

## Memorandum Urging Approval

NYSBA #3-GOV

August 22, 2017

S. 2079  
A. 1482

By: Senator Bonacic  
By: M. of A. Weinstein  
Senate Committee: Judiciary  
Assembly Committee: Judiciary  
Effective Date: January succeeding the date on  
which it shall have become a law

**AN ACT** to amend the estates, powers and trusts law, in relation to a trustee's power to adjust under the prudent investor act.

### **I. INTRODUCTION**

In this low-interest rate environment, trustees often find themselves utilizing the power to adjust set forth in Section 11-2.3(b)(5) of the New York Estates, Powers and Trusts Law (the "EPTL") to adjust between the principal and income of a trust to ensure that the income beneficiaries receive timely and appropriate distributions of income. As a result, many trustees must face the issue regarding the calculation of commissions for trusts where he or she has exercised the authority to make adjustments from principal to income. Many practitioners and trustees believe that the statute does not clearly address the commission calculation issue where a trustee utilizes the power to adjust.

### **II. OVERVIEW OF THE PROBLEM**

Section 11-2.3(b)(5) of the EPTL empowers a trustee to make adjustments between principal and income if the trustee considers such adjustment to be "advisable to enable the trustee to make appropriate present and future distributions" that would be "fair and reasonable to all of the beneficiaries...." However, a trustee is prohibited from making such adjustments in several circumstances.<sup>1</sup> One such circumstance is where the adjustment would benefit the trustee, either directly or indirectly.<sup>2</sup> Many trustees frequently decide to exercise the power to adjust to treat the beneficiaries fairly and in accordance with the statute. Such adjustments often incidentally result in an increase in trustee's commissions. This situation raises the question of whether such an adjustment violates clause (b)(5)(c)(viii) of Section 11-2.3 because the increase in the trustee's commission is a prohibited indirect benefit to the trustee within the meaning of the statute.

The amendments to the statute in 2008 clarified this issue by adding the parenthetical phrase "(which, however, shall not include the possible effect on a trustee's commission)."<sup>3</sup> The

<sup>1</sup> See EPTL § 11-2.3(b)(5)(C).

<sup>2</sup> EPTL § 11-2.3(b)(5)(C)(vii) applies to trustees who are neither a current beneficiary nor a presumptive remainderman of the trust.

<sup>3</sup> *Id.*

parenthetical language makes it clear that an incidental increase in the trustee's commission resulting from a trustee's exercise of the power to adjust is not the type of indirect benefit that would violate the statute. Indeed, the Practice Commentaries of McKinney's Laws of New York, written by Professor Margaret Valentine Turano ("Turano"), discusses whether the increase in trustees' commissions is a prohibited indirect benefit to the trustee and concludes that the 2008 amendments to the statute clarify this issue.<sup>4</sup>

Richard Nenno ("Nenno")<sup>5</sup> points out, however, that a question regarding the calculation of trustee's commissions arises where such commissions are based on the trust's income. Nenno concludes that it is unclear whether the trustee should be compensated on amounts adjusted from principal to income (e.g., whether the amount adjusted should be re-characterized for purposes of calculating commissions) notwithstanding the fact that some state statutes permit the trustee to be compensated on such adjusted amounts. In New York, for example, the commissions for a trustee of a wholly charitable trust are calculated based on the amount of income collected in a given year.<sup>6</sup> Under EPTL § 11-2.3, the trustee would be entitled to compensation on such income even where the trustee exercised the power to adjust and transferred an amount from principal to income, thereby increasing the base on which commissions are calculated. Nenno's questioning of whether amounts adjusted from principal to income should be re-characterized for purposes of calculating trustees' commission highlights the need for clarification, particularly in the case of wholly charitable trusts.

Other types of situations also present the need for clarification. For example, where an individual trustee of a private trust exercises his or her power to adjust principal to income, such trustee may prefer to continue to characterize the transferred amount as principal for purposes of the paying out and annual commission calculations. On the other hand, many banks and trust companies do not include such transferred amounts in the calculation of annual commissions. Consequently, there is the potential for conflict between an individual and a bank or trust company who are acting as co-trustees of a trust regarding the calculation of trustees' commissions.

### **III. PROPOSED SOLUTION**

In light of the above, a statutory amendment is needed. However, the problem cannot be addressed in a vacuum, but rather must be considered in light of (i) the basic purpose of the Prudent Investor Act, codified in New York at EPTL 11-2.3 (the "PIA"), as amended, as well as of the Uniform Principal and Income Act, codified in Article 11-A of the EPTL (the "UPIA"), (ii) the definitional section of the UPIA codified at EPTL 11-A-1.2 and (iii) the technical corrections that were made to the PIA in 2008.

In so doing, we conclude that, for purposes of the calculation of a trustee's commission, any adjustment of a trust asset from the trust's principal account to the trust's income account (or vice-versa) pursuant to the PIA effectuates a re-characterization of such transferred asset as an item of income (or principal, as the case may be). The failure to re-characterize the transferred asset would be inconsistent with the PIA and the UPIA.

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<sup>4</sup> Margaret V. Turano, McKinney's Laws of New York, EPTL Article 11, 2008 Practice Commentaries.

<sup>5</sup> Richard Nenno, *The Power to Adjust and Total-Return Unitrust Statutes: State Developments and Tax Considerations*, 42 REAL PROP. PROB. & TR. J. 657 (2008).

<sup>6</sup> SCPA 2309.

#### **IV. CONCLUSION**

Based on the forgoing, the New York State Bar Association **SUPPORTS** the passage and enactment of this bill, which was developed by its Trusts and Estates Law Section and urges its **APPROVAL** by Governor Cuomo.