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PUTTING OLD WINE IN A NEW BOTTLE. WILL IT AGE BETTER? DECANTING A TRUST

MASS LAWYERS WEEKLY – TRUSTWORTHY ADVISOR
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May 2017

Even estate planners who don't drink wine (there can't be many) must by now be quite familiar with the term, "decanting". The act of decanting occurs where a trustee of a discretionary trust elects to distribute all or a portion of the trust assets to a new or different trust "for the benefit of" one or more beneficiaries of the first trust. In some respects this could be regarded as a drastic move, but experience has shown us that decanting can quickly and easily solve the problem of an irrevocable trust whose terms have become outdated, or inconsistent with family circumstances, or in conflict with the settlor's wishes.

One problem with decanting has been that there is very little law on the subject, so courts have had to take a basic look at trust law and justify that a transfer most or all of the entire trust corpus to a new trust (the "receiving trust") would fall under the trustee's authority to make a distribution that was "for the benefit of" the subject beneficiaries. That is to say, if a receiving trust were created and the trustee of the receiving trust was authorized to provide for a particular beneficiary at the trustee's discretion, would a distribution to the receiving trust qualify as a distribution "for the benefit of" the subject beneficiary of the original trust, even though the trustee of the receiving trust may or may not decide to make distributions to or for the

beneficiary, depending on the exercise of its discretion? And what if there were two or three beneficiaries of the original trust and only one or two included in the receiving trust? Would it be enough to argue that this is justified because the trustee's discretion in the original trust allowed the trustee to favor one beneficiary over the others? Do the beneficiaries who are omitted from the receiving trust have a basis to object?

As the decanting idea took hold in the estate planning community (and take hold, it did!), states began to adopt specific decanting statutes, establishing rules to follow to achieve an enforceable, valid decanting. At last count, 25 states have adopted such statutes, 6 of which are based on the Uniform Law Commission's Uniform Trust Decanting Act (CO, IL, NC, NM, NV, and VA). Both the Uniform Act and most of the state acts require that the trust beneficiaries receive notice of the proposed decanting and that the new trust may not include any beneficiaries who are not beneficiaries of the first trust. Other provisions of the new trust, however, may be quite different. For instance, a trust that calls for distribution to a beneficiary at age 21 may be decanted into a trust that postpones distribution to a later age, or it may change the frequency or conditions of distribution, such as removing or adding a restrictive standard (such as health, education, maintenance, and support) or it may grant the beneficiary a general or nongeneral power of appointment, or it may even under some decanting statutes omit one or more of the beneficiaries of the original trust

Although Massachusetts is not one of the states with a specific decanting statute, it has nevertheless provided us with a couple of high court decisions that offer some insight as to how

we treat decanting, as well as some very helpful observations on trust drafting where we may want the option of decanting in the future.

The first case involved the famous New England Patriots' Kraft family. Several years ago, Bob and Myra Kraft established an irrevocable trust for their four sons; who were minors at the time and so could not serve as trustees. The trusts were intended to pass the trust assets to the Krafts' grandchildren without being exposed to the federal generation skipping transfer (GST) tax. In time, the Krafts wished their now grown sons to serve as trustees, but that was prohibited by the existing trust. The Krafts petitioned the court to rule that a decanting of the existing trust into a new trust with their sons as trustees (but with the same beneficial provisions as the old) would be permitted, "without the consent or approval of any beneficiary or court." (This language was important to avoid the GST tax).

In ruling on the trustee's authority to decant, the Supreme Judicial Court focused on the language of the trust, which gave the trustee the broad power to "take any steps" in furtherance of its administration that would serve the beneficiaries' best interests, "in their discretion, without order or license of court." Aided by an affidavit of Mr. Kraft setting forth his intentions in establishing the trust, the court confirmed that the trust authorized the decanting without special approval of the court or the beneficiaries. In short, the Krafts got what they wanted by a decanting.

A more recent case on the question of decanting came before the Supreme Judicial Court (SJC) two months ago (March 2017). This case involved a Connecticut divorce action (Michael Ferri, Trustee v. Nancy Powell-Ferri), where the husband, Paul, was the beneficiary of a 1983 trust established in Massachusetts by his father. In the midst of the divorce case, the trustee of Paul's trust elected to decant substantially all of the trust funds to a new, irrevocable, fully discretionary spendthrift trust for Paul's benefit (the 2011 trust), so as to prevent Nancy's access to those funds. An important aspect of the case which made it unique was that under the terms of the 1983 trust, Paul had the power to withdraw up to 75% of the trust funds at the time of the decanting.

In light of Paul's power to withdraw, Nancy asked the court to order a return all of the 1983 trust funds, and the Connecticut Superior Court on summary judgment agreed in principal, but ordered the return of 75% of the trust funds, the amount subject to withdrawal at the time of the decanting. On appeal, because the trust was governed by Massachusetts law, the Connecticut Supreme Court certified three questions for the SJC to answer, including the one we'll primarily discuss here, which is whether or not the decanting was, under Massachusetts law, authorized under the terms of the Ferri trust.

As with the Kraft trust, the SJC focused on the language of the trust to determine whether the power granted to the trustees was broad enough to allow such a significant move. And as with the Kraft trust, the language of Ferri trust was also quite strong. It allowed the trustee, for example, "to pay to or segregate irrevocably" the income and principal for later payment to the

beneficiary, for "so long as the beneficiary is living." Such language, the SJC concluded, was convincing evidence that the trustee had the authority to decant the funds to another trust.

A troublesome aspect of the case to some, however, was the fact that even as the trustees were preparing to decant, Paul had the power to withdraw 75% of the trust assets (later increasing to 100%). This seemed inconsistent with the conclusion that the trustees could nevertheless decant the trust assets into a protective trust for Paul. The SJC dealt with this by noting that the trustee's authority to decant was a parallel but separate power, exercisable independently from Paul's power to withdraw, which would be lost to the extent of the decanting prior to his exercise of the power. To hold otherwise would be to put the trustee in an untenable position, that of having legal title to property it is unable to control in the manner of a fiduciary.

The clear message in both the *Kraft* and the *Ferri* cases is that the language of the trust is controlling. If the settlor wishes a trust to allow for decanting, the drafter must include language in the trustee powers clause that clearly allows distribution to another trust "for the benefit of" one or more of the beneficiaries, and include expressions of the settlor's intent that clearly contemplates the trustee's option to make such decanting distributions. If the trust is ambiguous, however, all may not be lost. As long as the trust does not specifically prohibit decanting, the SJC held that a post-execution affidavit by the settlor setting forth his intent at the time establishment of the trust (which Papa Ferri provided) can save the day, and tip the scale towards finding a decanting power.

An interesting planning issue raised in the *Ferri* case is the income tax consequence of Paul's power to withdraw. Tax Code section 678 provides that Paul would be taxed on trust income (whether or not paid out) to the extent of his withdrawal powers. IRC section 678. This is no hardship to Paul, as he could exercise his power to withdraw to gain access to funds to pay the income tax. Upon the decanting, some might argue that Paul's power of withdrawal lapsed, and the tax law would treat him as the transferor of the trust property to the extent the value of the trust property subject to the lapse exceeded the greater of $5,000 or 5% of the trust property. IRC section 2514. So he would still have the income tax liability but not the withdrawal power to get the funds to pay the income tax. Sad, some might argue.