



Elder Law/Trusts & Estates

So You Think You Can Decant?

Trusts are frequently drafted to last for generations based on assumptions that may not reflect future reality, and every practitioner has come across a trust whose terms fail to take into account the current laws or beneficiaries. New York's decanting statute, Estates, Powers, and Trusts Law § 10-6.6 (first enacted in 1992), provides trustees with the flexibility to address these intractable realities by making changes to an otherwise irrevocable trust document.



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Simply put, decanting is a modification of a trust initiated by a trustee.

The reasons to decant include expanding a trustee's decision making authority, creating a step-up in basis for trust assets, expanding the trust's term or reducing a beneficiary's distribution rights to enable the beneficiary to qualify for Medicaid. The current decanting statute in New York makes it clear that decanting is an available tool in a trustee's arsenal, but when and how to utilize that tool becomes the difficult hurdle. Does the trustee have any fiduciary obligations when contemplating a decanting? What can be left out, or added, or what must remain the same in any trust

decanting? And what, if any, are the tax implications when the trustee decants by moving trust assets from one trust to a new trust with different terms?

It is essential that the receiving trust's attributes. The fundamental elements of decanting require a trustee to consider whether the current law and/or beneficiaries would cause the grantor to alter the original trust agreement. Therefore, notwithstanding the liberal decanting statute in New York, the statute still imposes upon a trustee a duty of loyalty and a fiduciary duty to be prudent. The duty of loyalty specifically requires that a trustee who chooses to decant must be exercising this power in the best interests of one or more of the beneficiaries of the old "invaded" trust.¹ And this duty of loyalty must be exercised in the same manner as a prudent person would act, under similar circumstances, i.e., reasonably, competently and in good faith.² Decanting for purely administrative purposes should not raise concerns, but decanting that shifts beneficial interest may implicate the duty of loyalty. It is important to always remember that trustees cannot act arbitrarily.

A trustee with absolute discretion can invade part, or all, of the principal of the old "invaded" trust. The trustee of the invaded trust can then appoint such principal "receiving" trustee for one, more than one, or all, of the current beneficiaries and the successor and remainder ben-

eficiaries of the receiving trust can be one, more than one, or all, of the current successor and remainder beneficiaries.³ In addition, a trustee with absolute discretion can grant a discretionary power of appointment to one or more of the current beneficiaries in the receiving trust if such beneficiary could receive principal outright under the terms of the invaded trust.⁴

However, if the invaded trust already granted a power of appointment, then the receiving trust may also grant a power of appointment as long as the receiving trust provides for the same class of permitted appointees and provides that it is exercisable in the same manner (i.e., the invaded trust provided for a testamentary power of appointment which expressly referenced the trust and therefore, the receiving trust, if it includes a power of appointment, must similarly provide).⁵ Finally, a trustee with unlimited discretion, if the beneficiaries of the invaded trust are described as a class, may provide in the receiving trust that the beneficiaries of the receiving trust include present or future members of the class.⁶

When the trustee of the invaded trust does not have unlimited discretion then the current beneficiaries of the receiving trust must be the same as the current beneficiaries of the invaded trust, the successor and remainder beneficiaries of the receiving trust must be the same as the invaded trust, and the receiving trust must have the same language as to

distributing income and principal.⁷

However, in the event that the receiving trust's term is extended for a period greater than the invaded trust, the trustee may be given unlimited discretion to invade principal during that extended period.⁸ In addition, if the beneficiary or beneficiaries of the invaded trust are described as a class, then the receiving trust must include present or future members of that class.⁹ Finally, if the invaded trust granted a power of appointment to a beneficiary, then the receiving trust must grant the power of appointment and the class of permissible appointees must be the same as the invaded trust.¹⁰

When a trustee exercises his or her authority under EPTL § 1906.6, it must be in writing, stating whether the power of appointment encompasses all of the principal or a part and if it is only a part, it must state the "approximate percentage of the value of the principal of the invaded trust" that is subject to the decanting.¹¹ The trustee must sign, date and have the acknowledgment of decanting notarized.¹² A copy of this signed and notarized document, accompanied by a complete copy of the invaded trust and a complete copy of the receiving trust must be delivered to the creator of the invaded trust, if he or she is then living, to any individual having the right, pursuant to the terms of the invaded trust, to remove or replace the trustee exer-

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cising the decanting and to any person having an interest in the invaded trust and the receiving trust, by registered mail, certified mail, personal delivery, return receipt requested or as directed by a court that has jurisdiction over the invaded trust.¹³ The decanting must be effective thirty days after the date of such service and any person interested in the invaded trust may object to the decanting by serving a written notice of objection upon the trustee exercising the authority to decant prior to the effective date.¹⁴ However, the failure to object does not constitute consent.¹⁵

The tax consequences of a decanting have not been resolved. The Internal Revenue Service in Notice 2011-101 asked for comments regarding these uncertainties, and in Revenue Procedure 2014-3, the IRS placed decanting on its "no ruling" list for specific income, gift, and GST-tax issues.¹⁶ There are significant potential tax issues in decanting that any practitioner should be familiar with to avoid potential missteps. For example, if a beneficiary acquiesces in a reduction of a beneficial interest in a decanting, the beneficiary may have made a taxable gift.¹⁷

This concept is further bolstered by the fact that the New York decanting statute provides a beneficiary with a legal right to object to the decanting¹⁸ and, thus, an acquiescence or consent would arguably be a voluntary transfer under the Internal Revenue Code section 2511. Similarly, a decanting can cause estate tax inclusion if a beneficiary is deemed to make a gift but the gift was incomplete because of a retained limited

power of appointment.¹⁹

With the availability of decanting, irrevocable no longer means forever. For this reason, it is important for practitioners to discuss the potential of decanting with grantors to enable a grantor to decide whether to expressly allow for decanting in specific circumstances or to expressly forbid decanting in all or some circumstances. Also, practitioners should discuss with trustees, who elect to decant, the interplay between a fiduciary's duties and a fiduciary's actions and should take steps to document reasons for the trustee's decisions, whether directly in the body of the receiving trust, in the notice of the decanting, or in a separate paper. And finally, always remember that while anyone can decant, it still requires a comprehensive analysis, and so the trust terms, the decanting statute, and the possible tax implications must always be reviewed and carefully considered.

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1. EPTL §10-6.6(h).

2. *Id.*

3. EPTL §10-6.6(b).

4. EPTL §§10-6.6(b)(1), (2).

5. EPTL §10-6.6(b)(3).

6. EPTL §10-6.6(b)(4).

7. EPTL §§10-6.6(c), (c)(1).

8. EPTL §10-6.6(c)(2).

9. EPTL §10-6.6(c)(3).

10. EPTL §10-6.6(c)(4).

11. EPTL § 10-6.6(j).

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.*

16. See Rev. Proc. 2014-3, 2014-1 I.R.B. 111.

17. See Treas. Regs. § 25.2512-8, Rev. Rul. 81-264.

18. EPTL §10-6.6(j)(4).

19. IRC §§ 2036, 2038.