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A Decade of Trust Decanting in Texas

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A DECADE OF TRUST DECANTING IN TEXAS¹

I. OVERVIEW

A. Introduction

On its face, it seems difficult, if not impossible, to change the terms of an irrevocable trust. After all, the settlor made the trust irrevocable by design and, in many cases, irrevocability is required to achieve the settlor's tax objectives. Despite this, over time, it may become necessary or desirable to modify an irrevocable trust to more accurately reflect the settlor's intent, respond to beneficiary needs and circumstances, address changes in the law, optimize tax consequences, or correct errors in the trust instrument itself. This seems particularly true now that Texas permits irrevocable trusts to last for up to 300 years, which is, of course, longer than the United States of America has been a country.

In Texas, there has always been a number of mechanisms available to modify both the terms and administration of an irrevocable trust, including judicial modifications and reformations, trust combinations and divisions, the removal and appointment of trustees, and the rising use of trust protectors or trust advisors. Perhaps no vehicle is as swift, however, as trust decanting, which Texas blessed by statute in 2013. Over thirty states now boast a decanting statute, and decanting has worked its way into a prominent position in most estate planners' toolboxes.

B. Decanting Defined

Neither the Texas Trust Code nor the Internal Revenue Code (referred to herein as the "Code") expressly defines the term "decanting."² Generally, decanting describes the act of a trustee exercising its power to distribute trust property to or for the benefit of a beneficiary by distributing such property to a new trust with different terms. The best way to understand trust decanting is to visualize the physical act of decanting wine, which involves the pouring of wine from one vessel to another for the purpose of removing unwanted sediment and adding oxygen to the wine. In the trust context, practitioners can view decanting as a trustee pouring the assets of an old trust into a new trust, with the less useful provisions (the so-called "sediment") left behind, while the "oxygen" of modern trust provisions breathes life into the trust.

As further explained below, a decanting power is often thought of as the trustee's exercise of a special power of appointment in a fiduciary capacity to distribute assets for the benefit of a beneficiary. Decanting proponents justify the technique with a rather simple argument—if a trustee has the authority to make a discretionary distribution of property to one or more beneficiaries outright, then the trustee should also have the authority to distribute such property subject to certain terms and conditions, which take the form of a new trust agreement.

¹ Portions of this paper are from an outline entitled "Decanting Comes of Age" originally prepared by Jeffrey D. Chadwick and Farhad Aghdami in May 2011.

² Webster's Dictionary defines the verb "decant" as follows: "(a) to draw off (a liquid) without disturbing the sediment or the lower liquid layers, (b) to pour from one vessel into another, and (c) to pour out, transfer, or unload as if by pouring."

C. Outline of Paper

This paper does not seek to be a definitive resource for decanting Texas trusts, nor does it attempt to address every issue or contingency.³ Rather, this paper is intended to provide a general overview of the decanting process based on ten years' worth of experience with the Texas decanting statute. Above all, this paper is designed to be helpful and practical. To this end, this paper is organized as follows:

- Part II establishes a framework by identifying common motivations for changing an irrevocable trust, many of which can be accomplished through decanting.
- Part III considers methods to modify irrevocable trusts in Texas prior to the enactment of the decanting statute in 2013, all of which remain potentially viable decanting alternatives.
- Part IV examines the Texas decanting statute, including changes from recent legislative sessions, the mechanics of decanting under the statute, and related practical considerations.
- Part V discusses federal tax issues, including potential income and transfer tax risks.
- Part VI offers some concluding remarks.
- Exhibit 1 contains the current Texas decanting statute, including a proposed change to Section 112.0715 of the Texas Trust Code that should take effect September 1, 2023.
- Exhibit 2 provides sample recitals to include at the outset of a new trust agreement when a trustee creates such new trust as part of the decanting process.
- Exhibit 3 contains a sample decanting notice letter to a beneficiary, as required by Section 112.074 of the Texas Trust Code.
- Exhibit 4 contains a sample decanting instrument, as required by Section 112.075 of the Texas Trust Code.

II. COMMON MOTIVATIONS FOR CHANGING AN IRREVOCABLE TRUST

If advisors could predict the future, designing an irrevocable trust would be pretty simple. Of course, that is not the case, and things change, particularly over time. Even the most careful and flexible drafting cannot anticipate every issue that may arise, and modifying the terms of an irrevocable trust can be beneficial in a wide variety of circumstances, discussed below.

A. Change Administrative Provisions

³ For excellent Texas decanting resources, see Crystal Rose, *Decanting More than Just Wine*, 7 ESTATE PLANNING AND COMMUNITY PROPERTY LAW JOURNAL, 385 (2014); Melissa J. Willms, *Decanting Trusts: Irrevocable, Not Unchangeable*, 6 ESTATE PLANNING AND COMMUNITY PROPERTY LAW JOURNAL 35 (2013).

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