

D R A F T
FOR DISCUSSION ONLY

TRUST DECANTING ACT

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAW

For December 7 – 8, 2013 Drafting Committee Meeting

Without Prefatory Note and Comments

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November 8, 2013

TRUST DECANTING ACT

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TRUST DECANTING ACT

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1 **TRUST DECANTING ACT**

2 **[ARTICLE] 1**

3 **GENERAL PROVISIONS**

4 **SECTION 101. SHORT TITLE.** This [act] may be cited as the Decanting
5 Distributions Act.

6 **SECTION 102. DEFINITIONS.** In this [act]

7 (1) “Ascertainable standard” means a standard relating to an individual’s health,
8 education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or
9 2514(c)(1) of the Internal Revenue Code of 1986, as in effect on the effective date of this
10 [act].¹

11 (2) “Authorized trustee” means a fiduciary,² other than the settlor,³ who has discretion
12 under the terms of the first trust to distribute the principal of the first trust to one or more
13 current beneficiaries.⁴ If a fiduciary, other than the settlor, has expanded discretion to
14 distribute the principal of a trust and a different fiduciary has ordinary discretion to distribute
15 principal of the trust, the fiduciary having expanded discretion is the authorized trustee.

16 (3) “Beneficiary” means a person who on the date the beneficiary’s qualification is
17 determined and assuming nonexercise of all powers of appointment:

18 (A) has a present or future beneficial interest in a trust, vested or contingent; or

19 (B) in a capacity other than that of trustee, holds a power of appointment over
20 trust property.⁵

21 (4) “Code” means the United States Internal Revenue Code of 1986, as amended from
22 time to time, including corresponding provisions of subsequent internal revenue laws.

23 (5) “Current beneficiary” means a beneficiary who, on the date the beneficiary’s

1 qualification is determined and assuming nonexercise of all powers of appointment, is a
2 distributee or permissible distributee of trust income or principal.⁶

3 (6) “Decanting distribution” means the distribution of part or all of the principal of a
4 first trust to the second trust pursuant to this [act] as an exercise of an authorized trustee’s
5 fiduciary discretion.

6 (7) “Decanting power” means the power granted to an authorized trustee pursuant to
7 this [act] to make a decanting distribution.

8 (8) “Distribute” means making a payment to or for the benefit of a beneficiary of a
9 trust.

10 (9) “Expanded discretion”⁷ means a discretionary distribution power that is not limited
11 to an ascertainable standard.⁸ Expanded discretion includes a discretionary distribution power
12 that includes purposes such as best interests, welfare, comfort, or happiness, regardless of any
13 requirement to take into account other resources of the beneficiaries.⁹

14 (10) “First trust” means an existing irrevocable inter vivos or testamentary trust from
15 which a decanting distribution may be or has been made.¹⁰

16 (11) “Irrevocable” means not revocable.

17 (12) “Ordinary discretion” means discretion that is limited by an ascertainable
18 standard.

19 (13) “Power of appointment” means a power that enables a powerholder acting in a
20 nonfiduciary capacity to designate a recipient of an ownership interest in or another power of
21 appointment over the appointive property.¹¹

22 (14) “Presumptive remainder beneficiary” means a beneficiary who on the date the
23 beneficiary’s qualification is determined and assuming nonexercise of all powers of

1 appointment, either (A) would be a distributee or a permissible distributee of trust income or
2 principal if the trust terminated on that date, or (B) would be a distributee or a permissible
3 distributee of trust income or principal if the interests of the current beneficiaries terminated
4 on that date without causing the trust to terminate.¹²

5 (15) “Principal” includes the accumulated and undistributed income of a trust at the
6 time of the exercise of a decanting power that is not otherwise currently required to be
7 distributed.¹³

8 (16) “Qualified beneficiary” means a beneficiary who, on the date the beneficiary’s
9 qualification is determined and assuming nonexercise of all powers of appointment:

10 (A) is a current beneficiary;

11 (B) is a presumptive remainder beneficiary.¹⁴

12 (17) “Record” means information that is inscribed on a tangible medium or that is
13 stored in an electronic or other medium and is retrievable in perceivable form.

14 (18) “Representative” is the person entitled to represent a beneficiary or other person
15 pursuant to the trust instrument or applicable law [including the Trust Code].

16 (19) “Revocable” means revocable by the settlor without the consent of the trustee or a
17 person holding an adverse interest.¹⁵

18 (20) “Second trust”¹⁶ means an irrevocable trust to which a decanting distribution is or
19 will be made, including a restatement of the first trust or a trust executed by an authorized
20 trustee for the purpose of receiving a decanting distribution.¹⁷ The second trust may be a trust
21 created or administered under the laws of any jurisdiction, within or without the United
22 States.¹⁸

23 (21) “Settlor,” except as provided in Section 402, means a person, including a testator,

1 who creates, or contributes property to, a trust. If more than one person creates or contributes
2 property to a trust, each person is a settlor of the portion of the trust property attributable to
3 that person's contribution except to the extent another person has the power to revoke or
4 withdraw that portion.¹⁹

5 (22) "Spendthrift provision" means a term of a trust that restrains both voluntary and
6 involuntary transfer of a beneficiary's interest.²⁰

7 (23) "Successor beneficiary" means a beneficiary who, on the date the beneficiary's
8 qualification is determined and assuming nonexercise of all powers of appointment, is not a
9 qualified beneficiary, including a person who may become a beneficiary in the future by
10 reason of inclusion in a class.

11 (24) "Trust instrument" means an instrument executed by the settlor or executed by
12 the trustee of the first trust to create the second trust that contains terms of the trust, including
13 any amendments.²¹

14 **SECTION 103. APPLICATION.** This [act] is applicable to trusts in existence on
15 the date of enactment or created on or after the date of enactment. This [act] shall be
16 construed as pertaining to the administration of a trust and shall be applicable to any
17 irrevocable trust that is administered under the law of this state or that is governed by the law
18 of this state with respect to the meaning and effect of its terms, including a trust whose
19 governing law for purposes of administration has been changed to the laws of this state.

20 [ARTICLE] 2

21 EXERCISE OF POWER TO MAKE A DECANTING DISTRIBUTION

22 **SECTION 201. NOTICE.**²² Except as provided in Section 304, an authorized
23 trustee may make a decanting distribution without the consent of any person and without

1 court approval, but an authorized trustee shall provide written notice of the intended decanting
2 distribution not later than 60 days before such exercise (the “notice period”) to (i) the settlor
3 of the first trust, if living; (ii) each qualified beneficiary, determined as of the date notice is
4 sent, or the qualified beneficiary’s representative;²³ (iii) any person who currently has the
5 right to remove or replace the authorized trustee;²⁴ and (iv) all trustees of the first trust who
6 are not authorized trustees.²⁵ The written notice shall (i) specify the manner in which the
7 trustee intends to exercise the power and the prospective effective date for the decanting
8 distribution and (ii) include a copy of the trust instrument for the first trust and a copy of the
9 trust instrument for the second trust. The decanting distribution may be made before the
10 expiration of the notice period if all persons receiving notice waive the notice period. An
11 authorized trustee is not required to provide notice to a qualified beneficiary who is a minor
12 and has no representative. An authorized trustee is not required to provide notice to a person
13 who is known to the authorized trustee but who cannot be located by the authorized trustee
14 after reasonable diligence or who is not known to the authorized trustee. If a charity is a
15 qualified beneficiary, notice shall also be given to [the Attorney General’s Charitable Trust
16 Bureau].²⁶ The right of a person to bring a claim that an exercise of the decanting power was
17 an abuse of discretion is not limited by the receipt of notice under this section, waiver of the
18 notice period, or the expiration of the notice period.

19 **SECTION 202. COURT INVOLVEMENT.** The authorized trustee may petition
20 the court to approve a decanting distribution. In a contested judicial proceeding under this
21 section, the authorized trustee has the burden of proving that the proposed exercise of the
22 power is in accordance with the purposes of the first trust. The costs of a petition made in
23 good faith shall be paid from the first trust regardless of whether or not the petition is granted.

SECTION 203. WRITTEN INSTRUMENT. The exercise of a power to make a decanting distribution must be made by a record in writing, signed and acknowledged by the authorized trustee [and the trustee of the second trust], and filed with the records of the first trust and the second trust.

[ARTICLE] 3

DECANTING AUTHORITY

SECTION 301. TRUST PURPOSES. An authorized trustee shall exercise the discretion to make or not make a decanting distribution subject to the trustee’s fiduciary duties,²⁷ in good faith and in accordance with the purposes of the trust.²⁸ Before exercising the power to make a decanting distribution, an authorized trustee shall consider the tax implications of the exercise of the power.²⁹

SECTION 302. DECANTING DISTRIBUTION IF EXPANDED

DISCRETION.³⁰ An authorized trustee who has expanded discretion to distribute the principal of a trust³¹ to one or more of the current beneficiaries may make a decanting distribution to a second trust subject to the following.

(1) The current beneficiaries of the second trust may include only one or more of the current beneficiaries of the first trust. The presumptive remainder beneficiaries and successor beneficiaries of the second trust may include only one or more of the beneficiaries of the first trust.³²

(2) The second trust may create a general or nongeneral power of appointment, including a presently exercisable power of appointment, in one or more of the current beneficiaries of the first trust to whom the authorized trustee has expanded discretion to distribute principal, and the class of permissible appointees in favor of whom the beneficiary

may exercise the power of appointment may be broader than or otherwise different from the beneficiaries of the first trust.³³

(3) The second trust may create a nongeneral power of appointment in any person provided that the permissible appointees of the new nongeneral power of appointment are qualified beneficiaries of the first trust.³⁴

(4) If the first trust creates a power of appointment in a powerholder other than a current beneficiary, the second trust may, but need not, create in the powerholder the same power of appointment that was created in such powerholder under the first trust.

SECTION 303. DECANTING DISTRIBUTION IF ORDINARY DISCRETION.

An authorized trustee who has ordinary discretion to distribute the principal³⁵ of a trust to one or more current beneficiaries may make a decanting distribution to a second trust. For purposes of this section,

(1) the beneficial interests of each beneficiary of the second trust must be substantially similar to the beneficial interests of the beneficiary in the first trust, and

(2) a power to make distributions for the benefit of a beneficiary shall be considered substantially the same as a power to make distributions to the beneficiary.

SECTION 304. RESTRICTIONS. The exercise of a decanting power is subject to the following restrictions:³⁶

(1) An authorized trustee may not exercise a decanting power to eliminate, reduce, limit, or modify any beneficiary's right that is currently in effect with respect to the beneficiary to a mandatory distribution of income or principal, to a mandatory annuity or unitrust interest, to withdraw a percentage of the value of the trust, or to withdraw a specified dollar amount.³⁷ For purposes of this section, a beneficiary's current right to a distribution of

1 income is not mandatory if, under the terms of the first trust, current distributions of principal
2 may be made to any person other than that current beneficiary.

3 (2) An authorized trustee may not exercise a decanting power to increase, or change
4 the method of determining, the compensation of the authorized trustee unless the increase in,
5 or change in the method of determining, that compensation has been consented to by all
6 qualified beneficiaries or their representatives or is approved by the court. An increase in
7 compensation of the authorized trustee arising solely because the duration of the second trust
8 is longer than the duration of the first trust is not considered an increase in, or a change in the
9 method of determining, the compensation of the authorized trustee.³⁸ No authorized trustee or
10 other trustee may receive a commission or other compensation for exercising a decanting
11 power,³⁹ but may be compensated at a reasonable rate for the time spent considering and
12 implementing the exercise of the decanting power.⁴⁰

13 (3) Except as provided in paragraphs (A) and (B), an authorized trustee may not
14 exercise a decanting power to decrease a trustee's liability, to exculpate or indemnify a trustee
15 from liability to a greater extent than provided in the first trust.⁴¹

16 (A) The second trust may divide and reallocate fiduciary responsibilities
17 among several persons, including one or more trustees, distribution advisors, investment
18 advisors, trust protectors, or other persons, and may indemnify or exonerate a person from
19 liability for actions of another person, but may not reduce fiduciary duties in the aggregate.⁴²

20 (B) The second trust may indemnify the trustee of the first trust for any
21 liabilities or claims that would have been payable out of the first trust if the decanting power
22 had not been exercised.⁴³

23 (4) An authorized trustee may not exercise a decanting power to modify a provision

1 granting another person the right to remove or replace the authorized trustee unless either (i)
2 the person currently holding the right consents to the modification or (ii) the court approves
3 the modification and, in either case, the modification grants the right to another person who is
4 independent of and nonsubservient⁴⁴ to the authorized trustee.⁴⁵

5 **SECTION 305. TAX RELATED LIMITATIONS.** The exercise of a decanting
6 power is subject to the following limitations:

7 (1) If a transfer to the first trust qualified, or would have qualified but for this [act], for
8 a marital or charitable deduction for purposes of the federal income, gift, or estate tax under
9 the Code, or for purposes of a state income, gift, estate, or inheritance tax, the governing
10 instrument for the second trust must not include or omit any term that, if included in or
11 omitted from the trust instrument for the first trust, would have prevented the first trust from
12 qualifying for that deduction, or would have reduced the amount of the deduction, under the
13 same provisions of the Code or under the same provisions of the applicable state law under
14 which the transfer to the first trust qualified.⁴⁶

15 (2) If a transfer to the first trust may be treated, or may be treated but for this [act]
16 would, as a gift qualifying for the exclusion from the gift tax described in Section 2503(b)⁴⁷ of
17 the Code, including by application of Section 2503(c) of the Code,⁴⁸ the trust instrument for
18 the second trust must not include or omit a term that, if included in or omitted from the
19 governing instrument for the first trust, would prevent the transfer from qualifying under the
20 same provisions of Section 2503 of the Code.

21 (3) If the assets of the first trust include shares of stock in an S corporation, as defined
22 in Section 1361 of the Code, and the first trust is, or if not for the provisions of this [act]
23 would be, a permitted shareholder under any provision of Section 1361 of the Code, an

1 authorized trustee may not exercise a decanting power to distribute part or all of the S
2 corporation stock to a second trust that is not a permitted shareholder under Section
3 1361(c)(2) of the Code.⁴⁹ If the assets of the first trust include shares of stock in an S
4 corporation, as defined in Section 1361 of the Code, and the first trust is, or but for this [act],
5 would be a qualified subchapter S trust, the governing instrument for the second trust must
6 not include or omit a term that prevents the second trust from qualifying as a qualified
7 subchapter S trust.⁵⁰

8 (4) If a transfer to the first trust may be treated, or may be treated but for this [act], as
9 a gift qualifying for a zero inclusion ratio for purposes of the federal generation-skipping
10 transfer tax under Section 2642(c) of the Code, the trust instrument for the second trust must
11 not include or omit a term that, if included in or omitted from the trust instrument for the first
12 trust, would prevent the transfer to the first trust from qualifying.⁵¹

13 (5) If the assets of the first trust include any interest subject to the minimum
14 distribution rules of Section 401(a)(9) of the Code and the treasury regulations issued under
15 that section, the trust instrument for the second trust must not include or omit any term that, if
16 included in or omitted from the trust instrument for the first trust, would have shortened the
17 maximum distribution period otherwise allowable under Section 401(a)(9) of the Code and
18 the treasury regulations with respect to the interest under the first trust.⁵²

19 (6)(A) In this paragraph, “tax benefit” means any federal or state tax deduction,
20 exemption, exclusion, or other tax benefit not otherwise listed in this section except for any
21 benefit from having the settlor considered the owner under Subpart E of Part I of Subchapter J
22 of Chapter 1 of Subtitle A of the Code.

23 (B) Subject to paragraph (7), if the trust instrument for the first trust expressly

1 indicates an intention to qualify for a tax benefit or if the terms of the trust instrument for the
2 first trust are clearly designed to enable the first trust to qualify for a tax benefit, and if the
3 first trust did qualify, or if not for the provisions of this [act] would have qualified, for the tax
4 benefit, the governing instrument for the second trust shall not include or omit a term that, if
5 included in or omitted from the trust instrument for the first trust, would have prevented the
6 first trust from qualifying for the tax benefit.

7 (7) Subject to paragraph (3), an authorized trustee may exercise the decanting power
8 to a second trust as to which the settlor is not considered the owner under Subpart E of Part I
9 of Subchapter J of Chapter 1 of Subtitle A of the Code even if the settlor is considered the
10 owner of the first trust, or may make a decanting distribution to a second trust as to which the
11 settlor of the first trust is considered the owner under Subpart E of Part I of Subchapter J of
12 Chapter 1 of Subtitle A of the Code even if the settlor is not considered the owner of the first
13 trust.⁵³

14 **SECTION 306. TERM OF THE SECOND TRUST.** The second trust may have a
15 term that is longer than the term set forth in the first trust, including a term measured by the
16 lifetime of a current beneficiary; but the second trust must be limited to the same permissible
17 period of the rule against perpetuities that applied to the first trust, or a shorter period, unless
18 the first trust expressly permits the trustee to extend its perpetuities period.⁵⁴ A violation of
19 this section voids the entire exercise of the decanting power unless the exercise is modified to
20 correct the violation.⁵⁵

21 **SECTION 307. NEED TO DISTRIBUTE NOT REQUIRED.** An authorized
22 trustee may exercise the decanting power whether or not there is a current need to distribute
23 principal under the discretionary distribution standard in the terms of the first trust.⁵⁶

SECTION 308. EXPRESS PROHIBITION. A decanting distribution may not be made if expressly prohibited by the terms of the governing instrument,⁵⁷ but a general prohibition of the amendment or revocation of the first trust or a spendthrift clause shall not preclude the exercise of a decanting power.

SECTION 309. OTHER AUTHORITY TO DISTRIBUTE IN FURTHER TRUST.

(a) This [act] shall not be construed to limit the right of any trustee or other person to distribute property in further trust, whether that power arises under the terms of the trust instrument, any other statute, common law, or a court order.

(b) The terms of a trust instrument may do any of the following:

(1) Confer upon the trustee the power to make any distribution, or confer upon any other person acting in a fiduciary capacity the power to direct the trustee to make any distribution in further trust that is broader or more limited than, or that conflicts with, the provisions of this [act];

(2) Provide for different requirements for notice of the trustee's exercise of the power conferred under the terms of the trust instrument or by this [act];⁵⁸

(3) Otherwise include any terms and conditions governing the decanting distribution that the settlor of the trust determines.

[(c) A decanting distribution may be made by a nonjudicial settlement agreement in accordance with [the virtual representation act].]

[ARTICLE] 4

EFFECT OF DECANTING DISTRIBUTION

SECTION 401. TERMS OF SECOND TRUST. Any reference to the governing

1 instrument or terms of the governing instrument in [the trust code] includes the terms of a
2 second trust established in accordance with this [act].

3 **SECTION 402. SETTLOR.** The settlor of a first trust is considered to be the settlor
4 of the second trust with respect to the portion of the second trust distributed from the first trust
5 in accordance with this [act].

6 **SECTION 403. LATER DISCOVERED ASSETS.** To the extent the authorized
7 trustee does not provide otherwise at the time of a decanting distribution and the second trust
8 does not provide otherwise:

9 (1) The distribution of all of the principal of the first trust to a second trust shall be
10 deemed to include subsequently discovered assets otherwise belonging to the first trust and
11 undistributed principal paid to or acquired by the first trust subsequent to the distribution to
12 the second trust.

13 (2) The distribution of less than all of the principal of the first trust to a second trust
14 does not include subsequently discovered assets belonging to the first trust and principal paid
15 to or acquired by the first trust subsequent to the distribution to the second trust; those assets
16 remain the assets of the first trust.

17 [ARTICLE] 5

18 REMEDIES AND FIDUCIARY DUTIES

19 SECTION 501. REMEDIES.

20 (a) For purposes of this section, a personal representative refers to a court appointed
21 guardian or conservator of the estate of a person.⁵⁹

22 (b) An authorized trustee who in good faith takes or omits to take an action under this
23 [act], including petitioning the court under Section 302, is not liable to any beneficiary or

1 other person. An act or omission by an authorized trustee under this [act] is presumed taken
2 or omitted in good faith unless it is determined by the court to have been an abuse of
3 discretion. If an authorized trustee in good faith takes or omits to take an action under this
4 [act] and a beneficiary or other person opposes the act or omission, the person's exclusive
5 remedy is to obtain an order of the court directing the authorized trustee to exercise authority
6 in accordance with this [act] in such manner as the court determines necessary or helpful to
7 further the purposes of the trust, including prospectively to modify or reverse a prior exercise
8 of the decanting power. Any claim by any beneficiary or other person that an act or omission
9 by an authorized trustee under this [act] was an abuse of discretion is barred if not asserted in
10 a proceeding commenced by or on behalf of the person within two years after the person or
11 the person's representative received the notice required by Section 301 or a notice or report in
12 writing sufficiently disclosing the decanting distribution such that the person or the person's
13 representative knew or reasonably should have known of the claim. [Except for a distribution
14 of trust principal from a first trust to a second trust made by agreement in accordance with
15 [the virtual representation statute],]⁶⁰ the preceding sentence shall not apply to a person who
16 was under a legal disability at the time the notice or report was sent and who then had no
17 personal representative.

18 **SECTION 502. NO DUTY TO DISTRIBUTE.** Nothing in this [act] is intended to
19 create or imply a duty to exercise the decanting power, and no inference of a breach of
20 fiduciary duty shall be made as a result of an authorized trustee not exercising the decanting
21 power. Notwithstanding any other provision of this [act], no authorized trustee or trustee has
22 a duty to inform beneficiaries about the applicability of this [act] or a duty to review the trust
23 to determine whether any action should be taken under this [act].

SECTION 503. FIDUCIARY DUTY.⁶¹ Except as provided in the following sentence, the authorized trustee shall exercise a decanting power [in good faith and in accordance with the terms and purposes of the trust]⁶² [using the standard of care when making other discretionary distributions].⁶³ For purposes of this [act], the terms of the trust shall be deemed to include the decanting power granted in this [act]. An authorized trustee's actions in accordance with this [act] shall not be deemed improper or inconsistent with the authorized trustee's duty of impartiality unless the authorized trustee acted in bad faith or with reckless indifference to the purposes of the trust.⁶⁴

[ARTICLE] 6

MISCELLANEOUS

SECTION 601. UNIFORMITY OF APPLICATION AND CONSTRUCTION.

In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 602. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL

AND NATIONAL COMMERCE ACT. The [act] modifies, limits, or supersedes the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., but does not modify, limit, or supersede Section 101(c) of that act, 15 U.S.C. Section 7001(c), or authorize electronic delivery of any of the notices described in Section 103(b) of that act, 15 U.S.C. Section 7003(b).

SECTION 603. EFFECTIVE DATE. This [act] takes effect . . .

¹ If the defined term “Code” is used, future amendments to the Code sections will be included.

² Only a fiduciary, subject to fiduciary duties, should have the power to decant. A distribution director who is not a fiduciary should not have the power to decant.

³ If a settlor is a trustee of an irrevocable trust, gift and estate tax problems could result if the settlor had a decanting power.

⁴ Could this be revised to also include a trustee who has discretion in the future to make distributions if no distributions are currently permitted? Some statutes prohibit certain interested trustees from decanting. If only interested trustees are acting, decanting may be prohibited. A statute that requires that a trustee have expanded discretion to decant, or a bifurcated statute that requires that a trustee have expanded 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 unascertainable 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 unascertainable 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.

⁵ See UTC § 103.

⁶ This is the first category of qualified beneficiaries.

⁷ Other statutes use the term “unlimited discretion” or “absolute discretion.”

⁸ The concept of “extended discretion” is used in Section 50 of the Restatement (Third) of Trusts. The Texas statute defines “absolute discretion” in a manner similar to “extended discretion.”

⁹ This sentence incorporates the standard in the Treasury Regulations for nonascertainable standard, but adds the standard “best interests.” The decanting statutes overwhelmingly define expanded discretion as discretion that extends to best interests, welfare, comfort or happiness. Several states define it as something beyond an ascertainable standard.

¹⁰ Alternatively, the term “original trust” or “invaded trust” could be used.

¹¹ Uniform Power of Appointment Act.

¹² See (B) and (C) of the definition of “qualified beneficiary.”

¹³ See Uniform Principal and Income Act § 102.

¹⁴ See UTC § 103.

¹⁵ See UTC § 103. “Adverse interest” is not defined.

¹⁶ Alternatively, the term “appointed trust” could be used.

¹⁷ 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.

¹⁸ See Kentucky statute.

¹⁹ See UTC § 103.

²⁰ See UTC § 103.

²¹ See UTC § 103.

²² 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.

²³ 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.

²⁴ New York provides for notice to trustee removers.

²⁵ Should notice be given to the trustee of the second trust, if such trust is in existence?

²⁶ 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.

²⁷ See UTC § 815(b).

²⁸ See UTC § 814(a), which also refers to the "interests of the beneficiaries." Including the "interests of the beneficiaries" is problematic in a UTC state because the UTC defines "interests of the beneficiaries" as "the beneficial interests provided in the terms of the trust." See UTC § 103(8). More expansive statements include:

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.

²⁹ Alaska statute.

³⁰ Bifurcated statutes are in Alaska, Illinois, Michigan, New York, Ohio, Texas and Virginia.

³¹ 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 trustee have “expanded discretion”; other statutes permit decanting even if the discretion is not absolute. Most of these states have restrictions on a beneficiary who is a trustee decanting. Some statutes have bifurcated standards that require expanded 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.

³² A trustee with expanded discretion to distribute to current beneficiaries can affect the interests of the remainder beneficiaries through the trustee’s exercise of discretion. Although some states limit the beneficiaries of the second trust to current beneficiaries of the first trust, such a strict theory effectively cuts off the remainder beneficiaries (unless the statute has a “boomerang provision”). Should the statute prohibit a technical acceleration of a future interest to avoid possible grantor trust issues? Permitting remainder interests to be accelerated would facilitate changing single beneficiary trusts into spray trusts.

³³ Optional language:

The power of appointment granted to a beneficiary shall be limited to the same permissible period of the rule against perpetuities that applied to the first trust, or a shorter period, unless the first trust expressly permits the trustee to extend its perpetuities period.

³⁴ This is not in the current decanting statutes.

³⁵ Under a bifurcated statute, we could consider allowing limited decanting if there is discretion to distribute income or principal.

³⁶ 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).

³⁷ Several states would permit eliminating an existing income right. See Delaware, Michigan, South Dakota, Missouri. Several states would permit eliminating an existing withdrawal right. See Florida, Indiana, Rhode Island and Tennessee.

³⁸ 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 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.

³⁹ The Illinois and Texas statutes also prohibit the trustee from receiving a special fee for decanting.

⁴⁰ Alaska statute.

⁴¹ The Illinois and Texas statutes prohibit decanting to decrease or indemnify against a trustee’s liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence and prudence. See also the Alaska statute, which 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. See Section 804 of the UTC which provides that a trustee shall administer the trust as a prudent person would, exercising reasonable care, skill and caution. The comment to Section 804 indicates that a settlor may modify the standard of care, but may not exculpate the trustee for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries. See UTC § 1008.

⁴² In other words, a trustee can decant to a directed trust that divides the trustee responsibilities (i.e., jobs) among various parties, but cannot eliminate the fiduciary duties that accompany those jobs. For example, an investment advisor can be appointed and the trustee can be relieved of fiduciary liability for the investment decisions so long as the investment advisor is acting in a fiduciary capacity and has fiduciary liability for the investment decisions.

⁴³ Michigan statute.

⁴⁴ “Nonsubservient” is not defined.

⁴⁵ 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. See also the Alaska statute, which 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.

⁴⁶ 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. 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.

⁴⁷ 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.

⁴⁸ 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. 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.

⁴⁹ 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.

⁵⁰ 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.

⁵¹ 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 Illinois, New York and Ohio statutes contain explicit restrictions on decanting to protect the GST annual exclusion.

⁵² 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.

⁵³ 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. 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.

⁵⁴ 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. 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.

⁵⁵ Alaska statute.

⁵⁶ “Current need” refers to whether the trustee would in fact deem it appropriate to exercise under current circumstances the discretionary distribution power.

⁵⁷ Note that South Carolina permits decanting even if prohibited by the trust with court approval.

⁵⁸ Decanting, as an exercise of a fiduciary power, should not theoretically require prior notice to any beneficiary. Under § 813(a) of the UTC, however, a trustee has a duty to keep qualified beneficiaries reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests. This duty can be waived. Optional UTC § 105(9), however, does not permit waiver of a trustee’s duty to promptly respond to a beneficiary’s request for information related to the administration of the trust.

⁵⁹ 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.” 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.

⁶⁰ The UTC generally permits modification of a trust only with court approval. About thirty-three states, however, permit certain modifications to trusts by nonjudicial settlement agreements. See Virtual Representation States Chart (on ACTEC website and maintained by Susan T. Bart). In these states a decanting could be protected from future challenges by beneficiaries if the decanting is within the scope of the state’s virtual representation statute and the approval of the necessary parties to bind all trust beneficiaries is obtained.

⁶¹ 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.

⁶² UTC § 801 also includes “and the best interests of the beneficiaries,” which may be problematic in the context of decanting.

⁶³ The Restatement (Third) of Trusts § 77 states that in administering a trust, the trustee has a duty to act as a prudent person, in light of the circumstances, purposes and terms of the trust. The duty of prudence requires the exercise of reasonable care, skill, and caution.

⁶⁴ UTC § 1008(a)(1) sets the minimum standard for trustee liability, but also includes “the interests of the beneficiaries,” which may be problematic in the context of decanting.