

## Trust Decanting In New York

By Joseph T. La Ferlita

In the relatively static world of New York trust law, few topics, if any, have sparked as much debate in the last few years as has trust decanting. Interestingly, the debate has been passionate among some of the more seasoned Trusts and Estates practitioners.

One possible explanation for this is that decanting is understood by some as violating one of the basic, fundamental premises on which the Trusts and Estates practice is built: that of safe-guarding, implementing, and enforcing the grantor's intent, which, in our world, and in the view of American common law, is sacred. In other words, some see decanting as an end run around long-established precedent concerning the irrevocability of trusts and the centrality of the grantor's intent. However, not every seasoned practitioner shares this view.

First, let us be clear on what a trust decanting is. Interestingly, one will not find the word "decanting" in the New York statute that authorizes decanting. "Decanting" is an informal, colloquial reference to the authorization of a trustee to distribute the assets constituting the corpus of one, not to the beneficiary of the trust outright, but rather to a different, separate trust for the benefit of the same beneficiary. Just as one decants wine from the old bottle to a new bottle, a trustee can decant trust assets from an old trust to a new trust.

Decanting arguably is rooted in the common law of certain jurisdictions. The seminal case is *Phipps v. Palm Beach Trust Company*.<sup>1</sup> Other notable cases are *Wiedenmayer v. Johnson* and *Matter of Spencer*.<sup>2</sup>

About 22 states have codified their own version of trust decanting. New York was the first to do so. The New York decanting statute is found in EPTL 10-6.6 (b)-(t). It is worth noting that the enactment of the first

decanting statute was originally related to allowing certain irrevocable trusts to remain grandfathered from the Generation Skipping Transfer tax laws, but practitioners soon realized that decanting offered numerous non-GST tax opportunities, not the least of which was effectuating a trust modification.

The power of decanting is rooted in the fact that it allows one to take assets that are subject to the terms and conditions of one trust and move them to another trust that has different

terms and conditions, possibly without the beneficiaries' consent and court approval. For this reason, many practitioners rightly characterize decanting as one of the most powerful tools to have ever emerged in estate planning and trust administration.

One best appreciates the power of decanting when considering that, in New York, it can be very difficult, and sometimes impossible, to amend the terms of an irrevocable trust. That can be problematic because, while irrevocable trust instruments cannot change, life changes. Circumstances change. Beneficiaries change. Tax law changes. The problem, stated simply, is whether the irrevocable trust, even if well suited to the situation that had existed at the time of the trust's creation, is now, years later, still well suited to the situation in which the trustees and beneficiaries find themselves.

As more trustees attempt to jump onto the decanting bandwagon, they, and the attorneys advising them, should keep in mind at least four basic aspects of New York's decanting statute.

First, not every trustee is allowed to decant. The statute allows only "authorized trustees" to decant, who are defined as trustees "other than (i) the creator, or (ii) a beneficiary to whom income or principal must be paid currently or in the future, or who is or will become eligible to receive a distribution of income or principal in the discretion of the trustee (other than by the exercise of a power of appointment held in a non-fiduciary capacity)."<sup>3</sup>

Second, even an authorized trustee has "a fiduciary duty to exercise the power in the best interests of one or more proper objects of the exercise of the power and as a prudent person would exercise the power under the prevailing circumstances."<sup>4</sup> In other words, the decanting statute does not give a trustee a license to act in bad faith. This point is relevant in light of other portions of New York's statute, which make clear that the very act of decanting is subject to an objection in an accounting proceeding.<sup>5</sup>

Third, not even an authorized trustee is empowered to decant "if there is substantial evidence of a contrary intent of the creator



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and it cannot be established that the creator would be likely to have changed such intention under the circumstances existing at the time of the exercise of the power."<sup>6</sup> The statute makes clear that the mere existence in the invaded trust of a provision that it is irrevocable, or of a spend-thrift clause, does not constitute such substantial evidence.<sup>7</sup>

Finally, and perhaps most significantly, the statute requires authorized trustees to consider

the tax consequences that would flow from a decanting.<sup>8</sup> Unfortunately, there are many open income, gift, estate, and GST tax issues, as there is not much guidance yet. In 2011, the IRS issued Notice 2011-101, which requested comments on a variety of such tax issues. Many bar associations, including the New York State Bar Association and the American Bar Association, have responded with very detailed comments to such issues, which practitioners would be well served to review. Unfortunately, to date, the IRS has not issued regulations addressing the issues raised in Notice 2011-101. Until then, trustees should proceed with caution by thoroughly considering the tax consequences of decanting.

Trust decanting has been the subject of great debate in recent years. In that regard, it will be interesting to see how the law affecting decanting develops as time moves forward.

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1. *Phipps v. Palm Beach Trust Company*, 142 Fla. 782 (1940).

2. *Wiedenmayer v. Johnson*, 254 A.2d 534 (N.J. Super. Ct. App. Div. 1969); *Matter of Spencer*, 232 N.W.2d 491 (Iowa 1975).

3. EPTL § 10-6.6(s)(2).

4. EPTL § 10-6.6(h).

5. See, e.g., EPTL § 10-6.6(j)(5).

6. EPTL § 10-6.6(h).

7. *Id.*

8. EPTL 10-6.6(o).

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