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WEEKEND INVESTOR

When to 'Decant' a Trust

It's getting easier to tinker with irrevocable trusts. Here's how it works.

By LIZ MOYER

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It is getting easier to tinker with irrevocable trusts, thanks to a process known as "trust decanting."

Such trusts used to be difficult and costly to alter even if the trustee thought a change could be in the beneficiary's best interest. But decanting lets trustees change certain terms by figuratively pouring the assets from an old trust into a new one.



Brian DeYoung

A group of trust lawyers and academics currently is drafting a model law that could serve as a template for states that want to allow decanting. So far, 21 states have adopted decanting laws, with Wyoming the most recent to do so, in July.

"I expect that certain states that already have decanting statutes will modify their statutes to reflect the uniform statute, or portions of it," says Amy Heller, a New York tax and estate lawyer at McDermott Will & Emery and an adviser to the drafting committee. "And states that do not already have decanting statutes may seek to adopt a version of the uniform statute."

Many families use irrevocable trusts to pass wealth to their children and others because the trusts carry certain tax advantages. Other types of trusts are easier to change, but

don't offer the same protection from taxes.

There are limits on what decanting can do. For instance, trustees can't change a beneficiary's already-vested interests in a trust.

But a trustee can, for example, push back the age at which the beneficiary receives a payout or move the trust to a state that offers greater flexibility regarding taxes or administrative roles within the trust. If the trustee wants to retire, decanting also can make it easier to name a new trustee.

Decanting can "breathe new life" into a trust, says Stephen Adamson Jr., an estate lawyer at Gonnella Adamson in Jackson, Wyo.

In the past, changing an irrevocable trust involved a lengthy and potentially costly trip to court, not to mention the publicity that may accompany such proceedings, lawyers say. Decanting is done outside of court, making it less expensive—with costs ranging from \$2,500 to \$10,000 versus tens of thousands of dollars for court proceedings—and more private.

Joe McDonald, an estate lawyer at McDonald & Kanyuk in Concord, N.H., says he recently decanted a trust set up 25 years ago by a software executive for his three children. The original trust held \$50,000 of shares in the executive's then-private company. More than a decade after the trust was created, the company had an initial public offering and the value of the trust assets soared to \$150 million.

The software executive didn't want his children to get a big financial windfall at too young an age. The trustee agreed to decant it to a new trust that wouldn't pay out until the kids were older, Mr. McDonald says.

The trustee doesn't have to get approval from the beneficiaries to decant. The trustee just needs to give notice it will happen. But many lawyers say they get cooperation from all the parties involved to smooth the process.

Some states that allow decanting also permit the trustee's role to be divided among multiple people, including someone to manage the investments, one to handle payments to the beneficiaries and one to deal with the trust paperwork.

In these states, which include South Dakota, Wyoming, New Hampshire and Delaware, trustees can move an old trust with one trustee managing all three roles to a new one with split roles where a family member can become the investment manager and keep a tighter rein on the family's investment holdings.

One murky area: taxation. Some families use decanting to move a trust to a state with more favorable taxes, such as one that doesn't have a levy on accumulated investment income. Not every state works the same way, however.

A New York trust that gets decanted to another state isn't necessarily getting out from under New York taxes, lawyers say. If the new trust still holds income-generating real estate located in New York decanted from the old trust, for example, the state still will tax it.

Federal tax questions, such as the implications for gift and income taxes and generation-skipping transfer taxes, also remain unresolved.

The Internal Revenue Service has been taking comments about trust decanting for two years but still hasn't put out guidelines on federal tax issues related to the practice. Lawyers say those guidelines could come out in early 2014.

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