Illinois when there is not a competent adult current beneficiary and presumptive remainder beneficiary, or in Illinois or Kentucky if a primary beneficiary objects to the decanting, or in Texas if the attorney general objects to the decanting. Court approval is also sometimes required in Illinois and Texas to change trustee

compensation. Court approval is required in Alaska to change trustee compensation or a removal provision. Ohio requires court approval for decanting a testamentary trust. In New York, the decanting instrument must be filed with the court if the trust had been subject to a proceeding in Surrogates Court. Some statutes explicitly permit a court to disapprove a proposed exercise of a trustee's power to decant, though presumably a beneficiary can always file a claim to object to the trustee's exercise of the power to decant.

## IV. What Changes Are Permitted to Beneficial Interests?

### A. Beneficiaries

1. **Can You Add 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 appointment.

2. **Can You Eliminate a Beneficiary?**

   a. **States Where Trustee Must Have Absolute Discretion**. 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. See, e.g., Michigan § 556.115a.

   b. **Other States**. Some state 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. See, e.g., Florida, Missouri, Nevada, Rhode Island and South Carolina.

3. **Must the Beneficiaries Remain 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. Can You Change the Standard for Distributions?

Presumably, absent a statutory requirement that the distribution standard or the beneficial interests remain the same, the new trust may have a different standard for distribution. 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. See, e.g., Illinois, New York, North Carolina and Virginia. Alaska permits the distribution standard to change during any extended duration of the second trust. Some states require that the distribution standard remain the same. See, e.g., Alaska, Michigan

§ 700.7820a and South Carolina. Missouri prohibits "removing restrictions on discretionary distributions."

Other states permit the new trust to have a different distribution standard, with certain exceptions especially when the trustee is a beneficiary. See, e.g., Arizona, Kentucky, Nevada, New Hampshire and South Dakota.

C. **Can You Change Mandatory Distribution or Withdrawal Rights?** Some statutes prohibit eliminating an existing mandatory right to income (Tennessee), or an income, annuity or unitrust interest (Alaska, Arizona, Florida, Illinois, Indiana, Kentucky, Nevada, New Hampshire, New York, North Carolina, Ohio, Rhode Island, Texas and Virginia), or all mandatory rights (Michigan § 700.7820a). Other states do not have such a prohibition. See, e.g., Delaware, Michigan § 556.115a, Missouri and South Dakota. South Dakota prohibits eliminating mandatory rights with respect to marital trusts, charitable trusts and GRATs. South Carolina prohibits eliminating a right to an income, interest or annuity interest if it would have disqualified the trust for a tax benefit. 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 such rights. See Section V, D.

Some states prohibit eliminating or restricting an existing withdrawal right. See, e.g., Alaska, Illinois, Kentucky, Michigan, Missouri, Nevada, New Hampshire, New York, North Carolina, Ohio, South Carolina, South Dakota and Texas. Other states do not. See, e.g., Florida, Indiana, Rhode Island and Tennessee. Michigan § 556.115a prohibits eliminating mandatory withdrawal rights if the beneficiary is the sole beneficiary, but not otherwise. 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. See Section V, D. Many states, however, would permit a future distribution or withdrawal right to be eliminated or restricted. Thus, for example, in Illinois a trust that is to be distributed when a beneficiary attains age 30 could be decanted to a trust that does not require distribution until a later age (or no age at all) if the beneficiary has not yet attained age 30.

D. **Powers of Appointment**. Commonly, decanting statutes explicitly permit the trustee to grant a power of appointment to one or more of the beneficiaries. See, e.g., Alaska, Delaware, Illinois, Kentucky, Michigan § 556.115a, Nevada, New Hampshire, North Carolina, South Carolina, South Dakota and Texas. 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. See, e.g., Delaware, Michigan § 556.115a, South Carolina and Texas. New York, however, limits the power of appointment over the new trust to the same power of appointment as in the old trust, unless the trustee has absolute discretion, in which case the new trust may alternatively grant a broad special power of appointment.

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 (except in North Carolina and Virginia) must contain the same power of appointment as in the old trust. This may be explicit in the statute (see, e.g., Alaska, Illinois, New York and Texas), or implicit in the requirement that the decanting not materially change the beneficial interests (see Michigan § 700.7820a).

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

1. **Limited to Current Beneficiaries**. 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. This appears to be the case under Alaska's and New Hampshire's statutes. Under such a statute, the remainder beneficiaries who are not also current beneficiaries must be deprived of their interest if the trust is decanted. This limitation may also apply under the Kentucky, Tennessee and Rhode Island statutes, and the Ohio statute where the trustee does not have absolute discretion. 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 provisions of the new trust revert to the beneficial provisions of the old trust, including the provisions regarding remainder beneficiaries. States that permit changes to beneficial provisions for current beneficiaries, but then also permit a boomerang provision so that the remainder beneficiaries of the old trust do not need to lose their interests, include Delaware, Nevada, Michigan § 556.115a and Ohio (when the trustee has absolute discretion).

2. **Not Limited to Current Beneficiaries**. In other 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. For example, the Illinois statute permits a trustee with absolute discretion to decant to a trust "for the benefit of one, more than one, or all of the current beneficiaries of the first trust and for the benefit of one, more than one, or all of the successor and remainder beneficiaries of the first trust." The Missouri statute permits the beneficiaries of the new trust to include current beneficiaries of the old trust and beneficiaries of the old trust "for whom a distribution

. . . may have been made in the future . . . or upon the happening of an event." See also South Dakota and Texas. Other state statutes are less explicit, but presumably allow the remainder beneficiaries of the old trust to be beneficiaries of the new trust. See, e.g., Arizona, Florida, Indiana, South Carolina and Virginia.

b. **Remainder Beneficiaries Must Remain the Same**. Other statutes, such as New York's statute when the trustee has absolute discretion, explicitly state that all remainder beneficiaries of the new trust shall 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**. In states that do not restrict the beneficiaries of the new trust to current beneficiaries of the old trust, can decanting accelerate a remainder interest in the old trust to a current interest in the new trust? In a few states, namely, Illinois, Missouri and South Dakota, 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. For example, the Virginia statute provides that a "beneficiary who has only a future beneficial interest, vested or contingent, in the original trust shall not have the future beneficial interest accelerated to a present interest in the second trust." See also New York, North Carolina, Rhode Island and South Carolina. Other statutes are silent about the acceleration of a future interest. See, e.g., Arizona, Florida, Indiana and Texas. 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.

1. **Danger of Permitting Acceleration**. 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. See, e.g., Internal Revenue Code ("Code") section 674(b)(5), (b)(6), (b)(7); Code section 674(c); Code section 674(d). Under the grantor trust rules, the power to add a beneficiary includes the power to make a remainder beneficiary a current beneficiary. Treasury Regulation section 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.") 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.

2. **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.

3. **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, for example in a bifurcated state when the trustee has absolute discretion, 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 re 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. 760 ILCS 5/16.4(d)(4)(iii).

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. The Rhode Island statute expressly protects 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**. Under statutes that require absolute discretion in order to decant in a manner that restricts a beneficiary's interest, a trustee without absolute discretion might not have the power to decant to a supplemental needs trust even though such a decanting may be in a beneficiary's best interest. Both Illinois and New York have bifurcated statutes that would not permit decanting in a manner that would alter a beneficial interest unless the trustee has absolute discretion. However, the Alaska, Illinois and New York 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. Virginia would permit a trustee of a trust who does not have absolute discretion to decant into a supplemental needs trust with court approval. The Illinois statute permits a trustee to decant a disabled beneficiary's interest to a supplemental needs trust if the trustee determines that to do so would be in the best interests of the disabled beneficiary, taking into consideration the financial impact to the disabled beneficiary's family. A supplemental needs trust is defined as a trust that would allow the disabled beneficiary to receive a greater degree of governmental benefits than the disabled beneficiary would receive if no distribution is made. The Illinois statute defines "disabled beneficiary" as a beneficiary who has a disability that substantially impairs the beneficiary's ability to provide for his or her own care and custody and that constitutes a substantial handicap whether or not the beneficiary has been adjudicated a "disabled person."

## V. Other Restrictions on Decanting

A. **Impairing Beneficiary Rights**. The Texas statute prohibits any decanting that would "materially impair the rights of any beneficiary of the trust." The Texas statute is not only bifurcated, but requires full discretion not modified by terms such as best interests in order to change beneficial interests. If there is full discretion, the statute appears to permit decanting in favor of one or more current beneficiaries and one or more successor presumptive beneficiaries, thus appearing to permit the elimination or reduction of a beneficiary's interest. Further, if there is full discretion, the statute appears to protect current, vested rights to mandatory distributions, but not future rights that have not vested. Does the restriction against materially impairing the rights of a beneficiary essentially eliminate the trustee's ability to change beneficial interests? Such a reading would essentially nullify much of the statutory language. Alternatively, are the "rights of any

beneficiary" always subject to the trustee's exercise of a discretionary power, including the power to decant, thus greatly limiting the reach of the prohibition on materially impairing a beneficiary's rights?

B. **Treatment of Future Class Members**. A handful of statutes explicitly deal with the issue of whether future class members may (or must) be included as beneficiaries in the new trust. For example, if the current beneficiaries of a trust are "the descendants of A," if the trustee decants to a new trust, may the new trust include as potential beneficiaries unborn descendants of A? It would seem obvious that the answer must be yes, but some states have made this logical assumption explicit. For example, the New York statute provides that if a trustee has absolute discretion, and "the beneficiary or beneficiaries of the invaded trust are described by a class, the beneficiary or beneficiaries of the appointed trust may include present or future members of such class." Under the New York statute, if the trustee has limited discretion and "the beneficiary or beneficiaries of the invaded trust are described by a class, the beneficiary or beneficiaries of the appointed trust shall include present or future members of such class." The Alaska, Illinois and Texas statutes are to the same effect. Michigan § 700.7820a (which applies to trusts with limited discretion) requires that future class members must be included in the new trust. See also Delaware.

C. **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 less than one, decanting to a trust that does not comply with 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. See, e.g., Alaska, Arizona, Indiana, New York, North Carolina, South Dakota, Tennessee and Virginia. The statutes in some states provide that for purposes of abiding by the rule against perpetuities, an exercise of the power to decant shall be treated as an exercise of a power of appointment under their rule against perpetuities statutes. See, e.g., Delaware, Florida and Ohio. Alaska's statute provides that a violation voids the decanting "unless the exercise is modified to correct the violation." This provision seems to provide a "do over" when a decanting inadvertently violates the rule against perpetuities.

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. See, e.g., Delaware, Florida, Indiana, Kentucky, North Carolina and Virginia.

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. Illinois and Texas, however, state that the new trust may not "reduce, limit or modify" the rule against perpetuities period. Thus in Illinois and Texas apparently 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.

D. **Tax Restrictions**. Certain tax benefits granted under the Internal Revenue Code are dependent upon a trust containing specific provisions. For example, a qualified terminable interest property 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 in which tax provisions of the Internal Revenue Code they address.

1. **No Tax Restrictions**. The Tennessee statute appears to impose no tax restrictions, not even for the marital deduction and the charitable deduction.

2. **Marital Deduction**. With the exception of Arizona, Michigan, South Carolina and Tennessee, all of the states restrict decanting in a manner that would cause the old trust to not qualify for the marital deduction if it was intended to so qualify. A trust might not qualify for the marital deduction if state law permitted the trustee to alter the required provisions for qualifying for the marital deduction. For example, a trust qualifying as a general power of appointment marital trust must grant the surviving spouse a general power of appointment. If a trustee could decant and deprive the spouse of her general power of appointment, a marital deduction might not be permitted for such trust. For example, the Illinois statute provides that "if any contribution to the first trust qualified for . . . the marital deduction under Section 2056(a) or 2523(a) of the Code [then the trustee shall not have the power to decant] in a manner that would prevent the contribution to the first trust from qualifying for or would

reduce the exclusion, deduction, or other tax benefit that was originally claimed with respect to that contribution." The Ohio and Michigan § 556.115a statutes explicitly address state estate, gift and inheritance tax marital deductions as well as the federal deductions. While Arizona and Michigan § 700.7820a do not have a specific provision addressing the marital deduction, they do have a catchall tax savings provision. Michigan § 556.115a and South Carolina prohibit a change in an income, annuity or unitrust interest in a trust that was intended to qualify for the marital deduction, but these provisions may not prohibit other changes that could disqualify the trust for the marital deduction.

3. **Charitable Deduction**. Similarly, the vast majority of states provide that the trustee may not decant in a way that would disqualify the trust for a charitable deduction or reduce the amount of the deduction. This restriction is important to ensure that charitable lead trusts, charitable remainder trusts and other charitable trusts cannot be modified in a way that arguably would prevent them from qualifying for the charitable deduction or that would reduce the amount of that deduction, as could be the case if the trustee could decant in a way that reduced the charitable interest in a split-interest trust. Only Arizona, Delaware, Michigan, South Carolina and Tennessee do not have tax restrictions protecting the charitable deduction. As mentioned above, Arizona and Michigan § 700.7820a have catchall provisions. Michigan § 556.115a and South Carolina prohibit a change in an income, annuity or unitrust interest in a trust that was intended to qualify for the charitable deduction. Note that the Delaware statute has a provision protecting the marital deduction but none protecting the charitable deduction.

4. **Gift Tax Annual Exclusion (Code Section 2503)**. Code section 2503(b) grants a gift tax annual exclusion for gifts of a "present interest." Present interests are often created in trusts by granting the beneficiary a Crummey right of withdrawal over contributions to the trust. If a trustee could decant in a manner that prematurely terminated a beneficiary's existing Crummey right of withdrawal over a prior contribution to the trust, then arguably the contribution would not qualify for the gift tax annual exclusion. However, the existing tax authority does not require that a Crummey right of withdrawal remain in existence indefinitely in order to qualify for the gift tax annual exclusion so long as the beneficiary has a reasonable period of time in which to exercise such right, which under some authorities may be as short as 30 days. Further, decanting to eliminate Crummey rights of withdrawal over future contributions to a trust should have no effect on the qualification of prior contributions for the gift tax annual exclusion. Therefore, it is not entirely clear that special tax restrictions are needed to protect the gift tax annual exclusion under Code section 2503(b). Nonetheless, most of the states have such a tax restriction. See, e.g., Alaska, Delaware, Illinois, Kentucky, Michigan § 556.115a, Missouri, Nevada, New Hampshire, New York, North

Carolina, Ohio, South Dakota and Virginia. Code section 2503(c) provides another method for qualifying gifts to a trust for the gift tax annual exclusion. Code section 2503(c) permits a gift tax annual exclusion for a gift to a trust for an individual under age 21 provided that the property and its income may be expended for the benefit of the donee before attaining age 21 and would to the extent not so expended pass to the donee upon attaining age 21, and in the event the donee dies before attaining age 21, will be payable to the estate of the donee or pursuant to a general power of appointment. Michigan § 556.115a specifically contains a tax restriction for Code section 2503(c) (but no restriction for 2503(b)). Other statutes contain restrictions that apply expressly to 2503(b) and 2503(c). See, e.g., Delaware, Kentucky, Missouri, Nevada, North Carolina, South Carolina, South Dakota and Virginia. For example, the Virginia statute states:

> If contributions to the original trust have been excluded from the gift tax by the application of 26 U.S.C. § 2503(b) or (c), the second trust shall provide that the beneficiary's remainder interest in the contributions shall vest and become distributable no later than the date upon which the interest would have vested and become distributable under the terms of the original trust.

Other statutes expressly refer only to Code section 2503(b). See, e.g., Alaska, Illinois, New Hampshire, New York and Ohio. Because Code section 2503(b) is the section that provides for the gift tax annual exclusion for a gift "other than gifts of future interests in property," and Code Section 2503(c) provides that a gift complying with that subsection shall not be considered a gift of a future interest, it would seem that a tax restriction that expressly applies only to subsection 2503(b) should be sufficient to protect 2503(c) trusts.

5. **GST Annual Exclusion (Code Section 2642(c))**. Code section 2642(c) grants a GST annual exclusion to gifts that qualify for the gift tax annual exclusion but imposes two additional requirements for gifts to trusts. First, the trust must be only for a single individual and second, if the individual dies before the termination of the trust, the assets of the trust must be included in the gross estate of such individual. Thus while gifts to trusts for multiple beneficiaries could qualify for the gift tax annual exclusion through the use of Crummey withdrawal rights, such gifts would not qualify for the GST annual exclusion. The 2642(c) restriction requiring a trust be for a single individual could be violated through decanting if the statute permitted accelerating a remainder interest to a current interest. The requirement that the trust be included in the gross estate of the individual could perhaps be violated by decanting to a trust that was not includible in the beneficiary's gross estate. The Alaska,

Illinois, New York and Ohio statutes contain explicit restrictions on decanting to protect the GST annual exclusion.

6. **GRATs (Code Section 2702)**. The Missouri and South Dakota statutes specifically prohibit a decanting that would reduce the income interest of an income beneficiary of a GRAT. Arguably, if a trustee could decant in a way that would reduce the annuity interest of the beneficiary of a GRAT, the value of such annuity interest would not reduce the value of the gift. Qualified personal residence trusts are not explicitly addressed by the decanting statutes.

7. **Beneficiary as Trustee**. A beneficiary who is acting as trustee could be deemed to have a general power of appointment that would cause inclusion in the beneficiary's estate if the beneficiary could decant in a manner that would permit distributions to such beneficiary subject to an unascertainable standard. Further, a beneficiary who is acting as trustee and who exercised such a decanting power could be deemed to have exercised a general power of appointment. The decanting statutes in many of the states have explicit restrictions either prohibiting an interested trustee from exercising a decanting power altogether or restricting the manner in which an interested trustee can exercise a decanting power to avoid such estate and gift tax issues. For example, the South Dakota statute prohibits an interested trustee from exercising a decanting power in a way that would benefit the interested trustee unless the exercise is limited by an ascertainable standard and does not have the effect of increasing the distributions that can be made to the interested trustee. See also Arizona, Kentucky, Missouri, Nevada, New Hampshire and Texas. The Virginia statute simply prohibits an interested trustee from exercising a decanting power. See also North Carolina. Some states, such as Delaware and Michigan, have provisions in other statutes prohibiting a fiduciary from making distributions to the fiduciary.

8. **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:

> 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.

See also Arizona, Illinois, Michigan § 700.7820a, New York and Texas.

9. **Consider Tax Implications**. The Alaska statute requires a trustee to consider the tax implications of decanting.

10. **Material Purpose of Trust**. Under a statute that requires that the trustee consider the material purpose of the trust when decanting if a material purpose of the trust was to qualify for a tax benefit, a change that would defeat such purpose would not be permitted.

E. **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").

1. **QSSTs**. In order for a trust to qualify as a QSST, (a) the terms of the trust must require that during the life of the current income beneficiary there shall be only one income beneficiary and (b) all of the income must be distributed to such beneficiary. Code section 1361(d)(3). Thus it may be important that a trust intended to qualify as a QSST not be permitted to be decanted into a trust that would not qualify as a QSST. The Kentucky and Ohio statutes would prevent a QSST from being decanted into a non-QSST. The Missouri statute prohibits reducing the income interest of a beneficiary of a QSST, but does not necessarily prevent other changes, such as granting the beneficiary a lifetime power of appointment, that could threaten QSST qualification. Although the Illinois statute prohibits decanting from a trust that qualifies as an S corporation shareholder trust to one that does not if the trust owns S corporation stock, it does not expressly prohibit decanting from a QSST to another type of trust that qualifies as an S corporation shareholder. The catch-all tax savings provision of the Illinois statute, however, may impose such a restriction if one considers qualifying as an S corporation shareholder a "tax benefit." Alternatively, the requirement in the Illinois statute that the decanting be in furtherance of the purposes of the trust may implicitly impose a restriction on converting a QSST to a non-QSST.

2. **ESBTs**. A trust that has made an ESBT election is not required to distribute all income to the beneficiary. Nonetheless, the Missouri statute prohibits decanting in a manner that reduces the income interest of a beneficiary of an ESBT. The Ohio and Kentucky statutes would prohibit decanting an ESBT to a non-ESBT, even if the new trust qualified as an S corporation shareholder as a wholly grantor trust or a QSST.

3. **Wholly Grantor Trust**. The Ohio statute would appear to prohibit decanting from a trust that qualified as an S corporation shareholder as a wholly grantor trust to an ESBT or QSST.

4. **Protecting S Election**. 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. The Illinois, Kentucky and Texas statutes appear to prevent an inadvertent decanting from a qualified S corporation shareholder to a trust that does not qualify as an S corporation shareholder. For example, the Illinois statute merely provides that during any period when the first trust owns S corporation stock, the trustee may not decant to a new trust that is not a permitted shareholder. The Ohio statute also protects the S election but is overly restrictive in that it requires that the new trust qualify as an S corporation shareholder under the same provision as the old trust. Thus the Ohio statute would not permit an ESBT to be decanted to a grantor trust or to a QSST, or a grantor trust to be decanted to a QSST or ESBT. The Alaska statute simply says that a trustee may not decant in a way that jeopardizes an S election.

F. **Minimum Distribution Rules (Code Section 401(a)(9))**. Complicated rules determine when the life expectancy of a trust beneficiary can be considered in determining the required minimum distribution rules when a trust is the beneficiary of a qualified retirement plan or IRA. Under these rules, only trusts with certain provisions and restrictions permit the life expectancy of the beneficiary to be used to determine required minimum distributions. If a trustee could decant to a trust that would not meet these requirements, then arguably the old trust would not qualify from the inception to use the life expectancy of the beneficiary. The Ohio statute recognizes this potential issue and addresses it as follows:

> If the assets of the first trust include any interest subject to the minimum distribution rules of Section 401(a)(9) of the Internal Revenue Code and the treasury regulations issued under that section, 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 shortened the maximum distribution period otherwise allowable under section 401(a)(9) of the Internal Revenue Code and the treasury regulations with respect to that interest under the first trust.

The Illinois and Texas statutes provide that if the first trust owns an interest in property subject to the minimum distribution rules of section 401(a)(9) of the Code, an authorized trustee may not exercise the power to decant to distribute part or all of the interest in such property to a second trust that would result in the shortening of the minimum distribution period to which the property is subject in the first trust.

G. **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 decanting statute that permits the conversion of a non-grantor trust to a grantor trust

is potentially troubling in at least two respects. First, permitting such conversion allows a trustee to impose on the grantor of the trust a tax liability that the grantor did not voluntarily accept and that the grantor may not have the ability to eliminate. Second, 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? Such a conversion would appear to be prohibited by the Arizona statute, which requires that any decanting "not adversely affect the tax treatment of the trust, the trustee, the settlor or the beneficiaries." In contrast, the Illinois statute explicitly permits a decanting from a non-grantor trust to a grantor trust:

> Nothing in this Section shall be construed as preventing the authorized trustee from distributing part or all of the first trust to a second trust that is a trust as to which the settlor of the first trust is considered the owner under Subpart E of Part I of Subchapter J of Chapter 1 of Subtitle A of the Code.

The Texas statute permits decanting "regardless of whether the settlor is treated as the owner of either or both trusts under Sections 671-679."

Although the New York statute does not explicitly authorize a conversion from a non-grantor trust to a grantor trust, the 2011 recommendation of the Surrogate's Court Advisory Committee states: "There is nothing contained in the proposed provision that precludes the authorized trustee from paying assets from a non-grantor trust to a grantor trust." New York Est. Powers & Trusts, Section 10-6.6. Most of the state decanting statutes are silent on this point, which presumably means that such a conversion is permitted.

2. **Conversion of Grantor Trust to Non-Grantor Trust**. Presumably, 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. The question can arise, however, in states that have catchall tax savings provisions as to whether the catchall provision would prohibit a decanting that would eliminate the grantor trust treatment. For example, the Arizona statute does not permit a decanting that adversely affects the "tax treatment of the trust, the trustee, the settlor or the beneficiaries." Michigan § 700.7820a appears to come close to prohibiting explicitly a conversion of a grantor trust to a non-grantor trust by including the following provision:

> If the governing instrument expressly indicates an intention that the first trust qualify for a tax benefit or the terms of the first trust are clearly designed to qualify the first trust for a tax benefit, and if the first trust would qualify for the

> intended tax benefit, the governing instrument of the second trust is not inconsistent with the tax planning that informed the first trust.

Arguably, converting a grantor trust to a non-grantor trust adversely affects the tax treatment of the trust. The Illinois statute explicitly addresses this issue by providing that the catchall tax restriction does not prevent a conversion from a grantor trust to a non-grantor trust. The Texas statute also appears to address this issue by permitting decanting "regardless of whether the settlor is treated as the owner of either or both trusts under Sections 671-679."

H. **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**. The New York statute provides that unless a court otherwise directs, the decanting power may not be exercised to change the provisions regarding the determination of the compensation of any trustee. The Alaska statute permits a change in trustee compensation with court approval. The Ohio statute permits a change in trustee compensation either with court approval or with the consent of all persons who are current beneficiaries of the second trust. See also Michigan § 700.7820a. The Illinois statute prohibits decanting solely to change the provisions regarding trustee compensation but permits decanting "in conjunction with other valid and reasonable purposes to bring the trustee's compensation in accord with reasonable limits in accord with Illinois law in effect at the time of the exercise." The Texas statute is similar to Illinois. Most of the state decanting statutes are silent on the issue of trustee compensation.

2. **Trustee Fee for Decanting**. The Alaska, Illinois and Texas statutes also 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."

3. **Trustee Liability**. The Illinois and Texas statutes also 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. The Alaska statute has a similar restriction unless a court otherwise directs. Michigan § 700.7820a prohibits a reduction in the standard of care applicable to the trustee or an expansion of the exoneration of the trusts, but permits indemnification of the trustee of the first trust.

4. **Trustee Removal Provisions**. The Texas statute prohibits decanting to eliminate a provision granting a person a right to remove or replace the Trustee. The Illinois statute specifically prohibits eliminating a provision under most circumstances. The Alaska statute has a similar restriction unless a court otherwise directs. Michigan § 700.7820a prohibits a diminution in the authority of a person who has a power exercisable in a fiduciary capacity to direct or remove the trustee.

5. **Asset Valuation**. The Alaska statute prohibits decanting to "fix as binding and conclusive the value of an asset for purposes of distribution, allocation, or otherwise . . ." § 13.36.158(i)(4).

VI. **Notice**. Generally a trustee is not required to provide notice to beneficiaries prior to exercising a discretionary power and thus 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 practical, in that it helps determine if any beneficiaries may challenge the decanting.

A. **No Notice**. A large number of states do not require the trustee to provide notice to the beneficiaries of the old trust before decanting. See, e.g., Arizona, Delaware, Michigan § 556.115a, Missouri, Nevada, South Dakota and Tennessee. New Hampshire requires notice only to charity. The Nevada statute states that the trustee may give notice to the beneficiaries.

B. **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 short as 20 days (South Dakota) or as long as 90 days (South Carolina).

1. **Current Beneficiaries**. Ohio and Michigan § 700.7820a require notice to current beneficiaries.

2. **Settlor**. Alaska and Michigan § 700.7820a require notice to the settlor.

3. **Oldest Generation of Remainder Beneficiaries and Current Beneficiaries**. Kentucky requires notice to the current beneficiaries and the oldest generation of remainder beneficiaries.

4. **Qualified Beneficiaries**. Uniform Trust Code states generally require notice to the qualified beneficiaries. See, e.g., Alaska, Florida, Indiana, North Carolina, Rhode Island, South Carolina and Virginia.

5. **Current Beneficiaries and Presumptive Remainder Beneficiaries**. Texas requires notice to the current beneficiaries and the presumptive remainder beneficiaries (the equivalent of qualified beneficiaries in a UTC state). A guardian or conservator represents an incompetent beneficiary.

If there is no guardian or conservator, a parent may represent a minor (apparently regardless of any conflict of interest). Further, a descendant of a beneficiary receiving notice does not need to be given notice if the descendant and the ancestor have similar interests in the trust and no apparent conflict of interest.

6. **Adult, Competent Beneficiaries**. Illinois requires notice to the adult competent current beneficiaries and the adult competent presumptive remainder beneficiaries. If there is not at least one adult competent current beneficiary and at least one adult competent presumptive remainder beneficiary, the trustee cannot decant without court approval.

7. **Removers**. Alaska and New York provide for notice to trustee removers, in addition to the settlor and persons interested in the trust.

8. **Notice to Beneficiaries of New Trust**. The state statutes containing notice provisions generally require notice to certain beneficiaries of the old trust. Missouri, however, requires notice to the beneficiaries of the new trust (not the old trust).

9. **Charities**. Where an unidentifiable charity is a beneficiary (for example, the trustee under some circumstances is to select the charities), the state's Attorney General may be authorized to receive notice on behalf of such charity. Even where a charitable beneficiary is identifiable, a statute may require notice to the Attorney General and the charity. See the Illinois and Texas statutes.

C. **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. See, e.g., Michigan § 700.7820a, Ohio, Rhode Island, South Carolina, South Dakota, Texas and Virginia.

D. **Effect of Objection**

1. **No Effect**. In most states an objection by a beneficiary does not prevent the trustee from decanting. The New York statute explicitly states this. Other statutes merely fail to give any effect to a beneficiary objection.

2. **Prevents Nonjudicial Decanting**. Illinois and Kentucky provide that a beneficiary objection prohibits the trustee from decanting without court approval. Rhode Island recently eliminated the ability of a beneficiary to block a non-judicial decanting by objection. A proposed amendment to the Illinois statute would also eliminate the ability of a beneficiary to block a non-judicial decanting by objection.

## VII. Procedural Issues

A. **Requirements for New Trust**. 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. See, e.g., Alaska, South Dakota and Tennessee. In contrast, Arizona expressly permits a restatement of the old trust.

B. **Tax Identification Number**. Does the second trust need to obtain a new tax identification number? This issue would not arise in the event (1) the second trust is a grantor trust and is permitted to use the grantor's social security number or (2) the second trust was a trust that was in existence prior to the decanting and already has a tax identification number. Further, in a case where the second trust was newly created for purposes of decanting, if 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 simply a continuation of the first trust for income tax purposes. See PLR 200736002.

C. **Do Assets Need to be Retitled?** If the second trust has a different tax id number, the decanted trust assets should be retitled to reflect the correct tax id number (and the name of the second trust). If the tax id number does not change; then the trustee should consider where 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 ________" or "as modified on ____________."

D. **Distribution Plan for Later Discovered Assets**. Illinois, New York and Texas 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, and the Michigan statutes expressly state that such issue may be addressed in the decanting instrument.

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.

VIII. **Application of Decanting Statute**. 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, Missouri and South Dakota. These statutes 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. Delaware's statute, in contrast, provides that its decanting statute is applicable when a trust is administered in Delaware. Other statutes provide that they may be used when the trust is administered *under* the law

of the particular state, apparently without regard for whether or not the trust is actually administered in that state. See, e.g., Kentucky and Virginia. Ohio's statute may be used when a trust is governed by Ohio law or Ohio is the principal place of administration. Illinois's statute may be used when the trust is governed by Illinois law as to matters of construction or is administered in Illinois. The statutes in Alaska and New York apply when a trust is governed by the applicable state's law or when there is a New York or Alaska trustee and the trustees agree that the primary administration of the trust will be in Alaska or New York, as the case may be.

## IX. Other Issues

A. **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.

B. **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.

C. **Codification of Common Law**. Some of the statutes state that they are codifying the common law. See, e.g., Michigan § 556.115a, Missouri, Ohio and Texas.

X. **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 such decanting without court approval if a beneficiary objects within the notice period.

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. The Florida statute explicitly states that providing the required notice to the qualified beneficiaries of the first trust "shall not limit the right of any beneficiary to object to the exercise of the trustee's power to invade principal except as provided in other applicable provisions of this code."

C. **Explicit Remedy**. The Illinois decanting statute includes an explicit remedies provision providing that a person interested in a trust may bring a claim that a decanting was an abuse of discretion within two years after the trustee has notified such person of the decanting. The Illinois statute appears to give a minor two years after attaining majority and receiving notice of the decanting to file a claim. Under the Illinois statute, the exclusive remedy is to obtain an order of the court to modify or reverse the decanting.

## XI. Trustee Liability

A. **No Duty to Decant**. Some of the statutes expressly state that the trustee has no duty to decant. See, e.g., Florida, Illinois, Indiana, Kentucky, Michigan § 700.7820a, Michigan § 556.115a, Missouri, Nevada, New Hampshire, New York, North Carolina, Ohio, South Carolina, Texas and Virginia. Some statutes further state that a trustee has no duty to even consider decanting. See Texas.

B. **Duty to Inform Beneficiaries**. Some statutes state that the trustee has no duty to inform beneficiaries about the availability of decanting. See Texas.

C. **Fiduciary Duties**. Obviously, 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. A few of the decanting statutes make this explicit. For example, the Missouri statute states that the exercise of the decanting power is subject to all fiduciary duties otherwise imposed under the trust instrument or Missouri law. See also New Hampshire and Virginia. 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.

D. **Duty of Impartiality**. Some have expressed concern that a trustee might violate its duty of impartiality by decanting. The Illinois statute provides that the trustee does not violate its duty of impartiality by arguing in favor of decanting unless the court finds that the trustee acted in bad faith.

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. 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.

## XII. Tax Issues

### A. Income Tax

1. **Conversion of Grantor Trust to Non-Grantor Trust**. If a trust owns assets that have liabilities that exceed the property's income tax basis, 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. Blattmachr, Jonathan G., Horn, Jerold, Zeydel, Diana, "An Analysis of the Tax Effects of Decanting," 47 *Real Property, Trust and Estate Law Journal* 141 (Spring 2012) (hereafter, "Tax Effects"); *see Madorin v. Comm'r*, 84 T.C. 667 (1985).

2. **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 Chief Counsel Memo. 200923024; Rev. Rul. 2004-64, 2004-2 C.B. 7.

3. **Negative Basis Assets**. 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* Tax Effects at 156; *Crane v. Comm'r*, 331 U.S. 1 (1947).

4. **Beneficiary Recognition of Gain**. It is possible that under the doctrine of *Cottage Savings Ass'n v. Comm'r*, 499 U.S. 554 (1991), 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. This may be of concern under the Illinois and Kentucky statutes. These statutes do not require a beneficiary's affirmative consent, but prohibit decanting without court approval if the beneficiary objects within the notice period. The IRS could construe the ability of a beneficiary to block decanting by objecting within the notice period as the equivalent of beneficiary consent.

5. **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 section 684. *See* Tax Effects at 159.

6. **The Accidental Grantor Trust**. Several of the exceptions to grantor trust treatment in Code section 674, such as the power to distribute corpus subject to an ascertainable standard (Code section 674(b)(5)(A)), the power to withhold income during the disability of a beneficiary (Code section 674(b)(7)) and the power of an independent trustee to make distributions (Code section 674(c)), do not apply if any person has a power to add a beneficiary to the class designated to receive income or corpus. The Illinois, Missouri and South Dakota statutes appear to permit decanting to make a remainder beneficiary a current beneficiary. See Section IV, F.

## B. Estate and Gift Tax

1. **Gift Tax**. Under the Illinois decanting statute, a trustee who has absolute discretion may decant to a second trust that eliminates, reduces or restricts the interest of a beneficiary. If such beneficiary is legally competent, such beneficiary will receive written notice of the trustee's intent to decant and can block the decanting by an objection in writing delivered to the trustee within the 60-day notice period. If a beneficiary whose interest in the trust will be reduced or eliminated by decanting fails to object, will such beneficiary be treated as making a gift to the trust or the other

beneficiaries of the trust? *See* Tax Effects at 160-164. Under the Illinois decanting statute, a beneficiary who is not legally competent is not required to receive notice and, if the trustee does not provide notice to such beneficiary, would have no power to object. Thus the gift tax risk would seem not to be present in a case where the beneficiary whose interest was being reduced or eliminated was not legally competent. A similar concern may arise under the Kentucky statute.

2. **Estate Tax**. If decanting reduced or eliminated a beneficiary's interest in a manner that resulted in a gift, then such beneficiary's estate might include the trust assets if Code section 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 section 2036(a).

C. **GST Tax**

1. **Grandfathered Trusts**. Generally trusts that were irrevocable on September 30, 1985, are grandfathered from the GST tax. Such grandfathering is lost if there is an addition or constructive addition to the grandfathered trust.

   a. A grandfathered trust will not lose its grandfathered status after being decanted if at the time the trust became irrevocable state law authorized the decanting and the terms of the second trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus the period of 21 years. More specifically, Treasury Regulation section 26.2601-1(b)(4)(i)(A) provides as follows:

> (A) *Discretionary powers*. – The distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the provisions of chapter 13, if –
>
> *(1)* Either –
>
> *(i)* The terms of the governing instrument of the exempt trust authorize distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; or

*(ii)* at the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or court; and

*(2)* The terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation. For purposes of this paragraph (b)(4)(i)(A), the exercise of a trustee's distributive power that validly postpones or suspends the vesting, absolute ownership, or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date the original trust became irrevocable) will not be considered an exercise that postpones or suspends vesting, absolute ownership, or the power of alienation beyond the perpetuities period. If a distributive power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

b. Alternatively, the grandfathering will not be affected if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Treas. Reg. § 26.2601-1(b)(4)(i)(D).

2. **GST-Exempt Trusts**. If a trust is exempt from GST tax by reason of allocation of GST exemption, at a minimum any change to such trust by decanting that would not affect the GST-exempt status of a grandfathered trust should not affect the GST-exempt status of such trust. *See* PLR 200919009. Thus if such a 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. 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. *See* PLR 200227020; PLR 9804046; PLR 9737024; PLR 9438023.

3. **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. Treasury Regulation section 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 provided that state law recognizes the post-severance trusts as separate trusts. Treas. Reg. § 26.2642-6(h).

## XIII. Considerations

A. **What state statute(s) applies to the trust?**

B. **Does the applicable state statute permit decanting?**

C. **Does the applicable state statute permit decanting to achieve the desired result?**

D. **Are there income, estate, gift or GST tax consequences or risks?**

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

F. **Should the trustee decant?**

G. **What notice is required? Advisable?**

H. **Is beneficiary consent desirable? Does it increase tax risks?**

I. **Is court approval required? Desirable?**

J. **Are there better alternatives to achieve the desired result?**

## XIV. Partial Checklist for Decanting Instrument.

A. **Governing Law**. Identify the law governing the construction of the trust, the law governing the administration of the trust and the place of administration. Does the statute apply to the trust?

B. **Trust Provisions**. Does the trust contain its own provisions for decanting? Does it expressly prohibit decanting?

C. **Trust Purpose**. What is the purpose of the trust? Does the proposed decanting further the trust purpose?

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

E. **Beneficiaries**. Identify the current beneficiaries and the presumptive remainder beneficiaries, whether they have legal capacity and whether they have been provided notice of the decanting.

F. **Powers of Appointment**. If the first trust grants a power of appointment, address the affect 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.

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 Elections**. If the first trust was a QTIP, QSST or an ESBT intended to continue as 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. **Future Decanting**. Consider whether to expressly permit (or limit) future decanting on different terms than permitted by the Illinois statute. 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.

## BIBLIOGRAPHY

Culp & Bennett Mellen, 871 T.M., *Trust Decanting*.

### Articles

1. Farhad Aghdami, Susan T. Bart and M. Patricia Culler, *Decanting: Refining a Vintage Trust* (ACTEC 2013 Annual Meeting)

2. Jonathan G. Blattmachr, Jerold I. Horn and Diana S.C. Zeydel, *An Analysis of the Tax Effects of Decanting*, 47 REAL PROP., TR. AND EST. L.J. 141 (Spring 2012)

3. Rashad Wareh and Eric Dorsch, *Decanting: A Statutory Cornucopia*, Tr. & Est. 22, (March 2012)

4. Joseph T. La Ferlita, *New York's Newly Amended Decanting Statute*, 34 PROB. & PROP. (July/August 2012)

5. Anne Marie Levin and Todd A. Flubacher, *Put Decanting to Work to Give Breath to Trust Purpose,* 38 EST. PLAN. 3 (2011)

6. William R. Culp, Jr. and Briani Bennett Mellen, *Trust Decanting: An Overview and Introduction to Creative Planning Opportunities*, 45 REAL PROP., TR. & EST. L.J. 1 (Spring 2010)

7. William R. Culp, Jr. and Briani L. Bennett, *Use of Trust Decanting to Extend the Term of Irrevocable Trusts*, 37 EST. PLAN. 3 (2010)

8. Diana S.C. Zeydel and Jonathan G. Blattmachr, *Tax Effects of Decanting – Obtaining and Preserving the Benefits*, 111 J. TAX 288 (Nov. 2009)

9. M. Patricia Culler and Diana S. C. Zeydel, *Decanting: An In-Depth View of the Latest Techniques* (ACTEC 2009 Fall Meeting)

10. Alan S. Halperin and Lindsay N. O'Donnell, *Modifying Irrevocable Trusts: State Law and Tax Considerations in Trust Decanting*, 2008 University of Miami School of Law 42nd Annual Heckerling Institute

11. Diana S. C. Zeydel and Jonathan G. Blattmachr, "Tax Effects of Decanting – Obtaining and Preserving the Benefits," *Journal of Taxation*, November 2009

### Notice 2011-101

1. Internal Revenue Bulletin: 2011-52, Notice 2011-101, *Transfers by a Trustee From an Irrevocable Trust to Another Irrevocable Trust (Sometimes called "Decanting"); Requests for Comments,* December 27, 2011

2. American Bar Association Section of Taxation, *Comments on Notice 2011-101 on Trustee Transfers, Changes in Beneficial Interests*, May 3, 2012

3. American College of Trust and Estate Counsel, *Comments of The American College of Trust and Estate Counsel on Transfers by a Trustee from an Irrevocable Trust to Another Irrevocable Trust (Sometimes called "Decanting")(Notice 2011-101) Released December 21, 2011*, April 2, 2012

4. Bessemer Trust, Office of Fiduciary Counsel, *Comments of Bessemer Trust on Transfers by a Trustee from an Irrevocable Trust to Another Irrevocable Trust ("Decanting") (Notice 2011-101, 2011-52 I.R.B. 932 (December 20, 2011))*, April 24, 2012

5. John G. Blattmachr, et al., *Report of Jonathan G. Blattmachr, Elaine M. Bucher, George L. Cushing, Mitchell M. Gans, Jerold I. Horn, Mary Ann Mancini and Diana S.C. Zeydel on Transfers by a Trustee from an Irrevocable Trust to Another Irrevocable Trust (Sometimes called "Decanting") (Notice 2011-101) Released December 21, 2011*, March 13, 2012

6. Brian Dooley, CPA, *Regarding – IRS Notice 2011-101 – A Distribution from One Trust to Another Trust (Decanting)*, 2012 WL 359993 (I.R.S.), January 10, 2012

7. Chris C. Gair, *Notice 2011-101 "Decanting"*, February 22, 2012

8. Scott K. Martinsen, Kirkland Woods & Martinsen PC, *Comments to Notice 2011-101 – in Transfers by a Trustee from an Irrevocable Trust to another Irrevocable Trust (sometimes called "Decanting")*, April 24, 2012

9. New York City Bar Association Committee on Trusts, Estates & Surrogate's Courts & New York City Bar Association Committee on Estate and Gift Taxation, *New York City Bar Association Response to Request for Comments to Notice 2011-101*, undated

10. New York State Bar Association Tax Section & New York State Bar Association Trusts and Estates Law Section, *Report on Notice 2011-101: Request for Comments Regarding the Income, Gift, Estate and Generation-Skipping Transfer Tax Consequences of Trust Decanting*, April 26, 2012

11. New York State Society of Certified Public Accountants, *IRS Notice 2011-101, Transfers by a Trustee From an Irrevocable Trust to Another Irrevocable Trust (Sometimes called "Decanting"); Requests for Comments*, April 19, 2012

12. State Bar of Texas, *Comments of the State Bar of Texas, Tax Section on Transfers by a Trustee from an Irrevocable Trust to Another Irrevocable Trust (sometimes called "Decanting")*, May 22, 2012

13. Robert L. Teicher, Brody Wilkinson PC, *Comments in Response to Notice 2011-101*, April 25, 2012

14. Uniform Law Commission, *Comments from the National Conference of Commissioners on Uniform State Laws on Transfers by a Trustee from an Irrevocable Trust to Another Irrevocable Trust (often referred to as "Decanting") in response to Notice 2011-101 (December 21, 2011)*, April 21, 2011

15. AICPA Comments on Notice 2011-101 on Transfers from Irrevocable Trusts, Changes in Beneficial Interests, Bloomberg BNA Daily Tax Report, June 26, 2012

# APPENDIX I

## STATE DECANTING STATUTES PASSED OR PROPOSED

**As of March 12, 2014[1]**
**compiled by M. Patricia Culler**
**Hahn Loeser & Parks LLP, Cleveland, OH**

| | State | Statutory Cite | Effective Date/Status |
|---|---|---|---|
| 1. | Alaska | Alaska Stat. §§ 13.36.157-13.36.159 (original § 13.36.157 repealed 9/9/13 and replaced with new 13.36.157-.159) | 9/15/98; amended 2006, 9/9/13 |
| 2. | Arizona | Ariz. Rev. Stat. § 14-10819 | 9/30/09; amended 7/20/11 |
| 3. | Delaware | 12 Del. Code § 3528 | 6/30/03; amended 6/24/04, 6/27/06, 7/5/07, 7/6/09, 7/13/11, 8/6/13 |
| 4. | Florida | Fla. Stat. § 736.04117 | 1/1/07 |
| 5. | Illinois | 760 Ill. Comp. Stat. 5/§ 16.4 | 1/1/13 |
| 6. | Indiana | Ind. Code 30-4-3-36; amended by SB 36: http://iga.in.gov/static-documents/f/2/9/e/f29e4ad4/SB0036.05.ENRS.pdf | 7/1/10; amendment eff. 7/1/14 |
| 7. | Kentucky | Ky. Rev. Stat. § 386.175 | 7/11/12 |
| 8. | Michigan | Mich. Comp. Laws § 700.7820a<br>Mich. Comp. Laws § 556.115a<br>Mich. Comp. Laws § 700.7103 (definitions) | 12/28/12 |
| 9. | Missouri | Mo. Rev. Stat. § 456.4-419 | 8/28/11 |
| 10. | Nevada | Nev. Rev. Stat. 163.556 | 10/1/09; amended 10/1/11 |
| 11. | New Hampshire | N.H. Rev. Stat. § 564-B:4-418 | 9/9/08 |
| 12. | New York | N.Y. Est. Powers & Trusts § 10-6.6(b)-(s) | 7/24/92; amended 8/17/11, 11/13/13 |

[1] The author has attempted to make this list as accurate and as current as possible with the assistance of other fellows of the American College of Trust and Estate Counsel (ACTEC). Other statutes may be under consideration.

| | State | Statutory Cite | Effective Date/Status |
|---|---|---|---|
| 13. | North Carolina | N.C. Gen. Stat. 36C-8-816.1 | 10/1/09, amended 7/20/10, 6/12/13 |
| 14. | Ohio | Ohio Rev. Code § 5808.18 | 3/22/12; amended 3/27/13 |
| 15. | Rhode Island | R.I. Gen. Laws § 18-4-31. | 6/23/12; amended 7/15/13 |
| 16. | South Carolina | S.C. Code §62-7-816A | Eff. 1/1/14 |
| 17. | South Dakota | S.D. Codified Laws §§ 55-2-15 through 55-2-21 | 3/5/07, amended 2008, 2008, 2009, 2011, 2013 |
| 18. | Tennessee | Tenn. Code § 35-15-816(b)(27) | 7/1/04, amended 7/1/13 |
| 19. | Texas | Texas Trust Code §§112.071-112.087 | 9/1/13 |
| 20. | Virginia | Va. Code § 55-548.16:1 Code of VA (original enactment)<br>Va. Code § 64.2-778.1 (renumbered as part of consolidation of trust and estate laws) | 7/1/12<br>10/1/12 |
| 21. | Wisconsin | Wisconsin Trust Code §701.0418<br>Enacted in 2013 Wisconsin Act 92: https://docs.legis.wisconsin.gov/2013/related/acts/92 | 7/1/14 |
| 22. | Wyoming | W.S. 4-10-816(a)(xxviii) | 7/1/13 |