



Summer 2018 Bulletin

FIXING IRREVOCABLE TRUSTS

DECANT IT!

Estate planning professionals and clients have always believed that an irrevocable trust is really irrevocable and, it is, except for very limited situations. Now 25 states allow you to change the terms of an old trust by a new process called "decanting". Under a decanting statute, you can change the terms of an irrevocable trust, because you simply don't like the terms. It's done without going to court and in certain states, without the beneficiaries' consent.

The trustee has to initiate a decanting. In essence, you are rewriting the terms of the trust by distributing assets from an old trust into a new trust with new terms, for the benefit of one or more of the beneficiaries of the first trust. It's called decanting, because it's like pouring wine from a bottle into a decanter, and leaving the residue (or unwanted trust terms) behind.

Thirteen states that allow decanting by statute passed their laws in the last five years, with most of the other states tweaking their laws to make them even more flexible—as states compete for trust business. Though California has a Uniform Trust Decanting Act which has been introduced in the legislature, but hasn't become law, it doesn't mean that you can't decant an irrevocable trust, which is governed by California law. You don't have to live in one of the states that has a decanting statute, in order to decant an irrevocable trust. One strategy is to move your trust to a decanting-friendly state (most trusts let you change "situs"), and then decant, in a two-step process.

For example, if you have an irrevocable trust for your children with private

company stock as a part of the trust estate the trust agreement provides that the trustee will distribute the stock to them at age 35, the trustee could move the trust to Nevada and decant it into a new long-term trust that would last for the children's lives, giving them creditor protection, and saving California's 13.3% top income tax rate (Nevada is a no-income-tax state). In order to move the trust to Nevada, you have to use a non-grantor discretionary trust with no California trustees to make it work.

Along with South Dakota, Tennessee, New Hampshire and Delaware, Nevada is considered destination decanting states, because their laws provide the most flexibility; however, even they have their differences. Which state you pick depends upon what you're trying to accomplish. Six states allow you remove a mandatory income interest. Four states allow you accelerate a remainder beneficiary's interest. Seven states let you decant without first giving notice to all of the beneficiaries. In most states, you have to send notices and copies of the old trust and proposed new trust to all the beneficiaries and wait a certain number of days. If there are no objections, then you can proceed with decanting the old trust.

Old trust terms often don't fit as the world changes. Decanting becomes an important mechanism when circumstances change. An old trust might limit investments to bonds; you can decant to invest more broadly. You can decant to create a directed trusteeship so you can invest in private equity.



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You must be careful to follow the decanting statute. In 2015, a New York trial court invalidated a decanting, because the trustee added new beneficiaries to the new trust, which is not allowed under New York's law. An appellate court in Florida invalidated a decanting, because the trustee failed (as required under Florida law) to notify two sisters (remainder beneficiaries under the first trust) when he decanted into a special needs trust for their brother and left them out of the trust.

Lawyers have been waiting for official guidance from the Internal Revenue Service on some of the trickier income, gift, and estate tax consequences of decanting since the IRS issued a Notice in 2011 that it wouldn't issue rulings on specific cases. A new model law, the Uniform Trust Decanting Act, was drafted in 2015, which provides tax safeguards, offers relief for a flawed decanting, and provides protection for trustees. The latest two decanting states, Colorado and New Mexico, passed it in 2016, and a handful of other states are considering it.

What if you're drafting a new trust? If you're open to changes, allow decanting. If you're heavy-handed and keen on the restrictions you've put into place, make sure you include a provision saying that it can't be decanted.