

UNIFORM TRUST DECANTING ACT

ISSUES MEMO

**2015 Annual Meeting
July 10-16, 2015
Williamsburg, Virginia**

Need for Flexibility. There is a need for mechanisms to modify the terms of irrevocable trusts to address changes in beneficiary circumstances (e.g., a beneficiary with special needs), changes in trust law (e.g., the introduction of the prudent investor rule), changes in the financial and investment worlds, changes in tax law (e.g., the rollercoaster of changing estate tax laws over the past 15 years) and other changes (such as changes in who might be an appropriate trustee). Historically, some flexibility could be provided by powers of appointment and judicial modifications. The Uniform Trust Code expanded the circumstances in which judicial modification is available. At least 33 states now allow the trustee and beneficiaries to make certain modifications to trusts without court involvement through nonjudicial settlement agreements, but the usefulness of these statutes is limited because (1) they may not permit changes to dispositive provisions; (2) using these statutes may result in adverse tax consequences; and (3) sometimes consent cannot be obtained on behalf of minor, unborn, or incapacitated beneficiaries.

Decanting. Twenty-three states have decanting statutes that permit the trustee to modify irrevocable trusts either directly or by distributing the trust assets to another trust. Decanting is an exercise of a trustee's discretionary distribution authority. Decanting is distinct from judicial modification because decanting does not require court approval. Decanting is also distinct from modifications by nonjudicial settlement agreements 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.

Need for Uniformity. Trusts may be governed by the laws of different states for purposes of validity, meaning and effect, and administration. The place of administration of a trust may move from state to state. It often may be difficult to determine the state in which a trust is administered if a trust has co-trustees domiciled in different states or has a corporate trustee that performs different trust functions in different states. As a result it may sometimes be unclear whether a particular state's decanting statute applies to a trust and sometimes more than one state's decanting statute may apply to a trust. A uniform statute can eliminate conflicts between different state statutes. It can also minimize issues about whether one state will recognize a decanting that occurred under a different state's statute.

Currently there is limited guidance on the income, gift, and generation-skipping transfer tax implications of decanting. A uniform statute may provide common ground for the promulgation of tax guidance.

Other Means of Modification Still Available. The Uniform Trust Decanting Act does not displace other nonjudicial means of decanting or modifying a trust, such as pursuant to the express terms of a trust or under the common law.

Extent of Decanting Authority Depends on Extent of Discretion Granted to Trustee. Under the act, the extent of the decanting authority depends upon the extent of the discretion granted to the trustee to distribute principal. Where the trustee has limited discretion (e.g., an ascertainable standard), generally the decanting can modify administrative, but not dispositive, trust provisions. Where the trustee has expanded discretion (e.g., “best interests,” “welfare” or no standard), the decanting may modify dispositive provisions subject to restrictions to protect “vested rights” and to protect qualification for tax benefits.

Decanting Subject to Fiduciary Duties. The act makes clear that the power to decant is a fiduciary power that must be exercised in accordance with fiduciary duties. A trustee must administer a trust in good faith, in accordance with its terms (subject to the decanting power) and purposes, and in the interests of the beneficiaries. An exercise of decanting power must be in accordance with the purposes of the first trust. The purpose of decanting is not to disregard the settlor’s intent but to modify the trust to better effectuate the settlor’s broader purposes or the settlor’s probable intent if the settlor had anticipated the circumstances at the time of decanting.

Notice. As a discretionary power, the decanting power may be exercised without consent or approval of the beneficiaries or the court, except in the case of a few specific modifications that may benefit the trustee personally. Nonetheless, qualified beneficiaries and certain other interested parties are entitled to notice and may petition the court if they believe the trustee has breached its fiduciary duty. Further, the trustee, another fiduciary, a beneficiary or the settlor may petition the court for instructions, approval of an exercise of decanting power, a determination that the trustee breached its fiduciary duties or a determination that the attempted decanting is invalid.

Tax Restrictions. The act contains extensive provisions to prevent a decanting, or the decanting power itself, from disqualifying a trust for a tax benefit, such as the marital or charitable deduction. In addition, the tax and other restrictions in the act on decanting are intended to be a “middle way” that provides significant flexibility to respond to changed circumstances without giving the trustee unbridled discretion to change trust terms. We hope that the IRS, in issuing guidance on the tax impact of decanting, will find that this “middle way” provides sufficient restrictions to avoid adverse tax consequences.

Protection of Settlor Intent. The act protects the settlor’s intent by requiring that any exercise of the decanting power be in accordance with the purposes of the first trust. The purpose of decanting is not to disregard the settlor’s intent but to modify the trust to better effectuate the settlor’s broader purposes or the settlor’s probable intent if the settlor had anticipated the circumstances at the time of the decanting. In addition, settlors may provide in trust instruments that the act does not apply to some or all of the trust terms.

Protection of Charitable Interest. The act also addresses in detail the extent to which charitable interests may be modified by decanting. The act does not permit decanting of wholly charitable trusts. If the first trust contains a charitable interest, the second trust cannot diminish

the charitable interest or change the charitable purpose. To ensure that these protections are respected, the Attorney General must receive notice of any decanting of a trust with a charitable interest. Further, the act prohibits changing the governing law of trusts containing determinable charitable interests without court approval if the Attorney General objects. The act also prohibits modifying trust terms in a manner that would be inconsistent with any charitable deduction that may have been claimed.

Protection of Beneficiaries with Disabilities. When a trust has a beneficiary with a disability, it may not be in the beneficiary's interest to make mandatory distributions to the beneficiary. Further, it may be in the beneficiary's interest to restructure the trust as a special needs trust so that the trust does not adversely affect the beneficiary's qualification for governmental benefits. This carries out the settlor's probable intent if the settlor had known of the beneficiary's disability. The act permits a trust to be decanted to restructure the interest of the beneficiary with a disability even if the trustee only has limited discretion to make principal distributions.

Protection of Trustee. The act does not create a duty in the trustee to exercise the decanting power. Further, the act permits a trustee to reasonably rely on a prior decanting under the law of the enacting state or a different state, even if a decanting done under the law of another state does not comply with all of the requirements of the state's uniform decanting statute.

Role of the Court. The act also delineates the role of the court in greater detail than in existing state statutes. While decanting generally does not require court approval, the authorized fiduciary may wish to seek instructions or approval from the court to confirm that the decanting is not an abuse of discretion. A fiduciary may also wish to seek court instructions as to the effect of a prior decanting, particularly if the prior decanting may be in some way flawed. The act permits the court to appoint a special fiduciary to exercise the decanting power in appropriate cases.

Savings Provision. The act provides a remedy for an imperfect attempted decanting, to avoid the uncertainty that would exist if an attempted decanting is later discovered to have failed to fully comply with the act. The act essentially reads out of the second-trust instrument any impermissible provision and reads into the second-trust instrument any required provision. This gives trustees exercising decanting power greater comfort that their intent will be implemented and not subject to challenge for an inadvertent misstep or technicality.