

**DECANTING:
REFINING A VINTAGE TRUST**

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for presentation at

*Chicago Estate Planning Council
Wednesday, September 11, 2013*

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APPENDIX I: STATE DECANTING STATUTES PASSED OR PROPOSED

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I. What is Decanting?

- A. **Decanting.** When wine is decanted, it's poured from a bottle into another vessel, usually called the "decanter," to leave the sediment in the bottle while pouring off the pure liquid into the decanter. In addition to leaving the sediment behind, decanting also allows the wine to aerate or to breathe. Decanting a trust is very similar. The assets of the old trust are poured into or transferred to a new trust which is free from the sediment of the old trust that might be preventing it from effectively and efficiently achieving its purposes. Decanting can modify administrative provisions, change the trustee and trustee provisions, and also change dispositive provisions of the trust, breathing new air into the trust.
- B. **Theory of Decanting.** The theory underlying decanting is that if a trustee has the discretionary power to distribute property to one or more current beneficiaries, then the trustee should have the power to distribute the property to a second trust for the benefit of such beneficiaries. Wine is decanted to bring out the best nose and flavor the grape offers; trusts should be decanted only in furtherance of the purposes of the trust.
- C. **Evolution of Decanting**
1. **Common Law.** Some cases have held that decanting is permitted under common law. *Phipps v. Palm Beach Trust Co.*, 196 So. 229 (Fla. 1940); *Wiedenmayer v. Johnson*, 254 A.2d 534 (N.J. Super. Ct. App. Div. 1969); *In Re: Estate of Spencer*, 232 N.W. 2d 491 (Iowa 1975); *Morse v. Kraft*, SJC 11233 (Supreme Judicial Court, Suffolk County, Massachusetts, July 29, 2013). Some state statutes assert that they are a codification of common law decanting powers.
 2. **State Statutes** Twenty-one states have decanting statutes. See Appendix I.
- D. **Uniform Law Project.** The Uniform Law Commission has formed a drafting committee for a Uniform Decanting Statute.

II. **Uses of Decanting**

- A. Administrative Change
- B. Change Investment Limitations, Authorize Acquiring or Retaining an Asset or Permit Lack of Diversification
- C. Define (and Limit) Beneficiary Rights to Information
- D. Change Governing Law
- E. Trustee Change
- F. Provide for Advisors, Trust Protectors or Directed Trustees
- G. Divide a Trust
- H. Consolidate Trusts
- I. Correct Scrivener's Error or Ambiguity
- J. Add or Remove Spendthrift Provisions
- K. Create a Supplemental Needs Trust
- L. Limit a Beneficiary's Rights, or Eliminate a Beneficiary
- M. Add a Beneficiary (with a Power of Appointment)
- N. Convert Non-Grantor Trust to Grantor Trust
- O. Convert Grantor Trust to Non-Grantor Trust

III. **Illinois Statute.** The Illinois decanting statute is new section 16.4 of the Trusts and Trustees Act and is titled "Distribution of Trust Principal in Further Trust."

A. **Decanting Authority**

1. **Terminology**

- a. **Illinois.** Under the Illinois statute, the term "first trust" refers to the original trust, and the trust into which the first trust is being decanted is referred to as the "second trust." Thus the first trust is akin to the original bottle of the wine, and the second trust is the decanter.
- b. **Other States.** In other state statutes, the "first trust" may be referred to as the "old trust," the "invaded trust" or the "original trust," and the "second trust" may be referred to as the "new trust" or the "appointed trust."

2. What Trusts May Be Decanted?

- a. **Illinois.** Illinois irrevocable trusts, whether in existence on the effective date of the decanting legislation or created on or after the effective date, may be decanted. Only irrevocable trusts may be decanted. The “first trust” may be an irrevocable inter vivos or testamentary trust. Subsection 16.4(a). The “second trust” must be an irrevocable trust. Subsection 16.4(a). Although not expressly stated in the statute, the second trust may be either a trust already in existence or a trust created for the purpose of serving as the second trust for purposes of decanting. A trust may be decanted in whole or in part. A trust could be decanted to more than one second trusts.
- b. **Other States.** Some statutes may make a distinction between inter vivos and testamentary trusts. Typically, the second trust may be either a trust already in existence or a new trust created for purposes of decanting. Commonly, a trust may be decanted in whole or in part and may be decanted to more than one trust.

3. Who Can Decant?

- a. **Illinois.** The Illinois statute permits an “authorized trustee” to decant. An authorized trustee is defined in the statute as “an entity or individual, other than the settlor, who has authority under the terms of the first trust to distribute the principal of the trust for the benefit of one or more current beneficiaries.” Note that the term “authorized trustee” could encompass a person such as a distribution director who is not literally the trustee of the trust but who has authority to direct distributions of trust principal. Further note that while a settlor acting as trustee would not be an authorized trustee, there does not appear to be a restriction on a beneficiary who is acting as trustee from decanting. However, subsection (b) of the statute is inconsistent in that it states that an “*independent trustee* who has discretion to make distributions to the beneficiaries shall exercise that discretion in the trustee’s fiduciary capacity, whether the trustee’s discretion is absolute or limited to ascertainable standards, in furtherance of the purposes of the trust.” (Emphasis added.)
- b. **Other States.** Some statutes prohibit certain interested trustees from decanting. If only interested trustees are acting, decanting may be prohibited. In some states, if all trustees are beneficiaries, the court may appoint a special fiduciary with authority to decant.

4. **Trust Prohibitions**

- a. **Illinois.** A trust, however, may expressly prohibit decanting or prohibit certain modifications through decanting. A spendthrift provision, provision prohibiting amendment or provision stating that a trust is irrevocable will not be construed as prohibiting decanting.
- b. **Other States.** A few other states permit decanting even if the trust prohibits decanting, with court approval.

5. **Trust Modifications of Decanting Statute.** In general, a trust instrument may expressly grant the trustee a power to decant even in the absence of a decanting statute or on terms different than those provided in the decanting statute.

6. **Grantor's Intent and Trust Purposes.**

- a. **Illinois.** The Illinois statute explicitly states that the exercise of the power of decanting must be exercised "in furtherance of the purposes of the trust." The power to decant is a fiduciary power, to be exercised in a fiduciary capacity. A trustee's actions with respect to decanting, however, will not be found to violate the trustee's duty of impartiality unless the trustee acted in bad faith. Subsection (f)(3).
- b. **Other States.** The South Dakota statute also directs the trustee to take into account the purposes of the trust. 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. The Texas statute also directs the trustee to consider the interests of the beneficiaries along with the "terms and purposes" of the trust.

7. **Is Beneficiary Consent Required?**

- a. **Illinois.** The Illinois statute does not require that the beneficiary affirmatively consent to the decanting. The trustee, however, must give prior notice of the decanting to all of the legally competent current beneficiaries and presumptive remainder beneficiaries, determined assuming the nonexercise of any power of appointment. If no beneficiary to whom notice was sent objects within 60 days, the trustee may decant without court approval. If any such beneficiary does object within the notice period, the trustee needs court approval in order to decant. The impact of the beneficiary right to object on the gift, estate and GST tax consequences of decanting should be considered.

- b. **Other States.** Most decanting statutes in other states do not give the beneficiary a right to block the decanting without going to court.

B. **What Discretionary Distribution Authority Must the Trustee Have to Decant?** In order to decant under the Illinois statute, the trustee must have the power to distribute the principal of the trust for the benefit of one or more current beneficiaries. Note that the power to distribute must extend to the *principal* of the trust. A trustee may decant even if there is no need for a current distribution. Subsection (k).

1. **Degree of Discretion**

- a. **Illinois.** Illinois permits decanting even if the trustee's discretion is limited by a standard (e.g. health, support and education). Changes to beneficial interests, however, can only be made in Illinois if the trustee has absolute discretion or is decanting to a supplemental needs trust.
- b. **Other States.** Some other state statutes, such as Florida, Indiana and Rhode Island, require that the trustee have absolute discretion in order to decant. Other states do not require that the trustee's discretion be absolute, such as Alaska, Arizona, Delaware, Kentucky, Missouri, Nevada, New Hampshire, North Carolina, South Carolina, South Dakota and Tennessee, but many of these states may have restrictions on a beneficiary who is a trustee decanting. Other states, like Illinois, require absolute discretion for some decanting but not for other decanting. The other states with bifurcated statutes include Michigan, New York, Ohio, Texas and Virginia. The trend of the newer statutes is to use a bifurcated standard. States that permit decanting if the trustee has discretion over *income or principal* include Arizona, Kentucky, Michigan, Missouri, Nevada, New Hampshire, North Carolina, South Carolina, South Dakota and Virginia.

2. **Interested Trustee**

- a. **Illinois.** The Illinois statute permits a trustee who is a beneficiary to decant. Usually this will not create any new tax issues because a trustee who does not have the absolute discretion will not be able to change the beneficial interests. Typically trusts will not give an interested trustee absolute discretion over discretionary distributions because such discretion would create gift and estate tax issues.
- b. **Other States.** Some statutes outside of Illinois prohibit certain interested trustees from decanting. In these states, if only interested trustees are acting, decanting may be prohibited. For

example, in Missouri a trustee whose discretion is not limited by an ascertainable standard cannot decant if the trustee is a beneficiary or has certain powers to remove and replace the trustee. See also New Hampshire. In Nevada, a trustee who is a beneficiary may not decant. See also New York, North Carolina, South Carolina and Virginia. In North Carolina, South Carolina and Virginia, if all trustees are beneficiaries, the court may appoint a special fiduciary with authority to decant. Other statutes address the potential adverse tax consequences of an interested trustee modifying a trust by limiting the types of modifications that can be made by an interested trustee.

C. **Modification of Beneficial Interest.** Under the Illinois statute, the extent to the which the beneficial interests under a trust can be modified by decanting depends upon whether or not the authorized trustee has the absolute discretion to distribute the principal of the trust. “Absolute discretion” means the right to distribute principal that is not limited or modified in any manner to or for the benefit of one or more beneficiaries of the trust, whether or not the term “absolute” is used. “A power to distribute principal that includes purposes such as best interests, welfare, or happiness shall constitute absolute discretion.” Subsection 16.4(a).

1. **No Absolute Discretion.** Under the Illinois statute, a trustee who has a power to distribute the principal of a trust but does not have the absolute discretion to distribute the principal of the trust may distribute part or all of the principal of the first trust in favor of a trustee of the second trust, but cannot change the beneficial interests.

a. **Beneficiaries Remain the Same.** If the trustee does not have absolute discretion, then the current beneficiaries of the second trust must be the same as the current beneficiaries of the first trust, and the successor and remainder beneficiaries of the second trust must be the same as the successor and remainder beneficiaries of the first trust. Subsection 16.4(d). If the beneficiaries of the first trust are described as a class of persons, the beneficiaries of the second trust shall include all persons who become includible in the class after the distribution to the second trust. Subsection 16.4(d)(2).

b. **No Change to Distribution Standards.** If the trustee does not have absolute discretion, then the second trust must “include the same language authorizing the trustee to distribute the income or principal of a trust as set forth in the first trust.” Subsection 16.4(d)(1).

c. **No Change to Powers of Appointment.** If the trustee does not have the absolute discretion to distribute principal, and if the first trust grants a power of appointment to a beneficiary of the trust, the second trust must grant the same power of appointment in the

second trust, and the class of permissible appointees must be the same as in the first trust. Subsection 16.4(d)(3).

d. **Supplemental Needs Trust.** Even if the trustee does not have absolute discretion, the trustee may distribute a disabled beneficiary's interest in the first trust in favor of a trustee of a second trust which is a supplemental needs trust if the trustee determines that to do so would be in the best interests of the disabled beneficiary. Subsection 16.4(d)(4)(i). The best interests of the disabled beneficiary may take into consideration the financial impact to the disabled beneficiary's family. A supplemental needs trust is defined as a trust that would allow the disabled beneficiary to receive a greater degree of governmental benefits than the disabled beneficiary would receive if no distribution is made. The Illinois statute defines "disabled beneficiary" as a beneficiary who has a disability that substantially impairs the beneficiary's ability to provide for his or her own care and custody and that constitutes a substantial handicap whether or not the beneficiary has been adjudicated a "disabled person."

2. **Absolute Discretion.** A trustee who has absolute discretion to distribute principal of the trust may distribute part or all of the principal of the trust in favor of a trustee of the second trust for the benefit of one, more than one, or all of the current beneficiaries of the first trust and for the benefit of one, more than one, or all of the successor and remainder beneficiaries of the first trust. Subsection 16.4(c). Note that while the terms "current beneficiary" and "successor beneficiary" are defined in the statute, the term "remainder beneficiary" is not defined. Presumably the term is shorthand for "presumptive remainder beneficiary," which is defined.

3. **With Absolute Discretion, Do the Beneficiaries of the Second Trust Have To Be the Same as the Beneficiaries of the First Trust?** Under the Illinois statute, if the trustee has absolute discretion to distribute principal, then the beneficiaries of the second trust do not have to be the same as the beneficiaries of the first trust. The beneficiaries of the second trust can be one or more of the current beneficiaries of the first trust and one or more of the successor and remainder beneficiaries of the first trust.

a. **No New Beneficiaries.** The second trust cannot include as a beneficiary anyone who was not a beneficiary of the first trust. This is consistent with the decanting statutes in other states.

b. **Eliminating Beneficiaries.** The second trust can eliminate one or more of the current beneficiaries, so long as at least one of the current beneficiaries of the first trust is a beneficiary of the second trust. The second trust can eliminate one or more of the successor and remainder beneficiaries, so long as at least one of the successor and remainder beneficiaries of the first trust is a beneficiary of the

second trust. It is notable that the statute does not permit a trustee to decant solely in favor of one or more current beneficiaries, as many other state statutes permit.

- c. **Changing Beneficial Interests.** It would appear that a successor or remainder beneficiary could become a current beneficiary. If this is so, it may have income tax implications under the grantor trust rules. In addition, it would appear that (1) a current beneficiary could become a remainder beneficiary and (2) a contingent remainder beneficiary could become a presumptive remainder beneficiary.

- 4. **With Absolute Discretion, Do the Distribution Standards Have To Be the Same?** If the authorized trustee has the absolute discretion to distribute principal, the distribution standards of the second trust may be different than the distribution standards of the first trust.

- a. **Change of Standard.** The second trust could have a distribution standard that is more restrictive than absolute discretion.

- b. **Change of Future Withdrawal Rights.** The second trust could eliminate or postpone future (but not already existing) withdrawal rights.

- c. **Change of Future Mandatory Distributions.** The second trust could eliminate future (but not already existing) mandatory distribution rights. For example, if a beneficiary is age 20 and the first trust provides for mandatory income distributions beginning at age 25, the second trust could eliminate such rights.

- 5. **With Absolute Discretion, Do Any Powers of Appointment Have To Be the Same?** Under the Illinois statute, if the authorized trustee has the absolute discretion to distribute principal, the authorized trustee may, but apparently is not required to, grant a power of appointment over the second trust to one or more current beneficiaries of the first trust provided that the beneficiary granted the power of appointment could receive principal outright under the terms of the first trust. Subsection 16.4(c)(1). If the authorized trustee grants such a power of appointment, the class of permissible appointees may be broader than or otherwise different from the current, successor and presumptive remainder beneficiaries of the first trust. Subsection 16.4(c)(2). Thus while the authorized trustee may not directly include a new beneficiary in the second trust, the second trust may grant a power of appointment to a current beneficiary that can be exercised in favor of appointees who are not beneficiaries of the first trust. Caution should be used when the first trustee grants testamentary powers of appointment and wills or other instruments may be in existence that purport to exercise these powers as of the holder's death. The second trust

should make clear whether such attempted exercises are valid under the second trust.

6. **Does the Trustee of the Second Trust Have To Be the Same?** The Illinois statute does not directly address the issue of whether the trustee of the second trust must be the same as the trustee of the first trust, but presumably there is no such requirement.
7. **Ability to Change Remainder Beneficiaries.** The ability to retain the interests of the remainder beneficiaries in the second trust, to eliminate remainder beneficiaries and to modify the interests of the remainder beneficiaries is not granted under all of the other state statutes.
 - a. **Some States Limit to Current Beneficiaries.** The narrowest theory of decanting permits decanting only to a trust for the benefit of the current beneficiaries (those who could receive a discretionary distribution) of the old trust. This appears to be the case under New Hampshire's statute. Under such a statute, the remainder beneficiaries who are not also current beneficiaries must be deprived of their interest if the trust is decanted. This limitation may also apply under the Kentucky, Tennessee and Rhode Island statutes, and the Ohio statute where the trustee does not have absolute discretion. This restriction may be mitigated in states that have a "boomerang provision." A "boomerang provision" permits the new trust to provide that at some future time the beneficial provisions of the new trust revert to the beneficial provisions of the old trust, including the provisions regarding remainder beneficiaries. States that permit changes to beneficial provisions for current beneficiaries, but then also permit a boomerang provision so that the remainder beneficiaries of the old trust do not need to lose their interests, include Delaware, Nevada, Michigan § 556.115a and Ohio (when the trustee has absolute discretion).
 - b. **Some States Do Not Limit to Current Beneficiaries.** In other states, remainder beneficiaries of the old trust may be, or under some statutes must be, beneficiaries of the new trust.
 - (i) **Remainder Beneficiaries of Old Trust May Be Beneficiaries.** The decanting statutes of some states appear to permit but not require that remainder beneficiaries of the old trust be remainder beneficiaries of the new trust. Generally, in these states the new trust could eliminate one or more of the remainder beneficiaries. For example, the Missouri statute permits the beneficiaries of the new trust to include current beneficiaries of the old trust and beneficiaries of the old trust "for whom a distribution . . . may have been made in the future . . . or upon the happening of an event." Other state statutes are less

explicit, but presumably allow the remainder beneficiaries of the old trust to be beneficiaries of the new trust. See, e.g., Arizona, Florida, Indiana, South Dakota and Virginia.

- (ii) **States in Which Remainder Beneficiaries Must Remain the Same.** Other statutes, such as New York's statute when the trustee has absolute discretion, explicitly state that all remainder beneficiaries of the new trust shall be the same as the remainder beneficiaries of the old trust. Statutes that require the beneficial interests of the new trust to be the same as the beneficial interests of the old trust implicitly require the remainder beneficiaries of the old trust to remain remainder beneficiaries of the new trust.

8. **Acceleration of Future Interests.** In Illinois, it appears that under the current statute decanting could be used to accelerate a remainder interest in the old trust to a present interest. While a few other states may also permit this, such as Missouri and South Dakota, other states explicitly prohibit an acceleration of a remainder interest. For example, Virginia, New York, North Carolina and Rhode Island explicitly prohibit the acceleration of a remainder interest.

- a. **Danger of Permitting Acceleration.** Obviously, a statute that permits the acceleration of a remainder interest to a present interest has more flexibility. There may be, however, an income tax risk with respect to trusts that are not intended to be grantor trusts. Several of the exceptions to the grantor trust rules do not apply if the trustee has the ability to add a beneficiary. See, e.g., Internal Revenue Code ("Code") section 674(b)(5), (b)(6), (b)(7); Code section 674(c); Code section 674(d). Under the grantor trust rules, the power to add a beneficiary includes the power to make a remainder beneficiary a current beneficiary. Treasury Regulation section 1.674(d)-(2)(b) provides that the "exceptions described in Section 674(b)(5), (6) and (7), (c) and (d) are not applicable if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where the action is to provide for after-born or after-adopted children." (Note that the power to add beneficiaries refers to a power to add to the class of beneficiaries who can receive "income or corpus.") It is possible to construct an argument that if the trustee of the trust has the power to decant, and if the trustee by decanting could accelerate a remainder interest to a present interest, then the trustee has a power to add beneficiaries within the meaning of the grantor trust rules. Under the grantor trust rules, the mere fact that a trustee holds this power, whether or not ever exercised, is sufficient to make the trust a grantor trust (or more precisely, to make certain exceptions to the grantor trust rules

inapplicable). Thus the possible risk is that the mere existence of a decanting statute that permits the acceleration of a future interest to a present interest causes trusts potentially subject to such statute to unintentionally become grantor trusts.

- b. **Circumventing a Prohibition on Acceleration.** Even in a state that explicitly prohibits the acceleration of a future interest to a present interest, it may be possible to effectively accelerate a future interest by decanting to a trust in which the interests of the current beneficiaries last for only a limited period of time such as six months.
- c. **Meaning of “Acceleration.”** Even in states that prohibit the acceleration of a remainder interest to a present interest, decanting might still result in the remainder interest taking effect more quickly because the decanting restricted or shortened the interests of the current beneficiaries. For example, if a trust provided that the trustee could make discretionary distributions among the grantor’s children, A, B and C, and then provided that at the death of such children the remainder of the trust should be distributed to grandchildren, and the trustee decanted to eliminate the interests of children B and C, such a decanting might result in a remainder interest taking effect more quickly because the remainder beneficiaries then only have to survive A as opposed to the survivor of A, B and C.

D. **Definitions**

- 1. **Authorized Trustee.** “ ‘Authorized trustee’ means an entity or individual, other than the settlor, who has authority under the terms of the first trust to distribute the principal of the trust for the benefit of one or more current beneficiaries.” Subsection 16.4(a). “Authorized trustee” could include a distribution director. Presumably, the statute was not intended to give a power to decant to a person holding a power of appointment in a non-fiduciary capacity. If there are more than one trustees, only some of whom have discretion to make distributions, the trustees with discretionary distribution authority are the “authorized trustees.”
- 2. **Absolute Discretion.** “ ‘Absolute discretion’ means the right to distribute principal that is not limited or modified in any manner to or for the benefit of one or more beneficiaries of the trust, whether or not the term ‘absolute’ is used. A power to distribute principal that includes purposes such as best interests, welfare, or happiness shall constitute absolute discretion.” Subsection 16.4(a). Note that the Illinois statute does not include “comfort” as a standard that constitutes absolute discretion. Other state statutes that contain an “absolute discretion” standard include “comfort” as a standard that constitutes absolute discretion (see Florida, New York

and proposed amendment to Alaska) or define absolute discretion as any non-ascertainable standard (see Indiana and Ohio).

3. **Beneficiaries**

- a. **Current Beneficiary.** “ ‘Current beneficiary’ means a person who is currently receiving or eligible to receive a distribution of principal or income from the trustee on the date of the exercise of the power.” Subsection 16.4(a).
- b. **Presumptive Remainder Beneficiary.** “ ‘Presumptive remainder beneficiary’ means a beneficiary of a trust, as of the date of determination and assuming non-exercise of all powers of appointment, who either (i) would be eligible to receive a distribution of income or principal if the trust terminated on that date or (ii) would be eligible to receive a distribution of income or principal if the interests of all beneficiaries currently eligible to receive income or principal from the trust ended on that date without causing the trust to terminate.” Subsection 16.4(a). This is the same as the definition used in the Illinois virtual representation statute. Section 16.1.
 - (i) Note that the statute sometimes uses the term “remainder beneficiary” instead of “presumptive remainder beneficiary.” Presumably, this is an oversight that will be corrected by an amendment.
 - (ii) Determining who are the presumptive remainder beneficiaries can be tricky and a matter for the exercise of some judgment. Determining who would be eligible to receive income or principal “if the trust terminated on that date” involves analyzing how the trust could terminate. Typically a trust could terminate upon the death of all of the current beneficiaries. If the trust is a spray trust for all of the descendants of an individual, under this termination scenario the presumptive remainder beneficiaries may be collateral relatives or charities. Alternatively, some trusts terminate at the end of the rule against perpetuities period, but by definition no beneficiary included in the class of measuring lives could be a presumptive remainder beneficiary. Another alternative termination scenario is termination under a small trust provision in the trust.
- c. **Successor Beneficiary.** “ ‘Successor beneficiary’ means any beneficiary other than the current and presumptive remainder beneficiaries, but does not include a potential appointee of a power of appointment held by a beneficiary.” Subsection 16.4(a).

4. **First Trust and Second Trust.** “ ‘First trust’ means an existing irrevocable inter vivos or testamentary trust part or all of the principal of which is distributed in further trust under subsection (c) or (d).” Subsection 16.4(a). “ ‘Second trust’ means any irrevocable trust to which principal is distributed in accordance with subsection (c) or (d).” Subsection 16.4(a).
5. **Distribute.** “ ‘Distribute’ means the power to pay directly to the beneficiary of a trust or make application for the benefit of the beneficiary.” Subsection 16.4(a).
6. **Principal.** “ ‘Principal’ includes the income of the trust at the time of the exercise of the power that is not currently required to be distributed, including accrued and accumulated income.” Subsection 16.4(a).

E. **Restrictions**

1. **Mandatory Distribution Rights.** Under the Illinois statute, an authorized trustee may not decant in a way that would reduce, limit or modify any beneficiary’s current right to a mandatory distribution of income or principal, a mandatory annuity or unitrust interest, a right to withdraw a percentage of the value of the trust or a right to withdraw a specified dollar amount provided that such mandatory right has come into effect with respect to the beneficiary, except with respect to a second trust which is a supplemental needs trust. Subsection 16.4(n)(1). Thus if a beneficiary currently has a right to income or an annuity or unitrust payment, the trustee cannot eliminate that right. On the other hand, if a beneficiary has a right to withdraw a certain portion of the trust at age 25 and has not yet reached that age, and the authorized trustee has the absolute discretion to distribute principal, the trustee could decant to a second trust that does not grant a right of withdrawal at age 25.
2. **Tax Savings Provisions.** The Illinois decanting statute provides certain tax limitations to make certain that important tax benefits, such as the marital deduction, the charitable deduction, the gift tax annual exclusion and others, will not be denied merely because a trustee has a decanting power. Subsection 16.4(p) provides: “If any contribution to the first trust qualified for the annual exclusion under Section 2503(b) of the Code, the marital deduction under 2056(a) or 2523(a) of the Code, or the charitable deduction under Section 170(a), 642(c), 2055(a) or 2522(a) of the Code, is a direct skip qualifying for treatment under Section 2642(c) of the Code, or qualified for any other specific tax benefit that would be lost by the existence of the authorized trustee’s authority under subsection (c) or (d) for income, gift, estate, or generation-skipping transfer tax purposes under the Code, then the authorized trustee shall not have the power to distribute the principal of a trust pursuant to subsection (c) or (d) in a manner that would prevent the contribution to the first trust from qualifying for or

would reduce the exclusion, deduction, or other tax benefit that was originally claimed with respect to that contribution.”

- a. **Gift Tax Annual Exclusion.** The gift tax annual exclusion under section 2503(b) is specifically enumerated. 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. Thus if a contribution to a trust qualified as a gift of a present interest because the trust granted a beneficiary a right of withdrawal over contributions, the trustee cannot modify the right of withdrawal in a way that would eliminate the present interest. Presumably, however, the trustee could eliminate the right of withdrawal with respect to future contributions. 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).

- b. **Marital Deduction.** Section 2056(a) refers to the estate tax marital deduction, and section 2523(a) refers to the gift tax marital deduction. A trust might not qualify for the marital deduction if state law permitted the trustee to alter the required provisions for qualifying for the marital deduction. For example, a trust qualifying as a general power of appointment marital trust must grant the surviving spouse a general power of appointment. If a trustee could decant and deprive the spouse of her general power of appointment, a marital deduction might not be permitted for such trust. Under the Illinois statute, if a trust qualified for the marital deduction by reason of granting the spouse a general power of appointment, the authorized trustee could not decant in a manner that would deprive the spouse of the general power of appointment. Alternatively, if a trust qualified as a QTIP, the authorized trustee could not decant in a way that deprived the spouse of the income interest necessary to qualify for a QTIP treatment.

- c. **Charitable Deduction.** Section 170(a) refers to the income tax charitable deduction. Section 642(c) refers to the income tax deduction for amounts paid or permanently set aside for a charitable purpose. Code section 2055(a) refers to the estate tax charitable deduction. Code section 2522(a) refers to the gift tax charitable deduction. The restriction on decanting in a way that would disqualify the trust for a charitable deduction or reduce the amount of the deduction 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.
- d. **GST Annual Exclusion.** Code section 2642(c) refers to the generation-skipping transfer tax annual exclusion and the GST tax exclusion for the direct payment of tuition and medical care expenses. 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. Given that the decanting statutes generally do not permit a trust to be decanted to add a beneficiary, it seems unlikely that the 2642(c) restriction requiring a trust be for a single individual could be violated through decanting. The requirement, however, 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.
- e. **Beneficiary as Trustee.** A beneficiary who is acting as trustee could be deemed to have a general power of appointment that would cause inclusion in the beneficiary's estate if the beneficiary could decant in a manner that would permit distributions to such beneficiary subject to an unascertainable standard. Further, a beneficiary who is acting as trustee and who exercised such a decanting power could be deemed to have exercised a general power of appointment. As noted above, the Illinois statute does not prohibit an interested trustee from decanting, but unless the trustee had absolute discretion, the decanting could not change beneficial interests. The decanting statutes in many of the states have explicit restrictions either prohibiting an interested trustee

from exercising a decanting power altogether or restricting the manner in which an interested trustee can exercise a decanting power to avoid such estate and gift tax issues. For example, the South Dakota statute prohibits an interested trustee from exercising a decanting power in a way that would benefit the interested trustee unless the exercise is limited by an ascertainable standard and does not have the effect of increasing the distributions that can be made to the interested trustee. See also Arizona, Kentucky, Missouri, Nevada, New Hampshire and Texas. The Virginia statute simply prohibits an interested trustee from exercising a decanting power. See also North Carolina. Some states, such as Delaware and Michigan, have provisions in other statutes prohibiting a fiduciary from making distributions to the fiduciary.

- f. **Conversion of Grantor Trust to Non-Grantor Trust.** One exception to the general rule that decanting cannot be exercised in a manner that would eliminate a tax benefit is with respect to the grantor trust rules. The statute specifically permits the authorized trustee to decant from a grantor trust to a non-grantor trust. Subsection 16.4(p)(1). Presumably, generally a trustee may decant a trust in a manner that converts a grantor trust to a non-grantor trust either as an incidental result of changing the terms of such trust (for example, to eliminate the interest of a spouse as a beneficiary) or as a primary purpose of the decanting.
- g. **Conversion of Non-grantor Trust to Grantor Trust.** The Illinois statute explicitly states that the trustee is not prohibited from decanting into a grantor trust. Subsection 16.4(p)(1).

Nothing in this Section shall be construed as preventing the authorized trustee from distributing part or all of the first trust to a second trust that is a trust as to which the settlor of the first trust is considered the owner under Subpart E of Part I of Subchapter J of Chapter 1 of Subtitle A of the Code.

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. In some situations, however, it can allow the second trust to grow more effectively by imposing the income tax liability on the grantor.

- 3. **S Corporations.** If the first trust owns subchapter S Corporation stock, an authorized trustee may not decant to distribute S Corporation stock to a second trust that is not a permitted shareholder under Code section 1361(c)(2). This provision, as currently drafted, does not explicitly address an issue that arises with respect to a QSST. 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.) Although the Illinois statute prohibits decanting from a trust that qualifies as an S corporation shareholder trust to one that does not if the trust owns S corporation stock, it does not expressly prohibit decanting from a QSST to another type of trust that qualifies as an S corporation shareholder. The catch-all tax savings provision of the Illinois statute, however, may impose such a restriction if one considers qualifying as an S corporation shareholder a “tax benefit.” Alternatively, the requirement in the Illinois statute that the decanting be in furtherance of the purposes of the trust may implicitly impose a restriction on converting a QSST to a non-QSST.

4. **Retirement Benefits Subject to Minimum Distribution Rules.** 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. The decanting statute provides that if the first trust owns an interest in property subject to the minimum distribution rules of section 401(a)(9) of the Code, an authorized trustee may not exercise the power to decant to distribute part or all of the interest in such property to a second trust that would result in the shortening of the minimum distribution period to which the property is subject in the first trust. Subsection 16.4(p)(3).
5. **Supplemental Needs Trusts.** A special exception with respect to supplemental needs trusts appears to permit an authorized trustee to decant a supplemental needs trust provided that the second trust is not subject to claims of reimbursement by any private or governmental body and does not reduce an individual’s entitlement to governmental benefits. This exception might also be intended to permit mandatory distribution or withdrawal rights to be eliminated if the trustee is decanting to a supplemental needs trust. Subsection 16.4(o) provides:
 - (o) **Exception.** Notwithstanding the provisions of paragraph (1) of subsection (n) but subject to the other limitations in this Section, an authorized trustee may exercise a power authorized by

subsection (c) or (d) to distribute to a second trust; provided, that the exercise of such power does not subject the second trust to claims of reimbursement by any private or governmental body and does not at any time interfere with, reduce the amount of, or jeopardize an individual's entitlement to governmental benefits.

This subsection is problematic. Presumably, it is intended to apply only when the second trust is a supplemental needs trust, but a literalist could argue that it applies to all decantings. Further, it requires that the decanting not subject the second trust to claims of reimbursement by any person or governmental body, but subsection 16.4(d)(4) permits supplemental needs trusts that are "pooled trusts" or that contain payback provisions complying with Medicaid reimbursement requirements. Further, note that subsection 16.4(o) requires that the second trust not "interfere with, reduce the amount of, or jeopardize" the beneficiary's entitlement to government benefits while subsection 16.4(d)(4) requires that the second trust "allow the disabled beneficiary to receive a greater degree of governmental benefits."

6. **Rule Against Perpetuities.** 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. Two different provisions of section 16.4 address the rule against perpetuities. Generally, the same rule against perpetuities period that applied to the first trust will apply to the second trust. Subsection 16.4(g) provides as follows:

- (g) **Term of the second trust.** The second trust to which an authorized trustee distributes the assets of the first trust may have a term that is longer than the term set forth in the first trust, including, but not limited to, a term measured by the lifetime of a current beneficiary; provided, however, that the second trust shall be limited to the same permissible period of the rule against perpetuities that applied to the first trust, unless the first trust expressly permits the trustee to extend or lengthen its perpetuities period.

In addition, subsection 16.4(n)(4) provides that an authorized trustee may not exercise a decanting power “to reduce, limit or modify the perpetuities provision specified in the first trust in the second trust, unless the first trust expressly permits the trustee to do so.”

- a. **Measuring Lives.** While subsection 16.4(g) could be read as permitting the second trust to use a broader class of measuring lives than the first trust, so long as all such lives were in being at the time the first trust became irrevocable, subsection 16.4(n)(4) does not appear to permit the change in the class of measuring lives unless the first trust expressly permits the trustee to do so.
 - b. **Reducing the Rule Against Perpetuities Period.** Subsection 16.4(n)(4) states that the new trust may not “reduce, limit or modify” the rule against perpetuities period. Thus in Illinois apparently the new trust could not adopt a shorter rule against perpetuities period; this restricts the ability to use the decanting statute to merge two trusts, one of which has a shorter rule against perpetuities period.
 - c. **Qualified Perpetual Trusts.** If the first trust is a qualified perpetual trust under the Illinois Statute Concerning Perpetuities, then the rule against perpetuities does not apply. 765 ILCS 305/4(a)(8). In such case, it would appear that a second trust would not be required to be subject to a rule against perpetuities and may also be a qualified perpetual trust. A GST-exempt trust (especially a grandfathered trust), however, might lose its exempt status if the new trust does not comply with the federal rule against perpetuities.
 - d. **Delaware Tax Trap.** The Delaware tax trap could be triggered if the new trust conferred upon a beneficiary a power of appointment that could be exercised in a manner that violated the rule against perpetuities period of the original trust. A number of the decanting statutes expressly require that any power of appointment granted to a beneficiary is subject to the original rule against perpetuities. See, e.g., Delaware, Florida, Indiana, Kentucky, North Carolina and Virginia.
7. **Trustee Fees.** The Illinois decanting statute has a number of provisions regarding trustee fees.
- a. **Changing Provisions Regarding Trustee Compensation.** Subsection 16.4(q)(1) prohibits a trustee from decanting solely to change the provisions regarding the compensation of the trustee. If a trust is being decanted for “other valid and reasonable purposes,” however, the second trust may alter the provisions regarding the compensation of the trustee to “bring the trustee’s compensation

into accord with reasonable limits in accord with Illinois law in effect at the time of the exercise.”

- b. **Trustee Compensation Under Second Trust.** Subsection 16.4(q)(2) provides that the “compensation payable to the trustee or trustees of the first trust may continue to be paid to the trustees of the second trust during the terms of the second trust and may be determined in the same manner as otherwise would have applied in the first trust . . .” Thus whatever compensation arrangement applied with respect to the first trust, absent any valid change to the terms of trustee compensation in the second trust, may continue after the decanting.
- c. **No Special Trustee Fees for Decanting.** Subsection 16.4(q)(2) also provides that “no trustee shall receive any commission or other compensation imposed upon assets distributed due to the distribution of property from the first trust to a second trust pursuant to subsection (c) or (d).” Thus if a trustee has been charging a fee on distribution of principal, such fee would not apply to any distribution of principal resulting from the decanting.

- 8. **Trustee Removal.** The Illinois decanting statute also protects against a trustee decanting to eliminate a person’s right to remove or replace such trustee. Subsection 16.4(n)(3) provides that an authorized trustee may not exercise the decanting power:

- (3) to eliminate a provision granting another person the right to remove or replace the authorized trustee exercising the power under subsection (c) or (d); provided, however, such person’s right to remove or replace the authorized trustee may be eliminated if a separate independent, non-subservient individual or entity, such as a trust protector, acting in a nonfiduciary capacity has the right to remove or replace the authorized trustee;

Thus a trustee may not entrench itself by completely eliminating the rights of other parties to remove or replace the trustee. This subsection appears to be intended to permit a change in the identity of the person who has a right to remove or replace the authorized trustee. For example, a beneficiary’s right of removal could be eliminated provided that the second trust permits a trust protector or a trustee remover to remove the trustee in a nonfiduciary capacity.

- a. **Nonfiduciary Capacity.** Note that this subsection requires that the new trustee remover act in a nonfiduciary capacity. The Illinois directed trust statute provides that a directing party is subject to the same duties and standards applicable to a trustee of a

trust unless the governing instrument provides otherwise, “but the governing instrument may not, however, relieve or exonerate a directing party from the duty to act or withhold acting as the directing party in good faith reasonably believes is in the best interests of the trust.” Subsection 16.3(e). A directing party is defined to include a “trust protector,” which in turn is defined to include a person who has the power to remove, appoint, or remove and appoint a trustee. Section 16.3.

b. **Independent, Nonsubservient.** Further, it is not clear what the definition of an “independent, nonsubservient individual or entity” is. One might refer to section 672 of the Internal Revenue Code, which presumes that a “related or subordinate party” is subservient unless such party is shown not to be subservient by a preponderance of the evidence. Section 672(c) of the Internal Revenue Code defines a “related or subordinate party” to include the grantor’s spouse if living with the grantor; the grantor’s father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; and a subordinate employee of a corporation in which the grantor is an executive. The decanting statute, however, is interested in whether the trustee remover is independent and not subservient *to the trustee*, whereas Code section 672 is interested in whether an individual is subservient *to the grantor*.

9. **Trustee Liability.** The Illinois decanting statute protects against a trustee decanting to a trust that increases a trustee’s protection from liability except to the extent the second trust reallocates fiduciary responsibilities from the trustee to another party by adding distribution advisors, investment advisors, trust protectors or other parties. Subsection 16.4(n)(2) prohibits an authorized trustee from exercising the decanting power:

(2) to decrease or indemnify against a trustee’s liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence, and prudence; except to indemnify or exonerate one party from liability for actions of another party with respect to distribution that unbundles the governance structure of a trust to divide and separate fiduciary and nonfiduciary responsibilities among several parties, including without limitation one or more trustees, distribution advisors, investment advisors, trust protectors, or other parties, provided however that such modified governance structure may reallocate

fiduciary responsibilities from one party to another but may not reduce them;

Thus one could decant a trust to take advantage of the new Illinois directed trust statute, which permits the allocation of powers to an investment trust advisor, distribution trust advisor or trust protector. Section 16.3.

F. **Supplemental Needs Trusts.** The Illinois decanting statute permits an authorized trustee to decant “a disabled beneficiary’s interest in the first trust in favor of a trustee of a second trust which is a supplemental needs trust if the authorized trustee determines that to do so would be in the best interests of the disabled beneficiary.” Subsection 16.4(d)(4)(i).

1. **Disabled Beneficiary.** “ ‘Disabled beneficiary’ means a current beneficiary, presumptive remainder beneficiary, or successor beneficiary of the first trust who the authorized trustee determines has a disability that substantially impairs the beneficiary’s ability to provide for his or her own care or custody and that constitutes a substantial handicap, whether or not the beneficiary has been adjudicated a ‘disabled person’.” Subsection 16.4(d)(4)(ii).
2. **Supplemental Needs Second Trust.** “ ‘Supplemental needs second trust’ means a trust that complies with paragraph (iii) of this paragraph (4) and that relative to the first trust contains either lesser or greater restrictions on the trustee’s power to distribute trust income or principal and which the trustee believes would, if implemented, allow the disabled beneficiary to receive a greater degree of governmental benefits than the disabled beneficiary will receive if no distribution was made.”
3. **Governmental Benefits.** “ ‘Governmental benefits’ means financial aid or services from any State, Federal, or other public agency.” Subsection 16.4(d)(4)(ii).
4. **Best Interests.** “ ‘Best interests’ of a disabled beneficiary include, without limitation, consideration of the financial impact to the disabled beneficiary’s family.” Subsection 16.4(d)(4)(ii).
5. **Remainder Beneficiaries**
 - a. **Remainder Beneficiaries to Remain the Same.** A supplemental needs second trust may name successor and remainder beneficiaries other than the disabled beneficiary’s estate, “provided that the second trust names the same presumptive remainder beneficiaries and successor beneficiaries to the disabled beneficiary’s interest, and in the same proportions, as exist in the first trust.” Subsection 16.4(d)(4)(iii).

- b. **Pooled Trusts and Payback Trusts.** If the first trust was created by the disabled beneficiary or the trust property has been distributed to or is under the control of the disabled beneficiary, the authorized trustee may distribute to a “pooled trust” or the supplemental needs second trust must contain payback provisions that comply with Medicaid reimbursement requirements of federal law. Subsection 16.4(d)(4)(iii).
- 6. **Protection from Governmental Claims.** Significantly, the decanting statute not only authorizes decanting to a supplemental needs trust but also seems to protect directly any supplemental needs second trust from the claims of the State of Illinois. Subsection 16.4(d)(4)(iv) provides: “A supplemental needs second trust shall not be liable to pay or reimburse the State or any public agency for financial aid or services to the disabled individual except as provided in the supplemental needs second trust.”

G. Procedure

- 1. **Notice.** 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.
 - a. **Illinois.** If an authorized trustee wishes to decant without court involvement, the authorized trustee must provide written notice to the legally competent current beneficiaries and presumptive remainder beneficiaries. If there are no legally competent current beneficiaries, or if there are no legally competent presumptive remainder beneficiaries, then the authorized trustee cannot decant without court approval. Subsection 16.4(e) provides that the authorized trustee can decant “without the consent of the settlor or the beneficiaries of the first trust and without court approval if”
 - (1) there are one or more legally competent current beneficiaries and one or more legally competent presumptive remainder beneficiaries and the authorized trustee sends written notice of the trustee’s decision, specifying the manner in which the trustee intends to exercise the power and the prospective effective date for the distribution, to all of the legally competent

current beneficiaries and presumptive remainder beneficiaries, determined as of the date the notice is sent and assuming non-exercise of all powers of appointment; and

- (2) no beneficiary to whom notice was sent objects to the distribution in writing delivered to the trustee within 60 days after the notice is sent (“notice period”).

It is possible that the IRS will take the position that the failure to object is equivalent to consent. If a beneficiary’s consent is required to decant, gift, estate tax and GST tax consequences may result.

- b. **Other States.** A large number of states do not require the trustee to provide notice to the beneficiaries of the old trust before decanting. See, e.g., Arizona, Delaware, Michigan § 556.115a, Missouri, Nevada, South Dakota and Tennessee. New Hampshire requires notice only to charity. The Nevada statute states that the trustee *may* give notice to the beneficiaries. Other states require notice to certain parties a certain number of days prior to decanting. The notice period is often 30 days, but may be as short as 20 days (South Dakota) or as long as 90 days (South Carolina).

2. **Beneficiary Objections.**

- a. **Illinois.** Under subsection 16.4(e) a trustee would be prohibited from decanting without court approval if any legally competent current beneficiary or legally competent presumptive remainder beneficiary objected in writing during the 60-day notice period. An objection made on behalf of a beneficiary who is not legally competent and to whom no notice was sent, for example, an objection by a parent of a minor beneficiary, would not prevent the trustee from decanting without court approval.
- b. **Other States.** In most states an objection by a beneficiary does not prevent the trustee from decanting. The New York statute explicitly states this. Other statutes merely fail to give any effect to a beneficiary objection.

3. **Charitable Beneficiaries.** In Illinois, if a charity is a current beneficiary or a presumptive remainder beneficiary, notice must also be provided to the Attorney General’s Charitable Trust Bureau. Subsection 16.4(e). Presumably, an objection by the Attorney General’s Charitable Trust Bureau would prevent the trustee from decanting without court approval.

4. **Unknown Beneficiaries.** Under the Illinois statute, a trustee is not required to provide notice to a beneficiary who is known to the trustee but who cannot be located by the trustee after reasonable diligence or who is not known to the trustee. Subsection 16.4(e).
5. **Written Instrument.** In Illinois, the actual act of decanting is accomplished by a written instrument signed and acknowledged by the trustee and filed with the records of the first trust and the second trust. Presumably, this instrument would identify the first trust and the second trust, would specify whether all of the principal of the first trust or certain assets of the first trust are being decanted and would state the effective date of the decanting. Subsection 16.4(r) provides as follows:
 - (r) **Written instrument.** The exercise of a power to distribute principal under subsection (c) or (d) must be made by an instrument in writing, signed and acknowledged by the trustee, and filed with the records of the first trust and the second trust.
6. **Application to Court.** In Illinois, a trustee may seek court approval of a proposed decanting if a beneficiary objects within the notice period or if there are no legally competent current beneficiaries or if there are no legally competent presumptive remainder beneficiaries or if the trustee just wants the comfort of a court order. Subsection 16.4(f)(1) provides as follows:
 - (1) The trustee may for any reason elect to petition the court to order the distribution, including, without limitation, the reason that the trustee's exercise of the power to distribute under this Section is unavailable, such as:
 - (a) a beneficiary timely objects to the distribution in a writing delivered to the trustee within the time period specified in the notice; or
 - (b) there are no legally competent current beneficiaries or legally competent presumptive remainder beneficiaries.
 - a. **Beneficiary May Petition.** In Illinois, if the trustee receives an objection within the notice period, either the trustee or the beneficiary "may petition the court to approve, modify, or deny the exercise of the trustee's powers." Subsection 16.4(f)(2).

- b. **Burden of Proof.** In Illinois, the burden of proof is on the trustee to prove that “the proposed exercise of the power furthers the purposes of the trust.” Subsection 16.4(f)(2).
- c. **Duty of Impartiality.** The Illinois statute provides that the trustee does not violate its duty of impartiality by arguing in favor of decanting unless the court finds that the trustee acted in bad faith. Subsection 16.4(f)(3) provides:

- (3) In a judicial proceeding under this subsection (f), the trustee may, but need not, present the trustee’s opinions and reasons for supporting or opposing the proposed distribution, including whether the trustee believes it would enable the trustee to better carry out the purposes of the trust. A trustee’s actions in accordance with this Section shall not be deemed improper or inconsistent with the trustee’s duty of impartiality unless the court finds from all the evidence that the trustee acted in bad faith.

This subsection would appear to protect the trustee from a claim by a beneficiary that the trustee violated its duty of impartiality if the trustee is seeking to modify or eliminate the beneficiary’s rights under the trust.

- 7. **Coordination with Virtual Representation.** The Illinois decanting statute makes clear that it does not limit any rights to decant that a trustee may have under the express terms of the trust. Nor does the decanting statute limit the ability of a trustee and beneficiaries of the first trust to modify the trust under the Illinois virtual representation statute. Subsection 16.4(j) provides:

- (j) **Other authority to distribute in further trust.** This Section shall not be construed to abridge the right of any trustee to distribute property in further trust that arises under the terms of the governing instrument of a trust, any provision of applicable law, or a court order. In addition, distribution of trust principal to a second trust may be made by agreement between a trustee and all primary beneficiaries of a first trust, acting either individually or by their respective representatives in accordance with Section 16.1 of this Act.

As the Illinois virtual representation statute explicitly permits a nonjudicial settlement agreement to address the exercise or nonexercise of any power by a trustee, where possible the trustee who is decanting to a second trust may wish to obtain such an agreement to provide the trustee with protection from liability for decanting beyond that provided by the decanting statute alone. As discussed below, the Illinois decanting statute gives a beneficiary a two-year period (or longer in the case of a beneficiary under a legal disability) to challenge the decanting. If, however, the decanting is approved by a nonjudicial settlement agreement under the Illinois virtual representation statute, it is “final and binding on the trustee and all beneficiaries of the trust, both current and future, as if ordered by a court with competent jurisdiction over all parties in interest.” Subsection 16.1(d)(6).

8. **Tax Identification Number.** Does the second trust need to obtain a new tax identification number? This issue would not arise in the event (1) the second trust is a grantor trust and is permitted to use the grantor’s social security number or (2) the second trust was a trust that was in existence prior to the decanting and already has a tax identification number. Further, in a case where the second trust was newly created for purposes of decanting, if only a portion of the first trust is decanted to the second trust then presumably the second trust should obtain a new tax identification number. If the second trust, however, was newly created for purposes of decanting and all of the assets of the first trust are decanted to the second trust, then it may be reasonable to treat the second trust as simply a continuation of the first trust for income tax purposes. *See* PLR 200736002.
9. **Do Assets Need to be Retitled?** If the second trust has a different tax id number, the decanted trust assets should be retitled to reflect the correct tax id number (and the name of the second trust). If the tax id number does not change; then the trustee should consider where assets should be retitled to reflect the name of the second trust. In some cases a trustee may, for convenience, decide to give the second trust a name identical or similar to the name of the first trust, perhaps adding the phrase “as decanted on _____” or “as modified on _____.”
10. **QTIP Election.** If a QTIP election was made over the first trust, will the QTIP election continue with respect to the second trust? Should the trustee take any action to confirm the election? With respect to a QTIP election, which requires that the trust contain (or not contain) certain provisions to qualify as a QTIP, the election with respect to the first trust should carry over to the second trust to ensure estate tax inclusion in the surviving spouse’s estate under Code section 2044. Nonetheless, until tax guidance is issued, if the second trust has a separate tax identification number, it may be advisable to make a protective election.

Could the IRS argue that the decanting should be treated as a disposition of the trust property by the spouse for gift tax purposes? If the spouse's consent is not required to decant, it would seem difficult for the IRS to argue that the spouse has made a disposition. The IRS could argue that the spouse has made a disposition if the spouse is a trustee or if the spouse's consent is required to decant. In Illinois, the spouse as a current beneficiary would have the ability to force the Trustee to obtain court approval to decant by merely objecting to the decanting within the notice period; the IRS could argue that this right of objection is the equivalent of consent. Even if the spouse is deemed to have consented to the decanting, Code section 2519 should not treat the decanting as a disposition of the property by the spouse for gift tax purposes so long as the spouse has a qualifying income interest for life in the second trust. Treasury regulation section 25.2519-1(f) provides: "The conversion of qualified terminable interest property into other property in which the donee spouse has a qualifying income interest for life is not, for purposes of this section, treated as a disposition of the qualifying income interest." Consequently, until further guidance is issued, when decanting a QTIP trust in Illinois, a QTIP election should be made over the second trust if there is any argument that it is more than a mere modification of the first trust. Exactly how one would do this, is another question!

11. **QSST Election.** If the first trust is a QSST, subsection 16.4(p) of the Illinois statute may require that the second trust also be a trust that would qualify as a QSST with respect to the same income beneficiary. In any event, the Illinois statute requires that the second trust be a permitted shareholder under Code section 1361(c)(2). If the second trust has a separate tax identification number from the first trust, or there is an argument that it is more than a mere modification of the first trust, a new QSST election should be made over the second trust to ensure that the trust is a qualified S corporation shareholder and the decanting is valid.
12. **ESBT Election.** If the first trust is an ESBT, it can be decanted into any trust that is a qualified S corporation shareholder. Thus the second trust could be a grantor trust, a QSST or an ESBT. If the second trust has a separate tax identification number, or if there is an argument that it is more than a mere modification of the first trust, and it is intended to be an ESBT, a separate ESBT election should be made for the second trust.

H. **Later Discovered Assets.** The Illinois decanting statute is one of the few statutes in the nation to explicitly address the assets subsequently discovered after the decanting. The trustee of the first trust may provide at the time of decanting how subsequently discovered assets are to be distributed. If the authorized trustee does not provide such instructions, if the first trust is decanted in its entirety to the second trust and an asset is subsequently discovered that belonged to the first trust, it will be deemed to be owned by the second trust. Thus, for example, if the first trust is designated as the beneficiary of an insurance policy and the

beneficiary designation is not subsequently changed, upon the death of the insured the proceeds of the policy will be paid to the second trust. If the authorized trustee does not provide instructions, in the event that the first trust is only partially decanted in favor of the second trust, then subsequently discovered assets belonging to the first trust are deemed to remain assets of the first trust. Subsection 16.4(i) provides:

- (i) **Later discovered assets.** To the extent the authorized trustee does not provide otherwise:
 - (1) The distribution of all of the assets comprising the principal of the first trust in favor of a second trust shall be deemed to include subsequently discovered assets otherwise belonging to the first trust and undistributed principal paid to or acquired by the first trust subsequent to the distribution in favor of the second trust.
 - (2) The distribution of part but not all of the assets comprising the principal of the first trust in favor of a second trust shall not include subsequently discovered assets belonging to the first trust and principal paid to or acquired by the first trust subsequent to the distribution in favor of a second trust; such assets shall remain the assets of the first trust.

I. **Liability and Remedies.** The Illinois decanting statute protects a trustee who in good faith decants. It also protects a trustee who in good faith does not decant. In addition, it establishes a statute of limitations for bringing claims against a trustee for decanting or failing to decant.

- 1. **No Duty to Decant.** A Trustee has no duty to decant, and “no inference of impropriety shall be made as a result of an authorized trustee not exercising the power” to decant. Subsection 16.4(l). Further, the trustee has no duty to inform the beneficiaries about the availability of decanting or to review the trust to determine if decanting would be advisable. Subsection 16.4(l).
- 2. **Good Faith.** Subsection 16.4(u) protects the trustee if the trustee acts in good faith and creates a presumption that the trustee has acted in good faith unless a court determines there has been an abuse of discretion. Subsection 16.4(u) provides in part:

A trustee who reasonably and in good faith takes or omits to take any action under this Section is not liable to any person interested in the trust. An act or omission by a trustee under this Section is presumed taken or omitted

reasonably and in good faith unless it is determined by the court to have been an abuse of discretion.

3. **Remedies.** The Illinois decanting statute provides that a person's exclusive remedy is to obtain an order of the court directing the decanting. Subsection 16.4(u) provides in part:

If a trustee reasonably and in good faith takes or omits to take any action under this Section and a person interested in the trust opposes the act or omission, the person's exclusive remedy is to obtain an order of the court directing the trustee to exercise authority in accordance with this Section in such manner as the court determines necessary or helpful for the proper functioning of the trust, including without limitation prospectively to modify or reverse a prior exercise of such authority.

4. **Statute of Limitations.** The Illinois decanting statute generally provides a two-year statute of limitations except in the case of a beneficiary under a legal disability. Subsection 16.4(u) provides in part:

Any claim by any person interested in the trust that an act or omission by a trustee under this Section was an abuse of discretion is barred if not asserted in a proceeding commenced by or on behalf of the person within two years after the trustee has sent to the person or the person's personal representative a notice or report in writing sufficiently disclosing facts fundamental to the claim such that the person knew or reasonably should have known of the claim. Except for a distribution of trust principal from a first trust to a second trust made by agreement in accordance with Section 16.1 of this Act, the preceding sentence shall not apply to a person who was under a legal disability at the time the notice or report was sent and who then had no personal representative. For purposes of this subsection (u), a personal representative refers to a court appointed guardian or conservator of the estate of a person.

- a. **Beneficiary Who Received Notice.** Although a trustee may decant if notice has been provided to all current beneficiaries and presumptive remainder beneficiaries who are not under any legal disability and none of them have objected within the 60-day notice period, a beneficiary receiving notice appears to still have a two-year period from the date of notice within which to bring a court action to undo the decanting. Thus in cases where the changes made by the decanting do not raise any potential tax implications, the trustee may prefer to obtain the consent of such beneficiaries to the decanting.

- b. **Beneficiaries Under a Legal Disability.** The statute does not require that the trustee provide notice of the proposed decanting to beneficiaries who are under a legal disability. Such beneficiaries may bring a court action to reverse the decanting at any time until two years have passed from the time they received notice of the decanting. Thus the trustee may wish to provide notice, either prior to or immediately after decanting, to beneficiaries under a legal disability who have a court appointed guardian or conservator of the estate even though such notice is not required. Further, where a beneficiary is under a legal disability at the time of decanting but subsequently gains legal capacity, the trustee may wish to provide notice at the time legal capacity is acquired so that the statute of limitations will begin to run. Alternatively, the trustee may wish to obtain court approval of the decanting which, while it would not appear to prevent a beneficiary who was under a legal disability from subsequently bringing a claim, would make it unlikely that the court would find that the prior court-approved decanting was an abuse of discretion that should be reversed.
- c. **Consent.** Presumably, a beneficiary who has legal capacity could consent to the trustee's exercise of the decanting power and waive the right to bring a subsequent claim that such exercise was an abuse of discretion. Consenting to decanting may (but probably should not) have tax consequences depending upon the nature of the decanting and how the tax rules develop.
- d. **Virtual Representation.** The risk that a beneficiary could in the future bring a court action to reverse the decanting can be eliminated if the trust modification can be made pursuant to a private settlement agreement under the Illinois virtual representation statute. The virtual representation statute, however, generally will permit only modifications arising out of a settlement of a dispute or that are administrative in nature.

J. **Effective Date.** The Illinois decanting statute was effective on January 1, 2013.

K. **Applicability.** In order to determine whether the decanting statute of a particular state can be used, first the statute should be reviewed to see if it contains specific provisions defining the trusts to which it applies. For example, the statute may require that its state law govern the administration of the trust or the construction of its terms. Generally, decanting is available to trusts regardless of whether they were established before or after the enactment of the decanting statute.

- 1. **Pre-existing Trusts.** The Illinois decanting statute applies to trusts in existence on January 1, 2013, or created on or after January 1, 2013. Subsection 16.4(v).

2. **Illinois Trusts.** The Illinois decanting statute applies to (1) any trust that is administered in Illinois under Illinois law or (2) that is governed by Illinois law with respect to the meaning and effect of its terms, including a trust whose governing law has been changed to the law of this state. Subsection 16.4(v). Thus a trust governed by Illinois law for purposes of construction may avail itself of the Illinois decanting statute even if such trust is governed by the law of another state for purposes of administration. In addition, a trust that is governed by Illinois law for purposes of administration may avail itself of the Illinois decanting statute provided that such trust is administered in Illinois. It is not clear whether a trust that is governed by the law of another state for purposes of construction, but that is governed by Illinois law for purposes of administration but not administered in Illinois could avail itself of the Illinois decanting statute. Arguably, any trust governed by the law of Illinois for purposes of administration should be able to avail itself of the statute. This construction is supported by the fact that the second sentence of subsection 16.4(v) states that the statute “shall be construed as pertaining to the administration of a trust.”
3. **Express Prohibition.** The Illinois decanting statute cannot be used if a trust expressly prohibits the use of such statute. The Illinois statute has two separate provisions on trust prohibitions on decanting, one of which requires express reference to the Illinois statute. Section 5/16.4(m) states:
 - (m) **Express prohibition.** A power authorized by subsection (c) or (d) may not be exercised if expressly prohibited by the terms of the governing instrument, but a general prohibition of the amendment or revocation of the first trust or a provision that constitutes a spendthrift clause shall not preclude the exercise of a power under subsection (c) or (d).

Section 5/16.4(v) states in part:

- (v) **Application.** . . . This Section shall be construed as pertaining to the administration of a trust and shall be available to any trust that is administered in Illinois under Illinois law or that is governed by Illinois law with respect to the meaning and effect of its terms, including a trust whose governing law has been changed to the laws of this State, unless the governing instrument expressly prohibits use of this Section *by specific reference to this Section*. A provision in the governing instrument in the form: “Neither the provisions of Section 16.4 of the Trusts and Trustees Act nor any corresponding provision of future law may be used in the administration of

this trust” or a similar provision demonstrating that intent is sufficient to preclude the use of this Section.

(Emphasis added.)

Under 5/16.4(v), a prohibition in a trust that generically prohibits the use of decanting under any state statute would not be sufficient because it would not specifically refer to the Illinois decanting statute. Further, a provision in a trust prohibiting amendment of the trust or a provision stating that a trust is irrevocable would not be sufficient to prohibit decanting.

IV. Tax Issues

A. **Tax Uncertainty.** The tax consequences of decanting are unclear under many circumstances.

1. **No Private Rulings.** The IRS will not rule on the tax consequences of a decanting that changes beneficial interests. Rev. Proc. 2011-3.
2. **Request for Comments.** In Notice 2011-101, the IRS requested comments on the tax consequences of decanting that changed beneficial interests. The American College of Trusts and Estates Counsel, various bar associations and others responded with detailed comments.
3. **No Priority Guidance.** Decanting was on the 2011-2012 Priority Guidance Plan, but is not on the 2012-2013 Priority Guidance Plan.
4. **Uniform Law Statute.** The Uniform Law Commission has formed a drafting committee to draft a uniform decanting statute.

B. Income Tax

1. **Conversion of Grantor Trust to Nongrantor Trust.** If a trust owns assets that have liabilities that exceed the property’s income tax basis, a conversion of a grantor trust to a nongrantor trust may cause the grantor to recognize gain to the extent the liabilities exceed the basis. Blattmachr, Jonathan G., Horn, Jerold, Zeydel, Diana, “An Analysis of the Tax Effects of Decanting,” 47 *Real Property, Trust and Estate Law Journal* 141 (Spring 2012) (hereafter, “Tax Effects”); see *Madorin v. Comm’r*, 84 T.C. 667 (1985).
2. **Conversion of Nongrantor Trust to Grantor Trust.** The conversion of a nongrantor trust to a grantor trust does not appear to have any income tax consequences. See Tax Effects at 159, citing Chief Counsel Memo. 200923024; Rev. Rul. 2004-64, 2004-2 C.B. 7.

3. **Negative Basis Assets.** When the trust property has a liability against it that exceeds the property's income tax basis (a "negative basis" asset), it is possible that decanting the negative basis assets will result in the recognition of gain. *See* Tax Effects at 156; *Crane v. Comm'r*, 331 U.S. 1 (1947).
4. **Beneficiary Recognition of Gain.** It is possible that under the doctrine of *Cottage Savings Ass'n v. Comm'r*, 499 U.S. 554 (1991), the IRS may take the position that a beneficiary recognizes gain if the decanting changes the quality of the beneficiary's interest and the beneficiary's consent (or possibly the court's approval) is required for the decanting. *See* Tax Effects at 157-159. This may be of concern under the Illinois statute. While the Illinois statute does not require a beneficiary's affirmative consent, it does prohibit decanting without court approval if the beneficiary objects within the 60-day notice period. The IRS could construe the ability of a beneficiary to block decanting by objecting within the notice period as the equivalent of beneficiary consent.
5. **Conversion of a Domestic Trust to a Foreign Trust.** The conversion of a domestic trust to a foreign trust may result in the recognition of gain under Code section 684. *See* Tax Effects at 159.
6. **The Accidental Grantor Trust.** Several of the exceptions to grantor trust treatment in Code section 674, such as the power to distribute corpus subject to an ascertainable standard (Code section 674(b)(5)(A)), the power to withhold income during the disability of a beneficiary (Code section 674(b)(7)) and the power of an independent trustee to make distributions (Code section 674(c)), do not apply if any person has a power to add a beneficiary to the class designated to receive income or corpus. The Illinois decanting statute permits a trustee who has absolute discretion to decant to a trust "for the benefit of one, more than one, or all of the current beneficiaries of the first trust and for the benefit of one, more than one, or all of the successor and remainder beneficiaries of the first trust" and does not prohibit advancing a remainder beneficiary into the class of current beneficiaries. It is possible that the mere existence of this decanting power, whether or not exercised, causes a trust to be a grantor trust. *See* Tax Effects at 159-160. In a trust intended to be a nongrantor trust, one could in drafting the trust preclude the use of the decanting power in a manner that would permit the trustees to add to the class of beneficiaries within the meaning of section 674, but only by specific reference to the Illinois decanting statute. *See* section 16.4(v).

C. Estate and Gift Tax

1. **Gift Tax.** Under the Illinois decanting statute, a trustee who has absolute discretion may decant to a second trust that eliminates, reduces or restricts the interest of a beneficiary. If such beneficiary is legally competent, such beneficiary will receive written notice of the trustee's intent to decant and

can block the decanting by an objection in writing delivered to the trustee within the 60-day notice period. If a beneficiary whose interest in the trust will be reduced or eliminated by decanting fails to object, will such beneficiary be treated as making a gift to the trust or the other beneficiaries of the trust? *See* Tax Effects at 160-164. Under the Illinois decanting statute, a beneficiary who is not legally competent is not required to receive notice and, if the trustee does not provide notice to such beneficiary, would have no power to object. Thus the gift tax risk would seem not to be present in a case where the beneficiary whose interest was being reduced or eliminated was not legally competent.

2. **Estate Tax.** If decanting reduced or eliminated a beneficiary's interest in a manner that resulted in a gift, then such beneficiary's estate might include the trust assets if Code section 2035, 2036, 2037, 2038, 2039 or 2042 applied. *See* Tax Effects at 164-165. For example, if the beneficiary was the trustee of the second trust with the power to make discretionary distributions, then the decanted property subject to gift tax might be included in the beneficiary's estate under section 2036(a).

D. GST Tax

1. **Grandfathered Trusts.** Generally trusts that were irrevocable on September 30, 1985, are grandfathered from the GST tax. Such grandfathering is lost if there is an addition or constructive addition to the grandfathered trust.

- a. A grandfathered trust will not lose its grandfathered status after being decanted if at the time the trust became irrevocable state law authorized the decanting and the terms of the second trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus the period of 21 years. More specifically, Treasury Regulation section 26.2601-1(b)(4)(i)(A) provides as follows:

(A) *Discretionary powers.* – The distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the provisions of chapter 13, if –

(1) Either –

(i) The terms of the governing instrument of the exempt trust authorize

distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; or

(ii) at the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or court; and

(2) The terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation. For purposes of this paragraph (b)(4)(i)(A), the exercise of a trustee's distributive power that validly postpones or suspends the vesting, absolute ownership, or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date the original trust became irrevocable) will not be considered an exercise that postpones or suspends vesting, absolute ownership, or the power of alienation beyond the perpetuities period. If a distributive power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

- b. Alternatively, the grandfathering will not be affected if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Treas. Reg. § 26.2601-1(b)(4)(i)(D). Grandfathered Illinois trusts arguably did not have any ability to decant at the time they became irrevocable and thus would not meet the requirements of Treasury Regulations section 26.2601-1(b)(4)(i)(A). Thus any decanting of such trusts would have to meet the requirement that the modification does not shift a beneficial interest to any beneficiary in a lower generation.

2. **GST-Exempt Trusts.** If a trust is exempt from GST tax by reason of allocation of GST exemption, at a minimum any change to such trust by decanting that would not affect the GST-exempt status of a grandfathered trust should not affect the GST-exempt status of such trust. *See* PLR 200919009. Thus if such a trust was created after January 1, 2013, when the decanting statute became effective, and the decanting did not extend the time for vesting, the decanting should not affect the GST inclusion ratio of the trust. Alternatively, if the decanting does not shift a beneficial interest in the trust to a beneficiary in a lower generation and does not extend the time for vesting, then the decanting should not change the inclusion ratio of the trust. *See* PLR 200227020; PLR 9804046; PLR 9737024; PLR 9438023.
3. **Severed Trusts.** Some decantings may create separate trusts. Thus the issue may arise as to whether the second trusts are treated as separate trusts for GST purposes. Treasury Regulation section 26.2642-6 sets forth the rules for a qualified severance. If the severance is not qualified, the GST tax regulations will still treat the trusts as separate provided that state law recognizes the post-severance trusts as separate trusts. *Treas. Reg. § 26.2642-6(h).*

V. Hypotheticals

A. Administrative Change

1. **Hypothetical.** Grantor established an irrevocable trust. The trust permits the Trustee to make discretionary distributions of income and principal to Child and Child's descendants for "health, education and support." Upon Child's death Child has a power to appoint to Child's spouse and descendants. In default of appointment, the assets will be allocated in shares per stirpes for Child's descendants, to be held in separate trusts on similar terms.

The Trustee would like to purchase and hold a residence in which Child would live, and would like explicit authority to do so because the residence would comprise a substantial portion of the trust assets.

Grantor's brother is the Trustee and Trust Company is successor Trustee. The Trust Agreement does not permit the individual Trustee to designate successor Trustees and does not give anyone the power to remove and replace the corporate Trustee. The Trustee would like the ability to designate a successor Trustee and would like to give the income beneficiaries a right to remove and replace the corporate Trustee, if any.

2. **Analysis.** If it furthers the purposes of the trust, the Trustee may decant to a second trust that would explicitly authorize the Trustee to purchase and hold a residence in which Child would live, permit the Trustee to designate a successor Trustee and give the income beneficiaries a right to

remove and replace the corporate Trustee, if any. The Trustee may decant without court approval if one of Child's descendants is legally competent and no beneficiary objects to the decanting within the 60-day notice period.

B. Trustee Change

1. **Hypothetical.** Grantor established an irrevocable trust for Child A that permits the Trustee to make discretionary distributions of income and principal to Child A. Upon the death of Child A, the assets will be distributed to Child A's descendants in shares per stirpes. Grantor's spouse is the Trustee of the trust. Grantor's spouse is now in her 90s and would like to designate Child B as Trustee for Child A. Further, grantor's spouse would like to permit an acting Trustee to designate successor Trustees. The trust, however, provides that if grantor's spouse ceases to act Trust Company will become the Trustee.
2. **Analysis.** If it furthers the purposes of the trust, the Trustee can decant to a second trust that modifies the trustee provisions to make Child B the Trustee and to give an acting Trustee the power to designate successor trustees. The Trustee may decant without court approval if Child A and one of Child A's descendants are legally competent and no beneficiary objects to the decanting within the 60-day notice period.

C. Create a Supplemental Needs Trust

1. **Hypothetical.** Grantor established an irrevocable trust. The trust permits the Trustee to make discretionary distributions of income and principal to Grantor's children, Child A, Child B, and Child C, and their respective descendants for "health, education and support." Upon the death of the last to die of Child A, Child B, and Child C, the assets will be allocated in equal shares per stirpes for each Child's descendants, to be held in separate trusts on similar terms.

Child C is unmarried and has no children. Child C is involved in a serious car accident and is rendered permanently incapacitated and will be eligible for public assistance, such as social security disability and Medicare. The Trustee is concerned that the assets in the trust will be considered resources available to Child C for her support and the assets of the trust will be dissipated to provide for her health and support. The Trustee would like to transfer one-third of the assets of the trust to a new special needs trust for the benefit of Child C for Child C's lifetime, with the remainder to be held in separate trusts for the benefit of the descendants of Child A and Child B.

Alternatively, could Child C be eliminated as a beneficiary if the Trustee believes that other assets will be sufficient for his support?

2. **Analysis.** Even though the Trustee does not have absolute discretion, the Trustee may decant part of the trust to a separate supplemental needs trust for Child C provided that it is in the best interests of Child C considering the financial impact to the family and the second trust will allow Child C to receive a greater degree of governmental benefits than Child C would receive if no distribution were made. Because the Trustee does not have absolute discretion, the Trustee cannot decant to a trust that eliminates the interest of Child C. The Trustee may decant without court approval if one of the current beneficiaries and one of the presumptive remainder beneficiaries are legally competent and no beneficiary objects to the decanting within the 60-day notice period.

D. Cut Out or Limit the Beneficiary

1. **Hypothetical.** Grantor established an irrevocable trust. The trust permits the Trustee to make discretionary distributions of income and principal to Grantor's children, Child A, Child B, and Child C for their best interests. Upon the death of the survivor of the children, the assets will be allocated in equal shares per stirpes for each of Grantor's descendants, to be held in separate trusts on similar terms.

Child C is legally competent, independently wealthy and no longer desires to have an interest in the trust. The Trustee would like to eliminate Child C as a beneficiary.

2. **Analysis.** If it furthers the purposes of the trust, because the Trustee has absolute discretion to make distributions, the Trustee can decant in a manner that would eliminate Child C as a beneficiary. Because Child C could object within the 60-day notice period, there may be gift tax consequences.

E. Add a Beneficiary

1. **Hypothetical.** Grantor established an irrevocable GST trust. The trust permits the Trustee to make discretionary distributions of income and principal to grantor's children, Child A, Child B and Child C for their "health, education, support and best interests." Upon the death of the last to die of Child A, Child B and Child C, the assets will be allocated in shares per stirpes for grantor's then living descendants, to be held in separate GST Trusts on similar terms. The trust defines "descendants" to exclude adopted children. Child C has two adopted children. The Trustee would like to decant to a trust that would treat adopted children the same as natural children. Child A, Child B and Child C are all legally competent, as is Child A's oldest child. Child B's children are all minors.
2. **Analysis.** The Trustee cannot decant to add a beneficiary. However, because the Trustee has absolute discretion, if it furthers the purposes of the trust the Trustee can decant to a trust that gives each child a broad

power of appointment that would permit Child C to appoint in favor of her adopted children. The Trustee can decant without court approval if Child A, Child B, Child C and Child A's adult child do not object within the 60-day notice period.

F. Divide a Trust

1. **Hypothetical.** Grantor established an irrevocable GST Trust. The trust permits the Trustee to make discretionary distributions of income and principal to grantor's children, Child A, Child B and Child C, and their respective descendants for "their happiness and comfort." Upon the death of the last to die of Child A, Child B and Child C, the assets will be allocated per stirpes for grantor's descendants, to be held in separate GST Trusts. The children have different investment preferences and anticipate that unequal distributions may be made from the trust to the three family lines. The Trustee would like to decant the trust to create a separate trust for each of the children.
2. **Analysis.** The Trustee may decant to separate trusts for each of the children if it furthers the purposes of the trust. The ability to distribute for "happiness," and arguably the ability to distribute for "comfort," constitutes absolute discretion. Note, however, that the Trustee may also be able to divide a trust under the severance and consolidation provision of the Trusts and Trustees Act. 760 ILCS 5/4.25. The Trustee may wish to follow the GST rules for a "qualified severance."

VI. Considerations

- A. **What state statute(s) applies to the trust?**
- B. **Does the applicable state statute permit decanting?**
- C. **Does the applicable state statute permit decanting to achieve the desired result?**
- D. **Are there income, estate, gift or GST tax consequences or risks?**
- E. **Is the proposed decanting consistent with the material purposes of the trust?**
- F. **Should the trustee decant?**
- G. **What notice is required? Advisable?**
- H. **Is beneficiary consent desirable? Does it increase tax risks?**
- I. **Is court approval required? Desirable?**
- J. **Are there better alternatives to achieve the desired result?**

VII. **Partial Checklist for Decanting Instrument.**

- A. **Governing Law.** Identify the law governing the construction of the trust, the law governing the administration of the trust and the place of administration. Does the statute apply to the trust?
- B. **Trust Provisions.** Does the trust contain its own provisions for decanting? Does it expressly prohibit decanting?
- C. **Trust Purpose.** What is the purpose of the trust? Does the proposed decanting further the trust purpose?
- D. **Trustee.** Identify the person (usually trustees) with the ability to distribute principal. Is the discretion absolute or not?
- E. **Beneficiaries.** Identify the current beneficiaries and the presumptive remainder beneficiaries, whether they have legal capacity and whether they have been provided notice of the decanting.
- F. **Powers of Appointment.** If the first trust grants a power of appointment, address the affect of a purported exercise of the power of appointment over the first trust.
- G. **Further Decanting.** Consider if the second trust should prohibit, authorize, or change the procedure for further decanting.
- H. **Rule Against Perpetuities.** The rule against perpetuities provision in the second trust should be the same period that applied to the first trust, unless the first trust expressly permits a change and the change will not create tax issues. If the first trust is a qualified perpetual trust and is also GST exempt, consider whether the second trust must comply with the federal rule against perpetuities to avoid adverse GST tax consequences.
- I. **Confirm Tax Elections.** If the first trust was a QTIP, QSST or an ESBT intended to continue as an ESBT, state the intent that the second trust will qualify as such and consider whether a separate election must be made for the second trust.
- J. **New Trust or Continuation.** State whether the second trust is merely a modification and continuation of the first trust, and will continue to use the same tax identification number, or whether the second trust will be a new trust using a separate tax identification number.
- K. **Future Decanting.** Consider whether to expressly permit (or limit) future decanting on different terms than permitted by the Illinois statute. For example, the second trust could permit future decanting but eliminate the right of beneficiaries to object to the decanting without going to court. Alternatively, if the decanting changes an absolute discretion standard to a more restrictive

distribution standard, the second trust might permit future decanting as if the trustee had retained absolute discretion.

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APPENDIX I

STATE DECANTING STATUTES PASSED OR PROPOSED

**compiled by M. Patricia Culler¹
Hahn Loeser & Parks LLP, Cleveland, OH**

DECANTING STATUTES as of July 1, 2013			
	State	Statutory Cite	Effective Date/Status
1.	Alaska	Alaska Stat. § 13.36.157 Amendments-- SB 165: http://www.legis.state.ak.us/PDF/28/Bills/SB0065Z.PDF	9/15/98; amended 2006; amended by SB 65 eff. 9/9/13
2.	Arizona	Ariz. Rev. Stat. § 14-10819	9/30/09, amended 7/20/11
3.	Delaware	12 Del. Code § 3528	6/30/03, amended 6/24/04, 6/27/06, 7/5/07, 7/6/09, 7/13/11
4.	Florida	Fla. Stat. § 736.04117	1/1/07
5.	Illinois	760 Ill. Comp. Stat. 5/§ 16.4	1/1/13
6.	Indiana	Ind. Code 30-4-3-36	7/1/10
7.	Kentucky	Ky. Rev. Stat. § 386.175	7/12/12
8.	Michigan	Mich. Comp. Laws § 700.7820a Mich. Comp. Laws § 556.115a Mich. Comp. Laws § 700.7103 (definitions)	12/28/12
9.	Missouri	Mo. Rev. Stat. § 456.4-419	8/28/11
10.	Nevada	Nev. Rev. Stat. 163.556	10/1/09, amended 10/1/11
11.	New Hampshire	N.H. Rev. Stat. § 564-B:4-418	9/9/08
12.	New York	N.Y. Est. Powers & Trusts § 10-6.6(b)-(s)	7/24/92, amended 8/17/11
13.	North	N.C. Gen. Stat. 36C-8-816.1	10/1/09, amended 7/20/10

¹ With help from (and thanks to) the ACTEC fellows who provided information, particularly regarding bills recently introduced or passed.

DECANTING STATUTES as of July 1, 2013

	State	Statutory Cite	Effective Date/Status
	Carolina		
14.	Ohio	Ohio Rev. Code § 5808.18	3/22/12, amended 3/27/13
15.	Rhode Island	R.I. Gen. Laws § 18-4-31. Proposed amendments (identical bills): H5501: http://webserver.rilin.state.ri.us/BillText/BillText13/HouseText13/H5501.pdf S0286: http://webserver.rilin.state.ri.us/BillText/BillText13/SenateText13/S0286.pdf	6/23/12 Amendments in S0286 passed by Senate 3/27/13 H5501 introduced 2/14/13 Scheduled for consideration 6/18/13
16.	South Carolina	§62-7-816A: S. 143 http://www.scstatehouse.gov/sess120_2013-2014/bills/143.htm	Eff. 1/1/14
17.	South Dakota	S.D. Codified Laws §§ 55-2-15 through 55-2-21 http://legis.state.sd.us/sessions/2013/Bill.aspx?Bill=1056	3/5/07, amended 2008, 2008, 2011, 3/2/12, 3/25/13 (amendment Signed by Governor)
18.	Tennessee	Tenn. Code § 35-15-816(b)(27) Amended by SB 713/HA0331: http://state.tn.us/sos/acts/108/pub/pc0390.pdf	7/1/04, amended 7/1/13
19.	Texas	Texas Trust Code §§112.071-112.089 http://www.legis.state.tx.us/BillLookup/Text.aspx?LegSes=83R&Bill=HB2913	9/1/13
20.	Virginia	Va. Code § 55-548.16:1 Code of VA (original enactment) Va. Code § 64.2-778.1 (renumbered as part of consolidation of trust and estate laws)	7/1/12 10/1/12
21.	Wyoming	W.S. 4-10-816(a)(xxviii) http://legisweb.state.wy.us/2013/Enroll/HB0139.pdf	7/1/13