

Trust Decanting

By Salvatore J. LaMendola

Trust decanting (or “decanting”) is an efficient way to amend irrevocable trusts. It is the legal process through which a trustee transfers some or all of the property held in an existing trust into a new trust with different and more favorable terms. Michigan law allows decanting—with one exception, noted below—without the consent of the beneficiaries, the settlor, or the court.¹ Decanting is available to trustees of trusts that allow discretionary distributions and contain no decanting prohibition. Following are some suggestions to help ensure a successful decanting transaction.

What changes are allowed?

Minor changes—
administrative decantings

There are two kinds of decantings in Michigan: administrative and dispositive. Administrative decantings are available under the Michigan Trust Code. They implement minor changes, such as:

- Altering trustee successor provisions, including trustee eligibility requirements
- Adding a power to remove a trustee
- Adding a change of situs clause
- Making the trust a grantor trust for income-tax purposes
- Making the trust a non-grantor trust for income-tax purposes

- Removing a perpetuities savings clause from a trust that would otherwise be perpetual except for that clause
- Increasing/changing the method of determining trustee compensation or charging a decanting fee/commission (beneficiary consent is required for this one)²

The following changes cannot be made with an administrative decanting:

- Reducing the standard of care applicable to the trustee’s actions
- Expanding the trustee exoneration provisions
- Diminishing or eliminating a power to direct the trustee
- Diminishing or eliminating a power to remove the trustee³

Major changes—dispositive decantings

Dispositive decantings are available under the Michigan Powers of Appointment Act.⁴ They accomplish major changes, typically affecting provisions governing who receives what, when, and how. As long as no intended tax benefit is jeopardized, dispositive decantings can accomplish any of the following:

- Removing a beneficiary
- Changing a mandatory distribution provision to a discretionary one
- Extending the term of a trust
- Converting a standard trust into a supplemental needs trust
- Adding new beneficiaries (indirectly) by granting a current beneficiary the power to appoint to the person to be added⁵

When is each type of decanting allowed?

If the trustee’s discretionary distribution authority is limited by an ascertainable standard (such as “health, education, maintenance, and support”), only administrative decantings are allowed. If a major change is needed, using the more permissive decanting laws of other states should be considered. Access to those laws can be facilitated by an administrative decanting that adds the power to appoint an out-of-state trustee, a change of situs provision, or both.

If the trustee’s discretionary distribution authority is not limited by an ascertainable standard (for example, any one or more of “best interests,” “welfare,” “comfort,” “happiness,” or “general development”), both administrative and dispositive decantings are allowed.

Which beneficial interest may be modified in a dispositive decanting?

No change to non-current beneficiaries

Dispositive decantings may only modify the interests of the beneficiaries who are currently eligible to receive distributions. To illustrate, assume that A is the beneficiary of Trust X. The trustee of Trust X may currently distribute income or principal only to A for A’s best interests. When A reaches age 35, Trust X terminates and distributes to A outright. If A dies before age 35, Trust X terminates and distributes equally to A’s three children (B, C, and D) outright. With A now age 34, the trustee of Trust X would like to remove the age-35 termination provision and have the trust continue for A’s lifetime for better creditor protection. For the same reason, the trustee would also like to continue the trust after A’s death for the lifetimes of A’s children.

The change to A’s interest is allowed because A is currently eligible to receive distributions from the trust. However, because

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A's children are not eligible (they must wait until A's death to receive benefits), no changes to the interests of A's children are permitted. Consequently, while the age-35 termination provision can be eliminated in the transferee trust, the outright remainders in A's children at A's death must be preserved in that trust. Had A's children been co-beneficiaries with A, lifetime trusts for A's children could have been implemented in the transferee trust too.

No change to takers of last resort

This same "no change to non-current beneficiary" limitation can arise when a modification to the "takers of last resort" is desired. To illustrate, assume now that A and A's descendants are the current beneficiaries of Trust Y for their comfort and welfare. Being a perpetual trust, Trust Y runs for as long as a least one descendant of A is still living, no matter how remote. When the last of A's descendants passes away, Trust Y terminates and distributes all of its assets to Charity 1. Since the time Trust Y was established, however, Charity 1 has fallen out of favor. It is now desired that Charity 2 replace Charity 1 as the taker of last resort. This change cannot be accomplished because only A and A's descendants—not charities—are currently eligible to receive trust distributions. Had charities also been currently eligible, the change could have been made.

Although implementing the lifetime trusts for A's children in the first example, and swapping Charity 2 for Charity 1 in the second example, could not be accomplished directly with a decanting, each could be accomplished indirectly by granting an appropriately drafted power of appointment to A in the transferee trust followed by A's exercise of the same.

Beware of this class closing rule

Membership in the beneficiary class is determined as of the effective date of the decanting. If not handled properly, later-born beneficiaries could be unintentionally cut off.⁶ To illustrate, let's look again at Trust Y. Recall that the current beneficiaries of Trust Y are A and A's three children, B, C, and D. Assume that eliminating child D as a beneficiary is desired. If the trustee of Trust Y decants to a trust that includes as

beneficiaries "A and A's descendants (except D)," the only beneficiaries of the transferee trust will be A, B, and C. All of B's, C's, and D's later-born descendants will be excluded as beneficiaries of the transferee trust because the presumption that the class of A's descendants closes with those who are alive on the date of the transfer was not overridden.

To prevent this, include language such as the following: "Contrary to the presumption of construction provided in MCL 556.131, the membership of the class in whose favor this transfer is being made shall not be determined as a result of the transfer."

Know what the trust assets are

After reviewing a trust document and applicable law, the conclusion is often drawn that either an administrative decanting or a dispositive decanting can accomplish the necessary changes. However, this is premature. Review the trust assets to ensure that no undesirable tax consequences will be triggered by the decanting transfer. For example, if an asset has a liability against it that is in excess of its income-tax basis, the decanting transfer may trigger taxable gain to the transferor trust. The same is true when installment sale notes are involved. And where real estate is concerned, a property tax "uncapping" could result.

Give notice

While in nearly all cases the consent of the beneficiaries of the transferor trust is not required, the beneficiaries are, nonetheless, still entitled to notice. For administrative decantings, notice of the intended transfer must be given to the beneficiaries (and to the settlor, if still living) of the transferor trust at least 63 days *before* the decanting will occur. For dispositive decantings, only the beneficiaries of the transferee trust are entitled to notice, which must be given within 63 days *after* the transfer is made.

Protect the trustee of the transferor trust

It is also important to protect the trustee of the transferor trust. Obtain the settlor's approval when possible, even though not required. This eliminates any argument that

the transaction deviated from the settlor's current intent. Documenting the beneficiaries' approval (but not consent), if possible, also makes sense.

To cover the possibility that a claim that could have been paid from the transferor trust may arise after the transferor trust no longer has any assets, have the transferee trust assume all liabilities and obligations of the transferor trust, and include a provision in the transferee trust to indemnify the trustee of the transferor trust.

Know what implementation procedures must be taken

After documents have been signed, assets must be re-registered in the name of the transferee trust. If all assets of the transferor trust are being moved, individual asset transfers should be backed up with a general assignment to include later-discovered assets. Filings with various state agencies (Liquor Control Commission, local property tax assessor, etc.) reflecting the transfer should be made when necessary. A new federal tax ID number for the transferee trust should be obtained.

Conclusion

Trust decanting is a powerful tool for adapting irrevocable trusts to changed circumstances. Following the suggestions covered in this article will help ensure a successful result. ■



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ENDNOTES

1. MCL 700.7820a(7).
2. See MCL 700.7820a(2)(a) and (b).
3. MCL 700.7820a(2)(c) and (d).
4. MCL 556.111 *et seq.*
5. See MCL 556.115a.
6. MCL 556.131.