An Update on Decanting Statutes

Introduction

This article updates certain aspects of an excellent article by Alan Halperin and Michelle R. Wandler entitled "Decanting Discretionary Trusts: State Law and Tax Considerations" which was published in 29 Tax Management Estates, Gifts & Trusts Journal (September 9, 2004). As that article stated, at the time it was published, four states (New York[2], Alaska[3], Delaware[4] and Tennessee[5]) had adopted statutes permitting trustees, in some cases, to transfer all or part of the assets of one trust over to a new or different trust. One of the purposes of this article is to discuss certain changes made to the Alaska statute and to discuss the new Florida and South Dakota statutes permitting such "decanting" (that is, the act of "pouring" the assets of one trust to another as one might, in an analogous sense, pour wine from one vessel to another). Much of the Halperin/Wandler article focused on New York law, the first state to adopt such legislation. Part of this article will discuss certain case law developments under that New York statute that have occurred since that article was published.

Overview of Effects of Decanting

It seems that decanting authority may be used to achieve a variety of goals, including: dealing with changed circumstances; modifying administrative provisions and to reduce administration costs[6]; altering trusteeship provisions[7]; extending the termination date of trusts[8]; correcting drafting errors; converting a non-grantor trust to a grantor trust or the reverse,[9] changing the governing law[10]; dividing trust property to create separate trusts; reducing potential liability[11]; making a trust interests spendthrift or

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[1] Part of this article is derived from Shaftel & Blattmachr, "Alaska's 2006 Amendments to Its Trust and Estate Statutes," Estate Planning (January 2007).

[2] EPTL 10-6.6.

[3] Alaska Statute 13.36.157.

[4] Del. Code Ann. tit. 12 § 3528.

[5] Tenn. Code Ann. § 35-15-816.

[6] *Matter of Vetlesen*, NYLJ June 19, 1999, p. 27, col. 3.

[7] *Cf. Matter of Riese*, 627 NYS2d 1028 (Surr. Ct. NY County 1995); *Matter of Joseph Klingenstein*, NYLJ April 20, 2000 (Surr. Ct. Westchester County) (beneficiaries granted authority to remove trustees). Note that under New York EPTL 10-6.6, the compensation of a trustee cannot be increased by decanting without the consent of the court. The other five state decanting statutes are silent on this issue but it seems that state law rules against self-dealing likely would foreclose a trustee using decanting to increase that trustee's compensation without court permission.

[8] *In re Alfred Hazan*, NYLJ April 11, 2000 (Surr. Ct. Nassau County).

[9] A grantor trust is one whose income, deductions, and credits against tax are attributed to the trust's grantor. See section 671 of the Internal Revenue Code of 1986 as amended ("I.R.C.").

[10] *Matter of Riese*, 627 NYS2d 1028 (Surr. Ct. NY County 1995).

[11] *Matter of Kaskel,* 620 NYS2d 217 (Surr. Ct. NY County 1994); *Estate of Grosjean,* NYLY December 20, 1997, p. 35, col. 6 (Surr. Ct. Nassau County).

the reverse[12]; avoiding a state or local tax[13]; and converting a trust into a supplemental needs trust (to permit the beneficiary to qualify for certain governmental benefits).[14]

Alaska Statutory Change

Alaska's statute as originally enacted, like the New York statute, permitted the invasion in further trust only if the power to invade granted to the trustee was not limited by a standard. The 2006 revisions to Alaska Statute 13.36.157 permit a trustee of an Alaska trust to invade in further trust even if the invasion authority is limited by a standard as long as the invasion standard remains the same. In other words, if the Alaska trust permits invasions for the beneficiary's support and education, the trustee can invade the corpus by paying it over to another trust as long as the invasion standard in the trust to which the corpus is paid remains exclusively for the beneficiary's support and education. This power to invade in further trust, as long as the invasion standard is not changed, may be exercised even though present distributions are not being made or the conditions for them to be made have not occurred. Hence, a trustee may invade the corpus of a trust with a standard for invasion and thereby change other aspects of the trust such as appointment of successor trustees, the time that the property remains in trust, and the governing law, as long as the invasion standard is not changed.

The Alaska statute also permits the trust to be extended by an invasion in further trust as long as essentially the term from the inception of the trust from which the invasion is being made does not exceed 1,000 years. Alaska law grants the power to invade in further trust to trusts that were not originally governed by Alaska law if the governing law is changed to Alaska. This permits a trust created under the law of a state that imposes a rule against perpetuities to be "moved" to Alaska and the trust term extended beyond the rule against perpetuities period. Such an extension, however, could cause exemption from generation-skipping transfer taxation to be lost.[15] However, if the trust is not so exempt, this will not be a concern.

Delaware and Tennessee allow decanting to a trust which gives the trustee a different standard for distribution--for example, from a trust which limits a trustee by an ascertainable standard to a trust which gives the trustee absolute discretion.[16] Alaska did not adopt this approach because of a perceived concern that the existence of such a statute may be construed as providing all trustees with an absolute discretion standard. For example, consider a surviving spouse who is named as the sole trustee of a non-marital deduction trust (e.g., a bypass trust). The above type of decanting statute gives the spouse the power (even though not actually exercised) to decant the trust to a

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[12] *Matter of Rockefeller*, NYLJ, August 24, 1999, p. 28, col. 2 (Surr. Ct. Nassau County); Matter of Kaskel, 620 NYS2d 217 (Surr. Ct. NY County 1994).
[13] *Matter of Riese*, 627 NYS2d 1028 (Surr. Ct. NY County 1995).
[14] *Estate of Grosjean*, NYLY December 20, 1997, p. 35, col. 6 (Surr. Ct. Nassau County).
[15] See Treas. Reg. § 26.2601-1(b)(vi). Note that this is a "grandparenting" provision, providing exemption from generation-skipping transfer tax on account of the effective date of the transfer to the trust (generally, before September 25, 1985). A trust may also be exempt from the tax on account of the allocation of GST exemption under section 2631 to the trust. No regulation indicates whether extending the term of such a trust could cause the exemption from taxation due to allocation of GST exemption to be lost as it would with respect to a grandparented trust.
[16] Del. Code Ann. tit. 12 § 3528; Tenn. Code Ann. § 35-15-816.

trust that gives the surviving spouse absolute discretion to make distributions to herself or himself. The result could be that the surviving spouse has a general power of appointment[17] and consequently the value of the assets in the trust will be included in the surviving spouse's gross estate for Federal estate tax purposes.[18]

Florida Statute[19]

As indicated in the Halperin/ Wandler article, Florida's Supreme Court in *Phipps v. Palm Beach Trust*, 142 Fla. 782 (1940), indicated that the law in the State of Florida permits a trustee with absolute discretion to distribute the principal of a trust among a class of beneficiaries, to distribute the principal of the trust into a new trust for a member of the class of beneficiaries, rather than making the distribution directly to the beneficiary. The *Phipps* case appears to hold that the trustee's absolute discretion over distributions of principal to be in the nature of a special power of appointment, and expressly held that the trustee's power of appointment could be exercised in further trust.

Florida had recently adopted the Florida Trust Code one of its objectives of which was to codify the law applicable to trusts in Florida. Members of the Florida Bar believed that the law established in the *Phipps* case also should be codified and supplemented in certain ways such as to provide beneficiaries with appropriate notice of a trustee's proposed exercise of the power to invade in further trust.

As with the New York statute, the trustee under the new Florida law must have absolute discretion to invade but a power to invade principal for purposes such as best interests, welfare, comfort or happiness constitutes an "absolute power" for purposes of this subsection.[20] But the trustee would not have the power to invade principal in further trust if the trustee's principal invasion power is limited to specific or ascertainable purposes.

Consistent with the decision in *Phipps v. Palm Beach Trust*, 142 Fla. 782 (1940), the beneficiaries of the second trust may include only beneficiaries of the first trust. The power to invade principal set forth in subsection (1) cannot operate to add beneficiaries to the second trust who were not beneficiaries of the first trust. However, it is not required that every beneficiary of the first trust also be a beneficiary of the second trust. Rather, this limitation was added to address the concern that a trustee not be permitted to "rewrite" the trust. It was not intended to prevent a trustee from granting a beneficiary a special or general power of appointment whereby the beneficiary could appoint outright or in further trust in favor of persons who were not beneficiaries of the original trust. Nor was it intended to preclude acceleration of beneficial interests such as by permitting remainder beneficiaries to become current beneficiaries. Thus, the power could be

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[17] I.R.C. § 2041.

[18] There may be a counter argument if a state has a statute which provides a default rule that a trustee-beneficiary must be subject to an ascertainable standard (see Alaska Statute 13.36.153). However, then the question exists as to which statute prevails with respect to the trustee's distribution powers—the decanting statute or the standard limitation statute.

[19] Much of the discussion under this heading is derived from a memorandum of explanation prepared for the Florida Bar Association, primarily by Diana S. C. Zeydel.

[20] Florida Statute sec. 736.04117 (1).

exercised so as to separate beneficiaries with differing needs and risk tolerance out of a single trust into separate trusts.

The exercise of the power cannot reduce any fixed income, annuity or unitrust interest in the assets of the first trust. This limitation was added to secure or preserve the tax effects of the first trust (such as with respect to a marital deduction trust required to pay all income to the surviving spouse) and to preserve the intentions of the settlor with respect to required distributions. The statute also provides that the power cannot be exercised so to prevent the marital deduction or charitable deduction to be allowed with respect to the first trust.

Other than the specific limitations contained in subsection (1), there are no restrictions on the terms of the second trust, which may change any administrative provision, the nature and extent of the trustee's discretion to make distributions and the timing of any right to receive distributions of principal.

The exercise of the power must be by an acknowledged written instrument and filed with the records of the trust. See Section 736.04117 (2).

The power may not be exercised to the trustee, individually, or to the trustee's creditors, the trustee's estate or the creditors of the trustee's estate. Further, the power cannot be exercised in a manner that would postpone the vesting of the trust estate for a period beyond the rule against perpetuities applicable to the original trust. This later limitation apparently is intended to prevent the power being exercised in a manner so as to cause a trust to lose "grandfathering" from generation-skipping transfer taxation. Florida Statute Section 736.04117 (3).

The Florida law requires that The trustee must notify all "qualified beneficiaries" (within the meaning of Florida Statute Section 736.0103 (14)), in writing, at least 60 days prior to the effective date of the trustee's exercise of the decanting power. Florida Statute 736.04117 (4). This 60 day waiting period may be waived by the qualified beneficiaries. The trustee is exonerated from liability for failure to exercise the power. Florida Statute 736.04117 (5). The exoneration provision provides important protection to trustees and avoids unnecessary conflicts between the trustee and the beneficiaries given the broad discretion conferred by the power.

Neither a spendthrift provision in the trust agreement or Will creating the trust nor a provision that prohibits the amendment or revocation of the trust forecloses the trustee from exercising the decanting power.

The new Florida statute does not abridge the right of any trustee who has a power of invasion to appoint property in further trust which arises under the terms of the trust instrument, another statute or the common law. Florida Statute 736.04117 (7).

South Dakota Statute

The new South Dakota statute (SD Statute Section 55-2-15) contains a number of provisions that some of the other state decanting statutes have but it also has some

provisions that are not contained in the five other decanting statutes. Apparently, absolute discretion is not required. See South Dakota Statute Section 55-2-15(2)(b).

It appears that an income interest may be reduce or eliminated, except for marital deduction trusts. See South Dakota Statute Section 55-2-15(4). Query whether this creates, by negative implication, an issue for charitable trusts such as so-called net income with make-up charitable remainder trusts or NIMCRUTs or for other tax qualified trusts such as a grantor retained annuity trust or GRAT. In addition, this might permit the trustee to eliminate a required income interest in a so-called Qualified Subchapter S Trust ("QSST") described in section 1361( ) of the Internal Revenue Code. The elimination of an income interest in a trust would not disqualify it as a QSST as income need not be required to be paid from the trust but only that the income be so paid. Nevertheless, the existence of another provision under the law could, perhaps, cause the trust to fail to be a QSST. It seems that an invasion in further trust may be made for future beneficiaries for whom distributions could be made. South Dakota Section 55-2-15(1). In another words, if one beneficiary is entitled or eligible to receive the income of the trust, the trustee can invade in trust for one or more of the remainder beneficiaries. If the trust was clearly intended by the settlor to be a QSST from inception, it seems the power to invade could not be exercised to terminate the current income beneficiary's income interest as that would seem to prevent the trust from being a QSST. On the other hand, if the settlor had no such intention, then the ability to invade in trust that would terminate the income interest might mean the trust could not become a QSST.

Apparently, the beneficiary or beneficiaries for whom the power may be exercised need not be entitled to receive the income but only be eligible to receive income or principal of the trust. See South Dakota Statute Section 55-2-15(1). Indeed, it seems that discretionary distributions of income may be made in trust for beneficiaries to whom only discretionary distributions of principal could be made. Also, it seems that discretionary distributions of income or principal may be made in trust for future beneficiaries for whom distributions could be made in the future.

The new South Dakota law prohibits the time for vesting for a Internal Revenue Code Sec. 2503(c) minority trust to be extended. See South Dakota Statute Section 55-2-15(3). This provision, quite obviously, was to prevent the statute from "disqualifying" a trust from being a Sec. 2503(c) trust which requires that the corpus of the trust must be distributed to the beneficiary by age 21 years (or, alternatively, the beneficiary must be given the power unilaterally to withdraw the trust property at that age). However, it seems that a trustee could not exercise a decanting power to extend the vesting time in any event under the first paragraph of the statute because it would be contrary to the purposes of the trust.

The South Dakota statute provides that the power does not apply to trust property over which a beneficiary has a presently exercisable power of withdrawal. See Section 55-2-15(5). This apparently is intended to insure that a power held by one or more beneficiaries to withdraw property transferred to the trust so the transfers qualify for the gift tax annual exclusion under *Crummey v. Commissioner*, 397 F2d 82 (9th Cir. 1968).

For most trusts, it seems such a safeguard would not be necessary as the settlor no doubt intended to so qualify transfers to the trust for the annual exclusion.

The South Dakota law expressly provides that a trustee who is a beneficiary or who is acting with respect to a trust under which any beneficiary may change trustees may not exercise the power unless it is limited to a standard of health, education, maintenance or support. South Dakota Section 55-2-15(2)(a). The limitation with respect to health, education, maintenance or support is intended to prevent a trustee or beneficiary from being treated as holding a general (estate/gift taxable) power of appointment. See sections 2041(b)(1)(A) and 2514(c)(1) of the Internal Revenue Code. Under Rev. Rul. 95-58, 1995-2 CB 191, powers described in section 2036 or 2038 of the Internal Revenue Code ("Code") held by a trustee are attributed to the trust's settlor (causing estate tax inclusion in his or her estate) if the settlor may remove the trustee and name another as trustee unless the settlor may not appoint himself or herself or anyone who is related or subordinate to the settlor within the meaning of section 672(c) of the Code. This attribution of the trustee's powers has been extended, unofficially, by the IRS to beneficiaries which could cause them to hold a general power of appointment.[21] Presumably, the South Dakota statute by using the words "change the trustees" intends to encompass not just a removal power, but a removal and replacement power, which might be construed as a general power of appointment unless trust distributions are limited to an ascertainable standard.

The new South Dakota law also provides that a trustee may not exercise the power, except to the extent it is needed for the health, education, maintenance or support of a beneficiary, if would have the effect of either (1) increasing the distributions to the trustee of the trust or to a beneficiary who may change trustees or (2) removing restrictions on discretionary distributions. *See* South Dakota Section 55-2-15(2)(b). The purpose and scope of this provision seems somewhat uncertain. For example, it may be that a trustee who is neither a beneficiary nor could be changed by one may not exercise the decanting power over a trust where the power to pay income or principal is limited to a standard (e.g., education) to pay property over to a trust which has a broader or different standard. On the other hand, the restrictions on discretionary distributions may mean ones relating to timing or amount. For example, if the trustee may invade only one-half of the corpus, then the trustee could not decant more than one-half.

Recent Case Law Developments

A number of developments under New York's decanting statute (EPTL 10-6.6) have occurred by case law. The cases have reinforced the importance of such laws to fulfilling the purposes of a trust, such as providing spendthrift type protection for trust interests, including making a trust a spendthrift or converting to a special needs trust, and that a "liberal" construction will be made to determine if the trustee has "absolute" power to invade the corpus. Also, at least one court has expressly stated that it will look at the of good faith (or reasonableness) of the exercise to determine if it falls within the scope

[21] *See, e.g.* ,PLR 200551020. Under IRC § 6110(k)(3), neither a private letter ruling ("PLR") nor a technical advice memorandum may be cited or used as precedent.

of the statute.[22] The requirement of good faith reasonableness seems appropriate and is important to ensure the power cannot be used to violate the intent of the settlor of the trust, such as to obtain a certain tax benefit by its creation.[23]

Further Generation-Skipping "Grandparenting" Thoughts

As discussed in detail in the Halperin/Wandler article, the exercise by the trustee of a state conferred decanting power that extends the term of the trust created before the effective date of the generation-skipping transfer tax could cause "grandparenting" of the trust from the tax to be lost.[24] The regulations indicate that the distribution of trust principal in a grandparented trust to a "new" or "continuing" trust will not cause the property to lose its exemption from taxation if either the terms of the exempt trust instrument authorize such distribution or state law, in effect when the trust became irrevocable, authorized the distribution without the consent of a court or any beneficiary. None of the six decanting statutes were in effect when the generation-skipping transfer tax took effect. Hence, the requirement that state law authorized the distribution when the trust became effective would not be met based upon such state statutes for trusts that are exempt by reason of the grandparenting rule.[25]

There seem to be, however, at least three issues with respect to the question of whether the trustee may exercise the power to invade in trust without negative GST effects. The first issue is whether the applicable state's common law permitted decanting. As discussed above, under Florida law, it seems a decanting power was present, and it is at least arguable that it existed under the common law of all states.[26] Second, the IRS has not construed the regulation strictly. For example, it has allowed trustees under EPTL 10-6.6 to exercise the power of a grandparented trust to make the trust a spendthrift one and to change the situs of the trust.[27] Hence, it may well be that, as long as the trustee does not extend the term of the trust, grandparenting is not lost. This may mean that the trustee could grant a beneficiary a special power of appointment which, perhaps, could be exercised without loss of grandparenting. Third, it seems that the trustee could exercise the power for the shorter of (1) a standard lives in being plus 21

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[22] *See In re Alfred Hazan*, NYLJ April 11, 2000 (Surr. Ct. Nassau County).

[23] For example, a trustee likely would be prohibited from being able to extend the term of a IRC § 2503(c) minority trust beyond the minor's age 21 years.

[24] Treas. Reg. § 26.2601-1(b)(4)(A).

[25] Certain trusts created after the initial effective date of the generation-skipping transfer tax are exempted (*e.g.*, where the settlor was incompetent). *See* Treas. Reg. § 26.2601-1(b)(3). Hence, one of the applicable state decanting statutes might have been enacted for such special date "grandparented" trusts by the time such a trust became irrevocable.

[26] Restatement 2d of Property (Donative Transfers) provides, in a comment to the section defining powers of appointment, that a trustee's discretionary power to make distributions among a class of beneficiaries is a power of appointment. However, the Restatement 3d of Property (Donative Transfers) (which is not yet published but has been approved by the ALI) specifically repudiates the notion that a trustee's power to make distributions is a power of appointment. The section defining powers of appointment expressly states that a trustee's power is not a power of appointment. Nevertheless, Comment g to the 3d Restatement merely states that the trustee's power of distribution is not a power of appointment because it is exercisable in a fiduciary power and does not lapse upon the death of the fiduciary. Hence, the Comment does not foreclose the fiduciary from exercising the power of distribution in trust.

[27] See, e.g., PLR 199942013 and PLR 200227020.

year term and (2) the maximum period so that the trust would not lose grandparenting protection.[28]

Application to Non-Grandparented but GST Exempt Trusts

A generation-skipping trust may be exempt, in whole or in part, from generation-skipping transfer tax not just by reason of grandparenting but also by reason of allocation of GST exemption to transfers to the trust.[29] Although the IRS has, in private rulings[30], applied certain of the grandparenting rules to trusts that are exempt by reason of allocations of GST exemption, it is uncertain whether the exercise of a state decanting power would cause such exemption from taxation to be lost.[31] Most "new" trusts likely were irrevocable when the applicable decanting statute (at least in New York, Alaska, Tennessee and Delaware) was enacted. Hence, applying the literal grandparenting requirements to a GST exemption allocated trust would not cause exemption from taxation to be lost. Also, the policy considerations seem quite different. In the absence of regulations, it would seem difficult for the IRS to argue that exemption from taxation is lost for a trust that is exempt from tax by reason of an allocation of GST exemption when the trustee exercises a decanting power even if the term of the trust is extended.

Conclusion

Decanting may seem like a strange provision, more powerful than effective drafting, faster than a court proceeding, and able to leap over improvident trust provisions in a single bound, and which, disguised as a benign statute, fights for better trust administration and tax effects under American law.

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[28] In PLR 200227020, the IRS ruled that grandparenting would not be lost in decanting a trust and explicitly noted that the new trust "will provide that, notwithstanding any other provision, no exercise of a power of appointment granted in the trust shall result in a termination date for a trust or a share thereunder or created pursuant to a power of appointment granted thereunder which is later than the date twenty-one years after the death of the survivor of all of Sister's descendants living at Decedent's death."

[29] IRC § 2631(a).

[30] *See, e.g.,* PLR 200551020.

[31] *See* PLR 9849005 holding that GST exemption allocation to a trust that made it exempt from the tax would continue where the trust's were to use EPTL 10-6.6 to pay the corpus over to a trust with "identical" terms.

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Decanting Discretionary Trusts: State Law and Tax Considerations

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INTRODUCTION

New York was the first state to enact a statute authorizing trustees to appoint trust property in favor of another trust. Twelve years ago — with generation-skipping transfer, or GST, tax planning in its sight — New York enacted EPTL §10-6.6(b). While it is unclear whether the coveted GST tax results may be attained, New York practitioners increasingly have been relying on this powerful statute to achieve other important objectives.

The statute's utility has gained recognition. Recently three states — Alaska, Delaware and Tennessee — have enacted similar statutes. We expect other states to follow. In addition, with heightened appreciation for the authority to distribute to new trusts, many practitioners now include pour-over provisions in the governing documents.[1]

This article explores the framework of the decanting statute, while highlighting some unsettled issues. It further analyzes the GST, gift, estate and income tax consequences of employing the statute. The article then describes the potential applications of the statute. And finally, it examines possible alternative ways to decant trust assets in favor of another trust. For ease of reference, and because New York provided the model statute, the statutory analysis and all other mention of state law, unless otherwise noted, refer to New York law.

STATUTORY FRAMEWORK

Statutory Prerequisites

New York Estates, Powers and Trusts Law (EPTL) §10-6.6(b)[2] has four statutory prerequisites: the trustee must have absolute discretion to invade the principal of the trust; the exercise of the power cannot reduce the fixed income right of any beneficiary; the exercise of the power must be in favor of one or more of the proper objects of the exercise of the power; and the new trust cannot contain certain provisions (described below) deemed to violate public policy.[3]

Unfettered Discretion to Invade Principal

The first test — the trustee's unfettered power to invade the principal of the existing trust — requires that

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[1] If the governing document contains decanting authority, the trustee need not rely on the applicable state statute.

[2] EPTL §10-6.6(b), L. 1992, Ch. 591, effective July 24, 1991 and applicable to all trusts whenever created.

[3] The statute provides, in part:

> (b) Unless the terms of the instrument expressly provide otherwise:
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> (1) A trustee who has the absolute discretion, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, to invade the principal of a trust for the benefit of one or more proper objects of the exercise of the power, may exercise such discretion by appointing all or part of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument, provided, however, that the exercise of such discretion (A) does not reduce any fixed income interest of any income beneficiary of the trust, (B) is in favor of the proper objects of the exercise of the power, and (C) does not violate the limitations of 11-1.7; and
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> (2) A trustee described in subparagraph (1) of this paragraph may act thereunder without consent of any interested person and without prior court ap-

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there be no constraint on the trustee's power to invade principal. The requirement is not met if there is any limitation on the trustee's discretionary power (other than normal fiduciary duties concerning abuse of discretion). Accordingly, if the trustee may invade principal, but only in accordance with an ascertainable standard (such as for the beneficiary's health, education, maintenance and support), EPTL §10-6.6(b) is not available.[4] Similarly, the trustee's power to distribute for the beneficiary's comfort, in the absolute discretion of the trustee, would seem to fall outside the requisite authority. " 'Absolute' discretion, for purposes of EPTL §10-6.6(b), connotes a standard that is unconstrained except by the implicit requirements of reasonableness and good faith." [5]

Fixed Income Interest

The second requirement — the exercise cannot reduce the fixed income interest of any income beneficiary — does not limit the statute's application if the beneficiaries are discretionary. Rather, the limitation applies only to a beneficiary who is identified specifically in the trust agreement, either by name or other label, as the sole person or persons who will receive the income interest for a fixed period of time.[6] This requirement generally ensures that the marital deduction for estate and gift tax purposes is available where a spouse is to receive all of the income from a trust.[7]

The statute does not deal specifically with a beneficiary's future fixed right to income (as opposed to a current fixed income right). Consider a trust with income payable to A for life (with complete discretion to invade principal for A), then income to B for life, and remainder to C. May the trustee appoint the trust asset in favor of a new trust for A for life, remainder to C, thereby eliminating B's future fixed right to income? It would appear that, since the trustee could eliminate B's future income right via an outright distribution to A, the trustee should be able to divest B of his or her interest by way of a decanting distribution under EPTL §10-6.6(b).

Interestingly, the statute also does not prohibit the elimination of other rights, such as a general power of appointment. Arguably, the potential elimination of such a power could jeopardize the zero inclusion ratio, for GST tax purposes, of transfers to certain trusts.[8] Similarly, the same concern could apply to annual exclusion transfers to trusts for minors.[9]

In Favor of the Proper Objects

The statute previously permitted appointments in further trust if the exercise of the power was "in favor of the beneficiaries of [the] trust." In 2001, New York amended EPTL §10-6.6(b) by replacing "beneficiaries of trust" with "proper objects of the exercise of the power." This change appears to have no meaningful difference and does little to clarify the intended meaning of the phrase "proper objects." [10]

Who are the "proper objects" of the exercise of the power? Are they the current income beneficiaries? Or must the remaindermen of the existing trust also be the same as those under the new trust?

One of the underlying rationales supporting EPTL §10-6.6(b), as described below, is that a trustee's power to invade is akin to a power of appointment. Therefore, the power of appointment rules should shed light on the meaning of this statutory requirement.

Absent a contrary provision in the governing instrument, a donee of a power of appointment may appoint property in further trust.[11] A donee may select one or more permissible appointees. Of course, the donee may exercise this right only within the scope permitted under the granted power. Accordingly, a donee of a power of appointment may not exercise the power in favor of someone who is not within the class of permissible appointees. For example, the power to appoint among the testator's descendants does not authorize an appointment in trust for the life of a child, with remainder to charity because charity was not included in the permissible class of appointees.[12]

A donee of a power of appointment may grant a permissible appointee yet another power to appoint in favor of persons to whom the donee could not directly appoint. For example, if the power is limited in favor of the testator's descendants, the donee may appoint in further trust for the life of a child, with the child having his or her own power of appointment in favor

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proval but is also authorized to seek such court approval . . .

[4] *In the Matter of the Estate of Gerald Mayer, Deceased*, 176 Misc. 2d 562 (Surr. Ct. New York County 1998).

[5] *Id.* at 565.

[6] Supp. Memo. in Support of Legis., Governor's Bill Jacket, 1992 Chapter 591, at 1-2.

[7] §§2056(b)(5), (7); 2523(e), (f).

[8] *See* §2642(c).

[9] *See* §2503(c).

[10] "Generation-Skipping Transfers; Effective Date Rule; EPTL §10-6.6 Amendment," *Practical Drafting*, Quarterly Commentaries 2002 (July 2002).

[11] *See generally Restatement (Second) of Prop.: Donative Transfers* §19.3 (2003); *see also In re Kennedy's Will*, 18 N.E.2d 146 (N.Y. 1938); EPTL §10-6.6(a).

[12] *See In re Fiske's Estate*, 195 Misc. 1017 (Surr. Ct. New York County 1949); *see also* Memo. in Support of Legis., Governor's Bill Jacket, 1992 Chapter 591, at 2-3.

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