NYSBA SPRING 2002 | VOL. 35 | NO. 1

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

The New York State Bar Association, in marking its 125th Anniversary this year, is creating a book of the substantial history of contributions of the Bench, Bar and Association in the development of the legal system and in addressing societal problems. The Association wants to include focus on the work of the Sections and asked us to identify major developments and initiatives of our Section. In starting to work on this important project, I formulated an initial list of our Section's very impressive, many major accomplishments, which include the following:

1. Development of statewide uniform forms for Surrogate's Court proceedings on HOT DOCs in conjunction with a major publishing company.
2. Repeal of the New York estate and gift taxes.
3. Providing materials and speakers for continuing legal education programs on substantive and procedural areas of trusts and estates practice.
4. Affirmative legislative proposals on all aspects of procedural and substantive law in the trusts and estates field.
5. Providing volunteer attorneys and mentors as well as computerized forms and resources for the families of the victims of the September 11th tragedy.
6. Formation of special committees to work with the EPTL-SCPA Legislative Advisory Committee and the OCA Surrogate's Court Advisory Committee on major areas of legislative changes.
7. Publication of practical skills treatises on *Probate and Administration of New York Estates* and *Estate Planning and Will Drafting*.

Of course, these are just a few of the Section's many achievements and we look forward to many more challenges and accomplishments in the future.

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Our immediate past Chair Stephen M. Newman served our Section with determination, dedication, leadership, hard work and expertise. Steve's personality and always present sense of humor gave us strength and support during the most difficult of times.

I want to take this opportunity to commend Stephen M. Newman, and the Editor of this *Newsletter*, Magdalen Gaynor, as well as contributors, Wallace L. Leinheardt, Sanford J. Schlesinger and Joshua S. Rubenstein, for their timely, important and informative Special Edition *Newsletter*, which disseminated information regarding procedures put in place in the aftermath of the September 11th tragedy, including provisions and forms to expedite access to assets and various emergency tax relief provisions.

We extend our appreciation and congratulations to Ilene S. Cooper, who chaired and edited the coursebook for a most interesting and informative program at the Annual Meeting on "21st Century Challenges for the Trust and Estate Practitioner," with presentations by David J. Arcella on the Principal and Income Act, Edward C. Northwood on the Estate Tax "Repeal," and James B. Ayers and Professor Roy D. Simon on the New MDP Rules, and the luncheon address by Commissioner of Taxation and Finance Arthur J. Roth.

Kathryn Madigan and Michael Zuckerman are chairing a program which will continue the theme at the Spring Meeting in Binghamton, with a focus on drafting in light of tax reform and the Principal and Income Act, gifts to tuition plans and the viability of life insurance in estate planning.

Although our Section's membership continues to be among the largest of the Association, we continue to need many active members to work on the important committee projects which form the backbone of our accomplishments. Kindly consult the committee list at the back of this *Newsletter* and contact the committee chair of any committee on which you wish to serve.

We look forward to seeing everyone in Binghamton at our Spring Meeting on April 25-26, 2002, and wish everyone a safe, healthy and successful year.

Arlene Harris

Editor's Message

Once again the *Newsletter* is fortunate in having members of its Section provide timely and informative articles for this issue. Anne Hilker has written on community property concerns for practitioners. With our mobile clients, this issue is more common than many would realize. Charles J. Groppe, the Section's ethics "guru," has presented an enlightening article on privity. Warren Whitaker writes on tax planning strategies for the multinational family in an informative manner. Paul Comeau, a tax specialist, has written on the important issue of domicile for estates. Often, clients have homes or spend time in more than one state. Sometimes, each of the states can try to impose its estate by claiming the decedent was a domiciliary.

With this issue, a new contributor for the Case Notes section of the *Newsletter* debuts. Ilene S. Cooper has joined with Donald S. Klein to continue this valued part of the *Newsletter*. I want to welcome Ilene and thank her for taking on this time-consuming task.

Magdalen Gaynor

Upcoming Meetings of Interest

April 25–26, 2002	New York State Bar Association Trusts and Estates Law Section. Spring Meeting. Binghamton, NY.
May–June, 2002	Practical Skills—Trust Planning and Taxation. Offered in eight locations throughout the state.
October 3–6, 2002	New York State Bar Association Trusts and Estates Law Section. Fall Meeting. Boston, MA.
September 11–14, 2003	New York State Bar Association Trusts and Estates Law Section. Fall Meeting. Victoria, British Columbia.
Fall 2004	New York State Bar Association Trusts and Estates Law Section. Fall Meeting. Savannah, Georgia.

Community Property Concerns for the New York Lawyer

By Anne K. Hilker

Client mobility is no longer the exception, but the rule. With it comes the need for estate planners in common law, or separate property, states to have a working familiarity with community property and its importance in estate planning.

I. Introduction to Community Property

Assume that you're presented with a married couple seeking estate-planning guidance after they arrive in or when they are contemplating leaving your separate property state. Since the key differences in community and separate property depend upon earnings during marriage, we'll focus on Spouses 1 and 2. S1 will be the first to die and is the earner spouse. S2 will be the second to die, with fewer or no earnings. We'll deal with issues for estate and gift planning only, not for divorce. Where particular aspects are noted, they will refer to California law unless otherwise specified.

All of the United States—except Georgia—have some form of protection for a non-propertied spouse when the earner spouse dies. Community property, based on Western European, and largely Spanish, civil law, views marriage as a partnership. The non-earner, S2, is protected not by a guaranteed share at S1's death, but by a current one-half ownership right in the assets the couple acquire during the marriage, regardless of titling.[1]

While the balance of this discussion will focus on diagnosing and planning for community property issues, it's important to remember that there are nine community property states, and ten if we include the recent upstart, Alaska. The balance are Arizona, California, Idaho, New Mexico, Louisiana, Washington, Nevada and Texas, as well as Wisconsin, recognized as a community property state by the IRS by virtue of its adoption of the Uniform Marital Property Act.[2] This discussion will focus only on states that impose a community property system as the default property system.

II. Issues in Planning with Community Property

Most states define community property as property acquired during marriage as the result of work performed by either spouse.[3] Exceptions are property held prior to marriage, property inherited or received as a gift during the marriage,[4] and property agreed, before or after marriage, to be separate property.[5] Jurisdictions differ in the following key aspects:

- California requires domicile in California to render an asset community property. Can you take the position that a retirement home for New Yorkers built in California is community property? What nexus does real property provide?
- When S2 leaves the protection of a forced share state, the community property system generally protects that spouse with an "expectancy" in S1's estate equal to one-half of what would have been the couple's community property had it been acquired while the couple was domiciled there. This is a class of property known as "quasi-community property."[6] At death quasi-community property includes what would be testamentary substitutes under New York law.[7] This is not an ownership right; rather, it protects S2 only when S2 survives S1.
- Community property may constitute a one-half ownership interest in each asset earned by the community, or it may be an undivided interest in the entire community. California is an example of the former; Texas is an example of the latter.
- When S1 earns income on separate property, is it community or separate? California calls it separate.[8] Texas calls it community. In each case its status is subject to agreement otherwise. This rule is not without its issues: suppose S2 spends most of her time on the beach in California daytrading to build up her separate property portfolio while she looks after the children. Is the portfolio separate or community?
- In California, community property is liable for the debts of either spouse incurred before or during marriage,[9] and the separate property of the debtor and nondebtor spouses is liable for debts incurred during marriage for the couple's personal needs.[10]

III. Identifying Community Property

Hornbook law had told us that joint property cannot also be community property. Until July 1, 2001, California was apparently the only state not to have enacted a hybrid form of title permitting survivorship rights in marital property. As of July 1, 2001, California Civil Code § 682.1 permits all property, except for multiparty accounts at financial institutions, to be held as "community property with right of survivorship."

Title does not play a significant role in identifying community property. While separate property planners honor title as the indicator of property rights between S1 and S2, community property lawyers virtually ignore title. Title in the name of either spouse alone does not indicate separate property, because the key determinant is method of acquisition.

Some special considerations also must be taken into account in identifying community property. *Boggs v. Boggs*[11] was a landmark case for S2's interest in retirement plans in community property states. After years of case law developed in California and other states to the effect that a qualified retirement plan was community property—and, therefore, that any beneficiary designation operated only to the extent of half of the community portion of the plan—*Boggs* held that ERISA preempted state law and that Section 401(k) plans belong to the earner spouse only, even if S2 dies first, regardless of the domicile of the earner in a community property state.[12] *Boggs* appears to apply to all plans governed by ERISA, and therefore appears to apply to IRAs as well.[13]

Fourteen separate property states have enacted the Uniform Disposition of Community Property Rights at Death Act, which recognizes community property at the death of either spouse to preserve ownership rights and the basis advantages.[14] On the flip side—quasi-community property—a preserved community property interest in one-half is typically larger than the elective share. To qualify for preservation under this Act, history of the property must be consistent with community ownership. (An agreement may suffice if the state involved has not enacted the statute.) Property subject to the statute falls out of the base for computing the elective share and is not included as received as part of the share.

IV. Changing the Character of Property

Community property states generally allow spouses to agree that property is other than what it is started as by agreement, before or after marriage. In California, a large body of case and statutory law details the requirements of such an agreement to protect the party at risk from a value standpoint.[15] Section 852 of the California Family Code provides that a transmutation "is not valid unless made in writing by an express declaration that is made, joined in, consented to, or accepted by the spouse whose interest in the property is adversely affected." Most California lawyers will say that separate counsel for such agreements is an absolute prerequisite to enforceability of the agreement. Even then, a court can overturn a marital agreement if it believes the agreement overreaches unconscionably.

Because the property characterization issue is often essential to the planning process, most community property lawyers either work from the characterization provided by the clients or, if clarification is necessary, counsel them on the need for an agreement and the option of separate counsel.

V. Ethics for Lawyers Representing Couples with Respect to Community Property

Historically, the estate planning bar has found itself outside traditional notions of conflicts of interest, whether set forth in Model Rules or state codes of ethics. These have been constructed to meet litigation and corporate representation. For planners, the overlay of the adversity assumed in the rules and codes simply does not fit the representation of husbands and wives. Still, a poorer spouse's silence at the meeting table, or the casual remark about the other spouse's business interests by the lawyer representing those interests, as well as writing wills for both spouses, made planners sufficiently uncomfortable to prompt their bars to act. Estate planners, especially those dealing with possible changes to property entitlements, need to be aware of the resources available to them in addressing these questions in their own practices. They need to formulate their own day-to-day practice rules. Finally, they should address whether to incorporate conflict waivers setting forth their approaches to these questions when the clients engage the lawyer.

On these matters, states differ in their ethical governance. Some follow the Model Rules set forth by the American Bar Association.[16] Others, like New York State, are governed by state codes, in New York's case by the Disciplinary Rules of the Code of Professional Responsibility, promulgated as joint rules of the Appellate Division of the Supreme Court.[17] The Rules and Code approach similar problems but with differing language and concepts.

Under the Model Rules, applicable sections for study are Rules 1.7(a) and (b), as follows:

> Model Rule 1.7(a):
>
> A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless:

(1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and

(2) each client consents after consultation.

Model Rule 1.7(b):

A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

(1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and

(2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

Under New York's Code, the applicable section for study is Canon 5 and the accompanying Disciplinary Rules, as follows:

(A) A lawyer shall decline proffered employment if the exercise of independent professional judgment on behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, or if it would be likely to involve the lawyer in representing differing interests, except to the extent permitted under DR 5-105 [1200.24] (C).

(B) A lawyer shall not continue multiple employment if the exercise of independent professional judgment on behalf of a client will be or is likely to be adversely affected by the lawyer's representation of another client, or if it would be likely to involve the lawyer in representing differing interests, except to the extent permitted under DR 5-105 [1200.24] (C).

(C) In the situations covered by DR 5-105 [1200.24] (A) and (B), a lawyer may represent multiple clients if a disinterested lawyer would believe that the lawyer can competently represent the interest of each and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved.[18]

Most studies in adapting adversarial rules to counseling rules have been by bar associations and restatement scholars, rather than by state law enactment. A significant exception is the state of Florida. Therefore, most writing on the subject is nonbinding commentary. Nonetheless, it provides significant guideposts for the planner in determining the course of his or her approach to conflicts of interest. Both the American College of Trust and Estate Counsel (ACTEC) and the Real Property Probate and Trust Law Section of the American Bar Association (RPPT) have published significant papers on the interpretation of the model rules for estate planners.[19] It is important to remember that they are not the law. While each has been approved by its governing body (the ABA Section report was approved by its governing council only, not the American Bar Association) they consist of the following key propositions:

The ABA Recommendations provide:

Rule 1.7 does not apply if there is a mere possibility of conflict between the spouses in the estate planning process. The status of marriage alone is not sufficient to create a substantial potential for a material limitation upon the lawyer's representation of either spouse.

Rule 1.7 is not applicable until the lawyer discerns that there is a substantial potential for a material limitation upon the lawyer's representation of either spouse.

> Once a substantial potential for a material limitation on the lawyer's representation of either spouse—the equivalent of a material potential for conflict—exists, the lawyer must obtain consent to the representation, preferably in writing, and for the first time Rule 1.7 applies.[20]

The Commentaries similarly address the point of conflict:

> *Joint and Separate Clients*. Subject to the requirements of MRPCs 1.6 (Confidentiality of Information) 1.7 (Conflict of Interest: General Rule) and 2.2 (Intermediary), a lawyer may represent more than one client with related, but not necessarily identical, interests (e.g., several members of the same family, more than one investor in a business enterprise). The fact that the goals of the client are not entirely consistent does not necessarily constitute a conflict that precludes the same lawyer from representing them. See ACTEC Commentary on MRPC 1.7 (Conflict of Interest: General Rule). Thus, the same lawyer may represent a husband and wife, or parent and child, whose dispositive plans are not entirely the same. When the lawyer is first consulted by the multiple potential clients the lawyer should review with them the terms upon which the lawyer will undertake the representation, including the extent to which information will be shared among them. The principal terms should, but need not, be reflected in a writing, a copy of which is given to each client. See ACTEC Commentary on MRPC 1.2 (Scope of Representation). The lawyer may wish to consider holding a separate interview with each prospective client, which may allow the clients to be more candid and, perhaps, reveal conflicts of interest.[21]

Florida Bar Association Opinion 95-4 (May 30, 1997) deals with the dilemma of the lawyer who has jointly represented both spouses in estate planning. Each has "substantial individual assets" and also "substantial jointly-held property." The wills contain marital trusts that pass ultimately to the couple's children. In its discussion section, the opinion holds:

> From the inception of the representation until Husband's communication to Lawyer of the information concerning the codicil and the extra-marital relationship . . . there was no objective indication that the interests of Husband and Wife diverged, nor did it objectively appear to Lawyer that any such divergence of interests was reasonably likely to arise. Such situations involving joint representation of Husband and Wife do not present a conflict of interests and, therefore, do not trigger the conflict of interest disclosure-and-consent requirements [of Florida's Ethics Rules].

The Florida opinion also imposes a reasonableness test, but one that the lawyer must apply personally.

Finally, New York's Code, Canon 5, also suggests a form of balancing. EC 5-15 states with respect to multiple clients having potentially differing interests:

> If the interests vary only slightly, it is generally likely that the lawyer will not be subjected to an adverse influence and that the lawyer can retain his or her independent judgment on behalf of each client; and if the interests become differing, withdrawal is less likely to have a disruptive effect upon the causes of the clients.

Under New York law, does a conflict exist in a joint spousal representation for estate planning? New York authority does not explicitly give us an answer. Turning to the Recommendations and New York's Disciplinary Rules, it is possible to set out at least one instructional blueprint. DR 5-105 [1200.24] (C) provides:

> If a lawyer's exercise of independent professional judgment on behalf of a client could be affected under the circumstances of the employment, a lawyer may represent multiple clients if a disinterested lawyer would believe that the lawyer can competently represent the interest of each and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved.

In sum, under either the Recommendations or the Code, the lawyer is subject to a lookback test in either a following lawsuit or ethics complaint. The Recommendations suggest that the lawyer must ascertain this individually; the Code mandates an objective test. Either appears impossible to perform with certainty. That is not to say that the lawyer should not undertake it; rather, it is the essence of one's job every day.

How should the estate planner make a determination if a conflict exists? The Recommendations provide that if a material limitation on the independence of the representation exists, "[t]he lawyer must obtain consent to the representation, preferably in writing, and for the first time Rule 1.7 applies." The Comment to this principle notes that:

> such a conflict occurs when spouses disagree on issues in which only one spouse can succeed, such as ownership rights or the characterization of property as separate or community or where the exercise of a forced share right will defeat the other spouse's intended plan. Mere disposition of assets in ways consistent with state-given property rights does not pose such a conflict.[22]

Property issues are not the only probable source of conflict. In the course of representing spouses, one spouse may impart to the lawyer a confidence that indicates that the plan will fail or that the other spouse is being misled or defrauded. The lawyer must have ready a course of action, again one determined in advance and used as a general practice.

Outside authority provides conflicts outcomes. In *A. v. B. v. Hill Wallack*,[23] the New Jersey Supreme Court considered the duty to disclose a unilateral confidence adverse to the nondisclosing spouse. Applying New Jersey's rule on disclosure of confidences, it held that a firm representing a husband and wife, while inadvertently at the same time representing the mother of husband's alleged child in a paternity suit, could, but did not have to, disclose the existence of the child to the husband's wife. Significantly for authoritative purposes, it noted that New Jersey's Rule of Professional Conduct 1.6 "[is] a more expansive commitment to the disclosure of confidential client information [than the Model Rules]."[24]

In contrast, in Florida Bar Association Opinion 95-4 (May 30, 1977), considering the situation of a confidence disclosed by one spouse in a joint representation adverse to the other spouse, the committee

> [rejected] the concept of discretion in this important area. Florida lawyers must have an unambiguous rule governing their conduct in situations of this nature. We conclude that Lawyer owes duties of confidentiality to both Husband and Wife, regardless of whether they are being represented jointly. Accordingly, under the facts presented Lawyer is ethically precluded from disclosing the separate confidence to Wife without Husband's consent.

New York sources are similarly in conflict: New York State Bar Association Committee on Professional Ethics, Opinion 555 (1984), provides as follows (while the following excerpts are lengthy, they are key to understanding the opinion):

> A and B formed a partnership and employed Lawyer L to represent them in connection with the partnership affairs. Subsequently, B, in a conversation with Lawyer L, advised Lawyer L that he was actively breaching the partnership agreement. B preceded this statement to Lawyer L with the statement that he proposed to tell Lawyer L something "in confidence." Lawyer L did not respond to that statement and did not understand that B intended to make a statement that would be of importance to A but was to be kept confidential from A. Lawyer L had not, prior thereto, advised A or B that he could not receive from one communications regarding the subject of the joint representation that would be confidential from the other. B has subsequently declined to tell A what he has told Lawyer L. Lawyer L now asks what course he may or must take with respect to disclosure to A of what B has told him and with respect to continued representation of the partners.
>
> It is the opinion of the Committee that (i) Lawyer L may not disclose to A what B has told him, and (ii) Lawyer L must withdraw from further representation of the partners with respect to the partnership affairs.
>
> The situation here presented involves two basic, and here perhaps inconsistent, duties of a lawyer. One is the duty of loyalty and the other the duty to maintain client confidences. One generally recognized

aspect of the duty of loyalty is the duty of a lawyer, as a fiduciary, to impart to the client information which the lawyer possesses that is relevant to the affairs as to which the lawyer is employed and that might reasonably affect the client's conduct with respect to such affairs. *Spector v. Mermelstein*, 361 F. Supp. 30 (S.D.N.Y. 1972). Indeed, this is a duty owed by any agent acting in a fiduciary capacity. Restatement (Second) Agency, Section 381 (1957). But a recognized agency exception is that the duty does not extend to matters the disclosure of which would violate a duty to a third person. *Id.*, Comment e (which states this exception expressly as applying to lawyers). Thus, generally, the lawyer has no duty (and, indeed, no right) to disclose to one client confidential information learned from, or in the course of representing, another client, at least where the information does not relate to a subject matter as to which the clients are joint clients . . . The Committee believes that the question ultimately is whether each of the clients, by virtue of jointly employing the lawyer, impliedly agrees or consents to the lawyer's disclosing to the other all communications of each on the subject of the representation. It is the opinion of the Committee that, at least in dealing with communications to the lawyer directly from one of the joint clients, the mere joint employment is not sufficient, without more, to justify implying such consent where disclosure of the communication to the other client would obviously be detrimental to the communicating client. This is not to say that such consent is never to be found. The lawyer may, at the outset of the joint representation or even perhaps at some later stage if otherwise appropriate, condition his acceptance or continuation of the joint representation upon the clients' agreement that all communications from one on the subject of the joint representation shall or may be disclosed to the other . . . Whatever is done, the critical point is that the circumstances must clearly demonstrate that it is fair to conclude that the clients have knowingly consented to the limited non-confidentiality. Both EC 5-16 and Rule 2.2 of the Model Rules emphasize that, before undertaking a joint representation, the lawyer should explain fully to each the implications of the joint representation. Absent circumstances that indicate consent in fact, consent should not be implied.

> Of course, the instant fact situation is a fortiori. Here, the client specifically in advance designated his communication as confidential, and the lawyer did not demur. Under the circumstances, the confidence must be kept.

In contrast,[25] a lawyer representing the limited partners of a client partnership asked whether she must disclose the funneling of profits into another business by the general partner, who was also her client for personal matters. In this case she learned of the practice from the GP's accountant and from her own personal investigation of the side business. Determining in part that EC5-14 and DR5-105(B) were implicated, the City Bar concluded:

> Such disclosure of GP's improprieties is not prohibited by the principle that an attorney has a duty to preserve the confidences and secrets of a client. While the attorney discovered the GP's improprieties in the course of her representation of the Partnership, her duty of loyalty to the Partnership would be paramount to any duty to respect the secrets of any individual partner, such as GP, disclosed during the course of Partnership presentation, even if GP is also a client.

OP 555 is a New York State Bar Association Ethics Opinion, while OP 1994-10 is an opinion of the Committee on Professional and Judicial Ethics of the Association of the Bar of the City of New York. Therefore, two separate New York bar associations appear to have reached differing conclusions. A reading of the facts reveals that OP 555 was the result of information revealed in confidence, while the 1994 opinion apparently was not. (Just such a distinction was noted in New York State Bar Association Ethics Opinion 674, fn. 11.) Nonetheless, the 1994 opinion concluded it was within the scope of a confidence because it was "gained within the professional relationship" and its disclosure obviously would be "detrimental to GP."

VI. Tax Planning Aspects of Community Property

Community property enjoys a number of tax aspects key to estate planning. At death, both halves of community property receive a step-up in basis.[26] Historically, gender-based actuarial facts justified the "rough justice" of the dual step-up. In common law states, the earner spouse was likely to die first and be male, leaving the bulk of the assets with a stepped-up basis to his widow. In a community property state, the survivor would, under this theory, receive a step-up in only half the assets. To resolve this situation, Congress bestowed the double step-up for all community property assets at the time of death. The key advantage in the double step-up is that it eliminates the hand of chance: All assets receive a step-up, no matter who dies first. The dual basis step-up has survived the repeal of section 1014 by section 542 of the Act. That section enacts IRC § 1022 in its place, effective January 1, 2010.[27]

> (iv) COMMUNITY PROPERTY.—Property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State or possession of the United States or any foreign country shall be treated for purposes of this section as owned by, and acquired from, the decedent if at least one-half of the whole of the community interest in such property is treated as owned by, and acquired from, the decedent without regard to this clause.

The statute is not a blanket step-up for all community property. S2's step-up requires that S1's step-up meet carryover basis requirements.

Community property is an automatic equalizer. Again, in estate and gift tax planning, title is determined by source rather than by actual documentary title. Community property can serve to absorb the credit shelter amount and the GST exemption, if appropriate, without the need for either gifts or retitling.

In addition, federal circuit courts governing community property states have consistently held that the half interest in community property is, like any other minority interest, subject to a discount.[28] In an estate plan where some tax will be paid—for example, in a second marriage where children from the first marriage will receive more than the credit shelter amount—this is a useful technique. Discounting works less favorably, of course, where no tax is paid at the first death and a high step-up is sought.

For the couple that includes a non-citizen spouse, community property is also a valuable estate planning tool. State property law allots half the couple's community property to each spouse, regardless of the status of citizenship. (A domicile of the non-citizen spouse outside the community property state threatens this principle.) Half belongs to the non-citizen spouse, without the limitations of annual exclusion gifts or QDOT treatment. S1 can move additional community or separate property by agreement to augment S2's existing community property holdings.

VII. Identifying Community Property in the Planning Setting—Some Practical Questions to Ask

1. Where have the clients lived during their marriage?
2. Do they have a pre- or post-nuptial agreement? Does it cover community property?
3. What are their thoughts on their marital property now?
4. Where does each of them live?
5. Is there one residence in a community property state and another in a separate property state?
6. Where is real property located?
7. Are there partnership interests holding real property?
8. Are there any significant tangible assets in any community property state? In some cases, community property is transferred to a separate property state in the form of a significant downpayment on a home and so can be easily traced. Other assets may carry hidden community property features.
9. Where were the appreciated stock options earned?
10. How recently did the couple move from a community property state?
11. What are their current holdings? Changes of title upon arrival can result in a loss of opportunity to preserve community property.
12. Where were the assets earned?
13. Does either spouse work in or travel extensively to a community property state?

14. Does the couple run a business together? While it might appear that S1 is the owner, S2 still has a community property half-interest when S2 leaves the community property state. Community property law will generally give the spouse active in the business the sole right of management of a community property business, but not the right to liquidate or sell.

15. Does the couple have existing wills or trusts?

16. Do they recite the character of property? In particular, schedules to funded revocable trusts may identify community and separate property assets.

17. Finally, does the couple want to preserve community property? Some don't. Some would rather commingle all property and let it "work itself out." Counseling should advise them of their lost opportunities should they choose this route. On the other hand, many couples choose a *laissez-faire* approach to marital assets as part of the chemistry of the marriage.

VIII. Common Planning Issues and Remedies

If the couple is common, practice tools to preserve community property are the following:

- Segregate community property in a revocable trust with both spouses as co-trustees. Recite that all property was earned in or brought from X state. Do NOT prepare single trusts for each spouse, as is common in separate property states, or you will risk an argument—by the IRS, if not others—that the community has in fact been severed. Under California law the trust must also provide that it is amendable only with the consent of both spouses.[29]

- *Taking new title*. Many couples sink their entire equity from the sale of their home in a community property state into a home in the new separate property state. How should they take title? Both the UDCPRA and the IRS require that title be taken "consistently" with community property. No insurer in the separate property state will issue clear title to "community property." The closest counterpart, it appears, is the creation of a tenancy in common: 50% by each spouse, with a side letter, in recordable form, attesting that the property was community property prior to the purchase and remains so at the time of purchase.[30]

- *Writing a new will.* Part of the planning process is the planner's recognition of community property and, if possible, its value in relation to other assets. In second marriages in particular, misunderstandings about the character of property can cause a serious post-mortem dispute. An agreement capturing the couple's best estimate of what is community can resolve this issue, and is commonly done in community property states as well.

If the couple is moving to a community property state, they can accomplish a number of planning items upon arrival:

- If community property is desirable for estate planning purposes, all separate property should be converted immediately upon acquisition of domicile. Real property left back in the separate property state may be most conveniently handled by a revocable trust to avoid a probate proceeding in the property left behind.

- Does S1 require counseling with respect to quasi-community property? Note that quasi-community property is a one-half expectancy held by S2 if S2 survives—much greater than the one-third elective share provided under New York law, for example. S2 needs to be reminded that real property left behind in a separate property state will remain governed at death by elective share rules.

- If either spouse is a resident non-citizen, community property is the most tax-efficient property system because half of all earned property simply belongs to the non-citizen spouse. Transmutation of separate to community upon arrival is most likely a gift by the U.S. citizen spouse to the non-citizen spouse, subject to the more onerous gift tax restrictions. While cross-owned insurance is largely a planning feature of the past, it has come back as a useful tool for non-citizen spouse planning. S2 can avoid the cutdown in the principal received from S1 at death by holding a policy on S1's life, an important precaution. In a community property state, the couple must establish that only S2's separate property funds the insurance. Such an agreement might reflect the couple's agreement to convert a portion of S2's community property to separate property.

Endnotes

1. The reach of community property does not yet extend to same-sex marriages or significant other relationships. Many local jurisdictions in both New York and California, however, as well as the state of Vermont, do recognize property rights in the surviving partner.
2. Rev. Rul. 87-13, IRB 1987-6, 4.
3. *See, e.g.*, Cal. Fam. Code § 760.
4. Cal. Fam. Code § 770.

5. Cal. Fam. Code § 880.
6. Cal. Fam. Code § 125, implemented at death by Cal. Probate Code § 102.
7. *Id.*
8. Cal. Fam. Code § 770(a)(3).
9. Cal. Fam. Code § 910.
10. Cal. Fam. Code § 914.
11. 117 S. Ct. 1954 (1997).
12. *See also Marriage of Shelstead*, 66 Cal. App. 4th 893 (1998).
13. The Ninth Circuit has held that ERISA does not preempt the application of community property laws to welfare benefit plans (employer-provided group life insurance or death benefit plans). *Emard v. Hughes Aircraft Cor.* 153 F. 3d 949 (1998), *cert. denied*, 525 U.S. 1122. The Fourth and Seventh Circuits, however, disagree. Social security benefits must be treated as the earner spouse's separate property under federal law.
14. New York's is located at EPTL 6-6.1 *et seq*.
15. *See* Cal. Fam. Code §§ 850 *et. seq.*
16. Model Rules of Professional Conduct, 1992 (Model Rules).
17. N.Y.C.R.R. Part 1200 (Code).
18. DR 5-105(A)–(C).
19. ACTEC, "Commentaries on the Model Rules of Professional Conduct," 3d ed. 1999 (Commentaries); Special Study Committee on Professional Responsibility, "Comments and Recommendations on the Lawyer's Duties in Representing Husband and Wife," 28 Real Property, Probate and Trust Joint 765 Committee (Recommendations).
20. Recommendations at 779–80.
21. Commentaries at 118–119.
22. Recommendations at 781 (footnote omitted).
23. 158 N.J. 51 (April, 1999), *leave to appeal granted*, 160 N.J. 85.
24. *Id.* at 59.
25. Association of the Bar of the City of New York, Ethics Committee Opinion 1994-10, N.Y.L.J., Oct. 31, 1994.
26. I.R.C. § 1014(b)(6).
27. *See* I.R.C. § 1022(d)(1)(B)(iv).
28. *Propstra v. United States*, 680 F.2nd 1248 (9th Cir. 1982).
29. Cal. Fam. Code § 761.
30. Despite its community property nature at the time of purchase, it will be virtually impossible to maintain "pure" community property if the earnings of either or both spouses pay an ongoing mortgage. The couple should determine on an ongoing basis what percentage of the property has remained community.

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Privity: The Accountant's and Lawyer's Friend

By Charles J. Groppe

The "M" word—malpractice—continues to be part of the vocabulary of every professional—attorney, accountant, financial planner—as well as medical practitioner. But unlike the specter of malpractice against doctors or hospitals, which is usually one-to-one and direct (doctor/patient or hospital/patient) and not involving third parties, the concept of malpractice vis-à-vis financial or legal service providers is often asserted by third parties, who claim to have been injured derivatively by some action or inaction in the performance of the provider's duty to the "real" client.

For example: "I sold my stock back to the corporation relying on the corporate accountants' financial reports prepared and furnished to the corporation. The figures were wrong. Ergo: I should recover damages."

Or: "I didn't get the legacy of $100,000 because the lawyer typed the will incorrectly and indicated only $1,000—or used an incorrect name. The lawyer blundered; I should be paid my legacy."

Or: "The bank failed to review the will properly when it took the business in and made an error—I should be paid."

The law and cases in New York do not present anything remarkably different from the law and cases elsewhere on the subject of malpractice, or negligence, or violation of duty of care that a professional *owes* to his or her *own* client. There is a highly developed body of tort law that spells out the obligations and duties of professional providers and the rights of, and means of seeking redress by, clients and customers for their negligence. We protect ourselves—or try to—by conscientious performance of our duties and keeping our malpractice premiums up.

But fortunately—at least for now—New York provides a defense to accountants and lawyers against claims by third parties who attempt to piggyback on the client relationship. This defense is the defense of privity.

Stated broadly, this means that no liability will be imposed on the attorney or accountant, in favor of one who claims to have been injured by the attorney's or accountant's negligence—action or inaction—unless there was privity of contract between them—or as the latest cases say, "a relationship so close as to approach that of privity."

That distinction is important: The test is "privity" or a "relationship so close as to approach that of privity," i.e., virtual privity.

In the cases up to and after 1992, the standard for protecting attorneys was actual *privity*. Accountants enjoyed a somewhat less tight protection; they could be liable if the relationship was deemed the equivalent of, or *nearly* privity. Casuistic courts and lawyers can draw these distinctions!

Since 1992, it may be said that the standard is the same for both professions. But the standard—and the protection it affords—still lives.

This has all been given recent focus by the Court of Appeals in December 2000.

Let's consider: In *Parrott v. Coopers & Lybrand L.L.P.*[1] the Court of Appeals stated:

> We have reiterated time and again [How's that for redundancy!] that "before a party may recover in tort for pecuniary loss sustained as a result of another's negligent misrepresentations there must be a showing that there was either actual privity of contract between the parties or a relationship so close as to approach that of privity."

The Court of Appeals affirmed the lower court's denial of relief to the plaintiff, Mr. Parrott, who claimed to have been injured in his sale back to his former employer, a client of Coopers & Lybrand LLP, of employer stock when he relied on a valuation statement routinely prepared semi-annually by Coopers for the employer company. There was no evidence that Coopers was aware that its valuation would be used to determine the buyback price, or that Mr. Parrott even had a buyback agreement. Further, Mr. Parrott had never read or received any of the Coopers reports or met or communicated directly with Coopers.

Restating the judicial purpose "to provide fair and manageable bounds to what otherwise could prove to be limitless liability," the Court restated and reaffirmed the rule that

> . . . before liability may attach the evidence must demonstrate (1) an awareness by the maker of the statement that it is to be used for a particular purpose; (2) reliance by a known party on the statement in furtherance of that purpose; and (3) some conduct by the maker of the statement linking it to the relying party and evincing its understanding of that reliance. . . .[2]

The Court of Appeals held: "The evidence here is insufficient to establish a relationship so close as to approach that of privity." Note the three-part test: (1) particular purpose; (2) particular person; (3) link.

Hard on the heels of *Parrott*, the Court of Appeals applied New York law to answer certified questions posed to it by the U.S. Court of Appeals for the Second Circuit in *Securities Investor Protection Corporation v. BDO Seidman, LLP*.[3] The New York Court of Appeals applied the same three-pronged test in holding that no privity—or even "virtual privity"—existed between Plaintiff, Securities Investor Protection Corporation (SIPC) and the accountants who had prepared audit reports for the failed brokerage firm where SIPC had not requested, relied upon or known about the reports. No privity, no recovery. Not even any "virtual privity" or the practical equivalent of privity. The bastion remains secure.

As a bit of legal history, it is interesting to note that the idea of limiting the class of potential claimants—the rationale underlying privity—was based on a string of cases going back to 1842. In that year, the English Court of Exchequer held that a mail coach repairman could not be held liable to a rider who was injured when the wheel fell off the coach he had negligently repaired. He would not be liable to all who might ride the coach in the future!

England, and New York in the 1916 case, *MacPherson v. Buick*[4]—a law school chestnut—changed the rules regarding carriages and wheels and repairmen. In *MacPherson*, Judge Cardozo let down the privity bar to allow recovery in a case involving defective manufacture of a dangerous instrumentality—an automobile.

Subsequently, in 1922 Judge Cardozo in *Glanzer v. Shepard*[5] allowed recovery by a party who was known to the defendant for whom services ordered by someone else resulted in a loss. The defendant was a public weigher—literally a bean counter—whose weighing process was necessary to a sale. But in 1931, in Cardozo's equally famous case *Ultramares v. Touche*,[6] the same Judge refused to extend the rule to the accounting profession—on the ground that in such cases the ultimate liability would be limitless.

The whole idea behind the limitation of liability in the accountants' cases derives from Judge Cardozo's intention to prevent a "thoughtless slip or blunder" from exposing "accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class."

Subsequently, in *Credit Alliance Corp. v. Anderson & Co.*,[7] cited in *Parrott* and relied on by the Court of Appeals, the Court adopted the three-part test set forth above. It became and remains the accountants' privity rule.

Moral: Of course, do the work properly but also be aware of what and to whom and for what purpose your work product is to be used. *Or* set limitations on its use and circulation. Dealing directly with the clients or customers of your clients, sending copies of statements, reports, financials to them, not limiting the scope and purpose of your work, all can link you to that person and result in liability.

As to lawyers—since lawyers and judges make the rules as to privity—lawyers had a better privity shield to stand behind. That is not the case today.

New York—one of only four states to do so (Ohio, Nebraska and Texas are the others)—still adheres to the rule that privity of contract must exist between an attorney and a third party claiming to be damaged by the attorney's negligence. These enlightened jurisdictions did not join the movement away from privity that began in California in 1958.

The leading case in New York for privity is *Spivey v. Pulley*,[8] and it was cited for this proposition as recently as February 8, 2001 in *Cherry v. Mallery*.[9] So it is still valid.

In *Spivey*, plaintiff, (Solomon) and defendant, (lawyer Pulley) acted as witnesses—the only two—to the will of Nettie Spivey that Pulley had prepared. When Spivey died, Solomon's testimony was needed to prove the will. That voided the bequest to her and, because she was not a distributee, she was not even entitled to an intestate share. She got nothing; she sued Pulley, the attorney. "Pulley made me do it!" She lost.

The Appellate Division stated:

> The well-established rule in New York with respect to attorney malpractice is that absent fraud, collusion, malicious acts or other special circumstances, an attorney is not liable to third parties, not in privity, for harm caused by professional negligence . . . . [w]hile the Court of Appeals in *Credit Alliance Corp. v. Andersen & Co.* . . . carved out a limited exception to the privity rule with respect to accountants, this court has repeatedly and recently declined to enlarge the application of this exception to professionals other than accountants.

Note that this case is captioned "Spivey, Estate of" against Pulley, not "Solomon" against Pulley. It was after all Solomon who lost her legacy. Why is that important?

Spivey's executors claimed that the executor, as the representative of the deceased, was in privity with the lawyer who had drafted the will. So, if the beneficiary couldn't sue, the executor could, alleging negligence in effectuating the decedent's testamentary plan. The executor claimed that the lawyer was in privity with his deceased client, the testatrix, and it was her will that caused the problem. The court did not buy it.

The Appellate Division held that (1) no privity existed between witness Solomon and defendant lawyer Pulley, and (2) the estate suffered no pecuniary loss. In addition, it specifically held that no privity existed between the estate and the defendant lawyer Pulley. No cause of action existed in favor of the executor against the negligent lawyer either.

The "recent case" that the *Spivey* court referred to as exemplifying its "no privity no recovery" rule was *Viscardi v. Lerner*.[10] This resulted from a drafting error.

Mr. Ragone instructed his lawyers in 1965 to prepare a will leaving his wife the minimum elective share—at that time it was in trust for her life, remainder to his sisters.

In 1973, he went back to the lawyers and allegedly instructed them to "omit the trust provisions, give the share outright to wife." The lawyer's note read "omit trust provision—outright to wife."

The lawyers prepared the will, which Ragone signed. It read: "I give and bequeath to my wife . . . if she survives me, such part of my estate as my wife would have received had I died intestate." Ragone died.

Surrogate Midonick construed the will and gave the widow her intestate—not her elective share, i.e., 100% not 50%, and she got it all outright. The Appellate Division reversed the Surrogate and was in turn reversed by the Court of Appeals, which upheld Surrogate Midonick.

Now the decedent's sisters sought their revenge—against the drafter!

Mr. Ragone's sisters sued the lawyer. The *Viscardi v. Lerner* case was the result. The Appellate Division—wrong once, but not again—held that the "firmly established rule in New York State" is that an attorney is not liable to a third party not in privity with him for "harm caused by professional negligence." Further, the court rejected references to the law in other states—Illinois, Wisconsin, Connecticut, California—and stated: "We decline to depart from the firmly established privity requirement in order to create a specific exception for an attorney's negligence or will drafting."

Similarly, in *Deeb v. Johnson*[11] the court affirmed the Supreme Court's order, dismissing as not stating a cause of action, the plaintiff executor's claim of damages against the drafting attorneys. They alleged that the drafter's error in drafting a marital deduction clause increased estate tax liability by more than $59,000.

The Appellate Division cited *Spivey*, *Viscardi* and numerous other authorities and affirmed that the lawyers were not liable. No privity, no recovery, whether the action is brought by the intended beneficiaries or by the estate itself.

Now we come to 1992. In that year, the Court of Appeals decided *Prudential Ins. Co. v. Dewey Ballantine, Bushby, Palmer & Wood*[12] involving a claim by a non-client lender who allegedly relied on the work product of the lawyer for a borrower. The lawyer's error, it alleged, caused it damage. That case held that the absolute privity rule for attorneys should not be as absolute as before. It suggested that the basis for malpractice was "either actual privity of contract between the parties or a relationship so close as to approach that of privity."

The Court held that the complaint by the third party, non-client stated a cause of action since it met the three-part test of (1) awareness of use of the opinion, (2) it was known that plaintiff would rely on it, and (3) the attorneys had engaged in conduct linking it to plaintiff.

Nevertheless, the *Prudential* Court did not find the lawyers liable in damages because it was not established that the attorneys had *in fact* made any misrepresentation.

In *Prudential*, the Court has adopted the same test for lawyers that it theretofore adopted for accountants.

We come to 1996—the plot thickens.

In *In re Pascale*,[13] Surrogate Holzman of Bronx County summarized the law to that date. He emphasized the *Prudential* case and its holding that the same three-part test formerly used for accountants was also to be applied to lawyers. *Pascale* dealt with a failure to include language in reciprocal wills stating that the survivor could not revoke. Surrogate Holzman asked whether the *Prudential* case signaled a change in the law so that attorneys can now be liable to beneficiaries of an estate in the event that allegations of malpractice in will drafting can be established.

He noted the state's longstanding reluctance to hold attorneys liable to disappointed beneficiaries for will drafting or will execution errors.

Surrogate Holzman answered his own question "No." Since *Prudential* did not analyze or cite any case involving drafting or supervising the execution of any will, he held that its value as a precedent was limited to holding that attorneys, like accountants, can be held liable to third parties under "limited circumstances approaching privity." He said *Prudential* did not signal a change in New York in Will cases—to make it over from one of the most restrictive privity states to one of the least—in a case of the type that he was adjudicating.

But Surrogate Holzman also said:

> If the instant case involved malpractice with regard to the statutory formalities required by EPTL 3-2.1, or in permitting a legatee named in a Will drafted by counsel to act as an attesting witness thereto without advising the testator or the legatee that this might result in a forfeiture of the legacy under EPTL 3-3.2, or perhaps even where the attorney conceded or it is self-evident from the Will itself that the attorney failed to draft a provision favoring an identified beneficiary, *this Court would seriously consider whether Prudential* . . . was a beacon provided by the Court of Appeals to the Courts below that New York is now ready to follow the majority rule that a viable cause of action is stated against an attorney *under these circumstances*. [Emphasis added].

Where does this leave us?

The privity doctrine is still good law in New York. The tests of its application are set forth in major Court of Appeals cases, most recently in *Parrott v. Coopers & Lybrand LLP* in December 2000. The leading cases found no liability. The same three-part test applies to accountants and lawyers: (1) particular purpose; (2) person; (3) link.

But even Surrogate Holzman, a respected jurist, would limit a departure from privity to a narrow class of cases. He did, for example, hint that liability would not be imposed if the lawyer drafted a will that resulted in a loss of a tax deduction and increased estate tax cost.

The privity doctrine lives. As noted, it was cited favorably as recently as February 8, 2001, by the Appellate Division, Third Department.

However, don't reduce your malpractice coverage just yet. Respectable commentary exists looking unfavorably on the doctrine in New York as an anachronism—it is a minority doctrine after all.

The *Restatement of the Law (Third): The Law Governing Lawyers* published in 2000 flatly states in section 51(3) that "a lawyer owes a duty to use care in the case of a non-client when and to the extent that the attorney knows that a client intends as one of the primary objectives of the representation that the attorney's services are intended to benefit the non-client."

What else is a will or trust agreement but the embodiment of a client's intentions to benefit others, who are not the attorney's clients? The illustrative cases under section 51 upholding liability look strangely like the facts in *Spivey*, *Viscardi* and *Deeb*.

Remember, too, that the rule in these cases is that privity will be a defense absent "fraud, collusion, malicious acts or other special circumstances." Thus, while the rule continues to be blessed by the courts, the fault line is there—"other special circumstances"—along which the tremor might start.

As to the bank trust officers reviewing documents in the process of accepting new business, the question is problematic. I know of no cases in New York that relate privity to trust officers. But there is a general rule of negligence that circumscribes liability for loss within the ambit of the duty to be performed or actually performed. Remember *Palsgraf*?

So if the trust officer positively undertook to act to review documents—to check out the Rule Against Perpetuities, for example, or to review a QTIP, QDOT or GST trust—and gets it wrong—watch out. Banks in other jurisdictions—Florida comes to mind—have been held liable in such cases.

And remember, going too far in this process approaches uncomfortably the unauthorized practice of law.

Given the imaginativeness and ingenuity of our brethren at the bar to conceive of new forms of action and parties, the assault on privity may accelerate in other ways.

For example, in *Vogt v. Witmeyer*,[14] an effort was made to "contest" a will by asserting that the attorney's conduct was a "tortious interference" with the beneficiary's expectancy—the wrongful deprivation of a beneficiary of his rightful share. Preposterous? Tort lawyers used to think that tobacco litigation was a losing cause, but they kept trying.

Add to this the delay, cost, embarrassment, increase in malpractice insurance premiums, loss of goodwill and client relationships; so it is better to do it right than to do it over.

Endnotes

1. 95 N.Y.2d 479, 718 N.Y.S.2d 709 (Dec. 14, 2000).
2. *Prudential Ins. Co. v. Dewey Ballantine, Bushby, Palmer & Wood*, 80 N.Y.2d 377, 384 (citing *Credit Alliance Corp. v. Anderson & Co.* 65 N.Y.2d 536, 551). *See also D'Amico v. First Union National Bank, et al.*, 285 A.D.2d 166, 728 N.Y.S.2d 146 (1st Dep't 2001).
3. 95 N.Y.2d 702, 733 N.Y.S.2d 750 (Feb. 20, 2001).
4. 217 N.Y. 382, 111 N.E. 1050 (1916).

5. 233 N.Y. 236, 135 N.E. 275 (1922).
6. 255 N.Y. 170, 174 N.E. 441 (1931).
7. 65 N.Y.2d 536, 483 N.E.2d 110 (1985).
8. 138 A.D.2d 563, 526 N.Y.S.2d 145 (2d Dep't 1988).
9. 280 A.D.2d 860, 721 N.Y.S.2d 144 (3d Dep't 2001).
10. 125 A.D.2d 662, 510 N.Y.S.2d 183 (2d Dep't 1986).
11. 170 A.D.2d 865, 566 N.Y.S.2d 588 (3d Dep't 1991).
12. 80 N.Y.2d 377, 590 N.Y.S.2d 831 (1992).
13. 168 Misc. 2d 891, 644 N.Y.S.2d 887 (Sur. Ct., Bronx Co.).
14. 212 A.D.2d 1013, 622 N.Y.S.2d 393 (4th Dep't 1995), *aff'd*, 87 N.Y.2d 998 (1996).

I express my appreciation to my associate, Brenda M. Lynch, Esq., for her assistance in the preparation of this article.

Tax Planning Strategies for Multinational Families

By G. Warren Whitaker

Despite the recent dip in the stock market, American prosperity has been rising steadily for years, and the United States is the global center for many financial, cultural and educational activities. As a result, wealthy non-U.S. families increasingly see their younger members moving to the United States on either a temporary or a permanent basis, forcing those families to confront U.S. income and estate taxes for the first time. However, multinational families also have planning opportunities that are not available to U.S. families, since the older, non-U.S. generation that still owns the wealth is generally not subject to U.S. taxes. This article will discuss a few of the planning opportunities that exist in such situations, as well as some of the pitfalls that can result from a failure to plan.

Basic Rules

First, the following is a brief and greatly simplified summary of the U.S. income and estate tax rules as they apply to multinational families.

U.S. Income Tax

1. U.S. persons are subject to U.S. income taxation on their worldwide income.
2. Non-U.S. persons are subject to U.S. income tax only on their U.S. source income, which includes dividends from U.S. corporations, rental income from U.S. real property and gains on the sale of U.S. real property. U.S. source income does *not* include interest paid by U.S. banks or interest on U.S. bonds, and does not include capital gains on the sale of U.S. stocks.
3. A U.S. person for income tax purposes includes a U.S. citizen, regardless of where he or she resides, and also includes a non-U.S. citizen who either (1) is present in the U.S. for 183 or more days in a year; (2) is present in the U.S. for an average of 122 or more days in three or more consecutive years; or (3) has a U.S. Green Card or permanent work visa. A U.S. trust and a U.S. corporation are also U.S. persons for income tax purposes.

U.S. Transfer Tax

1. U.S. persons are subject to gift, estate and generation-skipping transfer taxation on their worldwide assets.
2. Non-U.S. persons are subject to estate, gift and generation-skipping transfer tax only on U.S. situs assets. For estate tax and generation-skipping transfer tax purposes, U.S. situs assets include U.S. stocks, real property and tangible personal property located in the U.S., but not U.S. bonds or bank accounts. For gift tax purposes, only U.S. real property and tangible personal property are U.S. situs assets.
3. A U.S. person for transfer tax purposes is a person whose primary residence, or domicile, is in the United States, based on the person's intent as evidenced by all factors, including length of stay, ownership of residence, personal and business contacts, etc.

Trusts

1. A U.S. trust is taxed on its worldwide income. A foreign trust is taxed only on its U.S. source income.
2. If a trust, whether U.S. or foreign, meets the tests for a Grantor Trust, the person who is considered to be the grantor is treated as the owner of the trust for U.S. income tax purposes, regardless of whether the trust income is actually paid to the grantor, accumulated in the trust or paid to another beneficiary.

Treaties: To further complicate matters, the U.S. has income and death tax treaties with dozens of countries that may alter the above rules. However, no treaty exempts a U.S. citizen, regardless of where he or she resides in the world, from liability for income and transfer taxes on his or her worldwide assets.

Planning Scenarios

Armed with these U.S. tax rules, we can now consider planning opportunities for a multinational family. In the following scenarios, Father is a 65-year-old citizen and resident of Bermuda. (Bermuda is chosen because it has no income or estate taxes of its own that must be taken into account, and no treaty with the United States that alters the basic U.S. tax rules.) Son is a 30-year-old citizen of Bermuda who lives in New York and is therefore subject to all U.S. and New York taxes. Granddaughter, Son's newborn child, was born in New York and so is a U.S. citizen. For simplification, all figures do not take into account appreciation in the value of assets, expenses or spending of the assets. I will also assume that the top U.S. tax rates will apply: 60% for estate and gift taxes and 40% for income tax.

Scenario 1: Income without Taxes

Father wishes to give $5 million to Son. Son will have the money invested by a U.S. financial institution. Although Son does not presently need the money, he wants to know that he can receive income or principal if he does need it in the future.

Without planning: If Father gives Son $5 million, there will be no gift tax on the transfer. (Son must report receipt of the gift to the Internal Revenue Service; there is a penalty of 25% of the gift for failure to report.) Son will be liable for income taxes on all future income earned by the assets after the transfer. If we assume that each year the fund earns ordinary income of 5%, Son will pay as much as **$2 million** in U.S. income taxes over the next 20 years.

With planning: Instead of making an outright gift to Son, Father puts $5 million in a properly structured Grantor Trust for the benefit of Son in a foreign jurisdiction such as the Cayman Islands, the Bahamas or Bermuda. The trust is fully revocable by Father during his life. Son is a permissible beneficiary of both income and principal. The fund can be invested by the foreign trustee through a U.S. investment advisor selected by Son.

The trust, as a non-U.S. taxpayer, is not subject to U.S. income tax, except for withholding on U.S. corporate dividends. If Son receives distributions from the trust, he must report the distributions to the IRS, but **Son is not subject to U.S. income tax on distributions from the trust** as long as Father is alive.

Total Potential Tax Savings: The Son will potentially **save $2 million** in U.S. income taxes if Father lives for 20 years.

Scenario 2: No U.S. Estate Taxes

Father wants to leave $5 million to Son on Father's death. Son wants the funds to be available for emergencies, but hopes that he will not need the funds and that they will pass to Granddaughter. On Granddaughter's death, it is hoped that the funds pass to Great-Granddaughter, who is not yet born.

Without planning: Father leaves $5 million outright to Son in Father's will. (There is no U.S. estate tax on this transfer.) Son leaves the assets to Granddaughter on Son's death, and Son's estate pays estate tax at the 60% top rate. Granddaughter leaves the assets to Great-Granddaughter at Granddaughter's death, paying another estate tax at a top rate of 60%.

Total U.S. Estate Taxes Paid: $3 million on death of Son, plus **$1,200,000** on the death of Granddaughter, for a total of **$4,200,000.**

With Planning: Father leaves the assets to a properly structured trust, either foreign or U.S., for the benefit of his family, which continues for the lives of Son and Granddaughter and then passes outright to Great-Granddaughter. The family members may receive income and principal of the trust as needed in the trustee's discretion, but the assets that remain in the trust are not subject to U.S. estate tax on the death of Father, Son or Granddaughter.

Total Potential Tax Savings: $4,200,000.

Scenario 3: Temporary U.S. Sojourn

Father wants to leave $5 million to Son at his death. Son presently is a New York resident, but expects to leave the U.S. in 10 years and return to Bermuda. Son wants to leave the funds offshore. Son does not expect to spend any of the money, but wants to know he can receive income or principal if he needs it in case of emergency.

Without planning: Father leaves Son $5 million in his will. (There is no U.S. tax on this transfer.) Son invests the funds and earns 5% per year. Son pays U.S. income taxes totaling **$1 million** on the income over the next 10 years, even though Son leaves the funds offshore and never receives any distributions.

With planning: Father puts $5 million in a foreign trust for Son. The trust may initially be a Grantor Trust, but after Father's death, it will become a non-Grantor Trust. The trustee then invests the trust funds with a financial institution selected by Son. Son may receive distributions if he needs them, and the amounts distributed will generally carry out taxable income of the trust to Son. However, if Son never needs distributions, the $5 million remains in the foreign trust earning income and pays no U.S. income tax. After 10 years Son returns to Bermuda, and he can then withdraw funds from the trust without U.S. income tax liability.

Total Potential U.S. income tax savings: $1 million.

Scenario 4: Noncitizen Spouse

Father wants to leave $5 million to Son. Son wants his assets to be available after his death for Son's Wife, who is also a citizen of Bermuda and a resident of New York. On Wife's death, Son wants the assets to pass to Granddaughter.

Without planning: Father gives Son $5 million. Son gives $2.5 million to Wife. Five years later Son dies, with a simple will that leaves the remaining $2.5 million to Wife.

Gifts and outright bequests to a spouse who is not a U.S. citizen do not qualify for the estate or gift tax marital deduction. Therefore, the transfer of $2.5

million by Son to Wife was a taxable gift (except for an exclusion of $100,000), and a gift tax of as much as $1,440,000 is due, plus five years of interest and possible penalties.

At Son's death, without further planning or action taken by Wife, Son's estate will incur estate tax, possibly of as much as $1.5 million, for a total estate and gift tax of **$2,940,000**. (Wife can transfer the assets she receives from Son's estate to a Qualified Domestic Trust to avoid estate tax on the bequest at Son's death; however, principal distributions to Wife from this trust will be taxed to her at up to 60%, even if Wife returns to Bermuda, and the balance in the trust will be taxed at 60% on Wife's death.)

With planning: Father creates an irrevocable trust for Son's lifetime benefit. The trust provides that at Son's death he may appoint the trust assets outright or in further trust. Son exercises this power of appointment so that at his death the trust continues for Wife as discretionary beneficiary, with the remainder to Granddaughter on Wife's death. No estate or gift taxes are due during Son's life or at his death, or at Wife's death, for a savings of **$2,940,000.**

Wrapup

Multinational families can achieve some remarkable U.S. tax results with a little sophisticated planning. Without such planning, they can find themselves in an unanticipated and unnecessary quandary.

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This article originally appeared in *Private Wealth Management 2001/2002*, published by Campden Publishing Ltd., London, and is reprinted with permission.

Multistate Domicile Determinations—When States Take More Than One Bite of the Estate Apple

By Paul R. Comeau

When Howard Hughes died, several states wanted to tax his estate. The U.S. Supreme Court was asked to settle the matter but refused, ruling that each state had the power to impose its estate tax on its domiciliaries.[1] The Court warned that states might disagree on where an individual is domiciled and that this could lead to double, triple or even higher taxation. It further opined that people who straddle two or more states assumed this risk and that they should not look to the Court for relief. We have made some progress since that 1982 Supreme Court decision, but many serious questions and problems remain—largely due to inconsistent interpretations.

Overview

The concept of "domicile" is ancient. It refers to a person's principal, primary place of residence and is applied to both natural persons and statutory entities, such as corporations, partnerships, limited liability companies and trusts.[2]

An individual's domicile has great legal significance. For example, military service, educational and welfare benefits, voting, drivers' licenses, jury duty, community property or other marital rights, rights of election, rules of intestate succession, primary estate administration and resident income and estate taxation are often dependent on domicile. And, as is evident from the example above, domicile can have a huge impact on estate taxation.

Estate taxes are imposed by the state where property is physically located, but intangible property (such as a share of stock) is usually deemed to be located in the taxpayer's state of domicile. While virtually every state claims that a person can have only one domicile, each state has the right to apply its own domicile definition. It would be helpful if the federal government solved the problem by imposing a uniform definition. Unfortunately, federal tax law does not define domicile, and the lack of state uniformity can lead to serious risks for individuals who maintain housing or spend significant time in multiple states. As a result, an estate with substantial intangible assets may find several states—each with a different definition of domicile—seeking estate or income taxes based on a domicile determination.

Many states have entered multistate compacts aimed at reducing this problem, but this solution may result in one state taking 60% and another taking 70% of the tax otherwise due (a total exceeding 100% of the tax due to one state alone, and exceeding the maximum federal credit). In addition, even under these agreements, other tax and non-tax risks remain, especially in the areas of estate planning and administration. This article focuses on the concept of "domicile" and its importance for tax and estate practitioners.

Income and Estate Tax Domicile Tests

For federal income tax purposes, taxes are imposed on income sourced to the United States, with general taxation (irrespective of source) reserved for either citizens or "residents." Domicile, as such, is not a basis for federal income taxation. Domicile and federal "residence" are usually the same, but there are exceptions. For example, resident aliens holding a "green card" are taxed in the same manner as U.S. citizens, yet may retain both citizenship and domicile in a foreign country. In this instance, federal "residence" does not equate with the traditional concept of "domicile."

For state income tax purposes, every state that imposes a personal income tax uses "domicile" as a basis for taxation.[3] Most states also have a separate concept known as "statutory residence."[4] What is the difference?

As noted above, domicile refers to a person's principal, primary home, the place to which he or she returns when temporarily absent.[5] A person may leave the state for months or years, but if he or she intends to return, domicile may be retained. Domicile, once established, is presumed to continue until the taxpayer physically moves to a new location with the intent to remain there permanently.[6] A person asserting a change has a heavy burden of proof and must show that the old domicile has been terminated and a new one established.[7] This usually requires a severance of old ties.

Case law includes examples of individuals who moved to a foreign country, remained there for years, and who then returned to their former home. In some instances, these people have been treated as state domiciliaries during the entire time they were gone, despite their lengthy absence.[8]

Statutory residence is a completely mechanical concept that focuses on two tests: maintenance of a permanent place of abode (PPA) in the state and presence in the state for more than 183 days per year.[9] A PPA needn't be leased or owned—it need only be available for the taxpayer's use. A friend's apartment may be your PPA if it has cooking, bathing and sleeping facilities and you have unfettered access to it.[10] The 183-day test is also a bit tricky. For purposes of computation, a minute in the state is a "day," even if it is unrelated to the use of the PPA. Work time, tourist visits and medical appointments are all counted. Exceptions exist in New York for travel days and in-patient medical services.[11]

The domicile and statutory residence tests are completely independent from each other. A person may still be treated as a state domiciliary even though he or she spends 183 days or less in the state. Time spent in a state is a factor in determining domicile, but the 183-day rule does not apply. Instead, one must compare time spent in the state test with time spent in the claimed domicile state. A person who spends 182 days in New York and 110 days in Florida, with 73 additional travel days in Europe or California, may have difficulty proving a change of domicile from New York to Florida.

Double Domicile

Is double domicile possible? Definitely. Two or more states may have different rules or tests for determining domicile, and both may claim taxes on the same income or assets. Procedures have been developed to reduce this risk. In 1996, the members of NESTOA—the North Eastern States Tax Officials Association—agreed to adopt a uniform test to determine domicile for income tax purposes.[12] The twelve-member states plus the District of Columbia agreed to focus on a comparison of housing, business, time, and near and dear possessions in each state. Where these factors are inconclusive, the states will also examine family ties in each state, generally restricting the review to the location of the taxpayer's spouse and minor children.[13]

While this agreement helps to reduce the risk of multiple domicile determinations, it does not prevent a disagreement in a close case and has no impact on states outside the NESTOA group. For example, Florida has no income tax, but it imposes an intangibles tax on Florida domiciliaries. Florida has no "statutory resident" concept in its law. Domicile for NESTOA purposes focuses on the five factors listed above, but Florida relies more on formalities, such as declarations of domicile, voting registrations, drivers' licenses, bank accounts and similar items. Therefore, a person who is domiciled in a NESTOA state for purposes of that state's income tax could also qualify as a domiciliary of Florida under the intangibles tax.

Similar estate issues arise. A person may have multiple state estate tax exposure or may have very different rights or responsibilities depending on the ultimate domicile determination. Rights of election, community property, qualification of executors and numerous other issues may be impacted, as is illustrated below:

Example 1: The elective share of a disinherited spouse is 30% in one state and 33% in another.

Example 2: A marital trust counts toward the right of election in one state but not in another.

Example 3: A person dies without a will. Laws of intestacy apply, but the person's domicile status is unclear, and intestacy rules differ in the two states.

Example 4: A person has a holographic will, which is permitted in one state but not another.

Example 5: A typed will is witnessed by two people, but one of the unsatisfied beneficiaries claims domicile by the decedent in a state which requires three.

Example 6: A person names his trusted attorney as his executor, but upon his death, his children claim that he moved to another state, one that only permits a blood relative or a trust company to serve as executor.

Example 7: The federal estate tax has been repealed. One state still has an estate tax while the second state follows the federal repeal. If the person's domicile status is unclear, the first state might still seek taxes.

Example 8: A person dies in Florida and submits the estate for Florida probate, but a New York residency audit is also pending and ends with a New York domicile determination.

Resolving Disputes

"Income tax" domicile tests may not be the same as those used for estate tax or estate administration purposes. In a contested situation, how does an estate determine the domicile of the decedent? Generally, someone (often the named executor) commences probate proceedings in a particular state, and that state takes jurisdiction of the estate and accepts responsibility to determine any multistate disputes. In doing so, the court usually applies its own state's tests to determine domicile.

With this in mind, the outcome of a dispute may depend upon the law of the state where proceedings are initially commenced. If a claimant attempts to bring a subsequent action in the courts of a different state, he or she may find that the new court will, upon motion from the opponent, agree to defer to the first state court that is already considering overall estate issues. Some forum shopping may be possible because the race to the courthouse in another state may have a major impact on the outcome, especially when the laws of the two states differ dramatically.

Conclusion

Practitioners working in this area should advise clients of these risks and should also inform clients of differing rights (e.g., elective shares, executor rules, etc.) when they move from one state to another. With proper planning and record keeping, the tax and other risks described in this article can be reduced.

Endnotes

1. *Cory v. White*, 457 U.S. 85 (1982).
2. *See, e.g.*, N.Y. Tax Law §§ 605(b)(1), (3); 210.3(a)(6)(C). All citations are to New York tax law, regulations and case law, and readers are urged to keep in mind that each state employs its own particular residency rules.
3. N.Y. Tax Law § 605(b)(1).
4. N.Y. Tax Law § 605(b)(1)(B).
5. 20 N.Y.C.R.R. § 105.20(d)(1).
6. 20 N.Y.C.R.R. § 105.20(d)(2), (4).
7. *See, e.g.*, *Bodfish v. Gallman*, 378 N.Y.S.2d 138 (3d Dep't 1976).
8. *See, e.g.*, *Mercer v. New York State Tax Comm'n*, 459 N.Y.S.2d 938 (1983).
9. N.Y. Tax Law § 605(b)(1).
10. *See, e.g.*, *In re Evans*, New York State Division of Tax Appeals, Tax Appeals Tribunal (6/18/92).
11. New York State Dep't of Tax'n and Fin. Income Tax District Office Audit Manual, Nonresident Audit Guidelines, par. .5.D.1, .2; *Stranahan v. New York State Tax Comm'n*, 416 N.Y.S.2d 836 (1979); *Estate of Schmitz*, New York State Dep't of Tax'n and Fin., Advisory Opinion, TSB-A-00(3)I.
12. Eleven states plus the District of Columbia belong to NESTOA. Members include Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont and the District of Columbia.
13. NESTOA Cooperative Agreement on Determination of Domicile, Oct. 1, 1996.

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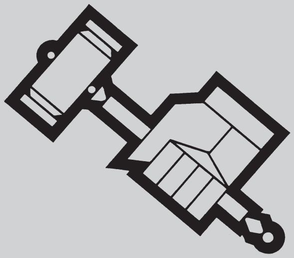


RECENT NEW YORK STATE DECISIONS

John C. Welsh

WILLS

PROBATE

In a contested probate proceeding, the Appellate Division affirmed the Surrogate's decision to admit the will to probate since the objectant failed to show undue influence or lack of testamentary capacity. Use of the "Dead Man's Statute" to bar testimony of the objectant did not mean that she was precluded from presenting any other available evidence in support of her objections. *In re Will of Beaumont*, __ A.D.2d __, 733 N.Y.S.2d 21 (1st Dep't 2001).

ETHICAL ISSUES

In a proceeding to probate decedent's will, matters were suspended to allow proponent to file a family tree as required by the uniform rules and an affidavit setting forth the efforts made to ascertain and identify existing distributees. The attorney-draftsman was to be limited to one-half of statutory commissions since he failed to file the disclosure statement required by SCPA 2307-a. No excuse was offered as to why testator had not made a written acknowledgment that his attorney had advised him that other persons could serve as executor and that by choosing the attorney he would become eligible for statutory commissions and possible legal fees as well. A Putnam-Weinstock hearing was scheduled to review the propriety of a cash gift of $50,000 to the wife of the attorney-draftsman resulting from an amendment to a revocable lifetime trust created by the testator. This amendment occurred approximately eight months before decedent's death. Inquiry was also to be made as to the propriety of decedent's designation of the attorney-draftsman as the successor trustee of the lifetime trust to become effective upon decedent's death. *In re Estate of Rothwell*, 189 Misc. 2d 191, 730 N.Y.S.2d 664 (Sur. Ct., Dutchess Co. 2001).

ADMINISTRATION OF ESTATES

LEGAL FEES—STIPULATION OF SETTLEMENT

Wills of decedent executed in 1972 and 1988 were offered for probate. After extensive litigation, a settlement agreement was entered into which provided a share to the principal beneficiary under the 1988 will exceeding $3 million. When the attorneys for the preliminary executors under the later will sought to have their legal fees fixed by the court, they were opposed by the executors under the 1972 will on the ground that they had knowingly offered an invalid will. The Appellate Division found this position to be untenable. By stipulating that a very substantial amount of the estate could be distributed to the charitable beneficiary under the 1988 will, the executors removed from controversy any issues as to the validity of that will. Reservation of the right to contest the reasonableness of the fees charged does not affect the stipulation to settle other issues, including the legitimacy of the representation furnished. There is a strong public policy supporting the use of stipulations as an effective means of resolving marginal issues. *In re Will of Hofmann*, __ A.D.2d __, 733 N.Y.S.2d 168 (1st Dep't 2001).

LEGAL FEES

A stipulation of settlement relating to claims of non-marital children against decedent's estate provided for payment to them of $1,300,000 as a total distribution in full satisfaction of all claims. All issues in a disputed probate proceeding were intended to be resolved by the stipulation together with all disputes relating to entitlement to shares. The Appellate Division agreed that the attorney's fee in question was intended to be paid from the general estate and not from the share of the non-marital children provided for in the stipulation. *In re Estate of Bianculli*, __ A.D.2d __, 732 N.Y.S.2d 436 (2d Dep't 2001).

DISTRIBUTION OF RESERVE

In a contented probate proceeding, a cash reserve was established by the estate for payment of legal fees, accounting fees and other expenses. When a motion was made to compel distribution of the reserve to the beneficiaries, the Surrogate agreed and the Appellate Division affirmed. The stipulation providing for the creation of the reserve was not based upon an indefinite continuance. Since public policy allows free access to the courts, the respondent was not enjoined from instituting additional litigation. *In re Estate of Leopold*, __ A.D.2d __, 732 N.Y.S.2d 56 (2d Dep't 2001).

TRUSTS

SUIT AGAINST FORMER TRUSTEE—STATUTE OF LIMITATIONS

In a cause of action brought against a former trustee for breach of fiduciary duty and negligence, the Appellate Division agreed that the three-year statute of limitations applied since the allegation against the trustee was that he knew or should have known of alleged conversion of trust assets by his co-trustee and failed to apprise the beneficiary of that fact. Since there was no allegation of fraud or breach of the terms of the trust instrument, the six-year period was inapplicable. The distinction was based upon whether the claimant sought money damages at law or equitable relief. An attempt to delay the running of the statutory period until the trustee refused to account was unsuccessful. The trust beneficiary was an aggrieved party entitled to appeal the dismissal of the cause of action. *In re Kaszirer v. Kaszirer*, 286 A.D.2d 598, 730 N.Y.S.2d 87 (1st Dep't 2001).

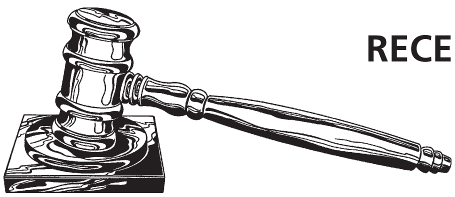
STANDING TO ENFORCE

Testator's grandson, in whose honor a charitable testamentary trust was created, had no standing to compel the trustee to distribute income of the trust pursuant to the terms of the trust instrument. Such power rested only with the Attorney General. *In re Alaimo*, __ A.D.2d __, 732 N.Y.S.2d 819 (4th Dep't 2001).

MISCELLANEOUS

INVALIDATION OF GIFT

A coexecutor of decedent's estate moved to set aside the conveyance of decedent's residence three and one-half weeks before her death. The grantee was a life-long friend who had taken decedent into her home and provided her with care for one month before the conveyance. The Surrogate found that a fiduciary and confidential relationship existed between the grantor and grantee. Thus, the validity of the gift could be sustained only by clear and convincing evidence. Decedent had indicated that she intended the proceeds from the sale of her home to be divided among her relatives in the Ukraine. Because of the fiduciary relationship, the transaction was presumed to be void. The burden was on the grantee to show that there was no fraud, mistake or undue influence. No such showing was made. *In re Estate of Mazak*, __ A.D.2d __, 732 N.Y.S.2d 707 (3d Dep't 2001).



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

Ilene Sherwyn Cooper and Donald S. Klein

Abatement of Legacies

In a proceeding by the executrix for leave to sell specifically devised real property, or alternatively to enter possession of the property for the purpose of collecting the rental income, the court was requested to determine two motions seeking to dismiss the proceeding. The relief sought by the executrix was apparently for the purpose of deriving sufficient liquid funds in order to satisfy the debts and expenses of the estate, as well as a $300,000 bequest to the decedent's surviving spouse.

In support of their application to dismiss the proceeding, the movants alleged, *inter alia,* that the bequest to the surviving spouse was a general bequest, and as such was not entitled to priority under the abatement statute. Movants further alleged that the terms of the decedent's will evidenced an intent to give the specific property, which housed the family business, to them.

In opposition to the motions, the petitioner maintained that the abatement statute, EPTL 13-1.3, allows for dispositions to a surviving spouse to abate last, and the presumed intent of the statute is not superseded by any possible contrary intent in the decedent's will.

After reviewing the provisions of the decedent's will, and the language of the abatement statute, the court noted that while specifically devised real property vests in the specific devisee at the moment of death, the executor obtains a qualified title to same in case it is needed to meet expenses and pay debts. The court further noted that the provisions of EPTL 13-1.3(c)(5) creates a statutory presumption that the decedent would have most preferred to benefit his estate with an estate tax marital deduction resulting from a bequest to a spouse, subject to any contrary expression of intention in a will. The order of dispositive provisions in a testamentary document is not considered determinative of the testator's intent regarding preferential treatment to be accorded a surviving spouse.

Although the movants argued that the surviving spouse was well-provided for in the form of nonprobate assets, and that the decedent intended they run the family business on the real estate on which it was situated, the court could not ignore the fact that the bequest to the spouse was made by the decedent after acknowledging that he had already made provision for her through nontestamentary means. This language, the Court found, only served to reinforce the statutory priority accorded the spouse.

Nevertheless, the court noted that the proceeding before it was made prior to the final accounting being filed. Further, it appeared that during the pendency of the proceeding the decedent's residence was sold, and that the proceeds were available to fully satisfy the debts and expenses of the estate. Accordingly, inasmuch as an accounting would make clear what assets, if any, remained to satisfy the bequest of the surviving spouse, the court dismissed the petition by the executor without prejudice to renewal of the application upon the judicial settlement of his account. *In re Estate of William F. Bindseil, Jr.,* N.Y.L.J., Sept. 20, 2001, p. 28 (Sur. Ct., Suffolk Co.) (Czygier, Sur.).

Amendment of Pleadings

In a contested proceeding involving the validity of a claim, the court authorized the respondent, executrix of the estate, to amend her pleadings despite the filing of a note of issue and statement of readiness by the petitioner. The court held that leave to amend a pleading should be liberally granted in the absence of surprise or prejudice relating directly to the delay, even where the amendment is sought during trial. The court found that the proposed amendment appeared meritorious, and that the petitioner had not alleged any surprise or prejudice which would render the amendment improper. Accordingly, leave to amend was granted, however, in view of the filing of the note of issue and statement of readiness, the period of time for additional discovery was restricted. *In re Estate of Gregg J. Walsh,* N.Y.L.J., Dec. 21, 2001, p. 28 (Sur. Ct., Westchester Co.) (Scarpino, Sur.).

Claim of Gift Denied as a Matter of Law

In a proceeding to compel the administratrix to account, the administratrix moved for summary judgment against a claimant who alleged that the decedent made gifts of certain jewelry to him before she died.

The only evidence that the claimant offered of the gift was a letter written by the decedent, in Japanese, to her son. Two alternate translations of the letter were offered. With respect to the jewelry in issue, one translation read "I will give jewels in safety box to Harry [the claimant] in reward for his tremendous help to me." The second translation read "I am giving the jewelry in the safe to Harry [the claimant] as a reward for the many favors he has done for me."

The court found the elements of a gift, intent on the part of the donor to make a present transfer, delivery, actual or constructive, and acceptance, to be lacking. Specifically, the court found that with respect to the element of intent, the evidence was at best equivocal. The language "I will give" as set forth in one translation of the letter, reflected an intent to give only *in futuro*. The court found that the language "I am giving," as reflected in the second translation, was not necessarily indicative of a present donative intent. Further, the court found that the statement "I am giving" was not by itself evidence of any antecedent delivery. Even if it did, the court noted that the donor's continued possession of the property until her death was inconsistent with a claim of a completed delivery of the purported gift. In the case presented, the jewelry remained in the decedent's safe in her home, and the decedent alone had access to its contents. *In re Estate of Atsuko Kondo,* N.Y.L.J., Dec. 5, 2001, p. 18 (Sur. Ct., New York Co.) (Roth, Sur.).

Disclosure of Financial Aid Records Denied

In a discovery proceeding brought by the decedent's estate, the petitioner moved, *inter alia,* to compel the respondents to provide written authorizations allowing him to obtain all information and records relative to requests made by respondents for financial aid on behalf of their children. Petitioner had previously requested these records from the United States Department of Education, but was denied access pursuant to the Federal Privacy Act, which prohibited their release without the consent of the student and the parent, or by order of the federal district court where the records are located.

The court held that the confidentiality of the information sought must be afforded the same protection as that accorded income tax returns. To that extent the moving party must make a strong showing of necessity and demonstrate that the information is not available from other sources. Further, the information contained in such records must be in controversy, or reasonably related to the case.

Applying this criteria to the case before it, the court found that the petitioner had already obtained access to the personal income tax returns of the respondents and their children, and had examined one of the respondents' children as well as the family accountant, who prepared all the returns. Additionally, the court concluded that the information was not relevant evidence-in-chief to the validity of the estate's claim to the assets in issue or the respondent's defense of gift. That is, it was not indispensable to the litigation, but rather, was apparently sought for impeachment purposes at trial.

Accordingly, petitioner's request for the financial aid records by compelling the respondents to execute authorizations was denied. *In re Estate of Richard Sakalian,* N.Y.L.J., Nov. 23, 2001, p. 25 (Sur. Ct., Nassau Co.) (Riordan, Sur.).

Eligibility of Preliminary Executor

In a contested probate proceeding, the named executor in the will sought preliminary letters testamentary. The application was opposed by the objectants, who made serious allegations of fraud and undue influence against the petitioner, and further claimed that petitioner misappropriated money from the decedent while acting as his attorney in fact. Objectants cross-petitioned for the issuance of temporary letters of administration to them.

The court denied both applications, finding that the matters raised by the pleadings were of a serious and substantial nature, which required the appointment of a party as temporary administrator who would be impartial to the concerns of all parties involved.

Accordingly, letters of temporary administration were granted to the Public Administrator. *In re Estate of Gregory Cavallo*, N.Y.L.J., Dec. 21, 2001, p. 26 (Sur. Ct., Richmond Co.) (Fusco, Sur.).

Jury Trial Denied

In a proceeding to restrain the sale of certain real properties, the petitioner moved to strike the respondent's demand for a jury trial on the grounds that the controversy before the court was an equitable one in which no jury trial was available.

The relief sought by the petitioner was for the enforcement of an agreement entered between the decedent and his wife, simultaneously with the execution of their reciprocal wills, which provided, *inter alia,* that neither party would make gratuitous transfers or change the provisions of their will during their respective lifetimes.

The petitioner argued that since the principal relief sought was for specific performance of the agreement, a permanent injunction, and a constructive trust, the proceeding was one sounding an equity, rather than law, requiring that respondent's jury demand be stricken.

The respondent, on the other hand, maintained that the proceeding was one for the enforcement of a contract, which is legal in nature, and subject to a trial by jury.

Citing the decision in *Tutunjian v. Vetzigian*, 299 N.Y. 315, the court found that a proceeding for the enforcement of a contract to bequeath property in a designated manner to be equitable in nature, and thus not triable by jury. Further, the court found that respondent's assertion of an equitable claim for rescission acted to waive the right to a jury trial, not only on the equitable claim but on the legal one as well.

Accordingly, the petitioner's motion was granted. *In re Estate of Thomas Carvel*, N.Y.L.J., Sept. 28, 2001, p. 26 (Sur. Court, Westchester Co.) (Scarpino, Sur.).

Jury Trial and Transfer to Supreme Court Denied

In a contested accounting proceeding, the petitioner moved for an order directing a jury trial of the issues raised, and a transfer of the trial to the Supreme Court.

The court opined that the New York State Constitution guarantees a right to a jury trial in those cases where the right has been previously granted by constitutional provision or common law, and in matters to which the right was extended by statute through 1894. The court noted that while equitable actions, including claims for an accounting and breach of fiduciary duty, are generally tried without a jury, the form of a proceeding is not itself determinative. Instead the nature of the relief sought and the issues in dispute govern the right to a jury trial. If money damages alone could fairly compensate the party bringing the action, the action is generally one at law.

Invoking this criteria, the court determined that in view of the objections to the account, which alleged self-dealing and breach of fiduciary duty, the matter was one in equity in which no right to a jury trial existed.

Additionally, the court denied petitioner's request to transfer the proceeding to the Supreme Court, finding that the issues raised were more appropriately subject to the jurisdiction of the Surrogate's Court, and that the resulting delay from a transfer would be unduly prejudicial to the beneficiaries of the estate. *In re Estate of Amaducci*, N.Y.L.J., Oct. 4, 2001, p. 27 (Sur. Ct., Westchester Co.) (Scarpino, Sur.).

Lost Will Denied Probate

In a proceeding for probate of a signed counterpart of decedent's will, the record indicated that the original will along with two counterparts were given to the testator while the attorney-draftsman retained one signed counterpart for his file. None of the wills in the decedent's possession could be located at her death.

The court held that when a will has been executed in multiple counterparts, all of the counterparts collectively constitute the will. In the absence of an adequate explanation for the non-production of all the executed copies, the failure to produce all of such executed copies requires a denial of probate. Moreover if a will, shown to have once existed and to have been in the possession of the testator, cannot be found after the testator's death, the legal presumption is that the testator destroyed the will with the intention to revoke it.

In the case at bar, the petitioners failed to offer an explanation as to what became of the original and counterpart instruments in the decedent's possession. Additionally, they failed to present any evidence to rebut the presumption that the decedent did not revoke her will. Accordingly, probate of the signed counterpart was denied. *In re Estate of Irene Richards aka Irene Bush*, N.Y.L.J., Nov. 1, 2001, p. 23 (Sur. Court, Kings Co.) (Feinberg, Sur.).

Proof of Paternity

In a contested proceeding to revoke letters of administration, the court granted summary judgment to the petitioner finding, as a matter of law, that she was the decedent's daughter and sole distributee.

In reaching this result, the court noted that although the provisions of EPTL 4-1.2(a)(2) and Section 24 of the Domestic Relations Law (DRL) both provide guideposts to reach a determination as to whether the paternity has been established, neither statute is in itself controlling. EPTL 4-1.2 does not provide the test for a non-marital child who later becomes the marital child of both parents. On the other hand, DRL § 24 focuses upon the legitimacy of children rather than the quantum of proof required to establish paternity. The court opined that the two sections may be read in harmony by applying the criteria of EPTL 4-1.2 in those cases where the mother of the non-marital child never married the alleged father, and by utilizing the presumption of legitimacy mandated by the DRL in those cases where the mother, after the birth of the child, married the father and both parents acknowledge that the husband is the child's father.

Applying the foregoing to the record presented, the court found that the petitioner had established that the decedent was her father. The petitioner's mother testified that the decedent was the petitioner's father. Both the petitioner's mother and the decedent swore in an official document that they were the petitioner's biological parents, and a birth certificate was issued listing the decedent as the petitioner's father. Further, the couple married after the birth of the child. *In re Estate of Ralph Cipriani*, N.Y.L.J., Nov. 8, 2001, p. 19, (Sur. Ct., Bronx Co.) (Holzman, Sur.).

Scope of Disclosure Under SCPA 1404

In a contested probate proceeding, the proponents moved for a protective order with respect to a document request served by potential objectants. The potential objectants moved for production.

By notice of deposition, the potential objectants sought the examination of the attorney/draftsman and witnesses to the will, as well as a request for discovery and inspection of documents. When the request for discovery and inspection was returned as premature, the motions for relief were served.

In support of their motion for a protective order, the proponents argued that CPLR Article 31 discovery may only be sought from those witnesses who are being examined, and that since proponents were not being examined, they did not have to produce documents. Proponents also argued that certain of the specific requests were irrelevant to the proceeding in that they deal with the valuation of the estate, or alternatively, were broad or intrusive.

In opposition to the motion and in support of the cross motion, the objectants argued that the discovery sought was proper and the scope of the demands appropriate.

Based upon the provisions of SCPA 1404(4), the court held that the scope of discovery in probate proceedings is broad and permits inquiry into all relevant matters which may be the basis of objection to the probate of a will. The court found that the proponents failed to offer any authority for their argument regarding the limitation on CPLR Article 31 discovery prior to filing objections.

Accordingly, the motion and cross motion were granted in part and denied in part, provided that any documents required to be produced would be limited to the time limitations set forth in UCR 207.27. *In re Estate of Irene E. Powers*, N.Y.L.J., Aug. 24, 2001, p. 23 (Sur. Ct., Westchester Co.) (Scarpino, Sur.).

Statute of Limitations Bars Recovery of Real Property

In an action commenced in the Supreme Court, and later transferred to the Surrogate's Court, the court was requested, *inter alia*, to vacate a deed and declare a Renunciation and Disclaimer a nullity. Defendants moved to dismiss the action, *inter alia*, on the basis of the statute of limitations. Plaintiffs opposed, arguing that a factual question existed as to the accrual date of the causes of action, and that defendants were equitably estopped from asserting the defense.

The court rejected plaintiffs' position and dismissed the complaint as time-barred. Reflecting upon the public policy behind statutes of limitations, the court opined that their purpose is to "protect parties from stale claims." Nevertheless, despite the statutes' salutary aims, the court was mindful of the need to determine the accrual date of the causes of action asserted. To this extent, the court concluded that there was no misrepresentation or concealment by defendants which would allow plaintiffs to invoke the doctrine of equitable estoppel with respect to the timeliness of their claims. Indeed, the court noted that the plaintiffs were duly notified of the underlying transaction of which they complained by virtue of a Renunciation filed with the court, and a recorded deed. "If a deed puts the world on notice of its contents and the property ownership denoted therein . . . then it follows that the recordation of that deed would have to commence the running of the statute of limitations for causes of action seeking to invalidate it."

The court further found that to the extent the issue of fiduciary repudiation affected the running of the statute of limitations, "[t]he recording of the subject deed reflecting the transfer of the property . . . combined with the use and occupancy of the property since-the execution of the deed . . ." was a sufficient repudiation to commence the running of the statute of limitations with respect to the causes of action sounding in breach of fiduciary duty.

Finally, as to the plaintiff's request for the imposition of a constructive trust, the court held that the "statute of limitations is six years, and that the cause of action accrues upon the occurrence of the wrongful act or event . . . [rather] than the discovery thereof . . ." *In re Estate of Medina*, N.Y.L.J., Nov. 19, 2001, pp. 33–34 (Sur. Ct., Suffolk Co.) (Czygier, Sur.).

Statute of Limitations for Rescission of Prenuptial Agreement

In a contested probate proceeding, issue arose as to the standing of the decedent's surviving spouse to seek an examination of the attesting witnesses under the will. The petitioners maintained that the spouse was precluded from seeking the examination on the grounds that she had relinquished her interest in the estate of the decedent by virtue of the terms of a prenuptial agreement. The spouse claimed that the agreement was invalid.

The court had previously found that the agreement was bona fide on its face, entitled to enforcement, and clearly provided that the parties thereto waived all rights in the estate of the other. Moreover, the court determined that absent any interest in the estate of the decedent, the surviving spouse would have standing to demand an examination of the attesting witnesses to the propounded will.

Upon further submissions by the surviving spouse, the petitioners further argued that any attempt by the surviving spouse to litigate the validity of the prenuptial agreement was time-barred by the statute of limitations.

The record reflected that the agreement was entered into by the parties in November, 1991. No evidence had been offered by the spouse to demonstrate that the decedent actively engaged in any continuing scheme to defraud her, unduly influence her or place her under duress during their marriage sufficient to toll the applicable statutory period.

The court found that absent such a toll, the statute of limitations to be applied was the six-year period applied to rescission actions, i.e., six years from the date of execution of the agreement. In view thereof, the court held the spouse's claims based upon rescission of the prenuptial agreement were time-barred. Accordingly, having no interest in the estate of the deceased, the spouse had no right to demand an examination of the attesting witnesses. *In re Estate of Anthony Mafoud, N.Y.L.J.,* Aug. 30, 2001, p. 23 (Sur. Ct., Richmond Co.) (Fusco, Sur.).

Stipulation of Settlement Enforced

In a proceeding brought to set aside a portion of a "so-ordered" stipulation of settlement, both the executor and the petitioner moved for summary judgment. Petitioner claimed that in consideration for her entering the stipulation, the executor orally promised to pay $125,000 to her two adult children. The executor claimed that his oral commitment was contingent upon the petitioner executing a written release which never occurred. The petitioner did not refute this allegation.

The court found the stipulation of settlement to be a binding contract between the parties, enforceable as agreed upon. With regard to the claim based upon the alleged oral promise between the parties, the court found that it was a dispute between living persons over which it lacked subject matter jurisdiction. *In re Estate of Cecil Marquez,* N.Y.L.J., Oct. 3, 2001, p. 26 (Sur. Ct., Westchester Co.) (Scarpino, Sur.).

Will Contest—Testamentary Capacity

In a contested probate proceeding, the issue before the court was whether the decedent possessed the mental capacity to execute the propounded will. In finding that the decedent had testamentary capacity, the court found that the testator, though suffering from a degree of Alzheimer's Disease, was lucid and rational at the time the will was executed. In particular, the court relied upon the testimony of the attesting witnesses, who stated that the decedent was responsive to questions posed to her regarding the will at the time of the will execution, and was conversant. Furthermore, the court noted that one of the witnesses, who knew the decedent for five years prior to the will signing, testified that she was conversational during this time, well-dressed and presented no reason for the witness to believe there was something wrong. The court found that the testimony of objectant's witness was not worthy of belief, and that the testimony of proponent's expert, though not based on personal observations, was in accord with the record.

Accordingly, the will of the deceased was admitted to probate. *In re Estate of Frances Woode,* N.Y.L.J., Nov. 6, 2001, p. 18 (Sur. Ct., N.Y. Co.) (Roth, Sur.).

Will Contest—Testamentary Capacity

In a contested probate proceeding, the court dismissed the objection which alleged that the decedent lacked the requisite capacity to execute the propounded codicils. The court found that objectant had produced insufficient proof that decedent's capacity was impaired by the nature of ailments and her ingestion of pain-killing medication. In fact, the decedent's treating physician testified that she was an "independent actor" in terms of making her own decisions, and "quite functional" during the period in question. *In re Estate of Emily P. Morse,* N.Y.L.J., Nov. 15, 2001, p. 24 (Sur. Ct., Westchester Co.) (Scarpino, Sur.).

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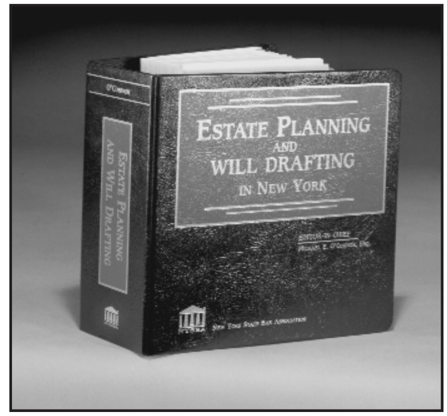

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