Title

Can it be that in Nevada a trustee by statute may now decant an income-only trust into a trust whose trustee has current principal-invasion authority?

Summary

Even in the absence of statutory authority a trustee with equitable discretionary authority to make principal distributions to or for the benefit of the beneficiary has long had equitable authority to distribute some or all of the entrusted principal to the trustee of another trust, provided the recipient trust is for the benefit of the beneficiary and the terms of the trust that is to be decanted are not violated thereby. It goes without saying that equity would frown on an effort to reverse decant, that is to distribute the principal of an income-only trust to the trustee of a trust under which the trustee would have the current principal-invasion authority. Apparently it is the case in Nevada, at least according to one commentator, that the trustee of a trust with "mandatory income interests" may now be judicially authorized to decant into a fully-discretionary trust, "unlike the decanting statutes of most other states." See Neil Schoenblum, Statute of Liberty, 24 STEP Journal, Issue 9, at pg. 59 (Nov. 2016) (citing to Nevada Revised Statute 163.556, specifically Section 1, which may be accessed at http://www.leg.state.nv.us/nrs/nrs-163.html#NRS163Sec556). Presumably any retroactive application of the statute's reverse-decanting provisions would unconstitutionally compromise the equitable property rights of remaindermen, absent special facts. As to future trusts, it seems clear that the express terms of an income-only trust may effectively deprive the trustee of such reverse-decanting authority. Trust scriveners take note. The decanting concept is discussed generally in §3.5.3.2(a) of *Loring and Rounds: A Trustee's Handbook* (2017), the relevant portions of which section are reproduced below.

Text

From *Loring and Rounds, A Trustee's Handbook* §3.5.3.2(a) (2017) [pages 204-208]:

****

Decanting: Discretionary fiduciary distributions of principal in further trust. Inherent in a trustee's unqualified power to make discretionary distributions of principal outright and free of trust to or for the benefit of a beneficiary is the lesser power to make a distribution of principal in further trust for the benefit of that beneficiary.[492] The Restatement (Third) of Property is in accord.[493] Moving property from one trust to another in this way is referred to as decanting in some circles.[494] On the other hand, a decanting for the benefit of someone other than that beneficiary could implicate the fraud on a power doctrine, which is covered generally in Section 8.15.26 of this handbook. In partial derogation of the doctrine, the Uniform Trust Decanting Act would authorize the exercise of a decanting power whether or not *at the time of the exercise* the fiduciary under the first trust's discretionary distribution standard would

[492]Phipps v. Palm Beach Trust Co., 142 Fla. 782, 196 So. 299 (1940) (holding that 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) (U.S.); Lewin ¶¶3-59, 3-67 (England). *See generally* Restatement (Second) of Property (Wills and Other Donative Transfers) §11.1; Restatement (Third) of Property (Wills and Other Donative Transfers) §19.14.

[493]Restatement (Third) of Property (Wills and Other Donative Transfers) §19.14, cmt. f.

[494]Restatement (Third) of Property (Wills and Other Donative Transfers) §19.14, Reporter's Note.

have made or could have been compelled to make a discretionary distribution of principal.[495]

The tax implications of a particular decanting will not necessarily be self-evident: "While the tax treatment of F … [corporate]… reorganizations is well settled, with case law going back to the 1920s and statutes providing nonrecognition treatment, the tax treatment of decantings is surprisingly unsettled."[496]

In Massachusetts, the decanting authority of trustees is regulated by general principles of equity.[497] In New York, decanting distributions are regulated by statute.[498] It has been suggested that the legal premise underlying the statute is that a trustee with an absolute fiduciary power to invade principal is analogous to a donee of a nonfiduciary special/limited power of appointment who may exercise the power in further trust.[499] The analogy, however, would seem a false one as trustees are constrained by the fiduciary principle in the exercise of their powers; donees of nonfiduciary powers of appointment generally are not.[500] Thus, a power in a trustee to select his successor, by decanting or otherwise, is held in a fiduciary capacity. At minimum this translates into a fiduciary duty on the part of the trustee to exercise due diligence in the selection of an appropriate successor.

Decanting can be a way for *the trustee* of an irrevocable trust to modify its administrative provisions, accommodate a beneficiary-related change of circumstances, respond to changes in the tax laws, or correct errors or ambiguities in the governing trust instrument.[501] The trustee, of course, would be subject to fiduciary constraints in the exercise of his discretionary decanting authority, and any such exercise would have to be done prudently.[502] Thus, the failure of the trustee to give due advance consideration to the tax consequences, if any, of a discretionary trust-to-trust decanting would amount to a prima facie breach of his duty to administer the trust prudently.

A transfer of property to a trustee in breach of some fiduciary duty to the legal or equitable owner of the property is subject to rescission and restitution.[503] Thus, if an agent in breach of a fiduciary duty to the principal transfers the principal's property to a trustee, the trustee is "liable in restitution" to the principal.[504] So also if a trustee in breach of trust decants to another trust with a different trustee and

---

[495]Unif. Trust Decanting Act § 21.

[496]Jason Kleinman, *Trust Decanting: A Sale Without Gain Realization*, 49 Prop., Trust & Estate L. J. 453, 458 (2015).

[497]*See generally* Morse v. Kraft, 466 Mass. 92, 992 N.E.2d 1021 (2013).

[498]N.Y. Est. Powers & Trusts Law §10-6.6. Alaska, Arizona, Delaware, Florida, Illinois, Indiana, Kentucky, Missouri, Nevada, New Hampshire, North Carolina, Ohio, South Dakota, Tennessee, and Virginia also have decanting statutes.

[499]*In re* Estate of Mayer, 176 Misc. 2d 562, 672 N.Y.S.2d 998 (Surr. Ct. 1998); Phipps v. Palm Beach Trust Co., 142 Fla. 782, 196 So. 299 (1940). *See generally* §8.1.2 of this handbook (exercising of powers of appointment in further trust).

[500]*See generally* §8.1.1 of this handbook (powers of appointment).

[501]Section 9 of the Uniform Trust Decanting Act would suggest that the Act is not in accord, at least not conceptually. See the accompanying official commentary ("Decanting by definition is an exercise of fiduciary discretion and is not an alternative basis for a court modification of the trust.") But see the commentary accompanying § 4 of the Act ("The exercise of the decanting power need not be in accord with the literal terms of the first-trust instrument because decanting by definition is a modification of the terms of the first trust … Where the trustee has a duty to seek a deviation and the appropriate deviation could be achieved by an exercise of the decanting power, the trustee could fulfill such duty by an exercise of the decanting power rather than seeking a judicial deviation.").

[502]*See, e.g.*, Unif. Trust Decanting Act § 4(a) (fiduciary duty).

[503]*See* Restatement (Third) of Restitution and Unjust Enrichment §17 (lack of authority).

[504]*See* Restatement (Third) of Restitution and Unjust Enrichment §17 (lack of authority). *See generally* §3.4.1 of this handbook (whether an agent acting under a durable power of attorney can effectively transfer the principal's property in trust).

different beneficiaries, absent special facts. The trustee of the other trust and, indirectly, the beneficiaries of the other trust are "liable in restitution" to the beneficiaries of the inception trust "as necessary to avoid unjust enrichment."[505]

Ultimately, whether or not there is decanting authority in the trustee should simply hinge on the intent of the settlor of the trust as divined from its terms, as well as on the motives of the trustee. If, for example, decanting would thwart the wishes of the settlor, then such a distribution in further trust ought to be judicially voidable.[506] So also if decanting is merely an attempt on the part of the inception trustee to end-run the ancient proscription against delegating to agents the entire administration of the trust or to avoid having to monitor the activities of agents to whom fiduciary discretions have been properly delegated.[507] When it comes to the motives of a trustee, equity looks to substance rather than to form.[508] One cannot forget that the trust, first and foremost, is a principles-based creature of equity.[509] Thus, whether decanting is permissible should be determined on a case-by-case basis taking into account the terms of the particular trust and the motives of the particular trustee.[510] To promulgate some hard and fast rule either way by statute only serves to further stultify and barnicalize the law of trusts:

> The growing universe of state decanting rules has resulted in an increasingly complicated patchwork of state laws on the subject. In addition, many of the states that have passed decanting legislation have specifically sought to retain preexisting common law principles. Furthermore, state decanting statutes remain subject to varying judicial interpretation. One significant area of variation among states exists with regard to the distribution standards necessary to decant a trust.[511]

In any case, it is at least a settled and universal principle that decanting may not serve as a vehicle for subverting settlor intent, or at least that was the case. The material purpose doctrine (aka the Claflin Doctrine), which is covered generally in Section 8.15.7 of this handbook and which has been the traditional doctrinal protector of settlor-intent, may have been neutralized in Washington State by an obscure piece of legislation known as the Trust and Estate Dispute Resolution Act (TEDRA).[512] Were it not for decanting one might be inclined to dismiss TEDRA as a doctrinal anomaly of minimal national relevance. We begin our explanation of what TEDRA does and why decanting makes TEDRA a matter of national relevance by recalling the current state of the material purpose doctrine. In recent years, reformers of trust law have been hard at work defanging the plain meaning rule, primarily by liberalizing the doctrines of reformation and deviation. The rule is discussed generally in Section 8.15.6 of this

---

[505]*See* Restatement (Third) of Restitution and Unjust Enrichment §17 (lack of authority).

[506]*See, e.g.*, Ferri v. Powell-Ferri, No. MMXCV116006351S, 2013 WL 5289955 (Conn. Super. Ct. Aug. 23, 2013) (unreported) ("The decanting frustrates … [the settlor's intentions] … and, therefore, cannot stand.").

[507]*See generally* §6.1.4 of this handbook (delegation).

[508]*See generally* §8.12 of this handbook (equity's maxims).

[509]*See generally* Chapter 1 of this handbook (equity in the Anglo-American legal tradition).

[510]*See* Phipps v. Palm Beach Trust Co., 142 Fla. 782, 785, 196 So. 299, 301 (1940) (whether decanting is permissible turns on the facts of the particular case and the terms of the instrument creating the trust); Morse v. Kraft, 466 Mass. 92, 98, 992 N.E.2d 1021, 1026 (2013) ("We conclude that the terms of the 1982 Trust authorize the plaintiff to transfer property in the subtrusts to new subtrusts without the consent of the beneficiaries or a court.").

[511]Ivan Taback & David Pratt, *When the Rubber Meets the Road: A Discussion Regarding a Trustee's Exercise of Discretion*, 49 Real Prop., Trust & Estate L. 491, 515 (2015).

[512]Chap. 11.96A.220 RCW.

handbook, the doctrines generally in Section 8.15.22. That having been said, the reformers have generally been quick to caution that these liberalizations are intended to buttress settlor-intent, not subvert it. At minimum, lip service is being paid to settlor-intent. There is one notable exception: Professor Langbein's "intent-defeating" (his words) benefit-the-beneficiaries rule, which has been incorporated into the Uniform Trust Code. This is a topic that is taken up in Section 6.1.2 of this handbook. This radical intent-defeating policy reform embedded in the UTC has met with considerable push-back. Both the Massachusetts and the New Hampshire legislatures, for example, have said "no thanks." Even some denizens of the ivory tower have declined to fall in line.[513]

Now, while all this has been going on, in Washington State the material purpose doctrine may well have been effectively defanged by TEDRA.[514] The legislation in part provides that a trust may be reformed nonjudicially by agreement of the trustee and beneficiaries without regard to the trust's material purposes, at least that is what its drafters intended. The agreement is final and binding on all parties. Idaho is, so far at least, the only other TEDRA state. These developments, isolated though they may be, have national implications. Here is why: There have already been decantings from other states into trusts sited in Washington State to facilitate subversion of their material purposes. Assuming this practice takes on a head of steam, which is likely, the trust instrument scrivener should consider advising his or her settlor-client that the material purpose doctrine may well be TEDRA-vulnerable, unless effective countermeasures can be taken at the drafting stage to defang TEDRA, or forestall a decanting to a TEDRA state. In theory, a decanting from a nonTEDRA state to a TEDRA state in order to subvert a trust's material purposes would be subject to equitable reversal by the courts of the nonTEDRA state. As a practical matter, however, the pursuit by a beneficiary (presumably someone who had not been a party to the TEDRA agreement) of such an equitable multi-jurisdictional action would not be a realistic option, absent special facts, if only because of the numerous and substantial personal expenditures of time and treasure that likely would be required to maintain the action.

The Uniform Trust Decanting Act (the "Act"), approved in July of 2015 by the National Conference of Commissioners on Uniform State Laws and promulgated "in the midst of a rising tide of state decanting statutes," would not supplant a trustee's right to decant under long-standing general principles of equity.[515] On this side of the Atlantic, more and more states now have in place dueling trust-decanting regimes. One regime is regulated by general principles of equity as tweaked by statute, whether of the aforementioned home grown variety or some version of the Act. (The Act is essentially just an aspirational grab bag of statutory tweaks in the trust-decanting space.) The other regime is regulated by general principles of equity that, for the most part, have *not* been barnacled by trust-decanting legislation. *Morse v. Kraft*[516] is a high-profile Massachusetts case in which the court authorized a trust decanting under general equitable principles, Massachusetts at the time not having a trust-decanting statute on its books.

Might a trustee under certain circumstances have an affirmative duty to decant? The Uniform Trust Decanting Act, specifically § 4(b), provides that the Act "does not create or imply a duty to exercise the decanting power." That the Act does not expressly impose on a trustee in possession of a decanting power a duty to exercise and it should not foreclose *equity* from imposing on the trustee such a duty should circumstances warrant, such as where the material purposes of the first trust would be significantly furthered by its decanting.[517]

---

[513]*See generally* §6.1.2 of this handbook.

[514]Chap. 11.96A.220 RCW.

[515]*See* Unif. Trust Decanting Act, Prefatory Note and § 3, cmt.

[516]466 Mass. 92, 992 N.E.2d 1021 (2013).

[517]See the official commentary accompanying § 4 of the Uniform Trust Decanting Act.

****