

**Reasons to Modify Section 10-6.6(b)
of the Estates, Powers and Trusts Law
and Recommended Changes**

by

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When the New York decanting statute¹ was enacted, its goals were fairly narrow.² The statute has proven, however, to have breadth and vitality far greater than initially anticipated. The statute has the potential to enhance planning even further, but this potential can only be realized if modifications are made to the statute that make it more expansive and clarify ambiguous provisions. The decanting statutes enacted in other states subsequent to the enactment of the New York statute all provide greater flexibility than the New York prototype.³ This article reviews a number of basic concepts in the existing New York statute and recommends changes to enhance the utility of the statute.

Concepts for Reconsideration

1. To appoint the principal of a trust to another trust, the trustee must have absolute discretion to invade the principal.

Under the current statute, unless the terms of a trust expressly provide otherwise, a trustee must have “absolute discretion,” pursuant to the terms of a testamentary instrument or irrevocable *inter vivos* trust agreement, to invade the principal of a trust for the benefit of a beneficiary in order to exercise such discretion by appointing all or part of the principal of the trust to another trust.⁴

The ability of a trustee, however, to distribute income or principal outright for *any purpose* (regardless of whether a trustee has absolute discretion) implicitly includes the ability to distribute income or principal in a manner other than outright, such as in further trust. Therefore,

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¹ Section 10-6.6(b) of the Estates, Powers and Trusts Law (“EPTL”). The act of invading the trust principal and paying the assets to a new trust under this statute is referred to as “decanting” and Section 10-6.6(b) is referred to as the “decanting statute.”

² See McKinnney’s Consolidated Law of New York, Annotated, Practice Commentaries; the principal goal was to permit trustees to take advantage of generation-skipping transfer tax planning opportunities.

³ Alaska Stat. 13.36.157; Arizona Revised Statutes, Section 14-10819; Delaware Code Ann Tit. 12 § 3528; Florida Statute Sec. 736.04117(1); New Hampshire Revised Statutes § 564-B:4-418; North Carolina, N.C.G.S. § 36C-8-816.1; South Dakota Statute Section 55-2-15; Tennessee Code Ann. 35-15-816.

⁴ EPTL Section 10-6.6(b)(1).

there is no reason for the statute to limit its application to trusts in which the trustee has “absolute discretion” to invade principal.

Recommendation: To enhance flexibility, the New York statute should be amended to permit the trustee of a trust (the “*invaded trust*”) to pay the principal, as well as the trust income, to another trust (the “*appointed trust*”) under the terms of any trust where the trustee has the ability to invade or pay income or principal *for any purpose*. So long as the trustee has the ability to distribute income or principal for some purpose (for example, if the trustee may make principal or income distributions for a beneficiary’s health, education, maintenance, and support), but not necessarily absolute discretion to otherwise invade principal or income, the trustee should have the ability to pay the trust funds (other than any funds currently required to be distributed) to an appointed trust; *provided, however, that* if the invaded trust limits a trustee’s ability to make distributions then the appointed trust must have the same limiting distribution language and the same set of beneficiaries. (Note, decanting should be permitted under these circumstances regardless of whether or not there is a current need to invade income or principal under any standard stated in the invaded trust.)

Caveat: Expanding the ability of the trustee to pay the trust fund to another trust raises the potential for a misuse of the statute to eliminate a beneficiary’s rights in the invaded trust. Accordingly, any modification of the statute must include safeguards to protect (1) the class of beneficiaries under certain circumstances, and (2) any vested rights that the beneficiary or beneficiaries may have in the invaded trust; such rights can not be affected by paying the assets to an appointed trust or by any other power included in the appointed trust.⁵ For example, if a beneficiary of the invaded trust has the current right to receive all of the income of the trust, that right to receive all of the trust income must continue in the appointed trust.⁶ Similarly, if the invaded trust includes a limitation on the trustee’s ability to make distributions, such as an ascertainable standard, the appointed trust must include the same limitation. For example, if the invaded trust provides that beneficiaries are entitled to receive distributions for their health, support, and comfort, the appointed trust must also provide that those same beneficiaries⁷ are entitled to receive distributions for their health, support, and comfort. If, however, the invaded trust also gives the trustee the unlimited discretion to invade income or principal, it should not be necessary for the appointed trust to include the same class of beneficiaries or the same limitation on distributions because the absolute discretion language should trump.

Notwithstanding the foregoing, the statute could provide additional flexibility if it facilitated the creation of spendthrift trusts. Therefore, the statute should permit changes in mandatory rights to be made when the trust pays over to a supplemental needs trust that

⁵ For example, if the trust grants a power of appointment (see discussion in 2, *infra*).

⁶ The provisions of the appointed trust should not reduce, limit, or otherwise change mandatory distributions of income, or mandatory annuity or unitrust interests, or a right annually to withdraw a percentage of the value of the trust, or a right annually to withdraw a specified dollar amount after such annual right to withdraw a percentage or specified dollar amount *has come into effect* with respect to the beneficiary. This is also consistent with the current statute. See EPTL Sections 10-6.6(b)(1)(A) and (b)(2)(A).

⁷ The trustee should only have the ability to exclude a current beneficiary of the invaded trust as a beneficiary of the appointed trust if the trustees have unlimited or absolute discretion to make distributions and the invaded trust does not include any limitations on a trustee’s ability to make distributions. If the invaded trust includes a limitation on a trustee’s ability to make distributions, the trustee should not be able to pay to an appointed trust with fewer than all of the beneficiaries of the invaded trust.

conforms to Section 7-1.12 of the EPTL, subject to limitations on the changes that would jeopardize any tax benefit received or expected in connection with contributions to the invaded trust.

2. The statute limits who can be the beneficiaries of the appointed trust.

The current statute provides that a trustee may pay the principal of a trust to another trust in favor of the “*proper objects of the exercise of the power...*”⁸ This permits the trustee to pay the principal of the trust to a trust for one, some, or all of the current beneficiaries of the invaded trust, but it is unclear whether the successor and remainder beneficiaries of the appointed trust must remain the same.

Unless the terms of a trust expressly provide otherwise, the ability of a trustee to exercise the power in favor of persons who are not beneficiaries of the invaded trust would give the trustee the power to amend or modify the trust beneficiaries, which would be inconsistent with the wishes of the settlor as established in the invaded trust. Therefore, the current statute’s limit on the beneficiaries of the appointed trust is logical and protective of the intent of the settlor. The statute could provide greater flexibility, however, if it permitted modification of the trust beneficiaries under certain circumstances.

Recommendation: With proper safeguards, the ability of the trustee to pay the trust assets outright to a beneficiary should include the ability to pay to a trust for fewer than all of the current beneficiaries and fewer than all of the successor or remainder beneficiaries provided there is no limitation of the trustee’s ability to make distributions. As discussed above, if there are beneficiaries that have current rights to the trust funds, the trustee should not be able to pay to an appointed trust that diminishes the rights of these beneficiaries, and if there is a limitation on the trustee’s ability to make distributions, the trustee should not be able to pay to an appointed trust that changes the trust beneficiaries.

Furthermore, it would not be inconsistent with the wishes of the settlor to allow the trustee to give a beneficiary of the trust who is entitled to receive the principal outright a power to appoint the trust property. Because the ability to distribute income or principal outright intrinsically includes the ability to distribute income or principal in a manner short of outright, the statute should be amended to permit a trustee to pay to a trust that includes a provision granting a beneficiary otherwise entitled to receive the property outright a power to appoint (whether general or specific) the trust assets to new or different beneficiaries.⁹ This additional flexibility could avoid or postpone the imposition of a generation-skipping transfer tax on a trust by the exercise of a power of appointment to add a non-skip person to the class of beneficiaries, or to permit the beneficiary to change the remainder beneficiaries of a trust.

Caveat: Any modification of the statute should preclude the exercise of the power of appointment in such a manner that would impact a beneficiary’s current right to withdraw or receive principal or income under the terms of the invaded trust.

⁸ EPTL Section 10-6.6(b)(1), *emphasis added*.

⁹ This position is also supported by the decisional law *e.g.*, *Cheever v. Cheever*, 172 A.D. 353, 157 N.Y.S. 428 (1st Dep’t 1916). *See also* EPTL Section 10-6.6 *Practice Commentaries*.

3. The statute does not limit a trustee’s ability to alter the “tax status” of the trust.

The current statute does not specifically protect the “tax status” of a trust. This means that a trustee could pay the assets of the trust to another trust and knowingly - or unknowingly - adversely alter the tax structuring relating to the funding or ongoing operation of the invaded trust. To facilitate its use, the statute should protect against such tax foot faults by including a tax savings clause.

Recommendation: The statute should be amended to include a provision that would protect and safeguard the tax status and structuring relating to the creation of the invaded trust by overriding the terms of the appointed trust or a trustee’s powers under EPTL Section 10-6.6(b) to the extent that such terms or powers could affect any right under the invaded trust that is necessary or required for tax purposes or for the settlor or trust to receive certain tax results or benefits that would otherwise be lost for income, gift, estate, or generation-skipping transfer tax purposes. For example, if the initial contribution to the trust qualified for the marital deduction under Section 2523 of the Code,¹⁰ the trustee should not be able to pay the assets to another trust that does not qualify for the marital deduction. Similarly, if the initial contribution qualified for the annual exclusion under Section 2503(b) of the Code, the appointed trust must retain the right of exercise of any outstanding Crummey withdrawal power. If the invaded trust was created under Section 2503(c) of the Code, the appointed trust must retain a beneficiary’s right to receive the principal of a trust upon attaining age 21. If the invaded trust qualified as a permitted shareholder within the meaning of Section 1361(c)(2) of the Code, the appointed trust must not include any provision that would disqualify the trust which owns S corporation stock from being a permitted shareholder. Similarly, if the invaded trusts owns an interest in property subject to the minimum distribution rules of Section 401(a)(9) of the Code, such property cannot be paid to an appointed trust that will result in the shortening of the minimum distribution period to which the property is subject in the invaded trust.

Caveat: Notwithstanding the foregoing, any modification to preserve the tax status should not prevent the trustee from converting the invaded trust from or to a grantor trust under Section 671, *et. seq.*, of the Code.

4. The current statute requires the trustee to file a copy of the instrument exercising the power to appoint with the office of the clerk of the court having jurisdiction over the trust.

The current statute provides that the exercise of the power to invade the principal of the trust must be “by an instrument in writing, signed and acknowledged by the trustee and filed in the office of the clerk of the court having jurisdiction over the trust.”¹¹ As a practical matter, it has been the experience of a number of practitioners that the clerks of the courts have questioned the filing of the instruments exercising the power, sometimes not even accepting the filing. In addition, it is sometimes unclear in which court the instrument should be filed. It is also unclear

¹⁰ All references to the “Code” are to the Internal Revenue Code of 1986, as amended from time to time, or to corresponding provisions of subsequently enacted internal revenue laws.

¹¹ EPTL Section 10-6.6(d).

whether the invaded trust agreement and/or the appointed trust agreement must also be filed with the court. To avoid these issues, the filing requirement should be removed from the statute.

Recommendation: The statute should be amended and give the trustee the option to file a copy of the instrument exercising the power to appoint and the invaded and appointed trust agreements with the court having jurisdiction over the trust; this filing requirement should not be mandatory.

5. The statute is unclear about what trusts can take advantage of the New York statute.

The current statute does not specify whether its use is limited to trusts initially subject to New York law or also to trusts whose primary administration is transferred to New York. To enhance the availability of the use of the statute, the statute should specifically contemplate an expansive use.

Recommendation: Unless the terms of a trust expressly provide otherwise, the New York statute should be available (a) to any trust (including a charitable trust) governed by the laws of New York, including a trust whose primary administration initially is in another state but is later transferred to New York, and (b) to a trust that has a trustee who is an individual domiciled in this state or an entity whose principal office is in this state, if a majority of the trustees sign an acknowledged instrument, maintained with the records of the trust, that provides that the primary administration of the trust will be in New York.

6. The statute is unclear about what amount of commissions can be paid to the trustee of the appointed trust.

The current statute gives little guidance regarding the compensation that can be paid to a trustee of the appointed trust; the statute merely provides that, unless the court otherwise directs, a trustee may continue to receive commissions from a trust once the principal is paid to another trust so long as the aggregate annual and principal commissions of a trustee are not increased.¹² This raises a question as to whether a trustee can continue to receive any compensation from an appointed trust if the term of the appointed trust is longer than the term of the invaded trust. For example, assume a trust is to terminate when the beneficiary attains age 30, and the trustee, who is entitled to statutory commissions under the terms of the trust, pays the principal of a trust to another trust that will terminate at the beneficiary's death. As a result of paying the principal to a trust that will last for the beneficiary's lifetime, the trustee of the appointed trust may continue to receive commissions for the beneficiary's lifetime, presumptively increasing the aggregate annual and principal commissions because the commissions are payable for a longer period of time than they were payable under the invaded trust. There is also no guidance regarding whether a trustee may continue to receive the same amount of commissions paid from the appointed trust or whether the trustee may continue to receive commissions if the trustee has not been paid the full amount of commissions the trustee could have received from the invaded trust. The ambiguous nature of the compensation provision should be addressed by a modification of the statute.

¹² EPTL Section 10-6.6(c).

Recommendation: The statute should be amended to permit the trustees of the appointed trust to be able to continue to receive compensation on the same basis as the trustees of the invaded trust, even if the term of the appointed trust is longer than the term of the invaded trust because they will be acting as trustee with fiduciary obligations during such longer period of the appointed trust.

Caveat: Any modification of the statute should preclude the trustees of the invaded trust from receiving compensation for appointing assets from the invaded trust to the appointed trust and from paying compensation from the appointed trust that is different from the compensation received by the trustees of the invaded trust unless the court orders a change in the calculation of the compensation.

7. The statute does not specify whether a trustee must utilize EPTL Section 10-6.6(b).

The fact that EPTL Section 10-6.6(b) can be used for many purposes, many of which could provide administrative, financial, or other benefits to the beneficiaries, raises the specter that a trustee or other individual could potentially be sued and held liable for failing to utilize the statute. The statute should protect against this.

Recommendation: The current statute should be modified to clarify that no trustee should be liable for failing to use EPTL Section 10-6.6; the existence of the statute itself should not create an inference or duty that a trustee of a trust should exercise the powers in the statute.