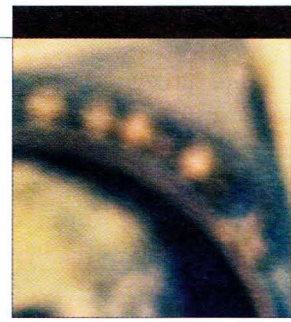

Put Decanting to Work to Give Breath to Trust Purpose

As more advisors become familiar with the significant benefits of state decanting statutes, practical questions arise concerning the use of decanting to amend problematic trusts.

ANNE MARIE LEVIN AND TODD A. FLUBACHER, ATTORNEYS

One of the most significant advancements in modern personal trust law is the enactment of state decanting statutes, which specifically authorize trustees to effectively amend the provisions of irrevocable trusts. What has colloquially become known as "decanting" is the act of a trustee exercising its power to distribute trust principal to a beneficiary by instead distributing the assets to a new trust.

The word "decanting" provides a rich metaphor to help us understand exactly what decanting a trust is all about. The word "decant" literally means to pour a liquid from one vessel to another, leaving unwanted sediment in the first vessel. When we decant a trust, the liquid is the trust principal, the first vessel is the original trust instrument, the second vessel is the new trust instrument, and the unwanted sediment is the unwanted terms and conditions of the original trust instrument, or the lack of desirable terms and conditions in the original trust instrument. Depending on the particular circumstances, decanting may be the most effective and economical option to fix problematic trusts.

Trustees and beneficiaries often are challenged by the terms of existing irrevocable trusts. Simple errors or ambiguities in existing irrevocable trusts may make it difficult or costly for a trustee to fulfill its duties to the trust beneficiaries. Some trusts lack provisions that could benefit the objects of the grantor's generosity or better fulfill the objectives of the grantor, while others contain provisions that impede or frustrate such objectives. Many existing trusts lack flexibility to adjust to unforeseeable changes in law or circumstances that arise with the inevitable passage of time.

Several remedial options are available to amend a trust instrument to better fulfill the objectives of the grantor and maximize the benefit to the beneficiaries.[1] Sometimes amendment can be accomplished efficiently by the exercise of authority granted under the terms of the trust to a trust protector, advisor, or independent trustee or by permissible amendment of the trust by the consent of the beneficiaries. In certain circumstances, the trust's objectives may be fulfilled with the use of a disclaimer, severance, consolidation of trusts, or the sale of trust assets. Alternatively, the trustee may petition the court for instructions, reformation, or modification of the trust. In certain circumstances, however, the simplest and most cost-effective way to mend a faulty or inadequate trust is the

ANNE MARIE LEVIN is a vice president and Delaware Advantage Trust Specialist for PNC Wealth Management in Wilmington, Delaware. PNC Bank does not provide legal, tax, or accounting advice. TODD A. FLUBACHER is a partner with the Trusts, Estates and Tax Group of Morris, Nichols, Arsht & Tunnell, LLP in Wilmington, Delaware. He is also a Fellow of the American College of Trust and Estate Counsel.

exercise by the trustee of its power to decant the trust and appoint some or all of the trust assets to a new and improved trust.

Under common law, the trustee may have the power to amend the terms of the trust by distributing trust assets to another trust for the benefit of the beneficiary. For example, a trustee who may make distributions not only to, but also for the benefit of, a beneficiary pursuant to the terms of the trust, arguably may make distributions to another trust for the benefit of the beneficiary.[2] It may also be argued that a trustee's power to invade principal is similar to a special power of appointment that may be exercised by distributing trust assets in further trust for the beneficiary.[3] It is from this common law foundation that state decanting statutes have sprung.

Comparison of state decanting statutes

In 1992, New York was the first state to enact a decanting statute that specifically authorizes a trustee in certain circumstances to pour the assets of an irrevocable trust over to another trust.[4] Since then, nine other states have also passed decanting statutes:

1. Alaska.[5]
2. Arizona.[6]
3. Delaware.[7]
4. Florida.[8]
5. Nevada.[9]
6. New Hampshire.[10]
7. North Carolina.[11]
8. South Dakota.[12]
9. Tennessee.[13]

Although the existing decanting statutes are similar, there are notable differences among them. The following is a brief summary highlighting some of the features and differences among the state decanting statutes.

Most decanting statutes include procedural requirements for decanting, including a required writing that is signed and acknowledged by the trustee and kept with the records of the original trust. The trustee may be required to give notice of the intended decanting to the beneficiaries. Delaware's statute, for example, provides that decanting may be accomplished by an instrument in writing, signed by the trustee and acknowledged (i.e., notarized). The signed instrument must be filed with the records of the trust.[14] The new trust instrument may be one that is already in existence or a newly created trust instrument.

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Trustee's power to invade. When considering whether statutory decanting is the appropriate tool to accomplish an objective in a particular situation, the threshold issue is whether it is even possible to decant under the decanting statute and the trust instrument. To extend the decanting metaphor a bit further, the "liquid" must pass through two filters:

1. The trustee must have the power to decant.
2. The decanting must be consistent with the trustee's fiduciary duties.

If the trustee does not have the power to decant under the specific circumstances, then decanting is simply not possible. The issue of whether decanting is consistent with fiduciary duties, however, can often be overcome by releases or consents from the beneficiaries.

The Delaware, Alaska, and Tennessee statutes permit a trustee who has the authority to invade principal to decant, whether the authority is absolute or limited by a standard. The New York and Florida statutes, on the other hand, require that the trustee has an absolute power to invade; the decanting power is not available if the trustee may invade trust principal only in accordance with an ascertainable standard. The New Hampshire and Arizona statutes simply refer to the trustee's discretion to make a distribution. South Dakota's statute provides that the trustee must have authority to invade the principal or distribute the income of the trust, authorizing distribution of income to another trust.

The decanting statutes give the trustee, not the beneficiaries, the power to appoint in further trust. A consideration of tax consequences may be warranted in some cases involving trustees who are beneficiaries when the authority to decant is not limited to trustees having an absolute discretion to distribute principal. Under the Delaware statute, for example, a trustee has the power to decant if the power to invade principal is absolute or if it is limited by a standard. The statute was recently amended to

1 See Burford, "Practical Prescriptions for Fixing a Broken Irrevocable Trust," 36 ETPL 9 (September 2009).

2 See Phipps v. Palm Beach Tr. Co., 196 So. 299 (1940), which held that a trustee could invade trust property by paying it over to another trust for the beneficiary.

3 See, e.g., Matter of Wiedenmayer, 254 A.2d 534 (NJ Super. Ct. App. Div., 1969). See also Phipps v. Palm Beach Tr. Co., *supra* note 2.

4 N.Y. Est. Powers & Trusts Law § 10-6.6.

5 Alaska Stat. § 13.36.157.

6 Ariz. Rev. Stat. § 14-10819.

7 12 Del. C. § 3528.

8 Fla. Stat. Ann. § 736.04117.

9 13 Nev. Rev. Stat. § 163.556.

10 N.H. Rev. Stat. Ann. § 564-B:4-418.

11 N.C. Gen. Stat. § 36C-8-816.1.

12 S.D. Codified Law § 55-2-15.

13 Tenn. Code Ann. § 35-15-816(27).

14 12 Del. C. § 3528(b).

clarify that the exercise of the decanting power must comply with any standard that limits the trustee's authority to make distributions from the original trust.[15] The South Dakota decanting statute does not permit a trustee to decant if the trustee is a beneficiary of the first trust or if a beneficiary may change the trustees, apparently because of the concern that if a beneficiary has the power to replace trustees, the decanting power could be imputed to the beneficiary.

Permissible beneficiaries. State statutes generally impose limits on the trustee's authority to decant. All of the statutes require that the exercise of the power must be in favor of one or more proper objects of the exercise of the power (i.e., the beneficiaries of the original trust). None permit the power to be exercised in favor of persons who are not permissible appointees. Under some decanting statutes—such as those enacted in Delaware and Nevada—however, it may be possible to effectively add otherwise impermissible beneficiaries to the second trust by giving a permissible beneficiary a limited or general power of appointment exercisable in favor of persons who were not proper objects or beneficiaries of the first trust.[16] The transfer tax consequences of the beneficiary's exercise of such a lifetime power of appointment must be taken into consideration. With proper planning, decanting to a new trust and granting a limited power of appointment may be done so as to avoid federal gift tax.

Limitations. The decanting statutes impose varying restrictions on the elimination of certain rights, such as fixed income interests, marital deduction trusts, and annual exclusion gift contributions. For example, the New York, Alaska, and Tennessee statutes provide that the exercise of the decanting power cannot reduce any fixed income interest of a beneficiary of the first trust. The Delaware statute applies this limitation only to trusts for which a marital deduction was taken. The South Dakota statute applies this limitation to trusts for which a marital deduction has been taken, a charitable remainder trust, or a grantor retained annuity trust. The Florida statute limits the exercise of the power in regard to not only a fixed income interest, but also as to an annuity or unitrust interest in the first trust.

Delaware's and South Dakota's statutes further limit the exercise of the power if any contributions to the first trust have been treated as annual exclusion gifts under Section 2503(c) or if a presently exercisable power of withdrawal is held by a beneficiary. Delaware limits the latter limitation to a beneficiary who is the only trust beneficiary to whom, or for the benefit of whom, the trustee has authority to make distributions. Florida's decanting statute contains a tax-savings clause relating to the charitable deduction and the marital deduction.

Beneficiary consent and court approval. Most of the state statutes do not require beneficiary consent or court approval. However, the decanting statutes of Arizona, Nevada, New York, and North Carolina permit the trustee or the beneficiary to seek court approval.[17]

Tax considerations

The trustee should exercise its statutory authority to decant only after a careful consideration of the potential gift tax, estate tax, and generation-skipping transfer (GST) tax consequences.[18] In most circumstances, no gift tax consequences should occur on the exercise of the decanting authority by a trustee who is not a beneficiary. It is the trustees, not the beneficiaries, who have the power to decant under the decanting statutes; none of the statutes require the consent of a beneficiary.

Generally, no adverse federal estate tax consequences should arise from a decanting that grants a limited power of appointment in the new trust. Inclusion of the trust property in a beneficiary's estate could occur under Section 2041, however, if a decanting grants a beneficiary a general power of appointment in the new trust or if the result is an incomplete gift that becomes complete on the death of the beneficiary.[19]

Whether decanting assets held in the original trust that is exempt from GST tax will cause the new trust to lose exempt status is squarely addressed by Reg. 26.2601-1(b)(4)(i)(E), Example 2. This example provides that the

[15] 12 Del. C. § 3528(a)(5).

[16] The Delaware statute was amended in 2007 to clarify that the trustee may grant a power of appointment (including a general power of appointment) to one or more beneficiaries who are proper objects of the exercise of the power in the first trust. 12 Del. C. § 3578(a); 13 Nev. Rev. Stat. § 163.556.5.(a).

[17] See Ariz. Rev. Stat. Ann. § 14-10819(D); 2009 Nev. Stat. 783; N.Y. Est. Powers & Trusts Law § 10-6.6(b)(2); and N.C. Gen. Stat. § 36C-8-816.1(h).

[18] For a detailed review of the tax consequences of decanting, see Culp and Mellen, "Trust Decanting: An Overview and Introduction to Creative Planning Opportunities," 45 Real Property, Tr. and Est. L. J. 16 (Spring 2010).

[19] Sections 2041(a)(2) and 2041(a)(3)(B).

decanting will not taint the GST-exempt status of a grandfathered trust provided that both:

1. The decanting could not (under any circumstance) shift a beneficial interest in the trust to a beneficiary who occupies a lower generation than the persons who held the beneficial interest prior to the decanting.
2. The decanting does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust.

Thus, with careful planning, it is possible to extend the duration of the trust without subjecting the new trust to GST tax. These principles governing grandfathered trusts should apply equally to trusts exempt from the GST tax by reason of the allocation of GST exemption.[20]

Trustee liability

As a practical matter, trustees are generally concerned about the potential liability to beneficiaries for breach of fiduciary duties associated with their exercise of discretion to appoint trust assets to a new trust, unless the reasons for the decanting are so ministerial and innocuous that decanting poses little or no risk to the trustee. Often it is the beneficiaries who desire to make the changes to the governing instrument, and they approach the trustee with their ideas. The accommodating trustee may be willing to go along with the plan so long as the risk to the trustee has been appropriately limited. The risk could be limited, or eliminated, if all of the beneficiaries consent to the decanting and release the trustee for all liability in connection with it. Under Delaware law, for example, such releases are enforceable.

Even though the decanting statutes do not require the consent of beneficiaries, trustees may require a release that binds all potential beneficiaries, including those who lack capacity and the unborn. Under Delaware's law, for example, the releases of adult beneficiaries and presumptive remaindermen generally will bind the trust's minor and unborn beneficiaries and contingent remaindermen.[21] In certain circumstances, however, the consent or release and indemnification agreement of the beneficiaries, or obtaining court approval, could have adverse tax implications for the beneficiaries.[22] In all instances, the trustee should exercise its decanting power after careful consideration of possible tax consequences, as well as alternative strategies to achieve the goals.

Not only will the trustee typically seek releases in connection with its exercise of discretion to decant, but it will likely seek releases and an accounting, and any other typical procedure that a trustee in its particular jurisdiction will seek when a trust is terminated and its service as trustee ends. When a trust is decanted, the assets of the first trust flow over into the second trust, and the first trust is emptied. When a trust has been emptied, it is no longer a valid trust, and it is terminated. Thus, the trustee of the original trust will typically wish to go through the entire administrative process that is necessary or advisable when a trust terminates.

Because the assets have been transferred to a new trust, which may or may not have the same trustee as the original trust, a decanting can also be viewed from the trustee's perspective as a removal of the trustee of the first trust and an appointment of a successor trustee. Consequently, it is advisable to include an indemnification provision in the new, second trust instrument that runs to the trustee of the original trust, even if the individual or corporate identity of the trustee is the same for both trusts (such individual or entity will still be serving in two different capacities). This satisfies the role of a receipt and refunding agreement that a trustee typically seeks from a successor trustee, so that the outgoing trustee knows that if claims, taxes, fees, liabilities, etc. from the original trust arise in the future, which would have been properly payable from the trust, the trustee of the original, now defunct trust can still have some recourse against the new trust to be reimbursed.

Planning Tip

When drafting new trust agreements, it is advisable to draft enabling provisions in the agreements that limit a trustee's liability and provides indemnification in connection with a decanting. This kind of advanced planning might provide the trustee with needed flexibility and protection to enable the trustee to perform a decanting in the future, if it is desired by the beneficiaries, without the delay and expense of releases, accountings, indemnifications, etc.

Uses for decanting

The purpose of decanting a trust is generally to modify its terms and conditions, although sometimes a decanting may be performed to transfer the trust's situs, change the trustee, or for other reasons. There are almost as many uses for decanting as there are reasons that beneficiaries and trustees wish that the terms and conditions of an existing trust could somehow be different. The uses for decanting can be viewed as pertaining to either

[20] See Ltr. Ruls. 200822008, 200743028, and 200714016.

[21] 12 Del. C. § 3588.

[22] Culp and Mellen, *supra* note 18.

administrative changes or changes to beneficial interests.

Administrative changes. One obvious use for decanting is to change the administrative provisions of a trust to modernize the trust instrument and provide for more flexibility and improved administration. Many existing trusts are governed by arcane instruments that lack the flexibility and modern tools that are found in trust instruments drafted today. An evolution of drafting techniques over the last 50 years has provided significantly more flexibility, utility, and detail in the terms of governing instruments. Many of the provisions that are boilerplate and have come to be expected by beneficiaries and fiduciaries are simply lacking in older documents. By decanting from a trust governed by an older instrument to a new trust that is governed by modern administrative terms, the parties can update and modernize the administration of an existing trust.

For example, many older trust agreements do not contemplate, and some even forbid, the transfer of the situs of the trust from the original jurisdiction to another state. There may also be a related problem when the trust instrument includes choice-of-law provisions that do not contemplate, or even forbid, a change in the law governing the administration of the trust. Many older instruments (which were often drafted by the banks themselves) entrench the trustee and provide no mechanism for the removal and appointment of the trustee. Sometimes there is no provision allowing the trustee to resign, which often means that the trustee cannot resign without court approval. In a jurisdiction where a trustee can decant to a new trust, the trustee can eliminate any of these limitations that restrict the mobility of the trust.

Expand trustee powers. The trustee powers provisions in older documents are usually brief and limited, and do not contemplate many of the sophisticated financial transactions that trusts often engage in today. A trustee's ability to exercise a power is generally limited to the list of powers articulated in the trust instrument, plus any default powers provided for by applicable statute. A new trust instrument can include modern trustee powers—such as the power to make loans to beneficiaries, invest in real estate or derivatives and options, divide the trust, adjust between income and principal, or guarantee loans.

Perhaps a trust holds an investment that will be the subject of an upcoming initial public offering. Such transactions involve numerous series of sophisticated transactions, documents, and regulatory filings. Under the terms of an old trust instrument with limited trustee powers, it may not be clear whether the trustee has the power and authority to accomplish effectively all that is necessary to consummate the transaction. By decanting to a new trust with an instrument that includes modernized trustee powers, a trustee may become better equipped to engage in transactions desired by the beneficiaries.

Revise trustee compensation. Older documents often limit trustee compensation to a rate that is too high or too low, frequently based on a percentage of trust accounting income and the value of principal, or a deferred compensation paid on the termination of the trust. Older documents may lack a specific standard of liability for the trustee or specific terms and conditions for when and how much the trustee may be indemnified for costs and liabilities from the trust fund. These provisions may be changed through decanting to adjust the trust terms to modern realities concerning compensation and liability.

In most circumstances, no gift consequences should occur on the exercise of the decanting authority by a trustee who is not a beneficiary.

Add flexibility. Many modern trust "technologies" used in practice today may be desired by the beneficiaries or necessary in order to accomplish a specific purpose for the trust. Over the last 50 years, and particularly over the last decade, trust laws have evolved to allow for more efficient, tailored, and flexible administration. A dozen or so jurisdictions around the country have positioned themselves to attract a larger slice of the assets under management and administration pies. In addition to these more proactive jurisdictions, the Uniform Trust Code, which has been adopted in 23 states, reflects a much more evolved set of rules for trust administration. The use of investment direction advisors, trust protectors, distribution advisors, or special asset direction advisors has become commonplace.

Trusts are frequently created to carry out specific and sometimes unusual investment purposes, and may hold concentrations of special securities, limited liability companies, family or other closely held businesses, or assets with unique management needs. The grantor, beneficiaries, and trustee often expect the trust to hold these assets and carry out specific purposes and objectives. In order for an older existing trust to accomplish these objectives, new provisions may need

to be included that indemnify the trustee and absolve it from liability, or at least waive the duty to diversify or the prudent investor rule.

Another modern approach to accomplish these goals is to bifurcate the investment responsibilities from traditional trustee administrative responsibilities by adding an investment advisor that directs the trustee with respect to all investments, or investment of a specific class of assets. This may also be desirable when the beneficiaries desire additional family control over investments or wish to interject a local investment manager to control the investments of the trust. Of course, a trustee will be wary of decanting to a new trust whose instrument includes an investment advisor provision and possibly names the initial investment advisor, because the trustee would potentially become vicariously liable for the actions of the investment advisor (similar to the way a trustee may be liable for a delegation if a delegatee is negligently hired by the trustee). For this reason, trustees generally prefer the option of a judicial reformation to add an investment direction advisor provision.

Restrict beneficiaries' rights. It may become advisable to decant assets to a new trust that limits the beneficiaries' rights to obtain information about the nature and extent of their interests in the trust. For example, a beneficiary may develop substance abuse problems, become incarcerated, or have other problems. The trust may grow greatly in excess of expectations, and beneficiaries who are eligible to receive discretionary distributions at a young age may become spoiled or lured into a lazy, unproductive or spendthrift lifestyle if they know the details of the trust fund that is available to support them. Under Delaware law, for example, it is possible to restrict the duties of the trustee to notify beneficiaries of the nature and extent of their interests in a trust,[23] and a decanting may be used to effect such a restriction.

Tax planning. Some states subject trusts to income taxation based on the location of the trustee or the location of the grantor who created the trust or funded it with assets. Some practitioners believe that it is possible to escape certain state and local income tax rules by decanting from one trust to another trust in a new jurisdiction.

Decanting could be a useful tool for converting a trust from a grantor trust to a nongrantor trust, or vice versa.

A trust that is a grantor trust or a nongrantor trust under federal grantor trust rules may not have a flexible mechanism for switching status from a grantor trust to a nongrantor trust, or vice versa. Decanting could be a useful tool for converting a trust from a grantor trust to a nongrantor trust, or vice versa, or including sophisticated provisions that provide a mechanism for switching between grantor and nongrantor trust treatment.

Asset protection. Some trusts lack a spendthrift clause that protects the interests of beneficiaries from the claims of their creditors and prevents beneficiaries from transferring their interests to others. A decanting can be used to add a spendthrift provision to the new trust, to protect the assets from beneficiaries' creditors or claims of a spouse pursuant to a divorce.

It is also possible to decant an existing self-settled trust into a new trust with terms that qualify as an asset protection trust. An irrevocable self-settled trust may have been created in a jurisdiction that does not permit asset protection trusts, or at a time before domestic asset protection trusts existed. Such a trust could be decanted in a jurisdiction that permits self-settled asset protection trusts to a new trust that includes provisions that conform with the requirements of the applicable asset protection trust statutes. Such a decanting should cause the new trust to be treated as an asset protection trust at the time of the decanting.

Change of jurisdictions. It may be necessary for a foreign trust to be converted to a U.S. person for federal tax purposes, or vice versa, such as when beneficiaries move between jurisdictions or when a current beneficiary dies. Converting a foreign trust to a U.S. trust may also avoid increased reporting requirements for offshore trusts and provide for greater growth potential and increased administrative and investment flexibility. Decanting can be effectively used to create provisions that cause a new trust to accomplish the desired result under the U.S. person and foreign trust rules under Section 7701.

Correct drafting errors. Of course, decanting also could be used to correct drafting errors or clarify ambiguities in the original document.

Changing the interests of beneficiaries. When decanting results in a change of the beneficial interests of the original trust, the trustee must take special care to ensure that it has the appropriate power to decant and has not violated any fiduciary duties, incurred unnecessary liability or caused adverse tax consequences. Changes to beneficial interests of a trust often collide with the powers, duties, and

[23] 12 Del. C. § 3303(a).

limitations that make it either impossible to decant, or difficult to reconcile with the fiduciary duties owed to all of the beneficiaries. That being said, the desired objective for a decanting is often a change in beneficial interests.

Split trusts. Frequently, the beneficiaries of single "pot" sprinkle trusts wish to split the trust into separate shares for each branch of the family. Over time it may become desirable to split the trust among beneficiaries, as family relations become unharmonious, unequal distributions are made to beneficiaries, or different families have different financial needs, investment approaches, or views on the identity of the trustee. Sometimes, a trust may have an inclusion ratio other than one or zero for GST tax purposes, and the trustee may wish to split the trust into an exempt and nonexempt trust for GST tax purposes. Subject to the statutory limitations, certain discretionary trusts can be split into separate trusts for the beneficiaries. When splitting a trust through decanting, drafting the remainder provisions can be very complicated.

If a trustee has the power to make discretionary distributions of principal among one or more beneficiaries, the trustee may decant the assets to a new trust that eliminates one of those beneficiaries as a beneficiary of the new trust. Of course, it is difficult to imagine the factual scenario where the trustee would not violate its fiduciary duty of impartiality owed to that beneficiary who is being eliminated; under the right circumstances, however, this is possible. For example, a father may have set up multiple separate trusts for each of his children with each child being the primary beneficiary, but with the other children also potentially eligible to receive discretionary distributions. Later, the children wish to separate their respective trusts from each other by having their trusts decanted into new trusts that include only the primary beneficiary as the sole beneficiary currently eligible to receive distributions.

Alter distributions. If a beneficiary is entitled to all of the income of a trust and also discretionary distributions of principal, the trustee can eliminate the beneficiary's income interest by decanting. A trustee can also include special needs or supplemental needs provisions for a beneficiary that did not exist in the original instrument.

It is also possible to provide a beneficiary who is currently eligible to receive distributions of principal with an inter vivos or testamentary general or limited power of appointment. This would make it possible for such a beneficiary to appoint the trust assets to or for the benefit of a person or entity that is not a beneficiary of the original trust, without the need for the assets to be distributed out of the trust to that beneficiary and then to have that beneficiary make a personal transfer to the person or entity.

Example. Assume a trustee may make discretionary distributions of any amount (including all) of the principal of a trust to beneficiary A, and on A's death, the trust assets go to B, C, and D. The trustee could decant the assets of this trust to a new trust that has those same dispositive terms, but also grants A an inter vivos power of appointment that could potentially be exercised in favor of charity Z. From this new trust, A could then exercise this power of appointment in favor of Z, with the result that B, C, and D will never take.

The theory behind this is that if the trustee could have distributed all of the assets outright, in its discretion, to the beneficiary, it should be a lesser included power for the trustee to grant that beneficiary a power of appointment to appoint the assets to others. If the trustee had distributed all of the assets to A during A's lifetime, A could have disposed of the assets as he wished, and B, C, and D would have never received anything.

One of the most frequently recurring scenarios where decanting has been used is a trust that is scheduled to terminate when a beneficiary reaches a certain age and all of the assets are to be distributed outright to that beneficiary. Often we see this occur with trusts that receive the remainder interest following the termination of a successful grantor retained annuity trust (GRAT). Apparently some GRATs have been wildly successful, because a frequently occurring issue involves the trust for descendants becoming much larger than the grantor ever expected or intended; as a result, the grantor's child is about to receive an enormous distribution at age 35. The grantor does not wish for his or her child to receive an enormous sum at this relatively young age, due to concerns about creditors, spouses, detrimental effects on lifestyle, productivity, and personal motivation. Thus, the parties look to find ways to postpone the distribution to the beneficiary.

If the child is entitled to discretionary distributions of principal and an outright distribution of the entire trust fund at age 35, but has yet to reach that age, then that trust could be decanted to a new trust that postpones the outright distribution. Numerous creditor and tax issues, however, must be addressed. For example:

- If the trustee does such a decanting, it will invariably seek a release from the beneficiary whose interest is being protracted. Arguably this can

be treated as the beneficiary releasing his or her interest in the trust, or having re-contributed his or her interest, at the age the distribution was originally scheduled to occur. Perhaps that could produce an adverse transfer tax or income tax result.

- Creditor problems could arise if the trust would thereafter be treated as a self-settled trust. If this does become a real concern, the new trust could be structured to satisfy the requirements of a domestic asset protection trust.

Of course, the decanting is performed by the trustee in its independent discretion. But does the presence of a release or consent produce any adverse result if it was "required" by the trustee for the decanting? Is a release from liability the same as consent to the conduct? Does the trustee's desire to protect itself from liability rise to the level of beneficiary participation that could produce an adverse result? Even in the absence of a release or consent, does the beneficiary's failure to assert his or her rights as a beneficiary and object to the decanting on the grounds of a breach of fiduciary duty become tantamount to an implicit consent? These are issues that can be successfully navigated; however, they need to be considered carefully.

GST tax-exempt trust. It is possible to postpone a beneficiary's right to receive an outright distribution from a GST tax-exempt trust. As discussed above, Reg. 26.2601-1(b)(4)(i)(D) provides that the modification of the governing instrument of a GST-tax exempt trust (which, under applicable Regulations would include a decanting) will not cause the trust to become subject to GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification and the modification does not extend the time for vesting of any beneficial interest beyond the period provided for in the original trust.

The IRS has ruled on several occasions, in private letter rulings, that a modification of a GST tax-exempt trust from a provision that would have distributed property to a beneficiary at a certain age to a revised provision that would instead continue to hold the property for that beneficiary, will not cause adverse GST tax consequences if certain requirements are met. The assets must continue to be held for the exclusive benefit of that beneficiary after the designated age, and the assets must ultimately be includable in the beneficiary's taxable estate as a result of the beneficiary possessing a testamentary general power of appointment or, in the absence of the general power of appointment or in the absence of its exercise, the assets must pass to the beneficiary's estate.[24]

Decanting might also be useful to accomplish the opposite objective: to cause estate inclusion in the taxable estate of a beneficiary of a nonexempt GST trust. If a trust will be subject to GST tax on the death of a beneficiary, it may be a more tax-efficient approach to trigger federal estate tax inclusion on the death of the beneficiary in order to take advantage of applicable estate tax credits or run up the rate brackets. This could be accomplished by decanting into a new trust that includes a GST tax formula-based general power of appointment applicable to that beneficiary.

Consolidate trusts. Often, a family patriarch or matriarch established multiple trusts for his or her descendants with substantially identical terms. Over time, some descendants may have multiple trusts held for their benefit that are basically the same. For administrative efficiency and to save costs, it is often desirable to consolidate these trusts into a single trust for the beneficiary. This can be accomplished by decanting all but one of the trusts into a surviving trust, or decanting all of them into a new trust. However, caution should be exercised to ensure that remainder men provisions are identical to the original instruments and that different perpetuities periods are not mixed in the surviving trust.

Lengthen IRA distribution period. It has also been suggested that when an IRA payable to a trust names a contingent beneficiary or permissible appointee older than the desired designated beneficiary, decanting may be used to stretch out the IRA by eliminating the older contingent beneficiaries or permissible appointees.

Conclusion

To date, ten states have enacted decanting statutes that give trustees the power to amend irrevocable trusts in certain circumstances. Trustees and beneficiaries who are faced with problematic irrevocable trusts may conclude that the exercise of a trustee's statutory power to decant is one of the best strategies available to fix problematic trusts. Taking into consideration possible tax and creditor consequences, the number of potential uses of decanting is limited only by the number of specific circumstances that warrant amending the terms of existing trust instruments. ■

[24] See, e.g., Ltr. Ruls. 200752018, 200736008, 200608001, 200520023, 200308045, and 200231011.