

# Some Practical Applications and Pitfalls of New York's Decanting Statute

By Andrew S. Katzenberg

There has been much discussion about the 2011 amendments to Section 10-6.6 of the New York Estates, Powers & Trusts Law, known as New York's decanting statute. The statute was originally enacted in 1992 and has been amended three times since its effective date, namely in 1995, 2001 and most recently in 2011. Signed into law on August 17, 2011 by Governor Andrew Cuomo, the amended decanting statute substantially broadened the powers available under EPTL 10-6.6. One notable expansion allows a trustee to decant despite a lack of unlimited discretion to distribute the principal of the trust. The amended statute also clarified the permissibility of excluding beneficiaries and extending the trust term by providing that the new, or "appointed," trust could have one or more beneficiaries of the original or "invaded" trust to the exclusion of other current beneficiaries,<sup>1</sup> and that the appointed trust could have a longer term than the invaded trust.<sup>2</sup> Despite the much needed clarification offered by the amended statute, there are a number of issues practitioners should keep in mind when counseling clients on the decanting of trusts.

## Power of Appointment

The new decanting statute specifically authorizes the trustee who has unlimited discretion to invade principal to grant powers of appointment to any of the current beneficiaries of the invaded trust, even to the exclusion of one or more of the current beneficiaries.<sup>3</sup> However, the power of appointment must either be identical in its scope and objects to the power of appointment in the invaded trust, or be a "broad" power of appointment which only excludes the "beneficiary, the creator, or the creator's spouse, or any of the estates, creditors, or creditors or the estates of the beneficiary, the creator or the creator's spouse."<sup>4</sup>

Where an entirely new trust is being created specifically for the purpose of decanting, it is easier to address this issue since the new trust could either track the power of appointment of the invaded trust or give the beneficiary a "broad" limited power of appointment. When a client wants to decant to an existing trust but the power of appointment is neither identical nor is not broad, problems may arise.

One solution is to have the beneficiary of the appointed trust release his power of appointment to the extent required to either match the invaded trust's power of appointment, or to eliminate his power of appointment altogether.<sup>5</sup> For example, assume a benefi-

ciary has a power of appointment for the benefit of the grantor's descendants and charities, and the trust into which the trustee wants to decant (the "recipient trust") grants the beneficiary a power of appointment for the benefit of the grantor's descendants, spouses of the grantor's descendants and charities. The beneficiary would have to release his power to appoint the recipient trust in favor of spouses of the grantor's descendants.<sup>6</sup> At that time, the trustee could decant from the original trust to the recipient trust because they would have identical powers of appointment. The same method could work if the original trust had a broader power of appointment than the recipient trust. For example, if the original trust had a power of appointment for the benefit of the grantor's descendants and charities and the recipient trust had a power of appointment for the benefit of only the grantor's descendants, the beneficiary could release his power to appoint the original trust in favor of charities.

## Grantor Trusts and Tax Reimbursement

One purpose of decanting is to convert a non-grantor trust into grantor trust or to convert a grantor trust into a non-grantor trust. A non-grantor trust reports its income and gain on the trust's tax return, whereas a grantor trust is disregarded for income tax purposes, and the trust's income and gain are reported and paid by the grantor.<sup>7</sup>

There is no provision in the decanting statute specifically authorizing the change of the tax status of the trust to and from a non-grantor trust and grantor trust. The only relevant provision of the decanting statute is that the trustee must consider the tax implications of decanting to a new trust.<sup>8</sup>

Depending upon the individual client's situation, converting a non-grantor trust to a grantor trust may be beneficial from an income tax perspective since it may allow the trust to grow without being subject to separate income tax at the compressed trust brackets. In effect the income can remain in the trust while being taxed to the grantor and the grantor's payments of the income tax, depending on the terms of the new trust may be tantamount to additional tax free gifts to the trust, above and beyond the federal annual exclusion and lifetime exclusion limits.

When converting a trust into a grantor trust, practitioners include a tax reimbursement clause giving the

trustee discretionary authority to reimburse the grantor for income taxes paid attributable to the trust.<sup>9</sup> This clause can ease clients' reservations that the burden of the trust's tax liability will become too great at some point in the future. It is important to note that by including a tax reimbursement clause (where the original trust did not have a reimbursement clause) the trustee has actually included the grantor as a discretionary beneficiary of the new trust.<sup>10</sup> The decanting statute only authorizes the trustee to allow current beneficiaries of the invaded trust to be beneficiaries of the new trust. New beneficiaries cannot be added.

Fortunately, New York trust law, by default, specifically gives trustees of all *inter-vivos* trusts discretion to pay the grantor an amount equal to the income taxes attributable to the trust property charged to the grantor.<sup>11</sup> Therefore, the grantor is always a current discretionary beneficiary of the original trust by default.<sup>12</sup> This means it would be permissible to include or exclude the grantor as a discretionary beneficiary of the new trust (but only for the amount of tax liability of the trust), whether or not the original trust had a reimbursement clause.

However, the original trust can expressly negate the default New York statute, prohibiting the trustee from reimbursing the grantor for income taxes charged to him.<sup>13</sup> In this case, the new trust would not be allowed to have a tax reimbursement clause since by doing so it would add the grantor as a new beneficiary not included in the original trust. It is also important to note that the new trust would also need to expressly negate the default statute as well. Therefore, practitioners should be sure to review older trusts for this issue before adding a tax reimbursement clause as a matter of practice.

## Conclusion

Though the amended decanting statute resolved much of the ambiguity of the former statute and eased the trust administration, issues still exist and further

exploration of the new decanting statute should continue.

## Endnotes

1. N.Y. Estates, Powers & Trusts Law (EPTL) 10-6.6(b).
2. EPTL 10-6.6(e). The statute states that the term includes, but is not limited to, a term measured by the lifetime of a current beneficiary. The language "but not limited to" in the statute permits longer terms than the life of a beneficiary. For example, a trust that terminated when the beneficiary reached the age of 30 could be decanted into a new trust which terminated at the death of the beneficiary. However, there may be adverse tax consequences if the term is extended longer than the rule against perpetuities, though such extension may be prohibited by EPTL 10-6.6(n)(5).
3. EPTL 10-6.6(b)(1).
4. EPTL 10-6.6(b)(2) and (3). A power of appointment granted to a current beneficiary of the invaded trust may be either identical to the power of appointment in the invaded trust or a broad power of appointment regardless if that beneficiary had the power of appointment in the invaded trust or not. If the power of appointment granted is the identical power of appointment from the invaded trust, is it not necessary that the original beneficiary who had the power of appointment in the invaded trust continue to have it in the appointed trust.
5. EPTL 10-9.2.
6. EPTL 10-9.2(b).
7. I.R.C. § 671 (2013).
8. EPTL 10-6.6(o).
9. New York State law specifically protects the trust assets from the grantor's creditors if such power exists. EPTL 7-3.1(d).
10. EPTL 10-6.6(b) and (c).
11. EPTL 7-1.11(a).
12. However, the grantor is limited as a beneficiary to the amount of the tax liability of the trust charged to him. Similarly, if a beneficiary had only an income interest in the invaded trust, that beneficiary could only have an income interest in the appointed trust.
13. EPTL 7-1.11(a).

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