



Probate Law Journal of Ohio

Robert M. Brucken, Esq. | Editor-in-Chief
January/February 2010 ■ Volume 20, Issue 3

IN THIS ISSUE

- 121** **EMERGENCY NOTICE**
- 122** **EDITOR'S MESSAGE**
- 122** **Thorny Issues under the Ohio Uniform Prudent Investor Act for Trustee-Owned Life Insurance: Working Toward Relief**
By Robert B. Barnett, Jr., Esq. and Brandon A. Borgmann, Esq.
- 128** **Why Ohio Should Enact the Uniform Power of Attorney Act**
By Richard E. Davis, Esq.
- 135** **Demystifying Decanting and Ohio's Proposed Statute**
By M. Patricia Culler, Esq.
- 145** **Reforming the Testamentary Trust**
By David W. Cox, Esq.
- 146** **Tax Malpractice Damages in Ohio—A New Look at Privity and Damages for Breach of Engagement**
By Frank D. Jacobs, Esq.
- 150** **Tax Planning for Nonqualified Annuities**
By Gary L. Miller, Esq.
- 152** **Qualified Disclaimers, Nonqualified Disclaimers and "Effective" Disclaimers**
By Thomas Pillari, Esq.
- 157** **Probate Reform: A Retrospective**
By Mark A. Leahy, Esq.
- 158** **Summaries of Recent Cases**
- 160** **Legislative Scorecard**

EMERGENCY NOTICE

There is a new twist on transfer on death (TOD) beneficiary designations for real estate. S.B. 124, which authorizes them by separate affidavit rather than by deed, did not become effective only after the usual 90-day period for practitioner education, but by last minute surprise addition of an emergency clause became effective immediately on signing by the Governor, which occurred on December 28. RC 5302.24 as enacted by the bill thus voids TOD designations in deeds recorded on or after that date. Those TOD deeds you have prepared for clients who signed them before December 28 or who have now just signed them, but that you did not record before December 28, stash them in the file and replace them with the new affidavits.

For background, see Meredith, Proposed Legislation for New Transfer on Death Affidavit, 19 PLJO 118 (Jan./Feb. 2009). The following is a form prepared by your editor for use when there is a single TOD beneficiary (that in most cases should be the owner's revocable trust). Additional forms for more complex designations are being posted on the OSBA's Web site.

TRANSFER ON DEATH DESIGNATION AFFIDAVIT

[RC 5302.22]

_____, owner, (marital status), now
owner of record of the following real property located at
_____, _____, Ohio as recorded at Vol.

enhance the usefulness of durable powers while at the same time protecting the principal, the agent, and those who deal with the agent. It should be enacted in every jurisdiction as quickly as possible.

ENDNOTES

1. Linda S. Whitton and Richard E. Davis, *Probate Law Journal of Ohio*, Vol. 18, No. 3 (2008) at p. 135.
2. Richard E. Davis, *Probate Law Journal of Ohio*, Vol. 14, No. 2 (2003), "All is Not Well with the 'Lowly' Power of Attorney," at p. 30.
3. See Alan Newman, 43 *Real Property, Trust and Estate Law Journal* 523 "Revocable Trusts And The Law Of Wills: An Imperfect Fit," by Alan Newman (Fall, 2008). Professor Alan Newman sets forth the issue as follows:

Note, however, that it is not entirely clear whether, under the UTC, an authorized agent may create a trust for a principal. Neither section 401, , describing methods for creating trusts, nor section 402, listing the requirements for doing so, mention an agent acting on behalf of a principal, and section 402(a) expressly requires that the settlor have capacity and indicate an intention to create the trust. See UNIF. TRUST CODE (UTC) §§ 401-402 (2000), 7C U.L.A. 478-81 (2006). Section 401's list of methods for creating trusts, however, is not an exclusive list. See id. § 401 cmt. Further, section 402 does not specify that the settlor must have capacity and express the intention to create the trust at the time it is created. See id. § 402(a) (1)-(2). For existing revocable trusts, the UTC includes a provision allowing an agent to exercise the settlor's rights if expressly authorized to do so in either the terms of the trust or the power of attorney. See id. § 602(e), 7C U.L.A. 547 (2006). The absence of a similar provision in the trust creation statutes arguably indicates that trusts may not be created by agents of settlors. It would be inconsistent, however, to allow an authorized agent to amend a revocable trust, as section 602(e) does, but not to allow an authorized agent to create such a trust. Further, authorized agents may give the principal's property away. See Restatement (Third) of Agency § 2.02 cmt. h (2006). At common law, authorized agents can create trusts for principals. At common law, authorized agents can create trusts for principals. See Restatement (Third) of Trusts § 11(5) (2003). As a result, the better argument is that under the UTC, which is supplemented by the common law, trusts can be created by agents if they are expressly authorized to do so. [emphasis added]
4. Under the common law, a power of attorney became ineffective upon the principal's incapacity. Therefore, it was not a useful tool to manage the affairs of an incapacitated principal since the principal's loss of capacity terminated the agent's actual authority. Restatement (Third) of Agency § 3.08 (2005).

Demystifying Decanting and Ohio's Proposed Statute

By M. Patricia Culler, Esq.¹
 Hahn Loeser & Parks LLP
 Cleveland, Ohio
 Chairperson, EPTPL Section Committee
 on Trust Decanting

I. What is Decanting?

Merriam-Webster Online Dictionary² has the following entry for "decant":

Main Entry: de·cant Pronunciation: \di-'kant, də-\

Function: transitive verb

Etymology: New Latin *decantare*, from Latin *de-* + Medieval Latin *cantus* edge, from Latin, iron ring round a wheel—more at cant

Date: 1633

1. to draw off (a liquid) without disturbing the sediment or the lower liquid layers
2. to pour from one vessel into another
3. to pour out, transfer, or unload as if by pouring

— de·can·ta·tion \də-kan-'tā-shən\ *noun*

The act of distributing (pouring) some or all of the assets from one irrevocable trust to another has come to be known in the trusts and estates profession as "decanting." The metaphor is apt because decanting a trust by distributing all or part of the trust property to a new trust can rid the trust of unwanted provisions (the sediment), leaving the desirable provisions in the new trust. Decanting is one of a number of tools that may be used to deal with problems arising with existing irrevocable trusts.

Conceptually, the power to decant is viewed as inherent in the power of the trustee to exercise the trustee's discretion to make certain distributions by distributing assets in further trust and, thus, the power may be exercised by the trustee without approval of any court or the

beneficiaries of the trust. The inherent power to make distributions in further trust is not, however, unlimited. Moreover, statutes codifying the power of a trustee to make distributions in further trust can and do include explicit limitations on the exercise of such power, primarily to insure that the existence of the power itself does not have adverse tax consequences and also, to a varying degree, to insure that settlor's intent is preserved.

The nomenclature for the trusts involved in a trust decanting varies among commentators and the statutes thus far enacted. The trust from which distributions are made is referred to sometimes as the "first trust" or the "invaded trust" and will be referred to in this article as the "original trust." The trust to which the distributions are made is referred to sometimes as the "second trust" or the "appointed trust" and will be referred to in this article as the "recipient trust."

II. History and Background

A. Common Law

There is very little case law acknowledging a power of a trustee, who has discretion to distribute principal to one or more beneficiaries, to make that distribution in further trust. Florida has long had common law set forth in the decision of the Florida Supreme Court in *Phipps v. Palm Beach Trust Co.*,³ that established the principle that a trustee with absolute discretion to distribute the principal of a trust among a class of beneficiaries has the authority to distribute principal of the trust into a new trust for a beneficiary. The court approved a distribution in further trust where the recipient trust granted a limited testamentary power of appointment to the beneficiary that permitted appointment to the beneficiary's spouse, even though the spouse was not a beneficiary of the original trust. The court reasoned that the trustee's discretion to make distributions was analogous to a limited power of appointment and that, since the trustee could exercise its discretion by creating an estate in fee, it could also do so by creating a lesser estate, that is by distributing in further trust.

The court indirectly acknowledged a common law decanting power in *Wiedenmayer v. Johnson*.⁴ In that case, the trustee sought the court's permission to distribute all of the trust property to the beneficiary, on the condition that the beneficiary would contribute the property immediately to a new trust. The trustee had absolute discretion to distribute principal of the trust to the beneficiary, limited only by the requirement that the distribution be in the beneficiary's best interests. The purpose of the distribution was to eliminate the contingent remainder benefi-

ciaries of the first trust because of the "mental anguish" caused the beneficiary by their continued interests in the trust. The court reasoned that the contingent remainder beneficiaries' interests could have been eliminated by an outright distribution to the beneficiary and thus conditioning the distribution on the beneficiary's immediate contribution of the assets to the new trust was within the trustee's power. This is essentially the same reasoning as the court's reasoning in *Phipps*.

B. Restatement

One basis in common law for the proposition that the power to distribute in further trust is inherent in a trustee's discretion to distribute to or for the benefit of one or more beneficiaries, some argue, is founded in the definition of powers of appointment in § 11.1 of the Restatement (Second) of Property, Donative Transfers (1986) (Restatement 2d) which provides "a power of appointment is authority, other than as a incident of the beneficial ownership of property, to designate recipients of beneficial interests in property." Comment d. to that section specifically states that a trustee's unlimited discretionary power to make distributions to or for a beneficiary or a group of beneficiaries is a power of appointment. The Restatement 2d further provides in § 19.3 that, absent a provision to the contrary in the instrument creating a power of appointment, a power of appointment may be exercised in further trust for one or more objects of the power. Under this analysis, all of the other principles governing, and limitations on, exercises of powers of appointment would also apply to a trustee's exercise of its distribution power by distributing in further trust. Examples of such principles and limitations are that a power may only be exercised in favor of objects of the power and that the exercise of a power of appointment is valid only to the extent that interests created by the power vest within any applicable perpetuities period.

Using common law principles governing powers of appointment as a legal rationale for a common law decanting power is called into question by the upcoming publication of the Restatement (Third) of Property, Wills and Other Donative Transfers (Restatement 3d) which will provide at § 17.1 that "a power of appointment is a power that enables the donee of the power, acting in a nonfiduciary capacity, to designate recipients of the beneficial ownership interests in the appointive property." Comment g to that section distinguishes fiduciary powers because they are subject to fiduciary standards, while acknowledging that a fiduciary distribution power is subject to other principles governing exercises of powers of appointment such as those mentioned above. A consistent position is taken in § 75 of Restatement

(Third) of Trusts. The power of a trustee with absolute discretion to distribute principal to a beneficiary or beneficiaries is always subject at least to the standard of good faith and often to the standard of reasonableness. In contrast, no good faith or reasonableness standards govern the exercise of a limited power of appointment held in a nonfiduciary capacity.

C. Statutes

The lack of support for treating a trustee's discretion to distribute as a limited power of appointment in the upcoming Restatement 3d may have been one impetus for the recent enactment of statutes in several states to give statutory authority for trust decanting. The original decanting statute, however, was enacted in 1992 in New York for a very different reason—to allow trusts that were exempted from the generation skipping transfer tax enacted in the Tax Reform Act of 1986 by reason the effective date rules (so-called “grandfathered trusts”) to take advantage of that exemption by decanting the grandfathered trust to a new trust that would continue in trust as long as permissible under the applicable rule against perpetuities.⁵

New York Estates, Powers and Trusts Law (EPTL) § 10-6.6(b) provides that “a 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 one or more proper objects of the exercise of the power, may exercise such discretion by appointing all or part 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 legislative history of the statute indicates that it is an enactment of the common law and both the statute and the legislative history indicate that the trustee's absolute discretion to invade the principal is a special power of appointment. Although New York's statute presently is arguably the most conservatively drafted statute, there are efforts under way among the New York bar to amend the statute and to expand its applicability.

There are now a total of 10 states that have enacted decanting statutes. In addition to New York, the following states currently have statutes: Alaska, Arizona, Delaware, Florida, New Hampshire, Nevada, North Carolina, South Dakota, and Tennessee. The Estate Planning, Trust and Probate Law Section Council (the Section Council) of the Ohio State Bar Association (OSBA) has prepared, and the OSBA Council of Delegates has approved, a decanting statute for Ohio. It is now in the hands of the OSBA lobbyists who will find a sponsor and shepherd it

through the legislative process, probably in conjunction with other OSBA proposals from the Estate Planning, Trust and Probate Law Section. In addition to Ohio, Colorado, Minnesota, Missouri, Pennsylvania and South Carolina are considering decanting statutes. No doubt others are in the works.

III. Why Decant?

Now that you know what trust decanting is, why would a trustee want to do it? Every professional in the trusts and estates field has, no doubt, sometime, likely many times, in his or her career encountered an irrevocable trust that was problematic in some way that might be solved by distributing to a new trust without the problematic provisions or with provisions that address unanticipated problems. The problems could arise because of poor drafting that is ambiguous or creates adverse tax consequences or because of changes in the law, beneficiary circumstances, family dynamics or financial factors, for example. Although there may be other methods to effect a change in a problematic trust, for example, reformation and nonjudicial settlements, decanting, if possible, permits the change without any requirement of consent by beneficiaries or court approval.

New York's statute originally required either court approval or beneficiary consent and thus a body of case law developed approving particular distributions in further trust that provides examples of reasons for doing so. Some examples of court approved decanting under New York's statute:⁶

- Protecting the tax treatment of a trust.
- Modifying administrative provisions of a trust.
- Changing restrictions on investment powers.
- Granting a power of appointment to a beneficiary.
- Changing succession of trusteeship provisions including provision for a procedure to appoint successors.
- Reducing administration costs.
- Extending the term of a trust.
- Change of governing law.
- Creating or eliminating grantor trust status.
- Applying or removing spendthrift provisions.

The increasing prevalence of multigenerational trusts, engendered by the enactment of the current generation skipping transfer tax regime, specifically the GST exemption, the elimination or loosening of the rule against perpetuities in many states and increased interest in asset protection, will no doubt increase the need to adapt trusts to changing circumstances in the future. The longer a trust continues, the greater the chances of unanticipated problems arising. Decanting can be a powerful tool to allow long term trusts to adapt to changing circumstances and avoid problems.

IV. When and How Can a Trust be Decanted?

As noted above, whether derived from common law or statute, a trustee's power to make distributions in further trust is not unlimited. Certain constraints on it are inherent in the grant of the trustee's distribution powers in the trust instrument and in other common and statutory law governing the disposition of interests in property. In addition, due regard must be given to carrying out the settlor's intent, both as to disposition of the property transferred to the trust and regarding the intended tax benefits and tax treatment of the trust. All of these limitations can be better understood by beginning with the proposition that there are two ways to look at the decanting power: as a limited power of appointment or as a power to amend the terms of the trust agreement. Although these perspectives of the decanting power would create certain limitations on its exercise, a statute may alter the limitations, by increasing or decreasing, even eliminating, them or by creating new limitations. It is probably safe to say that every statute thus far enacted does alter what might be viewed as the common law constraints on a trustee's power to make discretionary distributions in further trust. Moreover, the trust instrument itself may expressly grant the trustee the power to make distributions in further trust and may set the limits as broadly or narrowly as the settlor wishes, limited only by general trust law principles.

A. Decanting Power as a Limited Power of Appointment

As discussed above, both the case law (*Phipps*) and the first statute enacted in New York considered the power to make distributions in further trust to have its basis in the treatment of the power of the trustee to make distributions of principal in its sole and absolute discretion to or for the benefit of one or more beneficiaries as the equivalent of a limited power of appointment. Most of the statutes enacted to date include some recitation

that the power to distribute in further trust is deemed to be a limited power of appointment.

What are the limitations on exercises of limited powers of appointment and what effect would those limitations have on the decanting power if it is the equivalent of a limited power of appointment? First, a power of appointment may only be exercised in favor of objects of that power and is subject to any other limitations on the power in the instrument granting the power. Second, since interests created pursuant to the exercise of a power of appointment (other than a presently exercisable general power) are deemed to be created by the original grantor of the power, any such interests are subject to the same limitations on the remoteness of vesting and restraints on alienation as applied to the property subject to the power of appointment. That is, if a limited power of appointment is exercised in further trust for the benefit of one or more objects of the power, all interests in the recipient trust are subject to the same rule against perpetuities requirements as applied to the property held in the original trust. How does this apply to the decanting power?

1. Objects of the Power

The "objects" of the trustee's discretionary distribution power are, in Ohio Trust Code (OTC) parlance, the "current beneficiaries" of the trust at the time the power is exercised. Even though there may be additional beneficiaries of the trust to whom the trustee may make distributions at some time in the future, only those beneficiaries to whom, or for whose benefit, current distributions of income or principal may be made are "objects of the power."

This concept has very important implications for the exercise of a common law decanting power. Strictly speaking, the recipient trust may include provisions only for one or more of the current beneficiaries. This means that no other beneficiaries of the original trust, even the remainder beneficiaries who are not current beneficiaries, may be included as beneficiaries of the recipient trust. When a limited power of appointment is exercised in further trust, what happens when there are no longer any objects of the power? Generally, the property would revert back to the original trust. Similarly, when there are no longer any beneficiaries of the recipient trust who were objects of the power when the trustee made the distribution to the recipient trust, the property held in the recipient trust as a result of the decanting must be returned to the trustee of the original trust and administered on the terms then applicable to it. Needless to say, that limits the utility of common law decanting, particularly if the class of current beneficiaries is small.

2. *Solutions to the Remainder Beneficiary Problem*

Fortunately, the problem of how to include the remainder beneficiaries in the recipient trust can be, and has been, addressed in statutory decanting powers. Two different approaches have been taken in the statutes.⁷

Most states seem to permit the recipient trust to have provisions for remainder beneficiaries and to alter their interests, so long as the recipient trust does not have as beneficiaries anyone who is not a beneficiary of the original trust. In Ohio, the drafting committee (the Committee) of the Section Council considered this approach, but decided that the statute should not permit the trustee to defeat the vested interests of remainder beneficiaries. The Committee's thinking was that, however broad the trustee's discretion is to distribute among the current beneficiaries, no power was given to that trustee to create interests in the future beneficiaries.

Alaska, Delaware, and Nevada take a different approach. Their statutes permit the decanted property, after a time or an event specified in the recipient trust, to continue in the recipient trust for the beneficiaries of the original trust upon substantially identical terms and conditions regarding the interests of the beneficiaries of the original trust. In other words, rather than the property having to revert back to the original trust, the dispositive terms of the original trust can be included in the recipient trust. Although this does not permit the interests of beneficiaries who were not objects of the trustee's distribution power to be altered by decanting, other provisions of the trust, such as trustee succession, administrative powers and other nondispositive provisions could be altered and there would be no need for the decanted property to revert to the original trust. We decided to adopt this approach in Ohio's proposed statute.⁸

That said, it is not entirely clear what the words "after a time or an event specified in the recipient trust" really mean. For example, would it be possible to decant for one of several current beneficiaries for a short period of time (a day, a month, a year), after which the provisions for the remainder beneficiaries of the original trust would apply, thereby cutting off current beneficiaries and accelerating remainder beneficiary interests?

Additional flexibility is provided in the Delaware and Nevada statutes because the recipient trust may grant, to one or more of the persons for whose benefit the trust could have been decanted, a power of appointment, including a general power or a limited power exercisable in favor of a class that includes persons who are not beneficiaries of the original trust or the recipient trust. Ohio's

proposed statute has a similar provision. Proposed Ohio Revised Code § 5808.18 (A)(3)(a).

If the decanting statute or power granted in a trust agreement is not intended to allow the trustee to stray widely from the settlor's intent, then it seems that the better approach would be to allow incorporation of the remainder provisions of the original trust and also allow the recipient trust to grant beneficiaries powers of appointment.

3. *Rule Against Perpetuities*

Viewed as a limited power of appointment, the exercise of a common-law decanting power is only valid to the extent that all interests created by the exercise of the power will vest within the period required for vesting under the law applicable to the original trust. A statutory decanting power should also be exercisable in a manner that would create only interests that are certain to vest within the applicable time period under the rule against perpetuities. All but one of the statutes so far enacted have provided that the exercise of the power to decant is limited to the same extent that limited powers of appointment are under the applicable rule against perpetuities.

Although the recipient trust is subject to the limitations under state law on remoteness of vesting applicable to interests created by the exercise of a power of appointment, that does not necessarily mean that the measuring lives used in the original trust agreement are the only measuring lives that may be used in the recipient trust. Unless the terms of the original trust prohibit, it should be possible in the recipient trust to expand the class of measuring lives, provided the individuals are ascertainable and were in being when the original trust was created, and thus extend the duration of the recipient trust to some degree.

B. Decanting Power as an Amendment Power

To the extent a decanting power is in essence a power to amend the terms of the original trust, two separate areas of analysis are important. First, what is the extent of the trustee's discretion and how are the settlor's intent and material purposes of the trust reflected in the terms of the trust? Second, what constraints on the power to amend are implicit or necessary to insure that an amendment by distribution in further trust does not or cannot result in adverse tax consequences?

1. Dispositive Terms of Original Trust

The terms of the original trust creating the interests of the beneficiaries and granting distribution discretion

to the trustee are the most significant manifestation of the settlor's intent in creating the trust. The concept of common law decanting is premised on the trustee having unconstrained discretion to make distributions to or for the benefit of one or more beneficiaries, the theory being that the settlor placed her trust in the trustee to determine what distributions are appropriate, to whom and when. Thus, the first issue is whether and to what extent any standards or mandatory distributions in the terms of a trust will limit the power to make distributions in further trust. Put another way, what degree of discretion must the settlor have granted the trustee in order for the trustee to be deemed to have the power to make distributions in further trust?

2. Tax Considerations

In exercising a power to make distributions in further trust, the trustee may be limited by the manifestation in the trust agreement of the settlor's intent to obtain certain tax treatment of the trust or to avoid certain adverse tax consequences. In addition, state law (other than a decanting statute) may restrict certain distributions to insure a particular tax treatment. For example, state law may provide that a trust that qualifies for a marital deduction must distribute income at least annually even if the trust agreement does not specify the frequency of payments of income. See, for example, Ohio Revised Code § 5815.23.

To a varying degree, each of the statutes has attempted to include provisions that will safeguard the ability to qualify for certain tax treatments or benefits such as the marital and charitable deductions. First and foremost, a decanting power should be structured so that no adverse tax consequences would ensue from the mere possibility that a distribution could be made to another trust that has disqualifying provisions or does not include provisions required to qualify for a particular tax treatment.

To the extent that particular tax treatment can only be achieved by including certain governing instrument requirements, it must be clear that the terms of a recipient trust may not omit those requirements. It is necessary to prohibit changes to the trust terms that, if included in the original trust, would prevent qualification for a tax benefit for which the trust actually qualified.

In addition, if the decanting statute allows the terms of the trust to be altered by the trustee who is also a beneficiary, the trustee effectively already has any powers that the recipient trust could include. Thus many of the statutes have placed special limitations on the exercise of a decanting power by a trustee who is also a beneficiary.

A statute may include provisions that prevent the trustee from creating the tax problem by including provisions in the recipient trust that have adverse tax consequences, but placing too many restrictions on the power in an effort to prevent an inexperienced trustee from causing a problem will also limit its flexibility. Thus the preferable approach is to restrict only those changes that would prevent qualification for certain intended tax benefits ab initio and not try to protect from every possible mistake a trustee might make by decanting.

Some of the tax benefits that the various statutes attempt to protect are:

- Marital deduction.
- Charitable deduction
- Annual exclusion for gift tax purposes
- The zero inclusion ratio for GST purposes under § 2642(c) for certain nontaxable gifts in trust
- Effective date protection from the GST tax for trusts created before September 25, 1985
- Allowing the trust to qualify as an s-corporation shareholder
- Qualification for stretch payout of retirement plan assets
- Using decanting to make the trust a grantor trust or to terminate grantor trust status
- A blanket prohibition against including provisions that would disqualify for any other tax benefits for which the trust is clearly intended to qualify.

C. Absolute Power to Invade or Discretion to Distribute

New York's statute has, since its enactment, required the trustee to have absolute discretion under the terms of the trust "to invade the principal" of a trust "for the benefit of one or more proper objects of the exercise of the power." The statute was premised on, and intended to codify, the principle that absolute discretion in the trustee over distributions among beneficiaries was equivalent to a limited power of appointment and thus could be exercised in further trust as the trustee determined.

What does "absolute discretion mean? Florida's statute requires "absolute power" to invade principal, but provides that absolute power to invade principal includes powers not limited to specific or ascertainable purposes, whether or not

the word “absolute” is used and, further, that purposes such as “best interests, welfare, comfort or happiness” are not considered specific or ascertainable purposes.

Ohio’s proposal is for a bifurcated statute, with a broader decanting power if the trustee has absolute power to make distributions and a much more limited decanting power if the trustee does not. Ohio would define “absolute power” in the same manner as Florida does.

D. Limitations or Standards

At common law, it is arguable whether a trustee who has power only to distribute principal to a beneficiary or among several beneficiaries for ascertainable purposes such as maintenance, support, health and education, may distribute to another trust even if the terms of the recipient trust provide the same standard. The argument against it would be that the distribution to the second trust is not a distribution for the purpose. In addition, the inclusion of standards for distribution or conditions for mandatory distributions is strong evidence of the settlor’s intent, by establishing the trust, to place limits on the power conferred upon the trustee and regarding the interests created. Nonetheless, a statute may define the limits of a power and thus a number of states have enacted statutes that do not require absolute discretion or power to make distributions of principal among beneficiaries.

Assuming that it is desirable to permit decanting when the trust provides standards of some sort for distribution of income or principal, several questions arise as to what the scope of the decanting authority should be. For example:

- Must the recipient trust include the same standards or can it narrow or broaden the standards?
- If the original trust provides an age or ages for distribution to one or more beneficiaries, may the terms of the recipient trust accelerate those distributions or delay them, even to the point of holding the trust for the life of the beneficiary?
- Can mandatory income interests be defeated or reduced?
- Do the current beneficiaries of the recipient trust need to be the same as the current beneficiaries of the original trust?

If the decanting statute purports to apply to distributions made after its effective date from any trust governed by the laws of the state, whenever established,

provisions permitting the standards for distribution to be changed or changing the ages for distribution effectively allow the trustee to diverge substantially from the settlor’s intent as expressed in the terms of the trust. Perhaps there is less divergence from settlor’s intent if the recipient trust includes narrower standards for distribution than the original trust because distributions from the recipient trust would still be made only for a purpose or purposes specified by the settlor. On the other hand, because the act of decanting does not itself constitute distribution of funds for the purpose, even a narrowing of the standard is a divergence from the settlor’s intent as reflected in the standards for distribution.

If decanting may be used to raise the ages for outright distribution of the trust to a beneficiary, this gives the trustee the authority to hold assets in trust longer than the settlor granted and thus extends the time during which the trustee has control over the trust assets. Although it is up to each state to decide how broad to make its statutory decanting power, in the case of trusts existing on the effective date of the statute, allowing such variations from the trust’s original terms is substantially expanding the authority of the trustee.

The states that permit decanting from trusts where the trustee does not have absolute discretion or trusts with standards for distributions vary as to whether and to what degree they restrict the terms of the recipient trust as a result. Some appear not to require that any standards for distributions in the original trust also apply to the recipient trust, except, perhaps, if a beneficiary is serving as trustee.

North Carolina requires that if the power to distribute income or principal in the original trust is subject to an ascertainable standard, the recipient trust must have the same ascertainable standards for distribution and the same current beneficiaries. Alaska requires only that the recipient trust have the same standard for invading principal. Arizona requires any ascertainable standard to be the same or more restrictive if the trustee is a possible beneficiary under the standard. Ohio’s proposed statute will require that the interests of the beneficiaries (a defined term in the OTC) are not materially changed in the recipient trust. Proposed Ohio Revised Code § 5808.18(B).

The emphasis on “standards” for discretionary distributions contained in the original trust ignores the issue of whether decanting can alter ages for distribution or other events upon which mandatory distributions are conditioned, either by accelerating them or by postponing them. None of the statutes currently in effect directly addresses the issue and from that it may be inferred that, under most

of them, decanting may alter ages for distribution and even change a trust to be a lifetime trust for a beneficiary.

All of the statutes have some prohibition against the reduction of “fixed income interests” or “non-discretionary income payments.”

Ohio’s proposed statute and proposed changes to New York’s statute would also prohibit a reduction in an annual 5 or 5 power that has come into effect at the time of the decanting, thus preserving the credit for the tax on prior transfers under Internal Revenue Code § 2013 for the value of such powers.

V. Ohio’s Proposed Statute

Ohio’s proposed statute would be new § 5808.18 of the Ohio Revised Code. The statute has been approved by the OSBA Council of Delegates as an OSBA backed bill. The complete text of the proposed section is available on the OSBA Web site in the Fall 2009 Reports to the Council of Delegates. The approach the Committee adopted in drafting the statute was to bifurcate the powers to make distribution in further trust based upon the extent of the trustee’s discretion to make current distributions. Division (A) of the proposed statute sets forth the power to distribute in further trust if the trustee has absolute power to distribute principal and Division (B) sets forth the power in all other situations. In all cases the decanting power can be eliminated or otherwise limited by contrary provisions in the trust agreement.

A. When Original Trust Gives Absolute Discretion

Division (A) of the proposed section is modeled after the Florida and New York statutes in providing that a trustee who has absolute power to make distributions of principal to or for the benefit of one or more beneficiaries may distribute all or part of the principal to a second trust for the benefit of any one or more of those beneficiaries. “Absolute power” is defined as any power to make distributions that is not limited by reasonably definite standards or ascertainable standards (a defined term in the OTC), whether or not the word “absolute” is used. A power to distribute for “best interests, welfare, comfort or happiness” or similar terms, if not otherwise limited, is not considered to be limited by reasonably definite or ascertainable standards. Proposed Ohio Revised Code § 5808.18(A)(1) and (2).

Using the Delaware approach to the remainder beneficiary problem (discussed above), the recipient trust may (a) grant a general or limited power of appointment to any beneficiaries for whose benefit the property was distributed, including a power to appoint to persons who

are not beneficiaries of the original trust and (b) may provide that at a time or upon an event specified in the recipient trust, the recipient trust will be held upon terms regarding the interests of the beneficiaries that are substantially identical to the terms of the original trust except that a current beneficiary who was excluded by reason of the decanting may be excluded from these terms. Proposed Ohio Revised Code § 5808.18(A)(3).

The Committee viewed decanting under Division (A) to be a statement of an inherent power of a trustee to whom the grantor has given absolute discretion regarding distributions of principal, modified to address the practical issues posed by the problem of the remainder interests, to make it more useful and to avoid any tax issues created by the enactment of the statute.

B. When Original Trust Does Not Give Absolute Discretion

If the trustee does not have absolute power to make distributions of principal as defined in Division (A) of the statute, under Division (B) the trustee who has authority to distribute principal to or for the benefit of one or more beneficiaries may distribute all or part of the principal to a second trust, but the recipient trust may not materially change the interests of the beneficiaries of the original trust. This means that both standards for distribution and mandatory distributions, for example, upon attaining certain ages, must be included in the recipient trust.

In drafting the statute, the Committee was concerned that the decanting power not be able to defeat vested interests of the beneficiaries of a trust and to undermine the settlor’s intent as evidenced by the dispositive provisions of the trust. Those concerns were balanced against the desire to permit decanting of trusts where the trustee’s discretion regarding distributions has some limitations, but where it is desirable to decant in order to modify other provisions of the trust that do not directly affect vested interests of the beneficiaries, in order to achieve other objectives or to address changes in circumstances.

C. How to Decant

1. Limitations on Recipient Trust

Division (C) of the proposed section sets forth of limitations on the terms of the recipient trust primarily designed to avoid adverse tax consequences that might result from the mere existence of the power. The following issues are addressed. The recipient trust may not:

- Reduce, limit or modify any current right

of a beneficiary to a mandatory distribution of income or principal, mandatory annuity or unitrust interest, or certain annual withdrawal rights that have come into effect. A beneficiary's income interest is not considered mandatory if, under the original trust, distributions of principal may be made to anyone other than the beneficiary. Proposed Ohio Revised Code § 5808.18(C)(1).

- Include or omit provisions that would have disqualified the original trust from any marital or charitable deduction or reduced the deduction under the same provisions under which the original trust so qualified. Proposed Ohio Revised Code § 5808.18(C)(2).
- Include or omit provisions that would have prevented the original trust from qualifying for a gift tax annual exclusion in the manner in which the original trust did so qualify. Proposed Ohio Revised Code § 5808.18(C)(3).
- Include or omit provisions that would have prevented the original trust from qualifying as a shareholder in an S corporation. Proposed Ohio Revised Code § 5808.18(C)(4).
- Include or omit provisions that would have prevented qualification for the non-taxable gifts exclusion for GST tax purposes under Internal Revenue Code § 2642(c). Proposed Ohio Revised Code § 5808.18(C)(5).
- If there are qualified retirement plans or IRAs payable to the trust, include or omit provisions that would have shortened the maximum distribution period for distributions from those plans or IRAs. Proposed Ohio Revised Code § 5808.18(C)(6).
- Include or omit any provisions that would have disqualified the original trust from any tax benefit for which the terms of the trust agreement expressly indicate an intention, or are clearly designed, to qualify. Proposed Ohio Revised Code § 5808.18(C)(7).
- Increase trustee's compensation. Proposed Ohio Revised Code § 5808.18(C)(8)(a).
- Reduce the standard of care applicable to the trustee's actions. Proposed Ohio Revised Code § 5808.18(C)(8)(b).

Note that certain of these provisions require that, if the

original trust qualified (or would have qualified without regard to the statute) for a particular tax treatment using a particular method of qualifying, then the recipient trust may not include or omit provisions that would have prevented the original trust from qualifying under the specific method that the original trust so qualified. For example, if the original trust qualifies as a power of appointment marital trust under Internal Revenue Code § 2056(b)(5), then the recipient trust may not eliminate or place conditions on the general power of appointment that would have prevented it from qualifying as a power of appointment marital trust, even though it includes provisions that would have allowed the trust to qualify as qualified terminable interest property (QTIP) if a QTIP election had been made. This is important because otherwise the general power of appointment in the surviving spouse may not be considered to be "exercisable alone and in all events," thus preventing qualification for the marital deduction under § 2056(b)(5). Similarly, if the original trust qualifies for the annual exclusion because it meets the requirements of Internal Revenue Code § 2503(c), the recipient trust must include all of the governing instrument requirements of that section. This is a conservative approach to the statute, but is intended to insure that the mere fact of the statute does not prevent trusts from qualifying for certain tax benefits by reason of the trustee having a power to eliminate governing instrument requirements via decanting.

The proposed statute does not attempt to prevent trustees from causing any adverse tax consequences by exercising the power improperly. Rather it is intended to eliminate the instances where the decanting power itself could create a tax problem.

2. Written Instrument

The exercise of the power to distribute must be by a written instrument signed by the trustee and filed with the records of the first trust. Proposed Ohio Revised Code § 5808.18(D).

3. Duration of Recipient Trust

The provisions of the recipient trust must be subject to the same restrictions on remoteness of vesting of interests that apply to the original trust under Ohio Revised Code §§ 2131.08 and 2131.09(B). For this purpose only, the exercise of the power to distribute to the recipient trust is treated as if it is an exercise of a nongeneral power of appointment. Thus under the current Ohio Revised Code § 2131.09(B)(4), if the rule against perpetuities does not apply to the original trust by reason of Ohio Revised Code § 2131.09(B)(1), all interests created in the recipient trust

would be required to vest within lives in being plus 21 years. Proposed Ohio Revised Code § 5808.18(E). The Section Council is working on an amendment to Ohio Revised Code § 2131.09(B) that would permit nongeneral powers of appointment granted in a trust, to which the rule against perpetuities would not otherwise apply, to be exercised so as to create interests that could vest at a time much later than required by the rule against perpetuities, but which time is determined with reference to the date of the original creation of the power. Following Alaska's approach to this issue by fixing the term at 1,000 years is under consideration. The proposed decanting statute should accommodate that change without requiring amendment at the same time.

D. Other Details

1. Notice

The trustee of the original trust is required to give notice 30 days in advance of the distribution to the current beneficiaries of the intended distribution to the recipient trust. Distribution may be made sooner if all current beneficiaries waive the 30-day requirement. Waiver of the 30-day requirement will not limit the right of any beneficiary to object to the exercise of the trustee's power as provided elsewhere in the OTC. Proposed Ohio Revised Code § 5808.18(F). No court approval is required.

2. Other Fiduciaries with Distribution Powers

If the original trust grants powers to a person other than the trustee, such as a trust advisor, trust protector or distribution advisor, acting in a fiduciary capacity, to direct the trustee to make distributions of principal, then that person may direct the trustee to make a distribution in further trust under Proposed Ohio Revised Code § 5808.18(A) or (B), as applicable, as if that person were the trustee. Proposed Ohio Revised Code § 5808.18(G).

3. Common Trust Provisions Do Not Limit

A spendthrift clause or a provision prohibiting revocation or amendment of the trust do not prohibit the trustee of the original trust from exercising its powers under Proposed Ohio Revised Code § 5808.18(A) or (B). Proposed Ohio Revised Code § 5808.18(H).

4. Standards Applicable to Trustee

If the trustee of the original trust acts reasonably and in good faith in exercising its power to make distributions in further trust, then the trustee is presumed to have acted in accordance with the terms and purposes of the trust and the interests of the beneficiaries. Proposed Ohio Revised

Code § 5808.18(I). This is to prevent Ohio Revised Code § 5808.14(A) from negating the decanting power.

5. Other Limits

No duty to exercise a trustee's power to distribute in further trust under the decanting statute is implied or created by the statute and no inference of impropriety may be made by reason of a trustee not exercising the decanting power. Proposed Ohio Revised Code § 5808.18(J).

The decanting power applies to testamentary trusts, but may only be exercised as to those trusts with approval of the court having jurisdiction over the testamentary trust. Proposed Ohio Revised Code § 5808.18(K).

The decanting statute does not apply to revocable trusts while revocable or to any trust or portion of a trust as to which the trustee is also the settlor. Proposed Ohio Revised Code § 5808.18(L).

The decanting statute is not to be construed to limit any other power to make distributions in further trust that may arise out of common law, any other statute or the terms of the trust instrument for the original trust. A trust agreement may confer upon any trustee the power, or upon any other fiduciary the power to direct the trustee, to distribute in further trust with provisions that are broader, more limited or in conflict with the decanting statute, may provide different requirements and other conditions as the settlor determines. Proposed Ohio Revised Code § 5808.18(N).

E. Effective Dates

1. Decanting Under Division (A)

The proposed statute recites that it is intended to be an enactment of the common law as to trusts under which the trustee has absolute power (as defined in Division (A)) to distribute principal and thus applies to distributions, whenever made, from any trust, whenever created, that is governed by Ohio law or has its principal place of administration in Ohio. Proposed Ohio Revised Code § 5808.18(O).

2. Decanting Under Division (B)

The proposed statute applies to distributions in further trust under Division (B), where the trustee does not have absolute power to distribute principal, made on or after the date of enactment from any trust, whenever created, that is governed by Ohio law or has its principal place of administration in Ohio. Proposed Ohio Revised Code § 5808.18(O).

ENDNOTES

1. © 2009 M. Patricia Culler. All rights reserved.
2. Merriam-Webster Online Dictionary. 2009. Merriam-Webster Online. 7 December 2009 <http://www.merriam-webster.com/dictionary/decant>
3. *Phipps v. Palm Beach Trust Co.*, 142 Fla. 782, 196 So. 299 (1940).
4. *Wiedenmayer v. Johnson*, 106 N.J. Super. 161, 254 A.2d 534 (App. Div. 1969), judgment aff'd, 55 N.J. 81, 259 A.2d 465 (1969).
5. Unfortunately, Treasury Regulations regarding the effect of modifications of grandfathered trusts promulgated after the enactment of the New York statute provided that a distribution of principal from a trust exempt from GST tax under the effective date rules to a new trust would not cause the new trust to be subject to the generation skipping tax if either the terms of the governing instrument or of state law in effect when the trust became irrevocable permitted distribution to a new trust without the consent or approval of any beneficiary or court. Treas. Reg. §20.2601-1(b)(4)(A). Thus the statute is ineffective to achieve the purpose for which it was originally sought.
6. For case citations and a discussion of New York court approved decanting see Zeydel and Blattmachr, "Tax Effects of Decanting—Obtaining and Preserving the Benefits," 111 Journal of Taxation No. 5, November 2009 at 288 (Warren Gorham & Lamont).
7. New York's statute does not presently address this issue, but substantial amendments to the statute are under consideration and presumably the issue will be addressed in any modification of the statute.
8. Space constraints prohibit including the full text of the statute with this article. New proposed Ohio Revised Code §5808.18 may be found on the Ohio State Bar Association Web site. When on the Web site, from the menu on the left side of the screen, select "Publications: Special Reports: Council of Delegates: Fall 2009: Report of the Estate Planning, Trust and Probate Law Section. The report on the proposed statute begins on page 8 of that report.

Reforming the Testamentary Trust

By David W. Cox, Esq.
Cox & Keller
Xenia, Ohio

In 2001, the Montgomery County Probate Court appointed Scott Siebert as trustee of a testamentary trust

created in his father's Last Will and Testament for the primary benefit of his step-brother. The will did not waive bond for the trustee, and the trustee initially furnished a fiduciary bond in the amount of \$300,000. The trustee filed an inventory reporting trust assets valued at slightly less than \$300,000.

In March 2006, the Trustee filed his fifth account reporting assets on hand with a value of \$293,990. The probate court, sua sponte, ordered the amount of the trustee's bond to be increased to double that value per R. C. 2109.13 and Local Rule 75(H). In response, citing R. C. 2109.04(C), the trustee moved the court to reduce the amount of the bond for good cause shown in that it was expensive and unnecessary. Most of the money in the Trust was held in a variable annuity with the Northwestern Mutual Life Insurance Company and the Company had agreed, and sent a letter to the court so acknowledging, that it would not release any funds without a court order. Since Northwestern was not an approved fiduciary under R.C. 2109.13 to hold deposits like banks and trust companies established under state law, and since the Local Rule mandated a bond, the court denied the motion. This reporter was counsel for the applicant.

In December 2007, citing R.C. 5801.10(C)(4), the trustee moved the court to approve a Private Settlement Agreement under which the trustee and the trust beneficiaries agreed to modify the Will to dispense with bond for the trustee. The probate court denied the motion, holding that a Private Settlement Agreement authorized by R.C. 5801.10 cannot operate to deprive the probate court of jurisdiction to enforce a statutory requirement of R.C. Chapter 2109 governing administration of trusts. The trustee appealed.

The Montgomery County Court of Appeals noted that R.C. 5801.10 (J) "preserves the jurisdiction of the Probate Court to supervise the acts of trustees appointed by that court in relation to the terms of an agreement authorized by R.C. 5801.10(C)(4)," and that a private settlement agreement "cannot operate to divest the court of its jurisdiction." See *In re Frank*, 181 Ohio App. 3d 686, 2009-Ohio-1285, 910 N.E.2d 523 (2d Dist. Montgomery County 2009). However, the court found that the private settlement agreement in question was consistent with the provisions of R.C. 2109.04(A) (2) requiring the court to appoint a fiduciary without bond if the instrument creating the trust does not require bond, noting that the statute nevertheless permits the court to require a fiduciary bond if the court is of the opinion that the interest of the trust demands it. In overruling the probate court and remanding the case for further proceedings, the appellate court held that