

Title

May a trustee with discretionary authority to make principal distributions ever decant for the sole purpose of increasing his/her/its compensation?

Summary

The Uniform Trust Code requires that the trustee notify the qualified beneficiaries, usually the current beneficiaries and presumptive remaindermen, in advance of any change in the method or rate of the trustee's compensation.²⁸ The Uniform Trust Decanting Act, specifically §16, requires that if the "first trust instrument" (the instrument governing the terms of the to-be-decanted trust) specifies an authorized fiduciary's compensation, the fiduciary may not exercise the decanting power to increase the fiduciary's compensation above the specified compensation unless all qualified beneficiaries of the "second trust" (the recipient trust) consent in a signed record to the increase.¹ The accompanying official comment offers a somewhat circular rationale for why not all those with equitable property rights in the entrusted property need sign off: "Obtaining the consent of qualified beneficiaries, who would generally be immediately impacted by a change in compensation, should be sufficient." What about the equitable property rights of the non-qualified beneficiaries? The practice of apportioning trustee fees between the income and principal accounts comes to mind. It does not seem self-evident that that equitable property rights may be subject to fiduciary subversion so long as the impact is not "immediate." Decanting is taken up generally in §3.5.3.2(a) of *Loring and Rounds: A Trustee's Handbook* (2016). The portion of the section devoted to a general discussion of decanting is reproduced in its entirety below. The Uniform Trust Code's qualified beneficiary concept is explained and critiqued in §6.1.5.1 of this Handbook.

The Text

Trust Decanting

[Excerpted from §3.5.3.2(a) of the 2016 Edition of *Loring and Rounds: A Trustee's Handbook*, with post-publication modifications]

Decanting: Discretionary fiduciary distributions of principal in further trust. Inherent in a trustee's unqualified power to make discretionary distributions of principal outright and free of trust to or for the benefit of a beneficiary is the lesser power to make a distribution of principal to another trustee upon a different trust to or for the benefit of that beneficiary.⁴⁸⁶ The Restatement (Third) of Property is in accord.⁴⁸⁷ Moving property from one trust to another in this way is referred to as decanting in some

²⁸UTC §813(b)(4) (available at <<http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>>).

¹ See §16(a)(1) of the Act. See also §16(b)(1) of the Act ("If a first-trust instrument does not specify an authorized fiduciary's compensation, the fiduciary may not exercise the decanting power to increase the fiduciary's compensation above the compensation permitted by [this state's trust code] unless...all qualified beneficiaries of the second trust consent to the increase in a signed record...")

⁴⁸⁶*Phipps v. Palm Beach Trust Co.*, 142 Fla. 782, 196 So. 299 (1940) (holding that the 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) (U.S.); Lewin ¶¶3-59, 3-67 (England). See generally Restatement (Second) of Property (Wills and Other Donative Transfers) §11.1; Restatement (Third) of Property (Wills and Other Donative Transfers) §19.14.

⁴⁸⁷Restatement (Third) of Property (Wills and Other Donative Transfers) §19.14, cmt. f.

circles.⁴⁸⁸ On the other hand, a decanting for the benefit of someone other than that beneficiary could implicate the fraud on a power doctrine, which is covered generally in Section 8.15.26 of this handbook. “While the tax treatment of F . . . [corporate] . . . reorganizations is well settled, with case law going back to the 1920s and statutes providing nonrecognition treatment, the tax treatment of decantings is surprisingly unsettled.”⁴⁸⁹

In Massachusetts, the decanting authority of trustees is regulated by general principles of equity.⁴⁹⁰ In New York, decanting distributions are regulated by statute.⁴⁹¹ It has been suggested that the legal premise underlying the statute is that a trustee with an absolute fiduciary power to invade principal is analogous to a donee of a nonfiduciary special/limited power of appointment who may exercise the power in further trust.⁴⁹² The analogy, however, would seem a false one as trustees are constrained by the fiduciary principle in the exercise of their powers; donees of nonfiduciary powers of appointment generally are not.⁴⁹³ Thus, a power in a trustee to select his successor, by decanting or otherwise, is held in a fiduciary capacity. At minimum this translates into a fiduciary duty on the part of the trustee to exercise due diligence in the selection of an appropriate successor.

Decanting can be a way for *the trustee* of an irrevocable trust to modify its administrative provisions, accommodate a beneficiary-related change of circumstances, respond to changes in the tax laws, or correct errors or ambiguities in the governing trust instrument.² The trustee, of course, would be subject to fiduciary constraints in the exercise of his discretionary decanting authority, and any such exercise would have to be done prudently. Thus, the failure of the trustee to give due advance consideration to the tax consequences, if any, of a discretionary trust-to-trust decanting would amount to a prima facie breach of his duty to administer the trust prudently.

A transfer of property to a trustee in breach of some fiduciary duty to the legal or equitable owner of the property is subject to rescission and restitution.⁴⁹⁴ Thus, if an agent in breach of a fiduciary duty to the principal transfers the principal’s property to a trustee, the trustee is “liable in restitution” to the principal.⁴⁹⁵ So also if a trustee in breach of trust decants to another trust with a different trustee and different beneficiaries, absent special facts. The trustee of the other trust and, indirectly, the beneficiaries of the other trust are “liable in restitution” to the beneficiaries of the inception trust “as necessary to avoid unjust enrichment.”⁴⁹⁶

Ultimately, whether or not there is decanting authority in the trustee should simply hinge on the intent

⁴⁸⁸Restatement (Third) of Property (Wills and Other Donative Transfers) §19.14, Reporter’s Note.

⁴⁸⁹Jason Kleinman, *Trust Decanting: A Sale Without Gain Realization*, 49 Prop., Trust & Estate L. J. 453, 458 (2015).

⁴⁹⁰*See generally* Morse v. Kraft, 466 Mass. 92, 992 N.E.2d 1021 (2013).

⁴⁹¹N.Y. Est. Powers & Trusts Law §10-6.6. Alaska, Arizona, Delaware, Florida, Illinois, Indiana, Kentucky, Missouri, Nevada, New Hampshire, North Carolina, Ohio, South Dakota, Tennessee, and Virginia also have decanting statutes.

⁴⁹²Matter of Estate of Mayer, 176 Misc. 2d 562, 672 N.Y.S.2d 998 (1998); Phipps v. Palm Beach Trust Co., 142 Fla. 782, 196 So. 299 (1940). *See generally* §8.1.2 of this handbook (exercising of powers of appointment in further trust).

⁴⁹³*See generally* §8.1.1 of this handbook (powers of appointment).

² The Uniform Trust Decanting Act, see the official commentary to its §9, is not in accord, at least not conceptually: “Decanting by definition is an exercise of fiduciary discretion and is not an alternative basis for a court modification of the trust.”

⁴⁹⁴*See* Restatement (Third) of Restitution and Unjust Enrichment §17 (lack of authority).

⁴⁹⁵*See* Restatement (Third) of Restitution and Unjust Enrichment §17 (lack of authority). *See generally* §3.4.1 of this handbook (whether an agent acting under a durable power of attorney can effectively transfer the principal’s property in trust).

⁴⁹⁶*See* Restatement (Third) of Restitution and Unjust Enrichment §17 (lack of authority).

of the settlor of the trust as divined from its terms, as well as on the motives of the trustee. If, for example, decanting would thwart the wishes of the settlor, then such a distribution in further trust ought to be judicially voidable.⁴⁹⁷ So also if decanting is merely an attempt on the part of the inception trustee to end-run the ancient proscription against delegating to agents the entire administration of the trust or to avoid having to monitor the activities of agents to whom fiduciary discretions have been properly delegated.⁴⁹⁸ When it comes to the motives of a trustee, equity looks to substance rather than to form.⁴⁹⁹ One cannot forget that the trust, first and foremost, is a principles-based creature of equity.⁵⁰⁰ Thus, whether decanting is permissible should be determined on a case-by-case basis taking into account the terms of the particular trust and the motives of the particular trustee.⁵⁰¹ To promulgate some hard and fast rule either way by statute only serves to further stultify and barnacalize the law of trusts:

The growing universe of state decanting rules has resulted in an increasingly complicated patchwork of state laws on the subject. In addition, many of the states that have passed decanting legislation have specifically sought to retain preexisting common law principles. Furthermore, state decanting statutes remain subject to varying judicial interpretation. One significant area of variation among states exists with regard to the distribution standards necessary to decant a trust.⁵⁰²

In any case, it is at least a settled and universal principle that decanting may not serve as a vehicle for subverting settlor intent, or at least that was the case. The material purpose doctrine (aka the Claffin Doctrine), which is covered generally in Section 8.15.7 of this handbook and which has been the traditional doctrinal protector of settlor-intent, may have been neutralized in Washington State by an obscure piece of legislation known as the Trust and Estate Dispute Resolution Act (TEDRA).⁵⁰³ Were it not for decanting one might be inclined to dismiss TEDRA as a doctrinal anomaly of minimal national relevance. We begin our explanation of what TEDRA does and why decanting makes TEDRA a matter of national relevance by recalling the current state of the material purpose doctrine. In recent years, reformers of trust law have been hard at work defanging the plain meaning rule, primarily by liberalizing the doctrines of reformation and deviation. The rule is discussed generally in Section 8.15.6 of this handbook, the doctrines generally in Section 8.15.22. That having been said, the reformers have generally been quick to caution that these liberalizations are intended to buttress settlor-intent, not subvert it. At minimum, lip service is being paid to settlor-intent. There is one notable exception: Professor Langbein's "intent-defeating" (his words) benefit-the-beneficiaries rule, which has been incorporated into the Uniform Trust Code. This is a topic that is taken up in Section 6.1.2 of this handbook. This radical intent-defeating policy reform embedded in the UTC has met with considerable push-back. Both the

⁴⁹⁷See, e.g., *Ferri v. Powell-Ferri*, 2013 WL 5289955 (Conn. Super. Ct. Aug. 23, 2013), 56 Conn. L. Rptr. 828 (2013) ("The decanting frustrates . . . [the settlor's intentions] . . . and, therefore, cannot stand.").

⁴⁹⁸See generally §6.1.4 of this handbook (delegation).

⁴⁹⁹See generally §8.12 of this handbook (equity's maxims).

⁵⁰⁰See generally Chapter 1 of this handbook (equity in the Anglo-American legal tradition).

⁵⁰¹See *Phipps v. Palm Beach Trust Co.*, 142 Fla. 782, 785, 196 So. 299, 301 (1940) (whether decanting is permissible turns on the facts of the particular case and the terms of the instrument creating the trust); *Morse v. Kraft*, 466 Mass. 92, 98, 992 N.E.2d 1021, 1026 (2013) ("We conclude that the terms of the 1982 Trust authorize the plaintiff to transfer property in the subtrusts to new subtrusts without the consent of the beneficiaries or a court.").

⁵⁰²Ivan Taback & David Pratt, *When the Rubber Meets the Road: A Discussion Regarding a Trustee's Exercise of Discretion*, 49 Real Prop., Trust & Estate L. 491, 515 (2015).

⁵⁰³Chap. 11.96A.220 RCW.

Massachusetts and the New Hampshire legislatures, for example, have said “no thanks.” Even some denizens of the ivory tower have declined to fall in line.⁵⁰⁴

Now, while all this has been going on, in Washington State the material purpose doctrine may well have been effectively defanged by TEDRA.⁵⁰⁵ The legislation in part provides that a trust may be reformed nonjudicially by agreement of the trustee and beneficiaries without regard to the trust’s material purposes, at least that is what its drafters intended. The agreement is final and binding on all parties. Idaho is, so far at least, the only other TEDRA state. These developments, isolated though they may be, have national implications. Here is why: There have already been decantings from other states into trusts sited in Washington State to facilitate subversion of their material purposes. Assuming this practice takes on a head of steam, which is likely, the trust instrument scrivener should consider advising his or her settlor-client that the material purpose doctrine may well be TEDRA-vulnerable, unless effective countermeasures can be taken at the drafting stage to defang TEDRA, or forestall a decanting to a TEDRA state. In theory, a decanting from a non-TEDRA state to a TEDRA state in order to subvert a trust’s material purposes would be subject to equitable reversal by the courts of the non-TEDRA state. As a practical matter, however, the pursuit by a beneficiary (presumably someone who had not been a party to the TEDRA agreement) of such an equitable multi-jurisdictional action would not be a realistic option, absent special facts, if only because of the numerous and substantial personal expenditures of time and treasure that likely would be required to maintain the action.

The Uniform Trust Decanting Act (the “Act”), approved in July of 2015 by the National Conference of Commissioners on Uniform State Laws and promulgated “in the midst of a rising tide of state decanting statutes,” would not supplant a trustee’s right to decant under long-standing general principles of equity.³ On this side of the Atlantic more and more states now have in place dueling trust-decanting regimes. One regime is regulated by general principles of equity as tweaked by statute, whether of the aforementioned home grown variety or some version of the Act. (The Act is essentially just an aspirational grab bag of statutory tweaks in the trust-decanting space.) The other regime is regulated by general principles of equity that, for the most part, have *not* been barnacled by trust-decanting legislation. (*Morse v. Kraft*⁴ is a high-profile Massachusetts case in which the court authorized a trust decanting under general equitable principles, Massachusetts at the time not having a trust-decanting statute on its books).

⁵⁰⁴ See generally §6.1.2 of this handbook.

⁵⁰⁵ Chap. 11.96A.220 RCW.

³ See Uniform Trust Decanting Act, Prefatory Note and §3, Comment.

⁴ 466 Mass. 92, 992 N.E.2d 1021 (2013).