Decanting and its Alternatives: Remodeling and Revamping Irrevocable Trusts

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DECANTING AND ITS ALTERNATIVES: REMODELING AND REVAMPING IRREVOCABLE TRUSTS

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Trust decanting is the process of distributing a trust estate of an irrevocable trust to the trustee of a new trust. Recognized under the common law and now statutorily by ten states, decanting can achieve a number of goals and objectives, from correcting drafting errors to responding to beneficiaries' changed circumstances or objectives. Procedural requirements, fiduciary considerations, and tax issues will be explored.

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I. INTRODUCTION

The concept of decanting port wine is based on the need to filter out leaves or stems from an otherwise excellent alcoholic beverage. To decant, the port is poured from one container to another, with the aim of improving the drinkability of the wine held in the new vessel in the process. The process is easy to visualize and understand, and provides an excellent analogy for the more cerebral concept of trust decanting.

Trust decanting simply means the act of a trustee making a distribution to a new trust with different terms from the original trust. It is, in some ways, a "backdoor" way of approaching trust reformation. But decanting has also been called the "ultimate" in trust amendment powers for otherwise irrevocable trusts.1 "Irrevocable"—more and more in the trust world—does not mean immutable. In South Dakota in particular, the relative ease with which changes can be undertaken to an irrevocable trust is quite surprising, perhaps even alarming.

Trusts are arguably English lawyers' greatest idea and creation.2 Trusts have been in use going back to the Norman conquest of 1066.3 Today, trusts are widely used as an infinitely flexible property and estate planning tool.4 With the new tool of decanting, the flexibility—and future uncertainty—of even irrevocable trusts have increased exponentially.

2. Gerry W. Beyer, Simplification of Inter Vivos Trust Instruments – from Incorporation by Reference to the Uniform Custodial Trust Act and Beyond, 32 S. Tex. L. Rev. 203, 206 (1991) (citing F. Maitland, Equity 23 (1916)). "Of all the exploits of Equity the largest and most important is the invention and development of the Trust ... This perhaps forms the most distinctive achievement of English lawyers." Id. Trusts were not a part of Roman law. Id. at 206 n.2.
3. Id. at 206 (citing G. Bogert, Trusts § 2, at 6 (6th ed. 1987) ("Uses and trusts were introduced into England shortly after the Norman Conquest . . . .").
II. WHY DECANT?

There are many potential reasons that would motivate a trustee to pursue decanting. At least three broad categories of reasons, however, can be identified: (1) achieving state or federal tax benefits; (2) improving the administrative provisions of a trust; and (3) adding asset protection advantages.

The list of possible reasons to decant is almost as limitless as the list of reasons why a trust might be created in the first place. A partial illustrative list would include:

1. Modifying powers of appointment;
2. Amending administrative provisions of a trust;
3. Adding spendthrift protections;
4. Adding (or removing) grantor trust provisions;
5. Qualifying a trust as a qualified subchapter S trust, a QDOT, an IRA conduit trust, etc.;
6. Combining trusts for greater efficiencies;
7. Separating trusts to allow investment philosophies to be "fine tuned" for beneficiaries;
8. Segregating higher risk assets;
9. Avoiding state and local taxes;
10. Reducing distribution rights for Medicaid eligibility planning purposes;
11. Amending trustee succession provisions, removing or replacing a trustee;
12. Extending the term of a trust;
13. Changing the governing law provisions of a trust;
14. Correcting a scrivener's error or ambiguity; and
15. Decanting a beneficiary's share of a trust to a supplemental needs trust in order to preserve or obtain eligibility for public benefits.

Combining, segregating or otherwise improving irrevocable life insurance trusts (ILITs) and credit shelter trusts will no doubt be the more common uses of decanting, since those types of trusts are the most common irrevocable trusts with lengthy trust terms. Dynasty trusts, although less common, are also excellent candidates for decanting.

III. COMMON LAW BASIS

Arguably, the power to decant exists under the common law, and the new decanting statutes are simply a way of putting flesh on the bones of an existing common law trustee power which exists, at least in some form, unless specifically prohibited by the trust instrument. Iowa is unique in having case law that recognized this power before any statute attempted to codify the power. In states where the power has not been expressly recognized by case law, the non-statutory basis for the power might be subject to argument. Generally, the first American case to expressly recognize the power is said to be the 1940
Florida Supreme Court decision of *Phipps v. Palm Beach Trust Company*.\(^5\)

**A. PHIPESS**

The *Phipps* case involved the family of Henry Phipps, a real estate developer who at one time owned about one-third of the town of Palm Beach.\(^6\) In 1932, Ms. Margarita C. Phipps of Palm Beach created an irrevocable trust for the benefit of her four children, naming the Palm Beach Trust Company and her husband as co-trustees.\(^7\) The trust provided that upon the written instructions of the individual trustee, the co-trustees would distribute all or any part of the trust estate to one or more of the four beneficiaries.\(^8\)

Ms. Phipps’s husband was given absolute discretion in making such directions, and seven years after the trust was created, he instructed the corporate trustee to transfer the entire trust estate to the trustees of a second trust.\(^9\) The terms of the second trust were to be essentially the same as those of the first trust except that one of the adult children beneficiaries was to be allowed to add an income interest for his wife in the trust by providing so in his Last Will and Testament (thus adding a new beneficiary).\(^10\)

The corporate trustee sought court approval for this proposal.\(^11\) The trial


\(^6\) The Phipps family also owned 45 kilometers of oceanfront property between Palm Beach and Fort Lauderdale, prime bay-front property in downtown Miami, and 120 square kilometers of Martin County, Florida property. The family donated an ocean-to-lake frontage property to Palm Beach that is now known as Phipps Park. *Id.* See GLORIA JAHODA, *FLORIDA: A BICENTENNIAL HISTORY* 144 (1976) (discussing the prominent Phipps family in Palm Beach history and quoting Cleveland Amory as describing the Phipps as "the beefsteak of the Palm Beach social menu").

\(^7\) *Phipps*, 196 So. at 300. The trust was funded with securities from her separate non-community property. *Id.* One of Ms. Phipps’ sons was designated as the primary trust beneficiary. *Id.*

\(^8\) *Id.* The trust provided:

At any time within the duration of this trust, as hereinafter provided, upon the written direction of the then Individual Trustee, the Trustees shall pay over and transfer all or any part of the rest, residue, and remainder of the trust estate, both principal and income, which may at such time remain and be in the hands of the Trustees to the said John H. Phipps, Hubert B. Phipps, Margaret Douglas and Michael G. Phipps and to the descendants of any of them, in such shares and proportions as the said Individual Trustee, in his or her sole and absolute discretion, shall determine and fix even to the extent of directing the payment of the entire trust estate to one of said parties. The written direction of the said John S. Phipps [the grantor’s husband] may be contained in his last will and testament, anything herein to the contrary notwithstanding. *Id.*

\(^9\) *Id.* The grantor’s husband (as co-trustee) delivered written instructions to the corporate trustee to transfer the trust estate to the individual and the corporate trustee in trust for the benefit of the descendants of the original donor with the exception that provision be made for the payment of an income to wife of the beneficiary John H. Phipps [the grantor’s son and primary trust beneficiary], if he (John H. Phipps) should so provide in his will. *Id.*

\(^10\) *Id.*

\(^11\) *Id.* “The corporate trustee being in doubt as to whether or not the action of the individual trustee was within the scope of his powers granted in the original trust indenture brought this suit in equity praying for a construction of the original trust indenture with respect to its duties.” *Id.* All the trust beneficiaries and their children (i.e., grandchildren of the grantor) were named as defendants. *Id.*
court approved the proposal and one of the grantor's children appealed. The Florida Supreme Court posited the issue thusly: "May an individual and a corporate trustee clothed with absolute power to administer a trust estate in the interest of designated beneficiaries create a second trust estate, for the benefit of said beneficiaries at such time and in the manner determined by the individual trustee?" and answered the question in the affirmative after examining prior case law and the Restatement of Trusts.

The court concluded: "[T]he power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent." Essentially, the Florida court reasoned, the trustees held a special power of appointment. Therefore, the court affirmed the lower court's decision.

**B. SPENCER**

*In re Estate of Spencer* involved the construction of the will of Fern Spencer who died in 1944. Fern owned a quarter section of farmland; her
husband owned the other three quarter sections of the same section of land.\textsuperscript{19} Her will left her children a lifetime interest in trust, with the remainder to her grandchildren outright, funding the trust with a quarter section of Greene County, Iowa farmland and granted her husband/trustee a special power of appointment over the property to be exercised when he made a distribution of his own three quarter sections of farmland in the same manner.\textsuperscript{20} The case—like \textit{Phipps}—involved the judicial construction of the extent and breadth of a power of appointment held by a trustee/beneficiary when exercised in favor of a second trust.\textsuperscript{21}

Her husband survived her for 28 years, dying in 1972.\textsuperscript{22} When he died, his will purported to exercise the power of appointment by devising his wife's quarter section, along with his own three quarter sections, to a trust for his children to extend as long as the rule against perpetuities would permit.\textsuperscript{23} The

\begin{itemize}
\item \textsuperscript{19} \textit{Id.} at 493.
\item \textsuperscript{20} \textit{Id.} No oral evidence was introduced. \textit{Id.} at 492. A guardian \textit{ad litem} was appointed by the trial court to represent the interests of minor grandchildren. \textit{Id.} Fern's will provided in relevant part:

\begin{quote}
I hereby nominate [my husband] as Trustee, without bond, of [Fern's quarter section of farmland] and authorize and direct my said Trustee to take charge of said real estate on March 1, 1945, and to rent and manage the same during his lifetime or until such time as he makes distributions of his individual property, among his children, as hereinafter provided, such rents * * to be paid to my said children . . . to share equally in the income thereof . . . My said husband, L.J. Spencer, being the owner of [the other three quarters of the same section], except the Northeast Quarter (NE\textsuperscript{4}) thereof, which is owned by me, and it being the intention of both myself and my husband, that the entire of said Section Four remain in the family for the benefit of our said children; and therefore, pursuant to the purpose of both myself and my said husband, it is my will and I hereby direct that my said husband L. J. Spencer be and he is hereby, authorized and directed, either by his last will and testament or by deeds executed by him prior to his death, to dispose of (my real estate) * * * to my said children hereinbefore named, if living, and to the survivors of any of my said children if deceased, leaving no child or children of his or her own body, in connection with [sic] the disposal of the balance of the lands in said Section Four (4) . . . all of which shall be disposed of by him as a general disposition among said children, it being understood hereby that the said L. J. Spencer shall only dispose of said (real estate) * * * along with his land above referred to, and constituting the entire of said Section Four (4) in the equitable disposition of the entire of said Section Four (4) among said children, as he, in his judgment, finds best, and it being understood hereby that the said L. J. Spencer, in making disposition of said property among said children, shall dispose of the same to said children, granting of a life estate to such children with the remainder going to the survivors of such child or children of his or her own body. And further providing that in the event of the decease of any of said children prior to the division thereof, without leaving any issue by his or her own body then and in that event the life estate in said Northeast Quarter of Section Four and the life estate in the entire of said Section Four shall be granted to the survivors of said children, with the remainder in the children of said survivors respectively, it being the intention hereby that no power is granted to the said L. J. Spencer to dispose of said Northeast Quarter of said Section Four, except in the manner herein provided for in the equitable distribution of the entirety of said Section Four among my children as hereinbefore specified.

\textit{Id.} at 493-94.
\item \textsuperscript{21} \textit{See} JULIE L. PULKRABEK & GARY J. SCHMIT, 13 Iowa Practice Series (Probate) § 12.11 n.16 (2009) (referencing \textit{Spencer} as a construction of a power of appointment case).
\item \textsuperscript{22} \textit{Spencer}, 232 N.W.2d at 494.
\item \textsuperscript{23} \textit{Id.} The husband's will provided:

I hereby give, devise and bequeath unto the Trustee, hereinafter named, all of my real estate of every kind, nature and description, including land owned by me in Humboldt County and Greene County, Iowa, or wherever situated and in particular in this connection, I direct that the trust shall include the 160 acres of land * * * which was property owned by my wife, Fern Spencer, and as to which real estate I have under her Will, a power of appointment to dispose of
trial court found that the attempted exercise of the power of appointment by use of a trust exceeded the terms of the power and was therefore invalid. Thus, the trial court concluded Fern’s quarter section must pass by intestacy (since Fern’s will lacked a residuary clause) to the couple’s four adult children outright as tenants in common.

The Iowa Supreme Court reversed in part. The court framed the issue presented as whether a special power of appointment could be exercised so as to appoint property in trust. The court concluded that Fern’s will did not plainly prohibit the trustee from exercising the special power of appointment in favor of a trustee. Therefore, it held, the power could be exercised by appointing property in further trust. But the court squared the limitations in the powers of appointment with the multi-generational term of the trust created in her husband’s will by holding that the trust would terminate and vest final

either by Deed or Will.

(b) The trust herein created is equally for the benefit of my four children, * * * and their legal heirs in the event of their death, and in the event that any of my children should die, leaving children, then and in that event, said children shall take the share which would ordinarily have gone to their parents. If any child of mine dies without leaving a child of their own, the share shall be divided between my other living children. * * *

(e) Any sums remaining on hand after the establishment of the working balance, as hereinbefore provided, * * * shall be divided by the trustee into four equal shares to be held by the trustee for the use and benefit of each of my children during their lifetime

(h) The trust shall continue for the longest period permitted by law, which I understand to be that the trust can continue until the death of the last of the persons in being at the time of my death, who will take under this Will, plus 21 years. I would think, therefore, that this trust could and will continue to be in full force and effect, for as long as any of my children or great grandchildren or any of their descendants who are alive at the time of my death, plus 21 years. The trustee shall continue to make payments to the persons entitled thereto, upon the same basis as to my children during their lifetime. In the event that the law should be changed in any way extending the time that a trust might legally be in force, I hereby establish said trust for such longer period that the law permits. The trust contemplated hereunder is to be a legal trust complying fully with the laws of the State of Iowa, and the Court shall construe this Will to be a trust for as long a period as is legally possible, at the time that the trust would normally terminate, it is my wish that the persons benefiting under the trust, shall voluntarily extend the trust for a longer period.

Id.

24. Id. at 494.

25. Id. at 495. Part of the trial court’s ruling also rested on a determination that the husband’s attempted exercise of the power of appointment violated Iowa’s rule against perpetuities. Id. The Iowa Supreme Court did not reach that issue. Id. at 499.

26. Id. at 498. “We hold . . . the exercise was partially valid and partially void.” Id. The Iowa Supreme Court cited Phipps in reaching its decision. Id. at 496-97 (citing Phipps v. Palm Beach Trust Co., 196 So. 299, 301 (Fla. 1940)).

27. Id. at 495. “[D]id [the husband] exceed his authority by exercising his power of appointment in establishing a trust instead of making outright provision for the beneficiaries?” Id. The court also framed the issue as: “the ultimate question as to whose will-L.J.’s or Fern’s-shall govern disposition of this land.” Id. “Of course, it is Fern’s wishes which govern.” Id. “[T]he prime question [is] Fern’s intent.” Id. at 497.

28. Id. at 497. “We find nothing in Fern’s will to ‘manifest a contrary intent’ and we hold L.J.’s exercise of the power of appointment by designating a trustee to carry out Fern’s intent was valid.” Id. To that extent, the Iowa Supreme Court reversed the lower court’s decision. Id.

29. Id.
distributions to the grandchildren at the death of the couple's children.\textsuperscript{30}

If \textit{Spencer} is read narrowly, it stands for the proposition that when a trustee is granted a special power of appointment, the power can be exercised by either appointing property outright or in trust so long as the grant of the power does not expressly prohibit it. Read more expansively, it would authorize a trustee to decant trust property to a new trust unless plainly prohibited by the terms of the original trust.

\textbf{C. \textit{WIEDENMAYER}}

In \textit{Wiedenmayer v. Johnson},\textsuperscript{31} John Seward Johnson had established a trust for one of his six children in 1944, funding it with Johnson & Johnson common stock.\textsuperscript{32} By 1969, the value of the trust in question was $18 million.\textsuperscript{33} The trust directed the Trustees to distribute to the trust beneficiary, John Seward Johnson, Jr., any or all trust property “from time to time and whenever in their absolute and uncontrolled discretion they deem it to be for his best interests” with the remainder at the beneficiary’s death to his children.\textsuperscript{34} The parties in the action included John Seward Johnson, Jr., the Trustee, and a guardian \textit{ad litem} who had been appointed to represent the beneficiary’s two minor children.\textsuperscript{35}

The Trustees proposed to distribute the trust estate to the trustees of a new “substituted” trust for John Seward Johnson, Jr., without the contingent remainder interest to his children.\textsuperscript{36} In fact, the opinion suggests, the Trustees conditioned distributions upon the beneficiary “setting up a substituted trust” after determining that this was in the beneficiary’s best interests on account of his “matrimonial problems, divorce and the consequences thereof.”\textsuperscript{37} The court approved the Trustees’ request, reasoning that if the Trustees could distribute to the beneficiary, they could also “to safeguard the son’s best interests, condition the distribution upon his setting up a substituted trust.”\textsuperscript{38} Presumably, the substituted trust incorporated stronger spendthrift provisions and creditor protections for the beneficiary as against his estranged spouse. More significantly, however, the Trustee had concluded that the beneficiary’s peace of mind would be promoted if his children were disqualified as potential residual

\begin{footnotes}
\footnotetext[30]{Id. at 498. The court concluded:
We hold L.J.’s exercise of the power of appointment was valid in establishing a trust to carry out the life estate granted to the four children of L.J. and Fern. We hold the appointment invalid in attempting to circumvent the direction that the remainder, after the termination of the life estates, vest as heretofore set out. To that extent the exercise of the power was void.}
\footnotetext[32]{Id.}
\footnotetext[33]{Id. at 535.}
\footnotetext[34]{Id.}
\footnotetext[35]{Id.}
\footnotetext[36]{Id. at 536.}
\footnotetext[37]{Id. The court noted that the beneficiary was “satisfied with that condition.” Id.}
\footnotetext[38]{Id.}
\end{footnotes}
beneficiaries under the terms of the new trust. 39

The court considered, but ultimately dismissed, the interests of the contingent remainder interests held by the beneficiary’s two children under the original trust, stating:

if distribution of the Corpus of the trust were made to the son absolutely, as permitted within the unqualified discretion of the trustees, as opposed to the challenged distribution subject to the condition imposed, the same loss of the contingent remaindermen’s interest would equally be effected. Thus, these children are not suffering by this approved new setup the loss of any vested remainder interest.

The majority hung its hat on honoring the grantor’s intention to provide first and foremost for the “best interests” of his son and deferred to the Trustee’s analysis of those interests. 41

The dissent of Justice Conford helps illuminate the potential controversy of trust decanting as well as its true breadth and power, which the majority minimized in justifying the results its decision reached. “I do not believe that what the trustees propose to do constitutes a distribution at all, within the fair intent of the trust instrument, but rather an impermissible alteration of the substantive trust terms,” he begins. 42 Justice Conford pointed out that the Trustee had determined that distributing all net income (recall: on a corpus of $18 million in 1969 dollars) was adequate for the beneficiary’s needs, and that the Trustee had no intention of exercising its discretion to distribute any principal to the beneficiary outright, since it would have been beyond the beneficiary’s needs. 43

39. See id. at 537 (Conford, J., dissenting). “And this charade is approved solely in order to promote [the beneficiary]’s present peace of mind in knowing that [his children] are forever and irrevocably disqualified as potential sharers in the settlor’s disposition.” Id.

40. Id. at 536 (majority opinion).

41. Id. The court clearly found that “best interests” was an expansive mandate to the trustee:

The son’s “best interests” is not defined in his father’s trust indenture. The expression is not limited to a finding that distribution must be to the son’s best “pecuniary” interests. His best interests might be served without regard to his personal financial gain. They may be served by the peace of mind, already much disturbed by matrimonial problems, divorce and the consequences thereof, which the new trust, rather than the old contingencies provided for in his father’s trust indenture, will engender. Of what avail is it to rest one’s “best interests” on a purely financial basis, and without regard to the effect upon a man’s mind, heart and soul, if the end result would produce a wealthier man, but a sufferer from mental anguish? The creator of this Inter vivos trust was obviously concerned primarily with his son’s best interests. The interests of others were important, but they were only secondary in relation to the son. Courts may not substitute their opinions as to the son’s “best interests,” as opposed to the opinion of the trustees vested by the creator of the trust with the “absolute and uncontrolled discretion” to make that determination.

Id. at 536. Interestingly, the majority opinion fails to cite any authority whatsoever, whether case law, statutes, Restatements or secondary authority. See id. at 535-36.

42. Id. at 536 (Conford, J., dissenting).

43. Id. at 537. Justice Conford’s dissent also suggests that what the Trustee was proposing was not, in fact, a trust decanting, as such, but rather:

to distribute the trust estate to [the beneficiary], but expressly conditioned upon his simultaneously executing an irrevocable trust of the whole estate back to the trustees on the identical trust terms, insofar as control of distribution of the trust principal to Seward thereafter is concerned, and otherwise significantly altered from the original trust terms primarily to cut
Both the dissent and the majority, however, appeared to agree that the issue presented was the construction and breadth of a trustee's distribution powers, implied or otherwise, by the terms of the trust. Wiedenmayer is essentially the construction of a trustee's power to make distributions for a beneficiary's "best interests." Unlike Spencer and Phipps, there was not a specific power of appointment vested in a trustee/beneficiary to be analyzed. In Spencer and Phipps, the courts were construing a power held by a beneficiary. In Wiedenmayer, the power to "decant" into a second trust is considered for the first time as an implied trustee distribution power.

D. RESTATEMENT

The position of the Restatement (Second) of Property is that the holder of a power of appointment may appoint property in further trust, so long as the scope of the power does not specifically prohibit it. Thus, if there is a power to appoint property to a distributee outright, there is generally also the power to appoint property to a trust with the distributee as beneficiary.

A trustee's power to invade the principal of a trust estate and distribute it to one or more beneficiaries is categorized as a limited power of appointment. Thus, it stands to reason that a trustee with power to invade trust principal has the power to either distribute outright to a beneficiary or to another trust with beneficial rights for the beneficiary of the first trust. This reasoning underlies the case law that recognizes the existence of trustee decanting powers under a common law analysis. The Restatement notwithstanding, authority was actually split on the question of whether—absent on-point case law or statutory

out [the beneficiary's children] as eligible contingent remaindermen after [the beneficiary]'s life estate or as eligible appointees under [the beneficiary]'s power of appointment by will. There is no question whatever that the trustees would not transfer anything to [the beneficiary] without the simultaneous transfer back by him in trust.

44. Compare Wiedenmayer, 254 A.2d at 535-36 (construing the trustee's power to distribute in the son's best interests) with id. at 537 (complaining: "What concerns me is that there has neither been, nor proposed, any distribution, but only going through the motions of one.") (Conford, J., dissenting).

45. See id. at 536 (majority opinion).

46. See id. at 535 (stating that "[o]ur concern is with the power given to the trustees").

47. RESTATEMENT (SECOND) OF PROPERTY § 19.3 (1986). "Unless the donor has manifested a contrary intent, a donee of a non-general power is permitted to make any appointment that benefits only objects of the power that the donee could make of owned property in favor of those objects." Id.

48. RESTATEMENT (SECOND) OF PROPERTY § 11.1, cmt. d (1986). Section 11.1 states: "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." Comment d speaks to a Trustee's discretionary power as a power of appointment:

The trustee of a trust may be given discretion to invade principal for a life income beneficiary, or for some other person, or discretion to pay income or principal to a named beneficiary, or discretion to spray income or principal among a defined group of beneficiaries. The discretion given to the trustee gives the trustee the power to designate beneficial interests in the trust property. Though the trustee has the legal title to the trust property, such ownership is not beneficial ownership so far as the trustee is concerned. Consequently, the trustee holding a discretionary power has a power of appointment as defined in this section.

Id.
authorization—the holder of a limited power of appointment could appoint in further trust. 49

E. UNIFORM TRUST CODE

Twenty-three states including Nebraska, Wyoming, and North Dakota have now adopted some version of the Uniform Trust Code. 50 The Uniform Trust Code (UTC) was completed by the Uniform Law Commissioners in 2000, with amendments in the following years. The model UTC recognizes expanded possibilities for amending, modifying, and reforming irrevocable trusts, with or without court approval. Some states have restricted this liberalizing attitude of the model act in their final versions of the act. The UTC does not expressly outline a decanting process.

IV. SOUTH DAKOTA STATUTORY BASIS

South Dakota’s statutory framework for decanting was adopted in 2007, with slight modifications occurring in 2008 and 2009. 51 The framework is now contained within seven statutes, beginning with S.D.C.L. section 55-2-15, and codified within chapter 55-2 under the title “Duties and Liabilities of Trustees.” The statutes were seemingly modeled after Delaware’s decanting statutes and the bill was officially introduced by, inter alia, Senator Dave Knudson. 52 The Act as proposed was titled “An Act to Permit Trustees to Decant a Trust under Certain Circumstances” and introduced as House Bill 1288. 53 The word “decant” does not otherwise appear in the legislation. The bill passed both houses unanimously, but for a single “nay” vote from Senator Bill Napoli of Rapid City. 54

The South Dakota decanting statutes effectively grant trustees of irrevocable trusts the discretion to make a distribution to a beneficiary to exercise that authority by appointing trust assets to a new trust. 55 The “first

49. CHARLES E. ROUNDS, JR., LORING: A TRUSTEE’S HANDBOOK 279 (2000), (citing 1 SCOTT ON TRUSTS § 17.2 n.5); see In re Estate of Spencer, 232 N.W.2d 491, 496-97 (Iowa 1975) (citing decisions holding an appointment in trust to be a permissible exercise of a special power of appointment, as well as citing contrary holdings). After citing these two contrary lines of authority, the Spencer court concluded: “None of these cases fits our pattern perfectly. Perhaps the only lesson to be learned from them is that each case must turn on its own peculiar facts.”Id. at 497.


52. Legislative Research Council, http://legis.state.sd.us/sessions/2007/1288.htm (last visited Jan. 12, 2010). The bill was introduced by Representatives Cutler, Dykstra, Feinstein, Krebs, Nygaard, Olson (Russell), Olson (Ryan), Peters, and Rave and Senators Gray, Abdallah, Dempster, Gant, Knudson, and Peterson (Jim). Id.

53. Id.

54. Id.

55. S.D.C.L. § 55-2-15 (2009). The text of the statute provides:

Unless the terms of the instrument expressly provide otherwise, a trustee who has discretionary authority, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, to make a distribution of income or principal to, or for the benefit of, one or more beneficiaries of a
“trust” must, by its terms, grant its trustee “discretionary authority” to make a
distribution (of income or principal) to (or for the benefit of) a beneficiary. There are a number of exceptions to a trustee’s ability to exercise such a power, which are primarily concerned with preserving federal estate and gift tax objectives in the original trust and which are discussed in greater detail below. So long as none of the exceptions to the exercise of the power are present, however, the trustee is free to appoint trust assets to a new trust, even a new trust created or administered under the laws of another state or even another country’s

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(1) The second trust may have as beneficiaries only one or more of those beneficiaries of the first trust to or for whom a discretionary distribution may be made from the first trust and who are proper objects of the exercise of the power, or one or more of those other beneficiaries of the first trust to or for whom a distribution of income or principal may have been made in the future from the first trust at a time or upon the happening of an event specified under the first trust;

(2) No trustee of the first trust may:

(a) Exercise such authority to make a distribution from the first trust if the trustee is a beneficiary of the first trust, or if any beneficiary may change the trustees of the first trust, unless the exercise of such authority is for health, education, maintenance, or support; or

(b) Exercise such authority to the extent that doing so would have the effect either of (i) increasing the distributions that can be made in the future from the second trust to the trustee of the first trust or to a beneficiary who may change the trustees of the first trust, or (ii) removing restrictions on discretionary distributions imposed by the agreement under which the first trust was created, except that in either case participating in a change that is needed for the health, education, maintenance, or support of any such beneficiary is permitted;

However, the provisions of subdivision (2) only apply to restrict the authority of a trustee if either a trustee, or a beneficiary who may change the trustee, is a United States citizen or domiciliary under the Internal Revenue Code, or the first trust owns property that would be subject to the United States estate or gift taxes if owned directly by such person.

(3) In the case of any trust contributions which have been treated as gifts qualifying for the exclusion from gift tax described in § 2503(b) of the Internal Revenue Code of 1986, by reason of the application of I.R.C. § 2503(c), the governing instrument for the second trust shall provide that the beneficiary’s remainder interest shall vest no later than the date upon which such interest would have vested under the terms of the governing instrument of the first trust;

(4) The exercise of such authority may not reduce any income interest of any income beneficiary of any of the following trusts:

(a) A trust for which a marital deduction has been taken for federal tax purposes under I.R.C. § 2056 or §2523 or for state tax purposes under any comparable provision of applicable state law;

(b) A charitable remainder trust under I.R.C. § 664; or

(c) A grantor retained annuity trust under I.R.C. § 2702;

(5) The exercise of such authority does not apply to trust property subject to a presently exercisable power of withdrawal held by a trust beneficiary to whom, or for the benefit of whom, the trustee has authority to make distributions, unless after the exercise of such authority, such beneficiary’s power of withdrawal is unchanged with respect to the trust property;

(6) The exercise of such authority is not prohibited by a spendthrift clause or by a provision in the trust instrument that prohibits amendment or revocation of the trust.

Id. 56. Id.
DECANTING AND ITS ALTERNATIVES

jurisdiction, so long as the initial trust is not extended beyond any applicable termination date.\textsuperscript{57}

If a trustee is prohibited from exercising the power to decant (because, for example, the trustee is also a trust beneficiary), then a co-trustee or successor trustee may exercise the decanting power.\textsuperscript{58} South Dakota statutes clarify that the exercise of the power to decant is to be considered the exercise of a power of appointment, but not an exercise of a general power of appointment to the trustee individually.\textsuperscript{59} Another statute also clarifies that the newly enacted statutory framework for trust decanting is not intended to displace or abridge a trustee’s existing common law power to decant, or any power to decant that may be granted under the terms of the trust itself.\textsuperscript{60}

The power to decant is subject to several exceptions and limitations set forth in S.D.C.L. section 55-2-15. First, as mentioned above, a trustee who is also a beneficiary of the first trust cannot decant.\textsuperscript{61} A trustee also lacks the power to decant “if any beneficiary may change the trustees of the first trust, unless the exercise of such authority is for health, education, maintenance, or support.”\textsuperscript{62} A beneficiary is deemed to have the power to change trustees only if the beneficiary can—alone or jointly with others—name the beneficiary himself as trustee, or name a trustee who is a related or subordinate party.\textsuperscript{63}

The procedural process by which a trustee can exercise the power to decant is straightforward.\textsuperscript{64} The process does not require judicial approval, but does

\begin{thebibliography}{99}
\bibitem{57} S.D.C.L. § 55-2-16 (2009); S.D.C.L. § 55-2-20 (2009). S.D.C.L. section 55-2-20 provides:
The power under § 55-2-15 may not be exercised to suspend the power to alienate trust property or extend the first trust beyond any applicable termination date under the terms of the instrument of the first trust or the permissible period of any rule against perpetuities applicable to the first trust.
\bibitem{58} S.D.C.L. § 55-2-16 (2009). The text of the statute provides:
Any action that may not be taken by a trustee of the first trust by reason of the restrictions in subdivision 55-2-15(2) may instead be taken by any other trustee of the first trust who is not so restricted, or, if none, by the next available party who can be a successor trustee and who is not so restricted. The second trust may be a trust created or administered under the laws of any jurisdiction, within or without the United States. \textit{Id.}
\bibitem{59} S.D.C.L. § 55-2-19 (2009). The statute provides: “The exercise of the power to distribute the income or principal of the trust under § 55-2-15 shall be considered the exercise of a power of appointment (other than a power to appoint to the trustee, the trustee’s creditors, the trustee’s estate, or the creditors of the trustee’s estate).” \textit{Id.}
\bibitem{60} S.D.C.L. § 55-2-21 (2009). The statute provides: “No provision of §§ 55-2-15 to 55-2-20, inclusive, may be construed to abridge the right of any trustee who has the power to distribute income or principal in further trust which arises under statute, common law, or the terms of the first trust.” \textit{Id.}
\bibitem{62} \textit{Id.}
\bibitem{63} S.D.C.L. § 55-2-17 (2009). The text of the statute provides:
For the purposes of § 55-2-15, a beneficiary shall be considered to have the power to “change the trustees” if he or she can, alone or with others, name himself or herself as a trustee or can remove a trustee and replace that trustee with a new trustee who is the beneficiary or who is related or subordinate (as defined in § 672 of the I.R.C.) to the beneficiary. \textit{Id.}
\bibitem{64} S.D.C.L. § 55-2-18 (2009). The text of the statute provides:
The exercise of the power to distribute the income or principal of the trust under § 55-2-15 shall be by an instrument in writing, signed and acknowledged by the trustee and filed with the
\end{thebibliography}
require twenty days written notice to the beneficiaries prior to the exercise of the
power, unless notice is waived.\textsuperscript{65} Nothing prohibits a trustee from seeking
judicial approval, which may, in many cases, be warranted for various reasons.

V. ALTERNATIVES TO DECANTING

It seems likely that one of the reasons there has not been a great deal of
discussion or excitement about the enactment of South Dakota's trust decanting
statutes is that—unlike certain other states—South Dakota already had a
comprehensive and flexible statutory framework for making changes to
irrevocable trusts.\textsuperscript{66} Non-judicial reformation especially has provided a useful
means by which scrivener's errors can be corrected, administrative provisions
inserted, or even dramatic changes undertaken with irrevocable trusts. Thus,
where in other statutory trust decanting states the decanting procedure may be
frequently relied on in making reformations and modifications to irrevocable
trusts, its use in South Dakota is expected to be less frequent on account of the
other vehicles (briefly discussed below) that were already available, and remain
so today.

A. REFORMATION

Non-judicial reformation of an irrevocable trust is recognized in two
scenarios. First, an irrevocable trust may be modified for any reason with the
consent of the trustor and all of the beneficiaries.\textsuperscript{67} Second, if the trustor is
deceased, unwilling or unable to participate in a modification, an irrevocable
trust may still be modified with the consent of all the beneficiaries so long as
continuance of the trust on its existing terms is not necessary to carry out a
material purpose of the trust.\textsuperscript{68} The statute does not expressly require the
consent of the beneficiaries to be in writing. The definition of a "material
purpose" is not found in the statute, nor—at least yet—in the case law.

If one or more of the beneficiaries do not consent to a proposed

\begin{quote}
records of the trust. The trustee of the first trust shall notify all beneficiaries of the first trust, in
writing, at least twenty days prior to the effective date of the trustee's exercise of the power
under § 55-2-15 (applying the South Dakota Virtual Representation Statutes, §§ 55-3-31 to 55-
3-38, inclusive). If all beneficiaries entitled to notice waive the notice requirement by a signed
writing delivered to the trustee, the trustee may exercise the power under § 55-2-15
immediately. A copy of the proposed exercise of this authority and the second trust agreement
shall satisfy this notice obligation. For the purposes of this section, the term, beneficiaries,
means those persons who would be entitled to notice and a copy of the first trust instrument
under § 55-2-13.
\end{quote

\textsuperscript{65} Id.

\textsuperscript{66} See generally Charles D. Fox, How "Revocable" is "Irrevocable"? Obtaining Flexibility in
Irrevocable Trusts, 33 Ohio N.U. L. REV. 943 (2007); Walker, supra note 4 at 443.

\textsuperscript{67} S.D.C.L. § 55-3-24 (2004). "Whether or not continuance of the trust on its existing terms is
necessary to carry out a material purpose, an irrevocable trust may be modified or terminated upon the
consent of the trustor and all of the beneficiaries." Id.

\textsuperscript{68} S.D.C.L. § 55-3-24 (2004). "An irrevocable trust may be modified or terminated upon the
consent of all of the beneficiaries if continuance of the trust on its existing terms is not necessary to carry
out a material purpose." Id.
reformation, the court's approval may be secured if the rights of the non-consenting beneficiaries are not significantly impaired. This allows judicial reformation in the court's discretion over the objection of one or more beneficiaries so long as their rights are not adversely affected.

Two other circumstances where judicial reformations can be sought are also set forth. First, reformation can be secured where circumstances not anticipated by the trustor have arisen and modifying the trust would substantially further the trustor's purposes in creating the trust. Second, reformation can be secured "to conform to the trustor's intention if the failure to conform was due to a mistake of fact or law and the trustor's intent can be established." Thus, even if a non-consenting beneficiary's rights will be adversely affected by a proposed reformation, the court can still order a trust modification if either unanticipated circumstances or a mistake of law or fact can be established. This gives the court discretion, for example, to add trust provisions that suspend distributions to a beneficiary who is suffering from addictions if the trustor did not anticipate the beneficiary's particular circumstances, or even to extend the term of the trust beyond its applicable termination date—something impermissible under the decanting statutes.

Finally, S.D.C.L. section 55-3-30 recognizes that the foregoing options for modifying and terminating irrevocable trusts are not the exclusive means available to trustees, trustors, and beneficiaries. Thus, common law or the trust itself may provide additional mechanisms for amending irrevocable trusts. The only reported case that appears to have been issued since the enactment of the reformation statutes in 1998 disposed of the reformation request on the basis of the doctrine of laches.

69. S.D.C.L. § 55-3-25 (2004). The statute provides in part:
If any beneficiary does not consent to a requested modification or termination of a trust . . . the court, with the consent of the other beneficiaries, and of the trustor, if required, may approve a requested modification or partial termination if the rights or interests of the beneficiaries who do not consent are not significantly impaired or adversely affected.

Id. This statute also permits a trustor, a trustee, or a beneficiary to seek court affirmation of a proposed trust reformation that meets the requirements of S.D.C.L. section 55-3-24 (i.e., either the trustor has joined the consent of all beneficiaries, or continuance of the trust on its existing terms is unnecessary to carry out a material purpose). The statutes do not explicitly recognize the validity of non-judicial reformations, but the statutes can be fairly interpreted to mean that seeking court affirmation of S.D.C.L. section 55-3-24 reformation is permissive rather than mandatory.

70. S.D.C.L. § 55-3-26 (2004). "[T]he court may modify the administrative or dispositive terms of the trust or terminate the trust if, because of circumstances not anticipated by the trustor, modification or termination of the trust would substantially further the trustor's purposes in creating the trust." Id. Such a petition may be brought by a trustee or a beneficiary, but not by the trustor. Id.

71. S.D.C.L. § 55-3-28 (2004). Such a petition can be brought by a trustee or a beneficiary, but not by the trustor. "The terms of the trust may be construed or modified, in a manner that does not violate the trustor's probable intention, to achieve the trustor's tax objectives." Id.


73. In re Administration of C.H. Young Revocable Living Trust, 2008 SD 43, 751 N.W.2d 715. The following year, the South Dakota legislature adopted S.D.C.L. section 55-3-29.1, which effectively overruled the Young case. The statute reads: "No beneficiary of a trust may assert the defense of laches in any proceeding to modify, reform, or terminate a trust pursuant to §§ 55-3-23 to 55-3-29, inclusive." S.D.C.L. § 55-3-29.1 (2009).
B. JUDICIAL CY PRES

Cy pres is a doctrine designed to keep a charitable trust from failing if its purpose becomes difficult or impossible to carry out. South Dakota expressly recognizes charitable trust for any charitable, religious, educational, benevolent, or public use, even if specific charities or purposes are ill-defined, uncertain, or indefinite in the trust document. Stated another way, vague and poorly conceived trusts with any kind of charitable intention are liberally construed to carry out the donor's intent. Judicial reformation and clarification can be sought, however, by either the trustee, the attorney general, or any interested party.

In reforming a charitable trust, notice must be given to the South Dakota Attorney General's office and the trustor, whose consent must be given if he or she is then living and competent. The court can then enter an order directing the trust to be administered or distributed “in such manner as in the judgment of said court will, as nearly as can be, accomplish the general purposes of the instrument and the object and intention of the donor” free of any restriction or limitation that would otherwise interfere with the administration of the trust.

C. TERMINATION OF SMALL TRUSTS

Unless the terms of the trust prohibit it, a trustee is granted the statutory authority to terminate a trust with a trust estate of less than $50,000. This type of termination authority does not apply to charitable trusts. In addition, the trustee or beneficiary may petition the court to seek termination where the value of the trust estate exceeds $50,000, but the value of the trust estate is insufficient to justify the administrative costs being incurred.

D. COMBINATION OR DIVISION OF TRUSTS

A trustee is also given statutory authority to combine two or more trusts or divide a trust into two or more separate trusts (unless the terms of the trust prohibit it) without court approval. This statutory trustee power is arguably an earlier decanting procedure that has been available in South Dakota since its

81. Id. The court, however, is instructed to “consider the feasibility of appointing a new trustee to continue the trust.” Id.
82. S.D.C.L. § 55-3-29 (2004).
enactment by the legislature in 1998. It may be undertaken with or without court approval. 

E. NON-JUDICIAL UNITRUST CONVERSIONS

Whenever a trust provides for the distribution of the net income of a trust to one or more beneficiaries, the trustee was given the statutory power in 2002 to convert the trust to a "total return unitrust" by adopting a written policy providing for the same, sending it to the trustor and beneficiaries, and receiving no written objection within sixty days. If an objection is made or if the trustee elects, court approval for a unitrust conversion may be sought. The unitrust amount is generally three percent of the fair market value of the trust, determined annually.

F. DECLARATORY ACTIONS

An often-overlooked option for obtaining clarity in an otherwise arguably ambiguous provision in an irrevocable trust is a declaratory action. All that is generally required for a declaratory judgment action is the existence of a justiciable and ripe controversy between adverse parties. Declaratory actions in South Dakota are governed by S.D.C.L. chapter 21-24, and express authority is provided for those seeking a declaration of rights, legal relations, or construction of a trust document.

Declaratory actions can be brought by a wider class of individuals than a petition for trust reformation, but require all persons to be made parties who have an interest or claim in the matter and also require more formal notice and

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83. 1998 S.D. Sess. Laws 418-19, ch. 282, § 7. An amendment was made in 2004 to direct a court approving a combination or division of trusts to resolve any inconsistencies between the terms of the trust instruments by establishing the terms of the trust that will survive the combination or division. 2004 S.D. Sess. Laws 590, ch. 312, § 11.
84. S.D.C.L. § 55-3-29 (2004).
85. S.D.C.L. § 55-15-2 (2004). A trustee may also convert a total return unitrust back to an income trust. Id.
89. S.D.C.L. § 21-24-5 (2004). The text of the statute provides:

Any person interested as or through a personal representative, trustee, conservator, or other fiduciary, creditor, devisee, legatee, heir, next of kin, or cestui que trust in the administration of a trust, or of the estate of a decedent, minor, protected person, or insolvent, may have a declaration of rights or legal relations in respect thereto:

(1) To ascertain any class of creditors, devisees, legatees, heirs, next of kin, or others;
(2) To direct the personal representatives or trustees to do or abstain from doing any particular act in their fiduciary capacity;
(3) To determine any question arising in the administration of the estate or trust, including questions of construction of wills and other writings.

Id.
the issuance of a summons.\textsuperscript{90} A declaratory judgment that is issued by the court on a question of trust construction or otherwise has the force of a final judgment or decree.\textsuperscript{91}

G. TRUST PROTECTORS

The trust document itself can vest a trust protector with powers to amend an irrevocable trust.\textsuperscript{92} A "trust protector" is simply anyone who is appointed in the trust instrument.\textsuperscript{93} Some attorneys will name themselves as a trust protector in order to correct scrivener's errors or add tax savings language at a later date.

Because of the wide variety of judicial and non-judicial reformations, terminations, declarations, and clarifications that have been available in South Dakota for some time, the new option of trust decanting is less of a watershed event than in states without this attractive menu of options. In other states without, for example, non-judicial unitrust conversion procedures, the trust decanting process is being used for unitrust conversions. In South Dakota, it is expected that trust decanting will be utilized when it is the most appropriate vehicle for accomplishing the objectives identified relative to the other options outlined above.

\textsuperscript{90} S.D.C.L. § 21-24-7 (2004). See, e.g., Dan Nelson, Automotive, Inc. v. Viken, 2005 SD 109, 706 N.W.2d 239 (ruling that the State is an indispensable party to car dealer's declaratory action seeking an interpretation of excise tax statutes).

\textsuperscript{91} S.D.C.L. § 21-24-1 (2004).

\textsuperscript{92} S.D.C.L. § 55-1B-6 (2004 & Supp. 2009). The text of the statute provides:

The powers and discretions of a trust protector shall be as provided in the governing instrument and may be exercised or not exercised, in the best interests of the trust, in the sole and absolute discretion of the trust protector and are binding on all other persons. Such powers and discretion may include the following:

(1) Modify or amend the trust instrument to achieve favorable tax status or respond to changes in the Internal Revenue Code, state law, or the rulings and regulations thereunder;
(2) Increase or decrease the interests of any beneficiaries to the trust;
(3) Modify the terms of any power of appointment granted by the trust. However, a modification or amendment may not grant a beneficial interest to any individual or class of individuals not specifically provided for under the trust instrument;
(4) Remove and appoint a trustee, trust advisor, investment committee member, or distribution committee member;
(5) Terminate the trust;
(6) Veto or direct trust distributions;
(7) Change situs or governing law of the trust, or both;
(8) Appoint a successor trust protector;
(9) Interpret terms of the trust instrument at the request of the trustee;
(10) Advise the trustee on matters concerning a beneficiary;
(11) Amend or modify the trust instrument to take advantage of laws governing restraints on alienation, distribution of trust property, or the administration of the trust; and
(12) Provide direction regarding notification of qualified beneficiaries pursuant to § 55-2-13.

The powers referenced in subdivisions (5), (6), and (11) may be granted notwithstanding the provisions of §§ 55-3-24 to 55-3-28, inclusive.

\textit{Id.}

\textsuperscript{93} S.D.C.L. § 55-1B-1(2) (2009).
VI. OTHER STATES’ STATUTORY SCHEMES

There are currently eight states besides South Dakota which have statutorily authorized decanting: Alaska, Arizona, Delaware, Florida, Nevada, New Hampshire, New York, North Carolina and Tennessee. New York’s statutory decanting scheme was the first.94 The states’ various approaches to statutory decanting procedures differ from one another.95 A very brief summary of each follows. South Dakota’s decanting statutes have been called the most flexible of any state, and a brief comparison to other states’ statutes helps illustrate and highlight these differences.96

A. NEW YORK

Nationally known estate planning attorney Jonathan G. Blattmachr, a retired partner of New York’s Milbank, Tweed, Hadley & McCloy, drafted the first statutory decanting laws, which were enacted 18 years ago.97 The legislative history of the statutes suggested that the proposed act was merely clarifying what existing state law “would appear” to authorize.98 The proponents of the New York legislation claimed that at least arguably, decanting was already authorized under the existing common law theories underlying a trustee’s special power of appointment and the proposal was intended to codify this probable result. Blattmachr has stated that the legislation has been tremendously important in his practice and that his firm now undertakes a decanting about once a week.99

New York requires that the trustee enjoy absolute, unfettered authority to invade principal in order to decant a trust. There is no ability to decant, for example, when the trustee has the power to distribute governed by an ascertainable standard. Decanting was permitted under the 1991 version of the statutes if the power was exercised in favor of the beneficiaries of the trust; in 2001, New York amended its statutes to replace “beneficiaries of the trust” with “proper objects of the exercise of the power.”100

New York (along with Alaska and Tennessee) prohibits the reduction of any fixed income interest. New York recognizes that the power to decant is a special power of appointment held by the trustee and requires notice to the beneficiaries, along with filing an instrument, which acknowledges the trustee’s actions with the court. Neither New York nor any other state requires judicial

94. N.Y. EST. POWERS & TRUSTS LAW § 10-6.6 (McKinney 2002).
96. Rashad Wareh, Trust Remodeling, TRUSTS & ESTATES 18 (August 2007).
98. Halperin, supra note 5, at 9 n. 45.
100. Halperin, supra note 95. See N.Y. EST. POWERS & TRUSTS LAW § 10-6.6 (McKinney 2002).
approval, except New York does require judicial approval to increase trustee fees in the new trust.\textsuperscript{101} New York prohibits a trustee from exercising the decanting power to exonerate the trustee from its standard of care, or to make conclusive fixations of value for distribution or allocation purposes.

**B. ALASKA**

Alaska followed New York's lead by enacting the country's second statutory framework for trust decanting seven years after New York's initial statutes in 1998.\textsuperscript{102} Alaska permits decanting by a trustee who has any power to distribute principal, but requires that the standard for accessing principal in the new trust be no more expansive than the standard in the original trust.

**C. DELAWARE**

In 2003, Delaware became the third state to adopt trust-decanting statutes.\textsuperscript{103} Delaware allows a trustee to decant if the trustee possesses any discretionary authority to invade principal. Delaware—like South Dakota—provides that the decanting power does not apply to trust property presently subject to a withdrawal power and cannot reduce an income right for which a marital deduction was claimed. Delaware also specifically allows a trustee to grant a special or general power of appointment to a beneficiary of the new trust.

**D. TENNESSEE**

Tennessee was the fourth state to enact trust-decanting statutes, making them a part of its state UTC in 2004.\textsuperscript{104} Following Delaware, Tennessee permits a trustee to decant if the trustee has any discretionary power to invade trust principal. The decanting power can only be exercised in favor of one or more of the "proper objects" of the trustee's power and cannot be exercised where it would result in a violation of Tennessee's rule against perpetuities.

**E. FLORIDA**

Florida adopted its trust decanting statutes the same year as South Dakota, in 2007.\textsuperscript{105} Florida, like New York, requires that the trustee possess absolute power to invade principal before decanting can be considered. Florida provides that a power to invade principal for the best interests, welfare, comfort, or happiness amounts to an absolute power to invade. Florida provides that all of the beneficiaries of the new trust may only include beneficiaries of the existing trust. Florida also provides for an extended notice period and provides a method by which beneficiaries can waive notice.

\textsuperscript{101} N.Y. EST. POWERS & TRUSTS LAW § 10-6.6(c) (McKinney 2002).
\textsuperscript{102} ALASKA STAT. § 13.36.157 (2008).
\textsuperscript{103} DEL. CODE ANN. tit. 12, § 3528 (2007).
\textsuperscript{105} FLA. STAT. ANN. § 736.0417 (West 2010).
F. NEW HAMPSHIRE

The year after Florida and South Dakota adopted trust-decanting statutes, New Hampshire followed suit.\footnote{N.H. REV. STAT. ANN. § 564-B:4-418 (LexisNexis 2009).} New Hampshire’s statutes clarify that while there is a trustee power to decant, there is no fiduciary duty to do so. The statutes also clarify that a spendthrift provision does not defeat a trustee’s power to decant.

G. ARIZONA

Arizona encapsulates its trust decanting power in a single straightforward statute.\footnote{ARIZ. REV. STAT. ANN. § 14-10819 (2009).} The statute permits a trustee who has the discretion to make distributions for the benefit of a beneficiary (whether or not a standard is imposed) to appoint part or all of the trust estate in favor of a trustee of a new trust with or without court approval. The exceptions to this trustee power include not reducing any fixed income interests and not adversely affecting the tax treatment of the trust, the settlor, or the beneficiaries.

H. NORTH CAROLINA

North Carolina, like Arizona, codified its new trust decanting power into a single, yet lengthier statute, as an additional trustee power within its version of the UTC.\footnote{N.C. GEN. STAT. § 36C-8-816.1 (2009).} North Carolina clarifies that the Trustee power exists “whether or not there is a current need to distribute principal or income under any standard provided in the terms of the original trust instrument” but prohibits accelerating a beneficiary’s future beneficial interest in the first trust to a present interest in the second trust.

Reportedly, Colorado, Ohio and Pennsylvania are currently considering enacting trust-decanting statutes.\footnote{Jennie Cherry & Rashad Wareh, State Law Allows Modification of Irrevocable Trusts, International Law Office Newsletter, http://www.internationallawoffice.com/Newsletters/detail.aspx?g=4a8389b9-4843-40af-a22b-0921a6a3d55f (last visited Jan. 22, 2010).} The author has heard unofficial reports that the National Conference of Commissioners on Uniform State Laws (NCCUSL) may be considering the adoption of a uniform decanting act.

VII. HOW TO DECANT (IN SOUTH DAKOTA)

Decanting under South Dakota law need not be approved by a court, nor by the beneficiaries. The only steps required are 20 days notice to the beneficiaries and making a written record of the decanting in the trust records.\footnote{S.D.C.L. § 55-2-18 (2009).} In some cases, the Trustee may consider obtaining written waivers and releases from beneficiaries, but in cases where implied gifts by beneficiaries may result, express beneficiary consent or direction should be avoided even where it can
give the Trustee a measure of liability protection. Conceivably, beneficiary consent should also be approached with caution where a shifting of beneficial interests could arguably be subject to being invalidated as a fraudulent transfer.

A. OPTIONAL COURT SUPERVISION

Seeking judicial approval of a trustee’s decision to decant is optional. However, circumstances may suggest benefits to be obtained from receiving the court’s blessing, especially where Virtual Representation (discussed below) warrants court approval or where express beneficiary consent to the proposal is being intentionally avoided. The formality of a petition with notice of hearing gives the trustee protections from a beneficiary who might later decide to challenge or question the outcome of a trust having been decanted. This gives the trustee assurances that the decision is indeed appropriate and consistent with fiduciary considerations and provides a specific time and place with the judge for any beneficiary concerns to be articulated, addressed, and laid to rest.

The great majority of trusts administered in South Dakota are not under court supervision. Accordingly, to seek judicial approval of decanting, the trust must first be brought before the court. The procedure for doing so can be coupled with the petition to approve a decanting proposal so that only one hearing is necessary. If the trustee elects, it could also file accountings for court approval along with any other trust administration matters such as the sale assets without readily ascertainable value, distribution proposals, trustee fees, and the like.

The way in which court supervision can be invoked is described in S.D.C.L. chapter 21-22. Jurisdiction is appropriate in South Dakota courts if: (1) a trustee resides in the state; (2) a beneficiary resides in the state; or (3) any part of the trust estate has its situs within the state.111 The matter should be venued in the county where the trust estate, or a part thereof, is sitused. If there is no part of the trust estate in South Dakota, then venue lies where a beneficiary resides, and if no beneficiary resides in the state, then in the county where a trustee resides.112

Petitioning the court for court supervision is as simple as filing a petition asking that the court exercise supervision.113 The court is to fix a time and place for hearing, and, upon hearing, enter an order assuming supervision unless good cause to the contrary is shown.114 Within 30 days of the hearing, the trustee is required to file: (1) a verified inventory showing a description of all trust property, valuation estimates, encumbrances, and any claims against the trust; (2) a certified copy of the trust; and (3) a verified list of the names, residences

113. S.D.C.L. § 21-22-9 (2004). Petitioning for court supervision of a trust that is not a “court trust” appears to be limited to cases where a part of the trust estate has a situs in South Dakota or there is a South Dakota trustee. Id.; but see S.D.C.L. § 21-22-2 (2004) (including trusts where a beneficiary resides in South Dakota).
and post office addresses of all beneficiaries and trustees, with ages of any minors.

If the trustee is a nonresident, the trustee is required to file an appointment of agent for service of process.\(^{115}\) If the trust document fails to waive bond for the trustee, the court must determine an appropriate bond.\(^{116}\) The bond requirement should not apply to corporate trustees, but the potential requirement of an individual trustee to file a bond acts as a deterrent against seeking court supervision.

Once court supervision is commenced, any trustee or beneficiary may petition the court as to any matter that may be relevant to the administration of the trust.\(^{117}\) Court supervision can be dispensed with, or later resumed, upon notice and hearing.\(^{118}\) If court supervision continues, however, annual accountings and a final accounting upon trust termination must be filed.\(^{119}\)

If the trust is a "court trust," then a slightly different process is required. A "court trust" is one that was "established or confirmed by the judgment, decree, or order of" any court.\(^{120}\) Arguably, a testamentary trust being funded at the conclusion of a probate proceeding would qualify as a court trust, and be subject to "automatic" court supervision, except that probates concluding by verified statement (as opposed to an order of complete settlement) do not result in any court confirmation and the scope of the court supervision chapter takes pains to except "such trusts as... probate administrations, conservatorships, and all other trusts as to which specific provision is made for court supervision."\(^{121}\) The trustee of a court trust that has a South Dakota resident trustee or trust estate assets situated in the state are required to file an inventory, beneficiary statement, and the trust within 30 days of accepting trusteeship, whereupon court supervision is deemed to commence without any action of the court.\(^{122}\)

### B. Notice and Virtual Representation

Notice within court supervision proceedings is described both in chapter 21-22 and chapter 55-3 of South Dakota Codified Laws. S.D.C.L. chapter 21-22 is a set of fairly antiquated trust administration statutes that also describe the ways in which a trust can be brought under the court's supervision. Notice must be made to the trustees, beneficiaries, and attorneys of record by mail at least

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fourteen days prior to any hearing. "Beneficiaries" is a defined term and includes, very broadly, persons "in any manner interested in the trust" including creditors of the trust and "claimant[s] with any rights or claimed rights against the trust estate." Published notice may be authorized by the court where the number of persons to be served is large and the expense would be burdensome.

In most cases, trusts will include current as well as remainder, contingent, and possibly unascertained and unborn beneficiaries. In a trust which pays to A for life and then to A's issue, the identity of A's issue will remain unknown and incapable of ascertainment until A's death. A could adopt or have more children, for example. And A's existing children (if any) may have an incapacity on account of minority or disability. Providing appropriate notice to minors, disabled persons, and especially the unborn presents challenges. South Dakota's Virtual Representation statutes address these kinds of issues. In a trust decanting situation, whether or not court supervision is undertaken, the Virtual Representation Statutes must be followed with care in order to ensure that proper notice of the Trustee's proposal to decant is given.

South Dakota's Virtual Representation Statutes were first enacted in 1998. They apply in any "proceeding" (an undefined term but seemingly broader than merely court proceedings) in which (a) all persons interested in an estate or trust must be served or (b) their consent is required. Essentially, Virtual Representation may reduce, or in some situations define, the number of persons who actually need to be served or consent in a trust matter. When notice or

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127. See generally RESTATEMENT (THIRD) OF TRUSTS §65 (2003). This section provides:
   (1) Except as stated in Subsection (2), if all of the beneficiaries of an irrevocable trust consent, they can compel the termination or modification of the trust.
   (2) If termination or modification of the trust under Subsection (1) would be inconsistent with a material purpose of the trust, the beneficiaries cannot compel its termination or modification except with the consent of the settlor or, after the settlor's death, with authorization of the court if it determines that the reason(s) for termination or modification outweigh the material purpose.

*Id.* The comment indicates:

The rule of Subsection (1) requires that consent be obtained from or on behalf of all potential beneficiaries, including those who lack capacity. This requirement of unanimous consent also includes, for example, beneficiaries who are relatively unlikely ever to receive distributions, those whose interests arise by operation of law (i.e., reversionary, or "resulting trust," interests), and persons who hold powers of appointment under the trust, as well as those who would take in default of the exercise of any but a presently exercisable general power (on which see § 74). See generally § 48, Comment a, defining trust beneficiary. Also included among those whose consent is required are successors in interest of prior beneficiaries, and the potential unborn (including after-adopted) or unascertainable beneficiaries so often provided for by class description, as in a seemingly simple trust designed to pay income to A for life and then to distribute the principal to A's descendants who are living at her death.

*Id.* cmt. b (emphasis added).
129. See generally Gail E. Mautner & Heidi L.G. Orr, A Brave New World: Nonjudicial Dispute Resolution Procedures Under the Uniform Trust Code and Washington's and Idaho's Trust and Estate
consent is made consistent with the statutes, the decree or order entered is binding on all persons upon whom notice was not required.\textsuperscript{130} Non-judicial reformations and decantings are similarly to be conducted under the provisions of the Virtual Representation statutes.\textsuperscript{131}

Unborn or unascertained persons need not be provided notice unless there is no person with the same interests as them, and in that case, the court must appoint a guardian ad litem to represent their interests.\textsuperscript{132} No persons who are the potential appointees of a power of appointment need be noticed. Nor is it necessary to provide notice to the takers in default of a general power of appointment.\textsuperscript{133}

Contingent beneficiaries do receive notice under the Virtual Representation Statutes, but the identification of the contingent beneficiaries is accelerated in order to clarify who those individuals might ultimately turn out to be. The statute states: “In any contingency to the persons who shall compose a certain class upon the happening of a future event, then on the persons in being who would constitute the class if such event had happened immediately before the commencement of the proceeding.”\textsuperscript{134} This allows the individuals comprising the class of contingent beneficiaries to be artificially identified for notice purposes by imagining that the contingency that will vest their beneficial interests has already occurred. For example, if A’s children, per stirpes, will become beneficiaries upon A’s death, the remainders are identified by presupposing that A is now deceased. This would eliminate the requirement to provide notice to A’s living son’s children.

Similarly, the statute states: “To a person who is a party to the proceeding and the same interest has been further limited upon the happening of a future event to a class of persons described in terms of their relationship to such party, then on the party to the proceeding.”\textsuperscript{135}

When a beneficiary is under a disability, the disabled person need not be served so long as he or she has the same interest as another person who is being served.\textsuperscript{136} If notice must be served because there is no other person with the same interests, then notice to minor is given to: (a) a conservator; otherwise (b) a guardian; otherwise (c) the natural parents (plural); otherwise (d) the adoptive parent or parents; otherwise (e) the facility responsible for the minor’s care. For adults with disabilities lacking a conservator, notice is directed to: (a) an agent under durable power of attorney; otherwise (b) a guardian; otherwise (c) a

\textsuperscript{130} S.D.C.L. § 55-3-36 (2004).
\textsuperscript{132} S.D.C.L. § 55-3-32(3) (2004).
\textsuperscript{133} S.D.C.L. § 55-3-32 (2004).
\textsuperscript{134} S.D.C.L. § 55-3-32(1) (2004).
\textsuperscript{135} S.D.C.L. § 55-3-32(2) (2004).
\textsuperscript{136} S.D.C.L. § 55-3-35 (2004).
trustee; otherwise (d) any person responsible for the individual’s care.

Finally, the Virtual Representation Statutes set forth the requirements for a petition in any proceeding in which service upon persons may be dispensed with under the statutes.\textsuperscript{137} The petition must set forth the nature of the individuals’ interests, the basis on which service may be dispensed with, and whether the trustee has any discretion to affect the present or future beneficial enjoyment of the estate. The court then has the discretion to require notice if it finds that representation of a person’s interest may be inadequate. Notice can only be dispensed with for certain individuals in this manner by the court.

One out-of-place sentence in the first statute in the sequence of Virtual Representation Statutes reads: “The Department of Social Services shall be served in any matter where an interested party may owe a debt to the department pursuant to § 28-6-23.”\textsuperscript{138} S.D.C.L. section 28-6-23 relates to medical assistance paid by the South Dakota Department of Social Services (DSS) to an individual who is an inpatient in a nursing facility, intermediate care facility for the mentally retarded, or other medical institution, and to any person over fifty-five for nursing facility services, home and community based services, etc. (i.e., Medicaid).\textsuperscript{139} It is unclear whether this notice requirement applies in both judicial and non-judicial trust “proceedings.”

Some cautious attorneys read the DSS notice sentence to require notice to DSS even in non-judicial reformatory where no beneficiary is currently a Medicaid recipient since the beneficiaries “may” owe a debt to DSS at some time in the future. Certainly in the case where a trust has South Dakota resident beneficiaries, there is a possibility that at some future date such a beneficiary “may” owe a debt to DSS. Other attorneys adopt a narrower reading of the statute and simply ascertain whether any beneficiary is subject to a South Dakota Medicaid lien presently in determining whether DSS notice is required. Often the privacy of a family’s interests will resist providing DSS with detailed financial and other confidential information to the State of South Dakota, where those matters could otherwise be shielded and sealed by court order.

VIII. TAX ISSUES

Any trust matter usually has tax planning as an integral part of the equation. In any decanting, consideration of tax consequences must be methodically analyzed.\textsuperscript{140}

A. GST

The application of the generation-skipping transfer (GST) tax is especially implicated for “grandfathered” trusts that were irrevocable on or before September 25, 1985 and that are exempt from GST tax. The Treasury

\textsuperscript{137} S.D.C.L. § 55-3-37 (2004).
\textsuperscript{138} S.D.C.L. § 55-3-31 (2004).
\textsuperscript{139} S.D.C.L. § 28-6-23 (2004).
\textsuperscript{140} See generally Halperin supra note 5, at 221.
Regulations allow modifications of purely administrative provisions without loss of grandfathered exempt status, but any modification deemed to create a new trust does result in the loss of grandfathered status. There are four “safe harbor” exceptions: (1) exercises of discretionary trustee powers; (2) court-approved settlements; (3) judicial construction orders; and (4) modifications that do not: (a) shift beneficial interests to any beneficiary occupying a lower generational level; nor (b) extend the time for vesting of any beneficial interest beyond that provided in the original trust. The first and fourth exceptions are discussed below.

The first type of modification—a discretionary power to be exercised by the trustee—is only allowed without spoiling GST exempt status if “[a]t the time the exempt trust became irrevocable, state law authorized distributions to the new trust . . . without the consent or approval of any beneficiary or court.” The South Dakota statutes were only effective July 1, 2007. Thus, this type of modification is not expressly permitted by the Treasury Regulations unless reliance can be placed on the pre-statutory existence of the trustee power under common law, as discussed above.

The fourth type of modification—“other changes”—appears to cover the situation where the requirements of a discretionary power exercise are not met on account of the recent enactment of state law permitting trust decanting:

A modification of the . . . trust . . . by . . . nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Thus, decanting under statutory authority is permissible so long as the decanting does not exceed the limitations of not shifting any beneficial interests to lower generations nor extending the vesting time of a beneficial interest. An example in the regulations illustrates:

Example 2. Trustee’s power to distribute principal pursuant to state statute. In 1980, Grantor established an irrevocable trust (Trust) for the benefit of Grantor’s child, A, A’s spouse, and A’s issue. At the time Trust was established, A had two children, B and C. A corporate fiduciary was designated as trustee. Under the terms of Trust, the trustee has the discretion to distribute all or part of the trust income or principal to one or more of the group consisting of A, A’s spouse or A’s issue. Trust will terminate on the death of A, at which time, the trust principal will be distributed to A’s issue, per stirpes.

Under a state statute enacted after 1980 that is applicable to Trust, a

141. See RIA Estate Planning & Taxation Coordinator ¶ 46,066 through 46,073 (2009).
trustee who has the absolute discretion under the terms of a testamentary instrument or irrevocable inter vivos trust agreement to invade the principal of a trust for the benefit of the income beneficiaries of the trust, may exercise the discretion by appointing so much or all of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created, or under the same instrument. The trustee may take the action either with consent of all the persons interested in the trust but without prior court approval, or with court approval, upon notice to all of the parties. The exercise of the discretion, however, must not reduce any fixed income interest of any income beneficiary of the trust and must be in favor of the beneficiaries of the trust. Under state law prior to the enactment of the state statute, the trustee did not have the authority to make distributions in trust.

In 2002, the trustee distributes one-half of Trust's principal to a new trust that provides for the payment of trust income to A for life and further provides that, at A's death, one-half of the trust remainder will pass to B or B's issue and one-half of the trust will pass to C or C's issue. Because the state statute was enacted after Trust was created and requires the consent of all of the parties, the transaction constitutes a modification of Trust. However, the modification does not shift any beneficial interest in Trust to a beneficiary or beneficiaries who occupy a lower generation than the person or persons who held the beneficial interest prior to the modification. In addition, the modification does not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. The new trust will terminate at the same date provided under Trust.

Therefore, neither Trust nor the new trust will be subject to the provisions of chapter 13 of the Internal Revenue Code.\[145\]

The regulations do emphasize, however, that these "rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain . . . ."\[146\]

B. GIFT TAX

When decanting results in a shifting or transfer of beneficial interests in a trust, the implication of the federal gift tax must be considered. The gift tax applies to voluntary transfers. The IRS takes the position that an agreement between beneficiaries and a trustee to shift wealth to one or more beneficiaries generally results in a taxable event for gift tax purposes, except where the change derives from a settlement in a contested situation.

A taxable gift may result from the shifting of beneficial interest in a trust.\[147\]
But trust modifications that are merely "administrative" in nature do not run the risk of being deemed gifts by trust beneficiaries. The defining characteristic of a trust modification that results in a gift is one that changes the quality, value, or timing of any of the beneficial interests, rights, or expectancies originally provided in the trust.

Taxable gifts can be found when trusts are changed even when the beneficiaries did not expressly consent to the changes. The IRS has ruled in some circumstances that the failure to assert a claim to a trust interest (i.e., to do nothing) can also result in a taxable gift.

While trust reformations wherein beneficiaries are required to affirmatively consent to a change could very well have gift tax consequences, the fact that trust decanting does not require beneficiary consent reduces this risk considerably. In fact, unlike trust reformations, decanting cannot even be initiated by a beneficiary; the power to decant is a trustee power and is exercisable only by the trustee, whether or not a beneficiary consents, agrees, or approves. Conceivably, the IRS could argue that a beneficiary's failure to object to a decanting proposal amounts to a taxable gift, but this argument is weakened by statutes that do not require beneficiary consent.

Where a beneficiary is poised to receive a final trust distribution of principal at a designated age (say, 35) and the Trustee decants to a new trust where final distributions are deferred to a more suitable age, the IRS might argue that a lapse or release of a general power of appointment has occurred. The beneficiary's expectation that he or she will receive a distribution of trust principal at age 35 is akin to a general power of appointment. It remains to be seen whether the IRS could successfully argue that a beneficiary's failure to object to a trust decanting which defers this right results in a lapse of a general power of appointment. It seems that the strength of the IRS's argument would depend in large degree whether the beneficiary had any real legal rights to resist the trust decanting.

C. FEDERAL INCOME TAX

A trust modification does not constitute a sale or exchange of property resulting in the realization of gain. Decanting should not normally constitute

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149. Id.
151. It has been suggested that the beneficiary should be given a limited testamentary power of appointment in the new trust in order to make the potential gift resulting from decanting an incomplete gift. Adam F. Katz, Decanting an Irrevocable Trust: Are These Trusts Really Irrevocable? Nassau Lawyer (Dec. 2008), at 15, 16.
152. Extending the term of a trust is not permissible under the decanting power, but may be pursued in a trust reformation context in South Dakota.
153. See Halperin, supra note 5, at 15.
a sale or exchange either.155 Decanting will, however, result in distributable net income (DNI) from the old trust to the new trust, with a deduction (for the old trust) and matching receipt of income (for the new trust).156 Decanting encumbered assets or partnership interests with negative capital accounts will have additional income tax considerations.157 And decanting to a foreign trust should be approached with caution.158

D. ESCAPING STATE TAXES

State income taxation of trust income varies tremendously from state to state, but in some circumstances there is accepted legal authority for “moving” a trust situs to a state such as South Dakota without an income tax. In New York, for example, trusts created by New Yorkers are subject to New York’s state income tax, but if all of the trustees are non-New Yorkers and all of the trust estate is located (and produces income) outside of the State of New York, the trust can escape the state tax.159 A frequent use of New York’s decanting authority is for a trustee to decant those trust assets that meet the requirements for escaping taxation into a new, state tax-free trust, and retain only those assets, such as real property in the state, that cannot avoid the state tax.

IX. FIDUCIARY ISSUES

Generally, the duties imposed on trustees can be summarized as five fundamental duties: (1) the duty to be generally prudent; (2) the duty to carry out the terms of the trust; (3) the duty to be loyal to the trust and its beneficiaries; (4) the duty to give personal attention to trust affairs; and (5) the duty to account to trust beneficiaries.160

entity holding long-term, low-interest mortgages in the 1970s—when interest rates rose. To avoid closure by the Federal Home Loan Bank Board by selling the devalued mortgages outright (and taking a loss) it instead exchanged 90% interests in 252 of its mortgages for 90% interests in 305 other mortgages with an equivalent fair market value. The face value of the mortgage interests exchanged was approximately $2 million higher than the face value of the mortgage interests it received. Cottage Savings Association took a business deduction on the loss, while still retaining mortgage interests. Justice Marshall held that the participation interests exchanged by Cottage Savings and the other S&Ls were “materially different” because the loans involved were made to different obligors and secured by different properties. Even though the interests were “substantially identical” for banking purposes, they were materially different for taxation purposes. Therefore, the exchange was a “disposition of property,” Cottage Savings had realized a loss, and their deduction was appropriate. Cottage Sav. Ass’n, 499 U.S. at 555.; see I.R.S. Priv. Ltr. Rul. 1999-51-028 (Sept. 28, 1999). The Treasury Regulations essentially adopt the holding and reasoning of Cottage Savings.

159. See Halperin, supra note 5.
160. Rounds, supra note 49, at 147-48. South Dakota statutes specifically articulate that a trustee is bound to act in the “highest good faith” towards the beneficiaries of a trust in all matters connected with the trust. A trustee is prohibited from obtaining any advantage over a beneficiary “by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind.” S.D.C.L. § 55-2-1 (2004). A trustee is prohibited from obtaining any advantage over a beneficiary “by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind.” Id. A violation of these duties is a fraud against
The general duty of loyalty carries with it the specific duty to treat all beneficiaries impartially.161 The duty of impartiality as between current and remainder beneficiaries often arises in connection with the conflict between income generation and long-term capital appreciation and also between current discretionary distributions that have the effect of depleting the trust estate that will remain for the remaindermen. In many instances, this inherent conflict will be exacerbated depending on the specific decanting proposal under consideration.

The South Dakota trust decanting statutes do not relieve a trustee of the statutory and common law trustee fiduciary duties. The duty of impartiality will no doubt act as the primary “brake” on the trust decanting “train.” Where trust decanting could result in greatly altered beneficiary interests in a trust, the trustee’s duty of impartiality is at the fore. Conceivably, South Dakota will also be presented at some point with a claim for breach of fiduciary duty against a trustee for failing to decant.

X. CONCLUSION

When the country’s first statutory scheme for trust decanting was adopted in New York, GST tax planning was the primary benefit in mind for state legislators. Countless other uses for this trustee power have since been identified. It will doubtless prove an important new tool in administering trusts and advising trustees and trust beneficiaries.

Some practitioners—the author included—have reservations about the scope and startling reach of this newly enacted trustee power, whether or not the power may have already existed in some form under common law. Drafting against the possibility of future trust decanting by the trustee is certainly possible, as the very first phrase of the South Dakota trust decanting statutes suggests: “Unless the terms of the instrument expressly provide otherwise . . . .”162 Without addressing the possibility in the trust instrument itself, this trust power is now firmly in play. And trusts, as the greatest creation of English law, are subject to being rewritten by their trustees.

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161. Rounds, supra note 49, at 231; see RESTATEMENT (THIRD) OF TRUSTS § 79 (1992). The duty of impartiality also arises in connection with the disclosure of information to the remainder class, which can violate the financial confidences of current beneficiaries.