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Trusts and Estates Law Section Newsletter

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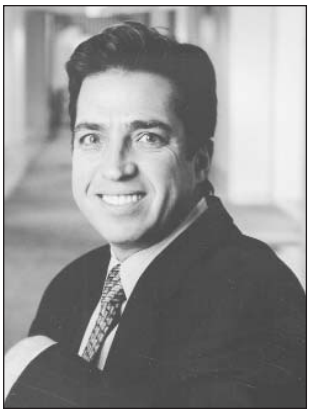
A Message from the Section Chair



As I write this inaugural report, I would like to begin by thanking **Clover M. Drinkwater** for all her incredible efforts on behalf of our Section. This past year, under her stewardship, our Section regained its position as having the largest membership of any section in the Bar Association. Many of the projects that will see implementation this year were commenced as a result of Clover's efforts, and she will be a hard act to follow.

The backdrop to Clover's final meeting as Chair was the largest snowstorm of the season. Although it delayed the arrival of many to the New York City Marriott Marquis, we nonetheless had record attendances at both the morning program (over 700) and at the lunch (over 750) on Wednesday, January 26. The program, on the EPTL-SCPA Legislative Advisory Committee's Report on the Principal and Income Act and on the default unitrust concept, was ably chaired by **Arthur E. Bongiovanni** of Syracuse. Opening the program was **Joseph Kartiganer**, of New York City, who gave an informative history of the background leading up to the necessity for rethinking concepts of principal and income. **Linda B. Hirschson**, also of New York City, followed with a thorough discussion of the unitrust as default legislation. **E. James Gamble**, of Bloomfield Hills, Michigan, then gave a detailed report on the Uniform Principal and Income Act, followed by **Susan Porter**, who spoke on the fiduciary power of adjustment and presented a courageous, contrarian view on the unitrust approach. **Robert B. Wolf**, of Pittsburgh, Pennsylvania, closed with an intriguing presentation on the Total Return Unitrust and the economic modeling that supports it.

At the Annual Luncheon, **Jonathan Schumacher** presented the slate of officers, district representatives and members-at-large on behalf of the Nominating Committee, which, to no one's surprise, was unanimously approved. **Surrogate C. Raymond Radigan**, the luncheon speaker, addressed the audience on the EPTL-SCPA Legislative Advisory Committee's upcoming projects, including, in particular, its consideration of making attorney's fees for estate administration statutory.

At the Executive Committee meeting on Wednesday afternoon, our hardworking committees unveiled their ambitious agendas for the current year. Our committees will be working on many

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important projects, including, but not limited to, the implementation of sop tax; repeal of New York State's fiduciary income tax; overhaul of New York's tax apportionment statute; modernization of executor's commissions; comments on uniform laws affecting our practice; enactment of living will legislation; enforceability of burial instructions; streamlined administration of small private foundations; promotion of trusts and estates practice in law schools; changes to the law necessitated by advances in reproductive technology; repeal of the rule against perpetuities; the creation of asset protection trusts; enhancement of our Web site; addition of new features to our newsletter; comparison of offshore trust jurisdictions; comparison of available technology for the trusts and estates practice; changes to the standards for removal of trustees; posthumous DNA testing; liability of trustees of life insurance trusts; and shepherding our affirmative legislation projects, as well as commenting upon other pending legislation affecting our practice.

It will be a busy year, and I thank all of our committee chairs and committee members for assuming this ambitious load. Joining and participating in one or more of our committees is a means not only to meet your colleagues from across the state, but also to be at the forefront of groundbreaking developments in our practice—indeed, to cause them to happen. I encourage each of you who is not currently on one of our committees to join one or more committees of your choice and participate in this exciting process.

On Thursday, January 27, the Executive Committee of the House of Delegates approved our Section's newest piece of affirmative legislation: a bill that will automatically delete the reference to the credit for state death taxes from formula credit shelter bequests contained in wills executed prior to February 1, 2000. Our Section will work hard this year to promote the enactment of this important legislation.

Our Spring meeting will be held in Rochester, on April 27 to 28, 2000, and our Fall meeting will be held in Sante Fe, New Mexico, from September 20 through 24, 2000. I hope that as many of you as possible will attend, so please save the dates on your calendars.

I look forward to working with everyone to make the year 2000 a banner year for our Section.

Joshua S. Rubenstein

Editor's Message

The *Newsletter* is introducing a Questions & Answers column in the next issue. Please send questions to my attention at 7-11 South Broadway, Suite 208, White Plains, New York 10601. If you have any suggestions for topics you would like to see covered in future issues, please let me know.

When most of a client's wealth is invested in retirement accounts, estate tax planning problems can occur. In this issue, there is a timely article on using a trust as a designated beneficiary of a retirement account. Another article details the many elections that face an executor in the administration of an estate.

This Section has many committees which are listed in the *Newsletter*. New chairs have been appointed and are always happy to get new participants. Each committee has its own tasks. For example, members of the Legislation Committee review all bills and supporting memoranda submitted to the NYS Legislature that affect our area of practice. Members prepare reports approving or disapproving the legislation. The Executive Committee of the Section then reviews the reports. If satisfactory, the State Bar prepares a final report which is then forwarded to the relevant committees of the legislature for review. It is a way to participate in a process that creates laws needed for our practice. If you would be interested in joining this committee, the chair of the committee's name and address are included in the committee's listing in the *Newsletter*. This is but one example of the work each committee undertakes.

I want to take the opportunity to thank Glenn Troost for all of the work he did while Editor of the *Newsletter* and Chair of the Publications Committee. Our Section's respected newsletter is a direct result of his efforts.

Magdalen Gaynor

REQUEST FOR ARTICLES

If you would like to submit an article, or have an idea for an article, please contact
Trusts and Estates Law Section Newsletter Editor
Magdalen Gaynor, Esq.
7-11 South Broadway
Suite 208
White Plains, NY 10601
(914) 949-3624

Articles should be submitted on a 3 1/2" floppy disk, preferably in WordPerfect or Microsoft Word, along with a printed original and biographical information.

Retirement Benefits: Should I "Trust" the Asset?

By Bradley M. Van Buren

Retirement benefits are increasingly becoming a considerable asset of people's estate and therefore a major consideration when estate planning.[1] A primary objective of an estate planner is to ensure the preservation of such benefits by avoiding premature taxation. As planners struggle with this dilemma, trusts have been raised as a potential tool in controlling and preserving these assets. The inevitable question that must follow is whether making retirement benefits payable to a trust will produce the favorable results a client seeks?

To appreciate the intricacies that go into answering this complex question, the reader must thoroughly comprehend the "minimum distribution rules" (MDR) and how such rules apply to pre-required beginning date (RBD) death and their effect after reaching such date. A "participant's" (i.e., the individual who owns the benefits) RBD generally refers to April 1 following the year in which the participant reaches age 70½.[2] For example, if the participant turns 70 in August 1998, he will become 70½ in February, 1999, and his RBD will be April of the year 2000.[3] However, there are exceptions to this general rule. First, a participant can now delay his RBD until his actual retirement date if he continues to work past age 70½ and he does not own 5% or more of the company.[4] Note that this exception only applies to employer-sponsored plans (e.g., pension and profit sharing plans). With an IRA, withdrawals must begin in the year following the year in which he becomes 70½, regardless of when he actually retires. (Note that if the spouse is the beneficiary of the benefits, she may roll the benefits over to her own IRA and ultimately delay distribution beyond the participant's RBD—this concept is discussed in further detail below.)

The reason for MDR was for Congress to ensure that retirement plans were used for just that—retirement. The intention of Congress was not to create large asset transfer vehicles. Thus, the MDR necessitate annual minimum distributions from such plans at age 70½ or death, if earlier, unless the spouse is the "designated beneficiary" (DB) and she elects to rollover the asset into her own IRA (as discussed below).[5] The failure to make such a required minimum distribution will result in an excise tax equal to 50% of the amount that should have been distributed but was not.[6]

The determination of the minimum amount that must be distributed and when such minimum amount must be distributed will depend on who will inherit the benefits when the participant (i.e., the individual who owns the benefits) dies and whether the participant has a "designated beneficiary" (DB). A DB, by definition, is an individual or group of individuals the participant or the terms of the plan specify to inherit the participant's benefits upon death.[7] An estate or charity does not qualify as a DB. A trust where all of its beneficiaries are individuals will qualify as a DB if it meets all of the requirements discussed in this article.

Minimum Distribution Rules (MDR)

Death Before the Required Beginning Date (RBD)

Generally, the death of a participant before his RBD will require that all benefits be distributed from the retirement plan by December 31 of the year which contains the fifth anniversary of the participant's death.[8] This is not the most extensive income tax deferral available. Planners must therefore rely on one of the exceptions to the general rule if the participant desires to defer income taxation as long as possible.

The first exception applies if the participant names a non-spouse DB.[9] The existence of the non-spouse DB allows the DB to use the "life expectancy method" when calculating minimum distributions. This method provides that the minimum amount the DB must withdraw per year, beginning with the year following the participant's death,[10] will be determined by the life expectancy of the DB. Prop. Reg. 1.401(a)(9)-1, Q&A E-3&4, mandates the use of the IRS's actuarial tables located in Table V and Table VI of Treas. Reg. § 1.72-9 to determine the DB's life expectancy. A fraction is created, with the DB's life expectancy as the denominator and one as the numerator. The resulting fraction is then multiplied by the plan balance (determined as of the end of immediately preceding plan year) producing a minimum distribution for that particular year, which must be distributed by December 31. (Note that if the person has more than one plan, a minimum distribution for each plan must be calculated separately based on the applicable balance and the respective life expectancies of the DBs specified.) Each year following, the denominator will be reduced by one, and the calculation repeated to make the subsequent minimum distribution determination. For example, a beneficiary whose life expectancy is twenty (20) years will have a life expectancy method fraction of 1/20 for the first year of distribution and 1/19 for the following year and so on.

Another exception to the general rule arises when the participant's spouse is named as the DB.[11] If the spouse is named as the DB, she has all the options of a non-spouse DB as well as additional options. First, the spouse can defer the start of minimum distributions, which will continue over her life or life expectancy, to the later of (i) December 31 of the year following the year the participant died or (ii) December 31 of the year the participant would have reached 70½.[12]

Second, unlike non-spouse DBs, the spouse may calculate her life expectancy by using the "life expectancy method" (explained above) or the "recalculation method." The recalculation method entails resorting to the IRS actuarial tables each year to determine the life expectancy based on the spouse's age in that year. This will produce a decrease in life expectancy of less than one full year because each additional year a person lives, the chances of living longer increase. For example, the life expectancy of a seventy (70) year-old is 16 years, while the life expectancy of a seventy-one (71) year-old is 15.3 years.[13] The recalculation method will therefore generally produce a smaller fraction (e.g., 1/15.3 [recalculation method] versus 1/15 [life expectancy method]) than the life expectancy method and thus result in a smaller required minimum distribution.

The final option unique to the spouse DB is her ability to "roll over" the participant's benefits to an IRA of her own so long as she had the absolute right (as beneficiary of an estate, trust, or as direct beneficiary of the plan or IRA) to receive the benefits.[14] In effect, the "rollover" will eliminate the participant's applicable RBD and shift to the spouse's applicable RBD as if she were now the "participant."[15] The spouse can now name her own DB for the account and begin distributions at her RBD over the joint life expectancy of herself and the new DB. Note that while the spouse is living, the "Minimum Distribution Incidental Benefit Rule" (MDIB) (discussed below) applies. However, after the spouse dies, the DB's actual life expectancy will be used for the remaining distributions. This can result in exceptional money savings since it extends the time that the benefits will remain compounding while in the account.

Living Past the RBD

Once the participant reaches age 70½, he is generally required to commence withdrawals out of the retirement plan by April 1 of the year following such date (Note the exceptions aforementioned).[16] To reduce the rate at which minimum distributions will be paid, the participant must name a DB. Otherwise, the benefits will be paid over the participant's life expectancy alone. A participant's alternatives include naming a spouse or a non-spouse individual as DB and having installments paid on a joint life expectancy basis (Note that under no circumstances will the naming of an estate, charity or corporation as beneficiary qualify as a DB). If a non-spouse DB is named, the joint life expectancy calculation will be subject to the "Minimum Distribution Incidental Benefit Rule" (MDIB) and the non-spouse DB will be deemed to be no more than 10 years younger than the participant. After the participant's death, the MDIB rule no longer applies and the actual life expectancy of the DB is used. If the participant chose the "recalculation method" for determining life expectancy, only the DB's life expectancy will be available for determining distributions. If the participant elected the "life expectancy" method, the DB can continue to use the remainder of the joint life expectancy for minimum distribution calculations.

Estate planners have additional concerns when dealing with a client who has lived past his RBD. For instance, the planner should be sure that, if the participant has the intention of naming a DB, it is done by the RBD; if a trust is named, the trust is irrevocable upon the death of the participant (discussed below); and the participant has made the irrevocable election to recalculate his life expectancy, if desired. The existence, or non-existence, of a DB on the RBD and the identity of the DB if there is one, will freeze the payout period permanently. Although the participant can later change his DB, the change will never lengthen the payout period beyond what was originally established at the RBD (Note that it can be shortened). The sole exception to this rule is that, if the participant's DB is his surviving spouse, a rollover by the surviving spouse after his death will commence a new payout period by the surviving spouse based on her elections and her DB.

When naming the DB, a participant has several options. He may name a non-spouse individual, his spouse, a group of individuals, or a trust where all of the beneficiaries are individuals. If the participant names a trust as DB, he must comply with the trust rules described below. The proposed regulations provide that if there are several people collectively who are the DBs (e.g., "To my surviving children"), the payout period will be calculated using the oldest member of the group, with consequently the shortest life expectancy. Thus, to avoid a younger child's payout being based on the oldest's age, the participant should consider creating separate accounts for each child.[17] This will allow each individual child to use his or her own life expectancy to calculate the applicable payout period.

Estate planners should also be wary of the inability of a participant to name non-individual benefici-

aries (e.g., charities, estates, corporations) when naming more than one beneficiary of a single plan or account. If a non-individual beneficiary is named, the participant will be treated as having no DB at all. This rule applies regardless of whether the non-individual beneficiary is one among many beneficiaries named for a single plan or account.[18] Thus, by doing so, the participant will not meet an exception to the general rule and will be required to abide by the five-year distribution standard, for such plan or account. If you desire to name a non-individual as beneficiary of a portion of a benefit, you should place that portion in a separate account.

The Trust Alternative

Naming a Trust as Beneficiary

Naming a trust as the beneficiary of a participant's retirement benefits will eliminate maximum income tax deferral if the participant does not comply with five trust requirements set forth in the proposed minimum distribution regulations.[19] If all of the trust rules are satisfied, the trust beneficiaries are treated as the participant's DBs for purposes of the minimum distribution rules. Some of these rules may apply somewhat differently depending on the date of death of the participant (i.e., Did the participant die before his RBD or has he lived past it?). If such a discrepancy exists, it will be noted.

The first rule should be easily satisfied. Simply stated, the trust must be valid under state law. Some practitioners are concerned that a testamentary trust would not satisfy this requirement. I believe that this concern is misplaced. Most commentators believe that this rule is not intended to prohibit the use of testamentary trusts since the trust will be a valid trust after the participant's death when it is funded.[20] The only trusts which would flunk this rule would be trusts that failed a state law requirement for a valid trust, such as a trust that violated the rule against perpetuities.

Until recently, the second rule was that the trust must be irrevocable. The "new proposed regulations," issued on December 30, 1997, have amended this rule. The proposed regulations now state that the trust need not be irrevocable until the participant's death.[21] This rule generally poses no problem to the pre-RBD death because a revocable trust typically becomes irrevocable upon the participant's death. Although it is no longer required that the trust be irrevocable as of the participant's RBD, if the participant lives beyond his RBD, he is confronted with an additional burden of complying with the new documentation requirements (discussed below).[22] Note that once a participant has passed his RBD he may alter the trust beneficiaries or revoke the trust, but the age of the oldest DB in existence at the RBD will continue to be used to calculate the minimum distributions unless the newly named DB is older.

The third trust requirement is that the beneficiaries of the trust be "identifiable." Being "identifiable" does not necessarily mean a beneficiary must be specified by name. Members of a class of beneficiaries will be identifiable if it is possible at the applicable time to identify the oldest beneficiary of such class whose life expectancy can be used to calculate minimum distributions.[23] Problems with the "identifiable requirement" may arise when a class of beneficiaries is named. For example, if the trust beneficiaries are "my surviving issue," presumably the oldest member of such group is identifiable and the addition of a member in the future will not produce a member with a shorter life expectancy (setting aside the possibility of an adult adoption by the participant). On the other hand, if the trust beneficiaries are "my children and if any shall not survive to their spouse," the beneficiaries will not be identifiable because it is not known whom the children will marry in the future and how old the people will be.

If a trust beneficiary is given a power of appointment, permissible appointees must be taken into account, unless all distributions from the plan or IRA are specifically required by the terms of the trust to be distributed to the income beneficiary. A general power of appointment which would allow possible appointment of the trust assets to a charity or an estate would violate this rule. A special power may eliminate such concerns, if the class is clearly limited to younger beneficiaries, i.e., "my issue."

As indicated above, the fourth trust rule entails that all beneficiaries of the trust must be individuals. Thus, the existence of a non-individual beneficiary, such as an estate, corporation or charity, as an income beneficiary of the trust will clearly allow the IRS to view the trust and the participant as having no DB. However, the IRS has taken the position that both income beneficiaries and remainder beneficiaries must be considered for purposes of determining whether the trust qualifies as a DB, unless the terms of the trust provide that the minimum distribution amount is required to be paid out from the trust upon receipt to the income beneficiaries or that the trust will terminate in favor of an income beneficiary upon attainment of a specified age.[24] Thus, if a trust with a charitable remainderman (e.g., a CRUT or CRAT or a QTIP) is named as beneficiary, the trust will not qualify as a DB and there will be no DB for purposes of determining the payout period.

On the other hand, the proposed regulations state that "if a beneficiary's entitlement to an employee's benefit is contingent on the death of a

prior beneficiary, such contingent beneficiary will not be considered a beneficiary for purposes of determining who is the designated beneficiary with the shortest life expectancy . . . or whether a beneficiary who is not an individual is a beneficiary."[25] Consequently, one would deduce from this statement that as long as a remainder interest is contingent on any other death besides the participant's, the trust will satisfy this rule regardless of the nature of the contingent beneficiary (i.e., regardless of whether the contingent beneficiary is an individual or a non-individual). The proposed regulations then also state that except for the prior statement, ". . . if a beneficiary's entitlement to an employee's benefit is contingent on an event other than the employee's [i.e., the participant's] death (e.g., death of another beneficiary) such contingent beneficiary is considered to be a designated beneficiary for purposes of determining which designated beneficiary has the shortest life expectancy."[26] However, it has become apparent from recent private letter rulings and oral communications between leading commentators on this issue and the IRS that the proposed regulations only disregard a contingent beneficiary of a trust who will take nothing if the primary beneficiary lives out his or her life expectancy.[27] A trust will not satisfy this criterion unless the minimum distribution amount is required to be paid out from the trust upon receipt to the current beneficiary(ies), or the trust will terminate in favor of a current beneficiary upon attainment of a specified age. In all other cases, the trust remainderman will have to be treated as a beneficiary for purposes of determining the payout period and must be individuals to avoid disqualifying the trust as a DB. This position is illustrated by PLR 9820021 where a revocable trust, which provided for two QTIP trusts, was named as beneficiary of a profit-sharing plan. The trust included a power to invade principal for S's health and medical needs, and would terminate on the death of S in favor of three charities. The IRS held that, in these circumstances, there was no DB; all the plan benefits were not required to be paid by the trust to S, and unless the trustee exercised the invasion power to distribute all the benefits to S, some portion would be received by the charities. Thus, the death of S would affect the timing rather than the availability of the benefits to the charities. On these facts, the IRS ruled, "the entitlement of [the charities] is not contingent on the death of [S]."

Based on this rationale, creating a trust where the non-individual's interest is merely postponed until the death of the income beneficiary but not necessarily contingent on such death will fail rules three and four aforementioned. For instance, a trust which provides, "to my daughter for life, then to XYZ charity," will produce a no DB situation.[28] In addition, if the trust is a long-term generation-skipping trust for the benefit of the participant's issue, terminating at the end of the rule against perpetuities period in favor of the participant's living issue and if none, to charity, it appears under the IRS reasoning that the charity will disqualify the trust as a DB.[29]

The lack of a controlling ruling by the IRS on this issue causes unnecessary confusion. In my opinion, the question of whether the trust will pass these rules depends greatly on the specific facts surrounding the trust. For example, let's assume the participant would like to create a trust "to his daughter at age 30 and if she fails to reach such age, to the Red Cross." In such a circumstance, whether the daughter would qualify as a DB may depend on the likelihood of the daughter reaching such an age. If, for instance, the daughter was age 25 at the participant's RBD, it may be safe to assume that the non-individual contingent beneficiary's (i.e., the Red Cross's) distant possibility of obtaining the benefits would not be enough for the IRS to disallow the daughter as a DB. But let's say the trust terms required the daughter to reach age 70. In this case, the greater possibility of the daughter not reaching such age and the Red Cross consequently obtaining the benefits may persuade the IRS to rule that the trust would produce no DB. As previously mentioned, the IRS has not issued any controlling precedent on this issue and undoubtedly further debates will follow.

It is very common for revocable trusts to contain language permitting (or requiring) the trustee to pay trust assets to the participant's estate for the payment of estate taxes, debts and other expenses of administering his estate. If you are making a plan or IRA benefits payable to this type of trust, it is important to provide in the trust document that the plan or IRA benefits cannot be used for this purpose. Otherwise, the IRS could argue that the estate is a beneficiary of the trust and the trust will not qualify as a DB.[30]

The last of the trust requirements is that a final copy of the trust OR a list of all the beneficiaries (including contingent and remainderman beneficiaries with a description of the conditions on their entitlement) of the trust and a certification must be furnished to the plan within nine months of the date of death or *before* the RBD, whichever occurs earlier.[31] If the participant does not name the trust as beneficiary of his plan benefits until after his RBD, he must provide documentation simultaneously with the beneficiary designation.[32] Presumably, "the plan" refers to the person or company who is responsible for distributing the benefits to the appropriate beneficiaries, and for complying with the MDR (i.e., the "plan administrator"). Since IRAs do not have "plan administrators," the 1997 proposed revisions to the 1987 proposed regulations clarified who may receive

the documentation by including ". . . IRA trustee, custodian or issuer."

Choosing the method of supplying a copy of the trust or a list of the beneficiaries to the plan administrator to comply with the documentation requirement will depend on personal preference and/or the administrator's demands. In either case, absent privacy concerns, simply supplying a copy of the trust instrument is probably the easier way to proceed.[33] However, this method will require the plan administrator to conduct the often unpleasant task of reviewing the trust instrument and determining the DB. Therefore, a plan administrator may require that a beneficiary list be furnished. Along with the list, the participant must certify that the list is correct and that the four other trust rules aforementioned are satisfied, agree to provide corrected certifications as needed in the event of any amendments to the trust, and agree to provide a copy of the trust to the plan administrator on demand.[34]

Trusts That Clearly Qualify as DB

Essentially, the proposed minimum distribution regulations offer only three possible situations where a trust will clearly qualify as a beneficiary of retirement benefits. The first possible trust structure would be one which allows the beneficiary to withdraw the benefits from the trust at any time. According to IRC § 678 (the "grantor trust rules"), a beneficiary is treated as the owner of trust assets for income tax purposes if he or she has the sole unrestricted right to withdraw those assets from the trust. Under the "beneficiary controlled trust" structure, the beneficiary should therefore be regarded as the sole DB according to the MDR.[35] IRC § 678 provides that "A person other than the grantor of a trust shall be treated as the owner of any portion of a trust with respect to which such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself."[36] Therefore, the "identity" of the remainder beneficiary becomes irrelevant and a participant (i.e., the grantor of the trust) would be able to name whomever he desired as such (e.g., estate, corporation, charity, etc.) without sacrificing the use of the life beneficiary's life expectancy to calculate minimum distributions. I have referred to this type of trust as the "beneficiary controlled trust." It is referred to as the "The 100% Grantor Trust" by well known commentator Natalie Choate.[37] This type of trust may be appropriate to assure that a non-citizen surviving spouse is allotted the modified marital deduction.[38] Placing the retirement benefits in a "qualified domestic trust" (QDOT) and granting the non-citizen surviving spouse the ability to invade and withdraw all of the benefits will preserve the marital deduction and satisfy IRC 401(a)(9).[39] Second, this type of trust may be appropriate with a mentally handicapped or disabled beneficiary where the beneficiary can only withdraw through a legal guardian. In this situation, the trust would provide similar benefits of a discretionary trust while allowing the use of the beneficiary's life expectancy for determining minimum distributions. (Note that this not a recommended choice if the planner is attempting to qualify for means-tested government assistance programs.)

The second type of trust structure that would clearly qualify as a DB is one which *requires* the trustee to withdraw the minimum required distribution and distribute it to the beneficiary. (Note that more than the minimum can be withdrawn if the trustee is given such discretion). I refer to this trust type as the "Grantor Policing Trust" because the trustee is granted the power by the grantor to monitor the payout of the benefits and guarantee that the beneficiary utilizes their life expectancy to determine minimum distributions. The purpose is to protect against the beneficiary who the participant (i.e., grantor) knows will be overeager to withdraw the entire amount and ensure that the asset is managed properly by a trustee. Under the "Grantor Policing Trust," the primary trust beneficiary is also regarded by the IRS as the sole DB due to the possibility of the life beneficiary living to his full life expectancy. If the life beneficiary (i.e., the DB) lives to his full life expectancy, he will have received 100% of the benefits leaving nothing for a remainder beneficiary (i.e., assuming the life expectancy method had been used to calculate the DB's minimum distributions). Thus, naming an identifiable remainder beneficiary is once again irrelevant. In this situation, it appears that the remainder beneficiary's interest is contingent on the death of a party other than the participant's and therefore should not be considered when calculating minimum distributions or identifying parties according to Prop. Reg. 1.401(a)(9)-1, Q&A E-5.

In addition, consider that if the life beneficiary of the Grantor Policing Trust is the spouse and the recalculation method is utilized, there may be remaining benefits even if the life beneficiary lives to full life expectancy. Arguably, this may not affect the IRS's view that the life beneficiary is the sole DB. When the spouse reaches such age, it is possible that the IRS will view the remaining benefits as insignificant in value and thus an inconsiderable factor when making the DB determination.

The third type of trust model that should qualify as a DB addresses the issues that the others do not. This structure consists of a non-discretionary life interest with the remainder to individuals. Essentially, this model, unlike the others, intends to keep the

retirement benefits out of the gross estate of the life beneficiary (e.g., the assets are includible with the "beneficiary controlled trust" under IRC § 2041 and if the beneficiary lives to the extent of his life expectancy, the date of death value, or alternate valuation date value, of the remaining assets will be includible with the "Grantor Policing Trust"), preserve the asset for the remainder beneficiary, and, if necessary, assure that the benefits are protected from a spendthrift beneficiary for whatever reason (e.g., creditor's claims, foreseeable divorce, too young, etc.). Such trust form may disallow the possibility of a marital deduction even though the spouse is a DB, since IRC § 2056 may not be satisfied. This type of trust is more appropriate for a credit shelter trust.

To satisfy the grantor's (participant's) desire to leave the life beneficiary enough power to ensure that she is properly cared for, but not too much where the IRS will include the asset in the life beneficiary's estate, a couple of alternatives exist. This may be accomplished through the inclusion of an ascertainable standard or a fixed percentage payout (such as "principal as needed for medical expenses and support," or "5% of the principal per year"). An invasion power in favor of the current income beneficiary of the trust will not disqualify the trust as a DB. Thus, a beneficiary will have rights that exceed mere income but will not be viewed by the IRS as the owner when her gross estate is being determined. These rights, subject to the limits explained, could also be included for the benefit of the remainder beneficiary without inclusion of the assets in the beneficiary's estate or disqualification of the trust as a DB.

Also, unlike the other trust models, this trust structure is not analogous to naming the beneficiary outright. According to the IRS, with this type of trust, remainder beneficiaries who come after the life beneficiary will be recognized as beneficiaries of the trust for the purpose of determining whether all trust beneficiaries are individuals and who is the oldest beneficiary for minimum distribution calculations. Therefore, both rule three (i.e., identifiable beneficiaries) and rule four (i.e., individual beneficiaries) of the trust rules explained above must be complied with, for all current and remainder trust beneficiaries, for the trust to recognize any DB.[40] Hence, a power of appointment would only be permitted if it is limited to individuals who are younger than the oldest individual who is identifiable from the trust instrument.

An example of this trust format would be the following: "Income to the participant's spouse (or some other individual), then to his children." The right to receive the income or a portion thereof would be granted to the life beneficiary while the life beneficiary would have no rights to the principal or be restricted by a fixed payout rate or ascertainable standard. Note that an invasion for the benefit of the children may also be included if accompanied by an ascertainable standard or in fixed amounts.

Disadvantages Associated with Placing Benefits in Marital Trust

When considering paying retirement benefits into a marital trust, estate planners must be aware of several disadvantages that may be of concern. First, if the spouse is a beneficiary of the trust, tax-deferred growth of the asset over the children's or grandchildren's life expectancies is not possible. Since the MDR state that the life expectancy of the trust's oldest beneficiary must be used when calculating minimum distributions, such calculations will be based solely on her life expectancy (presuming that the wife will be the oldest DB). Second, by naming a marital trust, the trust is the beneficiary of the account not the spouse, even if she is the DB. Therefore, the spouse will be unable to exercise the rollover option. This may cause unfavorable tax treatment due to the inability to exploit this greatly preferential tax-deferring technique. For example, if the spouse is an intended DB of the trust and the oldest DB, distributions will be calculated by using her life expectancy. The possibility of her rolling over the asset to her own account and naming an additional DB to extend tax-deferment has been eliminated by choosing the trust alternative.

Credit Shelter Trust

Generally, it is not suggested that a client fund a credit shelter trust with retirement benefits unless there is no other asset in the estate. Arguably, using the asset, under such a circumstance, to exploit the federal unified credit may be a reason but some experts have a different view. Some believe that leaving the benefits outright to the spouse to ensure a rollover situation and including a disclaiming option for the spouse is a more tax advantageous way to dispose of benefits. Under these terms, the disclaiming clause would state that if such option was exercised by the spouse, the benefits would then be payable to the credit shelter trust.[41]

This analysis of the credit shelter trust assumes a successful "first marriage" situation, with a husband, wife and their children, where the motivation for creating such a trust is for tax reasons alone. "Second marriages," where the new spouse may be younger than the participant's children, may provide for an entirely different discussion.

For several reasons, funding a credit shelter trust with retirement benefits may not be the right decision. This is especially true if a client is attempting to plan for the financial protection of his spouse. Nam-

ing the spouse as life beneficiary of the credit shelter trust provides that the trust benefits must be paid out over her life expectancy only. She will not have the opportunity to defer distributions until she reaches 70½ or name the children as DB when she reaches 70½ (i.e., by spousal rollover). Thus, the spouse is unable to use the life expectancy of her children to slow the payout process (subject to the MDIB rule) and the benefits are taxed prematurely. (Note that if the benefits had been left to the spouse outright and she rolled them over to her own IRA, those options would remain.)

Naming the spouse, or any other individual, as a beneficiary of the credit shelter trust may also cause distributions from the IRA to the trust to be taxed at a higher rate than if the distributions were to go directly to the named beneficiaries. Since a trust reaches the highest federal income tax bracket at $8,650 of taxable income and an individual at $288,350, the benefits will generally be taxed more heavily when paid to a trust (i.e., any trust) than if paid to an individual (assuming the individual is not in the highest tax bracket).[42]

One possible way to avoid such negative treatment would be to distribute income or principal to the beneficiaries causing the benefits to be taxed at the individual's tax rate (i.e., a concept known as "distributable net income" or "DNI").[43] DNI measures the amount of the distribution to the beneficiary which is deductible by the trust. The drawback to such maneuvers is that the benefits will now become a part of the beneficiary's estate and vulnerable to estate taxation. However, except for very large estates, this may not produce complications since the credit shelter is generally designed to avoid estate tax in the participant's estate. Thus, if the children are the beneficiaries and can either afford additional estate assets or have ample time to properly plan the assets, inclusion in their estate may not be a problem.

Conclusion

Using trusts to preserve retirement benefits is often an inappropriate maneuver for estate planners. In limited situations, the trust may be advantageous by providing a way for the participant to maintain a certain amount of control while ensuring that his beneficiaries take advantage of the available methods for obtaining tax deferral. Like many other estate planning tools, its logic depends greatly on the circumstances surrounding the individual client. As explained above, a participant's intentions (e.g., financial security of spouse, charity, etc.), his age, family situation, and so forth, will play an important role in deciding whether a trust would be beneficial.

Estate planning for retirement benefits, including paying the benefits to a trust, is an extremely complicated area. Much of what has been addressed by the IRS is proposed and therefore no clear rulings have been made on many topics. Thus, estate planners have the opportunity to explore with caution the limits and creatively structure ideas that may prove to be guidelines for the rest to follow.

[Note that the Taxpayer Relief Act of 1997 has introduced a new retirement option known as a Roth IRA. Contributions to the Roth IRA are not deductible, but "qualified distributions" are not taxable. This type of IRA is not subject to the MDR during the owner's lifetime. Thus, planning for its disposition is the subject of an entirely separate article.]

Endnotes

1. Please note that the author's reference to "retirement benefits" consists of qualified, tax-deferred plans such as, an "individual retirement account" (IRA) under § 408 of the Internal Revenue Code (IRC), a "qualified" plan under § 401(a) (such as a pension, profit sharing, 401(k), or Keogh plan, or an ESOP) or a "tax sheltered annuity" under § 403(b).
2. IRC § 401(a)(9).
3. Although the participant has until April 1 of the year following the year in which he becomes 70½ to take his first distribution, waiting until this date can cause him to take two distributions in one year because he will need to take another distribution (for age 71) by December 31 of the same year. This could push him into a higher income tax bracket and cause him to suffer an unnecessary increase in his income taxes.
4. IRC § 401(a)(9).
5. *Id.*
6. IRC § 4974.
7. Prop. Reg. 1.401(a)(9)-1, Q&E D-1.
8. IRC § 401(a)(9)(B)(ii) and Prop. Reg. 1.401(a)(9)-1, Q&A C-2.
9. Under the Retirement Equity Act of 1984 (REA), all defined benefit plans and many defined contribution plans must provide a joint and survivor annuity for married couples. Any election to pay benefits in any other form or to any other beneficiary must be consented to by the non-employee spouse in a witnessed writing. These rules do not apply to IRAs.
10. Prop. Reg. 1.401(a)(9)-1, Q&A C-3(a).
11. IRC § 401(a)(9)(B)(iv).
12. *Id.*
13. Prop. Reg. § 1.401(a)(9)-1, Q&A E-3&4; Treas. Reg. § 1.72-9, Table V &VI.
14. IRC § 401(a)(9).
15. *Id.*
16. *Id.*
17. Prop. Reg. 1.401 (a)(9)-1, Q&A H-2 *also see* IRC 401(a)(9)(B)(iii). The creation of separate accounts must be accomplished prior to the participant's RBD.

18. Prop. Reg. 1.401(a)(9)-1, Q&A E-5. Note that certain exceptions allow a non-individual to be named and the participant to retain a DB (e.g. a contingent beneficiary). For example, naming "the children who survive me or to XYZ charity if none survive me" will allow the children to continue as DBs regardless of the existence of the contingent non-individual beneficiary. This and the manner in which it is being interpreted by the IRS when a trust is named as the beneficiary will be discussed in more detail below.
19. Prop. Reg. 1.401 (a)(9)-1, Q&A D-5, D-6.
20. Choate, Natalie B. *Life and Death Planning for Retirement Benefits: The Essential Handbook for Estate Planners.* Ataxplan Publications, Boston, MA. 3rd Edition. Chapter 6. pp. 241-242.
21. Prop. Reg. § 1.401(a)(9)-1, Q&A D-5.
22. Prop. Reg. § 1.401(a)(9)-1, Q&A D-5-D-7.
23. Prop. Reg. § 1.401(a)(9)-1, Q&A D-2.
24. *See* Coleman, Virginia F. "Preserving the 'Designated Beneficiary' If a Trust Is Named as Beneficiary of a Qualified Plan or IRA." ALI-ABA Course of Study-Advanced Estate Planning Techniques (February 18, 1999).
25. Prop. Reg. 1.401(a)(9)-1, Q&A E-5(e)(1).
26. *Id.*
27. *See* Coleman, Virginia F. "Preserving the 'Designated Beneficiary' If a Trust is Named as Beneficiary of a Qualified Plan or IRA," *supra.*
28. *E.g.* PLR 9322005.
29. *See* Coleman, Virginia F. "Preserving the 'Designated Beneficiary' If a Trust is Named as Beneficiary of a Qualified Plan or IRA," *supra.*
30. *See* PLR 9809059.
31. *See* Prop. Reg. 1.401(a)(9)-1, Q&A D-7.
32. *Id.*
33. Coleman, Virginia F. "Preserving the 'Designated Beneficiary' If a Trust is Named as Beneficiary of a Qualified Plan or IRA," *supra* at 24.
34. *Id.*
35. *See* IRC § 678.
36. IRC § 678.
37. *See* Choate, Natalie B. *Life and Death Planning for Retirement Benefits: The Essential Handbook for Estate Planners.* Ataxplan Publications, Boston, MA. 3rd Edition.
38. *See* IRC § 2056A.
39. *See id.*
40. *See* Prop. Reg. § 1.401(a)(9)-1, Q&A D-6.
41. Note that due to the complexity of the issues and the scope of this article, QTIP trusts and Charitable Remainder trusts have been excluded from this discussion.
42. Rev. Proc. 98-61, Table 5-Section 1(e).
43. *See* IRC §§ 661 and 662.

Bradley M. Van Buren is an associate at the law firm of Martin, Shudt, Wallace, DiLorenzo & Johnson. He is a member of the Life Insurance & Employee Benefits Committee of the Trusts and Estates Section of the New York State Bar Association.

Executors' Elections

By Laurence D. Edelman

Introduction

In the process of an estate's administration, the ability of an executor to address available options and elections in a thoughtful and timely manner is extremely important from the standpoint of the estate's beneficiaries, both financially (i.e., by tax deferral or reduction) and psychologically (i.e., by providing peace of mind). It is therefore critical that executors take advantage of any options and elections available to them by adhering to the following process: recognizing the existence and applicability of options and elections; understanding their significance and impact; making appropriate decisions to exercise (or not exercise) them; and complying with any procedural requirements. The purpose of this article is to provide a tool to facilitate that process.

Elections

1. Decedent's Final Gift Tax Return

A. Overview

An executor is required to file the decedent's final gift tax return. Under IRC § 6075(b)(3), the final return is due the earlier of the due date of the decedent's final income tax return (including any extension) and the due date of the estate tax return (including any extension).

Under IRC § 2513, an executor and a decedent's surviving spouse can consent to gift-splitting with respect to gifts made by either the decedent or the spouse. However, the consent by an executor cannot be given for gifts made by the surviving spouse *after* the decedent's death. Furthermore, the consent to split gifts, if given, must be given to *all* gifts made during the calendar year by either spouse while married to the other.

B. Considerations

Splitting of gifts actually made by the decedent is generally advantageous to the estate in that it reduces the adjusted taxable gifts and thereby conserves more of the decedent's unified credit; however, if there would be no estate tax benefit by doing so, it is generally better not to split the decedent's gifts so as to conserve more of the surviving spouse's unified credit. On the other hand, splitting of gifts actually made by the surviving spouse is generally disadvantageous to the estate in that it increases the adjusted taxable gifts and thereby conserves less of the decedent's unified credit; however, if there would be no estate tax detriment in doing so, it is generally better to split the surviving spouse's gifts so as to conserve more of the surviving spouse's unified credit.

A potential disadvantage of consenting to gift-splitting is that, under IRC § 2513(d), the estate is jointly and severally liable with the surviving spouse for the *entire* gift tax due for that calendar year.

C. Miscellaneous

The *entire* amount of gift tax that is unpaid at the decedent's death which is attributable to a gift actually made by the decedent, is deductible as a debt for estate tax purposes even if the gift is split. On the other hand, generally no portion of the gift tax attributable to a gift actually made by the surviving spouse is deductible as a debt even if the gift is split.

Under IRC § 2035(c) and Revenue Ruling 82-198, gift taxes paid by the decedent (or his/her estate) on gifts made by the decedent or his/her spouse within 3 years of death are includable in the decedent's gross estate with respect to split gifts *regardless* of which spouse actually made the gift.

A request for prompt assessment of the decedent's gift tax liability and a request for discharge from personal liability for the decedent's gift taxes are available under IRC § 6501(d) and § 6905, respectively. *Note*—either of these requests may initiate an audit or an arbitrary assessment.

2. Decedent's Final Income Tax Return

A. Overview

Under IRC § 6012(b)(1), an executor is required to file the decedent's final income tax return. The return is due on the same date that the decedent would have been required to file had he/she lived for the entire tax year. The final return covers the period of time that begins on the first day of the decedent's taxable year and ends on the date of his/her death.

If the decedent was married at the time of his/her death, and if the decedent would have been permitted under IRC § 6013 to file a joint return with his/her spouse had the decedent lived for the entire tax year, then the executor may file a joint return with the decedent's spouse as long as he/she has not remarried prior to the end of the tax year.

Under Reg. § 1.6013-1(d)(3), if an executor has not been appointed before the due date for the income tax return, the surviving spouse may file a joint return with respect to himself/herself and the decedent. An executor who is thereafter appointed may disaffirm that joint return by filing a separate return for the decedent within 1 year after the due date for filing that joint return (including extensions). Under Reg. § 1.6013-1(d)(5), the disaffirmed joint return will in turn be treated as the surviving spouse's separate return.

An executor, with the consent of the surviving spouse, can make an election to file a joint return for prior taxable years in which the decedent and the surviving spouse, or the executor and the surviving spouse, filed separate returns for which a joint return could have been made under IRC § 6013(a). Under IRC § 6013(b)(1), the joint return must be filed within 3 years from the original due date (*not* including extensions) for filing the return for such taxable year. On the other hand, under Reg. § 1.6013-1(a)(1), the filing of a joint return is irrevocable once the due date for filing the return has expired (subject to the disaffirmance rule previously discussed).

B. Considerations

Filing a joint income tax return is generally advantageous in that the tax rates for joint filers reflect the tax on their combined taxable income at a lower rate than would apply to a single person with the same taxable income who filed separately. Another potential advantage to filing jointly arises when one spouse has deductions and/or capital losses that would end up being wasted were it not for the taxable income and/or capital gains of the other spouse.

A potential disadvantage to an executor filing jointly with the decedent's surviving spouse is that, under IRC § 6013(d)(3), the estate is jointly and severally liable with the surviving spouse for the *entire* income tax due for that taxable year.

C. Miscellaneous

The estate's share of the liability (or refund) due on the joint return is deductible as a debt (or includable as an asset) for estate tax purposes to the extent permitted by Reg. § 20.2053-6(f).

A request for prompt assessment of the decedent's income tax liability and a request for discharge from personal liability for the decedent's income taxes are available under IRC § 6501(d) and § 6905, respectively. *Note*—either of these requests may initiate an audit or an arbitrary assessment.

3. Accrued Interest on Series E and EE Savings Bonds

A. Overview

Interest on Series E and EE savings bonds is not paid currently (as is the case with Series H and HH savings bonds) but rather is accrued. The accrued interest is not taxable to the taxpayer until the bond is either redeemed or matures. However, under IRC § 454(a), a taxpayer can elect to report all unreported interest as taxable income.

If the taxpayer had not made the IRC § 454(a) election prior to his/her death, an executor can elect on behalf of the decedent to report all unreported interest on his/her final income tax return. The executor may instead make the election on the estate's fiduciary income tax return. If the executor does not make the election, then a beneficiary of the bonds may make an election on his/her own returns. In any event, the executor or beneficiary who makes the election must also report any future annual accrued interest as taxable income. Conversely, the transferee of the bonds is not bound by an election made by the transferor; consequently, the transferee may postpone tax on any future annual accrued interest until redemption or maturity.

B. Considerations

It may be advantageous to report accrued interest as taxable income on a decedent's final income tax return if the decedent has deductions which would otherwise be wasted. Another potential advantage lies in the fact that the decedent's increased income tax liability (or reduced refund) caused by treating the accrued interest as taxable income results in an increased deduction (or reduced asset) for estate tax purposes.

Alternatively, it may be advantageous to report accrued interest as taxable income on the estate's fiduciary income tax return if the executor elects to deduct administration expenses on that return (rather than on the 706) and if these deductions would otherwise be wasted (i.e., *not* the estate's final income tax year).

Compare the tax brackets of the decedent, the estate and the bond beneficiary in determining who should make the election. However, beware of a potential conflict in the situation where the bond beneficiary is not also the residuary estate beneficiary, and therefore one beneficiary will benefit from the election (or failure to elect) under IRC § 454(a) at the expense of the other beneficiary.

The IRC § 454(a) election, if made, must be made with respect to accrued interest of *all* savings bonds

owned by the taxpayer (including any accrued interest carried forward to Series H and HH bonds that were obtained in exchange for Series E and EE bonds). Therefore, in a situation where tax brackets warrant spreading the taxability of previously unreported interest over more than one tax year, consider not making the election; instead, consider the potential advantage of redeeming the bonds over a period of time.

C. Miscellaneous

Series E and EE savings bonds owned by a decedent are includable in his/her gross estate at their date of death redemption values (i.e., including accrued interest). The accrued interest is considered to be income in respect of a decedent for income tax purposes.

4. Medical Expenses Paid After Death

A. Overview

Under IRC § 2053(a)(3), an executor may elect to deduct medical expenses paid during the 1-year period after death on the decedent's income tax return for the year in which the expenses are incurred, rather than deducting the expenses as debts on the estate tax return. The executor must therefore weigh the benefits /detriments of deducting these medical expenses on the decedent's Form 1040 versus the estate's Form 706.

B. Considerations

Generally, the decision to make the election or not is reached by comparing the estate's estate tax bracket with the decedent's income tax bracket. An income tax deduction is usually less valuable than an estate tax deduction, due to the reduction and compression of income tax rates.

In the optimum marital formula situation, the initial tendency is to elect to deduct the medical expenses on the decedent's income tax return since the estate tax is eliminated and a deduction on the estate tax return would appear to be wasteful. However, claiming medical expenses on the decedent's income tax return in this situation will result in an increased marital share and a reduced non-marital share. Consequently, the optimum marital formula situation requires an analysis that compares (1) the time value of money based upon the surviving spouse's anticipated life expectancy (i.e., deducting medical expenses on the decedent's income tax return reduces income taxes due or increases an income tax refund due) with (2) the anticipated increase in estate tax that will ultimately be due upon the surviving spouse's death. Furthermore, beware of a potential conflict that arises where the marital share beneficiaries are not also the non-marital share beneficiaries, and therefore one set of beneficiaries will benefit from the election (or failure to elect) under § 2053(a)(3) at the expense of the other set of beneficiaries.

In the optimum marital formula situation, an executor must also keep in mind that if the non-marital share is wiped out because the credit shelter amount was used up by non-spousal bequests or by adjusted taxable gifts, claiming medical expenses on the decedent's income tax return will result in an estate tax now being payable.

A disadvantage to making the medical expense election is found in Revenue Ruling 77-357; if an executor elects to deduct medical expenses on the decedent's income tax return (which under IRC § 213(a) can only be deducted to the extent the medical expenses exceed 7.5% of the decedent's adjusted gross income), the executor cannot then deduct the unused 7.5% portion as an estate tax deduction. Subject to this limitation, Revenue Ruling 77-357 does permit the executor to make the § 2053(a)(3) election as to some items of the decedent's medical expenses, while not making the election as to other items.

Another disadvantage to electing to deduct medical expenses on the decedent's income tax return is that the executor thereby reduces the decedent's income tax debt *or* increases the decedent's income tax refund, either way potentially increasing the estate tax due.

C. Miscellaneous

If a § 2053(a)(3) election is made, the executor must file in duplicate (before the expiration of the statute of limitations applicable to the income tax year for which the deduction is claimed) a statement to the effect that the medical expense has not been allowed as a deduction on the estate tax return *and* an irrevocable waiver of the right to have such amount allowed at any time as an estate tax deduction.

5. Capital Gain Exclusion Upon the Sale of a Principal Residence

A. Overview

Under Revenue Ruling 78-32, the gain recognized from the sale of a decedent's principal residence that was completed by an executor under a contract entered into prior to death by the decedent, for which the decedent had substantially fulfilled the prerequisites to consummation of the sale, is deemed to be income in respect of a decedent. Inasmuch as step-up basis does not apply to income in respect of a decedent, the estate's basis in the decedent's princi-

pal residence will be the decedent's basis prior to his/her death. Therefore, the completion of the sale could result in the incurrence of a capital gain.

Under Revenue Ruling 82-1, the capital gain recognized in the above scenario should qualify for the capital gain exclusion provided by IRC § 121 (as amended by Section 312(a) of the Taxpayer Relief Act of 1997) if the ownership and use requirements of that section were satisfied by the decedent. However, an executor may *elect* out of the IRC § 121 exclusion on the decedent's final income tax return.

B. Considerations

If a decedent sold two principal residences within 2 years of each other and the second sale generated a larger gain than the first sale, the executor should consider electing out of the IRC § 121 exclusion with respect to the first sale. Otherwise, the exclusion of gain on the second sale will not be permitted because of the 2-year restriction contained in the statute.

C. Miscellaneous

The election not to exclude a capital gain is made by reporting the sale properly on Schedule D of the income tax return (Capital Gains and Losses) *and* attaching a separately signed sheet of paper stating that the executor is electing not to exclude the gain in accordance with IRC § 121(f).

6. Choosing a Tax Year

A. Overview

Under IRC § 441(e), an executor may elect a calendar year *or* any fiscal year as the estate's taxable year, as long as the first year is not more than 12 months and ends on the last day of a month. The executor must therefore compare the benefits/detriments of choosing a calendar year versus a fiscal year for the estate's taxable year. As part of this analysis, the executor must also weigh the benefits/detriments of choosing a short initial taxable year for the estate versus a long initial taxable year.

The analysis should be made very early in the estate's administration so that the executor may, if advantageous, be in a position to choose a short initial taxable year. In order to make an informed decision, the executor must project the income and deductions for the estate's initial 12 month period, and must consider the expected income tax brackets of the estate and residuary beneficiaries (although the compression of income tax brackets and rates make this less of a consideration today).

B. Considerations

a. Calendar Year Versus Fiscal Year

Since an estate's initial fiduciary income tax return and income tax are due 3½ months after the end of its initial taxable year, by choosing a taxable year that extends *beyond* December 31 of the year of the decedent's death (i.e., assuming that the decedent did not die in January), the estate can postpone reporting taxable income that is earned during the period from date of death through December 31.

Under IRC § 662(c), a residuary beneficiary includes in his/her gross income the amount of the estate's distributable net income taxable to him/her for the taxable year of the estate ending with or within his/her taxable year. Therefore, by choosing a taxable year that extends *beyond* December 31 of the year of the decedent's death (i.e., assuming that the decedent did not die in January), the residuary beneficiary who has received distributions during the estate's taxable year can postpone reporting income for 12 months (subject to the beneficiary making estimated payments).

b. Initial Short Taxable Year Versus Initial Long Taxable Year

By choosing a short initial taxable year that ends prior to the estate's collection of a significant amount of taxable income, the estate can postpone reporting that income for up to 11 months. In addition, by choosing a short initial taxable year, taxable income required to be reported by an estate can be spread over its first two taxable years to take advantage of lower tax brackets (although this strategy is less valuable in recent years due to the reduction and compression of income tax rates for estates).

By choosing a short initial taxable year during which period a distribution was made to a residuary beneficiary, the beneficiary can defer reporting for 12 months the distributable net income which the beneficiary would have been required to report had a longer initial taxable year been chosen.

For estates that contain both taxable and tax-exempt securities, and where administration expenses are to be deducted on the estate's income tax return (rather than on the 706), consider choosing a short initial taxable year during which period a distribution of the tax-exempt securities is made (i.e., *before* the tax-exempt income is collected by the estate). This procedure prevents the loss of an income tax deduction for that portion of the administration expenses which would have been deemed attributable to the tax-exempt income had that income been collected prior to the end of the estate's initial taxable year.

Where administration expenses are to be deducted on the estate's income tax return (rather than on the 706), and the expenses incurred during the early months of the estate's administration exceed the taxable income collected during that same period, consider choosing a long initial taxable year to ensure that the estate has time to generate sufficient taxable income to offset the deductions; excess deductions would otherwise be wasted in the estate's initial taxable year as they cannot be "passed out" to the residuary beneficiary.

Since an estate's initial fiduciary income tax return and income tax are due 3½ months after the end of its initial taxable year, a long initial year postpones the first return and tax. Furthermore, since an estate need not make quarterly estimated payments of income tax for its first two taxable years, a long initial taxable year further postpones the first required quarterly estimate.

C. Miscellaneous

The election of a taxable year for an estate must be made on or before the time prescribed by law (*not* including extensions) for the filing of the estate's first return, as established by the filing of Form 1041 or Form 2758 (Application for Extension of Time to File). Once a taxable year has been elected, such year must be used for all subsequent years unless prior approval is obtained from the Service to make a change.

IRC § 663(b), as amended by Section 1306(a) of the Taxpayer Relief Act of 1997, extends the application of the "65 day rule" to estates, in that an executor can *elect* to treat distributions made by the estate within 65 days after the close of the estate's taxable year as having been made on the last day of the taxable year. The election is made by checking the box on page 2 of Form 1041, question 6 under "Other Information."

7. Treating a Revocable Trust as Part of an Estate For Income Tax Purposes

A. Overview

Under IRC § 645 (formerly § 646), as added by Section 1305 of the Taxpayer Relief Act of 1997, an executor and trustee may together make an irrevocable election to treat a "qualified revocable trust" (any trust, a portion or all of which is treated under IRC § 676 as owned by the decedent with respect to whom the election is being made, by reason of a power in the grantor) as part of a decedent's estate, and not as a separate trust, for federal income tax purposes. *Note*—if there is no probate estate, and therefore no executor is appointed, the election may still be made.

The election, which must be made no later than the due date (including extensions) for filing the estate's income tax return for its first year, is effective from the date of the decedent's death until 2 years after death (if no estate tax return is required) *or* 6 months after the final determination of estate tax liability (if an estate tax return is required).

If the election is made, all income, deductions and credits that are attributable to the trust for the period subsequent to the decedent's death must be excluded from the trust's Form 1041 filed for the tax year ending after the date of the decedent's death and must instead be reported on the estate's Form 1041.

B. Considerations

The IRC § 645 election is potentially advantageous by reducing the total number of fiduciary income tax returns required to be filed, and by making a trust eligible for income tax benefits available to an estate but not otherwise available to a trust. Five examples of such income tax benefits are as follows:

1. The ability of an estate, under IRC § 642(c)(2), to take a charitable deduction for property permanently set aside for charity; trusts are only allowed a charitable deduction for amounts *paid* to charity.

2. The ability of an estate of a deceased taxpayer, under IRC § 469(i) with respect to rental real estate, to offset excess possible losses against up to $25,000 of non-passive income for the first two tax years following the death of the taxpayer if the decedent was actively participating in the activity in the year of death; trusts do not qualify for this special allowance.

3. The ability of an estate to deduct $600 as its personal exemption, while a trust may deduct only $100 or $300 (under IRC § 642(b)).

4. The ability of an estate to defer income tax by choosing a fiscal year rather than a calendar year as its taxable year; trusts are required to use a calendar year.

5. The ability of an estate holding "qualified timber property" to amortize "reforestation expenditures," while a trust is prohibited from doing so (under IRC § 194(b)).

Although a potential disadvantage to making the § 645 election lies in the fact that the qualified revocable trust is no longer a separate taxpaying entity (i.e., for "trapping distribution" purposes), this is not

significant due to the reduction and compression of income tax rates.

C. Miscellaneous

Revenue Procedure 98-13 provides the procedures for making the IRC § 645 election. A "statement" must be attached to the Form 1041 filed for the estate for its first taxable year; a copy of the "statement" must also be attached to the Form 1041 filed for the trust for its taxable year ending after the date of the decedent's death (*unless* Form 1041 for the estate's first taxable year is filed before the due date for filing a Form 1041 for the trust for the taxable year ending after the date of the decedent's death, the trust items attributable to the decedent are reported pursuant to Reg. § 1.671-4(b)(2)(i)(A) or (B), and the entire trust is a qualified revocable trust). If the trust already filed its 1041 for its taxable year ending after the date of the decedent's death, the trustee must file an amended 1041 with a copy of the "statement" attached.

The "statement" must (a) identify the election as an election made under IRC § 645; (b) contain the decedent's name, address, date of death and TIN; (c) contain the trust's name, address and TIN; (d) contain the estate's name, address and TIN; (e) represent that the trust was treated under IRC § 676 as owned by the decedent by reason of the decedent's power to revoke; (f) be signed and dated by both an executor/administrator of the estate and a trustee of the trust.

The election is considered made when the statement is attached to Form 1041 filed for the estate's first taxable year, or when a copy of the statement is attached to Form 1041 filed for the trust, whichever occurs first.

8. Distributions of Residuary Property in Kind

A. Overview

Under IRC § 643(e), distributions in kind of appreciated (or depreciated) property in satisfaction of a general bequest of a share of estate residue results in a gain (or loss) to the estate *if* an election is made to recognize the gain (or loss).

If the IRC § 643(e) election is made, a gain (or loss) will be recognized in the estate (i.e., by comparing the fair market value of the distributed property on the date of distribution with the cost basis of the property), the beneficiary's cost basis in the property will be the property's fair market value on the date of distribution, and the amount which is deemed to have been distributed to the beneficiary (for purposes of "passing out" distributable net income) will be the fair market value of the property on the date of distribution. In contrast, if the election is *not* made, there will be no recognition of a gain (or loss) in the estate upon the distribution, the beneficiary's basis in the property will be identical to the estate's basis, and the amount which is deemed to have been distributed to the beneficiary (for purposes of "passing out" distributable net income) will be the lesser of the property's cost basis and its fair market value on the date of distribution.

B. Considerations

Consider making the election as a way to resolve the potentially unfair situation where one residuary beneficiary will be receiving assets with a cost basis different from what another residuary beneficiary will be receiving (even though the distribution values are identical). By making the election, both beneficiaries will receive assets with the same cost basis.

An important point to keep in mind is that IRC § 267, which disallows recognition of losses on most sales of assets between "related persons," was amended by Section 1308(a) of the Taxpayer Relief Act of 1997 which expanded the definition of "related persons" to include an estate and a beneficiary of an estate (for tax years beginning after August 5, 1997), *except* in the case of a distribution in satisfaction of a *pecuniary* bequest.

C. Miscellaneous

The IRC § 643(e) election is made on the estate's income tax return for the taxable year in which the in kind distribution took place. The election, if made, is deemed to have been made as to *all* in kind distributions that took place during the same taxable year; the executor cannot make a partial election. Once made, the election may only be revoked with the consent of the Secretary.

9. Special Treatment with Respect to Stock Redemptions

A. Overview

Where corporate stock included in the decedent's gross estate is redeemed by the corporation, the executor will want the distribution received to qualify for capital gain treatment, as opposed to dividend treatment. The reason is simple; while a capital gain would be the difference between the amount realized and the step-up basis of the stock, a dividend would be the amount realized without regard to basis.

Under IRC § 303, the estate will qualify for capital gain treatment to the extent that the distribution received is *not* greater than the sum of (1) death taxes and interest due (including in some instances generation skipping tax) and (2) funeral and administration expenses (but not debts).

IRC § 303 only applies if the value of the stock included in the decedent's gross estate exceeds 35% of the value of the decedent's gross estate reduced by amounts deductible under IRC § 2053 and § 2054 (i.e., funeral and administration expenses, debts, and casualty and theft losses). If the decedent owned stock in more than one corporation, the value of the stock may be aggregated for purpose of the 35% rule if 20% or more of the value of the outstanding stock of each corporation is included in the decedent's gross estate.

IRC § 303 only applies to distributions made after the decedent's death and, in general, only if made within a period of 90 days following the expiration of the 3 year statute of limitations for the assessment of estate tax under IRC § 6501(a).

B. Considerations

While the desired capital gain treatment afforded to an executor under IRC § 303 is not itself an election, the ability of an executor to take advantage of this treatment is affected by his/her making (or not making) certain elections. For example, for purposes of satisfying the 35% rule the executor should consider the ramifications of electing (or not electing) alternate valuation or special use valuation. However, satisfaction of the 35% rule is *not* impacted by electing (or not electing) to use estate administration expenses as income tax deductions (rather than as estate tax deductions).

C. Miscellaneous

Where there is more than one distribution in redemption of stock during the prescribed period of time, the distributions are applied against the § 303 limitation in the order in which they are made.

10. Basis of Partnership Assets

A. Overview

While a decedent's interest in a partnership receives a step-up basis under IRC § 1014 (subject to adjustments for partnership liabilities and income in respect of a decedent), the underlying property held by the partnership does not itself receive a step-up basis unless the property is distributed to the estate in liquidation of the decedent's partnership interest. Therefore, if the partnership's underlying assets are sold by the partnership or distributed to the estate (other than in liquidation) before the decedent's partnership interest is itself sold by the estate, a gain could be realized by the estate.

Under IRC § 754, when a partner dies, a partnership can elect to adjust the internal basis of its property to take into account the estate's basis for the partnership interest as determined under IRC § 1014, but *only* with respect to the estate (which election is made on the partnership return for the year in which the partner died).

B. Considerations

While the election by a partnership to adjust the internal basis of its property with respect to a decedent's interest is potentially advantageous to an estate, a partnership may not be willing to so elect. In such a case, *the executor* may himself/herself make a somewhat limited election under IRC § 732(d), whereby any partnership property *distributed* to the estate within 2 years after the partner's date of death will receive the step-up basis.

C. Miscellaneous

In order to make an IRC § 732(d) election, an executor must submit a schedule with the estate's income tax return; the schedule must set forth that an election is being made under § 732(d), the computation of the basis adjustment and the properties to which the basis adjustments are allocated.

11. Alternate Valuation Election

A. Overview

Under IRC § 2032, the federal government allows executors to report on the estate tax return either the date of death value of assets included in a decedent's gross estate or, if it is lower, the alternate date value of the assets. The alternate date is six months following the decedent's date of death. For any assets sold or distributed prior to the alternate date, the alternate value is their sale or distribution date value.

The alternate valuation election can only be made *if*, by so electing, the value of the decedent's gross estate *and* the amount of federal estate tax due (reduced by available credits) are decreased. Further, the election, if made, must be applied to *all* assets included in the gross estate (probate and non-probate); the executor cannot make a partial election.

B. Considerations

If an executor elects the alternate valuation, the advantage to the estate is a reduction of federal estate tax. The downside to making the election is that the cost basis of each asset, for the purpose of determining capital gain or loss on subsequent sale(s), is reduced from date of death value to alternate value. An estate tax reduction (by making the election) is usually more valuable than either a capital gain reduction or capital loss increase (by not making the election). Therefore, the decision to make the election is generally a straightforward one, assuming that the estate tax bracket is greater than the prevailing long term capital gain rate (currently 20%). However, beware of a potential conflict that

arises when there are legatees of specific assets who are not also residuary beneficiaries, and therefore one set of beneficiaries will benefit from the election (or failure to elect) under § 2032 at the expense of the other set of beneficiaries.

Before making the decision to elect alternate valuation, an executor must consider the ramifications that so electing has on his/her ability to make certain other elections that may be more advantageous to the estate; for example, the ability to satisfy the 35% threshold requirement of IRC § 303 (pertaining to capital gain treatment on stock redemptions), the ability to satisfy the 35% threshold requirement of IRC § 6166 (pertaining to paying federal estate tax attributable to closely held business interests in installments), the ability to satisfy the 25% and 50% threshold requirements of IRC § 2032A (pertaining to special use valuation of real property used for farming or for a closely held business), and the ability to satisfy the 50% threshold requirement of IRC § 2057 (pertaining to the family-owned business deduction).

An executor should keep in mind that sales and/or distributions will set the alternate value of the asset(s) involved. However, prudence dictates that an executor not postpone making sales *solely* to "take advantage" of the lower estate tax values that would occur if financial markets happen to turn down during the 6 month alternate value period; after all, the loss incurred upon a later sale, although somewhat offset by a reduced estate tax, will nonetheless have a net negative financial impact on the beneficiary(ies). On the other hand, prudence generally dictates that an executor postpone making distributions of non-cash assets to the beneficiary(ies) until the expiration of the 6 month alternate valuation period *if* the beneficiary(ies) would be retaining these assets in kind during the 6 month period anyway; if financial markets happen to turn down during the 6 month period, the resulting reduction in estate tax will have a positive financial impact (*however*, beware of a potential conflict in postponing distributions if there are legatees of specific assets who are not also residuary beneficiaries).

C. Miscellaneous

The IRC § 2032 election is irrevocable and is made by checking "Yes" to the box on line 1, page 2 of Form 706 under "Elections by the Executor." However, the election cannot be made if the 706 is filed more than one year after the expiration of the time for filing (including extensions).

While IRC § 2032 does not specifically provide for an executor to make a protective election, a 1992 Tax Court case allowed one to be made.[1]

To the extent that assets have had changes in value due to mere lapse of time (i.e., patents, annuities, remainder interests), alternate valuation is *not* applicable and therefore, those assets are included in a decedent's gross estate at date of death value.

12. Special Use Valuation Election

A. Overview

Under IRC § 2032A, the federal government allows executors to value real property used for farming or for a closely held business on the basis of its "actual use," which will result in a lower value for estate tax purposes when compared to using "highest and best use." An executor may elect both IRC § 2032 (alternate valuation) and § 2032A (special use valuation).

The maximum amount by which the value of "qualified real property" can be reduced under IRC § 2032A is $750,000. However, for decedents dying after December 31, 1998, the $750,000 figure will be indexed annually for inflation pursuant to Section 501(b) of the Taxpayer Relief Act of 1997.

The special use valuation election is available to an estate of a decedent who was a citizen or resident of the United States at the time of death, and who then owned "qualified real property" directly, or indirectly through ownership of an interest in a corporation, partnership or trust (if owned indirectly, the decedent's interest must meet the ownership tests of IRC § 6166(b)(1) for an interest in a closely held business).

In order to be considered "qualified real property," IRC § 2032A(b)(1) requires satisfaction of the following six tests:

1. The property must be located in the United States;
2. The property must have been devoted to a "qualified use" (as defined in IRC § 2032A(b)(2)), by the decedent or a family member at the time of the decedent's death, and owned and used by the decedent or a family member for 5 out of an 8-year period ending on the date of death;
3. A present interest in the property must pass from the decedent to a "qualified heir": spouse of the decedent, ancestor of the decedent, lineal descendant of the decedent or of the decedent's spouse or parent, or spouse of such lineal descendant;
4. The "adjusted value" of the decedent's interest in the real and personal property used in

the farm or closely held business must be at least 50% of the "adjusted value" of the decedent's gross estate (the "adjusted value" of the real and personal property, or of the gross estate, is reached by reducing the value of the real and personal property or of the gross estate by mortgages or indebtedness with respect to the property);

5. The adjusted value of the decedent's interest in the qualified real property must be at least 25% of the adjusted value of the decedent's gross estate;

6. The decedent or a member of his/her family must have "materially participated" (as interpreted under IRC § 1402(a)(1)) in the operation of the farm or closely held business for 5 of the 8 years preceding the earlier of the decedent's death, disability or the commencement of receipt of social security; if a surviving spouse acquired the qualified real property from a deceased spouse, the surviving spouse may substitute "active management" for "material participation."

For purposes of determining whether an estate satisfies the 50% and 25% thresholds, gifts of non-qualified property made within 3 years of death (other than annual exclusion gifts) are brought back into the gross estate. For purposes of satisfying the 50% threshold (but not the 25% threshold), the executor may take into account gifts of qualified property made within 3 years of death as long as the property continued to be qualified until the decedent's death. Rev. Rul. 87-122.

Estate taxes saved as a result of making the special use valuation election may be recaptured by the government if, within 10 years of the decedent's death (and if prior to the death of the qualified heir), the qualified heir disposes of an interest in the qualified real property (other than by a disposition to a member of his/her family) *or* the qualified heir ceases to devote the property to a qualified use (as defined in IRC § 2032A(c)(6)). The recapture tax is due 6 months after the date of the disqualifying event (at which time a Form 706A is filed). Similarly, interest payable to the Service on the recapture tax generally begins to accrue 6 months after the disqualifying event.

B. Considerations

If an executor elects the special use valuation, the advantage to the estate is a reduction of federal estate tax. The downside to making the election is that the cost basis of the qualified real property, for the purpose of determining capital gain or loss on a subsequent sale, is reduced from a value based on "highest and best use" to a value based on "actual use." An estate tax reduction (by making the election) is usually more valuable than either a capital gain reduction or capital loss increase (by not making the election). Therefore, the decision to make the election is generally a straightforward one, assuming that the estate tax bracket is greater than the prevailing long term capital gain rate (currently 20%). However, beware of a potential conflict that arises when there is a specific legatee of qualified real property who is not also a residuary beneficiary, and therefore one beneficiary will benefit from the election (or failure to elect) under § 2032A at the expense of the other beneficiary.

Before making the decision to elect special use valuation, an executor must consider the ramifications that so electing has on his/her ability to make certain other elections that may be more advantageous to the estate; for example, the ability to satisfy the 35% threshold requirement of IRC § 303 (pertaining to capital gain treatment on stock redemptions) and the ability to satisfy the 35% threshold requirement of IRC § 6166 (pertaining to paying federal estate tax attributable to closely held business interests in installments).

Where the executor has discretion to allocate the qualified real property between marital and non-marital shares, it may be desirable to allocate the property to the non-marital share if the surviving spouse already holds qualified real property that would fully use the $750,000 limitation upon his/her death. Furthermore, it may be advisable to allocate the property to an individual best able to satisfy the qualified use requirements during the post-death period to avoid recapture tax.

An executor should consider electing special use valuation, notwithstanding his/her anticipation of an event that would ultimately result in recapture tax, since that tax is generally deferred interest free until 6 months after the disqualifying event.

C. Miscellaneous

The IRC § 2032A election is irrevocable and is made on the first federal estate tax return filed, by checking "Yes" to line 2 of Part 3 of Form 706, and including a completed Schedule A-1 with the return. *Note*: an agreement, which pertains to the payment of recapture tax and which must be signed by all persons with an interest in the qualified real property, must also be filed as part of Schedule A-1.

If at the time of filing there is uncertainty whether property is eligible for the election, an executor can make a protective election on a timely

filed return by checking the appropriate box on Part 1 of Schedule A-1 and providing the required information.

13. Family-Owned Business Deduction

A. Overview

Under IRC § 2057 (as added by Section 502 of the Taxpayer Relief Act of 1997 and as amended by Section 6007(b) of the Internal Revenue Service Restructuring and Reform Act of 1998), for estates of decedents dying after December 31, 1997 an executor may elect special estate tax treatment for "qualified family-owned business interests" if certain conditions are satisfied. An executor may make the IRC § 2057 election in addition to the special use valuation election under IRC § 2032(A) and the installment election under IRC § 6166.

The special estate tax treatment under IRC § 2057 is a deduction. This deduction is equal to the lesser of the "adjusted value" of the decedent's "qualified family-owned business interests" or $675,000 (not indexed for inflation). If the full $675,000 deduction is taken, the amount that can be effectively exempted by the unified credit ("the applicable exclusion amount") is $625,000 *regardless* of the year of death. However, if less than the $675,000 deduction is taken, the applicable exclusion amount is increased on a dollar-for-dollar basis, but only up to the applicable exclusion amount available for the year of death if no deduction had been taken.

The family-owned business deduction is available to an estate of a decedent who was a citizen or resident of the United States at the time of death, if the "adjusted value" of the decedent's "qualified family-owned business interests" that are passed to or acquired by "qualified heirs" exceed 50% of the decedent's adjusted gross estate.

Subject to the exceptions listed in IRC § 2057(e)(2)(A),(B),(C) and (D), a "qualified family-owned business interest" is an interest as a proprietor in a trade or business carried on as a proprietorship *or* an interest in an entity carrying on a trade or business, if at least 50% of the entity is owned by the decedent and members of his/her family, 70% of the entity is owned by members of two families, or 90% of the entity is owned by members of three families (for purposes of the 70% and 90% tests, at least 30% of the entity must be owned by the decedent and members of his/her family).

A "qualified heir" is (1) a member of the decedent's family: spouse of the decedent, ancestor of the decedent, lineal descendant of the decedent or of the decedent's spouse or parent, or spouse of such lineal descendant, (2) any "active employee" of the trade or business to which the qualified family-owned business interest relates if the employee has been employed for at least 10 years prior to the decedent's death, or (3) a trust, if all beneficiaries of the trust are qualified heirs.

In order to determine whether or not the "adjusted value" of the decedent's qualified family-owned business interests exceed 50% of the decedent's adjusted gross estate, a ratio must be calculated using the following numerator and denominator as provided in the Conference Report accompanying Section 502 of the Taxpayer Relief Act of 1997:

> 1. "The numerator is determined by aggregating the value of all qualified family-owned business interests that are includible in the decedent's gross estate and are passed from the decedent to a qualified heir, plus any lifetime transfers of qualified business interests that are made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the decedent's family and were not otherwise includible in the decedent's gross estate. For this purpose, qualified business interests transferred to members of the decedent's family during the decedent's lifetime are valued as of the date of such transfer. This amount is then reduced by all indebtedness of the estate, except for the following: (1) indebtedness on a qualified residence of the decedent (determined in accordance with the requirements for deductibility of mortgage interest set forth in section 163(h)(3)); (2) indebtedness incurred to pay the educational or medical expenses of the decedent, the decedent's spouse or the decedent's dependents; and (3) other indebtedness of up to $10,000."
>
> 2. "The denominator is equal to the decedent's gross estate, reduced by any indebtedness of the estate, and increased by the amount of the following transfers to the extent not already included in the decedent's gross estate: (1) any lifetime transfers of qualified business interests that were made by the decedent to members of the decedent's family (other than the decedent's spouse), provid-

ed such interests have been continuously held by members of the decedent's family, plus (2) any other transfers from the decedent to the decedent's spouse that were made within 10 years of the date of decedent's death , plus (3) any other transfers made by the decedent within three years of the decedent's death except non-taxable transfers made to members of the decedent's family."

In order for an executor to elect the family-owned business deduction, the decedent or a member of his/her family must have "materially participated" (as interpreted under IRC § 1402(a)(1)) in the qualified family-owned business interest for a period aggregating at least 5 of the 8 years preceding the earlier of the decedent's death, disability or the commencement of receipt of social security. Furthermore, the decedent or a member of his/her family must have owned the family-owned business interest for a period aggregating at least 5 of the 8 years preceding the decedent's death.

Estate taxes saved as a result of electing the family-owned business deduction may be recaptured by the government if any one of four events occur within 10 years after the decedent's death (and if prior to the death of the qualified heir): (1) the qualified heir or a member of his family ceases to materially participate in the qualified family-owned business interest for more than 3 years in any 8 year period, (2) the qualified heir disposes of any portion of the business interest, other than by a disposition to a member of the heir's family, (3) the principal place of business of the trade or business ceases to be located in the United States, or (4) the qualified heir loses United States citizenship, unless the heir places the qualified family-owned business interest into a trust meeting requirements that are similar to a "qualified domestic trust."

B. Considerations

Where the executor has discretion to allocate the qualified family-owned business interests between marital and non-marital shares, it may be desirable to allocate the qualified interests to the non-marital share if the surviving spouse already holds qualified interests that would fully use the $675,000 deduction upon his/her death. Furthermore, it may be advisable to allocate the qualified interests to an individual best able to satisfy the material participation requirements during the post-death period.

The instructions to Schedule T of the 706 appear to permit an executor to make the § 2057 election as to some, but not all, of the qualified family-owned business interests. If that is an accurate interpretation, then in view of the coordination between the § 2057 deduction and the applicable exclusion amount, an executor would at times need to choose between the § 2057 deduction and the unified credit. The executor should calculate and compare the estate taxes due under both choices. In addition, keep in mind that the estate tax benefits of a § 2057 deduction can potentially be recaptured in the future, while the unified credit is not, of course, subject to recapture.

C. Miscellaneous

The IRC § 2057 election is made by entering the deduction on page 3, line 22 of the Recapitulation page of Form 706 and by filing a completed Schedule T of Form 706. An agreement, which pertains to the payment of recapture tax and which must be signed by all persons with an interest in the qualified family-owned business interest, must also be filed as part of Schedule T.

14. Estate Tax Exclusion for Land Subject to a Conservation Easement

A. Overview

Under IRC § 2031(c), as amended by Section 508 of the Taxpayer Relief Act of 1997, for estates of decedents dying after December 31, 1997 an executor may elect to exclude from the gross estate the value of "land subject to a qualified conservation easement." An executor may elect the IRC § 2031(c) exclusion in addition to the deduction for qualified family-owned business interests. Furthermore, the existence of a "qualified conservation easement" does not prevent such property from qualifying for special use valuation treatment under IRC § 2032A.

The IRC § 2031(c) exclusion does not apply to the extent that the land is debt-financed and is limited to the lesser of 1) the "applicable percentage" of the value of "land subject to a qualified conservation easement," reduced by the amount of any charitable deduction under IRC § 2055(f) with respect to such land, or 2) the "exclusion limitation."

The "applicable percentage" is 40% reduced (but not below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the "qualified conservation easement" is less than 30% of the value of the land (determined without regard to the value of such easement and reduced by the value of any retained "development right"). The "exclusion limitation" is for estates of decedents dying in: 1998 - $100,000; 1999 - $200,000; 2000 - $300,000; 2001 - $400,000; 2002 and after - $500,000.

"Land subject to a qualified conservation easement" is land:

1. that is located (a) in or within 25 miles of an area that, on the date of the decedent's death, is a metropolitan area, (b) in or within 25 miles of an area that, on the date of the decedent's death, is a national park or wilderness area designated as part of the National Wilderness Preservation System, *or* (c) in or within 10 miles of an area that, on the date of the decedent's death, is an Urban National Forest,

2. that was owned by the decedent or a member of the decedent's family (i.e., spouse of the decedent, ancestor of the decedent, lineal descendant of the decedent or of the decedent's spouse or parent, or spouse of such lineal descendant) at all times during the 3 year period ending on the date of the decedent's death, *and*

3. with respect to which a "qualified conservation easement" has been made, as of the date of the election, by the decedent, a member of the decedent's family, *the executor of the decedent's estate* or the trustee of a trust, the corpus of which includes the land subject to the "qualified conservation easement." For the general definition of a "qualified conservation easement," refer to IRC § 170(h)(1).

For estate tax purposes, the exclusion is available *in addition* to the already reduced value of the land subject to a qualified conservation easement. However, when an executor makes a qualified conservation easement on behalf of the estate (thereby making the exclusion available), the value of the land subject to a qualified conservation easement cannot be reduced for estate tax purposes.

The value of "development rights" retained in the conveyance of a qualified conservation easement is *not* eligible for the estate tax exclusion. "Development right" means any right to use the land subject to the qualified conservation easement in which the right is retained for any commercial purpose which is not subordinate to, and directly supportive of, the use of the land as a farm for farming purposes. However, retained development rights will *not* be subject to estate tax if every person in being who has an interest in the land executes an agreement (to be filed with the estate tax return and in such form as prescribed by the Service) to extinguish those rights on or before the date for filing the estate tax return.

B. Considerations

Any failure to implement the aforementioned agreement to extinguish retained development rights by the earlier of (1) 2 years after the date of the decedent's death or (2) the date of the sale of the land subject to the qualified conservation easement, will result in the imposition of tax (due and payable on the last day of the sixth month following the date described in (1) or (2) above) in the amount which would have been due on the retained development rights subject to the agreement. Therefore, consider the benefit of deferring estate tax on retained development rights.

The cost basis of the excluded land under IRC § 2031(c) is the same as the basis in the hands of the decedent. Therefore, a downside to making the election is that the cost basis of the excluded land, for purpose of determining capital gain or loss on subsequent sale, is not stepped-up to the date of death value (as would happen by not making the election). Therefore, the decision to make the election is generally a straightforward one, assuming that the estate tax bracket is greater than the prevailing long-term capital gain rate (currently 20%). However, beware of a potential conflict that arises when there is a legatee of the land who is not also a residuary beneficiary, and therefore one beneficiary will benefit from the election (or failure to elect) under § 2031(c) at the expense of the other beneficiary.

Before making the decision to elect to exclude land under IRC § 2031(c), an executor must consider the ramifications that so electing has on his/her ability to make certain other elections that may be more advantageous to the estate; for example, the ability to satisfy the 35% threshold requirement of IRC § 303 (pertaining to capital gain treatment on stock redemptions), the 35% threshold requirement of IRC § 6166 (pertaining to paying federal estate tax attributable to closely held business interests in installments) and the 25% and 50% threshold requirements of IRC § 2032A (pertaining to special use valuation of real property used for farming or for a closely held business).

C. Miscellaneous

The IRC § 2031(c) election is irrevocable and must be made by the due date (including extensions) for the filing of the 706. The election is made by entering the exclusion on page 3, line 11 of the Recapitulation page of Form 706 and by filing a completed Schedule U of Form 706.

15. Executor's Waiver of Commissions

A. Overview

As is the case with other estate administration expenses, an executor's commission is deductible for estate tax purposes on Form 706 (under IRC § 2053) *or* deductible for fiduciary income tax purposes on Form 1041 (under IRC § 162 or IRC § 212). The downside is that the executor must reflect the commission in his/her personal income tax return as ordinary income (under IRC § 61). Therefore, *if* the executor is also the residuary beneficiary of the estate (or close relative of the residuary beneficiary), he/she must weigh the benefits/detriments of accepting a commission versus waiving a commission.

B. Considerations

Generally, the decision to accept or waive an executor's commission is reached by comparing the estate's estate tax/income tax bracket (i.e., deductibility) with the executor's income tax bracket (i.e., includability).

If the executor is a close relative of the residuary beneficiary, by waiving his/her commission the executor can effectively pass the amount of the commission to the beneficiary without being deemed to have made a taxable gift.

If the executor is a "skip person" for generation-skipping tax purposes, the commissions paid to that person will pass free from generation-skipping tax. In that situation, it could be advantageous *not* to waive commissions.

C. Miscellaneous

To insure that there are no income tax or gift tax ramifications to an executor when waiving a commission, the executor must formally or impliedly waive within the guidelines set forth in Rev. Rul. 66-167: "The crucial test of whether the executor of an estate may waive his right to receive statutory commissions without thereby incurring any income or gift tax liability is whether the waiver involved will at least primarily constitute evidence of an intent to render a gratuitous service." In essence, a waiver of commission should be finalized early and in a clear manner.

The issue arises as to whether or not an executor's commission should be included in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954. Rev. Rul. 58-5 indicates that generally, non-professional fiduciaries will not be required to include their commissions unless certain conditions are met.

16. Estate Administration Expenses

A. Overview

Estate administration expenses are deductible for estate tax purposes on Form 706 (under IRC § 2053), *as are* theft and casualty losses (under IRC § 2054). In addition, estate administration expenses and theft and casualty losses are deductible for fiduciary income tax purposes on Form 1041 (under IRC §§ 165, 212 and 641). However, an executor must choose between deducting estate administration expenses/theft and casualty losses (hereafter "administration expenses") on either the estate's 706 *or* the estate's 1041; under IRC § 642(g), they cannot be deducted on both sets of returns. The executor must therefore weigh the benefits/detriments of deducting administration expenses on the estate's 706 versus the estate's 1041.

B. Considerations

Generally, the decision as to where to deduct administration expenses is reached by comparing the estate's estate tax bracket with the estate's income tax bracket (or the beneficiaries' income tax bracket if distributions will be made to them, thereby "passing out" distributable net income).

An income tax deduction is usually less valuable than an estate tax deduction, due to the reduction and compression of income tax rates. Beware of a potential conflict that arises when the income beneficiaries are not also the principal beneficiaries, and therefore one set of beneficiaries will benefit from the choice made under IRC § 642(g) at the expense of the other set of beneficiaries.

In the optimum marital formula situation, the initial tendency is to choose to deduct the administration expenses on the estate's income tax return since the estate tax is eliminated and a deduction on the estate tax return would appear to be wasteful. However, deducting administration expenses on the estate's income tax return in this situation will result in an increased marital share and a reduced non-marital share. Consequently, the optimum marital formula situation requires an analysis that compares (1) the time value of money based upon the surviving spouse's anticipated life expectancy (i.e., deducting administration expenses on the estate's income tax return reduces income taxes due or increases an income tax refund due) with (2) the anticipated increase in estate tax that will ultimately be due upon the surviving spouse's death. Furthermore, beware of a potential conflict that arises when the marital share beneficiaries are not also the non-marital share beneficiaries, and therefore one set of beneficiaries, will benefit from the choice made under

IRC § 642(g) at the expense of the other set of beneficiaries.

In the optimum marital formula situation, an executor must also keep in mind that if the non-marital share is wiped out because the credit shelter amount was used up by non-spousal bequests or by adjusted taxable gifts, deducting administration expenses on the estate's income tax return will result in an estate tax now being payable.

Note—certain administration expenses charged to *income*, where the executor is given authority to do so by the Will or local law may be used as income tax deductions without reducing the non-marital share.[2] Under final regulations issued by the Service, reliance on "Hubert" has been curtailed by the categorization of administration expenses as either "estate management expenses" or "estate transmission expenses."

If administration expenses are to be deducted on the estate's 1041, keep in mind that *only* in the estate's final income tax year can excess deductions be "passed out" to the beneficiaries. Therefore, excess deductions in tax years other than the estate's final tax year are wasted.

Under Reg. § 1.642(g)-2, an executor may choose on an item by item basis whether to use a deduction for estate or income tax purposes. Moreover, a single item may be divided between the two returns.

C. Miscellaneous

If an executor chooses to deduct administration expenses on the estate's 1041, he/she must file in duplicate (before the expiration of the statute of limitations applicable to the return on which the deduction is claimed), a statement to the effect that the administration expenses involved have not been allowed as a deduction on the estate tax return *and* an irrevocable waiver of the right to have such expenses allowed at any time as an estate tax deduction.

If expenses are to be deducted for income tax purposes and if part of the estate's income is tax-exempt, Rev. Rul 59-32 provides that the pro-rata portion of administration expenses allocable to the tax-exempt income, which is not deductible for income tax purposes, may be deducted by the executor on the estate tax return.

Estates, Powers and Trusts Law Section 11-1.2 provides for an equitable adjustment between principal and income, in situations where an executor deducts administration expenses on the estate's income tax return that result in reduced income taxes and increased estate taxes (unless the decedent's Will states otherwise).

17. Qualified Terminable Interest Property (QTIP)

A. Overview

For estates of decedents dying after December 31, 1981, IRC § 2056(b)(7) allows an executor to elect an estate tax marital deduction for "qualified terminable interest property" (QTIP). "Qualified terminable interest property" is property passing from the decedent to his/her spouse who is entitled to *all* income from the property for life, payable at least annually; no person, including the spouse, is permitted to appoint any part of the property to anyone other than the spouse during the spouse's life.

Under IRC § 2044, qualified terminable interest property (for which an election has been made under § 2056(b)(7)), is includible in the surviving spouse's estate for estate tax purposes at his/her subsequent death.

A QTIP election can be made with respect to just a portion of the qualified terminable interest property, as long as the election is for a fractional or percentage share of the property and such portion shares in any increase or decrease in the value of the property. The executor must therefore weigh the benefits/detriments of making a full or partial QTIP election.

B. Considerations

An executor should make sure that the QTIP election is *not* made to the extent that property can be effectively exempted from federal estate tax by the unified credit (the "applicable exclusion amount"). To do otherwise would waste the decedent's unified credit and needlessly subject that property to estate tax in the surviving spouse's estate.

While the initial tendency is to fully elect QTIP treatment for taxable property exceeding the applicable exclusion amount, an executor must consider whether or not it would be financially advantageous to the estate's beneficiaries were the decedent's estate to incur at least some estate tax up front (i.e., by not fully electing QTIP treatment). Consequently, the situation requires an analysis that compares (1) the time value of money (by not incurring tax up front) with (2) the surviving spouse's expected estate tax rate and the anticipated increase in estate tax due upon the surviving spouse's death (by not incurring tax up front).

With respect to the time value of money, the key consideration is the surviving spouse's anticipated life expectancy. The time value of money by not incurring tax up front becomes less advantageous if the surviving spouse has a short life expectancy. Furthermore, if the surviving spouse is not expected to outlive the decedent by at least 10 years, an addition-

al reason to consider incurring estate tax up front is that the actuarial value of the surviving spouse's life interest in the trust will qualify for the credit for transfers previously taxed under IRC § 2013 (even though it is not includible in the surviving spouse's gross estate).

With respect to the anticipated increase in estate tax by not incurring tax up front, the key consideration is that the trust assets are likely to be taxed in the surviving spouse's estate at a higher marginal rate of tax than the rate that would have applied in the decedent's estate. However, the lower the surviving spouse's estate tax rate is expected to be, the less of a problem this becomes.

The decision to make a full or partial QTIP election impacts an executor's ability to make other elections as well. For estates holding closely held business interests for which the tax deferral election under IRC § 6166 would be available, the executor should consider incurring estate tax up front so as to take full advantage of § 6166 provisions. Furthermore, the alternate valuation election under IRC § 2032 is not available if there is no estate tax payable in the decedent's estate because of a full QTIP election.

Consider the surviving spouse's need for income; by not incurring estate taxes up front, there will be more assets on hand to generate income. However, beware of a potential conflict that arises where the surviving spouse is not a close relative to the ultimate remaindermen of the QTIP trust; the surviving spouse would be benefited by a full QTIP election (i.e., by increasing the potential income yield) while the remaindermen would be benefited by a partial election (i.e., by reducing the *total* estate taxes due).

Regardless of what conclusion is reached with respect to making a full or partial QTIP election, an executor should leave planning options open by routinely obtaining a 6-month filing extension under IRC § 6081 (i.e., in case of death or declining health of the surviving spouse during that 6-month period).

C. Miscellaneous

The QTIP election is made on the decedent's federal estate tax return by listing the qualified terminable interest property on Schedule M as a deduction and calculating the tax with the deduction. Under Reg. § 20.2056(b)-7(b)(4), the election is made on the last estate tax return filed on or before the due date of the return (including extensions) or, if a timely return is not filed, the first estate tax return filed after the due date. The election is irrevocable, except that it may be revoked or modified on a subsequent return filed on or before the due date of the return (including extensions actually granted). However, if an election is made with respect to one or more properties, no subsequent election may be made with respect to other properties included in the gross estate after the return is filed.

If at the time of filing there is uncertainty whether property is includible in the decedent's gross estate and/or is eligible for the election, an executor can make an irrevocable protective election by identifying the specific asset and the specific basis for the protective election.

If the surviving spouse is the only non-charitable beneficiary of a qualified charitable remainder annuity trust or unitrust, the surviving spouse's lead interest qualifies for a marital deduction under IRC § 2056 (b)(8); no QTIP election is involved and there will be no § 2044 inclusion at the surviving spouse's death.

Joint and survivor annuities that are included in the decedent's gross estate are treated as QTIP unless the executor elects not to have them treated in this fashion (by checking the appropriate box on Schedule M of the 706).

Estates, Powers and Trusts Law Section 7-1.13(a)(1)(A) permits a trustee to establish separate trusts in order to segregate a trust for which a QTIP election has been made from a trust for which no QTIP election has been made (unless the governing instrument states otherwise).

Generally, no marital deduction is allowed if the surviving spouse is not a U.S. citizen. However, there are two exceptions under IRC § 2056(d)(4) and (d)(2), respectively: (1) when the surviving spouse becomes a citizen before the due date of the federal estate tax return (including extensions) *and* the spouse was a U.S. resident at all times after the decedent's death and before becoming a citizen; (2) when the property passes to the surviving spouse in a "qualified domestic trust" (QDOT). The requirements for a QDOT are contained in IRC § 2056A; these requirements are *in addition to* the normal marital trust requirements of IRC § 2056(b)(5), (b)(7), and (b)(8).

18. Generation-Skipping Transfer Tax—Reverse QTIP Election

A. Overview

A QTIP trust that is includible in the surviving spouse's estate is treated as the surviving spouse's property for generation-skipping transfer tax purposes (i.e., the surviving spouse is the "transferor"). Therefore, use of the optimum marital formula results in the potential waste of a portion of the decedent's GST exemption amount (i.e., to the extent that the decedent's available GST exemption amount

exceeds the value of his/her property that will be effectively exempted by the unified credit).

A solution to the problem is for the executor to make a "reverse QTIP election" under IRC § 2652(a)(3). The effect of this election is to treat the decedent as the transferor of the QTIP trust, rather than the surviving spouse. However, no partial reverse QTIP elections are allowed.

B. Considerations

When a trust may be severed in accordance with the requirements of Reg. § 26.2654-1(b), an executor should fund a separate QTIP trust in the exact amount needed to use up any remaining balance of the decedent's GST exemption.

If the trust is not severed, the executor is forced to choose between: (1) making a reverse QTIP election as to an amount larger than required; when the surviving spouse dies, his/her executor will not then be able to apply his/her available GST exemption to the QTIP trust (since he/she will not be the transferor) or (2) not making the reverse QTIP election at all and thereby wasting some of the decedent's GST exemption amount.

If the trust is not severed, another concern in making a reverse QTIP election as to an amount larger than required is that the predeceased parent exception of IRC § 2612(c)(2) will *not* be available if a child dies in between the dates of death of his/her parents (since the second parent (i.e., the surviving spouse) is not the transferor). *Note*—under IRC § 2651(e)(2), for GST transfers made after December 31, 1997 the predeceased parent exception is extended to collateral heirs (i.e., grandnieces and grandnephews) *if* the decedent has no living lineal descendants at the time of the transfer.

C. Miscellaneous

The reverse QTIP election is irrevocable and must be made in the return on which the QTIP election is made. The April, 1997 revision of Form 706 no longer requires the executor to check a box on Schedule R to make the election; simply describe the trust in Part 1, line 9 of that schedule.

If a protective QTIP election is made, no election under IRC § 2652(a)(3) can be made unless a protective reverse QTIP election is also made.

Estates, Powers and Trusts Law Section 7-1.13(a)(1)(D) permits a trustee to establish separate trusts, in order to segregate a trust for which a reverse QTIP election has been made from a trust for which no reverse QTIP election has been made (unless the governing instrument states otherwise).

19. Disclaimer by Executor

A. Overview

Under IRC § 2518, a beneficiary may, by a "qualified disclaimer," irrevocably refuse to accept an interest in property that has been bequeathed or devised to that beneficiary (hereafter "the disclaimant") under a decedent's Will. By making a "qualified disclaimer," the disclaimed interest in property will *not* pass to the disclaimant, but rather will pass to a beneficiary next entitled to such interest; the disclaimant will *not* be deemed to have made a taxable gift of the disclaimed interest to the next beneficiary. A "qualified disclaimer" of an undivided portion of an interest in property is permitted, even if the disclaimant has another interest in the same property.

"Qualified disclaimers" must satisfy the following five conditions contained in Reg. § 25.2518-2: (1) the disclaimer must be irrevocable and unqualified; (2) the disclaimer must be in writing; (3) the writing must be delivered to the transferor of the interest (or his/her legal representative) within nine months of the later of the day on which the transfer creating the interest is made (i.e., the date of the decedent's death) or the day on which the disclaimant reaches age 21; (4) the disclaimant must *not* have accepted the interest disclaimed or any of its benefits; and (5) the interest disclaimed must pass either to the spouse of the decedent or to a person other than the disclaimant, without any direction on the part of the disclaimant.

Under Letter Ruling 8015014, the Service permits *the executor* of a deceased beneficiary to make a qualified disclaimer of his/her bequest or devise on his/her behalf where local law permits.

B. Considerations

Where an executor represents the estate of a beneficiary (hereafter "the second decedent") who was bequeathed or devised an interest in property under the Will of a previously deceased individual (hereafter "the first decedent"), the executor should consider making a qualified disclaimer on behalf of the second decedent if the beneficiary(ies) next entitled to such interest upon disclaimer are the same as (or close relatives of) those who would ultimately benefit were a disclaimer *not* made.

As a result of making a qualified disclaimer in an interest in property under this scenario, the value of that interest will *not* be included in the estate of the second decedent for estate tax purposes. In addition to benefiting from any estate tax savings, the ultimate beneficiary(ies) will benefit inasmuch as the executor's commission in the estate of the second

decedent could be reduced (i.e., in jurisdictions where the disclaimed interest would have been subject to an executor's commission). A further benefit could result from a reduction (or perhaps even elimination) of probate costs and other related expenses (i.e., in jurisdictions where the disclaimed interest would have been subject to such costs/expenses).

Let us take this scenario one step further. Where the second decedent was the surviving spouse of the first decedent, the executor should make an analysis that is similar to that previously discussed with respect to partial QTIP elections. For example, an executor should be sure that a disclaimer on behalf of the surviving spouse is made to the extent that property can be effectively exempted from federal estate tax in the estate of the first decedent by the unified credit (the "applicable exclusion amount"). To do otherwise would waste the first decedent's unified credit and needlessly subject that property to estate tax in the surviving spouse's estate. Moreover, the executor should strongly consider disclaiming an amount that exceeds the applicable exclusion amount in the first decedent's estate; it would be financially advantageous to the ultimate beneficiary(ies) for the two estates to be "equalized" for estate tax purposes.

C. Miscellaneous

Estates, Powers and Trusts Law Section 2-1.11(c) permits an executor to make a renunciation on behalf of a decedent *upon application* to the court having jurisdiction of the decedent's estate. Section 2-1.11(d) states that "unless the creator of the disposition has otherwise provided, the filing of a renunciation, as provided in this section, has the same effect with respect to the renounced interest as though the renouncing person had predeceased the creator . . ."

20. Extending Time to Pay Estate Tax, Generally

A. Overview

Under IRC § 6161(a)(1), an executor may request the Service for an extension of time to pay estate tax for up to 12 months. The extension is only granted if the executor demonstrates "reasonable cause"; examples of "reasonable cause" are enumerated in Reg. § 20.6161-1(a)(1). *Note*—IRC § 6081 permits granting of an extension to file Form 706 of only 6 months.

Under IRC § 6161(a)(2), an executor may request the Service for an extension of time to pay estate tax for up to 10 years. Once again, the extension is only granted if the executor demonstrates "reasonable cause."

B. Considerations

Notwithstanding that an executor is granted an extension to pay estate tax under IRC § 6161(a)(1) or (2), interest must be paid to the Service calculated for the period from the initial due date of the tax through the date actually paid. Under IRC § 6621(a)(2), such interest is the federal short-term rate (determined quarterly) plus 3 percentage points. Interest on an underpayment of estate tax is deductible for estate tax purposes under IRC § 2053. Rev. Rul. 81-154. When an extension that has been granted is no longer needed, the executor should compare the cost of letting the extension period run itself out (i.e., interest charged less the estate tax savings by deducting the interest) with the benefit of letting the extension period run itself out (i.e., interest earned on the cash held in the estate less the income tax due on that interest).

Under IRC § 6165, the Service may require the executor to furnish a bond if an extension to pay estate tax is granted (not exceeding double the amount of tax for which an extension is granted).

C. Miscellaneous

The application to request an extension to pay estate tax under IRC § 6161 is made by filing Form 4768 (Application for Extension of Time to File a Return and/or Pay Estate and Generation-Skipping Transfer Taxes) with the District Director on or before the initial due date of the tax.

Under IRC § 2661(2), the extension of time to pay estate tax is also applicable to Generation-Skipping Transfer Tax occurring as a result of the decedent's death.

21. Extending Time To Pay Estate Tax on Reversionary or Remainder Interests

A. Overview

Under IRC § 6163(a), an executor may elect to extend the time to pay estate tax attributable to a reversionary or remainder interest until 6 months after the preceding property interest terminates.

Under IRC § 6163(b), an executor may request the Service for an *additional* extension of time to pay the estate tax attributable to a reversionary or remainder interest for up to 3 years if the executor demonstrates "reasonable cause."

B. Considerations

Notwithstanding that an executor is granted an extension to pay estate tax under IRC § 6163(b), interest must be paid to the Service calculated for the

period from the initial due date of the tax through the date actually paid. Under IRC § 6621(a)(2), such interest is the Federal short-term rate (determined quarterly) plus 3 percentage points. Interest on an underpayment of estate tax is deductible for estate tax purposes under IRC § 2053. Rev. Rul. 81-154. When an extension that has been granted is no longer needed, the executor should compare the cost of letting the extension period run itself out (i.e., interest charged less the estate tax savings by deducting the interest) with the benefit of letting the extension period run itself out (i.e., interest earned on the cash held in the estate less the income tax due on that interest).

Under IRC § 6165, the Service may require the executor to furnish a bond if an extension to pay estate tax is granted (not exceeding double the amount of tax for which an extension is granted).

C. Miscellaneous

The election to extend the time to pay estate tax under IRC § 6163(a) is made by checking "Yes" to the box on line 4, page 2 of Form 706 under "Elections by the Executor." In addition, Reg. § 20.6163-1(b) requires the executor to file notice of his/her exercise of this election with the district director (which may be in letter form) before the date prescribed for payment of the tax (along with a certified copy of the instrument under which the reversionary or remainder interest was created, or a copy verified by the executor if the instrument is not filed of record).

22. Election to Postpone Payment of Estate Tax on Certain Interests in Closely Held Businesses

A. Overview

Under IRC § 6166, an executor may elect to pay the estate tax that is attributable to the value of a closely held business interest in up to 10 equal annual installments. The first installment may be paid at any date, but *not* later than 5 years after the date the estate tax was due, and in subsequent years each additional installment must be made on or before the anniversary of that first installment date. Once elected, the executor may accelerate payments without a prepayment penalty; on the other hand, if the election is made for a period less than the maximum, a longer period cannot subsequently be elected.

The value of an "interest in a closely held business" (excluding the portion of such interest which is attributable to passive assets," as defined by § 6166(b)(9)(B), held by the business) that is included in the decedent's gross estate must be more than 35% of the "adjusted gross estate."

For purposes of IRC § 6166, "adjusted gross estate" equals the gross estate reduced by amounts deductible under IRC § 2053 and § 2054 (i.e., funeral and administration expenses, debts, and casualty and theft losses). Deductions used on the fiduciary income tax return may be taken into account when calculating the adjusted gross estate. The deductions allowable under § 2053 and § 2054 are determined as of the earlier of the due date for filing the return (including extensions) or the date on which the return is actually filed.

For purposes of satisfying the 35% threshold, the value of two or more closely held businesses may be combined if more than 20% of the value of each is included in the gross estate. For purposes of meeting the 20% threshold, the value of a surviving spouse's interest will be treated as included in the decedent's gross estate if the interest was held as community property, joint tenants, tenants by the entirety or tenants-in-common. Furthermore, the 35% threshold must be satisfied both with and without including in the adjusted gross estate, gifts made by the decedent within 3 years of death.

An "interest in a closely held business" (as determined as of the time immediately before the decedent's death) is (1) an interest in a proprietorship, (2) an interest in a partnership if 20% or more of the capital interest in the partnership is included in the gross estate or if there are 15 or fewer partners, or (3) stock in a corporation if 20% or more in value of the voting stock is included in the gross estate, or if the corporation has 15 or fewer shareholders.

The right to continue deferring payments of tax may be lost under situations described in IRC § 6166(g): (1) disposition of the business interest or withdrawal from the business of 50% or more of estate tax value of the business interest; (2) failure to apply undistributed income (as defined in § 6166(g)(2)(B)), for any year ending on or after the date of the first installment, in liquidation of the unpaid portion of tax; (3) default by the estate in paying principal or interest.

B. Considerations

Notwithstanding that an executor elects to postpone paying estate tax under IRC § 6166, interest must be paid to the Service. Under IRC § 6166(f), interest for the period preceding the first installment is payable annually, while interest payable after that period is payable at the same time, and as a part of, each annual installment payment.

For decedents dying *before* January 1, 1998, an interest rate of 4% applies to the lesser of (1) the

amount of the tax deferred, or (2) $345,800 (i.e., estate tax attributable to $1 million of closely held business interests) *reduced* by the unified credit. The regular rate of interest for underpayments of estate tax under IRC § 6621 applies to the balance of tax which exceeds the 4% limitation. Interest is deductible as an administration expense, on an *as paid* (i.e., not estimated) basis, thereby necessitating annual interrelated recalculations of the estate tax liability and subsequent installment payments; a supplemental Form 706 is required.

For decedents dying *after* December 31, 1997, an interest rate of 2% applies to the lesser of (1) the amount of the tax deferred, or (2) the estate tax attributable to the first $1 million (indexed for inflation for estates of decedents dying in a calendar year after 1998) of closely held business interests *in excess of* the unified credit and any other exclusions. 45% of the regular rate of interest for underpayments of estate tax under IRC § 6621 applies to the balance of tax which exceeds the 2% limitation. Interest is not deductible as an administration expense (nor as an income tax deduction). *Note*: the deferred tax on "holding companies" and "non-readily tradable business interests" is not eligible for the 2% interest rate (under IRC § 6166(b)(7)(A)(iii) and (8)(A)(iii)).

Under IRC § 6166(k)(1) and § 6165, the Service may require the executor to furnish a bond if an election is made to postpone payment of tax under § 6166 (not exceeding double the amount of tax for which a postponement is elected).

C. Miscellaneous

The election under IRC § 6166 must be made on a timely filed estate tax return by checking "Yes" to line 3 of Part 3 of Form 706, and attaching to the return a notice of the election. Under Reg. § 20.6166-1(b), the notice must contain the following information: the decedent's name and taxpayer identification number, the amount of tax to be paid in installments, the date selected for paying the first installment, the number of installments in which the tax is to be paid, the properties included in the gross estate that constitute the closely held business (identified by schedule and item number) and the facts upon which the executor has concluded that the estate qualifies for deferral under § 6166.

If there is a direct skip of an interest in a closely held business, occurring as a result of the decedent's death, generation-skipping transfer tax on that direct skip may be postponed under § 6166 as well.

An executor may make a protective election under § 6166 by filing a notice of protective election with a timely filed estate tax return. The protective election will only apply to the portion of the tax remaining unpaid at the time values are finally determined and to any deficiencies attributable to the closely held business interest.

IRC § 7479 (as added by Section 505(a) of the Taxpayer Relief Act of 1997) provides that for estates of decedents dying after August 5, 1997, an executor may file a pleading with the Tax Court to request a declaratory judgment where there is an "actual controversy" with respect to an IRS determination (or IRS failure to make a determination) of an estate's initial or continuing eligibility for a postponement under § 6166.

23. Extensions of Time to Make Elections

A. Overview

The regulations under IRC § 301.9100-1 through 301.900-3, effective December 31, 1997, contain the standards that the Service will apply in determining whether to grant an extension of time to make various elections under the Internal Revenue Code.

There is an automatic extension of 12 months from the due date for making certain regulatory elections, including (1) the election to adjust basis on partnership transfers and distributions under IRC § 754 and (2) the election to specially value qualified real property (where the Service has not yet begun an examination of the return) under IRC § 2032A(d)(1). This extension is available regardless of whether the taxpayer timely filed its return for the year the election should have been made. However, the taxpayer must take "corrective action" within the 12-month extension period.

There is an automatic extension of 6 months from the due date of a return, *excluding* extensions, for making regulatory or statutory elections whose due dates are the due date of the return (*including* extensions). This extension is available provided the taxpayer timely filed its return for the year the election should have been made. However, the taxpayer must take "corrective action" within the 6-month extension period. This extension does not apply to regulatory or statutory elections that must be made by the due date of the return, excluding extensions. Alternate valuation, QTIP and reverse QTIP elections are three examples of elections that qualify for the 6-month automatic extension.

"Corrective action" means taking the steps required to file the election in accordance with the statute or the regulation published in the Federal Register, or the revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Requests for non-automatic extensions of time for regulatory elections will be granted when the tax-

payer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer "acted reasonably and in good faith," and that the grant of an extension will not "prejudice the interests of the government."

A taxpayer is deemed to have "acted reasonably and in good faith" if the taxpayer (1) requests an extension before the failure to make the election is discovered by the Service, (2) failed to make the election because, after exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity of the election, (3) reasonably relied on the written advice of the Service *or* (4) reasonably relied on a qualified tax professional and the tax professional failed to make, or advise the taxpayer to make, the election.

A taxpayer is deemed to *not* have "acted reasonably and in good faith" if the taxpayer (1) seeks to alter a return position for which an accuracy-related penalty has been or could be imposed under Section 6662 at the time the taxpayer requests an extension and the new position requires or permits a regulatory election for which an extension is requested, (2) was informed of the required election and related tax consequences, but chose not to file the election, *or* (3) uses hindsight in requesting an extension (i.e., if specific facts have changed since the due date for making the election that make the election advantageous to the taxpayer).

An extension is deemed to "prejudice the interests of the government" if (1) granting an extension would result in a taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money) *or* (2) the taxable year in which the election should have been made or any taxable years that would have been affected by the election had it been timely made are closed by the statute of limitations before the taxpayer's receipt of a ruling granting an extension; however, the Service may nonetheless grant an extension upon receiving from the taxpayer a statement from an independent auditor certifying that the interests of the government are not prejudiced under (1) above.

B. Miscellaneous

Any return, statement of election, or other form of filing that must be made to obtain an automatic extension must provide the following statement at the top: "Filed Pursuant to Section 301.9100-2." The filing must be sent to the same address that the filing to make the election would have been sent had the filing been timely made.

With respect to requesting non-automatic extensions, the taxpayer must (1) submit detailed affidavit(s) describing the events that led to the failure to meet a valid regulatory election and to the discovery of the failure, accompanied by dated declaration(s), (2) state whether the return(s) for the taxable year in which the election should have been made or for any taxable years that would have been affected by the election had it been timely made is being examined by a district court or is being considered by an appeals office or a federal court, (3) state when the applicable return, form or statement used to make the election was required to be filed and when it was actually filed, and (4) submit a copy of any documents that refer to the election. Requests for extensions should be submitted in accordance with the procedures required for requesting a letter ruling and must be accompanied by a user fee.

24. Selection of a Final Tax Year

A. Overview

It is usually advantageous to keep the estate as a separate taxpaying entity for income tax purposes. However, under Reg. § 1.641(b)-3(a), if the administration of the estate is deemed to have been "unreasonably prolonged," the Service will consider the estate as terminated for income tax purposes after the expiration of a reasonable period for the performance by the executor of all the duties of administration. An estate will be considered as terminated when all the assets have been distributed except for a reasonable amount which is set aside in good faith for the payment of unascertained or contingent liabilities and expenses (not including a claim by a beneficiary in the capacity of beneficiary).

If the estate's administration is deemed to have been terminated for income tax purposes under Reg. § 1.641(b)-3(a), the gross income, deductions and credits of the estate are thereafter considered the gross income, deductions and credits of the estate beneficiary(ies).

B. Considerations

Under IRC § 642(h), excess estate income tax deductions are deductible by the "beneficiaries succeeding to the property of the estate" (i.e., the residuary beneficiaries) in the year of termination (subject to the 2% floor in IRC § 67 for individuals and grantor trusts). Excess deductions in any other year are lost completely; they cannot be distributed out to beneficiaries and they cannot be carried forward by the estate. Therefore, if there are estate settlement expenses to be charged in a taxable year (i.e., executor commissions and legal fees) which are intended to be used as income tax deductions (but which exceed the estate's income for that taxable year), the

executor must make sure that the estate is treated as terminated for that taxable year. The pass through of excess deductions does not include the portion of disallowed deductions allocated to tax-exempt income; an executor should therefore consider distributing tax-exempt securities in a taxable year *prior* to the year of termination.

IRC § 642(h) also permits a pass through of a net operating loss carryforward (under § 172) or a capital loss carryforward (under § 1212) if, on the final termination of an estate, such loss carryover would have been allowable to the estate in a taxable year subsequent to the taxable year of termination were it not for the termination.

In selecting a final income tax year for an estate that was on a fiscal year, an executor should consider that a residuary beneficiary will be required to report on his/her personal tax returns the income passed through to him/her for the full fiscal year that immediately preceded the final year *in addition to* the income passed through to him/her for the final year itself (assuming that the final year has a closing date that falls within the same calendar year of the beneficiary as does the closing date of the fiscal year that immediately preceded the final year). An executor should also consider that capital gains realized in an estate during its final tax year are passed through to a residuary beneficiary as well.

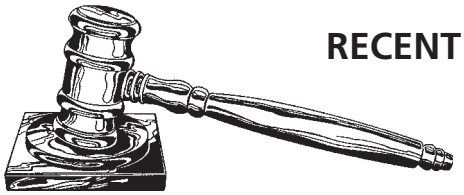
C. Miscellaneous

Under IRC § 643(g), an executor can elect, on or before the 65th day after the close of the estate's final tax year (by filing Form 1041T), to treat any portion of a payment of estimated income tax made by the estate for the estate's *final tax year* as if it was instead a payment made by the residuary beneficiary(ies). The amount so elected will be treated as paid or credited to the beneficiary(ies) on the last day of such taxable year and the amount will be treated as a payment of estimated tax made by the beneficiary(ies) on January 15 following such taxable year.

Endnotes

1. *Mapes Est. v. Comr.*, 99-TC-511.
2. *Estate of Hubert v. Comm'r*, 65 U.S.L.W. 4183, 117 S. Ct. 1124 (March 18, 1997).

Larry Edelman is a Senior Vice President of U.S. Trust Company of New York and has been a member of its Estate Administration & Trust Settlement Departments for the past 10 years.



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

Arlene Harris and Donald S. Klein

ATTORNEYS' FEES

In a proceeding to fix attorneys' fees, pursuant to SCPA 2110, the objectant, a son of the decedent and co-executor and beneficiary of trusts under this will, objected to the payment of legal fees based on the alleged breach of the disciplinary rules relating to conflicts of interest. The son, as co-executor, had brought a discovery proceeding against certain partnerships for the turnover of the estate's share of the partnership assets. The law firm appeared in the discovery proceeding on behalf of the trustee under the will and the partnerships, claiming that the partnerships survived the death of the decedent and the partnership interests should be distributed to the trusts under the will. The objectant claimed that the interest of the trustee in the discovery proceeding was adverse to that of the partnerships and that the representation of both violated the disciplinary rules prohibiting multiple representation of divergent interests (DR 5-105). The Court stated that the representation of clients with conflicting interests is considered a breach of the fiduciary duty of loyalty, but that the representation of multiple interests is not per se barred. The Court stated further that where adverse interests are not involved, counsel is free to represent multiple clients. The Court noted that the benefits of having the right to choose an attorney are especially important considerations in the trusts and estates field, where clients may be better served by retaining counsel to represent the family as a unit, including possible family controlled entities, in the context of estate planning, administration and even litigation, citing Ross, *The ACTEC Commentaries on the Model Rules of Professional Conduct—Guidance on Ethical Issues for the Estates and Trusts Lawyer*, ALI – ABA (May 3, 1999). The Court found that the son had no standing to raise the issue as the attorneys never represented him and thus could not have breached any fiduciary duty to him. The Court then found that even if the son had standing to raise the issue, he failed to establish the existence of a conflict of interest. The Court explained that there are two types of conflict of interest: actual and potential. Where there is an actual conflict between the positions of the parties, dual representation is prohibited, even if the parties consent and no confidential exchanges are alleged. The Court found no actual conflict, as the positions of the trustee and the partnerships in the discovery proceeding were aligned. Nor did the Court find any potential conflict of interest, in which case dual representation is ordinarily allowed, at least until the conflict becomes an actual one, provided there is full disclosure. Finally, the Court found no appearance of impropriety in the representation. The Court fixed the fees based upon the usual factors (time spent, difficulties involved, nature of the services, amount involved, professional standing of counsel, and the results obtained) and allocated the fees one-half to the trust and one-half to the partnerships. *In re Kenneth Brandman*, N.Y.L.J. November 15, 1999, p. 29, col. 3 (Kings Co. Surr. Feinberg).

ATTORNEY-IN-FACT—ACCOUNTING

The preliminary executrix sought an accounting by the decedent's attorney-in-fact under a power of attorney received from the decedent. The respondent raised the attorney-client privilege (CPLR 4503) to the application for an accounting. The Court found that it is clear that the respondent is using an attorney-client privilege as a shield. The Court held that the petitioner is neither asking for disclosure of legal advice given to the decedent by the respondent, nor is she seeking a disclosure of any legal services rendered by the attorney-in-fact who is also an attorney. The Court stated that the respondent cannot simply claim that everything he did for the decedent was in his capacity as attorney-at-law. Moreover, the Court stated that there may be public policy considerations that should prevent an attorney-in-fact from avoiding his obligation to account as such on a bold unsubstantiated claim of attorney-client privilege. *In re Melinda Roccesano*, N.Y.L.J. November 10, 1999, p. 31, col. 3 (Nassau Co. Surr. Radigan).

COMMON LAW MARRIAGE

To establish a common law marriage, the petitioner relied primarily on a four-day visit in 1982 to Atlanta. The Court noted that although common law marriages were abolished in New York on April 29, 1933, New York recognizes the validity of a common law marriage in a sister state if it is valid when con-

tracted. Georgia recognizes common law marriages contracted before January 1, 1997. The law to be applied in determining the validity of the marriage is the law of the state in which it occurred. The Georgia statute required (1) that the parties must be able to contract; (2) an actual contract; and (3) consummation according to law, with the burden on the petitioner. The Court found contradictory evidence as to the holding out as husband and wife on the general representation of marriage, and held that petitioner failed to establish her status as surviving spouse based on a common law marriage. *In re Anthony Libertini*, N.Y.L.J. November 2, 1999, p. 34, col. 6 (Nassau Co. Surr. Radigan).

CONSTRUCTION

The Executor sought a construction of a bequest to two individuals (Dorothy and William) to determine whether they are each entitled to a share of the residuary or whether they are to divide or share between them. The Will gave the bequest to "Rose, Dinah, Dorothy and William, and Gordon, Joy and Mercy Hospital, equally, to the survivor or survivors thereof." The Court found the Will to be ambiguous because it is capable of being understood in more than one sense. Also, the Court found the ambiguity to clearly be a patent, not a latent, one. Accordingly, statements as to the decedent's intent by a beneficiary and by the attorney-draftsman must be excluded because they are direct statements of intent which are inadmissible to explain a patent ambiguity. The Court found the use of punctuation not helpful because the word "and" was used not only between the names of Dorothy and William and before the bequest to the last named residuary legatee, as would be expected, but also before the bequest to Gordon. The Court found that the testator knew how to limit a bequest in other provisions of the Will and that Dorothy and William are not husband and wife but rather mother and son. The Court thus found that they were to be treated as individuals, and not as a unit. *In re Thomas L. Cartledge*, N.Y.L.J. December 3, 1999, p. 35, col. 3 (Nassau Co. Surr. Radigan).

The Executor sought a construction of a direction in the Will that a Chinese screen be sold "for the best price . . . (the executor) can obtain, but in no event less than $120,000" and that such proceeds be distributed to twelve legatees. According to the petitioner, the screen was appraised at between $40,000 and $60,000 and for five years it could not be sold for the minimum price specified in the Will. The Executor thus sought a construction that if the screen cannot be sold for at least $120,000, it be sold for the best price possible, with the legacies payable from the proceeds abated ratably. The Court granted the petition, finding that reading the article strictly would then deny the legatees their bequests and delay indefinitely a full distribution of the estate, a result which the testator could not have intended. *In re Eduardo Alejandro Llano*, N.Y.L.J. December 10, 1999, p. 27, col. 3 (N.Y. Co. Surr. Roth).

CONSTRUCTION—SCRIVENER'S ERROR

The decedent's will gave a fee simple in real property to one daughter (Catherine) and the next sentence of the will directed that the decedent's other daughter (Margaret) have a right to reside in and use the property, and if she waived such right, directed that the property be sold with the proceeds distributed one-half to daughter Catherine and one-half to Margaret's two infant children. The Court found the provisions of the will to be ambiguous. The Court stated that the only thing that is certain is that the decedent intended to give Margaret a life estate in the premises. What is unclear is what remainder interest was intended for Catherine—the entire fee as indicated by sentence one or one-half of the net sales proceeds as indicated by sentence three. The Court looked to extrinsic evidence to aid in discovering decedent's intent which is appropriate when there is an ambiguity in the language of the will. At the hearing, the attorney draftsman was permitted to testify and testified that the decedent never told him that he wanted Catherine to receive the fee, but rather that he used a model will from his computer and made a mistake in failing to edit the first sentence. The Court stated that it is well aware that the disregarding or excision of a portion of a will is a desperate remedy and should only be used as a last resort when all efforts to reconcile the inconsistency by construction have failed. The Court found, however, an admission of scrivener's error. The Court thus found that after the termination of Margaret's life estate, Catherine and the infants will share the remainder interest in the proportions indicated. *In re Robert Florio*, N.Y.L.J. October 12, 1999, p. 27, col. 6 (Kings Co. Surr. Feinberg).

CONSTRUCTION—GIFT BY IMPLICATION

The decedent's son died four months before the decedent. The decedent was survived by his wife, an adult daughter and three infant grandchildren, the issue of his predeceased son. The will provided that if a child dies after a separate share has been set apart for him but before the entire share has been distributed to him, the trustees shall, at the death of such child, distribute such share as such child shall appoint by will or if he fails to so appoint, to such child's issue. The will did not take into account the situation that did occur, to wit: the death of the child prior to the testator. The Court noted that while the

will does provide for an alternate disposition for the son's bequest in the event that he dies after his trust has been established but before attaining age 40, the will does not provide for the eventuality which in fact occurred: the son dying before his father. The Court stated that the anti-lapse statute, EPTL 3-3.3, provides that a bequest to issue or sibling will not lapse by virtue of the death of the beneficiary before the testator, but will vest in the beneficiary's issue, unless the will provides otherwise. The Court found that the will does provide otherwise as it provides that the remainder is to be distributed in accordance with the direction in the beneficiary's will or as provided in the decedent's will. The Court stated the issue is whether the ineffective bequest to the son is to be distributed as in intestacy or whether the Court may imply a gift by implication to his issue. Relying on *In re Bieley* (91 N.Y.2d 520), the Court found that this is a proper case for finding of a gift by implication. The decedent's will expresses a clear purpose to treat his children equally and the issue of a predeceased child should succeed to the interest of their deceased parent. *In re Joseph Ambrosio*, N.Y.L.J. November 2, 1999, p. 35, col. 1 (Nassau Co. Surr. Radigan).

The Will provided for the division of the proceeds of sale of real property, but not for the disposition of the remainder at the termination of a life estate by the death of the decedent's sister, which is what occurred. The Will contained no residuary clause. The Court held that where a Will bequeaths the proceeds of a sale of real property and no sale takes place, the Court may find a gift by implication of the real property to the named beneficiaries. The Court carried the gift by implication doctrine even further, finding that the decedent did not intend her sister to share in the remainder upon the termination of the sister's life estate by the sister's death even though the sister would have shared in the sales proceeds if the property had been sold while she was alive. *In re Julie Paskalig*, N.Y.L.J. January 4, 2000, p. 26, col. 6 (Nassau Co. Surr. Radigan).

DISCLOSURE

In a contested probate proceeding, proponent refused to respond to any inquiry concerning a Foundation, claiming that everything regarding the Foundation's business is subject to an attorney-client privilege or constitutes a "business secret," none of which may be divulged as a matter of Swiss law. The Foundation is a Liechtenstein corporation and is the "inter vivos" trust referred to in the probate petition as the repository of the decedent's assets. The Court found that the Foundation's documents were within the category of "relevant instrument" excluded from the attorney-client privilege under New York law, that is, CPLR 4503(b), which requires an attorney to disclose information "regarding the preparation, execution or revocation of any will or other relevant instrument." *In re Natasha Gelman*, N.Y.L.J. October 28, 1999, p. 28, col. 4 (N.Y. Co. Surr. Preminger).

FORFEITURE—MURDER OF DECEDENT

In a case of first impression, the Court extended the principles enunciated in *Riggs v. Palmer* (110 N.Y. 506)—no one shall be permitted to acquire property by his own crime to the case where the respondent would be disqualified as a distributee of decedent's estate due to his convictions for intentionally killing two of the decedent's siblings prior to decedent's death. Had respondent not killed the decedent's siblings, respondent would not have been an intestate distributee of decedent's estate. The Court recognized that *Riggs v. Palmer* and its progeny have generally been applied only where the killer was seeking a share as either a legatee or a distributee of his victim's estate. Nevertheless, the Court extended the principles to the limited circumstances at issue herein, because at the time of decedent's death, but for the homicide, the homicide victim had he or she survived the decedent, would have prevented the killer from attaining status as a distributee of the decedent's estate and the killer is not being deprived of any previously vested property or rights in property. *In re Melba E. Macaro*, N.Y.L.J. October 12, 1999, p. 31, col. 7 (Westchester Co. Surr. Emanuelli).

In a proceeding for damages for wrongful death, the Estate of a child moved to disqualify the child's parents as distributees. The mother, who had pled guilty to two counts of assault of her child in the second degree and who had contributed significantly to the child's ultimate death, was disqualified as a distributee of the child's estate. The Court based its determination on EPTL 4-1.4 and 5-4.4 as well as the Family Court Act. *Mark G. by Jones v. Sabol*, 694 N.Y.S.2d 290 (Sup. Ct., N.Y. Co. J. Schoenfeld).

GIFT

The Court was asked to determine whether the decedent had made a valid gift of stock to his nurse by writing a letter to his broker to sell the stock and send the proceeds of sale to the nurse. The Court held that where a confidential relationship existed between the donor and donee, as in the situation with a nurse, the donee has the additional burden of showing that the gift was the free and voluntary act of the donor, and held that the donee failed to meet this burden. The letters to the broker made no reference to a gift or state the purpose of the sale of the stock. *In re Frank E. Collins*, N.Y.L.J. December 9, 1999, p. 35, col. 3 (Kings Co. Surr. Feinberg).

JURISDICTION OF SURROGATE'S COURT

The estate sought a turnover of rents being withheld by tenants of a building owned by the estate and for a restraint of the moneys being withheld from being withdrawn by the tenants. The Court granted the restraint, holding that it is well-settled that the Surrogate's Court has jurisdiction to entertain landlord-tenant disputes involving an estate, although not every such dispute is appropriately entertained. The Court stated that resort to the Surrogate's Court should not be had in the "garden variety" summary proceedings or as an attempt to avoid compliance with the registration requirements of the Multiple Dwelling Law. The Court found that the dispute is properly being entertained, based on the claim of a pending mortgage foreclosure against the property due to the estate's lack of funds to pay the mortgage and the fact that the property is the only asset of the estate. *In re Rose Asaro*, N.Y.L.J. December 28, 1999, p. 26, col. 2 (Kings Co. Surr. Feinberg).

MEDICAL RECORDS

The Court stated that the medical and psychiatric records requested by objectant have a direct bearing on the critical controversies of the case—testamentary capacity, fraud and undue influence, and falls within the disclosure purview of CPLR 3101. The Court found that the information is clearly privileged matter under the physician-patient privilege of CPLR 4504(a). The Court found further that the provision of 4504(c) (referring to disclosure by a physician or nurse) must be read together with 4504(a) and are thus applicable to medical corporations and that the executors may waive their privilege. The Court found that any evaluation of the disclosure of the records under the Mental Hygiene Law or the Public Health Law is unnecessary because the information is properly discoverable under CPLR Articles 43 and 55. *In re Alfred D. Rappaport*, N.Y.L.J. December 9, 1999, p. 36, col. 4 (Nassau Co. Surr. Radigan).

PROBATE —SUMMARY JUDGMENT

The Court granted summary judgment in favor of admitting the will to probate, finding that the proponent has made out a *prima facie* case for both testamentary capacity and due execution. The burden of proving fraud is on the objectant, who submitted nothing on this issue. As to undue influence, where the burden is on the objectant, the Court found that the objectant failed to show that undue influence was actually exercised on the decedent. As to due execution, the Court noted that there is no requirement that the will be read aloud to the decedent, and that the difference in the recollection of the witnesses does not render the will invalid, as due execution can be established notwithstanding the failed or imperfect memory of both attesting witnesses. *In re Philip Schmitt*, N.Y.L.J. October 25, 1999, p. 43, col. 3 (Westchester Co. Surr. Emanuelli).

RIGHT OF ELECTION

The Court found that the application by a spouse for a construction must be denied, because the Will makes no provision for decedent's wife as it was written before the marriage of the decedent and his wife. The Court stated that it is well-settled law that a Court may not draw a Will for a testator. Nevertheless, the Court stated it would not leave the petitioner without any redress. Pursuant to a post-nuptial agreement, the Court held that the petitioner at a minimum is entitled to elect against the Will in order for her to obtain her life estate in certain real property. The Court found that the procedures provided for in EPTL 5-1.1(b)(c)(B) govern, as the decedent died on October 10, 1986, well before the September 1, 1992 effective date of EPTL 5-1.1A, so that the right of election must be made within six months from the date of issuance of letters testamentary, which petitioner failed to do. Nevertheless, the Surrogate may relieve the spouse from such default provided no decree to settle the account of the Executor has been made and twelve months have not elapsed since the issuance of letters. Accordingly, the Court granted petitioner time to file a right of election. *In re Easley*, N.Y.L.J. October 27, 1999, p. 31, col. 1 (Kings Co. Surr. Feinberg).

In a proceeding to determine the validity of a right of election, two women claimed to be decedent's surviving spouse: one to whom he was first married, and the second to whom decedent was married after obtaining an ex parte "mail order" Mexican divorce from wife one. The decedent, who died domiciled in New York, worked for the United Nations for many years. The decedent's first marriage was contracted in England and lasted fifteen years when the couple separated. They executed a separation agreement providing for the support of the wife and the two daughters adopted during the marriage. The wife subsequently sought a divorce in England and the decedent consented to the entry of a decree *nisi* which could have been converted into a final divorce decree but never was. At the time of the entry of the decree *nisi*, the decedent resided in Thailand. The wife never received notice of the Mexican proceedings. Thailand recognized the validity of the Mexican divorce decree and permitted the decedent to remarry another woman. Citing *Rosenthiel v. Rosenthiel* (16 N.Y.2d 64 cert. den. 389 US 971), the Court stated that an *ex parte* foreign divorce obtained from a jurisdiction to which the petitioning spouse does not have a "reasonable relationship" is not enti-

tled to recognition under the doctrine of comity. Thus mail order divorces are invalid in New York as a matter of public policy. Decedent had no relationship to Mexico when he obtained the divorce. The Court found that Thailand's recognition of the divorce does not create the relationship between the decedent and Mexico necessary for the decree to be recognized by the State of New York. The Court found that the English decree *nisi* is also ineffective to terminate the wife's spousal rights of election, as it is not a final judgment. The Court found that estoppel arguments also must fail. *In re Erskine Barton Childers*, N.Y.L.J. December 10, 1999, p. 27, col. 2 (N.Y. Co. Surr. Preminger).

SCANDALOUS MATERIAL

In a contested accounting proceeding, the accountant moved to strike the scandalous or prejudicial material unnecessarily inserted in the objections. The Court denied the motion, stating that by its very nature, litigation frequently entails assertions about adversaries that would expose them to public embarrassment, ridicule or scorn, and this is especially true in estates practice where the mixture of family and money frequently proves to be a combustible one. CPLR 3024 permits an application to strike "scandalous or prejudicial matter unnecessarily inserted in a pleading." If the allegations are material, they cannot be stricken as scandalous. The Court found the allegations and the objections relevant to the very high standards of conduct placed upon a fiduciary. *In re I. Jack Klasson*, N.Y.L.J. November 10, 1999, p. 31, col. 2 (Nassau Co. Surr. Radigan).

STATUTE OF LIMITATIONS

The decedent's son sought to set aside the transfer of stock into the names of decedent and his wife, as joint tenants in 1993. Decedent died in December 1995 and the proceeding was brought in 1998. The respondents moved to dismiss the proceeding on the basis that it is barred by the three-year statute of limitations applicable to actions for conversion. The Court agreed that petitioner's claim is one for conversion, but held that the alleged conversion took place within the applicable period of limitations because the acts constituting the alleged conversion did not occur until after the decedent's death when the widow sold the stock. The Court stated that if a conversion occurs subsequent to a decedent's death but before the grant of letters, the three years is computed from the date of the granting of the letters. In the instant case, preliminary letters were not granted until 1997. *In re Jacques Sartisky*, N.Y.L.J. October 27, 1999, p. 28, col. 6 (N.Y. Co. Surr. Preminger).

SUPPLEMENTAL NEEDS TRUST

Petitioners were appointed as guardians of the person and property of their incapacitated adult son. They were authorized to establish a supplemental needs trust with the proceeds of their son's structured settlement. The Court held that a family member who is also a contingent remainderman of a supplemental needs trust is not automatically excluded from being a trustee, distinguishing *DiGennaro v. Community Hospital of Glen Cove*, (204 A.D.2d 250, 611 N.Y.S.2d 591 (2d Dept. 1994)) because it dealt with a medical qualifying trust. *In re Pace*, N.Y.L.J. October 25, 1999, p. 42, col. 4 (Supreme Court of Suffolk Co.).

The sister and guardian of a disabled man sought to have a supplemental needs trust funded solely with the brother's monthly social security disability income payments. He had no other assets. The Court was troubled by the concept of funding a supplemental needs trust with benefits received from governmental entitlements that are granted to help provide the recipient with the necessities of life, which here included Medicaid coverage. The Court concluded that such a hoarding of entitlement funds flew in the face of the rationale supporting entitlement programs and was against public policy. *In re Robert Christopher Lynch*, N.Y.L.J. November 10, 1999, p. 32, col. 4 (Onondaga Co. Surr. Wells).

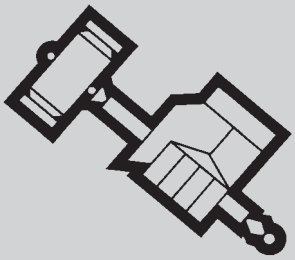
TRUSTS—SELF-DEALING

Objectants accused the trustee of breach of fiduciary duty and self-dealing in regard to certain loans and loan guarantees made by the trustee which are in default. The trustee moved to dismiss the objections on various grounds, including that the economic interest of the fiduciary is de minimis. The Court refused to dismiss on this basis, relying on the commentary of Professor Bogert on the subject of self-interested borrowing, stating that such an investment should be voidable at the option of the beneficiary, who should be able to require the trustee to replace the funds thus lent or to hold the trustee liable for any profit made from such a loan. The loan of trust funds to a third person with the intent of bringing indirect financial advantage to the trustee is equally disloyal. The Court stated that the avoidance of loss to the business may be a benefit in itself. The Court found further that the language of the trust instrument did not authorize self-interested investment of trust assets, but even if it did, "the law intervenes to prevent a trustee from being insulated from liability" if he commits a breach of trust in bad faith or intentionally or with reckless indifference to the interests of the beneficiaries, or if he has personally profited from the breach of trust. The Court thus ruled that

even if the trust instrument were interpreted to authorize the type of self-interested transactions that are the subject of these objections, the particulars of each transaction raise factual issues which preclude dismissal upon the pleadings. *In re Louis J. Amaducci*, N.Y.L.J. November 2, 1999, p. 36, col. 4 (Westchester Co. Surr. Emanuelli).

Arlene Harris—Counsel, Kaye, Scholer, Fierman, Hays & Handler, LLP, New York City.

Donald S. Klein—Donald S. Klein, P.C., White Plains, New York.



RECENT NEW YORK STATE DECISIONS

John C. Welsh

WILLS

PROBATE OF LOST WILL

Following execution of her will in 1985, testator took possession of the instrument which could not be found at her death. In a proceeding under SCPA 1407 to admit this will to probate as a last will that had not been revoked, petitioner was unable to rebut the presumption of revocation that arises from an unexplained failure to find a will known to have been in the testator's possession. Although testatrix may have had a visual disability, there was no proof as to its extent. Even with such proof, the presumption of revocation would not be rebutted. No evidence indicated an accidental destruction without any intention to revoke. *In re Evans*, ____ A.D.2d ____, 694 N.Y.S.2d 453 (2d Dep't 1999).

ADMINISTRATION OF ESTATES

ELECTIVE SHARE—TESTAMENTARY SUBSTITUTES

Although decedent's will left her entire estate to her husband, the existence of various trusts as testamentary substitutes caused the husband to file a notice of election under EPTL 5-1.1-A. In calculating the husband's elective share, the Surrogate excluded as a testamentary substitute the marital residence, although held in a tenancy by the entirety, because the purchase contract had been executed in March 1966, before the effective date of the statutory recognition of testamentary substitutes. Failure to complete renovations to the premises as soon as planned delayed the transfer of title until November 1966. Prior to that time, the statutory testamentary substitute concept had become effective and subsequently acquired tenancies by the entirety were expressly included. The Appellate Division found that delivery of the deed was the operative date for statutory inclusion and that the Surrogate erred in applying equitable conversion, a benefit to the husband. *In re Cahill*, ____ A.D.2d ____, 694 N.Y.S.2d 153 (2d Dep't 1999).

NEED TO SELL REALTY

Decedent's executor sought to file an intermediate account and obtain an order permitting sale of real property to pay debts. Several of executor's siblings claim that the executor took possession of $33,000 in cash from decedent's safe in their presence on the day of his funeral. The Appellate Division affirmed the Surrogate's finding that $8,000 in cash was removed from the safe and deposited in the executor's personal account. Consequently, the application for permission to sell realty was properly rejected. Life insurance proceeds received by decedent as beneficiary during his life and asserted to be the source of the allegedly missing $33,000 were reasonably well accounted for in other records. *In re Capaldo*, ____ A.D.2d ____, 694 N.Y.S.2d 233 (3d Dep't 1999).

UNCONSCIONABILITY—STATUTE OF LIMITATIONS

Decedent's will probated in 1978 appointed her daughter as executor and devised to her decedent's residence "with the expectation and desire but not a direction that if she should ever marry and have housing of her own and should desire to sell" the premises, she would share the proceeds equally with her siblings. In 1980, decedent's children executed a detailed written agreement that gave binding effect to the precatory language. In 1997, the devisee brought an action to cancel the contract on the grounds that it was unconscionable and induced by fraud. The Appellate Division agreed with the lower court that a six-year statute of limitations applied and the action was time barred. Any tolling period would have expired in 1990, two years after she was denied a home equity loan without obtaining the consent of the other parties to the agreement. Since the words of the will were clearly precatory, the unconscionability was patent in 1980. If not, she had notice of the problem when her loan was denied in 1988. *Heritage v. Mance*, ____ A.D.2d ____, 695 N.Y.S.2d 770 (3d Dep't 1999).

WRONGFUL DEATH ACTION—STATUTE OF LIMITATIONS

Decedent died intestate in 1988 leaving a nonmarital son, age 12, as his only distributee. In 1994, five months after the son reached age 18, he obtained limited letters of administration and within two years after reaching that age began a medical malpractice action against a doctor and a hospital alleging that their negligence caused his father's death. The Appellate Division agreed with the lower court that the actions were not barred by time. At decedent's death, no one was appointed personal representative and no one applied for letters of guardianship of the person or property of the son. Throughout his infancy, plaintiff resided with his mother, his natural guardian. Since no plaintiff was in existence to bring the action until a guardian was legally appointed for the son or he reached majority, whichever occurred earlier, the statutory period was suspended during that period. Failure of the mother to be appointed legal guardian of her son and apply for letters of administration on his behalf did not prejudice the son who acted in a timely manner. *Boles v. Sheehan Memorial Hospital*, ____ A.D.2d ____, 695 N.Y.S.2d 818 (4th Dep't 1999).

QUANTUM MERUIT FOR PROFESSIONAL SERVICES

Upon the death of a nature photographer in 1994, a friend and colleague agreed with his administrators that she would sort, arrange and identify thousands of slides in preparation for an exhibit suggested by her for a fee of $25,000. Almost five months later, the project was canceled for undisclosed reasons. At this time, the colleague had done substantial work and had received advances totaling $8,000. No written contract with the colleague had been made and no detailed hourly time records had been kept. In a suit in quantum meruit to recover for services rendered at the rate of $50 per hour, the Appellate Division found that $17.45 was the more appropriate rate. This measure was derived by dividing the number of hours originally estimated by the plaintiff for completion of the work into the proposed fee. The hourly rate of $15 used by the lower court was found to be somewhat inadequate. This rate had been used by plaintiff in measuring the value of other services performed for the estate. The Appellate Division accepted the plaintiff's estimate that 608 hours had been utilized on the project. *Rolleston-Daines v. Estate of Hopiak*, ____ A.D.2d ____, 694 N.Y.S.2d 225 (3d Dep't 1999).

ELECTIVE SHARE—EXTENSION OF TIME TO FILE

Testator's widow was named as the income beneficiary of his testamentary marital trust and a member of a class of beneficiaries to whom the trustees of a credit shelter trust may distribute income and principal ccording to their discretion. More than two years after decedent's death, the widow was successful in obtaining a second six-month extension of time to file her right to elect against his will. The estate had a pending medical malpractice action and the widow asserted that she could not know whether she had been adequately provided for until the amounts in the trusts were finally determined. Funds allocated to the wrongful death component would also enhance her outright distribution. The uncertain value of the estate was found to be sufficient to show reasonable cause for the extension. Although EPTL 5-1.1-A requires an election to be made no later than two years after decedent's death, this provision does not apply where a timely application for an extension has been filed. Multiple extensions are authorized in an appropriate situation. No prejudice arose for other estate beneficiaries since their needs were being satisfied presently and they were well aware of the pending malpractice action. *In re Levin*, 181 Misc. 2d 868, 695 N.Y.S.2d 287 (Sur. Ct., Erie Co. 1999).

RENUNCIATION OF CHILDREN'S SHARES

The mother of two children, ages 11 and 8, sought judicial permission to renounce one-tenth of life insurance proceeds in the amount of $500,000 due each child upon the death of their father. The guardian ad litem representing the infants in the proceeding successfully objected to the proposed renunciations. To permit the renunciations would allow the disclaimed $100,000 to pass to the mother free of estate tax, a savings of approximately $40,000. As a consequence, each child would receive proceeds diminished by $37,300. In matters of this kind, the loss to each child is the controlling consideration, not the overall family benefit. *In re Azie*, 181 Misc. 2d 651, 694 N.Y.S.2d 912 (Sur. Ct., Nassau Co. 1999).

CONTEMPT OF ADMINISTRATOR

When the administrator of decedent's estate was directed to file his final account and he failed to do so, a default order of contempt was filed against him. Failure of the administrator to purge himself of contempt resulted in the execution of a warrant of commitment against him. His argument that to compel him to account would violate his fifth amendment privilege was easily dismissed. By applying for letters of administration and filing his executed oath of office that he would faithfully discharge his duties and account for all assets that come into his hands, he waived any privilege against self-incrimination that related to matters embraced in the subject matter for his accounting. An attempt to show that his estate records were unavailable was equally unavailing. *In re Hamilton*, 181 Misc. 2d 697, 695 N.Y.S.2d 497 (Sur. Ct., Queens Co. 1999).

DISQUALIFICATION BY CRIMINAL ACTS

The Public Administrator of A, a deceased child of R and V, sued the city and related entities for physical injuries resulting in death inflicted upon A by R and V over a protracted period. Criminal charges against R and V were disposed of by R's plea of guilty to first degree manslaughter and V's plea of guilty to two counts of assault in the second degree. In the civil litigation, the court found that the nature of R's conviction was sufficient to disqualify him as a distributee. V was also disqualified on the basis of acts detailed in the Public Administrator's memorandum of law. These acts could also be treated as a refusal to provide for or an abandonment of A under EPTL 4-1.4. R's incarceration did not entitle him to the appointment of a guardian ad litem since he was no longer a person interested in the estate of his deceased son. *Mark G. v. Sabol*, 180 Misc. 2d 855, 694 N.Y.S.2d 290 (Sup. Ct., N.Y. Co. 1999).

VENUE TO CONTINUE NEGLIGENCE SUIT

In 1992, a domiciliary of Israel was struck by a New Jersey bus in Bronx County and was thereafter confined to a nursing home in Israel until his death in 1998. The son of decedent as named executor in decedent's will sought probate and issuance of letters testamentary in Bronx County primarily for the purpose of continuing a negligence suit brought by decedent before his death. Decedent had no tangible assets in Bronx County. Using CPLR 206, the Bronx Surrogate determined that the domicile of the defendant was the proper venue in which to pursue the action when the defendant has a presence in New York. However, since no such presence existed in this case, the court assigned the case to Nassau County, the location of grantor trust assets transferred by decedent to a residuary pour-over trust created as part of a comprehensive estate plan. *In re Chernofsky*, 181 Misc. 2d 412, 694 N.Y.S.2d 616 (Sur. Ct., Bronx Co. 1999).

TRUSTS

CAPACITY TO AMEND A REVOCABLE TRUST

In 1989, settlor created a revocable trust to pay the income to herself for life and thereafter to continue in perpetuity for the benefit of a Glens Falls library in memory of her husband. Under the terms of the trust, settlor would become "incompetent" to revoke if she a) became a chronic care patient at a skilled nursing facility or b) was certified by a physician to be unable to manage her own legal affairs. Six years later, settlor, who had become a permanent resident of a nursing home in Utah, purported to amend the trust by removing the original trustee, a Glens Falls bank, and substituting a Utah bank. The Appellate Division agreed with the lower court that the settlor had become "incompetent" by the terms of the trust agreement to make any changes in the trust. No question existed as to the nursing home residency and the language of the trust was unambiguous. Although settlor may have had substantial mental capacity at the time of the attempted substitution, such a fact was made irrelevant by the terms of the trust. *In re Manning v. Glens Falls Nat'l Bank*, ____ A.D.2d ____, 697 N.Y.S.2d 203 (3d Dep't 1999).

EQUITABLE DEVIATION

In a proceeding to terminate a testamentary trust, the trustee also moved to vary the restrictions placed on the investment of principal by the terms of the will. The Appellate Division applied the doctrine of equitable deviation which allows departure from explicit terms of the trust instrument when changes in circumstances threaten to defeat or substantially impair the purposes of the trust. The trustee was allowed to use the Prudent Investor Act as a substitute standard. No further details of the trust terms are provided. *In re Aberlin*, ____ A.D.2d ____, 695 N.Y.S.2d 383 (2d Dep't 1999).

ACCOUNT—RIGHT OF CO-TRUSTEES TO OBJECT

In intermediate accountings by a corporate co-trustee in six testamentary trusts created by decedent, the two individual co-trustees filed separate objections. Each individual charged that the other individual and the bank breached their fiduciary duties by improperly interfering in the business of operations of two closely held corporations whose shares were divided among the six trusts. The Appellate Division agreed that a claim by one individual co-trustee directly benefiting the trusts was properly assertable. The various objections that sought to recover damages on behalf of the trust were within the jurisdiction of the Surrogate's Court and should not be treated as conflicts between living persons. *In re Mooney*, ____ A.D.2d ____, 694 N.Y.S.2d 784 (3d Dep't 1999).

FORFEITURE PROVISIONS

Decedent's will created a residuary pour-over into an inter vivos trust which named her daughter as the income beneficiary. Included in the will were provisions that any beneficiary who sought to invalidate any of the trust provisions would forfeit all testamentary benefits and that beneficiaries of any appointive property passing under decedent's testamentary exercise of powers created in family trusts must release the trustees in order to share. Failure to execute such a release could be excused only by a judicial determination of fraud, deceit or dishonesty by the trustee. Similar provisions appeared in the trust. The income beneficiary sought to determine

whether the forfeiture language would be activated by a) a proceeding to revoke letters of trusteeship, b) filing objections to the accountings of the executors and trustees, or c) a proceeding to construe some of the trust provisions. The Surrogate found that any or all of the foregoing actions could be taken without loss of benefits. A challenge to the appointment of designated fiduciaries does not affect the validity of the will or the trust and is not within the prohibitory language. Any attempt to force beneficiaries to accept accountings of executors and trustees irrespective of content is void as against public policy. The right to challenge the reasonable care, diligence and prudence of executors and testamentary trustees without loss is guaranteed by EPTL 11-1.7. Although EPTL 3-3.5 specifically permits construction proceedings for wills without loss of benefits, no such statutory provision relates to trusts. A strict construction of the trust provisions resulted in a conclusion that such proceedings were not within their purview. *In re Stralem*, 181 Misc. 2d 715, 695 N.Y.S.2d 274 (Sur. Ct., Nassau Co. 1999).

CHARITABLE TRUSTS—JURISDICTION TO TERMINATE

The trustee of a lifetime charitable trust created in 1921 sought permission in Surrogate's Court to terminate the trust under EPTL 8-1.1(c)(2) because the total fund was only $44,000. All interested parties agreed that there should be an absolute disposition of the balance to the charity. The cited statute authorizing termination of trusts with assets of $100,000 or less by its terms relates only to testamentary trusts. However, in 1980, the legislature in general terms gave the Surrogate's Court concurrent jurisdiction with the Supreme Court over lifetime trusts. Since no conforming amendment was enacted at that time, a question arose as to whether the legislature in 1980 intended to expand the scope of EPTL 8-1.1(c)(2) to include lifetime trusts as well as testamentary trusts. The Surrogate ruled that such an expansion was consistent with legislative intent in broadly expanding the jurisdiction of the Surrogate's Court. Nothing in the legislative history indicated a desire to continue the old jurisdictional distinction for this limited purpose. *In re Harmon*, 181 Misc. 2d 924, 696 N.Y.S.2d 390 (Sur. Ct., N.Y. Co. 1999).

MISCELLANEOUS

POWER OF ATTORNEY—LEGAL FEES

M, a retired employee of Pan Am receiving monthly pension benefits, gave her sister, A, a broad durable power of attorney. Six years later, with M and A in failing health, A executed to S, her attorney, a power of attorney delegating the powers previously given by M to A. A agreed with S that he could retain as compensation one-third of any funds collected on M's behalf. Shortly after his appointment, S inquired of the administrator of the pension plan as to the availability of benefits to defray M's nursing home expense. Claim forms were filed by S and the maximum benefit of $100,000 was paid in three installments over a seven-month period. One-third of this payment was retained by S as his fee. Two years later, M had become incompetent and G, her nephew, sought appointment as her guardian, and challenged the fee paid to S. The Appellate Division and the lower court agreed that the statutory short form power of attorney executed by M to A gave the right to pursue all claims, undertake insurance transactions and delegate any of these powers to such persons as A might select. Thus, S was an authorized person to negotiate benefits resulting from Pan Am employment. After A died, S continued to manage M's financial affairs. Although the power of attorney made by A to S ended at A's death, the services of S benefited M and were worthy of compensation. Although the fee of $33,333 received by S as a result of the Pan Am claim was extremely generous, M received a benefit of twice that amount which would not have been forthcoming without the inquiry of S. *In re Minassian*, ____ A.D.2d ____, 695 N.Y.S.2d 312 (1st Dep't 1999).

REIMBURSEMENT OF GUARDIAN'S EXPENSES

The guardian of an incapacitated person serving under Art. 81 of the Mental Hygiene Law was ordered to appear at a removal hearing because of her personal reimbursement from the estate for a variety of routine expenditures. In general, such a guardian may be compensated at the rate applicable to trustees unless an alternative plan is set by the court. Payment of the guardian to herself of $631.22 was unauthorized and reimbursement was required. This amount included fax transmissions, photocopies, court filings, telephone charges and local travel that were intended to be absorbed by statutory commissions which had not been waived. This improper claim was too trivial for removal. *In re Livingston*, 180 Misc. 2d 977, 694 N.Y.S.2d 567 (Sup. Ct., Queens Co. 1999).

John C. Welsh is a professor at Albany Law School, Union University, Albany, N.Y.

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
Beth D. Tractenberg (Chair)
1114 Avenue of the Americas
New York, NY 10036

Christina M. Mason (Vice-Chair)
101 Park Avenue
New York, NY 10178

Committee on Continuing Legal Education
Richard P. Wallace (Chair)
279 River Street
P.O. Box 1530
Troy, NY 12181

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

Committee on Elderly and Disabled
Warren H. Heilbronner (Chair)
2400 Chase Square
Rochester, NY 14604

A. Robert Giordano (Vice-Chair)
235 Mamaroneck Avenue, Suite 205
White Plains, NY 10605

Michael F. Teitler (Vice-Chair)
1114 Avenue of the Americas, 45th Floor
New York, NY 10036

Committee on Estate Litigation
Colleen F. Carew (Chair)
350 Broadway, Suite 515
New York, NY 10013

Karin Johnson Barkhorn (Vice-Chair)
250 Park Avenue
New York, NY 10177

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

Gary B. Friedman (Vice-Chair)
600 Third Avenue
New York, NY 10016

Charles F. Gibbs (Vice-Chair)
30 Rockefeller Plaza
New York, NY 10112

Marilyn Ordover (Vice-Chair)
19 Grace Court
Apt. 6A
Brooklyn, NY 11201

Committee on Estate Planning
Denise P. Cambs (Chair)
One Lincoln Center, Suite 275
Syracuse, NY 13202

Susan Taxin Baer (Vice-Chair)
140 Grand Street, Suite 503
White Plains, NY 10601

Louis W. Pierro (Vice-Chair)
21 Everett Road Extension
Albany, NY 12205

Committee on Estate and Trust Administration
David J. Arcella (Chair)
1211 Avenue of the Americas, 34th Floor
New York, NY 10036

Anne Farber (Vice-Chair)
100 Park Avenue
New York, NY 10017

Susan Greenwald (Vice-Chair)
250 Park Avenue
New York, NY 10177

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

Committee on Governmental Relations
Michael K. Feigenbaum (Chair)
170 Old Country Road
Mineola, NY 11501

Thomas J. Collura (Vice-Chair)
111 Washington Avenue
Albany, NY 12210

Thomas E. Dolin (Vice-Chair)
One Commerce Plaza
Albany, NY 12260

Committee on International Estate Planning
Michael W. Galligan (Chair)
200 Park Avenue
New York, NY 10166

Davidson T. Gordon (Vice-Chair)
78 Elmwood Avenue
Rye, NY 10580

Richard E. Schneyer (Vice-Chair)
405 Lexington Avenue
New York, NY 10174

Committee on Legislation
Ronald J. Weiss (Chair)
Four Times Square
New York, NY 10022

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

Lenore W. Tucker (Vice-Chair)
233 Broadway, Suite 915
New York, NY 10279

Committee on Life Insurance and Employee Benefits
Kathleen M. Franklin (Chair)
100 State Street, Suite 900
Albany, NY 12207

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

David A. Pratt (Vice-Chair)
3 City Square
Albany, NY 12207

Committee on Membership and Relations with Local Bar Associations
Robert W. Johnson, III (Chair)
279 River Street
P.O. Box 1530
Troy, NY 12181

George E. Riedel, Jr. (Vice-Chair)
42 Delaware Avenue, Suite 300
Buffalo, NY 14202

Committee on Newsletter and Publications
Magdalen Gaynor (Chair)
7-11 South Broadway, Suite 208
White Plains, NY 10601

Michael Stephen Markhoff (Vice-Chair)
123 Main Street, 9th Floor
White Plains, NY 10601

Glenn M. Troost (Vice-Chair)
114 West 47th Street
New York, NY 10036

Committee on Practice and Ethics
Carl T. Baker (Chair)
One Broad Street Plaza
P.O. Box 2017
Glens Falls, NY 12801

S. Jeanne Hall (Vice-Chair)
114 West 47th Street
New York, NY 10036

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

M. Anne O'Connell (Vice-Chair)
331 Madison Avenue, 3rd Floor
New York, NY 10017

Committee on Surrogates Court
Cathryn M. Doyle (Chair)
Albany County Surrogates Court
County Courthouse
Albany, NY 12207

Donald S. Klein (Vice-Chair)
7-11 South Broadway
White Plains, NY 10601

Stacy L. Pettit (Vice-Chair)
1971 Western Avenue
Albany, NY 12203

Abbe G. Shapiro (Vice-Chair)
30 Rockefeller Plaza, 23rd Floor
New York, NY 10112

Committee on Taxation
Georgiana James Slade (Chair)
1 Chase Manhattan Plaza
New York, NY 10005

Ira M. Bloom (Vice-Chair)
80 New Scotland Avenue
Albany, NY 12208

Committee on Technology
David Goldfarb (Chair)
200 Park Avenue South, 14th Floor
New York, NY 10003

Ad Hoc Committee on Multi-State Practice
William P. Lapiana (Chair)
57 Worth Street
New York, NY 10013

Richard H. Bernstein (Vice-Chair)
9104 East Palm Tree Drive
Scottsdale, AZ 85255

Glenda A. Fowler (Vice-Chair)
3850 Chaneyville Road
Owings, MD 20736

Philip G. Hull (Vice-Chair)
One Battery Park Plaza
New York, NY 10004

Executive Committee District Representatives

First District

G. Warren Whitaker
126 E. 56th Street, 17th Floor
New York, NY 10022
(212) 751-3900

Second District

Marilyn Ordover
19 Grace Court, Apt. 6A
Brooklyn, NY 11201
(718) 780-0254

Third District

Thomas E. Dolin
One Commerce Plaza
Albany, NY 12260
(518) 487-7630

Fourth District

Michael R. Suprunowicz
1430 Balltown Road
Niskayuna, NY 12309
(518) 374-3399

Fifth District

Elizabeth A. Hartnett
4 Clinton Square, Suite 106
Syracuse, NY 13202
(315) 476-0532

Sixth District

Kathryn Grant Madigan
P.O. Box F-1706
Binghamton, NY 13902
(607) 763-9200

Seventh District

Philip L. Burke
2 State Street, Suite 700
Rochester, NY 14614
(716) 987-2850

Eighth District

Victoria L. D'Angelo
5888 Main Street
Wiliamsville, NY 14221
(716) 634-4407

Ninth District

Richard J. Bowler
10 Bank Street, Suite 650
White Plains, NY 10606
(914) 993-0936

Tenth District

John M. Czygier, Jr.
214 Roanoke Avenue
P.O. Box 449
Riverhead, NY 11901
(516) 727-2500

Eleventh District

Madaleine S. Egelfeld
125-10 Queens Boulevard, Suite 311
Jamaica, NY 11415
(718) 544-6363

Twelfth District

Sanford B. Glatzer
1500 Astor Avenue
Bronx, NY 10469
(718) 655-6100

Publication of Articles

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TRUSTS AND ESTATES LAW SECTION NEWSLETTER

Editor
Magdalen Gaynor
7-11 South Broadway, Suite 208
White Plains, NY 10601

Recent Decisions Editor
John C. Welsh
Albany Law School
80 New Scotland Avenue
Albany, NY 12208

Section Officers

Chair
Joshua S. Rubenstein
575 Madison Avenue, Room 2204
New York, NY 10022

Chair Elect
Stephen M. Newman
1800 M&T Plaza
Buffalo, NY 14203

Secretary
Arlene Harris
425 Park Avenue
New York, NY 10022

Treasurer
Timothy B. Thornton
75 State Street
Albany, NY 12207

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Trusts and Estates Law Section
New York State Bar Association
One Elk Street
Albany, New York 12207-1096