Tentative Report

The Proposed Mississippi Trust Decanting Act

2013 Secretary of State Business Law Reform Study Group

Trust Decanting Task Force

Prepared for:
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Introduction

The Trust Decanting Task Force ("Task Force") recommends the Mississippi Legislature expressly authorize trust decanting in Mississippi. There are currently 21 states with Trust Decanting statutes enacted or proposed. A power to decant is a power of appointment exercisable in a fiduciary capacity. It is based on the idea that a trustee with absolute authority to distribute principal to a beneficiary may distribute principal to another trust for the benefit of that beneficiary. This can be useful when changes are needed regarding trust administration or beneficiary status. Decanting can also be useful when changes in tax law make other jurisdictions more beneficial for creating a trust.

History of the project

The 2013 Trust Law Study Group found a need to review trust decanting for possible adoption in Mississippi. David Marchetti, a Fellow of the American College of Trust and Estate Council and attorney with Wells Marble & Hurst, was asked to chair the Decanting Task Force. Members included Ronald Loeb, Butler Snow LLP; Craig Stevens, Regions; and Robert Williford, Williford McAllister & Jacobus, LLP. The Task Force reviewed the laws from these states along with other trust laws such as the Uniform Trust Code to develop a decanting solution for Mississippi. In doing so, the Task Force focused heavily on Illinois's recent provision

Statement of the problem area

Before the development of trust decanting, if a trust document need revision a court order may be necessary to make the changes. This could be true even in events where the settlor, trustee, and beneficiaries all agree that the change is both beneficial and necessary. Trust Decanting provides an opportunity for assets of an old trust to be transferred to a new trust without the need for court intervention.

Summary of Proposal

The Mississippi Trust Decanting Act authorizes a trustee, with absolute discretion, to distribute the principal of a trust, with or without court approval, in favor of a trustee of a second trust for the benefit of one or more of the beneficiaries of the first trust, and one or more of the successor beneficiaries of the first trust. However, it does not allow a future interest in the first trust to be accelerated to a present interest in the second trust.

A trustee without absolute discretion is given similar authority to distribute the principal of a trust to a second trust, but all the beneficiaries of the second trust must be the same as the beneficiaries under the first trust. This requirement applies to both current and successor beneficiaries. Further, if the trustee does not have absolute discretion, where the first trust grants

a power of appointment to a beneficiary, the second trust shall grant such power and the class of permissible appointees shall be the same as in the first trust.

A trustee is authorized to distribute part or all of the principal of a disabled beneficiary's interest to the trustee of a second trust which is a supplemental needs trust, if the trustee determines that it is in the best interest of the disabled beneficiary.

A trustee may distribute the principal of the first trust to the trustee of a second trust without the approval of the settlor or beneficiaries, but notice of such distribution must be given not less than ninety (90) days prior to the planned effective date of the distribution. Notice must be given to both current and presumptive remainder beneficiaries, but is not required for anyone who cannot be located after reasonable diligence. If a charity is a beneficiary, notice must also be given to the Mississippi Secretary of State.

While court approval of a distribution is not required under the Mississippi Trust Decanting Act, Section 6 does allow for an action to approve or disapprove a distribution in favor of a second trust. Such action may be brought by the settlor, trustee, co-trustee, trust protector, trust advisor, beneficiary or beneficiaries, or the legal representative of a beneficiary.

Section 7 of the Act allows the term of the second trust to be longer than the term of the first, but it requires the second trust to comply with the same rule against perpetuities that applied to the first trust unless the first trust expressly permits the trustee to extend or lengthen the perpetuities period.

Unless otherwise directed by the trustee, a distribution to a second trust shall not include subsequently discovered assets or undistributed principal paid to or acquired by the first trust subsequent to the distribution.

The Act is not intended to limit the power of a trustee to distribute trust assets, it does not require a trustee to show a need to distribute before making a distribution to a second trust, and it does not create a duty that the trustee distribute assets as allowed under the Act. The Act does not require a trustee to inform beneficiaries about the availability of the act and to determine whether any action should be taken.

Section 14 of the act provides several restrictions on the trustee's ability to make distributions to a second trust under the Act. A distribution is not allowed if it would reduce, limit or modify a current right to a mandatory distribution. A trustee is not allowed to make distributions to decrease or indemnify against liability for failure to exercise reasonable care, diligence or prudence. A trustee may not attempt to eliminate a provision which grants another person the right to remove or replace the trustee or to change provisions regarding the compensation of the trustee.

An exercise of the power to distribute under the Mississippi Trust Decanting Act must be in writing, signed and acknowledged by the trustee. Further, the settlor of the first trust shall be considered the settlor of the second trust pursuant to this act. If the settlor of the first trust is not the settlor of the second trust, the settlor of the first trust shall be considered the settlor of the second trust only with respect to the portion of the second trust which was distributed from the first trust in accordance with this act.

The Mississippi Trust Decanting Act will apply to all trusts whether created before, on or after the effective date of the Act.

Conclusion

The focus of the group was to make Mississippi one of the best states in the nation for trusts. Part of this progress comes from recognizing trust decanting.

There are many instances where a trust could need reforming – to lengthen the term of the trust, to benefit from tax changes, to allow new or better investment options, or even to change or add a beneficiary. Trust decanting allows the assets from an old, outdated, or obsolete trust to be moved to a modern trust which can better meet the purposes of the settlor. While some authority for decanting may be found in common law, many trust professionals recommend administering trusts in states with laws providing for decanting. Therefore, to help move Mississippi forward as a trust friendly state and national leader in modern trust laws, decanting should be adopted.

Appendix

Proposed Mississippi Trust Decanting Act

AN ACT TO CREATE THE MISSISSIPPI TRUST DECANTING ACT; TO ENACT A SHORT TITLE; TO CREATE DEFINITIONS … AND FOR RELATED PURPOSES;

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MISSISSIPPI:

SECTION 1. SHORT TITLE. This chapter shall be known and may be cited as the Mississippi Trust Decanting Act.

SECTION 2. DEFINITIONS. In this chapter:

(1) “Absolute discretion” means the right to distribute principal that is not limited or modified in any manner to or for the benefit of one or more beneficiaries of the trust, whether or not the term "absolute" is used. A power to distribute principal that includes purposes such as best interests, welfare, or happiness shall constitute absolute discretion.

(2) “Authorized trustee” means an entity or individual, other than the settlor, a beneficiary, or a person who owes a duty of support to a beneficiary, who has authority under the terms of the first trust to distribute the principal of the trust for the benefit of one or more current beneficiaries.

(3) “Code” means the United States Internal Revenue Code of 1986, as amended from time to time, including corresponding

provisions of subsequent internal revenue laws and corresponding provisions of State law.

(4) “Current beneficiary” means a person who is currently receiving or eligible to receive a distribution of principal or income from the trustee on the date of the exercise of the power.

(5) “Distribute” means the power to pay directly to the beneficiary of a trust or make application for the benefit of the beneficiary.

(6) “First trust” means an existing irrevocable inter vivos or testamentary trust part or all of the principal of which is distributed in further trust under Section 4 or 5.

(7) “Presumptive remainder beneficiary” means a beneficiary of a trust, as of the date of determination and assuming non exercise of all powers of appointment, who either (i) would be eligible to receive a distribution of income or principal if the trust terminated on that date, or (ii) would be eligible to receive a distribution of income or principal if the interests of all beneficiaries currently eligible to receive income or principal from the trust ended on that date without causing the trust to terminate.

(8) “Principal” includes the income of the trust at the time of the exercise of the power that is not currently required to be distributed, including accrued and accumulated income.

(9) “Second trust” means any irrevocable trust to which principal is distributed in accordance with Section 4 or 5.

(10) “Successor beneficiary” means any beneficiary other than the current beneficiaries, including remainder beneficiaries, but does not include a potential appointee of a power of appointment held by a beneficiary.

SECTION 3. PURPOSE. An authorized trustee who has discretion to make distributions to the beneficiaries shall exercise that discretion in the trustee's fiduciary capacity, whether the trustee's discretion is absolute or limited to ascertainable standards.

SECTION 4. DISTRIBUTION TO SECOND TRUST IF ABSOLUTE DISCRETION. An authorized trustee who has the absolute discretion to distribute the principal of a trust may, with or without court approval, distribute part or all of the principal of the trust in favor of a trustee of a second trust for the benefit of one or more of the current beneficiaries of the first trust and for the benefit of one or more of the successor beneficiaries of the first trust; provided, a beneficiary who has only a future beneficial interest, vested or contingent, in the first trust cannot have the future beneficial interest accelerated to a present interest in the second trust.

(1) If the authorized trustee exercises the power under this subsection, the authorized trustee may grant a power of appointment (including a presently exercisable power of appointment) in the second trust to one or more of the current beneficiaries of the first trust, provided that the beneficiary

granted a power to appoint could receive the principal outright under the terms of the first trust.

(2) If the authorized trustee grants a power of appointment, the class of permissible appointees in favor of whom a beneficiary may exercise the power of appointment granted in the second trust may be broader than or otherwise different from the current and successor beneficiaries of the first trust.

(3) If the beneficiary or beneficiaries of the first trust are described as a class of persons, the beneficiary or beneficiaries of the second trust may include one or more persons of such class who become includible in the class after the distribution to the second trust.

SECTION 5. DISTRIBUTION TO SECOND TRUST IF NO ABSOLUTE DISCRETION. An authorized trustee who has the power to distribute the principal of a trust but does not have the absolute discretion to distribute the principal of the trust may, with or without court approval, distribute part or all of the principal of the first trust in favor of a trustee of a second trust, provided that the current beneficiaries of the second trust shall be the same as the current beneficiaries of the first trust and the successor beneficiaries of the second trust shall be the same as the successor beneficiaries of the first trust.

(1) If the authorized trustee exercises the power under this Section 5, the second trust shall include the same language

authorizing the trustee to distribute the income or principal of a trust as set forth in the first trust.

(2) If the beneficiary or beneficiaries of the first trust are described as a class of persons, the beneficiary or beneficiaries of the second trust shall include all persons who become includible in the class after the distribution to the second trust.

(3) If the authorized trustee exercises the power under Section 5 and if the first trust grants a power of appointment to a beneficiary of the trust, the second trust shall grant such power of appointment in the second trust and the class of permissible appointees shall be the same as in the first trust.

(4) Supplemental Needs Trusts.

(i) Notwithstanding the other provisions of this Section 5, the authorized trustee may distribute part or all of the principal of a disabled beneficiary's interest in the first trust in favor of a trustee of a second trust which is a supplemental needs trust if the authorized trustee determines that to do so would be in the best interests of the disabled beneficiary.

(ii) Definitions. For purposes of this paragraph 4: "Best interests" of a disabled beneficiary include, without limitation, consideration of the financial impact to the disabled beneficiary's family. "Disabled beneficiary" means a current or successor beneficiary of the first trust who the authorized

trustee determines has a disability that substantially impairs the beneficiary's ability to provide for his or her own care or custody and that constitutes a substantial handicap, whether or not the beneficiary has been adjudicated a "disabled person". "Governmental benefits" means financial aid or services from any State, Federal, or other public agency. "Supplemental needs second trust" means a trust that complies with subparagraph (iii) of this paragraph (4) and that relative to the first trust contains either lesser or greater restrictions on the trustee's power to distribute trust income or principal and which the trustee believes would, if implemented, allow the disabled beneficiary to receive a greater degree of governmental benefits than the disabled beneficiary will receive if no distribution is made.

(iii) Remainder beneficiaries. A supplemental needs second trust may name successor beneficiaries other than the disabled beneficiary's estate, provided that the second trust names the same successor beneficiaries to the disabled beneficiary's interest, and in the same proportions, as exist in the first trust. In addition to the foregoing, where the first trust was created by the disabled beneficiary or the trust property has been distributed directly to or is otherwise under the control of the disabled beneficiary, the authorized trustee may distribute to a “pooled trust” as defined by federal Medicaid law for the benefit of the disabled beneficiary or the

supplemental needs second trust must contain pay back provisions complying with Medicaid reimbursement requirements of federal law.

(iv) Reimbursement. A supplemental needs second trust shall not be liable to pay or reimburse the State or any public agency for financial aid or services to the disabled beneficiary except as provided in the supplemental needs second trust.

SECTION 6. NOTICE. An authorized trustee may exercise the power to distribute in favor of a second trust under Section 4 and 5 without the consent of the settlor or the beneficiaries of the first trust and without court approval if there are one or more legally competent current beneficiaries and one or more legally competent presumptive remainder beneficiaries and the authorized trustee sends written notice of the trustee's decision, specifying the manner in which the trustee intends to exercise the power and the prospective effective date for the distribution, to all of the legally competent current beneficiaries and presumptive remainder beneficiaries, determined as of the date the notice is sent and assuming non exercise of all powers of appointment, not less than sixty (60) days prior the prospective effective date for the distribution (“notice period”). A trustee is not required to provide a copy of the notice to a beneficiary who is known to the trustee but who cannot be located by the trustee after reasonable diligence or who is not known to the trustee. If a charity is a current beneficiary or presumptive remainder beneficiary of the

trust, the notice shall also be given to the Mississippi Secretary of State. If all persons to whom notice is otherwise required to be sent under this Section waive the notice period by a signed written instrument delivered to the authorized trustee, the authorized trustee’s power to distribute in favor of a second trust under Section 4 or 5 shall be exercisable after notice is waived by all such persons, notwithstanding the effective date of the distribution.

SECTION 7. COURT INVOLVEMENT. The trustee may for any reason, in its sole discretion, elect to petition the court to order the distribution, including, without limitation, the reason that the trustee's exercise of the power to distribute under this Act is unavailable because, for instance, there are no legally competent current beneficiaries or legally competent presumptive remainder beneficiaries. The settlor or a trustee, cotrustee, trust protector, trust advisor, beneficiary or beneficiaries (including the legal guardian or conservator of a legally incompetent beneficiary) may commence a proceeding to approve or disapprove of a proposed exercise of the authorized trustee’s power to distribute in favor of a second trust under Section 4 or 5. The authorized trustee’s notice under Section 6 shall not limit the right of any beneficiary to bring an action seeking relief as otherwise provided in Section 21 of this Act. In any action under this Section, the persons entitled to receive the notice under Section 6, if any, shall be made parties, and they

shall be the only necessary parties. If no such persons exist, then all interested parties shall be made parties to such proceedings, and the provisions of Section 22, Senate Bill XXXX(2014) shall apply for these purposes.

SECTION 8. TERM OF THE SECOND TRUST. The second trust to which an authorized trustee distributes the assets of the first trust may have a term that is longer than the term set forth in the first trust, including, but not limited to, a term measured by the lifetime of a current beneficiary; provided, however, that the second trust shall be limited to the same permissible period of the rule against perpetuities that applied to the first trust, unless the first trust expressly permits the trustee to extend or lengthen its perpetuities period.

SECTION 9. DIVIDED DISCRETION. If an authorized trustee has absolute discretion to distribute the principal of a trust and the same trustee or another trustee has the power to distribute principal under the trust instrument, which power is not absolute discretion, such authorized trustee having absolute discretion may exercise the power to distribute under Section 4.

SECTION 10. LATER DISCOVERED ASSETS. To the extent the authorized trustee does not provide otherwise the distribution of some or all of the assets comprising the principal of the first trust in favor of a second trust shall not be deemed to include subsequently discovered assets otherwise belonging to the first

trust and undistributed principal paid to or acquired by the first trust subsequent to the distribution in favor of the second trust.

SECTION 11. OTHER AUTHORITY TO DISTRIBUTE IN FURTHER TRUST. This Act shall not be construed to abridge the right of any trustee to distribute property in further trust that arises under the terms of the governing instrument of a trust, any provision of applicable law, or a court order.

SECTION 12. NEED TO DISTRIBUTE NOT REQUIRED. An authorized trustee may exercise the power to distribute in favor of a second trust under Sections 4 and 5 whether or not there is a current need to distribute principal under the terms of the first trust.

SECTION 13. NO DUTY TO DISTRIBUTE. Nothing in this Act is intended to create or imply a duty to exercise a power to distribute principal, and no inference of impropriety shall be made as a result of an authorized trustee not exercising the power conferred under Section 4 or 5. Notwithstanding any other provision of this Act, a trustee has no duty to inform beneficiaries about the availability of this Act and no duty to review the trust to determine whether any action should be taken under this Act.

SECTION 14. EXPRESS PROHIBITION. A power authorized by Section 4 or 5 may not be exercised if expressly prohibited by the terms of the governing instrument, and for trusts created after the effective date of this Act, by making specific reference to this Act, but a general prohibition of the amendment or revocation

of the first trust or a provision that constitutes a spendthrift clause shall not preclude the exercise of a power under Section 4 or 5.

SECTION 15. RESTRICTIONS. An authorized trustee may not exercise a power authorized by Section 4 or 5 to affect any of the following:

(1) to reduce, limit or modify any beneficiary's current right to a mandatory distribution of income or principal, a mandatory annuity or unitrust interest, a right to withdraw a percentage of the value of the trust or a right to withdraw a specified dollar amount provided that such mandatory right has come into effect with respect to the beneficiary, except with respect to a second trust which is a Supplemental Needs Trust unless the exercise of such power would subject the second trust to claims of reimbursement by any private or governmental body or would interfere with, reduce the amount of, or jeopardize an individual's entitlement to government benefits;

(2) to decrease or indemnify against a trustee's liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence, and prudence; except to indemnify or exonerate one party from liability for actions of another party with respect to distribution that unbundles the governance structure of a trust to divide and separate fiduciary and non-fiduciary responsibilities among several parties, including without limitation one or more trustees, distribution

advisors, investment advisors, trust protectors, or other parties, provided however that such modified governance structure may reallocate fiduciary responsibilities from one party to another but may not reduce them;

(3) to eliminate a provision granting another person the right to remove or replace the authorized trustee exercising the power under Section 4 or 5; provided, however, such person's right to remove or replace the authorized trustee may be eliminated if a separate, independent, non-subservient individual or entity, such as a trust protector, acting in a non-fiduciary capacity has the right to remove or replace the authorized trustee;

(4) to reduce, limit or modify the perpetuities provision specified in the first trust in the second trust, unless the first trust expressly permits the trustee to do so.

SECTION 16. TAX LIMITATIONS. If any contribution to the first trust qualified for the annual exclusion under Section 2503(b) of the Code, the marital deduction under Section 2056(a) or 2523(a) of the Code, or the charitable deduction under Section 170(a), 642(c), 2055(a) or 2522(a) of the Code, is a direct skip qualifying for treatment under Section 2642(c) of the Code, or qualified for any other specific tax benefit that would be lost by the existence of the authorized trustee's authority under Section 4 or 5 for income, gift, estate, or generation skipping transfer tax purposes under the Code, then the authorized trustee shall not

have the power to distribute the principal of a trust pursuant to Section 4 or 5 in a manner that would prevent the contribution to the first trust from qualifying for or would reduce the exclusion, deduction, or other tax benefit that was originally claimed with respect to that contribution.

(1) Notwithstanding the provisions of this Section 16, the authorized trustee may exercise the power to pay the first trust to a trust as to which the settlor of the first trust is not considered the owner under Subpart E of Part I of Subchapter J of Chapter 1 of Subtitle A of the Code even if the settlor is considered such owner of the first trust. Nothing in this Section shall be construed as preventing the authorized trustee from distributing part or all of the first trust to a second trust that is a trust as to which the settlor of the first trust is considered the owner under Subpart E of Part I of Subchapter J of Chapter 1 of Subtitle A of the Code.

(2) During any period when the first trust owns subchapter S corporation stock, an authorized trustee may not exercise a power authorized by Section 4 or 5 to distribute part or all of the S corporation stock to a second trust that is not a permitted shareholder under Section 1361(c)(2) of the Code.

(3) During any period when the first trust owns an interest in property subject to the minimum distribution rules of Section 401(a)(9) of the Code, an authorized trustee may not exercise a power authorized by Section 4 or 5 to distribute part

or all of the interest in such property to a second trust that would result in the shortening of the minimum distribution period to which the property is subject in the first trust.

SECTION 17. LIMITS ON COMPENSATION OF TRUSTEE.

(1) Unless the court upon application of the trustee directs otherwise, an authorized trustee may not exercise a power authorized by Section 4 or 5 solely to change the provisions regarding the determination of the compensation of any trustee; provided, however, an authorized trustee may exercise the power authorized in Section 4 or 5 in conjunction with other valid and reasonable purposes to bring the trustee's compensation into accord with reasonable limits in accord with Mississippi law in effect at the time of the exercise.

(2) The compensation payable to the trustee or trustees of the first trust may continue to be paid to the trustees of the second trust during the terms of the second trust and may be determined in the same manner as otherwise would have applied in the first trust; provided, however, that no trustee shall receive any commission or other compensation imposed upon assets distributed due to the distribution of property from the first trust to a second trust pursuant to Section 4 or 5.

SECTION 18. WRITTEN INSTRUMENT. The exercise of a power to distribute principal under Section 4 or 5 must be made by an instrument in writing, signed and acknowledged by the trustee, and filed with the records of the first trust and the second trust.

SECTION 19. TERMS OF SECOND TRUST. Any reference to the governing instrument or terms of the governing instrument in this Act includes the terms of a second trust established in accordance with Act.

SECTION 20. SETTLOR. The settlor of a first trust is considered for all purposes to be the settlor of any second trust established in accordance with this Act. If the settlor of a first trust is not also the settlor of a second trust, then the settlor of the first trust shall be considered the settlor of the second trust, but only with respect to the portion of second trust distributed from the first trust in accordance with this Act.

SECTION 21. REMEDIES. A trustee who reasonably and in good faith takes or omits to take any action under this Act is not liable to any person interested in the trust. An act or omission by a trustee under this Act is presumed taken or omitted reasonably and in good faith unless it is determined by the court to have been an abuse of discretion. If a trustee reasonably and in good faith takes or omits to take any action under this Act and a person interested in the trust opposes the act or omission, the person's exclusive remedy is to obtain an order of the court directing the trustee to exercise authority in accordance with this Act in such manner as the court determines necessary or helpful for the proper functioning of the trust, including without limitation prospectively to modify or reverse a prior exercise of such authority. Any claim by any person interested in the trust

that an act or omission by a trustee under this Act was an abuse of discretion is barred if not asserted in a proceeding commenced by or on behalf of the person within two (2) years after the trustee has sent to the person or the person's personal representative a notice or report in writing sufficiently disclosing facts fundamental to the claim such that the person knew or reasonably should have known of the claim. The preceding sentence shall not apply to a person who was under a legal disability at the time the notice or report was sent and who then had no personal representative. For purposes of this Section 21, a personal representative refers to a court appointed guardian or conservator of the estate of a person.

SECTION 22. APPLICATION. Except as otherwise provided in this Section, this Act applies to trusts created before, on, or after the effective date of this Act. This Act applies to any trust governed by the laws of the State of Mississippi, including a trust whose principal place of administration is transferred to this State before or after the effective date of this Act, unless:

(1) with respect to a trust created on or after the effective date of this Act, the governing instrument expressly prohibits use of this Act by specific reference to this Act; or

(2) with respect to a trust created prior to the effective date of this Act, the governing instrument expressly prohibits the use of decanting by specific reference thereto.

SECTION 23. EFFECTIVE DATE: This act shall take effect and be in force from and after July 1, 2014.