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Decanting a 'HEMS Only' Trust in Favor of an SNT

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In 1992, New York became the first state in the nation to enact a decanting statute, namely, New York Estates, Powers and Trusts Law (EPTL) 10-6.6. The statute subsequently was modified several times. The 2011 amendment was notable because it greatly liberalized the statute's application. Today, New York's decanting statute is a tool frequently used by practitioners.

One widely welcomed feature of the 2011 amendment was its attempt to facilitate decantings in favor of a supplemental needs trust (SNT) that conforms to the provisions of EPTL 7-1.12. S*ee* EPTL 10-6.6(n)(1). In that regard, it codified New York's emerging public policy of allowing reformation of certain irrevocable trusts so they could qualify as SNTs when appropriate. *See, e.g.*, *Matter of Rappaport*, 21 Misc. 3d 919 (Sur. Ct. Nassau County 2008); *see also Matter of Newman*, 18 Misc. 3d 1118(A) (Sur. Ct. Bronx County 2008); *Estate of Hyman*, 14 Misc. 3d 1232A (Sur. Ct. Nassau County 2007).

Nevertheless, the amended statute has a potential technical problem relating to certain decantings in favor of an SNT. This potential issue applies only to decantings of trusts that give the trustee the power to invade principal but without unlimited discretion. It does not affect trusts that give the trustee unlimited discretion to invade principal. The authors submit that a targeted technical amendment to EPTL 10-6.6 should be considered to address this issue, thereby more closely aligning the statute with New York's public policy of facilitating decantings in favor of SNTs where appropriate.

1. An Overview of Decanting a Trust Pursuant to EPTL 10-6.6

A trustee's ability to decant is rooted in that trustee's ability to invade the trust's principal. A decanting, by its nature, must include two trusts, the trust being decanted (the "invaded trust") and the trust receiving the assets from the invaded trust (the "appointed trust").

Conceptually, the decanting statute can be bifurcated into two main categories: (i) rules that apply to a trustee who is granted unlimited discretion to invade a trust's principal (EPTL 10-6.6(b)) and (ii) rules that apply to a trustee who is not granted unlimited discretion to invade a trust's principal (EPTL 10-6.6(c)). This article concerns the latter.

A trustee who is not granted unlimited discretion to invade a trust's principal may decant the invaded trust, albeit with requirements. One requirement is the invaded trust and the appointed trust must contain the same principal invasion standard. *See* EPTL 10-6.6(c)(1). For example, if the invaded trust permits principal invasion for a beneficiary's health, education, maintenance, or support (HEMS), the appointed trust must have the same distribution standard. It is this requirement that could be problematic when decanting these trusts in favor of an SNT.

2. An Overview of Supplemental Needs Trusts Pursuant to EPTL 7-1.12

Generally, an SNT is created by a settlor to support a severely and chronically disabled person without disqualifying that person from obtaining Medicaid and other forms of government assistance. *See* 12 Warren's Heaton on Surrogate's Court Practice 209.08 (6)(a). The bill notes to the legislation enacting EPTL 7-1.12 explain, in part, that "the purpose of the legislation is to encourage future care planning by instilling greater confidence in families and friends of persons with disabilities that the trusts they established for recipients of government assistance will be used for the purposes they intend." *See id.* (citing L. 1993, ch. 433, effective July 26, 1993, at § 1).

An SNT confers on the trustee the sole and absolute discretion to make distributions of trust principal and may also allow for the trustee to make distributions for the SNT beneficiary's food, clothing, shelter, or health care. EPTL 7-1.12(a)(5) & (e)(1) (although EPTL 7-1.12 uses the term "absolute discretion," it is the functional equivalent of the "unlimited discretion" provided for in EPTL 10-6.6). However, if the mere existence of a clause permitting the trustee to make distributions for the SNT beneficiary's food, clothing, shelter or health care would result in the loss of the SNT beneficiary's government benefits, then the SNT must expressly provide that that clause will be deemed null and void, in which case the trustee will not have the authority to make such distributions. *See* 12 Warren's Heaton on Surrogate's Court Practice 209.08 (6)(a); *see also* EPTL 7-1.12 (b)(5)(i). In short, an SNT, by definition, does not contain an ascertainable standard. *See generally* ETPL 7-1.12.

3. Reconciling EPTL 10-6.6(c)(1) and 10-6.6(n)(1)

Some practitioners understand EPTL 10-6.6(n)(1) as authorizing any decanting in favor of an SNT. *See* Martin, *Appointment of Trust Property to Supplemental Needs Trusts*, Practice Commentary, McKinney's Cons Laws of NY, EPTL 7-1.12 (citing *Kroll v. New York State Department*

of Health, 143 A.D.3d 716 (2d Dep't 2016) ("Pursuant to EPTL 10-6.6(n)(1), a trustee may decant funds into a supplemental needs trust even if it limits the beneficiary's rights to income or principal so long as the new trust conforms with EPTL 7-1.12").

However, it is not clear that this provision allows a trust with a principal invasion standard other than unlimited discretion, e.g., a HEMS standard, to be decanted to an SNT. EPTL 10-6.6(n)(1) prohibits a decanting to the extent it results in the reduction, limitation, or modification of any beneficiary's current right to a mandatory distribution of income or principal. It provides an important exception by stating:

> Notwithstanding the foregoing, *but subject to the other limitations in this section*, an authorized trustee may exercise a power authorized by paragraph (b) *or (c)* of this section to appoint to an appointed trust that is a supplemental needs trust that conforms to the provisions of section 7-1.12 of this chapter. (Emphasis added.)

Although the final sentence of EPTL 10-6.6(n)(1) appears to permit an authorized trustee to decant a trust pursuant to a HEMS standard (i.e., pursuant to "paragraph . . . (c)") in favor of an SNT, it also runs up against the "other limitations in this section," namely, EPTL 10-6.6(c)(1), which, among other things, requires the appointed trust to have the same principal invasion standard as that of the invaded trust.

The legislative history of the 2011 amendment, New York State Assembly Memorandum A08297 in Support of EPTL 10-6.6 (the "Memo"), does not explicitly address whether the HEMS standard in an invaded trust may be changed to unlimited discretion in the appointed SNT.

4. *Matter of Kroll*

Matter of Kroll is one of the few reported decisions concerning the post-2011 version of EPTL 10-6.6 that dives deeply into the issue of decanting in favor of an SNT. There, the invaded trust was fully discretionary as to principal payments while the beneficiary was a minor. *See Kroll v. N.Y.S. Dept. of Health*, 143 A.D.3d 716 (2d Dep't 2016). The invaded trust was decanted purportedly to maintain the trust beneficiary's eligibility for governmental benefits while utilizing the trust's assets for his supplemental needs. *Id.*

Practitioners sometimes offer *Matter of Kroll* as authority for a trustee's ability to decant an irrevocable trust in favor of an SNT. Unfortunately, this case does not shed light on the issue at hand because the trustee of the invaded trust had unlimited discretion to invade principal. Therefore, the trustee was able to decant that trust pursuant to the provisions of EPTL 10-6.6(b) and thus was not restricted in the trustee's ability to change the principal invasion standard in the appointed trust.

5. Conclusion

The question becomes, when decanting an invaded trust that only provides a HEMS principal invasion standard in order to convert it to an SNT, can the HEMS principal invasion standard be dropped in favor of an absolute discretion standard consistent with EPTL 7-1.12? In light of New York's aforementioned public policy, the authors submit that EPTL 10-6.6 should be amended to clarify that the answer is yes.

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