



DECANTING – Can Irrevocable Trusts be Changed?

By Jay R. Larsen, Esq.*

Irrevocable trusts are a common tool in estate planning. They play an important role in protecting assets, reducing taxes, and preserving legacies from one generation to the next. Irrevocable trusts come into existence in a number of ways.

A trustor who created a typical revocable living trust may die, at which point the trust becomes irrevocable. Or perhaps the trustor created an irrevocable trust to protect assets or remove a large life insurance policy from the trustor/insured's estate for estate tax purposes. The trustors may have grandchildren for whom they wish to establish an irrevocable minor's trust for future education.

There are many reasons for using irrevocable trusts, but a common characteristic is that they are typically not amendable. A carefully drafted irrevocable trust may provide some flexibility, for example through a limited power of appointment. But generally speaking, an irrevocable trust that has "gone wrong" in some way can be difficult to change.

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Why Might You Want to Change the Trust?

Rather than things going wrong with the trust, it is more likely that goals or circumstances change such that it is difficult to accomplish the original intent of the trust. Sometimes issues arise with trust assets or beneficiaries, and the trust language is too ambiguous to provide clear direction about what should be done.

Maybe circumstances arise which cause the parties involved to recognize the benefits of extending the trust beyond a fixed term or mandatory payout at a certain age. Changing a trust from one that provides for the health, education, support and maintenance needs of a beneficiary to a discretionary trust can provide superior asset protection. Perhaps it makes sense to combine trusts that otherwise cannot be merged by their terms. Or due to the differing needs of a pool of beneficiaries of a single large pot trust, it might make sense to divide the trust into separate trusts. Perhaps tax laws change.

In addition to the reasons above, there are many others for wanting to modify an otherwise seemingly unchangeable irrevocable trust. So how does one go about accomplishing that objective?

How to "Fix" the Irrevocable Trust.

Court Order: One possible method of dealing with desired changes is to petition the court. This works well to fix clerical errors, confirm new trustees, or clarify ambiguities. However, certain modifications, such as changing distribution provisions, may be more difficult, especially without the consent of all the beneficiaries affected by the change.

Non-Judicial Settlement Agreement: If beneficiary consent is going to be needed anyway, a non-judicial settlement agreement (“NJSA”) should be considered if your state allows it. Nevada statute permits a wide range of changes to an irrevocable trust, including its termination. NRS 164.940.

Decanting: A third option for fixing potential problems with irrevocable trusts is for the trustee to transfer assets from the irrevocable trust causing the concern to a new irrevocable trust that does not have the problems. This transferring process is known as “decanting.” Not all trusts are eligible for decanting and not all states allow decanting. Fortunately, Nevada statute allows for decanting as long as the statutory requirements are met. NRS 163.556.

The Decanting Process.

First, the irrevocable trust should be domiciled in Nevada and subject to Nevada law. If necessary, jurisdiction of the trust should be transferred to Nevada so that the Nevada decanting statutes apply.

Next, the trustee must satisfactorily answer several questions. Do the terms of the trust prevent decanting? If so, the trust may not be decanted. Does the trustee have discretion or authority to distribute income or principal of the trust either to or for the benefit of a beneficiary? If so, then the property which is subject to the discretion or authority may be transferred to a second irrevocable trust.

It is important to note that new beneficiaries may not be added to the second trust. Also, there are several circumstances under which decanting is not allowed. Such circumstances include the second trust reducing an income interest if the first trust is a marital trust, a charitable trust, or grantor retained annuity trust. Or if property specifically allocated to a particular beneficiary is not allocated to that same beneficiary in the second trust, unless the beneficiary consents. There are also a couple of other prohibited situations.

As you can imagine, in order to prevent a trustee from abusing the decanting power, there are additional restrictions to decanting if the trustee is also a beneficiary of the first irrevocable trust.

Once it is determined that the trustee may decant assets from the first irrevocable trust to the second, the next step is to create the second irrevocable trust, if it is not already established.

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Before appointing assets to the second trust, the trustee may give notice to the beneficiaries or may seek court approval. The statute is not clear whether or not the trustee may decant without either notice or court approval, but arguably should be okay. Nevertheless, the recommended course of action is to either obtain beneficiary consent, provide the appropriate notice, or obtain court approval. If court approval is sought, notice of the petition is given to the beneficiaries.

After court approval is obtained, the notice period expires, or beneficiary consent is obtained, the trustee may assign the desired assets from the first trust to the second trust.

Decanting has become an additional tool to remedy “broken” trusts, whether from drafting problems or from changed life circumstances. However, proper decanting is not a do-it-yourself project. Working with an experienced trust company serving as trustee and receiving the advice of experienced legal counsel is important for successful trust decanting.

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