

TRUSTEE-BENEFICIARIES, CREDITORS, AND NEW  
YORK'S EPTL: THE SURPRISES THAT RESULT AND HOW  
THE UTC SOLVES THEM

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I. INTRODUCTION

A trust is established. Tracy Brown is both the trustee and the beneficiary.<sup>1</sup> The settlor has empowered the trustee to make discretionary distributions from the trust to the beneficiary herself without any limitation, such as an ascertainable standard.<sup>2</sup> Much to the dismay of creditors, this means that Tracy Brown, as the trustee-beneficiary (hereinafter "T/B"), can access the trust funds at any time, yet the funds remain protected from her creditors while held in trust. Could the New York Legislature have intended such a consequence from the seemingly benign 2003, and subsequent 2004, amendments to section 10-10.1 of the New York Estates, Powers and Trusts Law (EPTL)?<sup>3</sup>

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<sup>1</sup> The disposition actually contains a second beneficiary to prevent merger (discussed *infra* Part II.A.), but for the purposes of this article the first, present beneficiary will be referred to simply as "the beneficiary." See N.Y. EST. POWERS & TRUSTS LAW § 7-1.1 (McKinney 2002) (recognizing a valid trust where the trustee is also a beneficiary provided there is another "beneficial interest" in the trust); see also *In re Estate of Seidman*, 395 N.Y.S.2d 674, 675 (App. Div. 1977) (illustrating the possibility of remote beneficiaries when, for example, the testator enables the life beneficiary to name the remaindermen).

<sup>2</sup> Typical ascertainable standard limitations include health, education, maintenance, or support. I.R.C. § 2041(b)(1)(A) (2000).

<sup>3</sup> N.Y. EST. POWERS & TRUSTS LAW § 10-10.1 (McKinney Supp. 2006). Article 10 of the EPTL is entitled "Powers"; part 10 is entitled "Provisions Affecting Powers Other Than Powers of Appointment"; section 10-10.1 is entitled "Power to distribute principal or allocate income; restriction on exercise." N.Y. EST. POWERS & TRUSTS LAW art. 10 at 290-91 (McKinney 2002). Section 10-10.1 of the Estates, Powers and Trusts Law provides:

A power held by a person as trustee of an express trust to make a discretionary distribution of either principal or income to such person as a beneficiary, or to make discretionary allocations in such person's favor of receipts or expenses as between principal and income, cannot be exercised by such person unless (1) such person is the grantor of the trust and the trust is revocable by such person during such person's

This protection against creditors occurs because the discretionary power under section 10-10.1 of the EPTL is not a general power of appointment—with the accompanying provisions for creditors—although it is tantamount to such a power. Should the Legislature act and amend the current law to prevent abuse from occurring?

This paper begins by presenting a brief background of trust law and creditor law, including the doctrine of merger and the rights of creditors, in Section II. Section III sets forth the evolution of section 10-10.1 of the EPTL. Section IV addresses the implications of the 2003 and 2004 amendments by first discussing provisions for creditors and then discussing why the discretionary power is not a power of appointment based on the definition of a power of appointment under section 10-3.1 of the EPTL; the legislative history of article 10 of the EPTL; and the statutory heading of article 10, part 10 of the EPTL. Section V presents the possible positions of the Uniform Trust Code and considers why New York should adopt versions of articles 1 and 5 of the Uniform Trust Code. Finally, Section VI suggests feasible legislative solutions for New York's current law.

## II. TRUST LAW AND CREDITOR LAW BACKGROUND

### A. *The Doctrine of Merger*

Historically, a sole trustee of a trust was not entitled to be simultaneously a beneficiary of the trust. Under the doctrine of merger,<sup>4</sup> formerly embodied in sections 7-1.1 and 7-1.2 of the EPTL,<sup>5</sup>

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lifetime, or (2) the power is a power to provide for such person's health, education, maintenance or support within the meaning of sections 2041 and 2514 of the Internal Revenue Code, or (3) the trust instrument, by express reference to this section, provides otherwise. If the power is conferred on two or more trustees, it may be exercised by the trustee or trustees who are not so disqualified. If there is no trustee qualified to exercise the power, its exercise devolves on the supreme court or the surrogate's court, except that if the power is created by will, its exercise devolves on the surrogate's court having jurisdiction of the estate of the donor of the power.

§ 10-10.1 (codifying Act effective May 18, 2004, ch. 82, § 1) (footnote omitted).

<sup>4</sup> For further descriptions of the doctrine, see Margaret Valentine Turano, Practice Commentaries, *in* N.Y. EST. POWERS & TRUSTS LAW § 7-1.1; *Reed v. Browne*, 66 N.E.2d 47, 49 (N.Y. 1946); *Weeks v. Frankel*, 90 N.E. 969, 971 (N.Y. 1910).

<sup>5</sup> Section 7-1.1 of the Estates, Powers and Trusts Law was formerly entitled "When right to possession creates legal ownership"; in 1997, the Legislature amended the statutory heading of section 7-1.1 so that it is now entitled "When trust interests not to merge." Act effective June 25, 1997, ch. 139, § 1, 1997 N.Y. Laws 1885, 1885; N.Y. EST. POWERS & TRUSTS LAW § 7-1.1. Section 7-1.2 of the Estates, Powers and Trusts Law retained the title "Trustee of passive trust not to take." N.Y. EST. POWERS & TRUSTS LAW § 7-1.2 (McKinney 2002) (originally

the trust automatically terminated if the individual named as the sole trustee was also named as a beneficiary since the trust would effectively be passive, and the trustee would have no duties to carry out.<sup>6</sup> Title of the same nature and for the same duration as the intended trust vested in the T/B.<sup>7</sup> Provided that the trustee was not the sole trustee, a trustee could, however, also be a beneficiary. For example, in *Woodward v. James*, the Court of Appeals of New York found that where, by the terms of his will, the decedent intended to leave his widow a life estate in half the income from his estate but did not expressly word the devise as a trust, “the law will not imply a trust where, in the moment of its creation, it will be invalid, and that, as the same person cannot be both trustee and beneficiary, the trust to [the widow] must fail.”<sup>8</sup> This decision led to “the inevitable result . . . that the equitable is merged in the legal estate, and the latter alone remains” so that the widow, in regard to her one-half of the income, “was not trustee, and took what was given to her by a direct legal right.”<sup>9</sup>

The merger doctrine, however, was not always strictly applied. In *In re Phipps' Will*, for example, the beneficiary was a co-trustee but became the sole trustee when the other trustee died.<sup>10</sup> The court distinguished cases where merger had been applied, reasoning that in those cases there was not a demonstrated “intention that the trust continue after the death of the sole beneficiary’s cotrustee,” and instead held that “[t]he doctrine of merger is not to be applied ‘with rigidity,’ and, where it appears to have been the intention of the settlor . . . that the trust continue or that a successor trustee be

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enacted as Act effective Aug. 2, 1966, ch. 952, 1966 N.Y. Laws 2761, 2806).

<sup>6</sup> Margaret Valentine Turano, Practice Commentaries, *in* N.Y. EST. POWERS & TRUSTS LAW § 7-1.1 (McKinney 2002). The original version of section 7-1.1 of the EPTL, enacted in 1966, provided, “[e]very person who by virtue of any disposition is entitled to the actual possession of property and the receipt of income therefrom has a legal estate in such property of the same quality and duration and subject to the same conditions as his beneficial interest.” Act effective Aug. 2, 1966, ch. 952, 1966 N.Y. Laws 2761, 2806. This provision interacted with section 7-1.2 of the EPTL, enacted simultaneously, which provided:

Every disposition of property shall be made directly to the person in whom the right to possession and income is intended to be vested and not to another in trust for such person, and if made to any person in trust for another, no estate, legal or equitable, vests in the trustee. But neither this section nor 7-1.1 shall apply to trusts arising or resulting by implication of law.

N.Y. Est. Powers & Trusts Law § 7-1.2 (originally enacted as Act effective Aug. 2, 1966, ch. 952, 1966 N.Y. Laws 2761, 2806).

<sup>7</sup> *Reed*, 66 N.E.2d at 49.

<sup>8</sup> *Woodward v. James*, 22 N.E. 150, 15152 (N.Y. 1889).

<sup>9</sup> *Id.* Mrs. James, however, was able to remain trustee over the other one-half of the income, which was given to “legal heirs.” *Id.*

<sup>10</sup> *In re Phipps' Will*, 157 N.Y.S.2d 14, 16 (1956).

appointed, the courts will act to prevent the extinguishment and termination of the trust.”<sup>11</sup> A more recent example is *In re Estate of Seidman*, in which the testator’s wife was named as trustee.<sup>12</sup> She was to receive the income from the trust for her life and was given a discretionary power to invade the trust principal, in addition to being given the power to appoint the remainder beneficiaries.<sup>13</sup> Although the wife argued that a merger of legal and equitable titles occurred because she had been given the power to withdraw the entire trust principal and no specific remainder beneficiaries, the court rejected this argument and instead held that “a cotrustee should be appointed.”<sup>14</sup>

In 1997, prompted by the increasing use of trusts to transfer assets and avoid probate while keeping a life estate,<sup>15</sup> the legislature enacted the current version of section 7-1.1 of the EPTL.<sup>16</sup> In effect, the legislation prevents merger from occurring in situations where the trustee is also a beneficiary, provided that another individual also holds a beneficial interest.<sup>17</sup> Consequently, the ability of settlors to designate the same individual as both sole trustee and one of the trust beneficiaries is codified.<sup>18</sup> It should be kept in mind, however, that where there is no beneficial interest other than that of the T/B, merger will still occur.

### *B. The Rights of Creditors*

When a debtor owes money, creditors look to any and all property that the debtor owns or in which such debtor maintains an interest in order to satisfy the debt. Some property that seemingly appears beyond the reach of creditors is not, while other property that creditors want to attach promises to be more elusive.

Section 5201(b) of the New York Civil Practice Law and Rules

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<sup>11</sup> *Id.* at 1718 (citation omitted).

<sup>12</sup> 395 N.Y.S.2d 674, 676 (App. Div. 1977).

<sup>13</sup> *Id.* at 675–76.

<sup>14</sup> *Id.* at 676.

<sup>15</sup> Margaret Valentine Turano, Practice Commentaries, in N.Y. EST. POWERS & TRUSTS LAW § 7-1.1 (McKinney 2002); Memorandum in Support, S. 4223, 220th Leg. Sess. (N.Y. 1997), reprinted in 1997 N.Y. Sess. Laws 2129, 2130 (McKinney).

<sup>16</sup> N.Y. EST. POWERS & TRUSTS LAW § 7-1.1 (codifying Act effective June 25, 1997, ch. 139, § 2, 1997 N.Y. Laws 1885, 1885–86).

<sup>17</sup> *Id.* The second beneficial interest, however, can be as uncertain as a contingent future remainder to avoid merger of the trust. *E.g.*, *In re Estate of Wickwire*, 705 N.Y.S.2d 102, 104 (App. Div. 2000) (requiring a “beneficial interest in some form” to prevent merger).

<sup>18</sup> See HAROLD D. KLIPSTEIN & IRA MARK BLOOM, DRAFTING NEW YORK WILLS § 11.04[7][b] (3d ed. 2005) (explaining the applicability of the 1997 amendment).

(CPLR) provides that “[a] money judgment may be enforced against any property which could be assigned or transferred, whether it consists of a present or future right or interest and whether or not it is vested, unless it is exempt from application to the satisfaction of the judgment.”<sup>19</sup>

However, section 5205(c)(1) makes this provision irrelevant for all practical purposes by providing that, with few exceptions, property held in trust for a judgment debtor is exempt from “application to the satisfaction of a money judgment,” so long as the judgment debtor did not create or fund the trust.<sup>20</sup> In effect, the New York Legislature provided automatic spendthrift provisions for all trusts. Section 5205(d)(1) of the CPLR exempts ninety percent of the income, or other payments, from trusts.<sup>21</sup> When read in conjunction with section 5205(c) of the CPLR, which exempts the trust principal, only ten percent of the trust income and none of the trust principal is left for creditors of the beneficiary.<sup>22</sup> Section 7-1.5 of the Estates, Powers and Trusts Law places additional limits on the voluntary alienation of trust interests. Although the premise is that all trust interests are alienable, the trust instrument must expressly allow the income beneficiary to alienate this right for the interest to be transferred.<sup>23</sup> Thus, the only way for creditors to effectively reach the assets that the T/B can access is for the T/B’s power to be interpreted as a power of appointment.

Trust dispositions for the settlor’s use are unequivocally “void as against [any] existing or subsequent creditors” the settlor may have,<sup>24</sup> as are dispositions in which the beneficiary is entitled to the trust corpus at will.<sup>25</sup> The underlying reason for these policies is

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<sup>19</sup> N.Y. C.P.L.R. 5201(b) (McKinney 1997).

<sup>20</sup> *Id.* 5205(c)(1).

<sup>21</sup> The statute provides that “except . . . as a court determines to be unnecessary for the reasonable requirements of the judgment debtor . . . [.] ninety per cent of the income or other payments from a trust” are classified as “personal property . . . exempt from . . . the satisfaction of a money judgment.” *Id.* 5205(d). Thus, if a court determines that the debtor needs a smaller portion of income or payments than is exempted, the court may reduce the amount of the exemption.

<sup>22</sup> *Id.* 5205(c)(1), (d); *see also* David D. Siegel, Practice Commentaries C5205:2 (Income Exemptions), *in* N.Y. C.P.L.R. 5205 (McKinney 1997) (further explaining the application of section 5205 of the CPLR to trusts).

<sup>23</sup> N.Y. EST. POWERS & TRUSTS LAW § 7-1.5(a)(1) (McKinney 2002). The income beneficiary is allowed to transfer income in excess of ten thousand dollars, but the class of eligible individuals is enumerated by the statute and does not include creditors. *Id.* § 7-1.5(b)(1).

<sup>24</sup> *Id.* § 7-3.1(a).

<sup>25</sup> *Ullman v. Cameron*, 78 N.E. 1074, 1076 (N.Y. 1906). The beneficiary was entitled to the trust principal if he demanded it “to engage in some business or enterprise”; considering the broad and personal nature of the purpose, the court found the trust to be a “pretext” for the

that it is “contrary to sound public policy to permit a person to have the absolute and uncontrolled ownership of property for his own purposes, and to be able at the same time to keep it from his creditors.”<sup>26</sup> Thus, in such situations, the creditor can reach the property that is the subject of the trust disposition.<sup>27</sup> Property held by a trustee for the benefit of others, however, is not subject to the trustee’s creditors.<sup>28</sup> This is true even if the trustee is also the settlor so long as the trustee is not a beneficiary as well.<sup>29</sup>

The relative standing that the beneficiary’s current creditors enjoy is decidedly murkier. Recall that only assignable or transferable property is subject to the enforcement of money judgments.<sup>30</sup> Consequently, if the beneficiary lacks the power to transfer or assign the property, it will be beyond the reach of the beneficiary’s creditors. Although section 5201 of the CPLR generally authorizes the enforcement of money judgments against property held in trust,<sup>31</sup> Article 10 of the EPTL more specifically delineates the actual rights of creditors.<sup>32</sup>

### III. THE EVOLUTION OF SECTION 10-10.1 OF THE EPTL

Designed to address tax issues, the precursor to the statute that evolved into section 10-10.1 of the EPTL was first introduced in

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purpose of allowing the testatrix to give property to her husband while keeping it from his creditors. *Id.* Such a situation would now be encompassed within the scope of section 10-7.2 of the EPTL, which subjects property covered by a presently exercisable power of appointment to the payment of claims of the creditors of the holder of the power. N.Y. EST. POWERS & TRUSTS LAW § 10-7.2 (McKinney 2002), *amended by* Act of Oct. 4, 2005, ch. 700, § 2, 2005 N.Y. Sess. Laws 1658, 1658 (McKinney); *see infra* Part IV.A. (elaborating upon creditors’ rights under part 7 of article 10 of the EPTL).

<sup>26</sup> *Ullman*, 78 N.E. at 1076 (quoting Chancellor Walworth in *Hallett v. Thompson*, 5 Paige Ch. 581, 584 (N.Y. Ch. 1836)).

<sup>27</sup> Section 5201(c)(2) of the CPLR provides that the proper garnishee for property controlled or held by a fiduciary such as a trustee is the fiduciary. N.Y. C.P.L.R. 5201(c)(2) (McKinney 1997).

<sup>28</sup> *See, e.g.*, *Finn v. Brown*, 12 N.Y.S.2d 150, 152–53 (App. Div. 1939) (holding that money and scrip unclaimed by debtholders and held in trust for debtholders may not be attached by creditors); *Wulff v. Roseville Trust Co.*, 149 N.Y.S. 683, 687 (App. Div. 1914) (holding that “[p]roperty which a debtor holds in trust for others, even though he has created the trust, is not subject to an attachment issued against his property”). This is also in accord with section 5201(b) of the CPLR since the interest could not be assigned or transferred for the benefit of the trustee—the trustee owes a fiduciary duty to the beneficiaries of the trust. N.Y. C.P.L.R. 5201(b).

<sup>29</sup> *Wulff*, 149 N.Y.S. at 687.

<sup>30</sup> N.Y. C.P.L.R. 5201(b).

<sup>31</sup> Recall that section 5205 of the CPLR exempts only certain personal property from application to the satisfaction of a money judgment. N.Y. C.P.L.R. 5205(a) (McKinney 1997).

<sup>32</sup> *See infra* Part IV.A.

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1945.<sup>33</sup> A revised version was introduced in 1966.<sup>34</sup> For the next thirty years the statute remained unchanged in the following form:

A power conferred upon a person in his capacity as trustee of an express trust to make discretionary distribution of either principal or income to himself or to make discretionary allocations in his own favor of receipts or expenses as between principal and income, cannot be exercised by him. If the power is conferred on two or more trustees, it may be executed by the trustees who are not so disqualified. If there is no trustee qualified to execute the power, its execution devolves on the supreme court, except that if the power is created by will, its execution devolves on the surrogate's court having jurisdiction of the estate of the donor of the power.<sup>35</sup>

The next amendment came in 1997 when the Legislature added the introductory phrase "[e]xcept in the case of a trust which is revocable by such person during lifetime" and provided the surrogate's court as an alternate court, along with the supreme court, qualified to exercise the devolving power.<sup>36</sup> Gender neutral language was also added.<sup>37</sup>

At the recommendation of the Chief Administrative Judge, based on a recommendation by the Surrogate's Court Advisory Committee, the Legislature amended section 10-10.1 of the EPTL again in 2003.<sup>38</sup> The New York State Assembly Bill Summary explains that the amendment allows the trustee to "make distributions to himself or herself in certain instances: 1) where such trustee is the grantor of the trust; 2) the power is a power to provide for such person's health, education, maintenance or support; or 3) the trust

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<sup>33</sup> Margaret Valentine Turano, Practice Commentaries, *in* N.Y. EST. POWERS & TRUSTS LAW § 10-10.1 (McKinney 2002); Act effective Apr. 18, 1945, ch. 843, § 1, 1945 N.Y. Laws 1867, 1867-68. The statute was enacted to prevent gift and estate tax consequences adverse to the holder of the power. Margaret Valentine Turano, Practice Commentaries, § 10-10.1; *see also* Ira Mark Bloom, *How Federal Transfer Taxes Affect the Development of Property Law*, 48 CLEV. ST. L. REV. 661, 671 (2000) (explaining that section 10-10.1 of the EPTL is an "unfortunate property law[]" enacted to prevent adverse tax consequences).

<sup>34</sup> Act effective Aug. 2, 1966, ch. 952, § 10-10.1, 1966 N.Y. Laws 2761, 2926. A technical amendment the following year added a comma following the phrase "on two or more trustees." Act effective Apr. 27, 1967, ch. 686, § 102, 1967 N.Y. Laws 1711, 1739.

<sup>35</sup> *Id.*

<sup>36</sup> Act effective June 25, 1997, ch. 139, § 6, 1997 N.Y. Laws 1885, 1887.

<sup>37</sup> *Id.*

<sup>38</sup> Memorandum in Support, A. 8090, 226th Leg. Sess. (N.Y. 2003), *reprinted in* 2003 N.Y. Sess. Laws 2062, 2063 (McKinney); Act effective Sept. 30, 2003, ch. 633, § 1, 2003 N.Y. Laws 3303, 3303.

instrument, by express reference, provides otherwise.”<sup>39</sup>

The New York State Assembly Memorandum in Support further rationalized: “The primary purpose of [section] 10-10.1 [of the EPTL] is to prevent a grantor from inadvertently causing the inclusion of the property subject to the power in the gross estate of the trustee for estate tax purposes under the general power of appointment provisions of section 2041 of the Internal Revenue Code.”<sup>40</sup>

The Assembly additionally reasoned that “the present provisions of [section] 10-10.1 [of the EPTL] are unnecessarily restrictive of trust grantors.”<sup>41</sup> As an example of this unnecessary restriction, the Memorandum cited *In re Estate of Seidman*,<sup>42</sup> explaining that the court held that “a trustee may not, under 10.10-1, exercise a discretionary power to invade corpus for his ‘maintenance and support’ even though possession of such a power would not require inclusion of the property under § 2041 [of the Internal Revenue Code].”<sup>43</sup> The Memorandum also rationalized that other states, including California, Florida, and Wisconsin, with statutes similar to section 10-10.1 of the EPTL, opted for an approach similar to that which was being proposed and concluded by summarizing that “[t]he instant measure would . . . retain the protection of the statute for an unwary grantor, while at the same time properly implementing the intentions of an informed grantor.”<sup>44</sup>

The proposed revision indeed passed and, effective September 30, 2003, section 10-10.1 of the EPTL was rewritten to read:

A power held by a person as trustee of an express trust to make a discretionary distribution of either principal or income to such person as a beneficiary, or to make

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<sup>39</sup> N.Y. LEGISLATIVE DIGEST, 209th Reg. Sess., A.B. 8090 (2003) (bill summary).

<sup>40</sup> Memorandum in Support, A. 8090, 226th Leg. Sess. (N.Y. 2003), *reprinted in* 2003 N.Y. Sess. Laws 2062, 2063 (McKinney).

<sup>41</sup> *Id.*

<sup>42</sup> 395 N.Y.S.2d 674 (App. Div. 1977).

<sup>43</sup> Memorandum in Support, A. 8090, 226th Leg. Sess. (N.Y. 2003), *reprinted in* 2003 N.Y. Sess. Laws 2062, 2063 (McKinney) (citations omitted) (citing *Seidman*, 395 N.Y.S.2d at 677). Section 2041(a)(1) of the Internal Revenue Code provides that the value of a decedent’s gross estate includes property over which the decedent had a general power of appointment but then sets forth an exception so that a power limited by an ascertainable standard is not included as a power of appointment. I.R.C. § 2041(a), (b)(1)(A) (2000). However, the Internal Revenue Code also provides that for income tax purposes a power is taxable to the holder of the power if the “power [is] exercisable solely by [the holder] to vest the corpus or the income therefrom in himself.” *Id.* § 678(a)(1) (2000); *see id.* § 671(2000).

<sup>44</sup> Memorandum in Support, A. 8090, 226th Leg. Sess. (N.Y. 2003), *reprinted in* 2003 N.Y. Sess. Laws 2062, 2063 (McKinney).

discretionary allocations in such person's favor of receipts or expenses as between principal and income, cannot be exercised by such person unless (1) such person is the grantor of the trust and the trust is revocable by such person during such person's lifetime, or (2) the power is a power to provide for such person's health, education, maintenance or support within the meaning of sections 2041 and 2514 of the Internal Revenue Code, or (3) the trust instrument, by express reference to this section, provides otherwise. If the power is conferred on two or more trustees, it may be exercised by the trustee or trustees who are not so disqualified. If there is no trustee qualified to exercise the power, its exercise devolves on the supreme court or the surrogate's court, except that if the power is created by will, its exercise devolves on the surrogate's court having jurisdiction of the estate of the donor of the power.<sup>45</sup>

The third alternative is of the most immediate concern.<sup>46</sup> It also should be noted that in 2004 the section was amended by the deletion of the words "or any other ascertainable standard" in the second alternative, following the Internal Revenue Code reference.<sup>47</sup> The purpose of the 2004 amendment, however, was to avoid a possible federal tax conflict that would be detrimental to the estate of a donee or trustee; it was not meant to diminish the newly expanded power of a trustee to make discretionary distributions.<sup>48</sup>

#### IV. THE IMPLICATIONS OF THE 2003 AND 2004 AMENDMENTS

The implications of the 2003 re-writing are speculative at best. It must be presumed that impairing creditors' rights was not a foreseeable consequence of the amendment; otherwise there would

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<sup>45</sup> N.Y. Est. Powers & Trusts Law § 10-10.1 (McKinney Supp. 2006) (codifying Act effective Sept. 30, 2003, ch. 633, § 1, 2003 N.Y. Laws 3303, 3303). The quoted text incorporates the technical amendment of 2004 New York Laws, chapter 82 by deleting the phrase "or any other ascertainable standard." Act effective May 18, 2004, ch. 82, § 1, 2004 N.Y. Laws 2515, 2515.

<sup>46</sup> Prior to the 2003 amendment, the prohibition on the trustee's exercise of discretionary power was a rule that could not be overridden and which, in some situations, served to frustrate the intention of the settlor. Bloom, *supra* note 33, at 671. Thus, although unintended consequences have followed, enabling a settlor to waive the default rule was a long-needed change to an "unfortunate property law[]." *Id.*

<sup>47</sup> Act effective May 18, 2004, ch. 82, § 1, 2004 N.Y. Laws 2515, 2515. The amendment was effective immediately. *Id.* § 2, 2004 N.Y. Laws at 2515.

<sup>48</sup> Memorandum in Support, S. 6308, 227th Leg. Sess. (N.Y. 2004), *reprinted in* 2004 N.Y. Sess. Laws 1614, 1614 (McKinney); *see also* KLIPSTEIN & BLOOM, *supra* note 18, § 11.04[6][c].

have undoubtedly been widespread and publicized lobbying efforts by creditors' rights groups. However, as it stands—intended or not—creditors remain unable to reach property that is in trust for Tracy Brown, the T/B, despite Tracy Brown's ability to invade the principal of the trust in her sole discretion. This is largely because the newly-given power to Tracy Brown is not actually a power of appointment, based on definitions of powers of appointment, legislative history, and the statutory heading, and thus is not covered by provisions under article 10 which would allow creditors to reach the trust.

### *A. Provisions for Creditors*

Part 7 of Article 10 of the EPTL is dedicated solely to the rights of creditors.<sup>49</sup> Creditors' rights are clearly laid out. If the beneficiary has a lifetime special power of appointment, the trust property is not subject to claims of the beneficiary's creditors.<sup>50</sup> Even if the power of appointment is general, so long as it remains subject to a condition precedent or subsequent, the creditors may still not reach the trust property.<sup>51</sup> If the power is general but not presently exercisable, the trust property also remains beyond the reach of creditors until the power becomes presently exercisable.<sup>52</sup> Furthermore, 2005 amendments enacted for clarification of creditors' rights subsequent to the 2003 amendment to section 10-10.1 of the EPTL delineate that a general power of appointment "exercisable solely for the support, maintenance, health and education of the donee" is excluded from the reach of the donee's creditors.<sup>53</sup>

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<sup>49</sup> Article 10, part 7 of the Estates, Powers and Trusts Law is entitled "Rights of Creditors in Appointive Property." N.Y. EST. POWERS & TRUSTS LAW art. 10 at 290 (McKinney 2002).

<sup>50</sup> *Id.* § 10-7.1, amended by Act effective Oct. 4, 2005, ch. 700, § 2, 2005 N.Y. Sess. Laws 1658, 1658 (McKinney). This is because under section 10-3.2(b) of the EPTL, a general power of appointment is defined as a power "exercisable wholly in favor of the donee, his estate, his creditors or the creditors of his estate," and fittingly, section 10-3.2(c) of the EPTL specifies that all powers of appointment that are not general are special. *Id.* § 10-3.2(b)–(c). Consequently, a lifetime special power is one that cannot be exercised in favor of the donee or his creditors.

<sup>51</sup> *Id.* § 10-7.2, amended by Act effective Oct. 4, 2005, ch. 700, § 2, 2005 N.Y. Sess. Laws 1658, 1658 (McKinney); *id.* § 10-7.3.

<sup>52</sup> *Id.* § 10-7.4(a)(2). The property can be reached by creditors, however, if the presently non-exercisable power of appointment was created by the donee himself. *Id.* § 10-7.4(a)(1).

<sup>53</sup> Act effective Oct. 4, 2005, ch. 700, §§ 1, 2, 2005 N.Y. Sess. Laws 1658, 1658 (McKinney) (amending N.Y. EST. POWERS & TRUSTS LAW §§ 10-7.1, 10-7.2). The ascertainable standard exception was added to legislatively overrule the outcome of *In re Flood*, which exemplified the rule that although an "ascertainable standard" may prevent a power from being a general

Creditors, however, should not be dismayed at these provisions. Creditors' saving grace lies in section 10-7.2 of the EPTL, which provides that if the donee's general power of appointment is presently exercisable and not subject to an ascertainable standard, then the trust property is subject to the claims of the donee's creditors.<sup>54</sup> This provision also applies to powers that have become presently exercisable though they once were not.<sup>55</sup> Whether the donee or some other party created the power and whether the donee has purportedly exercised the power are both immaterial.<sup>56</sup> The theory underlying this immateriality is that the donee could exercise the power in his own favor if he so chose, and thus he effectively owns the property outright.<sup>57</sup> This rationale is also expressed in the Practice Commentary to part 1 of article 10.<sup>58</sup> Part 1 of article 10 is entitled "Common Law of Powers Established with Exceptions."<sup>59</sup> The commentary explains:

In enacting the provisions of Article 10, the legislature had several objectives, among them (i) to eliminate the complex and confusing definitions in the prior statutes and substitute the 'simple terminology of the common law' . . . ; (ii) 'to clarify the rights of creditors of the donee of the power

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power of appointment in regards to taxation, the power may still be a general power in determining the rights of creditors. *In re Flood*, N.Y.L.J., Mar. 11, 1998, at 32, *aff'd on reh'g*, N.Y.L.J., May 13, 1998, at 32, *aff'd*, 691 N.Y.S.2d 354, 355 (App. Div. 1999); KLIPSTEIN & BLOOM, *supra* note 18, § 13.03[2]. The legislature found a "bright-line" statutory rule preferable to relying on drafting techniques to avoid the result of *In re Flood*; thus, a general power of appointment subject to an ascertainable standard is now definitively beyond the reach of creditors. Introducer's Memorandum in Support, S. 4342, 228th Leg. Sess. (N.Y. 2005).

<sup>54</sup> N.Y. EST. POWERS & TRUSTS LAW § 10-7.2, *amended by* Act effective Oct. 4, 2005, ch. 700, § 2, 2005 N.Y. Sess. Laws 1658, 1658 (McKinney).

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> Margaret Valentine Turano, Practice Commentaries 2002, *in* N.Y. EST. POWERS & TRUSTS LAW § 10-7.2 (McKinney 2002); Margaret Valentine Turano, Supplementary Practice Commentaries 2003, *in* N.Y. EST. POWERS & TRUSTS LAW § 10-7.2 (McKinney Supp. 2006). The text of section 10-7.2 of the EPTL in full provides:

Property covered by a general power of appointment (other than one exercisable solely for the support, maintenance, health and education of the donee within the meaning of sections 2041 and 2514 of the Internal Revenue Code) which is presently exercisable, or of a postponed power which has become exercisable, is subject to the payment of the claims of creditors of the donee, his estate and the expenses of administering his estate. It is immaterial whether the power was created in the donee by himself or by some other person, or whether the donee has or has not purported to exercise the power.

*Id.* § 10-7.2, *amended by* Act effective Oct. 4, 2005, ch. 700, § 2, 2005 N.Y. Sess. Laws 1658, 1658 (McKinney).

<sup>58</sup> Margaret Valentine Turano, Practice Commentaries, *in* N.Y. EST. POWERS & TRUSTS LAW art. 10, pt. 1, at 291-92 (McKinney 2002).

<sup>59</sup> N.Y. EST. POWERS & TRUSTS LAW art. 10 at 291.

of appointment . . . by generally enabling creditors to reach . . . whatever assets the debtor can dispose of as he chooses' . . .; and [sic] (iii) to eliminate the possibility of thwarting creditors by an attempt to make the donee's interest spendthrift . . .; and (iv) to address the interplay between releasing a power and contracting to exercise it.<sup>60</sup>

The provisions of article 10, which relate to creditors' rights, are not dealt with exclusively by part 7. If the settlor reserves an unqualified power to revoke the trust, then the settlor, in effect, never gives up absolute ownership of the property, thus allowing the property to remain subject to creditors of the settlor.<sup>61</sup> Interestingly, none of the aforementioned provisions have been amended since their enactment.<sup>62</sup>

If creditors are left looking to section 10-7.2 of the EPTL for authorization to reach property which is subject to some sort of power held by the donee, then it should be clear that much turns on whether the power recently granted to beneficiaries by the legislature is a general power of appointment or some other class of power.<sup>63</sup>

### *B. The Discretionary Power Is Not a Power of Appointment*

The definition of power of appointment and the legislative history and statutory outlay of article 10 of the EPTL all counsel against classifying the power authorized by section 10-10.1 of the EPTL as a general power of appointment such that creditors of the beneficiary would consequently be able to reach the property.

#### 1. The Definition of Power of Appointment Under Section 10-3.1 of the EPTL

At the outset, section 10-3.1 of the EPTL clearly defines a power of appointment as "an authority created or reserved by a person

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<sup>60</sup> *Id.* (citing THIRD REPORT OF THE TEMP. STATE COMM'N ON THE MODERNIZATION, REVISION & SIMPLIFICATION OF THE LAW OF ESTATES, N.Y. Leg. Doc. No. 19, at 611 (March 31, 1964) [hereinafter COMM'N ON ESTATES]). At the time of the Commission, the powers of article 10 were contained in article 5 of the Real Property Law; the Commission recommended an extensive revision which led to the formation of article 10 as it is today. COMM'N ON ESTATES, *supra*, at 610–11.

<sup>61</sup> N.Y. EST. POWERS & TRUSTS LAW § 10-10.6 (McKinney 2002).

<sup>62</sup> Compare N.Y. EST. POWERS & TRUSTS LAW § 10-10.6, *with* Act effective Aug. 2, 1966, ch. 952, § 10-10.6, 1966 N.Y. Laws 2031, 2135.

<sup>63</sup> N.Y. EST. POWERS & TRUSTS LAW. § 10-7.2, *amended by* Act effective Oct. 4, 2005, ch. 700, § 2, 2005 N.Y. Sess. Laws 1658, 1658 (McKinney).

having property subject to his disposition, enabling the donee to designate, within such limits as may be prescribed by the donor, the appointees of the property or the shares or the manner in which such property shall be received.”<sup>64</sup> The section goes on to explain that powers that are not powers of appointment include, though are not limited to, “a power to revoke a disposition previously made, a power during minority to manage property vested in an infant, *a power to disburse the principal of a trust*, a power to sell in a mortgage and a power in a life tenant to make leases.”<sup>65</sup> Since the power at issue relates to the distribution of trust principal, it is clearly encompassed by the latter section, powers which are not powers of appointment.<sup>66</sup>

## 2. The Legislative History of Article 10 of the EPTL

The second reason for not considering the distributive power as a power of appointment is found in the legislative history of article 10 of the EPTL. The legislative history from the Commission on Estates provides that the statute “establishes the common law but for the convenience of the profession it spells out major aspects of the thus adopted common law.”<sup>67</sup> Consequently, “[t]he definition of a power of appointment is borrowed from Restatement of Property § 318(1).”<sup>68</sup> A power of appointment under section 318(1) of the Restatement (First) of Property is in essence defined the same as a power of appointment under section 10-3.1(a) of the EPTL.<sup>69</sup> Section 318(2) of the Restatement (First) of Property, in a manner similar to section 10-3.1(b) of the EPTL, sets out powers not included under the term “power of appointment.”<sup>70</sup> The list enumerates “a power of sale, a power of attorney, a power of

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<sup>64</sup> *Id.* § 10-3.1(a).

<sup>65</sup> *Id.* § 10-3.1(b) (emphasis added).

<sup>66</sup> Recall that section 10-10.1 of the EPTL specifically reads: “[a] power held by a person as trustee of an express trust to make a discretionary distribution of either principal or income to such person as a beneficiary.” *Id.* § 10-10.1.

<sup>67</sup> COMM’N ON ESTATES, *supra* note 60, at 611.

<sup>68</sup> Memorandum from Professor Ira Mark Bloom, Justice David Josiah Brewer Distinguished Professor of Law, Albany Law Sch., to Professor Kenneth F. Joyce, Distinguished Teaching Professor, Univ. of Buffalo Law Sch., at 2 (Mar. 8, 2004) (quoting COMM’N ON ESTATES, *supra* note 60, at 615) (on file with author).

<sup>69</sup> RESTATEMENT (FIRST) OF PROP. § 318(1) (1940). The actual text defines a power of appointment as “a power created or reserved by a person (the donor) having property subject to his disposition enabling the donee of the power to designate, within such limits as the donor may prescribe, the transferees of the property or the shares in which it shall be received.” *Id.*

<sup>70</sup> *Id.* § 318(2).

revocation, *a power to cause a gift of income to be augmented out of principal*, a power to designate charities, a charitable trust, a discretionary trust, or an honorary trust.”<sup>71</sup> The Restatement further notes that “power” means power of appointment unless indicated otherwise by the context within which it is used.<sup>72</sup> Comment j, “Powers to augment income out of principal,” further clarifies that such a power is not to be construed as a power of appointment, explaining:

When the income of a trust is given to one or more persons it is frequently provided that the income may be augmented by payments of principal. Sometimes the power to augment is given to the trustee, sometimes to the recipient of income himself. Sometimes the power is unlimited; sometimes a restriction is imposed, as, for instance, that the income shall be augmented only to the extent deemed necessary “for the comfort and support” of the recipient. Such powers are incidental to the interest of the income recipient and do not give rise to the characteristic problems of this Chapter. They are commonly known as powers of dissipation or powers of augmentation, not as powers of appointment. For these reasons they are not treated as powers of appointment in this Restatement.<sup>73</sup>

In the scenario of Tracy Brown, the power is given to the income recipient and is unlimited; thus, it is clearly encompassed in the scope of comment j.

The distinction between powers of appointment and other powers, such as the power to augment income out of principal, and powers incidental to discretionary trusts, as laid out in section 318 of the Restatement (First) of Property, is also observable in the definitions provided under section 10-3.1 of the EPTL.<sup>74</sup>

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<sup>71</sup> *Id.* (emphasis added).

<sup>72</sup> *Id.* § 318(3).

<sup>73</sup> *Id.* § 318 cmt. j. Comment *l*, entitled “Discretionary trusts,” also lends support to the proposition that discretionary powers of augmentation are not powers of appointment:

It is common for a settlor to create a trust to last during the lives of a group, for instance, his children, and to declare that the trustee or some other person shall have discretion as to how much income of the trust shall be used for the group, or which members of the group shall receive income, or what proportion of the income shall be allocated to each member, or any combination of these. This type of provision is usually described as a discretionary trust. It is analytically close to a power to appoint the principal at the end of the trust but, conformably to common usage, it is not included within the term power of appointment as here defined.

*Id.* cmt. *l*.

<sup>74</sup> N.Y. EST. POWERS & TRUSTS LAW § 10-3.1 (McKinney 2002).

### 3. The Statutory Heading of Part 10, Article 10 of the EPTL

Lastly, the statutory headings of the EPTL are themselves instructive. Part 10, entitled “Provisions Affecting Powers Other than Powers of Appointment,”<sup>75</sup> unambiguously indicates that it does not encompass powers of appointment. Six parts of article 10, preceding part 10, all concern powers of appointment.<sup>76</sup> If section 10-10.1 had been meant to be construed as a power of appointment, the legislature surely would have added another section title to the ranks of the sixteen titles in article 10 which already explicitly include “power of appointment” in their heading.<sup>77</sup> At the very least, the legislature would have generally included section 10-10.1 in one of the six parts that would leave no doubt as to its intention.

In light of the aforementioned reasons—definition, legislative history, and statutory structure—it seems clear that the power under section 10-10.1 of the EPTL to grant Tracy Brown the power to distribute both income and principal to herself was not intended to result in a power of appointment and therefore should not be construed as such. Consequently, section 10-7.2's grant allowing creditors to reach property subject to a power of appointment that can be presently exercised does not apply, and creditors are indeed unable to reach such property.

Two obvious consequences stemming from the current state of the law in New York come to mind. First, until the legislature sorts the situation out, there exists the real potential for litigation in which creditors argue that they can reach Tracy Brown's property and in which the debtor T/B argues that the property is beyond the reach of creditors. Further, the debtor T/B will likely argue that the courts should be constrained to rule in favor of the donees since there is no authorization for creditors to reach the property. Second, once this outcome is realized, people will find that it is in the best interest of their donees to give property in trust instead of outright. Since the T/B will be given sole discretion as to whether to distribute both income and principal, the donee will be able to

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<sup>75</sup> *Id.* pt. 10 at 410.

<sup>76</sup> “Part 4. Creation of a Power of Appointment”; “Part 5. Extent of Donee's Authority to Appoint or Contract to Appoint an Estate in Appointive Property”; “Part 6. Rules Governing Exercise of a Power of Appointment”; “Part 7. Rights of Creditors in Appointive Property”; “Part 8. Rule Against Perpetuities and Accumulations as Affected by Powers of Appointment”; “Part 9. Revocation and Release of a Power of Appointment.” *Id.* art. 10 at 290–91.

<sup>77</sup> The sixteen sections whose titles include “power of appointment” are located in part 3 (Varieties of Powers) through part 9, inclusive. *Id.*

access the full amount of the gift; yet without statutory authorization, the money will remain safe from the donee's creditors.<sup>78</sup>

## V. THE UNIFORM TRUST CODE

### A. T/B's Power Under the Uniform Trust Code

The Uniform Trust Code (UTC), originally completed in 2000 and subsequently adopted in fifteen states, was enacted “[t]o provide a comprehensive model for codifying the law on trusts.”<sup>79</sup> The stated purpose includes “enabl[ing] states which enact it to specify their rules on trusts with precision and . . . provid[ing] individuals with a readily available source for determining their state’s law on trusts.”<sup>80</sup> The UTC primarily provides default rules that can be overridden by the terms of the trust<sup>81</sup> and is topically divided into eleven articles.<sup>82</sup> The present focus will be on Article 1, “General Provisions and Definitions,” and Article 5, “Creditor’s Claims; Spendthrift and Discretionary Trusts.”<sup>83</sup> Based on the interaction of these articles, a T/B’s power of withdrawal is either a general power of appointment or a fiduciary power under common law; consequently, the trust corpus is subject to the claims of the T/B’s creditors.

A power of withdrawal is defined as “a presently exercisable general power of appointment other than a power: (A) exercisable by

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<sup>78</sup> There may also be potential tax consequences, but they are beyond the scope of this comment. See Bloom, *supra* note 68, at 5; Debra D. Devaughn et al., *When to Choose a Corporate Fiduciary*, 172 N.J.L.J. 657 (2003).

<sup>79</sup> Uniform Law Commissioners: The National Conference of Commissioners on Uniform State Laws, A Few Facts About The . . . Uniform Trust Code, [http://www.nccusl.org/update/uniformact\\_factsheets/uniformacts-fs-utc2000.asp](http://www.nccusl.org/update/uniformact_factsheets/uniformacts-fs-utc2000.asp) (last visited Apr. 23, 2006).

<sup>80</sup> *Id.* The states that have adopted the Uniform Trust Code are Arkansas, the District of Columbia, Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, Oregon, South Carolina, Tennessee, Utah, Virginia, and Wyoming. *Id.* Additionally, UTC bills are expected to be introduced in Alabama, Colorado, Connecticut, Florida, Massachusetts, Oklahoma, and South Dakota in 2006. *UTC Legislative Update 2005*, UTC NOTES (Nat’l Conference of Comm’rs on Unif. State Laws), Oct. 2005, at 1, available at [http://www.nccusl.org/nccusl/newsletters/UTCNotes/UTCNotes\\_Oct05\\_print.pdf](http://www.nccusl.org/nccusl/newsletters/UTCNotes/UTCNotes_Oct05_print.pdf). Pennsylvania and Ohio have versions of the UTC pending. S.B. 660, 2005 Gen. Assem. (Pa. 2005); H.B. 416, 126th Gen. Assem. (Oh. 2005).

<sup>81</sup> UNIF. TRUST CODE prefatory note, default rule (amended 2005), 7C U.L.A. 178 (Supp. 2005); *id.* art. 1, general cmt., 7C U.L.A. 190 (2005).

<sup>82</sup> *Id.* prefatory note, overview of uniform trust code, 7C U.L.A. 180–81.

<sup>83</sup> *Id.* arts. 1, 5, 7C U.L.A. 190, 250.

a trustee and limited by an ascertainable standard; or (B) exercisable by another person only upon consent of the trustee or a person holding an adverse interest.”<sup>84</sup> Added in 2004 were both the first exception, in which the power is limited by an ascertainable standard,<sup>85</sup> and a provision in section 504 providing:

If the trustee's or cotrustee's discretion to make distributions for the trustee's or cotrustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee or cotrustee.<sup>86</sup>

The comment to 504 explains that both of these amendments were made “to preclude a claim that the power of a trustee-beneficiary to make discretionary distributions for the trustee-beneficiary's own benefit results in an enforceable claim of the trustee-beneficiary's creditors to reach the trustee-beneficiary's interest” despite the T/B's discretion being restrained by an ascertainable standard.<sup>87</sup> This concern arose in light of the potential applicability and interpretation of Trusts section 60, comment g, of the Restatement (Third)<sup>88</sup> which allows creditors to reach “the maximum amount the trustee-beneficiary can properly take” when the T/B has discretionary power that is limited by an ascertainable standard.<sup>89</sup> The Restatement may come into play when considering the UTC because section 106 of the UTC provides for the UTC to be supplemented by the common law and principles of equity.<sup>90</sup>

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<sup>84</sup> *Id.* § 103(11), 7C U.L.A. 192.

<sup>85</sup> *Id.* § 103 cmt., 7C U.L.A. 193.

<sup>86</sup> *Id.* § 504(e), 7C U.L.A. 256.

<sup>87</sup> *Id.* § 504 cmt., 2004 amend., 7C U.L.A. 257.

<sup>88</sup> Section 60 of the Restatement (Third) of Trusts provides that:

[I]f the terms of a trust provide for a beneficiary to receive distributions in the trustee's discretion, a transferee or creditor of the beneficiary is entitled to receive or attach any distributions the trustee makes or is required to make in the exercise of that discretion . . . . The amounts a creditor can reach may be . . . increased where the beneficiary . . . holds the discretionary power to determine his or her own distributions.

*Id.* Comment g specifically addresses the situation where the T/B holds a discretionary power, including a power subject to an ascertainable standard. *Id.* § 60 cmt. g.

<sup>89</sup> *Id.*; see Alan Newman, *The Rights of Creditors of Beneficiaries Under the Uniform Trust Code: An Examination of the Compromise*, 69 TENN. L. REV. 771, 805 (2002) (concluding that “it appears that the rule of the *Restatement (Third) of Trusts* allowing the creditors of a trustee-beneficiary to reach the maximum amount he or she can properly take from the trust also should be the result under the U.T.C.”).

<sup>90</sup> UNIF. TRUST CODE § 106 (amended 2005), 7C U.L.A. 204 (Supp. 2005). The comment to

The usual definition of an ascertainable standard, “a standard relating to an individual’s health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or 2514(c)(1) of the Internal Revenue Code of 1986” is set forth in section 103(2) of the UTC.<sup>91</sup> Notably absent from section 103, the definitional section, is the definition of a power of appointment. However, the comment to section 103 cites section 11.1 of the Restatement (Second) of Property: Donative Transfers, and explains that “[a] power of appointment is authority to designate the recipients of beneficial interests in property,” a power which can be classified as general or nongeneral and presently exercisable or not presently exercisable.<sup>92</sup> Ultimately, as in New York, the issue of whether a T/B’s power to make discretionary distributions to herself is a presently exercisable general power of appointment is raised.

### 1. T/B’s Power as a Power of Withdrawal

If a T/B’s power is deemed a presently exercisable power of appointment, then the power falls within the classification “power of withdrawal.” Keeping in accord with the intuitive outcome, “[d]uring the lifetime of the settlor, the property of a revocable trust is subject to the claims of the settlor’s creditors” under the UTC regardless of a spendthrift provision.<sup>93</sup> Furthermore, section 505(b)(1) provides that “during the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power.”<sup>94</sup> This means that the trust property is subject to the claims of creditors of the T/B, the power holder, just as if the T/B owned the trust property outright.<sup>95</sup> The comment to section 505 further clarifies that “a creditor or assignee of the power

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this section elaborates that in determining the common law and principles of equity, “a court should look first to prior case law in the state and then to more general sources, such as the Restatement of Trusts, Restatement (Third) of Property: Wills and Other Donative Transfers, and the Restatement of Restitution.” *Id.* cmt., 7C U.L.A. 204.

<sup>91</sup> *Id.* § 103(2), 7C U.L.A. 191. This section was added by the 2004 amendments as a result of the term “ascertainable standard” being added to sections 103(11) and 504. *Id.* cmt., 7C U.L.A. 193.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.* § 505(a)(1), 7C U.L.A. 258.

<sup>94</sup> *Id.* § 505(b)(1), 7C U.L.A. 258. The Restatement (Third) of Trusts asserts an analogous proposition: “the treatment of the assets subject to a presently exercisable general power is like the treatment of revocable trust assets.” RESTATEMENT (THIRD) OF TRUSTS § 56 cmt. b (2003).

<sup>95</sup> UNIF. TRUST CODE § 505 cmt. (amended 2005), 7C U.L.A. 258–59 (Supp. 2005).

holder generally may reach the power holder's entire beneficial interest in the trust, whether or not distribution is subject to the trustee's discretion."<sup>96</sup> Perhaps in an attempt to lessen the political debate that accompanies a state's consideration of whether to adopt the UTC, "the UTC doesn't take a position"<sup>97</sup> on the question of "whether a trustee's power to distribute trust property to himself or herself, not subject to an ascertainable standard, is a power of withdrawal."<sup>98</sup>

Although there is some thought that the T/B's power should not be deemed a power of appointment under the UTC, this is not the most logical conclusion. First, if this were the case, then there would have been no need to provide an express exception for a power of appointment subject to an ascertainable standard in defining a power of withdrawal; instead of the exception, an outright statement that a T/B's fiduciary power is not a power of appointment could have been made.<sup>99</sup> Additionally, although the comment to section 504(e) provides that "[t]he Code does not *specifically* address the extent to which a creditor of a trustee/beneficiary may reach a beneficial interest of a beneficiary/trustee [sic] that is not limited by an ascertainable standard,"<sup>100</sup> the use of the word "specifically" does not foreclose the assertion that the UTC does address this issue implicitly through

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<sup>96</sup> *Id.* The definition of power of withdrawal, however, excludes those discretionary powers which are limited by an ascertainable standard so that section 505(b)(1) and consequently section 505(a)(2) would not be applicable in that situation. See *supra* notes 84–85 and accompanying text.

<sup>97</sup> E-mail from David English, Reporter, Uniform Trust Code, to Ira Mark Bloom, Justice David Josiah Brewer Distinguished Professor of Law, Albany Law Sch. (Mar. 9, 2005) (on file with author).

<sup>98</sup> E-mail from Ira Mark Bloom, Justice David Josiah Brewer Distinguished Professor of Law, Albany Law Sch., to David English, Reporter, Uniform Trust Code (Mar. 6, 2005) (on file with author). The entire response provided to the question of classification states:

The answer to [the] question is that the UTC doesn't take a position on [the] question, leaving the issue to other law such as the Restatement. The purpose of the amendments 103(11) and 504(e) was to combat the major political problems created by Restatement (Third) of Trusts, comment g. The result is that creditors cannot reach the trustee beneficiary's interest if limited by an ascertainable standard whether it is classified as a power of withdrawal or not and whether the creditor tries to reach the interest under either Section 504 or Section 505.

English, *supra* note 97.

<sup>99</sup> UNIF. TRUST CODE § 103(11) (amended 2005), 7C U.L.A. 192 (2005); see Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 REAL PROP. PROB. & TR. J. 567, 593–94 (2005); E-mail from Lawrence Waggoner, Lewis M. Simes Professor of Law, Univ. of Mich. Law Sch., Reporter, Restatement (Third) of Property (Wills and Other Donative Transfers), to Ira Mark Bloom, Justice David Josiah Brewer Distinguished Professor of Law, Albany Law Sch. (Feb. 14, 2005) (on file with author).

<sup>100</sup> UNIF. TRUST CODE § 504(e) cmt., 2004 amend., 7C U.L.A. 257 (emphasis added).

sections 103(11) and 505(b).<sup>101</sup> Indeed, if the UTC did not implicitly address the issue, then the use of the term “specifically” would be superfluous.

Another argument that counsels against concluding that the UTC is silent on whether the T/B’s power is a power of appointment under the UTC is that if such were the case, then section 106, which provides for the applicability of the common law of the state,<sup>102</sup> would come into play and it would consequently be possible to reach opposite conclusions on whether the T/B’s creditors could reach the trust property in two different states, both of which had implemented the UTC.<sup>103</sup> This is completely contrary to the stated purpose of the UTC to provide “precise, comprehensive, and easily accessible guidance on trust law questions” and to “provide a uniform rule” “[o]n issues on which States diverge or on which the law is unclear or unknown.”<sup>104</sup> Thus, a T/B’s power should be considered a power of appointment under the UTC.

Presuming Tracy Brown’s power is a power of appointment under the UTC such that it would be considered a power of withdrawal, section 505(b) would then come into play.

## 2. T/B’s Power Under Common Law Per Section 106 of the UTC

If it is determined that the UTC does not satisfactorily address the issue, then section 106 directs for the UTC to be supplemented by “more general sources, such as the Restatement of Trusts, [and the] Restatement (Third) of Property: Wills and Other Donative Transfers.”<sup>105</sup> The recently drafted section 17.1, comment g of the Restatement of Property (Wills and Other Donative Transfers) defines a fiduciary distributive power to include “a trustee’s power

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<sup>101</sup> E-mail from Lawrence Waggoner, Lewis M. Simes Professor of Law, Univ. of Mich. Law Sch., to Ira Mark Bloom, Justice David Josiah Brewer Distinguished Professor of Law, Albany Law Sch. (Feb. 17, 2005) (on file with author); *see also* Newman, *supra* note 99, at 594 (concluding that a T/B with a power to distribute to him or herself that is not subject to an ascertainable standard will be treated as the settler of a revocable trust and as having a power of withdrawal).

<sup>102</sup> UNIF. TRUST CODE § 106 (amended 2005), 7C U.L.A. 204 (Supp. 2005). Section 106 provides that “[t]he common law of trusts and principles of equity supplement this [Code], except to the extent modified by this [Code] or another statute of this State.” *Id.*

<sup>103</sup> E-mail from Ira Mark Bloom, Justice David Josiah Brewer Distinguished Professor of Law, Albany Law Sch., to David English, Reporter, Uniform Trust Code (Feb. 14, 2005) (on file with author); E-mail from Ira Mark Bloom, Justice David Josiah Brewer Distinguished Professor of Law, Albany Law Sch., to Alan Newman, Associate Professor of Law, Univ. of Akron Sch. of Law (Mar. 11, 2005) (on file with author).

<sup>104</sup> UNIF. TRUST CODE prefatory note (amended 2005), 7C U.L.A. 178 (2005).

<sup>105</sup> *Id.* § 106 cmt., 7C U.L.A. 204.

to distribute principal to or for the benefit of an income beneficiary, or for some other person, or to pay income or principal to a designated beneficiary” and provides outright that “[a]s used in this Restatement and in the Restatement Third of Trusts, a fiduciary distributive power is not a power of appointment.”<sup>106</sup> However, a fiduciary power not subject to an ascertainable standard is still subject to creditors. Additionally, section 60, comment g of the Restatement (Third) of Trusts furthers the analogous treatment of fiduciary powers and powers of appointment, despite these powers being distinct, by bluntly providing:

Sometimes a beneficiary is trustee of the discretionary trust, with authority to determine his or her own benefits. In such a case, a rule similar to that of Comment *f* applies, with creditors able to reach from time to time the maximum amount the trustee-beneficiary can properly take . . . . The beneficiary’s rights and authority represent a limited form of ownership equivalence analogous to certain general powers under the rule of § 56, Comment *b*.<sup>107</sup>

Therefore, guidance from the common law as derived from the Restatements clearly dictates that a T/B’s property can be reached by creditors.

If Tracy Brown’s power is deemed a power of withdrawal then it is “specifically” addressed by the UTC; if not, section 106 of the UTC directs the application of the common law, including section 60 of the Restatement (Third) of Trusts. In either scenario, the same outcome occurs—Tracy Brown’s creditors would be able to reach the property of the trust to the same extent they would be able to reach it if she had instead created a revocable trust herself.

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<sup>106</sup> RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 17.1 cmt. g (Tentative Draft No. 5, 2006).

<sup>107</sup> RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. g (2003). Comment *f* applies where the trustee has discretion to pay income or principal to the settlor: “creditors of the settlor can reach the maximum amount the trustee, in the proper exercise of fiduciary discretion, could pay to or apply for the benefit of the settlor.” *Id.* cmt. *f*. Section 56, comment *b* sets forth the rule that:

Trust property subject to a presently exercisable general power of appointment (a power by which the property may be appointed to the donee, including one in the form of a power of withdrawal), because of the power’s equivalence to ownership, is treated as property of the donee of the power. It can therefore be subject to the satisfaction of the claims of the donee’s creditors.

*Id.* § 56, cmt. *b*.

*B. New York Considerations Regarding the Uniform Trust Code*

There is a recent trend toward states adopting the UTC. It has already been adopted in nearly one third of the states, and at least seven more states are expected to introduce bills for its adoption in 2006.<sup>108</sup> In keeping with the times, it is extremely likely that New York will also undertake consideration of whether the UTC should be adopted and, if so, what alterations, if any, should be made.

Presuming New York does decide to adopt the UTC, the provisions discussed in section V.A., *infra*, should be included in the adoption. However, due to the UTC's enigmatic nature as applied to a T/B's power, the definition of a power of withdrawal, section 103(11), should be classified. This could be done most simply by redefining a power of withdrawal as "a power to distribute to oneself" without first defining such a power as a power of appointment.

Adopting a version of the UTC would represent a change from the current law in New York since under the UTC creditors arguably can reach property subject to Tracy Brown's power while currently they cannot. Consequently, a policy debate between doing the "right thing," making the choice which is preferable based on a sense of fairness, and allowing trusts to be created which are not favorable to creditors and therefore would promote trust business in New York will ensue. Since New York is not among the ranks of the states who have repealed the law against perpetuities<sup>109</sup> or who have allowed for asset protection trusts which bar creditors from reaching property in trust,<sup>110</sup> these states will remain more preferential choices for settlors of trusts.<sup>111</sup> Because a refusal to adopt the standard UTC provisions would not boost New York to the top of trust settlors' "A List," New York should not make an imprudent decision and choose against the more ethically

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<sup>108</sup> Arkansas, the District of Columbia, Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, Oregon, South Carolina, Tennessee, Utah, Virginia, and Wyoming have adopted the UTC; UTC introductions are pending in Pennsylvania and Ohio, and introductions are expected in Alabama, Colorado, Connecticut, Florida, Massachusetts, Oklahoma, and South Dakota in 2006. *UTC Legislative Update 2005*, *supra* note 80, at 1; S.B. 660, 2005 Gen. Assem. (Pa. 2005); H.B. 416, 126th Gen. Assem. (Oh. 2005). Additionally, UTC studies are underway in states including Georgia, Michigan, New Jersey, North Dakota, Vermont, and Wisconsin. *UTC Legislative Update 2005*, *supra* note 80, at 1.

<sup>109</sup> Bloom, *supra* note 33, at 673 & n.82.

<sup>110</sup> *Id.* at 672 & n.74.

<sup>111</sup> For criticism of states enacting "unfortunate property laws" to attract the business of non-residents, see *id.* at 671-76 (characterizing Alaska as "[w]inning property law's race to the bottom" through measures such as repealing the rule against perpetuities).

upstanding choice based on an expected increase in trust business that will doubtfully be as generous as projected by its proponents. Instead, New York should join those states that have adopted or are considering adopting the UTC and should adopt the UTC provisions relating to creditors' rights as set forth by the drafters of the UTC.

## VI. POSSIBLE LEGISLATIVE SOLUTIONS FOR NEW YORK'S CURRENT LAW

Recall the hypothetical situation presented at the outset: a trust is established. The trustee, Tracy Brown, is also the beneficiary. The settlor has empowered the trustee to make discretionary distributions from the trust to herself, without any limitation, such as an ascertainable standard relating to health, education, maintenance, or support. Much to the dismay of creditors, this means that Tracy Brown can access the trust funds at any time, yet the funds remain protected from her creditors while in trust.<sup>112</sup> In other words, a settlor is enabled to pass assets through the use of a trust to a beneficiary and at the same time keep the assets out of the reach of creditors. There are a number of legislative solutions that could be enacted to remedy this presumably unintended result until such time as the UTC is adopted. These potential solutions include re-defining powers of appointment and modifying the trust exemption in section 5205(c) of the CPLR.

### A. *Re-Definition of Powers of Appointment*

New York's statute defining powers of appointment, section 10-3.1 of the EPTL, could be re-written to recognize the power of a T/B to distribute income or principal from a trust to herself as a power of appointment.<sup>113</sup> If this were done, then section 10-7.2 of the EPTL, which makes property subject to a presently exercisable general power of appointment also subject to the claims of the donee's creditors, would be applicable and creditors would clearly be able to reach the trust property. This would be reminiscent of section 505(b) of the UTC, which applies the same rules to a T/B with a

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<sup>112</sup> Once the funds are distributed from the trust to the beneficiary, "a game of hide-and-seek" often ensues between creditors who are searching for the money and the beneficiary who is trying to keep the money hidden. Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L.Q. 1, 2-3 (1995), quoted in ROGER W. ANDERSON & IRA MARK BLOOM, *FUNDAMENTALS OF TRUSTS AND ESTATES* § 8.03 (2d ed. 2005).

<sup>113</sup> See *supra* Part IV.B.1.

power of withdrawal as apply to the settlor of a trust<sup>114</sup> and may be similar to provisions in states including Arizona, California, Michigan, Texas, and Wisconsin.<sup>115</sup>

Alternatively, a sentence could be added to the end of section 10-10.1 of the EPTL providing that if the T/B would be deemed to have a power of appointment under section 2514(c) of the I.R.C., then section 10-7.2 of the EPTL will be applicable. Section 2514(c) of the I.R.C., which defines powers of appointment for gift taxes on transfers, states that “the term ‘general power of appointment’ means a power which is exercisable in favor of the individual possessing the power (hereafter in this subsection referred to as the ‘possessor’), his estate, his creditors, or the creditors of his estate” but further provides that “[a] power to consume, invade, or appropriate property for the benefit of the possessor which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor shall not be deemed a general power of appointment.”<sup>116</sup> Since the power given to the T/B, the “possessor,” is not subject to any ascertainable standard, the power would be considered a power of appointment under section 2514(c) of the I.R.C. An approach similar to this proposal has already been adopted in relation to spousal right of election, which refers to section 2041 of the I.R.C. in defining presently exercisable general powers of appointment held by the decedent.<sup>117</sup> This proposition eliminates the need to redefine powers of appointment under New York law. Instead, the Internal Revenue Code definition of power of appointment is referenced in this single, isolated situation to determine if the power at issue is indeed a power of appointment. If it is considered a power of appointment, then New York’s law regarding the rights of creditors in conjunction with general powers of appointment are applicable.

### *B. Modification of Section 5205 of the CPLR Trust Exemption*

A second solution category would be to make section 5205(c) of the CPLR, which exempts trusts from “application to the satisfaction

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<sup>114</sup> UNIF. TRUST CODE § 505(b) (amended 2005), 7C U.L.A. 258 (2005).

<sup>115</sup> David English, *Reporters Report: The UTC and Crummey Powers*, UTC NOTES (Nat’l Conference of Comm’rs on Unif. State Laws), Winter 2004, at 7, 8, available at [http://www.nccusl.org/update/newsletters/utcnote/utcnote\\_dec04\\_print.pdf](http://www.nccusl.org/update/newsletters/utcnote/utcnote_dec04_print.pdf). Section 505(b) has been retained without substantive change by all ten states that have enacted the UTC. *Id.*

<sup>116</sup> I.R.C. § 2514(c) (2000).

<sup>117</sup> N.Y. EST. POWERS & TRUSTS LAW § 5-1.1-A(b)(1)(H) (McKinney 1999).

of . . . money judgment[s],” inapplicable to trusts where there is a beneficiary trustee who has unlimited discretionary power pursuant to section 10-10.1 of the EPTL.<sup>118</sup> If this were done, then the trust assets over which a T/B has absolute discretionary power would once again be fair game for creditors, just as they would be if a T/B held a power of appointment and section 10-7.3 of the EPTL was applicable.

This modification could be implemented in a number of different ways. A sixth sub-section could be added to the presently existing five sub-sections of section 5205(c) of the CPLR, which would provide for the inapplicability of section (c) where the T/B has the power to make distributions to herself not subject to an ascertainable standard. Alternatively, a similar provision providing for the inapplicability of section 5205(c) of the CPLR could be added to section 10-10.1 of the EPTL. Yet another possible, though less desirable, approach would be to leave the trust principal as exempt but to make the ninety percent income exemption in section 5205(d) of the CPLR inapplicable to such trusts, either through an addition to section 5205(d) or through an addition to section 10-10.1 of the EPTL. In 2003 alone, the legislature made twenty amendments to the CPLR—this certainly seems to indicate a willingness to consider change.<sup>119</sup>

## VII. CONCLUSION

The legislature has enabled a T/B—given discretionary power not subject to an ascertainable standard pursuant to section 10-10.1 of the EPTL—to have access to trust funds as desired, yet the trust funds remain just beyond the reach of creditors since under New York law the T/B's power is not a power of appointment. This situation would be remedied by adopting a slightly amended version of the UTC and the accompanying standard provisions relating to the rights of creditors. Possible legislative solutions until then include re-defining powers of appointment and modifying section 5205 of the CPLR. Creditors' rights groups, however, will certainly expand upon these remedies once the situation comes to light. Regardless of the solution pursued, it is clear that the problem

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<sup>118</sup> N.Y. C.P.L.R. 5205(c) (McKinney 1997).

<sup>119</sup> 2003 N.Y. Sess. Laws tbl. 1, at T1-4 (McKinney). In the past three legislative sessions, there have been a total of forty-four amendments to the CPLR—fifteen made in 2002, twenty made in 2003, and nine made in 2004. *Id.*; 2002 N.Y. Sess. Laws tbl. 1, at T1-5 (McKinney); 2004 N.Y. Sess. Laws tbl. 1, at T1-5 (McKinney).

needs to be addressed before the situation is exploited by conscientious settlors to the disadvantage of rightful creditors.