386B.13-180 Tax-related limitations.

(1) As used in this section:

(a) "Grantor trust" means a trust as to which a settlor of a first trust is considered the owner under 26 U.S.C. secs. 671 to 677, as amended, or 26 U.S.C. sec. 679, as amended;

(b) "Internal Revenue Code" means the United States Internal Revenue Code of 1986, as amended;

(c) "Nongrantor trust" means a trust that is not a grantor trust; and

(d) "Qualified benefits property" means property subject to the minimum distribution requirements of 26 U.S.C. sec. 401(a)(9), as amended, and any applicable regulations, or to any similar requirements that refer to 26 U.S.C. sec. 401(a)(9) or the regulations.

(2) An exercise of the decanting power is subject to the following limitations:

(a) If a first trust contains property that qualified, or would have qualified but for provisions of KRS 386B.13-010 to 386B.13-280 other than this section, for a marital deduction for purposes of the gift or estate tax under the Internal Revenue Code or a state gift, estate, or inheritance tax, the second-trust instrument shall not include or omit any term that, if included in or omitted from the trust instrument for the trust to which the property was transferred, would have prevented the transfer from qualifying for the deduction, or would have reduced the amount of the deduction, under the same provisions of the Internal Revenue Code or state law under which the transfer qualified;

(b) If the first trust contains property that qualified, or would have qualified but for provisions of KRS 386B.13-010 to 386B.13-280 other than this section, for a charitable deduction for purposes of the income, gift, or estate tax under the Internal Revenue Code or a state income, gift, estate, or inheritance tax, the second-trust instrument shall not include or omit any term that, if included from or omitted from the trust instrument for the trust to which the property was transferred, would have prevented the transfer from qualifying for the deduction, or would have reduced the amount of the deduction, under the same provisions of the Internal Revenue Code or state law under which the transfer qualified;

(c) If the first trust contains property that qualified, or would have qualified but for provisions of KRS 386B.13-010 to 386B.13-280 other than this section, for the exclusion from the gift tax described in:

1. 26 U.S.C. sec. 2503(b), as amended, the second-trust instrument shall not include or omit a term that, if included in or omitted from the trust instrument for the trust to which the property was transferred, would have prevented the transfer from qualifying under 26 U.S.C. sec. 2503(b), as amended; or

2. 26 U.S.C. sec. 2503(c), as amended, the second-trust instrument shall not include or omit a term that, if included in or omitted from the trust instrument for the trust to which the property was transferred, would have prevented the transfer from qualifying under 26 U.S.C. sec.

2503(c), as amended;

(d) If the property of the first trust includes shares of stock in an S corporation as defined in 26 U.S.C. sec. 1361, as amended, and the first trust is, or but for provisions of KRS 386B.13-010 to 386B.13-280 other than this section would be, a permitted shareholder under any provision of 26 U.S.C. sec. 1361, as amended, an authorized fiduciary may exercise the power with respect to part of all the S corporation stock only if any second trust receiving the stock is a permitted shareholder under 26 U.S.C. sec. 1361(c)(2), as amended. If the property of the first trust includes shares of stock in an S corporation and the first trust is, or but for provisions of KRS 386B.13-010 to 386B.13-280 other than this section would be, a qualified subchapter S trust within the meaning of 26 U.S.C. sec. 1361(d), as amended, the second-trust instrument shall not include or omit a term that prevents the second trust from qualifying as a qualified subchapter S trust;

(e) If the first trust contains property that qualified, or would have qualified but for provisions of KRS 386B.13-010 to 386B.13-280 other than this section, for a zero inclusion ratio for purposes of the generation-skipping transfer tax under 26 U.S.C. sec. 2642(c), as amended, the second-trust instrument shall not include or omit a term that, if included in or omitted from the first-trust instrument, would have prevented the transfer to the first trust from qualifying for a zero inclusion ratio under 26 U.S.C. sec. 2642(c), as amended;

(f) If the first trust is directly or indirectly the beneficiary of qualified benefits property, the second-trust instrument shall not include or omit any term that, if included in or omitted from the first-trust instrument, would have increased the minimum distributions required with respect to the qualified benefits property under 26 U.S.C. sec. 401(a)(9), as amended, and any applicable regulations, or any similar requirements that refer to 26 U.S.C. sec. 401(a)(9), as amended, or the regulations. If an attempted exercise of the decanting power violates the preceding sentence, the trustee is deemed to have held the qualified benefits property and any reinvested distributions of the property as a separate share from the date of the exercise of the power, and KRS 386B.13-210 applies to the separate share;

(g) If the first trust qualifies as a grantor trust because of the application of 26 U.S.C. sec. 672(f)(2)(A), as amended, the second trust shall not include or omit a term that, if included in or omitted from the first-trust instrument, would have prevented the first trust from qualifying under 26 U.S.C. sec. 672(f)(2)(A), as amended;

(h) As used in this paragraph, "tax benefit" means a federal or state tax deduction, exemption, exclusion, or other benefit not otherwise listed in this section, except for a benefit arising from being a grantor trust. Subject to paragraph (i) of this subsection, a second-trust instrument shall not include or omit a term that, if included in or omitted from the first-trust instrument, would have prevented qualification for a tax benefit if:

1. The first-trust instrument expressly indicates an intent to qualify for the benefit or the first-trust instrument clearly is designed to enable the first

trust to qualify for the benefit; and

2. The transfer of property held by the first trust or the first trust qualified, or but for the provisions of KRS 386B.13-010 to 386B.13-280 other than this section, would have qualified for the tax benefit;

(i) Subject to paragraph (d) of this subsection:

1. Except as otherwise provided in paragraph (g) of this subsection, the second trust may be a nongrantor trust, even if the first trust is a grantor trust; and

2. Except as otherwise provided in paragraph (j) of this subsection, the second trust may be a grantor trust, even if the first trust is a nongrantor trust; and

(j) An authorized fiduciary may not exercise the decanting power if a settlor objects in a signed record delivered to the fiduciary within the notice period and:

1. The first trust and a second trust are both grantor trusts, in whole or in part, the first trust grants the settlor or another person the power to cause the first trust to cease to be a grantor trust, and the second trust does not grant an equivalent power to the settlor or other person; or

2. The first trust is a nongrantor trust and a second trust is a grantor trust, in whole or in part, with respect to the settlor, unless:

a. The settlor has the power at all times to cause the second trust to cease to be a grantor trust; or

b. The first-trust instrument contains a provision granting the settlor or another person a power that would cause the first trust to cease to be a grantor trust and the second-trust instrument contains the same provision.

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