



# WRMarketplace

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The *WRMarketplace* is created exclusively for AALU members by experts at Greenberg Traurig and the AALU staff, led **by Jonathan M. Forster, Steven B. Lapidus, Martin Kalb, Richard A. Sirus, and Rebecca Manicone**. *WRMarketplace #17-22* was written by Greenberg Traurig Associate Ashley Sawyer.

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## TOPIC: New Rules on Trust Decanting – Coming to a State Near You?

**MARKET TREND:** Clients want permanence and flexibility in irrevocable trust planning, which is increasing their use of (and the states’ need to regulate) trust decanting.

**SYNOPSIS:** Generally, a trust decanting statutorily authorizes a trustee to transfer assets from an existing trust to a new or another existing trust with different terms. The process allows modifications to irrevocable trusts without expensive judicial proceedings and may be used to achieve a wide range of goals, such as correcting drafting errors, changing administrative or distributions standards, and/or avoiding a transfer for value and valuation issues when transferring a life insurance policy from one trust to another. This significant flexibility has made decanting increasingly popular, which may lead more states to enact new or revised decanting legislation based on the Uniform Trust Decanting Act, finalized in July 2015.

**TAKE AWAYS:** Decanting offers a practical and economical solution to adapt irrevocable trusts to changing circumstances that may occur over multiple generations. For the trust and beneficiaries, it avoids the cost and publicity of judicial proceedings or

the administrative difficulties of valuing and transferring assets to another trust through a sale. With the release of the Uniform Trust Decanting Act, which provides a more comprehensive set of purposes for decanting, increases transparency of the process, enumerates the importance of considering tax issues, and provides added protection to both trust beneficiaries and acting fiduciaries, more states may soon follow in the footsteps of Virginia, New Mexico, and Colorado to adopt this new framework.

**PRIOR REPORTS:** 12-2; 14-21.

**MAJOR REFERENCES:** Uniform Trust Decanting Act (July 2015); Va. Code §§ 64.2-779.1 et. seq. (Effective July 1, 2017).

A trust decanting statutorily authorizes a trustee to transfer assets from an existing trust (“**original trust**”) to a new or another existing trust, with different terms (“**second trust**”). This flexibility has made decanting increasingly popular, which may lead more states to enact new or revised decanting legislation based on the Uniform Trust Decanting Act, finalized in July 2015 (“**UTDA**”). As the UTDA differs in certain respects from many existing state decanting laws, it is beneficial to understand the potential impact of, and opportunities provided by, its more noteworthy provisions for trust and life insurance planning.

### ***WHY CARE ABOUT DECANTING***

Decanting can allow modifications to irrevocable trusts, often without the need for expensive judicial proceedings. The process can achieve a wide range of goals, including correcting drafting errors, changing administrative or distributions standards, changing the trust’s jurisdiction, and increasing the trust’s creditor protection.

From a life insurance planning perspective, decanting can greatly streamline the transfer of a life insurance policy from one irrevocable life insurance trust (**ILIT**) to another. Without decanting, such transfers generally involve a sale of the policy between the trusts, which can run afoul of transfer for value and other income tax issues if the ILITs involved are not wholly-owned grantor trusts with regard to the policy’s insured. Further, determining the policy’s fair market value for sale purposes, which generally is based on its gift tax value determined under the Treasury Regulations, can be tricky and may require a professional appraisal, not just simple reliance on the interpolated terminal reserve value provided by the issuing life insurance company. Decanting may eliminate these hurdles since it does not involve a sale or other transfer for value of the policy.

### ***THE NEW UNIFORM TRUST DECANTING ACT***

Decanting is a relatively new and developing area of law. While 25 states have adopted decanting statutes, the process can vary significantly from state-to-state depending on the specific statutory requirements. In an effort to foster more uniformity among states and eliminate potential conflicts of laws with respect to trust decanting, the National Conference of Commissioners on Uniform State Laws promulgated the UTDA in July 2015. To date, Colorado, New Mexico and Virginia have adopted the Act, with Virginia

actually repealing its existing trust decanting statute (Va. Code § 64.2-778.1 (2014) (“**Old TD Statute**”)) to replace it with the Act, effective as of July 1, 2017.<sup>1</sup>

## **WHAT’S IN, WHAT’S OUT**

A review of the UTDA versus existing state laws can illustrate the potential implications of a state’s adoption of the UTDA. Using Virginia’s Old TD Statute as an example, the following compares noteworthy provisions of the UTDA to the Old TD Statute and notes some of the practical considerations of the UTDA’s changes (see also a summary chart of notable similarities and difference between the two statutes attached to the end of this report).

### **Decanting Implementation**

**Old TD Statute.** The power to decant was based in the trustee’s power to appoint or distribute assets to beneficiaries, which arguably allowed the trustee to make distributions on behalf of the original trust beneficiaries to a second trust for their benefit, instead of outright.

**UTDA.** The UTDA now includes in the decanting power the ability to modify the original trust directly, rather than requiring the transfer of assets to a separate, second trust. Accordingly, ***a trustee can accomplish a decanting under the UTDA simply by modifying or amending and restating the original trust.***<sup>2</sup>

✓ **Practical Impact.** The UTDA simplifies implementation of an exercised decanting power, presumably eliminating the down-stream administrative needs of re-titling or transferring assets to a second trust, obtaining a separate tax identification number for the second trust (if a new trust), or filing a final tax return for the terminated original trust.

### **Court Involvement**

**Old TD Statute.** A trustee could exercise the decanting power without court approval; however, a court could become involved in the decanting if:

- The trustee decided to seek court approval or guidance with regard to the exercise of a decanting power.
- The trustee’s power to distribute principal or income in the original trust was subject to an ascertainable standard. Court approval would be required to decant to the second trust if it changed the current beneficiaries of that distribution power or the ascertainable standard.
- The trustee of the original trust is unable to decant due to the terms of the original trust or the Old TD Statute. A trustee can petition the court to appoint a special fiduciary who may determine if and when to exercise the decanting power.

**UTDA.** In addition to the above, the UTDA specifies additional circumstances in which court approval or the consent of the original trust's qualified beneficiaries ("QBs")<sup>3</sup> and/or other persons is required to achieve certain modifications through a decanting:

- If the second trust provides for increased trustee compensation, the court may approve the decanting and/or the QBs must consent to the compensation increase in writing.<sup>4</sup>
  - If second trust modifies the persons who have the power to remove or replace the trustee, (1) the court must approve the modification or (2) the person holding the power must provide written consent, and, if the modification does not apply only to that person, the QBs also must provide written consent.<sup>5</sup>
- ✓ **Practical Impact.** The UTDA increases the checks and balances provided to QBs with regard to decanting changes made to trustee compensation and succession (which QBs may not recognize or fully understand if they simply received statutory notice of the exercise of the decanting power (discussed below)).

### **Notice Requirements**

**Old TD Statute.** A trustee needed to provide written notice of the trustee's intention to exercise the decanting power at least 60 days in advance of the decanting to: (1) the trust settlor, (2) the QBs, and (3) any advisors or protectors of the original trust. If, however, all QBs provided written waivers of the notice requirement, the trustee could exercise the decanting power without providing that notice.

**UTDA.** Under the UTDA, only the 60-day notice *period*, and not the notice itself, may be waived, and only if waived in writing by all persons entitled to receive notice. Further, in addition to the persons above, the UTDA requires that the trustee provide notice to (1) any person holding a presently exercisable power of appointment, (2) each person who has a right to remove or appoint a fiduciary, (3) each additional fiduciary of the original trust, and (4) each fiduciary of the second trust.<sup>6</sup>

- ✓ **Practical Impact.** The UTDA increases transparency with regard to the decanting process, ensuring that anyone with an interest in, or power over, the trust actually receives notice of the decanting. While these changes increase the administrative requirements for decanting approval, practically, they likely have minimal impact, since best practices under the Old TD Statute would have recommended providing notice to many of the same persons as under the UTDA. Further, simplification of the post-decanting administrative procedures, as discussed above, may offset these additional, upfront hurdles.

## **Greater Fiduciary Protection**

Several provisions of the UTDA grant added protection to trustees who intend to exercise (or have exercised) the power to decant:

**Choice of Law.** The UTDA applies broadly to eliminate difficult choice of law questions regarding which state law applies to the trustee's ability to exercise the decanting power. For a state that has adopted the UTDA, a trustee may decant under any original trust that (1) has its principal place of administration in that state, or (2) is governed by that state's law pursuant to the trust instrument or for purposes of construction or determining meaning of the terms of the original trust.<sup>7</sup>

- ✓ **Practical Impact.** This change may relieve a trustee of the decision of which state statute to decant under or provide greater assurance of the validity of a prior decanting.

**Broad Savings Provision.** A decanting pursuant to the UTDA will not be invalidated due to any provision in the second trust that, in part, violates a UTDA provision. Instead, the UTDA authorizes modifications to the second trust that effectively delete the impermissible provisions and read-in required provisions.<sup>8</sup>

- ✓ **Practical Impact.** This change provides greater certainty regarding the post-decanting trust to the trustee and the beneficiaries, since the exercise of a decanting power will not become wholly invalid if the second trust agreement only partially violates the UTDA. It also simplifies the correction procedure for certain mistakes in decanting, eliminating the need for another full decanting process to fix provisional errors.

**Reasonable Reliance.** If a trustee reasonably relies on the validity of a previous decanting under the UTDA or the law of another jurisdiction, the UTDA expressly provides that the trustee will not be held liable for such reliance.<sup>9</sup> To evidence "reasonable reliance," however, a trustee must review the facts of the prior decanting to ensure that the exercise was not clearly prohibited under the original trust or applicable law.

- ✓ **Practical Impact.** Given the recent popularity of trust decanting to correct errors or make a wide-array of changes to trust terms, this provision is particularly important to protect successor trustees, who had no involvement in the prior decanting. However, it also emphasizes how critical it is for successor trustees to conduct due diligence on trusts they take over, which is necessary to take advantage of this protection.

**Fiduciary Liability.** A second trust cannot relieve a fiduciary from liability for a breach of trust to a greater extent than the original trust. It may, however, reallocate powers and liability among fiduciaries, including trustees, distribution advisors, investment advisors, trust protectors, or others, so long as the changes do not reduce fiduciary liability in the aggregate.<sup>10</sup>

- ✓ **Practical Impact.** This provision effectively allows creation of the second trust as a “directed trust,” where discretionary decisions are handled by distribution, investment or other advisors, leaving only ministerial/administrative functions to an “administrative” trustee. The ability to decant to a directed trust may be helpful or even necessary to get a corporate or other professional trustee to serve, particularly if the trust holds non-traditional or illiquid assets (life insurance policies, real estate, closely-held business interests, etc.).

**Tax Considerations.** The UTDA is designed to provide flexibility to respond to changed circumstances while also limiting exposure to adverse tax consequences as a result of the decanting. Both the Old TD Statute and the UTDA protect against a decanting to a second trust that would adversely impact the original trust’s ability to qualify for a marital or charitable tax deduction or for a gift to the original trust to qualify for the annual gift tax exclusion. The UTDA, however, expands these protections to specifically provide that a second trust may not include or omit terms that would prevent qualification for certain tax treatment, if the original trust so qualified, including:

- Qualification as an S corporation shareholder when the original trust owns S corporation stock.
- Retention of the same generation-skipping transfer (“**GST**”) exempt status as the original trust and/or the ability to receive GST annual exclusion gifts.
- Retention of the same minimum distribution requirements applicable to the original trust if the trust is beneficiary of an IRA or qualified retirement plan.
- Qualification as a foreign grantor trust.<sup>11</sup>

**Grantor Trust Status.** The UTDA’s tax provisions do **not** treat grantor trust status as a tax benefit and **expressly permit the trustee to exercise the decanting power to change the grantor trust status of the second trust**, so long as the settlor does not object to the decanting in writing during the notice period.<sup>12</sup>

- ✓ **Practical Impact.** These changes can be exceeding importantly for decanting life insurance policies between trusts (e.g., to avoid transfer for value issues), or to adapt to changing tax laws and/or the trust settlor’s circumstances. For example, if the trust settlor can longer bear the burden of the original trust’s income tax liability, decanting to a second, non-grantor trust, may be a solution.

## **TAKE AWAYS:**

Decanting offers a practical and economical solution to adapt irrevocable trusts to changing circumstances that may occur over multiple generations. For the trust and beneficiaries, it avoids the cost and publicity of judicial proceedings or the administrative difficulties of valuing and transferring assets to another trust through a sale. With the release of the Uniform Trust Decanting Act, which provides a more comprehensive set of purposes for decanting, increases transparency of the process, enumerates the importance of considering tax issues, and provides added protection to both trust

beneficiaries and acting fiduciaries, more states may soon follow in the footsteps of Virginia, New Mexico, and Colorado to adopt this new framework.

<b>UTDA vs. Old TD Statute – Notable Similarities &amp; Differences</b>		
<b>Can a Trust Decanting...</b>	<b>UTDA</b>	<b>Old TD Statute</b>
Simply amend and restate the original trust agreement (rather than appoint to a separate, second trust)?	✓	
Eliminate beneficiaries of the original trust?	✓	✓
Add beneficiaries who are not beneficiaries of the original trust?		
Omit powers of appointment granted in the original trust? <sup>13</sup>	✓	
Create or modify a power of appointment to include permissible appointees that are not beneficiaries of the original trust? <sup>14</sup>	✓	✓
Amend discretionary distribution provisions not subject to ascertainable standards without court approval?	✓	✓
Petition the court to appoint a special fiduciary who can decant?	✓	✓
Modify trust administration provisions?	✓	✓
Add other fiduciaries (distribution/investment advisers, protectors)?	✓	✓
Forego notice with waivers from all qualified beneficiaries?		✓
Accelerate interests of remainder beneficiaries?		
Amend trustee succession and compensation provisions without court approval or qualified beneficiary consent?		✓
Extend the trust's duration (up to the applicable perpetuities period of the original trust for decanted property)? <sup>15</sup>	✓	✓

## **DISCLAIMER**

**This information is intended solely for information and education and is not intended for use as legal or tax advice. Reference herein to any specific tax or other planning strategy, process, product or service does not constitute promotion, endorsement or recommendation by AALU. Persons should consult with their own legal or tax advisors for specific legal or tax advice.**

## **NOTES**

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<sup>1</sup> See Va. Code §§ 64.2-779.1 et. seq. (effective July 1, 2017). Note that the provisions of the UTDA reviewed in this article were enacted by Virginia with substantially similar language. The citations herein note the UTDA article and the corresponding section of the new decanting laws enacted under the Virginia Code.

<sup>2</sup> “Second trust” means (i) an original trust after modification/restatement or (ii) a trust to which a distribution of property from an original trust is or may be made. See UTDA §2(23) (2015); Va. Code §64.2-701 (2017).

<sup>3</sup> A Qualified Beneficiary is a person who, on such date, (i) is a distributee or permissible distributee of trust income or principal or (ii) would be a distributee or permissible distributee of trust income or principal if the interests of the persons in clause (i) terminated on that date or if the trust otherwise terminated. See UTDA §2(20) (2015); Va. Code §64.2-701 (2017).

<sup>4</sup> UTDA §§9(b)(1) and 16 (2015); Va. Code §§64.2-779.6.B(i) and 64.2-779.13 (2017).

<sup>5</sup> UTDA §§9(b)(2) and 18 (2015); Va. Code §§64.2-779.6.B(ii) and 64.2-779.15 (2017).

<sup>6</sup> UTDA §7 (2015); Va. Code §64.2-779.5 (2017). Both the UTDA and the Virginia Code also require notice to the state Attorney General if the trust has a “determined charitable interest.” The Virginia Code also requires notice to each person holding an adverse interest who has the power to consent to the revocation of the original trust.

<sup>7</sup> UTDA §5 (2015); Va. Code §64.2-779.3 (2017).

<sup>8</sup> UTDA §22 (2015); Va. Code §64.2-779.19 (2017).

<sup>9</sup> UTDA §6 (2015); Va. Code §64.2-779.4 (2017).

<sup>10</sup> UTDA §17 (2015); Va. Code §64.2-779.14 (2017).

<sup>11</sup> UTDA §19 (2015); Va. Code §64.2-779.16 (2017).

<sup>12</sup> UTDA §§19(b)(8), (9), and (10) (2015); Va. Code §§64.2-779.16.B(8), (9), and (10) (2017).

<sup>13</sup> The second trust may only omit a power that is not a presently exercisable general power of appointment.

<sup>14</sup> Only a trustee with expanded distributive discretion as to principal may create or modify a power of appointment held by a current beneficiary.

<sup>15</sup> The second trust’s duration may differ from the original trust, provided that the property of the second trust that is attributable to the original trust must be subject to the same rule against perpetuities period of the original trust.