Personal Trusts Under New York Law

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Trusts are extremely flexible vehicles that individuals and entities can use to achieve a variety of purposes that involve one party holding property on behalf of another party. This practice note will focus on the uses of personal trusts for estate planning in New York. New York has a very well-developed trust law, as you would expect based on its rich history as a center of banking and finance and, of course, its large population of wealthy individuals. This practice note will provide you with a considerable amount of background information on New York trust law to make sure you have a suitable understanding of the legal terrain, and then will delve into a number of practical trust drafting and administration issues. This practice note will be of particular use to (i) junior New York attorneys practicing in the trusts and estates (T & E) field, (ii) more seasoned New York attorneys whose practice is not focused on T & E but who occasionally encounter trusts, and (iii) non-New York T & E lawyers who are interested in what makes New York trust law distinctive.

What is a Trust

Bifurcation of Property Ownership

A trust is a legal arrangement pursuant to which a grantor (a.k.a., settlor, donor, trustor) transfers property to a trustee to administer on behalf of one or more beneficiaries according to the terms of the instrument governing the arrangement. There are two fundamental characteristics of a trust. The first is the high degree of fiduciary duty expected of a trustee, which will be discussed in great detail below in Trust Administration. The second, which is generally the least intuitive feature of trusts, particularly for non-lawyers, is the bifurcation of legal ownership and beneficial ownership.

In the trust context, the trustee is the legal owner of the trust assets. Although it is convenient to think of a trust as a separate legal entity, and particularly as a separate taxable entity for income tax purposes, at common law, a trust had no existence separate from the person of the trustee. So, for example, you will see property owned in the name of "X, as Trustee of the ABC Trust" rather than simply in the name of "the ABC Trust." This can sometimes be a source of frustration if there is a change in trustees, when banks or other financial institutions may require that their accounts be re-titled to reflect the new trustee, or worse, when local property tax divisions insist that real estate be similarly re-titled. An argument can be made that this re-titling is not necessary because the trust still owns the property, but a counter-argument can also be made that because the trustee is the legal owner, a change in trustee is an ownership change that needs to be reflected properly in the title. As a practical matter, you will almost always find that the path of least resistance—re-titling the property—is the best course of action.

The trustee is the legal owner of, and is therefore tasked with administering, the trust assets, but the trustee does so only on behalf of the beneficiaries. The trustee can get no personal benefit from the trust assets (unless of course the trustee is also a beneficiary), though trustees are entitled to trustees' commissions as compensation for their efforts. The trustee's role is an active one, in contrast to that of the beneficiaries, which is primarily a passive one: merely to receive the benefits of the trust in the form of distributions when needed. Beneficiaries can play a more active role at times, however. They can enforce the trust by bringing a legal action against a trustee who is not administering the trust properly. And if the terms of the trust instrument provide them with authority to do so, they may have a role in certain aspects of the trust administration, for example, by exercising rights of withdrawal or other powers over distributions, or by naming successor trustees.

What about the settlor of trust; what role does he or she have? In fact, beyond creating the trust and transferring property to it, usually the settlor has very little role. As noted above with respect to beneficiaries, the terms of the trust agreement may provide the settlor with certain ongoing authority, for example in naming successor trustees. And with revocable trusts, the settlor typically reserves the unfettered right to amend or revoke the trust. But in most irrevocable trusts, the settlor has no authority to influence the administration of the trust, at least not directly. This can come as a surprise to clients, who often view the trust assets as "their money" even after they transfer those assets to a trust. The fact that settlors often misunderstand their role in a trust context gives rise to two key takeaways for you as attorneys. First, where you represent clients setting up irrevocable trusts, explain to them clearly and often that transfers of assets to the trusts are irrevocable, and once they transfer assets, they do not own those assets anymore. And second, where you represent trustees who are being pressured by settlors to act in a certain way, advise them that if they allow the settlor to influence them to act in a manner contrary to the best interests of the beneficiaries, they may be personally liable to those damaged beneficiaries. That can be very tricky, because the settlor usually chooses the trustee, and often chooses a particular trustee because of that trustee's loyalty to the settlor; yet, once the trustee accepts his or her office, legally, his or her sole loyalty must be to the beneficiaries. No one ever said being a trustee was easy!

Trust vs. Trust Agreement
A brief word about terminology: what is the difference between a trust and a trust agreement? A trust is the actual legal arrangement among the parties described above. A trust agreement (or, more broadly, a trust instrument) is the written document that sets forth the conditions under which the trust is to be administered. It is easy to be imprecise in this regard: you may, for example, hear people ask to see a copy of the trust, when what they really want to see is a copy of the trust agreement.

A trust agreement is sometimes referred to as a contract. That is not technically correct; a trust agreement is an agreement, but it is not a contract. One party to a contract does not, unless expressly stated, owe fiduciary duties to another, whereas, as noted above, fiduciary duty is a hallmark of the trustee/beneficiary relationship. Also, a contract may create ongoing obligations among the parties, but it does not create a separate legal/taxable entity. A robust discussion of all of the subtle differences between a trust agreement and a contract are beyond the scope of this practice note, as are the differences between trusts and other arrangements, such as escrows. (It is, after all, more important to know what a trust is than what it is not.) But being precise in your terminology can help your clients make sense of what can be a particularly confusing landscape.

Classification of Trusts

Revocable vs. Irrevocable
Trusts can be classified according to a number of different criteria, one of which is revocability. A trust is revocable if the settlor has under the trust agreement retained the right, either unilaterally or with the consent of another party, to revoke the trust and reclaim the trust assets. Revocable trusts are typically also amendable by the settlor, even if not expressly stated to be so, for the obvious reason that the settlor could always revoke the trust and re-settle the trust assets into a different trust, so the settlor should be able to achieve the same result by just amending the first trust. An irrevocable trust is, not surprisingly, a trust that does not fit the definition of a revocable trust. Under New York's Estates Powers and Trusts Law (EPTL), a trust that does not specify whether it is revocable or not is irrevocable. See NY CLS EPTL § 7-1.16. That said, to avoid doubt, every trust should expressly state whether it is revocable or irrevocable, which can be done fairly simply:

> "This trust agreement and the trusts created hereunder shall be irrevocable."

or

> "The settlor reserves the right by an acknowledged instrument in writing to revoke or amend this trust agreement or any trust hereunder."

Unless otherwise provided in the trust agreement, a revocable trust becomes irrevocable on the death of the settlor, though a revocable trust can still be revoked by a specific provision under the settlor's Will. See NY CLS EPTL § 7-1.16. Note that even if the trustee has discretion to distribute all of the trust's assets back to the settlor, the trust would not thereby be classified as revocable. Revocability is determined by the settlor's authority, not the potential for the settlor to receive the trust assets back based on a third party's decision. Similarly, if the settlor has a reversionary interest in the trust, such that, for example, the assets of the trust would be distributed back to the settlor if he or she is living at the death of the beneficiary, that would have no impact on the classification of the trust as revocable or irrevocable because it does not implicate the settlor's authority.

Though not legally required, the settlor is generally the sole beneficiary of a revocable trust during the settlor's lifetime, and is often the sole trustee as well while he or she retains capacity. It may therefore seem that revocable trusts are not very substantial arrangements: if the settlor is the sole beneficiary as well as the sole trustee, and can take back the trust assets at will, what has the settlor really accomplished by transferring those assets to the trust? In fact, the trust laws of many offshore jurisdictions do not expressly contemplate revocable trusts for that very reason. And even in the U.S., revocable trusts are typically treated as non-entities for creditors' rights purposes and tax purposes. See, e.g., NY CLS EPTL § 7-3.1; 26

USCS § 676; 26 USCS § 2038. Nonetheless, revocable trusts play a key role in probate avoidance and incapacity planning, as will be discussed below in Reasons for Creating a Trust.

Inter Vivos vs. Testamentary

Another criterion by which a trust can be classified is the instrument under which it is created. An inter vivos trust, as the name implies, is one created between living people; in other words, it is created via a separate agreement between a living settlor and the trustee. (It is worth noting that under certain circumstances an inter vivos trust can be established via a declaration by the trustee that he or she holds certain assets in trust for the beneficiaries; there would therefore be no stated settlor and, technically no "agreement" because the trustee is the only one signatory to the document. Declarations of trust are generally seen where the settlor and the trustee are the same person, or where a trustee of one trust exercises his or her discretion to set up another trust.) In contrast, a testamentary trust is one that is created under a decedent's Will; there is no separate trust agreement but rather the terms of the Will itself govern the trust, so the Will is the trust instrument. An inter vivos trust can be revocable or irrevocable; a testamentary trust is always irrevocable.

Testamentary trusts in New York suffer from a particular disadvantage: New York is among only a handful of states that require trustees of testamentary trusts to obtain authorization—called Letters of Trusteeship—from the court supervising the administration of the decedent's estate before they can serve as trustee. See NY CLS SCPA § 103(21); NY CLS SCPA § 701; NY CLS SCPA § 724. For the initial trustees of a testamentary trust, this is not a huge burden, because they can apply for Letters of Trusteeship as part of the same proceeding by which the Will is admitted to probate and the executors are granted Letters Testamentary. However, where a subsequent change in trustees of a testamentary trust is required, a separate proceeding must be brought in Surrogate's Court for new Letters of Trusteeship, which is both time consuming and relatively costly in terms of legal fees. Therefore, you should consider setting long-term trusts up as inter vivos trusts rather than as testamentary trusts.

It is worth noting that the Surrogate's Court has jurisdiction over inter vivos trusts as well as testamentary trusts, see NY CLS SCPA § 207, but the requirement for Letters of Trusteeship does not apply to the former.

Personal vs. Other

Although not germane to this practice note, it is worth noting that there are other kinds of trusts besides personal trusts. There are corporate trusts such as pension plans and bond indentures. (Interestingly, the value of assets held in corporate trusts utterly dwarfs the value held in personal trusts, yet there is comparatively little law applicable to corporate trusts relative to personal trusts.) There are business trusts, which are entities created under the law of certain states, such as Massachusetts but not New York, and that function more like corporations, with transferable shares. There are constructive trusts, which are remedies fashioned by courts of equity to prevent unjust enrichment. And there are resulting trusts, pursuant to which assets are held in trust by the recipient under circumstances where the transferor could not have intended the recipient to have beneficial ownership of them yet neglected to establish an express trust.

Reasons for Creating a Trust

Avoiding Probate

Probably the most common reason Americans create trusts is probate avoidance. Certain states have very expensive or tedious probate processes—i.e., judicial proceedings to administer the assets of a decedent—so it is common in those states for people to use revocable trusts as their primary estate planning document. The revocable trust is most useful in those states if it is fully funded; that is, if the client transfers all of his or her assets to the trust during life, so there are no assets left in his or her own name that would require probate for proper disposition. But even if the client does not actually re-title all assets into the name of the trust, in certain jurisdictions (notably, California), it may be possible to avoid probate merely by listing assets among the assets of the revocable trust on a schedule to the trust instrument, as those assets can be re-titled into the name of the trust after the client's death without the requirement of going through probate.
Revocable trusts have traditionally not been as popular in New York as they have been in certain other jurisdictions such as California and Florida. One explanation for the revocable trust's comparative lack of popularity in New York is, no doubt, a reluctance on the part of the New York T & E bar to adapt to new concepts. But in fairness to T & E attorneys in New York, because the probate system here is not unduly expensive or tedious, there has not been as much of a need for revocable trusts: probate avoidance is, after all, a lower priority where probate is less onerous. In addition, New York actually requires assets to be formally re-titled in the name of the trust for a transfer to be effective, see NY CLS EPTL § 7-1.18, making probate avoidance rather more cumbersome in New York than in states where, as noted above, merely listing the assets as owned by the trust can serve the required purpose. However, unfunded revocable trusts, used in conjunction with a pourover Will that names the revocable trust as the sole beneficiary of the decedent's estate, are growing in

popularity in New York, even though probate is not avoided at all if the revocable trust is unfunded. That popularity growth can presumably be attributed to certain advantages of revocable trusts becoming increasingly evident to drafting attorneys: (i) privacy—probated Wills are public documents, while revocable trusts are not—and (ii) obviating the need for Letters of Trusteeship.

Creditor Protection

Another widely touted benefit of trusts is creditor protection, with the most common creditors of beneficiaries being divorcing spouses. Assets of an irrevocable trust for the benefit of third parties (i.e., those other than the settlor or the trustee) are generally exempt from the claims of the beneficiaries' creditors for the very basic reason that the beneficiaries do not legally own those assets. However, if the beneficiaries can freely alienate their beneficial interests in the trust, the fact that creditors cannot directly access the assets of the trust may not matter much, as the creditors can obtain the beneficiaries' beneficial interests in the trust, and obtain indirectly what they could not obtain directly. The default law in New York is that trusts are "spendthrift" trusts—where beneficial interests are inalienable—only as to income, not principal, unless specified otherwise in the trust instrument. See NY CLS EPTL § 7-1.5. Therefore, it is generally advisable to include express spendthrift language in trust instruments to make beneficial interests in principal inalienable as well:

> "Each trust shall be a spendthrift trust to the maximum extent permitted by law and no interest in any trust hereunder shall be subject to a beneficiary's liabilities or creditor claims, assignment or anticipation."

A so-called "self-settled" trust, one in which the settlor is a beneficiary, does not offer any creditor protection under New York law. See NY CLS EPTL § 7-3.1. New Yorkers who want to create asset protection trusts, i.e., self-settled trusts that cannot be reached by the settlor's creditors, need to do so in an offshore asset protection jurisdiction such as the Cook Islands or a domestic asset protection jurisdiction such as Delaware or South Dakota. The efficacy of domestic asset protection trusts is a much-debated issue, and beyond the scope of this practice note, but suffice it to say that if you are contemplating drafting such a trust, it is advisable to obtain advice from local counsel in the given jurisdiction to make sure that the trust adheres strictly to the requirements of that jurisdiction's asset protection laws.

What about a trust where the trustee is a beneficiary? Unlike a self-settled trust, a trust does not cease being a spendthrift trust merely because a trustee is a beneficiary. Nonetheless, a trustee with discretion to make distributions to him or herself could arguably be compelled by creditors to exercise that discretion to the greatest extent permitted under the trust instrument. For maximum creditor protection, it may therefore be prudent to name only non-beneficiaries as trustees, or to restrict a beneficiary-trustee from exercising discretion over distributions.

A robust discussion of creditors' rights issues is beyond the scope of this practice note, but one additional point is worth making. Setting up and funding a trust to protect against claims of the beneficiaries' creditors is a different matter entirely than setting up and funding a trust to place assets beyond the reach of the settlor's creditors. Clients facing creditors' claims may ask you to create irrevocable trusts for the benefit of their family members so the clients can transfer their assets to those trusts and thereby frustrate the claims of the clients' creditors. Those transfers would likely be voidable as fraudulent conveyances, and if the client is in bankruptcy, could be deemed bankruptcy fraud. Moreover, your participation in the drafting process could expose you to claims of aiding and abetting that fraud. You should therefore be clear on your clients' overall financial picture before assisting them with their trust planning.

Paternalism

Use of trusts for creditor protection can basically be described as saving beneficiaries from third parties, but often clients are more interested in using trusts to protect beneficiaries from themselves. For young beneficiaries, paternalism is relatively easy to justify: how many 18-year-olds or even 21-year-olds are mature enough, either emotionally or financially, to handle a large inheritance? As beneficiaries get older, however, balancing out paternalism with encouraging autonomy becomes more complex. Some beneficiaries may never be sufficiently mature, emotionally or financially, to handle significant wealth, but many are quite responsible by age 30 or 35. Moreover, receiving some assets outright may actually help beneficiaries become financially mature by requiring them to manage their own money. (Alternatively, allowing beneficiaries to become co-trustees once they reach a certain age can have similar benefits from a financial education perspective.)

Some T & E attorneys for various reasons routinely recommend trusts to last for the lifetimes of all beneficiaries, but that might not be appropriate for all clients. The best course of action for you as an attorney is to discuss in detail with clients when they think their children/grandchildren ought to receive assets outright. Factors you should consider include the amount of wealth at stake—massive wealth militates in favor of keeping assets in trust—and how well the clients know their beneficiaries. You could, for example, draft a client's Will or revocable trust to include lifetime trusts for their children when their children are very young, when their financial maturity is inherently unknowable, but if the children seem to be maturing normally, and assuming the clients are still alive and still have capacity, revise the Will or revocable trust later on so that the trusts end at age 35, or in stages at ages 30, 35 and 40, for example. Or you could keep the lifetime trusts but encourage the clients to suggest to the trustee that she/he exercise her/his discretion to distribute assets liberally to the beneficiaries, including all of the assets of the trust, if the beneficiaries are financially mature enough to handle it.

One aspect of paternalism where New York has not gone as far as certain other jurisdictions concerns so-called "silent trusts." In some jurisdictions, including Delaware, clients have the option of incorporating into trust instruments provisions specifically prohibiting the trustee from informing the beneficiaries about the existence of, or assets in, the trust. Presumably the clients are concerned that mere knowledge of the trust could discourage beneficiaries from leading productive lives. New York does not permit silent trusts, as the basic fiduciary duty to keep the beneficiaries informed, and the resulting ability of the beneficiaries to enforce the trust to keep the trustee "in line" is presumably deemed more important than not spoiling the beneficiaries. See NY CLS SCPA § 2306.

Asset Management

A client may not be particularly concerned about protecting a beneficiary from creditors or from the beneficiary's own financial mismanagement but may merely feel that a trustee would do a better job managing assets than the beneficiary would do herself or himself.

As a corollary, a client may create and fund a revocable trust for his or her own benefit primarily so that if/when he or she becomes incapacitated, the successor trustee named in the trust agreement can assume the role of trustee and commence managing the assets of the trust for the settlor's benefit. There are, of course, other ways of addressing asset management in case of incapacity; for example, a legal guardian could be appointed for the client, or an attorney-in-fact under a power of attorney could manage the client's assets. But a guardianship proceeding is time-consuming and expensive, and an attorney-in-fact does not have the same fiduciary duties as a trustee. (An attorney-in-fact is a fiduciary, and therefore, when acting, must act in the best interests of the principal. However, an attorney-in-fact is not compelled to act, while a trustee is under an affirmative obligation to administer the trust's assets.) Consequently, incapacity planning, which is analytically a sub-category of asset management, is an often-cited benefit of revocable trusts.

Asset management can be an important objective for irrevocable trusts as well. For example, a settlor may want assets that would otherwise pass to multiple beneficiaries to be managed as a single pool. That can be particularly important where the assets consist of real property used by multiple family members or interests in a family business, where the centralized management afforded by a single trust could be advantageous.

New York law facilitates efficient asset management, though it is far from unique in that regard. For example, New York, like most jurisdictions, permits trustees to employ custodians, including broker-dealers, and to maintain securities in the "street name" of such broker-dealers rather than in registered form. See NY CLS EPTL § 11-1.10. New York also permits trustees to delegate investment discretion. See NY CLS EPTL § 11-2.3. Trustees can therefore open accounts with brokers, bankers or investment advisors, and thereby access more or less the entire range of asset management options the financial services industry has to offer.

Tax Benefits

Tax benefits are a frequently cited reason for the creation of certain irrevocable trusts. (Revocable trusts, as noted above in Classification of Trusts, afford no direct tax benefits.) A robust discussion of the numerous and varied tax benefits afforded by trusts is beyond the scope of this practice note, but suffice it to say that a wide range of opportunities can be obtained through different types of irrevocable trusts. Trusts can qualify for a charitable income tax deduction. Trusts can permit the deferral of estate taxes until the death of a surviving spouse. Trusts can help make maximum use of the Federal and state estate tax exemptions of both spouses. Trusts can facilitate the deferral of capital gains taxes. Trusts can permit leveraged gifting, where future appreciation on assets can be transferred to lower generations at little or no gift or estate tax cost. And trusts can allow parents essentially to pay the income taxes on income earned for the benefit of lower generations, thus allowing the assets set aside for those lower generations essentially to grow income tax-free.

Estate Planning

There is no universally accepted definition of estate planning, but for purposes of this discussion, you can view estate planning generally as organizing one's assets and circumstances so that one's wishes with respect to those assets and circumstances will be implemented when one is no longer capable of implementing them oneself. With that broad definition, most if not all of the issues discussed above would fall within the ambit of estate planning. However, there is one rather fundamental aspect of estate planning that has not yet been touched upon, namely, making sure that assets actually get to one's intended beneficiaries, where trusts can be important.

For example, if you have a married client who has children from a prior marriage, the client may well want to provide for his or her spouse (assuming the spouse survives) for the balance of the spouse's life, but ultimately will want assets to pass to his or her children from the prior marriage. But if the client leaves all of his or her assets to the spouse, the spouse is free to do with them what he or she wishes, which may not involve the deceased spouse's prior children at all. You can instead advise the client to create a qualified terminable interest property (QTIP) trust, a type of marital trust, where the spouse would be the sole beneficiary until the spouse dies, but the remaining trust assets pass to the deceased spouse's prior children thereafter. And even if there is no prior marriage, if the client fears that, if he or she dies, his or her spouse could re-marry and disinherit their joint children in favor of the new spouse, a QTIP trust can assuage those fears.

One point about QTIP trusts and New York law, though. New York has a fairly detailed statute, see NY CLS EPTL § 5-1.1-A, setting forth a surviving spouse's right of election, i.e., the right to receive an "elective share" of the deceased spouse's assets instead of what the deceased spouse provided for via Will or otherwise. The basic idea behind the right of election is to ensure that a deceased spouse makes adequate provision for the surviving spouse, but because the computation of the elective share is fairly involved, elective share issues tend to be quite complicated. A full discussion of those issues is beyond the scope of this practice note, but the relevant point in this context is that an interest in a QTIP trust does not qualify as making adequate provision, so a surviving spouse could, in theory, elect to take a portion of the deceased spouse's estate outright instead of enjoying the benefits of the QTIP trust. Often that is a bad deal economically because the QTIP trust provides access to the whole estate, whereas exercising the right of election nets the surviving spouse only a fraction of the estate. Spouses can also waive their rights of election in advance, either through a pre-nuptial or post-nuptial agreement or a stand-alone right-of-election waiver, and some T & E attorneys incorporate such waivers into every QTIP-based estate plan. That may be overkill, however, particularly as guaranteeing that a waiver is enforceable necessitates considerable financial disclosure and documentation. You should be aware of the issue, however, because in the right circumstances, obtaining such a waiver may be what saves the estate plan.

A trust may have similar estate planning benefits where children and grandchildren are concerned. A client may want to provide primarily for his or her grandchildren, but may not want to leave assets directly to them just in case his or her children might need access to those assets during their lives. Again, a trust can solve the problem by providing that both children and grandchildren are beneficiaries while the children are alive, but after the children are gone, the assets are distributed outright to the grandchildren.

And as a corollary to the last point, while some clients want assets divided strictly equally among their beneficiaries in a given generation, some clients are more concerned that different beneficiaries may have different needs. The hedge fund manager child may not need money, while the inner-city school teacher child does. In that case the client could simply provide more for the latter child, but that could be seen as harsh. Instead, you could advise the client to create one trust for both children; the trust would presumably benefit mostly the poorer child, but on its face it would not be discriminatory, and in any event the trust's assets would be available for the other child as well if, say, her hedge fund collapsed.

Formal Requirements for a Trust

Intent

It is axiomatic that a settlor cannot create an express trust without the intent to do so. Given the requirement for trusts to be in writing (as will be discussed below), it is impossible, or nearly so, to contrive a fact pattern where a settlor is alleged to have created an express trust by implication. Issues of intent therefore generally boil down to whether the settlor lacked capacity to enter into a trust, whether the creation of the trust was induced by fraud or undue influence, or whether the trust was created by mistake.

Technically, the standard for capacity to create an inter vivos trust is the slightly higher standard of contractual capacity—whether the settlor was able to understand the nature and consequences of a transaction and make a rational judgment concerning it—whereas mere testamentary capacity—knowing the nature and extent of one's assets and the natural objects of one's bounty—is all that is required to create a testamentary trust. See, e.g., In re Estate of Donaldson, 956 N.Y.S.2d 840 (Sur. Ct. 2012). (As a revocable trust is more similar to a Will than to a contract, however, it may be that mere testamentary capacity would be the standard for the creation of a revocable trust.) However, the burden of proof on capacity in the inter vivos trust context is on the objectant to a trust, whereas in the context of Wills and testamentary trusts, the burden of proof is on the proponent. See Id. Issues of fraud and undue influence are likely to be the same for inter vivos trusts as for testamentary trusts, and issues of mistake are likely to be the same for trusts as for contracts.

Identifiable Property

One old common law rule is that for a valid trust to exist, it must hold assets—in old-fashioned terms, there must be a trust res delivered to the trustee. However, as discussed above in "Avoiding Probate" in Reasons for Creating a Trust, unfunded revocable trusts are increasingly common. How can one reconcile these two concepts? Put simply, the unfunded revocable trust, or for that matter an unfunded irrevocable trust, is not yet a valid trust; it only becomes a valid trust upon funding. Could it be problematic to have a not-yet-valid trust? There is some concern that a trust that is not yet valid could not be effectively named as a beneficiary under a pourover Will. However, NY CLS EPTL § 3-3.7 seems clear on its face that as long as the trust agreement is validly executed, the trust can be a beneficiary under a Will; no funding requirement is mentioned. Nonetheless, to be safe, it has been common practice to recite in the schedule of trust assets some nominal amount of money (e.g., $10) to satisfy the requirement for a res. To satisfy the delivery requirement, a $10 bill is sometimes clipped to the schedule, though that can create problems for institutional trustees, who may be prohibited under their anti-money laundering policies and procedures from accepting cash transfers. In practice, the res requirement is highly unlikely to be an issue, but if one anticipates a contest, one can take steps to reduce the risk of the contest by funding the trust to a more-than-nominal degree promptly after creation.

Ascertainable Beneficiaries

Another old common law rule is that a trust must have ascertainable beneficiaries to be a valid trust. That does not mean a trust must have current beneficiaries—a trust is valid if there are no current beneficiaries for a period of time, and income must be accumulated for that period—but there must be some party in a position to enforce the trust. (Occasionally an inartfully drafted trust will omit the designation of beneficiaries, but in such a case the drafting attorney can generally be persuaded—perhaps via the threat of a malpractice action—to claim in the context of a judicial trust reformation proceeding that the omission was a scrivener's error.) The party enforcing the trust need not be an individual; non-natural persons such as charities or other trusts, or in theory other legal entities, can be beneficiaries. And, since 1996, pets can be the sole current beneficiaries of trusts. See NY CLS EPTL § 7-8.1.

In contrast, there is no requirement for a trustee to be specified in a trust instrument because a trustee can always be appointed, just like a vacancy in the office of trustee can always be filled, via a court proceeding.

Acknowledged Writing

One key formal requirement of trusts under New York law is statutory as opposed to common law: NY CLS EPTL § 7-1.17 specifies that inter vivos trust agreements must be in writing and acknowledged in the same manner as is required for a recorded deed, or alternatively they must be witnessed by two witnesses. (The witnessing alternative comes in very handy where signatories are outside the country.) Prior to the adoption of that Section, oral trusts were permitted in New York, but no longer. Testamentary trusts do not have the same requirement; they are valid if the Will under which they are created is valid. Of course, Wills generally must satisfy all of the requirements of the statute of Wills, NY CLS EPTL § 3-2.1, which include being in writing and witnessed, but there are exceptions. NY CLS EPTL § 3-2.2 permits nuncupative (i.e., oral) or holographic (i.e., handwritten and unwitnessed), but only if made by people in military service or mariners at sea. A trust created under such a Will would, in theory, still be valid, though in practice nuncupative or holographic Wills are likely to be short and simple, and thus highly unlikely to contain trusts.

Restrictions on Trust Purposes

Illegality

NY CLS EPTL § 7-1.4 codifies the common law rule that a trust may be created for any lawful purpose. So, for example, a trust could not be used for the payment of bribes, see In re Estate of Sage, 412 N.Y.S.2d 764 (Sur. Ct. 1979). Presumably, even if the permitted uses of the trust assets were not illegal, but the actual point of creating the trust was fraudulently to conceal assets from the taxing authorities or other creditors, or otherwise to circumvent some legal requirement, the trust would be void or voidable as well. See, e.g., National Superlease Inc. v. Reliance Ins. Co. of New York, 507 N.Y.S.2d 16 (App. Div. 1986) (a trust will not be recognized where the intent of the trust was to circumvent insurance law requirements).

Provisions Contrary to Public Policy

It is exceptionally rare to trip over an illegality of purpose issue. But it is not so uncommon to encounter provisions that are contrary to public policy. NY CLS EPTL § 7-3.1 refers to a specific situation that is generally contrary to public policy, namely, where a trust provides that the settlor or the settlor's spouse shall cease to be a beneficiary upon applying for government assistance. If you do Medicaid planning for clients by using trusts, that section could be implicated. But a more challenging issue is where a client asks you to include a provision in a trust disqualifying a beneficiary who marries a person of a different race or religion. There are cases in New York from the 1950s and before that permit such restrictions, but public policy is an evolving concept, and what was acceptable 60+ years ago may not be so today. You should research that issue thoroughly, including determining what courts in other states have decided more recently, before acceding to a client's request to incorporate such a provision into a trust instrument.

Trustees

Appointment

In general, any natural person can be a trustee. The same cannot be said for non-natural persons: generally, under New York law, only a bank/trust company can be trustee. See NY CLS Bank § 131. Moreover, although national banks and New York state-chartered banks and trust companies can serve as trustee without any additional steps, an out-of-state bank or trust company must establish a trust office in New York, which subjects it to examination by New York banking regulators, or it must essentially register, on a trust-by-trust basis, with the Surrogate's Court (for testamentary trusts) or with the superintendent of banks (for inter vivos trusts). See NY CLS Bank § 131.

But even for natural persons, there may be certain restrictions, at least where testamentary trusts are concerned. Specifically, under NY CLS SCPA § 707, certain categories of individuals are not eligible to receive Letters, including Letters of Trusteeship, namely: (i) individuals who are not yet adults; (ii) individuals who lack mental capacity; (iii) felons; (iv) individuals who are unqualified due to substance abuse, dishonesty, improvidence or want of understanding, or who are otherwise unfit; and (v) non-U.S.-citizens who are not resident in New York, unless they serve with one or more co-trustees at least one of whom is resident in New York.

The last of those restrictions is the one most likely to be problematic from a planning perspective, though not in connection with trusts. (Since the restriction only applies to testamentary trustees, you can plan around it by creating inter vivos trusts instead.) Rather, you may have young clients who have moved to New York from a foreign country and have no relatives here whom they would want to name as guardian of their minor children. That particular challenge is beyond the scope of this practice note, but it can be very real.

There is an interesting point concerning felons. In general, a convicted felon is ineligible for Letters, but convicted felons can apply for a certificate of relief from civil disabilities under New York Corrections Law, see NY CLS Correc § 700, et seq., which, if granted, will remove the felony conviction taint under NY CLS SCPA § 707. Nonetheless, the convicted felon may be ineligible for Letters under a different part of that statute, such as if the crimes he or she committed were crimes of dishonesty.

Note that a named trustee cannot be compelled to serve as such: a named trustee must voluntarily qualify as trustee (i.e., formally accept his or her appointment) before actually commencing to serve. Testamentary trustees qualify by petitioning the Surrogate's Court for Letters of Trusteeship and signing the required oath and designation. The initial trustees of an inter vivos trust qualify by signing the trust agreement. Successor trustees of an inter vivos trust accept by signing the instrument under which they are appointed, or a separate instrument drafted for that specific purpose, and the trust agreement may specify the formalities with which those instruments must be executed. In all cases, proper documentation is essential to forestall any claims that a trustee is acting without due authority. That is particularly an issue for successor trustees under testamentary trusts, who may be unaware of the requirement to obtain Letters of Trusteeship. (Even corporate trustees may be unaware of the requirement if they do not do much business in New York or in the handful of other states that require Letters for testamentary trustees.)

Succession

Although New York has an exceptionally well-developed trust law, one area where it is not as flexible as some other jurisdictions is in trustee succession. If a trust instrument names a successor trustee, or provides for a process of naming a successor trustee, there is generally no problem. But if there is no named successor willing and able to serve, and no mechanism set forth in the trust instrument that can be used to name a successor, there is no other option besides petitioning the Surrogate's Court for the appointment of a successor, even for an inter vivos trust. See NY CLS SCPA § 1502. In contrast, other jurisdictions may have statutes that, for example, authorize the beneficiaries to appoint a successor if the governing instrument does not provide for an effective appointment mechanism. See, e.g., Fla. Stat. § 736.0704.

Consequently, to obviate the need to go to Surrogate's Court, when drafting a New York trust, you should incorporate multiple layers of trustee succession provisions. To be truly thorough, you could empower the grantor to name successors, and if she or he cannot, her or his spouse could have the same power, but if there is nonetheless an unfilled vacancy, named individuals A, B and C, singly, in the order named, would be the trustee, with the last to act authorized to appoint a further successor, and in case a vacancy nonetheless arises, a majority of the adult beneficiaries could fill the vacancy, and then as a last resort, Bank X could be the trustee. Most drafting attorneys do not typically provide for that many fallback options, but some subset of them is advisable.

Note that under certain circumstances, the unrestricted power of a grantor or a beneficiary to remove and replace trustees could create tax problems for that person, see Rev. Rul. 95-58, 1995-2 C.B. 191, but the mere power to name successors should not be problematic, though if your trust is not supposed to be includible in the grantor's estate for estate tax purposes, you may want to provide expressly that the grantor cannot under any circumstances become a trustee.

Trust Administration

Duties of Trustee

Fiduciary Duty Generally

As noted above in What is a Trust, one of the fundamental characteristics of a trust is the trustee's fiduciary duty to the beneficiaries. At its most basic, that means that a trustee must act in the best interests of the beneficiaries, requiring a certain degree of selflessness. Arguably the most famous statement on fiduciary duty in American jurisprudence comes from a New York Court of Appeals case, Meinhard v. Salmon, 249 N.Y. 458 (1928), in which Judge Cardozo eloquently stated: "A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." (Though many quote that case, few know that it does not involve trusts at all, so why Cardozo chose to frame the concept of fiduciary duty in terms of a trustee is not clear. Nonetheless, that statement of the law is quite powerful.) The broad concept of a trustee's fiduciary duty has been broken down into various individual duties, which will be described in more detail below.

But first, it is important to delve into one point that often goes overlooked in discussions about fiduciary duties: not all fiduciaries are created equal. For example, an attorney-in-fact under a power of attorney is a fiduciary, but as noted above in "Asset Management" in Reasons for Creating a Trust, an attorney-in-fact has no affirmative obligation to act on behalf of the principal, while a trustee does. The fiduciary duties of attorneys-in-fact stem from the law of agency, not the law of trusts, and though it has not been written about extensively, less is expected of agents than of trustees. In particular, though this issue arises more often in other contexts than in estate planning, breaches of fiduciary duty in the agency context can generally be excused if they are properly disclosed, but in the trust context, disclosure alone will not suffice; informed consent is required.

Duty of Loyalty

Of the various individual duties owed by trustees, the most central to the fiduciary concept is the duty of loyalty. A trust must be administered solely in the best interests of the beneficiaries, not in the interests of the trustee. (The trustee is entitled to be paid for its efforts, however.) A trustee cannot generally engage in self-dealing—transactions between the trustee and the trust—for the obvious reason that the trustee cannot be relied upon to seek the best result for the trust and its beneficiaries if the trustee is on the other side of the transaction. Self-dealing falls into the general category of conflicts of interest, which a trustee is honor-bound to avoid as well. Say, for example, a trust owns 30% of the stock in a company and the trustee of that trust owns 30% of the stock individually. The trustee may not vote the trust's stock in a matter that will benefit the trustee personally unless the benefit accrues equally to all shareholders. The potential for a biased vote creates a conflict of interest even though no actual self-dealing is involved because there is no transaction between the trustee and the trust.

Interestingly, the evolution of modern financial institutions has led to a softening of the prohibition on self-dealing and conflicts of interest. For example, a corporate trustee may want to invest the trust's assets in mutual funds of an affiliate of the trustee. Under traditional trust law, that would be considered self-dealing, and as such, prohibited. But whether because of a recognition that it could well be in the best interests of the trust to permit such investments or because of lobbying from the financial services industry, such investments are now specifically authorized by statute. See NY CLS EPTL § 11-2.3(d). Note that, unless the trust provides otherwise, a trustee must choose between earning commissions on such investments or its affiliate earning its standard fees; there is no "double-dipping" permitted under the statute. However, many corporate fiduciaries will insist on inclusion of language in trusts where they serve as trustee overriding that proscription against "double-dipping" and also authorizing a range of other self-dealing transactions, on the theory that the settlor of the trust is choosing the trustee at least in part because of the range of investments that will thereby be made available to the trust. Therefore, when drafting a trust that will name a corporate trustee, as early in the drafting process as possible you should obtain from the trustee its preferred language on self-dealing so you can negotiate the provisions as needed and ultimately incorporate them into the trust.

Duty of Care

The next most basic individual duty owed by a trustee is the duty of care, that is, the trustee must act in its administration of the trust with the care and skill of an ordinary prudent person. (A fiduciary with particular expertise in an area will generally be held to a higher standard. For example, a trustee who is an accountant will be expected to know the tax law better than one who is not, and a corporate trustee will be expected to keep impeccable records whereas an individual trustee might be excused for minor lapses in that area.) Two points are worth noting here. First, prudence does not mean perfection. If a trustee makes prudent investments that do not happen to work out well, the trustee has not breached its duty of care even though the trust may have lost money. And second, prudence is a process-driven determination rather than a results-driven determination. If the decision-making process is sound, the trustee has fulfilled its duty of care, regardless of the result. But being able to demonstrate that the process was sound can be a challenge, and you should therefore encourage your trustee clients to document their decision-making as thoroughly as possible. Detailed minutes of trustee meetings can save the trustee from liability. (As an aside, non-trust lawyers sometimes have a bias against detailed minutes because they feel that any more detail than absolutely necessary gives potential litigants fodder for lawsuits. Whether or not that is true in other contexts, it is clearly wrong-headed thinking in the trust context, where the most important criterion for avoiding liability is the degree of attention to the decision-making process that the trustee demonstrates.)

Duty of Impartiality

Another individual duty is that of impartiality: a trustee must treat all beneficiaries fairly. Note that fairly does not mean equally, as different beneficiaries may have different needs. Current beneficiaries are not the only ones whose interests need to be considered; a trustee must be fair to remainder beneficiaries as well. So, for example, a trustee may be asked by a current beneficiary for a large distribution, and can even justify why such a distribution would be prudent (e.g., it is needed to pay for the beneficiary to go to law school to enhance her earning potential), but if the distribution constitutes a large percentage of the trust, it may unduly favor the current beneficiaries over the remaindermen.

That said, you may have a client who truly wants to favor the current beneficiaries over the remaindermen, or one current beneficiary over others. In that case, you may want to incorporate specific language into the trust agreement:

> "Without limiting the Trustee's discretion, the Trustee may consider the needs of the Settlor's daughter as more important than the needs of other descendants of the Settlor, and the Settlor encourages the Trustee to be liberal in making distributions to the Settlor's daughter, even to the extent of distributing the entire trust principal."

In a traditional trust that requires the trustee to distribute all of the trust income, the current beneficiaries may want the trustee to invest in assets that generate a great deal of income, and the remainder beneficiaries may want the trustee to invest in assets that have more potential for appreciation. Historically, trustees addressed the need to balance these competing interests by investing in an even mix of bonds—to produce income—and stocks—to generate growth. With the primacy of modern portfolio theory in investing, however, that balanced approach to investing is deemed inefficient; instead, trustees ought to invest for the maximum total return for a given risk tolerance. In 2001, New York incorporated the concept of divorcing asset allocation decisions from distribution decisions into its trust law by authorizing trustees to adjust between income and principal, see NY CLS EPTL § 11-2.3(b)(5), or to define income as 4% of the trust assets, see NY CLS EPTL § 11-2.4. Either of these powers can be used to facilitate an optimal asset allocation under the prevailing market conditions while not running afoul of the duty of impartiality.

You should be cautioned, however, that these statutes exist for the purpose of divorcing asset allocation decisions from distribution decisions, not to give trustees a method for increasing distributions to current beneficiaries. If a hypothetical balanced portfolio of 50% bonds and 50% stocks would generate, say, 2% income, but a trust's actual investment portfolio generates 1.5%, the use of the power to adjust could justifiably be used to boost distributions to the current beneficiaries to 2%, but not to boost distributions to 4%. This point is widely misunderstood by beneficiaries and trustees alike, but you should be clear on it when advising clients: these powers can only be exercised in a manner consistent with the duty of impartiality, not so as to generate a windfall for the current beneficiaries.

Duty to Keep Beneficiaries Informed
In theory, the duty to keep beneficiaries informed does not seem terribly complex. The trustee ought to send periodic statements to the beneficiaries so they are aware of the trust's assets and the transactions that are occurring in the trust's account; that way, the beneficiaries can fulfill their fundamental role of enforcing the proper administration of the trust. But what do you advise the parent who tells you that he or she does not want his or her children to know about the millions of dollars being held in trust for their benefit lest the children lose all incentive to be productive members of society? The short answer is that, in a New York-law trust, there is not much that a trustee can do to shield the beneficiaries from knowledge about the trust because to do so would be a breach of the trustee's fiduciary duty. In certain other states, such as Delaware, however, so-called "silent trusts" are permitted, where the trustee can be expressly relieved of any obligation to inform the beneficiaries even of the existence of the trust, and in fact can be prohibited from voluntarily releasing that information. One can question whether that is good public policy, but one can also understand the parent's concern. Perhaps advising the parent to have frank conversations with his or her children about money and his or her expectations for being productive members of society might make sense, but advising the parent to set up the trust in Delaware would not be irrational either.

Other Duties
Most other individual duties are really subsumed within one or another of the ones already discussed, but there are a few that warrant separate mention. One is the duty to administer the trust. That seems obvious, but as noted above, it is different than in other fiduciary duty contexts, where there may not be an affirmative duty to act. Another is the duty to act within the scope of the trustee's authority. For a trustee to take an action, the trustee must of course have the authority to do so; for example, if a trust does not authorize a distribution to a particular beneficiary until age 21, the trustee has no authority to make distributions to that beneficiary any earlier. But, circling back to the duty of care, whether a trustee can take an action is only the first stage of the analysis; equally important is whether the trustee should take that action. The trustee may be authorized to invest the entire corpus of the trust in high yield bonds, or in a beneficiary's start-up business, but that does not mean doing so would be prudent. Similarly, the trustee may have the authority to distribute all of the trust assets to the beneficiary, but if the beneficiary is financially irresponsible, that may be a poor decision.

Responsibilities of Trustee
It is a rather obvious point that, in administering a trust, the terms of the trust instrument, the identity of the beneficiaries, the nature of the trust assets, the law governing the trust, the tax status of the trust and the other circumstances applicable to the trust all influence what specific tasks the trustee must undertake, and rarely will those tasks be identical for two different trusts. Nonetheless, there are a few basic responsibilities that trustees will generally have:

- Trustees are required to maintain custody of the trust assets. Fortunately, though, as discussed above in "Asset Management" in Reasons for Creating a Trust, trustees are permitted to employ financial firms to hold investable assets, and do not need to maintain certificated securities in a safe, which used to be commonplace. Note that trustees are not permitted to commingle their own assets with those of the trust. See NY CLS EPTL § 11-1.6.
- Trustees are required to safeguard trust assets, which may mean choosing a custodian prudently and it may mean properly insuring real estate or artwork owned by the trust.
- Trustees are required to maintain records for the trust. And it is in the trustee's best interest to do just that, and to do so assiduously, because when a beneficiary calls on the trustee to submit an accounting of its administration of the trust, if the trustee lacks sufficient information to properly and fully account, the beneficiaries and the Surrogate's Court may well draw negative inferences that the trustee cannot rebut. Note that separately tracking income and principal may be required, particularly where the trust has different standards for income and principal distributions. There are detailed rules in EPTL Article 11A on allocation of receipts and disbursement to income or principal, which can affect not only distributions but also the computation of trustee commissions. See Compensation of Trustee below.
- Trustees are required to invest the assets of the trust, though as noted above in "Asset Management" in Reasons for Creating a Trust, trustees can delegate investment discretion to professional investment managers as long as they choose them prudently and oversee them prudently.
- Trustees are required to make whatever distributions are required under the trust instrument, and are required to consider beneficiaries' requests for discretionary distributions if the trust instrument vests the trustee with any distribution discretion.
- Trustees are required to file whatever tax returns are required for the trust. That can be a somewhat complicated undertaking. A trust may not have a separate filing obligation under Federal law because it is a grantor trust, though depending on circumstances there may be an informational return filing obligation even for a grantor trust. And in terms of state filing obligations, like individuals, trusts may have income sourced in different states and may

have to file non-resident returns in those states. Moreover, because different states classify trusts as resident in the state based on different criteria, a trust may be resident in more than one state. For example, a trust established by a New York settlor with a Delaware trustee and a California beneficiary may have to file in all three states. Finally, as discussed below in Tax Considerations, there are certain New York idiosyncrasies that may need to be considered as well. And if there are any international aspects to the trust, a whole additional set of reporting obligations may apply. You therefore ought to advise your trustee clients to hire accountants with experience preparing fiduciary income tax returns, not just personal income tax returns or business entity returns.

- Finally, trustees may be required to pursue claims on behalf of the trust, against service providers that have acted improperly, or against former trustees or even co-trustees who have done the same.

Certain states, such as Delaware and South Dakota, by statute permit so-called "directed trusts," where, for example, an investment advisor or a distribution advisor named in the trust agreement is vested with discretion over investments or distributions, as the case may be, and the trustee's role is simply to effectuate the directions it receives from the named advisors. In those states, the trustee is not responsible for making any decisions within the spheres of activity for which it is directed, and it is generally protected from liability if it acts as directed even if the direction is imprudent. New York law does not yet countenance directed trusts, and though you could draft a New York trust to operate like a directed trust, the trustee of such a trust would have no statutory protection from liability merely because it acted as directed. Consequently, you presumably ought to advise clients who want directed trusts to set them up in states whose laws expressly provide for them.

Note that, unless otherwise specified in the trust instrument, multiple trustees are to act by majority. See NY CLS EPTL § 10-10.7.

Liability of Trustee

New York generally follows the common law rules when it comes to trustee liability. A trustee who breaches his or her fiduciary duty can be surcharged (i.e., held liable for damages), can have his or her commissions denied, or both, and in extreme cases, a trustee can even be removed. Claims against a trustee are typically brought in the context of an accounting proceeding. See NY CLS SCPA § 2205.

A run-of-the-mill violation of the duty of care—say, neglecting to file tax returns in a jurisdiction where there was a filing obligation—would generally expose the trustee to surcharge, and the damages are designed to put the trust in the position it would have been in had the violation not occurred. But a denial of commissions would presumably only be appropriate where the violation was of a nature and severity that could reasonably be deemed a violation of the duty to administer the trust. See In re Estate of Kramer, 356 N.Y.S.2d 984 (Sur. Ct. 1977) (referring to executors but presumably no less applicable to trustees). This treatment is logical, because commissions are compensation for the administration of the trust, and even if the trustee makes some mistakes in that administration, the trustee is still working to administer the trust and has earned that compensation. But if the trustee is "asleep at the switch," so to speak, to such an extent that the trust is not actually being administered, then the trustee has not earned his or her commissions. And a serious violation of the duty of loyalty, referred to traditionally as a breach or violation of trust—if, e.g., the trustee steals from the trust, or uses the trust's assets to enrich himself or herself at the trust's expense—or a violation of law is generally grounds for removal. See NY CLS SCPA § 711, NY CLS SCPA § 719 and NY CLS EPTL § 7-2.6.

Any provision in a Will that purports to exonerate a trustee for violation of the duty of care is void as contrary to public policy. See NY CLS EPTL § 11-1.7. No such limitation applies to inter vivos trusts, and it is not uncommon to see liability in inter vivos trusts limited to acts of gross negligence. Abrogation of all of a trustee's fiduciary duties, however, even in an inter vivos trust, is void as contrary to public policy.

Trustees are generally not liable for the acts of a predecessor, but may be liable for failing to seek redress against a predecessor trustee. See NY CLS SCPA § 1506 (in the related context of a trustee receiving property from an executor). If the settlor of a trust is particularly concerned about the potential liability of successor trustees, language exonerating a successor trustee for failing to seek redress can be added to an inter vivos trust:

> "No Trustee shall be liable at any time by reason of, or in consequence of, any acts, omissions or defaults with respect to the administration of the trust by any predecessor trustee, and no Trustee shall have any duty to examine the accounts, records and acts of any predecessor trustee or to institute any action or claim against any predecessor trustee to compel redress of any breach of trust or for any other reason."

In contrast, trustees will generally be held liable for actions of a co-trustee, even if they do not participate in those actions, if they knew or should have known of them, unless they dissent in writing. See NY CLS EPTL § 10-10.7. Even dissenting in writing will not, however, absolve a trustee of liability for failure to prevent a true breach of trust or a failure to administer the trust.

Compensation of Trustee

Trustees are entitled to commissions for administering trusts. Under NY CLS SCPA § 2309, individual trustees are entitled to annual commissions based on the value of the principal of the trust according to a graduated rate schedule:
1.05% on the first $400,000 of principal;
0.45% on the next $600,000 of principal; and
0.30% on the balance of the principal.

In addition, individual trustees are entitled to so-called "paying-out" commissions of 1% of principal distributed. Note that paying-out commissions would apply whenever principal leaves a trustee's control, which would apply not only to distributions to beneficiaries, but also disbursements that are allocable to principal, and also turning over the trust assets to a successor trustee, so changing trustees can be expensive! And if a trustee is directed or authorized to retain income but not add it to principal, the trustee is entitled to commissions for subsequently paying out that retained income of 2% on the first $2,500 and 1% on the balance. However, most trusts authorize adding any undistributed income to principal, and since doing so simplifies record-keeping, it is common practice; commissions on paying out accumulated income are therefore rarely seen.

Principal paying-out commissions are payable from principal and income paying-out commissions are payable from income, whereas annual commissions are payable one-third from income and two-thirds from principal. Commissions payable from income must be paid from that year's income, so if a trustee mistakenly distributes all of the income for a given year without reserving for the portion of the trustee's commissions payable from income, that portion will be forfeited. (If income is retained, however, that result would not apply.) Trustees can pay themselves commissions only after furnishing to the beneficiaries a statement showing the trust's assets, the trust's transactions for the year, and the computation of the commissions.

Multiple trustees are entitled to split two commissions, regardless of how many trustees there are, unless the trust instrument provides otherwise. See NY CLS SCPA § 2313.

Corporate trustees are generally entitled under NY CLS SCPA § 2312 to "reasonable compensation" except to the extent the trustee has agreed to take a different amount pursuant to the trust instrument or a separate agreement. What constitutes "reasonable compensation" is undefined, though it is at least equal to the commission of an individual trustee. In any event, it is standard practice for corporate trustees to charge commissions at their published rate schedule unless there is an agreement to the contrary. The same rules about allocation of commissions to income and principal and the same requirement for furnishing a statement to the beneficiaries before taking commissions apply to corporate trustees just as well as individual trustees.

Amending, Revoking or Terminating a Trust

Obviously a revocable trust can be amended or revoked by the settlor in accordance with the terms of the trust agreement. But even an irrevocable trust can be amended, revoked or terminated under the appropriate circumstances. With the consent of all of the beneficiaries of a trust, the settlor can amend or revoke it pursuant to NY CLS EPTL § 7-1.9. That statute requires that the settlor is alive and competent and all of the beneficiaries (including remainder beneficiaries) have legal capacity. As a practical matter, therefore, because that confluence of circumstances is very rare, that statute is seldom invoked. In contrast, other states permit non-judicial settlement agreements, including potentially to amend or revoke a trust, under broader circumstances.

If a trust is too small to be administered economically, the trustee or a beneficiary can petition the Surrogate's Court to terminate the trust under NY CLS EPTL § 7-1.19. This is another area where New York law is less useful than that of certain other states, which may allow trustees to terminate small trusts without court involvement. However, you can address this issue in the trust instrument easily enough:

> "Notwithstanding any provision herein to the contrary if, at any time following the death of the Settlor, the Trustee in its sole discretion determines that continued administration of any trust created hereunder is unwarranted in

view of the size of the trust, such trust shall terminate and the Trustee shall distribute the property of such trust to . . ."

One area where New York was ahead of the curve, so to speak, is trust decanting: the ability of a trustee to pay over trust assets to another trust, including a trust newly created for the very purpose of receiving a distribution from the first trust. New York's decanting statute, NY CLS EPTL § 10-6.6, was the first such statute in the U.S., and served as the model for many other states. Initially, that statute was rather restrictive, as it could only be invoked if the trustee had unlimited discretion to invade principal, but in 2011 the statute was substantially modified to make it more broadly applicable. Decanting can be used essentially to amend a trust by pouring the trust assets into a different trust for the same beneficiaries. (Where a trustee has absolute discretion to invade principal, the new trust can have a subset of the beneficiaries of the old trust; where a trustee has limited discretion, the class of beneficiaries must be the same; under no circumstances can beneficiaries be added through a statutory decanting.) You may find it advisable to incorporate decanting provisions into your trusts to avoid some of the limitations of the New York statute, as will be discussed in "Extent of Discretion" in Drafting Considerations, but if not, New York law provides a perfectly workable mechanism for effectively changing the terms of an irrevocable trust.

Time Limitations on the Duration of a Trust—the Rule Against Perpetuities

The trust concept allegedly had its origins in England, many centuries ago, as a means of avoiding tax on the transfer of real property from father to son at death: if the property is held in trust, there would be one tax on the funding of the trust, but because legal title does not change as each generation dies and the next one succeeds to beneficial title, no tax would be due at each generation, as it would in the absence of the trust. To combat that tax avoidance strategy, the rule against perpetuities was devised in order to force real property out of trusts and into human hands, where it could again be taxed. In its traditional form, the rule provided that all estates in property must vest or fail within lives in being plus 21 years, and any estate in property that did not comply with the rule was void. The effect of the rule was to limit the duration of trusts because the interests of remote generations of beneficiaries would be unvested and would therefore violate the rule. To be valid, trusts had to be drafted to end within the perpetuities period.

New York's rule against perpetuities is codified in NY CLS EPTL § 9-1.1, and at least the part of it that applies to vesting of estates in property reads much like the traditional rule noted above. (There are, however, a number of rules of construction in NY CLS EPTL § 9-1.2 and NY CLS EPTL § 9-1.3 that are designed to ameliorate the harsher aspects of the rule, so that, for example, a disposition in trust lasting until age 25 that would otherwise be void is automatically reduced to last only until age 21 if that reduction in duration would permit the disposition to remain valid.)

There is, however, another part to New York's rule against perpetuities, namely, the prohibition on suspension of the absolute power of alienation. The absolute power of alienation—the power of all parties involved, collectively, to convey a fee simple interest—cannot be suspended for any period longer than lives in being plus 21 years. Because income interests in trusts are inalienable under New York law, see "Creditor Protection" in Reasons for Creating a Trust, the income beneficiaries of a trust cannot, in conjunction with the remainder beneficiaries, convey a fee simple interest. (This rule presupposes that if one person owns both the income interest and the remainder interest in a trust, the interests merge into a fee simple interest. This "merger" concept is codified in NY CLS EPTL § 7-1.1.) Therefore, if any income interest in a trust lasts for more than 21 years past lives in being, the prohibition on suspension of the absolute power of alienation would be violated. This portion of the rule against perpetuities could, in fact, invalidate certain dispositions that would not otherwise run afoul of the portion of the rule applicable to the vesting of estates in property.

To illustrate that last point, consider a disposition to a testamentary trust that provides all income to the testator's children for their lives, then all income to the testator's grandchildren for their lives, and then the remainder to the testator's then-living issue, per stirpes. This disposition violates the rule applicable to the vesting of estates in property: although the interests of the children are valid because they are all lives in being at the death of the testator, and the interests of the grandchildren are valid because their income interests vest at the death of the last living child of the testator, who is a life in being at the testator's death, the remainder interests of the issue, per stirpes, may not necessarily vest within 21 years of lives in being, since the testator's last living grandchild could have been born more than 21 years after the death of the testator. In other words, the identity of the class of remaindermen, namely, the testator's then-living issue, per stirpes, may not be determinable until after the expiration of the perpetuities period.

Now say the disposition is slightly different: all income to the testator's children for their lives, then to the testator's grandchildren for their lives, and then the remainder to Yale University. This disposition does not violate the rule applicable to the vesting of estates in property because the remainder to Yale is vested upon creation, so there is no open class of remainder beneficiaries.

However, this disposition nonetheless violates the rule against perpetuities because it violates the prohibition on suspension of the absolute power of alienation. It is true that the grandchildren's income interests vest within 21 years of lives in being because the class of grandchildren cannot be expanded after the death of the testator's last child, who was a life in being at the testator's death. But because the grandchildren's income interests are inalienable, those interests can only last 21 years after the death of the last child without violating the prohibition on suspension of the absolute power of alienation, whereas in this example, those interests last for life.

And, as noted in "Creditor Protection" in Reasons for Creating a Trust, notwithstanding that default New York law only makes income interests inalienable, it is standard practice to make all interests in trusts inalienable, which would tend to make violations of the prohibition on suspension of the absolute power of alienation even more common.
Can you imagine if T & E lawyers had to engage in this highly abstruse and technical analysis of the rule against perpetuities for every trust they drafted? Presumably nobody would draft trusts that lasted for more than one generation for fear of getting the analysis wrong. But fortunately, T & E lawyers really do not ever need to engage in that analysis, because it is standard practice to draft what are called "perpetuities savings clauses" into trust instruments. Those clauses simply provide that at the end of the lives-in-being-plus-twenty-one-years period, the trust automatically ends, which short-circuits any potential violation of the rule against perpetuities before it could invalidate the trust. For example:

> "Any trust under this Agreement still in existence upon the expiration of the Maximum Term for Trusts shall thereupon terminate, and the remaining trust property shall be distributed to the Beneficiary of the trust. The Maximum Term for Trusts shall end on the date twenty-one (21) years after the death of the last to die of the descendants of the Settlor's parents and the Settlor's Wife's parents who are living on the date of this Agreement."

Note that you would not want to provide for too large a class of measuring lives in the perpetuities savings clause because you need to track them to determine when the trust will end.

A fair number of states have abolished their rules against perpetuities, catering to the "control-freak" nature of settlors, who, if given the chance, would like nothing more than to influence, albeit indirectly, the financial lives of multiple generations of descendants. This "dead hand control" is most likely suboptimal from a policy perspective, to say nothing of the absurdity, given the pace of change in the world, of believing that any trust set up now will even be sensible a hundred years from now. But states are competing for trust business, and to do so, they entice clients with legal innovations that purport to give clients what they want. The great T & E scholar John Langbein has referred to this phenomenon as a race to the bottom. Fortunately New York has not, at least for now, chosen to participate.

Drafting Considerations

Planning for Contingencies
To be a good drafter, you must attempt to address as many contingencies as possible, within reason, of course. (For example, you may make a conscious decision, when drafting a Will for an unmarried client with no children, to provide for the possibility that he or she will get married, but not for the possibility that he or she will have children, simply because you expect that he or she will update the Will when and if that happens.) Some contingencies are less obvious than others, but thinking about what can go wrong should generally get you to the right place.

One basic issue that you should always consider is survivorship. Simply providing "I give $100,000 to X" is all well and good, but what if X is not then living? New York has a so-called "anti-lapse" statute, NY CLS EPTL § 3-3.3, such that a bequest to a child or a sibling of the testator who predeceases the testator will pass to the predeceased beneficiary's issue, per stirpes. But what if the beneficiary is not a child or sibling? And what if the client does not want that gift-over to issue, per stirpes? You should never rely on the anti-lapse statute, but instead you should draft the gift-over specifically:

> "I give $100,000 to X, or if X predeceases me, to Y, or if Y predeceases me, to Y's issue who survive me, per stirpes."

Survivorship must be considered not just with respect to the client, but with respect to other beneficiaries. Let us say the client wants to create a testamentary trust for the benefit of a sibling during the sibling's life, with the remainder to the sibling's children. First, the trust should only be created if the sibling survives the testator—that is one contingency to plan for. But what if a child predeceased the sibling? You should draft for that contingency as well:

> "At the death of my said sibling, the Trustee shall transfer, pay over and distribute any remaining trust assets to the then-living issue of my said sibling, per stirpes, or if none, then to . . ."

An alternative phrasing to "then-living issue" could be "the issue who survive my said sibling," but either way you should be defining the class of issue with survivorship in mind.

Taking survivorship issues to an extreme, you should generally provide for a so-called "ultimate disaster" clause to address the disposition of assets if all of the beneficiaries are no longer living. Collateral relatives who would not otherwise be beneficiaries could be the remote contingent beneficiaries, as could charitable organizations.

> "The Trustee shall transfer, pay over and distribute any property that is not otherwise disposed of under this Trust Agreement to . . ."

There may be circumstances, such as where the client has numerous children and grandchildren, in which you deem the odds of an ultimate disaster scenario as too remote to worry about, particularly because it is a topic that clients do not like to consider. But those cases are rare.

And when thinking about survivorship, consider that A could survive B, B could survive A, or A and B could die simultaneously. You should therefore always include a comprehensive "common disaster" clause in your documents, to apply whenever people die in quick succession:

> "Any beneficiary who dies within ninety (90) days following the date of death of the Settlor or of any other person upon whose death such beneficiary would otherwise become entitled to receive any principal or income hereunder shall be deemed to have predeceased the Settlor or such other person, as the case may be, for all purposes of this Trust Agreement."

New York has a survivorship statute, NY CLS EPTL § 2-1.6, but it only applies to deaths with 120 hours, and that may be too short a period.

One other point about survivorship bears mention. Say you are drafting mirror image documents for two spouses, and in each document you provide for a cash bequest to some third party, but only if the spouse predeceases, because the intent is to pay that bequest at the death of the second spouse. However, if under the survivorship clause of each document, each spouse is deemed to predecease the other if they die in a common disaster, that cash bequest could end up being paid twice. You may therefore need to draft a special carve-out for that bequest, such that in one document but not the other, the spouse is deemed to survive for purposes of that bequest. (There could be other circumstances where a reversal of the presumption of survivorship is warranted as well.)

Another contingency to consider besides survivorship is new members of a class being born or adopted into the class. New York has a statute to address afterborn (so-called "pretermitted") children, NY CLS EPTL § 5-3.2, but it only applies to children, not afterborn members of other classes. To the greatest extent possible, therefore, you should draft with reference to classes of people defined in relation to each other rather than with reference to specific individuals. So, for example, instead of a disposition of the remainder of a trust one-half to named child X and one-half to named child Y, consider a disposition to then-living issue, per stirpes, or, if the client prefers the share of a predeceased child to get re-allocated among the other children rather than to pass to that child's descendants, to then-living children, per capita.

What if nobody dies or is born unexpectedly, but rather the client's assets change after the drafting of the document? If a Will disposes of Blackacre, but the testator no longer owns Blackacre at death, the bequest of Blackacre is said to "adeem." New York law provides for different consequences in the event of an ademption depending on the circumstances of how the property came to no longer be owned. See NY CLS EPTL § 3-4.3; NY CLS EPTL § 3-4.4; and NY CLS EPTL § 3-4.5. In some cases the beneficiary may receive nothing and in others the beneficiary may receive the value of the adeemed property. To avoid having to determine which circumstances apply and what the consequences are, a disposition of a specific item should always be qualified with "if I own it at my death" or "if it then constitutes part of the principal of the trust."

Specific assets may not be the problem, but rather the overall level of a client's wealth could change. Dispositions of cash amounts could prove to be a larger percentage of the client's wealth than intended if the client spends down his or her wealth during life. That can be solved by providing for a disposition of a percentage of the trust assets instead of a cash bequest, but under different circumstances, a percentage of the trust assets could end up being more money than the client intended to give away if his or her wealth increases substantially. One solution is to provide for the lesser of the cash amount or a specified percentage of the trust assets.

Another contingency to think about is divorce. New York law has a fairly comprehensive statute, NY CLS EPTL § 5-1.4, providing that divorce will automatically revoke dispositions to the decedent's spouse under a Will, revocable trust or beneficiary designation, and will also automatically revoke fiduciary appointments. But as comprehensive as it is, the statute does not apply to irrevocable trusts, and it also does not cover circumstances where other people besides the settlor/testator get divorced. So, for example, if a client appoints a child-in-law as a fiduciary, it may make sense to condition the appointment on the child-in-law being married to the child at the time of appointment, and to further provide that the child-in-law shall immediately cease to act if he or she gets divorced from the child.

Clients may want to benefit particular charities in their documents. But what if a charity ceases to exist, or loses its charitable status? For major charities that have been in existence for decades or centuries, that is probably not a significant risk, but it certainly can and does happen to smaller, newer charities. You might therefore want to condition a bequest to a charity accordingly:

> "I give $100,000 to Charity X, if it is then in existence and is then an organization contributions to which qualify as deductible under Sections 170, 2055 and 2522 of the Internal Revenue Code."

And what if the bequest fails? Should there be a gift-over to a different named charity? Or to a charitable organization of the trustee's choosing? Or should the bequest simply lapse? If the client has general philanthropic intent, the gift-over will probably be her or his choice, whereas if the client just wanted to benefit that particular charity, maybe she or he will want the bequest to lapse if that charity no longer qualifies. (One unrelated point about naming charities in your documents: to avoid the risk of litigation over an improperly named charity, you should always look up the exact name and location of the charity on its website or the IRS' online list of tax-exempt organizations and describe it as such in the documents you draft.)

Extent of Discretion

A trustee can have little or no discretion under a trust instrument, or can have very extensive discretion. Traditionally, trusts provided for all income to be distributed to the current beneficiary but no principal. Then someone had the great idea to give the trustee discretion to invade principal, since a beneficiary might need more money than just the income could provide; as a result the role of the trustee became much more complicated! And then, building on that earlier innovation, the next great idea was to make both income and principal discretionary, because the beneficiary might not in fact need all of the income; the trustee's role then became even more complicated. Sometimes the degree of discretion you should provide in a trust instrument is driven by tax considerations, but often it is a function of the client's preferences, which you ought to discuss early in the drafting process.

It might be helpful to address a few relevant tax concepts at this point. First, a non-grantor trust is subject to income tax at the same rates as an individual, but the brackets are far more condensed, such that a trust hits the top marginal income tax rate at a far lower level of income than an individual. Second, without getting into all of the nuances of fiduciary income tax, as a general rule, non-grantor trusts get to deduct income distributions to beneficiaries, and the beneficiaries then have to pick those distributions up into income. Consequently, unless the beneficiaries are already in the top marginal income tax bracket, it will often be tax-efficient to distribute income from a non-grantor trust because the income will be taxed at a lower rate in the hands of the beneficiary than it will in the hands of the trust. And third, if a trustee who is also a beneficiary has unlimited discretion to make distributions, the trustee will be deemed to have a general power of appointment over the trust, with substantially adverse potential gift and estate tax consequences, whereas if the beneficiary/trustee's discretion is limited by an ascertainable standard, for example, only for health, education, maintenance or support, none of those adverse consequences typically arise.

If tax consequences were all that was relevant, you would tend to draft trusts so that income could be accumulated in grantor trusts but would be distributed in non-grantor trusts, and you would tend to incorporate extensive discretion in trusts where beneficiaries were not trustees but ascertainable standards where beneficiaries were not. (On that second point, to a large degree you can do both, by drafting different standards for beneficiary/trustees than for non-beneficiary/trustees.)

But sometimes clients want to limit discretion for non-tax reasons. For example, as discussed above in "Estate Planning" in Reasons for Creating a Trust, a client might want to provide primarily for grandchildren in a particular trust, but nonetheless name children as secondary beneficiaries just in case the children run out of money. Perhaps in that trust the trustee could be given extensive discretion to make distributions to grandchildren but could be given limited discretion to make distributions to children only for emergency needs. Or perhaps a client wants to put a cap on aggregate distributions to some or all of the beneficiaries, either as a dollar amount or as a percentage of the trust assets. (If there is a dollar amount cap on distributions, it might make sense to build in an inflation adjustment provision, though, particularly in a long-term trust.)

There are other areas besides distributions where trustees can have different degrees of discretion. For example, in the decanting context, as discussed above in Amending, Revoking or Terminating a Trust, trustees can essentially re-write a trust. You could go so far as to give the trustee the power to decant to a trust with entirely new beneficiaries. (Alternatively, you could draft a trust to permit the trustee to add beneficiaries without decanting. As the power to add beneficiaries is one way to make a trust a grantor trust, it is not uncommon to see trusts where the trustee has the power to add charitable organizations as beneficiaries.) Many clients would be uncomfortable granting a trustee such broad discretion, but some would not, so that is another topic of conversation you ought to raise with the client early in the drafting process.

One further point on discretion: you can give a trustee extensive discretion in the trust itself, but then give a trustee some guidance on how to exercise that discretion in a separate letter of wishes from the settlor. That letter is not part of the trust, and is not even legally binding—and you should expressly state as much in the text of the letter—but the client may well feel better by providing the trustee with some insight into the settlor's preferences, and the trustee may also feel better by having a better sense of the settlor's intent. Why not put that guidance in the trust itself? Mainly because the letter captures the settlor's wishes at a moment in time. The settlor's views could change and circumstances could change, and it may therefore be unwise to "hard-wire" limitations into the trust. It is easier, after all, for you to draft an updated letter of wishes if circumstances change than it is to decant the trust.

Broad Authorizations

Because the future is inherently uncertain, you do not know what assets a trust may hold in the future, or what sorts of investments a trustee may find it prudent to make. Consequently, it is often best to provide for very broad investment authorization among the powers provisions you incorporate into a trust. Fortunately, most boilerplate powers provisions already incorporate broad investment powers, as well as broad powers to borrow, lend, improve real property, remediate environmental issues and deal with a myriad of other issues as well. All other things being equal, providing more authority to a trustee is a positive: if the trustee never needs to use the authority, no harm done, but if the trustee might need to use it, at least the trust instrument empowers the trustee to do so.

However, all other things may not be equal. In particular, you have a client to deal with, and if the client gets a 50-page trust replete with detailed provisions on administering S-corporations, life insurance, art portfolios, commercial real estate, etc., when all the client actually owns are a few mutual funds, the client may not be happy. Moreover, some clients, including sophisticated ones, can be alarmed by broad authorizations to lend, borrow, buy alternative investments and derivatives, etc., because they envision the trustee using the full extent of his or her authority. You therefore need to balance the client's concerns, as well as a nearly universal bias that less is more when it comes to boilerplate language, with the benefits of broad authorizing provisions. One approach is to leave in the standard boilerplate powers provisions but only add separate life insurance, S-corporation, etc. language where you think there is a real likelihood that those provisions will be needed. But for particularly skittish clients, or ones particularly concerned with the length of the document, you could actually delete the powers provision entirely and instead include merely a cross-reference to the default New York law:

> "The Trustee may, without prior authority from any court, exercise all powers conferred by this Trust Agreement or by common law or by any fiduciary powers act or other statute of the State of New York or any other jurisdiction whose law applies to the trust, including without limitation, Section 11-1.1 of the New York Estates Powers and Trusts Law."

Retaining Flexibility

Many instances of drafting to retain flexibility have already been discussed elsewhere in this practice note. Incorporating decanting language into a trust is a particularly important way to preserve options for dealing with unanticipated future developments. Similarly, broad authorizing language and extensive distribution discretion provide trustees the flexibility to deal with changed circumstances. A few additional concepts warrant mention, however.

First, it is almost always prudent to provide a mechanism for removal of the trustee. Individual trustees can age, develop substance abuse problems, lose mental capacity or otherwise simply become distracted. Corporate trustees can go through reorganizations, budget cuts, etc. that may result in a diminution of service levels. Or the relationship between the trustee and the beneficiaries can deteriorate for a host of other reasons. On the other hand, you may not want to make it too easy for a beneficiary to remove and replace a trustee, because then the trustee may be overly beholden to the beneficiary, which could result in a loss of objectivity on the part of the trustee, potentially jeopardizing some of the goals of the trust. As a middle ground, the settlor, or the settlor's spouse, or a majority of the adult beneficiaries (if there are at least a few) could be empowered to remove a trustee, or you could designate a separate trust protector whose sole function is to remove and replace the trustee. (You then need to deal with trust protector succession as well, but you could simply provide that the trust protector can appoint his or her own successor.)

Second, you should try to preserve a certain amount of flexibility in the tax status of the trust as well. If a trust is a grantor trust, incorporate language to "de-grantorize" the trust by permitting a release of the powers that trigger grantor trust treatment. For example, if the trust is a grantor trust because the settlor has retained the power to substitute assets for assets of equal value, draft in a mechanism for the settlor to irrevocably waive that power. Or, alternatively (or in addition), authorize the trustee to reimburse the settlor for the tax obligations of the trust; that provision should not, by itself, result in inclusion of the trust in the settlor's estate for estate tax purposes, though if the trustee actually uses that authority regularly, the result could be different. On a separate note, it is not uncommon in the international trust context to see provisions in the trust mandating that the trust be a foreign trust for U.S. income tax purposes, but that may well be the wrong approach, because if circumstances change in the future, it may make sense for the trust to convert into a U.S. trust. It may well be best, therefore, not to "hard-wire" the tax status into the trust instrument but allow it to be changed if circumstances warrant such a change.

Third, you should incorporate a so-called "vesting-in-minors" clause into your documents. Assets may become payable outright to a person who is a minor at the time he or she is to receive the assets, and in the absence of a better option, the trustee may insist that a legal guardian for the minor's property be appointed by a court before the trustee will pay over the assets. The vesting-in-minors provision gives the trustee other options, such as paying the assets directly to the minor, or to the parents of the minor, or to a custodian under a Uniform Transfers to Minors Act or uniform Gifts to Minors Act, or even to a separate trust for the minor.

Finally, you may want to consider in multi-generational trusts incorporating powers of appointment. A power of appointment is essentially a mechanism to give someone else the power to determine the disposition of the remainder of a trust. The idea behind the power of appointment is that, when the remainder of a trust is to be distributed, someone with knowledge of the prevailing circumstances at that time may make better decisions than the settlor would have made many years in advance. A power of appointment is said to be general if it can be exercised in favor of the powerholder, his or her creditors, his or her estate or the creditors of his or her estate; otherwise the power is said to be limited. Assets over which a person holds a general power of appointment are includible in that person's estate for estate tax purposes, while assets over which a person holds a limited power are generally not. Note that a limited power could be very broad—exercisable in favor of anyone in the world except the powerholder, his or her creditors, his or her estate or the creditors of his or her estate—or it could be quite narrow, exercisable only in favor of the powerholder's descendants.

To be specific on terminology, the person who creates the power of appointment—the settlor of the trust, generally—is referred to as the donor of the power; the powerholder is referred to as the donee of the power; the class of people in whose favor the power can be exercised are referred to as potential appointees; and the class of people who would receive the assets that are the subject of the power to the extent the power is not exercised are referred to as takers in default of appointment. You should always include takers in default of appointment when you draft, to account for the contingency of the power not being exercised. Note that a power of appointment can be exercised in favor of a continuing trust for the potential appointees as well as to them outright. A sample provision granting a power of appointment is as follows:

> "Upon the death of the Beneficiary, the property of the Trust shall be distributed to such one or more persons (other than the Beneficiary, the Beneficiary's estate, the Beneficiary's creditors, or the creditors of the Beneficiary's estate) on such terms as the Beneficiary may appoint by a Will or other signed writing that is acknowledged before a notary public specifically referring to this power of appointment or, in default of appointment or insofar as an appointment is not effective, to . . ."

Overriding Statutory Limitations
There are a few provisions that you should include in New York trusts to address specific issues of New York law. One is the so called virtual representation provision:

> "In any proceeding relating to a trust hereunder, service upon any person under a legal disability need not be made when another person not under a disability is a party to the proceeding and has the same interest as the person under the disability."

NY CLS SCPA § 315 is New York's virtual representation statute, and it is addresses who must receive service of process in a judicial proceeding. For example, if a class of persons are interested parties, it is only necessary to serve the current members of the class. In general, the provisions of the statute are automatically effective, but in one instance, so-called "horizontal" virtual representation of a person with a disability by another party with the same interests, the governing instrument must authorize it. Without a provision like the one above, it could be necessary to have a guardian ad litem appointment to represent a minor beneficiary, whereas with the provision, an older sibling who is an adult and is a party to the proceeding anyway could represent the minor beneficiary without the cost and delay of having a guardian ad litem appointed.

Another provision is part of the vesting-in-minors clause. As noted above in Retaining Flexibility, the vesting-in-minors clause is designed to give the trustee flexibility to deal intelligently with property that would otherwise be payable outright to a minor. It is important in the vesting-in-minors clause to expressly authorize payment to a custodian under a Uniform Transfers to Minors Act or Uniform Gifts to Minors Act, because NY CLS EPTL § 7-6.6 provides that in the absence of such an authorization in the governing instrument, only amounts up to $50,000 can be paid over to a custodian.

You should also include a tax clause in any Will or revocable trust you draft. Under EPTL Sec. 2-1.8, estate taxes are apportioned against the property generating the estate tax obligation. That is rarely what clients want: when a client wants to give $50,000 to his or her sister, he or she generally does not want the sister to have to pay estate taxes on that $50,000, and is expecting that estate taxes will be paid out of the residue of the estate or trust. But apportionment must be specifically overridden by a provision in the governing instrument, hence you need to include a tax clause to direct, e.g., that estate taxes be paid from residue. Of course, it may be that under different circumstances you may want to direct that taxes be paid from a different source. In fact, there are a number of issues you may want to consider, including whether or not the tax clause covers only property passing under the instrument. A robust discussion of the nuances of tax clauses is beyond the scope of this article, but even a very basic tax clause that does no more than override apportionment will generally be a good addition to your documents.

Finally, you should include a bond waiver, at least in Wills. Fiduciaries are generally required to post a bond to secure the performance of their duties before they can receive Letters, see NY CLS SCPA § 708, unless the governing instrument waives the requirement. Consequently, to spare a testamentary trustee the time and expense of obtaining a bond, you should include language such as the following in Wills:

> "No Executor or Trustee shall be required to give bond or other security in any jurisdiction and, if despite this exoneration, a bond is nevertheless required, no sureties shall be required."

In fact, it cannot hurt to incorporate that language (absent the reference to the Executor) into inter vivos trusts as well, just in case a beneficiary would otherwise try to make a trustee's life difficult.

Tax Considerations

As noted above in "Tax Benefits" in Reasons for Creating a Trust, the tax-related issues concerning trusts are numerous and varied, and a detailed discussion of those issues could fill tomes, and, therefore, beyond the scope of this practice note. That said, two New York income tax-specific points are nonetheless worth making.

New York Resident Trusts
First, an irrevocable trust created by a New York settlor is a New York resident trust for New York income tax purposes (as is a formerly revocable trust that has become irrevocable upon the death of the settlor if the settlor was a resident of New York at death), and New York resident trusts are presumptively subject to New York income tax on their worldwide income. However, a New York resident trust that has no New York resident fiduciaries, no New York assets and no New York source income is exempt from New York income tax as a so-called "exempt resident trust," though it does have to file a New York

income tax return. See NY CLS Tax § 605(b)(3)(D). (Any income earned after January 1, 2014 and accumulated in an exempt resident that is distributed to a New York resident beneficiary of the trust after June 1, 2014, however, will be subject to income tax in the hands of the beneficiary. See NY CLS Tax § 612(b)(40).) It may therefore be possible for a New York settlor to create an irrevocable trust that escapes New York income taxes.

Note that the term "New York resident fiduciaries" could be interpreted more broadly than merely trustees, so if you have a client who wants to create, say, a Delaware directed trust that is intended to avoid New York income tax, to be safe, none of the parties giving direction to the trustee—investment advisor, distribution advisor, trust protector—should be resident in New York. Note also that the determination of residence of a corporate trustee is not entirely clear. A state-chartered trust company should, in theory, be resident where it is chartered, and a national trust company should, in theory, be resident where it is headquartered. If, however, the trust company maintains a trust office in New York, and particularly if the trust in question is actually administered by personnel in that New York trust office, arguably the trust would not be exempt. However, if a non-resident corporate trustee of an exempt resident trust is later acquired by a resident trustee, that will not, in and of itself, revoke the trust's exempt status. See NY CLS Tax § 605(b)(3)(D).

Incomplete Non-Grantor Trusts

Second, New York generally follows the Federal rules regarding grantor trusts, such that a trust treated as owned by the grantor for Federal purposes will similarly be treated as owned by the grantor for New York purposes. However, based on a law change in 2014, certain trusts that are not grantor trusts for Federal purposes will nonetheless be grantor trusts for New York purposes. Specifically, a trust to which the grantor has made an incomplete gift will be a grantor trust for New York purposes even if it is a non-grantor trust for Federal purposes. This law change was intended to thwart what had been a thriving New York state income tax avoidance strategy, whereby New Yorkers were creating so-called "ING" trusts (for "incomplete non-grantor"), often in Delaware (hence the common "DING" appellation), that were exempt resident trusts for New York income tax purposes. They would then transfer assets to the trust without incurring any gift tax because the gift is incomplete, and thereafter any income generated by the assets or capital gains on the sale of the assets avoided New York state income. The most brazen application of this strategy would involve the transfer of an asset shortly before sale, and the distribution of the sales proceeds back to the settlor in the next tax year. The ING strategy no longer works in New York, though residents of other states that have similar rules regarding income taxation of trusts may still be able to employ the strategy.

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