



Client Alert: Virginia Enacts Trust Decanting Statute

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On April 4, 2012, Governor McDonnell signed Senate Bill 110 into law, which allows trustees to exercise the power to distribute trust income or principal to or for the benefit of a beneficiary by distributing the assets to a new trust. The act of distributing trust assets to a new trust is commonly referred to as “decanting.” 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 into another for the purposes of adding oxygen and removing unwanted sediment. In the trust context, practitioners can view decanting as a trustee pouring the assets of an old trust into a new trust, with more beneficial provisions (the so-called “oxygen”) added and with less useful provisions (the so-called “sediment”) left behind.

Virginia’s decanting statute is a product of the Virginia Bar Association’s Wills, Trusts, and Estates Legislative Committee. This client alert summarizes the applicability of Virginia’s decanting statute, situations in which it may be beneficial to decant assets from an existing trust to a new trust, the administrative requirements under Virginia’s decanting statute, and how to limit a trustee’s fiduciary liability when exercising the decanting authority.

Applicability of Virginia’s Decanting Statute

Virginia’s decanting statute, which will be codified at Virginia Code § 55-548.16:1, has an effective date of July 1, 2012. Decanting will be available to any trust administered under Virginia law, regardless of when the trust was created, unless the terms of the trust explicitly prohibit the trustee from decanting. To date, fourteen states have adopted decanting statutes.

Reasons to Decant

Decanting is an incredibly useful tool for trustees, particularly for older trusts with antiquated language. For instance, a trustee may consider decanting to accomplish the following objectives:

- To change the trust’s administrative provisions, such as:
 - changing trust situs or governing law;
 - providing for the resignation, removal, and appointment of trustees without court approval;
 - 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;
 - providing for the division of trustee roles and responsibilities;
 - addressing issues related to trustee compensation or liability; or
 - consolidating trusts for administrative efficiency.

- To address a beneficiary-related change of circumstances, including:
 - limiting distributions to beneficiaries with substance abuse problems or those engaging in other unproductive behaviors;
 - removing beneficiaries for tax planning or other reasons;
 - transferring assets to a special needs trust for a disabled beneficiary; or
 - dividing a single “pot” trust into separate trusts for each branch of the family.
- To respond to changes in federal or state tax law; or
- To correct errors or ambiguities in the trust instrument.

Although Virginia law currently contains provisions permitting modifications of trusts, reformations to correct mistakes, and combinations and divisions of trusts, these mechanisms typically require consent from all of the qualified beneficiaries and, in some cases, court approval. Decanting, on the other hand, allows a trustee to change administrative provisions with minimal court intervention. Decanting, therefore, is a more cost-effective and timely alternative to the methods provided under current law.

Administrative Requirements under Virginia’s Decanting Statute

The Virginia statute is designed to balance the utility that decanting can provide with safeguards for trust beneficiaries and trustees. As a threshold matter, an “interested trustee” — generally defined as an individual trustee who has a beneficial interest in the trust — is prohibited from exercising the decanting authority. Moreover, disinterested trustees who are permitted to decant are still subject to fiduciary duties and are required to give 60 days’ written notice to the grantor (if living), the qualified beneficiaries, and any advisor or protector of the trust. Those persons entitled to notice are given both an opportunity to object to the decanting, as well as an opportunity to waive notice so that the trustee may decant prior to the expiration of the 60-day statutory window. As a practical matter, if the existing trust filed accounts with the commissioner of accounts, the new trust will also be required to file accounts.

How to Limit Fiduciary Liability

Although decanting provides a great benefit to trustees seeking to update a trust’s administrative provisions, some trustees may be concerned that decanting exposes the trustee to fiduciary liability. Fortunately, informed trustees may limit their liability by engaging in a handful of best practices. First and foremost, the Virginia statute contains a number of tax saving provisions, which generally shield the decanted trust from adverse income, estate, gift, and generation-skipping transfer (GST) tax consequences. As discussed above, the Virginia statute also encourages an open and honest process by prohibiting decanting by interested trustees and requiring notice to all qualified beneficiaries. Lastly, trustees may take proactive measures to limit their liability, such as petitioning the court for approval or entering into a release and indemnification agreement with the trust’s qualified beneficiaries.

The Internal Revenue Service has issued nearly two dozen private letter rulings that provide favorable guidance with respect to the income, estate, gift, and GST tax consequences of decanting. Given the increase in the popularity of decanting and the adoption of state statutes (like Virginia’s new statute) permitting decanting, the Internal Revenue Service recently issued Notice 2011-101, in which it requested public comment regarding the tax consequences of decanting. Numerous groups have submitted comments, including the American Bar Association’s Section of Taxation. A copy of the decanting comments by the ABA’s Section of Taxation can be accessed [here](#). It is anticipated that the Service will issue definitive guidance regarding decanting in the near future.

Conclusion

Decanting substantially improves Virginia’s trust law and makes the Commonwealth a more attractive jurisdiction for trust administration. As a growing number of states have recognized, decanting permits trustees to accomplish their objectives in a cost-effective and timely fashion, while still maintaining safeguards for trust beneficiaries and trustees. In many circumstances, decanting can provide an ideal solution to change a trust’s administrative provisions, address a beneficiary-related change of circumstances, respond to changes in federal or state tax law, or address errors or ambiguities in the trust instrument.

For more information about this topic, please contact the author or any member of the Williams Mullen Private Client & Fiduciary Services Team.

Please note:

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