

# Decanting: Doesn't That Sound Tasty?

By Stephanie Fierro

**T**he word “decant” literally means to gently pour something from one container to another without disturbing the sediment. Consequently, decanting is most often associated with liquid such as wine. Since I’m an attorney and not a sommelier, this decanting article may not be as tasty as you might have hoped. But for someone seeking to alter an irrevocable trust, decanting can prove fruitful.

In this article, decanting refers to the distribution of trust assets from one trust to another trust for the purpose of removing undesirable provisions.

As discussed in prior articles, most clients can be well protected with a standard estate plan. This plan usually includes powers of attorney, a will and a revocable trust. The beauty of a revocable document such as a revocable trust is that the client can readily amend or revoke the document when their circumstances change. The same cannot be said of an irrevocable trust. As its name suggests, it cannot be revoked. Nevertheless, clients enter into irrevocable trust agreements frequently because of the numerous benefits they afford and that cannot be achieved with a revocable trust.

Whether a trust is irrevocable from inception or becomes irrevocable by reason of the settlors’ incapacity or death, the world within which the trust operates changes all the time. New laws are enacted, beneficiaries behave badly and investment strategies change. Because it is impossible to know what the future holds it is impossible to draft documents that address every contingency that might possibly occur. For example, it’s 2:30 in the afternoon and I don’t even know what I am going to have for dinner let alone what kind of distribution my descendant will need to care for herself or himself 350 years from now. With 500 year perpetuity period in Arizona that is exactly what some clients may be asked to consider.

How then does one alter an “unalterable” trust in light of changed circumstances? You guessed it – decanting!

Since all documents are eventually irrevocable, there is a tremendous need for a way to correct a trust rendered ineffective because the world changed. Arizona is one of about a dozen states that responded to the need for irrevocable trust flexibility. A.R.S. 14-10819, Trustee’s Special Power to Appoint to Other Trust, a/k/a the decanting statute, allows a trustee to use his or her distribution authority to appoint all or part of the trust estate to another trust. This allows the trustee to move assets from a presumably flawed trust to a new trust designed to address and correct such flaws.

## Why Decant?

In Arizona, unless the trust expressly provides otherwise, the trustee may exercise his discretion to decant. And the trustee may do so without prior court approval or notice to the beneficiaries. The trustee may nevertheless choose to notify the beneficiaries or seek prior court approval depending upon the circumstances. Although decanting is not the only remedy, it is generally a less restrictive means for accomplishing a given objective and thus may prove more favorable than the other modification remedies outlined below.

By transferring the assets to another trust, the trustee can address or correct a myriad of issues that fall into four primary categories:

1. Administrative issues;
2. Changes in the law, especially tax law;
3. Changed circumstances; and
4. Drafting errors or ambiguities.

## Statutory Requirements.

Decanting is essentially a discretionary distribution on a large scale. So, in order to decant the trustee must first have the authority to make discretionary distributions to (or for the benefit of) a beneficiary under the governing instrument. If that ability exists in the trust, then the trustee may appoint the property to another trust. The statute further provides, among other things, that the new trust must be in favor of the beneficiaries of the trust. It can’t reduce fixed nondiscretionary income payments, and can’t adversely affect the tax treatment of the trust, the trustees, the settlor or the beneficiaries.

## Tax Implications.

Decanting has the potential to raise generation-skipping transfer (“GST”), income, gift and estate tax issues. The tax consequences of decanting can prove problematic if not carefully navigated and that is particularly true of GST tax. Given the relative youth of the laws regarding decanting, the tax issues and consequences are not yet settled. Trustees must be cautious not to inadvertently create such an issue. Generally speaking, however, decanting should not result in any adverse income, gift or estate tax consequences unless the decanting trustee is also a beneficiary or beneficiary consent is required to decant.

## Other Options.

In Arizona, decanting is not an exclusive remedy. Because our state also adopted the Uniform Trust Code (“UTC”), additional modification remedies are available to Arizona trustees. For example, under the UTC a trustee may change the trust through trust division, merger, modification or reformation. In some cases, the trustee may find one of these options a preferable method for accomplishing the objectives that could otherwise be accomplished through decanting. The point is – decanting is a useful tool for the administration of irrevocable trusts but a trustee has options and should explore the pros and cons of each before exercising his authority.



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