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**10TH ANNUAL CHANGES AND TRENDS AFFECTING  
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**Decanting Under the New Texas Statutes**

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## **Exhibit A**

# **DECANTING UNDER THE NEW TEXAS STATUTES**

## **I.**

### **INTRODUCTION TO DECANTING**

Although the term “decanting” sounds mysterious, in reality, decanting can simply be thought of as a form of trust modification that is initiated by a trustee. The modification is accomplished by moving all or some assets from one trust to a new trust pursuant to the trustee’s discretionary authority to make distributions to, or for the benefit of, one or more beneficiaries. The power is analogous to pouring wine from an old bottle into a new one. Estate planning attorneys often draft trusts which last for several generations, although no one can know exactly what the future may hold, especially the future of the beneficiaries. Decanting provides flexibility in that it allows a trustee the opportunity to change certain provisions in an irrevocable trust which are no longer desirable, or have become archaic over time, without having to do a judicial modification of the trust. This outline will provide a general overview of decanting under the common law and the new Texas statutes and the tax issues that should be considered when decanting.

## **II.**

### **WHAT IS DECANTING?**

The term “decanting” is not defined in the Internal Revenue Code or Treasury regulations. In December 2011, the IRS issued Notice 2011-101 (Notice 2011-101, 2011-52 I.R.B. 932) seeking comments regarding the various tax issues associated with decanting. As a result, we may see the IRS issue a formal definition in the future. In the meantime, in general terms, “decanting” is simply the exercise by a trustee of the trustee’s discretionary authority to distribute trust property to or for the benefit of trust beneficiaries by distributing assets from one trust to another trust.

Prior to the enactment of specific decanting statutes, practitioners relied on the common law for the authority to distribute trust property from one trust to a new trust. Under the common law, the rationale that underlies decanting is that if a trustee has the discretionary power to distribute property to, or for the benefit of, one or more current beneficiaries, then the trustee, in effect, has a special power of appointment that should enable the trustee to distribute the property to a new trust for the benefit of such beneficiaries. The trustee, moreover, should be able to give the current beneficiaries a special or general power of appointment under the terms of the new trust, the later which would be the functional equivalent of distributing the property outright to the beneficiaries. This view is in accord with the treatment of a trustee’s discretionary power to distribute as a special power of appointment under the Restatement (Second) of Property: Donative Transfers (1986) (“Restatement Second”) and the Restatement (Third) of Property: Wills & Other Donative Transfers (2011) (“Restatement Third”).

In the Restatement Second, a trustee's power to distribute property is akin to a special power of appointment. RESTATEMENT (2D) OF PROP: DONATIVE TRANSFERS § 11.1, cmt. d. According to the Restatement Second, "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." RESTATEMENT (2D) OF PROP: DONATIVE TRANSFERS § 11.1. Because a trustee who has discretionary authority to distribute trust property to beneficiaries does not have a beneficial interest in the trust property but can determine those persons who do have a beneficial ownership, the trustee is said to have a special power of appointment over the trust property. The Restatement Second terms the trustee's power as a special power because the trustee has the power to transfer all or less than all of the title authorized by the trust agreement. RESTATEMENT (2D) OF PROP: DONATIVE TRANSFERS § 11.1. The Restatement Second further provides that unless the donor provides otherwise, when the donor gives the powerholder the right to dispose of the property, the powerholder has the same rights that the powerholder would have if he or she owned the property and was giving it to the object of the power. RESTATEMENT (2D) OF PROP: DONATIVE TRANSFERS § 19.3. It follows that if a trustee has the power and discretion to transfer *full* legal title to a beneficiary, then the trustee should be able to transfer *less than* full legal title by transferring the property *in trust* for the beneficiary since the beneficial interests are still being transferred to the beneficiary who is a proper object of the power. *Id.* The Restatement Second does not address whether this power is held in a fiduciary or nonfiduciary capacity. Presumably, because the power is being exercised by a trustee, it is being exercised in a fiduciary capacity.

The Restatement Third makes an important clarification with regard to decanting, although interestingly, the term "decanting" is still not used. In the Restatement Third, a distinction is made between powers of appointment and fiduciary distributive powers. Specifically, a power of appointment may be exercised in a nonfiduciary capacity, may be exercised arbitrarily, is personal to the powerholder, and lapses upon the powerholder's death or other specified expiration if not exercised. RESTATEMENT (3D) OF PROP: WILLS AND OTHER DONATIVE TRANSFERS § 17.1. In contrast, a fiduciary distributive power is subject to the same general rules regarding powers of appointment, but the power must be exercised in a fiduciary capacity, it succeeds to any successor trustee, and it survives the death of a trustee. *Id.* Under the Restatement Third, decanting is likened to a power of appointment subject to fiduciary standards instead of simply being likened to a power of appointment. It may seem obvious that if a trustee is going to decant assets from one trust to a new trust, the trustee must act as a fiduciary. Even though obvious, it is critically important that when deciding whether to decant, the trustee examine all fiduciary duties applicable to the trust.

In addition, the Restatement Third specifies that unless the creator of a special power of appointment prohibits the exercise of the power in favor of a trust, the powerholder may exercise the power in favor of permissible appointees and appoint the property in trust. RESTATEMENT (3D) OF PROP: WILLS AND OTHER DONATIVE TRANSFERS § 19.14. Since a fiduciary distributive power is subject to the same general rules as powers of appointment, the ability to appoint in trust would also apply in a decanting situation. Remember that although the term is new, decanting is not. The most cited case that examines the decanting of a trust is the Florida case of *Phipps v. Palm Beach Trust Co.*, 196 So. 299 (Fla. 1940). In *Phipps*, a trust created in 1932 for the benefit of the grantor's beneficiaries, gave the individual trustee the discretion to distribute some or all of the income and principal of the trust to any one or more of the grantor's descendants. The individual trustee gave written instructions to the corporate

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