TRUST TO TRUST TRANSFERS IN NEW JERSEY – WHERE ARE WE AND WHERE DO WE GO FROM HERE?

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"Nothing endures but change."[1] Even a well-drafted trust document may, at some point, be insufficiently flexible to adjust to ongoing changes in the law and in the circumstances of the beneficiaries. What then might a trustee do with such a trust in order to react to those changes? One increasingly popular mechanism is what is commonly called trust "decanting" – taking some or all of the assets from the old trust and transferring them to a new trust. Certain jurisdictions -- such as New York and Delaware -- are blessed with a decanting statute.[2] New Jersey does not have a statutory provision that authorizes a trustee to transfer trust property into another trust. But New Jersey does have a patchwork of case law that could permit decanting in certain circumstances.

By way of background, New Jersey cases since *Cameron v. Crowley*, 72 N.J. Eq. 681 (Ch. 1907), have held that the donee of a power of appointment can exercise that power by creating a trust for the benefit of the potential appointees. *See also Guild v. Mayor of City of Newark*, 87 N.J. Eq. 38 (Ch. 1916); *Marx v. Rice*, 1 N.J. 574, 583-84 (1949); *Matter of Wold*, 310 N.J. Super. 382 (Ch. 1998); and *National State Bank of Newark v. Morrison*, 9 N.J. Super. 552 (Ch. 1950). But, more significantly, in *Wiedenmayer v. Johnson*, 106 N.J. Super. 161 (1969), the New Jersey Appellate Division considered at length the circumstances under which a *trustee* could decant an existing trust to another trust.

The trust instrument in *Wiedenmayer* gave the trustees the power:

> [t]o distribute the Trust Property as follows:
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> (a) from time to time and whenever in their absolute and uncontrolled discretion they deem it to be for his best interests, to use for or to distribute and pay over to John Seward Johnson, Jr., or to his guardian *ad litem* if he is under the age of twenty one (21) years, to be his absolutely, outright and forever, any or all of the Trust Property.

Id. at 164. The trustees proposed to pay over to Mr. Johnson all of the trust property, expressly conditioned on his simultaneously executing an irrevocable trust to consist of the same trust property and with terms identical to the original trust, except for the exclusion of two of the contingent remainderpersons. The excluded remainderpersons argued that the contemplated trust to trust transfer would improperly extinguish their contingent remainder interest. The court disagreed, and stated:

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[1] Heraclitus.

[2] *See* NY EPTL § 10-6.6; Del. Code § 3528.

> [I]f distribution of the corpus of the trust were made to the son absolutely, as permitted within the unqualified discretion of the trustees, as opposed to the challenged distribution subject to the condition imposed, the same loss of the contingent remaindermen's interest would equally be effected. Thus, these children are not suffering by this approved new setup the loss of any vested remainder interest. The basic intention of the original creator of the trust, that the trustees' decision should serve the son's best interests, is not being defeated by the distribution made by the trustees.

Id. at 166-67.

The court had also noted that the contemplated transfer to the new trust could be in the son's best interest even though it did not benefit him economically:

> The son's 'best interests' is not defined in his father's trust indenture. The expression is not limited to a finding that distribution must be to the son's best 'pecuniary' interests. His best interests might be served without regard to his personal financial gain. They may be served by the peace of mind, already much disturbed by matrimonial problems, divorce and the consequences thereof, which the new trust, rather than the old contingencies provided for in his father's trust indenture, will engender. Of what avail is it to rest one's 'best interests' on a purely financial basis, and without regard to the effect upon a man's mind, heart and soul, if the end result would produce a wealthier man, but a sufferer from mental anguish?
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> Courts may not substitute their opinions as to the son's 'best interests,' as opposed to the opinion of the trustees vested by the creator of the trust with the 'absolute and uncontrolled discretion' to make that determination. The trustees' decision herein was made in good faith, after consideration of all the facts and attendant circumstances, and for reasonably valid reasons. Only unwarranted judicial interference would induce a negating of the course pursued by the trustees.

Id. at 165.[3]

[3] In contrast to the majority opinion, the dissent argued that the distribution by the trustees was invalid, in part, because it did not confer a pecuniary benefit on the beneficiary. *See id.* at 166.

Wiedenmayer would thus, at least, stand for the proposition that the trustees of a trust with a "best interests" standard (especially if the trustees were empowered to distribute the *entire* trust directly to a beneficiary) could, consistent with the best interests standard, transfer all or a portion of the trust to a new trust for the primary benefit of that beneficiary, but with a reduced class of potential remainderpersons. It should also allow a trust to trust transfer that eliminates a present beneficiary, if the original trust provided for a sprinkle power (to the point of eliminating the trust) in the best interests of any or all of the collective beneficiaries, and the original trust permitted one or more beneficiaries to be completely excluded from any distributions. The *Wiedenmayer* holding should furthermore support a trust to trust transfer that affects matters related to trust administration (as opposed to more substantive matters) such as trustee appointments, trust situs, trustee administrative powers, etc. But *Wiedenmayer* would not support decanting the original trust to a new trust where the original trust lacked a best interests standard or the trustee was not vested with unencumbered discretion. Nor would it support a trust to trust transfer that reduced the amount a mandatory income beneficiary was entitled to receive or expanded the class of beneficiaries (as opposed to contracting the class of beneficiaries). Finally, the *Wiedenmayer* holding would not necessarily support a trust to trust transfer that elevated remainderpersons to present beneficiaries. In those particular instances, the trustees should seek court approval before they attempt to decant the original trust.

Assuming that the situation is sufficiently analogous to *Wiedenmayer* and that the trustees have determined to proceed with the transfer, how do they accomplish the transfer? In *Wiedenmayer*, the principal beneficiary created the new trust. The court did not discuss the appropriateness of this mechanism, but we would suggest that the better approach would be for the original grantors to also be the named grantors on the new trust, to help maintain consistency in tax treatment (as discussed later). In the case of a testamentary trust, the trustees may be the more appropriate grantors (with some reference in the recitals in the new trust to the trust to trust transfer). The trustees, in both cases, would then arrange to retitle the original trust assets in the name of the new trust.

Potential GST Consequences

Once it has been determined that a trust to trust transfer is appropriate and permissible under the trust instrument, the trustee must also consider a number of potential tax consequences of the transfer.[4]

If the existing trust is exempt from the generation skipping transfer ("GST") tax (either by virtue of the trust having been grandfathered from GST taxes or having had GST exemption allocated to it), will the transfer cause it to lose its exempt status?

[4] Unless otherwise indicated, any references to the "Code" or "IRC" refer to the Internal Revenue Code of 1986, as amended, and any references to "Treasury Regulations" or "Treas. Regs." refer to the regulations promulgated thereunder.

The Treasury Regulations allow for the exercise of a non-general power of appointment in favor of another trust provided: (i) the power of appointment was created by an irrevocable trust that was exempt from GST tax; and (ii) exercise of the power of appointment does not postpone or suspend the vesting, absolute ownership or power of alienation of an interest in the property beyond the common law rule against perpetuities period (measured from the date the exempt trust was created). *See* Treas. Regs. § 26.2601-1(b)(1)(v)(B). In addition, the Treasury Regulations provide that a transfer to another trust will not cause the resulting trust to be subject to GST tax if, among other things, "state law authorized distributions to the new trust … without the consent or approval of any beneficiary or court." Treas. Regs. § 26.2601-1(b)(4)(i)(A)(1)(*ii*).

There is no mention in the *Wiedenmayer* case of any requirement that a trustee who has absolute discretion to distribute trust principal and income and who wishes to distribute it in further trust must first seek the approval of the court (or beneficiaries). Thus, a trustee confronting a *Wiedenmayer* set of facts should be able to make the contemplated trust to trust transfer from a GST exempt trust to a new trust that is similarly GST exempt if Treas. Reg. § 26.2601-1(b)(1)(v)(B)(ii) is satisfied.

Conclusion

While the New Jersey case law is limited in that *Wiedenmayer* is our only anchor, its holding is sufficiently broad to permit trust to trust transfers in certain circumstances, i.e., when the transfer is consistent with the breadth of discretion granted to the trustee. Thus, a trustee who is confronted with the need to make a change in an otherwise irrevocable trust scheme should consider whether the transfer to a new trust is an available avenue.

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