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Trusts and Estates Law Section Newsletter

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A Message from the Section Chair

Wallace Leinheardt

"People who enjoy eating sausage and obeying the law should not watch either being made."
—Anonymous

Legislative Developments

Each year the Trusts and Estates Law Section (TELS) Executive Committee adopts an affirmative legislation proposal and submits the bills to the NYS Legislature and Governor for their consideration.

Unfortunately, few of our bills (even technical corrections) pass both houses, get signed by the Governor and become law.

Determined to improve our "batting average" this year, we approached the OCA Surrogate's Court Advisory Committee (OCASAC) chaired by Surrogate Renee R. Roth of New York County. We narrowed last year's list of 17 bills and sought OCASAC's support for the 5 that we wanted to concentrate on.

These were bills dealing with:

1. **Right of Election—**A technical fix-up to clarify EPTL 5-1.1-A (d)(2) to limit a surviving spouse's right of election to the same 2-year period as the Court's ability to grant extensions.
2. **Renunciation of Property Interests—**A technical fix-up of areas where EPTL 2-1.11 is currently more restrictive than federal tax law under I.R.C. § 2518.
3. **Positive Language on Adoptions—**A technical fix-up to amend the Domestic Relations Law; the Education Law; the Estates, Powers and Trust Law; the Executive Law; the Family Court Act; the Labor Law; the Public Authorities Law; the Public Health Law; the Real Property Tax Law; the Social Services Law; and the Surrogate's Court Procedure Act to replace the use of the phrase "natural parent" with the more modern, accepted terminology of "birth parent," to replace "natural mother" with "birth mother," to replace "natural father" with "birth father," and to replace "natural child" with "birth child."

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4. **Simultaneous Death—**A public interest change to repeal EPTL 2-1.6, which is presently based on actual simultaneous death, in favor of language which treats the death of a relevant person within 120 hours of the decedent as predeceasing the decedent, which is the same 5-day survivorship provision that many other states use.
5. **Pre-Mortem Probate—**A change to Mental Hygiene Law § 81.29(d) to prohibit a court presiding over a MHL Article 81 proceeding from invalidating or revoking the will or codicil of an incapacitated person.

We also indicated TELS's intention to support OCASAC's proposals concerning Revocatory Effect of Divorce and the Transfer of Property from a Guardian to the Estate Representative following the death of an incapacitated person.

Surrogate Roth subsequently advised us that OCASAC approved the bill regarding changes in the language regarding the use of "natural" vs. "birth" in the adoption statute, as well as TELS's proposals regarding simultaneous death and pre-mortem probate. With respect to the default period and the right of election, she indicated that OCASAC would support the 2-year limitation period if language was added to permit the court, at its discretion and for good cause shown, to extend such period beyond two years from decedent's date of death.

She also reported that no action was taken on the renunciation bill except that a sub-committee was appointed to review it would report at their next meeting in May.

Representatives of TELS (John Morken, Ira Bloom, Gary Freidman and Josh Rubenstein) met with Senator John A. DeFrancisco and Assemblywoman Helene E. Weinstein and their respective staffs in Albany on April 8, 2008 to present our package of the bills. The legislators were advised of OCASAC's letter of support as outlined above.

The TELS representatives came away hopeful that notwithstanding the changes in the Executive Branch as well as the state's tenuous fiscal condition our bills will receive affirmative action.

Upcoming "Away" Meetings

September 24–28, 2008—Broadmoor Hotel, Colorado Springs, CO

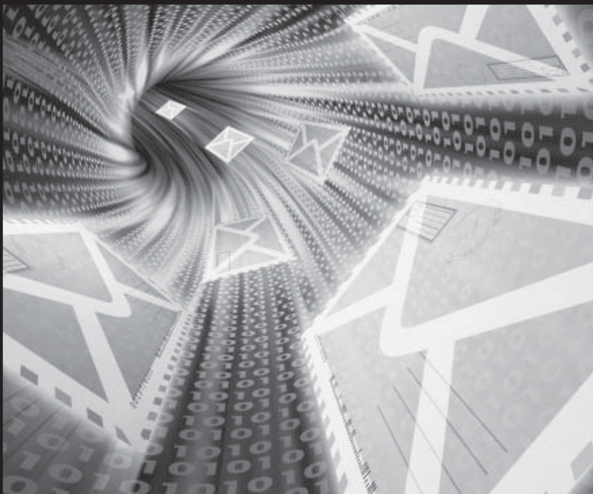
Program Chair Ilene Cooper is arranging a program which will deal with recent cases involving diversification, delegation and surcharging trustees; exoneration clauses; legal fees for representing the fiduciary or the objectant; directed trusteeships; proprietary investments and the quandary of investing as a fiduciary in N.Y.; ethical issues in representing multiple fiduciaries; and an interactive discussion on e-filing in Surrogate's Court, including the experience in Colorado.

March 18–21, 2009—Amelia Island Plantation, Amelia Island, FL

Following the cancellation of our New Orleans meeting due to Hurricane Katrina, the Executive Committee decided to switch our "away" meeting from the fall (hurricane season in the southeast) to the spring. This is the first of the spring "away" meetings. In 2010 we will meet in Chicago May 13–16. Please adjust your calendars accordingly.

Wallace L. Leinheardt

Request for Articles



If you have written an article you would like considered for publication, or have an idea for one, please contact the *Trusts and Estates Law Section Newsletter* Editor:

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Articles should be submitted in electronic document format (pdfs are NOT acceptable), and include biographical information.

www.nysba.org/Trusts&EstatesNewsletter

Good "Knight" to Full Deduction of Investment Advisory Fees—Or Is It?

By Veronica A. Van Nest and Victoria L. D'Angelo

In rendering its decision in the case of *Knight v. Commissioner*,[1] the United States Supreme Court has changed the way in which investment advisory fees on estates and trusts are deducted on fiduciary income tax returns. The case centered on the filing of the William Rudkin Testamentary Trust's fiduciary income tax return for the 2000 tax year. William Knight, as trustee of that trust, had hired Warfield Associates, Inc. to provide investment advice regarding investing the trust assets, which were approximately $2.9 million in value at the time. Warfield's investment advisory fees for 2000 were $22,241, which the trustee deducted in full on the trust's fiduciary income tax return. After audit, the Commissioner ruled that the investment advisory fees were miscellaneous itemized deductions subject to the two percent (2%) floor, resulting in a tax deficiency to the trust of $4,448.[2]

Thereafter, Mr. Knight appealed to the United States Tax Court requesting review of this assessment, arguing that such fees should be fully deductible because the trustee had a duty under the Connecticut Uniform Prudent Investor Act to act as a prudent investor, which required the trustee to hire an investment advisor to meet such duty and to pay for such services. Therefore, he argued, such fees were unique to the trust and should be fully deductible under Internal Revenue Code (I.R.C.) § 67(e)(1). The Tax Court did not accept that argument, and sided with the Internal Revenue Service (IRS) to hold that such fees are commonly incurred by individuals as well, and were, therefore, not unique to a trust and were subject to the two percent (2%) floor.[3]

The trustee proceeded to the Court of Appeals for the Second Circuit. The Second Circuit, in again ruling in favor of the Commissioner, came up with new reasoning for such determination, and held that since the costs were of a type which *could* be incurred if the property were held by an individual instead of a trust, the deduction of such fees was not unique to a trust and, therefore, subject to the 2% floor under I.R.C. § 67. Undeterred, the trustee pursued his case to the Supreme Court. As there had been some conflict among the Circuits on this issue, the Supreme Court granted *certiorari*.

I. History

At the time that *Knight* was heard, the issue of the deductibility of investment advisory fees had been considered in several other Circuits.

A. Sixth Circuit: Full Deductibility Allowed

In the Sixth Circuit, in *O'Neill v. Commissioner*,[4] the co-trustees argued that because they had an obligation to meet the prudent investor standard under Ohio law, and because none of them would have agreed to serve as co-trustee until an investment advisor was hired, payment of investment advisory fees by the co-trustees was warranted and should be fully deductible. The Sixth Circuit, in holding in favor of the trustees and ruling that the investment advisory fees were fully deductible on the fiduciary income tax return, stated, "The trustees here lacked experience in investing and managing large sums of money and, therefore, sought the assistance of an investment advisor. Without WPHA's management, the co-trustees would have put at risk the assets of the Trust. Thus, the investment advisory fees were necessary to the continued growth of the Trust and were caused by the fiduciary duties of the co-trustees."[5]

B. Federal and Fourth Circuits: Partial Deductibility Allowed

The Federal Circuit case, *Mellon Bank v. United States*,[6] involved thirteen irrevocable trusts which had been created for the Mellon family. The trustee argued that if a trustee incurs costs as part of its efforts to satisfy its fiduciary obligations under state law, then those expenses constitute fiduciary fees and should not be treated as miscellaneous deductions subject to the 2% floor, regardless of whether such costs would have been incurred in a non-fiduciary context if the funds were not held in trust.[7] In ruling against the trustees, the Court held that under the Pennsylvania prudent investor statute trustees were charged with making decisions as an individual would. Thus, it was "simply not reasonable to conclude that fees for investment advice incurred by a trustee pursuant to its statutory trust obligations would always constitute fees 'which would not have been incurred if the property were not held in such trust.'"[8]

A similar decision was reached in the Fourth Circuit in *Scott v. United States*.[9] The trust at issue in the case had approximately $25 million in assets with three co-trustees who had paid approximately $250,000 in investment advisory fees over two years. The fees had been fully deducted on the fiduciary income tax returns, but the IRS, after audit, determined that the investment advisory fees were miscellaneous itemized deductions subject to the 2% floor.[10] The district court

held in favor of the IRS, and the Fourth Circuit, in affirming the district court's finding, stated that investment advisory fees would be treated as fully deductible only if they were "unique to the administration of a trust and not customarily incurred outside of trusts. Put simply, trust-related administrative expenses are subject to the 2% floor if they constitute expenses commonly incurred by individual taxpayers."[11] The Court held that because such fees are those which would be commonly incurred outside of trust administration, by an individual, they are subject to the 2% floor.

II. Proposed Regulation

Following the Second Circuit's decision, but prior to the Supreme Court granting *certiorari*, on July 27, 2007, the U.S. Treasury issued Proposed Reg. § 1.67-4, which stated that the only costs not subject to the 2% floor were costs incurred by an estate or non-grantor trust which were *unique* to the estate or trust.[12] Further, in reiterating the Second Circuit's findings, the proposed regulation goes on to state that "a cost is unique to an estate or a non-grantor trust if an individual *could* not have incurred that cost in connection with property not held in an estate or trust."[13] There are also some examples in the proposed regulation of products or services that are and are not unique to an estate or trust, as well as a discussion of "bundled fees," some of which the regulation makes clear, are unique to an estate or trust and some of which are not, and of those which are not, the regulation makes clear, are subject to the 2% floor.[14]

III. Reasoning of the Supreme Court in *Knight*

Although the Supreme Court ultimately upheld the Second Circuit's decision in *Knight*, it did not agree with the Second Circuit's reasoning, particularly the Second Circuit's insertion of "could" instead of "would" in I.R.C. § 67(e)(1).[15] I.R.C. § 67(e)(1) states the following: "For purposes of this section, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that (1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which *would* not have been incurred if the property were not held in such trust or estate . . . shall be treated as allowable in arriving at adjusted gross income."[16]

In discussing this very issue, Justice Roberts, who delivered the opinion of the Court, stated that the Second Circuit's interpretation in asking "whether the cost at issue *could* have been incurred by an individual . . . flies in the face of the statutory language."[17] The Court went on to state that if Congress had intended the statute be read as the Court of Appeals suggested, Congress could have replaced "would" in the statute with "could," which it had not.[18] The trustee argued that "whether a particular expense of a particular trust or estate was caused by the fact that the property was held in the trust or estate" was the proper inquiry in determining whether or not such an expense is fully deductible and that investment advisory fees incurred by the trust met this test because these costs were caused by the trustee's obligation "to obtain advice on investing trust assets in compliance with the trustees' particular fiduciary duties."[19] In response to this argument, the Court stated that "[i]n asking whether a particular type of cost 'would *not* have been incurred' if the property were held by an individual, § 67(e)(1) excepts from the 2% floor only those costs that it would be *un*common (or unusual, or unlikely) for such a hypothetical individual to incur."[20]

The trustee also argued that because he had a fiduciary duty to act as a prudent investor under the Connecticut's Uniform Prudent Investor Act, it was necessary to hire an investment advisor to allow him to meet his fiduciary duties under the Act. The Court went on to discuss the Act and stated that, "[t]he prudent investor standard plainly does not refer to a prudent *trustee*; it would not be very helpful to explain that a trustee should act as a prudent trustee would. Rather, the standard looks to what a prudent investor with the same investment objectives handling his own affairs would do—i.e., a prudent individual investor."[21] The Court did, however, leave at least a small window open when it noted that "some trust-related investment advisory fees may be fully deductible 'if an investment advisor were to impose a special, additional charge applicable only to its fiduciary accounts.'"[22] The Court went on to state that "[i]t is conceivable, moreover, that a trust may have an unusual investment objective, or may require a specialized balancing of the interests of various parties, such that a reasonable comparison with individual investors would be improper. In such a case, the incremental cost of expert advice beyond what would normally be required for the ordinary taxpayer would not be subject to the 2% floor."[23] Unfortunately, in *Knight*, the trustee had not made such an argument.

IV. Response by Accountants

Following the issuance of the *Knight* decision, and in response to the proposed regulation which had been issued prior to the Supreme Court decision in *Knight*, the American Institute of Certified Public Accountants (AICPA) sent a letter to the IRS requesting that the proposed regulation be withdrawn and a new proposed regulation be issued, since the proposed regulation appeared to follow the Second Circuit's reasoning which the Supreme Court had rejected in *Knight*.[24] The AICPA also requested that the comment period be lengthened and the IRS issue interim guidance for trustees and tax preparers for preparation of 2007 fiduciary income tax returns on the bundled fees issue which was part of the proposed regulation. Finally, on the unbundling issue, AICPA requested that the Treasury Department and the

IRS reconsider the proposal to require unbundling of fiduciary fees in cases where the fiduciary fees charged were reasonable compared to state law guidelines for trustee's commissions and common practice. It also requested that the rule allow a one to two year transition period to allow fiduciaries the time to determine whether the fees should or could be fractured. The letter went on to give numerous examples to be considered in determining the meaning of "commonly" and "customarily" incurred by trusts. The letter ends with an analysis by AICPA of fifteen separate fact patterns and discussion of whether the investment advisory fees would be fully deductible under the scenarios presented.

In apparent response to this letter, the IRS issued Notice 2008-32 which was supposed to provide guidance on the "bundled fees" issue addressed in the proposed regulation. Notice 2008-32 stated that "[t]axpayers will not be required to determine the portion of a Bundled Fiduciary Fee that is subject to the 2-percent floor under § 67 for any taxable year beginning before January 1, 2008. Instead, for each such taxable year, taxpayers may deduct the full amount of the Bundled Fiduciary Fee without regard to the 2-percent floor. Payments by the fiduciary to third parties for expenses subject to the 2-percent floor are readily identifiable and must be treated separately from the otherwise Bundled Fiduciary Fee." The Notice goes on to extend the comment period on the proposed regulation until May 27, 2008, and to request comments on "whether safe harbors would be helpful and request suggestions on how the safe harbors may be formulated. Comments are specifically requested on reasonable estimates of the percentage(s) of the total costs of administering a nongrantor trust or estate that is attributable to costs subject to the 2-percent floor including, but not limited to, costs for investment management and advice. Comments are also requested on whether the safe harbors should reflect the nature or value of the assets in the nongrantor trust or estate, and/or the number of beneficiaries of the nongrantor trust or estate."

V. Conclusion

Where do we go from here? The answer is not entirely clear. Based on *Knight* it is clear that investment advisory fees are now subject to the 2% floor, unless and until companies providing these services establish different rates for individuals and trusts, as that appears to be one small window the Court left open. In the absence of that, if a trustee can establish that the trust has an "unusual investment objective" or requires "specialized balancing of the interests of various parties" as the Court pointed out in *Knight*, the trustee may be able to have full deductibility of investment advisory fees. However, it would appear that the IRS will be examining such requests closely, and trustees will have the burden of proving that the fees paid were for the purposes discussed above, which may be very difficult to do, especially on less complex trusts. It will also be instructive to see the final version of the regulation when it is issued, perhaps, sometime this summer.

Endnotes

1. 128 S. Ct. 782 (2008).
2. *Id.* at 786.
3. *Id.*
4. 994 F.2d 302 (6th Cir. 1993).
5. *Id.* at 304.
6. 47 Fed. Cl. 186 (Fed. Ct. 2000).
7. *Id.* at 189.
8. *Id.* at 191.
9. 328 F. 3d 132 (4th Cir. 2003).
10. *Id.* at 136.
11. *Id.* at 139-140.
12. Proposed Regulation § 1.67-4(a) (emphasis added).
13. Proposed Regulation § 1.67-4(b) (emphasis added).
14. Proposed Regulation § 1.67-4(b) and (c).
15. 128 S. Ct. 787.
16. I.R.C. § 67(e)(1) (emphasis added).
17. 128 S. Ct. 787.
18. *Id.*
19. *Id.* at 788.
20. *Id.* at 789.
21. *Id.* at 790.
22. *Id.* at 791.
23. *Id.*
24. See Letter from Jeffrey R. Hoops, Chair, Tax Executive Committee of American Institute of Certified Public Accountants, to Catherine Veihmeyer Hughes dated February 8, 2008, which is available on the AICPA website at www.aicpa.org.

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Representing Single and Multiple Fiduciaries: When to Seek Advice and Direction from Court

By Lucy Kats

I. Introduction

What happens when multiple fiduciaries disagree with respect to the exercise of their discretionary powers? For example, one fiduciary may believe it is prudent to sell the stock held by the trust, while others may vehemently disagree.

Most trusts and estates practitioners are familiar with SCPA 2107, under which the fiduciaries may seek advice and direction from the court. Historically, resolutions of disagreements between fiduciaries have been difficult to achieve because the New York courts refused to settle the disputes involving discretionary decisions. Since the law provided that their action must be joint, the courts' refusal to break the fiduciaries' deadlocks resulted in a situation which almost always favored the position of the fiduciary who wished to preserve status quo.

In 1993, the Legislature amended SCPA 2102(6) to expand the Surrogate's Courts' powers to resolve the fiduciaries' deadlocks. As a result, a proceeding for advice and direction under SCPA 2102(6) is now available to fiduciaries who disagree on "any issue affecting the estate." Although SCPA 2107 was also amended at that time, that amendment was not nearly as sweeping in its effect as the one that was adopted in the SCPA 2102(6), but merely incorporated a test previously set forth in caselaw. As a result, in the absence of a disagreement, the more stringent SCPA 2107 standard of "extraordinary circumstances" must be met by fiduciaries seeking advice and direction.

II. The Law Prior to 1993

Prior to the 1993 expansion of SCPA 2102(6) and 2107, the Surrogate could provide direction to fiduciaries only on a very narrow issue of the custody of money or other property.[1] The general rule was that the Surrogate had no power to "substitute his own discretion for the discretion of those upon whom the duty has been cast of settling the affairs of the estate."[2] This standard applied regardless of whether the proceeding was brought by a sole fiduciary or multiple fiduciaries.[3] The courts' reluctance to become involved, while disappointing for the fiduciaries seeking guidance and protection, brought to a screeching halt the administration of the trusts and estates whose fiduciaries were in a deadlock with respect to an important issue.

The courts consistently declined to interfere in situations where fiduciaries disagreed:

> This is a dispute among multiple fiduciaries concerning issues that are not appropriate for advice and direction. The authority of this court is to give advice and direction is exercised sparingly. Such applications will be denied unless unusual or extraordinary circumstances or compelling reasons are shown to justify interference with the exercise of the fiduciary's discretionary powers or the substitution of the court's judgment for that of the fiduciaries.[4]

Most cases holding that a court could not direct a trustee, executor, or administrator with respect to a decision involving discretionary judgment cited, as precedent, two 1930s Court of Appeals decisions, *In re Leopold's Estate*[5] and *City Bank Farmers' Trust v. Smith*.[6] In *In re Leopold*, two administrators disagreed on whether to compromise a claim that was pending against the testator at the time of his death.[7] One of them petitioned the Surrogate to authorize and approve the compromise agreement and to direct his co-administrator to join in the payment. The Surrogate's Court granted the application, but the Appellate Division reversed, holding that the Surrogate had no power to approve a compromise that was disapproved by one of the fiduciaries.[8] The Court of Appeals, while purporting to reverse the Appellate Division, struck a balance between that court's and the Surrogate's views by holding that:

(1) the co-administrator's failure to join in the compromise was not fatal, since the power to collect and discharge debts is a several power, not joint power, exercisable by one of multiple fiduciaries;

(2) the Surrogate can review the discretionary administration decisions of the fiduciaries, but cannot substitute his own discretion for theirs;

(3) the Surrogate could approve a compromise agreement, thus affording protection to the administrator compromising the claim;

(4) the court did *not* have the authority to compel a co-administrator to join in a compromise which such fiduciary found ill-advised; and

(5) the objecting co-administrator was directed to join in the payment of claim since the Surrogate

> had power to compel payment of a claim which has not been rejected.[9]

The confusing holding effectively amounted to the following: although the court could not compel a co-fiduciary to "sign off" on an action she disagrees with where the court approved of this action, the court could nevertheless compel her to do whatever was necessary to effectuate it. Despite the complexity of that opinion and the fact that the power in dispute was several, *Leopold's Estate* was swiftly adopted as precedent for the proposition that where joint, and not several, discretionary decision was involved, the court had no authority to compel one of the fiduciaries to act against such fiduciary's judgment.

Unlike *Leopold's Estate*, the *City Bank Farmers' Trust* case did not involve a disagreement among fiduciaries. Instead, a sole trustee was seeking the court's advice. The Court of Appeals held that a judge should not advise the trustee what course to pursue in administration of the trust, but it may provide instruction or advice "where, upon established equitable principles, instructions or directions are required for his protection and the discharge of his trust."[10] The purpose of such instruction or advice is to protect the trustee "because of the doubtful meaning of the trust instrument, or because of uncertainty as to the proper application of the law to the facts of the case."[11] This holding was consistent with *Leopold's Estate* inasmuch as the Court of Appeals explained that it approved the fiduciary's settlement of compromise to afford such fiduciary protection. *City Bank Farmers' Trust*, however, served to caution Surrogates that advice and direction in fiduciaries' discretionary matters should be exercised sparingly.

In a 1949 decision, *In re Rehill's Will*, the Surrogate's Court cited *City Bank Farmers' Trust* as precedent to hold that "the mere existence of an honest difference of opinion between trustees involving a question of business judgment does not justify the interference of the Court unless such action is required for the protection of the trustees or the discharge of the trust."[12] In *Rehill*, two co-trustees could not agree on whether certain real property should be sold or retained. The court refused to break the deadlock, stating that whether the trustees exercise their right to sell the premises was a matter of business judgment "which the courts will not usurp."[13] It further explained that it would resolve the conflict if either trustee could show "that the continued retention of the property in question would be imprudent, negligent or otherwise improper."[14] By refusing to become involved, however, the court effectively ruled in favor of the trustee who wished to preserve status quo, or to retain the property.

Similarly, in *In re Ebbets' Will*, two individuals serving as co-executors and as co-trustees of a testamentary trust brought an application for advice and direction on how they should vote certain shares of stock held by the estate.[15] The Surrogate held that such a decision involved business judgment and was not a question "properly determinable by this court."[16] In dicta, however, the court stated that in view of the experts' and interested parties' support of a vote in favor of a certain action, voting against such action "would unquestionably place upon [the fiduciaries] a heavy duty of explanation."[17] Thus, the court managed to effectively resolve the dispute without overstepping its boundaries.

In a 1960 case, *Estate of Bourne*, the estate assets were comprised of stock in a corporation wholly owned by the testator.[18] Two of the three executors disagreed on whether the corporation should be dissolved prior to distribution of the assets. The third executor declined to commit to a definite position.[19] Surrogate Cox refused to provide direction on this issue. Citing no less than fifteen cases as precedent, he held that the Surrogate's Courts could review the executors' discretionary decisions but lacked authority to exercise business judgment for them.[20]

In 1985, Surrogate Roth finally identified the dilemma facing the New York courts in attempting to break fiduciary deadlocks, in *Estate of Jacobs*.[21] In this case, the trustees were granted discretion to choose the charities that would receive the remainder of the trust corpus. The trustees disagreed as to which charities should be named remainder beneficiaries.[22] Interestingly, Surrogate Roth held that where fiduciaries disagreed, they could generally seek "advice and direction" from the court in order to provide all interested persons an opportunity to be heard. The trustees could not do so in the present proceeding, however, because there were no interested parties, except for the two trustees.[23] The court, therefore, faced a dilemma:

> The power to dispose of this fund is a joint power as distinguished from a several power. In general, the decisions define a joint power as one which requires the exercise of discretion. . . . Where there are only two fiduciaries, and the will does not contain any direction for breaking a tie vote, the consent of both fiduciaries is required to exercise a joint power. However, neither [EPTL 10-10.7] nor any decision provides any guidance to the problem before the court—how to resolve a dispute between two fiduciaries who hold a joint power. In fact, the deadlock situation between two trustees presents an issue of first impression in this jurisdiction.[24]

The court held that, except in extraordinary circumstances, it had no power to direct the trustees with respect to their discretionary decisions. Even if it gave such a direction, Surrogate Roth believed that it could not be enforced.[25]

Apparently not wishing to create new precedent, while at the same time attempting to resolve the situation, the court creatively held that, while lacking authority to give direction, it could give advice. The Surrogate then told the parties which charities it would choose, "[i]f the court were a trustee," while reminding them in the next sentence that they were not required to follow this advice.[26] To discourage further lack of cooperation, the court explained that it would appoint a third trustee to cast a deciding vote if the court's advice was not followed.[27]

III. 1993 Amendments

In 1993, the New York Legislature loosened the constraints placed upon the Surrogate's Courts by *Estate of Leopold* and *City Bank Farmers' Trust* by amending Section 2102(6) of the SCPA to provide that "[a] proceeding may be commenced to require a fiduciary . . . to comply with such directions as the court may make whenever two or more fiduciaries disagree with respect to *any issue* affecting the estate."[28] Such a proceeding may be commenced by a fiduciary, an interested person, or a creditor.[29]

Following this enactment, Surrogate's Courts at last became willing to resolve disputes between fiduciaries. In *Estate of Heim*, for example, one fiduciary asked the court to direct her co-fiduciary to cooperate in the sale of certain real property.[30] Citing its powers under SCPA 2102(6), the court broke the deadlock in favor of the sale, and directed the resisting co-fiduciary to cooperate.[31]

However, even after the expansion of the court's power of interference in SCPA 2102(6), the Surrogates remain somewhat reluctant to become involved where the fiduciaries' business judgment is concerned. In *Estate of Duell*, for example, the co-executors could not agree on any major or even simple management issues.[32] Without reference to SCPA 2102(6), Surrogate Roth resolved the situation by appointing an independent third fiduciary to break deadlocks and to avoid the expense and delay of repeated applications to the court for relief.[33] A year later, when the third independent fiduciary testified that even upon his resolution of the deadlocks, one of two original co-trustees was still refusing to cooperate and to sign papers, the court responded by removing the non-cooperative trustee.[34]

The standards set forth in *Estate of Leopold* and *City Bank Farmers' Trust* still apply where a sole fiduciary is uncertain regarding a discretionary course of action. A proceeding for advice and direction in that situation must be brought pursuant to SCPA 2107, and not under SCPA 2102(6). While the former was also amended in 1993, the effect was not nearly as sweeping as that of the SCPA 2102 amendment. Prior to 1993, SCPA 2107 allowed an advice and direction proceeding only as to "the propriety, price, manner and time of sale" of estate property whose value was uncertain. In amending this section, the legislature echoed the Court of Appeals' language in *Estate of Leopold* and *City Bank Farmers' Trust*, providing the Surrogates with additional authority to entertain an application "in other extraordinary circumstances such as complex valuation issues, or tax elections, or where there is conflict among interested parties," while reminding the Surrogates that they "need not entertain jurisdiction if to do so would be merely to substitute the court's judgment for that of the fiduciary."[35]

While this amendment appeared to have expanded the scope of advice and direction proceedings, in fact SCPA 2107(2) merely codified what was already permitted by the courts in cases such as *Estate of Leopold* and *City Bank Farmers' Trust*.

IV. Bottom Line for Practitioners

A fiduciary who faces difficult business decisions or disagrees with one or several co-fiduciaries with respect to such decisions requires sound legal advice. Practitioners representing such clients must know when to recommend a proceeding for advice and direction in the Surrogate's Court.

In advising clients with respect to advice and direction proceedings, attorneys must clearly understand the difference between SCPA 2102(6), which allows for such a proceeding "on any issue" that is the subject of disagreement among multiple fiduciaries, and SCPA 2107, which limits a sole fiduciary's ability to seek the court's advice and direction to certain "extraordinary circumstances." Accordingly, attorneys representing a sole fiduciary or multiple fiduciaries who do not disagree must weigh the costs of the proceeding against the probability that the facts of the case are unusual enough to satisfy the SCPA 2107 standard. Where fiduciaries disagree, however, practitioners should be less hesitant to bring a proceeding pursuant to SCPA 2102(6). Unlike SCPA 2107, this section does not require that special circumstances be present for the court to direct the parties' actions.

An advice and direction proceeding is, of course, not necessary every time a disagreement arises among fiduciaries. If the power in dispute is "several," or a purely ministerial power exercisable by the fiduciaries individually, one fiduciary can proceed without the permission of others.[36] Even the exercise of a joint pow-

er does not necessarily require a court's involvement, as long as such power was conferred upon three or more fiduciaries. Pursuant to EPTL 10-10.7, such power "may be exercised by a majority of such fiduciaries."

Where disagreement among the fiduciaries with respect to a joint discretionary power results in a deadlock and the governing instrument does not provide for a mechanism to resolve it, the court's involvement is inevitable. Under some circumstances, an SCPA 2102(6) proceeding may also be desirable where the disagreement among the fiduciaries does not result in a deadlock. Since passive fiduciaries can be held responsible for the wrongful actions of their co-fiduciaries,[37] the dissenting fiduciary who believes the majority's discretionary business decision is unsound, negligent or in breach of a fiduciary duty may wish to bring an SCPA 2102(6) proceeding to put his dissent on the record and to force the participation of all interested parties.[38]

Endnotes

1. Legislative Bill and Veto Jackets, Laws of 1993, Ch. 514, Assembly Bill 8414-A; S.C.P.A. § 2102, *Practice Commentaries*, Margaret Valentine Turano.
2. *In re Leopold's Estate*, 259 N.Y. 274, 277 (1932); *In re Sackler*, 192 A.D.2d 660, 661, 596 N.Y.S.2d 837, 838 (2d Dep't 1993); *In re Emmon's Will*, 59 N.Y.S.2d 264, 266 (Surr. Ct., Broome Co. 1946).
3. *See, e.g.*, *In re Osterndorf's Estate*, 75 Misc. 2d 730, 349 N.Y.S.2d 275 (Surr. Ct., Nassau Co. 1973) (whether or not to sell real property was a question of business judgment for the administrator and did not qualify as extraordinary situation which would justify the court's advice and direction).
4. *Estate of Tracy*, N.Y.L.J., Dec. 20, 1991, 34, (col. 4) (declining to interfere with decision of two out of three trustees to sell a work of art), citing *In re Leopold*, 259 N.Y. 274.
5. 259 N.Y. 274.
6. 263 N.Y. 292 (1934).
7. 259 N.Y. at 276.
8. *Id.* at 277.
9. *Id.* at 277-78.
10. 263 N.Y. at 295 (trustee holding real property asked the court to determine trustee's power to negotiate the tenant's rent, and the court held trustee's power was clear under the law and did not require the court's involvement).
11. 259 N.Y. at 296.
12. 90 N.Y.S.2d 384, 389 (Surr. Ct., West. Co. 1949).
13. *Id.*, citing *In re Ebbets' Estate*, 139 Misc. 250 (Surr. Ct., Kings Co. 1931).
14. *Id.* at 389-90.
15. 139 Misc. 250, 248 N.Y.S. 179 (Surr. Ct., Kings Co. 1931).
16. *Id.* at 253.
17. *Id.* at 252-53.
18. 22 Misc. 2d 681, 201 N.Y.S.2d 869 (Surr. Ct., N.Y. Co. 1960).
19. *Id.* at 683-85.
20. *Id.* at 685.
21. 127 Misc. 2d 1020, 487 N.Y.S.2d 992 (Surr. Ct., N.Y. Co. 1985).
22. *Id.* at 1021.
23. *Id.* The Attorney General appeared but took no position in that case.
24. *Id.* at 1022.
25. 127 Misc. 2d at 1022-23.
26. *Id.* at 1023.
27. *Id.* (citing *Stuart v. Continental Illinois Nat'l Bank & Trust Co.*, 68 Ill.2d 502, 369 N.E.2d 1262 (Ill. 1977)).
28. SCPA 2102(6) (emphasis supplied). The 1993 amendment expanded the scope of advice and direction proceedings by substituting the language "as to custody of money or other property of the estate committed to them" with "respect to any issue affecting the estate." Laws of N.Y., 1993 Regular Session, Ch. 514, § 47.

    SCPA 103(19) defines "estate" to include the property of "a decedent, trust, absentee, internee or person for whom a guardian has been appointed."
29. SCPA 2102, Practice Commentary, Margaret Valentine Turano; 17A West's McKinney's Forms, Estates and Surrogate's Practice, § 14:124.
30. N.Y.L.J., July 7, 2001, p. 32, col. 5 (Surr. Ct., Sufflk. Co.).
31. *Id. See also e.g. Estate of Stanley*, N.Y.L.J., Feb. 10, 1998 p. 27, col. 1 (Surr. Ct., N.Y. Co.) (advice and direction is available to fiduciaries under SCPA 2102(6) if they disagree with respect to joint powers); *Estate of Levitt*, N.Y.L.J., Jun. 14, 1993, p. 33, col. 1 (Surr. Ct., Nassau Co.) (SCPA 2102(6) proceeding was proper to resolve an apparent disagreement between trustees regarding proper investment vehicles).
32. N.Y.L.J., July 23, 1996, p. 23, col. 1 (Surr. Ct., N.Y. Co.).
33. *Id.*
34. *Estate of Duell*, N.Y.L.J., Sep. 22, 1997, p. 28, col. 5 (Surr. Ct., N.Y. Co.).
35. N.Y. EPTL 2107(1) and (2); Laws of New York, 1993 Regular Session, Ch. 514, § 51.
36. *Estate of Weinstock*, N.Y.L.J., Oct. 2, 2000, p. 31, col. 3 (Surr. Ct., Kings Co.) (internal citations omitted). Examples of purely ministerial powers are collection of assets or depositing of funds into a bank. *Id.*
37. *In re Rothko*, 84 Misc. 2d 830, 379 N.Y.S.2d 923 (Surr. Ct., N.Y. Co. 1975), *modified on other grounds,* 56 A.D.2d 499, 392 N.Y.S.2d 870 (1st Dep't 1977), *aff'd*, 43 N.Y.2d 305, 401 N.Y.S.2d 449, 372 N.E.2d 291 (1977). *See also* 2 Harris 5th N.Y. Estates: Probate Admin. & Litigation § 23:170 (2007).
38. At the very least, a fiduciary who disagrees with the majority's position should express his or her dissent in writing. John R. Morken & Gary B. Friedman, *Early Detection of Possible Pitfalls in Fiduciary Obligations Can Prevent Later Problems*, 74-Jan. N.Y. St. B.J. 22 (2002).

Protecting the Primary Residence from the Cost of a Nursing Home in a Post-DRA World

By Anthony J. Enea

Many years ago I had my first encounter with the disastrous consequences that result when a client fails to take the necessary steps to protect the client's residence from the cost of a nursing home. An elderly couple had consulted with me regarding a plan for protecting their assets in the event either one of them needed to enter a nursing home. At the time of the consultation the husband had serious health issues, however, his wife was in relatively good health. I made a number of recommendations to the clients, including suggesting that their home be transferred from the husband to the wife. Such a transfer is known in Medicaid parlance as a "spousal transfer," an exempt transfer, which does not create a period of ineligibility for Medicaid.[1]

Unfortunately, the clients decided not to implement my suggestions. As is often the case, several years later I received a telephone call from the couple's daughter advising me that her father had been placed in a nursing home because he suffered from senile dementia, and that her mother had just passed away. Because title to their house was jointly held with his wife, at her death title to the house had now passed by operation of law to the husband. Thus, the primary residence was now an asset against which Medicaid could place a lien and assert a claim.[2] Medicaid could recover from the proceeds of the sale of the home the Medicaid benefits properly paid for the nursing home care of the father.

As a result of the failure to implement a plan to protect the home, Medicaid was paid a significant amount upon the sale of the home. Although we were still able to protect a significant portion of the sale proceeds, significantly more could have been protected if the recommended advance planning had been implemented.

With the average cost of a home in Westchester County being in excess of $600,000, it is not unusual for the primary residence to be the most valuable asset the client owns. Thus, taking prudent steps to protect the residence are well worth the effort.

For Medicaid purposes, the primary residence is known as the "homestead" and is an exempt asset (does not affect eligibility for Medicaid) so long as it is occupied by the applicant, the applicant's spouse or the applicant's minor, disabled or blind child.[3] The homestead can be a one-, two- or three-family home, condo or co-op, and still be exempt for Medicaid eligibility purposes (although any net income derived from the property is not exempt).[4] However, as is stated above, the homestead is an asset against which Medicaid can have a lien or assert a claim. In compliance with federal law, New York has an estates recovery program in place.[5]

The homestead can be transferred to five categories of individuals without affecting Medicaid eligibility:

1. Spouse
2. Minor child
3. Disabled or blind child of any age
4. Adult child who has lived in the home for at least two years immediately prior to the parent's institutionalization, and who has been a caregiver to the parent
5. Sibling who has lived in the home for at least one year immediately prior to the institutionalization, and who has an equity interest in the home

Thus, if any of the aforestated transfers can be utilized, no ineligibility for Medicaid would result.

Once a decision has been made to transfer the primary residence, whether as an exempt transfer or a non-exempt transfer (one that will create a period of ineligibility for Medicaid), a variety of estate tax, gift tax as well as capital gains tax considerations come into play, depending on such factors as whether the client reserves a life estate, or transfers the property to a Medicaid Qualifying Trust, also known as an Irrevocable Income Only Trust. Additionally, the provisions of the Deficit Reduction Act of 2005 (DRA) must be carefully reviewed. The DRA created a five-year look back period for all non-exempt transfers, as well as an onerous period of ineligibility for Medicaid if an application for nursing home Medicaid is made before the five-year look back period has expired. These are issues that need to be fully explored and reviewed with the client.

A non-exempt transfer of the homestead with the retention by the transferor of a life estate in the transferred property often gives the transferor the comfort of knowing that he or she will have the legal right to remain in the premises for the remainder of his or her life. The reservation by the transferor of the life estate will also allow the transferee, upon the death of the transferor, to receive a full step-up in the cost basis of the property to its fair market value on the date of the transferor's death, if there is still an estate tax in existence at that time. However, the client should be advised that if the premises are sold prior to the life tenant's death, there will be capital gains tax consequences resulting from the loss of the step-up in cost basis. Additionally, the client would have to be compensated for the loss of the actuarial value of the life estate relinquished at the time of sale, which would have an impact on the client's Medicaid eligibility.

The most commonly utilized and perhaps best Medicaid planning option relevant to the primary residence is the transfer of the residence to a Medicaid Qualifying Trust, also known as an Irrevocable Income Only Trust. Title to the premises is deeded to the trustees of the trust and the transferor is generally granted a life estate in the premises, and in many cases is given the right to receive all of the trust's income if liquid assets are ever transferred to the trust. However, no invasion of the trust principal can be made to or for the benefit of the trust grantor, although the trust may authorize invasion of the principal of the trust for the benefit of the grantor's children or other third parties.

The transfer to the Irrevocable Income Only Trust will create a five-year look back period as a result of the provisions of the DRA. Thus, it would be most important not to apply for nursing home Medicaid until the look back period has expired to avoid the potentially lengthy ineligibility period imposed by Medicaid as a result of the DRA.

The transfer to the irrevocable trust offers many estate and gift tax advantages which make it preferable to an outright transfer with or without the reservation of a life estate. For example, the transfer to the trust can be structured so as to avoid any gift taxes and to allow the beneficiaries of the trust to receive a step-up in cost basis upon the transferor's death, as well as allowing the continued availability of the principal residence exclusion for capital gains tax purposes.

In conclusion, regardless of which specific planning option is chosen to protect the primary residence, it is critical that some steps be taken to do so. As I often tell clients, until the residence is transferred, nothing has been done to protect the asset from the costs of a nursing home.

Endnotes

1. Social Services Law § 366(5)(d)(3)(ii).
2. Social Services Law § 369(2)(a)(ii); 42 U.S.C.A. § 1396p(a)(1).
3. Social Services Law § 366(2)(a); 18 N.Y.C.R.R. §§ 360-1.4(f).
4. Social Services Law § 360-4.3(d); 18 N.Y.C.R.R. §360-1.4(f).
5. 42 U.S.C.A. § 1396 p(b)(1); Social Services Law §§ 104, 369.

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CALENDAR OF EVENTS

Section Meetings

Sept. 24–28, 2008
Fall Meeting 2008
Broadmoor Hotel
Colorado Springs, Colorado

December 5, 2008
Executive Committee Meeting
9:30 a.m.
La Guardia Marriott Hotel
East Elmhurst

January 27, 2009
Executive Committee Meeting
New York Marriott Marquis
New York City

March 18–21, 2009
Spring Meeting 2009
Amelia Island Plantation
Amelia Island, Florida

Institute

November 20–21, 2008
Sixth Annual
Sophisticated Trusts and Estates Institute
New York City

Meeting Changes Starting with Florida Meeting in March 2009

As you'll see from the Calendar of Events, there are two upcoming out-of-state meetings: The Fall 2008 Meeting will be held at the famous Broadmoor Hotel in Colorado Springs, Colorado in September 2008, while the Spring 2009 Meeting will be held at the Amelia Island Plantation in Amelia Island, Florida in March of 2009.

In effect, beginning in 2009, the out-of-state meeting has been switched from the fall to the spring. The reason for the change is primarily weather related. Hurricane season in the fall made planning for meetings in the south problematic; indeed, the Fall 2005 Meeting scheduled in New Orleans had to be canceled because of Hurricane Katrina. By scheduling the out-of-state meeting in the spring, meeting locations in the south should not be a problem, and indeed they should be more attractive. (For more information on the Amelia Island Plantation, about 30 miles east of Jacksonville, Florida, check out the resort's website: www.aipfl.com.)

Although not yet scheduled, the Fall Meeting in 2009 (and subsequent Fall Meetings) will be held in an upstate location. In effect, beginning in 2009, the upstate meeting has been switched from the spring to the fall. The Section is confident that upstate venues for Fall Meetings will prove equally attractive.

Trusts and Esta

Spring

May 1–2, 2008 • A

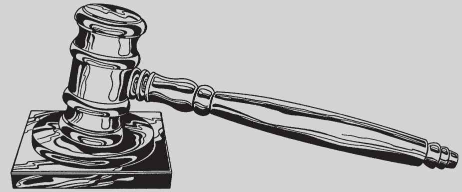
tes Law Section

Meeting

Albany, New York

Recent New York State Decisions

By Ira Mark Bloom and William P. LaPiana



BENEFICIARY DESIGNATIONS

Identification of Named Beneficiary of Annuity Contract as "Executor" Did Not Give Beneficiary a Personal Interest in the Proceeds

Testator applied for an annuity contract and the application designated a great nephew as beneficiary by name and also identified the great nephew as executor of the testator's will. Testator later executed a new will naming another relative as executor. The Appellate Division affirmed the Surrogate's finding that the great nephew was not the beneficiary of the annuity contract. The court agreed with cases from other jurisdictions and other authorities that identification of an individual beneficiary as executor or administrator means that the individual takes in the described fiduciary capacity. The Court of Appeals' holding in *McCarthy v. Aetna Life Ins. Co.*, 92 N.Y.2d 436, 681 N.Y.S.2d 790, 704 N.E.2d 557 (1998) is not to the contrary because the testator's second will did not change the beneficiary designation which was always the estate identified by its executor. *In re Estate of Pease*, 50 A.D.3d 132, 850 N.Y.S.2d 312 (4th Dep't 2008).

ELECTIVE SHARE

Annuities Are Not Insurance Contracts and Are Therefore Testamentary Substitutes

Surviving spouse brought a proceeding to determine the validity and value of her right of election against her husband's estate. Surrogate's Court determined that annuities owned by the husband at the time of his death were testamentary substitutes. Presumably wife was the beneficiary of these annuities because she appealed, relying on *In re Boyd*, 161 Misc. 2d 190, 613 N.Y.S.2d 330 (Sur. Ct., Nassau Co. 1994). The court in *Boyd* had held that the legislative history of EPTL 5-1.1-A shows life insurance contracts are not testamentary substitutes even though they could be found to be within the definition in EPTL 5-1.1-A(b)(1)(F) which includes as testamentary substitutes certain contractual arrangements.

The Appellate Division affirmed the Surrogate, holding that the weight of authority clearly holds annuities are not insurance principally because they do not involve payment as a result of a loss but rather are obligations to pay a stated sum for a period of time. *In re Estate of Zupa*, 48 A.D.3d 1036, 850 N.Y.S.2d 311 (4th Dep't 2008).

JURISDICTION

Exercise of Special Power of Appointment Will Not Sustain Jurisdiction of Donee's Estate

Surrogate's Court accepted jurisdiction and granted original probate of the will of a non-domiciliary. The Appellate Division reversed, holding that decedent did not have property in New York. Her exercise of special powers of appointment over trusts created by her husband who owned property in New York did not give her any interest in the assets subject to the powers. Nor did her ownership of three bank accounts in a New York bank mean she had property in New York, there being no reason to deviate from the usual rule that intangible property has its situs at the owner's domicile. *In re Estate of Baer*, 46 A.D.3d 1368, 849 N.Y.S.2d 143 (4th Dep't 2007).

MARRIAGE

Canadian Marriage Between Same-Sex Spouses Recognized in New York for Purposes of Employment Benefits

Plaintiff sued her employer, a community college, asking for a declaration that her Canadian marriage to her same-sex partner should be recognized for purposes of employer-provided health care benefits. The Appellate Division, Fourth Department, reversed the Supreme Court's judgment in favor of the employer, holding that the Canadian marriage is entitled to recognition in New York.

The court noted that New York has long recognized marriages solemnized outside of the state with only two exceptions: marriages whose recognition is prohibited by positive law and those "involving incest or polygamy, both of which fall within the prohibitions of 'natural law.'" The first exception does not apply

because the Legislature has not exacted legislation prohibiting the recognition of same-sex marriages and contrary to the defendant's contention, *Hernandez v. Robles*, 7 N.Y.3d 338, 821 N.Y.S.2d 770, 855 N.E.2d 1 (2006), does not stand for the proposition that same-sex marriages are contrary to New York public policy but only holds that nothing in the New York State Constitution compels recognition of same-sex marriages entered into in New York. Nor does the plaintiff's marriage fall within the natural law exception which is limited to marriages which, like incestuous and polygamous marriages, can be characterized as "abhorrent."

Finally, the court held that the case was not made moot by the defendant's eventual extension of spousal benefits to her spouse pursuant to new contractual provisions. *Martinez v. County of Monroe*, 50 A.D.3d 189, 850 N.Y.S.2d 740 (4th Dep't 2008).

Survivor of Vermont Civil Union Cannot Claim Workmen's Compensation Benefits for Death of Partner

In a sequel to *Langan v. St. Vincent's Hospital*, 25 A.D.3d 90, 802 N.Y.S.2d 476 (2d Dep't 2005), the Appellate Division, Third Department, has affirmed the Worker's Compensation Board's denial of a claim for death benefits by the surviving partner of a Vermont Civil Union, holding that the doctrine of comity does not require New York to recognize the claimant as a surviving spouse, nor does that determination violate the federal Equal Protection Clause. One justice dissented. *In re Langan*, 48 A.D.3d 76, 849 N.Y.S.2d 105 (3d Dep't 2007).

POWERS OF ATTORNEY

Lack of Authority to Make Gifts Overcome by Proof of Principal's Intent

While acting as his mother's attorney-in-fact under a power of attorney that did not expressly grant authority to make gifts, son wrote checks payable on his mother's account to himself and his sister as Christmas gifts. Mother died and son qualified as executor of her will. The Appellate Division affirmed the Surrogate's dismissal of the sister's objections to son's accounting, agreeing that while the absence of a grant of gift-giving authority gave rise to a presumption of impropriety, the evidence supported son's contention that the decedent clearly intended that he make the gifts. The evidence included the sister's testimony that she discussed checks she received which bore her brother's signature with her mother, who indicated that she instructed her son to write the checks, and that the amounts of the checks were consistent with her mother's past practice. *In re Estate of Masterson*, 46 A.D.3d 1091, 847 N.Y.S.2d 715 (3d Dep't 2007).

TRUSTS

Trustee's Exercise of Discretion Limited by Good Faith and Reasonableness

Testator created a testamentary trust for his granddaughter, making her father and his lawyer co-trustees and giving them broad discretion to make distributions to the beneficiary or to apply "for her sole benefit" income and principal, in their discretion, for "her proper support, education, maintenance, and general welfare." The trust terminates when the beneficiary reaches 30 years of age at which time principal and accumulated income are to be distributed to her. Two years before the testator's death, the beneficiary's parents divorced. From the testator's death in 1997 until 2003 when the beneficiary obtained an order directing the trustees to account, expenditures were made from the trust primarily for the beneficiary's secondary school and college expenses, although some health care expenses and the beneficiary's personal allowance were paid from the trust. In the meantime, in August 2000 the Supreme Court issued an order modifying the beneficiary's father's child support obligation by directing that the trust pay for normal and customary college expenses.

The beneficiary objected to the accounting. The Surrogate dismissed the objections to the expenditures for college expenses which were authorized by the 2000 order. The Surrogate sustained as a matter of law the objections to the expenditures for secondary school and health care expenses and for the payment of beneficiary's personal allowance on the grounds that the father/co-trustee could not avoid his support obligation by using his child's trust fund.

The Appellate Division affirmed the dismissal of the objections to expenditures for college expenses but reversed on the objections to the expenditures made during minority, finding them authorized by the trust. The participation of the co-trustee cured any possible problem related to using trust property to satisfy a trustee's support obligation. (*In re Estate of Wallens*, 30 A.D.3d 962, 816 N.Y.S.2d 793 (4th Dep't 2006)).

The Court of Appeals has now reversed the Appellate Division and remanded the matter to the Surrogate's Court. Although the distributions to pay the beneficiary's expenses which were part of the parent-trustee's support obligation were within the trustees' discretion, that discretion must be exercised in good faith and reasonably and solely in the furtherance of the beneficiary's interest. Therefore, on remand, the Surrogate's Court must determine if the distributions met that standard. *In re Estate of Wallens*, 9 N.Y.3d 117, 877 N.E.2d 960, 847 N.Y.S.2d 156 (2007).

WILLS

Direction in Gift to Spouse Makes General Legacy a Charge on Real Estate

Husband's will gave $100,000 to his surviving spouse and all of his real estate to his son, and then went on to reaffirm the gift to the wife "notwithstanding." In a construction proceeding, the Surrogate held that while the testator intended the legacy to the wife to be paid from personal property, the use of the word "notwithstanding" indicated the testator anticipated that his personal property might be insufficient to pay the legacy, and in that circumstance made the gift to his wife a charge on the real estate devised to his son. *In re Zorskas*, 18 Misc. 3d 600, 850 N.Y.S.2d 827 (Sur. Ct., Nassau Co. 2007).

No-contest Clause Not Violated by Providing Information to Objectant's Attorney

Decedent's will contained a no-contest clause revoking the interest of any beneficiary who "in any manner oppose[s] the probate" of the will. After decedent's son brought objections to probate which were dismissed, Surrogate's Court determined that the no-contest clause precluded him from taking under the will. The executor then began a proceeding to invoke the no-contest clause against the decedent's daughter who allegedly had written two letters to the son's attorney in response to a request for "background information" which disparaged the executor, decedent's second wife.

The Appellate Division affirmed the Surrogate's dismissal of the executor's proceeding, holding that because the daughter had signed a waiver and consent she did not oppose probate of the will. In addition, in the absence of any evidence of the daughter taking affirmative steps to oppose probate, the no-contest clause was not triggered by the two letters which did not deal with the validity of the will nor the widow's fitness to be executor. *In re Estate of Fairbairn*, 44 A.D.3d 973, 846 N.Y.S.2d 779 (3d Dep't 2007).

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Professors Bloom and LaPiana are the current authors of Bloom and Klipstein, *Drafting New York Wills* (Matthew Bender) (Bloom as principal author; LaPiana as contributing author).

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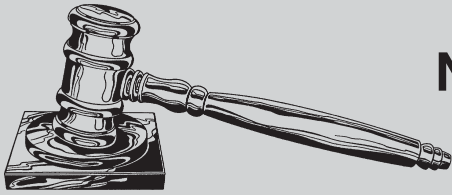

Case Notes—New York State Surrogate's and Supreme Court Decisions

By Ilene Sherwyn Cooper

Construction of Contract

In a proceeding to compel delivery of shares of a corporation, the petitioner, president of the company, moved for summary judgment. The application was opposed by the executor.

The record revealed that thirty years prior to his death, the decedent and another individual entered a shareholders' agreement, between themselves, individually and as shareholders of the subject corporation. At the time the agreement was signed, each owned 50% of the company.

The agreement defined the terms "shareholders" as the decedent and the other 50% owner, collectively, and the term "shareholder," as the decedent and the other 50% owner, individually. The agreement further addressed the logistics of the sale of the corporate stock upon the death of a shareholder, the manner in which the purchase price of the shares was to be calculated, and stated that the corporation was a "close corporation" for which there is "no market for the sale of its shares at a fair price either upon the death of a shareholder or during his lifetime. . . . "

At the time of his death, the decedent owned 50% of the corporation, and bequeathed his interest to his wife. Relying on the terms of the shareholders' agreement, the petitioner argued, on behalf of the corporation, that the unambiguous terms of the shareholders' agreement required the executor of the decedent's estate to deliver to him the shares of the stock in the company owned by the decedent at death. The fair value of the stock was provided to the executor with supporting documentation. The executor rejected the offer, claimed that the fair value of the company was worth more than was offered, requested a one-year lease of the premises where the company was situated, and claimed that the shareholders' agreement permitted a testamentary disposition of the company, or at the very least, was ambiguous in regard to the issue.

The court disagreed, finding that the clear language of the agreement, despite the executor's arguments to the contrary, required that upon a shareholders' death all of the shares owned by him were to be sold and purchased as set forth pursuant to its terms. The court opined that when an agreement is clear and unambiguous on its face, it will be enforced without resort to extrinsic evidence. Under such circumstances, the intention of the parties can be gathered from the four corners of the instrument, and the interpretation of the contract will be determined as a matter of law.

Accordingly, the court concluded that the subject agreement was not ambiguous, granted the petitioner's motion for summary judgment, and directed the executor of the estate to deliver the shares of the decedent's corporate stock to the corporation upon a determination of its fair value. The court, however, held that a question of fact existed as to the fair value of the stock and directed that a hearing be held on that issue.

In re Estate of DaSilva, N.Y.L.J., Mar. 21, 2008, p. 31 (Sur. Ct., Nassau Co.) (Surr. Riordan).

Construction and Reformation of Will

Before the court in *In re Estate of Sheehan* was an application by the executor for reformation of the decedent's Will in order to add a residuary clause, which allegedly had been omitted as the result of a clerical error.

In addressing the relief requested, the court opined that while its powers to construe and reform a Will were broad, they nevertheless were circumscribed by the traditional rule which prohibits reformation of an unambiguous Will, even in instances of mistake, such as the omission of a dispositive provision. The court noted that there was no explicit statutory mechanism for the correction of an error in a Will by the insertion of additional language based upon an allegation of testamentary intent not expressed in conformity with the Statute of Wills.

Moreover, the court found that while there have been limited exceptions crafted by courts in order to avoid a perceived injustice when a mistake is made, the petitioner had failed to produce extrinsic evidence demonstrating the actual intent of the testator in regard to the disposition of his residuary estate so as to warrant this result. Indeed, the court concluded that other than the bare allegation by the petitioner that the omis-

sion of the residuary clause was a "clerical error," there was nothing in the record concerning the testator's overall estate plan and his alleged desire that the residue of his estate pass to a revocable *inter vivos* trust.

Accordingly, while recognizing that the absence of a residuary clause would result in intestacy, the court held that, under the circumstances presented, it was constrained to deny the relief requested by the petitioner.

In re Estate of Sheehan, N.Y.L.J., Jan. 16, 2008, p. 37 (Sur. Ct., Suffolk Co.) (Surr. Czygier).

Exoneration Clause

Before the court in *In re Francis* was the issue of whether an exoneration clause in a power of attorney is enforceable.

The decedent died intestate survived by her nephew, who was appointed the administrator of her estate. Subsequently, the administrator instituted a discovery proceeding against the respondent, who was the decedent's attorney-in-fact, requesting a turnover of assets, that a tenancy agreement be set aside, and that the respondent be compelled to account.

The record revealed that the decedent's estate consisted of a two-family dwelling, and that the respondent and his mother resided on the first floor of the premises since 1972. The record also demonstrated that seventeen months prior to the decedent's death, respondent transferred all of the decedent's accounts to himself and his mother, acting as the decedent's attorney-in-fact. These accounts constituted the bulk of the decedent's liquid assets. Three months later, respondent prepared and executed on behalf of himself and as attorney-in-fact for the decedent a "Lifetime Tenancy Agreement," granting to himself and his mother a lifetime tenancy with joint right of survivorship to the two-family dwelling and its property. According to the agreement, the decedent was permitted to reside in the premises for her lifetime and was responsible for all bills, taxes, and expenses attendant to the property.

The subject power of attorney was drafted by the respondent and was given by him to the decedent to sign. The decedent was 98 years of age at the time. The document was three pages, the decedent's initials were inserted next to Item Q, which granted the agent all of the enumerated powers, and was followed by a broad power to make gifts, including to the attorney-in-fact, without liability.

After the completion of discovery, petitioner moved for summary judgment. The respondent opposed, maintaining that it was the petitioner's burden to establish that the decedent lacked capacity, and that the transfer of assets was not for the decedent's benefit. Moreover, the respondent asserted that the broad grant of powers under the power of attorney, the exoneration clause, and the law in effect at the time of the transfers, was a complete defense to petitioner's claims. Additionally, the respondent maintained that the statute of limitations precluded recovery.

The court held that the proceeding was not time-barred, inasmuch as the claims asserted were for breach of fiduciary duty, and thus governed by a six-year statute of limitations. The court opined that while the period begins to run when the fiduciary has openly repudiated his obligations or renders his account, since the respondent had never accounted, and did not repudiate his stewardship until after the commencement of the proceeding, it was timely.

With regard to the substance of the motion, the court reflected upon the abuse wrought by the attorney-in-fact upon the elderly decedent, and held that the exoneration clause could serve as no basis for exculpating him from liability for his conduct. Relying upon the dictates of EPTL 11-1.7, the court concluded that the rationale for the provision, i.e., the fundamental duty of every fiduciary to act in good faith and with undivided loyalty, applied equally to powers of attorney, as it did to wills and trusts. Accordingly, the court held the exoneration provision, to the extent that it sought to relieve the attorney-in-fact from all liability, was void.

Moreover, the court rejected the respondent's argument based upon the broad gift-giving powers afforded under the power of attorney, finding that the opinion of the Court of Appeals in *In re Ferrara* undermined the ability of an attorney-in-fact to make unqualified gifts to the holder of the power, especially when such gifts virtually impoverished the donor. The court concluded the respondent had failed to establish that the subject transfers were of any benefit to the decedent, or that the decedent intended to make gifts to him or his mother of the assets in issue.

Finally, the court held the exoneration provision void as against public policy insofar as it attempted to relieve the attorney-in-fact from the duty to account. The court held that the duty to account was fundamental to every fiduciary relationship, was absolute, and could not be waived by the principle during his or her lifetime.

Accordingly, petitioner's motion for summary judgment to set aside the transfers and the tenancy agreement was granted, and the respondent was directed to file an account of his stewardship.

In re Francis, 2008 WL 586210 (Sur. Ct., Westchester Co.) (Surr. Scarpino).

Exoneration Clause

In a miscellaneous proceeding, the guardian *ad litem* for the beneficiary of an *inter vivos* trust requested that the trustee be removed for her failure to account as directed by the court. The trustee, an attorney who drafted the instrument naming herself as "grantor" and as trustee, opposed the application on the grounds that the terms of the instrument exempted her from her duty to account to anyone during the beneficiary's lifetime.

The court rejected the trustee's position, concluding that such language in an *inter vivos* trust instrument is unenforceable as against public policy, as expressed by the provisions of EPTL 11-1.7 and common law. The court found that accountability is an essential element of all fiduciary relationships that cannot be waived. Further, the court opined that the provisions of EPTL 11-1.7 recognize that an attempt to render a fiduciary entirely unaccountable is inconsistent with the nature of a trust and void. These provisions, held the court, are equally as applicable to *inter vivos* trustees as they are to testamentary fiduciaries, particularly when there is no one in a position to protect the beneficiaries' interest during the existence of the trust.

The court declared untenable the trustee's argument that in drafting the trust to benefit her she was actually promoting the grantor's intentions, inasmuch as the trustee conceded that the trust was established in the first instance because the grantor was unable to protect his own interests. Indeed, the court opined that the trustee's conduct in drafting a trust that made her unaccountable under any circumstances constituted a violation of professional ethics.

Accordingly, the court granted the petitioner's application for removal of the trustee.

In re Shore, 2008 N.Y. Slip Op. 28102 (Sur. Ct., N.Y. Co.) (Surr. Roth).

Inheritance Rights of Adopted Children

In a contested administration proceeding, the issue before the court was whether the decedent's natural child could inherit from the decedent's estate, despite the fact that the child had been adopted by her paternal aunt and her aunt's husband one year after birth. The child, daughter of the decedent, maintained that her right to inherit from her natural mother had not been severed by the intra-family adoption.

In finding for the daughter, the court relied upon the provisions of DRL § 117(1)(e) and concluded that where the other requirements of the statute were satisfied, an adoptee may inherit from his or her birth mother and father so long as the adoptive parent was a descendant of the adoptee's natural grandparents on either the maternal or paternal side.

The court rejected arguments by the decedent's sister that the statute required the adoptive parent to have descended from the same grandparents as the decedent in order for the adopted child to inherit from a deceased natural parent. The court found that both the rules of statutory construction and the Recommendations of the Law Revision Commission contained support for the proposition that the statute was not intended to be so limited in its scope, but rather was designed to permit an adopted child to inherit from either natural parent under the circumstances set forth regardless of whether the adoptive parent was a descendant of a maternal or paternal grandparent.

The court further relied, for its result, upon the legislative history of the statute and policy considerations that supported the inheritance rights of adopted children from either natural parent in cases of intra-family adoptions. The court reasoned that unlike instances when a child is adopted out, when a child is adopted by a close family member there is a likelihood of contact between the child and his or her biological parents, and thus the concerns for severing family ties are not implicated. The court determined that under such circumstances the birth parents would likely want their child to receive the inheritance due pursuant to the laws of intestacy.

In re Estate of Johnson, N.Y.L.J., Jan. 25, 2008, p. 25 (Sur. Ct., Kings Co.) (Surr. Torres).

Jury Trial

In *In re Estate of Ruggiero*, the court dismissed defendant's demand for a jury trial, finding that the subject matter of the proceeding, to impress a constructive trust, was an equitable claim for which no right to a jury trial existed. In reaching this result, the court held that where the right to a jury trial is not granted by the New York State constitution, it is the nature and substance of the claim for relief, and not the court or the nature of the proceeding, that determines a right to a jury trial. Assessed within this context, the court concluded that the claim to impress a constructive trust on cash proceeds and real property would result in an award of money, and therefore no jury trial was available.

In re Estate of Ruggiero, N.Y.L.J., Feb. 28, 2008, p. 28 (Sur. Ct., Richmond Co.) (Surr. Gigante).

Paternity

In a contested proceeding for letters of administration, the petitioner maintained that the proof submitted by the cross-petitioner at a kinship hearing was insufficient to rebut the presumption of legitimacy which arose as a result of the fact that cross-petitioner's mother was married to another man at the time of her birth.

The cross-petitioner claimed that she was the non-marital child of the decedent. To establish that status, the court held she was required to present clear and convincing evidence that the decedent was her father and that he openly and notoriously held her out as his own. Further, the court held that the cross-petitioner was required to overcome the presumption that she was the biological child of the man to whom her mother was married when she was born.

The court found that while the presumption of legitimacy is rebuttable, it is one of the most formidable the law employs. To overcome it, it must be established by clear and convincing evidence that the application of such presumption under the particular circumstances presented is entirely incompatible with "common sense and reason." In other words, stated the court, the cross-petitioner must establish that it is "highly probable" that her mother's husband is not her biological father.

Based upon the proof presented, the court found that the cross-petitioner failed to satisfy this standard. Although the court concluded that the cross-petitioner had established the decedent had openly and notoriously held her out as his child, it held that this fact alone did not rebut the presumption of legitimacy. The court noted that when the facts show that a child's mother has engaged in an adulterous relationship, and no additional finding can be made excluding her husband as the biological father, courts have consistently concluded that the presumption of legitimacy has not been rebutted.

Accordingly, the court determined that cross-petitioner failed to establish she was the non-marital child of the decedent, and her petition for letters of administration was denied.

In re Estate of Frazier, N.Y.L.J., Mar. 24, 2008, p. 27 (Sur. Ct., N.Y. Co.) (Surr. Glen).

Reformation of Wills

In a contested miscellaneous proceeding, the petitioner, trustee, requested, *inter alia*, reformation of the decedent's will in order to deviate from the express prohibition in the instrument against sale of a parcel of property.

The petitioner was joined in its application by the guardian *ad litem*, who, with the petitioner, maintained that the proposed deviation was in the best interests of the trust beneficiaries. The application was opposed by other trust beneficiaries who alleged that the petitioner had not demonstrated unforeseen circumstances so as to warrant the application of the rule of equitable deviation, and that in any event, the proposed reformation was a marked departure from the decedent's will.

The court disagreed, finding that the decedent was unequivocal as to his desire to have the trust retain the subject parcel and to avoid its sale. The court opined that the rule of equitable deviation should not apply when the testator's intent is unambiguous and capable of fulfillment, but rather when unforeseen circumstances result in the testator's intent being frustrated. The court found that no such proof had been supplied, and that the "best interests" of the trust was not the dispositive test in determining whether deviation was appropriate.

In re Estate of Smathers, N.Y.L.J., Mar. 11, 2008, p. 27 (Surr. Ct., Westchester Co.) (Surr. Scarpino).

Spoliation of Evidence

In an action for personal injuries, the defendants moved for an order, pursuant to the doctrine of spoliation, precluding the plaintiff from presenting any evidence as to his allegation of certain injuries and the symptomology resulting therefrom.

The record revealed that as part of the discovery in the action, the defendants attempted to obtain copies of plaintiff's MRI films in order to have them reviewed by a physician. Plaintiff maintained that he did not have possession of the films. Plaintiff had apparently turned them over to one of his treating physicians, whose treatment facility had discontinued its business and vacated the premises. According to an affidavit from the physician, he had not seen plaintiff's films since that time. Plaintiff thus claimed that the films were lost, due to no fault of his own.

The court opined that the sanctions for spoliation of evidence is discretionary, and that striking a pleading is a drastic result to impose in the absence of willful or contumacious conduct. If the missing evidence does not deprive the moving party of the ability to establish his or her defense or case, a less severe remedy is appropriate.

Under the circumstances, therefore, the court held that the plaintiff could not be held responsible for the disappearance of the MRI films, or more importantly, that the plaintiff discarded the films in an effort to frustrate discovery. Moreover, the court concluded that the defendants were not deprived of their ability to defend the action, and could, at trial, seek an adverse inference jury charge regarding the missing MRI films, at the discretion of the trial judge.

Accordingly, defendants' motion was denied.

Castillo v. Staten Island Cable LLC, N.Y.L.J., Mar. 28, 2008, p. 28 (Civil Ct., Richmond Co.) (Dollard, J.).

Ilene Sherwyn Cooper, Partner, Farrell Fritz, P.C., Uniondale, New York.

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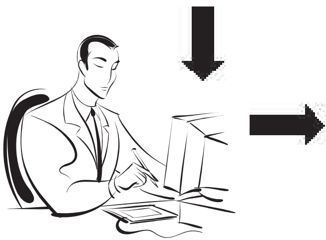

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