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## Pour carefully when decanting irrevocable trusts

By Christopher Burns & Lloyd Stern

In our prior article we discussed the breadth of changes to the Minnesota Trust Code that took effect Jan 1, 2016. (See, “Directions to top trust tips,” *Minnesota Lawyer*, Dec. 28, 2015.) We also briefly introduced the concept of a trustee’s power to decant, or the ability to move assets from one trust to another. Because of the complexity and novelty of the decanting concept, we reserved discussion of it until we could dive somewhat deeper into the details.



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Prior to the enactment of this new law, Minnesota lawyers were generally limited to the legal remedies of modification or reformation in order to modify or repair the provisions of an existing irrevocable trust. Revocable trust provisions, could of course, be changed relatively easy in accordance with powers retained by the grantor either by amendment or restatement.

Similar to the decanting or pouring of a fine wine from its original bottle into a serving decanter in order to improve quality and flavor, the concept of trust decanting is to pour assets from an obsolete or unworkable original trust (the “invaded” trust) for any one of a number of valid reasons. Trust decanting provides a new and useful vehicle, but it is not without its own traps and pitfalls, which warrant moderation and a careful approach by the practitioner.

Relying on New York law as a guide, the Minnesota UTC drafting committee also sought the input of experts in real property law, nonprofit law, banking law, and trust litigation to inform their work. Their combined wisdom should be seen as a caution to practitioners with limited expertise in any one of these areas to seek the counsel of experts in areas other than their own, as applicable, prior to advising a client regarding the use of decanting.

Unlike most of the recent changes to Minnesota trust law found in Chapter 501, the Minnesota decanting statute has been included in Chapter 502 of Minnesota Statutes as these statutory provisions are generally

entitled “Powers of Appointment.” In particular, Section 502.851, subd. 5 provides “[a]n exercise of the power to invade trust principal under subdivision 3 or 4 shall be considered the exercise of a special power of appointment.”

Section 502.851 also includes new definitions for specific terms used in its provisions. The new trust created to receive the decanted assets is referred to as the “Appointed Trust,” and the original irrevocable trust from which the assets decant is referred to as the “Invaded Trust.” The language in the original trust instrument defines, or will be used to interpret, whether the trustee has “unlimited discretion.” “Unlimited discretion” is defined as “unlimited power to distribute principal.”

The definition of “unlimited discretion” is one of the keys in determining how the new statute will work in practice. Only trustees with “unlimited discretion” are allowed to decant the assets into a new trust with “none, one, more than one, or all of the successor and remainder beneficiaries of the invaded trust.” Minn. Stat. 502.851, subd. 3(a). In the event the trustee does not have “unlimited discretion” as granted in

the original trust instrument, then the beneficiaries must remain the same for the invaded trust as they were for the appointed trust. Id. Subd. 4(a).

Decanting can occur without court approval or the consent of the settlor; provided, however, the trustee may seek court approval. Min. Stat. 502.851, subd. 11(b). Additionally, there is no requirement to state a current need to invade the principal in order to exercise this power. Id. Subd. 8. While these flexibilities open up numerous possibilities for trustees to better meet the evolving needs of beneficiaries, it is worth noting that the fiduciary duty standard applies throughout the exercise of any powers. Id. Subd. 9. And, finally, Minnesota has unique notice requirements regarding the exercise of powers that differ from other states.

#### **Limitations on power to decant**

Subdivision 15 lists a significant number of prohibitions limiting the trustee's power to decant. The exercises of that power cannot:

(1) Reduce, limit, or modify any beneficiary's current right to a mandatory distribution of income or principal;

(2) Decrease or indemnify against a trustee's liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence, and prudence;

(3) Alter or eliminate a provision granting another person the right to remove or replace the authorized trustee exercising the power under sub-division 3 or 4, unless notice has been provided to the persons under subdivision 11, paragraph (c), or approval is granted by a court having jurisdiction over the trust;

(4) Make a binding and conclusive fixation of the value of any asset for purposes of distribution, allocation, or otherwise;

(5) Extend the term of the appointed trust beyond any permissible period of the rule against perpetuities of the invaded trust, and any exercise of the power which extends the term of the appointed trust beyond the permissible period of the rule against perpetuities of the invaded trust shall void the entire exercise of the power; or

(6) Jeopardize:

(i) the deduction or exclusion originally claimed with respect to any contribution to the invaded trust that qualified for the annual exclusion under section 2503(b) of the Internal Revenue Code; the marital deduction under section 2056(a) or 2523(a) of the Internal Revenue Code; or the charitable deduction under section 170(a), 642(c), 2055(a), or 2522(a) of the Internal Revenue Code;

(ii) the qualification of a transfer as a direct skip under section 2642 (c) of the Internal Revenue Code; or

(iii) any other specific tax benefit for which a contribution originally qualified for income, gift, estate, or generation-skipping transfer purposes under the Internal Revenue Code.

The modernization of the trust statutes is significant and should not be ignored. The clarification of common law definitions and the added flexibility provide many new and innovative tools for Minnesota advisors. As we have attempted to express here, advisors should carefully proceed with attention to the unintended impacts of decisions on existing trusts. In particular, avoid pitfalls involving income, gift, estate, and generation-skipping taxes (note subd. 15 (6) quoted above). This brief article is not meant to turn estate planning attorneys into decanting sommeliers, but only to make us all more comfortable with the general concepts of estate planning decanting.

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