NYSBA

FALL 2006 | VOLUME 39 | NO. 3

Trusts and Estates Law Section Newsletter

A publication of the Trusts and Estates Law Section of the New York State Bar Association

A Message from the Section Chair

Colleen F. Carew

Mark H. Alcott, President of the New York State Bar Association, has asked each Section to identify its legislative priorities for the year 2007. President Alcott's request presents an opportune time for me to share with you our Section's legislative agenda.

Among our Section's priorities last year was a proposed new statute, EPTL 4-1.4, which provides for the disqualification of a parent found to have abused his or her child from inheriting from that child in intestacy. EPTL 4-1.4 was repealed and a new section enacted in its place. The statute provides that where a parent's rights were terminated by an order of the Family Court, or such an order was suspended pending a Surrogate's Court determination of its compliance, under Social Services Law § 385(b), such parent is disqualified from inheriting from such child.

The new provisions are consistent with our State's public policy to bar a parent from inheriting from a child he or she abandoned or failed to support. Recent reports of horrific abuse by a parent resulting in the death of the child confirmed the urgency for such legislation. The bill was sponsored by Senator John A. DeFrancisco and Assemblywoman Helene Weinstein and signed by Governor Pataki on July 26, 2006 (Chapter 285). We owe special thanks to our members Ilene Cooper and Staci Graber for their efforts on this bill.

While we are proud of this accomplishment there are several other bills for which we continue to seek legislative support.

The Trust and Estates Law Section has identified as our priorities the following: New York State estate tax

Inside

NYSBA

parity with the federal estate tax system; support of the technical corrections to the Principal and Income statute proposed by the EPTL-SCPA Advisory Committee; and revision of the durable power-of-attorney.

Reform of the New York State estate tax credit is dependent upon numerous factors, most important the economy. It is not likely that this bill will pass unless the Legislature and Governor are convinced that the failure to enact estate tax parity will have an adverse impact on state revenue. Notwithstanding the uphill battle, we will continue to devote our efforts in pursuit of parity.

The proposed technical corrections to the principal and income act continue to be refined and we hope that the Legislature will pass the bill within the next year.

Presently pending before the Legislature is a proposed bill which substantially changes the durable power-of-attorney. Warren Whitaker and Ronald Weiss have worked closely with Rose Mary Bailly, Chair of the New York State Law Revision Commission, in proposing changes to the General Obligations Law. Among the concerns with the current law governing powers-of-attorney is the increased incidence of abuse by agents. Recent case law indicates that the use of the power to make gifts is one means by which an agent may take advantage of a principal.

The authority of an agent to make gifts, even to oneself, has been an ongoing source of debate. Is the exercise of such power by an agent substituted judgment, or a means by which the agent may engage in sound estate tax planning for the principal, or perhaps an opportunity to steal? The difficulty is establishing a principal's intent after he or she has become incapacitated.

Warren and Ron proposed that the power to make gifts be set forth in a separate instrument which must be signed by the principal. The creation of a separate instrument under which an agent is authorized to make gifts of the principal's property may provide greater protection to the principal and should be evidence of his/her intent.

Whether a principal intended an agent to have the power to make gifts of substantially all of his property was the subject of a recent important Court of Appeals decision, *In re Ferrara*, 6 N.Y.2d 704 (2006). In *Ferrara*, the administrator, c.t.a. and sole beneficiary of decedent's estate, the Salvation Army, sought to recover $820,000 in decedent's assets transferred by his nephew, Dominick Ferrara, to himself as a gift under a hybrid form of statutory power-of-attorney. Decedent signed the power-of-attorney a few weeks before the transfer. The power-of-attorney expressly authorized the agent to make unlimited gifts to the agent. The gifts were upheld by the Surrogate, which decision was affirmed by the Appellate Division, Second Department.

The Court of Appeals reversed the Appellate Division, holding that the agent must exercise the gift giving power in the principal's best interests. Such standard, which is fundamental to the law of agency, may require us to revisit the proposed gift giving instrument to add language which conforms with the Court of Appeals decision.

Our Section has also proposed three bills which we hope to add to our legislative agenda as priorities. A proposed Slayer Statute has been approved by the State Bar. This statute seeks to disqualify an individual from benefiting financially from non-testamentary assets which pass to him/her as a result of the beneficiary's intentional killing. Our Section will seek sponsorship for this bill this fall.

The Section shall also seek approval by the State Bar of two proposed bills: one which would codify a living will and the other which would disqualify a divorced or legally separated spouse from receiving non-testamentary assets which pass upon the death of the former spouse. Both bills, if approved by the State Bar, will be added to our legislative agenda.

The Trusts and Estates Law Section welcomes your comments on these priorities and your ideas for future legislative proposals.

Colleen F. Carew

The Probate Exception to Federal Jurisdiction

By Eric W. Penzer and Frank T. Santoro

Federal courts are courts of limited jurisdiction, possessing only such power as authorized by the Constitution and by statute.[1] Whether a federal court has jurisdiction to entertain a matter is most often resolved by determining whether the action involves a federal question,[2] or whether there exists diversity between or among the parties.[3] Once jurisdiction is established, the obligation of a federal court to exercise the jurisdiction given to it is "virtually unflagging."[4] In making such jurisdictional determinations, however, there are certain jurisdictional exceptions that courts often have to consider.

One such exception to the jurisdiction of the federal courts is the probate exception. In the broadest sense, the exception excludes probate and certain probate-related matters from the federal courts.[5] The exception has been described as "one of the most mysterious and esoteric branches of the law of federal jurisdiction."[6] Recently, in *Marshall v. Marshall*,[7] the Supreme Court revisited the probate exception, cautioning against its expansive application and stating that the probate exception is "narrow," and should not be used as an excuse for federal courts to decline to exercise jurisdiction over actions merely because they involve a probate-related matter.[8]

I. The History of the Probate Exception—*Markham* and Its Progeny

The probate exception is rooted in Congress' statutory grant of diversity jurisdiction to the federal courts in 1789.[9] The Judiciary Act of 1789 was construed as limiting the grant of jurisdiction to those matters that would have been within the jurisdiction of the English courts of common law and the High Court of Chancery in 1789.[10] Courts, including the Supreme Court in *Markham v. Allen*, expressed the view that neither the English courts of common law nor the High Court of Chancery were vested with the power to address certain probate-related matters, and thus the federal courts also lack such jurisdiction.[11]

In *Markham*, the last Supreme Court case to address the probate exception before *Marshall*, the will of a California resident, which named German citizens as beneficiaries, was admitted to probate in state court.[12] The heirs of the decedent, American citizens, petitioned in state court, asserting that under state law the German legatees were ineligible as beneficiaries, and that petitioners, as United States citizens, were thus entitled to inherit the decedent's entire estate. The Alien Property Custodian, acting pursuant to the Trading With the Enemy Act, purported to vest himself as Custodian with all right, title and interest of the German beneficiaries, and brought suit in federal district court against the executor of the estate and the American heirs for a determination that the American heirs had no interest in the estate and that the entire estate belonged to the Alien Property Custodian.[13] Specifically, the Alien Property Custodian sought a declaration that he was "entitled to receive the net estate of the [decedent] in distribution, after the payment of expenses of administration, debts, and taxes."[14]

In *Markham*, the Court held that the federal district court had jurisdiction to hear the Alien Property Custodian's claim, setting forth a framework for the probate exception that drew various interpretations in the lower courts for more than sixty years, until *Marshall*. The Court explained that the federal courts lack jurisdiction to probate a will or to administer an estate.[15] However, the Court held that beyond the probate of a will or administration of an estate, the "federal courts of equity have jurisdiction to entertain suits 'in favor of creditors, legatees and heirs' and other claimants against a decedent's estate 'to establish their claims' so long as the federal court does not interfere with the probate proceedings or assume general jurisdiction of the probate or control of the property in the custody of the state court."[16]

The Court attempted to clarify this holding by explaining that the fact that the state probate court would be bound to recognize rights adjudicated in the federal court would not constitute an interference with the state probate proceedings.[17] Thus, the effect of the declaratory judgment sought by the Alien Property Custodian would not be an exercise of probate jurisdiction or an interference with property in the possession or custody of a state court. Instead, it would merely determine the Alien Property Custodian's right in the property, following administration by the state probate court.[18]

In the wake of *Markham*, courts employed various methods for determining the scope of the probate exception. While it was clear, after *Markham*, that federal courts could not probate or administer wills, the import of the Court's instruction that federal courts have jurisdiction "so long as the federal court does not interfere with the probate proceedings or assume general jurisdiction of the probate or control of the property in the custody of the state court" was subject to varying interpretations.[19]

Some courts examined the treatment of probate jurisdiction by the states. For example, in *Lamberg v. Callahan*, the Second Circuit was careful to cite the above-quoted language of *Markham*, but went on to hold that "[t]he standard for determining whether federal jurisdiction may be exercised is whether under state law the dispute would be cognizable only by the probate court. If so, the parties will be relegated to that court; but where the suit merely seeks to enforce a claim *inter partes,* enforceable in a state court of general jurisdiction, federal diversity jurisdiction will be assumed."[20] Commentators have described this approach as the "route test."[21] Under the route test, if a dispute could only be resolved by a probate court, and the state court of general jurisdiction had no subject matter jurisdiction, the federal court similarly had no jurisdiction.[22]

Other lower courts attempted to apply the probate exception by examining whether the claim asserted in federal court would require the court to rule on the validity of a will. Essentially, while the federal court could not make a ruling which would affect the validity of the will, it could affect a right to share in the distribution of the estate. Under this approach, the federal courts could not invalidate a will for lack of capacity or undue influence, but could make a declaration as to the interpretation of a will.[23] Commentators have described this approach as the "nature of the claim test."[24]

Still other courts employed what they perceived as the policy goals underlying the probate exception, namely, the judicial economy of resolving probate-related matters in a single forum, utilizing the expertise of state probate courts.[25]

Ultimately, in *Marshall*, the Court rejected all of the tests employed by these lower courts.

II. *Marshall*—The Facts

In *Marshall*, the decedent, J. Howard Marshall II, died without providing for his wife, Vickie-Lynn Marshall, in his will. According to Vickie, Marshall intended to provide for her through a gift in the form of a "catch-all" trust.[26] E. Pierce Marshall, Howard's son, was the ultimate beneficiary of Howard's estate plan.[27]

While the estate was subject to ongoing proceedings in the Texas probate court, Vickie filed for bankruptcy in California, and Pierce filed a proof of claim in the federal bankruptcy court alleging that Vickie had defamed him when her lawyers told members of the media that Pierce had engaged in forgery, fraud, and overreaching to gain control of Howard's assets.[28] Pierce sought a declaration that his claim was not dischargeable in bankruptcy, and Vickie answered and asserted counterclaims, including a counterclaim that Pierce had tortiously interfered with a gift she expected from Howard.[29] The Bankruptcy Court granted summary judgment for Vickie on Pierce's claim and, after a trial, entered judgment for Vickie on her counterclaim for tortious interference, awarding Vickie substantial compensatory and punitive damages.[30]

Following the trial, Pierce filed a post-trial motion to dismiss for lack of subject matter jurisdiction, asserting that Vickie's tortious interference claim could be tried only in the Texas probate proceedings.[31] The Bankruptcy Court and the District Court held that the probate exception did not encompass Vickie's counterclaim, and determined that Pierce had tortiously interfered with Vickie's expectancy by conspiring to suppress or destroy the *inter vivos* trust instrument Howard had directed that his lawyers prepare for Vickie, and to strip Howard of his assets by falsifying documents and presenting them to Howard under false pretenses.[32]

III. *Marshall*—The Ninth Circuit Decision

Citing *Markham*,[33] the then most recent Supreme Court case addressing the probate exception, the Ninth Circuit reversed the district court.[34] In so holding, the court set forth a two-part test for applying the probate exception, which it adopted from the Second Circuit's decision in *Moser v. Pollin*.[35] The first prong of the test was whether "the matter is purely probate in nature, in that the federal court is being asked directly to probate a will or administer an estate."[36] For the second prong of the test, the Ninth Circuit analyzed whether federal jurisdiction would "(1) interfere with the probate proceedings; (2) assume general jurisdiction of the probate; or (3) assume control over property in custody of the state court."[37]

The Ninth Circuit's decision in *Marshall* relied heavily on *Moser*. There, the Second Circuit explained that a federal court could only "assume control over property in the custody of the state court" where there are assets in the custody of a state probate court.[38] Additionally, in determining whether the federal court would be assuming "general jurisdiction of the probate court," the court followed a modified "route test."[39] Finally, the court in *Moser* explained that the "nature of the claim" test applied in determining whether federal courts were prohibited from "interfere[ing] with the probate proceedings."[40] The *Moser* court held that a decision in the federal court would have dictated the result of a pending petition to vacate a decree of probate in the Surrogate's Court, and was thus barred by the probate exception, as such a decision would interfere with probate proceedings.

Citing both *Markham* and *Moser*, the Ninth Circuit broadly interpreted the probate exception to apply to "not only direct challenges to a will or trust, but also questions which would ordinarily be decided by a probate court in determining the validity of the decedent's estate planning instrument."[41] In employing the two-part test as set forth in *Moser*, the court essentially held that the "route test" and the "nature of the claim" test precluded federal jurisdiction. The Court held that Vickie's claim, if successful, would "interfere with probate proceedings," because it would in effect destroy the validity of Howard's will. The Ninth Circuit explained that the probate exception reaches not only to direct challenges to a will or trust, but also encompasses other issues traditionally determined by probate court such as fraud, undue influence, and tortious interference.[42] Additionally, the Ninth Circuit held that where a state has relegated probate matters to a court of special jurisdiction, and stripped its state court of general jurisdiction of the jurisdiction to hear probate matters, as in Texas, that the federal courts also lack jurisdiction over probate matters.[43]

IV. *Marshall*—The Supreme Court

The Supreme Court rejected the Ninth Circuit's opinion that the probate exception applies broadly to issues which would ordinarily be decided by a probate court. The Court explained that "the probate exception reserves to state probate courts the probate or annulment of a will and the administration of a decedent's estate; it also precludes federal courts from endeavoring to dispose of property that is in the custody of a state probate court."[44] Thus, the Court held that the probate exception to federal jurisdiction did not apply to Vickie's claim, as her claim was not for the administration of an estate, the probate of a will, or any other purely probate matter, but was rather a tort claim, for which a judgment was sought against Pierce, and which did not interfere with a *res* in state court custody.[45]

In so holding, the Court addressed *Markham v. Allen*,[46] which was relied upon by the Ninth Circuit in applying the probate exception. The Court clarified language in the *Markham* decision, which it perceived as ambiguous, in order to eliminate confusion in the lower courts as to the breadth of the probate exception.[47] In doing so, the Court reformulated the probate exception to federal jurisdiction, dispelling lower court interpretations of the appropriate scope and nature of the probate exception.

The Court addressed *Markham*'s explanation of the probate exception, that federal courts of equity have jurisdiction to entertain suits "in favor of creditors, legatees and heirs' and other claimants against a decedent's estate to establish their claims so long as the federal court does not interfere with the probate proceedings or assume general jurisdiction of the probate or control of the property in the custody of the state court."[48] The Court further noted that *Markham* held that "[w]hile a federal court may not exercise its jurisdiction to disturb or affect the possession of property in the custody of a state court, . . . it may exercise its jurisdiction to adjudicate rights in such property where the final judgment does not undertake to interfere with the state court's possession save to the extent that the state court is bound by the judgment to recognize the right adjudicated by the federal court."[49]

The Court noted that lower courts have incorrectly interpreted the first quoted passage to preclude federal jurisdiction where federal courts would "interfere with the probate proceedings," as precluding federal jurisdiction over a wide range of matters.[50] The Court held that this language should not be interpreted so broadly, and is merely a reiteration of the second quoted passage in *Markham*, that the probate exception is limited, and should apply where federal jurisdiction would "disturb or affect the possession of property in the custody of a state court."[51] As the Court explained:

> In short, we comprehend the "interference" language in *Markham* as essentially a reiteration of the general principle that, when one court is exercising *in rem* jurisdiction over a *res,* a second court will not assume *in rem* jurisdiction over the same *res.* . . .Thus, the probate exception reserves to state probate courts the probate or annulment of a will and the administration of a decedent's estate; it also precludes federal courts from endeavoring to dispose of property that is in the custody of a state probate court. But it does not bar federal courts from adjudicating matters outside those confines and otherwise within federal jurisdiction.[52]

In its reformulated explanation of the probate exception, the Court declined to employ any of the tests that had developed in the lower courts following the *Markham* decision to determine the scope of the probate exception. For example, the Court rejected what commentators had described as the "route" test, the Ninth Circuit's determination that where a state has relegated probate matters to a court of special jurisdiction and stripped its state court of general jurisdiction to hear probate matters, the federal courts also lack jurisdiction over probate matters.[53] The Court similarly rejected the "nature of the claim test" that had been employed in the Ninth Circuit and in other lower courts.

The Court also declined to undertake an in-depth inquiry into the riveting dispute over the origins of the probate exception to federal jurisdiction. The Court noted that the probate exception has been linked to the Judiciary Act of 1789, which gave lower federal courts jurisdiction over suits in law and equity.[54] Rather than address the legitimacy of the supposed underpinnings of the probate exception, the *Marshall* Court merely stated that Vickie's claims fell far outside the probate exception described in *Markham*.[55]

Justice Stevens, concurring in the judgment, would have gone further, as he explicitly stated that he does not believe that there properly exists any probate exception to federal jurisdiction. Justice Stevens expressed his opinion that the origins of the probate exception as set forth in *Markham* is "an exercise in mythography," and cited cases where the federal courts exercised jurisdiction over matters which would fall within the probate exception recognized in *Marshall*.[56]

V. Case Law Post-*Marshall*

The Supreme Court's decision in *Marshall* has reined in expansive decisions with respect to the boundaries of the probate exception following *Markham*. There have already been several cases decided since *Marshall* that have applied the new boundaries set by *Marshall*, and which provide some insight into how courts will address the question of whether federal jurisdiction will "disturb or affect the possession of property in the custody of a state court," warranting application of the probate exception.[57]

In *Hoffman v. Sumner*, a decedent's widow, the executor of his estate, alleged that she and the decedent owned all shares of stock of certain corporations as joint tenants with rights of survivorship.[58] However, the defendants relied upon an agreement executed by the decedent pursuant to which the decedent and the defendants each owned shares, and a right of first refusal for other shares, of one of the corporations that the plaintiff claimed passed to her by right of survivorship.[59] The plaintiffs alleged that the defendants did not own any shares in that corporation, and that the agreement was unenforceable for various reasons. The plaintiffs sought a declaratory judgment in state court that defendants had no rights or interests in the corporation, and a state tort claim for conspiracy to commit unlawful conversion.[60] The defendants removed the plaintiffs' state court action to federal court on the basis of diversity jurisdiction, and the plaintiffs argued that there was no jurisdiction under the probate exception. Citing *Marshall*, the court held that the case did not fall within the probate exception to federal jurisdiction.[61] The court explained that its determination of the validity of the agreement and its effect on the decedent's ownership of the shares, and its determination of whether the defendants committed a tort against plaintiffs, would not interfere with the state court's administration of the decedent's estate.[62]

By contrast, in *Tolosa-Taha v. Nilooban* the court applied the probate exception to bar a plaintiff's action to quiet title against the defendants and unnamed defendants.[63] In *Tolosa-Taha*, the plaintiff, the son of the decedent, sought to recover unpaid rent from the defendants, and quiet title on property owned by the decedent, against the defendants and other unnamed defendants for the same property.[64] The Court dismissed the case, explaining that if it gave the plaintiff quiet title in fee simple it would be making a finding that the plaintiff was the sole heir, and would disturb the possession of real property in the custody of the Guam probate court.[65] According to the Court, this would be an interference with a *res* of the decedent's estate in the custody of a state probate court as prohibited by *Marshall*.[66]

As more lower courts address *Marshall*, different interpretations will likely emerge as to how and where the boundaries of the probate exception to federal jurisdiction should be drawn. However, practitioners should take note that *Marshall* has clearly reined in expansive views of the scope of the probate exception, and has rejected tests that were previously used in determining the application of the probate exception.

Endnotes

1. *Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 377 (1994).
2. *See* 28 U.S.C. § 1331.
3. *See* 28 U.S.C. § 1332(a)(1).
4. *Colorado River Water Con. Dist. v. U.S.*, 424 U.S. 800, 809 (1976).
5. *Marshall v. Marshall*, 126 S. Ct. 1735 (2006).
6. *Dragan v. Miller*, 679 F.2d 712, 713 (7th Cir. 1982).
7. *Marshall*, 126 S. Ct. 1735.
8. *Id*. at 1744.
9. *Markham v. Allen*, 326 U.S. 490, 494 (1946); *but see* Peter Nicholas, *Fighting the Probate Mafia: A Dissection of the Probate Exception to Federal Court Jurisdiction*, 74 S. Cal. L. Rev. 1479 (2001) (arguing the historical justifications for the probate exception are generally inaccurate).
10. *Markham*, 326 U.S. at 494.
11. *Id*.
12. *Id*. at 492-493.
13. *Id*.
14. *Id*.
15. *Id*. at 494.
16. *Id*.
17. *Id*. at 495.
18. *Id*.
19. *See* Nicholas, *supra* n. 9, at 1489-1490; Christian J. Grostic, *A Prudential Exercise: Abstention and the Probate Exception to Federal Diversity Jurisdiction*, 104 Mich. L. Rev. 131, 150 (2005).
20. *Lamberg v. Callahan*, 455 F.2d 1213 (2d Cir. 1972); *see also McKibben v. Chubb*, 840 F.2d 1525, 1529 (10th Cir. 1988).
21. *See* Nicholas, *supra* n. 9, at 1489-1490; Grostic, *supra* n. 19, at 150.
22. *Id*.
23. *Michigan Tech Fund v. Century Nat. Bank of Broward*, 680 F.2d 736 (11th Cir. 1982) (an action seeking an interpretation of a will is within federal court jurisdiction).
24. *See* Nicholas, *supra* n. 9, at 1489-1490; Grostic, *supra* n. 19, at 150 (2005).
25. *Dragan*, 679 F.2d at 713; *Storm v. Storm*, 328 F.3d 941 (7th Cir. 2003); Nicholas, *supra* n. 9, at 1490-1492.
26. *Marshall*, 126 S. Ct. at 1742.
27. *Id*.
28. *Id*.
29. *Id*.
30. *Id*.
31. *Id*. at 1743.
32. *Id*.

33. *Markham*, 326 U.S. 490.

34. *Marshall v. Marshall*, 392 F.3d 1118 (9th Cir. 2004).

35. *Id*. at 1133; *see Moser v. Pollin*, 294 F.3d 335 (2d Cir. 2002).

36. *Marshall*, 392 F.3d at 1133.

37. *Id*.

38. *Moser*, 294 F.3d at 341.

39. *Id*.

40. *Id*. at 342.

41. *Marshall*, 392 F.3d at 1133.

42. *Id*.

43. *Id*. at 1136.

44. *Marshall*, 126 S. Ct. at 1748.

45. *Id*. at 1748-1749.

46. *Markham*, 326 U.S. 490 (1946).

47. *Marshall*, 126 S. Ct. at 1747-1748.

48. *Id*. at 1747 (*quoting Markham*, 326 U.S. at 494).

49. *Id*.

50. *Marshall*, 126 S. Ct. at 1748 (*citing Mangieri v. Mangieri*, 226 F.3d 1 (1st Cir. 2000) (*holding* claim for breach of fiduciary duty against executor was barred by the probate exception); *Golden v. Golden*, 382 F.3d 348 (3d Cir. 2004) (*holding* claim for breach of fiduciary duty against executor was barred by the probate exception); *Lepard v. NBD Bank*, 384 F.3d 232 (6th Cir. 2004) (*holding* that probate exception applied to daughter's claim for breach of fiduciary duty against trustee of her mother and father's trust because claim fell within exclusive jurisdiction of Michigan probate courts); S*torm*, 328 F.3d 941 (7th Cir. 2003) (*holding* probate exception applied to claim that plaintiff's father tortiously interfered with plaintiff's inheritance by persuading his mother to change testamentary plan, because the practical effect of such suit was to akin to a will contest); *Rienhardt v. Kelly*, 164 F.3d 1296 (10th Cir. 1999) (*holding* probate exception bars claim that defendants exerted undue influence on testator and thereby tortiously interfered with plaintiff's expected inheritance).

51. *Marshall*, 126 S. Ct. at 1748.

52. *Id*.

53. *See Bedo v. McGuire*, 767 F.2d 305 (6th Cir. 1985); *see* Nicholas, *supra* n. 9.

54. *Marshall*, 126 S. Ct. at 1746.

55. *Id*.

56. *Marshall*, 126 S. Ct. at 1750-1751 (Justice Stevens concurring in part and concurring in the judgment).

57. *Hoffman v. Sumner*, Slip Copy, 2006 WL 1444677 (N.D. Ill. 2006).

58. *Id.* at 1.

59. *Id*.

60. *Id*.

61. *Id*. at 2.

62. *Id*.

63. *Tolosa-Taha v. Nilooban*, Slip Copy, 2006 WL 1805692 (D. Guam 2006).

64. *Id*. at 1.

65. *Id*. at 2.

66. *Id*.

Eric W. Penzer is Counsel and Frank T. Santoro is an Associate in the trusts and estates litigation department at Farrell Fritz, P.C., in Uniondale, New York.

Who Constitutes the "Natural Objects of One's Bounty"?

By Michael H. Friedman

As trust and estate practitioners are aware, one of the standard objections to probate is that the decedent lacked "testamentary capacity" when she executed the propounded instrument (the other standard objections are that the instrument was not "duly executed" or that the instrument was procured by either fraud or undue influence). While the burden of proof to demonstrate "testamentary capacity" falls on the proponent of the instrument,[1] where the Will execution was supervised by an attorney the burden shifts to the objectant to prove, by a preponderance of the evidence, that the testatrix did not have the requisite "testamentary capacity" at the time she executed the instrument.[2]

"[I]n response to the question of 'who constitutes the natural objects of one's bounty,' the courts have taken a facts and circumstances approach and have answered, generally, that 'it depends.'"

In order to have the requisite "testamentary capacity" to execute a Last Will and Testament, the testatrix must, at the time of execution, be aware of the nature and extent of her assets, and must know "who would be considered the natural objects of her bounty and her relations with them."[3] To satisfy the former requirement, a testator must only be generally, and not precisely or perfectly, familiar with her assets.[4] The latter requirement, whether the testator was aware of the natural objects of her bounty, is not so easily defined and can even be analogized to United States Supreme Court Justice Stewart's oft-quoted pornography test: "I know it when I see it."[5]

At first blush the term "natural objects of one's bounty" would seem to refer to one's closest relatives, in the order set forth in EPTL 4-1.1, which defines a decedent's intestate distributees. After all, the intestate succession statutes were drafted with the intent of providing for the descent and distribution of a decedent's property in the same manner as the decedent would have provided had she thought to do so. However, in response to the question of "who constitutes the natural objects of one's bounty," the courts have taken a facts and circumstances approach and have answered, generally, that "it depends."

In *In re Bush*,[6] an "'odd,' 'strange' and 'eccentric'" man executed a Will leaving his property to a son and father tandem, the Pringles, who were not members of his family. The uncontroverted testimony of the attorney draftsman revealed that this testator chose not to provide for his wife, from whom he had been separated some seven years and with whom he had no children. The testimony also revealed that the testator was aware that he had two sisters, each of whom had two children, but there was no evidence before the court to suggest that the testator had "a close relationship which would lead to the conclusion that he should have remembered them in his Will."[7] In concluding that the testator was aware of the natural objects of his bounty and his relations with them, the court stated that "[the testator's] choice of the Pringles as his beneficiaries, despite the fact that he had not been in contact with them for some years, is not so unnatural or unreasonable as to cast doubt on his testamentary capacity. He had apparently always felt kindly toward them and, in light of his eccentric disposition, cannot be said to be unreasonable."[8]

In *In re Stephani*,[9] the bizarre testimony of several doctors, an attesting witness and an alienist (yes, an alienist) highlight the exact question that we are attempting to answer. The testator, at the time he executed the Will at issue, had been confined in the criminally insane ward of Dannemora State Prison Hospital for some 32 years. As to whether the testator had the requisite testamentary capacity at the time he signed the Will, notwithstanding his long stay in the insane ward of the prison, the Surrogate had instructed a subscribing witness to the Will that the meaning of testamentary capacity included that the testator "must know his relatives, sometimes called the object of his bounty."[10] This instruction by the Surrogate would suggest that, yes, a testator's next of kin are the natural objects of his bounty.

However, we are told that the actual testimony of the other subscribing witness (Dr. Dexter), Dr. Bailey, and Dr. Hayes (the alienist employed by the prison hospital) was that the testator "knew who his relatives were *and* who were the natural objects of his bounty."[11] The use of the conjunction "and" suggests, contrary to the language employed by the Surrogate, that one's relatives and the natural objects of one's bounty are not necessarily one and the same.

In *In re McCarty*,[12] the testatrix executed a well-thought-out Will, consistent with her prior testamentary plan, to the exclusion of several first and second cousins who were heirs at law pursuant to the then applicable section of the Decedent's Estate Law. The testatrix had more than 30 cousins, only three of whom took under the Will. Most of these cousins lived in other countries, while a few, including the objectants, lived in "Greater New York" (the testatrix was domiciled in Brooklyn). In concluding that the testatrix, at the time of the execution of the Will, was possessed of testamentary capacity, the court noted that the testatrix had lived in this country for many years and it was "easy to see how she could have been oblivious to the claims upon her of these cousins in Ireland, Australia, Glasgow and Liverpool, whom she had probably never seen or heard of except as a matter of family record; and it might even be guessed that she was not recklessly unmindful of the duties of kinship in not keeping track of and remembering in her Will those second cousins, and even a first one, who now seek to overthrow the Will."[13] The court went on to conclude that "the 'natural objects of the testatrix's bounty' have something of a dissolving view; at least they are not as formidable in fact as they appear in rhetoric, and we are of the opinion that a person of sound and disposing mind might absolutely close his eyes and his mind to the existence of his cousins, and grant his entire estate to intimate business and social associates, without giving rise to the presumption of having been defrauded by undue influence in the disposition of his property."[14]

The suggestion, therefore, seems to be that whether an intestate distributee falls within the definition of the "natural objects of one's bounty" depends upon the remoteness of the distributee to the testatrix, both with regard to consanguinity and physical distance.

In his decision in *Estate of Lisa Steinman*,[15] Surrogate Holzman provides insight into those individuals who do not constitute the natural objects of one's bounty. In *Steinman*, objections to probate were filed by three first cousins once removed, the testatrix's sole intestate distributees, all of whom resided in Israel. The depositions and affidavits before the court evidenced that at least two of the objectants had a relationship with the testatrix and corresponded with the testatrix and that, at one time, it was envisioned that one of the objectants would inherit the testatrix's estate (she received only a $5,000 bequest under the propounded Will). However, relying on the fact that the objectants failed to proffer any proof that they communicated with the testatrix within the one-year period prior to the Will's execution or within the following one-year period between the Will execution and the testatrix's death, and that the terms of the Will itself did not suggest foul play or a lack of testamentary capacity, Surrogate Holzman, in granting summary judgment dismissing the objections to probate, held that "[t]here is no basis to conclude that the objectants were the natural objects of decedent's bounty inasmuch as they had not presented any proof to establish that they had any meaningful relationship with her either for the one year period prior to the time that she executed the propounded Will or for the almost one year period from the time that she executed the Will until the time she died."[16]

The court in *Steinman* did not equate one's intestate distributees with the natural objects of one's bounty, but rather seemed to reserve that latter nomenclature for those individuals involved in a current, "meaningful relationship" with the testator.[17]

"The suggestion . . . seems to be that whether an intestate distributee falls within the definition of the 'natural objects of one's bounty' depends upon the remoteness of the distributee to the testatrix, both with regard to consanguinity and physical distance."

In *Estate of Reece*,[18] the testatrix executed a Will in the hospital, shortly before she died, upon learning that she was suffering from terminal lung cancer. In summarily dismissing the objection to probate on the grounds of lack of testamentary capacity, Surrogate Scarpino was unpersuaded by the fact that the testatrix failed to mention any of her intestate distributees to the paralegal who prepared the in-take information for the attorney-draftsman. Rather, in determining capacity Surrogate Scarpino relied upon "the observations of the attesting witnesses and attending physician" and upon the fact that the terms of the Will were consistent with the testatrix's long-standing friendships, church activity and charitable giving.[19] Additionally, Surrogate Scarpino found that the testatrix did recognize one of the objectants as "a family member,"as he was listed as a cousin and as the emergency contact person on the testatrix's admissions records in the hospital, and that the testatrix had received him "warmly" on a visit in the hospital one week prior to the Will's execution. As to another of the objectants, the Surrogate noted that the objectant had met the testatrix "on only three occasions during their lives (a period in excess of 70 years), and had virtually no contact with her during the last 12 years of her life."[20]

Early in the decision the Surrogate seemed to equate the natural objects of one's bounty with one's family, stating that "objectants contend that the decedent did not understand the nature and extent of her assets and the natural objects of her bounty (i.e., her family members)."[21] Yet, in describing the differences between two of the objectants, the Surrogate seemed to be making a clear distinction: the cousin who had a relationship with the testatrix was a natural object of her bounty (and recognized as such by the testatrix), while the cousin who had only met the testatrix three times in over 70 years was not a natural object of her bounty.

In *Estate of William Dolinsky*,[22] the testator's twin daughters and sole distributees objected to the probate of his Will on the grounds, *inter alia*, that he lacked testamentary capacity on the date of execution. In dismissing this objection, Surrogate Scarpino noted that the objectants had virtually no contact with the testator during the final 40 years of his life, since the date their parents divorced when the objectants were 10 years old. Surrogate Scarpino held that the objectants were no longer natural objects of the testator's bounty in that the testator had maintained "a consistent testamentary plan from which the objectants were excluded, and objectants . . . failed to offer any evidence that they corresponded or communicated with the decedent for the majority of their lives."[23]

In *Estate of Eleanore E. Tobin*,[24] the elderly testatrix made a Will leaving $2,000 to each of her two intestate distributees (a niece and nephew), and made significant provisions for her caretaker and a long-standing family friend, which friend was also the petitioning nominated executrix. In discussing the issue of the natural objects of the testatrix's bounty, Surrogate Preminger observed that:

> The evidence establishes that petitioner was definitely a "natural object" of [decedent's] bounty (*Matter of Kumstar*, 66 N.Y.2d 691). Petitioner's mother and decedent were close friends who knew each other for their entire lifetimes, and decedent knew petitioner from the time that petitioner was born. Petitioner was in telephone contact with the decedent throughout the years, and began visiting decedent on a weekly basis as decedent became more aged. Decedent described petitioner as being "like a daughter to me" and the consistency of their friendship is shown in various correspondences submitted in support of summary judgment. In contrast, decedent had no relationship with the objectants during her lifetime, and commented to Ms. Leon, the petitioner, and the attorney who drafted the will that her niece and nephew contacted her infrequently and only to ask for money.[25]

It would appear, therefore, that a non-relative can be considered the natural object of one's bounty, while intestate distributees might not be considered as such absent a close and consistent relationship with the testator.

In *In re Rowehl*,[26] the 93-year-old testator executed a Will leaving his residuary estate equally to his 20 nieces and nephews and to a friend, which plan was in contrast to his prior Will (12 years earlier) in which he had greatly favored one nephew over the rest. In summarily dismissing the nephew's objection as to testamentary capacity, and with respect to the specific issue as to whether the testator was aware of the natural objects of his bounty, Surrogate Radigan concluded that "[a]s far as his awareness of his relatives, the decedent was able to impart comprehensive information to the attorney/draftsperson with regard to his many nieces and nephews, omitting inadvertently a brother and sister who had long since passed away and left no issue."[27] Based upon the specific language in the decision, it seems that Surrogate Radigan was equating one's relatives with the natural objects of one's bounty. It also appears that Surrogate Radigan not only determined that these cousins were the natural objects of the testator's bounty, but that, for better or worse, the testator was aware of his relations with them.

In *Estate of Rosa Sasso*,[28] the testatrix, on her deathbed, executed a one-page Will leaving her entire estate to her companion. In dismissing the objections after a non-jury trial, Surrogate Roth noted that "[a]lthough no mention of relatives was made in the context of the will execution, it is clear that testatrix was not unaware of her siblings since, according to the hospital records, her brother Mario's visit only a few days earlier produced a 'beneficial effect upon her disposition.'"[29] Additionally, Surrogate Roth concluded:

> under the circumstances of this case, it is not unusual that Ms. Sasso disinherited her relatives (citation omitted), particularly since, as mentioned earlier, she had provided for one of them outside of her will. The testimony shows that Ms. Sasso had no particularly close ties with her siblings. On the other hand, she had been living as man and wife for many years with [proponent], who was also her business partner. Clearly, her companion may be considered a natural object of Ms. Sasso's bounty and the will leaving [proponent] the entire probate estate . . . is natural.[30]

In conclusion, while it may amount to a virtual presumption that the natural objects of one's bounty are one's closest relatives, or "intestate distributees," this presumption is rebuttable based upon the testatrix's actual relationships, or lack thereof, with these relatives and with certain non-relatives. In the end, the identity of the natural objects of one's bounty will depend upon all the facts and circumstances of the particular case at hand.

Endnotes

1. *In re Kumstar*, 66 N.Y.2d 691 (1985).
2. *See, e.g.*, *In re Hedges*, 100 A.D.2d 586 (2d Dep't 1984).
3. *In re Kumstar*, 66 N.Y.2d 691 (1985).
4. *In re Fish*, 134 A.D.2d 44 (3d Dep't 1977); *In re Bonafoux*, N.Y.L.J., June 13, 1997, p. 32, col. 4 (Surr. Ct., Bronx Co.).
5. *Jacobellis v. Ohio*, 378 U.S. 184, 197, 84 S. Ct. 1676, 1683, 12 L.Ed.2d 793 (1964).
6. 85 A.D.2d 887 (4th Dep't 1981).
7. *Id*. at 888.
8. *Id*.
9. 250 App. Div. 253 (3d Dep't 1937).
10. *Id*. at 256.
11. *Id*. (emphasis added).
12. 141 App. Div. 816 (2d Dep't 1910).
13. *Id*. at 819-820.
14. *Id*. at 820.
15. N.Y.L.J., Aug. 31, 1998, p. 28, col. 1 (Surr. Ct., Bronx Co.).
16. *Id*.
17. *But see In re Flynn*, 71 A.D.2d 891 (2d Dep't 1979) where the court determined that a question of fact existed as to whether the testator knew the identities of the natural objects of his bounty, based *inter alia* upon the fact that the testator left a piano in his Will to his granddaughter "Ingabor," when in fact his granddaughter's name was "Tegan."
18. N.Y.L.J., Nov. 29, 2004, p. 29, col. 1 (Surr. Ct., Westchester Co.).
19. *Id*.
20. *Id*.
21. *Id*.
22. N.Y.L.J., Jan. 29, 2003, p. 21, col. 6 (Surr. Ct., Westchester Co.).
23. *Id*.
24. N.Y.L.J., Oct. 2, 2000, p. 26, col. 3 (Surr. Ct., New York Co.).
25. *Id*.
26. N.Y.L.J., Oct. 3, 1996, p. 27, col. 5 (Surr. Ct., Nassau Co.).
27. *Id*.
28. N.Y.L.J., Nov. 4, 1992, p. 27, col. 4 (Surr. Ct., New York Co.).
29. *Id*.
30. *Id*.

Michael H. Friedman is a partner in the White Plains, New York law firm of Kurzman Eisenberg Corbin & Lever, LLP.

(paid advertisement)

New Zealand Revises Foreign Trust Legislation

By Peter A. Cotorceanu and Dharshi Wijetunga

In April 2006, New Zealand finally adopted legislation revising its foreign trust regime.[1] The legislation followed two years of proposals, revised proposals, submissions, and debate. The law as enacted differs in some significant respects from prior proposals, not to mention from the bill that was introduced into Parliament.

The law, which goes into effect on October 1, 2006, makes some salutary changes to the prior regime. Although it imposes new obligations on New Zealand resident trustees of foreign trusts, those obligations are not burdensome and, if anything, are likely to enhance New Zealand's reputation as an international trust jurisdiction.

I. Background

Under New Zealand law, a "foreign trust" is a trust where the settlor and all the beneficiaries are non-residents of New Zealand, regardless of the residency of the trustee. Only a foreign trust's New Zealand-source income is subject to New Zealand tax. Thus, even if the trustee is a New Zealand resident, the foreign trust will not be subject to any New Zealand tax if its investments produce only non-New Zealand-source income. This favourable tax treatment, coupled with the fact that New Zealand is not on any country's "black list" of tax havens, has been a major reason for New Zealand's popularity as an international trust jurisdiction.

II. Significance of the New Law

The most significant aspect of the new legislation is the imposition of new record-keeping and disclosure requirements on New Zealand resident trustees of foreign trusts. If the necessary records are not kept or disclosed as required, the trust loses its beneficial tax treatment unless the trustee is a "qualifying resident foreign trustee," as explained more fully below.

A. "Resident Foreign Trustee" v. "Qualifying Resident Foreign Trustee"

The new law distinguishes between "resident foreign trustees" and "qualifying resident foreign trustees." The distinction is significant. If a resident foreign trustee who is not a "qualifying" resident foreign trustee is convicted of violating the record-keeping and disclosure requirements described below, not only is the trustee subject to criminal penalties, but the foreign trust loses its beneficial tax treatment. More specifically, the trust becomes subject to New Zealand tax on *all* of its income, not just any New Zealand-source income, for the year in question. In contrast, if a *qualifying* resident foreign trustee violates the record-keeping and disclosure requirements, the trustee is liable to criminal penalties, but the trust's taxation is not affected. Thus, the law creates a decided incentive in favour of appointing *qualifying* resident foreign trustees.

A "resident foreign trustee" is simply a trustee of a non-charitable foreign trust who is a tax resident in New Zealand. A "qualifying resident foreign trustee," in contrast, is a resident foreign trustee who is a member of an "approved organisation" or, in the case of corporate trustees, that has a director or other person with comparable influence over the company who is both a New Zealand tax resident and a member of an "approved organisation."

An "approved organisation" is one whose members include natural persons who are subject to a disciplinary code and who typically provide trustee services in the course of their business. In addition, such an organisation must satisfy other criteria established by, and must be specifically approved by, the Inland Revenue Commissioner. It is anticipated that the New Zealand Law Society and the New Zealand Institute of Chartered Accountants will be approved by the Commissioner for this purpose.

B. Record-Keeping Requirements

The resident trustee of a foreign trust is required to keep the following records:

- Documents that evidence the "creation and constitution" of the trust (presumably, copies of the trust deed, any amendments, and any related documents);
- Details of contributions to ("settlements on") and distributions from the trust;
- The names and addresses (if known) of the settlor and of any beneficiaries who have received distributions; and
- Detailed financial records, including records of the trust's assets and liabilities, and receipts and expenses.

The financial records mentioned above must be kept for seven years after the end of the tax year to which they relate.

C. Disclosure Requirements

Although a resident foreign trustee must *maintain* the above-referenced records, it is not required to automatically *disclose* them to the IRD. Under the new legislation, a resident foreign trustee is required to disclose, on a one-time basis, only the following information to the IRD (and to update such information as the trustee becomes aware of any changes):

- The name or other identifying particulars of the trust (for example, the date of the settlement);
- The name and contact details of the resident foreign trustees;
- Whether a settlor is an Australian resident; and
- If a resident foreign trustee claims to be a "qualifying" resident foreign trustee:
    a. the name of the approved organisation; and
    b. the name and contact details of the natural person whose membership in the approved organisation is claimed to satisfy the statutory definition of a qualifying resident foreign trustee.

For existing trusts with New Zealand resident trustees, the information must be disclosed within 60 days of the effective date of the new legislation (i.e., within 60 days of October 1, 2006). Otherwise, disclosure is usually required within 30 days of the trustee's appointment, although there are exceptions for, among other things, a non-professional trustee who becomes a New Zealand resident after being appointed trustee.

D. Delegation of Record-Keeping and Disclosure Duties

A resident foreign trustee may appoint any co-trustee who is also a resident foreign trustee as the former's agent for purposes of the record-keeping and disclosure requirements. However, the names of both the appointing and appointed trustee must be disclosed to the IRD.

III. Conclusion

New Zealand's new foreign trust legislation makes some welcome improvements to the country's foreign trust regime. The record-keeping requirements are not burdensome. Indeed, the records that must be kept are precisely the types of records professional trustees routinely keep even in the absence of mandatory legislation. Thus, the new law does not impose any significant new record-keeping requirements on professional trustees. In addition, the information about a foreign trust that must be disclosed to the IRD is not particularly intrusive. It does not include, for example, information about the settlor or the beneficiaries (except whether the settlor is an Australian resident). Finally, the incentive created by the new law to appoint a member of an approved organisation as a trustee (or as a board member of a corporate trustee) should be welcomed.

Endnote

1. *See* Peter A. Cotorceanu, "New Zealand Revises Proposed Changes to Foreign Trust Rules," NYSBA *Trusts and Estate Law Section Newsletter*, Spring 2005, at 28.

Peter A. Cotorceanu is an attorney with Baker & McKenzie Zurich, and Dharshi Wijetunga is an attorney with Baker & McKenzie, Wong & Leow in Singapore. Baker & McKenzie Zurich and Baker & McKenzie, Wong & Leow are member firms of Baker & McKenzie International, a Swiss Verein.

Priority of Creditor Claims Against Estates

By Bruce M. DiCicco

Priority of Payment in General

The Surrogate's Court Procedure Act 1811 sets forth priorities for the payment of estate expenses and debts. This statute is relevant to estate administration when assets are not sufficient to satisfy all the estate expenses and/or debts, and is critical to the enforcement of creditor claims against an estate. The legal issues relating to priority require a careful analysis and understanding of this statute, the meaning of which can be surprisingly counter-intuitive. This article discusses statutory priority granted to debts owed to New York State and New York City public welfare officials, the effect the type of property held in the estate may have on those priorities, and the effect the doctrine of equitable liens may have on those priorities. First we should look at the payment hierarchy set forth in the law.

Section 1811(1) gives express priority to the payment of funeral expenses and expenses of administration out of the first moneys received by the fiduciary. Debts of the decedent are then ordered as follows:

Section 1811(2)(a) gives first priority to debts entitled to a preference under the laws of the United States and the state of New York ("Priority One");

Section 1811(2)(b) gives second priority to taxes on property assessed prior to death ("Priority Two");

Section 1811(2)(c) gives third priority to "Judgments docketed and decrees entered against the decedent according the priority thereof respectively" ("Priority Three"); and

Section 1811(2)(d) gives last priority to all recognizances, bonds, sealed instrument, notes, bills and unliquidated demands and accounts ("Priority Four").

Following these ordering provisions comes the directive in SCPA 1811(3) that "Preference shall not be given in the payment of a debt over other debts of the same class, except those specified in subparagraph (c) of subdivision 2." In other words, Priority One and Two debts in excess of estate assets would be apportioned while Priority Three debts (Section 1811(2)(c)) are not apportioned, but rather preference is given according to the priority of the debt within that class.

Statutory Priority for the Public Welfare Official

One might suppose that in determining preference among Third Priority debts a "first-in-time, first-in-right" rationale might apply, akin for instance to the concepts of logic applicable to land title recordation. But as we shall see, this logic is not controlling, since debts granted statutory priority at times take precedence over recorded judgments prior in time. Two such statutes are Section 105 of the Social Services Law (formerly Section 129 of the Public Welfare Law) and Section 104 of the Social Services Law (formerly Section 128 of the Public Welfare Law). Section 105 expressly grants the Department of Social Services (Human Resources Division) a priority for its claims and provides:

> If person who has received relief and care at public expense, shall die leaving insurance, and the estate of the insured is named as beneficiary, or no beneficiary is named, the public welfare official shall be entitled to a *preferred claim* (emphasis supplied) to be paid out of such insurance to the amount of the cost of such relief and care, and for funeral expenses not to exceed one hundred and twenty-five dollars. If the insured leaves a widow or minor children who are, or are liable to become, public charges, the public welfare official may, in his discretion, waive his claim to such insurance or any part thereof to which he would otherwise be entitled.

Section 104 of the Social Services Law provides in relevant part:

> A public welfare official may bring action or proceeding against a person discovered to have real or personal property, or against the estate of the executors, administrators and successors in interest of a person who dies leaving real or personal property. . . .
>
> In all claims of the public welfare official made under this section the public welfare official shall be *deemed a preferred creditor*. (emphasis supplied)

Litigation over priority has ensued not only under the current statutes but also under their predecessor enactments and serves to highlight the substantial uncertainty in this area of the law. The case of *In re Ciappei's Estate*[1] was decided under the Sections of the old Surrogate's Court Act that provided for priority of payments from estates. Sections 216 and 222 directed that funeral and administration expenses should be paid from the first estate moneys, as does SCPA 1811(1) today. Section 212(1) of the old Act directed that the third highest priority (Sections 216 and 222 being the first two) was "debts entitled to preference under the laws of the United States and of the state of New York, pursuant to Section 212 subd.1." This language is essentially the same as current First Priority (Section1811(2)(a)). The *Ciappei* court stated:

> It is clear from the provisions of Section 129 of the Public Welfare Law that claims for reimbursement for payments for relief are included in the third group, as enumerated above, since they are entitled to a *preference* (emphasis supplied) under the laws of the state of New York. The claim of the city is thus entitled to priority over the claim of judgment creditors.

The court held that the claim of New York City came before the claims of a previously docketed judgment creditor since the claim of the City was a preference granted by law. The assets making up the estate of Mr. Ciappei were the proceeds of life insurance, and thus the case was later held to be limited to estates where the assets from which the claims of creditors were to be satisfied came from the proceeds of life insurance.[2] Thus, claims of the public welfare official could have priority of payment from an estate where life insurance was the asset from which the State or City sought payment.

However, other courts expanded the priority of the public welfare official beyond estates funded with life insurance proceeds. In *Clonan's Estate*,[3] the estate had insufficient assets to pay the claim of the Department and other general creditors. The assets of the estate were not made up of life insurance proceeds but of other intangible assets. The court first dealt with the absence of the "preferred creditor" language in then Section 128 of the Public Welfare Law, holding that Section 128 and Section 129 should be read *in pari materia*. Thus the court reasoned that there should be no distinction between estates holding life insurance proceeds and those holding other assets when it comes to priority of payment in favor of the public welfare official. The court found that the claim of the Commissioner of Public Welfare came before other creditors since it was a preference under the laws of the State of New York.

Other cases dealing with the statutory priority issue focused on whether or not the debt was due to New York State in its capacity as a sovereign public welfare official and thus entitled to the statutory preferences of Sections 104 and 105. For instance, in the case of *In re Stewart's Will*[4] judgment was obtained against the decedent during his lifetime. The State of New York claimed preference by virtue of having rented office space to the decedent for which he remained indebted at the time of his death. The court found for the creditor, holding that:

> The State had pointed to no statute or decision under which it is indicated that the debt is entitled to preference. It must be borne in mind that the debt is not one for taxes or other revenue nor is it for an obligation incurred in the exercise by the State of its sovereign or governmental functions . . . to support a preferential status under the statute, the intent of the legislature to accord such a status should be clearly expressed.[5]

The decisional history shows that in order to obtain preference over other debtors, specific statutory entitlement must be shown to exist. Perhaps the clearest statement of this point was made in *In re Hermans' Will*.[6] The matter involved the New York City Commissioner of Hospitals, who claimed a preference from an insolvent estate based on Section 104 of the Social Services Law following the addition in 1964 of the preferred creditor language (for a debt that arose prior to the effective date of the amendment).[7] The court squarely dealt with the meaning of the new amendment and the addition of the "preferred creditor" language. The court stated:

> Prior to the 1964 amendment there were conflicting decisions concerning the right to a preference to public welfare claims. *Clonan's Estate*;[8] *In re Andrews*;[9] *In re Smith*;[10] *In re Cornez*.[11] The statute resolves the conflict, but shows no purpose to operate retroactively in pending estates.

Although the Commissioner lost due to the fact that the amendment did not apply retroactively, the court spoke directly to the intended effect of the preference language added to the statute. From a reading of the cases, it is clear that the Department of Social Services is entitled to a preference over all other Third Priority judgment creditors of an estate pursuant to Section 104 and/or Section 105 of the Social Services Law, and that executors must pay those claims first even though they arise later in time than earlier filed claims of judgment creditors.

Defeat of the Statutory Priority of the Public Welfare Official for Specific Prior Liens

In *Estate of Livingston*,[12] the court addressed competing claims of two judgment creditors: one who did not move past docketing its judgment and one who caused an execution to issue and levied upon tangible personal property prior to the death of the judgment debtor. The court held that the creditor who executed on its judgment had priority, and in dicta commented upon the fact that the winning creditor might have had a preference over the State of New York based upon its "specific prior lien."

Many of the Third Priority cases do not mention this aspect of equity nor do they include an analysis of the type of property held in the estate. One can easily be misled by pronouncements of the Department of Social Services priority in these cases without realizing that there is a class of creditor that may have priority over the public welfare official notwithstanding the seemingly absolute priority language of the above quoted statutes. Indeed the cases reveal many litigants being so misled, including the Department of Social Services.

In *In re Pierce*,[13] the court was focused on the priority of estate debts in the context of the Department of Social Services lien and its asserted statutory priority. The decedent was a patient in the hospital prior to her death, incurring medical bills of $29,000. The hospital obtained two judgments against the patient for the unpaid hospital bills during her lifetime. The first judgment was docketed on December 11, 1981 and the second on March 31, 1982. Following the death of the decedent the Department of Social Services filed a claim against the estate of the patient for $59,332 for care rendered to decedent prior to her death. Estate assets were insufficient to pay the judgments and the claim in full. The sole issue before the court was priority of the creditors. The public welfare official relied first on Social Services Law Section 104 and the 1964 addition to the statute, citing *In re Ciappei's Estate*.[14]

The *Pierce* court did not even discuss the change in Section 104 of the Social Services Law in reaching its holding in favor of the hospital. Instead, the court found that the hospital, as judgment creditor, held a "specific prior lien" by virtue of the fact that the estate contained a parcel of real property. The court observed "that when the hospital filed its judgments prior to the death of the decedent, and prior to the filing of the claims of the Department of Social Services, said judgments became a specific lien on the decedent's real estate." The court left no doubt as to the grounds for its ruling, and pointed out that it was not necessary for the hospital, after filing its judgment, to issue an execution in order for its lien to attach to real estate held in the estate. This is so, explained the court, because under CPLR Section 5203, relating to priority and liens on docketing judgments, the transfer of real property by the judgment debtor is not effective as against the judgment creditor until ten years after the filing of the judgment. In other words, the lien attaches to real estate when filed. *Pierce* was appealed to the Appellate Division, where the court held in a one paragraph memorandum decision that the preference granted under Social Services Law Section 104 was only as to general creditors.[15]

Executors are thus instructed that where the estate is made up of personal property, the Department, operating under Section 104 or Section 105 of the Social Services Law, will take priority over judgment creditors who have not executed on the judgment. A case in point is *Estate of Patrick Pizzirusso*,[16] where a judgment creditor obtained and entered a judgment before the death of the decedent. The estate consisted solely of personal property that was insufficient to pay both debts. The judgment creditor, no doubt thinking "first-in-time equals first-in-right," served the executor with a restraining notice seeking to enforce his earlier filed claim over that of the Department of Social Services. The sole issue was which claim took.

The respondent judgment creditor claimed that his debt came first because it was a specific lien against decedent's property that had been filed of record before decedent's death pursuant to CPLR Article 52. The court disagreed, and explained that whereas liens against real property indeed attach at the time of docketing the judgment, in the case of personal property additional post-docketing steps are required in order to obtain priority rights over the personal property of the debtor. The judgment creditor must have an execution to a sheriff or have utilized other devices found in CPLR Article 52, such as CPLR 5202 (relating to delivered executions to a sheriff), CPLR 5225 (relating to possession of personal property by the sheriff) and CPLR 5228 (relating to appointment of a receiver) in order to have prevailed as against the Department and its statutory priority. The court reasoned that the service of the restraining notice on the executor did not cause the lien to attach to the personalty held in the estate because there was no specific property "seized and appropriated" for the satisfaction of the debt until there was further execution on the judgment. There was, thus, no specific prior lien.

The decision in *In re Robinson*[17] presents another articulation of the principle. The debtor patient had entered into an agreement with the creditor nursing home to satisfy fees for services rendered by the home. The agreement specifically provided for the satisfaction of the nursing home debt from the sale proceeds of a residence owned by the patient and another person as tenants-in-common. The agreement to pay the debt was not reduced to a judgment nor was any judgment ever docketed. Following the creation of the agreement, the patient received substantial Medicaid, then died on December 3, 1998. The Department of Social Services filed its claim against the estate in February 1999. The executrix of the estate waited the statutory period of 7 months after issuance of Letters before paying the claim of the nursing home.[18] The court stated that had the home obtained a judgment and docketed it, the claim of the Department of Social Services would have been subservient to a creditor with a "specific prior lien" since the lien would have attached to the real estate at the time it was first docketed.

The *Robinson* case, the *Pizzirusso* case, and others like them, seem to set down a black letter rule to the effect that statutory preference defeats prior docketed judgments in all cases except where there is real property held in an insolvent estate or where the judgment debtor has executed by one of the devices under CPLR Chapter 52. Upon closer examination of the decisional history, however, yet another factor emerges that affects the ultimate outcome in Third Priority cases.

Specific Prior Lien Preference Could Apply to Property Other Than Real Property

Many cases in this area of the law rely on the Appellate Division decision in *Pierce* without further support, and thus this one paragraph decision merits further analysis. The *Pierce* decision only cited two cases in support of its affirmance, *In re Warren* (a/k/a *Matter of Bloomfield*)[19]and *In re Lambert (*a/k/a *Matter of Gallucci*).[20] In *Warren*, the court was deciding a dispute between New York State and New York City as to which would have priority for reimbursement for the cost of care provided to an incompetent.[21] The court held that New York State, by virtue of Section 35 of the New York Constitution of 1777 and the common law of England, was a sovereign, succeeding to the Crown's prerogative right of priority and thus prevailed over the City.[22] *In re Lambert* held that the claim of the Office of Mental Health came before, and thus had a preference over various unspecified creditors, there being no specific prior liens. The decision is one paragraph in length and simply states the conclusion with citations to three cases: *Wise v. Wise L&C Co.*,[23] *In re Gruner*,[24] and *In re Carnegie Trust*.[25] *Wise v. Wise L&C Co*. did not involve any preference right granted by statute. *In re Carnegie Trust* found a preference for the New York State treasurer where a special fund was created by statute. The court stated that such a priority might not exist in the event there was a specific prior lien. In *Gruner*, the debtor assigned his ownership in his seat on the New York Stock Exchange for a loan of $212,000. The value of the seat was security for the loan pursuant to the assignment. The seat was later sold by the administratrix of his estate. The assignee, New York Trust Co., claimed its debt had priority over those of the United States and New York State for unpaid income taxes of the decedent even though the debt of the trust company had not been reduced to judgment, but was an assignee right. The court explained:

> Perhaps it should be pointed out to avoid misunderstanding that, even if the lien had been perfected prior to decedent's death, it still might not be a "specific" lien within the meaning given to that term by the Federal courts when dealing with the priority of the United States under Section 3466 over the statutory lien of State taxes, where no specific property has been seized and appropriated to the satisfaction of the lien or set apart from the general property of the debtor.

So in finding for the United States and New York State over the assignee, the court pointed out that certain liens could defeat even statutory priorities (i.e., the public welfare official, New York State and even the United States) but only where specific property of the debtor has been separated and applied to the satisfaction of the lien. While this case does support the personal property vs. real property distinction in Third Priority law and the *Pierce* touchstone, it is not without its detractors. The detractors cause one to more carefully consider when property has been so separated and applied as to constitute a specific prior lien.

Equitable Lien Theory Has Been More Broadly Applied

Illustrative of the question is the case of *Stathos v. Murphy*[26] that has been cited with approval consistently many times since the decision forty years ago. In this case the court provided a thoughtful analysis of the concept of the class of equitable liens that could operate as specific prior liens. The court distinguished (i) future claims that do not take effect when the right arises or the capacity to transfer the right arises, that do not result in an equitable lien and (ii) present claims not yet matured or dependent on future conditions even though there is not an immediate action at law available to enforce the claim. In the case, the court held that an assignee of the right (but not a judgment) to the proceeds of a pending lawsuit were present claims that gave rise to an equitable lien that defeated the right of a judgment creditor whose right arose later in time than the assignment. The interpretation of "equitable lien" may not, therefore, be limited to real property and property upon which an execution has been effected as suggested in *Pierce* and *Estate of Patrick Pizzirusso*, but rather may include situations where specific property subject to the lien has been "set apart and identified" equitably. The situation has often arisen in cases where loans were made in exchange for the assignment of rights to property. This aspect of Third Priority claims seems therefore to require careful analysis beyond the real property vs. personal property dichotomy set forth derived from *Pierce*. Counsel for executors should carefully examine the underlying facts of the claim and the nature of the property held in the estate prior to making the determination as to order of payment from insolvent estates.

Endnotes

1. 287 N.Y.S. 988 (Sur. Ct., N.Y. Co. 1936).
2. *In re Nifeneger's Estate*, 177 Misc. 198, 30 N.Y.S. 178 (Sur. Ct., Monroe Co. 1941); *In re Smith's Estate*, 1 Misc. 2d 657, 177 N.Y.S. 2d 767 (Sur. Ct., Fulton Co. 1958).
3. 176 Misc. 557, 28 N.Y.S.2d 88 (Sur. Ct., Orange Co. 1941).
4. 109 N.Y.S.2d 609 (Sur. Ct., Kings Co. 1951).
5. The court did note that the rent attributable to the period following issuance of Letters was an administration expense that was thus entitled to payment before the judgment creditor under Priority One.
6. 44 Misc.2d 585, 254 N.Y.S.2d 484 (Sur. Ct., Kings Co. 1964).
7. Prior to 1964, the language of the third Section of paragraph (1) in Section 104 quoted herein above was not included. This is the "preferred creditor" provision added by L 1964 Ch. 573 § 1. Letters and memoranda contained in the legislative bill jacket indicate that it was the express purpose of the amendment to give priority creditor status to the Department just as was already contained in Section 105. *Memorandum from the State of New York Banking Department dated April 13, 1964*; *Letter from the Surrogate's Association dated April 6, 1964*; *Letter from the Association of the Bar of the City of New York dated April 14, 1964*.
8. 176 Misc. 557, 28 N.Y.S.2d 88 (Sur. Ct., Orange Co. 1941).
9. 179 Misc. 876, 40 N.Y.S.2d 81 (Sur. Ct., N.Y. Co. 1942).
10. 11 Misc. 2d 657, 177 N.Y.S.2d 767 (Sur. Ct., Fulton Co. 1958).
11. 27 Misc. 2d 671, 207 N.Y.S.2d 343 (Sur. Ct., Kings Co. 1960).
12. 211 N.Y.S.2d 897 (Sur. Ct., N.Y. Co. 1961).
13. 472 N.Y.S.2d. 275 (Sur. Ct., Onondaga Co. 1984), *aff'd*, 483 N.Y.S.2d. 500 (App. Div., 4th Dep't 1984).
14. The Department also argued that the New York Constitution, Article 1, Section 14, gives New York State the prerogative over rights of its subjects which entitles it to a priority in payment of debts owed, and the fact that the Surrogate's Court must grant leave to execute on a judgment whenever the debtor has died as required under CPLR Section 5208.
15. 483 N.Y.S.2d 500 (App. Div., 4th Dep't 1984).
16. N.Y.L.J., Nov. 11, 2005, p. 34, col. 2. (Sur. Ct., Westchester Co.).
17. 754 N.Y.S.2d 525 (Sur. Ct., Nassau Co. 2003).
18. Note that the executor therefore knew of the alleged Medicaid claim but purposely did not pay it.
19. 53 N.Y.2d 118, 440 N.Y.S.2d 609 (1981).
20. 87 A.D.2d 818, 448 N.Y.S.2d 767 (A.D., 2d Dep't 1982).
21. Paul Powers, Secretary of the Surrogate's Court Association, in a letter to the Hon. Sol Neil Corbin, Counselor to the Govenor of the State of New York, communicated his disapproval of the 1964 Amendment to Social Services Law Section 104 and correctly predicted that this issue would be litigated.
22. The court commented upon the priority language of Section 104 of the Social Services Law and stated that the purpose of the statute was to render a priority over the "general creditors" of a decedent citing to the New York State legislative history found at N.Y. Legis. Ann. 1964 p. 322. That history states: "The proposed bill would clarify the intent of the section and would give public welfare claims clear preference over the claims of other general creditors. . . . The proposed bill would also entitle claims of the public welfare official to priority under Section 212 of the Surrogate's Court Act, which sets up classes of preferences. As amended, the section would grant a preference under the Surrogate's Court Act in the same manner as in Section 21(1) Surrogate's Court Act: "Debts entitled to a preference under the laws of the United States and the State of New York."
23. 153 N.Y. 507 (1897).
24. 295 N.Y. 510 (1946).
25. 206 N.Y. 390 (1912).
26. 276 N.Y.S.2d 727 (App. Div., 1st Dep't 1966).

Bruce M. DiCicco is an attorney-at-law and Masters of Law (LL.M. in Federal Taxation) with offices located at 99 Park Avenue in Manhattan, where he concentrates his practice in Estate Planning and Trust and Estate administration. Sarah A. Rode assisted in the preparation of this article.

Throw Mama From the Train: The Deficit Reduction Act of 2005 Abandons Our Nation's Elders

By Michael Gilfix and Bernard A. Krooks

It just got harder to be old and anything short of wealthy. Chapter 2 of the new Deficit Reduction Act of 2005 (DRA) focuses exclusively on "long-term care under Medicaid" and seeks to make it much harder for elders to protect any assets if they are to receive assistance from the federal Medicaid program while in skilled nursing facilities.

Adopted in the U.S. Senate by a margin of 51-50 (because Vice President Dick Cheney cast a deciding vote), and adopted in the House by the minuscule margin of 216 to 214, the legislation is fiercely partisan: Not a single member of the Democratic Party voted for it in the House. President Bush signed the DRA into law on Feb. 8.

One transparent purpose of the DRA's "long-term care under Medicaid" chapter is to trim Medicaid rolls. The legislation is designed to make it more difficult for elders who need long-term care to qualify for the program. Given the harsh and perhaps draconian nature of some provisions, this objective will no doubt be achieved.

Another purpose of the legislation is to increase the sales of long-term care insurance products. We expect this goal will be achieved as well. Government will pay less, private industry will sell more—but what will happen to the elderly? Many will be abandoned. And we're not just talking about the poorest of the poor. Many more middle-class elderly who exhaust their assets will be denied Medicaid because, for example, they inadvertently gifted in previous years, for purposes that had nothing whatsoever to do with asset preservation or Medicaid eligibility. Also, many skilled nursing facilities will be put in an untenable position. They either will have to provide care to individuals who cannot pay and are not Medicaid-eligible, or they'll be forced to discharge such residents. And when these elderly are put out of nursing homes, then what?

This is not just an issue for the middle class and the poor. It's an issue for all Americans with a conscience.

Dramatic Changes

Perhaps one of the most dramatic changes is what's been done to the penalty period. Since passage of the Omnibus Budget Reconciliation Act of 1993 (OBRA-93), the "look-back period" has been 36 months or, in the case of transfers to or from certain trusts, 60 months.[1] The look-back period is important because it may identify asset transfers that, if made for less than fair market value, create a period of Medicaid ineligibility.

If an individual is in a nursing home and applies for Medicaid under pre-DRA law, and assuming that he made a gift within the preceding 36-month period, he'll be ineligible for Medicaid for the number of months the gifted money would have paid for care had he retained the funds. A $10,000 gift made one year ago, for example, would create about a two-month period of ineligibility in most states. Very importantly, that period of ineligibility started on the date that the gift was made. In other words, this person would be ineligible for Medicaid for the two-month period following the date of the gift, which was 12 months ago. His period of ineligibility would have expired 10 months ago; thus the gift would not affect his current application for Medicaid.

"This is not just an issue for the middle class and the poor. It's an issue for all Americans with a conscience."

The DRA changes this. The extension of the look-back period from 36 months to 60 months would not be so bad if, as under pre-DRA law, the ineligibility period began on the date of the transfer. Instead, the DRA takes a punitive approach that will severely impact the ability of seniors to access government financed health care.

Under the DRA, the period of ineligibility starts on the date when the individual is in the skilled nursing facility, applies for Medicaid, and proves that he would have been eligible but for the application of the penalty period.[2]

Fortunately, the DRA is crystal clear in stating that pre-DRA law applies to all transfers made before the date of enactment of the DRA.[3]

Applications made in June 2007, for example, will be unaffected by transfers made in April 2004 because such transfers, (1) were made before DRA's enactment, and (2) were effected more than 36 months before the date of application.

These new provisions will be a formidable trap for the innocent and the unwary. Consider the grandmother who, four years before her stroke and placement in a nursing home, made a $40,000 gift to her granddaughter to help her granddaughter purchase a first home. Under pre-DRA law, that gift might have generated an eight-month period of ineligibility. That period would have started on the first day of the month in which the transfer was made.[4] Her period of ineligibility would have expired about eight months after making the gift. Medicaid eligibility for this now-destitute octogenarian for Medicaid would be granted.

But if this gift is made after the DRA's implementation date, it would result in a denial of eligibility. She'd apply for Medicaid and it would be determined that, but for the gift made four years ago, she would be eligible. Now, though, the eight-month period of ineligibility starts the month when she would otherwise have been eligible and is receiving skilled nursing care. She is already in a nursing home, destitute, and facing an eight-month period of ineligibility. She has no funds and Medicaid is denied. The nursing home will be stuck caring for a resident with no source of payment. Perhaps the DRA of 2005 should be renamed the "Nursing Home Bankruptcy Act of 2005."

Realistically, of course, nursing homes cannot be compelled to provide care without compensation. It's also an inescapable conclusion that safe, alternative placement options will simply not exist in most cases. States may therefore have no choice but to pay for long-term care out of other budgetary sources. So perhaps the DRA should be renamed the "State Budget Busting Act of 2005."

Also consider the individual who makes a $15,000 donation to his local charity in April 2006. In February 2011, that same individual is suffering from Parkinson's disease and requires long-term care in a nursing home. All of his assets have been spent on his care at home and thus he would otherwise be eligible for Medicaid coverage in a nursing home. But the $15,000 gift to charity almost five years earlier triggers a three-month penalty period starting when he goes into the nursing home. Unfortunately, he has no assets to pay for the cost of his care during this three-month period and he will either be denied admission to the nursing home or the nursing home will not be reimbursed for his care during that period. It is anticipated that the DRA will have a chilling effect on charitable giving by seniors for fear that they may need long-term care at some future date. So perhaps the DRA should be renamed "The Charity-Chilling Act of 2005."

There may be some solace in that Section 6011(d) of the DRA requires states to include a "hardship waiver process" in accordance with preexisting federal law.[5] An "undue hardship" would be established when the application of the new transfer of assets provisions would deprive the individual "of medical care such that the individual's health or life would be endangered; or of food, clothing, shelter, or other necessities of life."

States are required to give notice to recipients of the undue hardship exception, provide a timely process for determining when hardship waivers will be allowed, and establish a process for appeal.[6]

But don't be fooled by this escape hatch. Experienced advocates know that "undue hardship" waivers, which have been encoded in federal legislation for years, traditionally have been elusive, at best. It's not uncommon for such waiver requests to be routinely denied without even the pretense of a hearing. Still, such hardship waivers inevitably are going to have to play a major role in coming years. Given the extensive five-year look-back period, there will be many elders who transfer funds to children, grandchildren, and charities for reasons that have nothing to do with Medicaid eligibility. Indeed, there is even a new provision that permits nursing homes to file for undue hardship waivers on behalf of a resident with the consent of the individual or the personal representative of the individual. When a waiver request has been appropriately filed, states may provide payment for up to 30 days to hold the bed for the elder.

Effective Date?

When will this new look-back period and these penalty period computations go into effect? The answer to this critically important question is unclear. The new look-back period applies to transfers made on or after the date of enactment.[7] Presumably, that's when the president signed the DRA into law on Feb. 8.

But Section 6016(e) of the DRA has a somewhat different effective date provision. Section 6016 deals with additional reforms of Medicaid asset transfer rules, such as partial months of ineligibility, the aggregation of multiple gifts, limitations on certain notes and loans, and the treatment of life estate purchases. It leaves open the possibility that state legislative action may be required before its provisions go into effect. These aspects of asset transfers may continue to be analyzed under pre-DRA law until the earlier of state legislative action or the first day of the first calendar quarter that begins after the close of the first regular session of the appropriate state legislature that begins after the date of enactment. Section 6016(e) effectively imposes a one-year limit, stating that states with a two-year legislative session shall nevertheless be deemed as having one year to act for purposes of these provisions.

Perhaps unfortunately, this determination will not be up to state Medicaid programs. Rather, this potential and necessary delay in implementation will occur only in states where the U.S. Secretary of Health and Human

Services determines that a particular state plan, as the DRA puts it, "requires State legislation in order for the plan to meet the additional requirements" imposed by Section 6016.

Annuities

The DRA also changes the rules for annuities. Under the DRA, the purchase of an annuity is presumptively deemed a "disposal of assets" that is subject to the imposition of a period of ineligibility, unless the state is named as a remainder beneficiary in the first position for at least the total amount of medical assistance paid on behalf of the annuitant; or the state is named as a remainder beneficiary in the second position after the community spouse or minor or disabled child and is named in the first position if such individual disposes of such remainder interest for less than fair market value.[8]

In addition, the annuity must be irrevocable and non-assignable, actuarially sound, and provide for equal payments during the term of the annuity with, the DRA states, "no deferral and no balloon payments made." Thus, a balloon annuity or an annuity providing for deferred payments will be treated as an uncompensated transfer of assets and be subject to the penalty period provisions of the DRA even if the state is named as a remainder beneficiary in the first position.

Exceptions apply for annuities described in subsection (b) or (q) of Internal Revenue Code Section 408, or for those annuities purchased with proceeds from an account or trust described in sub-sections (a), (c), or (p) of IRC Section 408, a simplified employee pension (under IRC Section 408(k) or a Roth IRA described in IRC Section 408(A)).

The DRA requires the applicant for Medicaid to disclose "any interest (or that of a spouse) in an annuity (or similar financial instrument that may be specified by the Secretary), regardless of whether the annuity is irrevocable or is treated as an asset."[9] In addition, the state then is required to notify the issuer of the annuity of the state's preferred status. The state also may require issuers of annuities to notify the state if there is any change in the amount of income or principal being withdrawn after the date of the most recent disclosure.

These provisions apply to transactions (including the purchase of an annuity) occurring on or after the date of enactment of the DRA.

Forcing Home Sales

Before the DRA, a residence of any value was an "exempt resource." This means that its value was simply ignored in determining eligibility. So long as an individual, spouse, or siblings or children in limited circumstances were still residing in the residence, or an institutionalized homeowner maintained the "intent to return home," the house retained its exempt status and was not a barrier to Medicaid eligibility. The lack of a cap on the value of a residence was realistic, given the enormous variety in average home prices in different parts of the country.

As a matter of public policy, the average $200,000 residence in Michigan was given the same level of protection as an $800,000 house in Connecticut or California. Public policy was clear: Elders should not be disrupted and compelled to sell their residence as a condition of eligibility. This treatment was consistent with our nation's tax policy, which encourages home ownership and protects substantial gain from capital gains tax exposure.

The DRA imposes a $500,000 cap on the value of an exempt residence when the owner is institutionalized in a nursing home.[10] States are given the option of increasing the level of protection to no more than $750,000. These values will increase annually with the Consumer Price Index commencing in 2011.

Fortunately, there are exceptions. When an individual's spouse or his minor, blind or disabled child is living in the residence, this cap will not apply. It will, however, apply to single elders, most of whom will be women with no living spouse. The home equity cap provisions apply to individuals who are determined eligible for medical assistance with respect to nursing facility services or other long-term care services based on an application filed on or after Jan. 1.[11]

This provision of the DRA specifically references a "reverse mortgage or home equity loan" to reduce the equity interest in the home. The use of a reverse mortgage could be catastrophic and may result in the forced sale of the residence. Virtually every reverse mortgage contract calls for acceleration and complete payment of total indebtedness when an individual has ceased to reside permanently in her home. This is typically a maximum of one year after an individual moves out of the home for any reason.

Satisfaction of the loan will compel a sale that, in turn, results in cash proceeds then being in the name of the institutionalized individual. Deprived of any exempt asset (the residence), the individual will have countable or includible assets well in excess of the allowable limit (typically $2,000) and be denied Medicaid coverage. Her entire estate may then be dissipated.

A home equity loan will have the same result, given the immediate repayment responsibility and the inevitable inability of net rental income (assuming viability of renting) to service any home equity loan. Again, forced sale will be inevitable and the entire value of the residence will be lost. This provision is aimed at the individual who resided in a "million dollar house" and who somehow, therefore, ought not to receive any protection or support from the Medicaid program. But state Medicaid programs have long been protected in such circumstances by their right to assert estate claims on the estates of deceased Medicaid recipients or to impose liens on Medicaid-exempt residences. In other words, state Medicaid programs have been able to recover benefits paid and have collected hundreds of millions of dollars in this way. But at least they waited until the individual was deceased and clearly had no further use for their home.

The plight of a 68-year-old widow, a resident of San Jose, Calif., painfully makes the point. Afflicted with both diabetes and polio, she is extremely limited in mobility. She receives assistance from a state program that provides limited in home care and receives help from family members. Her eventual placement in a skilled nursing facility is a virtual certainty.

Her only asset is her residence, worth perhaps $700,000. Even in her lower-middle-class community, this is the average home value. As she'll be entering a skilled nursing facility after Jan. 1, the value of her residence will preclude Medicaid eligibility. Either a reverse mortgage or a home equity loan will, inevitably, cause the loss of her only asset, an asset she acquired after a lifetime's labor. This loss should be considered in the context of the Bush administration's overall tax, entitlement and fiscal policies. The administration relentlessly advocates the elimination of the estate tax because it doesn't want to force the sale of a parent's business to pay taxes. But the President doesn't hesitate to force middle- and lower-middle-class families to sell their primary asset, the parent's home, before allowing any degree of assistance from the Medicaid program.

It also should be noted that reverse mortgages are unavailable to individuals who are no longer living in their homes. Individuals who enter nursing homes and have equity in excess of $500,000, therefore, will have absolutely no opportunity to obtain reverse mortgages, notwithstanding the explicit suggestion in the DRA that they do so.

We also wonder what types of home equity loans will be available to isolated elders who are denied Medicaid because of the value of their homes. They have no income that can be used to repay such loans. Far too many will have no loved ones to protect their interests. Historically, the secondary market of lenders has taken advantage of vulnerable elders, loaning money with excessive closing costs and at high rates, knowing that the elderly homeowner will be unable to make payments. This ultimately results in the loss of the elder's home. Foreclosure will be inevitable.

Insurance

The Republicans are privatizing elder care not only by forcing home sales but also by forcing a move to long-term care insurance. But "private" does not necessarily mean "better."

Subchapter B of the "Long-Term Care Under Medicaid" chapter of the DRA is extensive. It reflects the DRA's rather explicit elevation of long-term care insurance as it seeks to diminish the role of Medicaid in paying the cost of long-term care for older Americans.

The State Long-Term Care Partnership Program was initiated many years ago with assistance from a grant from the Robert Wood Johnson Foundation. It was designed to encourage individuals to purchase long-term care (LTC) insurance by providing such purchasers with an elevated level of asset protection. The program was curtailed with the enactment of OBRA-93. But four states—California, New York, Connecticut and Indiana—have partnership programs that were grandfathered at that time.

Generally, these policies provide that purchasers of partnership long-term care insurance policies can shelter, dollar for dollar, funds received or utilized through the LTC policy.[12] For example, if a policy provides an individual with $100,000 worth of coverage and the individual exhausts the policy limits, he will be allowed to qualify for Medicaid while retaining $100,000, rather than the presumptive level of $2,000. Such protected assets also are shielded from Medicaid estate claims at the time of the Medicaid recipient's death.

The policies have not enjoyed consistent levels of success, in large part because other long-term insurance policies seemed more attractive and competitive to consumers. In a clear victory for the long-term care insurance industry, the DRA seeks to shift greater responsibility to the private sector and concomitantly, dollar for dollar, diminish the role played by Medicaid.

The protection of assets we've just described is allowed only if seven requirements are satisfied:

(1) The partnership policy must cover an insured who is a resident of the state when coverage first became effective.

(2) The policy must be a "qualified long-term care insurance policy" as defined in IRC Section 7702B(b). The policy must not be issued earlier than the effective date of the state plan amendment allowing for partnership LTC policies.

(3) The policy must satisfy or comport with sections of the Long-Term Care Insurance Model Act that are identified in the DRA and the 19 identified provisions in the Model Regulation

of the National Association of Insurance Commissioners (NAIC). Certification of satisfaction is to be the responsibility of each state's Insurance Commissioner.

(4) A policy must provide for "compound annual inflation protection" if an individual is under age 61 when the policy is purchased, "some level of inflation protection" for individuals age 61 through 75, and the optional provision of inflation protection for individuals age 76 and over at the time the policy is purchased.

(5) Each state Medicaid agency is to provide information and technical assistance to state insurance departments regarding its role in assuring that individual sellers (licensed agents) who sell long-term care insurance under the partnership receive appropriate training about the policies and how they relate to other sources of coverage for long-term care, presumably including other long-term care insurance policies and Medicaid.

(6) The insurance company must provide reports to the U.S. Secretary of the Department of Health and Human Services (DHHS), including the dates, amounts, and termination of any benefits.

(7) The state must not impose requirements on partnership policies that are not imposed on non-partnership policies.

Beyond this, there are extensive reporting requirements for the individual and DHHS ultimately must report on partnership programs and their impact on the cost of care (and specifically Medicare and Medicaid expenditures). DHHS also must establish a "National Clearinghouse for Long-Term Care Information" to provide consumer information.

Historically, long-term care insurance policies have not enjoyed a consumer-friendly reputation. The November 2003 issue of *Consumer Reports* published an extensive analysis of long-term care insurance policies then available. That article was extremely critical on balance. Policy options are proliferating and products are improving in response to such market pressures as the *Consumer Reports* piece, as well as in response to expected restrictions on access to Medicaid (as evidenced by the DRA). Consumers increasingly will be attracted to policies that, for example, combine LTC insurance benefit options with annuity features.

To the extent that invested dollars are not used to pay for the cost of long-term care, such dollars ultimately are recovered by identified residual beneficiaries in the form of annuity distributions. Life insurance policies are increasingly expected to allow the insured to utilize cash value or borrow against death benefits to pay the cost of long-term care.

But long-term care insurance cannot be expected to address the needs of individuals who cannot afford the cost of their premiums or who apply for insurance only after experiencing a health problem that enhances the likelihood of their long-term care needs. For such individuals, Medicaid will remain the payer of last resort. And the punishing provisions of the DRA are expected to impose difficult burdens on these individuals.

CCRC

Increasing numbers of America's elders are entering life care or continuing care retirement communities (CCRCs) across the nation.[13]

Some CCRC contracts allow a resident to access funds that are deposited with the CCRC to pay for the cost of living and the cost of care if their other assets are somehow depleted. Still other CCRC contracts provide that, upon the death of the resident, all or some portion of deposited funds are returned to the decedent's estate.

In determining Medicaid eligibility under the DRA, assets deposited or paid as an entrance fee shall be deemed available if the individual can use those funds to pay for care if other resources are exhausted, if the individual can obtain a refund upon death or termination of care, and if the payment of the entrance fee does not confer an ownership interest in the community.[14]

This provision is not expected to impact many individuals, as few CCRCs, and virtually no new life care communities accept Medicaid coverage for the skilled nursing component of their care continuum. Older communities, and particularly those that are religiously based and managed, often do accept Medicaid for qualifying individuals.

The DRA further provides that a CCRC admissions agreement may require residents to exhaust any resources they had at the time of admission before applying for medical assistance. Although most CCRCs are not Medicaid-certified, admissions agreements typically contain an anti-alienation provision designed to prevent a resident from transferring assets. Some provide for exceptions if prior approval of the facility is obtained. Maryland's highest court had previously held such provisions to be unenforceable.[15] The DRA, in effect, overrules that decision.

Stop the Madness

These are just a few of the significant changes the DRA makes to the Medicaid rules. Through the imposition of increasingly restrictive rules and interpretations, the DRA seeks to restrict access to the Medicaid program as a means of paying all or a portion of the cost of nursing home care for our nation's elders. It remains to be seen how many states will implement some of the more draconian provisions. Importantly, many other planning approaches that have been legal are not addressed in the DRA. They continue to be legal and will be available to elders in need.

Increased utilization of long-term care insurance is a potential outcome, confirming that the DRA is perhaps more a victory for the long-term care insurance industry than for the actual cause of deficit reduction. Indeed, the impact on the federal budget will be minuscule—while the impact on our most vulnerable elders will be as formidable as it is unfortunate.

As advisors to our clients, we have an affirmative responsibility to monitor implementation of the DRA at the state level and to document its inevitable abuses. Repeal of its onerous, irresponsible provisions must follow.

Endnotes

1. Some states, such as California, have not yet fully implemented OBRA-93 and are still utilizing the pre-OBRA-93 30-month look-back.
2. DRA Section 6011(b)(2).
3. DRA Section 6011(b)(1).
4. At the state option, the penalty period may commence in the month following the asset transfer.
5. 42 United States Code Section 1396(p)(c)(2)(D) of the Social Security Act.
6. DRA Section 6011(d)(2).
7. DRA Section 6011(c).
8. DRA Section 6012(b).
9. DRA Section 6012(a).
10. DRA Section 6014(a).
11. DRA Section 6014(a).
12. New York has a variation of the dollar-for-dollar partnership policy which provides for unlimited asset protection under applicable circumstances.
13. *See* Michael Gilfix, "Elder Housing," *Trusts & Estates*, April 2003, pp. 50-53.
14. DRA Section 6015.
15. *Oak Crest Village Inc. v. Murphy*, 379 Md. 229 (2004).

Michael Gilfix is a principal of the Palo Alto, CA law firm of Gilfix & La Poll Associates. Bernard A. Krooks is a founding partner of the law firm of Littman Krooks LLP, with offices in New York City and White Plains, N.Y.

This article was originally published in *Trusts & Estates* 145, no. 3, March 2006. Reprinted with permission.

Providing for Remote Descendants: What Language Do Lawyers Use?

By Martin L. Fried and Karla M. Meola

Any lawyer who has taken a course in estates and trusts has heard the term "per stirpes." Yet does the term mean the same thing to all lawyers? Those of us of a more ancient vintage will recall the traditional or English system of per stirpes in which the division into branches of descendants was made at the level of decedent's children, whether or not any children were living at the time of distribution. The system, which owes its origin to the doctrine of primogeniture and the common law rules for descent of real property, still is the default rule in fourteen states.[1]

Modern per stirpes, sometimes called per capita with representation, begins the division of the property at the level of descendants in which there are survivors and individuals who predeceased the decedent leaving descendants. This system can be found in the EPTL 1-2.14, which provides:

> The property so passing is divided into as many equal shares as there are (i) surviving issue in the generation nearest to the deceased ancestor which contains one or more surviving issue and (ii) deceased issue in the same generation who left surviving issue, if any. Each surviving member in such nearest generation is allocated one share. The share of a deceased issue in such nearest generation who left surviving issue shall be distributed in the same manner to such issue.

The system is followed by about one-half of jurisdictions in the United States[2] and was the method adopted by the Uniform Probate Code in 1969.[3]

Two studies conducted in Midwestern states during the late 1970s revealed that the vast majority of people preferred the modern system to the strict system.[4] But both systems suffer from the same infirmity—a more remote descendant can inherit more than one in a closer degree of relationship to the decedent. This led Professor Lawrence Waggoner, later the Reporter for the Uniform Probate Code, to propose a new system called per capita at each generation.[5] The system became the scheme of representation in the 1990 version of the Uniform Probate Code,[6] and entered New York law in 1992 as EPTL 1-2.16. Under per capita at each generation (called representation in the EPTL):

> The property so passing is divided into as many equal shares as there are (i) issue in the generation nearest to the deceased ancestor which contains one or more surviving issue and (ii) deceased issue in the same generation who left surviving issue, if any. Each surviving member in such nearest generation is allocated one share. The remaining shares, if any, are combined and then divided in the same manner among the surviving issue of the deceased issue as if the surviving issue who are allocated a share had predeceased the decedent, without issue.

The difference in result between modern per stirpes (EPTL 1-2.14) and per capita at each generation (EPTL 1-2.16) can be illustrated by the following example:

> A portion of *T*'s estate was left in trust "to pay the income to *T*'s wife, *W*, for life, remainder to *T*'s issue." At *T*'s death, he was survived by *W* and 3 children, *A*, *B*, and *C*. *A* has two children, *M* and *N*. *B* has one child, *O*. *C* has two children, *P* and *Q*. At *W*'s death, *T*'s then living issue were *A*, *M*, *N*, *O*, *P*, and *Q*.
>
> If *T*'s will stated that the remainder was to be paid to his issue per stirpes, *A* and *O* would receive one-third of the remainder each, while *P* and *Q* would share the remaining one-third equally (one-sixth each). If *T*'s will provided that the remainder should be distributed by representation, *A* would receive one-third of the remainder, while *O*, *P*, and *Q*, members of the same generation, would share the balance of the remainder equally (each taking two-ninths).

A survey of client preferences taken some years ago by the American College of Trust and Estate Counsel indicates that the per-capita-at-each-generation system of distribution is the one preferred by most clients.[7] There were 761 responses to that survey—541 respondents (71.1%) chose the per-capita-at-each-generation system. Seventy respondents (9.2%) chose modern per stirpes, and the balance, 145 (19.1%), chose the traditional or English per stirpes system.

Because New York's law contains two statutory schemes, we decided to conduct a survey to see whether attorneys in Onondaga County, who are members of the Onondaga County Bar Association Estates and Surrogate's Court Practice Committee or the Estate Planning Council of Central New York, or who list themselves in the Yellow Pages as offering estate planning and will drafting services, advise their clients of the possible differences in result that could arise from using the term "per stirpes" as opposed to "representation" in the will, and then draft accordingly. Approximately one-third of the 92 attorneys to whom surveys were sent responded. The survey questions and responses appear below.

I. Questions Relating to Drafting

1. Are you familiar with the difference between the distributional patterns under EPTL 1-2.14 (per stirpes) and EPTL 1-2.16 (representation) when a disposition is made to persons who take as issue or descendants of a deceased ancestor?

   ______ Yes (go to question 2)

   ______ No (go to question 4)

   Every person who answered the survey was familiar with the difference between the definition of per stirpes and the definition of representation.

2. Do you advise a client of the difference in result and ask which one the client desires when the client's dispositive scheme involves a gift to issue or descendants?

   ______ Yes (go to question 3)

   ______ No (go to question 4)

   The vast majority of respondents (almost 90 percent) advised clients of the difference in result. The balance did not, with one exception—an attorney who answered "sometimes."

3. Do you draft the dispositive provision to reflect that desire using the appropriate term ("per stirpes" or "by representation")?

   _____ Yes

   _____ No (go to question 4)

   All attorneys who advise their clients of the difference draft to reflect the desires of their clients.

4. Do you draft all dispositions to issue or descendants of a deceased ancestor using the term "per stirpes"?

   _____ Yes (go to question 5)

   _____ No (go to question 6)

   One-third of respondents always use the term "per stirpes" to specify the distributional scheme in dispositions to remote descendants. Three attorneys (10 percent) included a statement that they usually draft wills using "per stirpes" because this is what clients prefer.

5. Do you include a provision that defines the term "per stirpes"?

   _____ Yes

   _____ No

   Of those who always use "per stirpes," only one-third define the term in the dispositive document. Of interest is that of those who draft using either "per stirpes" or "representation," 25 percent will include a definition of "per stirpes" in the document.

6. Do you draft all dispositions to issue or descendants of a deceased ancestor using the term "by representation" or a term of similar import?

   _____ Yes (go to question 7)

   _____ No (go to question 8)

   Only one respondent always uses the term "representation" in drafting dispositions to issue or descendants.[8]

7. Do you include a provision that defines the term "by representation" or a term of like import?

   _____ Yes

   _____ No

   Only two respondents said they did.[9] The one attorney who always uses "representation" does not.

II. Possible Correlations—Firm Size and Organization Membership

The remaining questions in the survey sought to find out whether there was any correlation between the answers given to the above questions and firm size, percentage of practice devoted to will and trust drafting and estate planning, and membership in organizations such as bar association trusts and estates sections, ACTEC and the Estate Planning Council.

8. What is the size of your firm?

   _____ Under 5

   _____ 5 to 25

   _____ Over 25

9. What percentage of your practice is devoted to will and trust drafting and estate planning?

_____ Less than 10 percent

_____ 10 percent to 25 percent

_____ 25 percent to 50 percent

_____ Over 50 percent

10. Are you a member of: (check all that are applicable)?

_____ Estate Planning Council of Central New York

_____ Onondaga County Bar Association Estates and Surrogate's Court Practice Committee

_____ American College of Trust and Estate Counsel (ACTEC)

_____ New York State Bar Association Trusts and Estate Law Section

_____ American Bar Association Section of Real Property, Probate and Trust Law

Table 1—Breakdown on Respondents—Firm Size & Trusts & Estates Practice

Firm Size	# of Resp.	% of Resp.	% T&E	# Resp.	% of Resp.
Under 5	14	45.16%	< 10%	3	9.68%
5 to 25	5	16.13%	10% to 25%	4	12.90%
Over 25	12	38.71%	25% to 50%	8	25.81%
			Over 50%	16	51.61%
Total Resp.	31	100%	Total Resp.	31	100%

III. Correlation Between Firm Size and Trusts and Estates Work

The following survey results are from responses of thirty-one Onondaga County lawyers. Table 1 describes the survey participants' firm size and firm specialization in trusts and estates. It appears that firm size and specialization in trusts and estates does, in fact, have an influence on the usage of "per stirpes" in drafting all wills. An all "per stirpes" attorney is likely to be in a firm with fewer than five attorneys and specializes in trusts and estates, with over 50% of his/her practice in this specialty. *See* Table 2.

Table 2: Portrayal of Respondents Who Always Use Per Stirpes[10]

Firm Size	Qty. Resp.	Total %	% T&E Cat.	Qty. Resp.	Total %	# of Orgs.	Qty. Resp.	Total %
1	6	54.55%	1	0	0.00%	1	2	18.18%
2	2	18.18%	2	2	18.18%	2	1	9.09%
3	3	27.27%	3	3	27.27%	3	6	54.55%
			4	6	54.55%	4	1	9.09%

Table 3: Breakdown of "Per Stirpes" Firm Size & T&E Category

Firm Size	T&E Cat.	Qty. Resp.	Total % within Firm Size	Firm Size % of Total
1	1	0	0.00%	
1	2	2	33.33%	
1	3	0	0.00%	
1	4	4	66.67%	55%
2	1	0	0%	
2	2	0	0%	
2	3	1	50%	
2	4	1	50%	18%
3	1	0	0%	
3	2	0	0%	
3	3	2	66.67%	
3	4	1	33.33%	27%

Moreover, there appears to be a trend that the more an attorney focuses on trusts and estates, the greater the chance that the attorney will be an all "per stirpes" drafter. Virtually all attorneys who draft using only "per stirpes" devote at least 25% to 50%, or more than 50%, of their practices to work in trusts and estates. *See* Tables 1-3.

Table 4: Correlation Between Firm Size & Organizational Membership[11]

Organiz.	Size 1 Firm	Firm 1% in Org.	Size 2 Firm	Firm 2 % in Org.	Size 3 Firm	Firm 3% in Org.
EPCCNY	4	66.67%	2	100.00%	2	66.67%
OCBA	4	66.67%	2	100.00%	3	100.00%
ACTEC	3	50.00%	1	50.00%	1	33.33%
NYSBA	3	50.00%	1	50.00%	3	100.00%
ABA	2	33.33%	0	0.00%	0	0.00%

IV. Correlation Between Firm Size and Organizational Membership

There is no significant correlation between drafting the all "per stirpes" drafters and the type and quantity of organization memberships. There was a negligible difference between the average number of memberships between the all "per stirpes" drafters and all other respondents. *See* Table 5. There were, however, a few organizations that are more favored by the all "per stirpes" drafters and some more favored by the other respondents.

Table 5: Comparison in Type and Number of Organizations Between "Per Stirpes" Respondents and Total of All Respondents

Name of Org.	# of Per Stirpes Resp.	% of Stirpes Resp.	% of Total Resp.
EPCCNY	8	72.73%	74.19%
OCBA	9	81.82%	77.42%
ACTEC	5	45.45%	25.81%
NYSBA	7	63.64%	74.19%
ABA	2	18.18%	29.03%
None	0	0.00%	3.23%
Avg. # orgs./resp.	2.82		2.84

The survey responses indicate that the "per stirpes" drafters tend to be members of the American College of Trust and Estate Counsel ("ACTEC") and the Onondaga County Bar Association Estates and Surrogate's Court Practice Committee ("OCBA").[12] At the same time, the all "per stirpes" respondents were less likely to be members of the New York State Bar Association ("NYSBA") and the American Bar Association ("ABA").[13]

V. The Prevalence of Using "Per Stirpes" Drafting in Firms that Give Clients the Choice of Dispositive Methods

The following section looks at whether there is a correlation between discussing distributional methods with clients and the ultimate usage of "per stirpes" in will drafting. Only eight survey respondents stated that they discussed the distributional differences under New York state law, and subsequently drafted all wills using "per stirpes."[14] The survey responses indicate that a correlation exists between client choice and use of "per stirpes" in will drafting.[15]

Table 6: Differences within the "Per Stirpes" Respondent Class—To Give or Not to Give Clients Choice with Distributional Methods—Firm Sizes

	No Choice			Choice	
Firm Size	T&E Cat.	Qty. Resp.	Total % All Firm Sizes	Qty. Resp.	Total % All Firm Sizes
1	1				
1	2	2		2	
1	3				
1	4	4	55%	2	50%
2	1				
2	2				
2	3	1		1	
2	4	1	18%		13%
3	1				
3	2				
3	3	2		2	
3	4	1	27%	1	37.50%

Law firms with twenty-five or more attorneys appear to be more likely to give the clients the choice of distributional methods and ultimately draft all wills with "per stirpes." *See* Table 6. Moreover, a respondent's percentage of trust and estate practice becomes less important when drafting with "per stirpes" if the client has a choice in picking the distributional method.

Table 7: Differences within the "Per Stirpes" Respondent Class—To Give or Not to Give Clients Choice with Distributional Methods—Firm E&T Specialty

	No Choice		Choice	
% in E&T	No. Resp.	Total %—No Choice	No. Resp.	Total %—Choice
1	0	0.0%	0	0.0%
2	2	18.2%	2	25.0%
3	3	27.3%	3	37.5%
4	6	54.5%	3	37.5%

As seen in Table 7, the percentage of trust and estate practice at respondents' law firms appears to even out across the firms—attorneys with 10% to 25% trust and estates practice are nearly as likely to draft "per stirpes" as respondents' firms with more than 25%.[16]

VI. Organizational Membership Differences

A few noticeable changes occur in organizational membership within the client-choice/all "per stirpes" class. First, there is a slight drop in the number of organizations to which the respondents belong. Second, as seen in Table 8, there is a strong increase in OCBA membership.[17] Moreover, the trend in low NYSBA and ABA memberships continues. A drop was seen within the all "per stirpes" class—the NYSBA and ABA membership becomes even less preferred with the law firm that gives clients the choice of distributional methods.[18]

Table 8: Differences within the "Per Stirpes" Respondent Class—To Give or Not to Give Clients Choice over Distributional Methods—Organizational Membership

	No Choice	Choice	
Name of Org.	% of Stirpes Resp.	% of Stirpes Resp.	% of Total Resp.
EPCCNY	72.73%	75.00%	74.19%
OCBA	81.82%	87.50%	77.42%
ACTEC	45.45%	37.50%	25.81%
NYSBA	63.64%	50.00%	74.19%
ABA	18.18%	12.50%	29.03%
None	0.00%	0.00%	3.23%
Avg. # orgs./resp.	2.82	2.63	2.84

VII. Conclusion

The survey responses indicate that the majority of attorneys in Onondaga County continue to use the

EPTL version of "per stirpes" (modern "per stirpes") in drafting the distributional scheme for descendants and issue. Indeed, a few respondents told us that modern "per stirpes" is what their clients desire, a decision that tends to promote equality among family branches rather than at each generation.

We attempted to see whether there was any correlation between type of practice, firm size or association membership and drafting preference. The only significant correlation we found was in type of practice—the greater the wills and trusts practice, the greater the use of "per stirpes."

Endnotes

1. *See* Restatement (Third) of Property—Wills and other Donative Transfers, § 2.3 statutory notes. An example of a bizarre result that came from adherence to strict per stirpes can be found in *Maud v. Catherwood*, 67 Cal. App. 2d 636, 645-51, 155 P.2d 111, 116-19 (Cal. Ct. App. 1945).
2. *Id*.
3. Unif. Probate Code § 2-106 (1969).
4. Mary L. Fellows et al., *An Empirical Study of the Illinois Statutory Estate Plan*, 1976 U. Ill. L. F. 717, 741 (1976); Comment, *A Comparison of Iowans' Dispositive Preferences of the Iowa and Uniform Probate Code*, 63 Iowa L. Rev. 1041, 1111 (1978).
5. *See generally* Lawrence W. Waggoner, A *Proposed Alternative to the Uniform Probate Code's System for Intestate Distribution among Descendants*, 66 Nw. U. L. Rev. 626 (1971).
6. Unif. Probate Code § 2-106 (1990).
7. *See* Raymond H. Young, *Meaning of "Issue" and "Descendants*," 13 ACTEC Probate Notes 225 (1988).
8. This one respondent answered "yes" to drafting with the term "by representation" and "per stirpes."
9. Two respondents define "by representation" while drafting. Both respondents also define "per stirpes" when drafting.
10. The Tables use a shorthand method of describing Firm Size; Percentage of Trust and Estates Work; and Organizational Membership.

    Firm size categories are as follows: 1 = firms with fewer than five lawyers; 2 = firms with five to twenty-five lawyers; 3 = firms with over twenty-five attorneys.

    Trust and Estates practice categories are as follows: 1 = T&E accounts for less than 10% of the law practice; 2 = T&E accounts for 10-25% of the practice; 3 = 25-50% of the practice; 4 = T&E represent over 50% of the practice.

    Legal organizations are indicated as follows: "1" signifies that a respondent belongs to only one organization, "2" means respondent belongs to two organizations, etc.
11. There were a total of eleven respondents for Question 4. The breakdown totals within each firm size category is as follows: Firm Size 1 = 6 respondents; Firm Size 2 = 2 respondents; and Firm Size 3 = 3 respondents. The percentages are derived from dividing the total Firm Size respondents by the number of members within each group.
12. *See* Table 5. ACTEC membership numbers for "per stirpes" respondents (45.45%) are considerably greater than ACTEC membership for all other respondents (25.81%). OCBA membership, albeit to a lesser extent than ACTEC membership, is higher within the "per stirpes" class (81.82%) than the other respondents (77.42%).
13. *See* Table 5. ABA and NYSBA membership differentials between the "per stirpes" and all other respondents class is over 10% in each category.
14. A total of eight respondents answered "yes" to question two. The eight respondents are from the following firm size: four size one firms; one size two firm; and three size three firms.
15. *See* Table 6. The data shows a higher percentage of size three law firms that give clients the choice of distributional methods and ultimately draft all "per stirpes" wills. There is over a ten percent change in "per stirpes" drafting within the size three firms and a decrease in the other firm sizes.
16. Table 7 seems to indicate that respondents that ask their clients to choose distributional methods and eventually draft using "per stirpes" tend to be evening out across practices that focus on trusts and estates at any percentage practice level. There remains a heavy emphasis to use "per stirpes" in category 4 and 5 respondents, but the percentages have converged to 37.5%. Moreover, it appears that even category 2 respondents increased in percentage closer to category 4 and 5.
17. Table 8 indicates that 87.5% of per capita respondents that give clients a choice are members of OCBA. This is a difference in nearly 10% membership, as the all respondent group had an OCBA membership rate of 77.42%. This 87.5% membership rate is also a marked increase from the all "per stirpes" group discussed where 81.82% of respondents belonged to OCBA.
18. *See* Table 8.

Martin L. Fried is the Crandall Melvin Professor of Wills and Trusts at the Syracuse University College of Law, and of counsel to Hancock & Estabrook, LLP, Syracuse, New York.

Karla M. Meola is a member of the Syracuse University College of Law, Class of 2006.

Making Tax Free *Inter Vivos* Gifts to Grandchildren

By Lainie R. Fastman

Clients often express their desire to "do something for the grandchildren." Even if the client does not have apparent Generation Skipping Transfer Tax ("GST") concerns, it is a good idea to review all GST exempt gift-giving options.

GST taxes apply to all transfers after October 22, 1986 to certain donees called "skip persons."[1] A skip person is an individual assigned to a generation more than one generation below that of the transferor.[2] Thus grandchildren are "skip persons." The GST tax's flat rate is equal to the highest estate and gift tax rate in effect at the time of the transfer (46% in 2006). The GST tax exemption is equal to the federal estate tax exemption. In 2006, every individual has a GST tax exemption of $2,000,000.[3]

"The mysteries of the calculation of GST taxes are not the subject of this brief exploration; it is, rather, the avoidance of the imposition of the tax on lifetime giving to grandchildren that concerns us."

An *inter vivos* direct skip is a transfer of an interest in property made to a skip person that is subject to gift tax. The GST tax is not imposed on any "direct skip" that is an otherwise non-taxable gift.[4] Assume, for example, that the donor makes a gift of $3,000,000 in 2006. He gives $1,000,000 to his son and $2,000,000 to his grandchild. The donor will incur gift taxes, as the current gift tax exemption is $1,000,000. In addition, the $2,000,000 to the grandchild is a GST taxable gift. The donor may elect to allocate his total GST exemption of $2,000,000 to the gift, rather than saving the exemption for future gifts or for his estate. In such case, no GST tax is payable at the time of the gift over and above the gift tax imposed on the $3,000,000 gift.

The mysteries of the calculation of GST taxes are not the subject of this brief exploration; it is, rather, the avoidance of the imposition of the tax on lifetime giving to grandchildren that concerns us. Since a general transfer tax exemption is not always co-extensive with a GST tax exemption, a review of the differences and similarities between the exemptions is useful.[5]

The Annual Exclusion Gift

I.R.C. § 2503(b) provides that a donor may make a gift of a present interest in property to any person, including a grandchild, during any calendar year free of transfer taxes. The statute fixes a formula, on the base amount of $10,000 set in 1998, tied to a cost-of-living adjustment, to arrive at the precise amount constituting a tax free gift in any given year. The formula will yield a sum equal to a multiple of $1,000, and amounts to a $12,000 exemption in 2006.[6] If grandpa gives to each of his grandchildren an outright gift in 2006, he has made a "direct skip" type of transfer as defined in I.R.C. § 2611. Fortunately, if grandpa limits his gift to $12,000 per grandchild, he has made a GST tax exempt gift.[7] No gift tax return need be filed. If grandma decides to "split" the gift, the couple may give $24,000 to each of the grandchildren, even though the entire gift is paid out of grandpa's separate assets. At least one spouse must file a gift tax return Form 709, in accordance with I.R.C. § 2513. Each spouse must be a citizen of the U.S. at the time the gift is made and the consent of the spouse must be indicated on the return. If the gift is not in cash, valuation evidence must also be submitted with the return.

In accordance with I.R.C. § 6075(b), the return cannot be filed prior to January 1st of the year following the year of the gift and the return may not be filed later than April 15th of the year the return is due.

The fiduciary of a deceased spouse's estate may consent to split gifts made in the year of death, and a guardian may similarly consent on behalf of an incompetent spouse.[8] Of course, if the gift is to come out of the assets of an incompetent spouse, the guardian must secure consent from the Court pursuant to N.Y. Mental Hygiene Law § 81.21. Counsel should consider the inclusion of a power to consent to split gifts in any power of attorney prepared for a married client.

Uniform Transfers to Minors Act Gifts

One method for making a gift for the benefit of a person under the age of 21 is the establishment of an account pursuant to the Uniform Transfers to Minors Act ("UTMA"). Previously, such an account had to be distributed to the beneficiary when the beneficiary reached the age of 18, but the Estates Powers and Trusts Law[9] now provides that the distribution to the beneficiary may be deferred until age 21. Any interest in property may be the subject of an UTMA transfer. For instance, a donor may convey an interest in real property by executing a deed to A as custodian for B under the UTMA.

The creator of the account names a custodian, and, preferably, a successor custodian, to avoid the need to appoint a successor upon the death or incapacity of the original custodian. Since the donor will often neglect to name a successor custodian, one should be aware of EPTL 7-6.7, which permits an "obligor," e.g., a bank or brokerage house holding the property for the custodian, to name a successor custodian. If the property is worth less than $50,000, the property may be paid or distributed by the obligor to an adult member of the minor's family.

The custodian is a fiduciary pursuant to EPTL 7-6.12, and has unfettered power over the custodial property in accordance with EPTL 7-6.13. Counsel should ensure that the property is not included in a donor-grandparent's estate by instructing the client not to name himself as the custodian. Naming the child's parent is also not a good idea, since the parent's use of the property to discharge his duty of support may have undesirable income tax consequences.

The custodian may use the property for the benefit of the minor without regard to the resources and support available to the minor. A 14-year-old minor, or any interested person on his behalf, may seek a court order to have the custodian pay to the minor, or expend on his behalf, so much of the custodial property as the court considers advisable under the circumstances.[10]

It should be kept in mind that the custodial property is an asset belonging to the minor, and for various purposes may be deemed an "available" resource. In *In re Smith*,[11] in an Article 78 proceeding the court confirmed a determination by social service agencies which had denied petitioner-mother food stamps, as she would have been disqualified had she disclosed the existence of the mutual funds contained in her 5-year-old daughter's UTMA account.

Since an UTMA accounts is established for a single beneficiary, a gift to such an account not exceeding the annual gift tax exclusion amount will also qualify for the annual GST tax exemption, as such gift satisfies the "separate share" requirement of I.R.C. Reg. 26.2654-1(a).

Gifts to Minors Trusts

Although the annual gift tax exemption is only available for a gift of a "present interest," a notable exception of this rule is the Gift to Minors Trust pursuant to I.R.C. § 2503(c). A transfer to a trust for the benefit of a minor which meets the requirements of I.R.C. § 2503 (c) is not considered a gift of a future interest. To be tax-free, the gift may not exceed the exempt amount set forth in I.R.C. § 2503(b).

There are two basic requirements for a Section 2503(c) trust:

1) The trust's principal and accumulated income must be paid to the beneficiary when the beneficiary reaches the age of 21.

2) Should the beneficiary die prior to distribution of all income and principal, all trust assets must be paid to the beneficiary's estate or must be subject to a general power of appointment exercisable by the beneficiary.[12]

It is important in drafting the trust to take care that the trust provisions do not inadvertently violate the rules of Section 2503(c). For instance, a provision to pay the trust to the beneficiary's "heirs at law," if the beneficiary were to die before reaching the age of 21, will disqualify the trust, as the beneficiary's heirs at law may not be equivalent to the beneficiary's estate.[13]

The trust must provide that income and principal may be expended for the beneficiary's benefit until the beneficiary reaches the age of 21.[14] It is sufficient if the trust provides that the beneficiary has the right to demand the distribution to him of trust property for a reasonable period of time upon reaching the age of 21. If the beneficiary does not exercise the demand right, the trust may continue for whatever duration the terms of the trust instrument provide.

I.R.C. Reg. 25.2503-4(b)(1) provides that there may be "no substantial restriction"[15] on the exercise of the Trustee's discretion to spend income and principal for the benefit of the beneficiary. Accordingly, a grandparent cannot restrict the use of the trust assets to a specific purpose, such as education.

Rev. Rul. 69-345, 1969-1 C.B. 226, addresses the range of permissible restrictions by comparing various restrictions with the powers of a guardian under state law.[16] A direction which limited the Trustee's discretion to provide for the support, care, education, comfort and welfare was deemed to be broad enough not to offend the statute.[17] Similarly, a trust for the education, comfort and support is permitted.[18] The better practice is to provide the broadest discretion to the Trustee.

Clearly, the requirement that the trust property pass to the beneficiary at age 21, and, if the beneficiary dies before that time, that his estate is the irrevocable owner of the property, or that it is subject to the beneficiary's general power of appointment, will dictate that an I.R.C. § 2503(c) trust can have only one beneficiary. Compliance with that rule, however, will also ensure compliance with the requirement of the GST annual gift tax exemption that a separate share be maintained for the donee grandchild.[19]

If grandma names the custodial parent as Trustee, the Trustee's power to apply the property to discharge the parent's duty of support of the beneficiary may result in the property being taxed in the estate of the Trustee/parent. Similarly, if grandma is the Trustee, her unlimited power over income and principal may lead to inclusion of the property in grandma's estate under I.R.C. § 2036 or 2038. It is best to appoint a friend or other relative as Trustee.

The trust is a separate taxpayer for income tax purposes. While trust income that is distributed to the beneficiary may be deducted on the trust's fiduciary income tax return, it is taxable income to the beneficiary, and it may be important to consider the Kiddie tax. If children under the age of fourteen have unearned income in excess of $1,700 per year in 2006, their parents' highest income tax rate will apply. On May 17, 2006, the Kiddie tax was extended by the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. 109-222) to children under the age of 18, retroactive to January 1st of 2006. Of course, if the grandparent is inclined to pay income tax on the trust, the trust may be structured as a grantor trust.[20]

The Mandatory Income Trust

The "present interest" requirement for the annual exclusion under I.R.C. § 2503(b)(1) can be met with a "mandatory income trust," also known as a "Section 2503(b) income trust," under which all income is paid to the beneficiary. The income interest is the "present interest" required by the statute.[21] The income alone is eligible for the gift tax exemption. The trust may also provide that an annuity or unitrust interest be paid to the beneficiary.[22] In the case of an annuity interest, the beneficiary must be entitled each year to a fixed percentage of the initial principal funding the trust. A unitrust interest is a fixed percentage to be paid out of the trust property as revalued each year. If the income generated is insufficient to satisfy the unitrust amount, the balance is paid from principal. In fashioning a mandatory income trust, the income interest must be able to be valued for gift tax purposes.

The income beneficiary must have the immediate, unrestricted use, possession or enjoyment of the property.[23] Thus, the Trustee is prohibited from accumulating the income and may not divert the income for any reason. The income may be paid to the beneficiary directly, to a custodian under the Uniform Transfers to Minors Act, or to the beneficiary's legal guardian.

Only the income interest qualifies for the gift tax exemption. The remainder interest, being a gift of future interest, does not. Thus a taxable gift takes place at the creation of the trust, incurring potential GST gift taxes. However, by manipulating the duration of the trust, the remainder interest is devalued for gift tax purposes. The longer the term of the trust, the lower the value of the remainder interest. As the beneficiary must be entitled to the remainder interest, all growth of the remainder inures to him.

As with the gifts to minors trust we examined earlier, the income only trust may have only one beneficiary. This separate share requirement will ensure that the gift tax exclusion is also available for a GST exemption.[24]

The Crummey Trust

Some of the disadvantages of the standard I.R.C. § 2503 trust are the lack of flexibility in crafting the trust purposes and the mandatory termination when the beneficiary reaches the age of 21.

Grantors often desire to carefully circumscribe the trust's purposes under the discretion of the Trustee. A solution is the so-called "Crummey" trust. The grantor creates a trust to be the recipient of annual exclusion gifts, then makes an annual exclusion gift, notifying the donee of his right to withdraw the gift within a limited amount of time, typically at least 30 days. If the beneficiary declines to withdraw the property, it becomes an irrevocable part of the trust. The beneficiary's right to withdraw additions from the Crummey trust serves to satisfy the present interest requirement of the annual exclusion statute.

In *Crummey v. Commissioner*,[25] this method for obtaining the annual exclusion was sanctioned and has remained permissible in spite of challenges by the IRS.

The annual withdrawal power must be real and exercisable, and each beneficiary must be notified of the right to withdraw the additions to the trust. The IRS has attempted to challenge the bona fides of the exclusion on the grounds that the Crummey notices were not timely sent, that there were insufficient funds to draw from, or that the persons with the right to withdraw were not "interested" in the trust. In Technical Advice Memorandum 9628004 (Apr. 1, 1996), the exclusions failed because the donees were not given proper advance notice of their rights to withdraw the gift, the withdrawal rights expired before the funding of the trust and the Crummey power holders had no other right to the trust property other than withdrawal rights. In short, adding beneficiaries to the trust who have "naked powers" to withdraw but no vested remainder interests will not qualify for the annual exclusion.

Obviously there should not be a "prearranged understanding" that the withdrawal right will not be exercised and/or that doing so would result in undesirable consequences.[26]

Care should be taken that the Trustee, often a family member and beneficiary of the trust, does not have rights over the trust property which may be deemed so extensive as to constitute a general power of appointment, causing the trust property to be taxable in the Trustee's estate. This will not occur if the Trustee/beneficiary is granted discretion to distribute trust property according to an ascertainable standard, such as the beneficiary's "health, maintenance and support."[27]

It may be difficult for a standard Crummey trust to qualify for the GST tax annual exclusion. However, the IRS has determined that the annual GST exclusion was applicable where grandmother created separate trusts for the benefit of her four grandchildren.[28] The trusts contained Crummey withdrawal powers for each beneficiary authorizing the donee to withdraw each year the annual addition to the trust.

It is also permissible to have one trust agreement that provides explicitly that each of the grandchildren has a completely separate sub-account in the trust. The Trustee may not have discretion to transfer property between accounts. Each sub-account beneficiary must be irrevocably entitled to the account. Each sub-account must have its own tax ID number, and separate fiduciary income tax returns must be filed for each account.

One may also combine any of the previously discussed trusts with the Crummey trust. When, e.g., the I.R.C. § 2503(c) minor's trust would ordinarily end at 21, the trust could provide that if the beneficiary declines to withdraw the trust property at reaching 21, the trust will continue. The trust is then converted into a Crummey trust with the annual additions and concomitant withdrawal powers.

Gifts to 529 Plans

In addition to the foregoing methods of gifting, grandparents may use their annual exclusion by making cash contributions to an account earmarked for the tuition for higher education established for the exclusive benefit of designated beneficiaries, a so-called Qualified Tuition or 529 Plan. There are two basic types of qualified tuition programs, the prepaid tuition program and the college savings program.

A "designated beneficiary" means that beneficiary originally designated at the commencement of the contributions by the donor to the Plan, or, if the donor changed the beneficiary designation, the new beneficiary. Beneficiaries may be changed, provided the new beneficiary is a "member of the family" of the original beneficiary.[29] Effective January 1, 1998, a "member of the family" includes the beneficiary's spouse, child or other descendant, and certain ancestors, collateral relatives and in-laws.[30] The account holder's ability to change beneficiaries provides desired control. The donor may also terminate the plan and withdraw the funds and use them for another purpose, although this will cause income tax penalties.

Neither the donor nor the beneficiary may directly or indirectly direct the investment of any contributions. None of the trust assets may be used as security for a loan.[31] Although the statute specifically requires cash contributions, redemption by the donor of U.S. Savings Bonds to fund the Plan is permitted.

A Plan may pay for "qualified higher education expenses." Tuition, fees, books, supplies and equipment required for enrollment or attendance at an eligible educational institution, as well as room and board expenses, are included in such expenses. The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") provides that the maximum room and board expenses allowance is the amount applicable to the student in calculating costs of attendance for Federal financial aid programs under Section 472 of the Higher Education Act of 1965, or, in the case of a student living in housing owned or operated by an eligible educational institution, the actual amount charged to the student by the educational institution.

Qualified higher education expenses include expenses for accredited post-secondary educational institutions offering a bachelor's degree; associate's degree; a graduate-level or professional degree, or other post-secondary credentials. Certain post-secondary vocational schools are also eligible educational institutions. The institution must be approved by the IRS. Officers and employees of qualified institution programs are required to report contributions to and distributions from program accounts. To the extent that approved expenses are offset by grants or tuition assistance, they cannot be reimbursed by the gift into the Plan.

If the Plan is in compliance, the gift is treated as a completed gift of a present interest and thus qualifies for the annual exclusion for gift tax purposes.[32] Although completed gifts, contributions to a qualified tuition program, or 529 Plan, will not qualify under the unlimited I.R.C. § 2503(e) gift tax exclusion for money used to pay educational expenses.

The annual contribution will be eligible for the present-interest exclusion permitted by I.R.C. § 2503(b) provided that the total annual gift per donee does not exceed the applicable exclusion amount for the year of the gift. A program will not be treated as a qualified tuition program unless it requires separate accounting for each designated beneficiary.[33] The "separate account requirement" of the programs also ensures a GST tax exemption.

Although the 529 Plan contribution is an annual exclusion eligible gift, the gift may exceed the applicable annual exclusion if the donor elects to spread the gift over a maximum of five years, as if made ratably. For example, a $30,000 contribution to a qualified Plan could be treated as five annual contributions of $6,000 each, and the donor could make up the difference between that amount and the applicable annual exclusion amount in other transfers to the beneficiary.[34] Should the donor die, say, after two years having made a gift exceeding two years' worth of applicable annual exclusion amounts, the balance (three years' worth) will be includible in his estate. Under the rule that the donor may spread his contribution over five years, he could contribute $60,000 every five years, or, should his spouse split the gift, double that amount, assuming no other annual exclusion gifts are made.

> *"The annual gift tax exclusion continues to be an excellent way of transferring wealth to the next generation and there are many opportunities for grandparents who wish to extend their generosity to grandchildren to employ the exclusion."*

Qualified tuition programs or 529 Plans were once limited to state programs and now include prepaid tuition programs that are established and maintained by eligible private institutions that satisfy I.R.C. § 529 requirements.[35]

Another bonus of the plan: EGTRRA provides that accumulated earnings in the Plan may be withdrawn without income tax.[36] In addition, New York residents who contribute to a tuition savings account sponsored by the New York State College Choice Tuition Program are entitled to an income tax deduction of $5,000 for contributions.[37]

Gifts of Educational and Medical Expenses

In addition to the annual exclusion, a donor is also entitled to make unlimited gifts without incurring gift tax by paying an educational organization for tuition.[38] Payments must be made directly to the educational organization "for the education and training" of an individual.[39] The educational institution must maintain a regular faculty and curriculum and have an enrolled body of students.[40] Only tuition qualifies for the exemption. Books and supplies are not included. The gift must be made directly to the educational organization and cannot be a gift in trust which provides for the education of the grandchild.[41] A gift made to reimburse an individual for amounts he or she paid for education will not qualify for the I.R.C. § 2503(e) exemption. A recent Internal Revenue Ruling has determined that a grandparent who enters into a written agreement with a school to pre-pay each of his or her grandchildren's tuition through grade 12 was entitled to the exclusion.[42] It should be emphasized that a grandparent's commitment to pre-pay tuition must be separate with respect to each grandchild in order for the GST tax exemption to apply.[43]

The statute also permits an exclusion from gift tax for medical expenses. Again, in order to qualify for the exemption, payment must be made directly to the medical providers and may not be made to reimburse an individual for medical expenses. The I.R.C. § 2503(e) gift tax exemption for the payment of medical expenses will only apply to expenses for diagnosis, cure, mitigation, treatment or prevention of disease, as well as to pay for premiums for medical insurance.[44] The statute specifically excludes cosmetic surgery. If medical expenses are reimbursed by insurance, the gift will not qualify either.

As with tuition payments, grandparents who wish to ensure that medical payments made to pay for their grandchildren's medical expenses qualify for the unlimited I.R.C. § 2503(e) exemption must take care to make separate payments for each grandchild in order to obtain the GST tax exemption.[45]

Conclusion

The annual gift tax exclusion continues to be an excellent way of transferring wealth to the next generation and there are many opportunities for grandparents who wish to extend their generosity to grandchildren to employ the exclusion. They must, however, be vigilant to ensure that any gift to a grandchild beneficiary is distinctly separate from gifts given to other donees. Inadvertent co-mingling of donated assets, or the possibility of doing so, will disqualify the gift as a GST tax exempt annual exclusion gift.

Endnotes

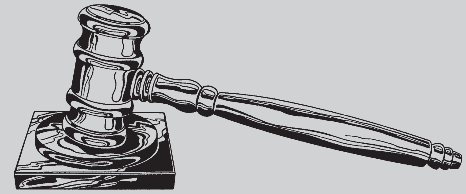
1. I.R.C. § 2601 (2006).
2. Treas. Reg. § 26.2612-1(d)(1).
3. I.R.C. § 2631(a).
4. *Id.* § 2642(c)(1).
5. Although, the amount of the exclusion is closely intertwined with the instrumentality of the gift, they are, of course, conceptually different.
6. I.R.C. § 2503(b)(2).
7. *Id.* § 2642(c)(1).
8. Treas. Reg. § 25.2513-2(c).

9. N.Y. Est. Powers & Trusts Law (“EPTL”) 7-6.20 (McKinney 2006).
10. *Id.* 7-6.14.
11. 767 N.Y.S.2d 751 (2003).
12. I.R.C. § 2514(c)
13. *Ross v. Comm'r*, 71 T.C. 897, 900-01 (1979), *aff'd*, 652 F.2d 1365 (9th Cir. 1981).
14. Rev. Rul. 74-43, 1974-1.
15. *Cf. Ross v. United States*, 348 F.2d 577 (5th Cir. 1965).
16. *Id.* at 581.
17. Rev. Rul. 67-20, 1967-2 C.B. 349.
18. *Heidrich v. Comm'r*, 55 T.C. 746 (1971); *see also Craig v. Comm'r*, 30 T.C.M. (CCH) 1098 (1971).
19. Treas. Reg. § 26.2654-1(a).
20. I.R.C. § 671.
21. *Id.* § 25.2503-3(c), example 4.
22. I.R.S. Priv. Ltr. Rul. 86-37-084 (June 17, 1986).
23. Treas. Reg § 25.2503-3(b).
24. *Id.* § 26.2654-1(a).
25. 297 F.2d 82 (9th Cir. 1968).
26. I.R.S. Tech. Adv. Mem. 96-28-004 (Apr. 1, 1996).
27. Treas. Reg. §§ 25.2511-1(g)(2), 25.2514-1(c)(2), 20.2041-1(c)(2).
28. I.R.S. Priv. Ltr. Rul. 200114026 (Jan. 5, 2001).
29. I.R.C. § 529(c)(3)(C).
30. *Id.*
31. I.R.C. § 529(b)(1)(B)(5).
32. I.R.C. § 529(c)(2)(A).
33. I.R.C. § 529(b)(1)(B)(3).
34. I.R.C. § 529(c)(2)(B).
35. I.R.C. § 529(b)(1).
36. I.R.C. § 529(a).
37. N.Y. Tax Law § 612(c)(32) (McKinney 2006).
38. I.R.C. § 2503(e).
39. Treas. Reg. § 25.2503-6.
40. I.R.C. § 170(b)(1)(A)(ii).
41. *See* Treas. Reg. § 25.2503-6, Example 2.
42. Priv. Ltr. Rul. 200602002. *But see* Blanche Lark Christerson, *Private Wealth Management, Duetsche Bank*, Tax Topics, Jan. 27, 2006, for possible income tax consequences to the parents whose duty of support may be discharged by the arrangement, pursuant to Treas. Reg. § 1.662(a)-4.
43. Treas. Reg. § 26.2654-1(a).
44. I.R.C. § 213(d).
45. *Id.* § 2642(c)(1).

Lainie R. Fastman is a partner with The Law Firm of Hall & Hall, LLP, Staten Island, New York.

Recent New York State Decisions

By Ira Mark Bloom and William P. LaPiana



ADMINISTRATION

Providing Support Does Not Prevent Finding of Abandonment

Decedent's parents both filed petitions for administration of decedent's estate and mother moved to disqualify father alleging that he had abandoned decedent within the meaning of EPTL 4-1.4. In an opinion thoroughly reviewing precedents, the Surrogate granted mother's motion for summary judgment, holding that father's lack of communication with decedent after the age of 15 until his death some 15 years later met the standard for abandonment even though father had paid all court-ordered support. *In re Pessoni*, 11 Misc. 3d 245, 810 N.Y.S.2d 296 (Sur. Ct., Cortland Co. 2005).

FIDUCIARIES

Revocation of Letters of Trusteeship of Beneficiary's Estranged Spouse Was Warranted

Decedent's will created a trust for her son and nominated his wife as trustee "so long as she is married to my son and living with him as husband and wife." Son petitioned for revocation of his wife's letters after he commenced a divorce proceeding and he and his wife were living apart. The Surrogate granted the petition holding that under SCPA 711(5) the contingency ending the wife's office had occurred and further noted that under SCPA 711(10) wife was an "unsuitable" person to act as trustee given the existence of the divorce proceeding "that is not amicable." *In re Bitter*, 11 Misc. 3d 1032, 811 N.Y.S.2d 907 (Sur. Ct., Nassau Co. 2006).

GUARDIANSHIP

Will Executed While Testator Lacked Capacity Must Be Invalidated

Rita R. was found to be an incapacitated person and a guardian was appointed. The Surrogate determined that certain legal documents executed by Rita R. before the appointment of the guardian, including durable powers of attorney, a health care proxy, and trust amendments, should be invalidated, Rita R.'s son having shown by clear and convincing evidence that each instrument had been executed while Rita R. was incapacitated. The son also showed that at the time his mother executed a will she was incapacitated but the Surrogate did not invalidate the will. Rita R.'s daughter appealed the Surrogate's order. The Appellate Division affirmed, and also held that the Surrogate's Court had the authority to invalidate the will as well under Mental Hygiene Law § 81.29(d) and should have done so. The appellate court therefore amended the Surrogate's order to invalidate the will as well. *In re Rita R.*, 26 A.D.3d 502, 811 N.Y.S.2d 89 (2d Dep't 2006).

PROCEEDINGS

Nominated Alternate Executor May Be Examined under SCPA 1404(4)

Prospective objectants sought to examine the nominated alternate executor under a will which contains an *in terrorem* clause. SCPA 1404(4) allows the examination of nominated executors where the will contains an *in terrorem* clause and EPTL 3-3.5(b) provides that the examination under SCPA 1404 of nominated executors will not trigger a no contest clause. The nominated alternate executor resisted the subpoena, asserting that the statutory provision does not apply to nominated *alternate* executors. The Surrogate's Court allowed the examination to go forward, finding that "judicial philosophy of late favors an expansive reading" of SCPA 1404(4), especially when prospective objectants are attempting to make an informed decision about the merits of their claims. *In re Marshall*, 11 Misc. 3d 674, 811 N.Y.S.2d 552 (Sur. Ct., Suffolk Co. 2005).

TRUSTS

Trustee's Consent Required for Revocation

The sole beneficiary and the creator of an irrevocable lifetime trust executed a document purporting to revoke the trust pursuant to EPTL 7-1.9, which allows an otherwise irrevocable trust to be revoked if the creator and all of those beneficially interested in the trust agree. The trust, however, contained a provision giving the trustee the power to amend or revoke the trust as the trustee deems "necessary and prudent." The Supreme Court granted the petition of the creator and beneficiary to terminate the trust and ordered the trustee to account. The trustee appealed and the Appellate Division reversed, holding that the language giving the trustee discretion to amend or terminate the trust requires the trustee's consent to termination under the provisions of EPTL 7-1.9 and remanded for a determination of whether the trustee unreasonably withheld consent to the termination. *In re Elser*, A.D.3d, 814 N.Y.S.2d 684 (2d Dep't 2006).

Investments: Conversion of Common Trust Fund to Mutual Fund Approved

The common trust fund has been a feature of New York law since the 1930s but recently has become almost extinct as corporate trustees have terminated the funds and converted the common trust fund units held for individual trusts into shares of mutual funds under control of the corporate fiduciary. One such corporate fiduciary brought a proceeding for final settlement of its accounts as trustee of several common trust funds, which included a request to sanction the trustee's conversion to shares in captive mutual funds. After reviewing the history of common trust funds the Surrogate's Court approved the final accounts but noted that the beneficiaries of the underlying trusts will lose the protection of the decennial accountings required of common trust fund trustees and suggested legislative action. *In re Chase Manhattan Bank*, 11 Misc. 3d 725, 813 N.Y.S.2d 855 (Sur. Ct., New York Co. 2005).

Distributions from CRAT to Discretionary Trust Belong to Income Beneficiary

Grantor created two lifetime trusts: a charitable remainder annuity trust (CRAT) and a custodial trust. Grantor was the beneficiary of the annuity paid from the CRAT. After his death the annuity was to be paid to the custodial trust whose trustee was to pay all the trust's income to the grantor's daughter as well as principal in its discretion for the "support, maintenance, and general welfare" of the daughter. The trustee was expressly instructed not to give daughter "any large sums of money." On the daughter's death the custodial trust is to be distributed to charity. After the daughter's death the trustee of the custodial trust distributed over half a million dollars of undistributed income from the trust to the daughter's estate. The charitable remainder beneficiaries objected, maintaining that the annuity payments from the CRAT to the custodial trust should be treated as distributions of principal or as accumulated income which in either case should be paid to them. Having lost in the Surrogate's Court and the Appellate Division, the charities prevailed in the Court of Appeals. The Court held that even if the payments to the CRAT are characterized as income, the grantor intended his daughter to receive only so much income as the trustee determined to be sufficient to cover her needs and as a general any surplus income is accumulated and belongs to the remainder interest. It would be "incongruous" to hold that daughter's estate could dispose of accumulated funds when she could not have received that sum during life. *In re Chase Manhattan Bank (Pioch)*, 6 N.Y.3d 456, 846 N.E.2d 806, 813 N.Y.S.2d 361 (2006).

Discretionary Trusts: Court May Ratify Distributions by Trustee to Self

Decedent was co-trustee of testamentary trusts created by his wife for the benefit of their daughters. Decedent could receive distributions from the trusts in the discretion of the disinterested co-trustee who was directed to be "extremely liberal" in exercise of the granted discretion, was absolved of any duty to inquire as to the decedent's other resources and was authorized to make distributions even though such distributions resulted in the termination of the trusts. Decedent was given a broad special power of appointment over the trusts. In 1990 the successor co-trustee ceased to act, informed decedent of his resignation but did not seek court approval. Decedent acted as sole trustee until his death in 2002 during which time he made distributions to himself in excess of $1,000,000. The daughters objected to the accountings filed by the decedent's estate and demanded repayment of the distributions received by the decedent alleging that at the time EPTL 10-10.1 prohibited the distributions. Despite the express prohibition by EPTL 10-10.1, which was subsequently amended to allow a trustee to make distributions to himself or herself if authorized by the settlor, the Surrogate held that after a hearing the court could retroactively ratify the distributions to the decedent if the court was satisfied that the distributions were permissible under the trust language creating the decedent's interest in the trusts. *In re Levitt*, 11 Misc. 3d 371, 812 N.Y.S.2d 805 (Sur. Ct., Nassau Co. 2005).

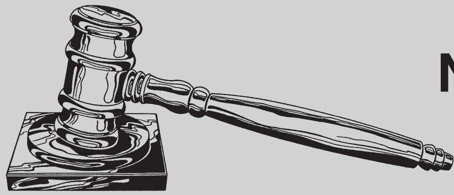
WILLS

Extrinsic Evidence Admitted to Show Identity of Beneficiaries

Decedent's will directed that her residuary estate be divided into twenty-five equal shares so that one share would be set apart for each niece or nephew who survived her or who predeceased her leaving child or children surviving her. The decedent had twenty-two nephews and nieces related by blood and three related by marriage, the blood nieces and nephews of her predeceased husband. The attorney who drafted the will submitted an affidavit stating that the decedent stated that she had twenty-five nieces and nephews. Citing other cases allowing extrinsic evidence contained in an affidavit by the drafter of a will as well as cases finding that the term nieces and nephews included persons related to the decedent by both consanguinity and affinity, the Surrogate accepted the affidavit and held that the decedent's late husband's nieces and nephews should each receive one twenty-fifth of the residuary estate. *In re McHugh*, 12 Misc. 3d 219, 810 N.Y.S.2d 635 (Sur. Ct., Broome Co. 2006).

Ira Mark Bloom is Justice David Josiah Brewer Distinguished Professor of Law, Albany Law School. William P. LaPiana is Rita and Joseph Solomon Professor of Wills, Trusts and Estates, New York Law School.

Professors Bloom and LaPiana are the current authors of Bloom and Klipstein, DRAFTING NEW YORK WILLS (Matthew Bender) (Bloom as principal author; LaPiana as contributing author).



Case Notes— New York State Surrogate's and Supreme Court Decisions

By Ilene Sherwyn Cooper

Attorney-Client Privilege

In a contested action, the defendants moved for an order directing plaintiffs to return copies of an allegedly privileged document inadvertently produced, asserting that the document was intended to remain privileged and confidential at all times. The plaintiffs argued that the document was not privileged, but even if it were found to be, claimed that its production was intentional and therefore the privilege was waived.

The court found that the document was privileged, and that it was the defendants' burden to prove that its production was inadvertent. To this extent, the court opined that defendants were required to demonstrate (1) that production of the document was inadvertent; (2) an intention to retain the confidentiality of privileged materials; (3) reasonable precautions to prevent disclosure; (4) prompt objection; and (5) an absence of prejudice were a protective order to be granted.

Applying these criteria, the court concluded that the production of the subject document was inadvertent and unintentional. Defendants submitted an affidavit indicating the precautions taken in document production in avoiding the production of privileged material. Moreover, upon discovering the error, defendants' counsel promptly objected to the disclosure. Lastly, the court found that no prejudice would result to plaintiff in the event that a protective order was granted.

The court further noted that despite the purported fiduciary relationship between the parties, the fiduciary exception to the attorney-client privilege did not apply, and that there was no basis for finding that the privilege had otherwise been waived.

Delta Financial Corp. v. Morrison, N.Y.L.J., June 9, 2006, p. 31 (Sup. Ct., N.Y. Co.) (Justice Warshawsky).

Attorney-Fiduciary and Disclosure

Before the court was an application by one of the nominated fiduciaries for a waiver of compliance with the provisions of SCPA 2307-a. The attorney-petitioner stated that he was the draftsman of the decedent's Will and is a member of the firm representing the estate. He further stated that he knew the decedent for over 15 years prior to her death and had drafted numerous Wills for her in which she specifically asked that he serve as fiduciary. The record revealed, however, that while the decedent executed a written acknowledgment of disclosure in connection with the decedent's prior Wills no such instrument had been submitted in connection with the propounded Will.

Inasmuch as the propounded Will was executed on October 26, 2004, the court held that the provisions of the statute, SCPA 2307-a, did not provide authorization for a waiver to be granted. The fact that the decedent had executed prior written disclosure statements was not dispositive. Accordingly, the court held that the attorney-fiduciary would only be allowed one-half statutory commissions.

In re Estate of Karlan, N.Y.L.J., April 11, 2006, p. 19 (Sur. Ct., Nassau Co.) (Surr. Riordan).

Attorney-Fiduciary and Disclosure

In *In re Estate of Brokken*, the court addressed the novel question of whether the disclosure requirements of SCPA 2307-a could be waived by the beneficiaries of the decedent's estate so that the attorney-fiduciary could receive full commissions.

The decedent's Will, dated December 16, 1994, named his brother and his attorney as co-executors of his estate, and expressly acknowledged his awareness that his attorney would be entitled to both commissions and legal fees. The court opined that this disclosure failed to satisfy the provisions of the statute, SCPA 2307-a(2), inasmuch as it was contained within the provisions of the Will, rather than in the form of a separate written instrument.

Nevertheless, the record reflected that the beneficiaries under the instrument had executed written consents to the attorney-fiduciary's receipt of full commissions, and acknowledged that they had been fully informed of the requirements of SCPA 2307-a. The question thus presented was whether these consents could be utilized to override the dictates of the statute so as to entitle the attorney-fiduciary to more than one-half the commission to which he would otherwise be entitled.

In concluding that the beneficiaries could waive the statute's protection, the court reviewed the legislative history and purpose of the statute, and noted that as a practical matter the true object of the statute's protection were the beneficiaries of the estate, who would be responsible for the legal fees and commissions payable to the attorney-fiduciary. As such, the court held it stood to reason to allow the beneficiaries to consent to full commissions under the circumstances, where full disclosure of the statutory dictates was made.

In re Estate of Brokken, N.Y.L.J., March 28, 2006, p. 24 (Sur. Ct., N.Y. Co.) (Surr. Roth).

Disclosure

In a copyright infringement suit, the court warned about the disclosure of Social Security numbers during the course of pretrial discovery. The court opined that given the significant privacy interests at stake and/or the potential burden of such disclosure, more than a "perfunctory analysis" was required before such disclosure should be ordered. Rather, the party seeking this information should provide substantial proof of a particularized need, and the court order for disclosure should restrict use of the information obtained to the articulated need. The court noted that while disclosure is typically broadly granted, this was not the case where invasion of privacy is threatened.

Entral Group International, LLC v. YHCL Vision Corp., N.Y.L.J., June 15, 2006 (E.D.N.Y.) (Judge Korman).

Disqualification of Fiduciary

In a contested probate proceeding, the proponent of the will, the decedent's son, sought expansion of the limited letters of administration that had been issued to him for the purpose of pursuing certain tax issues relating to the estate. The application was opposed by the decedent's daughter and the guardian *ad litem* appointed for his surviving spouse.

At the time of the decedent's death, litigation was pending between the decedent and his son with respect to significant transfers of assets claimed by the decedent as his own. The proponent conceded that he had a conflict of interest that disqualified him from representing the estate in connection with this suit, and agreed that the Public Administrator was the proper party to be appointed fiduciary for this purpose in his place and stead. Nevertheless, he claimed that his designation as executor under the propounded will and under prior wills of the decedent entitled him to be appointed fiduciary for the estate during the pendency of the probate proceeding.

The court disagreed, concluding that although a named fiduciary is presumptively entitled to deference, in the present case, the appointment was undercut by genuine issues surrounding the propounded will and penultimate instrument; issues of fraud and undue influence raised by members of the decedent's immediate family; the hostility between the proponent and his sister; certain charges of fraud and forgery leveled against the proponent by the decedent prior to his death; and the fact that the Public Administrator would be representing the estate in connection with a substantial lawsuit in the Supreme Court.

Accordingly, the proponent was authorized to continue serving as limited temporary administrator, and the Public Administrator was appointed temporary administrator.

In re Estate of Hirschfeld, N.Y.L.J., June 7, 2006, p. 35 (Sur. Ct., N.Y. Co.) (Surr. Roth).

Fiduciary Duty and Settlement

In a contested probate proceeding, all parties reached a settlement of the issues, but for the attorney-draftsman of a purported codicil of the decedent. In the proceeding for probate of the decedent's Will, the petitioner asked that the purported codicil be denied probate. The attorney-draftsman of the instrument objected. The Attorney General and the petitioner contend that the codicil is more in the nature of a charitable pledge rather than a testamentary document. Although the proposed settlement of the matter provided for the charitable gift set forth in the document, the attorney-draftsman nevertheless refused to withdraw his objections to probate.

Upon motion by the Attorney General and petitioner to dismiss the objections, the court held that absent good cause, a fiduciary may not stand in the way of a settlement of a probate contest arrived at among all parties beneficially interested in the estate. Moreover, the court noted that the attorney-draftsman presented no valid reason for his interference with the settlement.

Accordingly, the objections were dismissed, and the propounded instrument was admitted to probate.

In re Estate of Yuan, N.Y.L.J., June 7, 2006, p. 35 (Sur. Ct., N.Y. Co.) (Surr. Roth).

Forfeiture

In a contested administration proceeding, the petitioner, who was the decedent's sister, sought an order holding that the decedent's surviving spouse was instrumental in her death, and as such, had forfeited his interest as a distributee.

The record revealed that the police found the body of the decedent in her home after being summoned there by her husband. He was arrested and thereafter confessed to shooting his wife in the head and killing her. After being indicted for murder in the second degree, and while awaiting arraignment, the decedent's husband post-deceased her.

The distributees of the decedent's husband filed an answer with general denials of the allegations in the petition, and an affirmative defense that he was not criminally culpable for the decedent's death by virtue of a mental disease that was triggered by the decedent's poor health. The court noted that it had previously ruled on this theory, and had concluded that because the "trigger" defense had not gained acceptance in New York, any proof lending credence to same would be excluded. The distributees also submitted an affidavit from a forensic psychiatrist who requested the opportunity to establish at trial that the psychiatric condition the decedent's husband made him mentally incapable of criminally causing the death of his wife.

Based upon the record, the court concluded that the respondents had failed to raise a triable issue of fact respecting the mental capacity of the decedent's husband at the time of the decedent's death. Specifically, the court noted that respondents' request to submit psychiatric proof of the husband's mental condition was based upon hospital records reflecting a condition that existed two years before the decedent's death, and therefore, was too remote from the incident involving her murder.

Accordingly, the motion for summary judgment was granted, and the decedent's husband was held to have forfeited his interest in the decedent's estate.

In re Estate of Stiehler, N.Y.L.J., April 20, 2006, p. 21 (Sur. Ct., Richmond Co.) (Surr. Fusco).

In Terrorem Clause

In *Bernstein v. LoPata*, the court was presented with a petition for construction of the decedent's Will by his daughter, who claimed that the residuary clause of the instrument was void for indefiniteness and that, as a result, the residue passed by intestacy.

The residuary clause provided:

> I direct that my Executor/Executrix shall distribute the residuary of my estate to charities of his/her choice.

The construction proposed by the petitioner was opposed by the executor and by the Attorney General.

As a threshold matter, however, the executor claimed that the proceeding should be dismissed on the grounds that the petitioner lacked standing.

The court opined that in order to have standing to seek a construction, the petitioner must have an interest in the property that will be affected by the construction. The executor argued that inasmuch as the petitioner waged an unsuccessful probate contest and thereby triggered the *in terrorem* clause under the decedent's Will, she forfeited any interest in the decedent's estate that would have enabled her to pursue the requested construction.

In sustaining the executor's position, the court examined the language of the *in terrorem* clause of the decedent's Will, and found that inasmuch as it specifically disenfranchised a beneficiary, who participated in a court action "about the provisions of the Will," from an interest under the Will "or otherwise," it could be construed to disinherit a beneficiary from a testate and intestate share of the estate. Accordingly, the court concluded that the petitioner lacked standing to seek a construction of the residuary clause and dismissed the petition.

Moreover, and in any event, the court held that the residuary clause did not fail for indefiniteness, and constituted a valid charitable bequest.

Bernstein v. LoPata, N.Y.L.J., May 30, 2006, p. 45 (Sur. Ct., Nassau Co.) (Surr. Riordan).

Partial Revocation of Will

In an uncontested probate proceeding, the court was confronted with a Will wherein the decedent attempted to partially alter its provisions after the date of execution.

The instrument was dated February 21, 2003, and it was not drafted nor was its execution supervised by an attorney. It was signed by the testator and witnessed by three attesting witnesses. An acknowledgment of the testator's signature was also taken at the time of execution.

Apparently, the decedent made changes to the instrument, through obliterations, strike-outs, interlineations, and a hand-written statement, all of which were made after the date of its execution. Correction fluid appeared on the original document where some changes in names and percentages were made.

With respect to the question of the validity of the alterations made, the court set forth the general rule that in the absence of evidence that an alteration was made with the formalities of due execution, alterations made after the execution date of a Will form no part of the Will and the instrument is to be admitted in its original form. Moreover, the court noted that the law in New York does not recognize partial revocation of a Will by physical act.

However, the court opined that where, as in the present circumstances, an alteration obliterates the original form of the Will, such that admission of the instrument in its original form cannot be accomplished, an issue arises as to whether and to what extent the instrument, in its altered form, should be given effect. Upon analysis, the court concluded that while the rule as to partial revocation would dictate otherwise, case law has taken a more modified approach and admitted the Will in its altered form, unless it is apparent that the unascertainable portion of the Will would materially affect the remaining parts and probate would wholly disregard the decedent's intent.

Nevertheless, because application of this principle could prejudice the infant beneficiaries of the estate, the court deemed it appropriate to appoint a guardian ad litem to safeguard their interests, and to determine, whether, perhaps, scientific or other extrinsic evidence could reveal the terms of the original Will.

In re Estate of Menchel, N.Y.L.J., May 30, 2006, p. 44 (Sur. Ct., Nassau Co.) (Surr. Riordan).

Real Property

In *In re Estate of Massaro*, the court was asked to determine title to real property. Title to the property was in the name of the decedent at death. The petitioner, who claimed the property, maintained that the decedent had agreed with her to take title to the property in her name so that she could obtain a mortgage on the premises. The application was opposed by the administrator of the estate and the decedent's distributees who claimed title to the property by operation of law, and that the court lacked jurisdiction over the subject matter of the proceeding.

With regard to the jurisdictional question, the administrator alleged that the dispute was between living persons inasmuch as the subject property was in the decedent's name and passed to his distributees at death. The court disagreed, holding that in cases where it is claimed that the decedent held only equitable title to property but not legal title, a proceeding may be instituted in Surrogate's Court to recover the property on a theory of constructive trust.

Based upon the evidence adduced at the hearing of the matter, the court found that petitioner had established all the requisite elements of a constructive trust, i.e., a confidential relationship between herself and the decedent; a promise by the decedent to re-convey the premises to the petitioner and her husband when their credit permitted it; a transfer, in the form of a purchase of the property in the decedent's name, based upon the promise; and unjust enrichment.

Accordingly, the court concluded that the administrator of the estate was constructive trustee for the petitioner and directed the fiduciary to execute a deed transferring title to the premises to the petitioner and her husband.

In re Estate of Massaro, N.Y.L.J., Feb. 23, 2006 (Sur. Ct., Kings Co.) (Surr. Torres).

Real Property

Before the court was an application by the administratrix of the decedent's estate seeking permission to sell a parcel of real property.

The record revealed that the fiduciary had entered a contract for the sale of the subject premises to a non-family member, subject to court approval. On the return date of citation, a distributee of the decedent offered to purchase the property, and thereafter entered a contract of sale with the fiduciary, subject to court approval, for $150,000 more than the initial contract price.

In determining whether to approve the earlier or the later contract of sale, the court considered such factors as whether the earlier contract of sale was for fair market value, the length of time between the differing contracts, and the responsibility for the delay in closing title on the contracts. Principally, however, the issue required a determination of which contract is in the best interests of the estate. While presumably this would be the contract that would yield a greater sum of money for the estate, the court noted that decisions addressing the question considered whether the contract entered into was at the full market value at the time it was entered, and that when a higher contract price is chosen as being in the best interests of the estate, the competing contracts are generally entered within a month or two of each other.

Based upon the foregoing criteria, the court concluded that the later contract was in the best interests of the estate. Appraisals revealed that the initial contract was for less than the fair market value of the property, and that most of the distributees had signed waivers and consents to the sale of the property at the later contract price.

In re Estate of Washington, N.Y.L.J., Jan. 10, 2006, p. 28 (Sur. Ct., Kings Co.) (Surr. Tomei).

Ilene S. Cooper is a partner at Farrell Fritz, P.C., Uniondale, New York.

NEWS Briefs

Practical Pointer

The Westchester County Surrogate's Court requires that a petition to judicially settle a fiduciary's accounting pursuant to SCPA Article 22 include a prayer for the approval of legal and accounting fees and/or expenses, **regardless of whether the fees have been paid or have not been paid**. So when filing an accounting remember to include

1. an affidavit of legal services which contains the elements listed under section 207.45(a) of the Uniform Rules for Surrogate's Courts (22 N.Y.C.R.R. § 207.45);
2. a similar affidavit of accountant's services if approval of accountant's fees is sought. Any such affidavit of accountant's services must include the same information as for affidavits of legal services.

Note that contemporaneously maintained time/billing records and any other supporting documentation must be included with the foregoing affidavits of legal/accountant's services.

With regard to the citation, additional relief may be required to be listed. Westchester County takes the position that if the services of the accountant are those that would ordinarily be performed by counsel, the citation should provide that the accounting fees are subject to reduction or denial, and/or may be charged to the legal fees sought.

* * *

"Greenbook" Notice

The Section's Committee on Practice and Ethics has undertaken a project to bring to the attention of the publishers of the SCPA/EPTL "Greenbook" ways in which the index of that publication might be made more "user-friendly." For example, one can readily locate "Renunciation of Testamentary Dispositions," but there is no reference in the index to "Disclaimer of Testamentary Dispositions." One must know how the index refers to some things in order to find them there, which can be difficult for an inexperienced attorney (who is most likely to need to refer to the statutes).

Comments are welcomed by the editors of the Greenbook. Section members who have run into roadblocks in using the index are encouraged to advise Practice and Ethics Committee Vice-Chair Ralph M. Engel of suggested enhancements or improvements (Ralph M. Engel, Esq., Sonnenschein, Nath & Rosenthal, 1221 Avenue of the Americas, New York, NY 10020, rengel@sonnenschein.com). Ralph will pass these along to the editors, which we hope will result in a more useful research tool for Section members.

* * *

In Memoriam:
Anne Farber

(1948-2006)

We lost a treasured colleague when Anne Farber died on May 27th after a valiant battle with ovarian cancer. Anne was born in Brooklyn, educated at Barnard College, NYU Law School and Columbia University. Professionally, Anne was the lawyer we all strive to be: intelligent, analytical, measured with a calm, assured authority, great patience, dignity and a sense of humor. She was very active in our section, most recently as a Vice-Chair of the Estate and Trust Administration Committee. Her ability to work so effectively with others led her to found a discussion group of trust and estate lawyers nearly 20 years ago. At least ten original members continue to meet monthly and have jointly authored this remembrance.

In person, Anne was the ideal daughter, wife, mother, grandmother and friend we all hope to have. She was warm, loving, kind, generous and nurturing to everyone whose life she touched. Her deep faith led her to have her Bat Mitzvah as an adult only five years ago. We share her loss with her mother, Marjorie; husband, Richard Kaiser; children Rachel, Emily, Deborah and Samuel; and grandson Zachary. We are blessed to have known Anne and will miss her always.

Susan Baer
Allan Kirstein
Barry Lutzky
Elizabeth Munson
Nancy Niedt
Anne O'Connell
Joann Palumbo
Jane Revellino
Mary Beth Ritger
David Stack
Glenn Troost

Section Committees & Chairs

The Trusts and Estates Law Section encourages members to participate in its programs and to contact the Section Officers or Committee Chairs for information.

Committee on Charitable Organizations
Richard P. Wallace (Chair)
279 River Street
Troy, NY 12181

Ronni G. Davidowitz (Vice-Chair)
575 Madison Avenue, 21st Floor
New York, NY 10022

Robert W. Sheehan (Vice-Chair)
101 Park Avenue
New York, NY 10178

Committee on Continuing Legal Education
Marion Hancock Fish (Chair)
1500 MONY Tower I
Syracuse, NY 13221

John G. Farinacci (Vice-Chair)
300 Garden City Plaza
Garden City, NY 11530

Magdalen Gaynor (Vice-Chair)
10 Bank Street, Suite 650
White Plains, NY 10606

Committee on Elderly and Disabled
Robert Kruger (Chair)
225 Broadway, Room 4200
New York, NY 10007

Anthony J. Enea (Vice-Chair)
245 Main Street, 3rd Floor
White Plains, NY 10601

Robert M. Freedman (Vice-Chair)
521 Fifth Avenue, 25th Floor
New York, NY 10175

Lisa K. Friedman (Vice-Chair)
370 Lexington Avenue, Suite 1205
New York, NY 10017

Warren H. Heilbronner (Vice-Chair)
2400 Chase Square
Rochester, NY 14604

Kathryn Grant Madigan (Vice-Chair)
P.O. Box F-1706
Binghamton, NY 13902

Committee on Electronic Filings
Wallace L. Leinheardt (Chair)
300 Garden City Plaza, 5th Floor
Garden City, NY 11530

Committee on Estate Litigation
Jonathan J. Rikoon (Chair)
919 Third Avenue
New York, NY 10022

Karin J. Barkhorn (Vice-Chair)
1290 Avenue of the Americas
New York, NY 10104

Gary E. Bashian (Vice-Chair)
235 Main Street, 6th Floor
White Plains, NY 10601

Hon. John M. Czygier, Jr. (Vice-Chair)
320 Center Drive
Riverhead, NY 11901

Stephen B. Hand (Vice-Chair)
300 Garden City Plaza
Garden City, NY 11530

Barbara Levitan (Vice-Chair)
600 Third Avenue, 11th Floor
New York, NY 10016

John R. Morken (Vice-Chair)
West Tower, 14th Floor
EAB Plaza
Uniondale, NY 11556

Marilyn Ordover (Vice-Chair)
177 Montague Street
Brooklyn, NY 11201

Committee on Estate Planning
Ian William MacLean (Chair)
100 Park Avenue, 20th Floor
New York, NY 10017

Susan Taxin Baer (Vice-Chair)
399 Knollwood Road, Suite 212
White Plains, NY 10603

Philip A. DiGiorgio, Jr. (Vice-Chair)
20 Corporate Woods Boulevard, 3rd Floor
Albany, NY 12211

Richard E. Schneyer (Vice-Chair)
900 Third Avenue
New York, NY 10022

Linda J. Wank (Vice-Chair)
488 Madison Avenue, 9th Floor
New York, NY 10022

Committee on Estate and Trust Administration
Ilene S. Cooper (Chair)
1320 Reckson Plaza
Uniondale, NY 11556

David J. Arcella (Vice-Chair)
630 Fifth Avenue, 38th Floor
New York, NY 10111

Janet L. Blakeman (Vice-Chair)
1133 Avenue of the Americas
New York, NY 10036

Victoria L. D'Angelo (Vice-Chair)
5888 Main Street
Williamsville, NY 14221

Committee on Governmental Relations
Thomas J. Collura (Chair)
54 State Street, Suite 803
Albany, NY 12207

Thomas E. Dolin (Vice-Chair)
32 Swift Road
Voorheesville, NY 12186

Michael K. Feigenbaum (Vice-Chair)
East Tower, 15th Floor
1425 Reckson Plaza
Uniondale, NY 11556

Committee on International Estate Planning
Beth D. Tractenberg (Chair)
625 Madison Avenue
New York, NY 10022

Gerard F. Joyce, Jr. (Vice-Chair)
452 Fifth Avenue, 17th Floor
New York, NY 10018

Michael Joseph Parets (Vice-Chair)
625 Madison Avenue
New York, NY 10022

Daniel S. Rubin (Vice-Chair)
405 Lexington Avenue
New York, NY 10174

Committee on Legislation
Pamela R. Champine (Chair)
57 Worth Street
New York, NY 10013

Richard J. Bowler (Vice-Chair)
10 Bank Street, Suite 650
White Plains, NY 10606

Amy Karp (Vice-Chair)
120 Broadway
New York, NY 10271

Richard J. Miller, Jr. (Vice-Chair)
767 Third Avenue
New York, NY 10017

Eric W. Penzer (Vice-Chair)
1320 Reckson Plaza
Uniondale, NY 11556

Lenore W. Tucker (Vice-Chair)
39 Broadway, Suite 2420
New York, NY 10006

Committee on Life Insurance and Employee Benefits
Elizabeth A. Hartnett (Chair)
101 South Salina Street
Syracuse, NY 13221

Robert F. Baldwin, Jr. (Vice-Chair)
100 Clinton Square
126 North Salina Street, Suite 320
Syracuse, NY 13202

Amy J. Maggs (Vice-Chair)
240 Washington Avenue Extension
Albany, NY 12205

Susan B. Slater-Jansen (Vice-Chair)
1221 Avenue of the Americas
New York, NY 10020

Committee on Membership and Relations with Local Bar Associations
George E. Riedel, Jr. (Chair)
42 Delaware Avenue, Suite 120
Buffalo, NY 14202

Committee on Newsletter and Publications
Austin T. Wilkie (Chair)
195 Broadway
New York, NY 10007

Michael S. Markoff (Vice-Chair)
123 Main Street, Suite 900
White Plains, NY 10601

Committee on Practice and Ethics
S. Jeanne Hall (Chair)
One Rockefeller Plaza, Suite 301
New York, NY 10020

Carl T. Baker (Vice-Chair)
One Broad Street Plaza
Glens Falls, NY 12801

Ralph M. Engel (Vice-Chair)
1221 Avenue of the Americas
New York, NY 10020

Bonnie McGuire Jones (Vice-Chair)
5 Emma Lane
Clifton Park, NY 12065

Jerome L. Levine (Vice-Chair)
345 Park Avenue
New York, NY 10154

Committee on Surrogates Court
Stacy L. Pettit (Chair)
16 Eagle Street
Albany, NY 12207

Maureen A. Conley (Vice-Chair)
6 Pheasant Lane
Delmar, NY 12054

Staci A. Graber (Vice-Chair)
350 Broadway, Suite 515
New York, NY 10013

Robert W. Johnson, III (Vice-Chair)
P.O. Box 1530
Troy, NY 12181

Committee on Taxation
David A. Pratt (Chair)
80 New Scotland Avenue
Albany, NY 12208

Edward Falk (Vice-Chair)
4 Times Square, 23rd Floor
New York, NY 10036

Deborah S. Kearns (Vice-Chair)
29 British American Boulevard
Latham, NY 12110

Georgiana James Slade (Vice-Chair)
1 Chase Manhattan Plaza
New York, NY 10005

Committee on Technology
Gary R. Mund (Chair)
2 Johnson Street, Room 210
Brooklyn, NY 11201

David Goldfarb (Vice-Chair)
350 Fifth Avenue, Suite 1100
New York, NY 10118

Ad Hoc Committee on Multi-State Practice
Amy B. Beller (Chair)
2300 Glades Road, Suite 400 East
Boca Raton, FL 33431

Philip G. Hull (Vice-Chair)
1540 Broadway
New York, NY 10036

Ronald S. Kochman (Vice-Chair)
222 Lakeview Avenue, Suite 950
West Palm Beach, FL 33401

William P. LaPiana (Vice-Chair)
57 Worth Street
New York, NY 10013

Executive Committee District Representatives

First District
Gary B. Freidman
600 3rd Avenue, 11th Floor
New York, NY 10016
(212) 818-9600

Second District
Nora S. Anderson
26 Court Street, Suite 1501
Brooklyn, NY 11242
(718) 624-1084

Third District
Thomas E. Dolin
32 Swift Road
Voorheesville, NY 12186
(518) 765-4085

Fourth District
Carl T. Baker
One Broad Street Plaza
Glens Falls, NY 12801
(518) 745-1400

Fifth District
John S. King
1 Park Place
300 South State Street, 4th Floor
Syracuse, NY 13202
(315) 214-2035

Sixth District
Beth E. Westfall
P.O. Box 2039
Binghamton, NY 13902
(607) 723-9511

Seventh District
Warren H. Heilbronner
2400 Chase Square
Rochester, NY 14604
(585) 232-5300

Eighth District
Robert W. Constantine
One HSBC Center, Suite 2300
Buffalo, NY 14203
(716) 841-0355

Ninth District
Frank W. Streng
11 Martine Avenue, 12th Floor
White Plains, NY 10606
(914) 946-3817

Tenth District
Lawrence P. Murphy, Jr.
254 Nassau Boulevard S.
Garden City, NY 11530
(516) 538-1111

Eleventh District
Madaleine S. Egelfeld
125-10 Queens Boulevard, Suite 311
Kew Gardens, NY 11415
(718) 544-6363

Twelth District
Michael M. Lippman
135 Southside Avenue, 2nd Floor
Hatings on Hudson, NY 10706
(914) 478-8400

Fourth Annual Sophisticated Trusts and Estates Law Institute

13.5 MCLE Credits

includes
1.0 ethics credit

Co-sponsored by the Trusts and Estates Law Section and the Committee on Continuing Legal Education of the New York State Bar Association

Thursday and Friday, November 16 and 17, 2006

The Millennium Broadway Hotel • New York City

- A Nationally Prominent Faculty • Updates and Expert Analysis on all the Key Topics
- A Variety of Breakout Sessions—Tailor the Program to Your Specific Needs

Program Overview

Thursday, November 16

- Introduction and Overview
- Estate Tax Reform, Other Recent Developments and Hot Topics
- Update: Estate Litigation
- Update: Charitable Planning
- Update: Life Insurance
- Luncheon Speaker: Issues Confronting the Charities Bureau
- Thursday Workshops (A, B, C, D)
  - 145A & 245A. Asset Protection
  - 145B & 245B. Planning with Art
  - 145C & 245C. What Everyone Else Needs to Know About Florida
  - 145D & 245D. Planning with Musical and Literary Interests
- Panel Discussion: Valuation Issues

5:05-7:00 p.m. Cocktail Reception

Friday, November 17

- Cutting Edge Strategies
- Ethical Considerations in Estate Planning and Administration
- The Pension Protection Act of 2006 and Other Issues Affecting Retirement Planning
- Update: GST Planning
- Luncheon Speaker: Issues Confronting the Surrogate's Court
- Friday Workshops (E, F, G, H)
  - 135E & 235E. Planning with Entities
  - 135F & 235F. Planning for Professional Practices
  - 135G & 235G. Developments in Elder Law
  - 135H & 235H. New Life Insurance Planning Opportunities
- Panel Discussion: Trends in the Trust Industry

Program Faculty

Conference Chair

Joshua S. Rubenstein, Esq.
Katten Muchin Rosenman, LLP
New York, NY

Speakers

Lawrence Brody, Esq., Bryan Cave LLP, Saint Louis, MO * **Louis C. Ciliberti, CFP CLU ChFC**, Louis C. Ciliberti and Associates Ltd., Melville, NY * **Gail E. Cohen**, Fiduciary Trust Company International, New York, NY * **Harry (Hal) L. Curtis, III, CFA, ASA**, President, Management Planning, Inc., Princeton, NJ * **Hon. John M. Czygier, Jr**., Surrogate Court of Suffolk County, Riverhead, NY * **Robert M. Freedman, Esq**., Freedman Fish & Grimaldi LLP, New York, NY * **Alvin J. Golden, Esq.**, Ikard & Golden, P.C., Austin, TX * **Stuart J. Gross, Esq**., Roberts & Holland LLP, New York, NY * **Lance S. Hall, ASA**, FMV Opinions, Inc., New York, NY * **David A. Herpe, Esq**., McDermott Will & Emery, Chicago, IL * **Joanne E. Johnson, Esq.**, JP Morgan Private Bank, New York, NY * **Andrew M. Katzenstein, Esq.**, Katten Muchin Rosenman, LLP, Los Angeles, CA * **Lawrence P. Katzenstein, Esq.**, Thompson Coburn LLP, Saint Louis, MO * **Hugh Kendall, Esq**., Kendall Van Dolson Attorneys, Chattanooga, TN * **Ralph E. Lerner, Esq.**, Sidley Austin Brown & Wood, New York, NY * **James L. Levy, MAI**, Appraisers and Planners, Inc., New York, NY * **Gerald A. Rosenberg, Esq.**, Chief of the Charities Bureau, New York State Attorney General's Office, New York, NY * **Bruce S. Ross, Esq.**, Luce Forward, Los Angeles, CA * **Martin M. Shenkman, Esq**., Martin M. Shenkman, P.C., Tenafly, NJ * **James Dean Spratt, Jr., Esq.**, King & Spalding LLP, Atlanta, GA * **John (Jack) A. Terrill, II, Esq.**, Heckscher, Teillon, Terrill & Sager, P.C., West Conshohocken, PA * **Diana S.C. Zeydel, Esq**., Greenberg Traurig P.A., Miami, FL

Register by phone 1-800-582-2452 or online at www.nysba.org/cle/fall2006

Publication of Articles

The *Newsletter* welcomes the submission of articles of timely interest to members of the Section. Submissions may be e-mailed (austin.wilkie@hklaw.com) or mailed on a 3½" floppy disk (Austin Wilkie, Holland & Knight LLP, 195 Broadway, New York, NY 10007) in Microsoft Word or WordPerfect. Please include biographical information. Mr. Wilkie may be contacted regarding further requirements for the submission of articles.

Unless stated to the contrary, all published articles represent the viewpoint of the author and should not be regarded as representing the views of the Editor or the Trusts and Estates Law Section, or as constituting substantive approval of the articles' contents.

NEW YORK STATE BAR ASSOCIATION
TRUSTS AND ESTATES LAW SECTION
NYSBA One Elk Street, Albany, New York 12207-1002

ADDRESS SERVICE REQUESTED

TRUSTS AND ESTATES LAW SECTION NEWSLETTER

Editor

Austin T. Wilkie
Holland & Knight LLP
195 Broadway
New York, NY 10007
E-mail: austin.wilkie@hklaw.com

Section Officers

Chair
Colleen F. Carew
8 Avondale Road
Yonkers, NY 10710

Chair Elect
Philip L. Burke
700 Crossroads Building
2 State Street
Rochester, NY 14614

Secretary
Wallace L. Leinheardt
300 Garden City Plaza, 5th Floor
Garden City, NY 11530

Treasurer
Prof. Ira M. Bloom
80 New Scotland Avenue
Albany, NY 12208

This *Newsletter* is distributed to members of the New York State Bar Association's Trusts and Estates Law Section without charge. The views expressed in articles in this *Newsletter* represent only the author's viewpoint and not necessarily the views of the Editor or the Trusts and Estates Law Section.

We reserve the right to reject any advertisement. The New York State Bar Association is not responsible for typographical or other errors in advertisements.

ISSN 1530-3896

PRSRT STD
U.S. POSTAGE
PAID
ALBANY, N.Y.
PERMIT NO. 155