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Special Needs Trusts

A Guide for Attorneys, Financial Advisors and Trust Officers

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**Decanting Irrevocable Trusts
Under Texas Law**

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Decanting Irrevocable Trusts Under Texas Law

I. Introduction to Decanting - An Overview

A. What is Decanting?

Many wine experts will tell you that decanting certain wines is desirable as a means of improving the drinking experience. The process for decanting wine is simple: you pour the wine from one vessel (the bottle in which the wine was bottled), to a second vessel (such as a decanter, or other container), and the exposure to air (more specifically, oxygen), aerates the wine. The process is said to *renew* or *improve* the taste, aroma, and overall experience of the wine.

Similarly, decanting a trust can result in the improvement or renewal of an existing irrevocable trust. The “decanting” of a trust is the process of distributing all or a portion of the assets of an irrevocable trust to a second trust. It can be used as a means of dealing with a problematic, inconvenient, outdated, or inefficient provision or term of the first trust. Keep in mind that decanting is a tool for addressing a problem with an *irrevocable* trust. If a trust is revocable, there is no need to use a decanting power; instead, the individual with the power to revoke or modify the trust (generally the person who established the trust, known as the settlor or grantor), can simply modify or revoke the trust. Decanting is solely a tool for use in addressing problems unique to irrevocable trusts.

B. What is Decanting Used For? Modifying Irrevocable Trusts

Irrevocable trusts are extremely useful planning tools for many situations and circumstances, and are used for a variety of purposes, including but not limited to: (1) protecting the beneficiary from creditors or bad marriages, (2) protecting a minor or incapacitated person, by providing a vehicle to manage and administer assets without a guardianship, (3) accomplishing specific tax planning goals, (4) protecting public benefits such as SSI and Medicaid, or (5) simply setting firmly in stone exactly how the trust settlor wants the assets to pass to present and future generations of beneficiaries. But irrevocable trusts have a downside and that is that they are, of course, *irrevocable*. They cannot be changed easily if unintended circumstances arise, thwarting the intended purposes of the trust, or if a provision of the trust becomes inefficient or impossible to uphold or administer. A common example in the special needs planning world occurs when a trust is established for an individual who was healthy at the time that the trust was drafted or established, but who later becomes significantly disabled due to disease, illness, or accident. If the trust provides, for example, for mandatory distributions of income or principal, or for a scheduled final distribution when the beneficiary reaches a specific age, then the trust could be problematic for that disabled individual. It would often be advisable to attempt to modify or amend that trust, to provide for the management of the assets for the entire lifetime of

the beneficiary, and with restrictions necessary to protect eligibility for means-tested benefits such as SSI and Medicaid.

Decanting is simply one tool, in a fairly limited group of tools, that are available for modifying or reforming a problematic trust provision or term. Some of the other tools available include:

- (1) Judicial modification or reformation of the irrevocable trust by a court.
- (2) Merger and consolidation of one irrevocable trust with another trust.
- (3) Modification or amendment of the trust by a trust protector, who is granted specific authority in the trust agreement to modify the trust.
- (4) Non-judicial settlement agreements: In some states (but not Texas) a non-judicial settlement agreement between the trustee and the beneficiary or beneficiaries can be used to modify a trust provision.

In Texas, and in most states, the most common method for modifying or reforming an irrevocable trust with a problematic provision has historically been to file a petition with a court and seek judicial modification or reformation. (See, Texas Property Code §112.054, Judicial Modification, Reformation, or Termination of Trusts). However, judicial modification or reformation, especially in situations involving complex trusts, with complex multi-generational beneficiaries, can be expensive, and the process for going to court can often take longer than hoped or expected. Decanting -- when it is available to solve the problem in question -- can be a less expensive, more certain, more private, and quicker solution. However, decanting is undertaken as discretionary action on the part of the trustee, which brings with it some risk of a claim for breach of fiduciary duty, whereas a judicial modification or reformation provides the trustee with the protection of a court order directing the changes in the trust.

A comparison of the relative strengths and weaknesses of a judicial modification or reformation versus decanting can be summarized as follows:

Judicial Modification Compared with Decanting

| Decanting | Judicial Modification or Reformation |
|--|---|
| Less Expense | More Expense |
| More Certain Outcome | Outcome Less Certain |
| Quicker Process & Solution | Slower Process & Solution |
| More Exposure to Liability for Trustee | Less Exposure to Liability for Trustee |
| Private Process | Public Filing in Court |

What this chart summarizes is that decanting is a more cost efficient, private, faster, and certain process when it is available as an option for changing provisions of an irrevocable trust, but it

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