

A DECADE-PLUS OF TRUST DECANTING IN TEXAS

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I. OVERVIEW

A. Introduction

On its face, it seems difficult, if not impossible, to change the terms of an irrevocable trust.¹ After all, the settlor made the trust irrevocable by design, and in many cases, irrevocability is required to achieve the settlor's tax objectives.² Despite this, over time, it may become necessary or desirable to modify an irrevocable trust to more accurately reflect the settlor's intent, respond to beneficiary needs and circumstances, address changes in the law, optimize tax consequences, or correct errors in the trust instrument itself.³ This seems particularly true now that Texas permits irrevocable trusts to last up to 300 years, which is, of course, longer than the United States of America has been a country.⁴

In Texas, there has always been a number of mechanisms available to modify both the terms and administration of an irrevocable trust, including judicial modifications and reformations, trust combinations and divisions, the removal and appointment of trustees, and the rising use of trust protectors or trust advisors.⁵ Perhaps no vehicle is as swift, however, as trust decanting, which Texas blessed by statute in 2013.⁶ Over thirty states now boast a decanting statute; decanting has worked its way into a prominent position in most estate planners' toolboxes.⁷

B. Decanting Defined

Neither the Texas Property Code nor the Internal Revenue Code (Code) expressly defines the term "decanting."⁸ Generally, decanting describes the act of a trustee exercising its power to distribute trust property to or for the benefit of a beneficiary by distributing such property to a new trust with different terms.⁹ The best way to understand trust decanting is to visualize the physical act of decanting wine, which involves the pouring of wine from

1. Jeffrey D. Chadwick, *A Decade of Trust Decanting in Texas*, STATE BAR OF TEX. 1, 1, <https://www.texasbarcle.com/cle/OLViewArticle.asp?a=238477&t=PDF&c=20919&p=1> (last visited Feb. 21, 2024) [<https://perma.cc/3J93-DS89>].

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*

8. *Id.* See *decant*, MERRIAM WEBSTER DICTIONARY, www.merriam-webster.com/dictionary/decant (last visited Mar. 13, 2024) [<https://perma.cc/4NY2-FWE5>] (defining the verb "decant" as follows: "(a) to draw off (a liquid) without disturbing the sediment or the lower liquid layers, (b) to pour from one vessel into another, and (c) to pour out, transfer, or unload as if by pouring").

9. Chadwick, *supra* note 1, at 1.

one vessel to another for the purpose of removing unwanted sediment and adding oxygen to the wine.¹⁰ In the trust context, practitioners can view decanting as a trustee pouring the assets of an old trust into a new trust with less useful provisions (the so-called “sediment”) left behind while the “oxygen” of modern trust provisions breathes life into the trust.¹¹

A decanting power is often thought of as the trustee’s exercise of a special power of appointment in a fiduciary capacity to distribute assets for the benefit of a beneficiary.¹² Decanting proponents justify the technique with a rather simple argument—if a trustee has the authority to make a discretionary distribution of property to one or more beneficiaries outright, then the trustee should also have the authority to distribute such property subject to certain terms and conditions, which take the form of a new trust agreement.¹³

C. Outline of Article

This Article does not seek to be a definitive resource for decanting Texas trusts nor does it attempt to address every issue or contingency.¹⁴ Rather, this Article is intended to provide a general overview of the decanting process based on more than a decade’s worth of experience with the Texas decanting statute.¹⁵ Above all, this Article is designed to be helpful and practical.¹⁶

This Article is organized as follows: Part II establishes a framework by identifying common motivations for changing an irrevocable trust, many of which can be accomplished through decanting.¹⁷ Part III considers methods to modify irrevocable trusts in Texas prior to the enactment of the decanting statute in 2013, all of which remain potentially viable decanting alternatives.¹⁸ Part IV examines the Texas decanting statute, including changes from recent legislative sessions, the mechanics of decanting under the statute, and related practical considerations.¹⁹ Part V discusses federal tax issues, including potential income and transfer tax risks.²⁰ Part VI offers some concluding remarks.²¹

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.* See Crystal Rose, *Decanting More than Just Wine: Revocability in Irrevocable Texas Trusts*, 7 EST. PLAN. & CMTY. PROP. L.J., 385, 386 (2014); Melissa J. Willms, *Decanting Trusts: Irrevocable, Not Unchangeable*, 6 EST. PLAN. & CMTY. PROP. L.J. 35, 37–39 (2013).

15. See discussion *infra* Parts II–III.

16. *Id.*

17. See discussion *infra* Part II.

18. See discussion *infra* Part III.

19. See discussion *infra* Part IV.

20. See discussion *infra* Part V.

21. See discussion *infra* Part VI.

II. COMMON MOTIVATIONS FOR CHANGING AN IRREVOCABLE TRUST

If advisors could predict the future, designing an irrevocable trust would be pretty simple.²² Of course, that is not the case, and things change, particularly over time.²³ Even the most careful and flexible drafting cannot anticipate every issue that may arise, and modifying the terms of an irrevocable trust can be beneficial in a wide variety of circumstances discussed below.²⁴

A. Change Administrative Provisions

Perhaps the most common motivation for changing an irrevocable trust is to modify or update its administrative provisions.²⁵ Below is a non-exhaustive list of potentially helpful administrative changes:

- Changing the situs of the trust's administration;
- Changing the trust's governing law;
- Updating administrative provisions to respond to a development in the law;
- Adding a spendthrift clause to a trust that does not contain such a provision;
- Providing for the resignation, removal, and appointment of trustees without court approval or in a more streamlined manner;
- Expanding the trustee's powers to engage in more modern financial transactions, such as investing in derivatives and options, making or guaranteeing loans, adjusting between income and principal, or participating in an initial public offering;
- Facilitating the division and delegation of trustee or non-fiduciary responsibilities, such as investment advisors, distribution advisors, trust protectors, or special asset advisors;
- Addressing issues related to trustee compensation, which may be too high, too low, or unspecified;
- Addressing trustee liability and indemnification issues, such as a trustee's failure to diversify when a trust holds an overconcentration of a single asset (e.g., a closely held business interest);
- Consolidating trusts for administrative efficiency;

22. Chadwick, *supra* note 1, at 2.

23. *Id.*

24. *Id.*

25. *Id.* See Farhad Aghdami & Daniel J. Durst, *Decanting Comes of Age*, 1, 19, <https://www.wdcepc.org/assets/Councils/Washington-DC/library/Decanting%20%28Trusts%29%20Outline%20-%20Feb%202018.pdf> (Feb. 12, 2018) [<https://perma.cc/66TW-JP2U>].

- Dividing trusts to enable different trust administration, investment, and distribution objectives; and
- Converting a foreign trust to a domestic trust or vice versa.²⁶

B. Respond to a Change in Beneficiary Circumstances

It is also common to modify an irrevocable trust in response to an unanticipated change in a beneficiary's circumstances.²⁷ For example, it may be prudent to change the terms of an irrevocable trust to transfer assets to a special needs trust for a disabled beneficiary; expand or clarify a trustee's authority to make distributions to a beneficiary or class of beneficiaries; expand, restrict, or otherwise modify a lifetime or testamentary power of appointment; add beneficiaries; move the trust to another state with more favorable or targeted laws regarding a beneficiary's rights to obtain trust information, the creation and protection of self-settled spendthrift trusts, or other matters; limit or delay distributions to beneficiaries with substance abuse problems or those engaging in other unproductive behaviors; or eliminate a beneficiary altogether, although doing so would certainly implicate the trustee's fiduciary duties.²⁸

C. Engage in Tax Planning

There may also be tax reasons for changing the terms of an irrevocable trust.²⁹ For example, it may become necessary to minimize state income taxes by moving the trust to a new jurisdiction; convert a grantor trust to a non-grantor trust or vice versa; address concerns regarding the inclusion of trust assets in a beneficiary's gross estate for federal estate tax purposes; address concerns regarding an inadvertent taxable gift as a result of a trust's administration; preserve the generation-skipping transfer (GST) exempt status of a trust or facilitate the allocation of GST exemption to a trust; or divide a trust for marital or charitable deduction planning purposes.³⁰

26. Chadwick, *supra* note 1, at 2; Aghdami & Durst, *supra* note 25, at 19.

27. Chadwick, *supra* note 1, at 2; *Modifying Irrevocable Trusts – A Modern Approach to an Age-Old System*, LEECH TISHMAN (Feb. 15, 2023), <https://www.leechtishman.com/insights/blog/modifying-irrevocable-trusts-a-modern-approach-to-an-age-old-system/h> [<https://perma.cc/N578-CMZA>].

28. Chadwick, *supra* note 1, at 2.

29. *Id.*; Anna Soliman, *How can you modernize the terms of an irrevocable trust?*, FIDUCIARY TR. INT'L (Apr. 4, 2023), <https://www.fiduciarytrust.com/insights/article-detail/how-can-you-modernize-the-terms-of-an-irrevocable-trust> [<https://perma.cc/7ZDC-V2GT>].

30. Chadwick, *supra* note 1, at 2; Aghdami & Durst, *supra* note 25, at 18.

D. Correct Errors and Address Ambiguities

Finally, some irrevocable trust agreements contain drafting mistakes or ambiguities that impair the administration of the trust.³¹ Consequently, it may be helpful to modify an irrevocable trust to correct a scrivener's error; clarify ambiguities in the original trust agreement; correct a mistake of law or fact; or update a trust agreement to more closely conform with the settlor's original intent, if known.³²

III. TRUST MODIFICATIONS BEFORE THE TEXAS DECANTING STATUTE

The Texas decanting statute did not become effective until September 1, 2013.³³ Of course, before then, many trustees and beneficiaries still desired to modify irrevocable trusts for the same reasons specified above.³⁴ There were other statutory options available before Texas enacted its decanting statute, including trust divisions and combinations, as well as judicial modifications and reformations.³⁵ Decanting may have even been available under Texas common law, at least for the brave at heart.³⁶ The paragraphs below identify decanting alternatives available by Texas statute and discuss how decanting developed under the common law of other states.³⁷

A. Other Texas Modification Statutes

1. Trust Divisions and Combinations

Section 112.057 of the Texas Property Code, originally enacted in 1991, permits the division and combination of irrevocable trusts, which could be useful in certain circumstances.³⁸ For example, if a trustee is administering a mixed inclusion ratio trust, but wishes to divide the trust into two trusts—one exempt from GST tax and one not exempt from GST tax—to facilitate more tax-efficient distributions to different generations, dividing the trust may be

31. Chadwick, *supra* note 1, at 2; Soliman, *supra* note 29.

32. Chadwick, *supra* note 1, at 2; Aghdami & Durst, *supra* note 25, at 19.

33. Chadwick, *supra* note 1, at 2; Aghdami & Durst, *supra* note 25, at 4.

34. Chadwick, *supra* note 1, at 2; Aghdami & Durst, *supra* note 25, at 19.

35. Chadwick, *supra* note 1, at 3; Farhad Aghdami & Jeffrey D. Chadwick, *Decanting Comes of Age*, 23 PROB. PRAC. REP. 1, 10 (May 2011).

36. Chadwick, *supra* note 1, at 3.

37. *Id.* See *Trust Decanting Do's and Don'ts*, WEALTH COUNS. (Nov. 1, 2019, 11:36 AM), <https://info.wealthcounsel.com/blog/trust-decanting-dos-and-donts> [https://perma.cc/WWU7-C5VT] (demonstrating that if an irrevocable trust agreement contains a provision expressly authorizing the trustee to distribute trust principal to a new trust with different terms, the trustee may simply proceed in accordance with such authorization rather than relying on a state statute or common law to modify the trust).

38. TEX. PROP. CODE ANN. § 112.057.

more efficient than decanting the trust.³⁹ Similarly, if a trustee is administering multiple trusts for the same beneficiary with substantially similar terms, it may be more appropriate to combine the trusts rather than to decant the trusts into a new, single trust.⁴⁰ Like decanting, trustees can divide and combine trusts without a judicial proceeding.⁴¹

A trustee may divide a trust or combine trusts unless it is expressly prohibited by the trust instrument; the division or combination would impair the rights of any beneficiary; or the division or combination would adversely affect achievement of the purposes of the original trust.⁴² This gives a trustee fairly wide latitude, and many practitioners interpret these provisions broadly when advising a trustee to divide or combine trusts in the best interests of the beneficiaries.⁴³

To divide a trust or combine trusts, a trustee must give written notice of the division or combination, not later than thirty days before such division or combination, to each beneficiary who might be entitled to receive trust distributions at such time or when the trust is funded and execute a notarized, written instrument that the trust has been divided pursuant to Section 112.057 of the Texas Property Code and that the above notice requirements have been satisfied.⁴⁴ In the case of a division, the written division instrument must “allocate trust property among the separate trusts on a fractional basis, by identifying the assets and liabilities passing to each separate trust, or in any other reasonable manner.”⁴⁵ As a practical matter, a written combination instrument should confirm the surviving trust instrument and any other provisions from each trust agreement that continue to govern the ongoing administration of the merged trust.⁴⁶

If a trustee determines that a division or combination would improve the overall trust administration, these actions are fairly easy to accomplish under the Texas statute.⁴⁷ The trustee simply sends written notice to the beneficiaries who are eligible to receive distributions and executes a written instrument setting forth the division or combination.⁴⁸ Beneficiaries can even waive the notice requirement if it would be useful for the division or combination to be effective before the thirty-day waiting period typically imposed by statute.⁴⁹ Before pursuing a more burdensome alternative, such

39. Chadwick, *supra* note 1, at 3; Aghdami & Durst, *supra* note 25, at 19.

40. PROP. § 112.057(a), (c).

41. *See id.*

42. *See id.* (permitting more permissive standards than the original statute, which required significant tax savings before a trustee could divide or combine trusts without a judicial proceeding).

43. *Id.*

44. *See id.*

45. *See id.* § 112.057(b).

46. *See id.*

47. *See id.* § 112.057.

48. *Id.* § 112.057(a), (c).

49. *See id.* § 112.057(e).

as a judicial modification or decanting, a trustee should consider whether a simple trust combination or division would be sufficient.⁵⁰

2. Judicial Modifications and Reformations

Although trust combinations and divisions may work in some circumstances, they are not cure-alls, and some situations dictate an actual change to the language of an existing trust agreement.⁵¹ Before decanting, Texas trustees generally had to seek court approval to modify a trust agreement unless there was clear decanting or modification authority in the trust agreement itself.⁵²

Section 112.054 of the Texas Property Code, originally enacted in 1983, permits a court to order that a trustee be changed, the terms of a trust be modified, a trustee be directed, permitted, or prohibited from performing certain acts, or a trust be terminated, in whole or in part, if certain requirements are met.⁵³ Specifically, the trustee must show the court that the trust purposes have been fulfilled or have become illegal or impossible to fulfill; because of circumstances not known to or anticipated by the settlor, the court order will further the trust purposes; modifying administrative provisions is necessary or appropriate to prevent waste or impairment of the trust's administration; the order, if not contrary to the settlor's intent, is necessary or appropriate to achieve the settlor's tax objectives or to qualify a beneficiary for governmental benefits, in which case the order can be made retroactive; or the order is not inconsistent with a material purpose of the trust, but only if all trust beneficiaries have consented to the order.⁵⁴

Like trust divisions and combinations, the judicial modification statute gives a trustee fairly wide latitude when asking a court to change the terms of an irrevocable trust.⁵⁵ This is particularly true if all of the beneficiaries consent to the proposed modification, in which case a court may grant the requested relief so long as the order is not inconsistent with a material purpose of the trust.⁵⁶ In the author's experience, many Texas courts are willing to approve a trust modification if the trustee and all beneficiaries are in agreement.⁵⁷ A lower court's decision in this regard is not binding on the Internal Revenue Service (IRS), however, so it is also important for the

50. See *id.* § 112.057(a), (c).

51. Chadwick, *supra* note 1, at 3; see discussion *infra* Section III.A.1.

52. See PROP. § 112.054.

53. See *id.* § 112.054(a).

54. See *id.* § 112.054(a), (c), (d).

55. See *id.*

56. *Id.* § 112.054(d).

57. Chadwick, *supra* note 1, at 4.

trustee to understand the potential tax consequences of a judicial modification, if any, before proceeding.⁵⁸

Unless necessary to accomplish a settlor's tax objectives, a judicial modification is typically effective as of the date of the court order, but not beforehand.⁵⁹ If a trustee desires to change the terms of an irrevocable trust as of the date the trust was originally created, the trustee may seek a judicial reformation instead of a judicial modification.⁶⁰ To obtain a judicial reformation, a trustee must show the court that reforming administrative provisions is necessary or appropriate to prevent waste or impairment of the trust's administration; the order, if not contrary to the settlor's intent, is necessary or appropriate to achieve the settlor's tax objectives or to qualify a beneficiary for governmental benefits; or the order is necessary to correct a scrivener's error in the trust agreement, even if unambiguous, to conform the terms to the settlor's intent, as established by clear and convincing evidence.⁶¹ Not surprisingly, reforming a trust is typically harder than modifying a trust.⁶² Judicial reformation is generally reserved for correcting a mistake of law or fact, addressing a clear scrivener's error, or avoiding a negative, unplanned tax result.⁶³ Unlike a judicial modification, the trustee and beneficiaries cannot simply seek an agreed judgment on the basis that a judicial reformation is not inconsistent with a material purpose of the trust.⁶⁴ Instead, the court must find a compelling reason to reform an irrevocable trust as of its original creation date.⁶⁵

Even with the enactment and expansion of the Texas decanting statute, there are still many instances in which a judicial modification or reformation may be preferable to a trust decanting.⁶⁶ For example, a trust agreement may expressly prohibit trust decanting; a reformation or retroactive modification may be necessary for tax or other purposes; a trustee may only have limited discretion to distribute trust property, as further described below, yet seek to modify a dispositive provision of the trust agreement; a trustee may simply prefer a court order, either to minimize potential exposure from the IRS or to protect the trustee from potential fiduciary liability; a beneficiary may express dissatisfaction with a proposed trust modification or petition the court

58. *Id.* at 3. See Steve Hartnett, *Consequences of Modifying an Irrevocable Trust*, AM. ACAD. OF EST. PLAN. ATTY'S, <https://www.aaepa.com/2019/06/consequences-of-modifying-an-irrevocable-trust/> (last visited Jan. 21, 2024) [<https://perma.cc/9P69-5P8S>].

59. See PROP. § 112.054(c).

60. *Id.* § 112.054(b-1).

61. See *id.* § 112.054(b-1), (c). See also *id.* § 112.054(f) (stating the basis for reforming trusts in equity and under common law are still available).

62. See *id.* § 112.054(b).

63. See *id.* § 112.054.

64. See *id.*

65. See *id.* § 112.054(b-1).

66. Chadwick, *supra* note 1, at 4. See Laura K. Zeigler, *Making Changes to Irrevocable Trusts*, BESSEMER TR., <https://www.bessemertrust.com/insights/a-closer-look-making-changes-to-irrevocable-trusts> (last visited Jan. 21, 2024) [<https://perma.cc/D5HC-ZL42>].

himself or herself; or until more recently at least, a trustee may believe that decanting requires the retitling of hard-to-transfer assets, which could be avoided through a judicial proceeding that does not create a new trust to receive assets from an old trust.⁶⁷

Each situation is unique, and it is important for trustees, as well as those advising them, to consider all alternatives to modifying or reforming a trust under Texas law.⁶⁸ Sometimes a judicial modification or reformation is more appropriate, and perhaps even more straightforward, than a trust decanting.⁶⁹

B. Decanting Under Common Law

“New York was the first state to enact a decanting statute” in 1992, followed by Alaska in 1998, and then Delaware in 2003.⁷⁰ More than thirty states have now adopted decanting statutes, in addition to providing for other statutory modification alternatives similar to the Texas methods discussed above.⁷¹ Although trust decanting has only recently gained popularity with state legislatures, it is not a new concept.⁷² In fact, some practitioners believe that trustees have always had the authority to decant under common law, as evidenced by the Restatements and several prominent cases, further discussed below.⁷³

1. Restatements

The Restatements of Property support the notion that a trustee, under common law and absent an express prohibition in the trust instrument, has the authority to decant trust assets to a new trust.⁷⁴ This decanting authority is generally characterized as the trustee’s exercise of a special power of appointment, subject to the same fiduciary duties imposed on the trustee with regard to other distributions of trust property.⁷⁵

a. Restatement (Second) of Property: Donative Transfers

The Restatement (Second) describes a trustee’s ability to transfer trust property as being similar to a special power of appointment under which a

67. Chadwick, *supra* note 1, at 4.

68. See PROP. § 112.054(b).

69. See *id.*

70. Chadwick, *supra* note 1, at 4; William R. Culp, Jr. & Briani B. Mellen, *Trust Decanting: An Overview and Introduction to Creative Planning Opportunities*, 45 REAL PROP., TR. & EST. L. J. 1, 3 (2010).

71. Chadwick, *supra* note 1, at 4. See Culp & Mellen, *supra* note 70, at 3.

72. Chadwick, *supra* note 1, at 4. See Culp & Mellen, *supra* note 70, at 4.

73. Chadwick, *supra* note 1, at 4. See Culp & Mellen, *supra* note 70, at 4.

74. Chadwick, *supra* note 1, at 5. See Culp & Mellen, *supra* note 70, at 4.

75. Chadwick, *supra* note 1, at 5. See Culp & Mellen, *supra* note 70, at 17.

trustee may transfer an interest in property equal to or lesser than the title authorized under the trust instrument.⁷⁶ If the trustee is able to transfer full legal title to trust property to a beneficiary, the trustee should also be able to transfer less than full legal title by transferring the property in further trust.⁷⁷

Furthermore, a power of appointment permits persons to transfer a beneficial interest in property they do not otherwise possess, and the exercise of the power is considered the completion of a transfer originating with the creator of the power.⁷⁸ Therefore, the power to determine the identity of persons entitled to receive beneficial interests in property that are owned by persons other than the powerholder characterizes a power of appointment.⁷⁹ The Restatement (Second) characterizes a trustee's discretion to pay trust property to a beneficiary or among a class of beneficiaries as a power of appointment because the trustee is authorized to determine the recipients of beneficial interests in property that the trustee does not otherwise possess.⁸⁰

The Restatement (Second) also authorizes a powerholder to create a new special power of appointment in any other person, which is exercisable only in favor of permissible appointees of the original power.⁸¹ For example, a trustee with the discretionary power to distribute trust property outright to or for the benefit of one or more trust beneficiaries should be able to distribute property to a separate discretionary trust for the lifetime benefit of one beneficiary that gives the beneficiary a special power of appointment over the appointed trust assets.⁸²

*b. Restatement (Third) of Property: Wills & Other Donative Transfers*⁸³

The Restatement (Third) defines a power of appointment as a power that enables the holder to designate recipients of beneficial ownership interests in or powers of appointment over the appointive property.⁸⁴ The Restatement (Third) recognizes a trust beneficiary's ability to hold both a beneficial interest in trust property and a power of appointment over that property, thereby eliminating from the definition of a power of appointment the requirement that the holder possess the power to designate beneficial ownership interests in property "other than as an incident of the beneficial

76. RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 11.1 cmt. d (AM. L. INST. 1983).

77. *See id.* ("A power of appointment is authority, other than as an incident of the beneficial ownership of property, to designate recipients of beneficial interests in property.")

78. *Id.* § 11.1 cmt. b.

79. *See id.*

80. *Id.* § 11.1 cmt. d.

81. *Id.* § 19.4.

82. Chadwick, *supra* note 1, at 5.

83. Briani Bennet Mellen originally authored portions of this summary of the Third Restatement, which are reprinted here with her permission.

84. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1. (AM. L. INST. 2011).

ownership of property.”⁸⁵ A power to revoke or amend a trust, withdraw trust property, or direct the trustee to distribute trust property to another are described as powers of appointment over trust property.⁸⁶

The Restatement (Third) recognizes that a fiduciary distributive power, defined to “include a trustee’s power to distribute [trust property] to or for the benefit of [a designated beneficiary or] . . . among a defined group of beneficiaries,” is a special power of appointment.⁸⁷ A fiduciary distributive power, however, is not a “discretionary power of appointment,” which may be exercised arbitrarily as long as the exercise is within the scope of the power.⁸⁸ The distinction between a discretionary power of appointment and a fiduciary distributive power is based on the different treatment afforded to discretionary powers of appointment which may be exercised arbitrarily and fiduciary distributive powers which are subject to fiduciary obligations.⁸⁹ For example, unlike the exercise of a power of appointment, fiduciary standards are imposed on the exercise of a distributive power held in a fiduciary capacity.⁹⁰ A fiduciary power to distribute property, moreover, survives the death of a fiduciary and succeeds to its successor, but a power of appointment is personal to the holder and lapses upon the holder’s death if not exercised.⁹¹

Because of the fiduciary nature of fiduciary distributive powers, the Restatement (Third) of Property “defers to the Restatement Third of Trusts for the law governing the exercise of fiduciary distributive powers.”⁹² Nevertheless, comments to the Restatement (Third) of Property specifically recognize that, “subject to fiduciary standards and the terms” governing the trustee’s power, “a trustee or other fiduciary can exercise a fiduciary distributive power” to distribute trust property to create another trust.⁹³ The Restatement (Third) also recognizes that rules governing special powers of appointment may similarly apply to fiduciary distributive powers, such as limitations on the exercise of the power in favor of persons who are not permissible appointees or in violation of common law or statutory rules against perpetuities.⁹⁴

The Restatement (Third), therefore, expressly recognizes a trustee’s ability to exercise a discretionary power to distribute property by decanting

85. *Id.* § 17.1 rep. n. 1.

86. *Id.* § 17.1 cmts. e, f.

87. *Id.* § 17.1 cmt. g.

88. *See id.*; Chadwick, *supra* note 1, at 5.

89. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 cmt. g; Chadwick, *supra* note 1, at 5.

90. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 cmt. g; Chadwick, *supra* note 1, at 5.

91. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 cmt. g rep. n. 1; Chadwick, *supra* note 1, at 5.

92. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 cmt. g.

93. *See id.* § 19.14 cmt. f.

94. *See id.* § 17.1 cmt. g.

property to another trust.⁹⁵ In addition, although the Restatement (Third) of Property defers to the Restatement (Third) of Trusts, because of the fiduciary nature of fiduciary distributive powers, the established rules governing the exercise of special powers of appointment, including the power to appoint trust property further in trust, should provide guidance to trustees looking to exercise discretionary distributive powers over trust property by appointing such property in further trust.⁹⁶

The Restatement (Third) of Property expressly provides that a fiduciary distributive power is a special power of appointment and that a trustee may exercise a fiduciary distributive power to create another trust.⁹⁷ The Restatement (Third) also provides that the holder of a special power of appointment may exercise the power by appointing property to a trust solely for the benefit of permissible appointees of the power unless the creator of the power indicates otherwise.⁹⁸ The rationale is that except to the extent that the creator of the special power has manifested a contrary intention, the holder of a special power of appointment has the same breadth of discretion to appoint property to permissible appointees that the holder has in disposing of the holder's own property to the permissible appointees.⁹⁹ In the absence of a contrary intent, the holder of a special power has the authority to exercise the power by an appointment in trust.¹⁰⁰ The creator of a special power of appointment manifests a contrary intent to an appointment in trust if the language creating the power expressly prohibits an appointment in trust by the holder.¹⁰¹ Therefore, a holder of a special power of appointment is free to exercise the power by appointing outright or in trust to permissible appointees in the absence of express language to the contrary.¹⁰²

Language that merely authorizes, but does not require, an outright appointment is not construed to prohibit an appointment in trust.¹⁰³ For example, if the trustee is directed to pay income to the settlor's spouse for

95. *See id.* § 19.14 cmt. f.

96. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 cmt. g; Chadwick, *supra* note 1, at 6.

97. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS §§ 17.1 cmt. g, 19.14 cmt. f; Chadwick, *supra* note 1, at 6.

98. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. f; Chadwick, *supra* note 1, at 6.

99. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. a; Chadwick, *supra* note 1, at 6.

100. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. e; Chadwick, *supra* note 1, at 6.

101. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. e; Chadwick, *supra* note 1, at 6.

102. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. d (providing that where special power has only one permissible appointee, only an outright appointment or one in trust in which the permissible appointee is the sole beneficiary is permissible); Chadwick, *supra* note 1, at 6.

103. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. e; Chadwick, *supra* note 1, at 6.

life, “then absolutely, outright, and forever, for such issue of” the settlor and the settlor’s spouse as may be appointed by will, the settlor has not manifested an intention to limit the appointment of property outright, and the settlor’s spouse may exercise the power by appointing outright or in trust to the settlor’s issue.¹⁰⁴ If the special power of appointment may be exercisable in favor of only one permissible appointee, the holder may only exercise the power to appoint property outright to such permissible appointee or to a trust in which the permissible appointee is the sole beneficiary.¹⁰⁵

Similar to the Restatement (Second), the Restatement (Third) continues the view that the exercise of a special power to grant a general power of appointment to a permissible appointee is, in substance, the equivalent of a permissible outright appointment.¹⁰⁶ Similarly, the exercise of a special power by granting a testamentary general power to a permissible appointee approaches outright appointment to the appointee, especially where the appointee possesses a life interest in the property subject to the appointment.¹⁰⁷ In the absence of a contrary intent by the creator of the power, the holder may also exercise a special power of appointment by granting any other person, whether or not such person is a permissible appointee, the power to appoint to persons who are solely permissible appointees of the original power.¹⁰⁸

2. Common Law

In addition to general support from the Restatements, several courts have found that trustees have the power to decant under common law.¹⁰⁹ Particularly relevant case law is discussed below, some of which demonstrates the danger of decanting under certain circumstances.¹¹⁰

104. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. e, illus. 5 (internal quotations omitted); Chadwick, *supra* note 1, at 6.

105. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. d; Chadwick, *supra* note 1, at 6.

106. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. g(1); Chadwick, *supra* note 1, at 6.

107. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. g(1); Chadwick, *supra* note 1, at 6.

108. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 19.14 cmt. g(3)–(4); Chadwick, *supra* note 1, at 6.

109. Chadwick, *supra* note 1, at 6. *See* discussion *infra* Sections III.B.2.a–d.

110. *See* Regents of the Univ. Sys. v. Tr. Co. of Ga., 198 S.E. 345, 345–57 (Ga. 1938); Marx v. Rice, 62 A.2d 48, 48–55 (N.J. 1949); *In re Kroll*, 971 N.Y.S.2d 863, 863–66 (2013); Acheff v. Lazare, No. 1:12-CV-00100-JCH-RJS, 2014 U.S. Dist. LEXIS 179767, at *1–13 (D. N.M. May 2, 2014); Harrell v. Badger, 171 So.3d 764, 764–70 (Fla. 2015); Thomson v. Thomson, No. FA134024747S, 2015 WL 5237783, at *1–20 (Conn. Super. Ct. Aug. 4, 2015); *Kroll v. N.Y. State Dept. of Health*, 39 N.Y.S.3d 183, 183–87 (2016); *United States v. Lazare*, No. 2:14-cv-01075-APG-VCF, 2016 WL 1127627, at *1–6 (D. Nev. Mar. 4, 2016); *Ferri v. Powell-Ferri*, 72 N.E.3d 541, 541–54 (Mass. 2017); *Ferri v. Powell-Ferri*, 165 A.3d 1137, 1137–49 (Conn. 2017); *Hodges v. Johnson*, 177 A.3d 86, 86–102 (N.H. 2017); *In re Soble Fam. Tr.*, No. 334411, 2017 WL 6503004, at *1–7 (Mich. Ct. App. Dec. 19, 2017). *See also* Lydia

a. Phipps v. Palm Beach Trust Co.

In *Phipps v. Palm Beach Trust Co.*, the individual trustee and his successors had the power in their “sole and absolute discretion” to direct distributions of some, none, or all of the trust property to any one or more of the settlor’s descendants.¹¹¹ The individual trustee directed the corporate trustee to transfer the trust property to a second trust.¹¹² The second trust was identical to the first trust except that it gave one of the settlor’s children a special testamentary power of appointment to appoint trust income to that child’s wife.¹¹³

The corporate trustee sought court approval of the proposed decanting transaction.¹¹⁴ The trial court approved the decanting, but a beneficiary appealed to the Florida Supreme Court.¹¹⁵ The Florida Supreme Court, in approving the decanting, determined that the individual trustee’s power to distribute trust property to the limited class of persons designated as trust beneficiaries was a special power of appointment, and the trustee’s ability to appoint property further in trust for members of the class depended upon the extent of the power authorized under the terms of the trust agreement.¹¹⁶ The court stated, “the power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent.”¹¹⁷

b. In re Estate of Spencer

In *In re Estate of Spencer*, the decedent’s husband was the trustee and a beneficiary of a testamentary trust for the benefit of their four children.¹¹⁸ The trust held a one-fourth interest in a parcel of real estate.¹¹⁹ The husband owned the other three-fourths interest outright.¹²⁰ The trust provided that the assets were to be distributed to their grandchildren (or more remote descendants, per stirpes) after the death of the husband and children.¹²¹

The terms of the trust granted the husband a special power to dispose of the trust property by life estate to and among their children with the remainder

Lee Lockett & Peter Blumeyer, *Sour Grapes: When Decanting Gives Rise to Litigation*, 33 PROB. & PROP. 26, 26–31 (2019) (discussing many of the cases cited previously).

111. *Phipps v. Palm Beach Tr. Co.*, 196 So. 299, 300 (Fl. 1940).

112. *See id.*

113. *See id.*

114. *See id.* at 300.

115. *See id.* at 300–01.

116. *See id.* at 301.

117. *Id.*

118. *In re Est. of Spencer*, 232 N.W.2d 491, 493 (Iowa 1975).

119. *Id.*

120. *Id.*

121. *Id.*

to such children's surviving issue.¹²² The husband exercised his testamentary special power of appointment to appoint the assets from his wife's trust, along with his own interest in the real estate, to a new, multi-generational trust.¹²³

The court in *In re Estate of Spencer* held that the exercise of the power of appointment in further trust was a valid exercise but that the trust could not be a multi-generational trust and the assets should vest final distributions to the grandchildren at the death of the decedent's children.¹²⁴ An expansive reading of *In re Estate of Spencer* suggests that a trustee can decant trust property to a new trust unless plainly prohibited by the terms of the original trust.¹²⁵

c. *Wiedenmayer v. Johnson*

Under the trust instrument, the trustees were authorized to distribute any or all of the trust property to the beneficiary, the settlor's son, or to use the trust property on the son's behalf as the trustees determined "in their absolute and uncontrolled discretion" for the beneficiary's "best interests."¹²⁶ The trustees determined that they should condition distributions on the beneficiary setting up another trust (primarily because the beneficiary was going through a divorce and the new trust provided protection from marital claims).¹²⁷

The guardian *ad litem* challenged the distribution to the new trust on behalf of certain minor children and alleged that the children lost the contingent remainder interest provided to them under the original trust.¹²⁸ The court rejected the guardian *ad litem*'s challenge arguing that if the beneficiary received the distribution of the trust property outright—as permitted under the trust agreement—then the children would have lost their contingent remainder interest in the property that was distributed from the trust.¹²⁹ *Wiedenmayer* can be distinguished from *Phipps* and *In re Estate of Spencer* because the court in *Wiedenmayer* limited its inquiry to whether the trustees' discretionary power to distribute trust property in further trust was in the beneficiary's best interest and whether the exercise of that power was an abuse of discretion.¹³⁰

122. *Id.* at 492.

123. *Id.* at 494.

124. *Id.* at 498.

125. *See id.*; Chadwick, *supra* note 1, at 7.

126. *Wiedenmayer v. Johnson*, 254 A.2d 534, 535 (N.J. Super. Ct. App. Div. 1969).

127. *Id.* at 537 (Conford, J., dissenting).

128. *Id.* at 536.

129. *Id.*

130. *See id.* at 534–38; *In re Est. of Spencer*, 232 N.W.2d at 491–99; *Phipps v. Palm Beach Tr. Co.*, 196 So. 299, 299–301 (Fl. 1940); Chadwick, *supra* note 1, at 7.

d. *Morse v. Kraft*

Morse v. Kraft involved a trust created by New England Patriots owner Robert Kraft and his wife, Myra Kraft, in 1982.¹³¹ Under the trust instrument, four subtrusts were created for the benefit of the Krafts' four sons, who were then minors.¹³² Each son was the primary income beneficiary of his trust and possessed a special power of appointment exercisable among descendants, siblings, and spouses.¹³³ Each son's children were the contingent remainder beneficiaries of their father's respective subtrust.¹³⁴ Importantly, only a "disinterested trustee" was permitted to make distribution decisions for each subtrust.¹³⁵ The trust instrument defined a disinterested trustee as "all those trustees who are not transferors of property to [the] trust and who are not eligible, and who are not legally obligated to support any person who is eligible, to receive current distributions of income or principal from any trust."¹³⁶

The terms of the trust instrument vested the disinterested trustee with broad distribution authority.¹³⁷ Specifically, the disinterested trustee was directed to pay to each son "such portion or portions of the net income and principal thereof as the Disinterested Trustee shall deem desirable *for the benefit* of such child."¹³⁸ Moreover, the trust instrument directed that "[w]henever provision is made hereunder for payment of principal or income to a beneficiary, the same may instead be *applied for his or her benefit*."¹³⁹

Richard Morse, who had been serving as the disinterested trustee of the subtrusts since their creation, petitioned the Massachusetts Supreme Court to approve the transfer of all of the assets of the subtrusts into new subtrusts established pursuant to a new master trust formed in 2012.¹⁴⁰ Mr. Morse relied on his broad distribution authority, and *Phipps* and *Wiedenmayer*, to argue that he had the ability to decant the assets of the subtrusts to the new master trust.¹⁴¹ Importantly, the new master trust had the same basic beneficial interests as the original 1982 trust, although it specifically permitted each of the sons to serve as trustee of his own subtrust with distributions limited by an ascertainable standard.¹⁴² In connection with his petition, Mr. Morse also submitted affidavits from Robert Kraft (Myra Kraft

131. *Morse v. Kraft*, 992 N.E.2d 1021, 1023 (Mass. 2013).

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.* at 1025.

138. *Id.* (emphasis added).

139. *Id.* (emphasis added).

140. *Id.* at 1023.

141. *Id.*

142. *Id.*

was deceased), the drafting attorney, and himself reciting that the terms of the original 1982 trust were intended to allow distributions to new trusts without beneficiary consent or court approval.¹⁴³

Mr. Morse, now eighty-one years old and seeking to retire, contended that decanting the subtrusts was in the best interests of the beneficiaries because each of the sons was now in his forties and well qualified to manage the trust assets and make distribution decisions.¹⁴⁴ Decanting would only be in the beneficiaries' best interests, however, if it did not cause the subtrusts to lose their GST exempt status.¹⁴⁵ Consequently, the issue before the court was whether the terms of the original 1982 trust authorized decanting without beneficiary consent or court approval, which would theoretically prevent the decanting from triggering a GST tax.¹⁴⁶

In construing the trust instrument, the court generally described decanting as follows:

In effect, a trustee with decanting power has the authority to amend an unamendable trust, in the sense that he or she may distribute the trust property to a second trust with terms that differ from those of the original trust. A trustee can only exercise a decanting power, however, in keeping with fiduciary obligations.¹⁴⁷

Noting that a trustee's decanting authority turns on the terms of the trust instrument and the facts of the particular case, the court concluded that the terms of the original 1982 trust authorized Mr. Morse to transfer property of the subtrusts to the new 2012 master trust without beneficiary consent or court approval.¹⁴⁸ In reaching this conclusion, the court relied on *Phipps* and *Wiedenmayer*, in addition to the decision by the Massachusetts Supreme Court in *Loring v. Karri-Davies*, which held that the holder of a special power of appointment could appoint assets in further trust so long as the donor failed to express any intention to the contrary.¹⁴⁹ Based on this judicial precedent, as well as Mr. Morse's representations regarding the best interests of the beneficiaries and his own fiduciary obligations, the court confirmed Mr. Morse's decanting authority.¹⁵⁰

Although *Morse* effectively authorizes decanting in Massachusetts under appropriate circumstances, the Massachusetts Supreme Court declined the request of the Boston Bar Association to recognize an inherent decanting power in trustees of all irrevocable trusts irrespective of authorizing language

143. See *id.* at 1026.

144. *Id.* at 1023.

145. See *id.* at 1023–24.

146. *Id.* at 1024.

147. *Id.*

148. *Id.*

149. *Id.* at 1024–25; *Loring v. Karri-Davies*, 357 N.E.2d 11, 16 (Mass. 1976).

150. *Morse*, 992 N.E.2d at 1028.

in the trust instrument.¹⁵¹ Consequently, for decanting to be effective under a Massachusetts trust, the trust instrument must contain an appropriate “pay-or-apply” provision, which gives the trustee express authority to make a distribution for the benefit of or on behalf of a beneficiary.¹⁵² It is also notable that the disinterested trustee in *Morse* had unlimited discretion to distribute income and principal, although it appears likely that the court would have reached the same result if the trust instrument limited distributions to an ascertainable standard provided the trust instrument still contained an appropriate pay-or-apply provision.¹⁵³

IV. THE TEXAS DECANTING STATUTE

To fully understand decanting in Texas, the best place to start is with the statute itself.¹⁵⁴ While the statute certainly provides an excellent roadmap, there are also practical issues the statute does not (and largely cannot) address.¹⁵⁵ Below is a brief explanation of the purposes behind recent statutory amendments, a summary of the current statute, and related commentary.¹⁵⁶

A. Evolution of the Texas Decanting Statute

The original effective date of the Texas decanting statute was September 1, 2013.¹⁵⁷ Texas amended its decanting statute in 2017, 2019, and 2023.¹⁵⁸ Before diving into specific sections, it is important to understand the history behind the Texas decanting statute and its recent amendments.¹⁵⁹

1. Original 2013 Statute

Effective September 1, 2013, Texas became the twentieth state with a decanting statute when it enacted Sections 112.071 through 112.087 of the Texas Property Code.¹⁶⁰ At the time, and perhaps still today, the Texas decanting statute was viewed as fairly conservative compared to decanting statutes from states such as Delaware, South Dakota, or Nevada.¹⁶¹ In

151. *Id.* at 1027.

152. *See id.*

153. *Id.* at 1024.

154. *See* TEX. PROP. CODE ANN. §§ 112.071–.087; Chadwick, *supra* note 1, at 8.

155. *See* PROP. §§ 112.071–.087; Chadwick, *supra* note 1, at 8.

156. Chadwick, *supra* note 1, at 8. *See* discussion *infra* Section IV.A.

157. *See* PROP. §§ 112.071–.087.

158. *See id.*

159. Chadwick, *supra* note 1, at 8. *See* discussion *infra* Sections IV.A.2–4.

160. *See* PROP. §§ 112.071–.087; Chadwick, *supra* note 1, at 8.

161. *Texas vs. South Dakota: Who Has Better Trust Law?*, WEALTH ADVISORS TR. CO., <https://www.wealthadvisorstrust.com/blog/texas-vs-south-dakota-who-has-better-trust-law> (last visited Jan. 22, 2024) [<https://perma.cc/JE6S-FD6R>]; Chadwick, *supra* note 1, at 9.

essence, the statute states if a trustee has limited discretion to distribute trust property pursuant to an ascertainable standard, as further discussed below, a trustee can only decant to modify administrative provisions of a trust agreement.¹⁶² On the other hand, if a trustee has “full discretion to distribute” trust property, again as further discussed below, the trustee can decant to modify dispositive provisions in addition to administrative provisions.¹⁶³

2. 2017 Amendment

The Texas decanting statute was enacted before the Uniform Trust Decanting Act was published in 2015 and, in any event, was fairly unique in its overall structure.¹⁶⁴ As with most new laws, implementing the decanting statute was clunky at times, and practitioners agreed that the statutory language could be clarified in certain places.¹⁶⁵ Consequently, Texas enacted certain amendments effective September 1, 2017, which were mostly clarifying in nature.¹⁶⁶

Perhaps the most important amendment in 2017, however, was removing a prohibition from the original statute that a trustee could not decant if it would “materially impair the rights of any beneficiary of the trust.”¹⁶⁷ No one really knew what it meant to “materially impair” a beneficiary’s rights, and this prohibition was so broad, and, frankly, so scary for practitioners and trustees that it seemed to have a chilling effect on decanting.¹⁶⁸ Anecdotally, this seemed to cause many trustees to still pursue judicial modifications instead of decanting, thereby materially impairing the utility of the decanting statute itself.¹⁶⁹ This removal was a welcome change for decanting advocates and, in the author’s mind, made it much easier to recommend decanting to clients.¹⁷⁰

3. 2019 Amendment

Under the original 2013 statute and 2017 amendment, many advisors (often amidst pressure from their clients) questioned whether it was necessary

162. PROP. § 112.071(6); Chadwick, *supra* note 1, at 9.

163. PROP. § 112.072(a); Chadwick, *supra* note 1, at 9.

164. See UNIF. TR. DECANTING ACT (UNIF. L. COMM’N 2018).

165. See *id.*; Chadwick, *supra* note 1, at 9.

166. Chadwick, *supra* note 1, at 9.

167. See Act of Sept. 1, 2013, 83rd Leg., R.S., ch. 699, 2017 TEX. GEN. LAWS 1812 (amended 2017) (current version at TEX. PROP. CODE § 112.085(2)).

168. See Act of Sept. 1, 2013, 83rd Leg., R.S., ch. 699, 2017 TEX. GEN. LAWS 1812 (amended 2019) (current version at TEX. PROP. CODE § 112.085); Chadwick, *supra* note 1, at 9.

169. Chadwick, *supra* note 1, at 9.

170. *Id.*

to transfer or retitle assets as part of the trust decanting process.¹⁷¹ In the author's mind, at least, the answer was generally yes.¹⁷² After all, decanting involved the transfer of assets from an old trust to a new trust.¹⁷³ Even if the trusts were treated as the same trust for federal income tax purposes, as further discussed below, there was still a new trust involved, which would seem to require retitling of some sort.¹⁷⁴ If that were not the case, decanting could simply be characterized as a trustee's power to amend an irrevocable trust agreement, which seems inconsistent with the traditional decanting justifications under common law.¹⁷⁵ Perhaps this was a distinction without a real difference, but the practical impact could be severe if a trust held hard-to-transfer assets, such as closely held business interests, real estate, or mineral interests.¹⁷⁶ In fact, it often motivated trustees to pursue judicial modifications instead of decanting, which undercut the effectiveness of the decanting statute as a nonjudicial alternative to modify an irrevocable trust.¹⁷⁷

Not all practitioners shared the author's view on retitling, particularly in other states with more applicable statutory language, and many trustees decanted trusts without retitling assets prior to 2019.¹⁷⁸ Nevertheless, the 2019 amendment, which added Section 112.0715 of the Texas Property Code, was designed to clarify that a trustee could decant to a new trust with the same name and taxpayer identification number as the original trust.¹⁷⁹ The legislature also included language in its enactment that this amendment was a codification of common law, which was intended to protect trustees (and undoubtedly their advising attorneys) who decanted trusts prior to 2019 without transferring or retitling trust assets.¹⁸⁰

4. 2023 Amendment

Although the statutory language for the 2019 amendment was pulled from other sources, such as the Delaware decanting statute and the Uniform Trust Decanting Act, it proved somewhat imprecise.¹⁸¹ Specifically, former

171. *Id.* See Wilk Auslander, *Decanting Emerges as a Powerful Tool for Estate Planning*, LEXOLOGY (Aug. 29, 2016), <https://www.lexology.com/library/detail.aspx?g=5e714d70-1dce-43fe-9dfc-747cf74b9afd> [<https://perma.cc/6L45-Z6LU>].

172. Chadwick, *supra* note 1, at 9.

173. Chadwick, *supra* note 1, at 9. See Auslander, *supra* note 173.

174. Chadwick, *supra* note 1, at 9. See Aghdami & Durst, *supra* note 25, at 5.

175. Chadwick, *supra* note 1, at 9. See Aghdami & Durst, *supra* note 25, at 5.

176. Chadwick, *supra* note 1, at 9. See Aghdami & Durst, *supra* note 25, at 5.

177. Chadwick, *supra* note 1, at 9. See Aghdami & Durst, *supra* note 25, at 5.

178. Chadwick, *supra* note 1, at 9; Kristin Abati & Renat Lumpau, *The Uniform Trust Decanting Act*, TRS. & ESTS. (Jan. 27, 2016), <https://www.choate.com/images/content/1/0/v2/1091/Abati-Lumpau-The-Uniform-Trust-Decanting-Act> [<https://perma.cc/8VZC-35KC>].

179. TEX. PROP. CODE ANN. § 112.0715.

180. PROP. § 112.0715(c); Chadwick, *supra* note 1, at 9.

181. PROP. § 112.0715(c); UNIF. TR. DECANTING ACT (UNIF. L. COMM'N 2018); Chadwick, *supra* note 1, at 9.

Subsection 112.0715(a) of the Texas Property Code provided that, as part of a decanting, “[a] second trust may be created by a distribution of principal . . . to a trust created under the same trust instrument as the first trust from which the principal is distributed.”¹⁸² Former Subsection 112.0715(b) further provided that in such cases, “the property is not required to be retitled.”¹⁸³

A technical reading of the prior statutory language produced unclear results.¹⁸⁴ It could have been argued, for instance, that retitling could only be avoided if the second trust was already contemplated under the original trust instrument, as would be the case with a subtrust or a continuing trust to be formed upon a specified termination event.¹⁸⁵ Trustees most often consider decanting, however, when an actual change to the trust agreement is required, which generally results in a new trust agreement being drafted.¹⁸⁶

In an effort to further clarify that retitling is not necessary, subsections 112.0715(a) and (b) of the Texas Property Code were amended as follows:

(a) A second trust may be created by a distribution of principal under Section 112.072 or 112.073 to a second trust that retains the name used by the first trust. The second trust may retain, subject to applicable federal law, the tax identification number of the first trust ~~{created under the same trust instrument as the first trust from which the principal is distributed or to a trust created under a different trust instrument}~~.

(b) If a second trust is created by a distribution of principal under Section 112.072 or 112.073 to a trust that retains ~~{created under}~~ the name of ~~{same trust instrument as}~~ the first trust ~~{from which the principal is distributed}~~, the property is not required to be retitled.¹⁸⁷

This revised statutory language, which became effective September 1, 2023, is a welcome clarification for trustees desiring to decant—as well as third parties asked to respect such decanting—without changing the trust name, obtaining a new taxpayer identification number, or retitling assets.¹⁸⁸

B. Summary of Texas Decanting Statute with Commentary

With a better understanding of how the Texas decanting statute has evolved, we can now examine the statute itself, including practical observations and drafting tips associated with each section discussed.¹⁸⁹ The below discussion does not attempt to dissect each and every section of the

182. Act of Sept. 1, 2019, 86th Leg., R.S., ch. 1112, 2019 TEX. GEN. LAWS 3155 (amended 2023) (current version at TEX. PROP. CODE § 112.0715(a)).

183. *Id.*

184. *Id.*; Chadwick, *supra* note 1, at 9.

185. Chadwick, *supra* note 1, at 9.

186. *Id.*

187. Tex. H.B. 2196, 88th Leg., R.S. (2023).

188. *See id.*; Chadwick, *supra* note 1, at 10.

189. *See* discussion *infra* Sections IV.B.1–12.

Texas decanting statute but, instead, focuses on the most impactful provisions for practitioners.¹⁹⁰

1. Section 112.071. Definitions

Section 112.071 of the Texas Property Code sets forth definitions upon which the remaining provisions of the Texas decanting statute rely.¹⁹¹ Notable definitions are discussed below.

First Trust. A “first trust” under subsection 112.071(4) is simply an existing irrevocable trust from which trust principal is decanted.¹⁹² A first trust can be an *inter vivos* trust or a testamentary trust.¹⁹³

Second Trust. A “second trust” under subsection 112.071(9) is any irrevocable trust to which principal is distributed under the Texas decanting statute.¹⁹⁴ As contemplated by Section 112.0715, further discussed above, a second trust may actually be created under the same trust instrument as the first trust, and there is no requirement that a second trust have a different name or taxpayer identification number than the first trust.¹⁹⁵

Authorized Trustee. Subsection 112.071(1) defines an “authorized trustee” as “a person, other than the settlor, who has [the] authority [to distribute trust principal] to or for the benefit of one or more current beneficiaries,” defined below.¹⁹⁶ Notably, a settlor cannot be the trustee who exercises the decanting authority.¹⁹⁷ Therefore, if a settlor is serving as sole trustee, it is necessary for the settlor to resign and appoint a successor trustee to perform the decanting.¹⁹⁸ If a settlor is serving as a co-trustee, the decanting can be performed by one or more co-trustees other than the settlor.¹⁹⁹ A settlor is not prohibited from serving as trustee of the new, decanted trust, which enables a trustee who performs the decanting to resign once the decanting is complete.²⁰⁰ In these situations, it is important for advisors to remember who they actually represent—the settlor, the beneficiaries, or the trustee.²⁰¹ If a decanting trustee is not represented, it is generally worthwhile to remind the trustee of this fact and suggest that the

190. *Id.*

191. TEX. PROP. CODE ANN. § 112.071.

192. *Id.* § 112.071(4).

193. *Id.*

194. *Id.* § 112.071(9).

195. *Id.* § 112.0715.

196. *Id.* § 112.071(1).

197. *See id.*

198. *See id.*

199. *See id.*

200. *See id.*

201. *See Lawyers in the Middle: Between Trustees and Beneficiaries, to Whom is Owed the Duty of Confidentiality?*, WEALTHCOUNSEL (Dec. 8, 2020, 10:59 AM), <https://info.wealthcounsel.com/blog/lawyers-in-the-middle-between-trustees-and-beneficiaries-to-whom-is-owed-the-duty-of-confidentiality> [<https://perma.cc/4ZSH-2UY3>].

trustee consider retaining independent counsel.²⁰²

Principal. Subsection 112.071(8) defines trust “principal” as “property held in trust for distribution to a remainder beneficiary when the trust terminates and includes income of the trust that, at the time of [the decanting], is not currently required to be distributed.”²⁰³ While trust principal in this context often includes undistributed income, if a trustee only has the authority to make mandatory distributions of trust income (but not principal), the trustee is not an authorized trustee with decanting authority under the statute.²⁰⁴

Limited Discretion. An authorized trustee has “limited discretion,” according to subsection 112.071(6), if the trustee only has a power to distribute trust principal: (1) pursuant “to mandatory distribution provisions under which the trustee has no discretion; or” (2) “to or for the benefit of one or more beneficiaries . . . limited by an ascertainable standard, including for the health, education, support, or maintenance of the [beneficiaries].”²⁰⁵ While not expressly stated by the statute, when a trustee has limited discretion, the trustee’s decanting authority is generally limited to administrative changes only, as further discussed under Section 112.073.²⁰⁶

Full Discretion. An authorized trustee has “full discretion,” according to subsection 112.071(5), if the trustee has “a power to distribute [trust] principal to or for the benefit of one or more . . . beneficiaries of a trust that is not a trust with limited discretion.”²⁰⁷ This typically refers to an independent trustee with sole and absolute discretion to make distributions for any purpose whatsoever.²⁰⁸ Unlike a trustee with limited discretion, a trustee with full discretion can decant a trust with different dispositive provisions, as further discussed under Section 112.072.²⁰⁹

Current Beneficiary. Under subsection 112.071(3), a “current beneficiary” is “a person who is receiving or eligible to receive a distribution of [trust] income or principal from a trust” as of a certain date.²¹⁰ As further discussed below, it is important for a trustee to identify current beneficiaries not only for notice purposes but also to confirm that the decanting itself adequately protects the rights of the current beneficiaries.²¹¹

Presumptive Remainder Beneficiary. Under subsection 112.071(7), a “presumptive remainder beneficiary” is a beneficiary who, regardless of the potential exercise of any powers of appointment, “would be eligible to receive a distribution from the trust if: (1) the trust terminated on [the date of

202. See *id.*

203. PROP. § 112.071(8).

204. *Id.* § 112.073.

205. *Id.* § 112.071(6)(A)–(B).

206. See discussion *infra* Section IV.B.4.

207. PROP. § 112.071(5).

208. See *id.*

209. *Id.* § 112.072.

210. *Id.* § 112.071(3).

211. See discussion *infra* Section IV.B.3.

the decanting]; or (2) the interests of all current beneficiaries ended on that date without causing the trust to terminate.”²¹² Like current beneficiaries, presumptive remainder beneficiaries are entitled to notice and also have certain rights, particularly with a limited discretion decanting.²¹³ When assessing presumptive remainder (and successor) beneficiaries, the trustee should identify such beneficiaries in spite of any powers of appointment that may potentially be exercised.²¹⁴

Successor Beneficiary. Finally, subsection 112.071(10) defines a “successor beneficiary” “as a beneficiary other than a current or presumptive remainder beneficiary.”²¹⁵ The term does not extend, however, to potential appointees under a power of appointment.²¹⁶ A successor beneficiary is not entitled to notice but is included in the overall class of beneficiaries for purposes of decanting with limited or full discretion, as further discussed below.²¹⁷

2. Section 112.0715. Creation of Second Trust

As discussed above, Section 112.0715 of the Texas Property Code is designed to streamline trust decanting by permitting the second trust to be the same trust as the first for all intents and purposes (other than modifications to the trust agreement implemented by the decanting).²¹⁸ The purpose of this section is to clarify that the trustee is not required to transfer or retitle assets as part of a decanting, change the trust name, or obtain a new taxpayer identification number.²¹⁹

3. Section 112.072. Distribution to Second Trust: Trustee with Full Discretion

Through decanting, an authorized trustee with full discretion has broad authority to modify not only the administrative provisions of an irrevocable trust agreement but also its dispositive provisions.²²⁰ This can extend as far as limiting or expanding distributions or powers of appointment, removing beneficiaries, or even adding beneficiaries through indirect means.²²¹

When analyzed in conjunction with the historical justifications for decanting, this broad authority in a full-discretion decanting makes sense.²²²

212. PROP. § 112.071(7).

213. *See id.* § 112.074.

214. *See id.*

215. *Id.* § 112.071(10).

216. *Id.*

217. *See discussion infra* Section IV.B.3.

218. *See* PROP. § 112.0715.

219. *See id.*; Chadwick, *supra* note 1, at 11.

220. *See* PROP. § 112.072; Chadwick, *supra* note 1, at 11.

221. *See* PROP. § 112.072; Chadwick, *supra* note 1, at 11.

222. Chadwick, *supra* note 1, at 11. *See discussion supra* Section III.B.

If a trust instrument permits the trustee to make a distribution to a single beneficiary for any purpose whatsoever, even to the exclusion of all other beneficiaries, it stands to reason that a trustee should also be able to attach some extra strings to that beneficiary's distribution in the form of a new trust agreement with vastly different terms.²²³ In exercising this decanting authority, however, all of the trustee's same fiduciary duties still apply, most notably the trustee's obligation to act in good faith in the best interests of all beneficiaries.²²⁴

The basic provisions of Section 112.072 of the Texas Property Code are summarized below:

Decanting for "One, More Than One, or All" of the Beneficiaries. Under subsection 112.072(a), an authorized trustee with full discretion may decant "to a second trust for the benefit of one, more than one, or all of the current beneficiaries of the first trust, and for the benefit of one, more than one, or all of the successor or presumptive remainder beneficiaries of the first trust."²²⁵ In other words, the second trust must include at least one, but not necessarily all, of the beneficiaries of the first trust.²²⁶ While this technically enables the trustee to remove a beneficiary, most trustees (with very good reason) are hesitant to do so.²²⁷ Not only would the trustee be required to notify the beneficiary that they are being removed, but in most cases, it seems hard to justify how removing a beneficiary is in the beneficiary's best interests.²²⁸ Even if a beneficiary requests to be removed from a trust, it seems prudent for the trustee to obtain written documentation to this effect and, ideally, a liability release from the beneficiary.²²⁹ A release from liability feels awfully close to "beneficiary consent," however, which can contribute to adverse tax consequences, as further discussed below.²³⁰

Adding and Expanding Powers of Appointment. Subsection 112.072(b) permits the second trust to grant a new power of appointment, including a lifetime or testamentary power of appointment, to a current beneficiary who, at the time of the decanting, is eligible to receive a distribution of principal outright.²³¹ Under subsection 112.072(c), the class of permissible appointees may be broader or different than the current, presumptive remainder, or successor beneficiaries of the first trust.²³² These provisions are essentially a backdoor method to add trust beneficiaries.²³³

223. Chadwick, *supra* note 1, at 11. See discussion *supra* Section III.B.

224. PROP. § 112.072(e); Chadwick, *supra* note 1, at 11.

225. PROP. § 112.072(a).

226. *See id.*

227. *See id.*

228. *See id.*

229. *Id.*

230. *Id.*

231. *Id.* § 112.072(b).

232. *Id.* § 112.072(c).

233. *Id.* § 112.072(a)–(c).

While the trustee cannot add new beneficiaries directly (because such persons are not current, presumptive remainder, or successor beneficiaries), the trustee can grant a current beneficiary a power of appointment when the class of permissible appointees is broader than the existing class of beneficiaries.²³⁴ The current beneficiary can then exercise their power of appointment, during life or at death, to cause trust property to be transferred to a new beneficiary.²³⁵ Again, this provision makes sense at least in light of traditional decanting rationales.²³⁶ If a trustee can distribute principal outright to a beneficiary, who can then transfer such property to any person or entity, granting the beneficiary a power of appointment to essentially accomplish the same thing does not feel like a stretch.²³⁷ The difference is that the beneficiary's exercise of a new power of appointment may not be deemed a taxable transfer, whereas the beneficiary's receipt of an outright distribution and subsequent transfer certainly would.²³⁸ Similarly, subsection 112.072(d) provides that "if the beneficiaries of the first trust are described as a class of persons, the beneficiaries of the second trust may include one or more persons who become members of that class" after the decanting.²³⁹ This can help clarify whether after-born persons are included or excluded in a class of beneficiaries and address other potential ambiguities in the first trust agreement.²⁴⁰

Trustee's Fiduciary Duties. Subsection 112.072(e) confirms that, in spite of the broad power granted to authorized trustees with full discretion, the trustee must still exercise the decanting authority "in good faith, in accordance with the terms and purposes of the trust, and in the interests of the beneficiaries."²⁴¹

4. Section 112.073. Distribution to Second Trust: Trustee with Limited Discretion

An authorized trustee with limited discretion has much less decanting power than an authorized trustee with full discretion.²⁴² Generally, a trustee with limited discretion can only decant to make administrative changes to a trust agreement.²⁴³ Listed below are the requirements set forth in Section 112.073 for a limited discretion decanting:

234. *Id.*

235. *Id.*

236. *Id.*

237. *Id.*

238. *Id.* § 112.086.

239. *Id.* § 112.072(d).

240. *Id.*

241. *Id.* § 112.072(e).

242. *See id.*

243. Chadwick, *supra* note 1, at 12. *See Decanting*, KARISCH JONAS L. (Aug. 28, 2013), <https://texasprobate.com/texas-probate/decanting.html> [<https://perma.cc/V89G-NDCE>].

- (b) The current beneficiaries of the second trust must be the same as the current beneficiaries of the first trust, and the successor and presumptive remainder beneficiaries of the second trust must be the same as the successor and presumptive remainder beneficiaries of the first trust.
- (c) The second trust must include the same language authorizing the trustee to distribute the income or principal of the trust that was included in the first trust.
- (d) If the beneficiaries of the first trust are described as a class of persons, the beneficiaries of the second trust must include all persons who become members of that class after the distribution to the second trust.
- (e) If the first trust grants a power of appointment to a beneficiary of the trust, the second trust must grant the power of appointment to the beneficiary in the second trust, and the class of permissible appointees under that power must be the same as the class of permissible appointees under the power granted by the first trust.²⁴⁴

Like a full-discretion decanting, subsection 112.073(f) confirms that an authorized trustee performing a limited discretion decanting must act “in good faith, in accordance with the terms and purposes of the trust, and in the interests of the beneficiaries.”²⁴⁵

Compared to a trustee with full discretion, a trustee with limited discretion is severely restricted.²⁴⁶ Before and after the decanting, all of the beneficiaries must be the same, all of their beneficial interests and distribution provisions must be the same, and any powers of appointment must all be the same.²⁴⁷ Even with these restrictions, a limited discretion decanting can accomplish many desired changes.²⁴⁸ For example, if an irrevocable trust agreement does not adequately address trustee succession or fails to include a helpful administrative power, a limited discretion decanting can often provide the path of least resistance to modify the trust.²⁴⁹ Moreover, because the dispositive provisions of the trust are not changing, there should be minimal, if any, tax or liability risks to the decanting.²⁵⁰ In many ways, the Texas decanting statute is specifically designed to facilitate these types of administrative changes without judicial intervention, and practitioners should feel confident in both the effectiveness and security of a pure administrative decanting.²⁵¹

244. PROP. § 112.073.

245. *Id.* § 112.073(f).

246. *See id.* §§ 112.072, 112.073(f).

247. *Id.* § 112.073(b).

248. Rose, *supra* note 14, at 408–09; Chadwick, *supra* note 1, at 13.

249. Rose, *supra* note 14, at 408–09; Chadwick, *supra* note 1, at 13.

250. Tommy Jones et al., *Decanting a Trust: How to Aerate Your Assets*, ANDERSEN (2017), <https://andersen.com/publications/newsletter/Q1-2017/decanting-a-trust-how-to-aerate-your-assets> [<https://perma.cc/7LBL-PMHR>]; Chadwick, *supra* note 1, at 13.

251. PROP. § 112.073; Chadwick, *supra* note 1, at 13.

5. Section 112.074. Notice Required

A key feature of any decanting statute is that the trustee must generally provide notice to certain beneficiaries before the decanting can be effective.²⁵² At first glance, these notice provisions may appear deceptively simple, but questions can arise quickly once in the weeds.²⁵³ Major provisions of Section 112.074 of the Texas Property Code, which house the Texas notice provisions, are summarized below:

Notice Requirement Generally. Subsection 112.074(a) provides that an authorized trustee may decant an irrevocable trust, as provided in Sections 112.072 or 112.073, as applicable, without settlor consent, beneficiary consent, or court approval but only if the trustee first provides notice to all current beneficiaries and presumptive remainder beneficiaries.²⁵⁴ Subsection 112.074(f)(6) requires a thirty-day waiting period for the decanting to be effective, unless waived by the beneficiaries.²⁵⁵ Specifying that a trustee may decant without settlor or beneficiary consent, and without court approval, is important for tax purposes, as further discussed below.²⁵⁶ Notably, only current and presumptive remainder beneficiaries are entitled to notice.²⁵⁷ Successor beneficiaries, who are more-remote contingent beneficiaries, are not entitled to notice.²⁵⁸ When in doubt, however, it is typically prudent for a trustee to over notify parties, rather than risk an ineffective decanting because the required notice was not provided.²⁵⁹

Surrogate Notice. If a beneficiary is a minor or otherwise incapacitated, subsection 112.074(d) requires the trustee to give notice to a parent of the minor or a court-appointed guardian or conservator, as applicable.²⁶⁰ If a charity is a current or presumptive remainder beneficiary, subsection 112.074(c) requires a trustee to provide notice to the attorney general on behalf of the charity.²⁶¹ This includes a charity that is not specifically named or no longer in existence.²⁶² Importantly, however, if a charity is only a successor beneficiary, such as an ultimate contingent beneficiary, the trustee is not required to notify the attorney general.²⁶³

252. Audrey Young, *The Mechanics of Decanting*, THE TAX ADVISER (Apr. 1, 2014), <https://www.thetaxadviser.com/issues/2014/apr/clinic-story-04.html> [https://perma.cc/E2TC-YNRN]; Chadwick, *supra* note 1, at 13.

253. Young, *supra* note 252; Chadwick, *supra* note 1, at 13.

254. PROP. § 112.074.

255. *Id.* § 112.074(f).

256. Chadwick, *supra* note 1, at 13. See discussion *infra* Section IV.B.II.

257. PROP. § 112.074(a).

258. *Id.*

259. See Young, *supra* note 252; Chadwick, *supra* note 1, at 13.

260. PROP. § 112.074(d).

261. *Id.* § 112.074(c).

262. *Id.* § 112.074(e)(2).

263. *Id.* § 112.074(e)(4).

No Notice Required or Waiver of Notice. Pursuant to subsection 112.074(e), a trustee is not required to give notice “to a beneficiary who: (1) is known to the trustee and cannot be located by the trustee after reasonable diligence; (2) is not known to the trustee; (3) waives the requirement of notice” (including the attorney general on behalf of a charitable beneficiary); “or (4) is a descendant of a beneficiary to whom the trustee has given notice if the beneficiary and the beneficiary’s ancestor have similar interests in the trust and no apparent conflict of interest exists between them.”²⁶⁴

Most trustees prefer to obtain decanting waivers from all trust beneficiaries who are entitled to notice.²⁶⁵ Not only can this accelerate the effective date of a decanting by eliminating the thirty-day waiting period, it also keeps beneficiaries fully informed and arguably reduces a trustee’s exposure to liability even though such waivers do not usually contain a beneficiary release.²⁶⁶ While it can be tempting to rely on a beneficiary’s parent or grandparent to fulfill the notice requirement, best practices are to over notify whenever possible, particularly if a beneficiary could ever argue that the decanting infringed upon his or her rights in some way.²⁶⁷

Required Contents of Notice. Subsection 112.074(f) provides that a decanting notice must include a statement that the trustee intends to exercise the decanting authority, the beneficiary has the right to object, and the beneficiary may petition a court to approve, modify, or deny the proposed decanting; “describe the manner in which the trustee intends to exercise” the decanting authority; specify the proposed effective date of the decanting; “include the name and mailing address of the trustee”; include copies of the first trust agreement and the proposed second trust agreement; be given no later than thirty days before the proposed effective date of the decanting (unless waived); and “be sent by registered or certified mail, return receipt requested, or delivered in person” (unless waived).²⁶⁸

Again, obtaining notice waivers from the beneficiaries can take a lot of the guesswork out of satisfying the notice requirements under the statute.²⁶⁹ If the structure of the second trust agreement is similar to that of the first trust agreement, it can also be helpful to include a redlined copy of the second trust agreement to illustrate the proposed changes.²⁷⁰

264. *Id.* § 112.074(e).

265. *See Trust Decanting Do’s and Don’ts*, *supra* note 37; Chadwick, *supra* note 1, at 13.

266. *See Young*, *supra* note 252; Chadwick, *supra* note 1, at 13.

267. *See Mary Randolph, Executors: Keep Beneficiaries Informed*, ALLLAW, <https://www.alllaw.com/articles/nolo/wills-trusts/executors-keep-beneficiaries-informed.html> (last visited Jan. 16, 2024) [<https://perma.cc/C54V-KUX6>]; Chadwick, *supra* note 1, at 13.

268. PROP. § 112.074(f).

269. *See id.*; Chadwick, *supra* note 1, at 14.

270. Chadwick, *supra* note 1, at 14.

6. Section 112.075. Written Instrument Required

Section 112.075 of the Texas Property Code provides that a decanting must be evidenced by a “written instrument that is signed and acknowledged by the authorized trustee and filed with the records of the first trust and the second trust.”²⁷¹ There are no guidelines, however, regarding the substance or form of this required written instrument or whether the second trust agreement itself is sufficient to satisfy the writing requirement.²⁷² Many practitioners structure written decanting instruments similar to a beneficiary’s exercise of a special power of appointment.²⁷³

7. Section 112.077. Settlor of Second Trust

Under Section 112.077 of the Texas Property Code, the settlor of the first trust is considered to be the settlor of the second trust, at least with respect to the portion of the second trust received through the decanting of the first trust.²⁷⁴ This is important not only for federal tax purposes but also in terms of honoring the settlor’s original intent.²⁷⁵

8. Section 112.078. Court-Ordered Distribution

Section 112.078 of the Texas Property Code preserves certain judicial rights for both trustees and beneficiaries as follows:

Right or Requirement to Petition Court. Under subsection 112.078(a), an authorized trustee may petition a court at any time to request a court order directing the trustee to decant as specified in the order.²⁷⁶ Query, however, whether it would be simpler at that point to obtain a judicial modification if supported by the facts.²⁷⁷ Under subsection 112.078(b), if a trustee receives a written objection from a beneficiary, the trustee or beneficiary may petition a court to approve, modify, or deny a decanting before the proposed effective date.²⁷⁸ If the attorney general sends the trustee a written objection, the trustee is required to obtain court approval under subsection 112.078(c) before the decanting can be effective.²⁷⁹

Burden of Proof. Once in court, subsection 112.078(e) provides that the trustee has the burden of proving that the proposed decanting “furthers the

271. PROP. § 112.075.

272. *Id.*; Chadwick, *supra* note 1, at 14.

273. Jonathan G. Blattmachr et al., *Estate Planning’s Most Powerful Tool: Powers of Appointment Refreshed, Redefined, and Reexamined*, 47 REAL PROP., TR. & EST. L.J. 529, 565 (2013); Chadwick, *supra* note 1, at 14.

274. PROP. § 112.077(a).

275. *See* Jones et al., *supra* note 250; Chadwick, *supra* note 1, at 14.

276. PROP. § 112.078.

277. *See id.* § 112.054(b); Chadwick, *supra* note 1, at 14.

278. PROP. § 112.078(b).

279. *Id.* § 112.078(c).

purposes of the trust, is in accordance with the terms of the trust, and is in the interests of the beneficiaries.”²⁸⁰ Subsection 112.078(d) also provides that the trustee may present its “reasons for supporting or opposing a proposed distribution, including whether the trustee believes the distribution would enable the trustee to better carry out the purposes of the trust.”²⁸¹

Right to Sue for Breach of Trust. Subsection 112.078(f) confirms that, notwithstanding the foregoing provisions, “this section does not limit a beneficiary’s right to bring an action against a trustee for a breach of trust.”²⁸² This underscores a consistent theme that a trustee is still subject to ordinary fiduciary duties when choosing to exercise the decanting authority.²⁸³

9. Section 112.084. Certain Distributions Prohibited

Pursuant to subsection 112.084(a) of the Texas Property Code, an authorized trustee is not permitted to decant an irrevocable trust if the terms of the governing trust instrument expressly prohibit decanting.²⁸⁴ Subsection 112.084(b) clarifies that a general spendthrift or irrevocability provision is not sufficient to prohibit trust decanting under the statute.²⁸⁵ Given how expansive a trustee’s decanting powers may prove, advisors should visit with settlors when originally drafting trusts to confirm whether the settlor is comfortable with a possible decanting in the future, particularly if the advisor senses a strong dead hand from the settlor.²⁸⁶

10. Section 112.085. Exceptions to Power of Distribution

Section 112.085 of the Texas Property Code includes some general limitations on trust decanting, which apply to trustees with both limited discretion and full discretion.²⁸⁷ Specifically, an authorized trustee may not exercise the decanting authority to

- (1) reduce, limit, or modify a beneficiary’s current, vested right to:
 - (A) receive a mandatory distribution of income or principal;
 - (B) receive a mandatory annuity or unitrust interest;
 - (C) withdraw a percentage of the value of the trust; or
 - (D) withdraw a specified dollar amount from the trust;
- (2) materially limit a trustee’s fiduciary duty:
 - (A) under the terms of the original trust; or

280. *Id.* § 112.078(e).

281. *Id.* § 112.078(d).

282. *Id.* § 112.078(f).

283. *See Trust Decanting Do’s and Don’ts*, *supra* note 37; Chadwick, *supra* note 1, at 14.

284. PROP. § 112.084(a).

285. *Id.* § 112.084(b).

286. *See Young*, *supra* note 252 (stating the ideal decanting is aligned with the grantor’s goals); Chadwick, *supra* note 1, at 14.

287. PROP. § 112.085.

- (B) in a manner that would be prohibited by Section 111.0035 [of the Texas Property Code];
- (3) decrease or indemnify against a trustee's liability;
- (4) add a provision exonerating a trustee from liability for failure to exercise reasonable care, diligence, and prudence;
- (5) eliminate a provision granting another person the right to remove or replace the authorized trustee exercising the [decanting] power under Section 112.072 or 112.073; or
- (6) reduce, limit, or modify in the second trust a perpetuities provision included in the first trust, unless expressly permitted by the terms of the first trust.²⁸⁸

With the exception of the final item, these prohibitions are generally designed to protect beneficiaries from potential abuse of the trustee's decanting authority.²⁸⁹ While the perpetuities limitation is more of a tax-savings clause, it can also be an elephant in the room for trusts with significant assets, but a looming termination date exists under a traditional rule against perpetuities (compared to the new 300-year period permitted by Texas law).²⁹⁰ All things being equal, most wealthy families would prefer to shelter assets inside tax-preferred, creditor-protected trusts for as long as possible, rather than exposing such assets to federal transfer taxation and other liabilities.²⁹¹

11. Section 112.086. Tax-Related Limitations

Section 112.086 of the Texas Property Code includes limitations intended to safeguard trustees and beneficiaries from unintentional, adverse tax consequences.²⁹² Similar to the prohibitions in Section 112.085, an authorized trustee may not exercise the decanting authority to (1) disqualify a trust contribution from an exclusion, deduction, or other federal tax benefit that was originally claimed for that contribution, including the gift tax annual exclusion; the marital deduction; the charitable deduction; direct skip treatment for GST tax purposes; or any other tax benefit for income, gift, estate, or GST tax purposes under the Code; (2) transfer stock from a first trust that is an eligible S corporation shareholder to a second trust that is not

288. *Id.*

289. See House Comm. on Jud. & Civ. Juris., Bill Analysis, Tex. H.B. 2913, 83rd Leg., R.S. (2013) (stating that the trustee must act in good faith and in the interest of the beneficiaries); Chadwick, *supra* note 1, at 15.

290. See Ryan Reiffert, *Estate Planning Update: Texas Overhauls the Rule against Perpetuities*, L. OFFS. OF RYAN REIFFERT PLLC, <https://ryanreiffert.com/blog/estate-planning-texas-rule-perpetuities/> (Jan. 22, 2024) [<https://perma.cc/N4TT-WU3H>]; Chadwick, *supra* note 1, at 15.

291. Anthony W. Lunger, *Passing on Wealth and Values with Irrevocable Trusts*, WILMINGTON TR., <https://www.wilmingtontrust.com/library/article/passing-on-wealth-and-values-with-irrevocable-trusts> (last visited Jan. 1, 2024) [<https://perma.cc/59N9-5QVE>] (suggesting that it may be possible to move the trust's situs and change the trust's governing law to a jurisdiction with a more liberal decanting statute to facilitate an extended trust term without adverse tax consequences); Chadwick, *supra* note 1, at 15.

292. PROP. § 112.086.

an eligible S corporation shareholder; or (3) transfer property to a second trust with a shorter minimum distribution period than the first trust under Code Subsection 401(a)(9).²⁹³ In spite of these general limitations, subsection 112.086(b) expressly authorizes decanting from a grantor trust to a non-grantor trust, or vice versa.²⁹⁴

12. Section 112.087. Compensation of Trustee

Subsection 112.087(a) of the Texas Property Code prohibits trust decanting “solely to change trust provisions regarding the determination of the compensation of any trustee.”²⁹⁵ Subsection 112.087(b), however, permits decanting to modify a trustee’s compensation if the decanting is also addressing another valid and reasonable purpose.²⁹⁶ Nevertheless, subsection 112.087(d) prevents a trustee from receiving a commission or other compensation for the (deemed) distribution of trust property as part of a decanting.²⁹⁷

V. FEDERAL TAX ISSUES

While the Texas Legislature has been busy refining its decanting statute over the last ten years, the IRS has offered little guidance on the federal tax consequences of decanting.²⁹⁸ The sections below highlight notable IRS developments in this space before examining relevant federal authorities to decipher the most likely tax outcomes for common decanting situations.²⁹⁹

A. IRS Decanting Developments

1. IRS Places Decanting on “No-Ruling” List in 2011

As stated above, the term “decant” does not appear anywhere in the Code or Treasury Regulations.³⁰⁰ Given the growing number of states with decanting statutes, however, the IRS, in Revenue Procedure 2011-3, placed decanting on its no-ruling list.³⁰¹ Twelve years later, in 2023, decanting remained on the no-ruling list.³⁰² Specifically, Section 5 of Revenue

293. *Id.*

294. *Id.* § 112.086(b).

295. *Id.* § 112.087(a).

296. *See id.* § 112.087(b).

297. *See id.* § 112.087(d).

298. *See Trust Decanting Do’s and Don’ts*, *supra* note 37; Chadwick, *supra* note 1, at 15.

299. Young, *supra* note 252; Chadwick, *supra* note 1, at 15.

300. *See discussion supra* Section I.B; Chadwick, *supra* note 1, at 15.

301. Rev. Proc. 2011-3, 2011-1 I.R.B. 111; Chadwick, *supra* note 1, at 15.

302. Rev. Proc. 2023-3, 2023-3 I.R.B. 5; Chadwick, *supra* note 1, at 16.

Procedure 2023-3 provides that until the IRS publishes a more definitive revenue ruling, revenue procedure, regulation, or other publication, the IRS will not issue determination letters or rule on the following matters: (1) whether decanting gives rise to a Code Section 661 deduction or results in inclusion in gross income under Code Section 662; (2) whether decanting results in a taxable gift being made under Code Section 2501; or (3) whether decanting causes the loss of GST exempt status or constitutes a taxable termination or taxable distribution under Code Section 2612.³⁰³ Consequently, even if a trustee wanted to take the time and effort to request a private letter ruling from the IRS regarding the tax consequences of a proposed decanting, the IRS would reject the request.³⁰⁴

2. IRS Places Decanting on Priority Guidance Plan

After placing decanting on its no-ruling list in 2011, which typically indicates that an area is under study, the IRS placed decanting on its 2011–2012 Priority Guidance Plan.³⁰⁵ The IRS stated that it intended to issue notice on trust decanting under Code Sections 2501 and 2601.³⁰⁶ Interestingly, while the IRS targeted the gift and GST tax consequences of decanting, it did not mention the income or estate tax consequences in its 2011–2012 Priority Guidance Plan.³⁰⁷

3. IRS Requests Comments on Decanting

On December 27, 2011, the IRS issued I.R.S. Notice 2011-101, in which it requested comments regarding when a decanting that results in a change in beneficial interests is not subject to income, gift, estate, or GST taxes.³⁰⁸ According to I.R.S. Notice 2011-101, the IRS was studying the tax implications of decanting and was considering approaches to address relevant tax issues in published guidance.³⁰⁹ Many professional organizations, including the American College of Trust and Estate Counsel (ACTEC) and the Tax Section of the American Bar Association, submitted substantive comments to the IRS.³¹⁰

303. Rev. Proc. 2023-3, 2023-3 I.R.B. 5; Chadwick, *supra* note 1, at 16.

304. Rev. Proc. 2023-3, 2023-3 I.R.B. 5; Chadwick, *supra* note 1, at 16.

305. See I.R.S. Notice 2011-101, 2011-52 I.R.B. 932; Chadwick, *supra* note 1, at 16.

306. See I.R.S. Notice 2011-101, 2011-52 I.R.B. 932; Chadwick, *supra* note 1, at 16.

307. See I.R.S. Notice 2011-101, 2011-52 I.R.B. 932; Chadwick, *supra* note 1, at 16.

308. I.R.S. Notice 2011-101, 2011-52 I.R.B. 932; Chadwick, *supra* note 1, at 16.

309. I.R.S. Notice 2011-101, 2011-52 I.R.B. 932; Chadwick, *supra* note 1, at 16.

310. See *Comments of the American College of Trust and Estate Counsel on Transfers by a Trustee from an Irrevocable Trust to Another Irrevocable Trust*, AM. COLL. OF TR. & EST. COUNS. 1, 1 (Apr. 2, 2012), https://www.actec.org/wp-content/uploads/2023/08/Mezzullo_Comments_04_02_12.pdf [<https://perma.cc/Y8DZ-RVW4>]; Chadwick, *supra* note 1, at 16.

4. IRS Removes Decanting from Priority Guidance Plan

After placing decanting on its 2011–2012 Priority Guidance Plan, the IRS failed to include decanting on its 2012–2013 Priority Guidance Plan.³¹¹ The initial hope was that this meant guidance would be completed in 2013, or perhaps 2014, but ten years have now passed.³¹² The IRS has neglected to include decanting on its Priority Guidance Plan since 2011–2012, and trustees are still unable to request a private letter ruling, as mentioned above.³¹³

With minimal guidance from the IRS, most practitioners continue to view decanting, and the potential tax consequences flowing therefrom, as the exercise of a trustee's special power of appointment, as discussed above.³¹⁴ It is important to remain flexible, however, to enable critical evaluation of the actual results that a proposed decanting may yield.³¹⁵ For instance, as further discussed below, Treasury Regulations contain different provisions for special powers of appointment and distributions of principal in further trust.³¹⁶

B. Income Tax Issues

As a general rule, decanting assets from one domestic trust to another should generate minimal, if any, income tax consequences for the trusts and its beneficiaries.³¹⁷ It is important, however, that practitioners consider fiduciary income tax issues for both the first trust and the second trust, as well as the capital gain implications of *Cottage Savings* and the negative basis implications of *Crane*.³¹⁸

1. Fiduciary Income Tax Issues for the First and Second Trusts

To expand upon the general rule set forth above, decanting assets from one domestic trust to another should not affect the income taxation of the trusts because either the first trust and the second trust should be treated as the “same trust” for federal income tax purposes; or alternatively, the transfer of assets from the first trust to the second trust should carry out the first trust's distributable net income (DNI), resulting in income to the second trust with a corresponding distribution deduction for the first trust.³¹⁹

311. Chadwick, *supra* note 1, at 16. See Aghdami & Durst, *supra* note 25, at 6.

312. Chadwick, *supra* note 1, at 16. See Aghdami & Durst, *supra* note 25, at 6.

313. Chadwick, *supra* note 1, at 16. See Aghdami & Durst, *supra* note 25, at 6.

314. Chadwick, *supra* note 1, at 16. See discussion *supra* Section I.B.

315. Chadwick, *supra* note 1, at 16. See Aghdami & Durst, *supra* note 25, at 6.

316. Chadwick, *supra* note 1, at 16. See discussion *infra* Section V.D.2.

317. Young, *supra* note 252; Chadwick, *supra* note 1, at 16.

318. Young, *supra* note 252; Chadwick, *supra* note 1, at 16.

319. Chadwick, *supra* note 1, at 16. See Culp & Mellen, *supra* note 70, at 35.

As background, if a trust is classified as a grantor trust pursuant to Code Sections 671 through 679, then all of the trust's income tax attributes (gain, loss, deductions, credits, etc.) are passed through to the settlor.³²⁰ By contrast, for non-grantor trusts, income tax consequences are largely determined by a trust's DNI, which is computed in accordance with Code subsection 643(a).³²¹ DNI tracks the net income earned by a trust and is designed to represent the maximum amount on which the IRS may impose an income tax.³²² When the trustee makes a discretionary distribution to a beneficiary from an irrevocable non-grantor trust, the distribution is typically deemed to consist entirely of DNI, unless the distribution exceeds the trust's total DNI.³²³ With respect to the allocation of income taxes between the trust and its beneficiaries, accumulated income is generally taxed to the trust and, if added to principal, not taxed again upon distribution to the beneficiaries; distributed income is generally taxed to the beneficiaries to the extent it consists of the trust's DNI, with the trust receiving a corresponding deduction for the income distribution; and any amount distributed in excess of the trust's DNI should constitute principal that is not taxed to the trust or to the beneficiary.³²⁴

When a trustee decants all the assets of an existing trust to a new trust, the first and second trusts should be treated as the same trust for income tax purposes.³²⁵ Based on this "same trust theory," decanting should be viewed as a trust modification and not the creation of an entirely new trust.³²⁶ Although the Texas decanting statute expressly provides that the first and second trusts may use the same taxpayer identification number, obtaining a new taxpayer identification number, if the trustee chooses to do so, should not disturb the decanting as a non-recognition event for income tax purposes.³²⁷

320. See I.R.C. §§ 671–79.

321. See *id.* § 643(a).

322. Chadwick, *supra* note 1, at 16. See Will Kenton, *Distributable Net Income (DNI) Definition, Formula, Example*, INVESTOPEDIA, www.investopedia.com/terms/d/distributablenetincome.asp (Oct. 2, 2022) [<https://perma.cc/8NWV-PFWG>].

323. Chadwick, *supra* note 1, at 16. See Andrew L. Whitehair, *Removing Capital Gains From Trusts*, THE TAX ADVISER (Aug. 1, 2014), www.thetaxadviser.com/issues/2014/aug/tax-clinic-03.html [<https://perma.cc/D5GA-7BDJ>].

324. Chadwick, *supra* note 1, at 16; see Whitehair, *supra* note 323.

325. Chadwick, *supra* note 1, at 17; see I.R.S. Priv. Ltr. Rul. 200736002 (Oct. 26, 2007).

326. Chadwick, *supra* note 1, at 17; see, e.g., I.R.S. Priv. Ltr. Rul. 200723014 (Feb. 5, 2007) (ruling that a trust division would not cause a distribution under I.R.C. §§ 661–62); I.R.S. Priv. Ltr. Rul. 200607015 (Nov. 5, 2005) (ruling that a transfer of assets from existing trusts to new trusts for purposes of changing governing law and modifying administrative provisions would not cause the existing trusts, the new trusts, or the beneficiaries to realize income, gain, or loss under I.R.C. §§ 661–62).

327. TEX. PROP. CODE ANN. § 112.087; Chadwick, *supra* note 1, at 17.

Importantly, non-recognition should still apply even if the first and second trusts are treated as separate trusts for income tax purposes.³²⁸ As stated above, the first trust should terminate, and its DNI, including any capital gains for the year, should pour into the second trust.³²⁹ In addition, all of the first trust's unused loss carryovers and excess deductions on termination should be transferred into the second trust, primarily because the second trust should be considered the beneficiary succeeding to the property of the first trust.³³⁰ Under the separate trust theory, therefore, the second trust should receive taxable income under Code subsection 662(a) to the extent of the first trust's DNI, and the first trust should be entitled to a corresponding deduction under Code subsection 661(a).³³¹ While this should not produce a taxable event when viewed in the aggregate, it is important to consider any state income (or property) tax issues that may arise when transferring assets from one trust to another.³³²

2. Income Tax Issues for the Beneficiaries

In any trust decanting, the beneficiaries should be primarily concerned with two income tax issues: whether the mere act of decanting, which arguably involves the exchange of one property interest for another, causes the trust beneficiaries to realize gain or loss and whether a trustee's decanting of encumbered property or other negative basis assets causes the trust beneficiaries to realize a taxable gain.³³³ Generally, decanting should not cause the trust beneficiaries to realize any gain or loss unless the decanting converts a grantor trust to a non-grantor trust and the decanted assets include negative basis assets.³³⁴

a. The Beneficiary Gain Concern (Cottage Savings)

The mere act of decanting should be a non-recognition event for federal income tax purposes.³³⁵ The basic rule under Code Section 1001 is that a taxpayer only realizes gain or loss when the taxpayer sells or disposes of property in exchange for property that is materially different from the property the taxpayer sold or disposed.³³⁶

328. *Tax Consequences of Decanting*, YOUNG CONAWAY STARGATT & TAYLOR, LLP, <https://delawarelaw.widener.edu/files/resources/course-materials--thomas--tax-consequences-of-decanta.pptx> (last visited Jan. 31, 2024) [<https://perma.cc/S3S4-VTZ7>]; Chadwick, *supra* note 1, at 17.

329. Treas. Reg. § 1.643(a)-3(e), Example 7 (as amended in 2004); Chadwick, *supra* note 1, at 17.

330. I.R.C. § 642(h)(2); Chadwick, *supra* note 1, at 17.

331. See I.R.C. §§ 661(a), 662(a).

332. Chadwick, *supra* note 1, at 17. See *Tax Consequences of Decanting*, *supra* note 328.

333. See Young, *supra* note 252; Chadwick, *supra* note 1, at 17.

334. Chadwick, *supra* note 1, at 17. See Jones et al., *supra* note 250.

335. Chadwick, *supra* note 1, at 17. See Jones et al., *supra* note 250.

336. I.R.C. § 1001. See Treas. Reg. § 1.1001-1(a) (as amended in 2017).

In *Cottage Savings*, the Supreme Court considered whether a financial institution realized a loss when it exchanged its interests in one set of residential mortgage loans for another institution's interests in a different set of residential mortgage loans.³³⁷ The Court found that under Code subsection 1001(a) and Treasury Regulation subsection 1.1001-1(a), a taxpayer realized gain or loss whenever it received property that was "materially different" from the property the taxpayer exchanged.³³⁸ Two items of property are materially different, the Court explained, if their owners possess legal entitlements that differ in kind or extent.³³⁹ Although the financial regulatory agency found the two sets of mortgage interests substantially identical, the Court held the mortgages to be materially different because they were made to different borrowers and secured by different pieces of real property.³⁴⁰ As a consequence, the exchange of mortgage interests between the institutions constituted a realization event.³⁴¹

Following the Court's interpretation of Code subsection 1001(a) in *Cottage Savings*, the question with respect to decanting was whether the IRS would consider a trustee's distribution in further trust to be a realization event because each beneficiary's new interest was materially different from their old interest.³⁴²

In PLR 200743022, however, the Service confirmed that decanting would not result in a beneficiary's realization of income or loss so long as the decanting was authorized by the trust instrument or governing state law. The Service reasoned that the taxpayer's proposed decanting would not involve a taxable exchange of property because there would only be a transfer of assets from one trust to another, and not a reciprocal exchange involving the legal rights and entitlements of the trust beneficiaries.³⁴³

Stated another way, if a beneficiary's trust interest is subject to the trustee's discretion to decant—either under the terms of the trust or applicable state law—then there is no change in the quality of the beneficiary's interest (i.e., it is not materially different under *Cottage Savings*) when the trustee actually exercises that discretion.³⁴⁴ This is because

337. *Cottage Sav. Ass'n v. Comm'r*, 499 U.S. 554, 556 (1991).

338. *Id.* at 561–62.

339. *Id.* at 565.

340. *Id.* at 567.

341. *Id.* at 566.

342. Chadwick, *supra* note 1, at 17. See I.R.S. Priv. Ltr. Rul. 199951028 (Sept. 28, 1999). See also I.R.S. Priv. Ltr. Rul. 200231011 (Aug. 2, 2002) (finding a taxable exchange when a settlement provided a beneficiary with a unitrust interest instead of an annuity interest); Priv. Ltr. Rul. 200736002 (specifying that a beneficiary could realize a taxable gain if their interests in a new trust created under a pro rata trust division were materially different than their interests in the old trust).

343. *Tax Consequences of Decanting*, *supra* note 328; Chadwick, *supra* note 1, at 18; I.R.S. Priv. Ltr. Rul. 200743022 (Oct. 26, 2007).

344. Chadwick, *supra* note 1, at 18. See Young, *supra* note 252.

the beneficiary's interest was always subject to the trustee's decanting authority.³⁴⁵

The IRS confirmed its view with respect to *Cottage Savings* gain and decanting in Private Letter Ruling 201134017.³⁴⁶ In that ruling, the special trustee of a trust proposed to decant the trust assets to a new trust to ease the administration of various family entities.³⁴⁷ Under the terms of the original trust, the special trustee was expressly authorized to appoint income and principal, either outright or in trust, to or among any of the grantor's descendants or their spouses.³⁴⁸ The IRS ruled that the proposed decanting would not result in any beneficiary recognizing income under Code Sections 61 or 1001.³⁴⁹ Because the transfer of assets would be made pursuant to an express decanting authority, the IRS reasoned there would be no "exchange" within the meaning of *Cottage Savings* and, therefore, it was unnecessary to further consider the "materially different" standard further.³⁵⁰ With no taxable exchange, the IRS also ruled that the basis and holding period of each asset in the new trust would be the same as the basis and holding period of the asset in the old trust under Code Sections 1015 and 1223, respectively.³⁵¹

Importantly, however, if decanting is not authorized by the terms of the trust or local law, the IRS could persuasively argue that a beneficiary's consent to a decanting constitutes a recognition event.³⁵² Even if the trust instrument or state statute authorized decanting, the IRS could argue that requiring beneficiary consent connotes a change in the quality of the beneficiary's interest thereby resulting in a recognition event.³⁵³ For this reason, states have generally drafted their decanting statutes to require only beneficiary notice and not consent.³⁵⁴

345. Chadwick, *supra* note 1, at 18. *Cf.* Treas. Reg. § 1.1001-1(h) (as amended in 2017) (prescribing similar rules for the severance of trusts); I.R.S. Priv. Ltr. Rul. 200810019 (Mar. 7, 2008) (finding no adverse income tax consequences when income interest converted to unitrust interest under governing state law); I.R.S. Priv. Ltr. Rul. 200010037 (Dec. 13, 1999) (ruling that a taxable exchange would not occur when a trustee partitioned a trust pursuant to partition authority granted in the trust instrument).

346. I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011); Chadwick, *supra* note 1, at 18.

347. I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011); Chadwick, *supra* note 1, at 18.

348. I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011); Chadwick, *supra* note 1, at 18.

349. I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011); Chadwick, *supra* note 1, at 18.

350. I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011); Chadwick, *supra* note 1, at 18.

351. I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011); Chadwick, *supra* note 1, at 18.

352. Chadwick, *supra* note 1, at 18. *See, e.g.,* Rev. Rul. 69-486, 1969-2 C.B. 159 (finding that a non-pro-rata trust distribution will be treated as a taxable exchange if the trustee lacked authority to make such a distribution).

353. Chadwick, *supra* note 1, at 18. *See* Young, *supra* note 252.

354. Chadwick, *supra* note 1, at 18. *See* Young, *supra* note 252.

b. The Negative Basis Concern (Crane)

The negative basis concern arises when the trustee decants property with debt in excess of basis or an LLC or partnership interest with a negative capital account.³⁵⁵

In *Crane*, the Supreme Court considered whether the amount of gain realized under Code Section 1001 included any liability discharged by the taxpayer's transfer of property subject to a non-recourse debt.³⁵⁶ The Court found that a taxpayer's amount realized from a sale or disposition of property under Code Section 1001 includes cash and other property received in the transaction and the amount of liabilities from which the taxpayer is discharged as a result of the sale or disposition.³⁵⁷ In other words, when a transferee assumes the transferor's liability in connection with a sale or exchange, the transferor must include in their amount realized the liability assumed by the transferee.³⁵⁸

Similar to the holding in *Crane*, Code subsection 752(d) provides that when a transferor sells or exchanges a partnership interest, the transferor must treat any partnership liabilities transferred in the same manner as liabilities transferred in connection with the sale or exchange of any other property.³⁵⁹ Despite the Court's holding in *Crane* and the plain language of Code subsection 752(d), there is some argument that beneficiaries should not recognize gain under Code subsection 643(e).³⁶⁰ Code subsection 643(e) provides that in the case of trust distributions of property, the beneficiary will receive a carryover basis in the property received, subject to the trustee's election to recognize any gain on the distribution.³⁶¹ The question is whether Code subsection 643(e) overrides the gain recognition principles of *Crane*, Code Section 1001, and Code subsection 752(d).³⁶²

On one hand, because there is no authority directly on point, a trustee could use its fiduciary discretion to comply literally with the terms of Code subsection 643(e) and not make an election to recognize gain on the distribution of trust property to a beneficiary.³⁶³ On the other hand, the plain

355. Chadwick, *supra* note 1, at 18. See Jonathan G. Blattmachr et al., *An Analysis of the Tax Effects of Decanting*, 47 REAL PROP. TR. & EST. L.J. 141, 156 (2012).

356. *Crane v. Comm'r*, 331 U.S. 1, 2–5 (1947).

357. *Id.* at 3–4. See Treas. Reg. § 1.1001-2(a) (1980).

358. Chadwick, *supra* note 1, at 18; Aghdami & Durst, *supra* note 25, at 25–26. See *Crane*, 331 U.S. at 3–4.

359. Chadwick, *supra* note 1, at 18; Aghdami & Durst, *supra* note 25, at 26; I.R.C. § 752(d). See Treas. Reg. § 1.1001-2(a)(4)(v) (1980) (providing that upon the sale or exchange of a partnership interest, the transferor's share of partnership liabilities are treated as liabilities in which the transferor was discharged).

360. Chadwick, *supra* note 1, at 18; Aghdami & Durst, *supra* note 25, at 26. See I.R.C. § 643(e).

361. Chadwick, *supra* note 1, at 18; Aghdami & Durst, *supra* note 25, at 26; I.R.C. § 643(e).

362. Chadwick, *supra* note 1, at 18; Aghdami & Durst, *supra* note 25, at 26; I.R.C. §§ 643(e), 752(d), 1001; *Crane*, 331 U.S. at 3–4.

363. Chadwick, *supra* note 1, at 18; Aghdami & Durst, *supra* note 25, at 26; I.R.C. § 643(e).

language of Code subsection 643(e)(1) provides that the beneficiary's basis must be adjusted for any gain or loss recognized by the trust on the distribution.³⁶⁴ Because the trust could recognize a gain by discharging its liabilities, it is arguable that the gain should be recognized and the beneficiary's basis should be increased in accordance with Code subsection 643(e)(1).³⁶⁵

The interplay between Code subsection 643(e) and Code Section 1001 and Code subsection 752(d) causes the tax consequences of decanting negative basis property (i.e., whether the beneficiaries recognize any gain) to be uncertain in the following situations: (1) the decanting of negative basis assets from a complex trust to a complex trust; (2) the decanting of negative basis assets from a complex trust to a grantor trust; and (3) the decanting of negative basis assets from a non-grantor trust to a grantor trust.³⁶⁶ The law seems certain, however, with respect to the following issues: First, gain should not be recognized on the decanting of negative basis assets from a grantor trust to another grantor trust.³⁶⁷ Non-recognition is based on the bedrock principle that transactions between two grantor trusts (with the same grantor) are disregarded for income tax purposes.³⁶⁸ Second, gain should be recognized on the decanting of negative basis assets from a grantor trust to a non-grantor trust.³⁶⁹ When grantor trust status terminates, the grantor is treated as having transferred the assets to the trust and the grantor is deemed to realize an amount equal to any liabilities held as part of the trust property.³⁷⁰ Code subsection 643(e) does not offer any protection in this context because it does not apply to grantor trusts.³⁷¹

C. Gift and Estate Tax Issues

1. General Rules

Unless a decanting is purposefully designed to achieve certain gift or estate tax consequences, most trustees seek to avoid triggering a taxable gift

364. Chadwick, *supra* note 1, at 18–19; Aghdami & Durst, *supra* note 25, at 26; I.R.C. § 643(e)(1).

365. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 26; I.R.C. § 643(e)(1).

366. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 26–27; I.R.C. §§ 643(e), 752(d), 1001. *See* I.R.S. Gen. Couns. Mem. 200923024 (Dec. 31, 2024) (finding no income tax consequences upon the conversion from a non-grantor trust to a grantor trust, albeit without negative basis assets).

367. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 27.

368. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 27. *See* Rev. Rul. 85-13, 1985-1 C.B. 184.

369. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 27.

370. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 27. *See* Treas. Reg. § 1.1001-2(c), Example (5) (1980) (explaining the tax consequences associated with the termination of grantor trust status for a trust holding a partnership interest with a negative capital account).

371. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 27; I.R.C. § 643(e).

or causing inclusion of the trust assets in a beneficiary's taxable estate.³⁷² As a general rule, decanting should not cause a beneficiary to make a taxable gift to the second trust unless the trustee is also a trust beneficiary (and the trustee's discretionary distribution power is not limited by an ascertainable standard); the trustee's ability to decant is contingent on obtaining beneficiary consent (which is not required under the Texas statute); or the Delaware tax trap applies.³⁷³

Similarly, decanting should not result in estate inclusion for federal estate tax purposes unless the second trust gives a beneficiary a general power of appointment over trust property that would render such property includible in the beneficiary's gross estate under Code subsection 2041(a)(2); the decanting is treated as an incomplete gift pursuant to a beneficiary's testamentary limited power of appointment and such gift becomes complete at the beneficiary's death; a settlor's involvement in the decanting process supports an argument from the IRS that the settlor retained control over the trust assets within the meaning of Code Sections 2036 or 2038 (recall that under the Texas statute, a settlor is not an authorized trustee with the ability to decant); or the Delaware tax trap applies.³⁷⁴

2. Beneficiary Consent

The IRS could argue that when a beneficiary consents to a decanting, particularly if the trust's dispositive provisions are being changed, the beneficiary has exercised sufficient control over the trust assets to characterize such consent as a taxable gift.³⁷⁵ The IRS could also attempt to extend this line of reasoning to beneficiary acquiescence.³⁷⁶ The IRS could argue, for example, that if a beneficiary had the right to object to a trust decanting but did not, then the beneficiary's failure to exercise their right to object constituted a gratuitous transfer.³⁷⁷

Although beneficiary consent could arguably constitute a gift under appropriate circumstances, beneficiary acquiescence should not.³⁷⁸ This is because taxable gifts require the transferor to make a voluntary transfer.³⁷⁹ When a trustee exercises the power to decant in the trustee's sole discretion without beneficiary intervention, the beneficiary's inaction, as a factual

372. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 27.

373. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 28; I.R.C. § 2041.

374. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 28–29; I.R.C. §§ 2036, 2038, 2041(a)(2), 2514(d).

375. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 29.

376. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 29.

377. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 29.

378. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 29.

379. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 29. *See Harris v. Comm'r*, 340 U.S. 106, 111 (1950).

matter, should not constitute a voluntary transfer capable of triggering the gift tax.³⁸⁰

In any event, the IRS is unlikely to assert that beneficiary consent or acquiescence causes a beneficiary to make a taxable gift unless the decanting shifts a beneficial interest in the trust or delays the vesting of a beneficiary's property interest in the trust.³⁸¹ In Private Letter Ruling 201134017, the IRS confirmed that decanting should not constitute a taxable gift when there is no change in the beneficial interests in the trust.³⁸² Ruling on the gift tax consequences of a proposed decanting from an existing trust to a new trust, the IRS found that there should be no taxable gift when "all beneficial interests in trust assets will be the same before and after the proposed transfer."³⁸³

With respect to a delay in vesting, the IRS could advance this argument if the original trust provided that a beneficiary would receive trust principal at a specified age or ages.³⁸⁴ If the beneficiary consented or acquiesced to decanting the assets to a new trust that extended or eliminated the ages at which the beneficiary was entitled to principal, the IRS could treat the beneficiary's action or inaction as a release of a general power of appointment pursuant to Code subsection 2514(b).³⁸⁵ Again, the IRS's gift argument would be much stronger if the trustee also had a beneficial interest in the trust or if the decanting required beneficiary consent.³⁸⁶

3. Delaware Tax Trap

Code subsection 2514(d), commonly referred to as the "Delaware tax trap," provides that the exercise of a power of appointment will be considered a transfer for transfer tax purposes if (1) the powerholder, in exercising the power of appointment, grants another person the right to exercise a power of appointment and (2) under applicable local law, the new powerholder can exercise their power of appointment to postpone the vesting of any trust

380. Chadwick, *supra* note 1, at 19; Aghdami & Durst, *supra* note 25, at 29–30.

381. Chadwick, *supra* note 1, at 19–20; Aghdami & Durst, *supra* note 25, at 29–30.

382. Chadwick, *supra* note 1, at 20; Aghdami & Durst, *supra* note 25, at 29–30.

383. I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011) (applying Rev. Rul. 95-58 to a proposed decanting in which, under the terms of the new trust, the beneficiary would possess the power to remove and replace a special trustee. The new trust prohibited the special trustee from making distributions to or for the benefit of the special trustee, his creditors, the creditors of his estate, or any trust in which the special trustee has a beneficial interest. The new trust also prohibited any special trustee who was a related or subordinate party under I.R.C. § 672(c) from making distributions to or for the benefit of any beneficiary who participated in appointing the special trustee. If, at any time, no special trustee was able to make distributions due to the above limitations, an independent special trustee would be appointed. Under these facts, the IRS found that the trust beneficiary's ability to remove and replace special trustees would not constitute general powers of appointment under I.R.C. §§ 2041, 2514).

384. Chadwick, *supra* note 1, at 20; Aghdami & Durst, *supra* note 25, at 30.

385. Chadwick, *supra* note 1, at 20; Aghdami & Durst, *supra* note 25, at 30.

386. Chadwick, *supra* note 1, at 20; Aghdami & Durst, *supra* note 25, at 30.

interest or suspend the absolute ownership or power of alienation of such property for a period ascertainable without regard to the date that the first power was created.³⁸⁷

Importantly, the Delaware tax trap applies whether the second powerholder exercises the power in the prohibited manner or not.³⁸⁸ In other words, if the second powerholder has the mere potential to limit the ownership rights of trust property beyond the time period that such property was limited by the terms of the original trust instrument, then the first powerholder's appointment of the property will result in a taxable gift.³⁸⁹ If a person exercises a power of appointment as provided in Code subsection 2514(d) during their lifetime, then such exercise is treated as a taxable gift.³⁹⁰ If the person exercises their power at death, then such exercise will result in estate inclusion.³⁹¹ Many state statutes, including Texas's, directly prohibit the second trust from modifying the perpetuities period contained in the first trust.³⁹²

4. Limiting Taxable Gifts

If gift tax risks are particularly acute, advisors might recommend that (1) trustees attempt to insulate themselves from gift tax liability by ensuring that an independent trustee who has no beneficial interest in the trust is the only fiduciary who exercises the authority to decant; (2) limiting the decanting to administrative changes only, thereby avoiding the shifting of beneficial interests in trust and the postponement of vesting periods in trust property; (3) giving the beneficiary a testamentary limited power of appointment over the assets of the second trust; (4) or some combination of any or all of these.³⁹³

387. Chadwick, *supra* note 1, at 20; Aghdami & Durst, *supra* note 25, at 31.

388. Chadwick, *supra* note 1, at 20; Aghdami & Durst, *supra* note 25, at 31.

389. Chadwick, *supra* note 1, at 20; Aghdami & Durst, *supra* note 25, at 31.

390. Chadwick, *supra* note 1, at 20; Aghdami & Durst, *supra* note 25, at 31.

391. Chadwick, *supra* note 1, at 20. See Tereina Stidd, *The Power in Powers of Appointment*, AM. ACAD. OF EST. PLAN. ATT'YS, <https://www.aaepa.com/2022/04/the-power-in-powers-of-appointment/> (last visited Jan. 13, 2024) [<https://perma.cc/WU48-VDWD>].

392. See TEX. PROP. CODE ANN. § 112.085(6).

393. Chadwick, *supra* note 1, at 20. See Treas. Reg. § 25.2511-2(b) (as amended in 2020); I.R.S. Priv. Ltr. Rul. 200715005 (Jan. 3, 2007) (demonstrating that even if decanting results in a taxable gift, so long as distributions from the first trust were discretionary, then the fair market value of the gift would seem to be a factual issue that would be difficult, if not impossible, to determine in accordance with the general principles of I.R.C. § 2512. If a beneficiary is given a testamentary limited power of appointment over the assets of the second trust, then any taxable gift should be rendered incomplete for gift tax purposes, at least with respect to such beneficiary. If the beneficiary later releases this power of appointment, the gift would then be complete. If the beneficiary does not release the power during their lifetime, then the property would be included in the beneficiary's gross estate.).

D. GST Tax Issues

When decanting a GST exempt trust, it is critical to structure the decanting in a way that does not cause the trust to lose its GST exempt status.³⁹⁴ This issue arises frequently given that many trusts in need of decanting may be older trusts created before the GST tax rules were enacted.³⁹⁵ The stakes can often be high, and fortunately, the GST exempt status of a first trust should be preserved when a trustee with limited discretion decants to a second trust with only administrative changes.³⁹⁶ It is riskier for a trustee with full discretion to modify dispositive provisions, however, and the trustee should take the necessary precautions to satisfy one of several safe harbors in the Treasury Regulations, further discussed below.³⁹⁷

1. GST Trusts Generally

A trust is exempt from GST tax (and therefore able to make distributions to skip persons without incurring GST tax) if (1) the trust became irrevocable on or before September 25, 1985, which is the effective date of the GST statute, or otherwise qualifies for certain transition rules (referred to collectively as “grandfathered trusts”) or (2) if the trust was not irrevocable on or before September 25, 1985, the transferor affirmatively allocated GST exemption to the trust or the automatic GST allocation rules applied to such trust (referred to collectively as “non-grandfathered trusts”).³⁹⁸ Treasury Regulation subsection 26.2601-1(b)(1) provides that a grandfathered trust will lose its GST exempt status if an actual or constructive addition is made to the trust after the effective date.³⁹⁹

Although many practitioners (and even some state statutes) view decanting as the trustee’s exercise of a special power of appointment in a fiduciary capacity, the Regulations seem to take a different approach.⁴⁰⁰ The GST regulations relevant to a trustee’s decanting authority are organized as follows: Treasury Regulation subsection 26.2601-1(b)(1)(v)(B) determines whether a post-effective date exercise of a power of appointment over the assets of a grandfathered trust causes the trust to lose its GST exempt status; Treasury Regulation subsection 26.2601-1(b)(4)(i)(A) considers the impact of a trustee’s distribution of trust principal from an exempt trust to a new or continuing trust; and Treasury Regulation subsection

394. Chadwick, *supra* note 1, at 20; Jones et al., *supra* note 250.

395. Chadwick, *supra* note 1, at 20; Jones et al., *supra* note 250.

396. Chadwick, *supra* note 1, at 20–21; Jones et al., *supra* note 250.

397. Chadwick, *supra* note 1, at 21. See discussion *infra* Sections V.D.1–4.

398. Chadwick, *supra* note 1, at 21. See Treas. Reg. § 26.2601-1(b) (as amended in 2004).

399. Treas. Reg. § 26.2601-1(b).

400. Chadwick, *supra* note 1, at 21. See Treas. Reg. § 26.2601-1(b).

26.2601-1(b)(4)(i)(D)(1) deals with a trustee's modification of the governing instrument of an exempt trust.⁴⁰¹

2. Special Powers of Appointment Under the Regulations

The regulations provide that the exercise of a power of appointment over the assets of a grandfathered trust should not cause the trust to lose its GST exempt status unless the exercise violates the permissible perpetuities period under federal law.⁴⁰² The federal perpetuities period should not be violated by the exercise of a special power of appointment if the vesting, absolute ownership, or power of alienation of an interest in property is not suspended or delayed beyond some life in being at the date of the creation of the grandfathered trust plus twenty-one years or ninety years from the date of the creation of the grandfathered trust.⁴⁰³ Importantly, the mere release or lapse of a power of appointment after the effective date should not taint the GST exempt status of a grandfathered trust.⁴⁰⁴

3. Preserving GST Exempt Status for Grandfathered Trusts

Decanting should not cause a grandfathered trust to lose its GST exempt status if the decanting satisfies either the discretionary distribution safe harbor of Treasury Regulation subsection 26.2601-1(b)(4)(i)(A) or the trust modification safe harbor of Treasury Regulation subsection 26.2601-1(b)(4)(i)(D), as further explained below.⁴⁰⁵

a. Discretionary Distribution Safe Harbor

Under the discretionary distribution safe harbor of Treasury Regulation subsection 26.2601-1(b)(4)(i)(A), a decanting should not taint the GST exempt status of a grandfathered trust if the following conditions are satisfied: (1) when the grandfathered trust became irrevocable, either the terms of the trust instrument or local law (i.e., state statute or common law) authorized the trustee to make distributions to a new trust; (2) neither beneficiary consent nor court approval is required for the trustee to exercise its discretionary authority; and (3) the new trust will not suspend or delay the

401. Treas. Reg. § 26.2601-1(b)(1)(v)(B), (4)(i)(A), (4)(i)(D)(1).

402. Chadwick, *supra* note 1, at 21. See Treas. Reg. § 26.2601-1(b)(1)(v)(B).

403. Chadwick, *supra* note 1, at 21; Aghdami & Durst, *supra* note 25, at 34. See Treas. Reg. § 26.2601-1(b)(1)(v)(B)(2).

404. Chadwick, *supra* note 1, at 21; Aghdami & Durst, *supra* note 25, at 34. See Treas. Reg. § 26.2601-1(b)(1)(v)(B)(1).

405. Chadwick, *supra* note 1, at 21; Aghdami & Durst, *supra* note 25, at 34; Treas. Reg. § 26.2601-1(b)(4)(i)(A), (D).

vesting, absolute ownership, or power of alienation of an interest in trust beyond the permissible perpetuities period under federal law.⁴⁰⁶

b. Trust Modification Safe Harbor

If a decanting does not satisfy the discretionary distribution safe harbor, the trust modification safe harbor of Treasury Regulation subsection 26.2601-1(b)(4)(i)(D) acts as a catch-all.⁴⁰⁷ The trust modification safe harbor provides that a decanting should not taint the GST exempt status of a grandfathered trust if the following conditions are satisfied: (1) the decanting will not shift a beneficial interest in the trust to a beneficiary occupying a lower generation than the person or persons holding the beneficial interest under the terms of the original trust and (2) the decanting will not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust.⁴⁰⁸

c. Applying the Safe Harbors to Grandfathered Trusts

Note the following in reviewing and applying the safe harbors to potential decanting transactions: If a decanting involves only administrative changes, there should be no loss of GST exempt status.⁴⁰⁹ Under the trust modification safe harbor, this is true regardless of whether state law authorizes the decanting.⁴¹⁰ The first prong of the discretionary distribution safe harbor requires that decanting be authorized under the terms of the trust instrument or applicable state law.⁴¹¹ Because no state decanting statute existed at the time of the GST's effective date in 1985, a trustee must rely on their inherent ability under common law to decant the trust assets.⁴¹² This common law reliance may not pose a problem, especially if the trustee had

406. Chadwick, *supra* note 1, at 21; Aghdami & Durst, *supra* note 25, at 34–35; Treas. Reg. § 26.2601-1(b)(4)(i)(A).

407. Chadwick, *supra* note 1, at 21; Aghdami & Durst, *supra* note 25, at 35; Treas. Reg. § 26.2601-1(b)(4)(i)(D).

408. Chadwick, *supra* note 1, at 21–22; Aghdami & Durst, *supra* note 25, at 35; Treas. Reg. § 26.2601-1(b)(4)(i)(D).

409. Chadwick, *supra* note 1, at 22. See I.R.S. Priv. Ltr. Rul. 200607015 (Nov. 4, 2005). See also Treas. Reg. § 26.2601-1(b)(4)(i)(E) (explaining that a trust modification that is merely administrative should not taint GST exempt status even if the modification indirectly increases the benefits available to the beneficiaries). Cf. I.R.S. Priv. Ltr. Rul. 9737024 (Sept. 12, 1997) (finding that grandfathered status is preserved when a trust is modified pursuant to a state decanting statute so long as the terms of the new trust do not adversely affect the quality, value, or timing of any beneficial interest in the trust).

410. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 35. See Treas. Reg. § 26.2601-1(b)(4)(i)(D).

411. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 35–36.

412. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36.

the ability to move the trust situs to Florida, a state that explicitly recognized the common law decanting authority of its trustees.⁴¹³

Unlike the discretionary distribution safe harbor, a decanting will not fail the trust modification safe harbor solely by reason of a beneficiary's consent or a court's approval of the decanting.⁴¹⁴ While these measures may not affect the trust's GST status, they could result in adverse income, gift, or estate tax consequences, as discussed above.⁴¹⁵

A trustee may only extend an interest's vesting period beyond the period prescribed in the original trust if the decanting satisfies the discretionary distribution safe harbor.⁴¹⁶ Even then, the decanting cannot extend the vesting period beyond the federal perpetuities period.⁴¹⁷ A trustee may desire to extend the vesting period, for example, when a beneficiary is scheduled to receive trust principal at a certain age or upon the death of a certain person.⁴¹⁸ When extending the vesting period in these scenarios, it is important to include provisions in the new trust document limiting the vesting period to comply with the federal perpetuities period.⁴¹⁹

Interestingly, the federal perpetuities period contained in the decanting regulations prescribes a different starting point than the period contained in the power of appointment regulations.⁴²⁰ The power of appointment regulations measure the perpetuities period (the later of twenty-one years plus some life in being or ninety years) from the date of the creation of the trust, while the decanting regulations measure the perpetuities period from the date the grandfathered trust became irrevocable.⁴²¹

Like the extension of vesting periods, a trustee may only shift a beneficial interest in trust down generational lines if the decanting meets the requirements of the discretionary distribution safe harbor.⁴²² Because the trust modification safe harbor only prohibits the shifting of beneficial interests to persons occupying a lower generation, a trustee may still shift beneficial interests up or across generational lines under the trust modification safe harbor.⁴²³

413. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36. See *Phipps v. Palm Beach Tr. Co.*, 196 So. 299, 300 (Fla. 1940).

414. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36. See Treas. Reg. § 26.2601-1(b)(4)(i)(D).

415. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36.

416. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36.

417. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36.

418. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36.

419. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36; see Treas. Reg. § 26.2601-1(b)(4)(i)(D).

420. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36; Treas. Reg. § 26.2601-1(b)(4)(i)(A).

421. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 36–37; see Treas. Reg. § 26.2601-1(b)(1)(v)(B).

422. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37; see Treas. Reg. § 26.2601-1.

423. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37.

Treasury Regulation subsection 26.2601-1(b)(4)(i)(E), Example 2 provides a good example of the interaction between the discretionary distribution and trust modification safe harbors: Under the facts of the example, the grantor established an irrevocable trust for the benefit of the grantor's child "A," A's spouse, and A's issue.⁴²⁴ When the trust was established, A had two children, "B" and "C."⁴²⁵ The trust provided for discretionary distributions of income and principal to the beneficiaries.⁴²⁶ The trust terminated at A's death with the principal distributed to A's issue per stirpes.⁴²⁷ Pursuant to a state decanting statute enacted after the creation of the trust, the trustee may appoint the assets to a new trust with either the consent of the beneficiaries or court approval.⁴²⁸ The trustee did not have the authority to decant under state law prior to the enactment of the decanting statute.⁴²⁹ The trustee appointed one-half of the principal to a new trust pursuant to the state decanting statute.⁴³⁰ The terms of the new trust provide income to A for life with the remainder passing one-half to B or B's issue and one-half to C or C's issue.⁴³¹ The decanting does not satisfy the discretionary distribution safe harbor because beneficiary consent or court approval is required.⁴³² The decanting does satisfy the trust modification safe harbor, however, because it will not shift a beneficial interest in the trust, and it will not extend the vesting period beyond the period prescribed in the original trust.⁴³³

Care should be taken when converting a grandfathered trust from a complex trust to a grantor trust.⁴³⁴ The IRS could argue that the conversion constitutes a shift in the beneficial interest of the trust, resulting in a loss of GST exempt status.⁴³⁵ This argument, however, seems unlikely to succeed.⁴³⁶ When a settlor pays the income tax liability attributable to a grantor trust, this is typically not treated as a gift to the trust or its beneficiaries.⁴³⁷ If the payment of income taxes by the grantor is not deemed a taxable transfer, then a conversion to grantor trust status in and of itself should not shift a beneficial

424. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37; Treas. Reg. § 26.2601-1(b)(4)(i)(E), Example 2.

425. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37; Treas. Reg. § 26.2601-1(b)(4)(i)(E), Example 2.

426. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37; Treas. Reg. § 26.2601-1(b)(4)(i)(E), Example 2.

427. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37; Treas. Reg. § 26.2601-1(b)(4)(i)(E), Example 2.

428. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37.

429. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37.

430. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37.

431. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37.

432. Chadwick, *supra* note 1, at 22; Aghdami & Durst, *supra* note 25, at 37.

433. Chadwick, *supra* note 1, at 22–23; Aghdami & Durst, *supra* note 25, at 37–38.

434. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38.

435. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38.

436. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38.

437. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38. See Rev. Rul. 2004-64, 2004-2 C.B. 7.

interest in the trust.⁴³⁸

4. Preserving GST Exempt Status for Non-Grandfathered Trusts

Neither the Code nor the Regulations directly address the consequences of decanting the assets of a non-grandfathered trust.⁴³⁹ The IRS has indicated, however, that the GST Regulations for grandfathered trusts should apply to non-grandfathered trusts.⁴⁴⁰ In Private Letter Ruling 201134017, the IRS applied the discretionary distribution safe harbor to a proposed trust decanting of a non-grandfathered trust.⁴⁴¹ There, the IRS considered whether a proposed decanting by a special trustee would cause the trust to lose its GST exempt status.⁴⁴² Citing Treasury Regulation subsection 26.2601-1(b)(4)(i)(E), Example (1), the IRS concluded that following the decanting, the new trust would continue to have an inclusion ratio of zero because the decanting satisfied the discretionary distribution safe harbor.⁴⁴³ The IRS specifically found that the terms of the original trust expressly authorized the special trustee to decant; neither beneficiary consent nor court approval was required for the special trustee to exercise the decanting authority; and the terms of the new trust would not suspend or delay the vesting, absolute ownership, or power of alienation of an interest in the original trust beyond any life in being at the creation of the original trust plus twenty-one years.⁴⁴⁴

With more recent trusts, it is possible that a state decanting statute was in existence at the time a transferor allocated GST exemption to the trust (or the automatic allocation rules applied).⁴⁴⁵ Therefore, assuming the regulations for grandfathered trusts also apply to non-grandfathered trusts, a trustee could decant the trust assets pursuant to the state's decanting statute without losing GST exempt status and, so long as no beneficiary consent or

438. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38. See Rev. Rul. 2004-64, 2004-2 C.B. 7.

439. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38.

440. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38. See I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011) ("At a minimum, a change that would not affect the GST status of a grandfathered trust should similarly not affect the exempt status of such a [non-grandfathered] trust."); I.R.S. Priv. Ltr. Rul. 200743028 (May 29, 2007). See also I.R.S. Priv. Ltr. Rul. 200919008 (May 8, 2008) (confirming that the GST Regulations should apply to non-grantor trusts).

441. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38; I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011).

442. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38.

443. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38; Treas. Reg. § 26.2601-1(b)(4)(i)(E), Example 2.

444. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 38-39. See I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011).

445. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 39.

court approval was required, could shift a beneficial interest down generational lines or extend the vesting period of a trust interest.⁴⁴⁶

Even if the regulations for grandfathered trusts do not apply to non-grandfathered trusts, a non-grandfathered trust is likely to enjoy more liberal rules with respect to the preservation of its GST exempt status.⁴⁴⁷ For one, the policy rationales behind the GST rules for grandfathered and non-grandfathered trusts are different.⁴⁴⁸ The GST rules for grandfathered trusts are far more concerned with preventing abuse, while the rules for non-grandfathered trusts are more flexible.⁴⁴⁹ In addition, if the regulations for grandfathered trusts did not apply, more liberal analogies may be drawn, such as to the rules concerning special powers of appointment, as discussed above.⁴⁵⁰ Some analogy may be drawn, however, to the rules governing the qualified severance of trusts for GST purposes.⁴⁵¹

VI. CONCLUSION

Although decanting is by no means a new phenomenon, its popularity has grown by leaps and bounds in recent years.⁴⁵² As Texas continues to refine its decanting statute, more trustees and their advisors are beginning to view irrevocable trusts as a rough draft, rather than a final product.⁴⁵³ Nonetheless, it is important to remember that decanting is just one tool in a practitioner's toolbox when seeking to modify an irrevocable trust.⁴⁵⁴ Trustees should also consider decanting alternatives such as trust combinations or divisions or judicial modifications or reformations, which may be more appropriate in certain situations.⁴⁵⁵

If decanting is available and best accomplishes the objectives at hand, trustees must carefully comply with the requirements set forth in the Texas statute, while also avoiding any adverse tax consequences.⁴⁵⁶ Fortunately, the

446. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 39.

447. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 39. See I.R.S. Priv. Ltr. Rul. 201134017 (May 26, 2011).

448. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 39.

449. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 39.

450. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 39. See Treas. Reg. § 26.2601-1(b)(1)(v)(B) (as amended in 2004).

451. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 39. See Treas. Reg. § 26.2642-6 (as amended in 2008).

452. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 49.

453. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 49.

454. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 50.

455. Chadwick, *supra* note 1, at 23; Aghdami & Durst, *supra* note 25, at 49.

456. Chadwick, *supra* note 1, at 23. See Massingill Staff, *What Is Trust Decanting in Texas?*, MASSINGILL (Oct. 2, 2023), <https://jm.legal/articles/estate-planning/trust-decanting/> [<https://perma.cc/WXW2-4VUS>].

Texas decanting statute has been well cultivated, and with its changes over the last decade, continues to age like fine wine.⁴⁵⁷

457. Chadwick, *supra* note 1, at 23; Young, *supra* note 252.