Who Needs a Decanting Statute?

By Brad Dillon and Michael S. Schwartz

In *In re Hoppenstein*,[1] the New York County Surrogate's Court dealt a potentially devastating blow to the necessity and relevance of New York Estates, Powers and Trusts Law (EPTL) 10-6.6 (the "NY Decanting Statute") for trust decantings. In that case, the trustees of an irrevocable trust relied on their broad discretionary distribution authority in the trust instrument itself, as opposed to the NY Decanting Statute, to transfer trust assets from one trust to another. By confirming the validity of the transfer to the new trust, the court allowed the trustees to effectively remove a trust beneficiary without having to follow the specific statutory requirements of the NY Decanting Statute.

The decision in *Hoppenstein* opens the door for practitioners and trustees to completely avoid the requirements of the NY Decanting Statute so long as the governing trust instrument has sufficiently broad discretionary distribution language. While this may be beneficial for facilitating trust decantings and providing the flexibility to effectively make changes to an irrevocable trust that may not otherwise have been possible, it also potentially undermines some of the protections that the requirements of the NY Decanting Statute were meant to provide.

This article engages in a brief review of the history of trust decanting, including the NY Decanting Statute, and analyzes the impact that *Hoppenstein* may have on trust decantings in New York.

A Brief History of Decanting

A trust decanting involves the distribution by a trustee of the assets from one trust to another, potentially allowing a trustee to effectively modify an irrevocable trust by contributing the assets to a new trust with different terms. For example, decanting can be used to change the situs of a trust, remove beneficiaries, extend the duration of the trust, change fiduciaries or modify other administrative provisions.

The original support for the decanting power stemmed from the trustee's discretionary ability to distribute trust assets to or for the benefit of a beneficiary. If the trustee could make such distributions for the benefit of a beneficiary, then the trustee should also be able to instead exercise that authority by distributing assets in trust for the beneficiary. This decanting right is recognized in the common law of several jurisdictions,[2] and many of those states have in turn codified this common law right. In fact, New York led this charge in 1992 when it adopted its decanting statute, which has been refined by several amendments since that time. However, many of these state decanting statutes, including the New York statute, provide that they are not intended to abridge any decanting powers that the trustee may have under common law or the governing instrument.

Prior to *Hoppenstein*, no New York case had addressed either the common law right to decant or the right to decant pursuant to the terms of a trust's governing instrument, though several cases in other jurisdictions have analyzed the extent of a trustee's common law power to decant. For example, in *Phipps v. Palm Beach Trust Co.*, the Supreme Court of Florida held that a trustee with the unfettered discretion to distribute trust principal can exercise that power by appointing assets in further trust.[3] Similarly, in *In re Spencer's Estate*, the Iowa Supreme Court allowed a trustee who had the discretion to grant the trust beneficiaries a life estate over the trust property to establish a new trust for the benefit of those beneficiaries.[4] Finally, in *Wiedenmayer v. Johnson*, a New Jersey court rejected a challenge to distributions by a trustee to new trusts that the beneficiaries of the original trust set up as a condition of the distribution.[5]

New York's Decanting Statute

New York was the first state to adopt legislation specifically authorizing trust decanting with the enactment of EPTL 10-6.6 in 1992. As initially codified, the statute authorized the transfer of assets from one trust to another where a trustee had unlimited discretion to make principal distributions. New York has continued to be at the forefront of trust decanting legislation, as the NY Decanting Statute has been amended multiple times since its initial enactment. Some of these changes involved mere technical amendments,[6] but others have had a more significant impact. One such change involved an expansion of the scope of the NY Decanting Statute, which allows a trust decanting even if the trustee's distribution power is limited, so long as the distribution standard is retained in the new trust and certain other requirements are met.[7]

Importantly, like many other state decanting laws, the NY Decanting Statute explicitly provides that it is not intended to curtail a trustee's ability to effectuate a trust decanting via common law or pursuant to the

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terms of the trust's governing instrument. In particular, EPTL 10-6.6(k) provides that the NY Decanting Statute will not "abridge the right of any trustee to appoint property in further trust that arises under the terms of the governing instrument of a trust or under any other provision of law or under common law."[8] It is this potentially very broad "exception" to the NY Decanting Statute that was at the heart of the recent *Hoppenstein* decision.

In re Hoppenstein

In *Hoppenstein*, the trustees relied on their discretionary powers under the trust instrument to distribute a life insurance policy on the settlor's life to a new trust that was identical to the prior trust in all respects other than that it excluded an estranged daughter and her four children as beneficiaries. The original trust authorized the trustees "to pay such sums out of the principal of the trust (even to the extent of the whole thereof) to the Settlor's descendants, living from time to time, in equal or unequal amounts, and to any one or more of them to the exclusion of the others, as the Trustees, in their absolute discretion, shall determine."[9] The trust instrument required only that the trustees give notice to the settlor's descendants within 45 days of the intended distribution. The original trust also explicitly provided that distributions to beneficiaries could be made "by payment to a trust for his or her benefit."[10]

The daughter and her four children sought to void the trustees' distribution of the policy to the new trust, claiming, among other things, that the transfer did not comply with the provisions of the NY Decanting Statute. The New York County Surrogate's Court summarily dismissed their argument and granted summary judgment in favor of the trustees, noting that the trustees did not rely on the NY Decanting Statute to decant the policy but rather on their power to make discretionary distributions of principal under the terms of the trust instrument.[11] The court's decision cited EPTL 10-6.6(k) in affirming the trustees' rights to decant under the terms of the trust instrument rather than under the EPTL.[12]

An Exception That Swallows the Rule?

Hoppenstein appears to be the first case in New York to confirm the exception contained in EPTL 10-6.6(k), which allows trustees to decant based on the provisions of the trust instrument or common law, instead of having to follow the NY Decanting Statute. While the Surrogate's Court did not provide details of its reasoning, *Hoppenstein* should provide comfort to practitioners who may have previously been hesitant to rely on this statutory exception.

In fact, based on *Hoppenstein*, mere discretion over principal distributions alone engenders the power to decant. While the trust instrument in *Hoppenstein* specifically authorized distributions to be made to new trusts for the benefit of the beneficiaries, there is no indication in the court's decision that this provision impacted the result. Rather, in allowing the decanting and the effective removal of certain trust beneficiaries by way of the decanting, the decision only relies on the trustee's discretionary authority to make distributions of trust principal "to the Settlor's descendants, living from time to time, in equal or unequal amounts, and to any one or more of them to the exclusion of the others."[13] Thus, under the reasoning of *Hoppenstein*, trustees should be able to rely on simple discretion to make principal distributions, even when the trust instrument does not otherwise specifically allow distributions to be made "for the benefit" of the beneficiaries or "in further trust" for the beneficiaries.

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While the court in *Hoppenstein* appears to have explicitly allowed a decanting by a trustee with unlimited discretion over principal, it is not clear whether the case would extend to trustees with a lesser standard of discretion. EPTL 10-6.6(c) allows a trustee with a limited invasion power (such as a power to invade principal limited by an ascertainable standard) to decant to an appointed trust when certain requirements are met.[14] The Surrogate's Court in *Hoppenstein* relied exclusively on the trustee's discretionary authority over principal in finding a power to decant. If that discretion is limited, a power to decant under the terms of the trust instrument may not be as absolute as where discretion is unlimited. The court noted, however, that the EPTL does not abridge the right of a trustee to decant under the terms of the governing instrument of a trust. Presumably, then, a trustee with limited discretionary authority could still exercise a power to decant, provided that the governing instrument specifically allowed such an exercise. The governing instrument would likely have to be more explicit in this allowance.

The Surrogate's Court did not circumscribe a trustee's authority to decant when the trustee has unlimited discretion over distributions. This opens an unlimited number of possibilities for changing the dis-

positive terms of an appointed trust in ways that may not be allowable under the NY Decanting Statute. For example, a trustee might be able to rely on her broad discretionary authority over distributions to decant a trust's assets to a new trust that expands the class of beneficiaries. Although it is far from certain that this would be permissible, the ability to add beneficiaries via decanting could be beneficial in a situation where a settlor has a major unexpected life change (such as a marriage or birth of a child) after the initial creation of the trust. Conversely, allowing a trustee to add beneficiaries that the settlor did not initially name could yield unanticipated and undesired results.

A non-statutory decanting could perhaps also be used to achieve other objectives, such as elevating remainderpersons to present beneficiaries, prolonging the perpetuities period, altering the provisions regarding trustee compensation, or providing for other substantially different dispositive provisions. It could also, for example, sidestep the notice requirements under the NY Decanting Statute, limiting the chances of a disgruntled beneficiary challenging the decanting. While such a far reaching power could provide flexibility to make much needed changes to an irrevocable trust that may not otherwise have been possible or practical, taken to its extreme, such a power could also undermine the safeguards that the requirements of the NY Decanting Statute provide.

Similarly, certain considerations that a trustee must take into account under the NY Decanting Statute may not explicitly apply to a decanting under a trust instrument or common law. For example, the requirements under EPTL 10-6.6(h) and (o) that a trustee may only exercise her decanting powers if a prudent person would consider it in the best interest of the objects of the exercise of the power and if she has considered the tax implications of the decanting may not explicitly apply to decantings based on common law or the terms of the governing instrument.

Of course, even if a trust instrument which provides unfettered distribution discretion does not include limitations on the trustee's decanting power, the trustee still would be bound by her overriding fiduciary duties. For example, a trustee who exercises her discretionary distribution authority to transfer trust assets into a trust that enriches the trustee's interests may have breached her fiduciary duties, depending on the specific facts of the situation. Similarly, even in the absence of the applicability of EPTL 10-6.6(h) and (o), a trustee must still be mindful of the tax consequences of a trust decanting, which are largely unsettled at this time. While a detailed discussion of the potential tax implications of a decanting is beyond the scope of this article, a trustee must analyze and balance those potential tax consequences with the objectives that the trustee is seeking to achieve.

Unfortunately, because the *Hoppenstein* trustees decanted to a trust that excluded beneficiaries under the invaded trust—a power that is explicitly permitted under the NY Decanting Statute[15]—practitioners may have to wait and see what associated duties and restrictions apply to decantings and how far they can take the Surrogate Court's reasoning in substantially altering the dispositive terms of an invaded trust. Similarly, the Surrogate's Court does not address the breadth and scope of a trustee's power to decant under New York common law—a power which had not previously been confirmed by a New York court. This too will necessitate further guidance.

Conclusion

The recent *Hoppenstein* decision could have a major impact on decanting New York trusts in the future, as it seems to lessen the importance and relevance of the NY Decanting Statute. It is likely to be used by practitioners and trustees to side-step the requirements and restrictions of the NY Decanting Statute, at least in situations where trustees have unlimited discretion to make principal distributions. However, there is still a substantial amount of uncertainty as to how far the *Hoppenstein* decision can (or should) be extended. Until further guidance is issued, prudent practitioners may still wish to include explicit decanting language in the trust instrument itself, and also comply with the NY Decanting Statute to the extent possible.

Endnotes

1. *In re Hoppenstein*, 2015-2918/A, NYLJ 1202784244139, at *1 (Sur. Ct., N.Y. Co., decided March 31, 2017).
2. *See, e.g.*, Restatement Third, Property: Wills and Other Donative Transfers § 19.14 (2011); *Phipps v. Palm Beach Trust Co.*, 142 Fla. 782 (1940); *In re Spencer's Estate*, 232 N.W.2d 491 (Iowa 1975); *Wiedenmayer v. Johnson*, 106 N.J. Super. 161 (App. Div. 1969), *judgment aff'd*, 55 N.J. 81 (1969).
3. *Phipps*, 142 Fla. 782 (1940).
4. *In re Spencer's Estate*, 232 N.W.2d 491 (Iowa 1975).
5. *Wiedenmayer*, 106 N.J. Super. 161 (App. Div. 1969), *judgment aff'd*, 55 N.J. 81 (1969).
6. *See, e.g.*, Memorandum in Support of New York A7061, at (2).
7. New York's Estates, Powers and Trusts Law (EPTL) 10-6.6(c).
8. EPTL 10-6.6(k).
9. *Hoppenstein*, at 3.
10. *Hoppenstein*, note 3.
11. *Id.* at 6.
12. *Id*.
13. *Hoppenstein*, at 3.
14. The appointed trust must have the same current, successor, and remainder beneficiaries as the invaded trust. In addition, the appointed trust must maintain the same income distribution, principal invasion and power of appointment provisions as the invaded trust. EPTL 10-6.6(c).
15. EPTL 10-6.6(b) provides that "the successor and remainder beneficiaries of such appointed trust may be one, more than one or all of the successor and remainder beneficiaries of such invaded trust (to the exclusion of any one, more than one or all of such successor and remainder beneficiaries)."