

**IF YOU DON'T LIKE THIS TRUST,
WHY NOT DECANT TO A BETTER ONE?**

PRESENTED TO:

**THE ESTATE PLANNING COUNCIL
OF
METRO LOUISVILLE**

ON

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PRESENTED BY:

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I. INTRODUCTION

Eighteen states allow the trustee of certain irrevocable trusts to modify the way a trust is administered by distributing – or “decanting” – trust assets from the original irrevocable trust to a second irrevocable trust with different terms. This power allows a single party – the trustee – to modify a trust *without* court involvement *or* beneficiary consent. For a current list of the states with decanting statutes, see “Appendix A.”

Kentucky enacted its decanting statute in 2012. *See* KRS § 386.175 attached as Appendix B.

In states that have not enacted decanting statutes, a trustee’s power to decant may exist under the common law. *See, e.g.,* Phipps v. Palm Beach Trust Co., 196 So. 299 (Fla. 1940); *In re Estate of Spencer*, 232 N.W.2d 491 (Iowa 1975); *Wiedenmayer v. Johnson*, 254 A.2d 534 (N.J. Super. Ct. App. Div. 1969).

While there are many variables among state decanting statutes, certain commonalities exist. Representative statutes are discussed below, with a particular focus on Kentucky and Tennessee. For further comparison of state decanting statutes, see “State Decanting Statutes” prepared by U.S. Trust, Bank of America Private Wealth Management, attached hereto as “Appendix C.”

A trustee’s exercise of the power to decant raises numerous income, gift, estate and generation-skipping transfer tax issues and potential pitfalls. Several of those issues are identified in section VIII, *infra*. The IRS requested public comment on these associated issues in 2011. I.R.S. Notice 2011-101, 2011-52 I.R.B. 932. For an exhaustive examination of these issues, and a proposed Revenue Ruling regarding the same, see the comments submitted by ACTEC in response to such IRS solicitation. Letter from Louis A. Mezzullo, President, Am. Coll. of Trust & Estate Counsel to Internal Revenue Service (Apr. 2, 2012) (available at http://www.actec.org/public/Governmental_Relations/Mezzullo_Comments_04_02_12.asp).

II. WHEN TO USE DECANTING

- A. Settlor is not alive and the intended change is beyond the scope of nonjudicial settlement agreements in the jurisdiction.
- B. Beneficiary consent is impracticable and/or impossible because of the number of beneficiaries or a beneficiary’s unwillingness to consent.
- C. Modification alters beneficial interests so that beneficiary consent is inadvisable for tax purposes.

III. POTENTIAL USES OF DECANTING

- A. Postpone outright distributions to beneficiaries with mental illness, substance abuse, marital problems, or creditor problems.
- B. Extend termination date to a younger generation when beneficiary has estate tax or elective share issues.
- C. Change Grantor Trust to a Non-Grantor Trust.
- D. Change Non-Grantor Trust to a Grantor Trust.
- E. Modify administrative provisions – e.g., the Trustee may not invest in foreign securities.
- F. Modify definition of principal and income.
- G. Eliminate a remainder beneficiary.
- H. Grant a testamentary limited power of appointment to one or more beneficiaries.
- I. Grant a testamentary general power of appointment to one or more beneficiaries to avoid a generation-skipping tax or to achieve a stepped-up basis for income tax purposes.
- J. Allow a trust to qualify as a Qualified Subchapter S Trust or an Electing Small Business Trust.
- K. Allow the trust to qualify a “Special Needs” Trust so that the beneficiary can qualify for government benefits.

IV. NECESSARY PARTIES

- A. Trustee – consent required.
- B. Certain beneficiaries – notice may be required (*See VII, B infra.*)

V. SCOPE OF CHANGES

The modification is effected when the trustee exercises a discretionary power to distribute assets of one trust (often referred to as the “original trust,” the “first trust” or the “distributing trust”) to another trust that contains the desired provisions (often referred to as the “second trust” or the “receiving trust”).

The trustee has virtually unlimited power to modify administrative provisions. The trustee’s ability to modify dispositive provisions is determined by statute, with certain commonalities among states.

- A. **No new beneficiaries.** Only beneficiaries of the original trust may be beneficiaries of the second trust. *See* KRS § 386.175(4)(a).

Under certain statutes the second trust may give a discretionary beneficiary of the original trust a power of appointment and the permissible appointees of this new power of appointment may include persons who are not beneficiaries of the original trust or the second trust. *See* KRS § 386.175(4)(i). This power is subject to limitations concerning the rule against perpetuities and the suspension of power of alienation, if applicable. *See* KRS § 386.175(4)(i). However, see V. F. *infra*.

- B. **Preserve certain characteristics for tax purposes.**

1. If contributions to the original trust have been excluded from the **gift tax by the application of § 2503(c)** of the Internal Revenue Code, the terms of the second trust may not extend the trust beyond the vesting period in the original trust. *See* KRS § 386.175(4)(e).
2. If contributions to the first trust qualified for a **marital or charitable deduction for federal income, gift, or estate tax purposes**, the second trust may not contain any provision that, if included in the original trust, would have prevented the original trust from qualifying for the deduction or that would have reduced the amount of the deduction. *See* KRS § 386.175(4)(d).

- C. **Preserve certain fixed beneficial interests.**

1. “The second trust **may not reduce any fixed income, annuity, or unitrust interest** in the assets of the first trust.” *See* KRS § 386.175(4)(c).
2. If a beneficiary has a **power of withdrawal** (e.g., Crummey withdrawal power) over the original trust property, then either the “terms of the second trust must provide a power of withdrawal identical to the power of withdrawal in the original trust” or “sufficient trust property must remain in the original trust to satisfy the outstanding power of withdrawal.” *See* KRS § 386.175(4)(f).
3. **May not accelerate future interest.** “A beneficiary who has only a future beneficial interest, vested or contingent, in the original trust cannot have the future beneficial interest accelerated to a present interest in the second trust.” *See* KRS § 386.175(4)(b).

- D. **No violation of rule against perpetuities/permissible period of restraints on alienation.** The terms of the second trust may not extend the permissible period of the rule against perpetuities that applies to the original trust. *See* KRS § 386.175(6)(b); TENN. CODE ANN. § 35-15-816(b)(27)(C).

This prohibition against extending the permissible period of the rule against perpetuities generally applies even in states that have abolished the rule against perpetuities.

- E. **Distribution standard.** A trustee's power to decant trust property hinges on his power to make discretionary distributions of trust property.

1. In some states, e.g. Florida, a trustee is required to have full discretion in making distributions.
2. Other states permit the trustee to decant if his power to distribute is limited to a standard, but require that the discretionary standard in the second trust be similarly limited. *See* e.g. N.C. GEN. STAT. § 36C-8-816.1(c)(7).
3. A trustee may exercise her power to appoint trust assets despite a spendthrift provision, a prohibition on amendment or a prohibition on revocation in the original trust. *See* KRS § 386.175(6)(c).
4. A trustee may exercise his power to appoint trust assets "whether or not there is a current need to distribute" the assets under the terms of the original trust. *See* KRS § 386.175(2).

- F. **New or Different Power of Appointment may be granted in the Second Trust.** In certain states, the statute explicitly states that the second trust may grant a power of appointment to one or more beneficiaries of the original trust. *See* KRS § 386.175(4)(i) which states that the permissible appointees of the second trust may include persons who are not beneficiaries of the original trust

VI. ROLE OF TRUSTEE

- A. **Beneficiary as Trustee.**

A beneficiary serving as trustee may be prohibited from exercising the power to appoint or may be subject to additional limitations.

1. Under Kentucky law, if the original trust contains an ascertainable standard for making distributions, a trustee who is a beneficiary may decant to another trust if the standard applicable for distributions from the second trust are the same or more restrictive." *See* KRS § 386.175(h).

2. North Carolina provides that a trustee who is a beneficiary of the original trust may not exercise a decanting power. The decanting power may be exercised by:
 - a. If one or more co-trustees is not a beneficiary, the remaining co-trustee or a majority of the remaining co-trustees, or
 - b. A special fiduciary appointed by the court with the authority to exercise the power to appoint principal and income under § 36C-8-816.1(b), if the remaining co-trustee or all of the remaining co-trustees are also beneficiaries.

N.C. GEN. STAT. § 36C-8-816.1(d).

3. A Missouri statute provides that “[u]nless the exercise of such power [to appoint] is limited by an ascertainable standard, no trustee of the first trust may exercise such authority to make a distribution from the first trust if:
 - a. Such trustee is a beneficiary of the original trust; or
 - b. Any beneficiary may remove and replace the trustee of the first trust with a related or subordinate party to such beneficiary within the meaning of § 672(c) of the Internal Revenue Code.”

MO. REV. STAT. § 456.4-419.2(2).

B. Trustee Liability.

1. The power to decant is purely discretionary – a trustee does not have a duty to decant under any statute.

“Nothing in this section is intended to create or imply a duty to exercise a power to invade principal, and no inference of impropriety shall be made as a result of a trustee not exercising the power to appoint income or principal conferred [by the Kentucky decanting statute]. *See KRS* § 386.175(8).
2. Beneficiary consent and/or release
 - a. A decanting trustee may be tempted to have the qualified beneficiaries release the trustee from liability, ratify the action or otherwise consent to the exercise of the power to appoint assets – **proceed with caution!**
 - b. Consent by a beneficiary may have significant – and negative – gift tax consequences. (*See* section IX, B.)

- c. Consent by a beneficiary may also subject the second trust to creditors' claims by indicating that the beneficiary has control over the trustee's actions and the disposition of trust assets.
- d. Beneficiary consent and/or release – if obtained at all – should be limited to situations where decanting occurs for purely administrative purposes.

VII. PROCEDURE

A. Identification of “second trust” to receive original trust assets.

Most states permit the trustee to appoint property of the original trust to a trust already in existence or a trust created by the trustee, the initial settlor or another individual for the express purpose of receiving the original trust assets. *See* KRS § 386.175(2).

Example – Trust for Daughter and Son becomes irrevocable upon Mother's death. Bank, as Trustee, has power to distribute assets to Daughter and Son in Bank's discretion. Daughter develops a medical condition which qualifies her for government benefits subject to certain income limits. Bank may create a special needs trust for Daughter and appoint Daughter's share of the original trust's assets to the special needs trust in order to protect Daughter's share and allow her to qualify for government benefits.

B. Notice to certain beneficiaries.

Many states require the trustee to notify in writing the trust's beneficiaries of the trustee's plans to exercise his power of appointment. As addressed above, beneficiary consent is never required and is often unwise. (*See also* section IX, *infra*.)

- 1. KRS § 386.175(7)(b), provides that such notice must be:
 - a. In writing.
 - b. Provided to all current beneficiaries of the original trust and all beneficiaries of the oldest generation of remainder beneficiaries of the original trust by certified mail.
 - c. Provided at least 60 days prior to the effective date of the exercise of the power to appoint.
 - d. Accompanied by a copy of the instrument exercising the power to appoint, including the terms of the second trust.

However, one or more of the qualified beneficiaries may waive the 60-day notice period by a written instrument delivered to the trustee. KRS § 386.175(7)(c).

2. Tennessee does not explicitly require that the trustee provide notice (written or otherwise) to any beneficiary. TENN. CODE ANN. § 35-15-816(b)(27).
3. While most states identify the recipients of the required notice provisions with respect to the original trust, Missouri directs that the required notice be delivered to certain beneficiaries of the *second* trust: “the trustee of the first trust shall notify the permissible distributees of the second trust, or the qualified beneficiaries of the second trust if there are no permissible distributees of the second trust, of the distribution.” MO. REV. STAT. § 456.4-419.3

C. Exercise of power to appoint.

1. A number of states do not set forth the logistical procedure to decant trust property. *See, e.g.*, ALASKA STAT. § 13.36.157; ARIZ. REV. STAT. ANN. § 14-10819.
2. Jurisdictions that set forth the procedure for decanting generally require the exercise to be made:
 - a. By a written instrument, signed and acknowledged by the trustee
 - b. That is filed with the records of the original trust.

See, e.g., KRS § 386.175(7)(a).

D. Optional court approval.

1. The trustee and/or a beneficiary may bring a proceeding for the court to approve or disapprove a trustee’s proposed exercise of the decanting power. *See* KRS § 386.175(10).
2. A trustee concerned about liability – and unwilling to risk the consequences of beneficiary consent – may consider seeking court approval.

E. Suit to Enjoin Proposed Exercise.

In Kentucky, beneficiaries may file a proceeding in District Court to object to the proposed exercise of the decanting power. The suit must be filed within 30 days after receiving the required notice. *See*, KRS § 386.175(7)(d).

VIII. JURISDICTIONAL ISSUES

A trust's governing law may have a substantial effect on whether decanting is available to settlors and beneficiaries (and their advisors). Proper identification of the correct governing law is especially critical in instances where the governing instrument is silent or the law of one state governs the trust's substantive terms while the law of another state governs administrative matters. In some cases, it may be advisable to move a trust's place of administration in order to make decanting available.

A. Governing Instrument Designates Governing Law. Many trust instruments will have governing law provisions.

1. Where the trust's governing instrument designates the law by which the trust's "meaning and effect" will be determined, such law controls "unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue." UNIF. TRUST CODE § 107(1).
2. Similarly, a trust's designated principal place of administration will be respected as long as a "sufficient connection" with the designated jurisdiction exists (*e.g.*, a trustee is a resident of the jurisdiction; all or part of the administration occurs in the designated jurisdiction). UNIF. TRUST CODE § 108.

B. Governing Instrument Silent as to Governing Law. Some trust instruments, especially testamentary trusts, do not have a governing law provision.

1. If the governing instrument is silent on the trust's governing law, the "law of the jurisdiction having the most significant relationship to the matter at issue" will control the meaning and effect of the trust. UNIF. TRUST CODE § 107(2). When determining which jurisdiction has the most significant relationship to the matter at issue, consider factors including:
 - a. Domicile of settlor, trustee and beneficiaries.
 - b. Location of trust property.
 - c. Relevant policies of interested jurisdictions and degree of interest. UNIF. TRUST CODE § 107 cmt.

2. When an instrument is silent as to governing law, often “the law of the trust’s principal place of administration will govern administrative matters and the law of the place having the most significant relationship to the trust’s creation will govern the dispositive provisions.” UNIF. TRUST CODE § 107 cmt.

C. Trustee’s Ability to Change Governing Law

1. The UTC provides that “the trustee is under a continuing duty to administer the trust at a place appropriate to its purposes, its administration, and the interests of the beneficiaries.” As such, the trustee may transfer the trust’s principal place of administration upon 60 days’ written notice to the trust’s qualified beneficiaries provided that no qualified beneficiary objects to such transfer. UNIF. TRUST CODE § 108(b)-(d).

As this provision of the UTC is a default provision, the terms of many governing instruments will specifically permit the trustee to transfer the trust’s place of administration (and may not require notice to the qualified beneficiaries or permit the qualified beneficiaries to object to the transfer).

2. A trustee may use its power to transfer the principal place of administration in order to subject the trust to a jurisdiction’s laws that are more favorable to decanting.
3. Many of the matters most often addressed by a decanting are purely administrative (*e.g.*, trustee succession, court accounting requirements, bond). Unless the trust instrument states that administration of the trust is governed by the laws of a particular state, a transfer of the trust’s principal place of administration should subject the trust to the laws of the new jurisdiction with respect to administrative matters and will permit the involved parties to take advantage of the new jurisdiction’s decanting procedures.

***Example** – Governing instrument specifies that Indiana law governs the validity and construction of the trust but also permits Trustee to transfer the trust’s principal place of administration to any state in which a current beneficiary resides. Trustee, Settlor and all beneficiaries wish to decant the trust to postpone the date of distribution of trust assets. Indiana does not permit decanting, but neighboring Kentucky, the home of a beneficiary, allows decanting. Trustee may transfer the trust’s principal place of administration to Kentucky, thus enabling decanting.*

IX. TAX CONSEQUENCES OF DECANTING

A. Income Tax

1. **Uncertainties as to decanting.** There are a number of open questions regarding income tax treatment of a second trust receiving some or all property of an original trust under a state decanting statute. For example:
 - a. Is the distribution from the original trust to the second trust a distribution under Internal Revenue Code §§ 661 and 662 so that distributable net income is carried out to the second trust?
 - b. Does the distribution of appreciated assets from the original trust to the second trust cause any party to recognize gain under Code § 1001?
 - c. Does the second trust receive the “tax attributes” of the original trust (*e.g.*, capital loss and net operating loss carryovers)?

For consideration of these and other income and transfer tax issues related to decanting, see Letter from Louis A. Mezzullo, President, Am. Coll. of Trust & Estate Counsel to Internal Revenue Service (Apr. 2, 2012) (available at http://www.actec.org/public/Governmental_Relations/Mezzullo_Comments_04_02_12.asp).

2. **Subchapter S corporations.** Trusts that are shareholders in a subchapter S corporation, either as a qualified subchapter S trust (“QSST”) or an electing small business trust (“ESBT”), must take care not to jeopardize the corporation’s S election. *See* KRS § 386.175(4)(g).
3. **Grantor trusts.** Consider whether a proposed decanting will trigger grantor trust status under Internal Revenue Code sections 671 through 679 of a previously non-grantor trust (or will terminate grantor trust status of an existing grantor trust). Not only will a trigger or termination shift income tax liability, but an inadvertent termination of grantor trust status will preclude advantageous estate planning transactions like sales to defective grantor trusts.

B. Gift Tax

1. To avoid a potential taxable gift, a beneficiary must be careful not to consent to a decanting that results in a transfer of all or some of his beneficial interest to another beneficiary. “[A]ny transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.” Treas. Reg. § 25.2511-1(c)(1).

2. “A transfer by a trustee of trust property in which he has no beneficial interest does not constitute a gift by the trustee...” Treas. Reg. § 25.2511-1(g)(1).

An independent trustee may therefore exercise his decanting power, regardless of whether the action results in a shifting beneficial interest.

- C. **Estate Tax** – In order to avoid potential estate tax inclusion under Code Section 2036(a) or 2038, the author recommends that the Settlor NOT consent to a decanting.

D. **Generation-Skipping Transfer (“GST”) Tax**

1. Consider the character of the trust for GST purposes. If it has an inclusion ratio of zero for GST purposes or is exempt from the provisions of Chapter 13 of Subtitle B of the Internal Revenue Code as a grandfathered trust, care must be taken that the decanting does not jeopardize the trust’s GST-exempt status.
2. The decanting of a trust with a zero inclusion ratio should not subject the trust to GST tax. The regulations applicable to the modification of grandfathered trusts do not apply to trusts with a zero inclusion ratio, but the IRS has ruled privately that an action that would not affect a grandfathered trust (*e.g.*, modification) will not affect the exempt status of a trust with a zero inclusion ratio. PLR 200743028 (October 26, 2007).
3. A trustee of a grandfathered trust cannot exercise his power to decant in a manner so as to shift a beneficial interest in the trust property to any beneficiary occupying a lower generation without subjecting the second trust to adverse GST tax consequences.
 - a. “The distribution of trust principal from an exempt trust to a new trust ... will not cause the new ... trust to be subject to the provisions of Chapter 13, if ... **at the time the exempt trust became irrevocable, state law authorized distributions to the new trust . . . without the consent or approval of any beneficiary or court**” and
 - b. The terms of the second trust do not “**extend the time for vesting** of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation.”

Treas. Reg. § 26.2601-1(b)(4)(i)(A).

The first state decanting statute was enacted in 1992 by New York, well after a grandfathered GST trust could be created. A trustee will satisfy the first prong of the above test only if the ability to decant existed under the common law of the relevant state at the time the trust became irrevocable.

4. The IRS will no longer issue private letter rulings on whether a trustee's exercise of his power to decant results in the loss of GST exempt status. Rev. Proc. 2011-3, 2011-1 I.R.B. 1 (2011).

APPENDIX A

DECANTING STATUTES AS OF JANUARY 1, 2013

State	Statutory Cite	Effective Date
New York	NY EPTPL § 10-6.6(b)-(s)	07/24/1992
Alaska	AK Stat § 13.36.157	09/15/1998
Delaware	12 Del. C. § 3528	06/30/2003
Tennessee	Tenn. Code Ann. § 35-15-816(b)(27)	07/01/2004
Florida	Fla. Stat. § 736.04117	01/01/2007
South Dakota	S.D. Laws §§ 55-2-15 – 55-2-21	03/05/2007
New Hampshire	N.H. Rev. Stat. § 564-B:4-418	09/08/2008
Arizona	A.R.S. § 14-10819	09/30/2009
North Carolina	N.C.S.G.A. 36C-8-816.1	09/30/2009
Nevada	N.R.S. 163.556	10/01/2009
Indiana	IC 30-4-3-36	07/01/2010
Missouri	Mo. Rev. Stat. § 456.4-419	08/28/2011
Ohio	O.R.C. § 5808.18	03/22/2012
Rhode Island	General Laws of Rhode Island § 18-4-31	06/23/2012
Virginia	§ 55-548.16:1 Code of VA	07/01/2012
Kentucky	KRS § 386.175	07/12/2012
Michigan	MLC § 556-115A	12/28/2012
Illinois	706 ILCS 5/§ 16.4	01/01/2013

APPENDIX B

KRS § 386.175

386.175 Trustee's power to appoint principal or income in favor of trustee of second trust — Terms of second trust — Special fiduciary — Notice — Judicial proceedings.

- (1) For the purposes of this section, the following definitions apply:
 - (a) "Current beneficiary" means a person who is a permissible distributee of trust income or principal;
 - (b) "Original trust" means a trust established under an irrevocable trust instrument pursuant to the terms of which a trustee has discretionary power to distribute principal or income of the trust to or for the benefit of one (1) or more current beneficiaries of the trust; and
 - (c) "Second trust" means a trust established under an irrevocable trust instrument, the current beneficiaries of which are one (1) or more of the current beneficiaries of the original trust. The second trust may be a trust created under the same trust instrument as the original trust or under a different trust instrument.
- (2) A trustee of an original trust may, without authorization by the court, exercise the discretionary power to distribute principal or income to or for the benefit of one (1) or more current beneficiaries of the original trust by appointing all or part of the principal or income of the original trust subject to the power in favor of the trustee of a second trust. The trustee of the original trust may exercise this power whether or not there is a current need to distribute principal or income under any standard provided in the terms of the original trust. The trustee's special power to appoint trust principal or income in further trust under this section includes the power to create the second trust.
- (3) The second trust may be a trust created or administered under the laws of any jurisdiction, within or without the United States.
- (4) The terms of the second trust shall be subject to all of the following:
 - (a) The beneficiaries of the second trust may include only beneficiaries of the original trust;
 - (b) A beneficiary who has only a future beneficial interest, vested or contingent, in the original trust cannot have the future beneficial interest accelerated to a present interest in the second trust;
 - (c) The terms of the second trust may not reduce any fixed income, annuity, or unitrust interest of a beneficiary in the assets of the original trust, including an interest which is to take effect in the future;
 - (d) If any contribution to the original trust qualified for a marital or charitable deduction for federal income, gift, or estate tax purposes under the Internal Revenue Code, then the second trust shall not contain any provision that, if included in the original trust, would have prevented the original trust from qualifying for the deduction or that would have reduced the amount of the deduction;
 - (e) If contributions to the original trust have been excluded from the gift tax by the application of Sections 2503(b) and 2503(c) of the Internal Revenue Code, then the second trust shall provide that the beneficiary's remainder interest in the

- contributions shall vest and become distributable no later than the date upon which the interest would have vested and become distributable under the terms of the original trust;
- (f) If any beneficiary of the original trust has a currently exercisable power of withdrawal over trust property, then either:
 - a. The terms of the second trust shall provide a power of withdrawal in the second trust identical to the power of withdrawal in the original trust; or
 - b. Sufficient trust property shall remain in the original trust to satisfy the currently exercisable power of withdrawal;
 - (g) If the original trust holds stock of an S corporation, the terms of the second trust shall not prevent or eliminate an election to be a qualified subchapter S trust or an electing small business trust or result in the termination of the S election of such corporation;
 - (h) If the power to distribute principal or income in the original trust is subject to an ascertainable standard, then the power to distribute income or principal in the second trust shall be subject to the same or a more restrictive ascertainable standard as in the original trust when the trustee exercising the power described in subsection (2) of this section is a possible beneficiary under the standard; and
 - (i) The second trust may confer a power of appointment upon a beneficiary of the original trust to whom or for the benefit of whom the trustee has the power to distribute principal or income of the original trust. The permissible appointees of the power of appointment conferred upon a beneficiary may include persons who are not beneficiaries of the original or second trust. The power of appointment conferred upon a beneficiary shall be subject to KRS 381.224, 381.225, and 381.226 covering the time at which the permissible period of the rule against perpetuities and suspension of power of alienation begins and the law that determines the permissible period of the rule against perpetuities and suspension of power of alienation of the original trust.
- (5) The court may appoint a special fiduciary with the authority to exercise the power to appoint principal or income under subsection (2) of this section.
- (6) The exercise of the power to appoint principal or income under subsection (2) of this section:
- (a) Shall be considered an exercise of a power of appointment, other than a power to appoint to the trustee, the trustee's creditors, the trustee's estate, or the creditors of the trustee's estate;
 - (b) Shall be subject to KRS 381.224, 381.225, and 381.226 covering the time at which the permissible period of the rule against perpetuities and suspension of power of alienation begins and the law that determines the permissible period of the rule against perpetuities and suspension of power of alienation of the original trust; and
 - (c) Is not prohibited by a spendthrift provision or by a provision in the original trust instrument that prohibits amendment or revocation of the trust.
- (7) To effect the exercise of the power to appoint principal or income under subsection (2) of this section, all of the following shall apply:
- (a) The exercise of the power to appoint shall be made by an instrument in writing, signed and acknowledged by the trustee, setting forth the manner of the exercise

of the power, including the terms of the second trust and the effective date of the exercise of the power. The instrument shall be filed with the records of the original trust;

- (b) The trustee shall give written notice of the trustee's intention to exercise the power to all current beneficiaries of the original trust and all beneficiaries of the oldest generation of remainder beneficiaries of the first trust, by certified mail with restricted delivery and return receipt, at least sixty (60) days prior to the effective date of the exercise of the power to appoint. The notice shall include a copy of the instrument described in paragraph (a) of this subsection;
 - (c) If all beneficiaries entitled to notice have received the notice as evidenced by the certified mail return receipt and waive the notice period by a signed written instrument delivered to the trustee, the trustee's power to appoint principal or income shall be exercisable after notice is waived by all such beneficiaries, notwithstanding the effective date of the exercise of the power;
 - (d) A current beneficiary or a beneficiary who is not a current beneficiary but is a member of the oldest generation of the remainder beneficiaries of the original trust may, no later than thirty (30) days from the date of receiving notice under paragraph (b) of this subsection, commence a judicial proceeding in District Court pursuant to KRS 386.675 to object to the proposed exercise of the power under subsection (2) of this section. In such case the proposed exercise of the power shall require consent of the District Court as defined by KRS 386.450(3). Any determination of the District Court shall be subject to KRS 386.454(5); and
 - (e) In the event that a beneficiary did not receive the notice as evidenced by the certified mail return receipt, and no other beneficiary has commenced a proceeding under paragraph (d) of this subsection, the trustee may seek the approval of the District Court to exercise the power.
- (8) Nothing in this section shall be construed to create or imply a duty of the trustee to exercise the power to distribute principal or income, and no inference of impropriety shall be made as a result of a trustee not exercising the power to appoint principal or income conferred under subsection (2) of this section. Nothing in this section shall be construed to abridge the right of any trustee who has the power to appoint property in further trust that arises under the terms of the original trust or under any provision of law or under common law.
- (9) This section shall not apply to any charitable remainder trust as defined in 26 U.S.C. sec. 664(d).
- (10) A trustee or beneficiary may commence a judicial proceeding in the District Court pursuant to KRS 386.675 to approve or disapprove of a proposed exercise of the trustee's special power to appoint to a second trust pursuant to subsection (2) of this section. In such case approval by the District Court shall have the same meaning as provided in KRS 386.450(3) and the approval shall be subject to KRS 386.454(5).

Effective: July 12, 2012

History: Created 2012 Ky. Acts ch. 59, sec. 4, effective July 12, 2012.