

ISSUES MEMO

TRUST DECANTING DRAFTING COMMITTEE

I. Defining Decanting and Historical Context

Decanting as an Exercise of a Fiduciary Power. Trust decanting is an exercise of a fiduciary's discretionary distribution authority that permits the trustee to transfer the assets of a trust to a new trust (or to modify the terms of the trust). Decanting is distinct from judicial modification because decanting does not require court approval. Decanting is also distinct from modifications by agreement with the beneficiaries (and sometimes the settlor) because beneficiary consent is not required. Because decanting does not require beneficiary consent or court approval, adverse tax consequences may be avoided when making certain modifications. Further, the costs of a court proceeding are avoided.

History of Decanting. Starting in 1940, a number of cases have held that decanting is permitted under common law. Starting in 1998, the states began to pass decanting statutes. Twenty-two states now have decanting statutes. Even in states without case law supporting common law decanting or a decanting statute, attorneys have sometimes quietly decanted trusts on the theory there is a common law right or by relying on other state statutes such as those governing powers of appointment. Uniformity is needed. Guidance on when decanting is permitted is also needed, along with restrictions to (1) provide protection from adverse tax consequences; (2) protect the grantor's probable intent in light of changed circumstances; (3) protect beneficiary rights.

Context of Trust Modification. Trust law has been evolving over the past few decades to allow more flexibility in modifying irrevocable trusts, including nonjudicial modifications. Grantors want this flexibility because they cannot anticipate all future changes of circumstances. Trustees want this flexibility to fix administrative provisions and to carry out the grantor's broad purposes in light of changed circumstances.

Allowing more flexible modification of irrevocable trusts is not a new idea. It is already embedded in the Third Restatement of Trusts and in the Uniform Trust Code. Section 66 of the Restatement allows a court to modify administrative or distributive provisions of the trust if, because of circumstances not anticipated by the settlor, the modification or deviation will further the purposes of the trust.

Similarly, Section 412 of the UTC allows a court to modify an irrevocable trust if because of circumstances not anticipated by the settlor it will further the purposes of the trust. Section 412 of the UTC also allows a court to modify administrative provisions simply because the existing provisions are impracticable or wasteful or impair the trust's administration.

Further, Section 416 of the UTC allows a modification by the court to achieve a tax objective, and Section 415 allows reformation to correct mistakes of fact or law.

Section 411 of the UTC allows basically any modification with the consent of the settlor and all of the beneficiaries (court approval is optional) regardless of whether there are changed circumstances or whether it is consistent with the material purposes of the trust.

The UTC also took a step towards allowing nonjudicial modifications in Section 111. Section 111 allows nonjudicial settlement agreements for a variety of purposes, including construction of the trust, transferring the place of administration, or granting a power to the trustee. Twenty-eight states and the District of Columbia have statutes that permit certain trust modifications by nonjudicial settlement agreements. Nonjudicial settlement agreements require the consent of the interested parties, including the beneficiaries, and therefore are not an ideal way to effect dispositive modifications of a trust because of the tax issues that may arise when a beneficiary participates in a modification.

II. Objectives of Trust Decanting Act

The Trust Decanting Act seeks to take a middle way in light of the widely divergent state statutes and to balance the interests of the grantor and the beneficiaries. Administrative modifications are permitted if the trustee has discretion to make principal distributions even if the discretion is limited to an ascertainable standard. Dispositive modifications are permitted, with restrictions, when the trustee's discretion to make principal distributions is not limited to an ascertainable or fixed standard, because broad discretion indicates the grantor's intent to rely on the trustee's judgment.

The Act protects the beneficiaries by requiring notice of a proposed decanting and an opportunity to challenge a decanting in court. Further, the Act does not permit new beneficiaries to be added and prohibits certain changes to beneficial interests. The Act also protects the beneficiaries from the possible abuse of the decanting power by subjecting the exercise to fiduciary duties and restricting certain changes that might benefit the trustee personally.

The Act protects trusts and beneficiaries from adverse tax consequences by prohibiting modifications that would affect a trust's qualification for certain tax deductions, exclusions or other benefits.

The Act contains several innovations. First, it recognizes decanting made in compliance with the law of another state (Section 104). Second, it contains a "savings clause" that modifies an attempted decanting to the extent necessary to comply with the Act to resolve the uncertainty that would arise if an attempted decanting was later discovered not to be in full compliance with the Act (Section 310). Third, it explicitly addresses the disposition of claims against the first trust when the first trust is decanted (Section 404). Fourth, it delineates in greater detail than other statutes the role of the court (Section 203). Fifth, it explicitly recognizes that many decantings will not involve a second trust, but will essentially be "restatements" or "amendments" to the first trust.