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Trusts and Estates Law Section Newsletter

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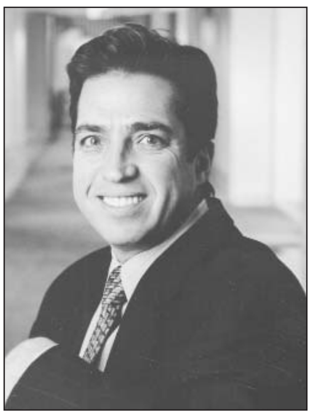
A Message from the Section Chair



Our Section inaugurated summer with a flurry of legislative activity. Arthur Bongiovanni's ad hoc committee worked around the clock and achieved a timely, consensus Principal and Income bill with the EPTL-SCPA Legislative Advisory Committee and the New York State Banker's Association. The hallmark of the compromise was to provide for a 4% unitrust on an *opt-in*, as opposed to *opt-out*, basis. Our Section submitted and advocated on behalf of ten pieces of affirmative legislation, and our Legislation and Taxation committees, chaired respectively by Ron Weiss and Georgiana Slade, commented on dozens of proposed bills affecting our practice.

Unfortunately, from a Trusts and Estates standpoint, the state legislative session ended with a whimper, not a bang. The compromise Principal and Income bill did not make it out of bill drafting in time for consideration by the legislature. Only two of our affirmative legislation bills passed both houses: one amending credit shelter formulae in wills executed prior to February 1, 2000, to eliminate references to the credit for state death taxes; and the other making technical amendments to the mechanics for service of process. Additionally, two bills sponsored by the Surrogate's Court Advisory Committee of the Office of Court Administration passed both houses as well; one permitting the non-judicial reformation of trusts by trustees for certain tax purposes; and the other permitting the Court to find that a person who has been continuously absent for a three-year period died earlier than on the third anniversary of the person's disappearance, when the person's absence follows exposure to a specific peril or where clear and convincing evidence demonstrates that death is the only reasonable explanation for the absence. Also passing both houses was a bill that will require trusts and not-for-profit corporations that are private foundations to publish annually notice of the availability for public inspection of their private annual foundation returns as filed with Internal Revenue Service. As of the submission of this letter, the only bill in our area to be signed by the governor is an amendment to SCPA § 1708 that will authorize the court to dis-

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pense with a bond when it authorizes the guardian of an infant to invest the guardianship funds pursuant to an investment advisory agreement with a bank, trust company, brokerage house or other financial service entity that is acceptable to the court. I will include a complete list of all enacted legislation in our area in my next Chair's letter.

We had a record turnout for the Fall Meeting in Sante Fe, New Mexico, September 20-24, 2000. The meeting's educational program, co-chaired by Colleen F. Carew and Charles F. Gibbs, was "Representing the Fiduciary: the Problems and the Remedies." It covered timely ethical and conflict issues between fiduciaries and beneficiaries and considered a whole panoply of miscellaneous proceedings that can be brought under the SCPA by and against a fiduciary. In addition, there was a host of stimulating social programs and an unparalleled opportunity for sightseeing.

As always, the Section depends upon its committees in order to conduct the wealth of activities it performs for the benefit of both the public in general and its members in particular. If you are not currently a committee member, I urge you to take a look at the list of committees contained on pages 55-56 of this *Newsletter* and contact the Chair of the Committee with which you would like to become involved.

For those of you who attended the Fall Meeting, it was great seeing you in Sante Fe!

Joshua S. Rubenstein

Editor's Message

In this issue of the *Newsletter*, there is an article for everyone. A wide range of topics is included.

Natalie Choate, whose book on retirement benefits, *Life and Death Planning for Retirement Benefits*, is a bible for many practitioners, has written a clear and interesting article for our *Newsletter* on the many elections involved in minimum distribution planning for IRA acounts. Mike Mariani has summarized changes in New York and Florida law. John McQuaid raises practical points regarding working with our clients. Professor Bloom weighs in on the topic of the Rule against Perpetuities and whether it is time to abolish it. Steve Hochhauser has used his personal experience in a case that was taken through the Appellate Division, and written on the enforceability of the *in terrorem* clause in New York. The final inclusion involves international planning. Mike Galligan discusses the need for ratification of the Hague Convention on the Law Applicable to Trusts. Many foreign countries do not recognize trusts as an entity and the Convention would allow trusts to function in such places.

Please send questions for the next Question and Answer Column. The one inquiry which was received for this issue was answered by Kathy Franklin and I thank her.

Magdalen Gaynor

Required and Permitted Elections Under the Minimum Distribution Rules

A Review of Deadlines and Default Rules for IRA Owners, Beneficiaries and Sponsors

By Natalie B. Choate

Introduction

This article discusses certain elections an IRA owner (the "participant") or beneficiary is required (or may be permitted) to make under the "minimum distribution rules" of § 401(a)(9) of the Code.[1] The rules discussed here also apply to Roth IRAs except as otherwise specified. In general, the article points out that deadlines and default rules for some of the elections may create unexpected consequences, and that IRA sponsors can make things easier for themselves and their clients by thoughtful drafting in the IRA agreement. The article also discusses issues raised by changes in the terms of an IRA agreement (or by transfer of funds from one IRA sponsor to another, where the applicable account agreements have different terms).

This article assumes the reader is familiar with the minimum distribution rules that apply to retirement plans, and in particular with the tax deferral advantages of the life expectancy payout method described in § 401(a)(9)(A)(ii), (B)(iii) and (B)(iv).[2] The statements in the article about what typical IRA agreements provide are based on this author's experience, not any scientific survey.

This article deals only with IRAs and Roth IRAs.[3] Although the distribution rules are similar for any defined contribution retirement plan,[4] there are many additional factors involved in the case of plans other than IRAs and Roth IRAs (such as, in the case of a qualified plan,[5] the risk of losing qualification). All such other plans are beyond the scope of this article. The rules discussed in this article do not apply to benefits paid in annuity form, regardless of the type of plan.[6]

Death Before the RBD: Whether the Five-Year Rule or an Exception Applies

If a participant dies before his "required beginning date" (RBD),[7] the general rule is that all benefits must be distributed out of the IRA (and accordingly included in the gross income of the beneficiary) by December 31 of the calendar year which contains the fifth anniversary of the date of the participant's death (the "five-year rule").[8] There is an exception (the "life expectancy payout method") to this rule: Benefits may be distributed to an individual beneficiary in annual instalments over a period not exceeding the beneficiary's life expectancy. If the sole beneficiary of the account is the participant's surviving spouse, these annual distributions must commence by the later of December 31 of the year following the year of the participant's death or December 31 of the year the participant would have attained age 70½.[9] If the individual beneficiary is not the participant's surviving spouse (or if the spouse is one of multiple individual beneficiaries), the distributions must commence by December 31 of the year following the year of the participant's death.[10]

How is it determined whether the general rule or the exception applies? The plan "may adopt a provision specifying which of the two methods" applies, or "may adopt a provision that permits employees (or beneficiaries) to elect on an individual basis" which method applies.[11] Most IRA agreements permit individual election. A plan that permits individual election may provide a default rule that applies if "neither the employee nor the beneficiary elects a method." Most IRA agreements provide a default rule, but plans vary as to what default rule they provide.

The proposed regulations provide, in the case of a non-spouse individual beneficiary, that "In operation, such an election must be made no later than" December 31 of the calendar year following the year of death, and that "as of such date" the election must be irrevocable and must apply to all subsequent years.[12] The proposed regulations do not specify any particular format for this election, nor is there any procedure for notifying the IRS of what election has been made.

Effect of Failure to Comply With the IRA Agreement in Making the Election

Commonly, the IRA sponsor specifies a procedure for the election, for example, that it must be made in writing and must be submitted to the IRA sponsor by the deadline. Ideally, the participant or beneficiary will make an informed and timely election, following the sponsor's prescribed procedure exactly. However, sometimes a beneficiary thinks he has made the election but does not follow the procedure specified in the IRA agreement.

Example: Ludwig died in 1998 prior to his required beginning date, leaving his IRA to his daughter Erica. The IRA sponsor is a brokerage firm. The IRA agreement says that Erica may elect to take distributions under § 401(a)(9)(B)(iii) by notifying the IRA sponsor in writing. If she fails to make any election, the default provision in the IRA agreement is that the five-year rule applies. Erica and the broker who handles the account discuss the matter extensively, and she tells the broker that she wants to use the life expectancy payout method of § 401(a)(9)(B)(iii). The distributions made to her by December 31, 1999 exceed the amount required (under Prop. Reg. F-1) to be distributed for that year under the life expectancy payout method. However, she never files with the brokerage firm a written notice of her election as required by the terms of the IRA agreement. Is her oral statement sufficient to make the election, despite the provisions of the IRA agreement? Have the IRA sponsor (through its agent, the stock broker) and Erica modified the IRA agreement's requirement of a written election? If the agreement provides that it cannot be modified by oral statements of the firm's brokers, can the sponsor retroactively waive the requirements of its IRA agreement to permit an oral election? Or do the minimum distribution rules somehow incorporate the terms of the IRA agreement, so that failure to comply with the agreement's procedure necessarily throws the beneficiary onto the default rule?

A *qualified* plan must be "maintained" in accordance with the written provisions of the plan,[13] and thus qualified plan sponsors are not free to bend the rules for individual employees. In contrast, an IRA is an *individual* agreement between the IRA sponsor and the participant (or beneficiary), which the parties can mutually amend, provided that any amendment adopted does not violate the provisions of § 408.[14] On an analogous question (whether a specific bequest of an IRA in the participant's will is effective to transfer the IRA to the beneficiary under the will, despite contrary provisions in the IRA agreement), New York courts (in deciding in favor of the legatees under the will) have held that the formalities of an IRA agreement are for the protection of the IRA sponsor, who can accordingly waive them.[15]

Nevertheless, at least one letter ruling suggests the IRS believes that the terms of the IRA agreement become part of the minimum distribution requirements. In PLR 9812034 (12/22/97), a beneficiary who had missed the deadline for electing the life expectancy payout method (because he did not learn of the existence of the account until after the deadline had passed) sought an extension of the deadline, pursuant to Treas. Reg. § 301.9100-1 (which allows the Commissioner, for good cause shown, to extend a deadline imposed by regulations). The IRS denied the request. Its denial was not based on any provisions of the Internal Revenue Code or regulations, but rather on the grounds that the *terms of the particular IRA agreement involved* "expressly fixed" the deadline as December 31 of the year after the participant's death. Of course the IRA agreement contained that deadline only because the IRS's proposed regulations impose that deadline. In view of this ruling, IRA sponsors might want to amend their agreements to incorporate the possibility of the IRS's extending the deadline; see the form at the end of this article.

The ideal IRA agreement would provide a lenient procedure for making the election, with the fewest possible formalities. The IRA sponsor's interest in the formalities is presumably that it not get blamed for failing to distribute the right amount (if it has assumed the responsibility for calculating required distributions); it can protect itself from that problem without making the entire election contingent on compliance with rigorous formalities. The IRA sponsor can provide ample information, warnings and formal procedures for making the election without precluding the alternative of informal procedures. See the form at the end of the article for an example of this approach.

Effect of Inadvertent, Forced or Default Election to Use § 401(a)(9)(B)(iii)

Once the beneficiary elects (or is forced by a plan provision that allows no choice, or is deemed under an applicable default rule to have elected) to use the life expectancy payout method, he must take distributions every year beginning by the end of the year after the participant's death; he cannot, apparently, cure the failure to take required distributions in the early years simply by withdrawing the entire balance within the five-year rule period.

Example: Zelda died in 1998 prior to her required beginning date, leaving her IRA to her son Melvin. The IRA sponsor is a bank. The IRA agreement says that Melvin may elect to take distributions under § 401(a)(9)(B)(iii) and that such election is made either by notifying the IRA sponsor in writing or by taking the first year's required distribution prior to the end of 1999. Melvin removes from the IRA, in 1999, enough money to pay the taxes on Zelda's estate, and this happens to be more than the required minimum distribution under Prop. Reg. F-1. He plans to withdraw the remaining balance in 2003. Although under his intended withdrawal schedule he will have withdrawn the entire balance by December 31, 2003, and thus will have complied with the five-year rule, it appears that, under the terms of this particular IRA agreement, he has made an irrevocable election to use the life expectancy payout method under § 401(a)(9)(B)(iii). Therefore, although he will be free to withdraw 100% of the remaining balance in 2003, he must also take annual withdrawals in the intervening years, 2000, 2001 and 2002.

This example illustrates a major drawback of either forcing the beneficiary to use the life expectancy method, or defaulting the beneficiary into the life expectancy method when he is not aware of it: instead of having five years (a generous amount of time) in which to become aware of and satisfy his obligation to take distributions, the beneficiary starts incurring penalties in as little as one year after the date of death.

What Should IRA Sponsors Provide?

The IRA sponsor can allow beneficiaries to choose between the five-year rule and the life expectancy payout method, or the sponsor could allow no choice; and if choice is allowed, the IRA sponsor should also provide a default rule. Assuming the sponsor's goal is to allow maximum income tax deferral to its customers, while minimizing administrative burdens for all concerned, there are tradeoffs and risks involved in choosing among these alternatives.

Certainly, allowing the beneficiary to elect between the methods gives the beneficiary the greatest flexibility, but it also creates the risk of a botched election or missed deadline. Could the sponsor avoid the messiness of elections, while retaining the maximum income tax deferral potential, by allowing payouts *only* under the life expectancy method and not permitting use of the five-year rule? The advantage of this approach would be that no designated beneficiary would have to make any election—a designated beneficiary would automatically qualify for the life expectancy payout method.

Unfortunately, this approach still does not provide an error-proof environment. For one thing, the five-year rule will still apply to beneficiaries who are not "designated" beneficiaries. So, confusion among the beneficiaries and the sponsor's staff as to which beneficiaries must use the life expectancy payout method and which must use the five-year rule may be substituted for botched elections. Also, the penalty for missing the deadline will increase: if choice is allowed, the penalty for failing to make a timely election is simply that the beneficiary must use the five-year rule. In contrast, if the beneficiary is *forced* to use the life expectancy payout method, and misses the first year's payment, he becomes subject to the 50% penalty under § 4974.

Since forcing the life expectancy payout method does not make the world any safer for IRA beneficiaries and sponsors, it makes sense that most IRA sponsors allow the beneficiary to elect either method.

If the IRA sponsor allows the beneficiary to choose a method, what then should be the default rule if the beneficiary fails to elect? The IRA sponsor does not have to provide the same default rule for everybody. For example it could provide one default rule for surviving spouses and another default rule for everybody else, "so long as there is a single method with respect to the benefit"[16] in question. The IRS's default rule (which applies if the plan does not have a default rule—or if the plan has no provision at all about which method must be used) is that the life expectancy payout method applies if the surviving spouse is the beneficiary, or if the surviving spouse is one of multiple designated beneficiaries; otherwise the five-year rule applies.[17]

The drawback of defaulting the beneficiary into the life expectancy method is the same as the disadvantage of forcing the beneficiary into that method: the beneficiary may incur penalties before even being aware that he is supposed to make an election. On the other hand, since the life expectancy payout method does—in most cases—give beneficiaries the most favorable payout option (deferral of some income taxes over the beneficiary's life expectancy, which in most cases is longer than five years), a sensible compromise might be the following: If the beneficiary has taken the first year's required distribution, so that defaulting him into the life expectancy payout method will not cause him to incur any penalties until at least the second year, default him into the life expectancy payout method (because it is in most cases the more favorable method). On the other hand, if the beneficiary has not taken the required distribution in the first year, he should be defaulted to the five-year rule. This approach is adopted in the form at the end of this article.

Deadline for the Election if the Beneficiary Is the Surviving Spouse

The proposed regulations provide, if the surviving spouse is the (sole) beneficiary, that

> In operation, such an election must be made no later than the earlier of (1) December 31 of the calendar year in which distribution would be

> required to commence in order to satisfy the requirements for the exception of [sic] the five-year rule in § 401(a)(9)(B)(iii) and (iv) . . . or (2) December 31 of the calendar year which contains the fifth anniversary of the date [sic] of the employee.[18]

So for the surviving spouse-beneficiary the deadline is the earlier of two dates: December 31 of the year that contains the fifth anniversary of the date of death; or, December 31 of the later of the year that contains the first anniversary of the date of death or the year the deceased participant would have attained age 70½. This deadline could have unexpected consequences depending on the plan's default rule.

Example: Buddy died in 1994 leaving his IRA to his spouse, Arlene. He would have turned age 70½ in 2002. Arlene knows that the minimum distribution rules permit her to postpone the commencement of distributions from the IRA she has inherited from Buddy until the year he would have reached age 70½, i.e., 2002, so she sits back and ignores the situation, figuring she'll look into it seriously once 2002 rolls around. What she does not realize is that the deadline for her election is actually much earlier than 2002. The deadline for Arlene to make her irrevocable election between the five-year rule and the life expectancy payout method is December 31 of 1999 (the year that contains the fifth anniversary of the date of death), because that is earlier than the later of December 31 of 1995 (the year that contains the first anniversary of the date of death) and December 31 of 2002 (the year Buddy would have reached age 70½).

What if Arlene fails to make any election prior to the December 31, 1999 deadline? Either the plan's default rule or the IRS's default rule will apply. Her failure to make an affirmative election by the applicable deadline could have highly varied results depending on the default rule that applies.

If the plan's default rule is that, in the absence of a timely election, the life expectancy payout method applies, Arlene is fine. She owes no penalties and she will continue to have the option of taking payments over her life expectancy commencing in 2002 or rolling over the entire account (other than minimum required distributions for the year of the rollover, if any) to an IRA in her own name. The IRS's default rule (which applies if the plan does not have a provision permitting Arlene to make an election; or if the plan permits an election but no election is made, and the plan does not have a default rule) would be that distributions must be made under § 401(a)(9)(B)(iv), in annual installments over Arlene's life expectancy commencing in the year (2002) Buddy would have reached age 70½, so if the IRS default rule applies Arlene is, again, fine.

Deemed Election by a Surviving Spouse to Treat the IRA as Her Own

What if the plan's default rule is that the five-year rule applies if Arlene does not make a written election one way or the other prior to the election deadline? It would *appear* that Arlene now owes a penalty (equal to 50% of the entire plan balance[19]) since as of December 31, 1999 she had not made any election, and therefore under the plan's default rule she is deemed to have elected to use the five-year rule, nor has she taken any distributions. However, she is apparently "saved" by another default rule:

> There is another election permitted to the surviving spouse, namely, the election to treat her interest as beneficiary of the IRA of her deceased spouse as her own IRA. If she makes this election, "the surviving spouse shall then be considered the individual for whose benefit the" IRA is maintained. The election to treat the inherited IRA as her own IRA "will be considered to have been made by the surviving spouse if . . . (1) any required amounts in the account . . . have not been distributed within the appropriate time period applicable to the decedent under" § 401(a)(9)(B).[20]

If the five-year rule applied as the plan's default rule, then Arlene would have been required to withdraw 100% of the plan balance by December 31, 1999. In our example, since this "required amount" was not "distributed within the appropriate time period applicable to the decedent," Arlene is presumably now deemed to have elected to treat the inherited IRA as her own. In Arlene's case, the deemed election to treat Buddy's IRA as her own IRA would save her from the penalty that would otherwise apply.

Now that she is deemed to have elected to treat the IRA as her own, she has a new required beginning date (under § 401(a)(9)(A), this time, not § 401(a)(9)(B)), which is the later of (i) April 1 following the year in which she reaches age 70½ or (ii) December 31 of the year following the year she is deemed to have elected to treat the IRA as her own. Note that the deemed election to treat the IRA as her own could cause new problems for Arlene if she is older than Buddy, especially if at the time of the deemed election she is already age 70½ or older: she will have to start taking distributions based on her own age, rather than being entitled to wait until Buddy would have reached age 70½.

Elections Regarding Method of Determining Life Expectancy

Introduction

In general, the Code allows the life expectancy of the participant and the participant's spouse to be a fixed term or to be redetermined annually for purposes of the life expectancy payout options under the minimum distribution rules.[21] The life expectancy of a non-spouse beneficiary may not be redetermined annually.

Under the proposed regulations, the plan may require one method or the other, or may allow the participant (or the spouse as beneficiary) to elect which method will be used. A plan which allows the participant or spouse to elect a method may provide a default method in case no election is made; and if the plan has no mandatory provision (or if the plan allows elections, but no election is made and the plan has no default provision on this point) the proposed regulations have a default rule, which is that the applicable life expectancy(ies) will be recalculated annually.[22]

The deadline for making this irrevocable election is "the date of the first required distribution."[23]

Death Before the RBD: Election to Redetermine Spouse's Life Expectancy Annually

The election whether to redetermine the spouse's life expectancy annually comes into play if the participant dies before his RBD, and the surviving spouse is the beneficiary (or one of the beneficiaries). Note that this election must be considered whether the spouse is named as a beneficiary directly or is deemed to be named as a beneficiary because the decedent's beneficiary is a trust that complies with the IRS's "trust rules,"[24] and she is a beneficiary of the trust.

Example: Beverly dies in 2000, before her RBD, leaving her IRA to a trust. The trust, which complies with the "trust rules," provides that all income of the trust will be paid to her husband, Jake, for life, and on his death the principal will be distributed to their then living issue. The trustee is entitled to take distributions from the IRA over the life expectancy of Jake because he is the oldest beneficiary of the trust. The IRA agreement permits the trustee of the trust to elect to determine the life expectancy of the participant's spouse by either the fixed term or the recalculate method, with recalculation as the default rule. The trustee elects to use the life expectancy payout method but fails to elect a method of determining life expectancy. Recalculation will be required under the default rule. The result is that minimum required distributions will be "stretched out" over Jake's lifetime, since as long as he lives his recalculated life expectancy will keep extending the payout period for the IRA. Once he dies, his life expectancy goes to zero in the following year, and the entire IRA balance will have to be distributed to the trust by the end of the year following his death.

At the RBD: Election to Redetermine Participant's and Spouse's Life Expectancies

When a participant reaches his RBD, he must begin taking distributions from his IRA, over a period no longer than his own life expectancy (if he has no "designated beneficiary") or (if he has a designated beneficiary) the joint and survivor life expectancy of himself and his designated beneficiary.[25] Along with his election on this point, he *also* must elect how to determine his life expectancy and his spouse's life expectancy, if the IRA permits such election. It is not the purpose of this article to discuss what is the "best method" to elect,[26] but rather to highlight some of the lesser known aspects of this rule.

For example, a participant who does not name his spouse as beneficiary understandably might not bother to make an election regarding whether to recalculate his spouse's life expectancy. If he later changes his mind and names the spouse as a beneficiary, the plan's (or IRS's) default rule will determine whether her life expectancy will be recalculated annually, because the deadline for this election is the date of the first required distribution, not the date the spouse is named as beneficiary.[27]

Example: Brian, a widower, names his children as his designated beneficiary at his RBD. He elects to use the fixed term method to determine his life expectancy; he makes no election regarding his spouse's life expectancy because he is not even married. A few years later, he remarries, and changes his beneficiary designation to his new wife, Sophie. She is older than his oldest child, so distributions to Brian must now be determined using the joint life expectancy of himself and Sophie. Under the plan's default rule, Sophie's life expectancy must be redetermined annually.

An unanswered question is: what if the participant, having irrevocably elected to determine both spouses' life expectancies by a particular method, transfers his IRA to a new sponsor who does not permit the particular method selected? Some IRA sponsors, for example, apparently do not permit the "hybrid" method described in Prop. Reg. E-8(b). How are required distributions determined for a participant who, having elected this method when his IRA was at a different sponsor which did allow the hybrid method, transfers his IRA to a sponsor which does not permit the method?

It can be extremely important, when advising an estate planning client, to know what distributions are required from that client's IRA, both during the remainder of the client's life and after his death. If the client is past his RBD, the required distributions depend on, among other things, what the client elected or was deemed to have elected regarding the method of determining life expectancy. It may be difficult or impossible to determine what those elections were if the client has moved his account from one IRA sponsor to another after the RBD. Even if the client has not transferred to a different IRA sponsor, however, the planner must somehow obtain copies of all versions of the account agreement in effect since the RBD, because the IRA sponsor may have changed its default rules after the deadline applicable to this client.

Example: Sharon had an IRA at Parry Mutual Fund. On her RBD her husband Lance was her designated beneficiary. The sponsor's IRA agreement permitted her to choose any method of determining their respective life expectancies, but she made no election. She comes to your office to do her estate plan when she is age 75, bringing the current version of her Parry Mutual Fund IRA agreement with her. Since this document provides that the fixed term method is the default rule when no election is made, you might assume the fixed term method applies. However, what you need to look at is not the current version of the IRA agreement, but the version that was in effect on Sharon's RBD—which may have provided a different default rule.

As with the election (in cases of death before the RBD) between the five-year rule and the life expectancy payout method, there is no IRS-prescribed form for making the election regarding the method of determining life expectancy(ies) at the RBD, and no requirement that the IRS be notified what election is made. Many IRA agreements specify that the election must be in writing and must be submitted to the IRA sponsor before the RBD. If the plan document states that a certain default rule applies if the sponsor's procedures are not complied with, the question arises (as with the election under § 401(a)(9)(B)(iii) or (iv)) whether the sponsor can waive this requirement (see discussion under that topic). If the sponsor's rules have supposedly been complied with, but the client and the sponsor have lost the relevant documentation, perhaps the taxpayer's burden of proof can be met with affidavits, especially if there is a clear record of calculating distributions over the years in the manner the taxpayer claims to have elected.

Particularly with this election regarding the method of determining life expectancy, unfortunately, it appears that strict enforcement of the Proposed Regulations will be impossible. The average IRA owner has multiple IRAs, typically with different beneficiaries, different election procedures and/or different default rules. As the average owner ages, he changes beneficiaries, moves the IRA from one sponsor to another, and loses his records from prior years. The average IRA owner is unaware of the existence of this election and has no possible way to calculate his required distributions. It seems doubtful that IRA sponsors will be able to train large numbers of staff to handle questions and calculations that are beyond the knowledge of the vast majority of trained tax professionals.

Election to Use Single or Joint Life Expectancy at RBD

To end this article with some good news, the IRS has confirmed in several recent letter rulings that there is one election that is not irreversible, namely, the election to take benefits, beginning at the RBD, over a single life expectancy, when one is entitled to use a joint life expectancy.

In each of PLRs 199936052 (6/16/99) and 2000-18057 (2/9/2000), the participant had designated his children as his beneficiaries at the RBD, and therefore was entitled to withdraw benefits over the joint and survivor life expectancy of himself and his oldest child (subject to the "MDIB rule"[28]). However, each of these participants had filed a form electing to take benefits over only his own life expectancy (i.e., the maximum payout period that would have applied if the participant had no designated beneficiary). In each case, the IRS ruled that the participant (or beneficiaries, after the participant's death) could revoke the participant's election to use a single life expectancy payout, and commence using the longer, joint and survivor life expectancy, payout period that the participant was originally entitled to use.

These letter rulings are not surprising and do not make new law. Required minimum distributions at and after the RBD are based on three factors: (1) whether the participant had a designated beneficiary on the RBD, and if so who it was; (2) whether the participant changed his beneficiary designation after the RBD, and if so to whom; and (3) what election the participant made regarding determination of life expectancy. Once minimum required distributions are established based on these three factors, the participant is always free to withdraw more than the required minimum in any year. The participants' elections in these rulings to withdraw based on a single life expectancy payout amount to nothing more than withdrawing more than they had to in the years in question, and in no way caused a loss of the right to use the joint and survivor life expectancy permitted under § 401(a)(9)(A)(ii).

Form: IRA Account Provision Dealing With Required Distributions (Death Before RBD)

Here is an example of a provision an IRA sponsor could use embodying the various points discussed in the first section of this article. This is an example only, and should not be used by any person or firm without advice of legal counsel.

Article X. Required Distributions: Death of Participant Before the Required Beginning Date

"X.01 If the participant dies before distributions are treated as having begun to the participant in accordance with IRC § 401(a)(9)(A)(ii), the participant's entire interest must be distributed no later than whichever of the following deadlines applies:

"(A) **Five-Year Rule:** The entire interest must be distributed by December 31 of the year that contains the fifth anniversary of the participant's death, unless an election under (B) or (C) applies.

"(B) **Life Expectancy Payout Option (participant's spouse):** If the participant's spouse is the sole beneficiary, the spouse may elect to take distributions of the account in annual instalments over a period of time not exceeding the spouse's life expectancy, commencing no later than the later of December 31 of the year that contains the first anniversary of the participant's death or December 31 of the year the participant would have attained age 70½. The spouse must make this election no later than the earlier of (i) December 31 of the year that contains the fifth anniversary of the participant's death, or (ii) December 31 of the year that contains the first anniversary of the participant's death or (if later) December 31 of the year the participant would have attained age 70½.

"(C) **Life Expectancy Payout Option (other beneficiaries):** If the sole beneficiary is an individual who is not the participant's spouse; or, if there are multiple beneficiaries, all of whom are individuals; the beneficiary(ies) may elect to take distributions of the account in annual instalments over a period of time not exceeding the life expectancy of the beneficiary (or of the oldest beneficiary, if there are more than one), commencing no later than December 31 of the year that contains the first anniversary of the participant's death. The beneficiary(ies) must make this election no later than December 31 of the year that contains the first anniversary of the participant's death.

"X.02 The following rules govern the interpretation of § X.01 above:

"(A) If any beneficiary is a trust that meets all the requirements of Prop. Reg. § D-5, D-6 and D-7, then Section X.01 shall be interpreted as if the participant had named the beneficiary(ies) of the trust directly as the participant's beneficiary(ies), except that the trustee of such trust (and not the beneficiaries thereof) shall have the sole responsibility and authority to make the election permitted under Section X.01.

"(B) If the Account is divided into separate accounts as of the date of death as provided in Prop. Reg. H-2A, then this Article shall be applied separately to each such separate account.

"(C) The deadlines provided in Section X.01 for elections by the beneficiary shall be extended to the extent allowed by the Commissioner of Internal Revenue pursuant to Treas. Reg. § 301.9100-1.

"(D) If, prior to the deadline for taking the first distribution under the life expectancy payout options provided in paragraphs (B) and (C) of Section X.01, there is distributed from the Account to the beneficiary an amount equal to or greater than the minimum required distribution for the first distribution year under IRC section 401(a)(9)(B)(iii) or (iv) (whichever is applicable), the beneficiary shall be deemed, as of the deadline for making the election, to have elected the life expectancy payout option, unless the beneficiary files with the Administrator, on or before the deadline for making the election, a written election to have the five-year rule of paragraph (A) of Section X.01 apply.

"(E) Except as provided in the preceding paragraph (D), an election permitted under § X.01 may be made by filing written notice with the Custodian, or in any other manner acceptable to the Custodian, provided, that if the election is made otherwise than by filing written notice of the election with the Custodian, the beneficiary must notify the Custodian in writing of what election the beneficiary has made if the Custodian so requests. An election under paragraph (B) or (C) of § X.01 shall be irrevocable as of the deadline for making the election."

Endnotes

1. A section reference in this article refers to a section of the Internal Revenue Code of 1986, as amended, unless the reference is preceded by "Treas. Reg." (Treasury Regulation) or by "Prop. Reg." (Proposed Treasury Regulation).
2. A reader unfamiliar with these rules may wish to read Chapter 1 of the author's book *Life and Death Planning for Retirement Benefits* (3d ed. 1999; Ataxplan Publications; 1-800-247-6553), or any of several other sources such as: *The Pension Answer Book* by Stephen J. Krass (2000 ed.; Panel Publishers, 800-638-8437), *Estate and Gift Tax Issues for Employee Benefit Plans* by Louis A. Mezzullo (BNA Tax Management Portfolio # 378), and *A Professional's Guide to the IRA Distribution Rules*

by Seymour Goldberg (Foundation for Accounting Education, 4th Ed., 1998).

3. As used in this article, "IRA" means an individual retirement custodial account or individual retirement trust described in § 408(h) or 408(a) and "Roth IRA" means an individual retirement custodial account or trust described in § 408A. For convenience, IRAs and Roth IRAs are sometimes referred to as "plans" in this article, but technically they are not retirement "plans"; rather, they are simply investment or property-holding arrangements that meet various requirements and therefore have certain tax characteristics.

4. Defined contribution plans would include money purchase pension plans, profit sharing plans, ESOPs, 401(k) plans and target benefit plans, and also some 403(b) plans.

5. A qualified plan is a retirement plan that meets the 34 requirements of § 401(a)(9). Qualified plans include 401(k) plans, Keogh plans, pension plans, ESOPs and profit sharing plans.

6. *See, generally*, Prop. Reg. B-5(b), F-1, F-3 *et seq.* regarding benefits paid in annuity form. References in this article to "Prop. Reg." refer to subsections of the Treasury's proposed minimum distribution regulation § 1.401(a)(9)-1 unless otherwise specified.

7. The required beginning date generally is April 1 following the year in which the participant reaches age 70½. However, Roth IRAs have no "required beginning date," so the rules discussed in this section apply to death benefits payable from a Roth IRA regardless of the participant's age at death. Also, the required beginning date for funds transferred to an IRA by means of a qualified rollover after December 31 of the year in which the participant turned 70½ is December 31 of the year following the year of the rollover. Prop. Reg. G-2; Prop. Reg. § 1.408-8, A-4, A-6.

8. § 401(a)(9)(B)(ii); Prop. Reg. C-2.

9. § 401(a)(9)(B)(iv); Prop. Reg. C-1, C-3(b), F-1.

10. § 401(a)(9)(B)(iii); Prop. Reg. C-1, C-3(a), F-1.

11. Prop. Reg. C-4(b), (c). This Prop. Reg. also contains a provision, C-4(a), not dealt with here, specifying what happens if the plan does not contain an optional provision specifying a method of distribution.

12. Prop. Reg. C-4(c). It is not clear to this author what the words "in operation" are intended to add to this provision.

13. Treas. Reg. § 1.401-1(a)(2).

14. See instructions to IRS forms for establishing IRAs and Roth IRAs, such as form 5305 (Traditional Individual Retirement Trust Account form, instructions under Article VIII).

15. *In re Martin Trigoboff, Deceased*, 175 Misc. 2d 370, 669 N.Y. S.2d 185 (1/14/98); *Estate of James B. Morse, Deceased*, 150 Misc. 2d 415; 568 N.Y.S. 2d 689 (4/1/91).

16. Prop. Reg. C-4(b).

17. Prop. Reb. C-4(a).

18. Prop. Reg. C-4(c). It is not clear to this author what the words "in operation" are intended to add to this provision.

19. § 4974(a).

20. Prop. Reg. § 1.408-8A-4(b).

21. § 401(a)(9)(D); Prop. Reg. E-6.

22. Prop. Reg. E-7.

23. Prop. Reg. E-7(c).

24. Prop. Reg. D-5, D-6 and D-7; see complete discussion of the trust rules in Chapter 6 of the author's book *Life and Death Planning for Retirement Benefits.*

25. § 401(a)(9)(A)(ii). This rule is not applicable to Roth IRAs.

26. For discussion of this issue, see the author's book *Life and Death Planning for Retirement Benefits*, *op. cit.*, pages 33-35.

27. Prop. Reg. E-7(c).

28. The "minimum distribution incidental benefit rule" generally requires that, unless the participant's only beneficiary is his spouse, a special table must be used for purposes of determining the joint life expectancy of the participant and beneficiary for purposes of calculating required distributions during the participant's life under § 401(a)(9)(A)(ii). The effect of the special table is to "deem" the beneficiary to be no more than ten years younger than the participant. *See* Prop. Reg. § 1.401(a)(9)-2.

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The author gratefully acknowledges Marcia Chadwick Holt, Esq., Seymour Goldberg, JD, CPA, and Stephen J. Silverberg, Esq., for their ideas used in this article.

Expanding Relationships with Clients

By John G. McQuaid

"Never go to a doctor whose office plants have died."—Erma Bombeck

The introduction of the computer into the practice of law has produced profound changes not only in how the production process has been revolutionized, but also in how practitioners and clients interact with each other in that process.

The Lawyer/Client Relationship—The Doctor/Patient Relationship

The starting point to relationships with clients in creating estate plans with them is to make the clients an integral part of the planning process in ways that have not been widely used before. The medical profession has undertaken steps to change the doctor/patient relationship by urging that doctors focus first on their own personal and professional approach to patients. This should result in the expansion of the relationship in new ways. And the starting point in this process is that the physician heal thyself.

In many ways, the relationship of attorney to client is comparable to that of doctor and patient[1]: The Journal of the American Medical Association has emphasized that the physician has a broader function than physical examination of the patient's ailment and prescribing treatment.[2] Paraphrasing JAMA's example of the doctor-patient relationship and applying it to that of the attorney-client relationship, too often attorneys focus on technical aspects of lifetime and estate planning at the expense of reflection, self-awareness and sensitivity to the client's feelings and values."

Ponder for a while how you yourself feel sitting in the waiting room[3] waiting to see a doctor; or how you interact with the doctor during the meeting in his or her office. How many questions and concerns about your own health and well-being do you really share with the doctor? Have you thought about mentioning a broader range of concerns than that which is the specific reason for your visit? Consider (or inquire directly) how the doctor feels as a client—does he or she not share many of the same concerns and reactions to the situation that you have when the relationship is reversed? In either such case the words unspoken leave a gap in the service that either might otherwise have rendered to the other.

Increase the Client's Share in Lifetime and Estate Planning

One significant way in which doctors are changing the quality and scope of their relationships with patients is to have the patients take a greater role in the selection and course of their treatment.[4] A recent article in the *New York Times* on the subject reports:

> Over the past two decades, a revolution in patients' rights and an explosion of information in books, newspapers, magazines and cyberspace have enabled women, and men, to educate themselves as never before. Doctors' attitudes have changed, too; once derided for their paternalism, many now expect patients to research their own diseases and make decisions on their own.[5]

The widely reported treatment Mayor Giuliani underwent for prostate cancer is a prime example of how medical decisions are increasingly being made by the patient in consultation not solely with the primary care physician, but by several or more experts in the field.

Have the Client Participate Directly in the Process

While there may not be such a great explosion of information in the estate-planning area as there is in medical treatment, there are ample sources of information both in book and magazine form and on the internet[6] to recommend to the interested client; and for enabling him or her to ask the right questions for a plan tailored to the client's particular family and financial needs and goals. A short list of such sources is annexed as **Appendix A**. When this scenario is carried out, the attorney may well becomes an integral player on a team captained by the client. This is the approach implicitly taken by a special committee of this Section in the recommendations it has developed to give to persons seeking an attorney for estate planning: See **Appendix B**.

Involve Client's Family in the Process

One subject that has been rarely dealt with in the past is disclosure of the proposed estate plan to the intended beneficiaries. The preparation of an estate plan is often confined to the lawyer and the client; and a bond of silence is observed between them. This bond of silence can result in decisions that are made in ignorance of some relevant fact or relationship. When the estate plan is being developed may well be the best, and may be the only, time when previously unmet issues and possible misunderstandings can be discussed head-on and resolutions reached during the lifetime of the client. Information about the family's relationships among themselves, and about the property that may be disposed of at death should be addressed by the client and the attorney, and often by the family members being affected by the estate plan.

If such issues are not resolved during the client's lifetime by an open understanding of those presumed beneficiaries who are affected by the estate plan, the chance may be lost for achieving understanding and avoiding expensive litigation such as resulted in the contests among the widow (former maid) and children of the testator/owner of a Johnson & Johnson fortune, or between the two sons of Harry Winston which was recently concluded with a settlement of over $50 million in favor of the less favored of the two. The estate planning process may offer the only opportunity for resolving family misunderstandings and ultimate conflicts that may result after the client has died.

The participation of beneficiaries ["inheritors"] in the development of the estate plan is the principal subject matter of "The Inheritor's Handbook"[7] which discusses approaches that may be made by the prospective beneficiary to overcome the conventional cloak of secrecy.

Attorneys often assume that confidentiality is required by the code of ethics as to the information that would bring the beneficiary in as a participant in the process. That may of course be waived by the client; but in order to do so the attorney should be careful to provide the client with full information as to the reasons and usefulness of the beneficiary's participation.

What should be kept in mind by both the attorney and client is the usefulness that openness among family members involved in the process may have in achieving greater understanding from all affected members of the considerations that underlie the basic dispositions. Further, the process may well produce some changes in the dispositions that otherwise might not have been thought of and taken account of.

Adopt the Team Approach

Some lawyers typically assume full individual responsibility for many or all aspects of the client's estate plan. This in itself may result in a failure to receive full information necessary to make an informed legal judgment as to particular matters to be resolved in the estate plan.

Initially, the estate plan's first focus is to carry out the objectives of the client and the security of the family. While the will and related trusts may be prepared by an attorney acting alone, or with others in the firm, lifetime/estate planning usually requires availability to the client and attorney of other specialists who serve the client. One proceeds at one's peril if the client's own selection of advisers is not informed of and involved in the planning process. The planning team typically includes the client's accountant, financial adviser, banker, executive or manager of any family business, professionals in IRAs, pension and profit sharing plans, and appraisers of property, as well as persons who have special knowledge of the family affairs.

Avoid Sex Stereotypes

While studies show that women make three quarters of the health care decisions in the United States, probably the reverse is true in family lifetime/estate planning. That too must be in the process of change with the increased participation of women in the fields of government, law, business, and other pursuits. Yet, notwithstanding that a major portion of estate planning has as its purpose making provision for the female survivors of married couples, the process has largely been controlled by the male "head of the family"; and it has largely been managed by male members of the legal profession: A quick review of the membership directory of the Trusts and Estates Law Section shows that the Section has approximately four to one male to female members. Surely, the time is approaching when that too will pass. The one place where greater attention and effort can be made in making women full partners in the planning process is in the offices of those of us who are reading this message.

If the lawyers in the trusts and estates field are to apply the self–examination of their individual attitudes to clients that JAMA calls for from doctors to patients, a far stronger focus must be brought to bear to overcome hidden sexist attitudes that have their roots in trusts and estates law as it was practiced in the 20th century.[8]

Without exception all papers comprising the estate plan documents must be reviewed by someone other than the author of the document: the power of error in the printed word is greater over the author-creator than over almost anyone else.

Extending the Planning Process Beyond Wills, Trusts and Taxes

There is a general reluctance at meeting with clients for planning purposes to consider the process as the natural and best time to gather together other aspects of the client's life that are not dealt with in the planning process. Typically, nothing but the estate plan itself—the estate and gift tax aspects, the lifetime trust, the will, power of attorney, living will and health care proxy—are the only matters discussed and documents executed at the time. As a result, when death occurs, the family, in the midst of the initial shock, may not be prepared to deal with the details that must be assembled and distributed promptly, such as funeral arrangements, obituary, particulars of the deceased's family background, education, professional history, public and private accomplishments and many other aspects of his or her life that may not have been passed on to them during the client's lifetime. There is simply no better time to seek and find and preserve this information than as part of the planning process.

For starters, a memorandum should be prepared of pertinent information about the client and family members that the family and friends will wish to know in all events if they do not know them already. To start with, ask the client or family member to assemble a family history, memorabilia and genealogical information. Where documentation is available, copies and their location should be made known to the family members at the time an estate plan is being prepared.

Genealogy

Genealogy is reported to be the third most popular hobby in the country, after collecting stamps and coins. Often the family records or other relevant information may have been collected over the years, but have never been organized, tabulated or used. These should be placed in one indexed central file that can be made available to all family members of all living generations quickly at anytime.

Usually, the best practice is to find a family member with the greatest interest in the family history, recommend that person to develop the family tree and other historical, or other significant information for all family members concurrently with the development of the estate plan.

Personal Information

The availability of a computer and of the time and ability to use it, provide the opportunity to the client or family member for placing the client's own interests, history, achievements and idiosyncrasies in printed form for those others of us who know and care about the client. One can easily create a folder in which to add items of reminiscence, lines of poetry, opinions, experiences, and the like, which in the ordinary course might not have been known by those who care for us. A recent Bank of New York publication[9] sets forth an example for us.

Ethical Wills: Handing Down Life's Lessons

> It's hard enough to pass on what you've earned in this life But now can you pass on something even more important—all the things you've learned? An ethical will can help. Rooted in ancient tradition, this is not a legal document. Rather, it allows you to put in writing all the values, lessons and ideas you've absorbed throughout your life. The benefit is twofold: it lets your children benefit from your wisdom, and it gives you the opportunity to clarify and organize your beliefs. And the news is that an ethical will costs nothing to create: all you need is [a computer or] a pen, paper and some quiet time to reflect.[10]

Many clients might appreciate being given a form to fill out and to distribute among family members and friends. A sample form will be found in **Appendix C.**

Obituary and Funeral Arrangements

The idea of preparing your own obituary and making your own funeral arrangements may seem repulsive to many people. That, too, is in the process of change.

The *New York Times* recently forecast[11] the fast-aging boomer generation is "going to turn dying into a form of self-expression." The article continues:

> Each and every last boomer is going to strive to make his or her death a unique and fulfilling ritual. They're going to be taking adult education classes on the joys of doing well. They'll have brunch discussions about what music should be on the stereo as one drifts of into the afterlife. They'll say things like "I don't want to just die, I want to claim ownership at my death" and they'll start buying self-actualizing books with titles like "The Seven Habits of Highly Effective Dead People." In short, the boomers are going to take death and they're going to turn it into a growth experience.

Regardless of which generation the client is a member of, a lot more thought must be given or asked to be given by the client of the details that will be required in preparation for death and the ceremonies to be followed to mark it well. **Appendix D** sets forth from a form for use in setting forth information useful for purposes of an obituary.

Quiz

The reader should review his or her own practice with colleagues to consider what changes might be made in that practice.

Are clients' files up to date? If not, what measures should be taken to clean them out of out-of-date material?

How often are the files reviewed?

What time table or change in law or practice should prompt the review?

Which of the following suggestions of this article would you consider putting into effect?

Expanding the lawyer/client relationship.

Suggesting to the client that he or she make "preneed" funeral arrangements as part of the estate plan.[12]

Increasing the participation of clients in the process.

Undertaking measures to educate the client.

Recommending books and internet sources.

Asking the client to draft his or her own estate plan.

Asking the client or a family member to prepare a complete obituary.

What continuing contact with clients does the attorney make or plan to make with clients after the completion of the lifetime/estate plan? What follow-up letters on possible changes in circumstances should be made. Inform the client of effect of changes in the law on the estate plan—viz., proposed repeal or changes in gift and estate tax law?

Final question: After having read the above, are you going to do something about it or are you going to excuse yourself because you have to meet with a client waiting in the waiting room?

Endnotes

1. Cf. Webster's Third International Dictionary for usage of "client" and "patient": "Client 1. A person under the protection of another, vassal, dependent (an 'impecunious client and favored dinner companion of Lorenzo the Magnificent and his court'); and patient as derived from *patiens*—present participle of *pati* to suffer."
2. Srinivasan, *Medical Professionalism: More Than Simply a Job*, and Epstein, *Mindful Practice,* Journal of the American Medical Association (Sept. 1, 1999).
3. Query: Why do doctors have waiting rooms and lawyers reception rooms?
4. The medical profession has recently pursued a controversy resulting from the report of the Institute of Medicine that the high instance of medical errors in hospitals caused between 44,000 and 90,000 hospital deaths per year. Lucian Leape, M.D., a professor at the Harvard School of Public Health and a contributor to the report, was asked the question, "What can patients do?" In his reply Dr. Leape said: "Smart doctors * * * are getting used to the idea that they're not going to know everything: Think of medical professionals as partners in your care, not gods." AARP Bulletin, January 2000 p. 2 The Bulletin recommends that its readers do their own research at the library or the internet on the ailment, before seeing the doctor. The controversy has recently been resumed by a critical article that the report's number of deaths was "greatly exaggerated," to which Dr. Leape countered. *Medical Mistake Study is Subject to Dispute*, N.Y. Times, July 6, 2000, p. A20.
5. Sheryl Gay Stolberg, *Patient Power-The Big Decisions? They're All Yours*, N.Y. Times, § 15 (Women's Health) June 25, 2000 at 1.
6. *See* Morgan, *Toward A New Perspective on Legal Ethics,* American Bar Foundation, Researching Law, Spring 2000, p. 4: "Books on legal information have been around for years . . . but the Internet makes such information ubiquitous."
7. Dan Rottenberg, The Inheritor's Handbook, Bloomberg Personal Bookshelf 1999.
8. Having myself been found guilty of the same presumption (*see* McQuaid, *Would You Leave Your Wife 27 Million Dollars Outright?* Trusts and Estates, June 1973, p. 426), I will leave to others an analysis of the effects of male dominance (if you will) in the estate planning field.
9. BNY Leading Indicator, Summer 2000, p. 2.
10. I have a folder of "*Words Remembered*" in which from time to time I record favorite songs, poetry, reminiscences, people I have known, and the like.
11. David Brooks, View—*The Valley of Death, Another Boomer Test*, N.Y Times 6/29/00 Styles p. 5.
12. "The Federal Trade Commission regulates the funeral industry. *** [I]ts 'funeral rule' requires funeral homes to give consumers [!] itemized price information and make various other disclosures about funeral goods and services." Alan L. Bessoff, *The Trouble with Funerals,* AARP Bulletin, 9/2/2000, p. 4.

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APPENDIX A

Books

1. Ernst & Young's Financial Planning for Women—1999
2. Esperti and Peterson, The Living Trust Workbook—Penguin 1995
3. Harold L. Lustig, 4 Steps to Financial Security for Lesbian and Gay Couples—Fawcett Books 1999
4. Steve Maple, The Complete Idiot's Guide to Wills and Estates—Alpha Books 1999
5. Dan Rottenberg, The Inheritor's Handbook—Bloomberg Personal Bookshelf 1999

Internet

1. www. actec.org
2. www.estateplanning.com
3. www.smartmoney.com
4. www.findlaw.com
5. www.rosenreade.com

APPENDIX B

Choosing a Lifetime/Estate Planning Attorney

A. The following questions may help you [the prospective client] in interviewing an estate planning attorney:

1. Ask the attorney to define "estate planning."
2. How much of the attorney's time is spent on estate planning?
3. What other professionals (i.e., accountants, appraisers, investment advisors, trust officers, insurance agents, etc.) will the attorney need to work with, and how will that be handled?
4. Has the attorney authored any estate planning materials?
5. Is the attorney's firm [office] technologically able to provide advanced estate planning calculations and projections?
6. What is the depth of the trusts and estates department in the attorney's law firm (i.e., are there partners, associates, paralegals and other resources available to you and the attorney)?
7. What will be the legal fees for the planning process and how are they determined?

B. In working with an estate planning attorney, you should expect to provide and receive some or all of the following information:

1. Details regarding your family and asset situation.
2. Inquiry into your personal objectives for the disposition of your assets.
3. Education regarding the estate and gift tax system.
4. A tax projection to show your potential tax exposure.
5. Information regarding various planning options available to you to control the disposition of your estate and reduce your tax exposure.
6. A proposal letter recommending planning documents and options for the control and distribution of your estate and providing estimated legal costs and fees to accomplish the recommended planning.

From report of a special committee of the New York State Bar Association Trusts and Estates Law Section.

APPENDIX C

Information to be prepared with estate plan

For family historical/genealogical and other purposes

Location of documents and memorabilia

Doctor, medical records, health care proxy, living will.

Power of attorney.

Attorney.

Accountant.

Bank.

Financial Adviser.

Other.

Safe deposit box—key, number, where, who authorized entry?

Locations of other facts or memorabilia?

Who is to be named as custodian of documents?

Place and kind of service—religious or memorial or none? Where? Clergy or other functionary in charge? Participation in service by family and friends?

Post-service gathering of family and friends?

Names and addresses of persons to be informed.

APPENDIX D

Obituary Facts

Name of Deceased: ______________________________

Residence: ______________________________

Age: ________ How long ill? ______________________________

Died when (date, time)? ______________________________

Cause of death: ______________________________

Born when? ______________________ Where? ______________________________

Name of mother: ______________________________

Name of father: ______________________________

Are both parents living? ______________________________

Is wife or husband living? ______________________________

Wife's maiden name: ______________________________

Married when? ______________________ Where? ______________________________

Survived by children (Number ______)

Names and addresses of children:

____

____

____

How many brothers? ______________________________ How many sisters? ______________________________

Names and addresses:

Brothers

____

____

____

Sisters

____

____

____

Grandchildren? (Number _________)

Education (schools and colleges)

____

____

____

Civic, fraternal organizations, clubs, fire company, etc. (and offices held now or in past)

____

____

____

____

Member of church or temple? ____

How long lived in town? ____

Ever lived elsewhere in Westchester? ____

Occupation: ____

By whom employed: ____

____

____

If in business for self, what: ______________________________ How long? ______________________________

Military/veteran information: ____

____

____

In lieu of flowers: ____

I have read the above and it is correct to the best of my knowledge.

Authorized signature: ____

Please print your name and telephone number:

______________________________ ______________________________

Courtesy of McMahon, Lyon & Hartnett, White Plains

Repealing the Rule Against Perpetuities: Should New York Follow the Crowd?

By Ira Mark Bloom

I. Introduction

The Rule Against Perpetuities is under siege in the United States. In the past three years, nine states have repealed the rule, and other states, including New York, are seriously considering its repeal. What is sparking the perpetuities repeal movement? Is it the recognition that this ancient property rule no longer serves any social policy? No. The rule is being repealed so that wealthy individuals will be able to create perpetual dynasty trusts to exploit the generation-skipping transfer (GST) tax system.

The federal GST tax system provides an inflation-adjusted exemption of $1 million. For the year 2000, the GST exemption amount is $1,030,000 per transferor. A unique feature of the GST exemption is that it must be allocated no later than when the transferor's estate tax return is due to be filed, even though trust distributions may be delayed for a substantial period of time after the transferor's death.

Consider a prototypical GST tax exempt (GST exempt) trust: A grandparent dies in 2000. A testamentary trust of $1,030,000 is created under the grandparent's will. The terms of the trust provide income to the grandparent's child for life, principal to the grandparent's grandchild. Assuming the grandparent did not use up any of her GST exemption during lifetime, the grandparent's GST exemption of $1,030,000 could be allocated to the testamentary trust.

Assume that the income beneficiary dies in 2030 and that the trust principal is then worth $15 million. Because the trust was made GST exempt on the grandparent's death, no GST tax will be payable on the $15 million trust distribution to the grandchild in 2030. In effect, $15 million will have escaped any transfer taxation at the child's generation level.

Although the skipping of transfer taxation on $15 million at one generation is not unimpressive, the $15 million will not escape transfer taxation at the grandchild's generation level. Moreover, since any income generated by the trust must be paid to the grandparent's child, the after-tax amount of income not consumed by the child will be subject to either gift or estate taxation at the child's generation level.

Estate planners understand that much better use can be made of the GST exemption under other GST trust arrangements. Ideally, the trust principal should not be mandatorily distributed but should be held in the trust as long as possible. Further, trust income should not be mandatorily distributed but should be accumulated and thereby held in trust for as long as possible.

The ideal GST exempt trust would last potentially forever, that is, a perpetual trust for the trust creator's family: a perpetual dynastic trust. The trust principal, enhanced by accumulations of trust income, would remain in trust. Any discretionary distributions of trust income or principal would be free from GST taxation, although the unconsumed distribution would be subject to transfer taxation at the beneficiary's level.

The impediments to perpetual dynastic trusts in most states have been state law property rules, in particular, the Rule Against Perpetuities. As of this writing, perpetual trusts may be created in 12 states. The perpetuities repeal movement is quite understandable. Unless a state repeals its rule, its wealthy residents will create GST exempt trusts in those states that have repealed the Rule Against Perpetuities with respect to trusts.

Part II of this article will show that states, in the race to facilitate the exploitation of the GST exemption by perpetual dynastic trusts, have overlooked the non-tax societal reasons for some rule against perpetuities. Parts III and IV of the article evaluate the positive and negative consequences of the perpetuities repeal movement. In Part V, I consider options for New York on the perpetuities repeal issue. Since my conclusion is that New York should not blindly follow the crowd, in Part VI of the article I offer my suggestion for what action New York should consider on the issue of perpetual trusts.

II. Contemporary Reasons for the Rule

As explained in The Restatement (Second) of Property (Donative Transfers), part I (1983), the Rule Against Perpetuities was developed by the English common law to foster the alienation of land, that is, the transfer of full ownership in land in fee simple absolute. If land was conveyed so that one person had a present estate in the land—typically a life estate—and one or more persons had a future estate in the land, fee simple ownership could be transferred only if all persons conveyed their estates in the land to a third person. If one or more future estates in land were made contingent on some future event—for example, on an unborn person being born—the present alienation of the land would be prevented until that future contingency was resolved.

In application, the Rule Against Perpetuities was designed to invalidate those remote nonvested interests in land that would have the effect of indirectly restraining the alienation of land for too long a period. If, however, land was held in trust, the alienation of the land would not be restrained provided the trustee had the power to alienate the land. Thus, the original purpose for the rule did not and does not apply to land (or any other property) held in trust provided the trustee has the power to sell the trust property.

Is there any modern justification for the Rule Against Perpetuities for property held in trust when the trustee has the power to sell the trust property? The late Professor Lewis M. Simes, one of the seminal perpetuities scholars and thinkers of the past century, undertook to answer this question in his famous monograph: *Public Policy and the Dead Hand* 56-63 (1955).

Simes's thoughts are compelling and timeless. He concluded (pages 58-59) that there were two modern bases "for the social policy of the Rule, the force of which can scarcely be denied."

> First, the Rule Against Perpetuities strikes a fair balance between the desires of members of the present generation, and similar desires of succeeding generations, to do what they wish with the property which they enjoy. . . . In a sense this is a policy of alienability, but it is not alienability for productivity. It is alienability to enable people to do what they please at death with the property which they enjoy in life. As Kohler says in his treatise on the Philosophy of Law [12 Modern Philosophy 205 (1914)]: "The far-reaching hand of a testator who would enforce his will in distant future generations destroys the liberty of other individuals, and presumes to make rules for distant times."
>
> But, in my opinion, a second and even more important reason for the Rule is this. It is socially desirable that the wealth of the world be controlled by its living members and not by the dead. I know of no better statement of that doctrine than the language of Thomas Jefferson, contained in a letter to James Madison, when he said: "The earth belongs always to the living generation. They may manage it then, and what proceeds from it, as they please during their usufruct."

With the late Professor A. James Casner as Reporter, The Restatement (Second) of Property (Donative Transfers), Part I (1983), expresses the contemporary societal concern over dead hand control:

> [I]t is fair to conclude that the social interest in preserving property from excessive interference . . . rests partly upon the necessities of maintaining a going society controlled primarily by its living members, partly upon the social desirability of facilitating the utilization of wealth, and partly on the social desirability of keeping property responsive to the current exigencies of its current beneficial owners.

Technically, the common law Rule Against Perpetuities only indirectly restricts the duration of trusts. However, there is a common law doctrine that relies on the rule to limit the duration of trusts. Section 2.1 of The Restatement (Second) of Property (Donative Transfers) sets forth the rule on undue trust duration:

> A trust created in a donative transfer, which has not terminated within the period of the rule against perpetuities as applied to such trust, shall continue until the trust terminates in accordance with its terms, except that a trust, other than a charitable trust, may be terminated at any time after the period of the rule against perpetuities expires by a written agreement of all of the beneficiaries of the trust delivered to the trustee, which agreement informs the trustee that the trust is terminated and gives the trustee directions as to the distribution of the trust property.

The Restatement's rationale amply justifies the need for some rule to curb excessive dead hand control over trust duration:

> When all the beneficiaries of a trust are ascertained and sui juris, they, acting together, can force a termina-

> tion of the trust, unless thereby a material purpose of the trust will be defeated. . . . The rule of this section places a limit on the period of time that the creator of a trust is allowed to force the effectuation of the material purpose of the trust, when the continued accomplishment of such purpose is against the wishes and desires of the current beneficial owners of the trust property. Some limit is desirable in order to prevent the possible undesirable social consequences of the views of persons long removed from the current scene influencing unduly the wishes and desires of those living in the present.

III. Positive Consequences of Repeal

A. Creating Trust Business

Before the Spring of 1997, only three states had repealed their rules against perpetuities as applied to property held in trust: Idaho, South Dakota and Wisconsin.[1] During the past three years, nine more states have repealed their Rule Against Perpetuities as applied to property held in trust: Alaska, Delaware, Illinois, Maine, Maryland, New Jersey, Ohio, Rhode Island and Virginia.[2] New York and other states, such as Colorado and Tennessee, are actively considering repealing their rules as applied to perpetual trusts.

My research compels me to conclude that, during the past three years, states have repealed the rule as applied to trusts for two major reasons: to attract new GST-exempt trust business from other states and to allow their residents to create GST-exempt dynastic perpetual trusts in their home states so that trust and legal business will not leave the state. In fact, Alaska began the rush to repeal in 1997 for the express purpose of attracting trust business to Alaska.[3] Delaware, the preeminent haven for out-of-state business, reflexively followed suit.[4]

Consider the recent experience of New Jersey, which repealed its Rule Against Perpetuities in 1999 under § 13 of "The Trust Modernization Act of 1999."[5] Sponsored by the New Jersey Bankers Association,[6] the legislative history explains the bill as follows:

> The bill repeals the Uniform Statutory Rule Against Perpetuities, . . . and supersedes the common law with respect to the rule against perpetuities. Under the bill, a trust can endure forever as long as the trust documents allow the trustee to sell an absolute ownership interest in the trust assets within a specified period, generally 21 years after the death of an individual or individuals alive at the time the trust is created. The effect of this repeal and supersession is to permit banks and trust companies to offer "dynasty trusts" to their customers, such as those that are being offered by banks and trust companies located in other states.

The bill was unanimously passed by the New Jersey Assembly 76-0, and by the Senate 40-0. On July 8, 1999, the Governor signed the bill into law. The conclusion is that New Jersey now sanctions perpetual trusts provided the trustee has the power to sell the trust property. In effect, neither the Rule Against Perpetuities, nor the related rule that might have limited trust duration, applies to qualified perpetual trusts in New Jersey.[7]

Not unexpectedly, banks and others have applauded the blessings that New Jersey has bestowed on perpetual trusts.[8] Consider the announcement of the New Jersey Bankers Association: "The new law repeals New Jersey's statutory and common law Rule Against Perpetuities . . . and thus permits banks and trust companies to offer 'dynasty' or 'wealth building' trusts."[9]

Surely, New Jersey lawyers will also benefit from trust business staying in New Jersey as well as from trust business coming from other states, primarily New York. In addition, lawyers will benefit if New Jersey residents who created trusts in dynasty trust states repatriate them to New Jersey.[10]

B. Eliminating Complexity: Revenge of the Law Student?

As every former law school student can attest, the complexities of the Rule Against Perpetuities were a learning nightmare.[11] In fact, the original common law Rule Against Perpetuities has been justifiably attacked as being too harsh and too complex.[12] Indeed the wait-and-see movement developed in response to the perceived problems with the common law rule.[13] The latest formulation of the wait-and-see rule is the Uniform Statutory Rule Against Perpetuities (USRAP), which has a 90-year wait-and-see period.[14] It has been enacted in more than half of the states.[15]

Since most nonvested interests will likely vest or fail to vest within 90 years of trust creation, USRAP should eliminate complexity for the current generations. If, however, the uncertainty is not resolved during the 90-year period, a court may then need to exercise its cy pres power to reform the trust. Fortunately, no living professional or jurist will have to deal with the problems of trust invalidity 90 years down the road.

The conclusion on complexity is inescapable: the repeal of the common law Rule Against Perpetuities, or the wait-and-see formulation of the Rule, eliminates complexity as applied to trust creation. A New Jersey estate planner applauded New Jersey's prospective repeal of USRAP: "'Who needs all this stuff? . . . Isn't good estate planning complex enough without something like this?'"[16]

IV. Considering the Consequences?

In their haste to jump on the repeal bandwagon, no repealing state appears to have seriously considered the negative consequences of sanctioning GST-exempt perpetual trusts.[17] Unfortunately, there will be serious negative consequences under the trust creator's infinite dead hand control.

Consider the prototypical GST-exempt dynastic trust in those states that have repealed the Rule Against Perpetuities and have no rule that limits trust duration if the trustee can sell the trust property: An individual is counseled to create a lifetime trust that uses the available GST-exemption amount—$1,030,000 in 2000.[18] To maximize the GST exemption, the trust will be designed to last as long as there are descendants of the trust creator, with a gift over to the settlor's heirs, but if none, a charitable gift over whenever the settlor's lineal line runs out.[19] The terms of the trust give the trustee the absolute discretion to distribute income or trust principal to the settlor's descendants. Any undistributed income shall be accumulated and added to the trust. On the advice of counsel, the settlor appoints a corporate trustee as immediate or successor trustee.

Consider some of the negative consequences of infinite dead hand control under such carefully crafted GST-exempt perpetual dynasty trusts.

A. Trust Duration in Perpetuity

Absent prior termination, a perpetual trust is just that—a trust that can last forever, in perpetuity. In an effort to quantify perpetuity, we might look to the world of astrophysics where it is reliably predicted that human life on earth could last for somewhat more than 1 billion years.[20]

It is no answer that a perpetual trust may be terminated before the transferor's lineal line runs out. Unless the corporate trustee exercises its discretion to terminate the trust, trust termination cannot be compelled absent some emergency.[21]

B. Administrative Nightmare

Quite understandably, the National Conference of Commissioners on Uniform State Laws (NCCUSL) is distressed by the perpetuities repeal movement. Indeed, if fully successful, the movement would be the undoing of USRAP.[22]

In October of 1999, NCCUSL issued a press release entitled: "Uniform Statutory Rule Against Perpetuities Is Law in 26 States: Move of a Few States to Abolish the Rule In Order to Facilitate Perpetual (Dynasty) Trusts is Ill-Advised."[23] Consider the potential trust administrative nightmare with dynastic trusts that is warned of by Professor Lawrence W. Waggoner, Director of Research of the Joint Editorial Board for the Uniform Probate Code in the NCCUSL press release:

> Over time, the administration of such trusts is likely to become unwieldy and very costly.
>
> Government statistics indicate that the average married couple has 2.1 children. Under this assumption, the average settlor will have more than 100 descendants (who are beneficiaries of the trust) 150 years after the trust is created, around 2,500 beneficiaries 250 years after the trust is created, and 45,000 beneficiaries 350 years after the trust is created. Five hundred years after the trust is created, the number of living beneficiaries could rise to an astounding 3.4 million.[24]

And, Professor Waggoner's statistics are only for relatively short-term periods possible under perpetual dynastic trusts.[25] Imagine the administrative problems with a dynasty trust for "only" a 1,000 years. How many beneficiaries might a perpetual trust have in 10,000 years? 100,000 years? 1 million years? 5 million years? 1 billion years? (About 100 million years before human life is predicted to be extinguished.)

C. Trustee Power

A well-drafted GST-exempt perpetual trust will have escape hatches so that the trust can be prematurely terminated. On one approach, the transferor would confer discretionary distributive powers on the corporate trustee.[26] In effect, the corporate trustee would be invested with the extraordinary power to control the wealth and well-being of the trust beneficiaries. Although the trustee's discretion is subject to court supervision, a court will not upend trustee decisions lightly.[27] Future generations of trust beneficiaries should not be surprised if a corporate trustee resisted exhortations by them for trust distributions.

Recall Professor Simes's point from Part II of this article: "It is socially desirable that the wealth of the world be controlled by its living members and not by the dead." I doubt that Professor Simes had in mind control over wealth by society's corporate trustees.

D. Size of Trust Principal

The ideal GST-exempt trust would amass as much wealth as possible, thereby preventing its depletion by federal transfer taxation.[28] Consider the wealth that might already be amassed or might be amassed in a perpetual trust based on the exponential explosion of the recent stock market.[29]

Who knows what lies ahead in the future? But consider the value of $1 million with an after-tax return of 6 percent for the following (relatively short) periods:[30]

Value after 100 years: $369 million
Value after 200 years: $136.43 billion
Value after 300 years: $50.395 trillion

Perpetual trusts can (and will) facilitate enormous wealth and power for dynastic families. In the process, we leave to future generations some serious issues about the nature of our country's democracy.[31]

E. Termination of GST Exemption

The recent repeal of perpetuities laws is designed to encourage the creation of GST-exempt perpetual dynastic trusts in the repealing state.[32] Yet, there is no real guarantee that the federal government will allow perpetual exemption from GST taxation.[33] Will the repealing states then reinstate some rule against perpetuities if the GST-exemption is limited, for example, to 90 or 100 years? Suppose Congress repeals the GST-tax system altogether, thus making GST-exempt trusts unnecessary?[34] If the GST-exemption is limited or the GST tax system is repealed, might GST-exempt perpetual trusts be terminable on the basis that their purposes have been accomplished?[35] If not, will there be problems with non-GST- exempt perpetual trusts?

F. Non-GST-Exempt Perpetual Trusts

Although states are in a mad dash to repeal the Rule Against Perpetuities so that $1 million+ GST-exempt perpetual dynastic trusts can be created, no state that has repealed the rule restricts perpetual trusts to those created for GST tax purposes. Even if non-GST-exempt perpetual trusts were subject to GST taxes, the after-tax amount in these trusts could be staggering. Consider a dot-com multimillionaire who creates a perpetual dynastic trust exceeding $50 million, or exceeding $100 million, or even more.

In the final analysis, the negative consequences under GST-exempt perpetual trusts could be greatly exacerbated under non-GST-exempt perpetual trusts.

G. Increase in Aggregate Power in Banks and Trust Companies

In my view, one of the most serious societal consequences of perpetual trusts will be the increase in aggregate power in the hands of banks and trust companies that serve as corporate trustees of multiple perpetual trusts. Already that power is significant and growing. From 1990 through 1998, the value of equities held in bank personal trusts and estates grew from $190 billion to $538 billion.[36] Consider also that the largest of the banks and trust companies have traditionally held a sizeable percentage of the common stock held by all banks and trust companies.[37]

V. Options for New York

In an isolated world, New York could keep its perpetuities rules intact.[38] New York would thereby adhere to the commendable principle of limiting dead hand which, as discussed in Part II of the article, is the contemporary basis for the rule. The reality, however, is that New York lives in a world of "competitive federalism."[39] As a result, New York is detrimentally losing trust business to states that have repealed their perpetuities rules for trusts.

Assuming New York should attempt to shore up trust business, the question becomes how might that be accomplished. One easy solution is to follow the crowd and allow perpetual trusts.[40] In the process, however, New York would allow infinite dead hand control which I rail against in Part IV of this article.

There must be a better solution. In the Spring of 2000, Florida amended its USRAP provisions to allow for a 360-year wait-and-see period.[41] Although this change extends dead hand control—unwisely in my judgment—the Florida legislation also addresses the problem of excessive dead hand control in two ways. First, courts may modify or terminate trusts in various circumstances, including when it is in the best interests of the trust beneficiaries.[42] Second, trusts may be modified or terminated with consent of all of the beneficiaries and trustees.[43] In both instances, termination and modification may be postponed by the trust creator but only for the first 90 years of the trust's existence.

In effect, Florida does not give the trust creator absolute dead hand control for 360 years. Rather the interests of the living (and unborn) may be taken into account by a court to modify or terminate the trust. In addition, the trust beneficiaries with the consent of the trustees may terminate or modify a trust, even if such act is in derogation of the trust creator's wishes.

Another approach to excessive or infinite dead hand control would be to require, after a certain period of a trust's existence, that a succession of individual beneficiaries be given powers of appointment so that the long-term or perpetual trust might be terminated. I find this approach less attractive than judicial (or non-judicial) modification since it would vest a succession of unknown individual beneficiaries with the extraordinary power of trust termination.

Still another approach would be to permit infinite dead hand control but only for GST-exempt trusts. For reasons unclear to me, this option was not elected by any repealing state so that New York would not be competitive if it limited perpetuities repeal to only GST-exempt trusts.

VI. Conclusion

My sad conclusion is that the GST tax tail is killing a vitally important societal rule that limits unacceptable control by the dead hand. By sanctioning perpetual trusts, those states, in my judgment, have abnegated their responsibilities to future generations. Accordingly, I firmly believe that New York should not follow the crowd and simply repeal its Rule Against Perpetuities for trusts.[44]

Not inconsistently, however, I would be in favor of New York repealing its rule for trusts provided it also enacts at least judicial (and possibly non-judicial) termination provisions. Florida's recent trust-termination legislation could serve as a starting point for discussion in New York.[45]

Endnotes

1. Idaho effectively repealed any dead hand control rules over personal property in 1957. Idaho Code § 55 -111. In 1969, Wisconsin repealed the common law Rule Against Perpetuities but maintained a rule against the undue suspension of the power of alienation in both real and personal property. Wis. Stat. Ann. § 700.16. However, no undue suspension of the power of alienation results if the trustee of a trust has the power to sell the trust property or someone has the power to terminate the trust. Wis. Stat. Ann. § 700.16(3).

   South Dakota followed suit in 1983. *See* S.D. Codified Laws § 43-5-8 (repealing the rule); S.D. Codified Laws § 43-5-4 (no undue suspension of the power of alienation if the trustee has the power to sell the trust property).

2. *See* Alaska Stat. §§ 34.27.075 and 34.27.100; Del. Code Ann. tit. 25, § 503(a) ; 765 Ill. Comp. State. Ann. § 305 /4; Me. Rev. Stat. Ann. Tit. 33, § 101-A; Md. Code. Ann. § 11-102(e); N.J. Stat. Ann. §§ 46:2F9-2F11; Ohio Rev. Code Ann. § 2131.09(B); R.I. Gen. Laws § 34-11-38; Code of Va. § 55-13.3F.

   Although Alaska was the first state that recently enacted perpetuities repeal legislation, the legislation did not effectively repeal the rule as intended. Legislation in the Spring of 2000 finally succeeded. *See* Alaska Stat. §§ 34.27.075 and 34.27.100 (adopting Wisconsin model described *infra* note 1). Alaska's Spring 2000 legislation also added a 1000-year vesting period for powers of appointment, *see* Alaska Stat. § 34.27.051, ostensibly to avoid the so-called Delaware trap under §§ 2041(a)(3) and 2514(d) of the Internal Revenue Code of 1986, as amended.

   The other eight states, however, appear to have been effective in crafting general repeal legislation, although differences exist on varying issues, such as whether the trust instrument must specifically provide that the Rule Against Perpetuities does not apply. *Compare* 765 Ill. Comp. State. Ann. § 305 /3 (requiring a specific provision in the trust document that the rule does not apply), *with* N.J. Stat. Ann. § 46:2F11 (omitting the requirement of a specific provision in the trust document that the rule does not apply). *See generally* Richard B. Covey, *Rule Against Perpetuities Changes and Perpetual (Dynasty) Trusts: Problems and Opportunities,* Prac. Drafting 5871-80 (Jan. 2000) (discussing issues raised by the repealing legislation of the various states).

3. The testimony of Representative Vezey, the sponsor of the Alaska perpetuities repeal legislation, revealed that perpetuities repeal was the result of his efforts

   > to look at what could be done to stimulate economic development in the state of Alaska and to look at why it is that Alaska couldn't be more of a financial center for the economy of Alaska, America and the whole world. . . . [H]e looked to see if there was an opportunity to change [Alaska's] laws that would encourage financial markets to headquarter in Alaska. With the help of a number of individuals who were also looking for a home for this type of an entity, they came up with some changes that could be made in Alaska to [Alaska's] trust laws that would make Alaska an attractive place to administer large trusts.

   Hearings on H.B. 101 Before the Subcomm. on Labor and Commerce, 20th Leg. (Ala. 1997) (statement of Representative Vezey).

   The principal beneficiaries of the Alaska legislation were predicted to be: "attorneys, bankers, certified public accountants and money managers." *Id.* Indeed, Jonathan Blattmachr, a well-known New York estate planning attorney, was instrumental in drafting the Alaska legislation. *See id.*; *see generally* Douglas J. Blattmachr and Jonathan J. Blattmachr, *A New Direction in Estate Planning: North to Alaska*, Tr. and Est., Sept. 1997, at 48. Jonathan Blattmachr is also a member of the Alaska bar; his brother is the president of a trust company in Alaska.

4. *See* Del. Code Ann. tit. 25, § 503(a) ; Katharine Fraser, *Delaware Matches Alaska Law Attractive to Personal Trusts*, Am. Banker, July 24, 1997, at 9.

5. Section 13 provides: "No interest created in real or personal property shall be void by reason of any rule against perpetuities, whether the common law rule or otherwise. The common law rule against perpetuities shall not be in force in this State." Trust Modernization Act of 1999, July 8, 1999, ch. 159, 1999 N.J. Laws 159 (codified at N.J. Stat. Ann. § 46:2F-9).

6. *See* Rachel Wolcott, *New Jersey Poised to Allow Dynasty Trusts*, Institutional Inv. Inc., May 17, 1999, at 1 ("The bill, sponsored by the New Jersey Bankers Association, was drawn up so that New Jersey trust institutions could avoid losing potential dynasty trust business and other types of trust business to Delaware, South Dakota and Alaska.").

7. Section 14 of the Trust Modernization Act provides in applicable part as follows:

> a. (1) A future interest is or trust is void if it suspends the power of alienation for longer than the permissible period. The power of alienation is the power to convey to another an absolute fee in possession of land, or full ownership of personalty. The permissible period is within 21 years after the death of an individual or individuals then alive.
>
> . . .
>
> b. The power of alienation is suspended when there are no persons then alive who, alone or in combination with others, can convey an absolute fee in possession of land, or full ownership of personalty.
>
> c. There is no suspension of the power of alienation by a trust or by equitable interests under a trust if the trustee has power to sell, either express or implied, or if there is an unlimited power to terminate in one or more persons then alive.

Trust Modernization Act of 1999, July 8, 1999, ch. 159, 1999 N.J. Laws 159 (codified at N.J. Stat. Ann. § 46:2F10).

The New Jersey legislation was patterned after the Wisconsin legislation discussed in note 1. *See Trust Modernization Act Signed by Governor*, 77 N.J. Banker's Ass'n Bulletin (July 14, 1999) (indicating New Jersey used Wisconsin as a model).

8. *See* Wendy Davis, *Remember the Rule Against Perpetuities? Well, Forget it! New Jersey Undoes Centuries of Jurisprudence with a Pen Stroke*, 157 N.J.L.J. 217 (1999).

9. Trust Modernization Act signed by Governor, note 7 *supra*.

10. Section 15(2) of the Act provides as follows:

> a future property interest or a power of appointment created before the effective date of this act pursuant to the laws of any other state that does not have the rule against perpetuities in force and to which, after the effective date of this act, the laws of this State are made applicable by transfer of the situs of a trust to New Jersey, by a change in the law governing a trust instrument to New Jersey law, or otherwise. For purposes of this section only, a future property interest or a power of appointment is created when the power is irrevocably exercised or when a revocable exercise becomes irrevocable.

Trust Modernization Act of 1999, July 8, 1999, ch. 159, 1999 N.J. Laws 159 (codified at N.J. Stat. Ann. § 46:2F11).

11. During the 1997 Illinois debates on the repeal of the rule, Representative Durkin asked:

> [r]epresentative, give me one more chance and educate me. What the heck is the rule against perpetuities? I went to law school, I took Bar-bri . . . [Bar-bri] said something about the rule against perpetuities states that all interests must vest, if at all, within 21 years in lives of being. What the heck does that mean?

Hearings on H.B. 1619 Before the House of Representatives, 90th Leg. (May 22, 1977).

12. *See*, *e.g.*, W. Barton Leach, *Perpetuities in a Nutshell*, 51 Harv. L. Rev. 638, 643-46 (1938).

13. *See* W. Barton Leach, *Perpetuities in Perspective: Ending the Rule's Reign of Terror*, 65 Harv. L. Rev. 721 (1952). Other states kept the common law Rule but made refinements to alleviate the perceived problems. *See, e.g.*, EPTL §§ 9-1.1 to 9.1-3. *See generally* Ira Mark Bloom, *Perpetuities Refinement: There Is an Alternative*, 62 Wash. L. Rev. 23 (1986).

14. USRAP is contained in §§ 2-901 to 2-906 of the Uniform Probate Code.

15. *See* note 23 *infra* and accompanying text.

16. *See* Davis, note 8 *supra*.

17. Florida, which extended its wait-and-see period to 360 years in the Spring of 2000, did take into account the undesirable effects of infinite dead hand control. This significant Florida legislation is discussed in Part V of the article.

18. Since the GST exemption amount will be annually adjusted upward for inflation, annual additions of property to the trust in the amount of the increased GST exemption amount can facilitate additional avoidance of GST taxation.

19. You might recognize this formulation as having ingredients similar to the fee tail, which was effectively abolished in the 15th century.

20. *See* I-Juliana Sackmann, et al., *Our Sun. III. Present and Future*, The Astrophysical J. 457 (Nov. 1993), also available at http://adsbit.harvard.edu/cgi-bin/nph-iarticle_query?1993ApJ . . . 418..457S (visited Mar. 28, 2000).

21. *See* The Restatement (Second) of Trusts § 335 (1959).

22. As examples, Alaska and New Jersey already have repealed USRAP prospectively. *See* Alaska Stat. Ann. § 34.27.070 and N.J. Rev. Stat. § 46:2F-11(a)(1).

In the Spring of 2000, Florida amended its USRAP law to provide a 360-year wait-and-see period instead of the standard 90-year period under USRAP. Fla. Sta. Ann § 689.225(2)(f). In the scheme of things, 360 years is a lot less than the some one billion years that a trust could endure under states that sanction perpetual trusts. *See* note 20 and accompanying text. Still the year 2360—360 years from now—and later years in the 24th century and beyond are beyond human comprehension. Indeed only the precocious toddlers reading this article can possibly expect to survive until the 22nd century.

23. The press release is set forth in http://www.nccusl.org/pressrel/usrap799.htm (visited March 28, 2000).

24. *See id.*

25. Professor Waggoner suggested to me that a way to think about distant future time was to think about time in the distant past. Think about how different our society was only 50 years ago, 100 years ago, during the middle ages, at the death of Mohammed, Christ, Moses. . . .

26. The discretionary trust powers could be without standards or with standards, for example, distributions necessary for the health, education, maintenance and support of trust beneficiaries. Other types of escape hatches could give trust beneficiaries considerable control over their destinies. For example, a concerned transferor might wish to give trust beneficiaries control over trust termination by way of ceding them special powers of appointment. The trust creator's dead hand control would also be minimized if the empowerment of trust beneficiaries were empowered to remove and replace the corporate trustee.

27. *See* The Restatement (Third) of Trusts § 50 (Tentative Draft No. 2, 1999). Powers subject to an ascertainable standard would be subject to greater court supervision, but courts will still be reluctant to interfere with corporate trustee's decisions, including the decision not to be made trust distributions. *See id.*

28. Although federal income taxation may be unavoidable, it may be minimized under the prudent investor standard whereby the trustee can invest for total return so that the vast bulk of income will be in form of capital gains. State fiduciary income taxation may be totally avoided in states such as Alaska and South Dakota.

29. The *New York Times* recently listed individual stocks that had meteoric rises during the 1990s. *See* Kenneth N. Gilpin, *10 Stocks for 2010: Buy-and-Hold Picks From Top Investors*, N.Y. Times, Feb. 20, 2000, at BU1. For example, Microsoft had a total return of 9,562 percent, but that pales in comparison with Cisco Systems, which had a rise of 69,000 percent during the 1990s! *See id.* at BU5.

30. *See* Ira Mark Bloom, *Transfer Tax Avoidance: The Impact of Perpetuities Restrictions Before and After Generation-Skipping Taxation*, 45 Alb. L. Rev. 260, 301 n.219 (1981).

31. Professors Simes and Leach thought that the problem of wealth concentration should be handled by taxation, not by a rule against perpetuities. *See* Lewis M. Simes, *Public Policy and the Dead Hand* 56-57 (1955). Assuming one agrees with this viewpoint, I doubt that they contemplated the $1 million+ exemption from transfer taxation. For reasons unpersuasive to me, Simes also did not take seriously the impact of inherited wealth for society. *See id.* at 57-58. However, consider the cogent observation of the late Professor Richard Powell: "That which the wealthy can do with their wealth shapes the lives of even our most unwealthy citizens." Richard R. Powell, *The Law of Future Interests in California* 3 (1980).

32. *See* notes 3-10 *supra* and accompanying text.

33. In 1997 Treasury made an abortive effort to limit the effectiveness of the GST exemption. *See* Mitchell M. Gans, *Federal Transfer Taxation and the Role of State Law: Does the Marital Deduction Strike the Proper Balance?*, 48 Emory L. J. 871, 878-79 (1999) (discussing promulgation and deletion of regulation).

34. On June 9, 2000, the House voted to repeal the estate, gift and GST-tax systems, effective on January 1, 2010. *See* H.R. 8, Death Tax Elimination Act of 2000, § 1.

35. The Restatement (Second) of Trusts provides that a trust will be terminated if the trust purposes become impossible to accomplish. *See The Restatement (Second) of Trusts* § 335 (1959).

36. U.S. Department of Commerce, *Statistical Abstract of the United States* 532 (119th ed. 1999).

37. *See* William L. Carey and Melvin Aron Eisenberg, Cases and Materials on Corporations 245 (1995). *See generally* Library of Congress, Congressional Research Service, The Exercise of Voting Rights by Large Institutional Investors: A Survey (1977).

38. New York's Rule Against Perpetuities has both an undue suspension of the power of alienation and a remote vesting component. EPTL § 9-1.1 Some refinement of New York's rule might be in order. *See* Ira Mark Bloom, *Perpetuities Refinement: There Is an Alternative*, 62 Wash. L. Rev. 23 (1986).

39. Professor Jeffery G. Sherman, Professor of Law at Chicago-Kent College of Law, coined this term for me in a recent e-mail.

40. This is effectively the legislation that was introduced in 1999. *See* S.B. 5957, 222nd Leg. (1999).

41. Fla. Stat. Ann. § 689.225(2)(f).

42. Fla. Sta. Ann. 737.4031, entitled "Judicial Modification of Trusts," provides in part as follows:

    (1) If the purposes of a trust have been fulfilled or have become illegal or impossible to fulfill or, if because of circumstances not known to or anticipated by the settlor, compliance with the terms of the trust would defeat or substantially impair the accomplishment of a material purpose of the trust or, if a material purpose of the trust no longer exists, upon the application of a trustee of the trust or any beneficiary a court at any time may modify the terms of a trust which is not then revocable to:

    (a) Amend or change the terms of the trust, including terms governing distribution of the trust income or principal, or terms governing administration of the trust;

    (b) Terminate the trust in whole or in part;

    (c) Direct or permit the trustee to do acts that are not authorized or that are prohibited by the terms of the trust; or

    (d) Prohibit the trustee from performing acts that are permitted or required by the terms of the trust.

    (2) Upon the application of a trustee of the trust or any beneficiary, a trust which is not then revocable may be modified at any time by a court as provided in subsection (1), and without regard to the reasons for modification provided in subsection (1), if compliance with the terms of the trust is not in the best interest of the persons having a beneficial interest in the trust.

    (a) The court shall exercise its discretion to order a modification of the trust under this subsection in a manner that conforms to the extent possible with the intention of the settlor, taking into account the current circumstances and best interests of the beneficiaries. . . .

    (3) In exercising its discretion to order a modification of a trust under this section, the court shall consider the terms and purposes of the trust, the facts and circumstances surrounding the creation of the trust, and extrinsic evidence relevant to the proposed modification.

    (4) To the extent the interests of any person with a beneficial interest in the trust who is unborn or unascertained, whose identity is not then known for any reason, or who is a minor or under a legal disability are not represented by another beneficiary, such person shall be represented by the person's legal guardian, if any, or, if none, by a guardian ad litem appointed by the court upon the court's own motion or upon application by the trustee or any beneficiary.

    (5) The court shall consider spendthrift provisions as a factor in making a decision whether to modify a trust under this section, but the court is not precluded from exercising authority to modify the trust because the trust contains spendthrift provisions.

    (6) For purposes of this section:

    (a) "Beneficiary" means:

    1. All current income or principal beneficiaries, whether the beneficiaries' beneficial interests are discretionary or mandatory.

    2. All reasonably ascertainable beneficiaries if all current income interests immediately terminated, determined as if any power of appointment over the trust assets were not exercised. . . .

43. Fla. Stat. Ann. § 737.4032, entitled "Nonjudicial Modification of Trusts," provides in part as follows:

    (1) A trust which is not revocable may be modified at any time after the settlor's death, upon the unanimous agreement of the trustee and all beneficiaries of the trust, to:

    (a) Amend or change the terms of the trust, including terms governing distribution of the trust income or principal or terms governing administration of the trust;

    (b) Terminate the trust in whole or in part;

    (c) Direct or permit the trustee to do acts that are not authorized or that are prohibited by the terms of the trust; or

(d) prohibit the trustee from performing acts that are permitted or required by the terms of the trust.

(2) This section shall not apply to any trust for which a charitable deduction is allowed or allowable under the Internal Revenue Code until the termination of all charitable interests in the trust.

(3) An agreement to modify a trust under this section shall be binding upon a person with a beneficial interest in the trust who is unborn or unascertained, whose identity is not then known for any reason, or who is a minor or under a legal disability, to the extent that his or her interest is represented by another beneficiary having the same or greater quality of beneficial interest in the trust, but only to the extent there is no conflict of interest between such person and such beneficiary or among the persons represented.

(4) To the extent the interests of any person having a beneficial interest in a trust who is unborn or unascertained, whose identity is not then known for any reason, or who is a minor or under a legal disability are not represented by a beneficiary under subsection (3), such person shall be represented by the person's legal guardian if there is one or, if the person does not have a legal guardian, such person shall be represented by a guardian ad litem appointed by the court upon application by the trustee or any beneficiary. Unless the court requires otherwise, the guardian ad litem's decision whether to consent to modify the trust shall be binding upon any person represented by the guardian ad litem without seeking court approval.

* * *

(7) Modification of a trust as authorized in this section is not prohibited by a spendthrift clause, or by a provision in the trust instrument that prohibits amendment or revocation of the trust.

(8) For purposes of this section:

(a) "Beneficiary" means:

1. All current income or principal beneficiaries, whether the beneficiaries' beneficial interests are discretionary or mandatory.

2. All reasonably ascertainable beneficiaries if all current income interests immediately terminated, determined as if any power of appointment over the trust assets were not exercised. . . .

44. New York would still not be fully competitive with other states since trusts created by New York residents with New York trustees would be subject to New York fiduciary income tax. *See* N.Y. Tax Law § 605(b)(3)(c). Thus, New York residents would still have an incentive to create perpetual trusts in states such as Alaska, Delaware and South Dakota where no fiduciary income tax would be imposed.

45. *See* notes 42-43 *supra* and accompanying text.

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Recent Changes in Rules and Procedures in New York and Florida Regarding Estate Taxes

By Michael M. Mariani

New York

For estates of individuals dying on or after February 1, 2000, the New York estate tax has been replaced with a "SOP" tax, or "pickup" tax, equal to the maximum allowable federal credit for state death taxes. Other changes have been made to many practices and procedures concerning these estates for New York estate tax purposes. The following summarizes some of these new procedures:

Estate Tax Waivers Eliminated: Estates of individuals dying on or after February 1, 2000 will no longer be required to secure estate tax waivers in order to transfer a decedent's assets held by banks, trust companies, brokerage houses, insurance companies and other institutions. The waiver provisions of Tax Law § 975(e) have been repealed and Tax Law § 975(f) has been re-lettered § 975(e). These institutions and other individuals in possession of assets belonging to, or standing in the name of, a decedent, or in the joint names of a decedent and one or more persons, may deliver those assets to the fiduciary, joint tenant or named beneficiary without receiving a tax waiver or notifying the State Tax Department.

Release of Safe Deposit Box: Estates of individuals dying on or after February 1, 2000 are no longer required to secure a release for a safe deposit box from the State Tax Department. However, a bank or trust company may still require a short form certificate of letters of appointment from an executor or administrator, or a court order, before allowing entry into, or release of, the safe deposit box.

Release of Lien of Estate Tax: A Release of Lien of Estate Tax (Real Property) (Form ET-117), for the transfer of a decedent's interest in real property, is still required. However, no fee is charged to secure the release of the estate tax lien.

Filing Thresholds: The requirement to file a New York State estate tax return is essentially the same as the requirement to file a federal estate tax return. Tax Law § 971(a). For estates of individuals dying on or after 2/1/2000, if no federal estate tax return is required, no New York estate tax return is required. The filing thresholds are as follows:

Year	Amount
Feb. 1, 2000 – Dec. 31, 2001	$675,000
2002 and 2003	700,000
2004	850,000
2005	950,000
2006 and after	1,000,000

Tax Payable: The amount of the New York State estate tax is limited to the maximum amount allowable against the federal estate tax as a credit for state death taxes. It is determined by computing the federal credit for state death taxes on the federal adjusted taxable estate. Tax Law § 952.

Payment of Estate Tax: The due date for the payment of the New York State estate tax is nine months after the date of death. Interest on underpayments is computed from that date. Tax Law § 974. (Estates are no longer required to make an estimated payment of 90% of the estate tax due within seven months after death to avoid imposition of interest charges.)

Time and Place for Filing Returns (Form ET-706): The New York State Estate Tax Return (Form ET-706), is due nine months after the decedent's death. Tax Law § 972(a). The requirement to file a duplicate copy of the estate tax return simultaneously with the Surrogate's Court and to pay a filing fee has been repealed. Each Surrogate's Court may require a duplicate copy of the return to be filed with the court. Tax Law § 972(c).

Florida

Intangible Tax: Effective for tax years beginning after December 31, 2000, the Florida Intangible Tax will be $1.00 per $1,000 of intangible asset value. This is a reduction of one-third from the present rate of $1.50. In addition, trusts for the benefit of non-Florida residents will be exempt from tax. (Currently, the intangible tax is imposed if a Florida resident or a Florida bank or trust company is the trustee, regardless of the beneficiary's residence). Note, however the new exemption does not extend to a Florida resident who has a beneficial interest in certain trusts. For example, a Florida resident who establishes a revocable trust will still be taxable on his or her individual return on the value of the trust assets.

Rule Against Perpetuities: Florida has extended the length of time for which assets may be held in trust to 360 years. This change only applies to trusts created after December 31, 2000. (New York is considering changes to its Rule Against Perpetuities.)

Nonjudicial Modification of Trusts: For trusts created after December 31, 2000, the trustees and all of the beneficiaries of a trust may, by unanimous action, amend the terms of the trust or terminate the trust. A trust for which a charitable deduction is allowable cannot be modified until the termination of all charitable interests in the trust.

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The *In Terrorem* Clause in New York After *Ellis*

By Stephen Hochhauser

I. Introduction

On December 31, 1998, the Appellate Division, Second Department, in *In re Ellis*,[1] unanimously enforced an *in terrorem* clause against a testator's two sons. The decision provided a measure of comfort to the Surrogates' Courts with respect to the willingness of an appellate court to sustain them when they enforce such clauses notwithstanding the severity of the resulting forfeiture. The decision also raised but did not decide numerous issues that are likely to come up in cases involving the construction of *in terrorem* clauses. It is therefore a worthy subject for the attention of practitioners in this area.

II. The Facts in *Ellis*

Mrs. Ellis' will provided for her real property and personal effects to go to her daughter, who was also the nominated executor. The residue went one-half to the daughter and one-quarter to each of her two sons. She told her attorney-draftsman that she was worried about one or both of her sons "making trouble," and that she wanted to dissuade them by offering them a share of her residue if they accepted it quietly without creating any problems for her daughter. The draftsman recommended and put into the will an *in terrorem* clause that provided for a forfeiture and gift over if any beneficiary "in any manner, directly or indirectly, contested [the] will or any of its provisions."

After Mrs. Ellis died, but before the will was offered for probate, the sons' attorney sent a letter to the daughter and her husband demanding the production of various documents. Shortly after the will was offered for probate, the sons served an answer to the probate petition in which they objected to the appointment of their sister as executor. They then served a lengthy verified bill of particulars with respect to the answer in which they made allegations of fraud and undue influence by their sister, and other allegations that their mother was not competent when she executed her will. They then moved to compel the posting of bond by their sister, who had previously been granted preliminary letters without a bond in accordance with the waiver of bond provision in the will. The Westchester Surrogate's general practice was to require preliminary executors to post a bond in all contested probate proceedings, and the sons' motion was granted. They later served objections to the will and incorporated by reference their earlier bill of particulars. The sons also served subpoenas upon non-party witnesses, including the hospital where Mrs. Ellis died, her prior attorney, and several banks and brokerage houses where she had accounts. They also served a subpoena to procure the brokerage records from accounts in the names of their sister and her husband.

The proponent conducted depositions of both brothers and of Mrs. Ellis' prior attorney as well as one of her close personal friends. The brothers conducted depositions of the draftsman, the witnesses to the will and their sister, and noticed but then did not conduct the deposition of her husband. After the sons' depositions were conducted, they amended their bill of particulars to allege their contentions "on information and belief." Discovery, including motions relating thereto, lasted over two years. During that period, one of the two sons commenced a proceeding in the Surrogate's Court and an action in Sullivan County Supreme Court, in which his submissions contained allegations that the will was procured by fraud and undue influence. Both proceedings were dismissed by those courts.

Just before the case was ready to be placed on the trial calendar, the parties were advised by the Surrogate's staff that the objections had never been filed by the objectants' original attorneys. The objectants then notified the Surrogate that they were not going to proceed with their objections.

After the will was admitted to probate the executor commenced a construction proceeding to enforce the *in terrorem* clause. The objectants argued that since they had not gone to trial with respect to their objections, they had not "contested" the will under the holding in an old Second Department decision, *In re Cronin*.[2] That case had construed the word, "contest," to be synonymous with "going to trial," and had refused to enforce an *in terrorem* clause where the objectant withdrew his objections before trial. The *in terrorem* clause in *Cronin* simply prohibited a "contest" of the will, but did not utilize the words, "in any manner, directly or indirectly." They also claimed that their answer challenging the fitness of the executor was a protected act immune from the reach of an *in terrorem* clause.

Both sides moved for summary judgment and the matter was referred to a Westchester County Court Judge, sitting as acting Surrogate. He determined that the holding in *Cronin* was controlling, and dismissed the executor's petition. The Appellate Division reversed, and directed that the executor's motion for summary judgment should have been granted, holding that in light of the broad language of the *in terrorem* clause, the surrounding circumstances and the sons actions in the aggregate, including letters to their mother in which they threatened to challenge her will if she did not treat them equally with their sister, the *in terrorem* clause had been violated. The Court of Appeals refused to grant the sons' motion for leave to appeal.[3]

The Appellate Division's opinion distinguished, but did not reject *Cronin,* noting that *Cronin*'s will did not contain the language, "in any manner," utilized in Mrs. Ellis' will. The Appellate Division also quoted extensively from the legislative history of EPTL 3-3.5 and SCPA 1404, and discussed the role that the objectant's discovery and their attack on the fitness of the nominated fiduciary played in the ultimate outcome. The Court also relied on the attorney-draftsman's affidavit as to the testator's intent as well as documentary evidence concerning the family history. Those matters make the *Ellis* decision one that should be closely studied by practitioners.

III. EPTL 3-3.5 and SCPA 1404

The first New York Legislation that expressly validated the enforcement of *in terrorem* clauses was § 3-3.5(b) of the Estates, Powers and Trust Law (EPTL), enacted in 1966 (L. 1966, ch. 952).[4] It approved the use and enforcement of *in terrorem* clauses, "despite the presence or absence of probable cause for a contest," thus rejecting the "probable cause" rule approved in § 9.1 of the Restatement (Second) of Property,[5] which was adopted in the Uniform Probate Code, § 2-517. New York is in the minority in its approach to the enforcement of *in terrorem* clauses.[6]

The New York statute included the three exemptions that were contained in a predecessor statute,[7] and expanded the list of exempt or protected conduct to include the assertion of a claim that the will is a forgery or was revoked by a later will, provided the claim was "based on probable cause;"[8] the assertion of an objection to the jurisdiction of the Court;[9] the preliminary examination of the proponent's witnesses under SCPA 1404;[10] and the institution of, joinder in or acquiescence in a construction proceeding.[11]

The Legislature has revisited the statute several times to amend its provisions without moving in the direction of the probable cause rule, which remains the majority position. The first amendment occurred in 1992, (L. 1992, ch. 127), when the scope of the protected preliminary examination under SCPA 1404(4) and EPTL 3-3.5(b)(3)(D) was expanded to include the examination of the draftsman. In 1993, (L. 1993, Ch. 514), SCPA 1404(4) and EPTL 3-3.5(b)(3)(D) were further amended to permit the preliminary examination of the nominated executors and the proponent, but SCPA 1404(4) limited those examination to cases involving a will that had an *in terrorem* clause. In 1996 (L. 1996, ch. 576), the Legislature clarified that the broadened preliminary examination could also be held where *in terrorem* clauses were directed against distributees as well as beneficiaries. The most recent amendment (L.1999, ch. 460), provided that the stenographic costs of the 1404 examination of the draftsman, the proponent and the nominated executor were payable by the respondent.

On each of those occasions the Legislature refused to adopt the "probable cause" rule applicable in the majority of the other states, and chose to expand and refine the scope of pre-objection discovery under SCPA 1404(4). Thus, New York is now firmly entrenched in the minority camp, enforcing *in terrorem* clauses regardless of whether there was any probable cause for the contest.

The asserted rationale for New York's adherence to the minority position was that *in terrorem* clauses served "the valid purpose of preventing needless litigation over the probate of a Will."[12] Professor Rohan explained that New York's refusal to adopt the "probable cause" exception was based on the desire "to discourage the all-too-common vexatious and unfounded estate litigation, with its attendant family discord and dissipation of estate assets."[13] To balance the need to discourage unfounded will contests, the Legislation provided sufficient preliminary discovery to allow beneficiaries to determine whether or not the facts warranted their taking the risk of forfeiture.[14]

In its decision in *In re Ellis, supra*, the Second Department quoted extensively from the legislative history and explained that:

> The intent of the Legislature was to preserve "the primacy of the testator's intention with respect to the disposition of his estate", that is, the testator's absolute right to disinherit a party (except a spouse) and, therefore, to make a bequest conditional upon compliance with, among other things, an in terrorem clause, while still permitting certain limited inquiries concerning the validity and authenticity of a will consistent with public policy considerations (see, Revisers' Notes § 3-3.4 appendix to L. 1966, ch. 952, 1966 Session Laws of N.Y., at 2899-2900).[15]

The preliminary discovery allowed under SCPA 1404(4) refers to specific categories of witnesses who can be examined before objections are filed. Under the predecessor statute, SCA 141, the preliminary examination covered "all" of the proponent's witnesses, but only with respect to the issues on which the proponent had the burden of proof (due execution and testamentary capacity). EPTL 3-3.5, unlike SCPA 1404, (but like SCA 141), does not identify any specific categories of witnesses, but refers to "a proponent's witnesses," who may be safely subjected to "preliminary examination, under SCPA 1404." Thus, it had been suggested that EPTL 3-3.5 was intended to permit a preliminary examination of all of the witness the proponent would (could possibly?) call.[16] The amendments, which enlarged the categories of protected preliminary examination in cases involving *in terrorem* clauses to include the proponent and the nominated executor, suggest that the Legislature did not construe EPTL 3-3.5 to include all of the proponent's possible witnesses.[17]

IV. Construction of *In Terrorem* Clauses in New York

A. Pre-Probate Construction

The general rule in this state is that a will cannot be construed prior to its admission to probate.[18] That rule has been applied to prevent parties from seeking what amounts to an advisory opinion where they contemplate taking action but are unclear of whether they will trigger the *in terrorem* clause.[19] However, courts have given advisory opinions where special and unique circumstances existed.[20] Nevertheless, absent those peculiar situations, a potential objectant should not expect to secure an advisory opinion regarding the prospective impact of an *in terrorem* clause on his proposed course of conduct.[21]

B. The Doctrine of Strict Construction

Virtually every case dealing with an *in terrorem* clause in New York, including *Ellis,* contains the statement that *in terrorem* clauses are "not favored" in New York because they result in a forfeiture, and are therefore "strictly construed."[22] However, in New York, as elsewhere, the primary function of a court in a will construction proceeding is to ascertain and carry out the intent of the testator.[23] The doctrine of strict construction is, therefore, subordinate to the intent of the testator.[24]

Moreover, since the State Legislature clearly appears to "favor" the use of *in terrorem* clauses to discourage unfounded litigation, it is time for the courts to recognize that *in terrorem* clauses serve a very useful purpose and adjust their rhetoric accordingly.

While the doctrine of strict construction prohibits the imposition of forfeiture for actions that are beyond those specified under the will, the decision in *In re Ellis, supra*, clearly showed that where the surrounding circumstances revealed that the testator anticipated and intended to cover any kind of opposition to probate that the beneficiaries mounted which hindered and delayed probate, i.e., "made trouble," a broadly worded *in terrorem* clause would be enforced even though it did not explicitly refer to the precise offending acts. Prior New York cases were to the same effect.[25]

The doctrine of strict construction also does not require that a court construing an *in terrorem* clause limit its inquiry to the four corners of the will. While extrinsic evidence is not permitted to alter or change the clear and unambiguous words of a will, evidence of the surrounding circumstances "may be admitted for the purpose of aiding a court in ascertaining the real intent of a testator or testatrix when intent cannot be ascertained from the language of the will itself."[26] Because courts are, understandably, reluctant to impose forfeitures, in all but the clearest of cases it will probably be necessary to look at the surrounding circumstances to ascertain the testator's intent when construing an *in terrorem* clause.[27]

In construing the language used in an *in terrorem* clause, courts must consider the fact that it involves technical words of art drafted by an attorney to carry out the testator's intent as expressed by the testator in layman's language.[28] In *In re Ellis, supra*, the Second Department considered the totality of the objectants' conduct and the surrounding circumstances from which it determined that the objectants' behavior was what the testator foresaw and intended it to result in forfeiture.[29]

The Court of Appeals has observed that "no will has a twin brother."[30] Thus, it is difficult to construe an *in terrorem* clause simply by looking at the way some other court construed similar language, without also examining the peculiar facts and circumstances that existed when each will was executed.

C. Construing the Word "Contest"

The Second Department in *Ellis,* neither reaffirmed nor overruled its prior definition in *Cronin*, that "contest" meant "going to trial," stating that it was not necessary to pass on that definition because Mrs. Ellis' will contained modifying language that distinguished it from *Cronin*.[31]

The *Cronin* case was decided in 1932, prior to the enactment of EPTL 3-3.5, which utilizes the word "contest" in ways that are clearly inconsistent with the "going to trial" definition. EPTL 3-3.5(b) states that a condition in a will that prevents a bequest from taking effect if the will is "*contested* by the beneficiary," is valid and enforceable whether or not there is probable cause for "*such contest*." It then lists the exemptions, most of which involve pre-trial activity: (b)(3)(A)—asserting an objection to the court's jurisdiction; (b)(3)(B)—"disclosure" of information to a party to the probate proceeding; (b)(3)(C)—"refusal" to join in or consent to the probate petition; and, especially, (b)(3)(D)—conduct of preliminary examinations under SCPA 1404. The Uniform Rules for Surrogate's Court also employ the word, "contest" in connection with pre-trial proceedings.[32]

If the Legislature intended for the word "contest," as used in EPTL 3-3.5 (b), to mean "a trial on the merits," then all of the statutory exceptions to the operation of an *in terrorem* clause which involve pre-trial activity would be meaningless. The long-standing rule is that courts should avoid a construction that renders statutory language superfluous.[33]

In *In re Ku*[34] decided one month before the Second Department's decision in *Ellis*, the Westchester Surrogate, citing *Cronin* as the controlling authority, held that where objections were dismissed on motion for summary judgment, the *in terrorem* clause ("contest, obstruct or otherwise resist . . . probate"), was not violated. Query, whether *Ku* would have been decided the same way if the Surrogate knew what the Second Department would say in the *Ellis* decision. While *Ellis* did not discuss what would have happened if the objections had been dismissed on motion for summary judgment rather than by voluntary withdrawal, the opinion would seem to indicate that the outcome would not have been different.

Nonetheless, until the Second Department or the Court of Appeals overturns the definition of "contest" in *In re Cronin*, practitioners in the Second Department who wish to avoid its application would be well advised to draft their *in terrorem* clauses to include the words, "in any manner, directly, or indirectly contest.the will or any of its provisions," and thus invoke the distinction that was drawn by the Second Department in *Ellis*.

V. Challenge to the Fitness of a Nominated Fiduciary

There is no controlling authority in New York on the issue of whether an *in terrorem* clause can validly proscribe challenges to the fitness of a nominated fiduciary. Such an attack is not among the protected conduct enumerated in EPTL 3-3.5(b) that cannot result in a forfeiture under an *in terrorem* clause. While objections to probate often include claims that the nominated executor is unfit, the trial of such claims, and related discovery, is normally postponed until after the will is admitted to probate. In *In re Lachman, supra,*[35] Surrogate Midonick held that the issue of qualification of the nominated fiduciary, and discovery pertaining to same, would be deferred until the will was admitted to probate, and he did not reach the issue of whether objections to the appointment of the nominated fiduciary would violate the *in terrorem* clause.

In *Ellis,* the Second Department held that an *in terrorem* clause may be violated by a pre-probate challenge to the fitness of a nominated fiduciary where it was utilized to make a plenary attack upon the validity of the will itself.[36] In *Ellis*, the answer purported only to challenge the fitness of the nominated fiduciary, but in support of their answer, the objectants served a verified bill of particulars which alleged, *inter alia*, that the testator lacked testamentary capacity at the time she executed the propounded will, and that the propounded will was procured by undue influence and fraud perpetrated by the nominated fiduciary.

The Second Department rejected the argument that the answer was merely a "legitimate inquir[y]" under SCPA 707, which could not, as a matter of public policy, violate the *in terrorem* clause. The court reasoned that the bill of particulars served in support of the answer indicated that the answer was actually being utilized to attack the validity of the will itself,[37] and stressed that the aggregate of the various direct and indirect tactical moves by the respondents, which delayed probate for more than two years, challenged the testator's testamentary plan and harassed the proponent, were all anticipated by the testator and formed the reason for her adoption of an *in terrorem* clause.[38]

The Restatement (Second) of Property, § 9, Comment C, states that a prohibition against a challenge to the appointment of the fiduciary should be enforced unless the objecting beneficiary had probable cause for making the challenge. However, neither of the applicable New York provisions, SCPA 707 and SCPA 709, refer to probable cause, and there are no New York decisions squarely on point.

An appellate court in the State of Washington held that a bad faith effort to remove a designated fiduciary *could* trigger a forfeiture under an *in terrorem* clause.[39] The court reasoned that while application of an *in terrorem* clause against a good faith challenge "might very well" violate public policy, there is "no public policy against forfeiture where an heir makes a bad faith challenge to some provision in a will."

The *in terrorem* clause in *Ellis* prohibited a contest of "any" of the will's provisions, which would seem to include the provision appointing the executor. Although the issue was raised, the Second Department's opinion did not need to address it because its opinion treated the objectants' attack on the qualifications of the fiduciary as one part of a "single concerted effort," involving other direct and indirect attacks on the will which were found to violate the *in terrorem* clause.[40]

Thus, it remains an open question in New York as to whether or to what extent a bad faith challenge to the testator's nominated fiduciary, or one asserted without probable cause, could result in a forfeiture under appropriate circumstances with an appropriately worded *in terrorem* clause. (See "VIII" below).

VI. Document Production Under SCPA 1404(4)

SCPA 1404(4) describes the categories of witnesses who can be examined prior to objecting, but it does not define the scope of document discovery that is permissible within the confines of EPTL 3-3.5. Pre-objection production under SCPA 1404 of prior wills and the decedent's instructions to the draftsman was directed by Surrogate Radigan,[41] and Surrogate Emanuelli[42] directed production of medical records, both relying on the policy of the statute that provided for broadened pre-objection discovery to give potential objectants an opportunity to determine whether there was any merit to their prospective objections prior to the deadline for filing objections.[43]

In *In re Ellis, supra*, the objectants went beyond the enumerated witnesses, and subpoenaed banks and brokerage houses seeking the proponent's husband's financial records. While the Second Department did note that discovery went beyond the limits of SCPA 1404(4), those efforts were not singled out by the opinion, which treated all of the actions by the objectants as mere parts of a single concerted attack on the validity of the will. However the opinion did make an interesting observation with respect to discovery under SCPA 1404(4), which states that parties may conduct the examinations "before or after filing objections to the probate of the will." Justice Ritter discussed the fact that some of the post objection discovery that was conducted pursuant to Article 31 of the CPLR, could have been taken under SCPA 1404(4) prior to objecting to the will. The Court noted that that fact would not save the objectants from the enforcement of the *in terrorem clause*.[44] How far a respondent can go in his pre-objection subpoenas of documents from non-enumerated witnesses for use in a 1404 examination of an enumerated witness, remains to be seen.

VII. Objections to Fiduciary Conduct

EPTL 11-1.7(a) provides that a will or trust provision that attempts to exonerate a fiduciary "from liability for failure to exercise reasonable care, diligence and prudence, is void as contrary to public policy," and EPTL 11-1.7(c) provides that a challenge to the purported grant of such exoneration to a fiduciary cannot result in a forfeiture under an *in terrorem* clause. Broadly drafted *in terrorem* clauses which purport to proscribe post-probate challenges to the conduct of the fiduciaries have repeatedly been struck down by courts.[45]

In *In re Shapiro*,[46] the court refused to enforce an *in terrorem* clause that purported to prohibit beneficiaries from objecting to the accounting of the testator as trustee of an *inter vivos* trust created by the testator in favor of that beneficiary. The court reasoned that such conduct was not proscribed by the language of the subject *in terrorem* clause.[47]

All of the decided cases involved broadly drafted *in terrorem* clauses whose scope included both good faith and bad faith conduct as well as objections asserted with or without probable cause. Neither the statute nor the cases decided under it deal with an *in terrorem* clause triggered only by a bad faith challenge to fiduciary conduct or one that is asserted without probable cause. That subject is treated in "VIII" below.

VIII. Bad Faith

The issue of bad faith and lack of probable cause have not been the subject of much comment in the post-1966 cases because New York is in the minority camp in enforcing *in terrorem* clauses regardless of whether the objectants have probable cause for their objections. The statute does not use the term, "bad faith." While one can have probable cause and still proceed in bad faith, that is, for some ulterior purpose having no relation to the merits of the case, the terms are normally used to cover the same set of circumstances, where a disgruntled heir vents his frustration by seeking to make trouble for its own sake or to exact a compromise or settlement.

The 1914 decision by the Fourth Department, *In re Kirkholder, supra,* codified in EPTL 3-3.5 (b)(1), made a distinction between objections asserted in good faith and those same objections asserted in bad faith.[48] That section is the only one where good faith is relevant. The State of Washington decision, *Estate of Kubick, supra*, made the same distinction, finding that public policy could not be invoked to defend actions taken in bad faith. The Second Department's opinion in *In re Ellis, supra*, discussed the issue of bad faith in connection with the objectants' claim that their discovery was primarily within the bounds of SCPA 1404. The opinion noted that the objectants' discovery lasted two years and was not limited to the preliminary examination allowed by SCPA 1404,[49] but it expressly stopped short of adopting a good faith discovery rule.[50] The opinion, however, clearly showed that the court had misgivings about the contestants' *bona fides*.[51]

It is doubtful that the Second Department would tolerate abusive and prolonged pre-objection examination under SCPA 1404(4), and costly and extended document production requests made in bad faith or without probable cause. However, unless or until an appropriate case is decided, the proponent's only current remedy is to apply to the Surrogate for a protective order,[52] or to seek sanctions where the parties' actions are found to constitute "frivolous conduct."[53] However, neither protective orders nor sanctions serve to carry out the full intent of a testator's *in terrorem* clause.

As for objections to fiduciary conduct, or to the appointment of the testator's nominated fiduciaries, the application of an appropriately worded *in terrorem* clause[54] to objections asserted in bad faith or without probable cause would be perfectly consistent with the legislative policy of EPTL 3-3.5 to discourage unnecessary litigation. New York enforces *in terrorem* clauses regardless of whether the contestants act in good faith, and exempts certain conduct from the reach of such clauses. If the general reasoning of the opinions in *Kubick, supra*, and *Kirkholder, supra*, were applied to all of the activities exempted from the reach of an *in terrorem* clause by EPTL 3-5(b), EPTL 11-7.1 and SCPA 1404(4), then such actions, if found to have been undertaken in bad faith or without probable cause, would lose their protection and result in forfeiture. As the court noted in *Kubick*, there are no public policy arguments that can be raised to protect bad faith. It remains to be seen whether the Courts will adopt such a rule.

Endnotes

1. 252 A.D.2d 118, 683 N.Y.S.2d 113 (Ritter, J.P).
2. 143 Misc. 559, 257 N.Y.S. 496 (Surr. Ct., West. Co. 1932), *aff'd*, 237 A.D. 856, 261 N.Y.S. 936 (2d Dep't 1932).
3. 93 N.Y.2d 805, 689 N.Y.S.2d 429 (1999).
4. The prior statute, § 126 of the Decedent Estate Law (DEL) was enacted in 1946, and exempted certain acts from the reach of an *in terrorem* clause, thus *impliedly* sanctioning forfeitures resulting from violations of conditions that were not protected under the statute. The three protected acts under DEL § 126 were: will contests commenced on behalf of infants; disclosures by legatees of information to a contestant that might help him oppose the will; and the refusal by a legatee to join in the probate petition.
5. *See* Restatement (Second) of Property § 9.1 note 3, ("Most of the jurisdictions have explicitly adopted a probable cause rule, effective regardless of the grounds for the contest"). The Restatement embraces the majority position. *Id.* cmts. a and j.
6. The principal states that, like New York, adhere to the minority position are California, *Estate of Miller*, 156 Cal. 119, 103 P. 842 (1909); *Estate of Fuller*, 143 Cal. App. 2d., 300 P.2d 342 (2d Dist. 1956); Alabama, *Donegan v. Wade*, 70 Ala. 501 (1881); Massachusetts, *Rudd v. Searles*, 262 Mass. 490, 160 N.E. 892 (1928); and Ohio, *Bender v. Bateman*, 36 Ohio App. 66, 168 N.E. 574 (1929); (*But compare Moskowitz v. Federman*, 72 Ohio App. 149, 51 N.E.2d 40 (1943) (containing *dictum* suggesting probable cause and good faith should be considered).
7. *See supra* note 4.
8. EPTL § 3-3.5(b)(1). This is the only provision in the statute that involves a probable cause test. It codified the Fourth Department's decision to that effect in *In re Kirkholder*, 171 A.D.153, 157 N.Y.S. 37 (1916), *aff'g* 86 Misc. 692, 149 N.Y.S. 87 (Surr. Ct., Erie Co. 1914).
9. *See* EPTL § 3-3.5(b)(3)(A).
10. *See id.* § 3-3.5(b)(3)(D).
11. *See id.* § 3-3.5(b)(3)(E).
12. *See* Second Report of the Legislative Advisory Committee of the EPTL-SCPA Draft Memorandum to Accompany Proposed Amendment to SCPA 1404, 1993 McKinney's Session Laws of N.Y. at 2363-2366. *See also* Harris, New York Estates: Probate, Administration and Litigation, 5th Ed., § 20.81. *In re Duke*, N.Y.L.J., November 28, 1994, p. 27, col. 3 (Surr. Ct. N.Y. Co.) (Preminger, J.).
13. Practice Commentary, Mckinneys Consolidated Laws of the State of N.Y., Book 17B (superseded), at 475.
14. *See* Margaret Valentine Turano & C. Raymond Radigan, New York Estate Administration § 3-5(b) (1999 Edition).
15. 252 A.D.2d at 130, 683 N.Y.S.2d at 120-121.
16. *See* Turano & Radigan, New York Estate Administration, (1986), Ch. 3, Sec. H, 4, at p. 94, fn. 37, citing *In re Lachman*, 100 Misc. 2d 21, 418 N.Y.S.2d 512 (Surr. Ct., N.Y. Co. 1979). The 1999 Edition of Turano & Radigan, § 3-5(b), at fn 171, indicates that the examination of "all of the proponent's witnesses," that was permitted under SCA 141 is no longer permitted since SCPA 1404(4) now enumerates those who can be examined prior to the filing of objections.
17. In practice, however, the only witnesses the proponent needed to call to present a *prima facia* case for probate were the attesting witnesses. *See Estate of Anna T. Lapugh*, N.Y.L.J., September 7, 1999, p. 34, col. 1 (Surr. Ct., Nassau Co.), where Surrogate Radigan held that absent an *in terrorem* clause, the respondents could not conduct an examination of the proponent. In *In re Ellis, supra*, 252 A.D.2d at 129, 683 N.Y.S.2d at 120, the Second Department noted that the notices of examination that were served by the objectants purported to be pursuant to Article 31 of the CPLR rather than SCPA 1404(4), and that even though they could have been examined within the scope of SCPA 1404's protection the fact that they examined under Article 31 after issue was joined was significant and "not an issue of form over substance."
18. *See In re Davis*, 182 N.Y. 468, 475 (1905) ("Probate logically precedes construction, for otherwise there is no will to construe").
19. *See In re Turco*, N.Y.L.J., December 21, 1987, p. 15, col. 6 (Surr. Ct., Nassau Co.), where Surrogate Radigan refused to construe an *in terrorem* clause prior to the will's admission to probate.

20. *See In re Grupp*, 160 Misc. 2d 407, 609 N.Y.S.2d 555 (Surr. Ct., Erie Co. 1994) (a charity secured a pre-objection determination that the *in terrorem* clause was not applicable because it disposed of the unsuccessful contestant's share as if he had "predeceased" the testator, and that could not possibly apply to a charitable corporation); *In re Cuneo*, N.Y.L.J., March 2, 1992, p. 36, col. 4 (Surr. Ct., West. Co.) (finding the clause inapplicable to a request for the decadent's medical records for use in the SCPA 1404 examination); *In re Zurkow,* 74 Misc. 2d 736, 345 N.Y.S.2d 436 (Surr. Ct., N.Y. Co. 1973) (while a construction must await probate, the participation of a beneficiary in the pre-probate hearing required to be conducted by the court pursuant to SCPA 1408 because the draftsman was a beneficiary [the so-called "Putnam hearing," *In re Putnam*, 257 N.Y. 140 (1931)], would not create any jeopardy under the *in terrorem* clause); *In re Rimland,* N.Y.L.J, February 28, 1992, p. 30, col. 4 (Surr. Ct., Suffolk Co.) (the Surrogate suggested that the examination of the attorney-draftsman would trigger the *in terrorem* clause).

21. *See In re Lachman*, 100 Misc. 2d 21, 418 N.Y.S.2d 512 (Surr. Ct., N.Y. Co. 1979), where Surrogate Midonick denied an application to take depositions prior to filing of objections in order to avert the impact of an *in terrorem* clause. See also, *In re Zaleski*, N.Y.L.J., October 27, 1999, p. 32 (Surr. Ct., Nassau Co.), where Surrogate Radigan expressed doubts as to the validity of an *in terrorem* clause, but refused to rule on it in advance, where the clause, if enforced, might have resulted in the forfeiture of the legacies to infant legatees because of the anticipated contest by their disgruntled father.

22. *In re Ellis, supra,* 252 A.D.2d at 127-128; 683 N.Y.S.2d at 119; *In re Cioffi*, N.Y.L.J., June 18, 1997, p. 33, cal. 6 (Surr. Ct., Westchester Co.); *In re Grupp, supra*; *In re Alexander*, 90 Misc. 2d 482, 486, 395 N.Y.S.2d 598 (Surr. Ct., N.Y. Co. 1977), *aff'd*, 63 A.D.2d 612, 405 N.Y.S.2d 613 (lst Dep't 1973), (an election against an excess charitable bequest made after the will was admitted to probate did not violate the *in terrorem* clause, strictly construed); *In re Ball*, 57 Misc. 2d 683, 293 N.Y.S.2d 561, (Surr. Ct., Kings Co. 1968), (strictly construing an *in terrorem* clause to be inapplicable to a beneficiary who claimed that a provision in the will violated the Rule against Perpetuities); *See also* 39 NYJUR 2d, "Decedent's Estates," § 967.

23. *See In re Fabbri*, 2 N.Y.2d 236, 239-240, 159 N.Y.S.2d 184, 187 (1957) ("All rules of interpretation are subordinated to the requirement that the actual purpose of the testator be sought and effectuated as far as is consonant with principles of law and public policy") *See also In re Cord,* 58 N.Y.2d 531, 544, 462 N.Y.S.2d 622, 624 (1983); *Fulton Trust Co. v. Phillips*, 218 N.Y. 573, 580 (1916); *In re Ellis, supra; In re Stiehler*, 133 Misc. 2d 253, 506 N.Y.S.2d 945 (Surr. Ct., Nassau Co. 1986).

24. *See In re Ellis, supra*, 252 A.D.2d at 127, 683 N.Y.S.2d at 119 ("The cardinal rule of construction of a will and, concomitantly, of an *in terrorem* clause, in to carry out the intent of the testator [citations omitted]; *In re Stiehler, supra*, 133 Misc. 2d at 255, 506 N.Y.S.2d at 847) ("As in any construction proceeding, the court must attempt to ascertain the testator's intention," citing *In re Fabbri, supra*); *See also* Claudia G. Catalano, Annotation, What Constitutes Contest of Attempt to Defeat Will Within Provision Forfeiting Share of Contesting Beneficiary, 3 A.L.R.5th 590, § 2[a] ("While it is true that a forfeiture clause is to be strictly construed, the courts, in interpreting no-contest clauses, recognize the paramount rule in the construction of wills that the ascertainment and effectuation of the testator's intention is controlling (footnote omitted]. The basic question for determination, therefore, is the meaning of the words found in the no-contest clause as employed by the testator. [footnote omitted]")

25. *In re Kirkholder, supra* (enforcing an *in terrorem* clause against a beneficiary who attempted in bad faith to prove a false and spurious document as being the last will of the testator, despite the fact that it did not specifically proscribe proffering a false will for probate); *In re Pasternack*, 52 Misc. 2d 413, 275 N.Y.S.2d 703 (Surr. Ct., N.Y. Co. 1966) (enforcing an *in terrorem* clause against a beneficiary who did not herself file any objections to probate, but who acted in concert with the formal objectant, despite the fact the clause did not specifically prohibit acting in concert with a formal objectant); *In re Cohn*, N.Y.L.J., Nov. 23, 1965, p. 16, col. 3, (Surr. Ct., N.Y. Co.) (DiFalco, J.) (enforcing an *in terrorem* clause against a beneficiary who asserted a claim to assets that poured over into the estate from a trust, despite the fact that the clause did not specifically proscribe the prosecution of a claim to trust assets); *In re Stewart*, 5 N.Y.S. 32 (Surr. Ct., N.Y. Co. 1889) (enforcing an *in terrorem* clause against a beneficiary who did not herself file objections to probate, but who entered into a secret written agreement to help the formal objectants and still receive the full amount of her legacy if the will was denied probate, where the *in terrorem* clause did not specifically proscribe participation in such an arrangement).

26. *In re Martin*, 255 N.Y. 248 (1930) (surrounding circumstances may be considered); *In re Ellis, supra*, 252 A.D.2d at 128, 683 N.Y.S.2d at 119 (the pre-date-of-death correspondence from the objectants to the testator; the testator's instructions to the attorney-draftsman and the testator's prior wills were considered for the purpose of assisting in the construction of the *in terrorem* clause). *In re Schuster*, 55 A.D.2d 957, 391 N.Y.S.2d 160 (2d Dep't 1977) (testator's intent gleaned from the will and the surrounding circumstances). *See also* 11 Warren's Heaton on Surrogate's Courts, 6th Ed. § 187.01[5], p. 187-34.

27. *See In re Stiehler, supra,* holding that whether or not the testator intended for the mere filing of objections to be a "contest" depended upon the testator's intent, which had to be determined on a case by case basis. *See also In re Piscionere*, N.Y.L.J., March 4, 1987, p. 15, col. 5 (Surr. Ct., West. Co.), where the court refused to decide until the determination of the objections whether the mere filing of objections constituted a "contest" as that word was used in an agreement to refund a gift if the donee "contested" the donor's will.

28. *See In re Orenstein*, 74 Misc. 2d 288, 290, 344 N.Y.S.2d 492, 494 (Surr. Ct., Nassau Co. 1973) (where Surrogate Bennett noted that technical words employed in a will are presumed to have been used in their technical sense, especially if the draftsman was skilled, and particularly where "a statute attributes a specific meaning to those words"). In *In re Ellis, supra,* the Appellate Division noted that the testator told the draftsman she wanted to dissuade one or both of her sons from, "making trouble for [her daughter]," whom she favored in the will and named as her sole executor. The attorney-draftsman translated "making trouble," into a prohibition against "in any manner, directly or indirectly, contesting this will or any of its provisions."

29. 252 A.D.2d at 128, 683 N.Y.S.2d at 119.

30. *In re King*, 200 N.Y. 189, 192 (1910); *See also* 11 Warren's Heaton on Surrogates' Courts, (6th Ed) § 187.01[3][b] ("Little light is cast on the interpretation of the language of one will by a decision construing another.")

31. 252 A.D.2d at 127, 683 N.Y.S.2d at 119.

32. *See* 22 N.Y.C.R.R. § 207.23, "Bills of Particulars in *Contested* Probate Proceedings;" § 207.26, "*Contested* Probate: Notice of Objections Filed," and § 207.27, "Examinations Before Trial in *Contested* Probate Proceedings," (emphasis added).

33. *See In re Smathers,* 309 N.Y. 497, 495 (1956); *In re Yolanda D.*, 88 N.Y.2d 790, 795, 651 N.Y.S.2d 1, 3 (1996); *Rodriguez v. Perales*, 96 N.Y.2d 361, 366, 633 N.Y.S.2d 252, 254 (1995); *Branford House, Inc. v. Michetti*, 81 N.Y.2d 681, 688, 603 N.Y.S.2d 290, 293-294 1993).

34. N.Y.L.J., Nov. 27, 1998, p. 32, col. 5 (Surr. Ct., West. Co.).

35. 100 Misc. 2d at 22, 418 N.Y.S.2d at 513-514.

36. 252 A.D.2d at 133, 683 N.Y.S.2d at 122-123.

37. *See* 252 A.D.2d at 125-26, 683 N.Y.S.2d at 118, where the court stated: "[A]lthough the record contains both an 'answer,' and 'objections to probate,' the respondents concede that, in proceedings before the Surrogates Court, both pleadings may serve the same purpose (*see* SCPA 302(l)[c]; *In re Herle*, 173 Misc. 879, 19 N.Y.S.2d 263). Here, this is made manifest by the fact that the allegations made in support of the objections to probate merely incorporated by reference the allegations in the bill of particulars served in support of the answer (*see*, *In re Scheu*, 29 A.D.2d 626, 285 N.Y.S.2d 380 [allegations of undue influence and misrepresentation may be sufficient to establish incompetence to serve under SCPA 707])." [bracketed material in original].

38. 252 A.D.2d at 120, 125 and 130, 683 N.Y.S.2d at 113, 118 and 123.

39. *See Estate of Kubick*, 9 Wash. App. 413, 419, 513 P.2d 76, 80 (Wash. Ct., App. Div. 2, 1973).

40. 252 A.D.2d at 125, 683 N.Y.S.2d at 118.

41. *See In re Muller*, 138 Misc. 2d 966, 967-8, 525 N.Y.S.2d 787, 788 (Surr. Ct., Nassau Co. 1988).

42. *See In re Cuneo*, N.Y.L.J., March 2, 1992, p. 36 col. 4, (Surr. Ct., West. Co.), citing *In re Muller, supra.*

43. A 1989 Third Department case, *In re Delisle*, 149 A.D.2d 793, 539 N.Y.S.2d 588, granted very broad document discovery even before the 1992 and 1993 amendment to the Statutes.

44. 252 A.D.2d at 129 683 N.Y.S.2d at 120.

45. *See In re Lang*, 60 Misc. 2d 232, 302 N.Y.S.2d 954 (Surr. Ct., Erie Co. 1969); *In re Lowenbauin*, N.Y.L.J., February 17, 1972, p. 19, col. 3 (Surr. Ct., Queens Co.); *In re Robbins*, 144 Misc. 2d 510, 544 N.Y.S.2d 427 (Surr. Ct., N.Y. Co. 1989); *In re Coven*, N.Y.L.J., June 14, 1990, p. 29, cal. 6. (Surr. Ct., N.Y. Co.); *In re Besdine*, N.Y.L.J., March 29, 1990, p. 29, col. 6 (Surr. Ct., Kings Co.).

46. N.Y.L.J., Dec. 22, 1977, p. 7, col. 3 (Surr. Ct., N.Y. Co.).

47. C.f., *In re Cohn, supra*, which enforced an *in terrorem* clause against a beneficiary who asserted claims to assets in an *inter vivos* trust that poured into the testator's estate, where the clause expressly referred to the claimant and conditioned her legacy on her not taking any action "to prevent my estate . . . from being distributed in the manner provided in this Will."

48. An older case, *In re Fellion*, 132 Misc. 805, 231 N.Y.S. 9 (Surr. Ct., Franklin Co. 1928), held that the commencement of a construction proceeding did not violate the *in terrorem* clause because it was not brought in "bad faith" or "from an improper motive." In *In re Stiehler, supra*, 133 Misc. 2d at 257, 506 N.Y.S. at 947, in addition to filing objections, the widow also attempted to offer a later will for probate. Even though the executor did not claim that the attempt to prove a later will violated the *in terrorem* clause, Surrogate Radigan took pains to note in *dictum* that no finding was ever made that the later will was invalid, and no proof was offered to show there was no probable cause for its submission.

49. 252 A.D.2d at 129, 683 N.Y.S.2d at 120.

50. *See id.* at 133, 683 N.Y.S.2d at 123 ("We do not purport to adopt a good faith standard of conduct as to disclosure pursuant to EPTL 3-3.5 and SCPA 1404 (4). Rather, we merely hold that EPTL 3-3.5 (b) (3) (D) may not be employed, with the benefit of hindsight, to convert a plenary and unsuccessful attack upon a will into a preliminary inquiry pursuant to SCPA 1404 (4) merely because the examination of certain parties, had it been conducted prior to the filing of objections, would have been permitted under the statute.")

51. *See id.* at 133, 693 N.Y.S.2d at 122-123 ("Moreover, despite disclosure lasting over two years, the respondents have not proffered one scintilla of evidence gleaned therefrom which indicates fraud or undue influence by [the nominated executor]. To the contrary, the competent evidence on the record has actually diminished. . . . Thus, the only reasonable inference to be drawn from the record is that the respondents neither sought the protections of, nor pursued their claims pursuant to SCPA 1404 or EPTL 3-3.5(b)(3)(D), but rather charted a course of litigation from the outset without regard for the consequences, and retreated only when on the brink of failure."

52. *See In re Giardina*, N.Y.L.J., June 15, 1999, p. 34 (Surr. Ct., Nassau Co.) where Surrogate Radigan found that the time limits of Rule 27 (22 N.Y.C.R.R. 207.27) were applicable to an SCPA 1404 examination, but that "special circumstances" existed to permit the respondents' inquiry to reach beyond the limit, citing *In re Ellis* regarding the legislative policy for the expanded discovery under the 1992 and 1993 amendments to the statutes. *See also In re Zaleski, supra,* where Surrogate Radigan, ordered that in view of the *in terrorem* clause, the proponent had to submit to a preliminary examination under SCPA 1404(4), but that the scope of the inquiry was confined to the time limits of Rule 27.

53. *See* McKinneys 1999 New York Rules of Court § 130-1.1 (22 N.Y.C.R.R. 130-1).

54. For example, "If any person, in any manner, directly or indirectly, contests this will or any of its provisions, or in bad faith or without probable cause, contests the fitness of or seeks the removal of any of my nominated executors, or in bad faith or without probable cause, objects to any of my executor's accountings. . . ."

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United States Trust Law and the Hague Convention on Trusts[1]

By Michael W. Galligan

Practitioners who develop estate plans for individuals and families with international holdings quickly learn, often to their chagrin, that many countries in the world, including some of the wealthiest and most economically important, do not have the institution of the trust and do not understand trusts. The purpose of the Hague Convention on the Law Applicable to Trusts and on Their Recognition is to gain the consent of countries that do not have trusts to recognize trusts validly established in countries that have trusts and to permit these trusts to function on an international basis with all the legal rights and privileges of trusts. The United States was a vital participant in the international conference that led to the drafting and approval of the Convention by the Hague Conference on Private International Law and is a signatory to the Convention.

Unfortunately, the United States has not ratified the Convention, which means that the United States is not yet officially a party to the Convention. While most of the major common law jurisdictions have become parties, only the Netherlands and Italy, among the civil law countries that do not ordinarily recognize trusts, have ratified the Convention. In the opinion of many, the failure of the United States to ratify the Convention has become a major disincentive to other important civil law countries that do not ordinarily recognize trusts, such as France, Germany, Japan, and Switzerland to become parties to the Convention.

In 1998, at the behest of the office of the Assistant Legal Advisor to the Secretary of State for Private International Law, the Committee on International Estate Planning of the Trusts and Estates Section of the New York State Bar Association, with the approval of the Executive Committee of the Trusts and Estates Section, became actively involved in efforts to promote U.S. ratification of the Convention. In canvasing support from the other major estate planning organizations in the United States, certain questions were raised about the effect the Convention would have on U.S. law concerning transfers of property to trusts, existing U.S. conflicts-of-law rules related to trusts, and the jurisidiction of U.S. courts over trusts. This article addresses each of these issues. The article concludes that (1) the Convention would not cause foreign law to apply to transfers of U.S. real property to trusts, (2) application of the Convention's choice-of-law rules will have no effect on domestic trusts and should not, as a practical matter, significantly change the way U.S. courts currently apply choice-of-law rules to foreign trusts, and (3) the Convention will not enlarge the jurisdiction of U.S. federal courts over domestic and foreign trusts.

1. The Convention Will Not Cause Foreign Law to Apply to the Disposition of U.S. Real Property

The purpose of the Convention is to enable trusts to operate as legal persons in jurisdictions where they previously have not been accorded legal status and to eliminate the possibility that a trustee of a valid trust could be considered to be acting in the trustee's individual capacity. For a trust to operate as a legal person means, among other matters, recognition of the capacity of the trustee to hold real property validly transferred to the trust in the name of the trust, without danger that the property would be considered property of the trustee in the trustee's individual capacity. Every jurisdiction within the United States (including Louisiana) recognizes the institution of the trust and the right of trusts to own real property without having the property rights of the trustee *qua* trustee confused with the property rights of the person acting as trustee. The Convention simply confirms this fundamental principle of trust law and provides a mechanism whereby this salutary principle may be recognized in countries where this principle, up to now, has not been generally recognized.

Article 8 requires state parties to apply the governing law of the trust only in matters affecting the internal order of the trust, such as the appointment, removal and resignation of a trustee, the rights and duties of trustees among themselves, the rights of trustees to delegate their authority, the power of trustees to dispose of and acquire assets, the power of investment, restrictions on the duration of a trust, the liability of the trustees to the beneficiaries, the distribution of trust assets and the duty to account. Article 11 lays down the primary rule of the Convention that a trust eligible for recognition under the provisions of the Convention is to be treated as a trust, and therefore, "at a minimum, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity." This means (1) that personal creditors of the trustees have no recourse against trust assets, (2) that the trust assets shall not form part of a trustee's estate in insolvency or bankruptcy, (3) that the trust assets will not form part of the matrimonial property of a trustee or a trustee's spouse nor part of the trustee's estate at death, and (4) that trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with the trustee's personal assets.

The key idea to note here is that while the Convention requires the trust's governing law to apply to the internal order of the trust, it does not authorize a trust to own real property in any other way than that allowed by local law. Articles 4 and 15 make it clear that the Convention does not purport to impose any rule of application or choice-of-law with regard to the manner in which property is transferred to or from the trust nor with regard to issues affecting the relationships of the trust to others persons "outside" the trust. Article 4 provides that the Convention does not apply to issues regarding "the validity of wills or other acts by which assets are transferred to the trustee." In the Explanatory Report that is included in the *travaux preparatoires* of the Convention, Proceedings of the Fifteenth Session of the Hague Conference on Private International Law, Vol. II, 370, 381, Professor Alfred Overbeck states,

> A transfer of assets to the trustee is a *sine qua non* condition for the creation of a trust. But the law designated by the Convention applies only to the establishment of the trust itself, and not to the validity of the act by which the transfer of assets is carried out. This act is entirely governed by the law to which the conflicts rules of the forum submit it.[2]

Consistent with this view, Article 15 sets forth key areas of law that continue to be governed by the law designated by the forum, including the protection of minors, marital rights, succession rights, the protection of creditors in bankruptcy—and most importantly for our purposes here—"the transfer of title to property and security interests in property." As Professor Overbeck explains, when "the law applicable to a trust recognized as such will encroach on the area of another law designated by the forum's conflict rules," under Article 15, "it is then that other law which will prevail . . . as concerns the mandatory rules of that other law,"[3] it being the intent of Article 15 "to preserve above all the forum's substantive law in cases where its conflicts rules designated its own law."[4]

According to Article 12, "[w]here the trustee desires to register assets, movable or immovable, or documents of title to them, he shall be entitled, *in so far as this is not prohibited by or inconsistent with the law of the State where registration is sought*, to do so in his capacity as trustee or in such other way that the existence of the trust is disclosed." (emphasis added). Presumably, if registration were a prerequisite to owning property at all, the forum would make some form of registration available in order to abide by Article 11. But beyond that, the forum state is afforded unlimited authority to require a trust to conform to the same rules regarding ownership of real property that any other person or entity authorized to own real property in the forum state would have to follow.[5]

2. Analysis of Effect of the Convention on U.S. Choice-of-law Rules Regarding Trusts

The Convention does not apply to interstate conflicts of law issues regarding domestic trust and should not, as a practical matter, significantly change the way U.S. courts currently apply choice-of-law rules to foreign trusts.

(a) Impact on Domestic Trusts

The Convention is not intended to deal with conflicts of law issues concerning domestic trusts. Article 24 provides that a state with different territorial units with their own rules of law regarding trusts is not bound to apply the Convention "to conflicts solely between the laws of such units." In other words, choice-of-law issues about domestic trusts that have connections with different states of the United States are not governed by the Convention, and therefore neither are trusts that have connections with only one state.

(b) General Approach of the Convention

It is helpful to differentiate between a "one-step" approach to the creation of trusts and a "two-step" approach. In the one-step approach, a trust is constituted by a donation of property to a trustee, often though not necessarily effected by a declaration or deed of trust.[6] The instrument and the transfer are integrally connected so that if the transfer is invalid the deed has to be a nullity. In the two-step approach, the trust instrument and the transfer of property are viewed separately. The trust is essentially established by the trust agreement (with what is often a token transfer of property to conform to the common law requirement that property be transferred to the trustee). The transfers of the assets intended for the trust are effected by separate deeds or instruments of conveyance. The two-step approach has been incorporated in New York's recent inter-vivos trust legislation, which requires that a trust agreement be validly executed in conformity with the statutory requirements for a valid agreement and that property be transferred to the trust by separate deed or instrument, rather than by the trust agreement.[7]

The Convention essentially embraces a two-step approach. It clearly distinguishes between the trust instrument and the transfer of property to the trust.[8] Article 3 states that the Convention "applies only to trusts created voluntarily and evidenced in writing." Article 4 of the Convention expressly excludes from the Convention's purview "the validity of wills or other acts by which assets are transferred to the trustee." The result is that the Convention focuses on the obligations and rights established by the written evidence of the trust, but not the property laws that govern transfers to the trust. Under Article 15, the latter are left to the law indicated by the situs of the property.

This distinction is important because it puts in proper context an otherwise apparent inconsistency between the Convention and the Restatement Second on Conflict of Laws regarding "trusts of land." According to Restatement Second § 277(1), the construction of a trust of land is to be governed by the law chosen by the settlor. *See* Restatement (Second) of Conflict of Laws: Construction of Trust Instrument § 277(1) (1969). To that extent, the Restatement is clearly consistent with the Convention. However, Restatement Second § 278 makes the law indicated by the situs (which need not but is often likely to be the law of the situs) the governing law regarding the validity of a trust of land, whereas the Convention looks first to the law chosen by the settlor.[9] This apparent inconsistency is removed once one appreciates that validity for the Restatement means the validity of the transfer of land to the trust, which, under the Convention is also governed by the law indicated by the situs.[10]

(c) Choice-of-law Rules for Foreign Trusts

Article 6 of the Convention provides that a trust shall be governed by the law chosen by the settlor, unless the law so chosen does not provide for trusts. Article 7 establishes as the default choice the law with which the trust is "most closely connected." Relevant considerations are the place of the trust's administration, the situs of the trust's assets, the place of residence or business of the trustee, and "the objects of the trust and the places where they are to be fulfilled." Article 9 provides that a severable aspect of the trust, particularly matters of administration, may be governed by a different law. These principles are consistent with the choice-of-law rules commonly applied by American courts. It is probably safe to say that most wills do not contain a choice-of-law provision. Testamentary trusts under such wills are in most instances governed by the law of the decedent's domicile, which is most likely to be the place of the trust's administration, the situs of the trust's assets, and the place of residence of the trustee, if not always the location where the beneficiaries, as "objects of the trust," may live.

Most courts will honor the choice-of-law contained in an inter vivos trust agreement as long as there is some connection between the trust and the country whose law is so designated.[11] Article 6 does not expressly require that the law chosen by the settlor have a substantial connection to the trust, but it does require that the law chosen by the settlor provide for trusts or the category of trust involved. Moreover, article 13 expressly excludes recognition in the case where the "significant elements" of a trust, *other than* the choice of applicable law, the place of administration and of the habitual residence of the trustee, are more closely connected to states that do not have the institution of the trust. As a practical matter, it is much more likely than not that a settlor's choice of law will be based on some connection between the trust, the trust grantor, the trust beneficiaries, or some related factor, and the country whose law is designated.

Besides, articles 16 and 18 of the Convention give a court broad latitude to curb an effort to import a rule that would offend the forum's concepts of fundamental justice, good order, or public policy, Article 16 authorizes a court to apply the "law of the forum which must be applied even to international situations," i.e., "laws of immediate application" or "mandatory rules" designed to foster public health, vital economic interests, the protection of weaker parties, and so forth.[12] Article 16 also permits a court to apply similar rules of another country if a case before it has a substantial connection with another country. And, under Article 18, the provisions of the Convention may be disregarded "when their application would be manifestly incompatible with public policy."

As noted above, under Article 15, "the transfer of title to property and security interests in property" and other important areas of law regarding the rights of third parties (including creditors' rights, marital and succession rights, and the rights of owners) are to be governed by the choice-of-law rules of the forum insofar as these cannot be varied by voluntary act. This means, for example, that a forum that applies the rule against perpetuities to all transfers of real property would not be required to recognize a transfer of real property to a trust that, under its governing law, could last longer than the applicable perpetuities period.[13] It also means that a forum would not have to apply the law of a country unduly hostile to creditors' claims just because the law of that country happens to be the governing law of the trust.

Section 279 of the Restatement Second on Conflict of Laws provides that the administration of a trust of an interest in land is determined by the law that would be applied by the courts of the situs of the land.[14] "Administration" includes matters relating to the "carrying out of the trust" such as the duties and powers of trustees and their right to compensation, but not issues of construction such as the identity of the beneficiaries and the nature of their interests.[15] Under the Convention, it is possible for a grantor to select a governing law other than the law of the situs. But the apparent difference between the rule reflected in the Restatement and the rule of the Convention dissolves into virtual insignificance on closer inspection. According to the Restatement § 279, Comment a, "if the testator or settlor provides that the local law of some other state shall be applied to govern the administration of the trust . . . the courts of the situs would apply the designated law as to issues which can be controlled by the terms of the trust." Again, Articles 16 and 18 of the Convention give a court broad latitude to prevent the application of a rule that would offend the forum's concepts of fundamental justice, good order or public policy and to apply its "mandatory rules" designed to foster vital economic interests such as the appropriate use and regulation of land.[16]

3. Analysis of Effect of the Convention on the Jurisdiction of U.S. Federal Courts Over Trusts

Federal courts have, under 28 U.S.C. § 1331, jurisdiction over matters arising under treaties of the United States with other countries. However, U.S. ratification of the Convention should not permit litigants to attempt to remove jurisdiction over such matters as trust construction, beneficiary rights, and accounting issues from the state courts to the federal courts. As discussed above, the Convention does not govern the choice-of-law rules applied to inter-state conflicts issues. Thus, the Convention cannot be used as a basis for conferring jurisdiction on a federal court in a disputed matter involving a domestic trust because the Convention does not apply to such trusts.

A foreign trustee may invoke the Convention when there is an issue involving the recognition of the trust's right to operate within the United States as a trust. However, this does not enlarge the jurisdiction that the federal courts currently have over certain foreign trusts. Under 28 U.S.C. § 1332(a)(2), the federal courts have jurisdiction over disputes between citizens of the United States and the citizens or subjects of a foreign state. Foreign trustees are "citizens" of foreign countries and therefore the federal courts already have jurisdiction over disputes involving foreign trusts as long as the diversity between the foreign and United States parties is not broken by having a foreign party on both sides of the claim or controversy.

In a case where complete diversity does not obtain between a foreign trust and the United States parties, the foreign trust would be required to avail itself of a state court. The mere invocation of the Convention will confer neither federal question jurisdiction under 28 U.S.C. § 1331 nor supplemental jurisdiction under 28 U.S.C. § 1367 on the federal courts. It is a fundamental axiom of federal question jurisidiction based on treaties that"[a]n action arises under a treaty only when the treaty expressly or by implication provides for a private right of action."[17] The Convention does not provide any remedies or causes of action, and therefore confers no independent basis for federal jurisidiction.

Even if there were a private right of action to enforce the Convention's choice-of-law rules, which there is not, any effort to invoke on that basis the supplemental jurisdiction of the federal courts with respect to any legal remedy under the substantive law of trusts would be likewise unavailing. To confer jurisdiction on a federal district court with original jurisdiction with respect to a supplemental claim, it is necessary under 28 U.S.C. § 1367(a) for the claim "to be so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution." While the issues of choice of law and recognition under the Convention may be significant preliminary issues in any claim or controversy, they are analytically distinct from any particular claim or controversy and thus would not appear to have the requisite relationship to such claim or controversy that § 1367(a) requires. Indeed, by themselves, they would not state a claim. Moreover, under 28 U.S.C. § 1367(b), a district court has discretion to decline supplemental jurisdiction whenever the supplemental claim "substantially predominates over the claim or claims over which the district court has original jurisdiction." While the threshold issues of applicable law and recognition are clearly critical, it is hard to imagine any claim that would not predominate over the preliminary issues regarding the trust's applicable law and right to recognition because it is the claim and not the threshold issues that would be the gravamen of the lawsuit.

Finally, because the Convention does not attempt to preempt issues regarding the validity of wills creating trusts,[18] the Convention would not affect state jurisdiction over ancillary probate and administration proceedings related to estates of non-United States decedents and would therefore not weaken the general principle that federal courts should avoid interfering in probate matters.[19]

4. Conclusion

U.S. ratification of the Convention should result in little, if any, significant change in the U.S. jurisprudence regarding the recognition of trusts and the choice of law issues that arise with foreign trusts. The Convention will not displace long-standing U.S. principles about the transfer of property to trusts, whether through wills or through inter vivos transfers. While courts will have to become acquainted with the Convention's choice-of-law principles for foreign trusts, the results will, in most cases, be the same as under current U.S. conflicts principles. Finally, state courts will continue to be the principal fora for the resolution of disputes involving trusts. Therefore, the Convention should not become an excuse to somehow "federalize" jurisdiction over trusts or the substantive law of trusts.

Endnotes

1. This Article is based on a Memorandum prepared for a committee of the American Council of Estate and Probate Counsel appointed last year to recommend a position on the proposed U.S. ratification of the Convention. I would like to express my thanks to my partners at Whitman Breed Abbott & Morgan for their support in this effort, to Andrew McNeela, an associate in the WBAM litigation department, for assistance with the research for Section 3, and to John Kostecky of the WBAM legal library for assistance with obtaining international legal materials. My thanks also to Professor Eugene Scoles of the University of Oregon School of Law, Sally Cummins, Esq. of the U.S. Department of State, and my colleagues on the New York State Bar Association Committees on International Estate Planning and International Estates and Trusts for reviewing and commenting on earlier drafts of this Memorandum.
2. Henry Christensen, International Estate Planning § 8.02[2] (1999), makes the same point when he says: "while the applicable law of the trust governs the validity of the trust, the Trust Convention presupposes that no antecedent law (e.g., concerning mandatory rules on perpetuities, forced shares or matrimonial property regimes) has operated to prevent the relevant property from being the subject of a valid trust."
3. *Id*.
4. *Id*. at 401.
5. It should also be noted that Article 11 expressly provides that the rights and obligations of any third party holding any commingled trust assets are to remain subject to the law required by the forum's choice of law rules.
6. *See generally* Restatement (Second) of Trusts: Methods of Creating a Trust § 17 (1957).
7. *See* N.Y. Est. Powers & Trusts Law §§ 7-1.17 to 7-1.18.
8. An analogy has been suggested of a "rocket" and a "rocket launcher." The Convention governs the "rocket" but not the "rocket launcher." To speak of a "two-step" approach does not mean that the Convention requires two separate instruments but rather a two-step analysis of the relevant documentation.
9. *See id*. at § 278.
10. According to the Restatement § 278, Comment b, in cases where land is to be retained in trust, the courts of the situs have applied the local law, for example, to determine whether there is a violation of the rule against perpetuities. *See* Restatement (Second) of Conflict of Laws § 278 cmt. b (1969). The Comment cites Restatement § 239, which expressly deals with "whether a Will effects an interest in land and the nature of the interest transferred." According to the Restatement of § 278, Comment c: "[w]here the owner makes a *conveyance* of land in trust the validity of the *conveyance* is determined by the law that would be applied by the courts of the situs." (emphasis added). Thus, the focus of Restatement Second § 278 is the validity of the trust as a conveyance or deed of land (i.e., a means of transferring land to a trust) rather than the validity of the trust independently of the type of property it may hold.
11. *See* Restatement (Second) of Conflicts of Law: Validity of Trust Movables Created Inter Vivos § 270(a) (1969).
12. Emmanuel Gaillard and Donald T. Trautman, in a comprehensive review of the Convention, view the rule against perpetuities "as a domestic mandatory rule, to come into play under Article 15." Trautman and Gaillard, *Trusts in Non-Trust Countries: Conflict of Laws and the Hague Convention on Trusts*, 35 Am. J. Comp. L. 307, 331 (1987). Professor Overbeck, in his Explanatory Report, *op. cit.*, at 404, suggests that Article 16 "may also serve to cause certain rules, considered as being fundamental in a country which has trusts (for example the rule against perpetuities), to prevail against a trust which is subject to the law of another country."
13. One forum may permit a trust to last without temporal limitation. Another forum may require, as a condition of validity, that all transfers of real property contain no limitation of the complete alienability of property beyond a set time period. Thus, it would not violate the applicable law of the trust to hold real property without a temporal limitation. But an attempted transfer to the trust of real property located in a jurisidiction that requires real property to be freely alienable after a certain time period would not be valid and would therefore be ineffective because of the trust's potential perpetuity.
14. *See* Restatement (Second) of Conflict of Laws: Administration of Trust of Land § 279 (1969).
15. *See id*. at § 279 cmt. a.
16. Nothing in the Convention prevents the administration of a trust of interest in land from being supervised by the courts of the situs of the land, as required by Restatement (Second) Conflict of Laws, § 276 (1969).
17. *Columbia Marine Services, Inc. v. Reffet Ltd.*, 861 F.2d 18, 21 (2d Cir. 1988) (citing *Dreyfus v. Von Finck*, 534 F.2d 24, 30 (2d Cir. 1976), *cert. denied*, 429 U.S. 835 (1976); *see also* Restatement (Third) of The Foreign Relations Law Of The United States § 111 cmt. e (1986) (stating that an action arises under international agreement only "if the plaintiff's complaint properly asserts a justiciable claim based upon such . . . agreement.").
18. *See* Articles 4 and 15 as discussed above.
19. *See* Charles A. Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice and Procedure*, § 3610 (2d ed. 1984).

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Q&A

By Kathleen M. Franklin

Q In Revenue Ruling 2000-2, 2000-3 I.R.B. 305, the Service provides that an executor may treat an IRA and a trust as QTIP when the QTIP trustee is the named beneficiary of the IRA and the surviving spouse has the right to compel the QTIP trustee to withdraw from the IRA, on behalf of the spouse, an amount equal to all the annual income earned on the IRA assets. As § 408(a)(6) requires annual minimum distributions paid over the life expectancy of the IRA beneficiary in any event, what practical change is effected by this new Revenue Ruling?

A As discussed below, Revenue Ruling 2000-2 clarifies the Service's position that an IRA may qualify as QTIP when the terms of the trust named as the beneficiary of the IRA give the surviving spouse the power to compel the trustee to withdraw all of the income earned on the assets in the IRA and pay that amount to the surviving spouse *or* when the terms of the trust require the trustee to withdraw all income earned on the IRA assets and pay that amount to the surviving spouse. This Ruling clarifies that accumulation of income within the IRA is allowed, as long as: (1) the distributions to the QTIP trust meet the minimum distribution requirements, (2) the surviving spouse has the right to demand all of the income earned on the undistributed portion of the IRA pursuant to the terms of the QTIP trust, and (3) the IRA instrument does not prohibit the QTIP trustee from making withdrawals from the IRA in excess of the minimum distribution amount.

In Revenue Ruling 89-89, 1989-2 C.B. 231, the Service held that a decedent's executor could elect to treat a decedent's IRA as QTIP where the decedent elected a distribution option for the IRA which required payments over the spouse's life expectancy *if* the income earned on the undistributed balance of the IRA is paid out annually to the trust and the trust requires both the income earned on the undistributed portion of the IRA and the income earned by the trust on the distributed portion of the IRA to be paid currently to the decedent's spouse. Revenue Ruling 89-89 led many practitioners to conclude that an amount equal to the *greater of*: (1) the minimum distribution required by Internal Revenue Code § 401(a)(9) or (2) all of the income earned on the undistributed portion of the IRA had to be distributed from the IRA to the trust in order to qualify the IRA for the QTIP marital deduction. In early years, this formula would require a larger payout from the IRA to the trust than would be required by the minimum distribution rules. For example, if payment is to be made in annual installments based on the spouse's life expectancy and her life expectancy is 33 years (for purposes of this illustration), in year 1, § 401(a)(9) would only require payout of 1/33rd of the IRA balance, or 3%. This amount may be less than the current income of the IRA.

Revenue Ruling 2000-2 obsoleted Revenue Ruling 89-89. The facts of Revenue Ruling 2000-2 state that the QTIP trust created under the decedent's will was the designated beneficiary of his IRA. The decedent died at the age of 55, survived by his spouse, who was 50 years old. A copy of the trust and a list of the trust beneficiaries were delivered to the IRA administrator within nine months of the decedent's death, as required by the proposed regulations. The life expectancy of the surviving spouse (the oldest trust beneficiary) was used to calculate the distribution period for purposes of the minimum distribution rules. Under the terms of the testamentary QTIP trust, all trust income was payable annually to the surviving spouse and no one had the power to appoint trust principal to any person other than the surviving spouse. Under the terms of the trust, the surviving spouse was also entitled to all the income of the trust, and was given the power to compel the trustee to withdraw an annual amount equal to all the income earned by the IRA assets during that year and distribute that same amount to the spouse as the beneficiary of the trust. The IRA document did not contain any prohibition on withdrawals from the IRA in excess of the annual minimum distributions. The Service ruled that the surviving spouse's power to compel the trustee's actions satisfy the "all income" requirement of the QTIP regulations. The Service noted that if the spouse does not exercise the right, the QTIP trustee will receive only the annual minimum distribution amount from the IRA. If the surviving spouse does exercise that right, the QTIP trustee will receive an amount equal to the greater of the annual minimum distribution amount or the amount of the IRA income for that year. If the surviving spouse does not demand all the income, accumulation of the amount of income in excess of the minimum distribution amount (if any) may stay in the IRA.

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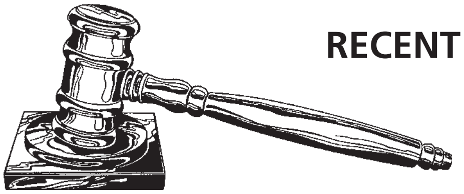

CASE NOTES— RECENT NEW YORK STATE SURROGATE'S AND SUPREME COURT DECISIONS

Arlene Harris and Donald S. Klein

ATTORNEY-CLIENT PRIVILEGE

The Court considered whether the attorney-client privilege applies to an antenuptial agreement. The Court stated the general rule that the attorney-client privilege survives the death of the client, and absent waiver or statutory exception, the attorney or his estate is not free to release privileged material concerning communications with the deceased client. One such exception is contained in CPLR 4503(b) that deals with the privilege being unavailable in probate proceedings or construction of a will proceedings. The Court reasoned that if it is true that the attorney met with both the decedent and the surviving spouse, then the Court would have little difficulty rejecting the privilege, especially in light of the recent Court of Appeals opinion in *In re Grieff* (93 N.Y.2d 817) which may indicate a willingness on the part of the Court to extend CPLR 4503(b) to antenuptial agreements. The Court noted that in the trial of *Grieff*, the attorney for the deceased spouse was allowed to testify as to conversations with the deceased apparently without objection. The Court finally stated that it remains to be seen whether the rationale and policy of CPLR 4503(b) should be extended to cover antenuptial agreements. *In re Altimont L. Beckford*, N.Y.L.J., May 19, 2000, p. 31, col. 1 (Nassau Co. Surr. Radigan).

ATTORNEYS' FEES

Despite a settlement with the estate's primary beneficiary, the Doris Duke Foundation, the Surrogate approved only $3.6 million of attorneys' fees for the Chicago firm of Katten Muchin for its services in connection with the probate and administration of the $1.3 billion estate. The firm had been paid $12.6 million for its services and the compromise amount reached with the Foundation was $9.6 million. Initially Katten Muchin represented both nominated preliminary executors of the estate, Bernard Lafferty (Mrs. Duke's butler) and U.S. Trust Company. Shortly after Ms. Duke's death in 1993 at age 80, headline-grabbing charges were raised that drugs had been administered to hasten her death. The matter was investigated by the Los Angeles District Attorney's Office, but no charges were ever filed. Charges were subsequently leveled that Mr. Lafferty had serious substance abuse problems and had lived lavishly at the estate's expense. U.S. Trust was caught in the web of those charges on two theories: that it had failed to curb the butler's spending and had loaned him $825,000, creating a conflict of interest.

Initially, Katten Muchin had represented the estate as a single entity, including both preliminary executors. But once Surrogate Preminger appointed former Manhattan District Attorney Richard Kuh to investigate the charges, Cravath, Swaine & Moore entered the case in January 1995 to represent U.S. Trust. From that point on, Katten Muchin separately represented Mr. Lafferty's interests. Relying on Mr. Kuh's findings, Surrogate Preminger removed both Mr. Lafferty and U.S. Trust as preliminary executors, and replaced them with two temporary administrators, Alexander Forger, of Millbank, Tweed, Hadley & McCloy, and the Morgan Guaranty Trust Co. Seven months later, the New York Court of Appeals reinstated both Mr. Lafferty and U.S. Trust, finding that Surrogate Preminger had erred in removing them on the strength of Mr. Kuh's report without conducting a fact-finding hearing. After several more months of tense negotiations, Mr. Lafferty agreed to step aside as an executor and to assume no role in the Foundation that was to receive the bulk of the estate once probate was completed. In addition, the estate agreed to accept one of the principal challengers to the will, Dr. Harry Demopoulos, who had previously cared for Ms. Duke, as a member of the Foundation's board.

One of the principal reasons Surrogate Preminger set forth for so sharply cutting Katten Muchin's fees was its decision to use two other firms to represent Mr. Lafferty. She particularly faulted the firm for spending many hours on the removal proceedings and appeals during periods when former U.S. Judge Herbert Stern, of Stern & Greenberg, had assumed the lead role in both court and negotiations. The Surrogate also cut the fees of other firms in the matter, including those of the Cravath firm. The Court found that the settlement proposed was not in the best interests of the Foundation and that circumstances had changed since the settlement negotiations, since the validity of the retainer agreement had not been determined. The Court found that the retainer agreement is not enforceable as the firm had failed to demonstrate its reasonableness at the time it was made or in retrospect—the $8 million flat fee set forth in the agreement covered too narrow a range of services to approach a realistic figure and nothing about the administration of the estate was so complex to make it likely that such a fee would be necessary. The Court also held that while the size and the breadth of the assets required extensive legal services authorizing sizable compensation to the firm, there is no reason to award the firm a premium over hourly rates. The Court stated that judicial review yields an unfettered evaluation of the reasonable value of the services without the consideration of extraneous factors. The Court allowed compensation to the extent that separate or additional counsel were engaged because the interests of the preliminary co-executors may have diverged or separate counsel was not employed to perform the same work. The Court would not, however, approve compensation where the use of multiple lawyers from different firms was excessive or unnecessary. *In re Doris Duke*, N.Y.L.J., May 3, 2000, p. 28, col. 6 (N.Y. Co. Surr. Preminger).

ATTORNEY'S LIEN

The Court rejected the argument that the attorney is deprived of a charging lien because he no longer acted as counsel at the time the matter was settled, following the Court of Appeals ruling acknowledging an attorney's entitlement to a lien even where he withdraws from a case prior to settlement, provided there is no misconduct by the attorney, or the attorney is not discharged for good cause or abandonment of the client. The Court also stated that the establishment of a charging lien should not turn on whether the prospective lienor was directly responsible for the creation of the fund to be charged. The Court finally stated that a hearing may be required to establish the reasonableness of the fee. *In re Martin Tananbaum*, N.Y.L.J., May 26, 2000, p. 27, col. 3 (N.Y. Co. Surr. Roth).

CLAIMS

In a proceeding to determine the validity of a Department of Social Service claim for Medicaid payments to the decedent, the Court held that, pursuant to CPLR 4518, computer printouts of Medicaid benefits are admissible as business records in order to support a claim against an estate, subject to further inquiry by the executor. *In re Mildred Zinna*, N.Y.L.J., March 13, 2000, p. 31, col. 5 (Nassau Co. Surr. Radigan).

The Court stated the general rule that for a claim against an estate to constitute an enforceable debt, it must be one that is collectible; if it is precluded by law, by the statute of frauds, for instance, then it cannot be collected, citing EPTL 13-2.1. The Court held that when the claimant testified that her mother repeatedly promised to compensate her from her estate she may very well be speaking the truth, but unfortunately such oral promises are unenforceable. *In re Katharine C. Margraf*, N.Y.L.J., June 26, 2000, p. 25, col. 1, (Nassau Co. Surr. Radigan).

The Court enforced the terms of a prenuptial agreement, finding that the decedent and the surviving spouse were "married to each other and living together as husband and wife in the same home at the date of death" of the decedent. *In re Jean Gleick Camhy*, N.Y.L.J., June 14, 2000, p. 33, col. 5 (Queens Co. Surr. Nahman).

CONSTRUCTION

The decedent's 1927 will, which was admitted to probate in 1934, provided a trust for his wife and daughter, with the provision that after they died, if there were no issue, the remainder should go to repay some of the $4.2 billion Britain had borrowed from the United States to finance its World War I effort. The decedent's only daughter died in 1996 without children. Over the objections of the daughter's estate, the Court enforced the will, applying international law since the debt arises between two autonomous sovereigns. The Court stated that although Britain had stopped paying its debt in 1934 and the United States made no effort to collect, there was no evidence that the United States waived its right to be repaid as official records listed it as outstanding. *In re James Bertram*, N.Y.L.J., April 13, 2000, p. 32, col. 2 (Westchester Co. Surr. Emanuelli).

Where a will disposed of the residuary estate "to issue then living of my daughter and my sons, per stirpes," and the daughter had six children and the son had one child, the Court held that the stirpes starts at the grandchildren's level, not the children's level, so each grandchild takes one-seventh. *In re James B. Magnor*, N.Y.L.J., March 29, 2000, p. 32, col. 4 (Nassau Co. Surr. Radigan).

Each trust under the will provided for the payment of income for the life beneficiary and contained an invasion power up to the full amount of the principal of the trust. The trusts did not contain a bequest of the remainder upon the deaths of the life beneficiaries. The petitioner requested that the Court reform the will to include a bequest of the remainder to the children of the income beneficiaries, alleging that this would provide tax relief in that the decedent's GST exemption could be allocated to the trusts. The Court found nothing in the record to lead to the conclusion that it was the testator's intent that his grandchildren be the remainderman of the trust. The Court stated that it cannot reform, rewrite or reconstruct the will and it may not add new provisions. The Court held that it cannot draft a disposition of the remainder under the guise of reformation. The Court further determined that where a will creates a valid life estate but fails to dispose of the remainder, it falls into the residuary. Although the life beneficiaries are the same as the residuary beneficiaries (the decedent's children), the Court held that the trust will continue for their lives with the remainder payable to their respective estates, stating that there is nothing incongruous or illegal in a life beneficiary being vested with a remainder that can never come into actual possession. *In re Louis Grossman*, N.Y.L.J., May 18, 2000, p. 34, col. 6 (Nassau Co. Surr. Radigan).

CY PRES

The Court found that the hospital-beneficiary under the decedent's will and the will of his deceased wife has met the three required tests for application of the *cy pres* doctrine under EPTL § 8-1.1 and thus granted the hospital's application to modify the restrictions in the wills so as to permit the hospital to secure new financing and renovate and improve facilities necessitated by the dramatic changes in the health care industry. The three conditions that must be met are: (1) the gift or trust must be charitable in nature, (2) the language of the will or trust instrument, when read in the light of all attendant circumstances, must indicate that the donor demonstrated a general, rather than a specific, charitable intent, and (3) it must be determined to the Court's satisfaction that the particular purpose for which the gift or trust was created has failed, or has become impossible or impracticable to achieve. *In re Donald F. Othmer*, N.Y.L.J., June 5, 2000, p. 35, col. 3 (Kings Co. Surr. Feinberg).

DISQUALIFICATION OF SPOUSE

In an administration proceeding, the Court held that the decedent's mother failed to establish that the objectant-husband is disqualified as the decedent's surviving spouse on the grounds of abandonment or failure to support. As to abandonment, the Court stated the rule that the person alleging abandonment must have established that the decedent and the objectant lived separate and apart and also that the objectant departed without any justification or intention to return. The Court found that it was the decedent rather than the objectant who departed from the marital abode and the departure was consensual. The Court stated further that if the petitioner had established that the objectant refused to desist from engaging in sexual relations with the objectant's sister, such evidence might suffice to support a funding of constructive abandonment. As to support, the petitioner had to establish that the decedent had looked to the objectant for support, that the objectant possessed the means to furnish support and that he failed to provide support. The Court found that the objectant was entitled to receive letters of administration and was not disqualified as a surviving spouse under the existing applicable statute (EPTL 5-1.2). Nevertheless, the Court noted that it is its opinion that the result is neither in accord with the probable wishes of the decedent nor is it supported by public policy considerations. The Court referred the decision to the Surrogate's Advisory Committee in order that it may consider whether to propose legislation which would disqualify a surviving spouse on the basis of having lived separate and apart from the decedent for a specific period prior to death, such as three to five years and where there was no outstanding order of support for the survivor. *In re Susana Carmona*, N.Y.L.J., May 12, 2000, p. 30, col. 2 (Bronx Co. Surr. Holzman).

GIFT BY IMPLICATION

The Court considered the question of whether under a joint will, which failed to provide expressly for the disposition of the survivor's own estate, the survivor disposed of her estate by implication. The will would have disposed of the survivor's estate if she and her husband had died simultaneously as the result of a common disaster. Relying on the Court of Appeals case in *In re Bieley*, 91 N.Y.2d 520, the Court stated that it may be appropriate to find a gift by implication where the will reflects an intent to dispose of the entire estate, but does not address the particular contingency that has occurred. In such a case, however, the implication must "be a necessary one, not merely one that is possible or probable,". . . it "must be so strong . . . that the contrary cannot be supposed." The Court found a gift by implication to the four beneficiaries named in the will. *In re Marie J. Reid*, N.Y.L.J., June 27, 2000, p. 21, col. 2 (N.Y. Co. Surr. Roth).

INTEREST

The Court determined that although the Court has discretion to award interest at a rate lower than 9%, the rate of 9% is presumptively fair and reasonable. Thus with respect to interest on the funds improperly withdrawn from the infant, the Court fixed the rate of interest at 9% pursuant to CPLR 5004. *In re Jessica Kathleen Egan*, N.Y.L.J., March 14, 2000, p. 31, col. 4 (Suffolk Co. Surr. Prudenti).

The Court found that the 6% interest rate set forth in EPTL 11-1.5 is sufficient compensation for the delay in distributing the elective share to the surviving spouse, such interest to be paid from seven months from the time letters issued to the executor. The Court found that the delay was not so "unreasonable" so as to justify the Court's exercise of its discretion under EPTL 11-1.5(e) to award 9% interest. *In re Harold Lester Goodman*, N.Y.L.J., May 19, 2000, p. 24, col. 2 (N.Y. Co. Surr. Preminger).

The Court denied petitioner's request for compound interest on damages for breach of an agreement, stating that compound interest is not favored by the Courts and requires express agreement by the parties. The Court thus awarded only simple interest even though the respondent repeatedly showed contempt for the agreement and Court orders. *In re Sara H. Davidson*, N.Y.L.J., June 22, 2000, p. 35, col. 3 (Nassau Co. Surr. Radigan).

INVASION IN FURTHER TRUST

The Court granted an application by the trustees of an irrevocable trust to appoint the principal to a supplemental needs trust for the benefit of the beneficiary of the trust who suffered from a disability, applying EPTL 10-6.6 (b)(2). The Court stated that the proposed transfer of the corpus to a supplemental needs trust will not reduce any fixed income interest of the beneficiary because all payments of principal or income are discretionary with the trustees. The only possible complication was that the trust was to terminate when the beneficiary reached age 32 on April 5, 2000. If that should happen, a guardian could seek to establish a supplemental needs trust for the beneficiary at that time. However, the trust could then lose its third-party status and be deemed a self-settled trust, subjecting it to a requirement that the trust include a pay-back provision which is not required for third-party trusts. The Court reasoned that it is certainly reasonable for the trustees to seek to maintain the protection from government claims to which the trust has been entitled and it is apparent that the proceeding is brought in good faith. *In re Alfred Hazen*, N.Y.L.J., April 11, 2000, p. 30, col. 5 (Nassau Co. Surr. Radigan).

JURISDICTION—LETTERS OF ADMINISTRATION

The Surrogate's Court of Nassau County granted limited letters of administration where the sole asset of the estate was the decedent's claim against Syria pursuant to the Foreign Sovereign Immunities Act § 1605(a)(7). The decedent, a U.S. citizen residing in Israel, was killed in Jerusalem allegedly as the result of a terrorist bombing incident sponsored by Syria. The Court analyzed the Anti-Terrorism and Effective Date Penalty Act, which amended the Foreign Sovereign Immunities Act in 1996. In light of the amendment, the Court found that petitioner had asserted a basis for jurisdiction in the U.S. courts and as the Act specifically provided for jurisdiction in any state or federal court in the U.S., the Court stated there was no reason to deny granting the application. *In re Ira Weinstein*, N.Y.L.J., July 7, 2000, p. 35, col. 3 (Nassau Co. Surr. Radigan).

JURISDICTION—LANDLORD AND TENANT

The administrator of the decedent's estate commenced a turnover proceeding against the tenants of a multiple dwelling apartment building owned by the decedent seeking to have the funds held by the tenants turned over to petitioner, seeking damages against a tenant association and for eviction of tenants who failed to turn over rent arrears. The Court dismissed the action against the community association, finding that its activities to be protected by the Real Property Law § 230 and the U.S. Constitution. The Court then stated that it is well-settled that the Surrogate's Court has jurisdiction to entertain landlord-tenant disputes involving the affairs of a decedent, but nevertheless not every landlord-tenant dispute is appropriately entertained by the Surrogate's Court, especially "garden variety" summary proceedings. Since the property was no longer at risk of foreclosure, the Court held that the remaining landlord-tenant disputes are more appropriately determined in the Civil Court. *In re Rose Asaro* N.Y.L.J., July 7, 2000, p. 33, col. 4 (Kings Co. Surr. Feinberg).

PROBATE—OBJECTIONS DISMISSED

The Court stated that where an attorney supervises the execution of a will, it is presumed that all of the statutory requirements have been met. The Court found that the testimony of the attorney-draftsman and the other attesting witness satisfied the proponent's burden on that issue and dismissed the objection as the objectant offered no evidence as to the invalidity of the execution. With regard to the issue of testamentary capacity, the attorney-draftsman and the attesting witness were found to have presented a prima-facie case in favor of testamentary capacity and the objections were dismissed on that issue as the objectant presented only speculation and conjecture. The Court found that the objectant, who has the burden, offered no evidence of fraud, and dismissed that objection. With regard to undue influence, to be successful the objectant must show (1) the existence and exercise of undue influence, (2) the effective operation of undue influence as to subvert the mind of the testatrix at the time of the execution of the will and (3) the execution of a will that but for undue influence would not have been executed. The Court found no proof of undue influence and dismissed that objection as well. *In re Anne Baker Delaney*, N.Y.L.J., June 5, 2000, p. 36, col. 6 (Nassau Co. Surr. Radigan).

REAL ESTATE—USE AND OCCUPANCY

The Court considered the amount of rent to be charged the decedent's son, after establishing the estate's right to charge rent on the basis of *Limberg v. Limberg*, 256 App. Div. 72, *aff'd*, 281, N.Y. 821, which stands for the proposition that a person in possession of real estate can be compelled to pay rent for the portion he occupies. The Court found that the son, who occupied the decedent's one-family house, could not successfully argue that since he only used two rooms of a seven-room house, he should pay 2/7 of the reasonable rent. *In re Carmela P. Roberts*, N.Y.L.J., June 12, 2000, p. 36, col. 3 (Nassau Co. Surr. Radigan).

RENUNCIATION

The Court granted an application by the executor of the deceased husband's estate to renounce certain joint property so as to take advantage of the decedent's unified credit. The Court found no need to serve citation on those whose interests are created or increased by the renunciation. The Court stated that the notice to such persons required by the statute is not jurisdictional and is not intended to give the recipient standing to contest the renunciation. *In re Isidore Lowenstein*, N.Y.L.J., May 19, 2000, p. 31, col. 3 (Nassau Co. Surr. Radigan).

SANCTIONS—DISCLOSURE

The Court stated that CPLR 3126 has consistently been read to mean that a pleading will not be struck as a penalty for failure to comply with disclosure, unless the party seeking the sanction can show that the failure was deliberate or contumacious. The Court found that a more appropriate remedy is to impose a monetary sanction to compensate petitioners for the expenses they incurred in preparation for and attendance at both scheduled depositions at which the respondent failed to appear as well as the legal fees and disbursements incurred by counsel in preparation of the instant motion. *In re David Reichberg*, N.Y.L.J., June 19, 2000, p. 36, col. 4 (Westchester Co. Surr. Emanuelli).

SURVIVING SPOUSE

A state court judge in Kansas upheld a son's challenge to the second marriage of his father to an individual who had been born a male but had had a sex change operation in Wisconsin. The Court, according to the *Wall Street Journal*, in effect issued a "once-a-man—always-a-man" ruling. The spouse is appealing. The decedent died intestate so the result of the ruling was that the son inherited his father's entire $2.5 million estate. *In re Marshall Gardiner*, Wall St. J., July, 7, 2000, p. 1, col. 4.

TRUSTS—AMENDMENT OR REVOCATION

The Court stated the general rule under EPTL 7-1.9 that the court may permit amendment of a trust agreement without the consent of infants or other beneficiaries who are unable to give their consent, so long as the proposed amendment does not reduce the beneficial interest of those particular parties. Since the proposed amendment did not adversely affect the infant's interest, the Court dispensed with the consent of the infant contingent remainderman. *In re Wynn Breen Trust*, N.Y.L.J., June 28, 2000, p. 27, col. 5 (N.Y. Co. Surr. Preminger).

TRUSTEE ESTOPPEL AND COMMISSIONS

In a contested accounting proceeding, where the individual trustee filed objections to the commissions of his corporate co-trustee, the Court stated that statutory commissions are deemed reasonable as a matter of law. The Court found the objectant to be estopped from challenging his co-trustee's commissions because of his own conduct and silence during the administration of the trust; the objectant was deemed to have acquiesced and consented to the payment of such commissions. *In re Maxwell A. Maybaum* N.Y.L.J., 5/19/00, p. 29, col. 3 (N.Y. Co. Surr Preminger).

TRUSTS—INVESTMENTS

The Court considered the standard of investment prudence by which to judge the conduct of trustees of 30-year-old *inter vivos* trusts. The trust was funded with Teledyne Stock, a company to which the grantor had sold a portion of his family's business. The trustees were the grantor's brother and a bank. The trust provided that no sales of securities would be made except upon the written direction of the grantor's brother, the co-trustee. In an accounting for the trusts, the grantor's children seek to surcharge the bank for its failure to sell 95% of the Teledyne Stock as soon as the trusts were created and for losses attributable to the Bank's failure to retain the portfolio of equities which were sold by the bank at the request of the grantor. The Court refused to grant summary judgment for either side in view of the essentially factual nature as to whether the Bank's conduct complied with the prudent person standard then in effect. The Court distinguished the *Janes* case (165 Misc. 2d 743, mod. 223 A.D.2d 20, *aff'd*, 90 N.Y.2d 41) which held that the bank which was co-executor of decedent's estate with his elderly widow should have promptly sold 95% of the Kodak stock and its failure to do so was imprudent and a breach of fiduciary duty. The Court stated that *Janes* involved an estate which was the sole support of a widow, not an *inter vivos* trust holding the stock of a company that was continuing the grantor's family business and could be sold only at the direction of the co-trustee and the trust agreement's provisions confirmed discretion not to diversify. *In re Kuo Chengi Li*, N.Y.L.J., April 26, 2000, p. 27, col. 4 (N.Y. Co. Surr. Roth).

TRUSTS—OUTRIGHT DISTRIBUTION

The decedent's will provided for the establishment of three memorial funds, two in the amount of $5,000 each and the third to pay $1,000 a year to students attending a university. The residuary estate will be about $34,000. The Court found that although testamentary trusts may not be avoided merely by consent of the parties if it appears that this would contravene the intent of the testator, there is precedent for permitting the assets of a trust to be distributed outright where its administration would be economically unfeasible. The Court found that it appears that the decedent's intention to benefit the charitable beneficiaries is clear and would not be contravened by outright distribution. *In re Lou Rettie*, N.Y.L.J., June 2, 2000, p. 27, col. 6 (Bronx Co. Surr. Holzman).

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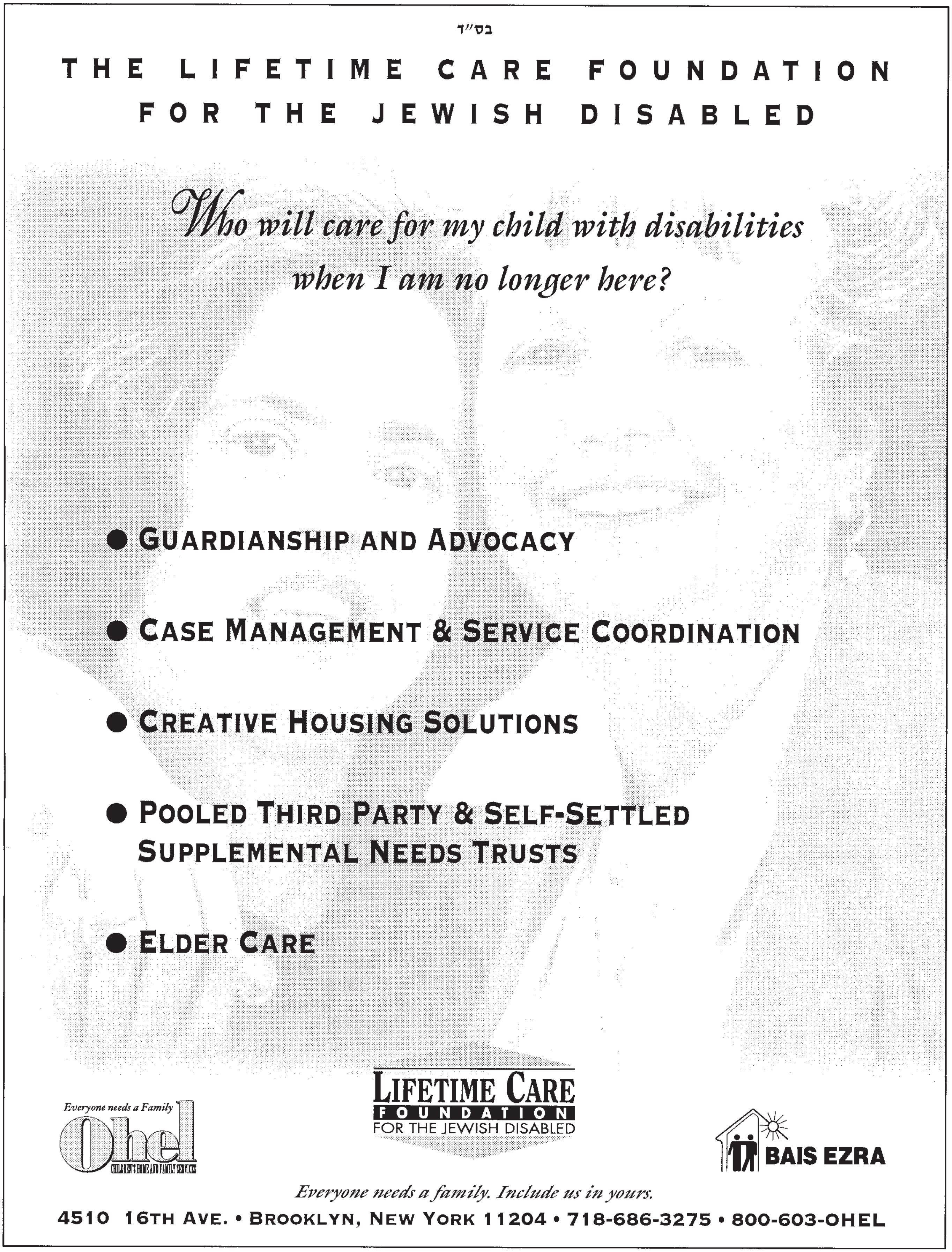

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RECENT NEW YORK STATE DECISIONS

John C. Welsh

WILLS

PROBATE—WILL EXECUTION

Objectant failed in her proof of improper execution and lack of testamentary capacity. The presumption of regularity arising when the attorney-draftsman supervises the will execution was not overcome. Failure of the attesting witnesses to recall the circumstances of the execution ceremony was insufficient. It was within the discretion of the Surrogate to allow the recall of the two attesting witnesses after they had finished testifying. Proponent had not rested and objectant had a full opportunity to cross-examine and thus suffered no prejudice. Proof indicated that decedent knew the nature and extent of her property and the natural objects of her bounty. *In re Finocchio*, __ A.D.2d __, 704 N.Y.S.2d 634 (2d Dep't 2000).

PROBATE—CAPACITY—UNDUE INFLUENCE

Nephews, grandnieces and grandnephews objected to the probate of decedent's will executed four days before his death. The Appellate Division affirmed the dismissal of the objections by the Surrogate. Testimony of the attorney-draftsman, an attesting witness, was sufficient to meet the proponent's burden of proof. Opposition affiants had no personal knowledge of decedent's capacity or of any undue influence or fraud actually exercised. Objectants failed to substantiate their claim that they needed additional time to obtain decedent's medical records after the expiration of the discovery period. *In re Dietrich*, __ A.D.2d __, 706 N.Y.S.2d 763 (3d Dep't 2000).

PROBATE—OBJECTIONS BY REPLACED EXECUTOR

An attorney nominated in testator's will as executor and trustee sought to file objections to a later codicil which replaced him in each capacity with another attorney. As a means of obtaining permission to object based upon good cause shown, the attorney waived all commissions which had been limited under the will to one-half of the statutory amount. Decedent's widow and two daughters, the distributees, consented to the probate of the will and the codicil. The Surrogate found that the statutory requirement of good cause was applicable irrespective of whether the fiduciary claimed commissions. It was intended to shield the estate from excessive expense or delay. Proof indicated that the widow felt more comfortable with the replacement attorney named in the codicil who had been named as a successor executor in an earlier will which designated the widow as the primary fiduciary. The replaced attorney's claim that he would not have been replaced if decedent had known about a discontinued guardianship filing by the named attorney was mere speculation. The widow was frail and depressed and was not capable of managing her own affairs. When her husband's health improved following an illness, he was able to manage her financial affairs and no guardianship was then deemed necessary. *In re Torczyner*, 183 Misc. 2d 564, 706 N.Y.S.2d 573 (Sur. Ct., N.Y. Co. 2000).

CLAIMS OF COMPANION TO AN ESTATE SHARE

The female companion of decedent claimed a substantial portion of his estate as legatee under a will that could not be located after decedent's death. One attesting witness asserted that she and another named person signed a document that had been handwritten by the companion. She did not state that the will was signed or acknowledged by decedent in her presence. The other alleged witness stated that he had never seen decedent's will. Even if the will was properly executed, no copy was produced and the presumption of revocation was not rebutted. The companion also failed in her proof that she and decedent had created a common law marriage under Pennsylvania law through several overnight stays in that state. The basic cohabitation continued in New York and decedent did not hold himself out as married to his companion. Although a confidential relationship existed between decedent and his companion, she was unable to show that she had relied upon any promise of decedent that would justify impressing a constructive trust in order to prevent the unjust enrichment of the distributees. *In re Certo*, __ Misc. 2d __, 707 N.Y.S.2d 588 (Sur. Ct., Niagara Co. 1998).

DESCENT AND DISTRIBUTION

PROOF OF PATERNITY

Following decedent's death intestate in 1993, two daughters of his long-term companion claimed to be his children and thus entitled to inherit as distributees. Each daughter denied the paternity claim of the other daughter and the Surrogate upheld both denials. Although the record showed that decedent had acknowledged each claimant as his own, it was also necessary for a successful claimant to prove paternity separately by clear and convincing evidence. Claimant M was supported by her mother who asserted that she had sexual relations exclusively with decedent at the time M was conceived. As to claimant D, her mother denied the paternity of decedent and asserted that D was conceived in a random sexual encounter during a time when she and decedent were estranged. The relationship of the mother with M was far closer than her relationship with D who had been sent to live with foster parents shortly after her birth. Decedent's bond with M was also much stronger than with D. After finding paternity of M but not D, the Appellate Division remitted the matter to the Surrogate for further proceedings. *In re Sekanic*, __ A.D.2d __, 705 N.Y.S.2d 734 (3d Dep't 2000).

PROOF OF PATERNITY

The mother of a nonmarital daughter brought an action to establish paternity in a decedent who had died suddenly approximately four months before the child's birth. If successful, the daughter would be decedent's sole distributee. The mother failed to provide evidence that the decedent had "openly and notoriously acknowledged the child as his own." However, the court accepted proof of an earlier paternity blood test taken by decedent which proved that he was not the father of a child born to a different woman. When the results of this test were compared with blood samples of the alleged daughter and her mother, the probability of paternity was found to be 98.35%. Comparison with the blood samples voluntarily provided by decedent's parents indicated a paternity probability of 99.69%. The Surrogate was concerned about lack of completeness in the comparison of decedent's blood samples since only one system benchmark was used. Consequently, the matter was remanded pending a hearing on the results of a complete analysis on all of the systems for which decedent was originally tested. *In re Wilkins*, __ Misc. 2d __, 707 N.Y.S.2d 774 (Sur. Ct., Niagara Co. 2000).

ADMINISTRATION OF ESTATES

INCLUSION OF ASSETS IN ESTATE

About ten years before his death intestate, decedent opened accounts for A and B, two of his four children, in his name as custodian for each of them under the Uniform Gifts to Minors Act. Thereafter, decedent made periodic transfers of these funds to other UGMA accounts, sometimes changing owners from one child to another. At decedent's death all of the funds were held in accounts in decedent's name. The Appellate Division found that irrevocable gifts were made to each named child when the accounts were opened and the proceeds of those accounts held by decedent at death were owned equally by A and B so as not to be part of the estate. In addition, three accounts under a Keogh profit-sharing retirement plan were awarded to A and B, the named beneficiaries under a change designation that had removed all four children, the original designees. The omitted children were unsuccessful in their attempt to show an unauthorized deletion on the beneficiary change form. The names of the omitted children had appeared on the substitute designation form with lines drawn through them. *In re Ajamian*, __ A.D.2d __, 705 N.Y.S.2d 704 (3d Dep't 2000).

RIGHT TO ACCOUNTING

Following the death of A, intestate, her sister, B, was appointed administrator of the estate. During the next six years, various distributions were made to C, a third sister, but no accounting had been made despite C's request. When B died ten years after A, C began a proceeding to compel an accounting against the executor under B's will. The Appellate Division found that the six-year statute of limitations had not run since the claim remained open until there was an open repudiation of the fiduciary obligation or the judicial settlement of an account. There was no claim that either event had occurred. Inquiries by C of B while B was serving as administrator did not cause the statutory period to begin running. *In re Rodken*, __ A.D.2d __, 705 N.Y.S.2d 429 (3d Dep't 2000).

RECOVERY FOR BREACH OF FIDUCIARY OBLIGATION

Petitioner was unsuccessful in her proceeding to compel the administrator of decedent's estate to pay the full amount of a final judgment entered against him in his representative capacity since the account of the estate had not yet been settled. Any attempt to recover on his fiduciary bond was premature since his liability had not been fully ascertained. *In re Zipser*, __ A.D.2d __, 704 N.Y.S.2d 277 (2d Dep't 2000).

PETITION TO COMPEL PAYMENT OF LEGACY

In a proceeding to compel payment of a fractional residuary legacy, the executor sought to avoid payment by asserting that unspecified tax liabilities might consume the assets of the estate. The Appellate Division affirmed the Surrogate's decision that the legacy must be paid. Speculation alone was insufficient to defeat the application. *In re Ehmer*, __ A.D.2d __, 708 N.Y.S.2d 143 (2d Dep't 2000).

ELECTIVE SHARE—EXTENSION OF TIME

In 1985, testator made a will which left the entire residue in trust to pay the income to his wife for life with remainder to his nieces. Under the elective share statute in effect at that time, the wife would have no right of election if she survived. When testator died in

1999, the law had changed so that a life income trust no longer satisfied the elective share requirements. A surviving spouse could choose to reject the entire income interest and take outright one-third of the elective share estate or refrain from electing and accept the benefits provided by decedent. When the spouse attempted to elect and take one-third of the estate outright and preserve her income interest in the remaining portion of the trust, the Surrogate found no statutory authority permitting such a choice. Consent by the nieces to the spouse's plan was irrelevant. The time to elect was extended an additional 45 days to allow the wife to make an informed decision. *In re Bank*, __ Misc. 2d __, 707 N.Y.S.2d 800 (Sur. Ct., Kings Co. 2000).

TRUSTS

SUBSTITUTE TRUSTEE DESIGNATION

At decedent's death in 1973, she created trusts for two sisters and named her father as trustee with a corporate trustee named as "substitute." When the father died 24 years later, the corporate trustee stood ready to serve. However, each sister sought appointment as sole trustee of the trust for her benefit as "successor" to her father. The Appellate Division found no distinction between the use of "substitute" for "successor" and held that the trust company was clearly intended to assume the fiduciary responsibilities upon the father's death. Elimination of the merger rule which formerly barred a sole beneficiary from being sole trustee has no relevance when the beneficiary is not named as trustee. No case for reformation was made since no mistake was shown. No ambiguity existed. Unwillingness of the income beneficiaries to pay commissions was not a reason to vary the clear terms of the trust. *In re Wickwire*, __ A.D.2d __, 705 N.Y.S.2d 102 (3d Dep't 2000).

APPOINTMENT BY GUARDIAN OF ADDITIONAL TRUSTEES

E created a revocable trust for her benefit with specific retained power to alter, amend or revoke the trust in whole or part by providing written notice to the three trustees, herself, her attorney and L, her brother. The trust provided that, upon E's inability to serve as trustee the trustees "surviving her, shall be the sole Trustees." Three years later, E was adjudicated to be an incapacitated person under Mental Hygiene Law Article 81. L was named as guardian and served briefly until shortly before his death when his son, J, became E's sole guardian. Over the objection of E's attorney, L had sought to add J and K as additional cotrustees based upon L's right as guardian to exercise the power of modification retained by E. Following L's death, J sought an order validating L's designation of the two additional trustees. The Appellate Division agreed that L properly exercised E's retained right of modification. Under the statutory plan, a court may authorize a guardian to exercise almost any right retained by the incapacitated person. Trust modification was found to be within this general grant of power. Inclusion of J and K as trustees continued family involvement in the administration of the trust as intended by the settlor. The Appellate Division stated that it would have been better practice for L to have petitioned for judicial approval prior to exercising the power of modification. *In re Elsie B.*, __ A.D.2d __, 707 N.Y.S.2d 695 (3d Dep't 2000).

ACCOUNTING—COMMON TRUST FUNDS

After 18 years of administering a testamentary trust for the testator's daughter, the corporate trustee filed an intermediate account which was judicially settled after payment of a surcharge with interest. Fourteen years later, a successor trustee was appointed to continue paying income to testator's daughter who lived for 30 years after the date of the intermediate account. When the successor trustee filed its final account, the remaindermen objected that petitioner had failed to comply with the prudent person rule then in effect which resulted in a principal loss of $34,000. Here petitioner had permissibly invested the trust corpus in common trust funds as regulated by Banking Law 100-c and had filed five accountings which were judicially settled during the 30 years after the intermediate account. The Appellate Division found that these decrees were binding and conclusive on the remaindermen in that they concluded that the prudent person standard had been satisfied. The argument of the remaindermen that it was imprudent to use common trust funds as the investment vehicle was held to be unavailing. Under Banking Law 100-c(6), the judicial settlements were binding and conclusive as to all persons having an interest in the common trust funds. *In re Mendleson*, __ A.D.2d __, 706 N.Y.S.2d 228 (3d Dep't 2000).

UNJUST ENRICHMENT

The maker of a promissory note payable to decedent unsuccessfully claimed that two beneficiaries of decedent's estate would be unjustly enriched if they were allowed to inherit a portion of its proceeds. Plaintiff failed in his proof that the beneficiaries prevented decedent from carrying out her intent to release him from the debt. The maker of the note was denied a constructive trust on the proceeds of the note. *Levy v. Moran*, __ A.D.2d __, 704 N.Y.S.2d 609 (2d Dep't 2000).

AUTHORITY OF TRUSTEE TO SETTLE ACTION

After the lower court denied the petition of the trustee for a declaration of authority to enter into a settlement of litigation and to approve a proposed settlement, the Appellate Division found that the trustee had authority to make a settlement agreement and remanded the proposed settlement for further consideration. The terms of this trust agreement gave the trustee authority to begin the underlying suit and the power to take necessary action with respect to the subject matter. These provisions were controlling and gave the trustee the power it sought. *In re IBJ Schroder Bank & Trust Co.*, __ A.D.2d __, 706 N.Y.S.2d 114 (1st Dep't 2000).

SUPPLEMENTAL NEEDS TRUST

The parents of a disabled person sought to establish a supplemental needs trust to be funded solely with supplemental security income (SSI) payments of $500 monthly. A planned relocation of the son to an agency-operated residence was expected to increase the monthly payments to $905. The purpose of the trust was to shelter his income and to depend upon Medicaid and other governmental programs for his care and support. The Surrogate denied the creation of the trust with funds paid for food, clothing and shelter of the recipient. Sheltering these payments would be contrary to the principles of the SSI program. A supplemental needs trust is intended to provide for an enhancement of life over and above basic necessities. *In re Ullman*, __ Misc. 2d __, 707 N.Y.S.2d 603 (Sur. Ct., Onondaga Co. 2000).

CONSTRUCTION—GIFT TAX ANNUAL EXCLUSION

Settlor created two identical inter vivos trusts for the benefit of his two grandchildren with distribution to be made to each grandchild when the beneficiary attained age 21. All income was to be accumulated until that time. Upon death of the beneficiary under age 21, the balance of the trust, if any, became part of the beneficiary's estate. The trustee was empowered to make payments for expenses of the beneficiary directly to the guardian or other person with whom the beneficiary resided. The Internal Revenue Service asserted that the trusts were ineligible for the annual exclusion from gift tax because the accumulation provision barred use of the funds for the child's benefit prior to reaching age 21. The Surrogate reconciled the alternate payment provision and the fund exhaustion possibility with the accumulation provision to allow use of the funds, income and principal, for the benefit of the donee prior to attaining the required age. By so doing, the annual exclusion under IRC 2503(c) was preserved for both trusts. *In re Asserson*, __ Misc. 2d __, 707 N.Y.S.2d 821 (Sur. Ct., Nassau Co. 2000).

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