

TRUST DECANTING – UPDATING AN OUTDATED TRUST

Trust decanting, as its name would suggest, is an estate planning technique through which a trustee transfers assets from one trust to a second trust. In New York State, decanting is specifically authorized by statute (EPTL § 10-6.6).

While irrevocable trusts have a variety of uses in estate planning, they lack flexibility. Because irrevocable trust agreements generally cannot be amended, modified or revoked, unforeseen future events or a change in a client's estate planning objectives may cause the terms of an existing irrevocable trust to become outdated.

Decanting is a solution to this problem. If a trustee has the power to invade an existing trust's principal, the trustee may use the authority given to him or her under New York's decanting statute to transfer the trust's assets to a second trust with terms that are more aligned with a client's current objectives. Subject to certain limitations discussed below, the second trust may have administrative (such as giving a trustee specific authority to administer a closely-held business) or even dispositive provisions that are different from the first trust. Decanting is, therefore, a de facto way of modifying or amending an irrevocable trust, and it is an important tool in allowing a trustee of an irrevocable trust to adapt to changing circumstances.

As suggested in the preceding paragraph, decanting is only possible when a trustee has the power to invade a trust's principal. If a trustee has unlimited discretion to invade principal, the trustee may transfer the trust's assets to a second trust (the "appointed trust") for the benefit of one, more than one or all of the current beneficiaries of the first trust (the "invaded trust"). The remainder beneficiaries of the appointed trust may be one, more than one or all of the successor and remainder beneficiaries of such invaded trust (to the exclusion of any one, more than one or all of such successor and remainder beneficiaries). Given this authority, a trustee with unlimited discretion may decant to an appointed trust in which one or more beneficiaries from the first trust are eliminated.

If the trustee's discretion to invade principal is limited to one or more ascertainable standards (e.g., a beneficiary's health, education, support and maintenance), the trustee may only transfer the trust's assets to an appointed trust in which current beneficiaries are the same as the current beneficiaries of the invaded trust and the remainder beneficiaries of the appointed trust are the same as the successor and remainder beneficiaries of the invaded trust. Thus, a trustee with limited discretion cannot eliminate any beneficiaries that were in the first trust.

Given the parameters of when a trustee may decant to another trust, let's look at a common application of the decanting statute. Two concerns that often arise some years after a parent has created an irrevocable trust for his or her children are: (a) they are concerned about the child's inheritance ending up in the hands of his or her spouse in the event of death or divorce of the child; and (b) the child has creditors or is too immature to handle large amounts of money. Pursuant to authority granted under EPTL 10-6.6(e), the trustee of the trust may address these concerns by decanting the existing trust's assets to a second trust that has a longer term.

The duration of second trust can even be extended for the lifetime of the child. The following example illustrates how decanting may address the client's concerns:

- George B. establishes an irrevocable life insurance trust for his youngest child, Buster. Upon the death of George, the trust provides that Buster is to receive lump sum distributions of principal at ages 30 and 35. While the trust is being administered, the trustee has authority to invade principal for Buster's health, education, maintenance, and support. In the years following the creation of the trust, Buster marries Lucille, they have no children and they have a tumultuous marriage. George is concerned about divorce and wants to ensure that trust assets cannot be reached by Buster's spouse in divorce settlement. Pursuant to EPTL 10-6.6(e), the trustee may transfer the trust's assets to a second trust that holds the trust's assets in trust for Buster's lifetime. Because Buster will never own the trust's assets outright, they cannot be reached by Lucille.

It is also possible to decant a testamentary trust (i.e., a trust created under a Will) to a second trust after the death of the testator. If the trustee of the testamentary trust has the power to invade its principal, the trustee may transfer the trust's assets to a second trust. If the second trust is not created under a Will (i.e., an inter vivos trust), it could be beneficial to decant the assets in the testamentary trust to the second trust even if the terms of the two trusts are identical. Trusts created under Wills are more closely supervised by the Surrogate's Court than inter vivos trusts. For instance, an application to the Court needs to be made each time there is a change of trustee of a testamentary trust. Such applications are costly and time consuming. In contrast, no such application is required to change trustees of a inter vivos trust as long as a successor trustee is named in the trust or there are provisions in the trust that allow the trustee to designate his or her successor. By transferring the assets of a testamentary trust to an inter vivos trust, the assets held in trust are removed from the close supervision of the court thereby potentially reducing the cost of the trust's administration expenses.

As you can see, decanting has many potential uses, and any trustee with a power to invade principal should consider decanting when it appears an existing irrevocable trust can no longer accomplish the estate planning goals of its settlor. This has only been a brief summary of the potential benefits of the trust decanting, and there are many other potential applications of decanting. There are also potential income, gift, estate and generation-skipping tax ramifications of decanting, as well as some limitations under New York's decanting statute, that should be examined before a trustee exercises the power to decant.

For more information about decanting, including possible tax ramifications of decanting, please contact our estate planning partners at Danziger & Markhoff LLP, Michael Markhoff, Harris Markhoff or Christopher Miehl, with any of your questions. You can reach us by phone in our office or via email at mmarkhoff@dmlawyers.com, hmarkhoff@dmlawyers.com and cmiehl@dmlawyers.com “