

New York's Newly Amended Decanting Statute

TYPIFIES TREND TOWARD GREATER FLEXIBILITY

By Joseph T. La Ferlita

The last couple of years have seen a flurry of activity on the trust decanting front. Since 2010, at least three states have enacted decanting statutes for the first time and at least three states have amended their already-existing decanting statutes. At least five states have trust decanting legislation that has been, or may soon be, introduced in the legislative branch. Apparently, many states have taken notice of the potential utility—and business development opportunities—offered by flexible trust decanting statutes. Perhaps most indicative of the trend in this area is New York's recently amended statute.

This article will highlight some of these recent developments but will place particular emphasis on recent changes to the New York statute, which was the nation's first and, now, is among the nation's most progressive decanting statutes.

A Brief History and Some Basic Principles of Trust Decanting

The decanting reference is based on the imagery of decanting wine (here, trust assets) from one bottle (here, the old or "invaded" trust) to another bottle (here, the new or "appointed" trust). 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 in the form of the trustee's discretion to invade and distribute trust principal.

New York was a pioneer, having enacted the nation's first decanting statute in 1992, codified at N.Y. Est. Powers & Trusts Law § 10-6.6. The statute was part of an attempt to allow certain trusts (most generally, trusts that were irrevocable on or before September 25, 1985, provided that there

were no subsequent additions to the trusts) to enjoy continued exemption from the federal generation skipping transfer tax (GSTT), which had been put in place as part of the Tax Reform Act of 1986. It is not clear if this goal was accomplished. As originally enacted, N.Y. Est. Powers & Trusts Law § 10-6.6 required a trustee to obtain either court approval or the beneficiaries' consent to decant. In 2001, however, this requirement was removed from the statute after the Treasury Department in 2000 issued regulations indicating that the requirement would disallow continued exemption from the GSTT. Thus, after the 2001 amendment, decanting in New York became fully discretionary for trustees of certain trusts (discussed below), although the statute preserved the ability of a trustee to seek either the beneficiaries' consent or a court's permission if the trustee saw fit to do so. In addition, under Treasury regulations (Treas. Reg. § 26.2601-1(b)(4)(i)) adopted in 2000 relating to decanting and the grandfathering of trusts from the GSTT rules, a state decanting statute, by itself (that is, absent language in the grandfathered trust authorizing the decanting) generally could effectuate continued grandfathering only if such statute were in effect before September 25, 1985. As mentioned above, the New York decanting statute, which was the nation's first, was not enacted until 1992.

Notwithstanding the decanting statute's potential GSTT benefits, sophisticated trust and estate practitioners quickly realized that decanting also offered a multitude of non-GSTT opportunities. In essence, these opportunities allow greater flexibility in administering an otherwise irrevocable trust. For instance, if an irrevocable trust's administrative provisions, such as those governing the appointment of successor trustees, become impractical because of changed circumstances, a trustee may be able to decant to an appointed trust containing provisions that are better suited to the new circumstances. To take another example, suppose that, after a trust's creation, a beneficiary becomes eligible for governmental assistance. A trustee may be able to decant to an appointed supplemental needs trust and thus protect the trust's assets from the government's reach.

Joseph T. La Ferlita is counsel to Farrell Fritz, P.C., in Uniondale, New York.

Or take a third example: a trustee might reduce the trust's state income tax exposure by decanting some or all of the trust's assets to another trust that has as its situs a state that does not subject the trust to fiduciary income tax.

Regardless of the reason for decanting, some practitioners have asked whether the decanting power gives trustees too much discretion. The concern is that decanting creates a tension between the notions of promoting greater efficiency and flexibility in trust administration, on the one hand, and of fulfilling the settlor's intent, on the other.

In spite of these concerns, multiple states followed New York's lead by adopting their own decanting statutes. As of the writing of this article, 12 other states have adopted decanting statutes: Alaska (Alaska Stat. § 13.36.157), Arizona (Ariz. Rev. Stat. § 14-10819), Delaware (12 Del. Code Ann. § 3528), Florida (Fla. Stat. § 736.04117), Indiana (Ind. Code 30-4-3-36), Missouri (Mo. Rev. Stat. § 456.4-419), Nevada (Nev. Rev. Stat. § 163.556), New Hampshire (N.H. Rev. Stat. § 564-B:4-418), North Carolina (N.C. Gen. Stat. Ann. 36C-8-816.1), Ohio (Ohio. Rev. Code Ann. § 5808.18, effective Mar. 22, 2012), South Dakota (S.D. Laws §§ 55-2-15-55-2-21), and Tennessee (Tenn. Code Ann. § 35-15-816(b) (27)). Colorado, Illinois, Kentucky, Michigan, and Virginia are in various stages of considering proposed decanting legislation. Clearly, states are jumping on the decanting bandwagon.

Highlights of the Recent Changes in Six States

To ascertain trends among those states that have recently adopted or amended their decanting statutes, it is helpful to consider recent statutory enactments or amendments. Since 2010, Indiana, Ohio, and Missouri have enacted decanting statutes for the first time, while New York, Nevada, and Arizona have amended their existing statutes. A brief comparison of some key aspects of these statutes follows.

Whether Absolute Discretion Is Required

As will be discussed below, New York's original decanting statute authorized trustees to decant only if they had absolute discretion to invade principal. Interestingly, of the six recently enacted or amended statutes, only Indiana requires the trustee to have absolute discretion to invade the assets of a trust in order to decant. Ohio, New York (under its newly amended statute, discussed below), and Nevada allow decanting when the trustee has less than absolute discretion, but generally only if the beneficiaries of the appointed trust (or "second trust") are the same as those of the invaded trust (or "first trust"). Missouri and Arizona allow trustees with less than absolute discretion to decant without the need for the invaded trust and the appointed trust to have the same beneficiaries.

Whether Court Filing Is Required

New York's original decanting statute required, among other things, a court filing. Of the six states highlighted here, four have no filing requirement. Ohio requires a filing

only for decantings of testamentary trusts (for which the court's permission is also required). New York's amended statute, as will be discussed below, abolishes the filing requirement for inter vivos trusts that have not been the subject of a proceeding in the Surrogate's Court.

Whether Beneficiaries Must Be Given Notice

Four out of the six states mandate that the trustee provide some sort of advanced notice of the decanting before it takes effect. Indiana, Missouri, and New York require 60 days' notice. Nevada requires either notice or court approval of the decanting. Arizona is the only one of these states that has no notice requirement.

Whether Impropriety Can Be Inferred from Failure to Decant

Five out of the six states' statutes provide that a trustee's failure to decant does not give rise to an inference of impropriety. The Arizona statute is the only one that does not state as much.

Whether Trust Term Can Be Extended

None of the six statutes explicitly prohibits the extension of the trust's term. New York, however, stands alone in explicitly permitting extensions of the trust term under certain conditions discussed below.

Whether Both Trusts Must Have Same Beneficiaries

Three of the six states, Ohio, Missouri, and Nevada, do not explicitly require the beneficiaries of the decanted trust to be the same as those of the invaded trust. Indiana's and Arizona's statutes are unclear in this regard. Although Indiana requires the beneficiaries of the two trusts to be the same, it also permits a decanting in favor of one or more of such beneficiaries. The Arizona statute simply requires the decanting to be "in favor of the beneficiaries of the trust." Ariz. Rev. Stat. § 14-10819(A)(3). The New York statute is much clearer on this issue. As discussed below, the answer depends on the level of discretion conferred on the trustee of the invaded trust.

Whether Beneficiaries' Interests Must Be Identical

None of the six states explicitly requires the beneficial interests of the invaded and decanted trusts to be identical, except that, when a New York trustee with less than absolute discretion decants, the interests must be the same.

What Is the Trend?

For better or worse, decanting statutes are becoming more liberal. In many ways, New York's amended statute is the most progressive. In one respect, this is not surprising, because New York was the vanguard in the decanting arena. Yet, in another respect, it is surprising, because, until the recent amendments, the New York statute was among the most stringent. In any event, New York's amended statute likely will serve as a model for other states that are considering adopting or amending a decanting statute.

Thus, a closer examination of the breadth and scope of the changes in New York's statute may prove useful.

The Former Version of N.Y. Est. Powers & Trusts Law § 10-6.6

A basic understanding of the former N.Y. Est. Powers & Trusts Law § 10-6.6 allows one to better appreciate what the amended statute accomplishes. Under the former section 10-6.6, a trustee of an irrevocable lifetime trust or testamentary trust (which, by definition, is irrevocable) could appoint some or all of the principal to a separate trust provided that (1) the invaded trust gave the trustee absolute discretion (that is, unfettered by any ascertainable or non-ascertainable standard) to invade principal; (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 N.Y. Est. Powers & Trusts Law § 11-1.7 (prohibiting, inter alia, 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 trust by registered or certified mail, return receipt required, by personal delivery, or by any other manner directed by the court. "All persons interested in the trust" was defined under the former N.Y. Est. Powers & Trusts Law § 10-6.6(e) 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" Surrogate's Court Procedure Act (SCPA) § 315 (New York's virtual representation statute).

Practically, the statute left many practitioners unsure about its meaning. 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 actually permit the appointed trust's term to be extended beyond that of the invaded trust? Could a trustee be found liable for failing to decant? Do assets discovered after a decanting belong to the invaded trust or to the appointed trust?

The Newly Amended N.Y. Est. Powers & Trusts Law § 10-6.6

The newly amended decanting statute answers many of the questions left unanswered by the former statute. As with the former statute, its terms automatically apply unless the trust instrument provides otherwise. Significantly, the amended statute applies retroactively.

When approaching the rather lengthy amended rules for the first time, it is helpful to divide them conceptually into three categories: (1) rules that apply when trustees have "unlimited discretion" (a newly defined term meaning "the

unlimited right to distribute principal that is not modified in any manner," N.Y. Est. Powers & Trusts Law § 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.); (2) rules that apply when trustees do not have unlimited discretion; and (3) rules that apply in either case. 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. Id. § 10-6.6(f).

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"—a newly defined term meaning those to whom a trustee may currently distribute principal. Id. § 10-6.6(s)(4). For example, the statute explicitly allows trustees to decant in favor of one, more than one, or all of the 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. Id. § 10-6.6(b).

The amended statute explicitly permits trustees to grant to one, more than one, or all of the current beneficiaries, to the possible exclusion of one or more current beneficiaries, a discretionary power of appointment if such beneficiaries could receive principal outright under the terms of the invaded trust. Id. § 10-6.6(b)(1). Also, if the beneficiaries of the invaded trust are described as a class (for example, the settlor's children), then the beneficiaries of the appointed trust *may* include present or future members of such class (for example, children born to the settlor after the invaded trust's creation). Id. § 10-6.6(b)(4).

Rules Applicable When Trustees Do Not Have Unlimited Discretion

One of the key differences between the former and amended statutes is the newfound ability to decant even when trustees do not have unlimited discretion. Id. § 10-6.6(c). Practitioners should realize, however, that 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. Id. Thus, if the trustee is required to distribute principal to A or B for A's and B's health, education, maintenance, and support (known as the "HEMS standard"), for so long as A and B are alive, with the remainder, if any, 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 invasionary standard as did the invaded trust. Id.

§ 10-6.6(c)(1). Thus, using the facts of the previous example, the appointed trust must contain the HEMS standard in favor of A and B and may not, for example, grant the trustee the additional authority to distribute to A “for A’s happiness.”

Also, if the appointed trust contains 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 set forth in the invaded trust, but only until the term set forth in the invaded trust otherwise would have terminated. Id.

§ 10-6.6(c)(2). Thereafter, the standard can be different. Id. For example, if the invaded trust requires the trustee to distribute to A under a HEMS standard until A reaches age 35, when the trust must terminate and its remainder be distributed to A, outright, then the appointed trust must contain a HEMS standard until A reaches age 35. After that time, the appointed trust may grant the trustee 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 the power must be the same. Id. § 10-6.6(c)(4) (emphasis added).

Finally, if the beneficiaries of an invaded trust are described by a class, the beneficiaries of the appointed trust “shall include present or future members of such class.” Id. § 10-6.6(c)(3) (emphasis added).

Select Rules Applicable Regardless of Whether Trustees Have Absolute Discretion

A number of provisions of the amended statute apply whether or not the trustee has unlimited discretion. Perhaps the most notable, and controversial, of these provisions explicitly allows the appointed trust to have a longer term than that of the invaded trust. Id. § 10-6.6(e). 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 be extended beyond when A reaches age 35, and may continue until A’s death or longer. Thus, despite the terms of the invaded trust, it is theoretically possible that A will never receive an outright distribution of the appointed trust’s principal.

The legislature was not unmindful of the additional 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. Id. § 10-6.6(h).
- 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.” Id. Little guidance is given on what constitutes “substantial evidence” of a contrary intent except that the terms of the invaded trust, alone, do not constitute substantial evidence. Id. Thus, it seems likely that the courts will be called on to clarify its meaning.

- Requires trustees to give not only notice of the decanting but also copies of the invaded and appointed trust instruments to (1) all “persons interested in the invaded trust” (defined by the amended statute as “any person or 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 [SCPA 315],” id. § 10-6.6(s)(7)) and in the appointed trust, (2) the settlor, if living, and (3) “any person having the right, pursuant to the terms of the invaded trust, to remove or replace” the trustee exercising the decanting power. Id. § 10-6.6(j)(2).
- Requires the filing of the original decanting instrument with the court having jurisdiction over the invaded trust, provided that, when a trustee decants a lifetime trust that has never been the subject of a proceeding in the Surrogate’s Court (that is, no file number exists for the trust), no filing is required. Id. § 10-6.6(j)(6). Notably absent is a requirement to file copies of the invaded or appointed trust with the court.
- Postpones the effective date of the decanting until no earlier than 30 days after the completion of the above-referenced service of notice, id. § 10-6.6(j), and authorizes interested persons to serve the trustees with written notice of objection to the decanting before its effective date, although the failure to object does not constitute consent. Id. § 10-6.6(j)(4). This 30-day period also provides interested persons with the opportunity to seek a judicial stay of the decanting or 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 (1) compel the trustees to account specifically for the decision to decant, (2) compel the trustees to account generally, or (3) file objections to the trustees’ account.
- Requires the decanting instrument to state explicitly 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. Id. § 10-6.6(j)(3). Moreover, in the event that 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. Id. § 10-6.6(i)(1). If the decanting comprises only some of the invaded trust’s assets, then

such property belongs to the invaded trust. *Id.* § 10-6.6(i)(2).

- Requires trustees to “consider the tax implications” of the decanting. *Id.* § 10-6.6(o). Note that, with certain explicit exceptions, *id.* § 10-6.6(n), trustees can decant even if the decanting has a negative tax result. Trustees are shielded from liability in this case only if they can show that the decision to decant was prudent in light of the “prevailing circumstances.” See *id.* § 10-6.6(h). For example, if decanting Subchapter S stock from the invaded trust to an appointed trust would cause a revocation of the company’s Subchapter S election but also results in a more valuable reduction of the trust’s New York State income tax exposure, the decanting may be appropriate. Of course, the trustees may be called on to account for the decision in a judicial accounting proceeding. See *id.* § 10-6.6(j)(5).
- Prohibits any change to trustee commissions absent a court order. *Id.* 10-6.6(q).

There are other less controversial, but important, generally applicable provisions. One allows trustees to decant in favor of a supplemental needs trust, provided that all of the section’s other requirements are satisfied. *Id.* § 10-6.6(n)(1). Another confirms the trustees’ authority to decant even when there is no current need to invade principal. *Id.* § 10-6.6(g).

Some Questions Raised by the Amended N.Y. Est. Powers & Trusts Law § 10-6.6

The amendments to N.Y. Est. Powers & Trusts Law § 10-6.6 raise some questions, especially about the interplay between the new notice provisions and the right to object to the 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 30-day notice period? Because the statute states that the consent of interested persons is not required, *id.* § 10-6.6(j)(1), the objection arguably would not prevent the decanting. But if it does not prevent the decanting, what effect would the objection have? Perhaps it would do no more than put the trustees on notice that an interested person is likely to seek either (1) a judicial stay of the decanting or (2) to hold the trustees liable for their decision to decant. An important question, however, is whether service of the objection, or the failure to object, starts the statute of limitations running, especially given that (1) “the failure to object shall not constitute a consent,” *id.* § 10-6.6(j)(4), and (2) the interested person’s receipt of notice of the decanting “shall not affect the right of [such person] to compel [the decanting trustees] to account for such [decanting] and shall not foreclose any such interested person from objecting to an account or compelling a trustee to account.” *Id.* § 10-6.6(j)(5). In particular, is the act of decanting the functional equivalent to the trustees’ open repudiation of their obligation to account, or does the decanting bring to an end the invaded trust relationship, thus triggering the running

of the statute of limitations? See *Tydings v. Greenfield, Stein & Senior, LLP*, 897 N.E.2d 1044 (N.Y. 2008), and *In re Estate of Barabash*, 286 N.E.2d 268 (N.Y. 1972).

Also, what effect would the settlor’s objection have, if the settlor is not deemed a person interested in the invaded trust? It seems reasonable to conclude that the objection may constitute “substantial evidence of a contrary intent of the creator” and thus could divest the trustees of the authority to decant. N.Y. Est. Powers & Trusts Law § 10-6.6(h). 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. See *id.* § 10-6.6(j)(4). Perhaps the reason for this discrepancy is to ensure that the settlor is not deemed by the taxing authorities, by virtue of the amended statute, to have a retained power over the trust, thus minimizing any potential exposure to IRC § 2036.

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

Conclusion

The recent amendments to New York’s N.Y. Est. Powers & Trusts Law § 10-6.6 have greatly liberalized the nation’s first decanting statute. These amendments likely are a sign of things to come as more states adopt or amend their own decanting statutes. ■