May 3, 2012

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments in Response to Notice 2011-101

Dear Commissioner Shulman:

Enclosed are comments in response to notice 2011-101. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

William M. Paul
Chair, Section of Taxation

Enclosure

cc: Emily S. Mcmahon, Assistant Secretary (Tax Policy), Department of the Treasury
William J. Wilkins, Chief Counsel, Internal Revenue Service
Catherine Hughes, Attorney Advisor, Department of the Treasury
ABA SECTION OF TAXATION
COMMENTS IN RESPONSE TO NOTICE 2011-101

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these comments was exercised by Farhad Aghdami of the Estate and Gift Taxes and Fiduciary Income Tax Committees of the Section of Taxation. Substantive contributions were made by David A. Berek, Mary Cascino, Jeffrey D. Chadwick, George D. Karibjianian, and Sharon Klein. These comments were reviewed by Paul E. Van Horn, Chair of the Estate and Gift Taxes Committee, and Lisa Stern, Chair of the Fiduciary Income Tax Committee. These comments were further reviewed by Louis Mezzullo of the Section’s Committee on Government Submissions and by Mary Ann Mancini, Council Director for the Estate and Gift Taxes Committee and the Fiduciary Income Tax Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: May 3, 2012
EXECUTIVE SUMMARY

In Notice 2011-101, 2011-52 I.R.B. 932 (the “Notice”), the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) invited comments from the public regarding the income, gift, estate and GST tax issues and consequences arising from transfers by a trustee of all or a portion of the principal of a Distributing Trust to a Receiving Trust that change beneficial interests. Treasury and the Service also invited comments as to the relevance and effect of thirteen various facts and circumstances listed in the Notice and the identification of other factors that may affect the tax consequences. Treasury and the Service also encouraged the public to suggest a definition for the type of transfer (“decanting”) the Notice is intended to address. Additionally, the Notice encouraged comments on the domestication of foreign trusts and transfers to foreign trusts.

States are adopting decanting statutes at an accelerating pace. The Section of Taxation of the American Bar Association (the “Tax Section”) commends the Service and Treasury for inviting comments to address the income, gift, estate and GST tax issues and consequences of decanting as this planning tool and solution becomes more widely used.

We suggest that the Service adopt regulations consistent with the following recommendations:

1. In a valid decanting, any beneficial interest that is both vested and fixed in the Distributing Trust should remain vested and fixed in the Receiving Trust, but discretionary interests, because they are discretionary and not vested, may be modified or deleted in the decanting if the trustee exercises good faith with respect to the decanting.

2. No taxable gifts occur on the transfer to the Receiving Trust by the trustee of the Distributing Trust because a trustee has no donative intent and cannot satisfy the elements for a taxable gift; likewise, a beneficiary of the Distributing Trust with a non-vested contingent interest and without a general power of appointment over the assets of the trust lacks the ability to make a gift.

3. Because decanting authority is analogized to a special power of appointment under the common law, no future interests may be created. States that have adopted decanting statutes, however, may allow the creation of such future interests, but such creation is dependent on the relationship between terms used in the decanting statute and the statutory definition of such terms. Regardless, such issues are state law issues and should not be considered in any taxable transfer analysis with respect to the exercise of a decanting power.

4. Decanting from a Distributing Trust to a Receiving Trust should result in the pass through to the Receiving Trust of Distributing Trust’s DNI, etc. If a decanting is to more than one Receiving Trust, the pass through of the income tax consequences should be proportionate to the decanted assets.

5. Unless there are circumstances where Crane v. Commissioner., 331 U.S. 1 (1947) and Madorin v. Commissioner., 84 T.C. 667 (1985) may apply, the transfer of assets from a
grantor trust to a non-grantor trust (or vice versa) should not generally result in any income tax consequences. In addition, no gain or loss should be recognized under Cottage Savings Ass’n v. Commissioner, 499 U.S. 554 (1991) when a decanting power is exercised to transfer assets from a grantor trust to a non-grantor trust (or vice versa).

6. To provide a workable framework for determining whether a decanting will cause a trust to lose its GST exempt status, we suggest that the Service issue guidance providing that both grandfathered and non-grandfathered trusts must satisfy either the discretionary distribution safe harbor of Regulation section 26.2601-1(b)(4)(i)(A)\(^1\) or the trust modification safe harbor of Regulation section 26-2601-1(b)(4)(i)(D). 7. As a threshold matter, decanting should result in adverse gift or estate tax consequences only if the decanting (i) is performed by an interested trustee and (ii) shifts a beneficial interest in trust or delays the vesting period of a beneficiary’s property interest in a trust. Once this threshold issue is established, decanting may constitute a taxable gift or cause estate inclusion depending on the facts and circumstances of the decanting and whether other provisions of the Code apply, such as section 2036 or section 2038. Such facts and circumstances may include whether beneficiary consent or court approval is required, but not necessarily if consent or approval is obtained, although not required. In addition, several actions, without more, should be deemed insufficient to cause a taxable gift or estate inclusion. These include (i) obtaining beneficiary consent or court approval pursuant to the terms of a state statute, (ii) beneficiary acquiescence (i.e., receiving notice of a trust decanting, but failing to object), (iii) a trustee’s decision to petition the court for approval or enter into an agreement with beneficiaries that limits fiduciary liability, and (iv) giving notice to or obtaining the consent of the state Attorney General.

\(^1\) References to a “section” herein are to a section of the Internal Revenue Code of 1986, as amended, unless otherwise indicated, and references to the “Regulations” are to the Treasury Regulations promulgated thereunder.
In Notice 2011-101, 2011-52 I.R.B. 932 (the “Notice”), the Treasury Department (“Treasury”) and the Internal Revenue Service (the “Service”) invited comments from the public regarding the income, gift, estate and GST tax issues and consequences arising from transfers by a trustee of all or a portion of the principal of a Distributing Trust to a Receiving Trust that change beneficial interests. Treasury and the Service also invited comments as to the relevance and effect of thirteen various facts and circumstances listed in the Notice and the identification of other factors that may affect the tax consequences. Treasury and the Service also encouraged the public to suggest a definition for the type of transfer (“decanting”) the Notice is intended to address. Additionally, the Notice encouraged comments on the domestication of foreign trusts and transfers to foreign trusts. The following comments first review the concept of decanting and its common law origins; next, the comments review common circumstances where decanting is often used; and finally, the comments address the items and issues identified in the Notice.

I. BACKGROUND AND INTRODUCTION.

A. Decanting.

Decanting is the act of a trustee exercising its power to distribute trust principal to or for the benefit of one or more beneficiaries by distributing the assets to a new trust. The best way to understand trust decanting is to visualize the physical act of decanting wine, which involves the pouring of wine from one vessel to another for the purpose of removing unwanted sediment and adding oxygen to the wine. In the trust context, practitioners can view decanting as a trustee pouring the assets of an old trust (the “Distributing Trust”) into a new trust (the “Receiving Trust”), with the less useful provisions (the so-called “sediment”) left behind, while the “oxygen” of modern trust provisions breathes new life into the Receiving Trust.

B. Common Law Origins.

At first glance, decanting is a difficult concept to reconcile. It does, after all, permit a trustee to alter the terms (and arguably the beneficial interests) of an irrevocable trust. Not only does decanting seem to contradict the essence of irrevocability, it also seems to create an opportunity for trustees and beneficiaries to collude in contravention of a settlor’s original intent. Despite these misgivings, a trustee’s authority to decant is well-rooted in common law.

The common law rationale behind decanting is that if a trustee has the discretionary power to distribute property to or for the benefit of a beneficiary, then the trustee has the power to distribute property to a second trust for the benefit of such beneficiary. Both the Restatement (Second) of Property: Donative Transfers (the “Second Restatement”) and the Restatement (Third) of Property: Wills & Other Donative Transfers (the “Third Restatement”) characterize this power in the nature of a special power of appointment exercisable in a fiduciary capacity.2

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1. The Phipps Case.

The earliest reported case authorizing trust decanting is *Phipps v. Palm Beach Trust Co.*, 196 So. 229 (Fla. 1940). The *Phipps* case involved an action in equity by the corporate co-trustee of an irrevocable *inter vivos* trust seeking clarifications of the actions of the individual co-trustee. In *Phipps*, Mrs. Margarita C. Phipps created a trust for the benefit of her four children, naming her husband, John S. Phipps (“JSP”), and Palm Beach Trust Company (“PBTC”) as the trustees. Section Six of the trust provided, in part, that:

> At any time within the duration of this trust, as hereinafter provided, upon the written direction of the then Individual Trustee, the Trustees shall pay over and transfer all or any part of the rest, residue, and remainder of the trust estate, both principal and in-come, which may at such time remain and be in the hands of the Trustees to the said John H. Phipps, Hubert B. Phipps, Margaret Douglas and Michael G. Phipps and to the descendents of any of them, in such shares and proportions as the said Individual Trustee, in his or her sole and absolute discretion, shall determine and fix even to the extent of directing the payment of the entire trust estate to one of said parties. The written direction of the said John S. Phipps may be contained in his last will and testament, anything herein to the contrary notwithstanding.3

On July 25, 1939, JSP, pursuant to Section Six of the trust, executed and delivered to the corporate co-trustee written directions to transfer assets from the Distributing Trust to the Receiving Trust, under which JSP and PBTC would hold the property in trust for the benefit of Mrs. Phipps’s descendents (the “Receiving Trust”). The provisions of the Receiving Trust were nearly identical to those of the Distributing Trust with one exception – the Receiving Trust provided John H. Phipps (“JHP,” who was a son of JSP and Mrs. Phipps) with a testamentary power of appointment to provide that income from the Receiving Trust could be paid to his wife. JHP’s wife was not a beneficiary of the Distributing Trust.

In allowing the distribution of property from the Distributing Trust to the Receiving Trust, the Florida Supreme Court held that, “[t]he general rule gleaned from … cases of similar import is 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 (emphasis added).”4 The Court rejected the argument of PBTC that the reverse was true, *i.e.*, that the power to create a second trust estate is present under a special power of appointment only where such authority is specifically granted.5 The Court concluded that, so long as the beneficiaries of the second trust are limited to the class of beneficiaries under the first trust, the power in the trustees to appoint in further trust, much like a power of appointment, is absolute, and to hold otherwise

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3 *Id.* at 784, 300.

4 *Id.* at 786, 301.

5 *Id.; see also* Bogert’s Trusts and Trustees (through 2011 Update), Chapter 39, § 812, under the discussion of the express (and unlimited by an ascertainable standard) power in the Trustees to distribute principal.
would limit the power of the individual trustee to administer the trust estate in a way not contemplated by the donor of the original trust.\textsuperscript{6}

A conclusion from \textit{Phipps} is that an absolute power in the trustee to distribute property to a beneficiary may be exercised in any manner at least equal to the interest that the beneficiary would receive had the property been distributed outright to the beneficiary. So long as the trust does not prohibit the granting of a lesser interest, this power could include the power to distribute in trust for the benefit of the beneficiary. Further, if the trustee has the absolute power to distribute trust property to any one or more of a class of beneficiaries, absent a restriction in the trust agreement, there is no prohibition against distributing property to a trust for some, but not all, of the beneficiaries.

It should be noted that the decision reached by the Florida Supreme Court was not specific as to a particular Florida law. It has been argued that the Florida Supreme Court simply acknowledged the presence of a common law power of trustees with broad discretionary powers of distribution that is applicable regardless of whether a state has enacted decanting laws.\textsuperscript{7} To date, fourteen states have enacted decanting statutes,\textsuperscript{8} and at least three additional states have pending decanting bills.

Moreover, practitioners continue to rely on \textit{Phipps} when state law has not statutorily authorized decanting. The argument is based on two principles: first, a trustee with absolute power to invade principal, as a matter of property law, is the equivalent of a donee of a special power of appointment, and second, absent a contrary provision in the governing document, a donee of a power of appointment may exercise such power in a manner which is less extensive than authorized by the instrument creating the power. Under this latter principle, if there is authority to distribute outright, there is authority to distribute in further trust. The argument could be made that even if distribution authority is subject to an ascertainable standard, so long as there is authority to distribute property outright, there is authority to distribute in further trust. Both the Second Restatement in § 19.14 and the Third Restatement in § 17 support this conclusion.

\textsuperscript{6} \textit{Id.} at 787, 301. Note that the opinion did not discuss the inclusion of JHP’s wife as a permissible recipient under a power of appointment; presumably, she was not a current beneficiary of the New Trust and could only receive an interest upon JHP’s death. The granting of a testamentary power of appointment naming persons who were not beneficiaries under the original trust would appear to be viewed as if the trustee appointed the property outright to the beneficiary who could then devise the property to whomever he or she desired.


2. **In Re: Estate of Spencer.**

In *Spencer*, the decedent’s husband was the trustee and a beneficiary of a testamentary trust for the benefit of their four children. The trust held a 1/4\textsuperscript{th} interest in a parcel of real estate. The husband owned the other 3/4\textsuperscript{th} interest outright. The trust provided that the assets were to be distributed to their grandchildren (or more remote descendants, *per stirpes*) after the death of the husband and children. The terms of the trust provided the husband with a special power to dispose of the trust property by life estate to and among their children, with the remainder to such children’s surviving issue. Husband exercised his testamentary special power of appointment to appoint the assets from wife’s trust, along with his own interest in the real estate, to a new, multi-generational trust. The court in *Spencer* held that the exercise of the power of appointment in further trust was a valid exercise, but that the trust could not be a multi-generational trust and the assets should vest final distributions to the grandchildren at the death of their children. An expansive reading of *Spencer* suggests that a trustee can decant trust property to a new trust unless plainly prohibited by the terms of the original trust.

3. **Wiedenmayer v. Johnson.**

In *Wiedenmayer*, under the trust instrument, the trustees were authorized to distribute any or all of the trust property to the beneficiary—the settlor’s son—or to use the trust property on his behalf as the trustees determined “in their absolute and uncontrolled discretion” for the beneficiary’s “best interests.” The trustees determined that they should condition distributions on the beneficiary setting up another trust (the beneficiary was going through a divorce and the new trust provided protection from marital claims). The guardian *ad litem* challenged the distribution to the new trust on behalf of certain minor children and alleged that the children lost the contingent remainder interest provided to them under the original trust. The court rejected the guardian *ad litem’s* challenge arguing that if the beneficiary received the distribution of the trust property outright—as permitted under the trust agreement—then the children would have lost their contingent remainder interest in the property that was distributed from the trust. *Wiedenmayer* can be distinguished from *Phipps* and *Spencer*, in that the court in *Wiedenmayer* limited its inquiry to whether the trustees’ discretionary power to distribute trust property in further trust was in the beneficiary’s best interest and whether the exercise of that power was an abuse of discretion.\(^{11}\)

\(^{9}\) 232 N.W.2d 491 (Iowa 1975).


\(^{11}\) See also, *Regents of the University System v. Trust Company of Georgia*, 186 Ga. 498 (Ga. 1938); *Marx v. Rice*, 1 N.J. 574 (N.J. 1949).
C. View of the Restatements on Decanting.

1. Second Restatement.

Section 11.1, Comment (d) of the Second Restatement provides that the trustee’s ability to transfer trust property is similar to a special power of appointment, under which a trustee can transfer an interest in property equal to or less than the title authorized under the trust instrument. If the trustee is able to transfer full legal title to trust property to a beneficiary, the trustee should be able to transfer less than full legal title by transferring the property further in trust. Comment (d) provides that “[a] power of appointment is authority, other than as an incident of the beneficial ownership of property, to designate recipients of beneficial interests in property.” Comment (b) of § 11.1 provides that a power of appointment permits persons to transfer a beneficial interest in property they do not otherwise possess, and the exercise of the power is considered the completion of a transfer originating with the creator of the power. Therefore, the power to determine the identity of persons entitled to receive beneficial interests in property that are owned by persons other than the “powerholder” characterizes a power of appointment. Comment (d) of § 11.1 characterizes a trustee’s discretion to pay trust property to a beneficiary or among a class of beneficiaries as a power of appointment because the trustee is authorized to determine the recipients of beneficial interests in property that the trustee does not otherwise possess. Section 19.4 of the Second Restatement also authorizes a powerholder to create a new special power of appointment in any other person, which is exercisable only in favor of permissible appointees of the original power. For example, a trustee with the discretionary power to distribute trust property outright to or for the benefit of one or more trust beneficiaries should be able to distribute property to a separate discretionary trust for the lifetime benefit of one beneficiary that gives the beneficiary a special power of appointment over the appointed trust assets.

2. Third Restatement.

Section 19.14 of the Third Restatement provides that the holder of a special power of appointment may exercise the power by appointing property to a trust solely for the benefit of permissible appointees of the power. Unless the creator of the power expressly prohibits an appointment of property in trust, the holder of a special power has the authority to exercise the power in favor of permissible appointees by appointing property further in trust. The Third Restatement, however, defines a power of appointment as a power granted to a holder acting in a non-fiduciary capacity. The Third Restatement distinguishes between powers of appointment and fiduciary distributive powers based on the different treatment afforded the powers. Fiduciary standards are imposed on the exercise of a power held in a fiduciary capacity. In addition, a fiduciary power survives the death of a fiduciary and succeeds to the successor fiduciary. By contrast, a power of appointment may be exercised arbitrarily and a power of appointment is personal to the powerholder and lapses if not exercised. Comment (g) of § 19.14 of the Third Restatement recognizes that a fiduciary distributive power is subject to the same general rules regarding special powers of appointment, such as the requirement that the power be exercised in favor of permissible appointees, and it may be subject to the same common law or statutory rules relating to perpetuities otherwise applicable to special powers of appointment. In
reconciling this seeming conflict, it appears that trustees can exercise a decanting power, but must do so within their fiduciary discretion.

D. Decanting and the Uniform Trust Code.

The Uniform Trust Code (the “UTC”) provides a comprehensive model for codifying the law on trusts. It was completed by the Uniform Law Commissioners in 2000, and amended in 2001, 2003, 2004 and 2005. It has been enacted in Alabama, Arizona, Arkansas, District of Columbia, Florida, Kansas, Maine, Michigan, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Vermont, Virginia, West Virginia, and Wyoming. In 2011, it was introduced in Connecticut, Massachusetts, and New Jersey. The UTC does not have a decanting provision. The UTC contains provisions permitting modifications of trusts, reformations to correct mistakes, and combinations and divisions of trusts. Five states with decanting statutes—Tennessee, Florida, New Hampshire, Arizona, and North Carolina—have adopted the UTC.

Many of the changes that are sought through decanting can be accomplished through a trust modification, reformation, division, or merger under the Uniform Trust Code, specifically UTC §§ 411 (modification by consent), 412 (modification due to unanticipated circumstances), 414 (modification of uneconomic trust), 415 (modification to correct mistakes), 416 (modification to achieve settlor’s tax objectives), and 417 (combination and division of trust). Decanting and changes and modifications under the UTC are not mutually exclusive or in conflict, but rather different paths to achieve similar and often identical goals.

II. REASONS TO DECANT.

Once comfortable and familiar with the concept of decanting, a trustee may utilize its decanting authority in a wide variety of trust circumstances. While it would be both ambitious and unwieldy to provide a comprehensive list of the reasons to decant, a trustee may consider decanting to accomplish the following objectives:

A. To Change the Trust’s Administrative Provisions.

Decanting is not the only method by which a trustee may amend or modify an irrevocable trust. The UTC, for instance, contains provisions permitting modifications of trusts, reformations to correct mistakes, and combinations and divisions of trusts. A key advantage to decanting, however, is that it allows a trustee to change administrative provisions with minimal court or beneficiary interaction. Common administrative changes that may be accomplished by decanting include:

1. changing trust situs or governing law;
2. providing for the resignation, removal, and appointment of trustees without court approval;
3. expanding the powers of a trustee to engage in sophisticated financial transactions, make or guarantee loans, adjust between income and principal, or participate in an initial public offering;

4. providing for the division of trustee roles and responsibilities through the use of investment direction advisors, distribution advisors, trust protectors, or special asset direction advisors;

5. addressing issues related to trustee compensation, which may be too high or too low;

6. addressing trustee liability (and indemnification) for failure to diversify under the prudent investor rule with respect to an over-concentration of investment assets, such as closely held business interests;

7. converting a foreign trust to a domestic trust or vice versa; and

8. consolidating trusts for administrative efficiency.

B. To Address a Beneficiary-Related Change of Circumstances.

A change in the grantor’s family circumstances can complicate the purposes of an irrevocable trust. A trustee may utilize its decanting authority to respond to these changes by:

1. limiting distributions to beneficiaries with substance abuse problems or those engaging in other unproductive behaviors;

2. transferring assets to a special needs trust for a disabled beneficiary;

3. limiting beneficiary rights to obtain information about the nature and extent of their trust interests by moving assets to a state, such as Delaware, where the trustee’s duty to provide such information can be restricted;

4. dividing single “pot” sprinkle trusts into separate trusts for each branch of the family;

5. eliminating a beneficiary altogether; or

6. transferring a self-settled irrevocable trust to a jurisdiction that recognizes asset protection in such circumstances.

C. To Respond to Changes in Federal or State Tax Law.

When the tax laws change, the provisions of an irrevocable trust may become stale or inefficient. In these instances, a trustee may consider decanting to maximize tax efficiencies by:
1. mitigating state income taxation by moving assets to a new trust in a jurisdiction that does not subject the trust to income taxation based on the trustee’s or grantor’s location;

2. converting a non-grantor trust to a grantor trust or vice versa;

3. maximizing GST planning for assets being distributed to a beneficiary outright (or over which the beneficiary has a general power) by decanting to another trust to make use of the beneficiary’s and the grantor’s available GST exemption; or

4. dividing trusts for GST or marital deduction planning purposes.

D. To Correct Errors or Ambiguities in the Trust Instrument.

When a trust document contains errors or is unclear on its face, a trustee may decant to correct a scrivener’s error, address ambiguities in the original trust instrument, or add a spendthrift clause to a trust that does not contain such a provision.

III. RESPONSE TO REQUEST FOR COMMENTS UNDER NOTICE 2011-101.

Treasury and the Service invited comments as to the relevance and effect of thirteen various facts and circumstances listed in the Notice. Each of the thirteen circumstances is discussed (in the order set forth in the Notice) below.

1. A beneficiary’s right to or interest in trust principal or income is changed (including the right or interest of a charitable beneficiary).

2. Trust principal and/or income may be used to benefit new (additional) beneficiaries;

3. A beneficial interest (including any power to appoint income or corpus, whether general or limited, or other power) is added, deleted, or changed;

Fact patterns 1, 2, and 3 are best addressed jointly because they all relate to the addition, deletion, or modification of beneficial interests in a trust.

a. Creation or Deletion of Beneficial Interests through Decanting: Mandatory Rights Must be Maintained, while Discretionary Rights May be Altered.

The decision in *Phipps* may be interpreted to support the proposition that a trustee’s unlimited authority to distribute property to a beneficiary includes the power to distribute the entire trust principal to such beneficiary. The power is similar to that of a special power of appointment, except that the trustee has a fiduciary duty to exercise such power in good faith.12

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12 *See* UTC § 105, which prohibits a trust instrument from exonerating a trustee’s duty to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.
For federal transfer tax purposes, however, the separate fiduciary duty is not relevant as there does not appear to be any distinction between a power held in a fiduciary capacity and one held in a non-fiduciary capacity (i.e., a power of appointment). For this reason, the transfer tax analysis of the trustee’s power to distribute principal (i.e., the “decanting authority”) is analogous to that of the exercise of a special power of appointment. These are state law powers.

It is the “good faith” argument that restricts the ability of a trustee with respect to decanting authority over current rights. Because the trustee must act considering the interests of the beneficiaries, the trustee cannot act in a manner that would restrict or remove a current or mandatory right in a beneficiary. A beneficiary’s rights in a trust can be broken down into either (i) current or mandatory rights, or (ii) contingent or future rights. It is logical to conclude that any current, vested rights in the beneficiary must be maintained; otherwise, the trustee would be circumventing such beneficiary’s rights and arguably would be acting in bad faith as to such beneficiary. With regard to decanting, this would require that the trustee preserve a beneficiary’s mandatory current income and principal rights.

A beneficiary’s discretionary rights, however, are different. A trustee’s absolute discretionary power to distribute principal to a beneficiary does not require that such beneficiary receive the principal; on the contrary, the trustee is under no obligation to effect any distributions absent an abuse of discretion. Where the discretion of the trustee is uncontrolled in making distributions, the general rule is that, absent arbitrary acts by the trustee or the exercise of bad faith or abuses in the exercise of such discretion, the settlor’s intentions regarding the trustee’s absolute authority with respect to distributions should be upheld and a beneficiary will not be able to compel the trustee to make any payment to him or her or to apply payments for his or her benefit. For this reason, it would appear to be possible and permissible for the trustee, acting in good faith, to change the future income and principal rights of a beneficiary if such interests are contingent and non-vested rights.

b. A Change in a Beneficiary’s Contingent, Non-Vested Interest Should Not Be Considered a Gratuitous Transfer of an Interest in Property.

The question then becomes whether the change in a beneficiary’s contingent, non-vested interest in the trust is somehow deemed to be a gratuitous transfer of that interest, thereby causing transfer tax consequences.

Under the Code, the determination of whether a donor has made a taxable gift rests on whether there has been a completed transfer of an interest in property to the extent that the donor does not receive something of value in return (with the exception of a transfer that results from an ordinary business transaction or the discharge of legal obligations). This definition of gifts

does not require the intent to make a gift. To constitute a gift, a transfer must satisfy two basic requirements: It must lack consideration, in whole or in part (that is, the recipient must give up nothing in return); and the donor must relinquish all control over the transferred interest. To constitute a completed gift, a transfer also must constitute a present interest in property.

The trustee, acting either in a fiduciary capacity or, as in *Phipps*, pursuant to a common law limited power of appointment, by decanting is not making a donative transfer. The donor remains the person who established the trust; the trustee is merely carrying out the direction of the donor and is limited by the terms of the trust and state law; therefore, from the trustee’s perspective, there cannot be a taxable gift. If the trustee is also a beneficiary and possesses the power to make distributions to himself or herself which are not limited by a reasonably fixed or ascertainable standard, a distribution by the trustee/beneficiary would have gift tax implications. However, most governing instruments (and often state law) limit the ability of a beneficiary/trustee to make such distributions and only allow distributions for support, health, education, and maintenance. Many state statutes limit the exercise of a decanting power to a disinterested trustee.

If a beneficiary (i) has a non-vested contingent interest in the Distributing Trust and (ii) does not hold a presently exercisable general power of appointment over the assets of the Distributing Trust, the beneficiary does not have the requisite possessory interest in property to make a gift when the assets are transferred by the trustee to the Receiving Trust. The beneficiary did not create the trust and, assuming the beneficiary does not have a general power of appointment over the trust, he cannot relinquish dominion or control over the property of the trust, since he never had any. The only way a beneficiary could be making a taxable gift when a trustee exercises discretionary authority is if the beneficiary has some legal right to prevent the trustee’s action. Mere acquiescence by a beneficiary who has a contingent, non-vested interest in a trust to a decanting by an independent trustee with full discretion to make distributions to the beneficiaries should not rise to the level of making a taxable gift. See later discussion regarding beneficiary consent.

c. A Decanting by a Trustee Who Is an Income Beneficiary (Mandatory or Discretionary) May Result in a Taxable Gift.

The preceding portions of the analysis assume that the trustee is disinterested in the trust and does not possess a beneficial interest. The above conclusions may be different if the trustee is also an income beneficiary (either mandatory or discretionary). If the trustee has a mandatory income interest, the conclusions reached above do not change; a mandatory income interest must be maintained for a valid decanting. If the trustee’s income interest is permissive or discretionary, however, the conclusions may be different. Considering that decanting may be analogized to the exercise of a special power of appointment, the Service has ruled (through Treasury regulations and rulings) that an income beneficiary’s exercise of an *inter vivos* special

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14 I.R.C. § 2503(b).

15 See, e.g., MO. REV. STAT. § 456.4-419.2(2)(a); N.H. REV. STAT. ANN. § 564-B:4-418(c); N.C. GEN. STAT. § 36C-8-816.1(d); S.D. CODIFIED LAWS § 55-2-15(2); VIRGINIA CODE § 55-548.16:1.D.
power of appointment in favor of others in a manner that reduces his or her income interest, even if that interest is discretionary, may result in a taxable gift. For this reason, if the trustee also possesses a beneficial interest, the trustee/beneficiary’s exercise of his or her decanting power to reduce his income interest could be a taxable gift.

d. Because the Permitted “Beneficiaries” of the Receiving Trust Should Be Determined by State Law, a Special Power of Appointment Granted under the Receiving Trust May Effectively Expand the Class of Permitted “Beneficiaries” of the Distributing Trust.

As stated above, under the Phipps rationale, the trustee’s authority to appoint in further trust is an extension of the trustee’s power to distribute to the beneficiaries, which must be exercised in good faith. With respect to distributions, a trustee will always be restricted in its actions by two factors: applicable state law and the terms of the governing instrument. A trustee can never exceed either of these restrictions.

With decanting, the focus is on the recipients of property in the Receiving Trust. While the trustee’s discretionary authority to distribute principal may be absolute as to discretion, under the common law, it is limited as to the class of beneficiaries to whom property may be distributed, namely, the beneficiaries stated in the trust. To add beneficiaries to those initially stated in the trust agreement would appear to be a violation of the terms of the governing instrument, and thus an improper action.

Both the Second Restatement and the Third Restatement codify the common law (although the Second Restatement adopts a provision reflecting a minority position that has come to be an accepted position through statutory adoption). The Second Restatement, in § 1.2, provides the historical rule that “the rule of this [§ 1.2] does not permit the creation of a non-general power to be executed by objects of the power in favor of non-objects of the original power.” The Third Restatement, in § 19.14, provides that “[the recipient of the newly created

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16 See generally Reg. § 25.2514-1(b)(2), PLR 8535020 (September 3, 1985), and Rev. Rul. 79-327, 1979-2 CB 342, wherein the exercise by a beneficiary of a lifetime special power of appointment was deemed to be a taxable gift despite the non-inclusionary nature of the special power of appointment because the power holder has relinquished a portion of his or her income interest by the exercise. Contrary results were reached in Comm. v. Walston, 36 AFTR 1020, 168 F.2d 211, 48-1 USTC ¶10619 (4th Cir. 1948), and Self v. U.S., 49 AFTR 1913, 135 Ct. Cl. 371, 142 F. Supp. 939, 56-2 USTC ¶11613 (Ct. Cl. 1956). Note that Rev. Rul. 79-327 expressly states that to the extent the holding is in direct conflict with Regulations, the Service will not recognize the Self decision. Self was also distinguished in Regester v. Commissioner, 83 T.C. 1 (1973), which stated that the Walston decision was fact based and that the Court of Claims in the Self decision misapplied the Walston decision by ignoring the limiting facts in Walston. In addition, with respect to the transfer tax valuation of a gift of a discretionary income interest, see Rev. Rul. 75-550, 1975-2 CB 357, which provides an example of the correct method of computing the value of a decedent’s interest in a residuary trust subject to the discretionary power of the trustee to invade corpus for the benefit of others.

special power of appointment] can only be authorized to appoint to permissible appointees of the first [special] power, excluding himself or herself.”\(^{18}\)

Despite this, the issue becomes blurred because state decanting statutes rarely describe persons as “permissible appointees”; rather, such statutes often refer to “beneficiaries.”\(^{19}\) Thus, conformity to a state statute requires defining the term “beneficiaries.”

Section 103 of the UTC defines “beneficiary” as follows:

“(3) “Beneficiary” means a person that: (A) has a present or future beneficial interest in a trust, vested or contingent; or (B) in a capacity other than that of trustee, holds a power of appointment over trust property.”

The Comments to § 103 of the UTC provide that “the term ‘beneficiary’ includes not only beneficiaries who received their interests under the terms of the trust but also beneficiaries who received their interests by other means, including by assignment, exercise of a power of appointment, resulting trust upon the failure of an interest, gap in a disposition, operation of an anti-lapse statute upon the predecease of a named beneficiary, or upon termination of the trust.”

Under the UTC, it is unclear whether permissible recipients of property under a special power of appointment are considered beneficiaries of a trust. Consider a trust created by A which purports to benefit A's child, B, and B's descendants. The trust provides that the trustee has absolute discretion to distribute income and principal to B for B's life, and, upon B's death, B has a special power of appointment to appoint the trust property to any one or more of B's descendants; in default of the exercise of B's power of appointment, the trust property passes in equal shares, \textit{per stirpes}, to B's descendants. Under the UTC definition of “beneficiary,” it is clear that the beneficiaries of the trust are B and B's descendants. Suppose that B exercises the power of appointment by appointing the trust property in further trust for each of B's descendants, C and D, and, upon each individual's death, the individual is granted a special power of appointment to appoint among the individual's descendants and the individual's surviving spouse; in default of exercise, the property is paid outright to the individual's descendants (who would be B's remote descendants). The respective surviving spouses of C and D are not members of the class of permissible appointees under the original trust agreement; however, the UTC definition of “beneficiary” does not clarify the status of permissible appointees under a power of appointment. It may be argued in the negative that if such appointees were considered to be beneficiaries, the statute would have stated as such, so therefore, they should not be considered “beneficiaries.” If that is true, the permissible

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\(^{18}\) Restatement (Third) of Property (Wills and Donative Transfers) § 19.14 (2011) at Comment (g)(3).

\(^{19}\) Emphasis added. \textit{See, e.g.}, N.Y. EPTL § 10-6.6(b) (“An authorized trustee with unlimited discretion to invade trust principal may appoint part or all of such principal to a trustee of an appointed trust for, and only for the benefit of, one, more than one or all of the current beneficiaries of the invaded trust (to the exclusion of any one or more of such current beneficiaries); Fla. Stat. § 736.04117(1)(a)(1) (“for the current benefit of one or more of such persons under the same trust instrument or under a different trust instrument; provided. . . .[the beneficiaries of the second trust may include only beneficiaries of the first trust”)
appointees would not be considered to be beneficiaries, meaning that interpreted literally, the UTC statutory “beneficiaries” under B’s exercise of the special power of appointment are still only B's descendants and the decanting is permissible.

Some states, like Florida, provide clarity on this point. The Florida definition of “beneficiary” under Fla. Stat. §736.0103(4), states:

“Beneficiary” means a person who has a present or future beneficial interest in a trust, vested or contingent, or who holds a power of appointment over trust property in a capacity other than that of trustee. An interest as a permissible appointee of a power of appointment, held by a person in a capacity other than that of trustee, is not a beneficial interest for purposes of this subsection. Upon an irrevocable exercise of a power of appointment, the interest of a person in whose favor the appointment is made shall be considered a present or future beneficial interest in a trust in the same manner as if the interest had been included in the trust instrument.

(emphasis added). Under the Florida Statutes, a permissible appointee under a power of appointment is specifically not considered to be a beneficiary. Therefore, C and D’s respective spouses would clearly not be “beneficiaries” for purposes of Fla. Stat. § 736.04117 and, therefore, B’s exercise of the special power is statutorily valid.

As a result, if permissible appointees of a special power of appointment are not considered to be “beneficiaries” under applicable state law, a special power of appointment granted under the new trust in a decanting may expand the class of permissible appointees beyond those classified as “beneficiaries” under the decanted trust. Such actions are state law concerns and should not result in the imposition of any federal transfer taxes.

The above analysis is consistent with the analogy of a decanting power to a special power of appointment. As the Phipps case illustrated, if a trustee has a discretionary power to distribute an estate in fee to a beneficiary, such power includes the power to distribute an estate less than a fee to the beneficiary, unless the donor clearly indicates a contrary intent. Thus, a trustee with the discretionary authority to distribute the trust estate in fee to a beneficiary, would have the discretionary authority to distribute the trust estate to a separate trust for the benefit of such beneficiary, granting the beneficiary a special power of appointment.

e. Conclusion.

To summarize, in a valid decanting, any beneficial interest that is both vested and fixed in the Distributing Trust should remain vested and fixed in the Receiving Trust. Discretionary interests, however, because they are discretionary and not vested, may be modified or deleted in the decanting if the trustee exercises good faith with respect to the decanting. If a beneficiary (i) has a non-vested contingent interest in the Distributing Trust and (ii) does not hold a presently exercisable general power of appointment over the assets of the Distributing Trust, the beneficiary does not have the requisite possessory interest in property to make a gift when the assets are transferred by the trustee to the Receiving Trust. Therefore, in most cases, where a
disinterested trustee exercises a decanting power, there should be no adverse gift tax consequences to the beneficiary or Trustee. Finally, because decanting authority is analogized to a special power of appointment under the common law, no future interests may be created. States that have adopted decanting statutes, however, may allow the creation of such future interests; such creation is dependent on the relationship between terms used in the decanting statute and the statutory definition of such terms.

4. The transfer takes place from a trust treated as partially or wholly owned by a person under sections 671 through 678 (a “grantor trust”) to one which is not a grantor trust, or vice versa:

Decanting should be considered a continuation or modification of an existing trust or akin to severance of trusts from an existing trust as allowed under Regulation section 26.2642-6. In either case, decanting assets from one domestic trust to another should not affect the income taxation of the trust because either (i) the Distributing Trust and the Receiving Trust are treated as the same trust for income tax purposes, or (ii) the transfer of assets merely carries out the Distributing Trust’s distributable net income (DNI), resulting in income to the Receiving Trust(s) under section 662(a) with a corresponding distribution deduction for the Distributing Trust section 661(a). There should be no recognition of gain or loss by a beneficiary resulting from decanting, except possibly to the extent of an asset having a negative basis.

In a grantor trust, the grantor is treated as the owner of the trust for income tax purposes under section 671, so that the DNI of the trust is taxed to the grantor, as is any capital gain or loss. Transactions between two grantor trusts (with the same grantor) are disregarded for income tax purposes. In a non-grantor trust, undistributed DNI is taxed to the trust and if a distribution is made to a beneficiary, the taxable portion of the distribution consists of the lesser of the amount of the DNI or the amount distributed to the beneficiary. Capital gain may be retained in the trust or distributed to the beneficiary.

In general, decanting is not a taxable exchange that will result in a beneficiary’s realization of income or loss so long as the decanting is authorized by the trust instrument or governing state law. If a beneficiary’s trust interest is subject to the trustee’s discretion to decant—either under the terms of the trust instrument or applicable state law—then there is no change in the quality of the beneficiary’s interest (i.e., it is “not materially different” under Cottage Savings) when the trustee actually exercises that discretion. Regulation section 1.1001-


21 I.R.C. § 643(e).

22 See PLR 200743022 (Oct. 26, 2007).

23 The basic rule under section 1001 is that a taxpayer realizes gain or loss only when the taxpayer (i) sells or disposes of property (ii) in exchange for property that is materially different from the property the taxpayer sold or disposed of. See Reg. § 1.1001-1(a). In Cottage Savings Ass’n v. Commissioner, 499 U.S. 554 (1991), the Supreme Court explained that two items of property are materially different if their owners possess legal entitlements that differ materially in kind or extent.
1(h) (appearing to provide a safe harbor for decanting pursuant to state law and prescribing similar rules for the severance of trusts, even if there is a non-pro-rata distribution).

On the other hand, decanting could result in a taxable exchange if the decanting is not authorized by the terms of the trust or applicable state law.\textsuperscript{24}

The threshold issue here is whether decanting from a grantor trust to a non-grantor trust or vice versa, could change that result and cause the trust beneficiaries or the grantor to realize gain or loss despite Regulation section 1.1001-1(h). The answer appears to be that when a grantor trust loses its grantor trust status for income tax purposes, the grantor may experience gain if a negative basis asset is transferred via decanting from a grantor trust to a non-grantor trust; however, the same is not true of a decanting from a non-grantor trust to a grantor trust.

In Chief Counsel Advice 2009-23024 (Dec. 31, 2008), the office of Chief Counsel addressed a transaction where a non-grantor trust was converted to a grantor trust. The Chief Counsel Advice held that the conversion of a non-grantor trust to a grantor trust was not a deemed transfer of property from the trust to the grantor requiring income tax recognition.\textsuperscript{25}

The Chief Counsel Advice noted, however, that in the opposite situation, the conversion of a grantor trust to non-grantor status would be a deemed transfer of property from the grantor to the trust requiring income tax recognition in certain instances. When grantor trust status terminates during the grantor’s lifetime, the grantor is deemed to realize an amount equal to any liabilities held as part of the trust property.\textsuperscript{26}

Irrespective of this issue, decanting may also produce taxable gain if the property transferred includes negative basis assets, such as property with debt in excess of basis or an LLC or partnership interest with a negative capital account. In *Crane v. Commissioner*, 331 U.S. 1 (1947), the Court explained that when a transferee assumes a transferor’s liability in connection with a sale or exchange of property, the transferor must include in its amount realized under section 1001 the liability assumed by the transferee. In other words, a taxpayer’s amount realized includes any debt discharged.\textsuperscript{27}

Although it seems clear that the transfer of negative basis property should result in gain under *Crane*, section 643(e) provides that the fiduciary’s basis in the property received carries over to the beneficiary, in this case, the Receiving Trust. The question is whether section 643(e), which applies to non-grantor trusts, overrides the gain recognition principles of *Crane* in a

\textsuperscript{24} See, e.g., Rev. Rul. 69-486, 1969-2 C.B. 159 (non-pro-rata trust distribution treated as a taxable exchange if the trustee lacked authority to make such a distribution).


\textsuperscript{26} See Reg. § 1.1001-2(c), Example (5); *Madorin v. Commissioner*, 84 T.C. 667 (1985).

\textsuperscript{27} See I.R.C. § 752(d) (providing that a transferor’s share of partnership liabilities are included in the transferor’s amount realized).
decanting situation from a non-grantor to a grantor trust. This question should be resolved by the Service.

5. The situs or governing law of the Receiving Trust differs from that of the Distributing Trust, resulting in a termination date of the Receiving Trust that is subsequent to the termination date of the Distributing Trust.

The Service properly identified the above set of facts as one that may potentially affect the generation-skipping transfer (GST) tax consequences of the Receiving and Distributing Trusts. Specifically, the issue is whether a transfer that results in a termination date of the Receiving Trust that is subsequent to the termination date of the Distributing Trust will cause such trust to lose its GST exempt status, if such trust is exempt from GST taxation, either by reason of the trust’s grandfathered status or the transferor’s allocation of GST exemption. For purposes of this analysis, a trust that became irrevocable on or before September 25, 1985 shall be referred to as a “grandfathered trust” and a trust that is exempt by reason of the transferor’s allocation of GST exemption shall be referred to as a “non-grandfathered trust.”

a. Regulatory Framework

The loss of GST exempt status is one area in which the Regulations provide some guidance, although the scope of such guidance remains unclear, as discussed below. Even though the common law and many state statutes define the trustee’s exercise of the decanting power as the exercise of a special power of appointment, the Regulations contain explicitly different provisions for special powers of appointment (Regulation section 26.2601-1(b)(1)(v)(b)) and a trustee’s distribution of trust principal from a grandfathered GST exempt trust to a new or continuing trust (Regulation section 26.2601-1(b)(4)(i)(A)).

b. Exercise of Special Powers of Appointment

With respect to powers of appointment, the Regulations provide that the exercise of a power of appointment over the assets of a grandfathered trust will not cause the trust to lose its GST exempt status so long as the exercise does not extend the trust’s term in violation of the permissible perpetuities period under federal law.\(^{28}\) For these purposes, the federal perpetuities period will not be violated if the vesting, absolute ownership, or power of alienation of an interest in property is not suspended or delayed beyond some life in being at the date of the creation of the grandfathered trust plus twenty-one years, or ninety years from the date of the creation of the grandfathered trust.\(^{29}\)

c. Regulatory Safe Harbors

The Regulations provide a separate framework for the effect decanting has on a grandfathered trust. As a general matter, decanting will not cause an exempt trust to lose its


exempt status if the decanting satisfies either the discretionary distribution safe harbor or the trust modification safe harbor.

i. Discretionary Distribution Safe Harbor.

Pursuant to Regulation section 26.2601-1(b)(4)(i)(A), decanting will not taint GST exempt status if the following conditions are satisfied:

- when the trust became irrevocable, either the terms of the trust instrument or local law (i.e., common law or state statute) authorized the trustee to make distributions to a new trust;
- neither beneficiary consent nor court approval is required; and
- the new trust will not suspend or delay the vesting of an interest in trust beyond the federal perpetuities period, which is measured from the date the trust became irrevocable to the later of some life in being plus twenty-one years or ninety years.

ii. Trust Modification Safe Harbor.

In the event a decanting does not satisfy the discretionary distribution safe harbor, it may still satisfy the trust modification safe harbor of Regulation section 26-2601-1(b)(4)(i)(D), which acts as a catch-all. Under the trust modification safe harbor, the judicial or non-judicial modification of a trust will not taint GST exempt status so long as the modification:

- does not shift a beneficial interest in the trust to a beneficiary occupying a lower generation than the person holding the interest under the original trust; and
- does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust.

In this context, decanting is akin to a non-judicial modification of a trust.

d. Suggested Solution: Regulatory Safe Harbors Apply to Both Grandfathered Trusts and Non-Grandfathered Trusts.

The present uncertainty surrounding the GST tax consequences of decanting largely stems from the question of whether the regulatory safe harbors apply only to grandfathered trusts, or apply also to non-grandfathered trusts. We suggest that the Service answer this question in its published guidance and, in the process, provide a uniform approach for preserving GST exempt status when decanting trusts.

While the Service has previously indicated that the GST Regulations for grandfathered trusts should apply to non-grandfathered trusts, the different policy rationales behind the preservation of GST exempt status for non-grandfathered trusts may dictate disparate treatment.

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30 See, e.g., PLR 201134017 (May 26, 2011) and PLR 200743028 (May 29, 2007).
Under the current regulatory framework, it is arguable that non-grandfathered trusts may preserve GST exempt status by complying with the Regulations governing the exercise of special powers of appointment contained in Regulation section 26.2601-1(b)(1)(v)(B). This argument may be particularly convincing considering that the common law and many state statutes define decanting as the trustee’s exercise of a special power of appointment. If this were the case, a decanting would not taint the GST exempt status of a grandfathered Distributing Trust so long as the decanting did not extend the term beyond the federal perpetuities period, as described in Part 5.b., supra. Further, a decanting would not taint the GST exempt status of a non-grandfathered Distributing Trust as long as the decanting did not extend the term beyond the perpetuities period under applicable state law.

To provide a workable framework for determining whether a decanting will cause a trust to lose its GST exempt status, we suggest that the Service issue guidance providing that both grandfathered and non-grandfathered trusts must satisfy either the discretionary distribution safe harbor of Regulation section 26.2601-1(b)(4)(i)(A) or the trust modification safe harbor of Regulation section 26-2601-1(b)(4)(i)(D).

i. Applying Regulatory Safe Harbors.

Whether decanting results in a loss of GST exempt status turns on the facts and circumstances. As a practical matter, a grandfathered trust without a specific decanting provision in the trust instrument would have a more difficult time satisfying one of the regulatory safe harbors than a non-grandfathered trust that became irrevocable when the trust’s governing law had a decanting statute in place. The first state decanting statute was not enacted until 1992, which may cause the discretionary distribution safe harbor to be unavailable. It is arguable, however, that under Phipps, the common law of most, if not all, states authorized the decanting of a grandfathered trust. Consequently, depending on the state, state common law may have permitted decanting at the time the trust became irrevocable, although this argument would likely require judicial construction.

Under the discretionary distribution safe harbor—which would be available only to trusts with a specific decanting provision or trusts whose applicable state law authorized decanting at the time the trust became irrevocable—a beneficial interest in trust would have always been subject to the trustee’s discretion to decant. Consequently, there should not be an adverse transfer tax result when the trustee actually exercises that discretion, so long as such exercise does not extend the Distributing Trust’s term beyond the federal perpetuities period.

For those trusts without a specific decanting provision or applicable state statute in existence at the date the trust became irrevocable, the trust modification safe harbor would still be available to preserve GST exempt status. The trust modification safe harbor would prevent a decanting that shifts beneficial interests in trust to a lower generation or extends the term of the Distributing Trust term beyond its original term. Again, this result makes practical sense. Trust interests that were not originally subject to the trustee’s decanting authority (either by the trust terms or applicable law) should be required to meet more stringent requirements to preserve GST exempt status.
ii. **State Law Considerations.**

Assuming that grandfathered trusts were required to satisfy the trust modification safe harbor, the term of the Receiving Trust would be limited to the term of the Distributing Trust, as described in Part 5.c.ii., *supra*. It is important to note that with respect to the extension of a trust’s term, this comports with the view the Service has taken in the discretionary distribution safe harbor (Regulation section 26.2601-1(b)(4)(i)(A)), described in Part 5.c.i, *supra*. In this regard, the Service has rejected the view adopted by several states that the applicable perpetuities period commences upon the exercise of a power of appointment, and instead recognizes that the applicable perpetuities period begins on the date the Distributing Trust became irrevocable.

While the trust modification safe harbor may appropriately limit a trustee’s ability to decant to take advantage of another state’s perpetuities laws, the Receiving Trust should be entitled to the maximum term permitted under the governing law and terms of the Distributing Trust. In other words, in those states where the rule against perpetuities has been abolished or substantially expanded, and the Distributing Trust is not otherwise subject to the federal perpetuities period, state law should control and decanting should not affect the maximum term otherwise available to the Receiving Trust, provided that the trust modification (or discretionary distribution) safe harbor is satisfied.

iii. **Conclusion.**

Applying the current regulatory framework to all GST exempt trusts represents a uniform approach while also taking into account the different policy rationales that may exist for grandfathered and non-grandfathered trusts. In this regard, the regulatory safe harbors recognize that the trustee’s exercise of the decanting authority does not change the nature of a beneficial interest in a trust that contained a specific decanting provision or that was subject to a state decanting statute at the time of irrevocability. Consequently, for grandfathered trusts, it would be difficult to shift beneficial interests down generational lines or extend the trust’s term unless a specific decanting provision were included in the trust instrument. For non-grandfathered trusts, the applicable state law at the time the trust became irrevocable should apply. The suggested approach, therefore, strikes a nice balance between the administrative utility decanting can provide, and the preservation of the settlor’s original intent.

6. A court order and/or approval of the state Attorney General is required for the transfer by the terms of the Distributing Trust and/or applicable law.

7. The beneficiaries are required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law.

8. The beneficiaries are not required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law.

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9. Consent of the beneficiaries and/or a court order (or approval of the state Attorney General) is not required but is obtained.

Fact patterns 6 through 9 are best addressed jointly because they all concern the effect that requiring or obtaining consent from the trust beneficiaries, approval from a court, or approval from the state Attorney General have on the tax consequences of decanting. The comments below focus on the gift and estate tax consequences of such consents or approvals. The comments do not discuss the GST tax consequences, as those are adequately addressed in the discussion of the regulatory safe harbors in fact pattern 5.

a. Potential Gift and Estate Tax Consequences.

It is arguable that when a beneficiary consents or acquiesces to a decanting, the beneficiary has exercised sufficient control over the trust assets to characterize such consent as a taxable gift or, if the gift is incomplete, to include the trust assets in the beneficiary’s gross estate for federal estate tax purposes. Similarly, if a beneficiary (who is also a trustee) has the legal right under state law to consent to or object to a decanting when the beneficiary’s interest is reduced, such an interested trustee may be deemed to make a voluntary gift of property under these circumstances. We suggest that the Service issue definitive guidelines or safe harbors regarding the gift and estate tax consequences of decanting with room for a facts and circumstances test to take into consideration situations falling outside the safe harbor.

b. Decanting by an Interested Trustee Should Cause Transfer Tax Consequences Only When the Decanting Shifts a Beneficial Interest in Trust or Delays a Vesting Period in Trust.

As a preliminary matter, in the context of a decanting by an interested trustee (i.e., a trustee who also has a beneficial interest) decanting should result in adverse gift or estate tax consequences only if the decanting authority is exercised by an interested trustee to shift a beneficial interest in trust or delay the vesting period of a beneficiary’s property interest in trust. In the case of an independent trustee, decanting should not be treated as a gift to the trust’s beneficiaries. When an independent trustee decants, the trustee is not reducing his or her own interest in the trust because the trustee does not individually own the property. Consequently, the trustee cannot make a gift. Likewise, even if the decanting is initiated by an interested trustee, decanting for purely administrative reasons should not constitute a taxable gift nor should it cause the trust assets to be includible in a settlor’s or a beneficiary’s gross estate.

c. Requiring or Obtaining Beneficiary Consent May Result in Adverse Transfer Tax Consequences Based on the Facts and Circumstances of the Decanting.

As stated above, beneficiary consent in a decanting could result in adverse gift tax consequences. We suggest that the Service’s published guidance provide that if beneficiary consent or court approval is required, then decanting may constitute a taxable gift or, if other

33 See Reg. § 25-2512-8.

34 Cf. PLR 201134017 (May 26, 2011).
provisions of the Code apply, cause the trust assets to be included in the settlor’s or the beneficiary’s gross estate, as the case may be. Despite this, such guidance should make clear that obtaining beneficiary consent or court approval pursuant to the terms of a state decanting statute, in and of itself, is insufficient to cause a taxable gift or estate inclusion. This position is consistent with *Commissioner v. Bosch.*

d. **Beneficiary Acquiescence Does Not Rise to the Level of a Taxable Power.**

Many state statutes require a trustee to notify the affected beneficiaries of a trust decanting. Beneficiaries who receive a trustee’s notice of decanting, but who fail to object, should not be treated as making a taxable gift of the decanted trust assets, and such assets should not be included in the beneficiaries’ gross estates. Taxable gifts generally require the transferor to make a voluntary transfer. When a beneficiary merely acquiesces to a decanting by failing to exercise his or her right to object, the beneficiary’s inaction, as a factual matter, should not constitute a voluntary transfer capable of triggering the gift tax. Imposing adverse transfer tax consequences in these situations would discourage trustees from notifying beneficiaries of a trust decanting and would pose problems for existing state statutes. To adequately protect all of the beneficiaries’ interests in a trust, we suggest that the Service’s guidance help promote an open and communicative process by not imposing adverse transfer tax consequences on beneficiaries who receive notice of a trust decanting, but fail to object.

e. **Fiduciaries Should Be Able to Protect Themselves from Fiduciary Liability Without Triggering Adverse Gift or Estate Tax Consequences.**

Although obtaining a beneficiary’s consent, under certain circumstances, should constitute a taxable gift and potentially result in estate inclusion, we suggest that the Service recognize the inherent risk of fiduciary liability associated with decanting and provide such fiduciaries with adequate avenues of protection. To protect trustees and beneficiaries, many state statutes have required that trustees notify beneficiaries of the decanting, and give beneficiaries an opportunity to object.

Because a trustee exercising the decanting power must still discharge its fiduciary duties, including the duty of loyalty, prudent trustees often seek beneficiary indemnification or court approval in appropriate circumstances. Several states have recognized this and permit trustees to petition the court to approve the decanting, either prior to or after the decanting has taken place.  

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36 See, e.g., Fla. Stat. Ann. § 736.04117(4); Ind. Code § 30-4-3-36(e); N.C. Gen. Stat. § 36C-8-816.1(f); S.D. Codified Laws § 55-2-18.


38 See, e.g., Fla. Stat. Ann. § 736.04117(4); Ind. Code § 30-4-3-36(e); N.C. Gen. Stat. § 36C-8-816.1(f); S.D. Codified Laws § 55-2-18.

Other alternatives to limit fiduciary liability include the execution of a release and indemnification agreement, or a receipt and refunding agreement, by the beneficiaries. We suggest that the Service’s published guidance permit these measures to help limit a fiduciary’s liability for exercising the decanting power.

Taking measures to protect against fiduciary liability, such as petitioning the court for approval or requesting indemnification from the beneficiaries, should not cause the settlor or the beneficiaries to experience adverse gift or estate tax consequences. Neither scenario requires beneficiary consent or court approval, and such actions are simply measures that a prudent trustee may take to limit its liability in a particularly difficult set of circumstances. Again, we suggest that the Service’s published guidance encourage decanting to be an open and collaborative process that is mindful of the interests of all beneficiaries and the trustee.

f. **Giving Notice to or Obtaining the Consent of the State Attorney General Should Not Result in Adverse Gift or Estate Tax Consequences.**

If a trust has a charitable beneficiary, a state decanting statute may require the trustee to provide notice to the Attorney General or obtain the consent of the Attorney General prior to decanting. We suggest that the Service’s published guidance explicitly provide that no taxable gift occurs when the state Attorney General is required to approve the decanting, or the trustee is otherwise required to notify the Attorney General of the decanting. In these instances, the Attorney General is a state-mandated third party who is not a beneficiary and who is incapable of making taxable gifts of the trust assets. Even if the state Attorney General were capable of making gifts, such gifts would not be taxable.

g. **Concluding Recommendations.**

To summarize the foregoing, we suggest that the Service issue guidance providing that:

i. Decanting by an interested trustee will result in adverse gift or estate tax consequences only if the decanting shifts a beneficial interest in trust or delays the vesting period of a beneficiary’s property interest in a trust;

ii. Decanting may constitute a taxable gift if beneficiary consent or court approval is required, depending on the facts and circumstances, but not necessarily if consent or approval is obtained, although not required;

iii. Depending on the facts and circumstances, and if other provisions of the Code apply, such as section 2036 or section 2038, decanting may cause the trust assets to be included in the settlor’s or the beneficiary’s gross estate if beneficiary consent or court approval is required, but not necessarily if consent or approval is obtained, although not required;

iv. Obtaining beneficiary consent or court approval pursuant to the terms of a state statute is insufficient, in and of itself, to cause a taxable gift or estate inclusion;

v. Beneficiary acquiescence (i.e., receiving notice of a trust decanting, but failing to object) will not cause adverse gift or estate tax consequences;
vi. A trustee’s decision to petition the court for approval or enter into an agreement with beneficiaries that limits fiduciary liability will not cause adverse gift or estate tax consequences; and

vii. Giving notice to or obtaining the consent of the state Attorney General will not result in a taxable gift or estate inclusion.

10. Effect of state law on each of the above addressed tax consequences identified in Notice 2011-101: (1) changed beneficial interests, (2) the addition of new beneficiaries, (3) added/deleted/altered powers of appointment (4) change between grantor and non-grantor tax status, (5) the change of situs resulting in an extended termination date, (6) a court order or approval of the Attorney General, (7-9) consent of the beneficiaries to the decanting, whether required or not.

If decanting is analogized to reformation and modification of trusts requiring court approval, state law should control. Commissioner v. Bosch, 387 US 456 (1967). In Bosch, the Court determined that federal entities are not bound by a state court’s ruling on property interests if the United States is not a party; however, federal entities are to follow the ruling of the highest court of a state, and if none, rulings by other state courts. Therefore, under the common law of a state such as Florida, there should be no gift tax consequences from decanting. Further, if the decanting is pursuant to an applicable valid state statute, the same outcome should result.

a. Items 1-3: (1) Changed Beneficial Interests, (2) The Addition of New Beneficiaries, (3) Added/Deleted/Altered Powers of Appointment

Beneficial interests can be changed in many ways, two of which include the addition of new beneficiaries and powers of appointment listed above.

i. Income tax consequences.

Under most state decanting statutes, the independent trustee is authorized to distribute the trust income and principal into separate trusts for one or more of the beneficiaries. This action is consistent with a qualified (or nonqualified) severance of the Distributing Trust as allowed under Regulation section 26.2642-6. Because the trustee has full discretion to distribute income and principal among multiple beneficiaries, the distributions to the Receiving Trusts need not be equal as to each beneficiary. For income tax purposes, in a qualified or nonqualified severance, any income or gain should be attributed to the trusts pro rata. Most state decanting statutes provide for this allocation.

Some state statutes that allow a change to the beneficiaries’ interest are recognized by the Service not to alter the income tax consequences of the change, for example, total return trusts (or unitrusts). State income tax consequences could be triggered by a change in situs, but that is

40 See Phipps v. Palm Beach Tr. Co., 142 Fla. 782, 196 So. 299 (1940).

41 See Cottage Savings; Reg. § 1.1001-1(h).
not the subject of these comments. Otherwise, state law should not have a serious effect on the federal income tax consequences of decanting.

ii. Gift Tax Consequences.

aa. Changed Beneficial Interest.

An independent trustee who decants is doing so pursuant to the governing instrument and/or state law or common law. He or she does not personally own the property nor does he or she have a beneficial interest in the trust, so he cannot make a taxable gift of the property. He or she does not have a general power of appointment, i.e., the trustee cannot decant in favor of himself or herself, his or her creditors, his or her estate or the creditors of his or her estate. Therefore, an independent trustee would not and could not be a donor.

An issue arises if a beneficiary is acting as trustee. An interested trustee who distributes trust income and principal to unequal separate trusts for the beneficiaries that reduces the interested trustee’s beneficial interest could be considered to be making a gift of part or all of his interest to the other beneficiaries. (See Notice 2011-101 Item 9 above and comments below regarding consent of beneficiary). Most state decanting statutes, or the governing instrument, limit an interested trustee’s discretion to distribute pursuant to an ascertainable standard under section 2041(b)(2) to prevent that outcome.

bb. Adding a Beneficiary.

Adding a beneficiary, at least through a power of appointment granted under the Receiving Trust, to a trust in which the independent trustee has full discretion to distribute the principal and income does not change a beneficial interest. Because there is no voluntary transfer from one beneficiary to another, there should not be any gift tax consequences to adding a beneficiary to a trust by the independent trustee. Under a discretionary distribution standard, any one individual beneficiary does not have any more right to the assets of the trust than another. If an interested trustee has the authority to add a beneficiary, however, it is possible a taxable event could occur. Again, state law limiting an interested trustee’s discretion to an ascertainable standard under section 2041 should prevent that outcome.

The governing instrument may provide that the trust may be distributed among the objects of the grantor’s bounty or a similar class of individuals, such as the grantor’s descendants. After decanting to a Receiving Trust, some state decanting statutes provide that the class of beneficiaries may include a person(s) who become includible after the decanting. Again, as long as the independent trustee has total discretion to distribute to multiple beneficiaries consisting of a class, he could distribute to an addition to the class without adverse

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42 Reg. § 1.671-2(e)(5).

gift tax consequences.\textsuperscript{44} The trustee would not become a grantor or be deemed making a gift as a result of the decanting because the governing instrument and state law allowed him to make the distribution to the Receiving Trust. Again, there is no voluntary transfer from any beneficiary to another. As indicated above, an interested trustee participating in the decanting could trigger gift tax consequences, but state decanting laws generally prohibit that result by limiting an interested trustee’s decanting power.

cc. \textit{Limited Power of Appointment.}

Similarly, a beneficiary may be added by granting the beneficiary of a Receiving Trust a limited power of appointment. Under state common law, the trustee may already have that authority, unless limited in the governing instrument. For example, the frequently cited \textit{Phipps} opinion stated that a trustee with total distributive discretion had authority to create a succeeding trust that granted a limited power of appointment to a beneficiary.\textsuperscript{45} In addition to common law, the state decanting statute can give that authority.

If the Receiving Trust confers on any beneficiary a limited power of appointment, and the trustee has the authority under applicable state law, whether statutory or common, or under the governing instrument to confer such a power, then consistent with the foregoing, the grant of a non-general or limited power of appointment to a beneficiary in the Receiving Trust would appear not to have gift tax consequences to any beneficiary of the Distributing Trust. The question becomes, as discussed in answer to Notice 2011-101 Item 1-3, d., above, whether the potential appointees are permitted beneficiaries under the original trust document.

Under state laws that allow conversion of a trust to a unitrust having basically the same terms as the Distributing Trust, using decanting to accomplish the same result should not result in gift, estate or GST tax consequences despite a changed beneficial interest.\textsuperscript{46}

dd. \textit{State Law Trust Termination Date.}

State law also affects the termination date of a trust. Trusts that became irrevocable when the common law rule against perpetuities was in effect should be able to be decanted into a Receiving Trust that is consistent with the current state law perpetuities period, which may be longer than the common law rule. (See answer to Notice 2011-101 Item 5 above and Item 12 below for GST issues.)

ee. \textit{State Law Rule Against Perpetuities.}

\textsuperscript{44} See PLR 201138027 (September 23, 2011) (a beneficiary could not have children; the terms of the trust did not include adopted children; trust was modified to include children adopted prior to the age of majority; citing Reg. § 26.2601-1(b)(4)(i)(E), Ex. 7 the Service ruled the modification would not result in a gift, but cautioned that upon adoption, a gift may occur because it could change the current beneficiaries’ interests).

\textsuperscript{45} 142 Fla. 782, 196 So. 299 (1940).

\textsuperscript{46} PLR 201104003 (January 28, 2011).
As discussed in Part 5.d.ii., supra, there is debate on whether a trust can be converted into a longer term or perpetual trust under state decanting laws. The traditional future interest rules and restatement of trusts view is that the perpetuities period is established on the date the trust is created or became irrevocable. Further, state law may limit which trusts might be able to be extended. For example, in Illinois, 765 ILCS 305/6 states that qualified perpetual trust rules apply only to instruments (including exercises of powers of appointment) that become effective after the 1991 effective date of the act.


Whether a grantor trust is changed to a non-grantor trust or vice versa seems to be a federal matter rather than one affected by state law.

c. Item (5): The Change of Situs Resulting in an Extended Termination Date.

The effect of a change of situs of a trust to another state to extend the termination date should not result in gift or estate tax consequences for trusts that are not GST exempt. (See answer to Notice 2011-101 Item 5 above and Item 12 below for discussion regarding GST exempt trusts).

Regulation section 26.2601-1(b)(4)(i)(E), Example 4, illustrates the effect of changing the situs of a grandfathered trust for the benefit of the Grantor’s issue. The trust stated the common law rule against perpetuities and the trust did not identify which state’s law was to govern administration and construction of the trust. The effect of changing trustees in this case resulted in a change of situs to a state that had no rule against perpetuities. The Service determined that because the governing instrument required the common law rule against perpetuities, there would be no shift of beneficial interest to a lower generation and there was no extension of the time for vesting. The new state’s perpetuities statute had no effect on the perpetuities provision in the governing instrument. The Service noted that if the change in situs resulted in an extended perpetuities period, the trust would lose its GST exempt status.

It also appears that the GST exemption should continue until the trust terminates pursuant to the perpetuities rule in effect in the state in which the grantor established an irrevocable trust. (Most, if not all, grandfathered trusts were established under the common law rule against perpetuities.) A logical extension of Example 4 to a perpetual trust created after a decanting statute was in place is that a change of situs should not result in a shift of beneficial interest to a lower generation than that was already in place and the vesting period would not be extended because it is already perpetual.

d. Items (6) Approval of the Attorney General, and (7-9): Consent of the Beneficiaries to the Decanting, Whether Required or Not.

Items 6 through 9 adequately address the effect of state consent laws on the tax consequences of decanting. To reiterate, the general idea is that when a trustee simply complies with the terms of a state decanting statute, or otherwise takes advantage of certain procedures available under state law, these actions, standing alone, should not trigger adverse gift and estate
tax consequences. Moreover, if the gift tax consequences of decanting may be compared to GST tax consequences, there are several analogous private letter rulings indicating that a state court approved settlement will not affect the GST exempt status of a trust if there is a bona fide dispute and the settlement is within reason. In PLR 201049008 (December 10, 2010), for example, the Service determined that the proposed trust modifications in a non-judicial settlement agreement would not result in a shift of beneficial interest to a person in a lower generation than the current beneficiaries and would not extend the time for vesting, and because the modifications meet the requirement of state law, the inclusion ratio would not be affected. In PLR 201104003 (January 28, 2011), the Service determined that conversion of a trust to a unitrust pursuant to state law did not cause a loss of GST status. If these determinations could be applied to gift tax, no gift tax would be incurred as a result of decanting.

11. **A change in the identity of a donor or transferor for gift and/or GST tax purposes.**

The grantor of an irrevocable trust having an independent trustee remains the grantor, whether of the Distributing Trust or the Receiving Trust, unless the trustee or a beneficiary has a general power of appointment. An independent trustee does not become the grantor when exercising a power to decant, unless it would be considered a general power of appointment, that is, if the trustee could decant in favor of himself, his creditors, his estate or the creditors of his estate. If, however, an individual having an interest in the trust has a general power of appointment under section 2041 or section 2514, he becomes a grantor for gift or estate tax purposes upon the decanting.

If a beneficiary has direct or indirect control over the trustee through a power to remove or replace the trustee, he could be deemed to be a grantor of a portion or all of the trust. This consequence can usually be controlled by the trust instrument or state law by not allowing the beneficiary the ability to appoint a related or subordinate party as trustee. If a beneficiary acts as a co-trustee in decanting a trust, and the standard of invasion of the income and principal is the same in the Distributing and the Receiving Trust so that section 2041 is not triggered, the decanting should not change the beneficiary into a grantor, even if his interest is reduced.

12. **The Distributing Trust is exempt from GST tax under Regulation section 26.2601-1, has an inclusion ratio of zero under section 2632, or is exempt from GST tax under section 2663.**

   a. **Regulation section 26.2601-1 (Grandfathered GST Trusts).**

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47 PLR 201121009 (May 27, 2011) (resolving ambiguity whether beneficiary entitled to income); 201123014 (June 10, 2011) (settlement of years of litigation resulting in distribution of cash instead of real property); 201013017 (April 2, 2010) (equitable adjustment); 201121011 (May 27, 2011) (modification to correct scrivener’s error regarding rule against perpetuities).

48 Reg. § 1.671-2(e)(5).

In addition to the regulatory safe harbors discussed in Item 5, there are also safe harbors contained under many state laws. As a general matter, most state decanting statutes include savings provisions that prohibit decanting when it would cause a GST exempt trust to forfeit its tax benefits. Therefore, a trustee would be acting contrary to state law if he did so.

b. **Inclusion ratio equivalent to zero under section 2632.**

If a Distributing Trust has an inclusion ratio of zero, the Receiving Trust should have the same inclusion ratio after decanting pursuant to section 2654(b). The Service has approved the division of a trust into separate trusts without loss of GST status. In PLR 201109004 (March 4, 2011), the Service allowed a pro rata division of a trust into separate trusts, both of which retained the inclusion ratio of the Distributing Trust of zero where the time for vesting was not extended and there was no shift of beneficial interests to a lower generation. It would seem that if an independent trustee of the Distributing Trust with an inclusion ratio of zero had full distributive discretion that the result would be the same if there were non-pro rata distributions into separate trusts for multiple beneficiaries. Regulation section 26.2642-6(h) provides that separate trusts resulting from a non-qualified severance that are treated as separate trusts under state law will be respected for GST purposes, and the inclusion ratio of the resulting trusts will remain the same as the inclusion ratio of the original trust.\(^{50}\)

c. **GST exempt under section 2663 (Application of Chapter 13 to Nonresident/Noncitizens (“NRA”)).**

Chapter 13 applies to NRAs to the extent the property is also subject to Chapters 11 or 12, up to the amount of the GST exemption then allowed to a NRA.\(^{51}\) Conceivably, if a Distributing Trust created by an NRA to which GST exemption were allocated is decanted to a Receiving Trust in the same manner as above and the Receiving Trust complies with the GST rules, then the GST exemption would not be lost. Regulation section 26.2601-1(b)(4)(i)(A) should reasonably apply to trusts that were created after September 25, 1985, to which the grantor allocated his GST exemption. For trusts created after a decanting statute becomes effective, the Receiving Trust should not lose its GST exemption by decanting pursuant to state statute. Similarly, assuming the state common law allowed distribution to a trust for the benefit of a beneficiary and the Distributing Trust became irrevocable after September 25, 1985, the Receiving Trust should not lose its GST exemption.

13. None of the changes described above, are made, but a future power to make any such changes is created.

The Receiving Trust can be structured with greater flexibility than the Distributing Trust. This is one reason decanting statutes are being enacted. Trustee powers may be added to allow decanting or change any other acceptable administrative provision, such as the power to change

\(^{50}\) See also Reg. § 26.2642-6(j) Example 12.

the situs of the trust or to amend the trust in order to comply with changed tax laws. The position of trust protector may be established, giving the trust protector the power to make an amendment.

Again, the power held by an independent trustee to decant is not a general power of appointment and an independent trustee is neither a grantor nor a beneficiary of the trust. The power to decant is more like a limited power of appointment, as many state statutes provide and to which most authoritative articles written about decanting analogize the power. State statutes, for the most part, are written to avoid tax repercussions, such as allocation of income and gain and limiting the authority of an interested trustee to decant. Therefore, creating a future power to decant should likewise not have adverse tax consequences to the trust or the beneficiaries.

14. **Definition of Decanting.**

The Notice also requests a definition of decanting. We believe the following elements should be contained in such a definition:

1. Exercise of a discretionary power held by the Trustee;
2. Pursuant to state statute, the terms of the trust instrument, or common law;
3. Exercised by the Trustee in a fiduciary capacity;
4. Appoint some or all of the trust income or principal from one trust to another trust;
5. For the benefit of one or more of the current beneficiaries of the original trust.

The following is a proposed definition that attempts to incorporate these elements:

The Trustee’s exercise of a discretionary power, held in a fiduciary capacity and pursuant to state statute, common law, or the terms of the trust instrument, to distribute principal or income to or for the benefit of one or more current beneficiaries of the original trust by appointing all or part of the principal or income of the original trust subject to the power in favor of a trustee of a second trust.

**IV. SUMMARY AND CONCLUSION.**

We commend the Service and Treasury for inviting comments on the tax implications of decanting. Given the increased legislative activity and utility found in decanting, we urge the prompt promulgation of regulations consistent with the comments set forth herein.