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Decanting California Trusts: It's Not Just for Wine

While decanting a good bottle of wine may be familiar to many people, California recently enacted a law that allows a new type of decanting: trust decanting.

California enacted the Uniform Trust Decanting Act on Sept. 14. Similar to wine decanting, trust decanting is a method by which a trustee may remove or modify trust provisions from an irrevocable trust by pouring — or distributing — the trust assets from an old trust into a new trust.

Prior to enactment of the Act, a court proceeding or the consent of all trust beneficiaries was necessary to modify the provisions of a California irrevocable trust, absent trust language providing otherwise. Under the new law, subject to certain exceptions, a trustee may modify an existing irrevocable trust without the consent of the settlor and beneficiaries, or prior court approval, by pouring the assets from the old trust into a new, improved trust.

Only certain trusts may be decanted. For example, a trust held solely for charitable purposes, such as a private foundation structured as a trust, cannot be decanted. A trust containing a charitable interest, such as a trust with a charity as a remainder beneficiary, can be decanted, however.

What can be changed?

The more discretion the trustee has over the principal distributions, the more options the trustee has for modifying the trust through decanting. The provisions regarding what can be modified through decanting break down into two categories: (1) the rules that

apply to trustees with “limited distributive discretion” and (2) the rules that apply to trustees with “expanded distributive discretion.”

The new statute defines a trustee with limited distributive discretion as a trustee that has discretion to distribute trust principal that is limited to an ascertainable standard. For example, a trust may provide a trustee with the power to distribute principal for the beneficiary’s health, education, maintenance or support. (This is also known as a HEMS standard or reasonable support standard.) A trustee with limited distributive discretion may exercise the decanting power to modify administrative provisions of the trust, including the successor trustee provisions or the powers of the trustee. However, the trustee may not materially change the dispositive provisions of the trust.

A trustee with expanded distributive discretion is defined as a trustee that has discretion to distribute trust principal that is not limited to an ascertainable standard or reasonable support standard. For example, a trust may give the trustee sole discretion to make distributions of principal. A trustee with expanded distributive discretion may exercise the decanting power to modify both the administrative provisions and certain dispositive provisions of the trust. The trustee could use the decanting power to eliminate a beneficiary, change the standard for distributions, grant a power of appointment or extend the duration of the trust. Generally speaking, however, a trustee may not

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add a new beneficiary (except perhaps indirectly by granting a power of appointment to a beneficiary).

What cannot be changed?

Even if a trustee has expanded distributive discretion, significant limitations restrict its ability to modify trust provisions related to trustee compensation, trustee liability, and the removal or replacement of a trustee.

Likewise, substantial limitations exist regarding the modification of trust provisions related to charitable interests. For example, if a trust contains a charitable interest — such as having a charity named as an ultimate remainder beneficiary — and all family members are deceased, the new trust created through the decanting cannot diminish the charitable interest.

Some of the most stringent limitations on decanting are the rules related to tax benefits. Under the Act, the decanting power cannot be exercised in any way that would jeopardize the tax benefits of the original trust. The Act contains savings language to avoid inadvertent negative tax consequences from the changes. It also makes clear that, subject to certain protections, a trustee may exercise the decanting power to change a trust from a grantor trust to a nongrantor trust or vice versa.

Who must receive notice of the decanting?

Before exercising the decanting power, a trustee must give at least 60 days' notice to (1) the settlor, (2) each qualified beneficiary, (3) each holder of a presently exercisable power of appointment over the original trust, (4) each person with a current right to remove or replace the trustee, (5) each other trustee of the original trust, (6) each trustee of the new trust and (7) the California Attorney General, if the original trust contains certain charitable interests. The act provides guidelines on what must be stated in the notice, including specific warning language notifying the recipients of their right to contest the decanting. In fact, California's newly adopted decanting statute contains stricter notice provisions than does the general Uniform Trust Decanting Act, including detailed provisions applicable to certain trusts for minors.

Moving forward

Although the Act may be an improvement over prior California law, it has several shortcomings. First, the fact that trustees with limited distributive discretion can modify only administrative provisions significantly limits the changes that can be made to most irrevocable trusts. Second, the strict notice provisions may require court intervention in certain decanting situations.

Clients can avoid these disadvantages in one of two ways. First, clients should consider including a specific decanting power in otherwise irrevocable trusts, allowing for more flexible options with less onerous notice requirements. Second, clients could move the situs of the trust to a more flexible jurisdiction such as Delaware, Wyoming or Nevada, to rely on such other states' more liberal decanting provisions to achieve desired modifications. Please note that the decanting statute will apply to all California trusts unless the trust instrument specifically opts out of the statute.

If you have any questions regarding California's decanting statute or your other estate planning needs, please do not hesitate to contact us.

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