

Matter of Johnson (Cowen)

2015 NY Slip Op 30017(U)

January 13, 2015

Surrogate's Court, New York County

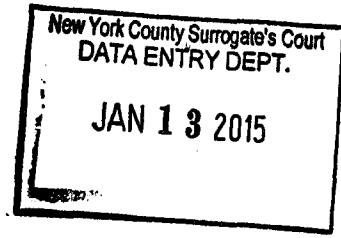
Docket Number: 2011-2809/B

Judge: Rita M. Mella

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SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK



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Petition of Katharine A. Johnson to Nullify the
Decanting of the Trust Created under an Agreement
Dated as of April 21, 1997, between

MICHAEL L. JOHNSON,

DECISION
File No.: 2011-2809/B

as Grantor, and Barbara Cowen, as Trustee, for the
Benefit of Christopher A. Johnson and Katharine
A. Johnson, and for Other Relief.

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Petition of Katharine A. Johnson to Nullify the
Decanting of the Trust Created under an Agreement
Dated May 8, 1985, between

PHYLLIS C. JOHNSON,

DECISION
File No.: 2011-2810/A

as Settlor, and Michael L. Johnson, as Trustee, for
the Benefit of Katharine A. Johnson, and for
Other Relief.

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M E L L A, S.:

Katharine A. Johnson has filed companion petitions for orders: (1) invalidating the July 25, 2011 decanting of each of two trusts created for her benefit and (2) directing the return of the "decanted assets" to the trustees of the invaded trusts. One invaded trust was created under an agreement dated May 8, 1985, between her mother, Phyllis C. Johnson, as "settlor," and her father, Michael L. Johnson, as trustee; the other was created under an agreement dated April 21, 1997, between her father, as "grantor," and Barbara Cowen, as trustee. With respect to the 1985 trust, petitioner seeks, in addition, an order charging its co-trustees, individually, with the cost of the instant proceeding plus a determination of the constitutionality of the retroactive application of EPTL § 10-6.6. With respect to the 1997 trust, petitioner seeks an order charging its trustee, individually, "and/or Michael L. Johnson" with the cost of the instant proceeding. At the time of

the decanting, petitioner was 27 years of age, the value of the 1985 trust was \$900,000, and the value of the 1997 trust was \$1 million. Petitioner's mother supports the petitions; Robert D. Lowenfish, the trustee of the 2011 trust into which the two trusts were decanted, opposes them.

1985 TRUST

Under the 1985 trust, the trustee was directed to accumulate the net income from the trust and to add it to the trust principal, and the trustee had discretion to invade principal for the benefit of petitioner or any of her issue.¹ Initially, such discretion was subject to an ascertainable standard and therefore limited (*see Matter of Mayer*, 176 Misc 2d 562 [Sur Ct, New York County 1998]). Article II (A) of the trust instrument reads:

“ . . . the trustee is hereby authorized, from time to time and in his absolute discretion, to pay to the Beneficiary, or to one or more of her descendants, so much of the principal of such trust as the trustee shall deem necessary or advisable (a) for the maintenance and education of the Beneficiary or any of her descendants, (b) for accident, illness or other emergencies (of a similar or of a different nature) affecting the Beneficiary or any of her descendants, or (c) to enable the Beneficiary or any of her descendants to purchase, build or improve a home, to establish herself in a business or profession, or to enter into any other financial transaction which the trustee shall deem to be in her best interests.”

However, upon petitioner's attaining the age of 25, the trustee's discretion to invade principal — for the benefit of petitioner — became unlimited. In addition, the trustee was directed to consider terminating the trust by distributing all the trust principal to petitioner. So long as the trust continued (after petitioner's attaining the age of 25), the trustee was directed to give regular consideration to terminating the trust until petitioner attained the age of 35, at which point

¹ At the time the trust was created, petitioner was less than one year old. At the time the petitions were filed — December 23, 2011, with respect to the 1985 trust, and January 5, 2012, with respect to the 1997 trust — petitioner had no issue; however, she has yet to attain the age of 35.

termination would be mandatory. Article II (B) of the trust instrument reads:

“Following the twenty-fifth (25th) birthday of the Beneficiary, the trustee shall consider whether to distribute to her all, or a major portion, of the then principal of such trust. If the trustee shall determine that any such distribution to the Beneficiary would be in her best interest, the trustee shall promptly make such distribution. If the trustee shall determine not to make such distribution when the Beneficiary attains the age of 25, he shall periodically review the basis for his determination and, if at any later time he shall determine that such distribution would be in the best interests of the Beneficiary, the trustee shall promptly make such distribution.”

The 1985 instrument provided that, if petitioner were to die before the termination of the trust, the trust principal would be distributed in accordance with petitioner’s limited testamentary power of appointment, outright or in further trust, provided, however, that, if any descendant of the settlor, petitioner’s mother, were living, every appointee was to be a descendant of the settlor;² in default of the exercise of the power, the trust principal would be distributed to petitioner’s issue per stirpes, but, if none, to petitioner’s mother’s issue per stirpes, but, if none, to petitioner’s mother and her husband, or the survivor of them, but, if neither survived, then to the New York City Ballet, Inc.

Subsequent Events Regarding the 1985 Trust

In 1997, settlor and her husband divorced.

In 1998, Mr. Lowenfish was appointed as co-trustee with petitioner’s father.

On July 25, 2011: (1) a trust agreement, entitled “The Katharine A. Johnson 2011 Trust,” was executed by petitioner’s father, as “grantor,” and Mr. Lowenfish, as trustee (“the appointed trust”), and (2) Mr. Lowenfish, as trustee of the 1985 trust, purported to exercise his authority

² The 1985 trust instrument provided, at Article I (B): “the power of appointment so granted to the Beneficiary shall not be exercisable, to any extent, in favor of the Beneficiary, her estate, her creditors, or the creditors of her estate[.]”

under EPTL § 10-6.6 — as it existed before the amendment which went into effect on August 17, 2011 — by decanting the 1985 trust into the appointed trust. On July 26, 2011, Mr. Lowenfish filed in this court a notice to that effect, dated July 25, 2011, and petitioner was served with a copy of the notice.

The Appointed Trust

The terms of the appointed trust differ from those of the 1985 trust.³ The appointed trust continued for the life of petitioner, during which time petitioner was the sole beneficiary.

(Article II reads: “The ‘Beneficiary’ of the trust shall be the Grantor’s daughter, KATHARINE A. JOHNSON[,] and all property transferred to the Trustee during the Beneficiary’s lifetime shall be held for the Beneficiary under the terms of the Beneficiary’s Separate Trust hereunder.”)

Petitioner was granted a limited power to appoint the trust remainder to one or more of the issue of her father (“other than the Beneficiary”). The provision for the disposition of the trust remainder, in default of the exercise of such power, Article IV (B) (2), reads:

“ Upon the Beneficiary’s death, the property then held in his or her trust shall be:

1. . . . in default of appointment or insofar as an appointment is not effective; [sic]
2. set aside and divided into per stirpital shares for the Beneficiary’s descendants then living or, if there is no descendant of the Beneficiary then living and if the Beneficiary was a grandchild or more remote descendant of the Grantor, for the descendants then living of the Beneficiary’s nearest ancestor who was a descendant of the Grantor, with descendants then living or, if there is no such descendant then living or if the Beneficiary was a child of the Grantor, for the

³ What remained the same was that the trustee’s discretion to distribute principal to petitioner was unlimited. (Article IV [A] [1] reads: “The trustee shall distribute to the Beneficiary as much of the net income and principal of the trust as the Trustee . . . may at any time and from time to time determine, for any purpose.”)

Grantor's descendants then living, the share so set aside for a descendant to be distributed to the Trustees of a Beneficiary's Separate Trust, to be held as a separate trust to be disposed of under the terms of this Article, the descendant for whom the share is set aside to be the Beneficiary of his or her own Beneficiary's Separate Trust."⁴

Article V of the appointed trust provides that, to the extent the remainder is not effectively disposed of pursuant to Article IV, the property should be distributed to those persons who would have qualified as the intestate distributees of petitioner's father had he died on the same date as petitioner, intestate, unmarried, and a resident of New York State.

Thus, under the appointed trust instrument: (1) the trust does not terminate upon petitioner's attaining the age of 35 but instead continues for petitioner's lifetime, (2) petitioner's issue, if any, have no beneficial interest in the trust before it terminates, (3) the class of permissible appointees of the trust remainder consists not of the issue of petitioner's mother, if any, and, if none, anyone other than petitioner, her estate, her creditors, or the creditors of her estate, but, instead, consists of the issue of petitioner's father,⁵ and (4) the remainder beneficiaries, in the event petitioner did not effectively exercise her power to appoint the trust remainder, would not be the same (*e.g.* the ultimate contingent beneficiary of the 1985 trust was the New York City Ballet, Inc., but the ultimate contingent beneficiaries of the appointed trust would be those persons who would qualify as the intestate distributees of petitioner's father, if he

⁴ Because the term "Beneficiary" is defined in Article II as "KATHARINE A. JOHNSON," the petitioner herein and the daughter of Michael Johnson, grantor of the appointed trust, the use of the word "Beneficiary," in Article IV, on the very next page of the trust instrument, to refer to a "grandchild or more remote descendant of the Grantor," is, at best, anomalous.

⁵ Although, at this point, the two classes are identical, the situation could change.

were to die on the same date as petitioner, intestate, unmarried, and a resident of New York State — a class of people that, in theory, could consist of collateral relatives of Michael L. Johnson, persons who have no interest under the 1985 trust instrument).

Petitioner argues that the decanting of the 1985 trust did not comply with the statute.

EPTL § 10-6.6 in Effect as of July 25, 2011

The version of EPTL § 10-6.6 (b) (1) in effect at the time of the decanting — the result of an amendment which went into effect on August 20, 2001— applied to “trusts whenever created” (L 2001, ch 204, § 2). That iteration provided:

“(b) Unless the terms of the instrument expressly provide otherwise:

“(1) A trustee who has the absolute discretion, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, to invade the principal of a trust for the benefit of one or more proper objects of the exercise of the power, may exercise such discretion by appointing all or part of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument, provided, however, that the exercise of such discretion (A) does not reduce any fixed income interest of any income beneficiary of the trust, (B) is in favor of the proper objects of the exercise of the power, and (C) does not violate the limitations of 11-1.7[.]”

At issue is whether the trustee satisfied the second condition, that is: whether the decanting was “in favor of the proper objects of the exercise of the power.” The threshold question is: what is meant by the exercise of discretion in favor of “the proper objects of the exercise of the power”?⁶

⁶ One commentator, reflecting in 2012 on the 2001 amendments to EPTL § 10-6.6 (b) (1), wrote:

“Practically, the statute left many practitioners unsure about its meaning. For example, who are the ‘proper objects’ of a decanting? Could an appointed trust exclude some of the beneficiaries of the invaded trust? Could an appointed

For elucidation, we look to the legislative history of EPTL § 10-6.6.

Legislative History

The prior iteration of EPTL § 10-6.6 (b) (1) — the original “decanting” statute (L 1992, ch 591) (which was unaffected by the 1995 amendments [L 1995, ch 479]) — read:

“(b) Unless the terms of the instrument expressly provide otherwise:

“(1) A trustee, who has the absolute discretion, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, to invade the principal of a trust for the benefit of the income beneficiary or income beneficiaries of the trust, may exercise such discretion by appointing so much or all of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument with the consent of all persons interested in the trust but without prior court approval, provided, however, that (A) the exercise of such discretion does not reduce any fixed income interest of any income beneficiary of the trust, (B) the exercise of such discretion is in favor of the beneficiaries of the trust, and (C) does not violate the limitations of 11-1.7[.]”

According to the Memorandum in Support of Legislation, the purpose of the 1992 amendment was as follows:

“The passage of the clarifying proposed amendment will place New York on an equal basis with other states in providing certain persons having interests in New York trusts with a means of dealing with the new generation-skipping transfer tax (“GSTT”) as introduced by the Tax Reform Act of 1986 in a manner available

trust have beneficiaries who were not beneficiaries of the invaded trust? Did the statute actually permit the appointed trust’s term to be extended beyond that of the invaded trust?”

Joseph T. La Ferlita, *New York’s Newly Amended Decanting Statute Typifies Trend Toward Greater Flexibility*, 26 Prob & Prop 34 (July/Aug. 2012).

under the law of other states.”

(Mem in Support, Bill Jacket, L 1992, ch 591, at 000017.)

The 2001 amendment was prompted by changes in federal tax regulations regarding the generation-skipping transfer tax:

“The purpose of this bill is to restore the intended purpose of the section to permit certain powers to be exercised without triggering generation-skipping transfer tax, which purpose has been foiled by federal regulations providing that procedural aspects contained in the present law will cause such an exercise to void the trust’s exemption from such tax.

“ . . . Under the generation-skipping transfer tax ‘grandfathering’ rules exempting irrevocable trusts in existence on September 25, 1985, a special power of appointment may be exercised in trust to extend the original trust to deeper generations without triggering that heavy tax.

* * * * *

“The Internal Revenue Service has recently promulgated regulations which would impact negatively on New York trusts. Specifically, the new regulations provide that the trust will be exempt from GST only if the trust can make distributions without court approval or consent by beneficiaries. Thus, under the current § 10-6.6 the tax exemption of these trusts is threatened.” (Emphasis added.)

(Sponsor’s Mem, L 2001, ch 204, 2001 NY Legis Ann at 116-117.)

Discussion

Thus, EPTL § 10-6.6 (b) (1) was enacted in 1992 in response to the introduction of the generation-skipping transfer tax, and the 2001 amendment was enacted in response to changes in the regulations regarding the generation-skipping transfer tax. Whereas the 1992 amendment provided for “the exercise of . . . discretion in favor of the beneficiaries of the trust,” the 2001 amendment provided for “the exercise of . . . discretion . . . in favor of the proper objects of the exercise of the power.” Such modification seems unrelated to the stated purpose of the 2001 amendment (“to permit certain powers to be exercised without triggering generation-skipping

transfer tax”), and the Bill Jacket for the 2001 amendment offers no reason for the modification. It is unclear how those two provisions differ.

Both the express language of the provision — the “proper objects of the exercise of the power” — and legislative history suggest a construction that would limit the beneficiaries of an appointed trust to persons named as beneficiaries in the instrument of the invaded trust. Moreover, the legislative history of the 2011 amendment, enacted after the decanting which occurred here, confirms such reading.⁷

The 2011 amendment amplified the authority of a trustee, so that it could be used for purposes other than avoiding the imposition of the generation-skipping transfer tax.⁸ The legislative history for the 2011 amendment indicates:

“The potential uses of this statute support the enactment of a New York statute that is expansive rather than restrictive in nature, one that permits more flexibility and liberalizes the current statute.”

(Senate Introducer Mem, Bill Jacket, L 2011, ch 451, at 000010; Assembly Sponsor’s Mem, Bill

⁷ As stated in 2A Norman J. Singer & Shambie Singer, *Statutes and Statutory Construction* § 48:20, at 641-642 [7th ed 2014]:

“[W]hile the views of a subsequent legislature cannot override the unmistakable intent of the enacting one, such views may be entitled to significant weight, particularly when the precise intent of the enacting legislature is obscure.”

⁸ “New York pioneered the realm of powers to appoint by enacting section 10-6.6 (b) in 1992. It is time again for New York to act as a vanguard and update and improve the statute, incorporating important provisions enacted by the other states or being considered by states, as well as adding significant, thoughtful, and creative elements, that are useful to practitioners but do not undermine the tenor of the statute.”

(Senate Introducer Mem, Bill Jacket, L 2011, ch 451, at 000025; Assembly Sponsor’s Mem, Bill Jacket, L 2011, ch 451, at 000042; OCA, In Support, Bill Jacket, L 2011, ch 451, at 000068.)

Jacket, L 2011, ch 451, at 000027; OCA, In Support, Bill Jacket, L 2011, ch 451, at 000051.) Further, “[t]he measure makes a number of notable clarifications, changes and additions to the existing statute”; among other things, “this measure clarifies the operation of the statute in the context of a multi-beneficiary trust” (Senate Introducer Mem, Bill Jacket, L 2011, ch 451, at 000010; Assembly Sponsor’s Mem, Bill Jacket, L 2011, ch 451, at 000027; OCA, In Support, Bill Jacket, L 2011, ch 451, at 000051). Specifically:

“Our Advisory Committee believes that the integrity and sanctity of the trust and the wishes of the settlor could be undermined if the trustee could reconstitute a trust with different beneficiaries. . . .

* * * * *

“ . . . The successor and remainder beneficiaries of the appointed trust do not have to be the same as the successor or remainder beneficiaries of the invaded trust; rather, the successor or remainder beneficiaries of the appointed trust must fall within the class of such beneficiaries identified in the invaded trust. In other words, the class of successor or remainder beneficiaries may be more narrow than those named in the invaded instrument.” (Emphasis added.)

(Senate Introducer Mem, Bill Jacket, L 2011, ch 451, at 000016 and 000017; Assembly Sponsor’s Mem, Bill Jacket, L 2011, ch 451, at 000033 and 000034; OCA, In Support, Bill Jacket, L 2011, ch 451, at 000058 and 000059.)

Thus, legislative history demonstrates that, under the 2011 amendment: (1) a trustee’s authority was expanded and liberalized to give the trustee more flexibility than the trustee had had under the 2001 amendment; and (2) the class of successor and remainder beneficiaries of an appointed trust could be narrower than the class of successor and remainder beneficiaries of the invaded trust but could not be broader. Implicit in such expression of legislative intent is: under the 2001 amendment, a trustee would not have had the authority to decant a trust in such a way as to broaden the class of successor and remainder beneficiaries.

Here, Mr. Lowenfish did just that: the class of remainder beneficiaries of the appointed trust — both the permissible appointees and the takers in default of an effective exercise of the power of appointment — is broader than the class of remainder beneficiaries of the 1985 trust. Therefore, the July 25, 2011 decanting of the 1985 trust into the appointed trust was not in accordance with the statute in existence at that time and is invalid.⁹

1997 TRUST

On April 21, 1997, Michael L. Johnson created a trust, entitled, “Christopher A. Johnson and Katharine A. Johnson Irrevocable Trust of 1997,” for the benefit of petitioner and petitioner’s brother, Christopher A. Johnson, “pursuant to” the April 18, 1997 separation agreement between Michael Johnson and Phyllis Johnson.¹⁰ The trust instrument provided for

⁹ The court, having determined that Mr. Lowenfish violated a provision of the decanting statute, need not address the following issues:

(1) whether petitioner’s mother’s bias towards early termination of the trust, clearly articulated in the 1985 instrument, constituted, in the words of the decanting statute — enacted seven years thereafter — “terms of the instrument [which] expressly provide otherwise” (*see* EPTL § 10-6.6 [h] [2015]);

(2) whether, prior to the 2011 amendment, the term of the appointed trust could extend beyond the term of the invaded trust (*see* EPTL § 10-6.6 [e] [2015]; Bill Jacket, L 2011, ch 451, at 000015, 000032, and 000057 [“This measure also specifically provides that the appointed trust to which an authorized trustee appoints the assets may have a term that is longer than the term set forth in the invaded trust, including a term measured by the lifetime of a current beneficiary”]; *but see Matter of Genovese*, NYLJ, Aug. 4, 2000, at 27, col 5, and NYLJ, Sept. 22, 2000, at 27, col 4 [Sur Ct, Nassau County]); or

(3) the constitutionality of the retroactive application of EPTL § 10-6.6.

¹⁰ The preamble to the 1997 trust instrument reads:

“WHEREAS the grantor desires to establish a trust for the purpose of providing a reasonable allowance for the support of **Christopher A. Johnson**,

the division of the trust into two equal shares, one of which was to be held for the benefit of petitioner. The trustee was granted unlimited discretion to distribute principal and income to or for the benefit of petitioner.

Article TWO of the 1997 trust instrument reads:

“With regard to each of the trusts, the trustee may from time to time, in her absolute discretion:

“(a) Expend all or any part of the said net income, whether current or accumulated, and all or any part of the principal, for the benefit of the Beneficiary

born February 15, 1984, and **Katharine A. Johnson**, born July 7, 1984 (the “Children” in the plural, and the “Child” in the singular), the children of the marriage of the grantor and **Phyllis C. Johnson** (the “Wife”), pursuant to Articles VII and X of the Separation Agreement (the “Separation Agreement”) dated April 18, 1997 between the grantor and the Wife.”

Article VII of the 1997 Separation Agreement does not appear to contain any direct reference to the 1997 trust.

Article X (E) (2) of the Separation Agreement, at page 47, reads:

“[T]he Husband agrees to assign 13,333 of the ‘NQO’ issued on that date to the to be created irrevocable trust for the pari passu benefit of Christopher and Katherine [sic] Johnson which is referred to in Article X, Section E (7) hereof.”

Article X (E) (7) of the Separation Agreement, at page 51, reads:

“The Husband agrees that from and after the date of this Agreement, a newly-created irrevocable trust for the pari passu benefit of Christopher and Katharine Johnson will be the beneficial owner of one-third (1/3) of any Future Options issued to him and any CPI or other equity securities issued as a result of the exercise of such Future Options and all income, expenses and liabilities related to the Future Options or equity securities issued upon their exercise, including but not limited to all Federal, state and local withholding and income taxes. The trust agreement will provide that the Husband will be the grantor of the trust and shall name the trustee(s) thereof.”

for education, care, support or comfort or any other purpose whatever; or

“(b) Pay all or any part of said principal and income to the parent, guardian or person having the care or custody of the Beneficiary; [sic] to be applied by such recipient for the benefit of the Beneficiary for education, care, support and comfort or for any other purpose whatever; or

“(c) Pay all or any part of the said principal and income, in such amounts as deemed advisable, directly to the Beneficiary as an allowance for personal or living expenses or otherwise, or to any legal representative of the Beneficiary.”

Article THREE of the 1997 trust instrument reads:

“Any distribution made by the trustee for the benefit of a Beneficiary shall be made in the following order: Firstly, out of current income of his or her trust; secondly, out of accumulated income of his or her trust; and thirdly, out of the principal of his or her trust. To the extent not distributed, all current income shall be accumulated.”

Upon petitioner’s attaining the age of 35, the trustee was directed to terminate the trust by distributing the trust principal “and any undistributed income” to petitioner. The 1997 trust instrument provides that, if petitioner were to die before attaining the age of 35, the trust principal “and any current or accumulated income therefrom” would be distributed in accordance with petitioner’s exercise of a testamentary power of appointment “to and among a class comprised of the Beneficiary’s spouse and the Beneficiary’s issue, as such Beneficiary shall determine”; to the extent such property was not effectively appointed, it would be distributed to petitioner’s issue per stirpes, but if none, to the grantor’s issue per stirpes, but if none, “to the Beneficiary’s Estate.”

Subsequent Events Regarding the 1997 Trust

Since October 1, 1999, Mr. Lowenfish has been acting as sole trustee of the 1997 trust.

On July 25, 2011, Mr. Lowenfish, as trustee of the 1997 trust, purported to exercise his

authority under EPTL § 10-6.6 by decanting the 1997 trust into the appointed trust, just as he had done as trustee of the 1985 trust. On July 26, 2011, Mr. Lowenfish filed a notice in this court to that effect, dated July 25, 2011, and petitioner was served with a copy of the notice.

Petitioner argues that the decanting of the 1997 trust did not comply with the statute.

Discussion


Under the terms of the 1997 instrument, the class of permissible appointees of the trust remainder consisted of petitioner's spouse and issue. By contrast, under the terms of the instrument of the appointed trust, the class of permissible appointees consisted of the issue of petitioner's father. Thus, except to the extent petitioner's spouse is excluded, the class of permissible appointees under the appointed instrument is broader than that under the 1997 instrument. Accordingly, for the reason stated hereinbefore, the decanting of the 1997 trust violated the version of EPTL § 10-6.6 (b) (1) in effect as of July 25, 2011.

CONCLUSION

The decanting of each of the 1985 trust and the 1997 trust is invalid. Accordingly: (1) Mr. Lowenfish is directed to turn over to himself and to Michael L. Johnson, as co-trustees of the 1985 trust, the assets of the 1985 trust which Mr. Lowenfish has held pursuant to the 2011 trust instrument; and (2) Mr. Lowenfish holds the assets of the 1997 trust pursuant to the original trust instrument. The balance of petitioner's requested relief is denied.

This decision constitutes the order of the court.

Dated: January 13, 2015


S U R R O G A T E