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Decantation Deliverance

By Robert L. Moshman, Esq.

New statutes governing the decanting of trust assets have sprung up in 10 new jurisdictions over the past two years and the trend appears to be continuing.

Why is there so much interest in the decanting technique? How do the various state decanting statutes compare? Is decanting preferable to the alternatives?

Here, we provide some context on the decantation trend and consult esteemed chartmeister Steven J. Oshins, Esq. for comparative analysis of state approaches.



A Sketchy Past

In the wilderness of states without decanting statutes there is arguably a common law basis for decanting based on what may be the first decanting case in the United States, *Phipps v. Palm Beach Trust Co.*, 196 So. 299 (Fla. 1940). At least the American College of Trusts and Estates Counsel (ACTEC) made that observation in commenting on *IRS Notice 2011-101* in a letter published in April, 2012.

Presented With Our Compliments

However, there is a paucity of definitive case law on decanting. Instead, there is a patchwork of cases spread over 74 years and 50 states. After *Phipps* from Florida came *Wiedenmayer v. Johnson*, 106 N. J. Super 161 (1969), *In re Estate of Spencer*, 232 N.W.2d 491, 493–95 (Iowa 1975), and two recent additions, *Morse v. Kraft*, 992 N.E.2d 1021 (Mass. 2013), and *Ferri v. Powell-Ferri*, MMX-CV-11-6006351-S (August 23, 2013).

Within any given state, there is a simmering quiche of cases involving divorce, powers of appointment, and areas that aren't quite on point or which rely on the few decanting cases from neighboring states. Understandably, trustees have been reluctant to test this unpredictable common law pastiche.

The common law basis for decanting follows the logic that a trustee with discretionary authority to distribute assets has, in effect, a power of appointment to transfer the assets into a new trust. This is consistent with provisions of the Restatement (Second) of Property: Donative Transfers and the Restatement (Third) of Property: Wills and Other Donative Transfers.

Trending Now

The technique of decanting trust assets from a flawed trust and re-situating them with improved terms is not new—it has been part of common law for 74 years.

In 1992, New York developed the nation's first decanting statute. A handful of states followed suit over the next decade. By 2011, when New York revisited its decanting statute, a dozen states had developed statutes. This number grew to 18 by the time we canvassed the field for “Decanting Pre-ATRA Trusts” (*The Estate Analyst*, March 2013). Since that time, South Carolina, Texas, Wisconsin, and Wyoming have joined the list, bringing the current total to 22.

In December 2013, the National Conference of Commissions on Uniform State Law released a draft of the Trust Decanting Act; when that Act is finalized and various states adopt it, the number of states relying only upon decanting common law will be a distinctly shrinking minority.

Decanting statutes have been enacted in 22 states:

Alaska	New York
Arizona	North Carolina
Delaware	Ohio
Florida	Rhode Island
Illinois	South Carolina
Indiana	South Dakota
Kentucky	Tennessee
Michigan	Texas
Missouri	Virginia
Nevada	Wisconsin
New Hampshire	Wyoming

The statutes generally allow a trustee with discretionary authority to distribute assets under the terms of the trust into a new trust that continues to benefit one or more of the same

beneficiaries. However, the 22 statutes then impose differing requirements.

Trusts with an ascertainable standard for distributions can be decanted in 17 states, but Florida, Indiana, and Michigan require the trustee to have absolute discretion to invade principal, and two states, Tennessee and Wyoming, are silent. Only South Dakota allows trustees to decant from a trust with an ascertainable standard of distribution into a trust with absolute discretion to distribute and also remove a mandatory income interest.

Seven of the states have statutes that do not require notice of decanting to the beneficiaries, while 15 states have various notice requirements. Note: Arizona and Wyoming have very brief statutes with limited guidance.

For an excellent comparison, a new chart compiled by attorney Steven J. Oshins can be found online at oshins.com/images/Decanting_Rankings.pdf.

Why the trend? Is it just a good idea catching on across the country like a wave around a stadium? After all, everyone likes having a do-over option. Or have the emergence of state statutes and the regulated use of decanting made it easier for states to follow suit, which in turn encouraged greater usage of decanting?

Perhaps decanting also received a boost from the 2012 deadline to squeeze assets into irrevocable trusts before the gift tax exemption expired...followed by the ATRA whiplash of having the \$5 million gift tax exemption continue with cost of living adjustments and portability of a deceased spouse's unused exemption. We went from fiscal cliff famine to DSUE feast, and grantors hastily funding trusts in 2012 had an interest in decanting and repairing trusts in 2013.

The Essence of Emotion

Perhaps decanting is part of a more primal set of emotions. What motivates a grantor's regrets? What emotions drive beneficiaries to take action?

To appreciate true regret, consider *The Sorrows of Young Werther* by Johann Wolfgang van Goethe. Written in 1774 in the Sturm und Drang period of German literature, it swiftly made the author an international celebrity and resulted in *Werther Fieber* (“*Werther Fever*”).

Why? Passion. Werther writes to Wilhelm about his time in Walheim. Werther loves Lotte, but Lotte is engaged to Albert. Werther's unrequited feelings overwhelm him. Such pain! He travels to Weimar where he suffers a social humiliation. Then, returning to Walheim, he discovers that Lotte has married Albert! Oh, jealousy and despair! Woe is Werther! Consumed with angst, he ironically borrows Albert's gun and shoots himself in the head (“Bang!”)...but spends 12 hours dying, wallowing in his sorrows, dying some more, and writing out his final letter to Wilhelm, of course.

Juxtapose the raw emotions of love, pain, jealousy, and angst against the pragmatic trustees performing objective due diligence and tweaking trusts for superior efficiency. Something doesn't add up.

Trusts aren't merely objective receptacles of tax savings and asset protection. Trusts are monuments that represent a grantor's achievements, power, control, and success. Trusts are subjective expressions that determine which family members benefit and which do not. A trust is a blueprint for the grantor's vision of a family's future.

Wherever there is a trustee decanting assets for some plausible objective purpose, look into the shadows to see unhappy grantors or beneficiaries who are directing the trustees. Often, they would expose assets to extra taxation rather than allow them to reach family members who have fallen out of favor.

Decanting Cases

Some of the motivations for decanting have been illustrated by the few decanting cases that exist.

Wiedenmayer v. Johnson from 1969 is often cited as the basis for decanting. In that case, the primary beneficiary was J. Seward Johnson II, a third-generation member of the Johnson & Johnson fortune. Several books have been written about this dysfunctional family, their enormous wealth, and their epic legal battles. It was J. Seward Johnson II's father, John Seward Johnson, who had limited relations with his children from his first two marriages, married his second wife's chambermaid, and, in a will executed just before his death, left her \$402 million.

In 1944, John Seward Johnson established trusts for each of his six children with shares of Johnson & Johnson; by 1969, these trusts were each worth about \$18 million. The trust that made J. Seward Johnson II the primary beneficiary made his children contingent beneficiaries. When it was revealed that J. Seward Johnson II was not the biological father of two children that his unfaithful wife had given birth to, J. Seward Johnson II made unsuccessful attempts at suicide and a successful effort to have his trustees decant the trust funds. He later became a world-renowned sculptor.

Note: The Johnson trust funds were not merely decanted into a new trust established by the trustees. Instead, they agreed to distribute all of the trust assets to J. Seward Johnson II (as they had the discretion to do), in return for an agreement that J. Seward Johnson II would then transfer the funds into another trust. This prompted a dissenting opinion from Judge Conford. However, the majority opinion established that trustees with discretionary authority to distribute assets could act in the best interest of the beneficiary by transferring the assets

to a new trust without the consent of contingent beneficiaries or court approval.

In *Morse v. Kraft*, 992 N.E.2d 1021 (Mass. 2013), the Massachusetts Supreme Court approved of the reasoning in *Wiedenmayer v. Johnson*. Note: Highly accomplished author Diana S.C. Zeydel, Esq., correctly points out that *Morse* became the second case following *Phipps* to squarely address decanting, due to *Wiedenmayer's* decanting via beneficiary by proxy.

However, a case decided soon thereafter illustrates an important limitation on decanting. In *Ferri v. Powell-Ferri*, MMX-CV-11-6006351-S (August 23, 2013), the Connecticut Superior Court declined to permit decanting of trust assets that the trust beneficiary had a vested right to withdraw. One of the trustees was the beneficiary's brother and business partner, and the proposed decanting was being undertaken just prior to the beneficiary's impending divorce.

Decanting Options

Sound trusts are drafted with built-in flexibility, trustee discretion, or a trust protector. Other trust modifications can be achieved using disclaimers, selling trust assets, merging or severing trusts, or seeking judicial reformation.

A well-executed decanting can change situs, clarify ambiguities, correct drafting errors, enable trusts to be subdivided among beneficiaries, switch trust from grantor trust status for tax purposes to non-grantor status, include spendthrift or other asset protection clauses to limit transfers that would be exposed to creditors, change administrative terms of trust, change trustees, expand trustee powers or investment ability, modify trustee compensation, and incorporate separate investment supervision.

A Few Caveats

Just because there is a legal basis and a reason to decant doesn't always mean decanting is the best path to follow. For every emotion-driven grantor or primary beneficiary, there are secondary or contingent beneficiaries who can offset decanting benefits with litigation, sometimes without any justification other than spite.

After decanting, there may be some investment and tax consequences that, in hindsight, didn't turn out as well as hoped. However, one should not conclude that decanting, being new and bold, is an option of last resort. In many cases, decanting can be a preferable option that is more efficient to implement than the alternatives.

So shall the trust draftsman be proactive and include a fully articulated

Decanting De Cash

By Nipsey Russell's Ghost

**I trust your trust is trusty
And its terms are not too rusty
But when draftsmen are forgetful
Or trust clients are regretful
There's no need to rave or rant
Nor keep a plan that disenchants,
Move trust assets with transplantation
Reboot a new trust incantation.
Roses are red, violets are blue
22 states decant and so can you.**

decanting provision? Perhaps not! A specific decanting provision could actually backfire—especially when the grantor is granting “permission” in the form of rules, as opposed to empowering the trustees.

Those affected could consent to the proposed decanting, and release the trustee from liability. The trust itself can be drafted to indemnify a trustee for decanting, so as to facilitate such action without obtaining releases of beneficiaries.

Planners must also consider whether a proposed decanting has any potential income, estate, or gift tax consequences. Those undertaking a decanting must take note of the potential exposure to generation skipping transfer tax where trust assets have a GST exemption allocated to them or have GST-exempt grandfathering status. Decanting can be structured to avoid GST exposure under Reg. 26.2601-1(b)(4)(i)(E), example 2, so long as there can be no shift of assets to beneficiaries in a lower generation and there is no extension of time for assets to vest.

A Visit with Steven J. Oshins, Esq., AEP (*Distinguished*)

Suddenly, there is a multiplicity of differing state statutes on decanting. To deliver us from the fray, attorney Steven J. Oshins has provided a superb chart.

The chart not only compares critical differences of the state statutes on decanting, but also provides an overall ranking system which incorporates state rules on dynasty trusts, domestic asset protection trusts, rules against perpetuities, state income taxation, and other relevant criteria. Naturally, we turned to Steve to serve as our decanting sommelier, as it were.

Q: How critical is it to establish a trust in a jurisdiction with favorable statutory decanting ability rather than a state that has only common law decanting rules?

A: Given the uncertainty of decanting a trust under common law authority, I believe that it is very important to have a roadmap using state statutory authority. Otherwise, you never know if your changes will be respected by the courts. Clients generally want certainty—or at least near certainty.

Q: What variable do you believe is the most important in selecting an appropriate trust jurisdiction?

A: Approximately two-thirds of the jurisdictions with decanting statutes require notice to all beneficiaries before decanting a trust. Most, if not all, of my clients would not want to send a copy of the existing trust and proposed decanting trust to all of the trust beneficiaries. Most people are very private. Therefore, I believe that you should try to select a jurisdiction that doesn't require notice.



Q: Is decanting a dangerous shortcut that will tempt trust draftsmen to plan less strenuously?

A: In some cases, yes. But, in many situations, it can enable some of our clients to make a transfer even though the client is unsure of the future. This allows the draftsman to include all potential beneficiaries as discretionary beneficiaries in contemplation of potential future changes. Strategically, this can have a very positive effect. I call the decanted trust a “do-over trust” when explaining it to clients. This generally makes them feel more comfortable.

Q: When faced with a trust modification, would you explore other alternatives first or go right to the decanting option as the cleanest means of repair?

A: Although there are other means of modification, the first thought I always have is to see if the trust can be decanted. Decanting has become so widely accepted that it should be at the top of your mind whenever your client wants a change or where you have an opportunity to fix or enhance an existing irrevocable trust.

Q: Should all irrevocable trusts now include a general decanting clause to anticipate statutory and common law decanting standards?

A: It's hard to say. There are arguments both for and against decanting. Many of our clients truly intend for an irrevocable trust to be irrevocable and therefore may be unhappy if the trustee can make changes that arguably change the client's wishes. If the trust does include a decanting provision, it is likely a good idea to discuss this with the client so the client understands the ramifications.

Q: Should there be a limit on repeat decanting of the same trust assets?

A: I don't think so. The general concept is that if the trustee is given the power to make an outright distribution to a beneficiary, then the trustee should be able to make the distribution with whatever trust strings are desirable. This philosophy should apply whether the trustee decants once or multiple times, so long as all decantings are done in furtherance of the settlor's original intent in the initial irrevocable trust.

Steven J. Oshins is a member of the NAEPC Estate Planning Hall of Fame® and is deservedly considered one of the nation's elite estate planning attorneys by numerous publications. He is a prolific author and has previously assisted us with explanations on dynastic trusts, DAPTs, and—most recently—on “NING” trusts. Steve is a member of the Law Offices of Oshins & Associates, LLC, in Las Vegas, Nevada. He can be reached at 702-341-6000, ext. 2, or soshins@oshins.com. His law firm's website is oshins.com.