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Trusts and Estates Law Section Newsletter

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

A Message from the Section Chair

At the long-awaited (at least by me) start of my year as Chair, I confess to both excitement and nervousness. My several predecessors, each a distinguished practitioner, demonstrated by their respective performances how a Section should be operated. Whether I have learned enough to do the job well remains to be seen, but I am truly excited by and grateful for the opportunity to serve as Section Chair.

As many of you know, we constitute one of the largest Sections of the NYSBA, further evidence of the extraordinary capabilities of our past leaders. Without in any way attempting to violate the "if it ain't broke, don't fix it" rule of management (although my personal preference runs along the lines of "if it isn't broken, break it!"), I would very much welcome hearing from as many members who care to comment as to how we can make our Section more helpful to you in your practices. For example, one specific idea that we hope to implement in future *Newsletter*s is to provide some information on the substantial number of bills affecting our practice area that are filed in the New York State Legislature. Most of these, even (some might say "especially") those we support, will not become legislation, but for a variety of reasons we can frequently benefit from knowing what is proposed.

In January, we completed an excellent program regarding living wills, health care proxies and corporeal rights after death. Our spring meeting will be held on April 26th and 27th in Buffalo (home to both genuine "Buffalo wings" and New York State's only NFL team), and the program chaired by Bill Lapiana will focus on the Uniform Trust Code and the status

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of New York's law of trusts. Bill's panel of speakers will discuss reformation and judicial modification of trusts, as well as proposals to change our long-standing rule against perpetuities. Victoria D'Angelo has organized a tour of a most interesting local home designed by Frank Lloyd Wright and an elegant dinner. (Wings are not on the menu.) Our fall meeting will be held at the lovely Silverado Resort in Napa Valley, California. The location is, of course, on the New York side of the valley. The meeting dates are October 4-7. I have for some time devoted considerable thought and study to the particular wines that will be selected for this meeting; I plan to turn my attention soon to selecting the substantive program that will be presented between tastings.

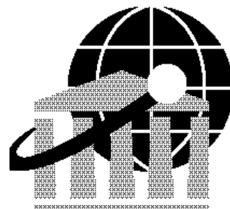
In all seriousness, our Section programs are consistently excellent. With the advent of mandatory CLE, we have seen a considerable increase in attendance, but we would like to see more of you enjoy the benefit of the very considerable effort that goes into planning both the substantive and social aspects of these programs.

As we begin the new millennium, I am confident that an exciting year lies ahead. The prospect of significant legislative change at both the federal and state levels is high. At this point we of course do not know whether the federal estate, gift and generation-skipping taxes will be repealed, modified or left unchanged, or whether we will see the return of carryover basis or perhaps the imposition of capital gains at death. As Josh indicated in the last *Newsletter*, several significant legislative proposals are also pending in Albany. We welcome your thoughts on these proposed changes and would be happy to devote space in this *Newsletter* to an exchange of views. While we cannot ignore the fact that many of us make all or a significant portion of our living from providing tax and estate planning services to our clients, I hope that our financial interest will not prevent us from speaking out on the subject of repeal. At least two of our former Section Chairs have spoken forcefully against repeal, and without regard to the merits of their position (to which I confess to being very sympathetic), I do applaud them for expressing their thoughts.

Finally, by long-standing tradition a new Chair praises his or her predecessor for a job well done. I do indeed very much want to express my congratulations to Joshua Rubenstein on achieving the coveted title of "Former Chairperson" and express thanks to Josh for his incredible efforts on behalf of the Section over the past year. Josh has been a valuable contributor for a good many years, but his remarkable performance as Chair is truly a most difficult act to follow. In addition to being extraordinarily well informed on virtually every endeavor of every Section committee and every Section activity, Josh has distinguished himself as perhaps the best in recent memory at selecting both the restaurant for and the wine to be served at dinner on those all too few occasions when the officers can manage to gather. You will not be surprised to know that Joshua is under serious consideration for a position as beverage consultant for the Napa meeting. Thanks, Josh, for a truly extraordinary job.

Looking forward to hearing from you.

Stephen M. Newman



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Editor's Message

The spring meeting of the Section will take place in Buffalo on April 26th and 27th. The reservations for the meeting show it will be well attended. There will be a combination of education (Uniform Trust Law) and culture (the Frank Lloyd Wright Darwin Martin House complex) which I am certain will be enjoyed by all.

This Section has many committees which are listed in the *Newsletter*. The Chairs of these committees are always happy to get new participants. Each committee has its own tasks. For example, the Committee on Practice and Ethics focuses its efforts on issues relating to the conduct of a Trusts and Estates practice and ethical considerations involved in both estate planning and estate settlement work. Current projects include technology for the trusts and estates practice; ethical checklists for the T & E practitioners; issues relating to the settlement of the estate of a sole practitioner (e.g., handling of client files, special issues for the fiduciary, and pre-planning for the sole practitioner's retirement, disability or death); retainer agreements for planning and settlement practices; issues arising between the attorney and estate fiduciary (responsibility, compensation, etc.); among others.

Anyone wishing to become involved with these projects or Committee on Practice and Ethics should contact the Committee Chair, Carl T. Baker, at 518-745-1400 or via e-mail at ctb@fmbf-law.com.

Once again, the *Newsletter* offers great variety of topics for your reading pleasure. John Czygier gives practical pointers on the need to comply with the rules of SCPA 2307-a for attorneys who are nominated as executors in wills. Sandy Schlesinger and Dana Mark have written about charitable contributions for items of tangible property. Ed Northwood has presented information regarding the proposed Treasury regulations which were issued in January. An interesting article from Lee Slavutin is included on life insurance planning. Frequent contributors Myron Kove and Jim Kosakow illustrate a potential problem when transferring IRAs in connection with a divorce. To round it out, our former Chair, Josh Rubenstein, has compiled a list of the Top Ten Dumbest Laws from our area of practice.

Please remember that the Section's fall meeting will take place in Napa from October 4th to the 7th. The location chosen by the Section's Chair, Steve Newman, is the Silverado resort. Mark your calendars.

Magdalen Gaynor

Request For Articles

If you would like to submit an article, or have an idea for an article, please contact

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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.

IRS Simplifies Minimum Distribution Rules

By Edward C. Northwood

On January 17, the IRS published new proposed regulations[1] for calculating minimum distributions that must be paid during life and after death from IRAs, qualified retirement and pension plans, § 403(b) annuity contracts, and certain retirement plans sponsored by tax exempt organizations (so-called § 457 plans). These proposed regulations replace lengthy and complex proposed regulations first issued more than 13 years ago, and subsequently modestly modified by amendments and IRS notices.[2] Not only are the calculations made remarkably simpler under these new rules, but also they undoubtedly will make the required lifetime and post-death minimum distributions smaller for a vast majority of IRA owners, plan participants, and their beneficiaries. Moreover, estate and tax planning opportunities are enhanced under these new rules, particularly by two new features regarding when "designated beneficiaries" are relevant and when they are determined.

Many of the procedures and definitions that applied under the prior rules remain in place. For example, the "required beginning date" and "designated beneficiary" are defined the same way,[3] and the ability to postpone taking the first year's required distribution (generally, that for age 70½) until the first quarter of the following year, is retained.[4] And, of course, the relevant statutes have not been amended. Thus, for example, a failure to timely withdraw the required minimums results in a penalty of 50% of the shortfall.[5]

This article briefly summaries the new rules in the context of account balance plans and IRAs. The rules applicable to benefits paid in the form of an annuity are also rewritten, and are analogous to the account balance treatment.

Requirements During Lifetime

These new rules may be used for determining an IRA owner's or plan beneficiary's required distribution for 2001 (and must be used after that).[6] The steps[7] are simple:

1. As before, obtain the December 31 account balance for each IRA or qualified plan interest;
2. Look up the factor corresponding to the age that the IRA owner or plan participant will be on his or her birthday in the year in question (The factors are reproduced in Table 1); and
3. Divide that factor into the account balance to determine the amount that is required to be distributed for that year.

Example 1. John inherited an IRA from his wife and rolled it over into his own IRA several years ago. He will celebrate his 72nd birthday in 2001. He has segregated his IRA into four separate accounts, each with a different beneficiary as follows: his church; his older sister Jane (age 75); his son Jack (age 45); and his daughter Jill (age 41). Under the new rules the account balance for each IRA is divided by the same factor, 24.4.

There are several important points to keep in mind:

- One may use this table no matter who or what is the named beneficiary. (The rule used to be that if a person named a charity or an estate as the beneficiary, for example, the person would have to use a single life expectancy table.)
- If one's spouse is the named beneficiary and such spouse is more than ten years younger than the account owner/participant, then Table VI of Treas. Reg. § 1.72-9 (the joint life expectancy table) is utilized to determine the applicable factor.[8]
- The life expectancy recalculation option has been eliminated, so we no longer have to worry about that complexity.
- As before, once one determines the total of required distributions from all of one's IRAs of the same category (that is, traditional IRAs, or Roth IRAs), the IRA holder may withdraw that amount from any one or more of those IRAs, in any combination.[9] The key is to make sure that the IRA holder withdraws the required minimum distribution in the aggregate. This aggregation rule does not apply to qualified plan benefits.
- These rules apply to required distributions **for 2001** and thereafter. Any year 2000 required distribution that was postponed until the first quarter of 2001 must be based on the old rules.[10]

Requirements After the Death of the IRA Owner or Plan Participant

For death benefits from IRAs and qualified plans that have account balances, the minimum distributions required to be paid each year to the beneficiary also are computed by dividing the account balance as of the end of the prior year by a factor. The new rules have changed how that factor is determined. The new rules may shorten the post-death distribution period in some cases for those who die after their required beginning dates, but generally they are very favorable to taxpayers. The following summarizes how to determine that factor for post-death distributions with respect to IRA owners and plan participants dying after 1999 (in most cases).[11]

> If there is a "designated beneficiary" other than one's spouse (now determined as of December 31 of the year following death), then the factor for the first calendar year after death is the life expectancy factor of that beneficiary for his or her attained age in that year. (Attained age factors are reproduced in Table 2.) The factor for each year after that is the factor for the prior year, reduced by one.
>
> If the "designated beneficiary" is one's spouse, the MRD factor is that for such spouse's attained age for each year after death. After the spouse dies, the factor is such spouse's life expectancy factor in the year of death, reduced by 1 for each subsequent year.
>
> If there is no "designated beneficiary," the factor for the year following death is the life expectancy of the decedent, using the decedent's attained age as of his or her birthday in the calendar year of death. In subsequent years, the factor is reduced by 1 for each calendar year that has elapsed since the year of death.

Example 2. Suppose John dies in 2002. Each beneficiary would have to begin taking distributions in 2003. The church would use 13.9 for 2002, reduced by one thereafter (of course, it likely would withdraw the entire balance shortly after John's death). John's sister would start with a factor of 11.9; Jack, 36.8; and Jill, 40.6.

> If death occurs before the required beginning date (generally, April 1 of the year following the individual's attaining age 70½), a special exception is available. If a distribution required for any of the first 5 years after death was not made, the 50% excise tax is imposed. The 50% excise tax may be avoided, however, by completing full distribution of the account by December 31 of the 5th year after death.[12]

The term "designated beneficiary" has the same meaning as under the prior rules. In short, a designated beneficiary is either an individual or a trust, the beneficiaries of which are all identifiable individuals (including identification by class, such as "my children").[13] Moreover, in the case of a trust beneficiary, it must be certain that all of the minimum required distributions to the trust will be distributed to individuals, even if some portion of those minimum required distributions are accumulated in the trust.[14] Neither an estate nor a charity is a "designated beneficiary."

Amendment and Reporting Issues

Because these new regulations are proposed, they may be changed on final adoption. Nonetheless, the author believes it likely that they may be relied upon for this year, and that in final form they will be substantially the same.

Plan and IRA documents must be amended effective for 2002 and thereafter.[15] If a plan sponsor wants to begin using the new rules in 2001, it may adopt a model amendment this year.[16] Adoption of the new rules in a plan document or an IRA agreement may not be fully effective until these new rules are issued as final regulations, an action the IRS hopes to complete this year.

Because the method for calculating required distributions is now uniform and based solely on one's age, IRA custodians and trustees will be required to report to the IRS the amount of each person's required distribution.[17] Plan administrators already inform the IRS of these figures through Form 1099 reporting. This will enable the IRS to monitor compliance.

Planning Considerations

Two rule changes, in particular, broaden distribution and beneficiary planning opportunities. Charitable planned giving may be encouraged by virtue of the rule change that lifetime distributions are determined under a uniform system that ignores whom, or what, is the named beneficiary.[18] Thus, an IRA owner who names a charity (or charitable trust) as her or his beneficiary no longer must base her or his

lifetime required distributions on a single life expectancy factor.

Even more helpful to estate planners is the new rule that the designated beneficiary, for purposes of setting the post-death distribution factor, is not determined until December 31 of the year following death.[19] This permits the post-death elimination of beneficiaries who may otherwise have shortened the permissible post-death distribution period, by means of disclaimers, or the total payout of a beneficiary's interest prior to such date.[20]

Example 3: Suppose John did not have separate IRAs but instead had a single IRA with his multiple beneficiaries. If his sister disclaims her beneficial interest and the charity has its share of the IRA paid out prior to December 31 of the year after John's death, then his children would be the only beneficiaries on the key date, in which case they qualify as designated beneficiaries, and the IRA balance may be paid out over the life expectancy of Jack, the older child.

Endnotes

1. 26 C.F.R. Parts 1 and 54 [REG-130477-00; REG-130481-00]; published at 66 Fed. Reg. 3928 (Jan. 17, 2001).
2. The history is set forth in the Preamble to these proposed regulations at 66 Fed. Reg. 3929. The rules set forth under the first set of proposed regulations were discussed by the author in the Winter 1998 issue of this *Newsletter* (Vol. 31, No. 4) in an article entitled "A Primer on the Rules of Governing Minimum Required Distributions from Qualified Plans and IRAs."
3. Prop. Reg. § 1.401(a)(9)-2, Q&A 2 and Prop. Reg. § 1.401(a)(9)-4, respectively.
4. Prop. Reg. § 1.401(a)(9)-5, Q&A 1(c).
5. IRC § 4974.
6. Preamble, 66 Fed. Reg. 3934 ("Proposed Effective Date").
7. Prop. Reg. § 1.401(a)(9)-5.
8. Prop. Reg. § 1-401(a)(9)-5, Q&A 4(b).
9. Prop. Reg. § 1.408-8, Q&A 9.
10. Announcement 2001-18 (IRB 2001-10, March 5, 2001).
11. Prop. Reg. § 1.401(a)(9)-5, Q&A 5, generally.
12. Prop. Reg. § 54.4974-2, Q&A 3(c).
13. Prop. Reg. § 1.401(a)(9)-4, generally.
14. Prop. Reg. § 1.401(a)(9)-4, Q&A 5.
15. Preamble, 66 Fed. Reg. 3934.
16. *Id*.; Announcement 2001-18.
17. Prop. Reg. § 1.408-8, Q&A 10.
18. Unless, as noted previously, the beneficiary is the individual's spouse and the spouse is more than ten years younger than the individual.
19. Prop. Reg. § 1.401(a)(9)-4, Q&A 4.
20. *Id*.

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TABLE 1

UNIFORM MINIMUM DISTRIBUTION TABLE
(For Lifetime Required Payments from IRAs and Account Balance Plans)

Attained Age	Divisor
70	26.2
71	25.3
72	24.4
73	23.5
74	22.7
75	21.8
76	20.9
77	20.1
78	19.2
79	18.4
80	17.6
81	16.8
82	16.0
83	15.3
84	14.5
85	13.8
86	13.1
87	12.4
88	11.8
89	11.1
90	10.5
91	9.9
92	9.4

Attained Age	Divisor
93	8.8
94	8.3
95	7.8
96	7.3
97	6.9
98	6.5
99	6.1
100	5.7
101	5.3
102	5.0
103	4.7
104	4.4
105	4.1
106	3.8
107	3.6
108	3.3
109	3.1
110	2.8
111	2.6
112	2.4
113	2.2
114	2.0
115 and older	1.8

From Prop. Reg. § 1.401(a)(9)-5, Q&A 4(a)(2)

TABLE 2

POST-DEATH MRD FACTORS

Attained Age	Life Expectancy Factor
5	76.6
6	75.6
7	74.7
8	73.7
9	72.7
10	71.7
11	70.7
12	69.7
13	68.8
14	67.8
15	66.8
16	65.8
17	64.6
18	63.9
19	62.9
20	61.9
21	60.9
22	59.9
23	59.0
24	58.0
25	57.0
26	56.0
27	55.1
28	54.1
29	53.1
30	52.2
31	51.2
32	50.2
33	49.3
34	48.3
35	47.3
36	46.4
37	45.4
38	44.4
39	43.5
40	42.5
41	41.5
42	40.6
43	39.6
44	38.7
45	37.7
46	36.8
47	35.9
48	34.9
49	34.0
50	33.1
51	32.2
52	31.3
53	30.4
54	29.5
55	28.6
56	27.7
57	26.8
58	25.9
59	25.0
60	24.2
61	23.3
62	22.5
63	21.6
64	20.8
65	20.0
66	19.2
67	18.4
68	17.6
69	16.8
70	16.0
71	15.3
72	14.6
73	13.9
74	13.2
75	12.5
76	11/9
77	11/2
78	10.6
79	10.0
80	9.5
81	8.9
82	8.4
83	7.9
84	7.4
85.	6.9
86	6.5
87	6.1
88	5.7
89	5.3
90	5.0
91	4.7
92	4.4
93	4.1
94	3.9
95	3.7
96	3.4
97	3.2
98	3.0
99	2.8
100	2.7
101	2.5
102	2.3
103	2.1
104	1.9
105	1.8
106	1.6
107	1.4
108	1.3
109	1.1
110	1.0
111	.9
112	.8
113	.7
114	.6
115	.5

From Treas. Reg. 1.72-9, Table V (as provided under Prop. Reg. § 1.401(a)(9)-5, Q&A-6

Charitable Gifts of Tangible Personal Property

By Sanford J. Schlesinger and Dana L. Mark

A charitable contribution may take the form of tangible personal property, e.g., works of art, antiques, books, furniture and furnishings, and the like. The amount of the income tax charitable deduction which the donor will be allowed is dependent upon whether the contributed property is ordinary income property or long-term capital gain property in the hands of the donor and whether the use of the property is related to the donee organization's exempt purpose or function.

Income Tax Charitable Deduction

The donor will be entitled to an income tax charitable deduction of the fair market value of the property contributed if the property has been held long term, i.e., more than one year, and if the use of the property is related to the donee's exempt function.[1] In the case of a gift to an organization classified as a public charity (i.e., generally those organizations which are not classified as private foundations), the deduction is limited to 30% of the taxpayer's adjusted gross income[2] with a five-year carryforward.[3]

If the use by the donee organization is unrelated to its exempt purpose, the charitable contribution deduction is limited to the lesser of cost or fair market value.[4] An unrelated use is a use which is unrelated to the purpose or function constituting the basis for the donee charitable organization's exemption.[5]

The donor may treat the contributed property as being put to a related use if (i) he or she establishes that the property is not in fact put to an unrelated use by the donee organization, or (ii) at the time of the contribution, it is reasonable to anticipate that the property will not be put to an unrelated use by the donee organization.[6]

A contribution of tangible personal property which is "ordinary income property" will result in an income tax charitable deduction for the lower of cost basis or fair market value.[7] The contribution is deductible up to 50% of the taxpayer's adjusted gross income[8] with a five-year carryover for contribution amounts in excess of the ceiling limitation.[9]

Ordinary income property means property any portion of the gain on which would not have been long-term capital gain if the property had been sold by the donor at its fair market value at the time of the gift.[10] Ordinary income property includes inventory, a work of art created by the donor and capital assets held less than one year.

Partial Interests

Subject to certain limited exceptions, in the case of a charitable contribution not in trust of less than the donor's entire interest in the contributed property, no charitable contribution deduction is allowable.[11] Where the donor of a work of art owns the copyright, the donor must contribute both the copyright and the work of art to qualify for the income tax charitable deduction.[12] A gift of the work of art without the copyright will be treated as a gift of a partial interest. Note, however, that the gift and estate tax charitable deductions are allowed for gifts of works of art although the copyright itself is not transferred to the donee charitable organization.[13]

Future Interests

I.R.C. § 170(a)(3) provides that a charitable contribution of a future interest in tangible personal property is treated as complete only after all the intervening interests in, and rights to the actual possession or enjoyment of, the property have expired or are held by persons other than the taxpayer or those standing in a relationship to the taxpayer described in I.R.C. § 267(b) or § 707(b). Thus, no charitable deduction will be allowed for the remainder interest in tangible personal property as long as the donor (or family members) retains an income interest in the property.

Private Letter Ruling 9452026[14] addressed, among other things, the income tax consequences of a gift of a musical instrument to a charitable remainder annuity trust. The Internal Revenue Service (the "Service") ruled that because the musical instrument was tangible personal property, I.R.C. § 170(a)(3) prevented any deduction for the remainder interest as long as the taxpayer retained an income interest in the instrument. However, an income tax charitable deduction would be allowed to the donor when the trustee sells the instrument. At that time the donor would no longer be considered as retaining an intervening interest in the property and would then be holding only an income interest in the sale proceeds. The donor's intervening interest in the property would terminate on the sale of the property.

The sale of the musical instrument by the charitable remainder trust would be putting the musical

instrument to an unrelated use. As a result, the Service ruled that the donor's deduction is limited to the remainder element of the donor's basis as opposed to the remainder element of the fair market value.

Valuation of Charitable Gifts

If the value of contributed property for which a charitable deduction is claimed exceeds $5,000 (other than cash or publicly traded securities), Treas. Reg. § 1.170A-13 requires a "qualified appraisal."

A "qualified appraisal" is an appraisal prepared by a qualified appraiser (a person other than the taxpayer, a party to the transaction in which the taxpayer acquired the property, any person employed by any of the foregoing or any person whose relationship to the taxpayer would cause a reasonable person to question the independence of such appraiser), which includes:

1. a description of the property and, in the case of tangible property, the physical condition of the property;
2. the fair market value of the property on the date of the contribution and the basis for the valuation;
3. a statement that the appraisal was made for income tax purposes;
4. the appraiser's qualifications; and
5. the signature and taxpayer identification number of the appraiser.

To be a qualified appraisal it must be made no earlier than 60 days before the contribution and no later than the due date of the return (including extensions) for which the deduction is claimed.

If the contributed property is disposed of or sold by the donee organization within two years of receipt by it, the donee must file an information return with the Service disclosing the name of the donor, the property, date of contribution, date of disposition and amount received by the organization on disposition.[15] A copy of the return must be supplied to the donor.

Substantiation

Under I.R.C. § 170(f)(8)(A), an income tax charitable deduction is denied for a charitable contribution of $250 or more unless the taxpayer substantiates the contribution by a written acknowledgment from the donee organization. The acknowledgment must be contemporaneous with the contribution, meaning that the taxpayer must obtain the acknowledgment on or before the earlier of the due date or the filing of the taxpayer's personal income tax return.

Conclusion

In order to achieve the optimal income tax benefits for a charitable contribution of tangible personal property, the donor must be careful to meet the requirements set out by the Internal Revenue Code and the Treasury Regulations. A misstep can result in a completed charitable contribution without the taxpayer-donor receiving an income tax charitable deduction.

Endnotes

1. Treas. Reg. § 1.170A-4.
2. I.R.C. § 170(b)(1)(C)(i). All I.R.C. references are to the Internal Revenue Code of 1986, as amended.
3. I.R.C. § 170(b)(1)(C)(ii).
4. I.R.C. § 170(e)(1)(B)(i).
5. Treas. Reg. § 1.170A-4(b)(3).
6. Treas. Reg. § 1.170A-4(b)(3)(ii).
7. I.R.C. § 170(e)(1)(A); Treas. Reg. § 1.170A-4(a)(1).
8. I.R.C. § 170(b)(1)(A).
9. I.R.C. § 170(d)(1).
10. Treas. Reg. § 1.170A-4(b)(1).
11. Treas. Reg. § 1.170A-7.
12. Treas. Reg. § 1.170A-7(b).
13. I.R.C. §§ 2055(e)(4), 2522(c)(3); Treas. Reg. §§ 20.2055-2(e)(1)(ii), 25.2522(c)-3(c)(1)(ii).
14. A private letter ruling may only be relied upon by the taxpayer(s) requesting the ruling. It may not be used or cited as precedent. I.R.C. § 6110(j)(3).
15. I.R.C. § 6050L.

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Revocable Trusts in New York: Why Not?

By G. Warren Whitaker

New York estates attorneys talk only rarely, and then in hushed and slightly puzzled tones, about the use of revocable trusts in estate planning, preferring instead to address such tax arcana as GRATs, QPRTs and QDOTs. When we read about the widespread use of revocable trusts in California and Florida, we regard this as a cultural phenomenon peculiar to those states, like surfboards or Disney theme parks. The only New Yorkers who talk frequently about revocable trusts are certain snake-oil salesmen at the fringes of our profession who prey on the public's mistrust of lawyers and fear of the court system by touting "Living Trusts" that supposedly save astronomical costs and taxes. These purveyors of fear have undoubtedly tarnished the reputation of the revocable trust in the eyes of many New York practitioners.

Nevertheless, in other states attorneys routinely use revocable trusts for their wealthy and mid-size clients (say $500,000 and up). Have they come upon legitimate advantages to these vehicles that we in New York have overlooked? I think they have, and this article will discuss why I believe that revocable trusts should be the preferred estate planning vehicle in New York in most situations.

I. Basic Observations

Before describing those advantages, I would like to clarify a few points:

Taxes: Revocable trusts do not save taxes. More accurately, any estate or income tax savings that could be achieve by a revocable trust can also be achieved by a will alone. The federal tax law has been amended several times to insure identical treatment for estates and revocable trusts. (For example, revocable trusts can elect to have the same calendar year as the decedent's estate for income tax purposes,[1] and gifts within three years prior to the decedent's death, whether outright or via a revocable trust, are not brought back into his or her gross estate.[2]

Creditor Protection: A revocable trust offers no protection against the creditors of the creator (or grantor) of the trust. While an ongoing trust can provide protection against creditors of the beneficiaries after the grantor's death, this can also be achieved by a trust under a will.

Avoiding Probate: Probate can be avoided only if *every* asset of the grantor is transferred into the name of the revocable trust (or into some other testamentary substitute, such as joint ownership) during the lifetime of the grantor. This is an enormous burden and is rarely achieved. Has anyone tried to register an automobile with the Department of Motor Vehicles in the name of "The Smith Family Trust"? Moreover, in most cases New York probate is not as horrendous an experience as laymen have been led to believe and does not warrant the effort required to avoid it. Therefore, the best plan is usually to have both a revocable trust and a "pourover" will, which directs that all property in the name of the decedent pass to the revocable trust for disposition.

Funded vs. Unfunded: It is not necessary to transfer *any* assets into the name of the revocable trust (other than a nominal amount such as $10 to ensure that the trust has an initial *res* and is not a dry trust, which may raise questions as to validity). Although some of the benefits of revocable trusts, particularly during the period of estate administration, are lost if it is not funded during lifetime, other advantages are still achieved.

II. Advantages of Revocable Trusts

The advantages of revocable trusts occur at three distinct periods: during the incapacity of the grantor, during the administration of the grantor's estate, and during the ongoing administration of the trusts that are created under the grantor's will. Each of these periods is addressed below. The question of commissions, another potential advantage of revocable trusts, is then discussed separately.

A. Incapacity

As our society ages and medical science prolongs human life, the management of wealth owned by elderly persons who are unable to make their own financial decisions must be addressed with ever greater frequency. There are three primary methods available:

1. Guardianship: While the appointment of a guardian by a court to handle the affairs of an incapacitated person is a necessary default procedure that our laws must provide, most of us will agree that it is not the preferable method to deal with incapacity. Our courts do not need to be clogged with multitudes of guardianship proceedings. The guardianship proceeding can be slow, cumbersome and expensive, with court approval needed at many stages and annual accountings required to be filed.

Finally, most people facing the approach of incapacity want to select in advance the person who will make decisions for them, rather than have a court make the choice when that are unable to voice their wishes.

2. Power of Attorney: A durable power of attorney is simple to prepare and can be useful in dealing with the management of assets of an incapacitated person. However, over an extended period of incapacity the drawbacks of a power of attorney become evident. Trust agreements can be tailored to the personal wishes of the grantor to a far greater degree than powers of attorney. The powers and authority of a trustee are more clearly delineated under New York law than those of an agent under a power of attorney. Finally, and regrettably, powers of attorney are not always readily accepted by financial institutions without delay, and it may be necessary to establish the agent's ongoing authority at the time of each transaction.

3. Revocable Trust: A revocable trust is the preferred vehicle for holding the assets of an incapacitated person for an extended period of time. The powers of trustees, as well as the appointment of co-trustees and successors, can all be clearly set forth in the instrument and amplified by many provisions of New York law. The extent of the trustee's authority is generally not questioned.

It is not necessary for the revocable trust to be funded at the time of creation in order for it to be effective during the grantor's incapacity. Instead, the grantor can execute both a revocable trust and a durable power of attorney which specifically gives the agent the power to add all assets to the trust. If the grantor then approaches incapacity, the agent can transfer assets from the principal's name into the trust.

A recent New York Supreme Court case casts a pall over the use of revocable trusts during incapacity. In *In re Elsie "B."*[3] an elderly woman created a revocable trust and named her attorney and her brother as the trustees. Trustees were not given the power to appoint successors. She added most of her assets to the trust and later became incompetent. The grantor's brother was then appointed as her guardian, solely to deal with the few assets that she had not transferred to her trust. After his appointment, however, he claimed that as guardian he possessed the grantor's right to amend the trust agreement, which he purported to do in order to appoint his sons as successor trustees. The brother then died and the nephews claimed to be appointed successor trustees. The Supreme Court upheld (and the Third Department affirmed) the guardian's power to amend the trust pursuant to § 81.21 of the Mental Hygiene Law.

Unless this case is overturned on further appeal or overruled by statute, it represents a threat that a revocable trust which was carefully crafted by a grantor to accomplish his or her wishes during incapacity may be freely amended by a guardian after the incapacity occurs. One way to avoid this result might be to specifically provide in the revocable trust agreement that only the grantor may amend the agreement, and not a guardian appointed for the grantor.

B. Estate Administration

A revocable trust can provide speed and flexibility during the administration of a decedent's estate. The benefits during administration can *only* be achieved if the grantor (or his agent under a power of attorney) has effectively funded the revocable trust by transferring title to assets to the trust. When this is done, the following are among the advantages:

Avoiding Probate: Complete avoidance of probate can only be achieved if *all* of the decedent's assets are transferred to the revocable trust (or into another testamentary substitute such as joint ownership or Totten trust accounts.) As indicated previously, this is difficult to achieve and is not necessary or desirable in most cases, since probate is usually not an onerous procedure. However, there are some circumstances in which complete avoidance of probate may be desired. The most obvious is where the client's distributees, or closest relatives, cannot be located. Under New York law the distributees, who would take the decedent's estate under intestacy, must be cited and given the opportunity to object to probate of a decedent's will. For an 80-year-old childless and unmarried woman who was an only child, her intestate distributees may be first cousins once or twice removed whom she has never met or even heard of. Transfer of *all* assets to a revocable trust, if it can be achieved, will avoid the necessity of locating and citing these persons.

Avoiding Loss Due to Delays in Probate: While there may not be a reason to entirely avoid probate, a partly funded revocable trust can prevent harm that might result from the executor's inability to act until the will has been probated. One problem that immediately confronts the attorney on the death of a client is that stocks and bonds registered in the decedent's name cannot be sold until probate of the will and issuance of letters testamentary establish the authority of the executor to act. As we have seen with the recent gyrations of the NASDAQ, the ability to sell securities promptly can be critical. Even in the best of circumstances probate often takes several weeks and

requires information and signatures by family members at a time when the family may not want to focus on such questions. Preliminary letters may alleviate this problem by giving the named executor authority to buy and sell assets before probate has been obtained; however, preliminary letters require the filing of a completed probate petition and are usually not granted instantaneously.

By contrast, if securities accounts are held in a revocable trust, the trustees (including the successor to the deceased grantor) can make investment decisions without interruption before the will is admitted to probate. While probate is still necessary to transfer the assets that are not held in the trust, this can be done at a more leisurely pace, without the need for a mad post-death dash to the Surrogate's Court.

Transferring Assets: One of the most time-consuming tasks of estate administration is the transfer of each security and bank account from the decedent's name into the name of the estate or the beneficiary. Many elderly clients have dozens of bank accounts and individual stock certificates registered in their name; each of these requires a separate transaction to transfer, including correspondence with the transfer agents and submission of completed forms. Moreover, it often seems that stock transfer agents hire their employees from medical insurance companies; correspondence and forms mysteriously disappear, and multiple submissions are required to obtain a favorable response.

If the assets are to be held in continuing trust after the owner's death, tedious and prolonged work after death may be avoided if they are transferred into the name of the trust during the grantor's life. However, if the grantor's assets are to pass outright to individuals, the savings achieved by a transfer to a revocable trust will be reduced, since the assets must still be transferred into the name of the beneficiary, although surrogate's certificates and death certificates will not be needed.

Of course, the client will have to expend time and effort transferring the assets into the name of his or her revocable trust, and many will tire of corresponding with transfer agents and leave the job to their executor and lawyer (and the paralegal). (This may also give the client a greater appreciation of the time required to administer an estate.) However, even if the client hires his lawyer to transfer his assets to his revocable trust during his life, there will be less work than if the attorney transfers the same assets after the grantor has died.

Privacy: Many clients do not want their testamentary documents to be on file with the court and available for examination by the curious. It is uncertain whether this can be achieved in New York. If the decedent's will pours over to a revocable trust, the Surrogate's Court clerk will ask for a copy of the trust agreement in order to ensure that all beneficiaries are given notice of probate. Normally the trust agreement is filed with the Court and becomes part of the public record. However, it is the experience of this author that in some counties, if the attorney probating the will so requests, the clerk will review the trust agreement and then return it to the attorney without putting it into the file. Therefore, grantors fortunate enough to die in such a county can achieve the goal of privacy.

Avoiding Ancillary Probate: This is a clear benefit of revocable trusts for clients who own real estate in multiple jurisdictions. If the properties are held in an individual name, ancillary probate will be required in each state. However, if title to each property is held in the name of the revocable trust, multiple ancillary probates will not be required.

Protection from Will Contest: Revocable trusts may offer greater protection from contest than wills in certain circumstances. The proponent of a will must meet the burden of proof to establish validity; however, this burden is normally met by producing the witnesses, and the contestants must then make their case. With a trust, the burden is generally on the objectant to establish invalidity. One case[4] indicates that a higher level of competence is required to execute a revocable trust agreement than to execute a will; however, it is unclear whether this decision constitutes settled New York law or is merely an anomaly.

The procedures for contest of a will are clearly set forth in the SCPA, while an objectant to a revocable trust must draw up a road map as he goes along. (The SCPA-EPTL Legislative Advisory Committee has proposed enactment of a more specific procedure for the contest of lifetime trusts.)

It is true that by putting *all* of the client's assets into a revocable trust, the need for probate can be avoided, and with it the requirement that distributees be cited and informed of their right to contest. However, in most acrimonious situations the contestants are well aware of the death of the decedent and will challenge dispositions of assets whether or not they are served with a citation.

One practical advantage to a funded revocable trust in adversarial situations is that the trustees will have control of the assets during the course of litigation. This may not be the case if the assets are held in the decedent's individual name and issuance of preliminary letters to the nominated executor is contested by a distributee.

C. Trust Administration

Inter vivos trust agreements can provide greater flexibility and efficiency in the administration of ongoing trusts after the death of the grantor. Examples include:

Appointment and Resignation of Trustees: Trustees under lifetime trust agreements (whether revocable or irrevocable) need not be appointed by a court or obtain letters of trusteeship. By contrast, every trustee of a testamentary trust in New York must be appointed and issued letters of trusteeship by the Surrogate's Court, and court permission must be obtained for revocation of those letters on the resignation of the trustee. These are usually routine procedures, but occasionally they can drag on for months or even years.

Reformation: In recent years, complex and changing tax laws have resulted in the need for amendment of many trusts in order to obtain favorable tax treatment. This has occurred, for instance, in such areas as Qualified Domestic Trusts and charitable remainder trusts. Testamentary trusts can only be altered by a reformation proceeding in the Surrogate's Court, which can be a time consuming and costly proceeding. However, a revocable trust agreement can authorize the trustees to amend it in order to achieve desired tax results or to grant an administrative power that was not originally included. It is doubtful that an executor can be given a similar power to amend a will after the testator's death without court permission; the Statute of Wills would seem to preclude such a power.

Change of Jurisdiction: The trustee under a New York testamentary trust must obtain court permission to change the jurisdiction of a trust, usually with the consent of (or at least notice to) all interested parties. However, the trustee of a revocable trust can be given the authority to move the trust situs to another state without going to court.

III. Commissions

Assets held in a decedent's revocable trust at death are not subject to an executor's commission, whereas assets held in the decedent's individual name are commissionable. This may appear to be a major cost savings for the client, but that is not always the case. Often the surviving spouse, children or other relatives of the decedent are the executors, and they may not claim a commission. In some large estates where family members act as executors, it is advantageous to have them each receive a full commission that will be taxed at their income tax rate instead of being subject to the higher estate tax rate (and possibly the generation-skipping transfer tax as well). In addition, many banks that act as trustee under a revocable trust agreement will charge an executor's commission at the grantor's death, on the theory that they are required to perform as much work as if they had been appointed executor.

Independent professionals such as attorneys and accountants who are appointed as executor are the ones most likely to have their executor's commissions reduced if the testator uses a funded revocable trust; however, they will still charge professional fees for their services to both the estate and the trust. Presumably professionals will insist on a minimum aggregate of fee and commission in order to administer the estate, whether or not a revocable trust is involved.

In addition, each trustee of a revocable trust is entitled to an annual trustee's commission. Some commentators have indicated that the annual trustee's commissions for a revocable trust during the grantor's life will offset the savings on the executor's commission at death, but this is not necessarily the case. The grantor can now act as the sole trustee of the trust during his or her lifetime, with the recent elimination of the "merger" doctrine.[5] Moreover, if the grantor maintains his securities in an account with a trust company, he is already paying that trust company for its investments or other services, and the additional fee for it to act as a co-trustee of the revocable trust may be modest.

After the grantor's death, another trustee is needed, and he or she will be entitled to an annual commission. If the trust only continues for a year or so, the trustee's commission will be less than an executor's commission, even though the trustee receives a 1% paying out commission on termination.[6] If there are ongoing trusts, the trustee's commission will be the same whether the trusts are under a will or a revocable trust agreement, but the executor's commission will have been reduced or avoided.

In summary, revocable trusts that are funded prior to death may result in savings for the client on commissions in certain situations, and under almost no fact pattern will they result in greater commissions.

IV. Disadvantages

The most frequently cited disadvantages to revocable trusts are not persuasive. They are:

1. "The revocable trust is not all it is cracked up to be." All right, but what is? Revocable trusts cannot cure all that ails the probate system, but this should not blind us to the advantages that these trusts do offer.

2. "The savings in executor's commissions is offset by the cost of the trustee's commissions." As noted above, the entire question of commissions must be examined closely in each individual case. In any event, while revocable trusts may not always produce a substantial savings in commissions, it would be a rare situation in which the overall commissions were higher for a revocable trust than for a testamentary structure.

3. "Our firm has already developed legal forms for drafting wills, not trusts." Readers can judge for themselves whether this is a valid reason to have their clients forego the benefits of revocable trusts.

4. "I create more billable legal work for myself by not using revocable trusts." Again, readers can reach their own conclusion as to whether this is an ethical position for attorneys who have a duty of loyalty to their clients.

Conclusion

Revocable trusts offer a variety of potential advantages and no significant downside. Why shouldn't they be the standard in New York, as they are in most other states?

Endnotes

1. I.R.C. § 645.
2. I.R.C. § 2035(d).
3. Sup. Ct., Albany Co., March 1, 1999; *aff'd,* App. Div. 3d Dep't, May 11, 2000.
4. *In re ACN*, 133 Misc. 2d 1043 (Sur. Ct., N.Y. Co. 1986).
5. EPTL 7-1.1.
6. SCPA 2207, 2209.

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Recent Developments for Attorney/Fiduciaries and SCPA 2307-a

By John M. Czygier, Jr.

Introduction

The summer 1994 edition of this newsletter contained a column from former Section Chair Sanford J. Schlesinger, Esq.[1] wherein he highlighted the impending legislation concerning the compensation of attorney/fiduciaries. The new section, SCPA 2307-a, limits the compensation of attorney/fiduciaries, who are the draftspersons of the instrument, to one-half the statutory executor's commission unless there is an affirmative informed written waiver by the testator indicating that he was informed of the financial ramifications of nominating the attorney/draftsperson as executor. Mr. Schlesinger strongly suggested that this section merited a careful review, since it would "impact upon the practice of every trusts and estates lawyer, and possibly every lawyer in the State of New York who will ever be asked to serve as executor of an estate."

That advice was quite prescient; in the five years since its enactment attorneys are falling into traps that, if not always resulting in a loss of maximum commissions, cause unnecessary delay in the probate proceeding, and perhaps some degree of embarrassment to the attorney/draftsperson. Imagine the conversation with the persons interested in the will when you inform them that there may be some delay in the probate of the will because you, the attorney/draftsperson, failed to comply with the statute that entitles you to a full commission, and, in order to preserve this right, application will have to be made to the court on your behalf to try to remedy the oversight. It would not be surprising if a residuary beneficiary politely suggested that one-half of a statutory commission should suffice. That beneficiary might conclude that the testator, not having received the disclosure outlined in the statute, would not have agreed to a full commission, or, since it was the attorney's lapse, he or she should live with the loss. Rather than being placed in such a situation, it is worthwhile to review the statute and some of the cases where courts have had to consider the import of SCPA 2307-a.

The Statute

SCPA 2307-a is quite clear: it sets forth what is required of an attorney/draftsperson who is being nominated as executor and even includes a sample of the disclosure language that should be used to inform the testator of the potential consequences of nominating an attorney/fiduciary. One might think it difficult to go wrong with such a specific guide, however, the number of cases that have arisen with this section show otherwise.

In 1993, in response to a number of abuses[2] concerning attorneys serving as executors and collecting commissions in addition to legal fees, the Legislative Advisory Committee proposed legislation that would require certain disclosures to a testator where the attorney/draftsperson was being nominated to serve as executor. The current statute was enacted in 1995 and applies to wills and codicils executed after January 1, 1996, and the estates of persons dying after December 31, 1996, regardless of the date of the instrument. The statute does not prevent attorneys from serving as executors, but limits them to collecting only one-half the statutory amount of commissions if certain disclosures are not properly made to the testator.

Subject to statutory exceptions, anyone, including an attorney, is eligible to serve as an executor. Absent a contrary agreement, such person, including an attorney, will receive a statutory commission for serving as executor. If an attorney serves as executor, such attorney is entitled to both executor's commissions and reasonable compensation for legal services provided disclosure of dual compensation has been made. For wills executed prior to January 1, 1996, written disclosure that substantially conforms to the statutory model will be accepted, and in the absence of such language, application may be made to the court for a waiver of the statute based on good cause.

The premise for the need of such a statute was grounded in cases such as *In re Weinstock* and *In re Putnam*,[3] and based in the New York Code of Professional Responsibility Ethical Canon 5-6, which states that an attorney should not consciously influence a client to nominate the attorney as executor or trustee in an instrument. There was also the common sense rationale that clients, unaccustomed to making wills and possibly unfamiliar with their options, may be led to the appointment of an attorney, or may think it cheaper to have the attorney act as executor and do the legal work.[4] It is with this backdrop that, in a variety of different circumstances, judges are called upon to apply, or waive the application of, the current statute's provisions.

Waiving the Statutory Requirements

The first common situation where a waiver of the statute is requested is in a will drafted prior to January 1, 1996, which nominates an attorney as the fiduciary and lacks written disclosure regarding legal fees and commissions. Pursuant to the statute, if the testator dies after December 31, 1996, the nominated executor would be limited to one-half commissions unless he or she had, after the enactment of the statute (and possibly many years after the signing of the will), obtained the requisite SCPA 2307-a disclosure from the testator. Of course, there are obvious problems in such a case: the attorney would have to be able to identify those instances where he or she was nominated to serve as fiduciary, and then contact the testator and request cooperation in conforming with the statute. Due to these inherent difficulties, in a number of cases, courts have been requested to waive the statutory requirements.

For those attorneys who have no system that keeps track of the instances when they have been nominated as a fiduciary, a manual search of the files or wills could be the only way to discover situations where they may have been so nominated; such a search could entail a significant investment of time. In *In re DeMontagut*,[5] an attorney/draftsman of a will done years before the new statute requested the court to dispense with the strict imposition of the statute. The request was based on the grounds that it would be too burdensome to require that a review of all old will files be made to discover wills containing the nomination of the attorney/draftsperson as executor. The court denied the request for a waiver of the statute and limited the attorney to one-half the statutory commissions. The court stated that since the attorney had made an economic decision that it was too much of a burden to review his files in order to make the necessary disclosure, he should bear the economic consequences of that decision.

In *In re Marum*,[6] waiver was allowed where the nominated attorney had been named as alternate executor in all of testator's wills since 1978, and at the time SCPA 2307-a went into effect, the testator was elderly and incapable of making any judgment with regard to the statute, and therefore beyond being advised of the statutory requirements. In *In re Waldman*,[7] waiver was granted where the attorney described attempts to obtain compliance with the statute by discussing the statutory changes with the testator who, before the disclosure documents could be executed, became ill and passed away.

In *In re Powers*,[8] however, the request for a waiver of the statute's provisions was denied. The claimed disclosure only consisted of an oral statement to the testator supported by a letter from the client purporting to acknowledge the statutory requirements. The court found the letter to be devoid of any language to support the contention that disclosure had been made. Another case involving an oral disclosure was *In re Castelnuevo*,[9] that involved a pre-January 1996 will naming the drafting attorney as co-executor. A post-January 1996 codicil was executed, but without the statutory written acknowledgment of disclosure. Surrogate Radigan held that since the effect of the codicil was to republish the will as of the new date, a written disclosure was necessary. The attorney's orally advising the client of the statute was insufficient, since the statute required written acknowledgment and nothing less.

A couple of interesting recent decisions have dealt with the issue as to whether the written acknowledgment could be included in the body of the will itself. Although the statute does not expressly state that the written acknowledgment must be in a separate document, it does state that it must be executed concurrently, prior to or subsequent to the execution of the document. Clearly, if contained in the body of the instrument, it would qualify as being executed "concurrently" with the execution of the document. However, it appears that the legislature intended that the acknowledgment be contained in a document separate and distinct from the will, so as to insure the testator's full attention to the specifics of the disclosure. Having the acknowledgment contained within the instrument itself, especially if the document was lengthy, could increase the chances that the disclosure language was not fully appreciated, or even noticed, by the testator. This issue was addressed in two New York County cases jointly decided by Surrogate Roth. In *In re Pacanofsky and Hinkson*,[10] the court found that disclosure language contained in the will itself did not conform to the statute, and limited the nominated executors to one-half statutory commissions. Upon examination of the legislative history of the statute, Surrogate Roth concluded that it was the intent of the legislature to have the disclosure statement made in a document separate from the will. Furthermore, the court stated, a separate instrument stands as its own proof that it was received by the testator, thereby eliminating the need for any extended inquiry as to whether disclosure was made.

A contrary result was arrived at in *In re Winston*.[11] In that case, the disclosure was contained in the will, but found by Surrogate Holzman to be set forth in such a way so as to indicate that there had been a meaningful discussion with regard to the disclosure, i.e., it was not included as "boilerplate," or buried within complex language in the will. The court also disagreed with dicta contained in *Pacanofsky and Hinkson* to the extent that the dicta could be

construed to read that the requirements of SCPA 2307-a can never be satisfied by disclosure in the will itself; the Surrogate did caution however that the safest procedure is to set forth the statutory disclosure language in a writing other than the will. Indeed, the language of the disclosure should follow the statutory form. In *In re Stankiewicz*,[12] noncompliance with the statute was found where the effort to comply with the statute was the last sentence of the will which read: "My attorney read 2307-a regarding Executor's Compensation."

While the statute provides for a request to be made for the waiver of its requirements, it does not set forth a procedural guideline for doing so. In *In re Newman*,[13] Bronx Surrogate Holzman required that the residuary beneficiaries be given 20 days notice by ordinary and certified mail of the attorney's request for a waiver of the statutory provisions. Although SCPA 2307-a[7] states that the issue of statutory compliance should be determined in the probate proceeding, courts have sometimes held the matter in abeyance until the time of the accounting or other appropriate proceeding.[14]

By these cases, practitioners are being put on notice as to the financial consequences of not following the statutory prescriptions. For wills executed before January 1, 1996, there is a price to be paid for deciding to forego a review of old will files to ascertain if there are cases that must be attended to in order to insure compliance with the statute. For wills executed after January 1, 1996, the attempt to comply with the statute by inclusion of the disclosure language within the will itself could result in a finding that there was a failure to comply. Although these oversights might be able to be corrected by application to the court, failing to conform to the straightforward language of the statute could result in additional delays to the administration of the estate, and possible embarrassment to the neglectful practitioner.

Conclusion

If you think you may have been nominated as executor in a will drafted by you prior to January 1, 1996, you would be well served to search your records to insure that statutory compliance with the new statute will not be a problem. If you are requested by a client to draft a will nominating yourself as fiduciary, utilize the disclosure language set forth in the statute, and do so in a document separate from the will. The embarrassment you save could be your own.

Endnotes

1. "Chairperson's Corner," Trusts & Estates Law Section Newsletter Vol. 27, No. 2, Summer 1994.
2. *In re Klenk*, 151 Misc. 2d 863, 574 N.Y.S. 2d 438 (Sur. Ct., Suff. Co. 1991), *aff'd*, 204 A.D.2d 640, 612 N.Y.S.2d 220 (2d Dep't 1994) *In re Thron*, 139 Misc. 2d 1045; *In re Gillett*;, 139 Misc. 2d 188, 527 N.Y.S.2d 690 (Sur. Ct., Suff. Co. 1988). The reader is directed to an excellent article by Josh Rubenstein, *Compensation of Attorney/Executors Practitioners Often Caught Between Scylla and Charybdis*, N.Y.L.J., April 29, 1996, p. 9, col. 1, for a detailed discourse on the issues confronting the attorney/fiduciary.
3. *In re Weinstock*, 40 N.Y.2d 1; *In re Putnam*, 257 N.Y. 140.
4. The statute was not specifically designed to address the type of attorney overreaching condemned by the Court of Appeals in *Weinstock*. *See* Carp & Schlesinger, *Disclosure Requirements for Attorney Serving As Executor*, New York State Bar Journal, Vol. 67, No. 6, Sept./Oct. 1995, p. 10.
5. 178 Misc. 2d 521, 679 N.Y.S.2d 273 (1998).
6. N.Y.L.J., 12/23/97, p. 35, col. 1 (Sur. Ct, Nassau Co.).
7. 172 Misc. 2d 130, 658 N.Y.S.2d 565 (1997).
8. N.Y.L.J., 6/4/99, p. 34, col. 4 (Sur. Ct., Westchester Co.).
9. N.Y.L.J., 6/23/99, p. 33, col. 3 (Sur. Ct., Nassau Co.).
10. N.Y.L.J., 10/20/00, p. 32, col. 3 (Sur. Ct., N.Y. Co.).
11. N.Y.L.J., 12/5/00, p. 27, col. 6, (Sur. Ct., Bronx Co.).
12. N.Y.L.J., 8/9/00, p. 27, col.4 (Sur. Ct., Bronx Co.).
13. 177 Misc. 2d 72, 675 N.Y.S.2d 836 (1998).
14. *In re Rosenak*, 184 Misc. 2d 807, 710 N.Y.S.2d 813 (2000); *In re Fleshler*, 176 Misc. 2d 583, 672 N.Y.S.2d 1005 (1998).

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Beware Tax Trap When Transferring IRA to Spouse Pursuant to Divorce Decree

By Myron Kove and James M. Kosakow

In a recent case, the Tax Court held that a withdrawal from an IRA (individual retirement account) was a taxable event even though the IRA owner claimed that it was a nontaxable transfer pursuant to a divorce decree. In *Jones*, TC Memo 2000-219, in connection with a pending divorce, Mr. Jones closed his IRA account in May 1994 and endorsed the check over to his wife on June 12, 1994. The wife never deposited the check into an IRA account. On June 14, 1994, the parties executed a stipulation for judgment and Marital Settlement Agreement, which awarded the IRA to the wife.

Transfer of IRA Incident to a Divorce Not Taxable

Generally, amounts distributed from an IRA incident to a divorce are not taxable, provided two conditions are satisfied: (1) there is a transfer of the interest from the IRA owner, and (2) the transfer is pursuant to an actual divorce or separation instrument.[1] The issue raised by the IRS and decided against the IRA owner was that the withdrawal and endorsement of the check was not a transfer of the IRA.

Withdrawal and Endorsement Are Not a Transfer

The court held that the withdrawal and endorsement was not a transfer of Mr. Jones' interest in the IRA because his interest was extinguished at the time he withdrew the funds. The court stated that § 408(d)(6) does not allow an IRA participant to allocate to a nonparticipant spouse the tax burden of an actual distribution. Therefore, the terminated IRA was subject to income tax and the 10% early withdrawal penalty since Mr. Jones was under age 59½ at the time of the withdrawal.

Practice Pointer

The parties should have effected the transfer in a trustee-to-trustee transfer. If Mrs. Jones thereafter withdraws the funds, she is taxed, not Mr. Jones.

Endnote

1. Code § 408(d)(6).

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Save the Dates!

Trusts and Estates Law Section

Fall Meeting

October 4-7, 2001

Silverado Resort
Napa Valley, CA

Answers Provided by
Gary B. Freidman, Michael E. O'Connor and Magdalen Gaynor

Q Is the cost of a guardian *ad litem* always charged against the estate or trust?

A It depends. The compensation of guardians *ad litem* is governed by SCPA 405. Prior to January 1, 1994, the Surrogate was limited to charging the fees of a guardian *ad litem* against the estate or the interest of the person under a disability or both. However, SCPA 405 was substantially revised in 1993 and a new subparagraph 1(c)[1] was added.[2] With this provision, the Surrogate now has the power to direct that a guardian's fee be payable, for good cause shown, by other parties to the proceeding.[3]

Q Where is the best place to deduct administration expenses—the estate tax return or the income tax return?

A The place of deduction is determined on an estate by estate basis. In each case, the tax brackets (income tax and estate tax) are to be compared. Where no estate tax is imposed because of use of a unified credit bequest and marital deduction, you might determine that the administration expenses should be deducted on the Form 1041. The result of making that decision is an adjustment to the funding of the unified credit and marital shares. The amount deducted as an income tax expense is subtracted from the amount used to fund unified credit share. This decreases the principal amount that can then pass on tax free to remainder beneficiaries. In effect, it increases the marital gift since the amount is deducted from the nonmarital share of the estate. This leaves more subject to estate tax when the surviving spouse dies.

In each case, you have to take a look at the surviving spouse's age and health. Given the length of time estimated, you may want to forego the income tax deduction and use the expense on the estate tax return. This then reduces the marital share which will be included in the surviving spouse's subsequent estate for tax purposes.

Q An irrevocable inter vivos trust was created which provided income back to the grantor. It also authorized the trustees to distribute any amount of principal to the grantor in the trustee's absolute discretion. The grantor was not a trustee. There was no retained power of appointment in the agreement. Is this a completed gift requiring consumption of the credit and/or payment of gift tax at the creation of the trust?

A As a general rule, a gift is complete for gift tax purposes if the donor has given up all right to alter the ultimate disposition of the property. This is so even if the donor has retained some rights over the trust property during life. For example, a typical Medicaid-type trust will provide the donor/grantor the right to "income" for life, but no right to the distribution to principal. If such a trust had those provisions and nothing more, the funding of it would be a completed gift, subject to gift tax. To avoid that unwanted gift tax consequence, it is typical for such trusts to provide a retained limited power of appointment to the grantor. This is a power which allows the grantor to change the proportions of the various remainder beneficiaries or to add new beneficiaries within a limited class after the trust has been created and funded. Such a power causes the gift to be incomplete and eliminates the gift tax problem.

The trust addressed in this question does not provide such a retained power of appointment, and the issue is whether that causes the creation of the trust to become a gift taxable event. There is another method by which a gift can be deeded incomplete for gift tax purposes. If, under state law, the donor's creditors can reach the trust assets to satisfy claims the creditors may have against the donor, then the transfer of the property to the trust would be an incomplete gift.[4] EPTL 7-3.1 provides that a disposition in trust for the use of the creator of the trust is void as against existing or subsequent creditors of the creator. Case law has defined this statute to mean that a creditor could reach only the maximum

amount which the creator of the trust could receive assuming full exercise of all discretionary powers of the trustee.[5] Since the trustees of this trust have discretion to distribute all of the principal to the grantor, then the entire trust would be subject to EPTL 7-3.1. The logic of applying the incomplete gift doctrine in such a situation is that the grantor could borrow an amount equal to the principal of the trust and simply leave the creditor to obtain repayment from the trust assets.[6]

Endnotes

1. SCPA 405, subd. 1, provides:

   1. For services rendered a guardian ad litem shall receive reasonable compensation to be allowed by the court payable from any or all of the following, in such proportion as directed by the court:

   (a) the estate,

   (b) the interest of the person under disability, or

   (c) for good cause shown, any other party.

2. Laws 1993, Ch. 514, § 8.

3. *See In re Ault*, 164 Misc. 2d 272, 624 N.Y.S.2d 351 (Sur. Ct., N.Y. Co. 1995); where Surrogate Roth, after examining the legislative history, held that this amendment was specifically designed to bring uniformity to the civil courts and that the Surrogate in interpreting the statute should follow the precedents in the decisions construing CPLR 1204. Those cases hold that a party may be charged with payment of the compensation of a guardian ad litem only where the actions of such party generated unnecessary, unfounded or purely self-serving litigation that resulted in the appointment of a guardian, citing *Board of Education of Northport-East Northport U.F.S.D. v. Amback*, 90 A.D.2d 227,458 N.Y.S.2d 680, 690 (3d Dep't 1982), *aff'd*, 60 N.Y.2d 758, 469 N.Y.S.2d 669 (1983), *cert den.*, 465 U.S. 1101, 104 S.Ct. 1598 (1984); *Perales v. Cuttita*, 127 A.D.2d 960, 512 N.Y.S.2d 565 (3d Dep't 1987); *In re Lydia Hall Hospital*, 117 Misc. 2d 1024, 459 N.Y.S.2d 682 (Sup. Ct., Nassau Co. 1982). For recent cases in the Surrogate's Court following the holding in *Ault*, *see In re Reisman*, N.Y.L.J., May 18, 2000, p. 34, col. 5 (Sur. Ct., Nassau Co.); N.Y.L.J., August 25, 1997, p. 33, col. 1) [Radigan, S.]; *In re Stern*, N.Y.L.J., February 18, 1997, p. 33, col. 4 (Sur. Ct., Westchester Co. 1997) [Emanuelli, S.]; *In re Bobst*, N.Y.L.J., May 1, 1996, p. 31, col. 1 (Sur. Ct., N.Y. Co. 1996) [Roth, S.].

4. *Commissioner v. Vander Weele,* 254 F.2d 895 (6th Cir. 1958).

5. *Vanderbilt v. Manhattan (1984,* 100 A.D.2d 544, 473 N.Y.S.2d 242.

6. Rev. Rul. 76-103.

Gary B. Freidman is the Chair of the Estate Litigation Committee of this Section. Michael E. O'Connor is the former Chair of the Committee on Continuing Legal Education of this Section. Magdalen Gaynor is the Chair of the Newsletter and Publications Committee and the former 9th District Representative of this Section.

Congratulations!

This is the first opportunity that the *Newsletter* has had to note that two of this Section's members are now Judges of the Surrogate's Court. Eugene Peckham, a past Chair of the Section, is Surrogate of Broome County. Cathryn M. Doyle, who chairs the Committee on Surrogate's Court for this Section is now the Surrogate of Albany County.

Cathryn M. Doyle

Eugene Peckham

Developments and Emerging Opportunities in Planning with Life Insurance

By Lee Slavutin

Over the last two years, there have been three important lessons in the area of estate planning with life insurance and three emerging planning opportunities. The three lessons involve buy/sell agreements, aggressive tax schemes, and the importance of insurance company ratings and selecting a strong company. The three planning opportunities are the use of family partnerships in holding a life insurance policy, private-placement-variable life, and "life settlements."

Buy/Sell Agreements

The first lesson concerns a buy/sell agreement, the case of *R. Cartwright Est.*[1] At the time of Cartwright's death, a buy/sell agreement provided that five million dollars of life insurance would be paid to Cartwright's estate. The first part of the agreement provided that a portion of the life insurance would be used to redeem Cartwright's stock. The second part of the buy/sell agreement was a complete disaster; it said that another portion of the insurance would be used to pay for work in progress for which the estate or Cartwright had not yet been paid. As a result of this clause in the buy/sell agreement, a large portion of the insurance settlement, close to four million dollars, was changed from a non-taxable asset to income. The four million dollars represented compensation for work in progress and was deemed to be income in respect of a decedent.

Never draft a buy/sell agreement to use life insurance as a form of compensation. If you want to provide insurance as a form of compensation, you need to separate it out. You would provide one million dollars, in this case, for the buy/sell to redeem the stock. The other four million of life insurance could be structured as a split-dollar agreement to benefit an irrevocable insurance trust. Under the split-dollar agreement, the trust owns the policy, the corporation pays the bulk of the premiums, and the trust receives the insurance benefit, net of the corporation's investment, free of tax. Never lump the stock redemption and the "compensation" piece together under the buy/sell agreement, because this converts the insurance into a taxable asset. Cartwright is a Ninth Circuit case, highly relevant if you are involved in succession planning for businesses and very instructive in how *not* to write a buy/sell agreement.

Aggressive Life Insurance Schemes

The IRS has focused on two aggressive life insurance schemes in the last two years. The first one has been eliminated, namely charitable-reverse-split-dollar. The second aggressive scheme involves employee benefit trusts that are being used, in some cases, to fund life insurance policies and supposedly provide a way of deducting the life insurance premium payments for income tax purposes.

Charitable-split-dollar insurance arrangements had been promoted for years as a way to buy life insurance, assign a portion of the death benefit to a charity, and then make payments to the charity, claiming those payments as income tax deductible contributions. This scheme violated a very basic principle: there is no income tax deduction for the donation of a partial interest in property to charity (there are a few exceptions, for example, charitable remainder trusts). Someone made the mistake of talking to a *Wall Street Journal* reporter about these arrangements and the *Journal* published an article on its front page in January 1999. Within two weeks, there was a bill on the subject in Congress. By the end of the year, charitable-reverse-split-dollar was not only eliminated, but the charities that were involved in this scheme had to a pay an excise tax if they continued to pay premiums under these arrangements. The end result is that clients and charities had to get out—they had to unwind the arrangements.

The second scheme involves welfare benefit trusts and voluntary employee benefit associations (VEBAs), under Code §§ 419A and 501(c)(9). A recently decided Tax Court case borders on a tax-abusive situation. If you were to guess which group of professionals would get involved in this type of arrangement, who would you guess? You would be right if you answered, "doctors." Now, I do not know why this is. I used to practice medicine. I think that when I was in medical school they must have had a subliminal message in our anatomy and physiology classes that said, "Buy tax shelters. They are always risk-free." Every time you read about an abusive tax scheme, the one group of people who always seem to buy into them is medical doctors. The case is *Neonatology Associates*.[2] This case was about a group of doctors who bought into a VEBA to buy life insurance and deduct the premiums. Not only did the doctors get involved, but also the Medical Society of New Jersey endorsed the scheme after receiving a payment from the promoters.

The IRS disallowed the deductions and *imposed penalties*, and their position was upheld in Tax Court. Two other cases were consolidated with this case and in an additional 19 cases the parties agreed to be bound by the decision. So the message really is, if any of your clients are given a proposal to buy life insurance, and they are told that the premiums are tax deductible, your sensory alert system should raise a red flag. Apart from a few limited situations, such as buying insurance in a pension plan or group-term insurance (up to $50,000 in coverage), you cannot deduct the premiums on life insurance.

Life Insurance Company Financial Strength Ratings

The third lesson is to always remember to look at the financial strength ratings of a life insurance company, when a client is buying life insurance, and to regularly review the ratings of the companies from whom a client has purchased insurance. A trustee of an insurance trust has an even greater responsibility to monitor the ratings of an insurance company. We might think that, because Mutual Benefit failed ten years ago, and we have not had major problems in the last few years, we can forget about ratings. That is totally wrong. For example, General American was a large insurance company, with $14 billion of assets, that made an investment decision I do not understand. The company offered short-term funding instruments, like commercial paper, to institutional investors. It gave the investors the right to get a refund of their entire investment with a seven-day put notice. About five billion dollars of these instruments were issued. Moody's downgraded General American, and so all the pension plans and other institutional investors said, "We want our money back." General American did not have enough short-term liquid assets to return the investors' money. The company was taken over by the State Insurance Department and went into rehabilitation. Metropolitan Life ultimately purchased it and thankfully there was no major problem. The message to be gained from this is that you need to look carefully at the ratings and the rating evaluations. If you had looked at Moody's ratings on this company, you would have seen that Moody's had downgraded the company well before this problem occurred.

The *Insurance Forum* is a very helpful publication in this area. It is an excellent reference source for the ratings and how to choose a strong company. The publisher's phone number is (812) 876-6502 and its Web site is *theinsuranceforum.com*. The September 2000 issue is a special issue devoted to the ratings of life insurance companies. It lists about 60 companies that have extremely high ratings across the board from A. M. Best, Fitch (formerly Duff & Phelps, which was acquired by Fitch), Moody's, Standard & Poor's, and Weiss Research. These companies are very strong. In my experience, there is no reason to go outside of that group of 60 companies for a life insurance policy, unless the client has a health problem. If a client cannot get a reasonably priced offer from one of the triple A companies, I might go to a lower rated company, but not one that has financial problems.

Planning Opportunities: Family Limited Partnerships

In the typical estate plan, life insurance is owned by an irrevocable trust to exclude the insurance from the insured's estate. However, family limited partnerships (FLPs) are sometimes an attractive alternative to irrevocable trusts because they are flexible (i.e., amendable), they offer other estate planning benefits (e.g., valuation discounts) for non-insurance assets and they can solve the thorny transfer-for-value problem (discussed below).

IRS Letter Ruling 200017051 is a very useful ruling on the purchase of life insurance by a family limited partnership (FLP). It tells you how to structure the FLP to avoid the inclusion of the insurance in the general partner's estate when the general partner is the insured person. The insured general partner is prohibited by the terms of the partnership agreement from exercising any incidents of ownership over the policies.

PLR 20001705 is also instructive because it discusses transfer for value, which is the transfer of a life insurance policy for something of value (i.e., consideration). It is potentially disastrous because such a transfer causes the insurance proceeds to be taxed as income to the beneficiary. The valuable consideration does not have to be money. It can be the forgiveness of debt. For example, the gift of an insurance policy subject to a loan is a transfer for value—the donor is relieved of the policy debt and the amount of the consideration is the loan (if the loan exceeds the donor's basis there is a current taxable gain [equal to loan minus basis] and transfer for value will be a problem). Fortunately, the Code provides some safe harbor exceptions to this rule. Two important exceptions are transfers of life insurance policies (even ones where the donors receive valuable consideration) to partnerships, in which the insured is a partner, and transfers to partners of the insured. When clients are about to transfer policies, where there may be a transfer for value, this ruling and a 1999 ruling, IRS Letter Ruling 199905010, are both good rulings to look at.

The 1999 ruling says something interesting: Dad has a policy on his life owned by a corporation. He wants the corporation to sell the policy to his children, so the children can now own that policy and have it outside his estate (the sale eliminates the three-year rule for a life insurance policy because it is not a gift). Shortly before the sale, Dad proposes to give each of the children a limited partnership interest in an FLP completely unrelated to the corporation. The children would then become partners of the insured (i.e., Dad) and protect the sale of the policy from the transfer for value rule. I thought that the IRS would look a bit askew at such a close time frame between the gift of the LP interest and the sale of the policy. No problem, the IRS said. It should be noted, however, that the partnership had been in existence for some time and had a business purpose unrelated to the life insurance transfer.

Private Placement Variable Life

The second planning opportunity is private-placement-variable life insurance. Variable life insurance is a product that allows the owner of the policy to invest in mutual-type funds. It gives the policy owner the flexibility to invest in a variety of equity and bond funds, so that she is not stuck with the general account assets of the insurance company. Private-placement-variable life insurance goes a step further for wealthy clients who are willing to invest a million dollars or more in a life insurance product. In private placement variable life, the arrangement goes something like this: "Mr. Client, you want to invest in your favorite hedge fund. We will bring your hedge fund manager on board at XYZ Life Insurance Company and we will now allow you to put your money into an account of XYZ Life managed by the same hedge fund manager. The taxable gains that you normally have to recognize in the hedge fund will be sheltered by this private-placement policy." This transaction is not so simple—there are important diversification and investor control rules, which must be followed and are beyond the scope of this article.[3]

This transaction costs are lower than those in off-the-shelf variable life policies and so private placement policies are becoming increasingly popular not only in the United States, but also offshore. There are now offshore companies in the Cayman Islands, Bermuda, and elsewhere that are offering these products. The main advantages of the offshore carriers are: (1) there is no state premium tax, which can be two to four percent of the annual premium, and (2) more flexible offshore investments are available. However, premiums paid to offshore carriers by U.S. residents are subject to an excise tax of one percent.

You must do the due diligence on these offshore companies because some of them are tiny. For example, I received a request to look at a company that has $800,000 in capital. The company has less net worth than my client! Financial strength of the insurance company is always important, even if most of the risk is reinsured—the primary obligation to pay a death claim rests with the primary insurer.

Life Settlements

The third planning opportunity is life settlements, which have grown out of viatical settlements. About five to ten years ago, people facing death from AIDS owned life insurance policies and wanted access to extra funds to help pay medical expenses. They were no longer so interested in seeing the death benefit of the insurance policy paid to a beneficiary. A new industry was born to fulfill this need. Organizations, called "viatical settlement providers," offered to buy policies from these insureds. The settlement provider pays the insured an amount that represents up to 60 or 70% of the death benefit. A $300,000 policy, for example, might be sold for $180,000 in cash (tax free to the insured).

The terminally ill client could then use that money to cover current expenses. Note that the sales price typically is much greater than the cash value of the policy (of course, if the policy is term insurance it has no cash value). The viatical settlement provider is expecting to receive the full death benefit within 12 to 24 months if the insured is terminally ill and calculates its purchase price by discounting the value of the death benefit for the 12- to 24-month wait plus other costs it incurs.

Now we have a whole new development called "life or senior settlements." For example, a corporation owns a three million-dollar, key-person life insurance policy on an executive. The executive retires. The policy is term insurance. What does the corporation get if it cancels a term insurance policy? Nothing. But now, that executive is 65 or older and has had some deterioration in his health. He is not dying and he is not terminally ill. Maybe the executive had a heart attack five years ago. Because of that deterioration in health, the term policy now is worth something to a life settlement company (often the same company that is a viatical settlement provider, but here the seller of the policy is not terminally ill). The settlement company will pay, perhaps, $500,000 on a three million-dollar term policy, depending on the medical history, for something that the corporation owning the policy would otherwise have gotten nothing. It should be noted that the $500,000 is not tax-free. Unlike the viatical settlement, it is a taxable transaction. The taxable gain is the sales price less

basis. Is basis the sum of all premiums paid on the policy or should the policy be treated as a one-year term policy, which is renewed annually? In the latter case, which is the more conservative approach, 'basis' is one annual premium or a portion thereof if the policy is sold during the policy year, some time after the annual premium is paid. Most practitioners believe that this gain is capital gain, not ordinary income. The answer is not black and white. Even if it were ordinary income, $500,000 after taxes is much more than nothing for a term insurance policy. This is a whole new area developing in the life insurance industry.

The tax treatment of the gain is slightly different for cash value policies. If the policy in the example above was a whole life policy with basis of $180,000 and cash value of $300,000, then the total gain of $320,000 (sales price of $500,000 minus basis of $180,000) is divided into two parts: (1) gain up to the cash value, i.e., $120,000 (cash value minus basis), is taxed as ordinary income, and (2) gain over the cash value, i.e., $200,000 (sales price minus cash value), is taxed as capital gain.

Conclusion

Insurance products are continuously evolving to meet the changing needs of customers. This article focused on one of these products, private placement variable life, but there are others: guaranteed premium universal life, 30-year level premium term insurance, and long-term care insurance. Simultaneously, creative individuals around the world are developing new insurance applications, such as life settlements, and new tax strategies, such as charitable split dollar and welfare benefit trusts. In recommending new strategies to clients, common sense and a little hindsight are valuable. Distinguish between aggressive strategies that have a sound underlying tax or economic principle (e.g., in non-insurance planning, taking a substantial valuation discount on a gift of an LP interest), and those that may apply the law literally but not its intent (e.g., charitable split dollar). Finally, do not forget the basics, like the financial strength ratings of insurance companies.

Endnotes

1. CA-9, 99-2 USTC ¶50,666, 183 F.3d 1034 (July 12, 1999).
2. 115 TC—No. 5, CCH Dec. 53,970.
3. Code § 817(h) and Rev. Rul. 81-225.

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Upcoming Meetings of Interest

May 2001	"Income Taxation of Decedents, Their Estates and Their Trusts." New York State Bar. Eight locations throughout the state: Binghamton (5/9), Albany (5/15), Rochester (5/17), Tarrytown (5/21), Melville (5/23), Syracuse (5/23), New York City (5/30), Buffalo (5/31).
August 8-11, 2001	New York State Bar Elder Law Section Summer Meeting, Florence, Italy.
September 2001	"Estate Planning and Will Drafting." New York State Bar. Eight locations throughout the state. Dates and location to be finalized soon.
October 4-7, 2001	New York State Bar Trusts and Estates Law Section Fall Meeting, Napa, CA.
October 3-6, 2002	New York State Bar Trusts and Estates Law Section Fall Meeting Boston, MA.

Trusts and Estates Top Ten Dumbest Laws

By Joshua Rubenstein

I was recently asked to prepare a top ten list of the dumbest trusts and estates laws thankfully gotten rid of prior to the 21st century. The following is my humble submission:

1. *Mortmain Law*: This was a law that allowed your family to contest your will if you left more than half of your estate to charity. This was not exactly a common means of disinheriting children, and if your kids had ten times more than you, why should the brats be able to stop you from getting your name inscribed on a door in a hospital, church or synagogue?

2. *Prudent Man Rule*: This was a law that required trustees to invest trust assets as would prudent men of discretion, seeking preservation of capital and reasonable return on investment. Not only did it unduly restrict trustees from investing trust assets for total portfolio return, but it also prevented trustees from investing like women, who are by definition more prudent than men. We now have a prudent "person" rule. How PC.

3. *50% Marital Deduction*: This was a law that provided that even if you left your entire estate to your spouse, you could deduct only half of it against your estate taxes. This encouraged people to divert half of their estates from their spouses, since the excess over half would only be taxed again when the surviving spouse died. Now you can leave (and deduct) as much as you want to as many spouses as you want (so long as you have only one at a time).

4. *General Power of Appointment Trusts*: It used to be that the only way you could get a marital deduction for leaving property to a spouse in trust was to give the spouse the ability to appoint the property to anyone in the world. This defeated the purpose of putting property in trust in the first place, when you wanted to ensure that on your spouse's death, the property went to your children by your prior marriages and not to your spouse's new personal trainer. Now we have QTIP trusts (not a Johnson & Johnson product), which allow you all the dead hand control you deserve.

5. *Orphans Exclusion*: This was a law that allowed you to receive a $5,000 estate tax deduction for each child both of whose parents died prior to his or her 18th birthday. Not only did it rarely happen, but it took up valuable space in an otherwise overcrowded Internal Revenue Code.

6. *Flower Bonds*: This was a law that permitted you to buy bonds at a discount but redeem them at face in satisfaction of one's estate tax liability. The only problem was that these bonds (called flower bonds because they "blossomed" at death) had the worst rate of return in the world, so you had to root for mom or dad to kick the bucket as soon as possible after purchasing these bonds, otherwise your prospective inheritance would start depreciating before your eyes.

7. *Excess Retirement Accumulations Tax*: This was perhaps the most shameless taxpayer double-cross of all time. Originally, taxpayers were encouraged to save for their own retirement, rather than relying upon the Social Security system, by getting an income tax deduction for saving their earnings when they were in a high tax bracket and deferring spending them until they were in a low tax bracket (i.e., retirement). As an additional incentive, taxpayers were also told that they would get an estate tax deduction for all such savings still remaining when they died. First, Congress repealed graduated income tax rates, so now your income tax rates will essentially be the same before and after retirement, and you won't have saved any income taxes (indeed, you will have converted capital gains to ordinary income). Next, Congress repealed the estate tax deduction for retirement savings, so that when you die, your retirement accounts will be subject to both income and estate taxes at the same time. Last, Congress enacted the excess retirement accumulations tax, which said that assuming you did everything Congress had originally encouraged you to do and saved for your own retirement, if you saved "too much," you would pay a 15% nondeductible tax on the amount that you "oversaved." How much was too much? You were allowed to save only the amount equal to the present value of the right to receive an annuity of $112,500 for the rest of your life, commencing on the date of your death (disre-

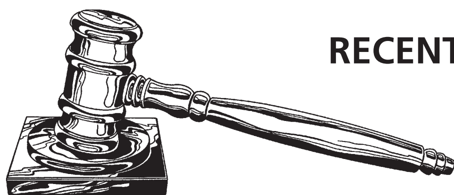
garding the minor detail that you happened to be dead). Good riddance.

8. *Filing New York State Estate Tax Returns in Surrogate's Court*: This was a law that required you not only to file your estate tax returns in court (as opposed to with the Department of Taxation and Finance, like every other tax return), but also to pay a $1,000 filing fee. This was the first time that anyone ever imposed a penalty for filing, as opposed to not filing a tax return.

9. *Tax Waivers*: This was a law that provided that you could not collect assets in New York after someone died unless you received tax waivers from the Department of Taxation and Finance in Albany. You had to fill out the multiple-layered carbon forms yourself and send them to Albany, and then wait for Albany to stamp and return them. The process took on average six weeks, unless you made a mistake, in which case your forms were returned after six weeks uncorrected and you had to start all over again. The process could be accelerated if you drove up the Taconic and delivered the forms by hand, unless you went over 50 miles an hour, in which case you spent the night in the Akram traffic court.

10. *New York Estate and Gift Taxes*: This was a law that provided that for the privilege of dying a New Yorker, you had to pay a 60% estate tax, rather than the 55% estate tax that your Aunt Sadie in Boca paid. And for the privilege of making a gift in New York, you paid up to a 76% gift tax, unlike the 55% gift tax that Aunt Sadie would have paid if only she had not been too cheap to make gifts. Now New York's independent estate and gift taxes have been repealed, and there is no reason to go to Florida to die. Be a sport, die at home.

Joshua Rubenstein is this Section's immediate past Chair and a partner in the Manhattan law firm of Rosenman and Colin.



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

Arlene Harris and Donald S. Klein

Executors—Commissions

In the first case brought in New York through a contested proceeding in which a corporate fiduciary insisted that the Court determine its commissions under SCPA 2312, the Court considered whether a corporate trustee was entitled to commissions in excess of the commissions charged by an individual trustee and what factors to consider when making this determination. The corporate trustee argued that the commission it gave itself under its own commissions schedule was "reasonable compensation." The executors of the estate argued that the trustee failed to distribute adequate amounts to the life beneficiary of the trust and did not provide services that warranted commissions above the statutory rates for individual trustees. The corporate trustee invested the trust in its common trust funds.

After an exhaustive discussion of the legislative history of SCPA 2312 and the cases decided under SCPA 2312, the Court set the standard for future cases. In uncontested proceedings, the Court will look to the tenets laid out in *In re McDonald*, 138 Misc. 2d 577 (1988), only where it has legitimate cause to scrutinize the actions of a corporate trustee seeking compensation under SCPA 2312. In contested proceedings, the Court will base its analysis on the 12 factors established in *In re McDonald*, 138 Misc. 2d at 580. The 12 factors are: (1) the size of the trust; (2) the responsibility involved; (3) the character of the work involved; (4) the results achieved; (5) the knowledge, skill and judgment required and used; (6) the time and services required; (7) the manner and promptness in performing its duties; (8) any unusual skill or experience of the trustee; (9) the fidelity of the trustee; (10) the amount of risk; (11) the custom in the community for allowance to trustees; and (12) any estimate of the trustee of the value of its services. The Court will give weight to the corporate trustee's published fee rates within their respective "marketplace." Applying the standard to this contested proceeding, the Court concluded that the corporate trustee was entitled to enhanced commissions but not commissions based on its published fee rates because the trustee did not maintain sufficient contact with the life beneficiary or provide the life beneficiary with an investment strategy tailored to her needs. *In re Estate of Prankard*, N.Y.L.J., Dec. 22, 2000, p. 34, col. 2 (Westchester Co., Sur. Emanuelli).

Executor—Disclosure Statement

Surrogate Riordan of Nassau County ruled that the SCPA 2307-a requirements meant the disclosure was to be in a separate writing and not part of the will. The Court reviewed the legislative history and concluded the purpose of the law in providing a safeguard against overreaching was best met in a writing separate and apart from the will. The Judge further held that had it permitted language in a will to meet the requirements of SCPA 2307-a, the acknowledgment in this will did not show the testator received any disclosure and was insufficient to meet the requirements of the statute. *In re Bruder*, N.Y.L.J., March 15, 2001, p. 25, col. 3 (Nassau Co. Sur. Riordan).

Surrogate Radigan decided that a waiver of the SCPA 2307-a disclosure requirements was proper where a woman acknowledged her understanding that her attorney/fiduciary was entitled to both commissions and attorney's fees and reaffirmed her will without signing a disclosure statement. The attorney/fiduciary named in the 1981 will had retired. In 1999, the attorney for the attorney/fiduciary visited the testatrix in the hospital to review her estate plan. At that time, the attorney for the attorney/fiduciary informed the testatrix that her attorney/fiduciary was entitled to both attorney's fees and commissions which she acknowledged. There appearing to be no immediate threat to the testatrix's health, the disclosure statement was not obtained at that time. The testatrix suddenly died five days later without having signed a disclosure statement. Surrogate Radigan decided on these facts that waiver of the SCPA 2307-a disclosure requirements was proper. *In re Smith*, N.Y.L.J., Nov. 28, 2000, p. 29, col. 3 (Nassau Co. Sur. Radigan).

The Surrogate of the Bronx County held that an SCPA 2307-a disclosure statement contained in the will, itself, rather than in a separate writing, was still valid and the designated executor, who also was the attorney who drafted the will, was entitled to a full executor's commission. The testatrix designated her executor in the following language: "I hereby appoint

Philip L. McGrory to be the executor of this my Last Will and Testament; I realize he is my attorney and would be entitled to a fee both as the executor and as the attorney for the estate but I wish him to serve as the executor because my sister has refused." Surrogate Holzman declined to follow Surrogate Roth's holdings in *In re Pacanofsky* and *In re Hinkson*, 714 N.Y.S.2d 433 (N.Y. Co. 2000) (Sur. Roth). Those cases held that a disclosure statement, consisting of the general language of the statutory model and contained in the will, failed the requirements for a disclosure statement under SCPA 2307-a. Surrogate Holzman reasoned that even though the statute envisions the disclosure statement set forth as a separate writing, the statute does not contain an absolute prohibition against the disclosure being set forth in the will itself.

Addressing the language of the testatrix's will, Surrogate Holzman thought the disclosure set forth in the will reflected a more meaningful discussion between the decedent and her attorney than could have been presumed to have occurred from the general language of a statutory model. Finally, the Court distinguished *In re Pacanofsky* and *In re Hinkson* on the grounds that in those cases, the disclosure statement contained within the will was the boilerplate language of the statutory model. In contrast, the language of the testatrix's will reflected a meaningful conversation between the testatrix and her attorney. *Estate of Cooper*, N.Y.L.J., Dec. 5, 2000, p. 27, col. 6 (Bronx Co. Sur. Holzman).

Federal Jurisdiction—Probate Exception

The Second Circuit determined that the probate exception to federal court jurisdiction did not bar relief to a decedent's judgment creditor who requested that the District Court (1) declare the creditor's right to a share in the estate and (2) direct the executor to (a) produce the will, (b) file the will for probate, and (c) reveal other information relating to the estate. The decedent's nephew had obtained a judgment in the District Court against the decedent while the decedent was alive for breach of an oral agreement. At the decedent's death, the decedent still owed his nephew a portion of the judgment. The decedent's executor refused to file the will for probate or provide information relating to the estate. The Court held that because the nephew had not asked the District Court to probate the will, administer the estate or in anyway interfere with the state probate proceeding, the relief requested did not run afoul of the probate exception to federal jurisdiction.

An order of the District Court directing the executor to produce and probate the will "in no way interferes with a state's exercise of control over a decedent's assets so as to administer the estate." More problematic was the nephew's request for a declaration that he had a right to a share in the estate. The Second Circuit distinguished this request from a request for distribution of any of the assets or a declaration of his right to receive a particular sum from the estate, both of which would trigger the probate exception. The Court reasoned that a declaration of the nephew's right as a judgment creditor to share in the estate, if there are assets to satisfy that judgment, would not interfere with the state probate court's administration of the estate or discharge of its duties. The District Court's refusal to entertain the nephew's application for relief based on the probate exception was vacated. *Dulce v. Dulce*, N.Y.L.J., Nov. 27, 2000, p. 25, col. 3 (2d Cir. Nov. 22, 2000) (Leval, C.J.).

Guardianship—Totten Trusts

The Court considered whether money that had been held in a Totten trust and transferred to an Article 81 guardianship account after the incapacity of the decedent should be distributed to the beneficiaries of the estate or to the beneficiary of the original Totten trust. Several of the beneficiaries of the estate argued that if the amount originally held in the Totten trust were paid to the beneficiary of that account, there would be nothing left for the beneficiaries of the estate, which would contravene the decedent's desired distribution of her estate. The Court noted that as a matter of public policy, Totten trusts should be preserved during the incapacity of the depositor and invaded only for the maintenance and care of the incapacitated person. A Totten trust is not a testamentary asset and, therefore, should not be used to pay either the decedent's debts or the administration expenses of the estate. The Court held that because of the strong public policy preserving Totten trusts and because the assets of the Totten trust would have passed to the beneficiary of the account but for the transfer to the guardian account, the beneficiary of the original Totten trust should be paid the amount she would have received under the Totten trust. *In re Reczko*, No. 500051/97 (N.Y. Co. Sup. Ct., Aug. 28, 2000) (Parness, J.).

Medicaid Reimbursement and Supplemental Needs Trust

The Court approved the creation and funding of a supplemental needs trust but declined to approve a settlement agreement whereby the decedent's daughter was given half the estate with part payable to the government for Medicaid received after the decedent's death and the other part payable to the supplemental needs trust. The decedent had two children, a son and a mentally incapacitated daughter. The decedent executed a will before the birth of his daughter, giving his entire estate to his son. As a part of the co-

executors' attempt to settle judicially their account and determine the rights of the afterborn daughter, the Attorney General sought a reimbursement for Medicaid paid to the daughter after the decedent's death, claiming that the daughter's prospective inheritance was an excess resource.

The Court held that the Attorney General did not have standing to assert a claim against the daughter's possible inheritance. Citing *In re Lainez*, 79 A.D.2d 78, *aff'd,* 55 N.Y.2d 657, the Court held that it did not have jurisdiction over an unliquidated claim by a creditor of a distributee of an estate. The Court, therefore, could not entertain the application for approval of the settlement. In addition, the Court held that the daughter did not have excess or available resource because her claim to a share of the estate as an afterborn child was not an available resource until it is paid. A mere claim is not an available resource. The Attorney General, therefore, could not claim reimbursement for Medicaid expenses unless and until the daughter received a distribution from the estate. Finally, the Court approved the creation and funding of a supplemental needs trust for the daughter. *In re Moroch*, N.Y.L.J., Dec. 4, 2000, p. 36, col. 2 (Westchester Co. Sur. Emanuelli).

Personal Jurisdiction

In an action to remove trustees, obtain information from them and appoint new trustees, the Court held that the petitioners properly obtained jurisdiction over one of the trustees of their grandparent's trusts, but did not properly obtain jurisdiction over the other trustee. The trustees were the petitioner's uncles. The petitioners became beneficiaries of their grandparent's testamentary trusts when their father exercised his power of appointment in his will. They petitioned the Court for an order directing their uncles to account and when no accounting was filed, they petitioned to remove their uncles as trustees.

The petitioners personally served one uncle, a New York domiciliary, in Massachusetts on July 6, 2000. Service was proper under New York Surrogate's Court Procedure Act 307(1) and 309(1). The petitioners failed to obtain personal jurisdiction over him, however, because when service is made on a person outside New York but within the United States, it must be served 20 days before the return date of the citation. Only 13 days had elapsed between the date of service on July 6 and the July 19 return date on the citation. The Court did not have personal jurisdiction because the petitioners failed to comply with the time requirements of the return date.

The Court did, however, have personal jurisdiction over the other trustee because service of process was both proper and timely. Accordingly, all the actions against the untimely served uncle were dismissed. The petitioner's application to appoint them as trustees was also dismissed because they failed to notify all interested parties when they failed to join properly one of their uncles. Finally, the uncle who was properly and timely served was ordered to file an answer to the petitioner's action to dismiss him and for the information requested by the petitioners. *In re Estate of Bergner*, N.Y.L.J., Oct. 18, 2000, p. 33, col. 4 (Nassau Co. Sur. Radigan).

Probate Vacatur

The decedent's son petitioned the Court to vacate a probate decree and revoke Letters Testamentary. The decedent died in 1996, leaving $200,000 for each of this three children in trust. The remainder of his estate went to his second wife. The children decided not to contest the will and it was admitted to probate. Forty-four months later, the decedent's son filed an action to vacate the probate decree and revoke the Letters Testamentary. The son alleged that he was fired from the company where his father was president two weeks after his father death. He alleged that his stepmother colluded with his father's successor to deprive him of his distributive rights. He further alleged that his father told him shortly before his death of a different testamentary scheme. Finally, the son alleged that due to his perilous financial situation after being fired and his affliction with Lyme disease in 1999, he was not able to commence the proceeding until 44 months after the will was admitted to probate.

The Court held that the son was not able to establish a substantial basis to contest the will and had not provided evidence to substantiate his claims. There was no proof that the decedent lacked testamentary capacity; the son was capably represented by counsel when the will was first probated; the Lyme disease claim was without merit; any evidence that the son knew his father's intentions was likely barred by CPLR 4519; the conspiracy theory would have to be left to another forum because it did not relate to the will contest; and, finally, a 44-month delay was wholly unreasonable and would cause prejudice to the decedent's wife if the Court granted the son's petition. *In re Estate of Cznarty*, N.Y.L.J., Dec. 12, 2000, p. 33, col. 2 (Dutchess Co. Sur. Pagones).

Procedure

An estate is not a necessary party in a suit for a breach of an agreement to buy out an interest in a trust and other assets after the death of the parties' mother. The plaintiff and defendant were sister and brother. In an effort to reduce the taxes due upon their mother's death, the plaintiff and defendant entered into an agreement whereby the defendant

was to become the executor of their mother's estate and buy out his sister's interest in a trust, a partnership and other holding companies after their mother's death. The mother died and her will was admitted to probate in Florida. The plaintiff objected to her brother's appointment as personal representative, sought the appointment of a curator to marshal the assets of the estate and petitioned the Florida court to compel an accounting. The defendant agreed to both the curator and the accounting and tendered a check to the plaintiff, which she rejected. The plaintiff then initiated a proceeding in the Supreme Court, Nassau County, alleging that her brother used a power of attorney to appropriate their mother's assets and breached the agreement. The defendant moved to dismiss his sister's suit for failure to join their mother's estate.

The Court held that because there was no claim against the estate of the mother in the New York action, the estate was not a necessary party. The New York action sought only specific performance of the agreement. The central question in the New York action regarding the agreement required the same accounting that was underway in Florida. Rather than dismiss the suit, the Court stayed the action pending the resolution of the Florida probate proceeding. *Chasanoff v. Perlberg*, N.Y.L.J., Dec. 19, 2000, p. 31, col. 2 (Nassau Co. Sup. Ct., Austin, J.).

Real Property

In a discovery proceeding, the decedent's ex-husband tried to assert a claim of adverse possession to the decedent's house. The decedent and her husband were divorced in 1974. In connection with that divorce, the husband conveyed his interest in the marital home to the decedent. Sometime thereafter, the husband returned to the residence and continued to live there until the decedent's death in 1985. The decedent's will, executed before the divorce, appointed her husband executor of her estate. The decedent's children consented to the probate of the will but did not consent to the appointment of their father as executor. In 1997, the decedent's ex-husband sold the marital home by executor's deed. The Court rejected the ex-husband's argument that his adverse possession of the home began upon decedent's death. The evidence suggested that the ex-husband entered the home with the decedent's permission. This permission was presumed to have continued until the decedent repudiated his right to possession. The Court held that neither the probate of the will nor the appointment of the ex-husband as executor of the estate were acts adverse to the titleholder. Title to real property devised in a will vests in the beneficiary, not the executor. It was not until 1997, when the ex-husband conveyed the property by executor's deed, that he asserted title to the real property that was actual, hostile, under a claim of right, open, notorious, exclusive and continuous. Because the ten years required for vesting of title by adverse possession had not elapsed, the ex-husband's claim of adverse possession was without merit. *Estate of Aprile*, N.Y.L.J., Nov. 15, 2000, p. 31, col. 6 (Queens Co. Sur. Nahman).

Release Agreement

The Court considered whether a general release executed in an individual capacity also applied to the signatory's representative capacity as an executor. As part of a settlement agreement between the decedent's family and the decedent's former business partner, the former business partner agreed to release the decedent's family from liability on their personal guarantee of a loan for one of the partnership's business ventures. The family members of both of the partners had personally guaranteed the loan. In exchange, the former business partner's son agreed to purchase a share of the family's interest in their father's residuary estate. The settlement also provided that the former business partner was to be appointed the executor of the estate. The former business partner then signed a general release in favor of the decedent's wife. After Letters were issued to the former business partner, he attempted to challenge certain transfers between the decedent and his wife prior to the decedent's death. The executor claimed that the transfers occurred at time when the decedent was insolvent and, therefore, violated the New York Debtor and Creditor Law.

The Court refused to limit its view of the release, executed in the partner's individual capacity, to the four corners of the document. Rather, the Court construed the release in the context of the settlement negotiations: "To hold that these were 'personal' releases divorced from their surroundings, where the parties never had any personal dealings whatsoever, would be patently absurd." The Court held that even though the former partner did not sign the general release in his capacity as executor of the estate, the release operated prospectively and barred his claim against the decedent's wife. *In re Estate of Frankel*, N.Y.L.J., Dec. 27, 2000, p. 28, col. 5 (Nassau Co. Sur. Radigan).

Renunciation

A devisee of real property did not effectively renounce the devise of a house in his father's will under New York Estates, Powers and Trusts Law 2-1.11 or by common law renunciation. The decedent devised one house to his daughter and one house to his son. The daughter became the executor of the estate and eventually executed an executor's deed, transferring the son's house to the son and daughter

in equal shares. Upon the son's death, his son became the executor of his estate and challenged the executor's deed. The daughter conceded that the requirements set forth in EPTL 2-1.11 were not met, but argued that her brother made a common law renunciation of the devise of the house. The Court held that the matter did not fall within the common law of renunciation. In addition, the law presumes that a devise is accepted, absent evidence to the contrary, especially where the devise is beneficial. The decedent's son even tried to convey the property at issue in his will. Finally, the Court held that the daughter's transfer of the son's house to herself raised doubts as to its validity and was presumed invalid. The Court voided the executor's deed and all subsequent deeds and conveyed the property to the estate of the decedent's son. *In re Estate of Lenkauskas*, N.Y.L.J., Dec. 12, 2000, p. 32, col. 1 (Queens Co. Sur. Nahman).

Right of Election

The Court held that New York Estates, Powers and Trusts Law 5-1.1A(d)(2), allowing a Surrogate to extend the time during which a spouse can exercise a right of election, permits deviation from the timeliness requirements for election under 5-1.1A(d)(1). The decedent died in 1997 and preliminary letters testamentary were issued to two of decedent's children. The decedent's surviving spouse filed objections to the will offered for probate. Forty months after decedent's death and 39 months after the Court issued preliminary letters testamentary, the spouse attempted to exercise his right of election. EPTL 5-1.1A(d)(1) requires a spouse to exercise the right of election six months from the date of issuance of letters testamentary and in no event later than two years after the decedent's death. Initially, the Court held that the issuance of preliminary letters testamentary does not mark the beginning of the six-month period. Next, the Court reviewed legal commentary to and the legislative history of EPTL 5-1.1A and held that the two year requirement of 5-1.1A(d)(1) was not an absolute statute of limitation. The extensive settlement discussions between the decedent's children and the decedent's spouse, and the pending discovery proceeding that would increase the size of the testamentary estate, were factors the Court considered when deciding to use its discretion and allow the spouse's petition for election. So long as the petition came within three months after the issuance of letters testamentary, the spouse's application for election would be timely. *In re Estate of Rosenkranz*, N.Y.L.J., Nov. 21, 2000, p. 30, col. 5 (Nassau Co. Sur. Radigan).

Right of Election—Antenuptial Agreement

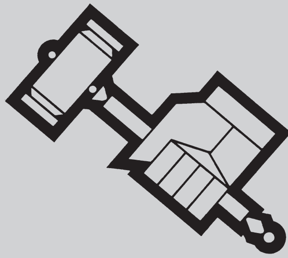
A notice of election was not valid in an estate proceeding where the decedent and his wife entered into an antenuptial agreement that waived all rights in the property or estate of the other party. The decedent's wife was not able to show on a motion for summary judgment that the antenuptial agreement she entered into with her late husband was procured by undue influence and overreaching. The wife alleged that her late husband took her to the lawyer's office two days before their wedding to sign the antenuptial agreement, that she relied on her husband's knowledge of such matters when executing the agreement, that she was not advised to obtain separate counsel, that she had no knowledge of her husband's assets until his death, and that her husband never shared financial information with her. The Court held that the wife's challenge to the antenuptial was barred by the six-year statute of limitations and rejected her contention that she was unable to discover the alleged fraud until decedent's death. The Court thought that she had simply to read the two-page document to discover the "fraud." The Court concluded that at the time she entered into the antenuptial, she had or would ultimately enter into other legal contracts, execute a will, administer an estate and execute the parties' tax returns, which evidenced her ability to understand legal documents. *In re Neidich*, N.Y.L.J., Dec. 6, 2000, p. 31, col. 6 (Westchester Co. Sur. Emanuelli).

Stipulation Agreement

A stipulation agreement to buy a life estate is enforceable even where the life tenant's signature was defective. The Court held that only the fiduciary of the life tenant has standing to challenge the validity of the agreement. The decedent gave her son a life estate in real property through her will. The decedent's grandchildren by a post-deceased child moved to terminate the life estate because of waste. Eventually, the decedent's son and grandchildren entered into a stipulation agreement whereby the grandchildren bought the life estate. After the Court's acceptance of the stipulation but before a decree was settled thereon, the life tenant died. The grandchildren argued that the stipulation was not valid because the life tenant did not sign the agreement, but rather the life tenant's son acting pursuant to a power of attorney signed the agreement. The Court noted that the power of attorney was a joint power that was not exercised jointly and the power was not properly recorded. The Court held, however, that even though the life tenant's signature was defective the other parties to the agreement could not use the defective signature of their adversary to escape liability under the agreement. Only the fiduciary of the deceased life tenant has standing to challenge the validity of the agreement. *In re Estate of Zwieback*, N.Y.L.J., Dec. 26, 2000, p. 37, col. 6 (Kings Co. Sur. Feinberg).

Use and Occupancy

In a proceeding for interim relief, the Court held that the executor of an estate could demand the payment of use and occupancy from a tenant of the decedent who refused to pay rent. The decedent's grandson occupied a rental unit on property owned by his grandmother. After the grandson's preliminary letters testamentary were revoked, his mother, the decedent's daughter, obtained letters testamentary and demanded rent and continued use and occupancy as well as the moneys from the grandson's unauthorized collection of rents from another income-producing unit on the property. After being awarded a money judgment, the decedent's daughter instituted collection proceedings. The Court awarded her interim relief and directed her son to pay her for his use and occupancy over a six-month period as well as rent for any continued occupancy of the premises. *Estate of Beiwinkler v. Helfrich*, N.Y.L.J., Oct. 19, 2000, p. 32, col. 5 (Westchester Co. Sur. Emanuelli).



RECENT NEW YORK STATE DECISIONS

John C. Welsh

WILLS

CONSTRUCTION—SURVIVORS

Testator's will left one half of his residuary estate to his brother, L, "or to his survivors." L predeceased the testator leaving a wife and three children by a prior marriage. L's widow died intestate 30 months after the testator also leaving three children by her prior marriage as her only distributees. These children claimed that a gift to L's "survivors" was equivalent to a gift to his distributees and that their mother was entitled to the intestate fraction of the questioned portion of the residuary. The Surrogate excluded the widow and found that the "survivors" was meant to include only L's three children, the same result that would occur when the anti-lapse statute is applied. The court used EPTL 3-3.3 and testator's intention as alternative grounds to support the result. There was no evidence to show a special relationship between testator and either L's widow or her children or any antipathy toward L's children. *In re Estate of Bernstein*, 185 Misc. 2d 493, 713 N.Y.S.2d 454 (Sur. Ct., Bronx Co. 2000).

EXECUTOR'S COMMISSIONS—DISCLOSURE REQUIREMENT

In two unrelated probate proceedings, it appeared that the will of each decedent named the attorney-draftsman as executor and purported to include the disclosure statement now required under SCPA 2307-a in order for the executor to collect full commissions. After reviewing the statutory requirements, the Surrogate concluded that the acknowledgment of disclosure required of the testator was intended to be by a separate writing and not through a will provision. This separate statement is better evidence that the disclosure has been made in a clear manner to the testator and excludes the possibility that the testator will ignore the comparable will provision as legal boilerplate. *In re Estate of Pacanofsky, In re Estate of Hinkson*, __ Misc. 2d __, 714 N.Y.S.2d 433 (Sur. Ct., N.Y. Co. 2000).

DESCENT AND DISTRIBUTION

ELIGIBILITY FOR LETTERS

In a proceeding for limited letters of administration, decedent's wife, a nonresident alien living in Ecuador, consented to the appointment of an unrelated third party to administer the estate. The infancy of decedent's two children prevented them from consenting. Under SCPA 1001(6), letters of administration may be granted to an eligible person who is not a distributee upon the consents of all eligible distributees or of all distributees when there are not eligible distributees. The court found that the nonresident alien spouse was an "eligible" distributee because she could have received letters to serve with one or more co-fiduciaries, including at least one New York resident. By treating the spouse as an eligible distributee, consents by a guardian of the ineligible children became unnecessary. *In re Pesantez*, 185 Misc. 2d 869, 714 N.Y.S.2d 652 (Sur. Ct., Nassau Co. 2000).

ADMINISTRATION OF ESTATES

ACCOUNTING

In an intermediate accounting, the Surrogate directed decedent's brother to pay decedent's estate more than $1.7 million as the fair market rental value of certain estate properties. The brother had correctly asserted in an earlier appeal to the Appellate Division in a related matter that Supreme Court and Surrogate's Court had concurrent jurisdiction of the issues. As a result, he was barred from asserting lack of jurisdiction of the Surrogate's Court in this later appeal. Similarly, the brother's lack of success in asserting that the Surrogate's Court had exceeded its authority in directing that certain claims be pursued against him prevented him from a later assertion of the same claim because of the doctrine of res judicata. Although the brother was a de facto fiduciary ordinarily entitled to commissions, various items of misconduct by him warranted the denial of commissions. The matter was remitted for a recalculation of damages based upon rents paid on month-to-month

tenancies. In a companion case, the Appellate Division found that the Surrogate's Court had jurisdiction over the application of the administrator to hold the wife of the former executor in contempt for disobedience of an information subpoena. *In re Lupoli*, __ A.D.2d __, 714 N.Y.S.2d 503 (2d Dep't 2000); 275 A.D.2d 44, 714 N.Y.S.2d 497 (2d Dep't 2000).

DISCOVERY—ISSUES OF FACT

Decedent's first wife and four children brought a discovery proceeding to recover the proceeds of life insurance policies and a share of decedent's pension benefits. The Appellate Division found that the lower court had erred in granting the second wife's motion for summary judgment on the ground that three of the children had become emancipated, thus ending decedent's obligation to maintain the policies for their benefit. The obligation concerning the policies was based upon the terms of a separation agreement that were found to be ambiguous. With respect to the pension plan, no issues of fact were presented by petitioners and summary judgment in favor of the second wife was correct. *In re Estate of McGeough*, __ A.D.2d __, 714 N.Y.S.2d 526 (2d Dep't 2000).

ACCOUNTING—IMPROPER PAYMENT

The executrix paid out of the assets of decedent's estate a hospital bill of $19,675 for services rendered to decedent's husband who had predeceased his wife. Although judgment on the claim had been once entered in favor of the hospital, that judgment had been vacated prior to payment. The claim for services was likely provable as an obligation of the estate but the executrix failed to exclude the contrary possibility. The Appellate Division affirmed the Surrogate's decision to limit the surcharge to the amount of the projected statutory commissions. *In re Labua*, __ A.D.2d __, 714 N.Y.S.2d 131 (2d Dep't 2000).

RELEASE OF FUNDS IN FORFEITURE ACTION

In a civil preconviction forfeiture action, the criminal defendant died during the pending of the criminal proceeding but after the issuance of an order of attachment and restraining order. The administratrix of decedent's estate sought the release of a portion of the attached assets to pay present and future bills. It appeared that the estate had no other assets to apply to these obligations. The court found that the statutory permission to have funds released to pay reasonable living expenses was broad enough to include reasonable administration expenses for the estate of a decedent. Costs of meals and flowers incurred in connection with the funeral and legal fees for both the criminal proceeding and the estate administration were proper items for release. In addition, various expenses related to carrying charges and sale of real property together with projected accounting fees were also appropriate for release. However, the court declined to estimate the amount of future legal fees and authorize immediate release of those funds. Release of $55,000 was permitted for interim fees with the balance to be determined after trial. *Dillon v. Marelli*, 185 Misc. 2d 461, 713 N.Y.S.2d 449 (Co. Ct., Nassau Co. 2000).

TRUSTS

BREACH OF FIDUCIARY OBLIGATIONS

In a dispute between two co-trustees of a testamentary trust and a third co-trustee, the lower court agreed with the two trustees and revoked the letters issued to the third trustee because of a conflict of interest. Apparently, that trustee had an interest in an insurance business that was in competition with an insurance business held in the trust. The Appellate Division affirmed this removal but directed the removal of the other two co-trustees as well. Proof indicated that they had breached their duty of cooperation by excluding the other trustee from meetings and failing to turn over financial and other documents. As a result, it was not possible for the removed co-trustee to discharge her fiduciary responsibilities. The matter was remanded to Supreme Court to consider the appointment of one or more independent trustees. *In re Hall*, __ A.D.2d __, 713 N.Y.S.2d 622 (4th Dep't 2000).

MISCELLANEOUS

ACCOUNTING BY GUARDIAN

In a proceeding to settle the final account of the son of an incapacitated person who served as her guardian until his removal, attorney's fees were awarded to his sister who had petitioned for the appointment of a special guardian and to his surety which had properly appeared in the sister's proceeding. The removal was based upon the refusal of the guardian to pay her nursing home costs from her assets and to deliver to the sister savings bonds that were payable to her. The surety had been exposed to liability through the sister's claim that the guardian had converted her assets. Attorney's fees were also recoverable by the surety under the terms of the indemnity agreement. *In re Sherman*, __ A.D.2d __, 715 N.Y.S.2d 746 (2d Dep't 2000).

COMMISSIONS OF GUARDIANS

In determining the commissions owed to co-guardians, the court eliminated the value of the ward's literary property and her residence which reduced the base approximately 20 percent. The Appellate Division affirmed that determination, noting that the value of the faithful performance of the

guardians' duties is not necessarily related to the monetary value of the ward's assets. The standard for compensation of guardians set forth in the Mental Hygiene Law speaks only to use of the formula for trustees' commissions as a guideline. Modification based upon the circumstances of the case is permissible and appropriate. *In re Crouse*, __ A.D.2d __, 715 N.Y.S.2d 395 (1st Dep't 2000).

INVALID INTER VIVOS TRUST

A letter written by decedent directing his bank to put $125,000 at the disposal of appellant in case he died unexpectedly did not constitute a gift. The authorization was not intended to take effect until death and was properly revoked during the interim. Alleged oral promises made by decedent to petitioner were unenforceable under the Statute of Frauds. *In re Huyot*, __ A.D.2d __, 714 N.Y.S.2d 344 (2d Dep't 2000).

TOTTEN TRUST BANK ACCOUNTS

At the time of his death, decedent was the owner of five Totten trust accounts in three banks with an aggregate balance of $447,443. Although decedent had become divorced from the beneficiary several years prior to his death, no change in the form of the account was ever made. A simple will executed after the divorce became final made no mention of the bank accounts. The separation agreement entered into by the estranged spouses prior to divorce purported to guarantee to each spouse his or her own assets free of any claim of the other, with full power of disposition in the owner. The named beneficiary was held to be entitled to the funds on deposit since the accounts had not been revoked by decedent in the manner set forth in EPTL 7-5.2. Neither the divorce nor the separation agreement warranted a result to the contrary. *Eredics v. Chase Manhattan Bank*, __Misc. 2d __, 715 N.Y.S.2d 609 (Sup. Ct., Nassau Co. 2000).

LEGAL FEES—CLAIM FOR UNLAWFUL IMPRISONMENT

An administratrix to whom limited letters had been issued sought judicial permission to distribute $150,000 received from the state based upon a claim for unjust conviction and imprisonment of the decedent. Decedent was tried for homicide three times. Convictions in the first and second trials were reversed on appeal. After ten years of incarceration, he was found not guilty in a third trial. The attorney for the administratrix unsuccessfully argued that his firm's fee should be 50% of the recovery as provided in the retainer agreement and that the rule limiting legal fees in personal injury cases to one-third of the recovery did not apply. The Surrogate found that the limitation on fees provided by rule in the First Department did apply. This interpretation is consistent with General Construction Law 37-a which included within the term "personal injury" false imprisonment or other actionable injury to the person. *In re Estate of Hernandez*, __Misc. 2d __, 715 N.Y.S.2d 627 (Sur. Ct., Bronx Co. 2000).

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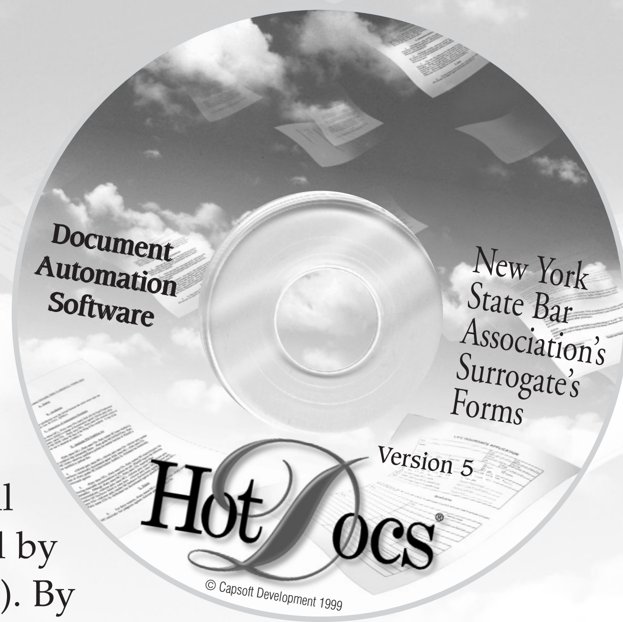

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