



PREMIER TRUST

"It's A Matter Of Trust"SM

Decanting an Irrevocable Trust: The “Do-Over” Trust

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What is Decanting?

How often do our clients set up and fund an irrevocable trust and then come back to us wanting to change the trust terms? This even sometimes happens within a matter of days, not even weeks, of funding the trust. Human nature is such that people change their minds. And it is also likely that circumstances will change after the trust has been funded.

For many years, practitioners have struggled to find ways to change the terms of an irrevocable trust. However, through common law and through the decanting statutes that have been enacted in many jurisdictions, it is now possible to modify an irrevocable trust. The rationale for allowing such a modification is that a trustee who has the power to distribute the trust property to or for the benefit of one or more beneficiaries should be able to make the distribution to them in trust and dictate the terms of that trust. Decanting is essentially a “do-over”.

Trust decanting is the act of distributing assets from one trust to a new trust with different terms. Just as one can decant wine by pouring it from its original bottle into a new bottle, leaving the unwanted sediment in the original bottle, one can pour the assets from one trust into a new trust, leaving the unwanted terms in the original trust.

The Decanting Process

First Step: Move the Trust – Assuming the trust’s existing jurisdiction either has no decanting statute (and the planner wants more certainty than attempting to decant under a “common law” theory) or its decanting statute does not allow the desired modifications or has a user unfriendly statute, the first step is to look at the existing irrevocable trust to see if it can be moved to a different jurisdiction. If the trust agreement allows the trustee or trust protector to move the trust to a different jurisdiction, then the attorney can draft the appropriate documentation to move the trust to Nevada, including adding a trustee or co-trustee based in Nevada in order to take advantage of the Nevada jurisdictional advantages. If the trust agreement does not allow the jurisdiction to be changed, then the planner can check local law or otherwise petition the local court for approval to move the trust, or even use local decanting laws to add a provision allowing the trust jurisdiction to be changed.

Second Step: Decant the Trust – The second step is for the attorney to prepare appropriate documents to decant the trust to change some or all of the terms by pouring the assets into a trust with different terms.

This might include creating a new trust or otherwise might just use another pre-existing irrevocable trust as the recipient of the trust assets.

Move Trust to Nevada, then Decant It

Nevada, South Dakota, Alaska and Delaware have historically been the so-called first-tier trust jurisdictions. This whitepaper will describe the benefits of moving a pre-existing irrevocable trust to the State of Nevada to then utilize Nevada's flexible decanting statutes. Having some of the most flexible, easy-to-use, decanting statutes in the United States, Nevada received a Total Score of 97.5 out of a possible 100 on the 2014 Trust Decanting State Rankings Chart at http://www.oshins.com/images/Decanting_Rankings.pdf. [The chart at this link is updated on an annual basis.] Pursuant to the "First Step" as described above, the trust can be moved to Nevada to take advantage of these flexible, user-friendly laws.

Nevada Revised Statutes ("NRS") Section 163.556(1) provides that, "[u]nless the terms of a testamentary instrument or irrevocable trust provide otherwise, a trustee with discretion or authority to distribute trust income or principal to or for a beneficiary of the trust may exercise such discretion or authority by appointing the property subject to such discretion or authority in favor of a second trust for the benefit of one or more of those beneficiaries." This statute provides the general decanting authority.

One of the key advantages of Nevada law is that there is no requirement that the trustee must provide notice of the decanting to

the beneficiaries, nor does the trustee need to provide copies of the pre-existing or proposed new trust to the beneficiaries. This is not intended to allow the trustee to violate his or her fiduciary duties, but since most people desire privacy, this is a huge advantage inherent in Nevada law. Pursuant to NRS Section 163(5), “[b]efore appointing property pursuant to subsection 1, a trustee may give notice of a proposed action... or may petition a court for approval...” [emphasis added] The discretion under Nevada law to provide notice or obtain court approval is important for a trustee who is concerned that the proposed modifications may violate the trustee’s fiduciary duties to one or more beneficiaries. Most other jurisdictions that have decanting statutes require notice to be given for every decanting.

Decanting Examples

Following are ten reasons to consider decanting an irrevocable trust:

1. Extending the term of the trust: Many trusts are drafted to make mandatory distributions to the beneficiaries at staggered ages. This can make the trust assets liable for unnecessary estate taxes and make open the trust up to creditors and divorcing spouses of the beneficiaries. The trustee should consider decanting the trust into a long-term Dynasty Trust that lasts for multiple generations. However, the duration of the new Dynasty Trust must still be limited by the perpetuities period established in the preexisting trust. And for trusts moved from a longer-term Dynasty Trust jurisdiction, the decanted trust can continue to take advantage of the longer term up to 365 years and also take advantage of other features of Nevada’s trust and tax laws.

2. Changing a support trust into a discretionary trust: Many trusts are drafted to give the trustee the power to make distributions to the beneficiaries for their health, education, maintenance and support. These trusts are often called support trusts. Depending upon state statutes and case law, support trusts are often available to certain classes of creditors, including divorcing spouses. A discretionary trust, on the other hand, gives the trustee absolute discretion over distributions and thus generally protects the assets from all classes of creditors. Thus, decanting a support trust into a discretionary trust can be a valuable strategy.

3. Correcting drafting errors or ambiguous terms: Many trusts have drafting errors or ambiguous terms that need to be fixed. Some trusts give a trust protector or independent trustee the power to fix these types of errors, while others do not. Decanting the trust into a new trust can cure these problems.

4. Changing the governing law of the trust: Many trusts were established in a jurisdiction with a state income tax that can be avoided or bad creditor protection statutes or case law that can also be avoided. While many of these trusts have a provision allowing the trustee to move the trust to a different situs, many of them do not. This is easily solved by decanting the trust into a trust domiciled in a superior trust jurisdiction. This also includes the ability to decant a Dynasty Trust or Domestic Asset Protection Trust from one state to a state with superior laws. As one of the leading Dynasty Trust and Domestic Asset Protection Trust jurisdictions, decanting the trust under Nevada law can significantly improve a trust.

5. Modifying powers of appointment: Many trusts do not contain powers of appointment which would enable a person to change the succeeding interests of the beneficiaries and how they receive the assets. In today's planning world where the estate tax exemption is much higher than it had been in the past and in which income tax reduction has been so much more important, it is often also useful to be able to give a beneficiary a general power of appointment over certain trust assets in order to achieve a new income tax basis at that person's death. This can be accomplished through decanting.

6. Changing trustee provisions: Many trustee provisions do not allow for a succession of trustees or for a list of people who can name successors, while other trusts have a succession of trustees who the settlor may have wanted at the time the trust was established, but who would now not be selected by the settlor if the settlor could redo the trust today. This can be changed through decanting.

7. Combining trusts for greater efficiencies: Many of our clients set up trusts at different times, and sometimes with different law firms over the years. Ultimately, the family has more trusts than are needed. If the trusts aren't sufficiently similar enough to merge them, then they can be combined through decanting one trust into another or by decanting multiple trusts into a newly formed trust.

8. Separating trusts: Many trusts have been drafted so the entire family benefits from one large pot trust. Although this sometimes makes sense in certain situations, more often than not it creates problems because different beneficiaries have different needs and different investment philosophies.

A large pot trust can be decanted into separate trusts for each beneficiary so the beneficiaries have their own autonomy.

9. Creating a special needs trust: It may not have been contemplated when the initial trust was drafted that there would be a beneficiary that has special needs and will require a trust that preserves eligibility for public benefits. A trust can be decanted to add this language.

10. Qualifying a trust to own S corporation stock: Many trusts have been drafted without the trust scrivener contemplating the possibility that the trust would need to be able to own S corporation stock at some point. This includes other forms of business entities that elect to be taxed as an S corporation. If the trust agreement doesn't give a trust protector or independent trustee the power to add such provisions, the trust can be decanted to add the provisions.

This list is not intended to be exhaustive. There are other reasons one may want to decant a trust. Decanting is perhaps the most underused tool in the estate planning industry in relation to the benefits and flexibilities it provides and likely will become more popular as more practitioners become aware of these opportunities.

Nevada Trustee Requirement

In order to take advantage of Nevada's laws, at least one trustee generally must be a natural person residing in Nevada, a trust company that maintains an office in Nevada, or a bank that possesses trust powers and that maintains an office in Nevada. Individuals wishing to set up a Nevada trust who may not have any individual contacts in Nevada generally use a trust company based in Nevada to serve in that capacity.



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