

HOUSE BILL REPORT

SSB 5012

As Reported by House Committee On: Judiciary

Title: An act relating to the distribution of a Washington trust's assets to another trust.

Brief Description: Concerning the distribution of a Washington trust's assets to another trust.

Sponsors: Senate Committee on Law & Justice (originally sponsored by Senators Pedersen, Padden, Frockt, Fain, Mullet and Kuderer; by request of Washington State Bar Association and Uniform Law Commission).

Brief History:

Committee Activity:

Judiciary: 3/14/17, 3/22/17 [DP].

Brief Summary of Substitute Bill

- Establishes a trust decanting statute that authorizes a trustee to modify the terms of an irrevocable trust or distribute the income and principal of an irrevocable trust to one or more second trusts.
- Establishes standards, procedures, and limitations on a trustee's exercise of the decanting power and allows a trustee, beneficiary, and others to bring court proceedings regarding the exercise of the decanting power.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: Do pass. Signed by 13 members: Representatives Jinkins, Chair; Kilduff, Vice Chair; Rodne, Ranking Minority Member; Muri, Assistant Ranking Minority Member; Frame, Goodman, Graves, Haler, Hansen, Kirby, Klippert, Orwall and Shea.

Staff: Edie Adams (786-7180).

Background:

A trust is created when a person transfers property to another person, the trustee, for the benefit of other individuals or for a beneficial purpose. The person transferring the property is called a trustor or settlor, and the persons who benefit from the trust are the beneficiaries.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

The beneficiaries hold equitable title to the property, meaning the beneficiaries enjoy the property, but do not have control over the trustee or how the trustee manages trust assets. The trustee is a fiduciary who has a duty to administer the trust in good faith in accordance with the trust's terms and purposes and in the interests of the beneficiaries. Charitable trusts do not have actual beneficiaries but instead are established for a public charitable purpose. Trusts can be made revocable or irrevocable by the trustor.

Washington statutes governing trust and estate law address a range of issues relating to trusts, including the requisites for creating and amending trusts, the duties and powers of trustees, trust administration, distribution of assets, liability issues, and the investment of trust funds. The Trust and Estate Dispute Resolution Act (TEDRA) provides procedures for resolving trust and estate disputes. The TEDRA includes provisions allowing binding nonjudicial procedures to resolve matters through written agreement among the parties interested in the trust. If an agreement is reached, it may be filed with the court and is equivalent to a final court order.

In 2015 the National Conference of Commissioners on Uniform State Laws adopted the Uniform Trust Decanting Act (UTDA) with a stated intent of allowing flexibility to change terms of an irrevocable trust so that the trustor's purposes can be carried out under changed circumstances. The UTDA establishes standards and procedures by which a trustee with discretion to distribute principal may directly modify a trust or distribute the trust's assets to a new trust. The extent of the trustee's authority to exercise the decanting power depends on whether the trustee has limited or expanded authority to distribute principal. In exercising the decanting power, a trustee must act in accordance with the trustee's fiduciary duties, including the duty to act in accordance with the purposes of the first trust.

Summary of Bill:

A new chapter is created establishing standards and procedures for trust decanting. "Decanting power" means the power of a trustee to distribute income and principal of a first trust to one or more second trusts, or to modify the terms of a first trust.

Scope of the Decanting Power.

The scope of the trustee's decanting power depends upon the discretion granted to the trustee to distribute principal under the trust. A trustee has "expanded discretion" if the trustee has a discretionary power of distribution that is not limited to an ascertainable or reasonably definite standard. A trustee has "limited discretion" if the trustee's discretionary power of distribution is limited to an ascertainable or reasonably definite standard.

In the exercise of the decanting power, a second trust may be a trust created or administered under the law of any jurisdiction. If a trustee has discretion to distribute part but not all of the principal of a first trust, the trustee may exercise the decanting power only over that part of the principal.

Expanded Discretion. A trustee with expanded discretion to distribute the principal of a first trust may exercise the decanting power over the principal subject to specified requirements. With some exceptions, a second trust may not:

- include as a current beneficiary a person that is not a current beneficiary of the first trust;
- include as a presumptive remainder beneficiary or successor beneficiary a person that is not a current beneficiary, presumptive remainder beneficiary, or successor beneficiary of the first trust; or
- reduce or eliminate a vested interest.

A second trust may retain or omit a power of appointment granted in the first trust, except a presently exercisable general power of appointment may not be omitted. In addition, a second trust may create or modify a power of appointment under specified circumstances.

Limited Discretion. A trustee with limited discretion to distribute the principal of a first trust may exercise the decanting power over the principal, subject to the following requirements:

- Second trusts must grant each beneficiary of the first trust beneficial interests which are substantially similar to the beneficiary's beneficial interests in the first trust.
- A power to make a distribution under the second trust for the benefit of a beneficiary who is an individual must be substantially similar to a power under the first trust to make a distribution directly to the beneficiary.

Exercise of the Decanting Power.

A trustee may exercise the decanting power if the trustee determines that to do so is consistent with the trustee's fiduciary duties. In exercising the decanting power, a trustee must act in accordance with the trustee's fiduciary duties, including the duty to act in accordance with the purposes of the first trust. A trustee must provide a 60-day prior written notice of the intent to exercise the decanting power to each qualified beneficiary, each holder of a presently exercisable power of appointment over any part of the first trust, and each person that has the right to remove or replace the trustee. If the first trust contains a charitable interest, the trustee must give written notice of the intent to exercise the decanting power to the Attorney General.

The notice must include specified information, including the manner in which the trustee must exercise the decanting power and the proposed effective date for exercise of the decanting power. Notice is not required to a person who is not known to the trustee or is known but cannot be located after reasonable diligence. An exercise of the decanting power is not ineffective for failure to give required notice if the trustee acted with reasonable care to comply with notice requirements.

The trustee, a qualified beneficiary, a holder of a presently exercisable power of appointment over any part of the first trust, and each person that has the right to remove or replace the trustee may petition the court regarding the exercise of the decanting power. The court may provide instructions regarding whether the exercise of decanting power is permissible and consistent with the trustee's fiduciary duties; approve an exercise of the decanting power; determine that a proposed or attempted exercise of the decanting power is ineffective; or order other relief. A trustee of a first trust may petition the court regarding exercise of the

decanting power for an increase of the trustee's compensation or for modification of a provision granting a person the right to remove or replace the trustee.

Trust for Beneficiary with a Disability.

A trustee may exercise the decanting power over a trust that has a beneficiary with a disability to establish a special needs trust even if the trustee does not have expanded authority to distribute principal to the beneficiary with a disability. The trustee may exercise the decanting authority to establish a special needs trust if the trustee determines it will further the purposes of the first trust. A "special needs trust" means a trust the trustee believes would not be considered as a resource for purposes of determining whether the beneficiary with a disability is eligible for governmental benefits.

The second trust for a beneficiary with a disability may be one that meets Medicaid law requirements for certain trusts for the sole benefit of a beneficiary with a disability, including requiring a payback to the state of Medicaid expenditures. The restriction that a vested right may not be reduced or eliminated does not apply to the interests of the beneficiary with a disability.

The second trusts must grant each other beneficiary of the first trust beneficial interests in the second trusts that are substantially similar to their beneficial interests in the first trust, except as affected by any change to the interests of the beneficiary with a disability.

Effects and Consequences of Decanting.

Except as otherwise provided, all the rights, privileges, immunities, powers, and purposes of the first trust remain vested in the second trust. All debts, liabilities, or other obligations enforceable against income and principal of the first trust are enforceable against that income and principal when held by the second trust. Title to all property owned by the first trust remains vested in the second trust without reversion or impairment. Any proceeding pending by or against the first trust may be continued by or against the second trust.

The settlor of the first trust is deemed to be the settlor of the second trust with respect to the portion of the principal of the first trust subject to the exercise of the decanting power. If the trustee intends to distribute all principal of a first trust to a second trust, subsequently discovered assets of the first trust and any principal paid to or acquired by the first trust after the distribution are included in the second trust. A trustee or other person that reasonably relies on the validity of a distribution of income and principal of a trust to another trust is not liable to any person for any action or failure to act as a result of the reliance.

Specific Prohibitions.

A trustee may not exercise the decanting power to the extent the first trust instrument expressly prohibits or restricts exercise of the decanting power. If the first trust instrument includes an express restriction on the decanting power, the restriction must be included in the second trust instrument.

A trustee may not exercise the decanting power for the following purposes unless all qualified beneficiaries consent or the action is approved by the court: (a) increase the trustee's compensation above that provided in the first trust, or above the compensation authorized under statute if the first trust did not specify compensation; or (b) modify a

provision in the first trust instrument giving another person power to remove or replace the trustee.

A second trust instrument may not relieve a trustee from liability for breach of trust or provide for indemnification rights to a greater extent than provided in the first trust instrument, and may not reduce fiduciary liability in the aggregate. A second trust instrument may divide and reallocate fiduciary powers among fiduciaries and relieve a fiduciary of liability for an act or omission of another fiduciary as permitted by law.

If a first trust contains a charitable interest, the Attorney General has the rights of a qualified beneficiary and may represent and bind the charitable interest. The second trusts, in the aggregate, may not diminish the charitable interest, diminish the interest of any entity that holds the charitable interest, or alter any charitable purpose stated in the first trust instrument.

If the first trust contains assets that qualified for any specified tax benefit, or would have qualified but for a provision of the act, the second trust instrument must not include or omit a term which would have prevented the first trust from qualifying for the tax benefit or would have reduced the amount of the tax benefit. Separate requirements are established with respect to grantor and nongrantor trusts.

Other Provisions.

The act does not apply to a trust held solely for charitable purposes or a trust that may be revoked or modified by the grantor. The act does not create or imply a duty to exercise the decanting power.

The act applies to a trust created before, on, or after the effective date of the act that has its situs in this state or provides by its trust instrument that it is governed by the law of this state, including for purposes of administration, construction of trust terms, or determining the meaning or effect of trust terms.

If exercising the decanting power would be effective except that the second trust instrument in part does not comply with the act, the exercise of the decanting power is effective and any provision in the second trust instrument that is not permitted under the act is void, and any provision required under the act that is not contained in the second trust instrument must be included to the extent necessary to comply with the act.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) This bill is joint request legislation of the Washington State Bar Association and the Uniform Law Commission, and it is based on the Uniform Trust Decanting Act. The analogy is to wine decanting, where you may have a good wine in a bad bottle. The bottle is the trust, and it needs to be replaced when it is no longer able to meet its purposes. Decanting allows a streamlined procedure for modification if a trust becomes old, outdated, or obsolete. It is important to create a process without having to go to court, which is time consuming and costly. Often people establish trusts to take care of their children when they are gone. The people who suffer when there is an outdated trust are those of moderate means. This legislation could make a real difference for people who are vulnerable.

The bill has two important features. There is a fiduciary requirement that the trustee determine that modifying the trust would be in the best interest of beneficiaries. It also requires prior notice to the beneficiaries, and allows beneficiaries and others the ability to object and bring a court proceeding challenging the modification. The current procedures for modifying a trust through a court process are not being eliminated. Half of the states have some form of statute allowing trust decanting. Two states have adopted the uniform law and several other states are considering adoption of the uniform law this year. This change will help attract and retain trusts for our financial institutions.

(Opposed) None.

Persons Testifying: Senator Pedersen, prime sponsor; and Michael Carrico, Washington State Bar Association.

Persons Signed In To Testify But Not Testifying: None.