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# The Rise of Trust Decanting in the United States

Robert H. Sitkoff\*

## Abstract

In a *trust decanting*, a trustee who under the terms of a trust (the *first trust*) has a discretionary power over distribution uses that power to distribute the trust property to a new trust (the *second trust*) with updated provisions, leaving behind the sediment of the first trust's stale provisions. This article canvasses the rise of trust decanting in American trust practice, taking notice of its common law origins, its contrast with traditional American doctrine on trust modification and termination, the proliferation of state trust decanting statutes, and several areas of doctrinal divergence across the states.

## Introduction

In common usage, to 'decant' is to pour a liquid from one vessel into another, typically to separate the liquid from any sediment. An older red wine, for example, might be decanted to separate it from sediment that formed while the wine was cellared.<sup>1</sup> In a **trust decanting**, a trustee who under the terms of a trust (the **first trust**) has a discretionary power over distribution uses that power to distribute the trust property to a new trust (the **second trust**) with updated provisions, leaving behind the sediment of the first trust's stale provisions.

This article canvasses the rise of trust decanting in American trust practice, taking notice of its common law origins, its contrast with traditional American doctrine on trust modification and termination, the proliferation of state trust decanting statutes, and several areas of doctrinal divergence across the states.

## A stylized example

Suppose *T* devises a fund in trust to *X* to pay or apply so much of the income and principal to *A* or *B* as *X* determines from time to time in *X*'s sole discretion. The terms of the first

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<sup>1</sup> Decanting also aerates the wine, making it apt for a full-bodied younger wine too. See Ed McCarthy & Mary Ewing-Mulligan, *Wine for Dummies* (6th edn, 2016) 108-110.

trust lack a provision for trustee succession and have been rendered tax inefficient by subsequent changes in the tax laws. X declares a new trust for the benefit of A and B with terms otherwise identical to the first trust, except the second trust includes a provision for trustee succession and other changes to achieve the settlor's intended tax objectives in light of current tax law. X funds the second trust with a distribution – a decanting – of the entire corpus of the first trust.

### Decanting at common law

#### *Phipps v. Palm Beach Trust Company*

Most commentators point to *Phipps v. Palm Beach Trust Company*, decided by the Florida Supreme Court in 1940, as the first American trust decanting case.<sup>2</sup> In *Phipps*, the court held that a trustee who has a discretionary power to distribute property to a beneficiary outright may also distribute the property to the beneficiary in further trust. Applying the prevailing rule applicable to a power of appointment, the court concluded that a '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.'<sup>3</sup> The theory underpinning common law decanting, in other words, is that the greater power includes the lesser power. By giving a trustee a power to make an outright distribution, the settlor implicitly gave the trustee a power to make a conditional distribution in further trust.

#### *Comparison with the Claflin and deviation doctrines*

In contrast with the relaxed rules for trust modification and termination in the British Commonwealth, American law has traditionally recognized only two grounds for modification or termination of a trust without the settlor's consent: (1) by consent of all the beneficiaries if the modification or termination is not contrary to a **material purpose** of the settlor (the *Claflin* doctrine<sup>4</sup>), and (2) **changed circumstances** not anticipated by the settlor that would defeat or substantially impair the accomplishment of the purposes of the trust (the **equitable deviation** doctrine).<sup>5</sup>

Reflecting the primacy in American law of respecting the settlor's freedom of disposition,<sup>6</sup> the *Claflin* and deviation rules tie modification or termination to a judicial determination of consistency with the settlor's actual or probable intent. Thus, a modification under the *Claflin* doctrine requires a judicial determination that the modification would

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<sup>2</sup> 196 So. 299 (Fla. 1940).

<sup>3</sup> *Ibid* 301.

<sup>4</sup> So named because the rule derives from *Claflin v. Claflin*, 20 N.E. 454 (Mass. 1889). The rule is codified by Uniform Trust Code § 411 (Unif. Law Comm'n 2004). Compare Paul Matthews, 'The Comparative Importance of the Rule in *Saunders v. Vautier*,' 122 L.Q. Rev. 266 (2006), with John H. Langbein, 'Why the Rule in *Saunders v. Vautier* Is Wrong,' in P.G. Turner (ed), *Equity and Administration* (2016) 189-202.

<sup>5</sup> See, e.g., Uniform Trust Code § 412 (Unif. Law Comm'n 2000); Restatement (Third) of Trusts § 66 (Am. Law Inst. 2003).

<sup>6</sup> See, e.g., Robert H. Sitkoff, 'Trusts and Estates: Implementing Freedom of Disposition' (2014) 58 St. Louis U. L.J. 643.

not interfere with a material purpose of the settlor. The material purpose rule safeguards the settlor's freedom of disposition, because the beneficiaries cannot overcome a material purpose of the settlor. Likewise, a modification under the deviation doctrine requires a judicial determination that, given unanticipated changed circumstances, the modification is necessary to further the purposes of the trust. 'The objective [of deviation] is to give effect to what the settlor's intent probably would have been had the circumstances in question been anticipated.'<sup>7</sup>

A common law trust decanting, by contrast, does not require court involvement, much less a judicial determination of consistency with the settlor's actual or probable intent. To the contrary, the decanting might result in the creation of a second trust that varies from a material purpose of the first trust. A decanting is subject to judicial review only if an interested party petitions the court and only for the trustee's compliance with the trustee's fiduciary duties under the first trust. Thus, the onus is on a beneficiary who objects to the decanting to bring an action for judicial review. Owing to a paucity of case law, the nature of that review is somewhat unclear.<sup>8</sup>

### *The stylized example revisited*

Returning to the stylized example given at the outset, suppose the second trust named only *A* as a beneficiary. If *B* wanted to object to the decanting, *B* would need to bring an action against *X* for breach of trust. Of course, the same would be true if *X* exercised her discretion under the terms of the trust to distribute the entire corpus outright to *A*. This example thus brings into sharp relief the deep conceptual question raised by trust decanting, namely, should the settlor's grant to *X* of the greater power to distribute the entire corpus to *A*, excluding *B*, be interpreted as including the lesser power to decant the corpus into a new trust for *A* only?

Consider another variant. Suppose that under the first trust *X* was required to distribute quarterly all income to *B*. Could *B*'s mandatory income interest be destroyed by a decanting into a second trust for *A* only or for *A* and *B* but without the mandatory income interest? Should the settlor's grant to *X* of the greater power to distribute the entire corpus to *A*, excluding *B*, be interpreted as including the lesser power to decant the corpus into a second trust without *B*'s right to mandatory income distributions?

### *Morse v. Kraft*

In *Morse v. Kraft*, decided by the Massachusetts Supreme Judicial Court in 2013, the trustee had 'discretion to distribute property directly to, or appl[y] for the benefit of, the trust beneficiaries.'<sup>9</sup> The court read 'this broad grant of almost unlimited discretion as evidence of the settlor's intent that the ... trustee have the authority to distribute assets in further trust for the beneficiaries' benefit. Such interpretation is in keeping with the reading of

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<sup>7</sup> Restatement (Third) of Trusts § 66 cmt. a (Am. Law Inst. 2003).

<sup>8</sup> See Stewart E. Sterk, 'Trust Decanting: A Critical Perspective' (2017) 38 Cardozo L. Rev. 1993.

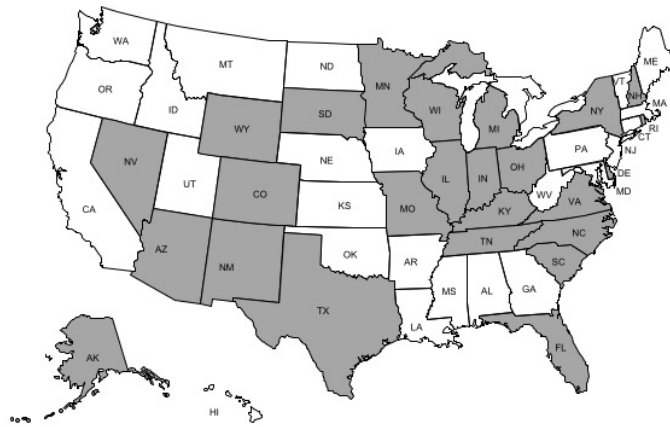
<sup>9</sup> 992 N.E.2d 1021, 1026 (Mass. 2013).

similar trust language in *Phipps*.<sup>10</sup> However, the court declined to ‘recognize an inherent power of trustees of irrevocable trusts to exercise their distribution authority by distributing trust property in further trust, irrespective of the language of the trust.’<sup>11</sup> *Morse* thus held that the extent to which a trustee may decant at common law is a question of interpreting the terms of the trust.<sup>12</sup>

### The decanting statutes

Owing to the uncertainties surrounding common law decanting, the growing number of older trusts with stale terms, and the increasingly intense jurisdictional competition for trust funds,<sup>13</sup> trust lawyers and bankers have successfully sought enactment of trust decanting statutes. New York adopted the first decanting statute in 1992.<sup>14</sup> Alaska and Delaware followed respectively in 1998 and 2003.<sup>15</sup> Since then, other states have adopted decanting statutes at an increasingly rapid pace. By year-end 2016, at least 25 states had enacted a decanting statute.<sup>16</sup>

**Trust Decanting Statutes (2016)**



The decanting statutes provide for a decanting power by default. They provide for

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<sup>10</sup> *Ibid.*

<sup>11</sup> *Ibid* 1027.

<sup>12</sup> The Massachusetts court confirmed this holding in a later case. *See Ferri v. Powell-Ferri*, 72 N.E.3d 541, 546 (Mass. 2017) (confirming that “a trustee’s decanting authority turns on the facts of each case and the terms of the instrument that establishes the trust”).

<sup>13</sup> *See, e.g.*, Robert H. Sitkoff & Max Schanzenbach, ‘Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes’ (2005) 115 *Yale L.J.* 356.

<sup>14</sup> N.Y. Est. Powers & Trusts Law § 10-6.6 (2017).

<sup>15</sup> Alaska Stat. Ann. §§ 13.36.157-159 (2017); Del Code Ann. tit 12, § 3528 (2017).

<sup>16</sup> The states are Alaska, Arizona, Colorado, Delaware, Florida, Illinois, Indiana, Kentucky, Michigan, Minnesota, Missouri, Nevada, New Hampshire, New Mexico, New York, North Carolina, Ohio, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Virginia, Wisconsin, and Wyoming.

a default rule of construction under which a trustee's discretionary power to distribute trust property is read to include a power to decant—a power to distribute in further trust—unless the terms of the trust provide otherwise. By providing a statutory default rule in favor of decanting, the decanting statutes have expanded decanting practice, especially in those states in which the courts had not yet had occasion to recognize decanting under the common law. But the statutes also constrain the decanting power by imposing procedural and substantive safeguards.

By way of example, the Uniform Trust Decanting Act (UTDA) (Unif. Law Comm'n 2015) recognizes a default decanting power in a trustee of a discretionary trust. But the UTDA also imposes a handful of categorical limits on the decanting power and confirms that the power is subject to the trustee's fiduciary duties. The UTDA therefore codifies with respect to decanting the 'basic principle of trust administration' that 'all powers held in the capacity of trustee must be exercised, or not exercised, in accordance with the trustee's fiduciary obligations.'<sup>17</sup>

### **Variation across the statutes**

There is meaningful variation across the states in the particulars of the trust decanting statutes.<sup>18</sup> Among the more important margins of variation are: (1) whether to tie the trustee's decanting power to the breadth of the trustee's distribution discretion; (2) whether to permit creation of a special needs trust by decanting regardless of the breadth of the trustee's distribution discretion; (3) whether to require notice to the beneficiaries in advance of a decanting; and (4) whether the decanting power may be used to effect a direct modification of the first trust without a distribution to a second trust.

#### ***(1) Tying the decanting power to the breadth of the trustee's distribution discretion***

Some of the trust decanting statutes, including the UTDA, connect the breadth of the trustee's decanting power to the breadth of the trustee's discretionary distribution power. If the trustee has broad discretion to distribute, then the trustee will have a broad decanting power. If the trustee has a narrower discretion to distribute, then the trustee will have a narrower decanting power. This structure follows from the common law greater-includes-the-lesser theory of decanting.

For example, UTDA § 12 provides that if a trustee's power to distribute is limited by an 'ascertainable' or 'reasonably definite' standard, which in American trust practice are terms of art derived from federal tax law,<sup>19</sup> then the trustee 'must grant each benefi-

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<sup>17</sup> Restatement (Third) of Trusts § 70 cmt. a (Am. Law Inst. 2007).

<sup>18</sup> Susan Bart, a leading U.S. trust lawyer who served as reporter for the UTDA, maintains a survey at <http://www.actec.org/assets/1/6/Bart-State-Decanting-Statutes.pdf>. See also Stephanie Vara, Two Cheers for Decanting: A Partial Defense of Decanting Statutes as a Tool for Implementing Freedom of Disposition (manuscript on file with author).

<sup>19</sup> Under UTDA § 2(2), an "ascertainable standard" means a standard relating to an individual's health, education, support, or maintenance within the meaning of 26 U.S.C. Section 2041(b)(1)(A)[, as amended,] or

ciary of the first trust beneficial interests [in the second trust] which are substantially similar to the beneficial interests of the beneficiary in the first trust.’ By contrast, if a trustee has broad discretion that is not limited by such a standard, then under UTDA § 11 the trustee has a broad power to decant other than (a) adding a beneficiary who was not a beneficiary of the first trust, or (b) reducing a beneficiary’s fixed right to a distribution.

But not all states impose such limits. The Nevada decanting statute, for example, allows a trustee with almost any discretion over distribution of income or principal to decant,<sup>20</sup> and the trustee is permitted to decant into a second trust that removes a beneficiary’s fixed right to a distribution under the first trust.<sup>21</sup> Still, no state decanting statute, not even the Nevada statute, permits including as a beneficiary of the second trust a person who was not a beneficiary of the first trust.<sup>22</sup>

## ***(2) A special needs trust exception***

A recurring pattern in American trust practice involves a disabled remainder beneficiary, commonly a grandchild born after the grandparent/settlor’s death, whose eligibility for government benefits will be lost when the beneficiary becomes entitled to a distribution. If the settlor had anticipated these circumstances, probably the settlor would have structured the beneficiary’s interest to qualify as a ‘supplemental’ or ‘special needs’ trust, preserving the beneficiary’s government benefits eligibility.<sup>23</sup> Under modern understandings of the deviation doctrine, a court could authorize such a modification of the trust.<sup>24</sup>

In a few states and under UTDA § 13, a trustee may decant to create a supplemental or special needs trust for a disabled beneficiary even if the trustee’s discretion is otherwise limited by an ascertainable or reasonably definite standard.<sup>25</sup> Statutory recognition of this power is in effect a per se private power of deviation that may be justified on grounds of judicial economy and settlor intent. If in these cases a court will typically allow deviation, why not authorize by statute a comparable decanting and suppress the

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26 U.S.C. Section 2514(c)(1)[, as amended,] and any applicable regulations.’ Under UTDA § 2(21), a “‘reasonably definite standard” means a clearly measurable standard under which a holder of a power of distribution is legally accountable within the meaning of 26 U.S.C. Section 674(b)(5)(A)[, as amended,] and any applicable regulations.’

<sup>20</sup> Nev. Rev. Stat. § 163.556 (2017), as amended by 2017 Nevada Laws Ch. 311, § 49 (A.B. 314).

<sup>21</sup> *Ibid.*

<sup>22</sup> Thus, for example, in *Harrell v. Badger*, 171 So. 3d 764 (Fla. App. 2015), the court invalidated a decanting in part because not all beneficiaries of the second trust were beneficiaries of the first trust.

<sup>23</sup> See, e.g., Mary F. Radford & Clarissa Bryan, ‘Irrevocability of Special Needs Trusts: The Tangled Web That Is Woven When English Feudal Law Is Imported into Modern Determinations of Medicaid Eligibility’ (2012) 8 NAELA J. 1; Joseph A. Rosenberg, ‘Supplemental Needs Trusts for People with Disabilities: The Development of a Private Trust in the Public Interest’ (2000) 10 B.U. Pub. Int. L.J. 91.

<sup>24</sup> Compare *In re Riddell*, 157 P.3d 888 (Wash. App. 2007) (deviation allowed), with *In re Trust of Stuchell*, 801 P.2d 852 (Or. App. 1990) (deviation denied). *Riddell* reflects the position of modern American law, following Uniform Trust Code § 412 (Unif. Law Comm’n 2000) and Restatement (Third) of Trusts § 66 (Am. Law Inst. 2003).

<sup>25</sup> In *In re Kroll*, 971 N.Y.S.2d 863 (Sur. 2013), the court upheld a decanting to create a special needs trust against a challenge by the state attorney general.

social and private costs of litigation? Wouldn't the settlor almost certainly want to allow such a deviation and therefore such a decanting?

### **(3) Notice requirements**

Under most state trust decanting statutes, and under UTDA § 7, a trustee must give prior notice of an intended decanting to the beneficiaries of the first trust.<sup>26</sup> This rule may be understood as a codification of the American background common law rule that requires a trustee to make affirmative, advance disclosure to the beneficiaries of significant or non-routine developments in the administration of the trust.<sup>27</sup> The theory is that such disclosure puts the beneficiaries on notice, giving them an opportunity to object or otherwise protect their interests, for example by seeking a court order enjoining the trustee from the proposed course of action.

In a few states, however, such as Delaware, Nevada, and South Dakota, the decanting statute does not require advance notice.<sup>28</sup> Lawyers in these states commonly take the position that, because their decanting statutes do not require notice, a trustee need not give advance notice before decanting under one of those statutes. But if a decanting effects a significant reworking of the first trust, arguably the common law duty to give advance disclosure of significant or nonroutine developments would apply.<sup>29</sup> The Delaware statute is silent about notice. In other contexts, American courts have held that statutory silence is not enough to negate background common law.<sup>30</sup> The Nevada and South Dakota statutes, by contrast, provide for permissive notice.<sup>31</sup> Perhaps these permissive notice provisions reflect a legislative override of the background common law notice rule? Thus far, there is no appellate case law answering these questions.

### **(4) Direct modification without distribution to a second trust**

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<sup>26</sup> In *Harrell v. Badger*, 171 So. 3d 764 (Fla. App. 2015), for example, the court invalidated a decanting in part because the beneficiaries had not been given advance notice as required by the state decanting statute.

<sup>27</sup> See, e.g., Restatement (Third) of Trusts § 82 cmt. d (Am. Law Inst. 2007). The leading case is *Allard v. Pacific National Bank*, 663 P.2d 104 (Wash. 1983).

<sup>28</sup> See Del. Code Ann. tit. 12, § 3528; Nev. Rev. Stat. § 163.556(7) (permissive); S.D. Codified Laws §§ 55-2-15 to 55-2-21. -18

<sup>29</sup> The Restatement offers “some generalizations” by way of examples of significant matters warranting affirmative disclosure:

significant changes in trustee circumstances, including changes in the identities, number, or roles of trustees or in methods of determining trustee compensation; decisions regarding delegation of important fiduciary responsibilities or significant changes in arrangements for delegation; important adjustments being considered in investment or other management strategies; significant actions under consideration involving hard-to-value assets or special sensitivity to beneficiaries (such as liquidating or selling shares of a closely held business or a sale or long-term lease of a major real-estate holding); [and] plans being made for distribution on termination or partial termination (or perhaps subdivision) of the trust.

Restatement (Third) of Trusts § 82 cmt. d (Am. Law Inst. 2007).

<sup>30</sup> See, e.g., *Wilson v. Wilson*, 690 S.E.2d 710 (N.C. App. 2010) (holding that the state's enactment of the Uniform Trust Code, which omitted the Code's codification of a particular mandatory rule, did not negate the common law version of that rule).

<sup>31</sup> See Nev. Rev. Stat. § 163.556(7); S.D. Codified Laws §§ 55-2-18.



Under the UTDA and in some states, a trustee who has a decanting power can exercise that power by modifying the first trust directly, instead of distributing the property to a second trust. Arguably, such a direct modification goes beyond the greater-includes-the-lesser theory of the common law. It is hardly obvious that a settlor who gives a trustee a broad power to distribute principal intends for that trustee therefore to have a broad power to modify the terms of the trust. On the other hand, there seems little substantive difference between direct modification by the trustee and decanting into a second trust with different terms. Sidestepping the formality of distribution into a fresh trust often avoids the need for a new tax identification number, a transfer of property into retitled accounts, and redundant accountings and tax returns, which suppresses costs to the advantage of the beneficiaries.

### **Conclusion**

This article canvassed the rise of trust decanting in American trust practice, taking notice of its common law origins, its contrast with traditional American doctrine on trust modification and termination, the proliferation of state trust decanting statutes, and several areas of doctrinal divergence across the states. However, the emphasis on variations across the state statutes should not obscure the clear trend in American law toward judicial and statutory recognition of trust decanting. Half the states have already enacted trust decanting statutes, and more will do so in the coming years. Trust decanting has become a routine feature of trust practice in the United States. The clear trend in American law is toward a default rule of construction under which a trustee's discretionary power to distribute trust property includes a power to distribute that property in further trust – that is, toward recognizing trust decanting.