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Steve Leimberg's Estate Planning
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Subject: Mary P. O'Reilly and Jason Smith - Trust Beneficiaries
Eliminated Through a Decanting Done Pursuant to the Trust
Instrument Found Valid in New York

EXECUTIVE SUMMARY:

In *Matter of Hoppenstein*, NYLJ 1202783016744 [Sur Ct, NY County 2017], the New York County Surrogate's Court found the distribution of a life insurance policy from one trust to another trust which eliminated certain beneficiaries of the original trust was a valid exercise of the trustee's discretionary power to distribute principal under the trust instrument. Under the terms of the original trust, the independent trustee had discretion to distribute principal to one or more beneficiaries (to the exclusion of other beneficiaries) and/or to a trust for their benefit after providing written notice to all beneficiaries. The ruling is a significant victory for settlors and clients creating trusts, confirming that the words of the trust instrument matter and can be relied upon by trustees in administering trusts. In the ruling, the court determined that a decanting may be accomplished under the terms of a trust instrument alone and need not comply with the provisions of New York's Estates Powers and Trusts Law ("EPTL") §10-6.6, which governed the trust. The court also held that the lapse of so-called *Crummey* withdrawal rights is not contingent on the *Crummey* beneficiaries receiving written notice of their withdrawal rights and is instead dictated by the terms of the trust instrument. Finally, and perhaps most significantly, the court found a trustee with complete discretion to distribute principal had the authority to eliminate beneficiaries and seemingly looked only to the trustee's compliance with the terms of the trust instrument to uphold the distribution.

FACTS:

The authors of this article represented the trustees in their accounting of the trust, including the distribution of the life insurance policy to the new trust where certain trust beneficiaries were excluded. In its decision and order on the excluded

beneficiaries' motion for partial summary judgment in this contested accounting proceeding, the court found that the independent trustee provided the requisite notice and that the distribution of the policy to the new trust was fully authorized under the provisions of the trust agreement. Accordingly, the court determined that there was no triable issue of fact concerning the propriety of the transfer, denied the excluded beneficiaries' motion and granted summary judgment for the trustees approving their accounting.

By way of background, the trustees served over a 2004 insurance trust and accounted to the trust's remainder beneficiaries—the four children of the settlor and their descendants. In 2008, due to an acrimonious relationship between the settlor and his daughter, Cheryl Hoppenstein, the settlor, pursuant to a power reserved in the trust instrument, excluded Cheryl, her husband and her children as *Crummey* beneficiaries of the trust. In 2012, three years prior to the settlor's death, the relationship between the settlor and Cheryl deteriorated further and the daughter commenced litigation against the settlor and other family members in connection with another trust. The settlor appointed an independent trustee and the settlor notified the trustee that if he did not decant the trust's primary asset—a \$10 million life insurance policy on the life of the settlor—to a new trust that excluded Cheryl and her descendants as beneficiaries, then the settlor would cease to make contributions to the trust to cover the premium payments, causing the policy to lapse.

Under the original trust, the independent trustee had the authority to “pay such sums out of the principal of the trust (even to the extent to the whole thereof) to the Settlor's descendants, living from time to time, in equal or unequal amounts to any one or more of them to the exclusion of the others, as the Trustees in their absolute discretion shall determine...” Additionally, the original trust provided that any distribution of trust property to a beneficiary could be made “by payment to a trust for his or her benefit.” The trust instrument required the independent trustee to give written notice to the beneficiaries at least 45 days prior to the distribution, but did not require that the notice set forth the nature of the distribution with any specificity. Pursuant to his authority in the original trust, the independent trustee simply notified the beneficiaries that a distribution of principal would be made (without any details of the distribution) and, after 45 days, distributed the policy to the new trust, which excluded Cheryl and her descendants as beneficiaries.

After the settlor's death, the trustees of the original trust filed their accounting and disclosed the distribution of the \$10 million life insurance policy to the new trust.

Cheryl and her children moved for partial summary judgment to invalidate the distribution on various grounds, all of which the court rejected.

COMMENT:

The court's ruling is a major win for settlor's intent and is of primary significance for practitioners in New York and beyond. First, the ruling holds that trustees can rely on powers within a trust instrument to decant trust assets. Cheryl and her children argued that, in order to be valid, the distribution must comply with the statutory requirements of EPTL Section 10-6.6. The court rejected that argument, citing EPTL Section 10-6.6(k), which provides that that "section shall not be construed to abridge the right of any trustee to appoint property in further trust that arises under the terms of the governing instrument of a trust or under any other provision of law or under common law...". The court's ruling is the first New York case that expressly confirms the plain language of the statute and holds that decantings can be done pursuant to the terms of the trust without having to follow the specific parameters set forth in EPTL Section 10-6.6. As a result, for clients who would like this type of flexibility in their irrevocable trust instruments, regardless of whether the applicable state's statute permits decanting or not, practitioners should include language in their trust documents that gives the trustees the ability to do so.

Second, the ruling confirms that a *Crummey* beneficiary's withdrawal right lapses pursuant to the terms of the trust instrument itself and is not contingent on the beneficiary's being notified of the withdrawal right. Cheryl and her descendants argued that their *Crummey* withdrawal rights did not lapse because they were not provided with notice of such withdrawal rights other than one time after the settlor made his initial contribution to the 2004 trust, thus invalidating the transfer. The court rejected that argument, relying on the *Estate of Turner v. Commissioner* (T.C.M. 2011-209), which held that written notice of the withdrawal right was not required to establish the substantive rights of a *Crummey* beneficiary under a trust instrument. Instead, the court held that the lapsing of a beneficiary's *Crummey* withdrawal rights as set forth in the trust is not contingent on the beneficiary being notified of his or her *Crummey* withdrawal rights.

Finally, the ruling confirms that a trustee having complete discretion over principal distributions means just that—that a trustee can exercise his discretion over principal and eliminate a beneficiary. Although the court referred to the acrimonious relationship between the settlor and Cheryl as the basis for the

settlor's decision to exclude Cheryl and her family as *Crummey* beneficiaries, the court did not indicate this was a dispositive factor in determining that the trustee's distribution of the policy was a valid exercise of the trustee's discretion. Instead, the court looked to the requisite notice requirements set forth in the trust instrument and found that since the trustees complied with those requirements, the distribution was valid and approved the trustees' accounting.

In conclusion, the court in *Matter of Hoppenstein* upholds the long-standing trust principle that the settlor's intent is paramount. In creating the original trust, the settlor explicitly provided that the trustee had absolute discretion to distribute the principal of the trust at the exclusion of one or more of the beneficiaries. Additionally, the settlor reserved the right to exclude *Crummey* beneficiaries and set forth how *Crummey* withdrawal rights would lapse. The settlor's intention and flexibility given to the trustees in the original trust was clear and unambiguous, and the trustees' administration of the trust was in accordance with those clear terms. The decision is a victory for New York settlors and should assure trustees that they can rely on clear trust terms when administering trusts. Additionally, the implications of the case extend beyond New York—blessing decantings done pursuant to the terms of a trust instrument for trusts administered in states that do not have decanting statutes and championing the American trust tradition of following settlor's intent.

CITES:

Matter of Hoppenstein, NYLJ 1202783016744 [Sur Ct, NY County 2017]