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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 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 of descendants and charity.[13] The rationale is that, if the donee could have appointed the property outright in favor of the child, the child could be given a power to expand the class of permissible appointees under his or her own power of appointment.

With this background, let's return to the statutory rule requiring that the exercise of the EPTL §10-6.6(b) power be in favor of the "proper objects of the exercise of the power." Consider a trust for child for life (with full discretion to invade principal), with remainder (if any) to grandchildren. The trust receiving property under EPTL §10-6.6(b) may have the child, and no one else, as a current beneficiary. The remaindermen of the new trust similarly should be limited to one or more grandchildren, the remaindermen of the original trust. However, in exercising the EPTL power, the trustee may grant the child a testamentary power of appointment. That power of appointment may include persons beyond the class of the remaindermen of the original trust.

Suppose that child had a broad special power of appointment under the original trust. May the takers-in-default under the new trust be different than those under the decanted trust? The statute does not address this point.

Public Policy Limitations

EPTL §10-6.6(b) requires that the appointed trust not violate EPTL §11-1.7. That statute, in turn, prohibits the grant of certain powers or immunities to testamentary trustees on the grounds that such powers or immunities are contrary to public policy. The proscribed actions are: (1) the exoneration of such trustee from liability for failure to exercise reasonable care, diligence and prudence, and (2) the power to make a binding and conclusive fixation of the value of any asset for purposes of distribution, allocation or otherwise.[14] Because EPTL §11-1.7 applies only to testamentary trustees, it seemingly has no application where the decanting trust is an inter vivos trust.

Utilizing the Statute

Assuming the statutory prerequisites of EPTL §10-6.6(b) are satisfied, a trustee may exercise the power to appoint to a different trust in two ways: either without or with prior court approval.

Without Court Approval

Writing

If a trustee chooses to act without prior court approval, the power must be exercised in a written document that is signed and acknowledged by the trustee, and then filed in the office of the clerk of the Surrogate's Court that has jurisdiction over the trust.[15] Our general (but not universal) experience has been that the court clerk will not require copies of the decanting or new trust to be included with the filing. Some in-take clerks, however, have requested that a copy of the decanting trust be filed.

Service

A copy of the written document must be served on "all persons interested in the trust." Such persons are those individuals who would need to be served in a judicial settlement of a trustee's account. Service on a minor with an interest in the trust may be made on the guardian of the property of the minor or on the parent or parents with whom the minor resides.[16]

In New York, the virtual representation rules under Surrogate's Court Procedure Act (SCPA) §315 apply to EPTL §10-6.6 (b). Specifically, under certain circumstances, SCPA §315 permits an individual to represent either a class of individuals with similar interests or another individual with a more contingent interest.[17]

With Court Approval

The statute also permits a trustee to seek court approval.[18] A court proceeding may be an attractive option to a trustee who is concerned about its ability to meet the statutory prerequisites [19] or potential personal liability relating to the transfer of assets. The same writing, filing and service requirements apply.

GST TAX IMPLICATIONS

The GST tax was a significant driving force leading to the enactment of EPTL §10-6.6(b), and its subsequent amendment.[20] The critical question is whether the EPTL provision and similar statutes in other states serve the GST tax purpose.

GST-Exempt Trusts

Congress enacted the current GST regime, consisting of chapter 13 of the Internal Revenue Code, as part of the Tax Reform Act of 1986 (TRA). Under §1433(b)(2)(A) of the TRA, transfers from a trust that was irrevocable on September 25, 1985 [21] generally are not subject to the GST tax.[22] Chapter 13 also does not apply to any GST under a Will or revocable trust executed before October 22, 1986 (the date Congress enacted the TRA), if the decedent died before January 1, 1987.[23] The GST regulations refer to these trusts as "exempt trusts." [24]

Post-effective date additions cause an exempt trust to lose GST grandfather protection.[25] Such tainting additions may come in various forms, including actual transfers and constructive (or deemed) additions.[26]

Extending Exempt Trusts

Careful tax planning often calls for extending GST exempt trusts as long as the law permits (and avoiding actual and constructive additions). Significantly, the GST regulations confirm that a beneficiary's extension of an exempt trust by exercise of a non-general power of appointment in favor of another trust does not expose the trust to chapter 13.[27]

Suppose the beneficiary does not have a power of appointment over an exempt trust, and (by the terms of the governing document) the trust property will pass outright to the remaindermen at the death of the current beneficiary. Alternatively, consider a situation in which an exempt trust is about to expire by its terms (say, when a child or grandchild attains a specified age). In these cases, trust property will pass outright to beneficiaries, thereby potentially exposing GST-exempt assets to transfer taxes. Is it possible to extend such exempt trusts via EPTL §10-6.6(b) (or a similar rule in another state) without losing grandfather protection? [28] The answer turns on the GST regulations and applicable state law.

GST Regulations

Since 1988, the GST regulations have provided that an exercise of a special power of appointment over an exempt trust in favor of another trust generally does not cause the second trust to be subject to chapter 13.[29] For years, in private letter rulings, the IRS had asserted that modifications of an exempt trust do not cause the trust to lose its exempt status, but only if the modifications do not result in any change in the quality, value or timing of any beneficial interest under the trust.[30] Following the enactment of EPTL §10-6.6(b), a question arose as to whether the IRS would consider an extension of an exempt trust under the EPTL provision (or a similar rule in another state) tantamount to an exercise of a special power of appointment or, alternatively, as a modification. If the former characterization controlled, grandfather protection would continue; if the latter description was adopted, the new trust would lose exempt status.

Private Letter Rulings

Prior to the issuance of final regulations, the IRS published numerous rulings specifically dealing with EPTL §10-6.6(b).[31] At the time of those rulings, the New York statute permitted a trustee to appoint in further trust only with the beneficiaries' consent or court approval. In the rulings, the new trust invariably had the same substantive provisions as the old, exempt trust. The changes often involved administrative provisions, usually relating to the trusteeship provisions. In many of the rulings, the IRS cited both the regulations involving the exercise of powers of appointment and its interpretation concerning modifications of exempt trusts. In such rulings, the IRS concluded that the former was not directly on point:

> Section 26.2601-1(b)(v)(B) of the regulations does not address the situation presented in the instant case where a trustee is exercising an invasion power pursuant to a state statute requiring participation or concurrence by the court and/or trust beneficiaries. However, because the substantive and dispositive provisions of ... [the existing, exempt trusts] are identical to the respective successor trusts, the proposed transfers will not change the quality, value or timing of any beneficial interest otherwise provided for under the original trusts. Accordingly, we conclude that the proposed ... [distributions to new trusts in accordance with EPTL §10-6.6(b)] (including the trust beneficiaries' acquiescence and consent to the transaction) will not result in any constructive addition to the trusts within the meaning of section 26.2601-1(b), nor will the transactions cause the successor trusts to be subject to the provisions of chapter 13....[32]

Although not clearly stated, the IRS seemed to suggest that it would have reached a different conclusion if the substantive provisions in the new trusts were different than those under the old, exempt trusts.

Final Regulations

In December 2000, under the caption "Retention of trust's exempt status in case of modifications, etc.," the Treasury issued final regulations. The regulations provide that a distribution from an exempt trust to a new trust or retention of exempt trust principal in a continuing trust will not cause the new or continuing trust to be subject to the GST tax if, among other things, "at the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or court." [33] Thus, under this regulation, an extension of a trust under EPTL §10-6.6 (or a similar rule in another state) will not taint GST exempt status only if both of the following conditions are satisfied: (1) authority under applicable state law permitting a trustee to appoint in further trust existed at the time the exempt trust became irrevocable; and (2) the trustee must be able to exercise such authority without the consent or approval of any beneficiary or court.[34]

Several points are noteworthy. First, the new rule was part of a set of provisions relating to trust modifications, and not the exercise of powers of appointment. In addition, the regulation does not turn on whether the quality, value or timing of beneficial interests under an exempt trust are changed. And finally, the regulation indicates that grandfather protection is forfeited if, as required by the then New York statute, distribution to a new trust could be made only with the consent or approval of the beneficiaries or a court.

In response to the GST regulations, the New York legislature amended the EPTL provision by excising the requirement that the trustee must obtain consent of the beneficiaries or court approval. However, exempt trusts generally are those trusts that (among other things) were irrevocable on or prior to September 25, 1985. New York, as the vanguard in this area, did not enact EPTL §10-6.6(b) until 1992, seven years *after* the cut-off date; and, at least as a procedural matter, the New York statute required consent or approval of the beneficiaries or court for nearly a decade until 2001.[35] Query whether state law therefore could have permitted appointment in further trust at a time when an exempt trust became irrevocable. The answer turns on the common law prior to the enactment of EPTL §10-6.6(b). Before examining this issue, it is necessary to explore other GST regulations that could affect the exempt status of a trust altered in accordance with EPTL §10-6.6(b) or similar authority in another state.

Other Modifications

Regs. §26.2601-1(b)(4)(i)(D)(*1*) provides:

> A modification of the governing instrument of an exempt trust (including a trustee distribution ... that does not satisfy paragraph (b)(4)(i)(A) ...) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in

> the original trust.[36]

Thus, even if the applicable state law did not empower the trustee to appoint in further trust when the exempt trust became irrevocable but such authority under state law now exists, the distribution to a new trust will not cause the loss of GST grandfather protection if the following conditions are met: (1) the exercise of such power does not cause a beneficial interest in the trust property to be shifted to a beneficiary in a lower generational slot for GST purposes; and (2) such distribution to a new trust does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Extending an exempt trust prior to its termination plainly extends the time for vesting of a beneficial interest and likely shifts a beneficial interest to a lower generation. This regulation, therefore, does not provide GST protection when a trustee extends an exempt trust under EPTL §10-6.6(b) (or a similar statute in another state). However, it confirms that a new trust will not be subject to chapter 13 if the only change is administrative in nature. It further extends exempt status to a new trust even if the changes are substantive, provided that there is no shift of beneficial interest to a lower generation[37] and the time for vesting of any beneficial interest is not extended.[38]

Common Law

Recall that the GST regulations require an examination of applicable state law to determine whether an appointment in further trust taints exempt status. If there is a shift in a beneficial interest to a lower generation beneficiary or a delay in the vesting of any beneficial interest, the reference point dates back nearly two decades (and perhaps more), prior to the enactment of EPTL §10-6.6(b).

There is some support for the position that EPTL §10-6.6(b) and similar statutes in other states merely codify the common law. The argument is based on two principles. First, a trustee with absolute power to invade principal, as a matter of property law, is the equivalent of a donee of a special power of appointment.[39] Second, absent a contrary provision in the governing document, a donee of a power of appointment may exercise such power in a manner which is less extensive than authorized by the instrument creating the power. Under this latter principle, if there is authority to distribute outright, there is authority to distribute in further trust.

As for the first point -- a trustee's invasion power is akin to a power of appointment -- the Restatement of Property states that a Trustee's power to make discretionary distributions is a power of appointment.[40] In addition, state statutes often treat a trustee's power to invade trust property as a special power of appointment.[41]

As for the second point -- a donee of a power of appointment may exercise the power in a fashion which is less extensive than outright appointment -- there is significant authority. Absent a contrary provision in the governing document, a donee with the power to appoint outright generally has the power to appoint in trust.[42]

In at least one older case, a court permitted a trustee with unlimited power to invade principal to appoint the trust property in further trust. In *Hubert B. Phipps v. Palm Beach Trust Company*,[43] a 1940 Florida case, the trustee had sole discretion to sprinkle income and principal among a class of beneficiaries. The trustee exercised the power by distributing the trust property to a new trust. The court approved the distribution, stating:

> An examination of the trust indenture in this case leaves no doubt of the power of the individual trustee to create the second trust provided one or more of the descendants of the donor of the original trust are made the beneficiaries.[44]

The 1992 memorandum in support of legislation, included in the legislative history leading to the enactment of EPTL §10-6.6(b), suggests that the provision merely clarifies then existing state law. The memorandum states:

> Although ... a trustee's power of invasion seems to fall completely under the EPTL definition of a special power of appointment, New York courts appear to have never addressed the issue of a trustee's ability to invade principal in order to appoint in further trust. There is no authority in New York that would prevent such action, and case law from other states as well as general principles of New York law would appear to permit such an exercise; it, therefore, follows that a trustee could do so under New York law. The proposal is intended to codify this probable result.[45]

The IRS and the federal courts, of course, might have a different view. While applicable state law undoubtedly is a key element under the GST regulations, in a controversy involving federal taxes, a federal court may make its own determination of the underlying state law issue unless there is precedent from the state's highest court.[46] In the absence of any such precedent, a federal court is to give "proper regard" to lower court cases in arriving at applicable state law.

In short, there is support for the position that, under common law, a trustee who has complete discretion to distribute trust property may do so in further trust. If that power existed under applicable law as of the time an exempt trust became irrevocable (prior to 1986), a distribution to a new trust will not taint exempt status. This is so even if beneficial interests are shifted to a lower generation. However, the state law prerequisite is not entirely free from doubt.[47]

Loss of Exempt Status

What are the resulting GST tax consequences if the IRS or a court concludes that the distribution to a new trust or an extension of an existing trust, via an exercise of the power under EPTL §10-6.6(b) (or a similar state law), taints GST exempt status? In considering this question, recall that, as a general rule, all GST events occurring after the effective date of the GST tax are subject to chapter 13. While there is an exception for exempt trusts, a tainting modification, distribution or extension will cause the trust to lose its label as an exempt trust.

By way of example, suppose an exempt trust is about to expire, by its terms, when a grandchild attains a specified age, say 35 years. Prior to that date, the trustee extends the trust by exercising the EPTL §10-6.6(b) power. If the IRS successfully argues that such extension taints GST exempt status, does it follow that all subsequent distributions to the grandchild are GST events? That result would seem draconian: the extension, *if* violative of the GST regulations, admittedly should not allow the trust assets to escape a transfer tax when the beneficial interest devolves to the generation below the current beneficiary. However, even without such trust extension, the current beneficiary (here, the grandchild) would have received the property free of transfer tax.

In the foregoing example, distributions from the new (or extended) trust to the grandchild should not trigger a GST tax. It is reasonable to conclude that the generational step-down rule under §2653(a) would cause the transferor's generational slot to shift to that of the original transferor's child.[48] Even though the creation and funding of the trust may have been exempt from chapter 13, once the tainting event has occurred, in arriving at the generational assignment of the transferor and beneficiaries, arguably all of the operative provisions of chapter 13 should apply. Those rules in many cases will narrow the range of generations between the transferor and the beneficiaries if a GST event has occurred and property remains in trust. While the foregoing analysis would shield distributions to the current beneficiary from GST tax, it would lead to a GST event upon the termination of the current beneficiary's interest, when lower generational beneficiaries will have interests in the trust property (or when there otherwise will be distributions to beneficiaries occupying a lower generation during the grandchild's lifetime).

If, in the prior example, the trust beneficiary is the transferor's child (rather than grandchild), and the trust is extended beyond the protective cover of the GST regulations, that taint will not trigger an immediate GST tax. The transferor would continue to be the grantor. [49] However, when trust property eventually passes to someone two or more generations below that of the original transferor, say at the child's death, presumably the IRS will seek to impose a GST tax.

GIFT AND ESTATE TAX IMPLICATIONS

Under EPTL §10-6.6(b), the trustee -- and not the beneficiaries -- have the power to appoint in further trust. Furthermore, the statute no longer calls for beneficiary consent or court approval. Assuming the beneficiary is not a trustee (and therefore is not exercising the power), the trustee's exercise of the power should not be a taxable gift.

It is conceivable that the IRS might argue that, unless the beneficiary objects to the modification, distribution or extension, the beneficiary has made a gift. (Presumably the IRS would advance this argument, if at all, only in cases where there is the potential for the shifting of beneficial interests or a delay in vesting.) Under this possible theory, the beneficiary's acquiescence would be the equivalent of a gratuitous transfer. This argument, if advanced, should not prevail. For a taxable gift to occur, the donor must make a voluntary transfer, and no such transfer occurs when the trustee initiates the act (and the consent of the beneficiary is not required).[50]

The IRS further may argue that the expectation to receive the trust principal at the stated age is the equivalent of a general power of appointment (if the beneficiary lives to that age)[51] and the failure to object to a trust extension under EPTL §10.6.6(b) (or a similar rule under applicable state law) is a lapse or release of that general power of appointment.[52] However, this argument again is based on the assumption that the beneficiary has the legal right to prevent the trustee's action. If a court could approve a trust extension over the beneficiary's objection, the beneficiary likely will not be deemed to have a general power of appointment. If, on the other hand, it is determined that a court could not sanction an extension in a disputed matter, the gift argument is strengthened.

To minimize the risk that the IRS might assert that a gift has occurred, the beneficiary should be given a limited testamentary power of appointment over the modified, new or extended trust. A power of appointment would render the purported gift incomplete for transfer tax purposes.[53] This precautionary step is warranted where the distribution is to a new trust with a potential shifting of beneficial interests or a delay in vesting. It is not necessary where the differences between the exempt and new trusts are limited to administrative provisions.[54]

If the beneficiary's acquiescence is deemed to be tantamount to a gift, and if the gift is incomplete due to the beneficiary's power of appointment in the new or extended trust, the trust property will be included in the beneficiary's gross estate.[55] However, in the more likely case that there is no gift upon the trustee's exercise of the power under EPTL §10-6.6(b) (or a similar rule in another state), there is no estate tax inclusion. In that case, the IRS has another weapon in its arsenal. As noted earlier, if the modification, distribution or extension falls outside of what is permitted under the GST regulations, a GST tax might occur at the beneficiary's death.

INCOME TAX CONSEQUENCES

General Situations Involving Non-Recognition Events

An exercise of the power to appoint in further trust pursuant to EPTL §10-6.6(b) typically is not a recognition event for income tax purposes. In general, gain or loss is realized if: (1) an action involving a trust represents a sale or exchange of property, and (2) the property received is materially different from the property surrendered.[56] Reliance on EPTL §10-6.6 (b) should result in neither an exchange of trust property nor the receipt of "materially different" property.

In the often-cited *Cottage Savings* [57] case, a financial institution (Cottage Savings) exchanged its participation interests in one group of mortgages for another institution's participation interests in a different group of mortgages. The Supreme Court determined that "properties are `different' in the sense that is `material' to the Internal Revenue Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent." The Court held that the exchanged interests did embody legally distinct entitlements because the mortgages were made to different obligors and secured by different homes, and therefore Cottage Savings did realize losses when it exchanged its interests.[58]

In early rulings following *Cottage Savings*, the IRS suggested that a distribution in further trust might constitute a taxable exchange of an interest by each beneficiary of the original trust for an interest in a new trust if the beneficiary's new interest was "materially different" from its old interest.[59] However, in recent years, the IRS appears to recognize that a distribution in further trust does not constitute a recognition event for a beneficiary if the distribution is authorized either by the trust document[60] or by local law.[61] This new approach makes sense. In the context of a trust decanting (at the sole discretion of the trustee), the beneficiaries are not exchanging any interests. Therefore, the exercise of the EPTL power to appoint in further trust generally should not trigger a recognition event.

Special Situations that May Lead to Income Recognition

While a distribution under EPTL §10-6.6(b) generally should not give rise to a recognition event, special rules apply if the trustee transfers encumbered property or a partnership or LLC interest with a negative capital account.

By way of background, §1001 of the Code provides that gain from the sale or other disposition of property is the amount realized over the property's adjusted basis. In *Crane v. Comr.,*[62] the U.S. Supreme Court held that when property subject to a nonrecourse liability is sold, the amount realized includes not only the cash or other property received in exchange for the encumbered property, but also the full amount of the liability. Similarly, if there is a part-sale, part-gift, where the only consideration by the transferor is the transferee's assumption of the liability, there is a deemed sale to the extent of the liability (and a gift of the fair market value of the property which exceeds the liability). In that case, the transferor's amount realized is equal to the assumed liability.[63]

The regulations confirm the *Crane* holding: "the amount realized from a sale or other disposition of property includes the amount of liabilities from which the transferor is discharged as a result of the sale or disposition." [64] Regs. §1.1001-2(a)(4) (v) further provides that liabilities from which a transferor is discharged as a result of the sale or disposition of a partnership interest include the transferor's share of the partnership liabilities.[65]

Example 5 of Regs. §1.1001-2(c) deals with the income tax consequences arising when a grantor trust holding a partnership interest with a negative capital account ceases to be a grantor trust. In that example, grantor trust status terminated because the grantor released those powers which initially caused grantor trust status. When the grantor released such powers, the grantor ceased to own the property for income tax purposes. At that moment, the grantor is treated as having transferred the partnership interest to the trust, which is considered a separate taxable entity. The grantor is deemed to realize an amount equal to the amount of partnership liabilities allocable to the trust's interest. To the extent that amount exceeds the basis of the partnership interest, there is taxable gain. [66]

Under these principles, if the decanting trust ceases to be subject to liabilities as a result of a distribution – whether because the property is encumbered or because an interest has a negative capital account -- the trust realizes an amount equal to the encumbrance or negative capital account, potentially leading to a gain. If the transferring trust and the receiving trust are both grantor trusts for income tax purposes, these special rules should have no impact. This is so because transactions between two grantor trusts (with the same taxpayer as the grantor) generally are ignored for income tax purposes.[67] However, if one or both trusts are simple or complex trusts, the tax advisor must examine whether the liability encumbering any transferred property exceeds basis.

Another situation may give rise to income recognition. If the decanting trustee transfers property to a foreign trust, there may be a recognition event. Under §684, the transfer of property to a foreign trust of an appreciated asset is treated as a sale or exchange. If the transfer involves all of the decanting trust's assets, however, recognition likely will not be a problem. In the last year of its existence, the decanting trust will receive a distribution deduction for the income generated by the transfer to the foreign trust. Moreover, if the transfer is to a grantor trust (with respect to the transferor), there is no deemed sale or exchange at that time.[68] Rather, the deemed sale or exchange occurs once grantor trust status terminates.[69]

Other Income Tax Considerations

In most cases, as described earlier, a distribution under EPTL §10-6.6(b) (or a similar rule in another state) will not give rise to a recognition event. Nevertheless, the distribution has other income tax consequences. The distribution will carry out a proportionate share of the trust's distributable net income, or DNI, under the tier system. Consequently, the distribution will give rise to a deduction for the decanting trust [70] and income inclusion for the receiving trust.[71] The character of the income for the receptacle trust will remain the same as that for the decanting trust.[72]

POTENTIAL USES

While it is not altogether clear that EPTL §10-6.6(b) serves the intended GST purposes (described earlier), the statute has been remarkably useful in other areas. Over the past 12 years, practitioners in New York have employed EPTL §10-6.6 (b) to achieve a variety of objectives.[73]

For example, complex trusts created by New York settlors or under wills of New York decedents, referred to as New York resident trusts, generally are subject to New York State income tax.[74] However, such trusts are not subject to New York State income tax if the following three conditions are met: (1) all the trustees are domiciled outside New York State; (2) the entire corpus of the trust, including real and tangible property, is located outside of New York State; and (3) all income and gains of the trust are derived from sources outside of New York State.[75] Intangible personal property held by a trust with no New York trustees generally will not generate New York source income and will not be considered New York property.[76]

Suppose a trustee of a New York resident trust with unfettered discretion to distribute principal holds both a substantial portfolio of financial assets, such as securities and hedge fund investments, and New York real estate investments (either directly or though LLCs or partnerships). The trustee may employ the statute to create a separate trust to isolate the financial assets from the assets that generate New York source income. So long as the trustee of the trust holding the financial assets is not a New York domiciliary, that trust generally will escape New York State tax on accumulated income and capital gains.[77]

EPTL §10-6.6(b) also could be used to facilitate the funding of life insurance trusts or to meet other trust obligations. Over time, an individual may have created multiple trusts. It is possible that one such trust has on-going obligations (say, to pay life insurance premiums or interest and principal payments on a loan), while another trust has available liquidity. Depending on the particular terms of the trusts, it may be possible to combine the available liquidity and the asset giving rise to the obligation. This objective may be attainable, again depending on the terms of the trusts, in several ways: a transfer of liquid assets to the trust with the obligation; a transfer of the assets with the obligation (for example, the insurance policy) to the trust with the liquid assets; or transfers from both trusts to a third, perhaps newly created, trust.

Trustees further have used EPTL §10-6.6(b) to achieve other goals, such as: dealing with changed circumstances; modifying administrative provisions; altering trusteeship provisions; extending the termination date of trusts (for non-tax reasons); correcting drafting errors; converting a complex trust (for fiduciary income tax purposes) to a grantor trust (or vice versa); changing the governing law; dividing trust property to create separate trusts (to facilitate varying investment strategies for different beneficiaries); limiting exposure to New York State real property transfer tax; and reducing potential liability.[78]

OTHER STATES

Alaska, Delaware and Tennessee recently enacted statutes that are modeled closely on EPTL §10-6.6(b).

Alaska's statute, enacted in 1998, is an almost verbatim version of New York's EPTL §10-6.6(b)(1).[79] Delaware's statute, signed into law on June 30, 2003, and Tennessee' s recent statute, effective as of July 1, 2004, are very similar to each other and largely follow EPTL §10-6.6(b)(1). However, unlike New York and Alaska's statutes, Delaware and Tennessee's statutes do not require that the trustee of the original trust have absolute discretion to invade the principal of the trust; rather, they include a less stringent requirement that the trustee simply have authority (rather than absolute discretion) to invade.[80] The Delaware statute further deviates from New York's by omitting a requirement that the exercise of the discretion to invade principal cannot reduce any fixed income interest of any income beneficiary of the original trust.[81]

ALTERNATIVES TO STATUTES

There are, of course, other alternatives to utilizing EPTL §10-6.6(b) or similar statutes of other states.

Provisions in Governing Instrument

The original trust instrument might contain express authority allowing the trustee to pour over the assets to another trust. Indeed, many attorneys increasingly are including an explicit pour over provision to facilitate the transfer of trust assets, without needing to rely on a state statute.

The original trust agreement further might grant the trustees the power to amend the terms of the trust. Some practitioners include provisions bestowing upon trustees the power to change the trusts' administrative provisions. It is more rare, however, for trustees to be given the power to amend dispositive provisions.

Trust documents also might provide for a lifetime power of appointment granted to a beneficiary, thereby allowing him or her to appoint the trust property to another trust with different terms. A beneficiary who exercises a lifetime power of appointment should not be deemed to have made a gift unless the beneficiary relinquishes a vested right to the trust property.

Amendment by Grantor in Accordance with Statute

While the grantor is alive, even an irrevocable, unamendable trust may be amended. In New York, EPTL §7-1.9(a) allows the grantor of an irrevocable trust to revoke or amend the trust in whole or in part, as long as the grantor obtains the written, acknowledged consents of all persons with an interest in the trust. Although the grantor need not obtain the consent of unborn beneficiaries,[82] the grantor does need to secure the consent of all living beneficiaries, including minors. This requirement could be problematic because New York case law generally holds that a minor cannot consent.[83] New York courts, however, have relaxed this rigid rule somewhat by holding that the consent of a minor beneficiary is unnecessary if the proposed amendment to the trust is favorable to the minor.[84] Nonetheless, a grantor likely will have difficulty relying on EPTL §7-1.9 to amend a trust if a minor beneficiary is involved. In addition, the consent requirement may give rise to unexpected tax consequences, as described earlier. And finally, EPTL §7-1.9 is not available if the grantor is not living.

Division and Establishment of Separate Trusts

Under certain circumstances, a trustee may divide a trust into two or more separate trusts. In New York, EPTL §7-1.13(a)(1) permits a trustee to divide a trust and establish separate trusts, without the consent of the beneficiaries and without prior court approval, in order to achieve one of several specified purposes. Trust divisions (absent court direction or beneficiary consent) are permitted primarily in connection with tax planning, such as to isolate marital and non-marital assets, GST exempt and non-exempt assets and subchapter S stock from other trust assets.[85]

Significantly, this EPTL provision does not require that the trustee have unfettered discretion to invade the principal of the trust. However, it is limiting because the trustee may use it only to accomplish fairly specific purposes. Paragraphs (2) and (3) of EPTL §7-1.13(a) expand the potential use of the statute. These provisions, respectively, allow a trustee to divide a trust "for any reason which is not directly contrary to the primary purpose of the trust," provided that the trustee obtain either the consent of all the trust beneficiaries or court approval.[86] They therefore offer a trustee more leeway in terms of the reason for dividing a trust. However, the division still must be consistent with the purpose of the trust (and court or beneficiary approval is required). In addition, each divided trust established pursuant to EPTL §7-1.13(a), with limited exception, must be identical to the original trust.[87]

Reformation or Modification

One other option is reformation or modification if the state has a statute similar to §411 of the Uniform Trust Code (or UTC). This uniform rule seeks to expand common law rules on trust modification and termination to enhance flexibility.[88] The UTC provision requires a court proceeding. In a reformation, the court amends the language of a trust, but not the grantor's actual intent. If the requested relief is modification, by comparison, the court amends both the language of the trust and the grantor's intent.[89]

The UTC provides that an irrevocable trust may be modified or terminated either upon the consent of the grantor and all the beneficiaries or upon the consent of all the beneficiaries if the court concludes that all the trust's material purposes have been accomplished.[90] Furthermore, even if all the beneficiaries have not consented, the court still may approve a modification or termination if the court determines that the trust could have been modified or terminated if all the beneficiaries had consented and that the interests of a beneficiary who does not consent will be shielded.[91] Under the UTC, courts can modify the administrative or dispositive provisions of a trust, or terminate a trust, because of a change in circumstances.[92] Common law typically authorizes the modification of a trust's administrative provisions because of a change in circumstances, but the UTC's authorization of changes to a trust's dispositive provisions for the same reason represents a departure from the norm.

A grantor relying on the UTC, if enacted in the state, will not face the same difficulty of obtaining consent from a beneficiary who is a minor as a grantor trying to use EPTL §7-1.9 because the UTC contains a number of helpful provisions regarding the representation of beneficiaries. The UTC allows minor, unascertained and unborn beneficiaries to be represented by virtual representation or by a guardian ad litem.[93] The UTC also allows such beneficiaries to be represented by a conservator, guardian, agent, trustee, personal representative or parent, assuming, of course, that there is no conflict of interest between the representative and the beneficiary.[94] The inclusion of additional possible representatives would give courts significantly more leeway in approving modifications or terminations of trusts.

CONCLUSION

While EPTL §10-6.6(b) initially was enacted with GST tax planning in mind, the statute has been used in countless other circumstances. Several states have replicated the New York statute, with more likely to follow suit. The exercise of the power to decant, however, has tax consequences that must be considered.

Footnotes

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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:

[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.

[13] *See Matter of Moore*, 129 Misc. 2d 639 (Sup. Ct. N.Y. Co. 1985); Memo. in Support of Legis., Governor's Bill Jacket, 1992 Chapter 591, at 3.

[14] EPTL §11-1.7(a).

[15] EPTL §10-6.6(d).

[16] EPTL §10-6.6(d), (e).

[17] For example, suppose a trust exists for A for life, remainder to A's descendants, or if none, to B, or if B is not living, to C. If the trustee wishes to exercise the power to invade, service must be made on A and B (assuming A has no descendants); it is not necessary to serve C because C's interests are adequately represented by B.

[18] EPTL §10-6.6(c).

[19] Because trustees are not required to seek court approval, it is unlikely that we will see many court decisions addressing the open issues noted earlier.

[20] The 1992 memorandum in support of legislation, included in the Governor's Bill Jacket, explains that the (then proposed) EPTL provision would provide "a

means of dealing with the new generation-skipping transfer tax." Memo. in Support of Legis., Governor's Bill Jacket, 1992 Chapter 591, at 2. The legislative history further confirms that the 2001 amendment to EPTL §10-6.6(b) (described below) was designed to "restore the intended purpose of the section to permit certain powers to be exercised without triggering generation-skipping transfer tax, which purpose has been foiled by federal regulations." Memo. in Support of Legis., Governor's Bill Jacket, 2001 Chapter 204, at 1.

[21]On Sept. 26, 1985, the House Ways and Means Committee began considering the bill containing the GST provisions.

[22]*See also* Regs. §26.2601-1(b)(1)(i).

[23]TRA §1433(b)(2)(B), as amended by the Technical and Miscellaneous Revenue Act of 1988. *See also* Regs. §26.2601-2(b)(2)(i). The GST tax also does not apply to any generation-skipping transfer under a trust to the extent such trust consists of property included in the gross estate of a decedent, but only if the decedent was under a mental disability as of Oct. 22, 1986 which prevented him or her from changing the testamentary plan (and such decedent did not regain competence before death). TRA §1433(b)(2)(C); Regs. §26.2601-1(b)(3).

[24]Regs. §26.2601-1(b)(4).

[25]Regs. §26.2601-1(b)(1)(i).

[26]*See* Regs. §26.2601-1(b)(1)(v).

[27]Regs. §26.2601-1(b)(1)(v)(B); *see also* Regs. §26.2601-1(b)(1)(v)(D) (*Ex. 4*). To come within this rule, the power of appointment must not be exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation in property for a period extending beyond the rule against perpetuities period (measured from the creation of the exempt trust).

[28]The 1992 memorandum in support of legislation asserted that, with the passage of the (then proposed) EPTL provision, "a trustee with a fully discretionary power of invasion could fund a new trust (for an object of the power of invasion) and thereby extend the length of time in which the property is exempt from GSTT." Memo. in Support of Legis., Governor's Bill Jacket, 1992 Chapter 591, at 5.

[29]Regs. §26.2601-1(b)(1)(v)(B); *see also* Regs. §26.2601-1(b)(v)(D) (*Ex. 4*); T.D. 8187, 1988-1 C.B. 332.

[30]*See, e.g.*, PLR 9448024 (Aug. 31, 1994); PLR 9244019 (July 31, 1992); PLR 8927026 (Apr. 6, 1989); PLR 8851017 (Sept. 2, 1988).

[31]*See, e.g.*, PLR 20013025 (Mar. 31, 2000); PLR 9848043 (Nov. 27, 1998); PLR 9849007 (Sept. 1, 1998); PLR 98804046 (Oct. 18, 1997); PLR 9737024 (June 17, 1997); PLR 9450036 (Sept. 20, 1994).

[32]PLR 9848043 (Nov. 27, 1998); PLR 9849007 (Sept. 1, 1998).

[33]Regs. §26.2601-1(b)(4)(i)(A)(*1*)(*ii*). The final regulations also require that the new (or continuing) trust cannot extend beyond the rule against perpetuities period, measured from the date the original trust became irrevocable.

[34]The IRS recently noted that there are no regulations specifically addressing modifications of trusts that are GST-exempt because of the allocation of the GST exemption (rather than due to grandfather protection). Nevertheless, according to the IRS, the regulations dealing with pre-1986 trusts, by analogy, are relevant. *See* PLR 200420011 (May 14, 2004). The grandfather regulations dealing with modifications presumably are relevant to other trusts which are not subject to chapter 13, such as a trust created by a nonresident alien and funded with non-U.S. assets.

[35]Indeed, in response to the proposed amendment to the EPTL provision, the Commissioner of the New York Department of Taxation and Finance questioned whether the change would solve the GST tax problem. *See* Letter dated June 25, 2001 from Arthur J. Roth, Commissioner of New York Department of Taxation and Finance, to Governor George Pataki, Governor's Bill Jacket, 2001 Chapter 204, at 2.

[36]Regs. §26.2601-1(b)(4)(i)(D)(*1*).

[37]*See* Regs. §26.2601-1(b)(4)(i)(D)(2) for rules concerning when modifications will cause a shift in a beneficial interest to a lower generation beneficiary.

[38]*See, e.g.*, Regs. §26.2601-1(b)(4)(i)(E) (*Ex. 2*).

[39]In fact, in 1995, the New York legislature enacted EPTL §10-6.6(f), which confirms that the exercise of the power granted to a trustee under EPTL §10-6.6(b) "shall be considered the exercise of a special power of appointment. EPTL §10-6.6(f), L. 1995, ch. 479, effective Aug. 2, 1995 and applicable to trusts whenever created.

[40]*Restatement (Second) of Prop.: Donative Transfers* §11.1 cmt. d (1986).

[41]*See, e.g.*, EPTL §§10-2.1, 10-3.2.

[42]*See, e.g., Restatement (Second) of Prop.: Donative Transfers* §19.3 (2003); *In re Hart's Will*, 262 A.D. 190 (N.Y. Sup. Ct. 1941).

[43]*Phipps v. Palm Beach Trust Co.*, 196 So. 299 (Fla. 1940).

[44] *Id.* at 301.

[45] Memo. in Support of Legis., Governor's Bill Jacket, 1992 Chapter 591, at 4. In 2001, the New York legislature added paragraph (g), which provides that EPTL §10-6.6 "shall not be construed to abridge the right of any trustee who has a power of invasion to appoint property in further trust which arises under any other section of this chapter or under another statute or under common law."

[46] *Comr. v. Bosch Est.*, 387 U.S. 456 (1967).

[47] New York trusts have an additional complication: for nearly a decade, from 1992 to 2001, the statute required either beneficiary consent or court approval. Under the GST regulations, either condition would cause the authority under state law to fall outside the safe harbor rule. However, the alternative conditions (which have been removed from the EPTL) could be viewed merely as a procedural requirement that did not exist under state law (prior to 1987).

[48] Section 2653 provides that, if there is a GST event and thereafter property is held in trust, for purposes of applying chapter 13 to subsequent transfers from the trust, the transferor shall be assigned to the first generation above the highest generation of the person who has an interest in such trust immediately after the transfer.

[49] For GST tax purposes, the transferor generally is the person who transferred property for estate and gift tax purposes. §2652(a)(1).

[50] See *DiMarco Est. v. Comr.*, 87 T.C. (1986), *acq.* 1990-2 C.B. 1. *See also Harris v. U.S.*, 71 S. Ct. 181 (1950).

[51] §2514(c).

[52] §2514(b).

[53] Regs. §25.2511-2(b).

[54] If a beneficiary is deemed to have made a gift, that beneficiary will become the transferor for purposes of chapter 13. §2652(a)(1)(B).

[55] §§2036(a), 2038.

[56] Regs. §1.1001-1(a).

[57] *Cottage Savings Ass'n v. Comr.*, 499 U.S. 554 (1991).

[58] *Id.*

[59] *See, e.g.*, PLR 199951028 (Sept. 28, 1999); PLR 199951009 (Sept. 14, 1999); PLR 199933027 (May 24, 1999); PLR 199930011 (Apr. 16, 1999); PLR 199930010 (Apr. 16, 1999); PLR 199922030 (Mar. 2, 1999); PLR 199913022 (Dec. 30, 1999); PLR 99912034 (Dec. 28, 1999); Lloyd Leva Plaine & Pam H. Schneider, *Generation-Skipping Transfer Tax Planning in 2003*, SH069 A.L.I.-A.B.A. 2055, 2152-2153 (2003).

[60] *See, e.g.*, PLR 200207018 (Nov. 16, 2001) (where trustee had discretion to distribute income or principal outright or in further trust, the beneficiaries of the new trusts did not acquire their interests as a result of the exchange of their interests in the original trust, but rather by reason of the authority granted to the trustees of the original trust to make distributions outright or in further trust); PLR 200010037 (Dec. 13, 1999) (trustee had discretion to distribute income or principal and to divide the trust, so trustee's division of the trust into three separate trusts was not an exchange).

[61] *See, e.g.*, PLR 200135007 (May 29, 2001) (trustees' proposal to partition a trust into 12 separate trusts in accordance with a state statute did not result in an exchange because the beneficiaries acquired their interests in the individual trusts by reason of the authority granted under the Georgia law, not as a result of an exchange of their interests in the original trust). *See also* PLR 200423006 (June 4, 2004) (to correct drafting errors and effectuate the grantors' original intent, state court approved the reformation of a trust to provide for mandatory income distributions when a beneficiary attains 35, rather than 21, years; because the reformation did not cause the trust or the beneficiaries' interests in trust to differ materially, neither trust nor beneficiaries recognized gain or loss under §1001).

[62] *Crane v. Comr.*, 331 U.S. 1 (1947).

[63] *Levine Est. v. Comr.*, 634 F.2d 12 (2d Cir. 1980).

[64] Regs. §1.1001-2(a).

[65] For example, suppose a taxpayer's basis in a limited partnership interest is \$20,000 and his or her proportionate share of partnership liabilities is \$15,000. If the taxpayer sells the interest for \$10,000 in cash, the amount realized is \$25,000 (\$10,000 of cash plus \$15,000 of liability discharge). Because the cost basis is \$20,000, there is a \$5,000 gain (\$25,000 less \$20,000). Regs. §1.1001-2(c) (*Ex. 3*).

[66] *See also Madorin v. Comr.*, 84 T.C. 667 (1985).

[67] *See generally* Rev. Rul. 85-13, 1985-1 C.B. 184; *but see Rothstein v. U.S.*, 735 F.2d 704 (2d Cir. 1984). Note that Regs. §1.671-2(e)(4) provides that if a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust usually is considered the grantor of the transferee trust.

[68] §684(b); *see also* §679 to determine if the receptacle trust is a grantor trust for income tax purposes.

[69]Regs. §1.684-2(e)(1).

[70]§661(a)(2).

[71]§662(a)(2).

[72]§§661(b), 662(b).

[73]In *Matter of Kaskel*, 163 Misc. 2d 203 (Surr. Ct. N.Y. County 1994), the court observed: EPTL §10-6.6(b) "was intended to assist trustees in taking maximum advantage of the grandfathered exemption from generation-skipping transfer tax. Thus, it was contemplated that trusts created before the effective date of the GSTT could be extended for the perpetuities period in order to postpone any transfer tax for the maximum length of time ... . There does not appear to be any language in EPTL §10-6.6(b)(2) that restricts its use to GSTT reformations."

[74]N.Y. *Tax Law* § 605(b)(3) (2003).

[75]N.Y. Tax Law §605(b)(3)(D) (2003). *See also* TSB-A-94(7)I (New York resident meeting three requirements was not subject to New York State tax); TSB-A-96 (A)I (same); TSB-A-00(2)I (same).

[76]However, if the intangible personal property itself is used in a trade or business in New York, the intangible personal property will be deemed to generate New York source income. N.Y. *Tax Law* § 631 (2003); *see also In the Matter of the Petition of Estate of Evangelas Karayannides* (New York Division of Tax Appeals, Administrative Law Judge Determination, 1997) (taxpayer not subject to New York State or City income tax because the dividends and long-term capital gains were attributable to intangible personal property that was not used in a trade or business carried out in New York).

[77]As noted earlier, a distribution under EPTL §10-6.6(b) (or similar authority in another state) likely carries out a proportionate share of the trust's DNI. §§661(a)(2), 662(a)(2). The character of the income received by the new trust generally will be the same as the character generated by the distributing trust. Accordingly, if the distributing trust has any New York source income in the year of distribution, the receiving trust likely will have New York source income in the year of distribution. In that case, the receiving trust will be exposed to New York State income tax in the year of receipt, but not necessarily in subsequent years.

[78]*See, e.g., Matter of Reise*, 164 Misc. 2d 1098 (Surr. Ct. N.Y. County 1995) (court allowed trustee to pour over trust assets to two new identical trusts in Florida in order to avoid New York real property transfer gains tax); *Matter of Kaskel*, 163 Misc. 2d 203 (Surr. Ct. N.Y. County 1994) (court allowed trustee to pour over assets to a new trust that was identical to original trust but added a provision allowing the beneficiary to assign his interest in the trust, in order to limit the beneficiary's liability regarding the trust property); PLR 200013025 (Mar. 31, 2000) (transfer of non-realty assets from original trusts to new trusts in order to change administrative provisions); PLR 9804046 (Oct. 28, 1997) (transfer of corpus of two trusts to two new trusts with spendthrift clauses); PLR 9737024 (June 17, 1997) (transfer of assets from original trust to new trust to provide for new successor trustee provisions); PLR 9438023 (June 27, 1994) (transfer of corpus of trust with New York situs to new trust with Illinois situs); PLR 9332014 (May 13, 1993) (transfer of corpus from original trusts to new trusts with new provisions regarding the succession of trustees).

[79]Alaska Stat. § 13.36.157 (1998). Alaska's statute contains an explicit provision granting a trustee the power to appoint in further trust if the original trust is migrated to Alaska, with Alaska's law applying to the original trust.

[80]Del. Code Ann. 12 §3528 (2003); 004 Tenn. Pub. Acts 537 § 74(b)(27).

[81]A trustee of a trust governed by a state law that does not have a statute along the lines of EPTL §10-6.6(b) may consider migrating the trust to New York (or another state that has enacted a similar statute). Of course, there must be authority under the governing document or applicable law to change the governing law for this strategy to work. Also, such action may have other consequences.

[82]*See Matter of Peabody*, 158 N.E.2d 841 (N.Y. 1959); *Matter of Roth*, 73 A.D.2d 560 (N.Y. Sup. Ct. 1979).

[83]*See Whittemore v. Equitable Trust Co.*, 165 N.E. 454 (N.Y. 1929); *Matter of Fletcher*, 57 Misc. 2d 554 (Sup. Ct. N.Y. County 1968).

[84]*See Matter of Cord*, 449 N.E.2d 402 (N.Y. 1983); *Matter of Wynn Breen*, N.Y.L.J., June 28, 2000, at 27, col. 5 (Surr. Ct. N.Y. County June 28, 2000).

[85]EPTL §7-1.13(a)(1)(A)-(G).

[86]EPTL §7-1.13(a)(2), (3).

[87]The terms of the disposing instrument generally must govern the new trust. In the case of separate trusts for one or more members of a class of beneficiaries, a trustee acting pursuant to EPTL §7-1.13(a)(2) may distribute the original trust assets to separate trusts for one or more members of the class on a per stirpal or per capita basis, "whichever is consistent with the terms of the disposing instrument." EPTL §7-1.13(c).

[88]Unif. Trust Code, Prefatory Note (2000).

[89]S. Alan Medlin, "Trust Reformation and Modification Under the Uniform Trust Code," *Prob. Prac. Rep.*, Apr. 2004, at 1, 2.

[90]Unif. Trust Code §411(a), (b).

[91]*Id.* at §411(e).

[92] *Id.* at § 412(a).

[93] *Id.* at §§304, 305.

[94] *Id.* at §303.