

DECANT I CAN'T: THE DELAWARE TAX TRAP AND THE TEXAS DECANTING STATUTE

Comment

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I.	DECANTING AND THE DELAWARE TAX TRAP—AN INTRODUCTION ...	58
A.	<i>“Here’s a Story About a Man Named Brady.”</i>	58
B.	<i>The Road Ahead</i>	59
C.	<i>What Is in the “Trap?”</i>	59
D.	<i>Decanting Basics</i>	61
1.	<i>Power of Appointment</i>	62
2.	<i>What Makes This Power Special?</i>	63
E.	<i>The Interaction</i>	65
II.	DECANTING IN HEART OF TEXAS	65
A.	<i>What I Can</i>	65
1.	<i>General</i>	65
2.	<i>Discretion</i>	66
B.	<i>Trapping in Texas</i>	67
III.	HOW OTHER STATES HANDLE THIS ISSUE	68
A.	<i>Delaware</i>	68
B.	<i>Arizona</i>	69
C.	<i>Florida</i>	71
D.	<i>Ohio</i>	72
IV.	THE SOLUTION	73
A.	<i>The Statute</i>	73
B.	<i>The Trust Itself</i>	74
C.	<i>Why</i>	76
V.	CONCLUSION	76

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I. DECANTING AND THE DELAWARE TAX TRAP—AN INTRODUCTION

A. “Here’s a Story About a Man Named Brady.”¹

The Bradys are a large family consisting of two parents, six kids, a dog, and a witty housekeeper.² With six children, problems always exist.³ Mr. Brady was a successful architect with considerable assets built up to leave to his family.⁴ With a large family who depended on him, Mr. Brady knew the full importance of having an adequate trust for his life savings.⁵

Mr. Brady passed away after living a full, long life.⁶ Before he passed away, Mr. Brady decided to name Mrs. Brady as the beneficiary of the trust.⁷ They lived in Texas, which recognizes decanting.⁸ Under the decanting statute, Mrs. Brady is considered the First Power and has special power of appointment.⁹ Mrs. Brady is aging, and she does not understand the full terms and effects of the trust her husband created years ago.¹⁰ Using her appointment power, Mrs. Brady named her beloved daughter, Marcia Brady, the Second Power of the trust.¹¹ Marcia finds the outdated language of the trust very confusing.¹² She decides to create a new trust with updated language that adheres to modern trust laws.¹³

One of the possible drawbacks of the decanting statute is the delay in the Rule Against Perpetuities (RAP) period.¹⁴ In the Bradys’ case, the trust would not vest during Mrs. Brady’s lifetime because Marcia created a new trust.¹⁵ This triggers a delay in the perpetuities period.¹⁶ A delay in Rule Against Perpetuities can cause the Delaware Tax Trap.¹⁷ The Delaware Tax Trap allows trusts to avoid estate and gift tax liabilities because of the delay

1. *The Brady Bunch* (ABC 1969–1974).

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*

8. TEX. PROP. CODE ANN. §112.071 (West 2015).

9. See Melissa J. Willms, *Decanting Trusts: Irrevocable, Not Unchangeable*, 6 EST. PLAN. & COMMUNITY PROP. L.J. 35, 37 (2013); see *The Brady Bunch*, *supra* note 1.

10. See *The Brady Bunch*, *supra* note 1.

11. See MICHAEL M. GORDON ET AL., THE TAX CONSEQUENCES OF DECANTING: AN OVERVIEW OF THE GIFT, ESTATE, INCOME, AND GENERATION-SKIPPING TRANSFER TAX ISSUES TO CONSIDER WHEN CONTEMPLATING A TRUST DECANTING 8–9 (2013), <http://www.gflmlaw.com/sites/default/files/pdfs/Gordon,%20Michael%20-%20BHBA%20-%20January%2015%202013%20Tax%20Consequences%20of%20Decanting.pdf> [https://perma.cc/F237-8DLH]; see *The Brady Bunch*, *supra* note 1.

12. See *The Brady Bunch*, *supra* note 1.

13. See Willms, *supra* note 9; see *The Brady Bunch*, *supra* note 1.

14. See GORDON ET AL., *supra* note 11.

15. *Id.* See *The Brady Bunch*, *supra* note 1.

16. See GORDON ET AL., *supra* note 11; see *The Brady Bunch*, *supra* note 1.

17. See Jonathan G Blattmachr & Georgiana J. Slade, *More Than One Hundred Post-Mortem Tax Planning Sections*, 66 N.Y. ST. B.J. 26, 30 (July/Aug. 1994); see *The Brady Bunch*, *supra* note 1.

in vesting.¹⁸ Thus, these taxes will not be paid in Mrs. Brady's lifetime.¹⁹ Payment of these taxes might occur in Marcia's lifetime if the trusts vests.²⁰ This scenario creates a form of tax evasion.²¹

B. *The Road Ahead*

This comment will focus on Texas law and explore all the nuances of the Delaware Tax Trap, as well as how it interacts with decanting statutes.²² This article will revisit the introductory hypothetical to explain how the separate statutes play out in real life.²³ This hypothetical also provides a basic introduction to triggering The Delaware Trap's liabilities.²⁴ This article aims to prevent the Delaware Tax Trap from triggering under the Texas decanting statute.²⁵

The next section further explains the Delaware Tax Trap, then gives a general description of decanting statutes.²⁶ The focus will shift to decanting in Texas and how it interacts with the Delaware Tax Trap.²⁷ Specifically, Part II will address the conflicts and ramifications of the Texas decanting statute.²⁸ Next, this comment will examine how other states handle the Delaware Tax Trap, including brief examinations of their decanting statutes.²⁹ Lastly, this comment will propose new legislation that will clear up the confusion between the Delaware Tax Trap and the Texas decanting statute.³⁰

C. *What Is in the "Trap?"*

The Delaware Tax Trap, which is the nickname for Internal Revenue Code Sections 2041(a)(3) and 2514, allows a delay in estate and gift tax liabilities.³¹ The Delaware Tax Trap derives from the Delaware Rule Against Perpetuities.³² The definition of the Rule Against Perpetuities is

18. See Blattmachr & Slade, *supra* note 17; see *The Brady Bunch*, *supra* note 1.

19. See GORDON ET AL, *supra* note 11; see *The Brady Bunch*, *supra* note 1.

20. See GORDON ET AL, *supra* note 11; see *The Brady Bunch*, *supra* note 1.

21. See GORDON ET AL, *supra* note 11; see *The Brady Bunch*, *supra* note 1.

22. See *infra* Part II.

23. See *infra* Section I.A.

24. See *infra* Section I.A.

25. See *infra* Part III.

26. See *infra* Section I.D.

27. See *infra* Section II.B.

28. See *infra* Section II.B.

29. See *infra* Sections III.A–D.

30. See *infra* Part IV.

31. See Richard W. Nenko, *Terrors in the Deep: Tax Dangers When Exercising Powers Over Trusts—The GST Regulations and the Delaware Tax Trap*, 34 TAX MGMT. EST., GIFTS & TR. J. 1, 8 (2009).

32. See Cynthia D.M. Brown, *Delaware Tax Trap Planning—How to Take Advantage of a Step-Up in Income Tax Basis in a World of Increased Estate Tax Exemptions*, COMMONWEALTH TR. CO. 1, 1

“prohibit[ing] trusts in which the ability to ascertain the identity of the beneficiaries in whom equitable title will vest is delayed beyond a specific time period.”³³ In most cases, the time period is twenty-one years.³⁴ Essentially, the Rule Against Perpetuities requires meeting the conditions of the trust.³⁵

Decanting allows the creator of the trust to place property in one trust and then give a Second Power to appoint in a future trust.³⁶ Mr. Brady appointed Mrs. Brady as the creator, and he granted Mrs. Brady First Power, which allows her to create additional powers.³⁷ Mrs. Brady appointed Marcia, and Marcia could appoint someone else.³⁸ Thus, this property floats around without coming into absolute ownership because it never vests in anyone, and no one pays an estate or gift tax.³⁹ The paying of these taxes creates the “Trap” scenario until the property finally vests in someone, and that individual is liable for the estate and gift tax liabilities.⁴⁰

The Internal Revenue Code (IRC) controls the Delaware Tax Trap.⁴¹ It describes how to handle this property.⁴² For example, “[p]roperty subject to a general power of appointment that the decedent had at the time of the decedent’s death is included in the gross estate.”⁴³ However, if a second power is created, certain assets that were not originally part of the irrevocable trust will be included.⁴⁴ These assets unintentionally become part of the gross estate.⁴⁵ The sister section to this estate tax requirement is a similar gift tax section.⁴⁶

Section 2041(a)(3) controls the power of appointment for estate taxes stipulating that:

(2015), <http://www.comtrst.com/trust-our-word/wp-content/uploads/2015/01/CTC-Annual-Newsletter-2015.pdf> [<https://perma.cc/T7RM-MH6U>].

33. GERRY W. BEYER, *EXAMPLES & EXPLANATIONS: WILLS, TRUSTS, AND ESTATES* 389 (Vicki Bean et al. eds., Wolters Kluwer Law & Business 5th ed. 2012).

34. *Id.*

35. *Id.*

36. See Les Raatz, *Delaware Tax Trap Opens Door To Higher Basis For Trust Assets (And Avoid GST Tax Problems With Nonexempt Indirect Skip Trusts)* (2014), <http://www.dickinson-wright.com/~media/Documents/Documents%20linked%20to%20attorney%20bios/Newest%20Delaware%20Tax%20Trap.pdf> [<https://perma.cc/4BM7-BR5V>].

37. See Raatz, *supra* note 36; see *The Brady Bunch*, *supra* note 1.

38. See Raatz, *supra* note 36; see *The Brady Bunch*, *supra* note 1.

39. See Brown, *supra* note 32.

40. See Raatz, *supra* note 36.

41. I.R.C. § 2041(a)(3) (West 2013).

42. *Id.*

43. See BEYER, *supra* note 33, at 533.

44. See I.R.C. § 2041(a)(3)(A)–(B); see Raatz, *supra* note 36.

45. See I.R.C. § 2041(a)(3)(A)–(B); See Raatz, *supra* note 36.

46. I.R.C. §§ 2041(a)(3), 2514(d).

To the extent of any property with respect to which the decedent—
(A) by will, or
(B) by a disposition which is of such nature that if it were a transfer of property owned by the decedent such property would be includible in the decedent's gross estate under section 2035, 2036, or 2037, exercises a power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.⁴⁷

Section 2514(d) controls the gift tax power of appointment in relation to The Delaware Tax Trap:

Creation of another power in certain cases—If a power of appointment created after October 21, 1942, is exercised by creating another power of appointment which, under the applicable local law, can be validly exercised so as to postpone the vesting of any estate or interest in the property which was subject to the first power, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power, such exercise of the first power shall, to the extent of the property subject to the second power, be deemed a transfer of property by the individual possessing such power.⁴⁸

Thus, the IRC contains similar provisions for both the gift and estate taxes.⁴⁹ These two code sections essentially state that when exercising the power of appointment, the gross estate incorporates certain assets of an irrevocable trust.⁵⁰ These sections allow the Delaware Tax Trap to spring.⁵¹ Yet decanting is unclear because these two code sections discussed above clearly do not allow it.⁵² This raises issues with decanting and how a well-intentioned law creates other problems.⁵³

D. Decanting Basics

Decanting statutes generally work to help trustees modify existing trust agreements.⁵⁴ This allows a trust to adapt to new times and new laws; however, this can also change the perpetuity period.⁵⁵ A change in the

47. *Id.* § 2041(a)(3).

48. *Id.* § 2514(d).

49. *See id.* §§ 2041(a)(3), 2514(d).

50. *See id.* § 2041(a)(3)(A)–(B); *see also* Raatz, *supra* note 36, at 9–10.

51. *See* I.R.C. §§ 2041(a)(3)(A)–(B), 25041(d); *see also* Raatz, *supra* note 36.

52. *See* I.R.C. §§ 2041(a)(3), 2514(d).

53. *See infra* Section I.D.

54. *See* Ann Marie Levin & Todd A. Flaubacher, *Put Decanting to Work to Give Breath to Trust Purpose*, 38 EST. PLANN. 1, 3 (Jan. 2011).

55. *Id.*

perpetuity period can cause a delay in the vesting of property.⁵⁶ For example, “decanting occurs when a trustee, exercising discretionary authority to distribute trust property to or for the benefit of trust beneficiaries, distributes assets from one trust to another.”⁵⁷ This helps update an old, outdated trust to a modern and pliable trust.⁵⁸ Decanting focuses on the concept of the special power of appointment.⁵⁹

1. Power of Appointment

A power of appointment is the ability to appoint a new owner of property.⁶⁰ This power is based off ownership.⁶¹ Thus, the power of appointment in the wills and trust context is the ability that the donor gives to the donee when distributing property to beneficiaries under a trust.⁶² For example, in the above hypothetical, Mr. Brady is the donor because he is the original owner of the property.⁶³ The donee is Mrs. Brady and then Marcia.⁶⁴

The rest of the family are the objects of the power and can receive the property from Marcia or Mrs. Brady.⁶⁵ If the donee exercises the power of appointment that the donor granted, the new property owners are appointees. However, if the power is never exercised, then the property passes to default takers.⁶⁶ If the donee—either Mrs. Brady or Marcia—never appoints default takers, then the property reverts back to the donor or the donor’s estate.⁶⁷ The donee has no legal or equitable title to the property, only the power to appoint.⁶⁸ The appointees take title to the property directly from the donor.⁶⁹

Further, donees are under no obligation to actually exercise their power.⁷⁰ This differs from trustees who are obligated to distribute trust assets.⁷¹ The donor can also decide the manner in which the donee distributes the property.⁷² For example, Mrs. Brady or Marcia could have the power

56. *Id.*

57. Willms, *supra* note 9.

58. *See id.*

59. Crystal Rose, *Decanting More Than Just Wine: Revocability in Irrevocable Texas Trusts*, EST. PLAN. & COMMUNITY PROP. L.J. 385, 398 (2014).

60. *See* BEYER, *supra* note 33, at 287.

61. GERRY W. BEYER, *EXAMPLES & EXPLANATIONS: WILLS, TRUSTS, AND ESTATES* 287 (Vicki Bean et al. eds., Wolters Kluwer Law & Business 5th ed. 2012). A donee holds the power of appointment and the donor is the creator is the trust. *Id.*

62. *See* BEYER, *supra* note 33, at 287.

63. *See id.*; *see The Brady Bunch*, *supra* note 1.

64. *See* BEYER, *supra* note 33, at 287; *see The Brady Bunch*, *supra* note 1.

65. *See* BEYER, *supra* note 33, at 287; *see The Brady Bunch*, *supra* note 1.

66. *See* BEYER, *supra* note 33, at 287.

67. *See id.*; *see The Brady Bunch*, *supra* note 1.

68. *See* BEYER, *supra* note 33, at 287.

69. *See id.*

70. *See id.*

71. *See id.*

72. *See id.*

solely during their lifetimes, which is an inter vivos power.⁷³ They also could exercise their power at will under a testamentary power.⁷⁴ Mr. Brady could also allow his power of appointments to do both.⁷⁵

2. What Makes This Power Special?

A special power of appointment is the most effective way to trigger the Delaware Tax Trap for three reasons.⁷⁶ First, the property in the trust is still protected from creditors.⁷⁷ Second, the beneficiaries, upon the inception of the trust, do not have to immediately claim the property.⁷⁸ Third, the new power does not have to include the trust assets for estate or gift tax purposes.⁷⁹ An individual with a special power of appointment has the ability to create a new trust and thus create new beneficial interests.⁸⁰ The Restatement (Second) of Property first introduced the idea of a special power of appointment.⁸¹ As it explains, “[a] power of appointment is authority, other than as an incident of the beneficial ownership of property, to designate recipients of beneficial interests in property.”⁸²

In the introductory hypothetical, Mr. Brady was the donee because he was the individual that created the trust.⁸³ Mrs. Brady is the First Power, which in this context is a special power, because she can appoint a Second Power of the trust as long as it is not for her benefit.⁸⁴ Marcia, whose mother appointed her, is also considered the Second Power with special power of appointment, allowing her to create the second trust.⁸⁵ This new trust does not have tax liabilities tied to Marcia.⁸⁶ However, many statutes do not allow the option for a special power of appointment.⁸⁷ A general power of appointment can also invoke the Delaware Tax Trap.⁸⁸

This power may be divided into general and nongeneral powers.⁸⁹ A power is general if it has one or more of these exercising powers: “the donee of the power, the donee’s creditors, the donee’s estate, or the creditors of the

73. See BEYER, *supra* note 33, at 287; see *The Brady Bunch*, *supra* note 1.

74. See BEYER, *supra* note 33, at 287; see *The Brady Bunch*, *supra* note 1.

75. See BEYER, *supra* note 33, at 287; see *The Brady Bunch*, *supra* note 1.

76. See Raatz, *supra* note 36, at 11.

77. See *id.*

78. See *id.*

79. See *id.*

80. See Rose, *supra* note 59.

81. RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 11.1 (1986).

82. *Id.*

83. See Levin & Flaubacher, *supra* note 54; see *The Brady Bunch*, *supra* note 1.

84. See Levin & Flaubacher, *supra* note 54; see *The Brady Bunch*, *supra* note 1.

85. See Raatz, *supra* note 36; see *The Brady Bunch*, *supra* note 1.

86. See Raatz, *supra* note 36; see *The Brady Bunch*, *supra* note 1.

87. See Levin & Flaubacher, *supra* note 54, at 4.

88. See Blattmachr & Slade, *supra* note 17.

89. See Rose, *supra* note 59.

donee's estate."⁹⁰ All other powers are nongeneral under the Second Restatement.⁹¹ The donee limits this power to the extent they desire.⁹² Nongeneral powers are also referred to as specific, special, or limited.⁹³ A nongeneral power is the ability to specify a certain group of beneficiaries that may not include creditors.⁹⁴ Under this power, the donor may place certain conditions on the donee.⁹⁵

The Restatement (Third) of Property: Wills and Donative Transfers similarly defines a power of appointment, however there are many important distinctions.⁹⁶ First, a discretionary power of appointment differentiates from a fiduciary power of appointment.⁹⁷ This is significant because if the power is discretionary it can be exercised arbitrarily and will end upon death.⁹⁸ However, the fiduciary power does not end, rather it goes on to a successor.⁹⁹ Most importantly, "[b]ecause the trustee must act in a fiduciary capacity if the trustee is going to appoint principal from one trust to another, it is important that the trustee know all of the fiduciary duties applicable to a trustee when deciding whether to decant."¹⁰⁰

In the introductory hypothetical, Marcia, as the Second Power, would have to understand her powers as both a trustee and fiduciary under the Restatement (Third) of Property.¹⁰¹ Under the Special Power, Marcia has the power to control the trust and the distribution of its assets to the beneficiaries.¹⁰² If she has a general power, then she has broad control including interaction with creditors.¹⁰³ However, if Marcia's power is nongeneral, then she might be subject to limitations.¹⁰⁴

90. *See id.*

91. RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 11.1 (1986).

92. *See Rose, supra* note 59.

93. *See BEYER, supra* note 33, at 287.

94. *See id.*

95. *See id.*

96. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 (2003).

97. *Id.*

98. *Id.*

99. *Id.*

100. *See Rose, supra* note 59.

101. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 (2003).

102. *See id.*; *see The Brady Bunch, supra* note 1.

103. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 (2003); *see The Brady Bunch, supra* note 1.

104. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 (2003); *see The Brady Bunch, supra* note 1.

E. The Interaction

So how do these two seemingly unique and unrelated ideas come into contact with each other?¹⁰⁵ Decanting can ignite the Delaware Tax Trap.¹⁰⁶ The new trust will vest in someone down the line who will have to pay tax liabilities.¹⁰⁷ Most states include tax-related clauses in their decanting statutes.¹⁰⁸ Yet, the Delaware Tax Trap occurs anyways.¹⁰⁹ Texas takes a unique position on this issue.¹¹⁰

II. DECANTING IN HEART OF TEXAS

A. What I Can

Texas recently implemented a decanting statute.¹¹¹ This statute served the same purpose as many of the other state statutes.¹¹² The Texas state legislature wanted to allow individuals to update old, outdated trusts and allow more flexibility in who can control asset distributions.¹¹³ The purpose is truly to help everyone, including the original donor and the donees.¹¹⁴

1. General

The Texas decanting statute characterizes the “first trust” as the original and the “second trust” as the newly created trust.¹¹⁵ A power of appointment can have either full or limited discretion.¹¹⁶ Significantly, donees with full discretion “may . . . grant a power of appointment . . . in the second trust to one or more of the current beneficiaries of the first trust.”¹¹⁷ This means they are able to name whomever they wish as a power of appointment in the second trust.¹¹⁸ In contrast, donees with limited power of appointment must “[i]f the first trust grants a power of appointment to a beneficiary of the trust, the second trust must grant the power of appointment to the beneficiary in

105. *Supra* Section II.A–C.

106. William R. Culp, Jr. & Brian Bennett Mellen, *Trust Decanting: An Overview and Introduction to Creative Planning Opportunities*, REAL PROP., TR. & EST. L.J. 1, 35 (Spring 2010).

107. *Id.*

108. *Id.*

109. *Id.*

110. *Infra* Part II.

111. *See* Rose, *supra* note 59, at 386.

112. *See id.*

113. *See id.*

114. *See id.*

115. TEX. PROP. CODE ANN. § 112.071 (West 2015).

116. *Id.* §§ 112.072–.073.

117. *Id.* § 112.072.

118. *See id.*

the second trust.”¹¹⁹ The class of individuals allowed as appointed powers must remain the same in the second trust as in the first.¹²⁰

2. Discretion

Discretion examines the distribution of assets.¹²¹ Under the full discretion standard, a person with the power of appointment has no limitations or guidelines that the individual has to use when making distributions.¹²² This gives people with power of appointment many options and possibilities when decanting.¹²³ For example, “a trustee may add beneficiaries to a second trust, who were not beneficiaries of the first trust, by granting a power of appointment to a beneficiary of the first trust (with the potential appointees of the power including beneficiaries who were not beneficiaries under the first trust).”¹²⁴

Limited discretion trustees have similar powers.¹²⁵ They can still create a second trust with all or part of the first trust, however they must meet certain requirements.¹²⁶ These conditions include:

The current, successor, and presumptive remainder beneficiaries of the second trust must be the same respective beneficiaries of the first trust. If the beneficiaries in the first trust are a part of a class, the beneficiaries of the second trust must include everyone who is or could be a member of that class. The distributive provisions of the second trust also must be the same as those in the first trust. Last, if the settlor of the first trust granted a power of appointment to a certain individual or group of individuals, the individual or group of individuals must retain the power of appointment in the second trust.¹²⁷

Thus, a limited discretion trustee has less flexibility than a full discretion trustee.¹²⁸ However, there is the possibility that the current power could appoint another power with more authority.¹²⁹ Based off these limitations, decanting trusts are generally only modified for administrative purposes.¹³⁰ Discretion and power of appointment compose the basics of decanting statutes.¹³¹

119. *Id.* § 112.073.

120. *Id.*

121. *See* Rose, *supra* note 59, at 406.

122. *See id.*

123. *See id.* at 407.

124. *See id.*

125. *See id.* at 408.

126. *See id.*

127. *See id.*

128. *See id.* at 409.

129. *See id.*

130. *See id.*

131. *See id.*

B. Trapping in Texas

The imperative section of the Texas decanting statute that deals with the Delaware Tax Trap explains:

- (a) The authorized trustee may not distribute the principal of a trust under Section 112.072 or 112.073 in a manner that would prevent a contribution to that trust from qualifying for or that would reduce the exclusion, deduction, or other federal tax benefit that was originally claimed for that contribution, including:
- (1) the annual exclusion under Section 2503(b), Internal Revenue Code of 1986;
 - (2) a marital deduction under Section 2056(a) or 2523(a), Internal Revenue Code of 1986;
 - (3) the charitable deduction under Section 170(a), 642(c), 2055(a), or 2522(a), Internal Revenue Code of 1986;
 - (4) direct skip treatment under Section 2642(c), Internal Revenue Code of 1986; or
 - (5) any other tax benefit for income, gift, estate, or generation-skipping transfer tax purposes under the Internal Revenue Code of 1986.¹³²

As stated in Subsection (5) of the above statute, no other types of generation-skipping transfers are allowed.¹³³ However, this definition is somewhat unclear.¹³⁴ The language applies only to tax benefits not tax liabilities.¹³⁵

The Wills, Trusts, and Estates Examples and Explanations defines generation-skipping transfer (GST) as a “tax imposed on certain inter vivos and at-death transfers to donees who are more than one generation younger than the transferor.”¹³⁶ This definition applies to Marcia and the other children, but it does not apply to Mrs. Brady.¹³⁷ This tax is a flat rate that must be paid on top of other federal gift or estate taxes.¹³⁸

These taxes are intended to honor the constitutional requirement of taxation.¹³⁹ Decanting acts to update outdated trusts.¹⁴⁰ However, this does not account for situations where a decanting statute paves the way for

132. TEX. PROP. CODE ANN. § 112.086 (West 2015).

133. *Id.*

134. *Id.*

135. *Id.*

136. See BEYER, *supra* note 33, at 287.

137. See *id.*; see *The Brady Bunch*, *supra* note 1.

138. See BEYER, *supra* note 33, at 287.

139. U.S. CONST. art. I, § 2.

140. See Culp & Mellen, *supra* note 106.

taxation skipping.¹⁴¹ Decanting statutes allow for a transfer without vestment.¹⁴² Thus, the Texas law is unclear.¹⁴³

III. HOW OTHER STATES HANDLE THIS ISSUE

States vary on how they address the Delaware Tax Trap.¹⁴⁴ Delaware, the creator of the Trap, specifically spells out how to create a power of appointment.¹⁴⁵ Specifically, the Rule Against Perpetuities period vests at the time of the original trust.¹⁴⁶ Arizona also adopts this policy.¹⁴⁷ Ohio completely eliminated the Rule Against Perpetuities, which effectively eliminates the Delaware Tax Trap because there is no measurable period to skip.¹⁴⁸ Florida extended the Rule Against Perpetuities period to 360 years.¹⁴⁹ This is unique in that the perpetuity period is not modified or eliminated as in other states, and there is no governing statute addressing the Delaware Tax Trap.¹⁵⁰

A. Delaware

The Delaware decanting statute allows a second trust to create a power of appointment in a trust beneficiary.¹⁵¹ The main issue is when the perpetuities period comes into play.¹⁵² Mainly, when does the Rule Against Perpetuities period vest?¹⁵³

There is also a difference in the appointment power if the appointed power has beneficiary or testamentary capacity.¹⁵⁴ Specifically, the way the powers delay the trust is different, however, both effectively delay the perpetuities period.¹⁵⁵ The beneficiaries can extend the Rule Against Perpetuities period if they exercise their appointment during their lifetime, creating a taxable gift.¹⁵⁶ If the power granted is testamentary, the vesting

141. TEX. PROP. CODE ANN. § 112.086 (West 2015).

142. See Culp & Mellen, *supra* note 106.

143. PROP. § 112.086.

144. See ARIZ. REV. STAT. ANN. § 14-2901 (2016); DEL. CODE ANN. tit. 25 § 504 (West 2016); FLA. PRAC. ESTATE PLANNING 12 § 12:70 (2014-2015); OHIO REV. CODE ANN. § 2131.09 (West 2015-2016).

145. DEL. tit. 25 § 504.

146. *Id.*

147. ARIZ. § 14-2901.

148. OHIO § 2131.09.

149. FLA. § 12:70.

150. *Id.*

151. DEL. CODE ANN. tit. 25 § 504 (West 2016).

152. See *id.*; see GORDON ET AL, *supra* note 11, at 9.

153. See GORDON ET AL *supra* note 11, at 9.

154. See *id.*

155. See *id.*

156. See *id.*

property extends beyond the Rule Against Perpetuities period.¹⁵⁷ Thus, it becomes a part of the beneficiary's estate.¹⁵⁸

The pertinent statutory language incorporated in Delaware requiring the Rule Against Perpetuities to vest is:

(2) Whether the first power was created before or after the passage of this section, shall, for the purpose of any rule of law against perpetuities, remoteness in vesting . . . to have been created at the time of the creation of, and not at the time of the exercise of, the first power . . . if any part of an estate or interest in property created through the exercise of the first power includes another power of appointment (the "second power"), then the second power of appointment and any estate or interest in property . . . created through the exercise of the second power shall be deemed to have been created at the time of the creation of the first power.¹⁵⁹

Delaware establishes the vestment period, which is a very effective approach to decanting and the Delaware Tax Trap.¹⁶⁰ This statute basically explains that even with the creation of a second power the trust vests with the first power.¹⁶¹ This prevents triggering the Delaware Tax Trap because the vesting period is not delayed.¹⁶² In applying this standard to the introductory hypothetical, the special power of appointment will allow the trust to continually "change hands," but it vests with Mrs. Brady.¹⁶³ This means that Marcia can then appoint Greg as a power, then Greg can appoint Jan, and Jan appoint Peter, and so on and so forth without any additional tax liabilities.¹⁶⁴ The tax liabilities vest with the first power, eliminating tax liabilities by the later powers.¹⁶⁵

B. Arizona

Arizona allows the Delaware Tax Trap to spring with a Special Power of Appointment.¹⁶⁶ The individual holding the appointment power can create a special power of appointment, which triggers the Delaware Tax Trap.¹⁶⁷ Essentially, the date the special power holder appoints a new power is the creation date for the trust.¹⁶⁸ That date starts the clock on the RAP period.¹⁶⁹

157. *See id.*

158. *See id.*

159. DEL. CODE ANN. tit. 25, § 504 (2016).

160. *See* GORDON ET AL, *supra* note 11, at 9.

161. DEL. tit. 25, § 504.

162. *Id.*

163. *Id.*; *see* GORDON ET AL, *supra* note 11, at 9; *see The Brady Bunch*, *supra* note 1.

164. DEL. tit. 25 § 504.

165. *Id.*

166. *See* Raatz, *supra* note 36, at 11.

167. *See id.* at 12.

168. *See id.*

169. *See id.*

Thus, the Rule Against Perpetuities period is measured from the point the second power of appointment is made.¹⁷⁰ Thus, exercising power of appointment creates new powers.¹⁷¹ This allows individuals to choose to trigger the Delaware Tax Trap because they re-start the RAP period with every creation of a new power.¹⁷²

Arizona reads two statutes together to accomplish this result.¹⁷³ Arizona Revised Statutes Section 14-2902(A) explains “[e]xcept as provided in subsections B and C of this section and Section 14-2905, subsection C, the time of creation of a nonvested property interest or a power of appointment is determined under general principles of property law.”¹⁷⁴ This means that vestment begins when a power initiates under basic property law.¹⁷⁵ Arizona Revised Statute Section 14-2905 states “[e]xcept as otherwise provided, this article applies to a nonvested property interest or a power of appointment that is created on or after December 31, 1994.”¹⁷⁶ This section applies the rules of that article, including Section 14-2902, to trusts created after 1994.¹⁷⁷ Together, these two statutes effectively trigger the Delaware Tax Trap at the time a new power is created.¹⁷⁸

Further, Arizona allows for decanting to trigger the Delaware Tax Trap.¹⁷⁹ This depends on whether the trustee has the discretion to make distributions under the trust.¹⁸⁰ The decanting statute stipulates under Section 14-10819(A):

Unless the terms of the instrument expressly provide otherwise, a trustee who has the discretion under the terms of a testamentary instrument or irrevocable inter vivos agreement to make distributions, regardless of whether a standard is provided in the instrument or agreement, for the benefit of a beneficiary of the trust may exercise without prior court approval the trustee’s discretion by appointing part or all of the estate trust in favor a trustee of another trust[.]¹⁸¹

This statute allows for a new RAP to commence as long as no violation exists under Sections 14-2901 and 14-905.¹⁸² It does not mention RAP commencement dates.¹⁸³ Thus, the Arizona decanting statute itself allows

170. *See id.* at 14.

171. *See id.*

172. *See id.* at 12.

173. *See id.* at 14.

174. ARIZ. REV. STAT. ANN. § 14-2902(A) (2013).

175. *Id.*

176. *Id.* § 14-2905.

177. *Id.*

178. *See Raatz, supra* note 36, at 14.

179. ARIZ. § 14-10819(A); *see Raatz, supra* note 36.

180. ARIZ. § 14-10819(A); *see Raatz, supra* note 36.

181. ARIZ. § 14-10819(A).

182. *Id.* § 14-10819(A)(6).

183. *Id.*

for the Delaware Tax Trap to occur.¹⁸⁴ The Brady family has two avenues to trigger the Delaware Tax Trap in Arizona.¹⁸⁵ First, they could create a new power every time the RAP period comes close to vestment.¹⁸⁶ Second, the decanting trust utilized provides an avenue to trigger the Delaware Tax Trap.¹⁸⁷

C. Florida

In Florida, the Rule Against Perpetuities period extends to 360 years.¹⁸⁸ This effectively limits the period from ever vesting, eliminating the issues created in a decanting statute.¹⁸⁹ The period is indefinite regardless of the creation or modification of a trust.¹⁹⁰ Florida also allows for decanting.¹⁹¹ As an important side note, the Florida decanting statute is not limited to certain purposes such as health, safety, or maintenance.¹⁹² Florida is unique in this respect.¹⁹³ However, the decanting statute directly deals with the Rule Against Perpetuities period:

(3) The exercise of a power to invade principal under subsection (1) shall be considered the 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, and shall be subject to the provisions of s. 689.225 covering the time at which the permissible period of the rule against perpetuities begins and the law that determines the permissible period of the rule against perpetuities of the first trust.¹⁹⁴

This approach is unique, but it does not solve the Delaware Tax Trap issue.¹⁹⁵ A major factor in extending the Rule Against Perpetuities period is to avoid the Delaware Tax Trap.¹⁹⁶ Thus, Florida takes a unique approach to handling this issue.¹⁹⁷ The long Rule Against Perpetuities period would

184. See Raatz, *supra* note 36, at 19.

185. ARIZ. § 14-10819(A); see *The Brady Bunch*, *supra* note 1.

186. See ARIZ. §§ 14-2902(A), 14-2905; see *The Brady Bunch*, *supra* note 1.

187. ARIZ. § 14-10819(A); see *The Brady Bunch*, *supra* note 1.

188. Pieter Van Dien, Shelly Wald Harris & Abraham M. Mora, *Why Florida Has Not Repealed the Rule Against Perpetuities*, FLA. PRAC. SERIES: EST. PLANN. § 12:70 (2014–2015).

189. *Id.*

190. *Id.*

191. FLA. STAT. ANN. § 736.04117 (West 2007).

192. *Id.*

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.*

197. *Id.* § 736.04117.

prevent the trust from ever vesting in Marcia.¹⁹⁸ Further, the trust could also decant in Marcia's decedents.¹⁹⁹

D. Ohio

Ohio decided it did not want to bother with the Rule Against Perpetuities anymore.²⁰⁰ Eliminating the Rule Against Perpetuities helped solve multiple problems with basic property and probate law.²⁰¹ Because there is no Rule Against Perpetuities period, there are no issues with the Delaware Tax Trap.²⁰² With no measurable period, the Delaware Tax Trap cannot delay the vesting of any assets.²⁰³ The relevant statutory text under Section 2131.09 stipulates:

(B)(1) No rule of law against perpetuities or suspension of the power of alienation of the title to property, any other existing law against perpetuities, or any law restricting or limiting the duration of trusts shall apply with respect to any interest in real or personal property held in trust if both of the following apply: (a) The instrument creating the trust specifically states that the rule against perpetuities . . . shall not apply to the trust . . . (b) The trustee has unlimited power, or one or more persons have the unlimited power to direct the trustee or to approve the trustee's decision, either to sell all trust assets or to terminate the entire trust.²⁰⁴

Therefore, because there is no RAP period, there is no vesting period.²⁰⁵ Thus, there are no Delaware Tax Trap issues.²⁰⁶ Mrs. Brady would be liable for whatever trust assets she has for tax purposes.²⁰⁷ If Ohio allows for decanting, then Marcia would not be able to use it to skip tax liabilities.²⁰⁸ The Delaware Tax Trap cannot be triggered in this state.²⁰⁹

198. *Id.*; see *The Brady Bunch*, *supra* note 1.

199. FLA. § 736.04117; see *The Brady Bunch*, *supra* note 1.

200. OHIO REV. CODE ANN. § 2131.09 (West 2012).

201. See M. Patricia Culler, "Opting" Out From the Rule Against Perpetuities in Ohio: Nine Years Later, 18 OHIO PROB. L.J. 145 (2008).

202. *Id.*

203. *Id.*

204. OHIO § 2131.09.

205. See Culler, *supra* note 201.

206. See *id.*; see OHIO § 2131.09.

207. OHIO § 2131.09; see *The Brady Bunch*, *supra* note 1.

208. OHIO § 2131.09; see *The Brady Bunch*, *supra* note 1.

209. OHIO § 2131.09; see *The Brady Bunch*, *supra* note 1.

IV. THE SOLUTION

A. *The Statute*

The main issue with the Texas statute is the lack of clarity.²¹⁰ Therefore, this article proposes a statutory solution that clarifies the trust code to prevent forms of tax skipping such as the Delaware Tax Trap.²¹¹ The decanting statutes and trusts language is easy to manipulate.²¹² Thus, the implementation of specific language would allow the modification of a trust into the statute.²¹³

This modification will fall under the same subsection of the other tax-related limitations as Sections 112.086(b) and should read:

An authorized donee, or any individual granted with special power of appointment, may not distribute the principle of a trust under section 112.072 or 112.073 in a manner that would prevent a contribution to that trust qualifying for or that would reduce the exclusion, education, or other federal tax liabilities that was originally claimed for that contribution, including:

- (1) decanting statutes in relation to estate taxes under Section 2041(a)(3)
- (2) decanting statutes in relation to gift taxes under Section 2514(d).²¹⁴

This new language clarifies the statute, initially, by using appropriate language.²¹⁵ There is a distinct difference between a trustee and donee.²¹⁶ They also have different powers and different responsibilities.²¹⁷ Thus, this new language clarifies to estate planners that this section applies to special power of appointment relationships triggered under decanting.²¹⁸

Second, this new section clarifies that this statute applies to both deductions and benefits of taxes.²¹⁹ The language of the original tax limitation applies more to tax benefits that apply to every trust situation.²²⁰ Only the last section applies to other tax limitations.²²¹ This new language clarifies the tax situation issues.²²²

210. TEX. PROP. CODE ANN. § 112.086 (West 2015).

211. *See infra* Section IV.A.

212. *See infra* Section IV.A.

213. *See infra* Section IV.A.

214. *See* Willms, *supra* note 9.

215. *See id.*

216. *See id.*

217. *See id.*

218. *See id.*

219. *See* TEX. PROP. CODE ANN. § 112.086 (West 2015).

220. *See id.*

221. *See id.*

222. *See id.*

Third, the language applies directly to the Delaware Tax Trap.²²³ This direct application prevents the issue completely because statutory text specifically prevents it.²²⁴ One of the pivotal issues of the Delaware Tax Trap is the lack of statutory prevention.²²⁵ Thus, the Texas statute paves the way for other states to directly prevent the Delaware Tax Trap as well.²²⁶

Once this law is applied to the Brady family, they are unable to use the Delaware Tax Trap to their advantage.²²⁷ The statute is similar to the Delaware approach because it requires a trust to vest for tax purposes with the first power.²²⁸ Thus, during Mrs. Brady's lifetime the trust vests, which requires tax payments.²²⁹ Marcia can still be a second power and create a new trust.²³⁰ This is beneficial because no one down the road is stuck with tax consequences.²³¹

B. The Trust Itself

Another way to eliminate any issues with the Delaware Tax Trap is to amend the actual language of the trust.²³² Estate planners could implement model form language into trusts directly eliminating the Delaware Tax Trap.²³³ This prevents confusion, prevents complicating the purpose of trusts, and prevents triggering the trap.²³⁴

The taxes discussed are general taxes applicable to wills and trusts.²³⁵ This includes gift and estate taxes.²³⁶ A form language example for decanting trust is: "The beneficiary shall have a special power . . . to direct the trustee to distribute all or any part of the property . . . to any one or more of my lineal descendants, *in trust or otherwise*, as the beneficiary shall choose."²³⁷ This language implements the special power, which allows for decanting.²³⁸

For the purpose of this example, there is not language discussing tax language pertaining to the Delaware Tax Trap.²³⁹ A plain reading of the

223. See Culp & Mellen, *supra* note 106.

224. See *id.*

225. See *id.*

226. See *id.*

227. See *id.*; see *The Brady Bunch*, *supra* note 1.

228. DEL. CODE ANN. tit. 25, § 504 (2014); see *The Brady Bunch*, *supra* note 1.

229. DEL. tit. 25, § 504; see *The Brady Bunch*, *supra* note 1.

230. DEL. tit. 25, § 504; see *The Brady Bunch*, *supra* note 1.

231. DEL. tit. 25, § 504; see *The Brady Bunch*, *supra* note 1.

232. See DONALD J. MALOUF ET AL., 11 West's Legal Forms, Estate Planning § 11.7 (3d ed. 2014).

233. Benjamin H. Pruett, *Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective*, 35 AM. C. OF TR. & EST. PLANN. 331, 337–38 (2010).

234. See *id.*

235. See Blattmachr & Slade, *supra* note 17.

236. See *id.*

237. See Pruett, *supra* note 233.

238. See *id.*

239. See *id.*

above stated language allows for the creation of new trusts.²⁴⁰ The issue is that no language discusses vesting.²⁴¹ Assuming there is no statutory language speaking directly to when a decanting trust vests, this trust could trigger the Delaware Tax Trap.²⁴²

This trust tax section is a form of Bypass trust, which is similar to a decanting statute, in which the donee holds special power of appointment.²⁴³ This is similar to Mr. Brady's situation.²⁴⁴ He would, as the donor under this trust agreement, appoint Mrs. Brady as the donee, and Mrs. Brady would contain the special power of appointment in order for Marcia to take over the bypass trust.²⁴⁵

However, there is not language in this standard trust agreement regarding the second trust's tax liabilities.²⁴⁶ Thus, new language will make sure no avoidance of tax liabilities occurs through situations like the Delaware Tax Trap.²⁴⁷ This language should be very easy to implement because it is a clarification of other tax responsibilities.²⁴⁸ For example, possible language that the drafter could implement into a similar trust agreement is:

A trust allowing for a special power of appointment shall vest in the first power of appointment.²⁴⁹

This language implements the Delaware fix to the trap.²⁵⁰ This language requires the trust to vest with the first power.²⁵¹ This is effective because it is a simple and short fix.²⁵² Another possible trust fix is addressing the tax liabilities so that there is no confusion on the requirements of taxes paid.²⁵³

Possible language that the drafter could implement addressing tax liabilities is:

A trust granting a special power of appointment in a trustee, which is exercised, shall apply to current tax requirements including gift and estate taxes.²⁵⁴ Further, if the trust allows a First Power of Appointment to create

240. *See id.*

241. *See id.*

242. *See id.*

243. HENRY J. LISCHER, JR. ET AL., 16A West's Legal Forms, Estate Planning § 11.36 (2015).

244. *Id.*; *See The Brady Bunch*, *supra* note 1.

245. *See LISCHER*, *supra* note 243; *see The Brady Bunch*, *supra* note 1.

246. *See LISCHER*, *supra* note 243.

247. *See id.*

248. *See id.*

249. DEL. CODE ANN. tit. 25, § 504 (2014).

250. *Id.*

251. *Id.*

252. *Id.*

253. *Id.*

254. *See LISCHER*, *supra* note 243.

a new trust or a pour over trust, which second trust shall apply to all state and federal gift, estate and Internal Revenue Code of 1986.²⁵⁵

Because none of these terms are defined in this standard trust agreement, drafters need to add these terms to the standard definition section.²⁵⁶ The pertinent definitions include:

Special power of appointment—generally, this power is characterized as the ability to appoint property to a new owner. This power does not include a personal property right to said property.²⁵⁷

Second power of appointment—a second power created in the trust by the individual holding the special power of appointment. The second power shall have the ability to create a new trust if state law allows.²⁵⁸

Second trust—A new trust created out of the original trust that is updated to modern laws. This is created by the second power of appointment.²⁵⁹

Pour-over trust—When an old trust is “poured-over” into a new trust so that modern trust laws apply.²⁶⁰

C. Why

There are two solutions for this problem.²⁶¹ These solutions will allow both the actual statutory law and binding trusts to solve the problems leaving no room for mistakes in the future.²⁶² This should prevent litigation and give clear legal guidance if litigation occurs.²⁶³ Hopefully, no issues will arise as drafters create decanting trusts.²⁶⁴ The Delaware Tax Trap will not trigger because the trusts are subject to all tax liabilities.²⁶⁵

V. CONCLUSION

Oliver Wendell Holmes, Jr. once said: “Taxes are what we pay for a civilized society.”²⁶⁶ They are mandated under the United States Constitution so we must pay them.²⁶⁷ The purpose of this article is to demonstrate the

255. *See id.*

256. *See id.*

257. *See* BEYER, *supra* note 33.

258. *See id.*

259. *See id.*

260. *See id.*

261. *Supra* Sections III.A–B.

262. *Supra* Sections III.A–B.

263. *Supra* Sections III.A–B.

264. *Supra* Sections III.A–B.

265. *Supra* Sections III.A–B.

266. Internal Revenue Service, *Tax Quotes*, (Jan. 22, 2016, 2:24 pm), *quoting* Oliver Wendell Holmes, Jr., <https://www.irs.gov/uac/Tax-Quotes> [<https://perma.cc/7C92-D8MU>].

267. U.S. CONST. art. I, § 2.

problems that occur when decanting statutes trigger the Delaware Tax Trap.²⁶⁸

Decanting statutes serve a useful purpose.²⁶⁹ They allow individuals to update outdated trusts with modern trust laws.²⁷⁰ They further enable individuals with the power of appointment to appoint another power.²⁷¹ These powers are very specific and very important.²⁷² The Delaware Tax Trap occurs when certain tax liabilities are delayed.²⁷³ This is reflected in the Rule Against Perpetuities.²⁷⁴ When both are present an individual avoids certain tax liabilities because the property never vests.²⁷⁵ This is the Trap.²⁷⁶

This comment's solution to the Delaware Tax Trap came in two parts.²⁷⁷ First, a statutory solution that prevents avoiding any tax liabilities by requiring a second trust that is subject to all tax liabilities in the Internal Revenue Code.²⁷⁸ Second, implementing trust language that prevents triggering the Delaware Tax Trap.²⁷⁹

It also depends heavily on the estate planner's ability to recognize and look for the Trap.²⁸⁰ However, Mr. Brady, as a member of a civilized society, needs to make sure his trust is adequate.²⁸¹ This is for his protection and his family's protection.²⁸² Now, Marcia has two ways to prevent springing the Delaware Tax Trap.²⁸³ This prevents anyone from having gift and estate tax liabilities down the road.²⁸⁴ She can now handle the trust assets in a proper manner and keep singing "that's the way we became the Brady bunch."²⁸⁵

268. *Supra* Section I.B.

269. *See* Willms, *supra* note 9.

270. *See id.*

271. *See id.*

272. *See id.*

273. *See* GORDON ET AL, *supra* note 11, at 1.

274. *See id.*

275. *See id.*

276. *See id.*

277. *Supra* Part III.

278. *Supra* Section III.A.

279. *Supra* Section III.B.

280. *Supra* Part III.

281. *Supra* Part IV; *see The Brady Bunch*, *supra* note 1.

282. *Supra* Part IV; *see The Brady Bunch*, *supra* note 1.

283. *Supra* Part IV; *see The Brady Bunch*, *supra* note 1.

284. *Supra* Part IV; *see The Brady Bunch*, *supra* note 1.

285. *See The Brady Bunch*, *supra* note 1.