

New York's Newly Amended Decanting Statute

By Joseph T. La Ferlita

On August 17, 2011, Governor Cuomo signed into law Assembly Bill A8297, which substantially modified Section 10-6.6 of the New York Estates, Powers & Trusts Law (EPTL), otherwise known as the "decanting" statute. The decanting reference is based on the imagery of decanting wine (here, trust assets) from one bottle (the old or "invaded" trust) to another bottle (the new or "appointed" trust). The power of a trustee to decant depends on the trustee's authority to invade and distribute the principal of an irrevocable trust to or for the benefit of a beneficiary. Since decanting can be of enormous benefit to trustees and beneficiaries, trusts and estates practitioners would be well served to familiarize themselves with the revised statute in order to better advise their clients. This article discusses the basic principles of decanting and highlights key differences between New York's former and revised decanting statutes.



I. A Brief History and Some Basic Principles of Trust Decanting

A trust decanting involves a trustee's exercise of a power to invade the principal of an irrevocable trust by paying over some or all of the principal to a separate trust. It is rooted not in a power to amend the invaded trust, but rather in the trustee's limited power of appointment over it. This limited power of appointment is usually not expressed in the trust instrument as a power of appointment *per se*, but rather is part of the trustee's discretion to invade and distribute trust principal.

New York State was a pioneer in the decanting area, having enacted the nation's first decanting statute in 1992. The principal purpose of the statute was to allow certain trusts to enjoy continued exemption from the federal generation-skipping transfer (GST) tax, which was enacted as part of the Tax Reform Act of 1986. As originally enacted, Section 10-6.6 required a trustee to obtain either court approval or the beneficiaries' consent in order to decant. This requirement was stricken from the statute in 2001, a year after the Treasury Department issued regulations indicating that the requirement would disallow continued exemption from the GST tax. Thus, after the 2001 amendment,

decanting in New York became fully discretionary for trustees of certain trusts (as discussed below), although the statute preserved the ability of a trustee to seek either the beneficiaries' consent or the court's permission if the trustee saw fit to do so.

Sophisticated trusts and estates practitioners quickly realized that decanting also offered a multitude of non-GST-related opportunities, particularly by allowing greater flexibility in administering an otherwise irrevocable trust. For example, if an irrevocable trust's administrative provisions, such as those governing the appointment of successor trustees, became impractical due to changed circumstances, a trustee could decant to an appointed trust containing provisions better suited to the new circumstances. Another opportunity might arise if, after a trust's creation, a beneficiary became eligible for governmental assistance. In that event, a trustee could decant to a supplemental needs trust and thus protect the trust's assets from the government's reach. The former statute could also allow a trustee to reduce a trust's New York State income tax exposure by decanting some or all of the trust's assets to another trust not considered a New York resident trust.

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Regardless of the many reasons for decanting, some practitioners asked whether the statute gave trustees too much discretion. The concern was that decanting created a tension between the goals of promoting greater efficiency and/or flexibility in trust administration, on the one hand, and of fulfilling the settlor's intent, on the other. In an attempt to balance the two potentially competing goals, key safeguards were built into the revised statute, which are highlighted below.

II. Former Section 10-6.6

Under the former EPTL 10-6.6, a trustee of an irrevocable lifetime trust or testamentary trust could appoint some or all of the principal to a separate trust as long as: (1) the invaded trust gave the trustee absolute discretion to invade principal, unfettered by any ascertainable or non-ascertainable standard; (2) the

decanting did not reduce any fixed income interest in the invaded trust; (3) the decanting was in favor of “the proper objects of the exercise of the power” to invade; and (4) the appointed trust did not violate the limitations of EPTL 11-1.7 (prohibiting, among other things, a trustee’s exoneration from liability for failing to exercise reasonable care, diligence and prudence).

Procedurally, the former statute required the decanting to be by a written instrument, signed and acknowledged by the trustee and filed in the office of the clerk “of the court having jurisdiction over the trust.” The trustee was required to serve a copy of the decanting instrument on all persons interested in the trust¹ by registered or certified mail, return receipt required, by personal delivery or by any other manner directed by the court.

In practice, the statute left many practitioners unsure about the scope of a trustee’s power to decant. For example, who are the “proper objects” of a decanting? Could an appointed trust exclude some of the beneficiaries of the invaded trust? Could an appointed trust have beneficiaries who were not beneficiaries of the invaded trust? Did the statute permit the appointed trust’s term to extend beyond that of the invaded trust? Could a trustee be found liable for failing to decant?

In part because of these types of questions, and the fact that other states had adopted their own, more liberal decanting statutes, some New York trusts and estates practitioners called for revisions to EPTL 10-6.6.

III. The Newly Amended Decanting Statute

The newly amended decanting statute, which took effect immediately and applies retroactively, answers many of the questions raised by the former statute. As with the former statute, its terms apply unless the trust instrument provides otherwise.

When approaching the rather lengthy amended rules for the first time, it is helpful to divide them conceptually into three categories: (i) rules that apply when trustees have unlimited discretion to invade;² (ii) rules that apply when trustees do not have unlimited discretion; and (iii) rules that apply in either case.³

Rules Applicable When Trustees Have Unlimited Discretion

The amended statute provides more guidance for trustees with unlimited discretion to invade principal in favor of one or more “current beneficiaries.”⁴ For example, it explicitly allows trustees to decant in favor of one, more than one or all current beneficiaries, to the possible exclusion of the other current beneficiaries, and the appointed trust may benefit one, more than one or all of the successor and remainder beneficiaries, to the possible exclusion of the other successor and remainder beneficiaries.⁵

The amended statute explicitly permits trustees to grant to one, more than one or all current beneficiaries, to the possible exclusion of one or more current beneficiaries, a discretionary power of appointment if the beneficiaries could receive principal outright under the terms of the invaded trust.⁶ Also, if the beneficiaries of the invaded trust are described as a class (e.g., the settlor’s children), then the beneficiaries of the appointed trust may include present or future members of such class (e.g., children born to the settlor after the invaded trust’s creation).⁷

Rules Applicable When Trustees Have Limited Discretion

One of the key differences between the former and amended statutes is the new ability to decant even when trustees do not have unlimited discretion to invade principal.⁸ However, different, and more restrictive, rules apply in this case. Most importantly, the appointed trust must have the same current beneficiaries, and successor and remainder beneficiaries, as the invaded trust.⁹ Thus, if the trustee of an invaded trust is permitted to distribute principal to A or B for their health, education, maintenance and support (known as the “HEMS standard”) for so long as A and B are alive, with the remainder going outright to C, the appointed trust must have A and B as current beneficiaries and C as a remainder beneficiary.

Another key rule requires the appointed trust to contain the same distribution standard as did the invaded trust.¹⁰ Thus, using the facts of the previous example, the appointed trust must contain the HEMS standard for distributions to A and B and may not, for example, grant the trustee the additional authority to distribute to A for A’s “happiness.”

If the appointed trust has a longer term than that of the invaded trust (the power to extend the trust’s term is discussed below), the appointed trust must contain the same standard regarding distributions as the invaded trust during the invaded trust’s original term.¹¹ Thereafter, the standard can be different. For example, assume that the invaded trust permits the trustee to distribute to A for A’s health, education, maintenance or support until A reaches age 35, when the trust must terminate and its remainder be distributed to A. In this case, distributions from the appointed trust must be subject to a HEMS standard until A reaches age 35. After that time, the trustee of the appointed trust may have absolute discretion to invade principal for A’s benefit.

Similarly, if the invaded trust grants a power of appointment to a beneficiary, the appointed trust must grant the identical power of appointment to the beneficiary, and the class of permissible appointees of such power must be the same.¹²

Finally, if the beneficiaries of an invaded trust are described as a class, the beneficiaries of the appointed trust must include all “present or future members of such class.”¹³

Select Rules Applicable Regardless of the Trustees’ Discretion

A number of provisions of the amended statute apply whether or not the trustee has unlimited discretion. Perhaps the most notable of these explicitly allows the appointed trust to have a longer term than that of the invaded trust.¹⁴ For example, if an invaded trust must terminate and its remaining principal be distributed to A when A reaches age 35, the appointed trust’s term may continue for A’s lifetime or longer. Thus, despite the terms of the invaded trust, it is possible that A will never receive an outright distribution of the appointed trust’s principal.

The Legislature was not unmindful of the discretion the new rules confer on trustees. As a result, it included a number of provisions designed to prevent abuse and safeguard the settlor’s intent. For example, the amended statute:

- Explicitly imposes on the trustee a fiduciary duty to decant in the best interests “of one or more proper objects” of the power to invade as a prudent person would under the prevailing circumstances.¹⁵
- Prohibits a decanting if there is “substantial evidence of a contrary intent of the creator and it could not 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.”¹⁶ Little guidance is given as to what constitutes “substantial evidence” of a contrary intent except that the terms of the invaded trust, alone, do not constitute substantial evidence.¹⁷ Thus, it seems likely that the courts will be called upon to clarify its meaning.
- Requires trustees not only to give notice of the decanting but also to provide copies of the invaded and appointed trust instruments to (i) all “persons interested in the invaded trust”¹⁸ and the appointed trust, (ii) the settlor, if living, and (iii) “any person having the right, pursuant to the terms of the invaded trust, to remove or replace” the trustee exercising the decanting power.¹⁹
- Requires the filing of the original decanting instrument with the court having jurisdiction over any invaded trust other than a lifetime trust that has never been the subject of a proceeding in the Surrogate’s Court.²⁰ Notably absent is any

requirement to file copies of the invaded or appointed trusts with the court.

- Postpones the effective date of the decanting until thirty days after the completion of service of notice of the decanting²¹ and authorizes interested persons to serve the trustees with written notice of objection to the decanting prior to its effective date, although the failure to object does not constitute consent.²² This thirty-day period also provides interested persons with the opportunity to seek a judicial stay of the decanting and/or to compel the trustees to account for their decision to decant.
- States that an interested person’s receipt of the decanting instrument does not affect the person’s right to (i) compel the trustees to account specifically for the decision to decant, (ii) compel the trustees to account generally or (iii) file objections to the trustees’ account.
- Requires the decanting instrument to explicitly state whether the decanting comprises some or all of the invaded trust’s assets and, in the former case, imposes an additional duty to state the “approximate percentage of the value of the principal of the invaded trust that is subject to” the decanting.²³ Moreover, if the decanting comprises all of the invaded trust’s assets, any subsequently discovered assets and principal paid to or acquired by the invaded trust after the decanting belongs to the appointed trust.²⁴ If the decanting comprises only some of the invaded trust’s assets, then such after-acquired property belongs to the invaded trust.²⁵
- Requires trustees to consider the tax implications of the decanting.²⁶ Note that, with certain explicit exceptions,²⁷ trustees can decant even if the decanting has a negative tax result. Trustees will be shielded from liability in this case only if they can show that the decision to decant was prudent in light of the “prevailing circumstances.”²⁸ For example, if decanting Subchapter S stock from the invaded trust to an appointed trust would cause a termination of the company’s Subchapter S election but, at the same time, result in a more valuable reduction of the trust’s New York State income tax exposure, the decanting might be appropriate. Of course, the trustees may be called on to account for such a decision in a judicial accounting proceeding.²⁹
- Prohibits any change to trustee commissions absent a court order.³⁰

There are other important generally applicable provisions. One expressly allows trustees to decant in favor of a supplemental needs trust, provided that all of the section's other requirements are satisfied.³¹ Another confirms a trustee's authority to decant even when there is not a current need to invade principal.³²

IV. Some Questions Raised by the Amended Statute

The amended statute raises some interesting questions, especially concerning the interplay between the new notice provisions and the right to object to a decanting. For instance, would an objection to a proposed decanting, duly served on the trustees by an interested person, prevent the decanting from becoming effective at the end of the thirty-day notice period? Since the statute explicitly states that the consent of interested persons is not required,³³ an objection arguably would not prevent the decanting. But, if it does not prevent the decanting, what effect would an objection have? Perhaps nothing more than putting the trustees on notice that an interested person is likely either to seek a judicial stay of the decanting or to hold the trustees liable for their decision to decant. An important question is whether service of an objection, or the failure to object, starts the running of the statute of limitations, especially given the statute's provisions that (i) failure to object does not constitute consent³⁴ and (ii) receipt of notice of a decanting does not affect an interested person's right to compel the trustees to account for the decanting or foreclose an interested person from objecting to an account or compelling a trustee to account.³⁵ In particular, is the act of decanting the functional equivalent of the trustees' open repudiation of their obligation to account, or does the act bring to an end the invaded trust relationship, thus triggering the running of the statute of limitations?³⁶

Also, what effect would the settlor's objection have, assuming he is not deemed a person interested in the invaded trust? It seems reasonable to conclude that such an objection might constitute "substantial evidence of a contrary intent of the creator" and thus could divest the trustees of the authority to decant.³⁷ Moreover, it should be noted that while the settlor is entitled to notice of the decanting, the settlor is not necessarily part of the class of interested persons who can serve objections to the decanting.³⁸ Perhaps the reason for this discrepancy is to ensure that the settlor is not deemed by the taxing authorities to have a retained power over the trust, thus minimizing any potential estate tax inclusion under Section 2036 of the Internal Revenue Code.

It remains to be seen how the courts will resolve these issues.

V. Conclusion

The recent amendment to EPTL 10-6.6 addresses many unanswered questions raised by the former statute and promotes greater flexibility in trust administration without losing sight of the settlor's intent.

Endnotes

1. "All persons interested in the trust" was defined under the former statute as "all the persons upon whom service of process would be required in a proceeding for the judicial settlement of the account of the trustee, taking into account" N.Y. Surrogate's Court Procedure Act 315.
2. A newly defined term meaning "the unlimited right to distribute principal that is not modified in any manner." N.Y. Estates Powers & Trusts Law (EPTL) 10-6.6(s)(9). The definition further provides that "[a] power to pay principal that includes words such as best interests, welfare, comfort, or happiness shall not be considered a limitation or modification of the right to distribute principal." *Id.*
3. It should be noted that if a trustee of an invaded trust has unlimited discretion, and the same or another trustee also has a separate, limited power to invade principal, the trustee with absolute discretion is permitted to decant. EPTL 10-6.6(f).
4. A newly defined term meaning those to whom a trustee may currently distribute principal. EPTL 10-6.6(s)(4).
5. EPTL 10-6.6(b).
6. EPTL 10-6.6(b)(1).
7. EPTL 10-6.6(b)(4).
8. EPTL 10-6.6(c).
9. *Id.*
10. EPTL 10-6.6(c)(1).
11. EPTL 10-6.6(c)(2).
12. EPTL 10-6.6(c)(4).
13. EPTL 10-6.6(c)(3).
14. EPTL 10-6.6(e).
15. EPTL 10-10.6(h).
16. EPTL 10-10.6(h).
17. *Id.*
18. The definition of "interested persons" is essentially unchanged under the amended statute. *See* EPTL 10-6.6(s)(7).
19. EPTL 10-6.6(j)(2).
20. EPTL 10-6.6(j)(6).
21. EPTL 10-6.6(j).
22. EPTL 10-6.6(j)(4).
23. EPTL 10-6.6(j)(3).
24. EPTL 10-6.6(i)(1).
25. EPTL 10-6.6(i)(2).
26. EPTL 10-6.6(o).
27. *See, e.g.,* EPTL 10-6.6(n).

28. See EPTL 10-6.6(h).
29. See EPTL 10-6.6(j)(5).
30. EPTL 10-6.6(q).
31. EPTL 10-6.6(n)(1).
32. EPTL 10-6.6(g).
33. EPTL 10-6.6(j)(1).
34. EPTL 10-6.6(j)(4).
35. EPTL 10-6.6(j)(5).
36. See *Tydings v. Greenfield, Stein & Senior, LLP*, 11 NY3d 195 (2008) and *Matter of Barabash*, 31 NY2d 76 (1972).

37. EPTL 10-6.6(h).
38. See EPTL 10-6.6(j)(4).

Joseph T. La Ferlita is a counsel at Farrell Fritz, P.C., focusing his practice on estate planning and trust and estate administration. He is Chair of the Surrogates Court Committee of the Trusts and Estates Law Section and a member of the Estate and Trust Administration Committee.

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