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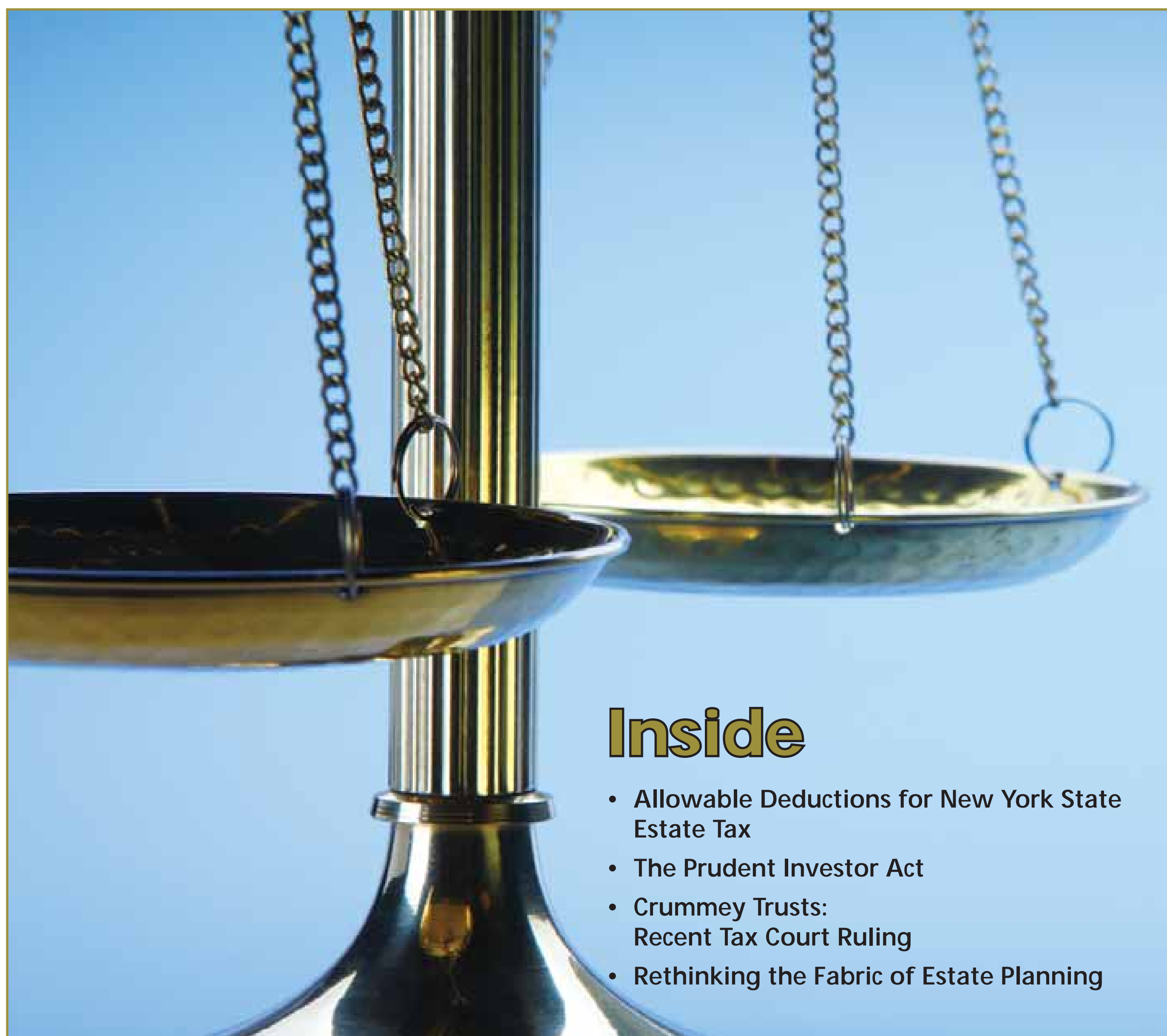
Trusts and Estates Law Section Newsletter

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



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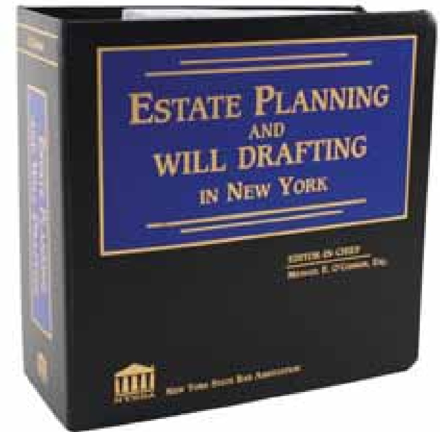

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A Message from the Chair

The Trusts and Estates Law Section has a great many achievements. Our *Newsletter* has been consistent in providing articles that are of great value to practitioners. Our committees report on proposed legislation, and also generate proposals for improving New York laws. We offer a wide array of Continuing Legal Education programs aimed at all levels of experience. These programs have become easier to attend with the increase in the Webcasts. The speakers who participate are volunteers and are to be commended for the effort undertaken to make the programs valuable to our members. To keep up the work of the Section, please consider joining one of the many committees. We welcome your participation.

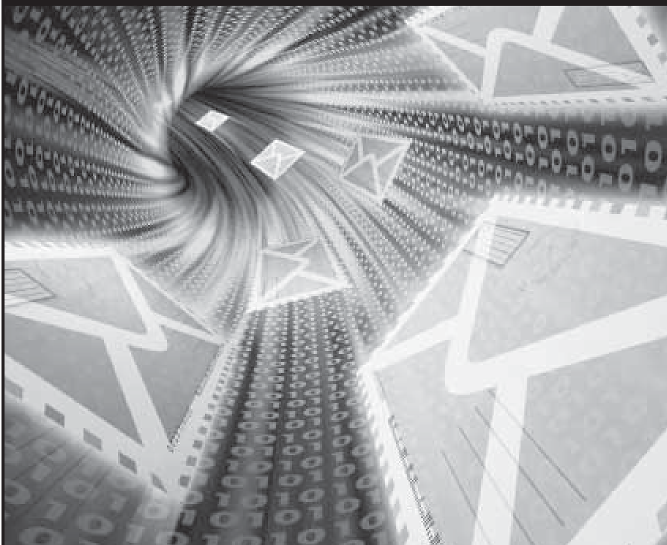
In May, the Section met in the foothills of Sonoran Desert at the Boulders Resort & Spa in Carefree, Arizona for a program regarding how to protect against attacks on a fiduciary and on the attorney. The program was organized by Carl Baker and Jill Beier and well received by the attendees. Ilene Cooper provided a well-annotated course book with applicable cases and articles, which will be a great resource material for future use. Once again the Section was fortunate to have had judges from four Surrogate's Courts join us, who participated in the program and interacted with the attendees during the social portions of the two-day program.

The Section next meets in Saratoga Springs at the Gideon Putnam Hotel on October 6 and 7. The location is one which most members can easily attend by car or train. I look forward to seeing you there. On Thursday afternoon, several roundtables on a variety of areas will take place followed by dinner at the Automobile Museum. The CLE presentation will be on Friday morning.

The Section, under the leadership of Ronald Weiss, recognized that there were issues with the New York State Short Form Power of Attorney and initiated proposed legislation to address a number of technical problems with the statute. Responding to our initiative and a more extensive proposal for modification of the statute from the Elder Law and Special Needs Section, then-NYSBA President Glenn Lau-Kee set up a Task Force with members from the Trusts and Estates Law, Elder Law and Special Needs, Real Property Law, Business Law and Health Law Sections to recommend amendments to the statute. NYSBA has now endorsed proposed legislation supporting our technical amendments: combining the Power of Attorney and the Statutory Gifts Rider into one form and providing that forms that are in substantial compliance with the statutory form, although not using the exact wording, will be valid. The proposed legislation also provides for sanctions for third parties that act unreasonably in refusing to honor the agent's authority, but holds third parties harmless if they act in good faith in accepting the power of attorney.

Magdalen Gaynor

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/TrustsEstatesNewsletter

Editor's Message

It was so nice seeing many of our readers at the Section's Spring Meeting at the Boulders Resort & Spa in Carefree, Arizona. I appreciated hearing so much feedback about our publication, and was pleased to learn that the *Newsletter's* recently updated look has been so well received.

In this edition, Darcy M. Katris guides us through computing New York Estate Tax deductions in light of Technical Memorandum TSB-M-15 (4) M that was recently issued by the New York State Department of Taxation, and Joshua Asherian provides an in-depth look at the Prudent Investor Act, analyzing fiduciary investments in Real Estate Investment Trusts within that context. Also in this issue is an article by C. Raymond Radigan, Jennifer F. Hillman, and Joni Hasday addressing the 2015 U.S. Tax Court case of *Mikel v. Commissioner* and the resulting effects of arbitration and *in terrorem* provisions on Crummey trusts, and an article by Avi Z. Kestenbaum and Amy F. Altman, providing an alternative perspective on estate planning.

Our next submission deadline is September 7, 2016. A reminder to those who have contributed their writings and those who may be contemplating doing so—authors may earn up to 12 CLE credits per reporting cycle for legal research based writing. For information about obtaining credits, please feel free to contact me directly.

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Computation of Allowable Deductions for New York State Estate Tax—New Guidance

By Darcy M. Katris

Introduction

On October 27, 2015, the New York State Department of Taxation and Finance issued Technical Memorandum TSB-M-15 (4) M, which provides guidance on the computation of allowable deductions for New York estate tax purposes. Under New York law, deductions must be related to the New York taxable estate to be taken on the New York estate tax return.

For a decedent who was a resident of New York State at the time of his or her death, this means that deductions relating to real or tangible personal property located outside of New York State may not be taken on the New York estate tax return. For a decedent who was a nonresident of New York State, deductions relating to real or tangible personal property located outside of New York State, and deductions relating to intangible personal property, may not be taken on the New York Estate Tax Return.

The Technical Memorandum clarifies that (i) for resident and nonresident estates, deductions both directly and indirectly relating to real or tangible personal property located outside New York State are disallowed, and (ii) for nonresident estates, deductions both directly and indirectly relating to intangible personal property are also disallowed. The Technical Memorandum also explains how to determine which deductions directly relate to property and how to calculate the amount of deductions which indirectly relate to property.

Deductions Directly Relating to Real or Tangible Personal Property Outside New York

In both the analysis for resident and nonresident estates, deductions directly relating to real or tangible personal property outside New York are disallowed and must be computed. The first step is to identify tangible personal property and real property reported on the Federal estate tax return which is located outside of New York. Then, all deductions taken on the Federal estate tax return must be reviewed to identify those that directly relate to such property. Examples of deductions which directly relate to real or tangible personal property are: fees to appraise such property, real estate taxes, maintenance, utilities and insurance premiums relating to such property, claims against such property, commissions paid to sell such property, charitable deductions for such property, mortgages secured by such property, and the amount of such property for which a marital deduction is taken on Schedule M of the Form 706.

Deductions Directly Relating to Intangible Personal Property

In the analysis for nonresident estates, deductions directly relating to intangible personal property are disallowed and must be computed. The first step is to identify intangible personal property reported on the Federal estate tax return. Examples of intangible personal property are: stocks (including stock representing ownership of a cooperative apartment), bonds, cash, bank and brokerage accounts, and interests in closely held companies, partnerships and limited liability companies. The next step is to review all deductions taken on the Federal estate tax return to identify those which directly relate to the intangible personal property. Examples of deductions that directly relate to intangible personal property are: investment management fees, maintenance for a cooperative apartment, commissions and other expenses incurred to sell a cooperative apartment, check fees, and the amount of intangible personal property included in a marital deduction taken on Schedule M of the Form 706.

Deductions Indirectly Relating to Real Property, Tangible Personal Property or Intangible Personal Property

In the analysis for a resident estate, deductions indirectly relating to real or tangible personal property located outside New York are disallowed. In order to determine which deductions indirectly relate to real or tangible personal property located outside of New York, all deductions which indirectly relate to any property must first be identified. Then, the total amount of deductions which indirectly relate to any property is multiplied by a fraction, the numerator of which is the value of real and tangible personal property located outside of New York and the denominator of which is the value of the Federal gross estate. The product of this computation yields the amount of Federal deductions that indirectly relate to real or tangible personal property outside New York and which are disallowed for a resident estate.

In the analysis for a nonresident estate, deductions indirectly relating to (i) real property or tangible personal property outside of New York, and (ii) all intangible personal property are disallowed. All deductions that indirectly relate to property must first be identified. Then, the total amount of deductions that indirectly relates to property is multiplied by a fraction, the numerator of which is the value of real property and tangible personal property located outside New York plus the value of all intangible personal property, and the denominator of which is the value of the Federal gross estate. The product of this computation yields the amount of Federal deductions that indirectly relates to real and tangible personal property outside New York and intangible personal property and which are disallowed for a nonresident estate.

Deductions that indirectly relate to property are those not directly related to real property (wheresoever located), tangible personal property (wheresoever located) or intangible personal property. Examples of deductions which indirectly relate to property are: executor's commissions, attorney's fees, accountant's fees, funeral expenses, and unsecured debts.

Example 1

Assume a resident of New York has a Federal gross estate of $20 million, which consists of $5 million of real and tangible personal property in New York, $2 million of real and tangible personal property in Florida, and $13 million of securities and cash. All real and tangible personal property is bequeathed to the decedent's spouse, $4 million is bequeathed to a family trust, and the residuary estate is bequeathed to the surviving spouse. Deductions taken on the Federal estate tax return total $16 million and include: $30,000 of funeral expenses, $100,000 of legal fees, $40,000 of New York real estate tax, $20,000 of Florida real estate tax, $4,000 of fees to appraise New York property, $2,000 of fees to appraise Florida property, and a marital deduction of $15,804,000.

Deductions directly relating to real or tangible personal property are computed as follows: real and tangible personal property located outside of New York consist of $2 million of property in Florida. Deductions directly relating to the Florida property are: $20,000 of real estate tax, $2,000 of appraisal fees and a marital deduction of $2 million. None of these deductions may be taken on the New York return.

Next, deductions indirectly relating to real or tangible personal property located outside of New York must be computed. The total amount of deductions which indirectly relate to any property are: funeral expenses of $30,000 and legal fees of $100,000, for a total of $130,000. The amount of the deductions that indirectly relate to real and tangible personal property located outside of New York is computed in accordance with the following formula:

Total amount of deductions indirectly relating to any property	X	Value of real and tangible personal property outside NY / Federal gross estate	=	Deductions indirectly relating to real and tangible personal property located outside NY
$130,000	X	$2 million / $20 million	=	$13,000

In this example there is a total of $2,035,000 disallowed deductions comprised of $2,022,000 (those directly relating to real or tangible personal property outside NY) and $13,000 (those indirectly relating to real and tangible personal property outside NY).

Example 2

Assume a nonresident of New York has a Federal gross estate of $100 million. There is a house in Connecticut worth $2 million, artwork in Connecticut worth $5 million, a cooperative apartment in New York worth $10 million, artwork in the New York apartment worth $50 million, and cash and securities worth $33 million. The estate is taxable. Deductions taken on the Form 706 are: funeral expenses of $40,000, legal fees of $500,000, commissions to sell art in Connecticut of $500,000, commissions to sell art in New York of $2.5 million, broker's commissions to sell the New York apartment of $500,000, Connecticut real estate taxes of $20,000, maintenance on the New York apartment of $100,000 and investment management fees of $30,000.

Deductions directly relating to real or tangible personal property located outside of New York are: commissions for the sale of art in Connecticut of $500,000 and Connecticut real estate taxes of $20,000. These deductions total $520,000 and are disallowed.

Deductions directly relating to intangible personal property are: broker's commissions of $500,000, maintenance on the New York apartment of $100,000 and investment management fees of $30,000. These deductions total $630,000 and are disallowed.

Deductions indirectly relating to property (those which do not directly relate to property) are: funeral expenses of $40,000 and legal fees of $500,000. The

amount of deductions indirectly relating to real and tangible personal property located outside New York and intangible personal property is computed in accordance with the following formula:

Total amount of deductions indirectly relating to any property	X	Value of real and tangible personal property outside NY plus intangible personal property / Federal gross estate	=	Deductions indirectly relating to real and tangible personal property outside NY and to intangible personal property
$540,000	X	$50 million / $100 million	=	$270,000

In this example there is a total of $1,420,000 disallowed deductions comprised of $520,000 (directly relating to real and tangible personal property outside New York), $630,000 (directly relating to intangible personal property), and $270,000 (indirectly relating to real and tangible personal property outside New York and to intangible personal property). The Federal deductions must be reduced by $1,420,000 when computing the New York taxable estate.

Conclusion

The new guidance on computation of allowable deductions applies to New York estate tax returns filed for decedents dying on or after April 1, 2014 and, in particular, to decedents who were New York residents with real or tangible personal property located outside of New York or who were nonresidents of New York. Returns filed before the issuance of the Technical Memorandum must be amended if they do not comply. The state in which a New York resident owns real or tangible personal property (or in the case of a nonresident of New York, the state in which he or she resides) may have a different rule for determining its state's estate tax.

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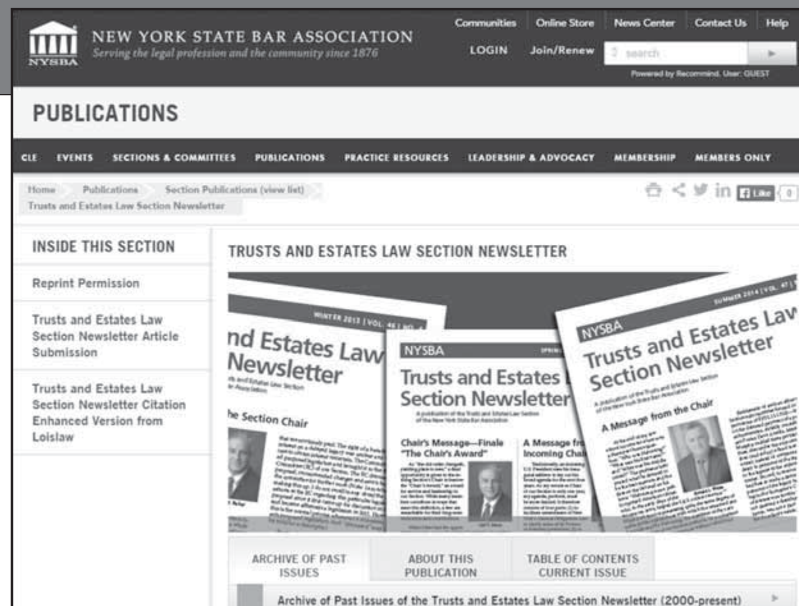

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The Empire State Building an Imprudent Investment? The Prudent Investor Act and Real Estate Investment Trusts

By Joshua Asherian

The Prudent Investor Act, the governing law on how trustees may invest trust and estate assets, is rooted in English principles of what constituted a safe investment.[1] However, since American investments made by American fiduciaries were different than their British counterparts, the law, like many other laws, had to adapt.[2] Through this emerged the principle known as the "Prudent Man Rule," a law which governed the investment strategies of fiduciaries made on behalf of trusts.[3] Again, however, as time progressed and the marketplace of available investments changes, along with their underlying mechanics, new and pioneering investment opportunities changed the attitudes of what is viewed as smart investing.

A new rule was eventually needed to take the place of the "Prudent Man Rule," to give the modern investor the appropriate flexibility and freedom to rely on these new products.[4] The new rule, which was adopted by the majority of states, was the "Uniform Prudent Investor Act."[5] Although the new Uniform Prudent Investor Act gives trustees more flexible standards for their investment strategies in order to allow them to diversify and manage portfolio assets, a question can be raised as to whether it is time again for the rule to adapt to allow fiduciaries to invest in Real Estate Investment Trusts ("REITs").[6]

In the past, a New York court held that a newly formed REIT for investment in construction and development mortgages was virtually per se imprudent as a trust investment,[7] which effectively put a halt to investment in REITs.[8] REITs, a once new and risky venture, are now a commonly seen investment vehicle. It can be argued that the new formulation of the fiduciary investment rules should, for a sophisticated trustee, permit investments in REITs provided that the fiduciary is aware of the risk.[9] For example, the recent inclusion of New York State's Empire State Building in a REIT may come to show that even though the new rule leaves some room for flexibility, the market for REITs still carries a certain level of insecurity.

I. The Prudent Man Rule

English law during the nineteenth century restricted trustees from making risky or speculative investments and in effect limited trustees to government-backed securities.[10] At around the same time, comparable American securities did not generate the same reward as their English counterparts, and a prudent investor was better served funding new developing business endeavors.[11] In recognition of the need for change, the Supreme Court of Massachusetts, in the 1830 case of *Harvard College v. Armory*,[12] rejected the English rule as constrictive and instead adopted the Prudent Man Rule.[13] The court refused to follow England's strict fiduciary rules and did not charge a trustee for investing in common stocks.[14] The Prudent Man Rule states:

> All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital invested.

Similarly, in *King v. Talbot*,[15] the New York Court of Appeals extended the same principles of the Prudent Man Rule to New York executors. However, New York courts subsequently limited the Prudent Man Rule, declaring investments in securities imprudent in response to an economic depression.[16] Shortly thereafter, New York's legislature enacted lists of investment instruments that were deemed safe for investment by fiduciaries.[17] Through these "legal lists," the Prudent Man Rule returned to its roots in the English common law.[18] States were unable to adapt to the newly restrictive "legal lists," and in the 1930s, a more flexible and adaptive standard of the Prudent Man Rule emerged, codified as the "Model Prudent Man Investment Act."[19]

The Model Prudent Man Investment Act permitted investment in such securities "as would be acquired by prudent men of discretion and intelligence in such matters who are seeking a reasonable income and preservation of their capital."[20] Under this rule, a trustee's investments were to be examined for prudence, and more specifically looked to the production of income and the preservation of principal. The trustee was required to adhere to a "duty of loyalty" in administering the trust for the benefit of both the income and remainder beneficiaries.[21] In effect, the trustee's prudence was examined on the basis of each investment, regardless of the result with regard to the entire portfolio.[22]

Much of the mid-to-late twentieth century fiduciary jurisprudence was based largely on the work of Professor Austin Wakeman Scott, reporter for the First and Second Restatement of Trusts and *The Law of Trusts.*[23] Although Scott's formulation was designed to rid the legal lists and their restrictions, Scott's interpretation of the rule was more restrictive[24] and differed significantly from the view set forth in *Harvard College.*[25] Scott first required that the prudent investor seek "preservation of the estate" rather than "permanent disposition of their funds."[26] In addition, trustees had to act as "men who [were] safeguarding the property of others."[27] Additionally, adding to his constrictive interpretation, Scott forbade trustees from investing in certain types of securities altogether. These constraints caused confusion and conflict between prudent investments and adherence to the Prudent Man Rule. In fact, in *The Puzzling Persistence of the Constrained Prudent Man Rule*, Jeffrey N. Gordon wrote:

> An investment strategy designed to preserve principal will presumably be more cautious than one aimed at permanent disposition, which could include a buy-and-hold portfolio of common stocks at a higher level of risk and expected return. Moreover, in inflationary times, a mandate to preserve the estate becomes confounding; to preserve the estate in nominal terms may well defeat the testator's objective of transferring wealth to the next generation, but to preserve the estate in *real terms* requires investment that may risk the loss of principal.[28]

Scott viewed investments in isolation of the portfolio as a whole, according to especially safe objectives, in effect rejecting modern portfolio theory which, to the contrary, used different objectives and looked at the portfolio as a whole.[29] Scott's restrictions on specific investments in effect limited the trustee's ability to apply investment strategies that were being used by the modern investor.[30] Trustees were limited in that they were averse to investment instruments that could be considered "speculative."[31]

Therefore, according to the rule's interpretation, any investment involving risk could be considered imprudent.[32] As mentioned earlier, this created a great restraint on the trustee, disallowing any investment in new enterprises such as REITs and other real estate investments,[33] foreign stocks, venture capital pools,[34] short sales,[35] futures and options, buying on margin,[36] and other investments. Essentially, under Scott's respected interpretation of the Prudent Man Rule, trustees, being viewed as conservators of the estate rather than an investor of its assets, were prevented from maximizing return on the investment portfolio.[37] Since speculative investment, which resulted in losses, was construed against the trustee, trustees had a natural tendency to invest in investments that offered a low overall rate of return and had a very low risk of loss.[38] The scrutiny placed on trustees, looking at each investment separately from the investment as a whole, resulted in a lack of diversification in trust investments, which can present more risk than a diversified portfolio.

For decades, the Prudent Man Rule and Scott's analysis thereof remained largely unchanged and unchallenged. However, over time, the Prudent Man Rule was widely criticized for limiting the trustee's ability to invest and restricting the trustee's investments too rigidly.[39] Some of the major objections to the Prudent Man Rule were that it was focused on individual assets rather than on the overall portfolio; it was focused on the preservation of the nominal value of the corpus rather than on maintenance of its purchasing power; it completely prohibited certain investments and classes of investments; it prohibited delegation of all but ministerial duties; it encouraged the avoidance of acquiring new investment products and employing new investment techniques; and it approved certain investments without inquiry.[40] The rule, with these restrictions, did not allow the trustee to fulfill his fiduciary duty to the beneficiaries because trustees were fearful of following modern investment practices.[41]

II. The Modern Rule—The Prudent Investor Act

The legislature responded to the shortcomings of the Prudent Man Rule by enacting the Prudent Investor Act. In 1992, the American Law Institute adopted the Third Restatement of the Law of Trusts, which included the Uniform Prudent Investor Act. On July 26, 1994, the Uniform Prudent Investor Act was signed into law in New York, effective January 1, 1995.[42]

The new Uniform Prudent Investor Act replaced the rigidity of the earlier laws and provided trustees with the flexibility that was needed in order for them to be able to invest with modern investment strategies. The statute reflects "modern portfolio theory," measuring asset management on the total return of the *entire portfolio* rather than on individual investment decisions.

In describing the responsibilities of the trustee, section 11-2.3(b)(2) of the New York Estates, Powers and Trusts Law ("EPTL") provides that "[a] trustee shall exercise reasonable care, skill and caution to make and implement investments and management decisions as a prudent investor would for the entire portfolio, taking into account the purpose and terms and provisions of the governing instrument."[43]

Therefore, a trustee's prudence is judged by the overall investment strategy rather than considering each particular investment individually, and at the time the decision was made, or by the "standard of conduct" rather than the "outcome or performance" of the investment decision.[44] In making an investment decision, the trustee must consider a number of factors such as the total return of income and appreciation as opposed to the profit or loss on any particular investment, the needs of the beneficiaries, the economy as a whole, the overall return of the investment, the size of the trust corpus, the effects of inflation, deflation and general economic conditions, the expressed goal of the settlor or testator, the trust's needs for liquidity, the size of the portfolio, tax consequences of the trustee's investments, and projected distributions.[45]

A trustee is also required to diversify the trust assets unless he reasonably determines that diversification is not in the beneficiaries' best interests.[46] In addition, under the Act, "no particular investment is inherently prudent or imprudent for purposes of the prudent investor standard."[47] Rather, each investment is judged in light of the entirety of all of the assets within the trust.[48] Furthermore, EPTL 11-2.3(b)(4)(C) states that a trustee is specifically authorized to "delegate investment and management functions if consistent with the duty to exercise skill, including special investment skills."

Delegation of the trustee's responsibilities can be an extraordinarily helpful tool for the trustee who does not have professional investment experience in a certain area and is afraid of making incorrect investments that could be deemed "imprudent" under the Uniform Prudent Investor Act as specified in EPTL 11-2.3. In fact, it has been suggested that trustees have a "virtual duty" to delegate the investments in a certain area of investment if they are not personally familiar with or do not have the skill needed to manage that investment prudently.[49] It is helpful for trustees to have the option to place their trust in individuals who are more skilled in the particular area of investments.

However, this power to delegate cannot be exercised arbitrarily. EPTL 11-2.3(c)(1) requires that the trustee exercise

> care, skill and caution in: (a) selecting a delegee suitable to exercise the delegated function, taking into account the nature and value of the assets subject to such delegation and expertise of the delegee; (b) establishing the scope and terms of the delegation consistent with the purposes of the governing instrument; (c) periodically reviewing the delegee's exercise of the delegated function and compliance with the scope and terms of the delegation; and (d) controlling the overall cost by reason of the delegation."[50]

Even if the trustee delegates investment decisions to an advisor, he still retains the duty to oversee the delegee' s actions and manage costs. In effect the trustee cannot exculpate himself by means of delegation and cannot delegate his fiduciary duties to an investment advisor. The statute provides that "an attempted exoneration of the delegee from liability for failure to meet such duty is contrary to public policy and void."[51]

In addition, EPTL 11-2.3(c)(2) requires the delegated investment advisor to act within the parameters of his delegation and exercise "due care" in his investment choices.[52] This acts to prevent investment advisors from insulating themselves from liability. Without this liability they could be induced to make risky decisions with the trust's funds with no worry of responsibility. This protects beneficiaries who have a beneficial interest in the funds the advisor is managing.

A trustee claiming to have special skills is held to a higher standard under the statute,[53] and a trustee also is required to manage the assets with the goal of making distributions according to the instrument.[54] The fiduciary must exercise reasonable care along with the level of skill and caution that a prudent investor would in making investment decisions.[55] Whether the investment decision is prudent is a question of fact.[56] When determining whether an investment was prudent, the surrogate will consider the facts and circumstances surrounding the decision to invest without taking into account hindsight or the actual performance of the investment.[57] The court in *Matter of Janes* stated that although "no precise formula exists for determining whether the prudent person standard has been violated in a particular situation," the court should "engage in a balanced and perceptive analysis of the fiduciary's consideration and action…at the time of the action or its omission to act."[58]

The new Uniform Prudent Investor Act allows the trustee to invest more freely, diversifying trust investments and even taking on some risk, without disregarding the trustee's fiduciary duty to his beneficiaries. The statutory right to delegate investment decisions, and the standard of review over the trustee's overall investment decisions, are just some of many examples of the flexibility that the Uniform Prudent Investor Act gives to the trustee.

Although the Uniform Prudent Investor Act has allowed trustees to invest based on modern, suitable investment theories, there is still room for improvement. For example, trustees may face difficulties in adequately diversifying investment allocation to balance the needs of income and remainder beneficiaries due to the economic climate. Post-recession, modern investment theory favors growth investments, whereas high yield-

ing investments such as bonds are less attractive.[59] This trend, where growth stocks are more attractive and perform better than income-producing investments, is typical in a strong market and growing economy.[60]

Similarly, trustees may seek to maximize growth by utilizing new investment vehicles. In a post-recession economy, the real estate markets, particularly in New York City, have grown rapidly. With this growth comes investment in real estate in REITs. However, trustees have traditionally deemed REITs as a risky investment for fear of not fulfilling their fiduciary duties to the trust beneficiaries.

III. Prudent Investment and Real Estate Investment Trusts

The recent changes in the laws for fiduciaries should have increased the participation of trusts in real estate investment given the favorable risk and return relationship normally associated with real estate investments. However, when examining the trend in real estate investing by trusts, it is found that underinvestment in real estate remains a problem in private trust investment.[61]

Real estate has had a checkered history as a potential asset in a fiduciary investment portfolio. Although many trusts have traditionally contained real estate, they were given to the trustee as specific trust property and consequently considered nondiscretionary trust items, as the settlor required their inclusion in the trust. However, unless specifically provided for in a trust instrument, real estate traditionally had been considered as too risky for inclusion in a fiduciary investment portfolio.[62]

Numerous studies have judged the diversification value of real estate.[63] The results overwhelmingly supported the notion that real estate offers substantial diversification benefits while at the same time offering protection against unanticipated inflation.[64] The historical return on real estate investments has also been high relative to their risk and they appear to have little or no correlation with other assets.[65] As a result, it seems that prohibiting or discouraging investment in real estate not only harms the beneficiary of the portfolio, but also has negative implications for society as a whole.[66]

In analyzing a trustee's investments, two questions should be considered: first, is this the type of investment proper for trust holdings? Second, was the particular investment prudent under the circumstances, and was it chosen with the appropriate level of care and skill in light of the objectives of the trust, the distribution requirements and other circumstances of the trust, and the need for diversification? In the past, a real estate investment would not be included under either of these criteria. The law has changed in this regard, but it is not altogether clear that the attitudes of trustees have changed.[67]

A question sometimes arises as to whether the grant of authority extends "discretion" to a trustee outside the investment authority of the Prudent Investor Act. Where there is no specific elaboration of investment authority within a trust instrument, the trustee adopts the Uniform Prudent Investor Act as the appropriate default standard. Most trust instruments are completely devoid of any instructions with regard to the inclusion of real estate in the trust portfolio. In absence of specific instructions from fiduciary instruments, fiduciaries have traditionally been required to meet the standard of care of the Prudent Man Rule.[68]

However, in *King v. Talbot*,[69] the New York Court of Appeals rejected a liberal interpretation of the Prudent Man Rule by stressing that the rule "excluded all speculation, all investment for an uncertain and doubtful rise in the market."[70] The court opined that the entire asset class of common stocks had been imprudent investments, and suggested that a trustee should only be concerned with the preservation of the corpus, and obtaining a reasonable income. Additionally, the court rejected investments in common stocks, stating that by so investing, the trustee had in effect delegated the performance of the trust to corporate directors. This case raised the evil prospect of fiduciary "speculation."[71]

But what is speculation? No consistent definition exists in case law. The lack of clarification on the subject constitutes a major problem that continues to this day.[72] Because of the prospect that there may be a surcharge for "speculation" losses, fiduciaries traditionally have been reluctant to try anything novel. Even today, fiduciaries move into new territory very slowly. This continues to be the case for the trustee thinking about investing in real estate investments.

In 1899, the New York Legislature codified a much more restrictive investment standard, the "Legal List Rule," which enumerated a list of legal investments.[73] For the next five decades, this became the fiduciary investment standard applied in the majority of the states. A typical Legal List Rule statute disallowed *nearly all real estate investments*.[74] The system of specific "prudent" investment blessed by legal lists saw little modification until about 1940.[75] However, studies at the time showed that returns on trust investments in states that followed the Prudent Man Rule were almost double than the returns on trust investments in states that the Legal List Rule, because of the conservative nature of legal list investments.[76]

Although the traditional Prudent Man Rule focused on asset preservation and prevented trustees from investing trust funds in accordance with modern portfolio theory, modern portfolio theory focuses on a risk-return analysis for each portfolio. As mentioned above, there were many objections to the Prudent Man Rule, and it was reformulated to the new Uniform Prudent Investor Act in the 1990s.[77] The Restatement's Pru-

dent Investor Act was based on certain "principles of prudence."[78] Each of these principles of prudence had effects in terms of the role real estate would play in a fiduciary portfolio. Real estate is the largest asset class, and it goes without saying that some real estate is necessary for proper diversification. However, the particular formulation of each principle may have specific implications with regard as to what is the best method of incorporating real estate into a fiduciary portfolio.[79]

In 1990, there was a reformulation of the rule that lifted the limitation on real estate investment. The Restatement's formulation provides that "[t]he trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements and other circumstances of the trust."[80] This new standard does not make any reference to the type of proper investment. This means that there is no outright limit on real estate investment; yet the standard contains unspecified limitations. Real estate investment is only mentioned in the Restatement, with no explanation of the proper role for such investments.[81] Restatement Third, Trusts § 227, comment o (1992) states:

> There may be good reasons for a particular trust to hold equity positions in real estate, provided the particular investment or investment program fits the circumstances and purposes of the trust and can otherwise be handled in a prudent manner—because of its importance as a part of the country's capital markets, real estate is a potentially valuable ingredient of a diversification strategy, especially in light of its limited covariance with publicly traded equity and debt securities with thoughtful selection of properties or structuring of ownership positions, a trustee can organize the elements of the return toward the enhancement of either income productivity or principal appreciation, as might be desired for a particular trust portfolio.

Although this language can be construed as opening the door for real estate investment, the comment that follows seems to again, impose a roadblock on trustees:[82]

> Despite the potential advantages of investing in real estate, it would not be prudent for a trustee to disregard the complexities, burdens, and special risks associated with a decision to commit a portion of the trust estate to such investments. High transaction costs are to be expected. In addition, the absence of regulated and efficient central markets that deal in a largely uniform asset creates specialized problems and significant extra risks. Inefficiencies in pricing inevitability cut both ways.[50]

Both the Restatement[83] and the Uniform Prudent Investment Act[84] are attempts to incorporate modern portfolio theory into trust management practices. Their language suggests that a portfolio should be constructed by ascertaining the risk tolerance and return objectives of the trust. They require the trustee to be sensitive to risk and return, but both recognize that risk tolerance may vary greatly in each trust.[85] If modern portfolio theory is to be applied, trustees should be evaluated based on the investment's effects on the portfolio as a whole, rather than each portfolio on its own.

As an asset, real estate can play an important role in protecting a portfolio against the destructive effects of inflation. Studies have shown that real estate is an excellent hedge against both anticipated and unanticipated inflation.[86] Both the Restatement [87]and the Uniform Prudent Investor Act[88] permit a trustee to hold any investment as part of a trust. No asset class is imprudent in and of itself.[89] The basis of this rule is the finding of modern portfolio theory that a risky investment can actually reduce the overall volatility of a trust portfolio because it moves inversely to the other investments.[90] However, even with all of the proof in favor of real estate investments, trustees still remain cautious. It has been proffered that since it is very hard to estimate the return probability for a real estate asset, it is very difficult to calculate the appropriate role for real estate in any investment portfolio.[91]

A. *In re Newhoff*

In the case of *In re Newhoff*,[92] the Surrogate's Court of Nassau County held that trustees' investments of trust funds in real estate investment trusts were imprudent for the trusts and, therefore, the trustees were surcharged for the resultant losses.[93] The beneficiaries alleged that the trustees' investments in REITs had been speculative and unproductive.[94] In deciding against the trustees, the court considered the fact that the subject REITs had existed in their current form for only a short time prior to the investments, and that there was no solid history of a productive return upon which the trustees could base a decision that each REIT was a proper investment.[95] Furthermore, the court stated that the primary objective of a trustee should be preservation of the trust rather than enrichment of the beneficiary.[96]

Overall, despite real estate's value in an investment portfolio, the response has been limited with regard to its use in as an investment vehicle. As shown

above, in spite of the law having changed, trustee attitudes have not. Trustees could be missing a critical area of investment and in effect missing an opportunity to fulfill their fiduciary duties to the fullest. Possibly, because real estate investment requires special skills which are not easily taught in academic environments, trustees do not have access to the knowledge in order to make such investments. Trustee attitudes may slowly change with time, on a marginal basis, as the education in the area and information in the area become more readily available.[97]

The case of *Newhoff* and others like it show examples of New York courts' strict scrutiny of trustee investment in real estate, especially in REITs. Courts still find the investment new and unpredictable, making it too risky for a trustee. But with the increasing change in financial markets, and REITs becoming as common as stocks in investment portfolios, has a time for change come about? One could argue that the unpredictability and risk of REIT investment has significantly decreased, removing it from the category of imprudent investments. However, even though trustees may have more leeway now than they did 30 years ago to make REIT investments, that is not to say that there is not some risk involved—even in REITs that seem to be a "sure thing."

B. Empire State Realty Trust: A Case Study for REIT Investment by Trustees

In September of 2013, the owner and manager of the Empire State Building, Malkin Holdings, was considering packing the 2.9-million-square-foot tower into a REIT along with 18 other buildings and properties.[98] While Malkin was pushing for the IPO in a REIT, there were numerous offers from larger real estate players looking to buy the building separate from the IPO, some bids topping $2.3 billion.[99] Before the building was put into the REIT, there were at least six large real estate players bidding to purchase the building, including Thor Equities and Cammeby's International Group. However, the building owners (including the Helmsley estate, which had the biggest financial stake in the building) were not looking to wait for a purchase, and wanted to cash out as soon as possible.[100]

In September of 2013, the U.S. Securities and Exchange Commission released documents that pointed out key financial factors that any new owner would need to scrutinize before taking ownership of the building.[101] This information, along with other private information which was collected by *The Real Deal*, a real estate magazine, revealed vast amounts of information on the internal workings of the building, including but not limited to the top income generating tenants (*e.g.,* LinkedIn, Walgreens and others), along with the terms of their leases and the prices they pay; managerial costs of the building; the complicated ownership structure of the building; and breakdown of expenses.[102]

On October 2, 2013, the Empire State Building, by decision of Malkin Holdings, was placed into a REIT named Empire State Realty Trust, at $13 per share, raising $1.89 billion in its IPO through investors—a far cry from the $2.2 billion-plus that investors offered the iconic tower before it was packaged into the REIT.[103] The initial public offering forced investors to pay "for the privilege of getting them hundreds of millions of dollars less than they would have in the open market with virtually no costs." It cost $280 million to take the portfolio public.[104] The $13 share price was on the low end of analyst estimates before the IPO, and questions arose if this really was the best way for investors who had a stake in the building to get a payoff—as opposed to an outright sale of the building. The market's reception of the REIT was lukewarm at best, with an increase to $13.71 within the first month.[105]

About a month after the IPO of Empire State Realty Trust, the controversy continued when the base investment unit of thousands of individual investors who invested in the Empire State Building in 1961 was worth about $82,000 (or 25%) less than Malkin Holding's cited projections.[106] A month after the IPO, at an opening price of $14.05 per share, the base unit for approximately 2,800 investors who bought into the building in 1961 was valued at $242,000—a far cry from the $323,000 that Malkin repeatedly cited in regulatory filing and public statements as a rough guide to what each $10,000 investment would be worth following the public offering.[107]

Following the discrepancy, Jason Meister, a broker and vice president at commercial brokerage firm Avison Young, who represented Joseph Sitt and Rubin Schron in their unsuccessful bids for the Empire State Building, claimed that the investors in the iconic tower were misled into believing that they would get greater returns if the building was taken public.[108] Meister pointed out that the Empire State Building was officially transferred to the Empire State Realty Trust, a publicly traded REIT, for $1.89 billion—substantially less than the $2.1 billion offered by his investors a month earlier. In effect, original 1961 investors had lost out on $100,000 for each $10,000 share they had originally invested in the building.[109]

While the effect of the IPO (as opposed to a private sale) on original 1961 investors seems to have led to a loss of 25% in resale value of their original $10,000 shares, notice should be taken that even at the $242,000 per share number as a result of the IPO, original investors have received a return of 2,400% on their investment. This is not a meager return, and shows the possibility that exists with investment in real estate by trustees. In addition, with regard to the REIT shares, it has been argued that the REIT sale resulted in a $300 million decrease in the return for original investors. However, on the flip side, this also can be used to show

that the present day REIT investors have a $300 million cushion on their investment.

The Empire State Building, with its iconic status, would be a very good reference point for future trustee investment in REITs. Given the vast amounts of information that investors have available before they enter into REIT investments, investors are no longer in the dark. This is obvious by the extensive amount of information the SEC made public with regard to the tenants, lease information, income and expenses of the Empire State Building before it was made a part of Empire State Realty Trust. Two months after the ignition IPO in the stock exchange, the Empire State Realty Trust stock is still hovering around the $13 opening share price.[110] Only time will tell whether this REIT will result in favorable returns for present day investors.

IV. Conclusion

Real estate in an investment portfolio is common practice in today's modern investment strategy. In order to truly diversify one's portfolio, real estate as a sector is almost too large not include in one's investment strategy. Many investors have made lucrative investments in the real estate area. More information is available now than ever before to allow investors to make well-educated decisions. Despite the risk that is involved, it could be contended that we have reached a point where the information has the ability to balance much of that risk. But notwithstanding the value of real estate in an investment portfolio, there has been limited response from trustees in using it as an investment vehicle in fiduciary portfolios. Although the law does not seem to disallow this type of investment, the hesitancy likely stems from cases like *In re Newhoff*, where a REIT investment was deemed imprudent.

The Prudent Investor Act implemented changes to allow fiduciaries to account for modern portfolio theory when making investments for a trust. But it is not clear that the attitude of trustees has evolved with the law. Trustees should take notice that present day investment in real estate and REIT is worlds away from similar investments decades ago.

According to the Prudent Investor Act, no investment is per se imprudent; however, the way fiduciaries have been approaching real estate and REIT investment would suggest otherwise. Modern investment strategy, especially with stocks and the unpredictable real estate market, carries with it a certain amount of risk that cannot be ignored. It was the Prudent Man Rule which considered any investment involving risk to be imprudent. However, the Prudent Investor Act looks at the portfolio as a whole, rather than each individual investment.

Finally, as mentioned above, the new laws of the Prudent Investor Act generally allow the fiduciary to delegate his investment duties. Since many states, as well as the Second Restatement of Trusts, formally permitted delegation for ministerial duties only, not discretionary investment decision-making, a potentially productive opportunity for those with specialized investment expertise, including expertise in real estate, now exists.[111]

For fiduciaries contemplating real estate as part of their investment, the new changes of the prudent investor rule could also offer rich opportunities for increasing a portfolio's return. These types of portfolios have routinely provided a long-term average rate of return comparable to a typical bond portfolio. However, real estate responds differently than bonds to economic factors such as inflation, thus creating an important hedge in a well-diversified portfolio.[112]

There are many kinds of real estate investments that are available to a fiduciary, but REITs will almost certainly benefit the most by the new laws. Since real estate returns are usually based on appraisals and not arm's-length transactions in an active and liquid market, REITs offer the unique quality of a real estate investment in the form of equity instruments efficiently traded on various exchanges and across-the-counter.[113]

However, despite what economists and shrewd investors have long known about the benefits of a total portfolio approach to investments, the manner in which these laws are actually interpreted and applied may continue to lag far behind prevalent investment practices. Unfortunately for beneficiaries, should old habits persist, their fiduciaries may be unreasonably sacrificing greater financial rewards in the name of a standard of prudence which objective data suggest should be discarded.[114] Just as the rule for prudent investment has evolved, from the English standard to the Prudent Man Rule, and from the Prudent Man Rule to the Prudent Investor Act, in order to allow for investment in accordance with modern investment strategy, so too should fiduciaries' investments grow with the times.

Endnotes

1. *Trustee Investment: The Prudent Person Rule or Modern Portfolio Theory, You Make the Choice*, Stephen P. Johnson, 44 Syracuse L.Rev. 1175 (1993).
2. *Id.*
3. *The Puzzling Persistence Of The Constrained Prudent Man Rule*, Jeffrey N. Gordon, 62 N.Y.U. L. Rev. 52 (1987).
4. *Id.*
5. Restatement (Third) of Trusts § 90 (2007).
6. *See* Johnson, *supra* note 1 (discussing in the inclusion of real estate in the modern portfolio and prudent investment).
7. *Matter of Newhoff*, 107 AD2d 417 (2d Dep't 1985).
8. Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 N.Y.U. L. Rev. 52, 98 (1987).

9. Gary S. Moore, *Real Estate in A Fiduciary Portfolio?*, 33 Real Est. L.J. 154, 166 (2004).

10. 44 Syracuse L. Rev. 1175.

11. *Id.*

12. *See* Paul G. Haskell, *The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory*, 69 N.C.L. Rev. 87, 91 (1990).

13. *Id.*

14. *See* Lawrence W. Waggoner, Gregory S. Alexander, & Mary Louise Fellows, FAMILY PROPERTY LAW, CASES AND MATERIALS, 1234-35, The Foundation Press (2d ed. 1997) (1991) (noting the Prudent Man Rule that flowed from *Harvard College* as having two elements: first a substantive standard of safe investment and second, in making investments, trustees were subject to how prudent men invest, not speculate); Mayo Adams Shattuck, *The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century,* 12 Ohio St. L. J. 491, 4920493 (1951) (discussing how fiduciary practices in England were conservative and generally limited to government obligations).

15. 40 N.Y. 76 (1869).

16. *See* Austin Fleming, *Prudent Investments: The Varying Standards of Prudence,* 12 Real Prop. Prob. & Tr. J. 243, 244 (1977) (discussing how economy was the main concern in the court's making the decision to limit the Prudent Man Rule).

17. 44 Syracuse L. Rev. at 1176.

18. *Id.*

19. *See* Stephen P. Johnson, *Trustee Investment: The Prudent Person Rule of Modern Portfolio Theory, You Make the Choice*, 44 Syracuse L. Rev. 1175, 1176 (1993).

20. See NY EPTL11-2.2 (a)(1) (McKinney's 2001).

21. *See* Leslie Joiner Bobo, *Nontraditional Investments of Fiduciaries: Re-Examining the Prudent Investor Rule*, 33 Emory L.J. 1067, 1070 (1984) (discussing the duty that a trustee has to beneficiaries and remaindermen—duty of loyalty).

22. Johnson, *supra* note 19, at 1179 (discussing how each investment made by the trustee is analyzed in isolation of the rest of the portfolio in order to check for prudence); *In re Bank of New York,* 35 N.Y.2d 512, 323 N.E.2d 700 (1974) (noting the fact that the portfolio increased in value overall "does not insulate the trustee from responsibility for imprudence with respect to the individual investments within the portfolio...").

23. 62 N.Y.U. L. Rev. at 58.

24. *Id.*

25. *Id.*

26. Restatement (Second) of Trusts § 227(a) (1959).

27. 62 N.Y.U. L. Rev. at 58.

28. *Id.* at 59.

29. *Id.* at 60.

30. *Id.* at 61.

31. *Id.* at 62.

32. *See* Paul G. Haskell, *The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory*, 69 N.C.L. Rev. 87, 91 (1990).

33. *See In re Newhoff,* 435 N.Y.S. 2d 632, 636 (Sur. Ct., Nassau Co. 1980), *aff'd,* 486 N.Y.S. 2d 956 (2d Dep't 1985); *First Ala. Bank of Montgomery v. Marin,* 425 So.2d 415, 428 (1982) *cert. denied*, 461 U.S. 938 (1983).

34. *See* Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 NYU L. Rev. 52, 98 [1987] (listing investments that the Prudent Man Rule discourages and noting that many modern prudent investors invest in such vehicles).

35. *See Gee v. Womack,* 263 S.W.6 (Ky. Ct. Ap. 1924); *In re White,* 476 A.2d. 1148, 1150 (Pa. Super. Ct. 1983), *rev'd on other grounds*, 484 A.2d 763 (Pa. 1984).

36. *See Merrill Lynch v. Bacock*, 247 F. Supp. 373, 379 (S.D. Tex. 1965).

37. *Prudent Investor Act: Its Effect on Executors,* Edward V. Atnally, 67-Aug N.Y. St. B.J. 12 (1995).

38. *See* Fleming, *supra* note 16 at 248.

39. *See* Gordon *supra* note 34, at 53-54 (discussing that the Prudent Man Rule was founded on a narrow conception of risk and safety that was superseded by contemporary understanding of markets and investments).

40. Moore, *supra* note 9, at 162.

41. *See* Margaret Valentine Turano, *McKinney's Practice Commentaries to NY EPTL 11-2.3* (McKinney's 2001) (discussing how the Prudent Person Rule was limiting the abilities and effectiveness of trustees and describing that the rule was "hopelessly out of step with modern investment theory").

42. 67-Aug N.Y. St. B.J. 12. *See* EPTL 11-2.3 (McKinney's 2001).

43. *See* NY EPTL11-2.3 (McKinney's 2001) *See, e.g., Matter of Hahn,* 93 A.D.2d 583, 462 N.Y.S.2d 924 (4th Dep't 1983), *aff'd.*, 62 N.Y.2d 821, 477 N.Y.S.2d 604 (1984) (discussing how securities purchased by the trustee are held to a higher prudent standard compared to the same securities retained from the creator); *Matter of Bankers Trust Co.*, 219 A.D.2d 266, 636 N.Y.S.2d 741 (1st Dep't 1995) (noting that the Prudent Investor Act provides the trustee with greater flexibility by allowing the trustee to consider the portfolio as a whole); *Matter of Saxton,* 274 A.D.2d 110, 712 N.Y.S. 2d 225 (3d Dep't 2000) (holding trustee charged with damages where he imprudently retained assets).

44. NY EPTL 11-2.3 (b)(1) (McKinney's 2001).

45. NY EPTL 11-2.3 (b)(3)(B) (McKinney's 2001).

46. NY EPTL 11-2.3 (b)(3)(C) (McKinney's 2001).

47. NY EPTL 11-2.3 (b)(4)(A) (McKinney's 2001).

48. Westchester B.J. 292 (1944).

49. N.Y. Prac., Trusts and Estates Practice in New York, § 13:85.

50. NY EPTL 11-2.3 (c)(1) (McKinney's 2001).

51. *Id.*

52. NY EPTL 11-2.3 (c)(2) (McKinney's 2001).

53. 21 Westchester B.J. at 293.

54. NY EPTL 11-2.3 (b)(3)(A) (McKinney's 2001).

55. *Id.*

56. *Matter of Janes,* 90 N.Y.2d 41, 659 N.Y.S.165 (1997).

57. *Matter of Bank of New York*, 35 N.Y.2d 512, 364 N.Y.S.2d 164 (1974).

58. *Matter of Janes* at 50.

59. *See id.* at 569 (describing that in the current economy, most of the return in investments comes in equity rather than dividends from corporations based on the value of their stock—which in effect has caused problems for raising income for trust beneficiaries).

60. *See* Kenneth M. Morriss & Alan M. Siegel, THE WALL STREET JOURNAL GUIDE TO UNDERSTANDING MONEY & INVESTING, 70-71, The Lightbulb Press (1993).

61. Moore, *supra* note 9.

62. *Id., Bowman v. Pinkham,* 71 Me. 295, 1880 WL 4145 (1880); *West v. Robertson*, 67 Miss. 213, 7 So. 224 (1890); *Gilmore v. Tuttle*, 32 N.J. Eq. 611, 1880 WL 7585 (Ch. 1880); *King v. Mackellar*, 109 N.Y. 215, 16 N.E. 201 (1888).

63. Norman, Shirman and Benjamin*, The Historical Environment of Real Estate Returns*, J. of Real Est. Portfolio Mgmt. 1 (1995) 1-24.

64. Moore, *supra* note 9, at 155-56.

65. *See* Ibbotson and Siegel, *Real Estate Returns: Comparison With Other Investments*, AREUEA Journal 12 (Fall 1984): 219-242.

66. *See* Moore, *supra* note 9, at 155-56.

67. *Id.*

68. *Id.*

69. 40 N.Y.76 (1869).

70. *Id.*

71. *See* Moore, *supra* note 9, at 155-56.

72. *Id.*

73. *See* Aalberts and Poon, *The New Prudent Investor Rule and The Modern Portfolio Theory: A New Direction for Fiduciaries*, 34 Am. Bus. L.J. 42-48 (1996).

74. *See* Moore, *supra* note 9.

75. *See* McSwain, *The Prudent Man Rule*, 106 Trusts and Estates 742-43 (1967)

76. *See* Aalberts and Poon, *supra* note 73.

77. *See* Moore, *supra* note 9.

78. *See* Restatement (Third) of Trusts Intro (2007).

79. *See* Moore, *supra* note 9.

80. Restatement (Third) of Trusts, § 227 (2007).

81. *See* Moore, *supra* note 9.

82. Moore, *supra* note 9, at 165.

83. Restatement (Third) of Trusts provides: "This [prudent investor] standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust." Restatement (Third) of Trusts § 227(a) (2007).

84. The Uniform Prudent Investor Act provides: "A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably suited to the trust." Uniform Prudent Investor Act, § 2(b).

85. *See* Moore, *supra* note 9.

86. *Id. See also* Miles and McCue, *Historical Returns and Institutional Real Estate Portfolios*, 10 AREUEA Journal 187 (1982).

87. Restatement (Third) of Trusts § 227 (2007).

88. *See* Uniform Prudent Investor Act, § 2(e), which provides: "A trustee may invest in any kind of property or type of investment consistent with the standards of this [Act]."

89. *See* Restatement (Third) of Trusts § 227 (2007).

90. *See* Moore, *supra* note 9.

91. *Id.*

92. *Matter of Newhoff' s Will,* 107 Misc. 2d 589, 435 N.Y.S.2d 632 (Sur. Ct., Nassau Co. 1980), *decree aff'd sub nom. Matter of Newhoff,* 107 A.D.2d 417, 486 N.Y.S.2d 956 (2d Dep't 1985).

93. *Id.*

94. *Id.* at 632.

95. *Id.*

96. *Id.*

97. *Id.*

98. Adam Incus, *Empire State Building: a buyer's manual*, THE REAL DEAL (September 2013).

99. *Id.*

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102. *Id.*

103. Whiten Satanic and Adam Incus, *It's Official: Empire State Building worth $300M less in REIT*, THE REAL DEAL (October 2013).

104. *Id.*

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112. *Id.*

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Recent Tax Court Ruling on Crummey Trusts

By C. Raymond Radigan, Jennifer Hillman and Joni Hasday

Crummey trusts are an important tool for estate practitioners looking to help their clients take advantage of the annual gift tax exclusion. Despite their relative popularity, Crummey trusts are sometimes challenged by the Internal Revenue Service ("IRS").[1] A recent U.S. Tax Court case, *Mikel v. Commissioner*[2] reviewed the continuing viability of Crummey trusts when the trust contains an arbitration clause and an *in terrorem* clause. The decision is an important lesson and review for estate practitioners who utilize these types of trusts in their practice.

Utilizing Crummey Powers

Under federal tax law, individuals can give up to $14,000 a year to family or friends tax-free, provided the donee has a "present interest" in the money and can access the money right away. *See* Section 25.2503-3(b), Gifting Tax Regs. which defines a present interest as "an unrestricted right to the immediate use, possession, or enjoyment of the property or the income from property such as a life estate or term certain."

The so-called Crummey trust is a way to parlay the annual gift tax exclusion into a larger estate planning tool. The donor gifts the annual exclusion amount into a trust for the benefit of the donee. The trust satisfies the "present interest" criteria set forth in Internal Revenue Code § 2503(b) because the donee gets a small window, usually 30 days, to access the money. If the donee does not access the money during this period of time, then the money remains in the trust. *Crummey v. Commissioner*[3] was the U.S. Court of Appeals for the Ninth Circuit appellate decision which reviewed this estate planning practice. In *Crummey*, the donors created an irrevocable trust for the benefit of their children, some of whom were minors. The trust agreement provided that following a gift of property to the trust, each beneficiary had a right to demand cash from the trust. The Ninth Circuit held that where the trustee could not legally resist the demand, the gift was a gift of a present interest and the property was subject to the annual exclusion.[4]

As stated in *Crummey* and subsequent cases, the test to determine a "present interest" is not whether the beneficiary was likely to receive the present enjoyment of the gift, but whether the beneficiary had the ability to exercise their right to withdraw trust corpus and whether the trustee could likely resist a beneficiary's demand for payment.[5] It follows that annual gift tax exclusions for trusts which utilize Crummey powers are appropriate where the trust instrument gives the beneficiaries a "*bona fide* unrestricted legal right to demand immediate possession and enjoyment of trust income or corpus."[6] However, the IRS has been known to deny the exclusions where the withdrawal rights are illusory.

Mikel v. Commissioner

In 2015, the U.S. Tax Court decided important questions for trusts which utilize Crummey powers in *Mikel v. Commissioner*, namely, the effect that arbitration and *in terrorem* provisions have on the viability of Crummey trusts.

In 2007, a New York husband and wife, Israel and Erna Mikel, each gave $1.6 million to a family trust. They both filed separate gift tax returns reporting the gifts and claiming an annual exclusion of $720,000, asserting that each gift included a $12,000 gift of a present interest to each of the trust's 60 beneficiaries. The beneficiaries were the Mikels' children, lineal descendants and their spouses. Many of the beneficiaries were 18 years of age or younger. The trust had a specific provision granting each of the beneficiaries 30 days to withdraw the $12,000 gift to them, in an attempt to utilize the practice outlined in *Crummey*.

Of particular note, the trust had an arbitration provision, stating that any dispute involving the interpretation of the trust must be submitted to a rabbinical arbitration, also known as a *beth din*. Pursuant to the terms of the trust, the *beth din* was instructed to "enforce the provisions of [the trust] and give any party the rights he is entitled to under New York law." A separate provision of the trust stated the trust should be interpreted "to effectuate the intent of the parties…that they have performed all the necessary requirements for [the trust] to be valid under Jewish law."

The trust also had an *in terrorem* provision, which prohibited a beneficiary of the trust from directly or indirectly instituting, conducting or in any manner taking part in any proceeding to oppose a distribution of the trust's corpus by filing a court proceeding "or challeng[ing] any distribution…in any court, arbitration panel or any other means.…" If a beneficiary violated the terms of the *in terrorem* clause, he was to be excluded from any participation in the trust and not receive any benefits from the trust.

In August 2007, pursuant to terms of the trust, each beneficiary received a document entitled "Notice of Right of Withdrawal." The letter informed each recipient that a contribution had been made to him or her and that he or she had a 30-day window to withdraw the $24,000 from the trust. There was no evidence of any pre-arranged plan or understanding among the Mikels and the beneficiaries of the trust which would

prevent the beneficiaries from exercising their withdrawal rights.

Upon review of the filed gift tax returns, the IRS sent the Mikels notices of deficiency determining that they were ineligible for the claimed annual exclusions. The IRS conceded that the trust afforded each beneficiary an unconditional right of withdrawal. The IRS also did not suggest any basis upon which the trustee of the trust could properly refuse to honor a timely withdrawal demand. Still, the IRS argued that there was no "present interest" in a practical sense because of the arbitration provision and the *in terrorem* clause. The Mikels petitioned to the U.S. Tax Court, and the parties both cross-moved for partial summary judgment.

In the Tax Court, the Mikels relied upon *Crummey* and its progeny and argued that the annual exclusion should apply because the trust gave each beneficiary an unrestricted right to withdraw the gifts for a 30-day period and timely notices concerning their withdrawal rights were sent and received.

The IRS argued that while the beneficiaries, in practice, had a right to immediately withdraw the money from the trust, these were not legally enforceable rights. The IRS argued that the beneficiaries would be dissuaded from enforcing their rights under the trust because of the arbitration and *in terrorem* clauses, and thus they did not have an enforceable right.

The Tax Court ruled for the Mikels, finding that all of the trust beneficiaries had a present interest in the property. It found that the beneficiaries had an unconditional right to withdraw property from the trust which could be enforced through a *beth din*. The court rejected the IRS's argument that a beneficiary must be able to go before a state court to enforce their withdrawal rights. Further, it stated that the IRS had not set forth any explanation why a *beth din* was not enforcement enough.

The Tax Court also reviewed the (admittedly) unclear *in terrorem* clause and interpreted it as only covering situations where the beneficiary was opposing or challenging a trustee's distribution to another beneficiary. The court did not interpret the clause to include any action to compel a trustee to honor a timely withdrawal demand. Thus, it concluded that the *in terrorem* provision, when properly construed, would not deter beneficiaries from pursuing judicial relief.

Analysis and Practice Tips

Despite the ruling of the Tax Court, this case highlights several practice tips that should guide estate practitioners when utilizing Crummey powers in trust documents.

First, the viability of the arbitration clause may have turned on the fact that the trust terms required the *beth din* to follow the laws of New York State. New York law provides that an arbitration award may be confirmed, vacated or modified pursuant to CPLR 7510 and 7511. This may have been determinative for the court when finding that the beneficiaries had a legally enforceable right. The same result may not follow if the arbitration clause were drafted differently, or if New York was not the governing law.

Second, the Tax Court, while noting the provision was "not a paragon of draftsmanship," construed the *in terrorem* provision to only cover challenges to distributions to other beneficiaries. The court focused on the "most sensible limiting construction" in interpreting the clause, relying upon several canons of construction, including *noscitur a sociis*, a Latin phrase which translates to "it is known by its associates."[7] This canon holds that "the meaning of an unclear word or phrase should be determined by the words immediately surrounding it."[8]

While this may have been the right result, the Tax Court went to great lengths to support its construction of the clause. A hypothetical beneficiary cannot be assured that a New York State court would interpret the *in terrorem* provision the same away as the Tax Court (due to the ambiguity of the clause) and thus might very well be deterred from pursuing judicial relief.

Practitioners should be mindful of this ruling. *In terrorem* clauses should be used sparingly. If a client insists upon an *in terrorem* clause, any clause should specifically state that it does not apply to actions brought by beneficiaries to enforce any withdrawal rights. It is also important to coordinate the Crummey power provision with the other provisions of the trust so that the trustee does not have the authority to otherwise defeat any exercise of the Crummey power.

There are some other good practices to remember when using Crummey powers including:

1. There must not be any arrangement with the donee that he will not exercise the Crummey power. *See Trotter v. U.S.,* T.C. Memo 2001-250 (where the Tax Court found an implied understanding that the donor would continue to use and enjoy the condo after it was transferred to the trust, causing estate tax inclusion and finding Crummey powers were a mere "paper formality without economic substance.") The benefits of keeping assets in a trust can be explained to a beneficiary, but the trustee or grantor must never imply that withdrawals are prohibited.
2. The withdrawal period should not be too short. While the IRS has accepted periods of 15 days,[9] 30 days is more frequently utilized.

(Continued on page 22)

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3. Withdrawal notices should be sent using a method that can provide proof of mailing.
4. Notices should be sent so that the withdrawal period expires before the end of a tax year to avoid confusion.
5. Be wary of the "five-and-five" rule. If you are gifting more than $5,000 or 5% of the trust corpus, draft a hanging withdrawal power so that the excess over the five-and-five amount hangs over to future years. For more information on this, see Radigan, *Crummey Powers: A Refresher*, NYLJ Nov. 2, 2009.

Conclusion

Crummey trusts have proven to be a useful mechanism for gifting money out of an estate without gift tax consequences. When utilizing these trusts, estate practitioners should be aware of the *Mikel* case for the guidance it provides drafters.

Endnotes

1. *See Cristofani v. Commissioner*, 97 T.C. 74 (1991) distributed July 15, 1996 stating that the IRS "will continue to litigate cases whose facts indicate that the substance of the transfers was merely to obtain annual exclusions and that no *bona fide* gift of a present interest was intended."
2. *Mikel v. Commissioner*, T.C. Memo 2015-64 (2015).
3. 397 F.2d 82 (9th Cir, 1968).
4. *See id.* at 88; *see also Cristofani v. Commissioner*, 97 T.C. 74 (1991).
5. *See Cristofani, supra* n.4*; see also Crummey, supra* n.3.
6. *Mikel v. Commissioner*, T.C. Memo 2015-64 (2015).
7. *Id.*
8. *Id.*, at fn. 7.
9. *Cristofani, supra* n.4.

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Have We Got It All Wrong? Rethinking the Fabric of Estate Planning

By Avi Z. Kestenbaum and Amy F. Altman

As estate practitioners, our mission is to provide our clients with an estate plan that maximizes the transfer of wealth to specified heirs in a way that will improve their life courses.[1] But, what if this goal is impossible to meet? What if, by maximizing the transfer of wealth, we aren't improving, but instead are diminishing, the life courses of our clients and their heirs, as well as deteriorating society in the process? To this end, the more important questions that we seek to analyze are ones that every estate planner should pose to his clients: Would you prefer to pass as much wealth as possible to your descendants? Or, would you rather give your heirs the greatest chance of truly being happy, well adjusted, self-fulfilled and successful?

Whose Objectives Are Being Served?

Let's consider, from a psychological and philosophical point of view, exactly whose objectives are being served when wealth transfers occur. Three possibilities are: (1) the client's; (2) the beneficiaries' for whom the plan is being created; and (3) society's at large (including government and charities).[2]

The client. In our experience, many clients assert that the act of creating an estate plan is a purely selfless endeavor and exclusively for the benefit of their descendants. This belief may stem from the fact that they won't be living when estate taxes will be due or when certain estate assets will be transferred. However, estate planning may not be purely altruistic. Planning and implementing wealth transfers may fulfill the clients' psychological and emotional needs to be prudent about the assets they've worked so hard to maintain and to assure their legacies after death. Also, many clients who claim to create estate plans purely out of love for their heirs add contingencies before their heirs can benefit from their assets. Thus, even after their deaths, their preconditions take effect, a phenomenon commonly referred to as "dead hand control."[3]

The psychology behind dead hand control stems from a variety of sources, including the desire to be relevant forever and fear of death. By controlling the estate even after death, the client is able to fantasize about what life will be like after he dies, and how, even after death, he can exert great influence.[4] Additionally, this exercise may have the effect of easing his mind about the future. For others, the need to control may be connected to pride in the assets earned over their lifetimes.

Fear and distrust of descendants may be another motivating factor that spawns dead hand control. Some people don't believe their descendants will use the inheritance in a meaningful way or will continue their way of doing things. In many cases, dead hand control may serve an important purpose, especially when the individual is actually correct about his descendants. However, each case is different and requires very deep and thoughtful self-discovery and assessment by the client and his estate planner (and perhaps the client's psychologist).

"[The questions] every estate planner should pose to his clients: Would you prefer to pass as much wealth as possible to your descendants? Or, would you rather give your heirs the greatest chance of truly being happy, well adjusted, self-fulfilled and successful?"

Whether or not our clients perceive the creation of their estate plans as fulfilling their own psychological need to control, most will agree that it's a prudent endeavor. They also believe that transferring as much wealth as possible to their descendants is the most desired outcome, and as planners, we reinforce this notion with the complex structures we set up to minimize taxes and protect assets. But, is the transfer of the maximum wealth really the most desirable outcome? Or, can an argument be made that maximizing the transfer of wealth actually isn't in the heirs' and society's best interests, and if our clients really believed this theory, they might plan things very differently?

The beneficiaries. On Jan. 9, 2015 *The New York Times* ran an article that discussed the murder of a wealthy "hedge-fund-running" father, Thomas Gilbert, by his 30-year-old son, Thomas Gilbert Jr. The murder occurred over a dispute about Gilbert Jr.'s trust fund allowance. The article raised the question of whether Gilbert Jr.'s behavior stemmed from being raised in an affluent household.[5] It further cited academic research that affluent children have higher rates of depression, anxiety and elevated levels of substance abuse and delinquent behaviors (such as stealing).[6]

Psychological research indicates that wealth can rob young children of their search for their own identity and self-worth; they aren't forced to find out how they can be productive in society because they don't have the need or hunger to do so.[7] As Andrew

Carnegie once said, “The parent who leaves his son enormous wealth generally deadens the talents and energies of the son, and tempts him to lead a less useful and less worthy life than he otherwise would.”[8] Likewise, research suggests that being in the workforce isn’t just about earning a paycheck, but also is a source of personal satisfaction and development, which affluent children may miss out on.[9] It stands to reason that children who grow up expecting wealth without earning it themselves could lack motivation and self-confidence.

Perhaps even more troubling is the research that indicates that affluent children entering adulthood may also be sheltered from the basic everyday frustrations of life, such as changing light bulbs, shoveling snow or making their own meals. This sheltering could likely slow their maturity while they retain unfettered power over people whom they employ, as well as those looking to benefit from their fortune.[10]

Estate planners may argue that outright transfers of wealth are the problem and not transfers of wealth into trusts. Trusts with strict distribution provisions may reduce a beneficiary’s lack of motivation because he can’t simply secure a distribution from the trust whenever he wants one. Similarly, incentive trusts that set forth required goals and behaviors, which when accomplished, trigger a distribution, may mitigate the potential spoiling of a beneficiary. A settlor may create any rule or contingency he wants, for example, a beneficiary completing higher education, starting a business or maintaining a status quo (such as not committing a crime or using drugs). A settlor may also link distributions to the amount a beneficiary earns through his occupation. This may drive a beneficiary to work harder and motivate him further. However, some practitioners are critical of this planning tool because it may create resentment, is a recipe for litigation and, in some situations, may be difficult to monitor. Furthermore, clients should also be mindful that even trusts that are fully or partially discretionary may work only to protect those assets from creditors’ claims, but may not be in the best interests of a beneficiary who feels entitled to live off of the trust at the expense of meeting his true potential.

If large transfers of wealth, whether outright or in trust, have the potential to create generations that lack motivation and maturity, not to mention unhappy individuals with poor self-esteem, it raises the question of whether excessive transfers of wealth should be considered a good estate plan. Perhaps many of the plans we’re recommending are harmful for the beneficiaries, as well as society at large.

Society. Aside from clients who are naturally philanthropically inclined, our experience is that the needs of society seldom enter the framework when discussing estate planning with our clients. After all, the primary concern for most individuals is the well being of their own families and not humanity. In contrast, the Buffett-Gates Giving Pledge encourages billionaires to make a commitment to give most of their wealth to philanthropic causes. As of December 2015, 141 billionaires or former billionaires signed the pledge.[11] This begs the question of what will become of the descendants from those families who aren’t so philanthropically inclined and the descendants of those who signed up for the pledge, who are still leaving exorbitant amounts to their heirs.

On Jan. 19, 2015, *CNN.com’s* top news story stated, “The richest 1% will own more than all the rest by 2016,” based on a study by the international agency Oxfam. But, the story didn’t discuss what will become of the heirs of this unprecedented wealth. This quandary has become a hot topic for wealthy parents who are now rethinking the way they raise their children. Some have offered their children trips around the world—not for the purpose of exposing them to European cultures—but rather to expose them to poverty, slums and orphanages as a way to gain perspective on their privileged way of life.[12]

In fact, the very purpose of creating the federal estate tax was to prevent massive amounts of wealth from passing between generations.[13] Theodore Roosevelt, who was a believer in estate taxes, said: “We grudge no man a fortune in civil life if it is honorably obtained and well used. It is not even enough that it should have been gained without doing damage to the community. We should permit it to be gained only so long as the gaining represents benefit to the community.”[14] The premise underlying the purpose of the estate tax and Roosevelt’s statement is that bloated fortunes will do little to advance, and will more likely impair, the beneficiaries’ life courses and would be better served aiding humanity.

The Vanderbilts, one of the wealthiest families in America’s history, saw their vast fortune disappear within a few generations.[15] William Kissam Vanderbilt, grandson of Cornelius Vanderbilt, who retired to look after his yachts and thoroughbred horses, said, “inherited wealth is a real handicap to happiness.… It has left me with nothing to hope for, with nothing definite to seek or strive for.”[16] His sentiments are now bolstered by academic research demonstrating the lack of motivation and incidences of mental health issues in affluent children.

Ways to Mitigate

Hard work and philanthropy may be the two most effective ways to mitigate the perils of prosperity.[17] Work can help level the playing field, ignite descendants’ interests, increase their self-worth and help them learn to deal with deadlines and inevitable everyday frustrations. Philanthropy can make heirs see that their fortunes can be used to benefit worthy causes and may help foster a sense of responsibility.

An interesting case study involves Pablo Picasso's granddaughter, Marina Picasso, who lived on the edge of poverty during her childhood and later inherited a significant portion of her grandfather's estate. On Feb. 4, 2014, *The New York Times* published an article regarding her plans to sell off her grandfather's art to broaden her philanthropy.[18] Although most of the article focused on the worries of the art market, it discussed the juxtaposition of her childhood versus her current wealth. She recalled her father Paulo (Picasso's estranged son) begging Picasso for money and admitted that planning the sale is an aggressive effort to "purge herself" of Picasso's legacy. Regarding her difficult childhood, she said: "I think because of it I developed my sense of humanity and my desire to help others."[19] Although she became suddenly wealthy at the age of 21 on the death of her grandfather, her struggles early in life forged her path towards philanthropic giving. Now that her five children are grown (three of whom were adopted from Vietnamese orphanages), Marina devotes her time to humanitarian work.

Communication

The Institute for Preparing Heirs (IPH), an innovative training company that helps financial advisors, estimates that only one-third of wealth transfers are successful. They define "successful transfers" as those in which family harmony is intact after the transfer.[20] The IPH's studies of the so-called "successful transfers" found that those families had a family mission statement and interactive discussions about the overall purpose of their wealth. Thus, according to the IPH, getting as many family members as possible to buy into the family mission, goals and purposes of wealth may elevate the chances of successful transfers.

In "Changing the Playbook,'" Marvin E. Blum discusses the importance of preparing heirs for the responsibilities associated with receiving an inheritance.[21] He uses the analogy of a large mansion resting on a tiny foundation to explain how unrealistic it is to expect unprepared heirs to handle a substantial inheritance. He believes that creating an education strategy will widen the proverbial foundation.

Human Capital

Successful transfers of wealth include a main ingredient far more valuable than money: human capital. "Human capital" is defined as the collective skills, knowledge and other intangible assets of individuals, such as habits, personality attributes and creativity, which embody the ability to perform in the world to produce economic value (that is, skills and experiences that are unique to an individual).[22] It's what a person wants his descendants to know about his life and values; how that information could help the next generations; and the transmission of a skill set, experience and values. A transfer of wealth versus an investment of human capital is analogous to giving a man a fish or teaching a man how to fish.

One of the best examples of the investment in human capital is Walt Disney. Walt was one of five children—four boys and a girl. He lived most of his childhood in Marceline, Mo., where he began drawing, painting and selling pictures to neighbors and family friends. While Walt's family wasn't wealthy, they noticed his ability to draw and cultivated his talent by sending him to take night courses at the Chicago Art Institute to improve his drawing skills.[23] Walt's family gave him the opportunity to create his lasting legacy.

While the maximization of wealth transfers is likely the clients' goal when they meet with estate planners, they may not realize that a more thorough analysis of their values, coupled with an open dialogue with their descendants, could lead to a better overall plan and the transfer of human capital or the skills and life experiences that are unique to them and their family. A mission statement can be one part of creating a successful transfer of wealth and may aid in the transfer of human capital. Transmitting this mission might also include meetings and communications from our clients to their descendants on a variety of topics, including: (1) how to handle life's challenges; (2) general words of wisdom and advice from ancestors; (3) family history and experiences; (4) values and ethics; and (5) religion.

The concept of transferring human capital by means other than traditional estate plans isn't a new phenomenon. Ethical wills have been around for hundreds of years and recently regained popularity.[24] An ethical will is a non-legal document, sometimes referred to as a "legacy letter," in which a client may express an array of personal thoughts and directives, not just about his wealth but also about his personal values and life lessons. It's a way to have family members understand the reasons the client chose to dispense his assets in a certain way and may assist in ameliorating potential conflicts. Although ethical wills started as an oral tradition by the Jewish people[25]—which was later formalized into written documents—they've now entered the 21st century with PowerPoint presentations that include a slideshow of photographs. There's even an iPhone app dedicated to creating ethical wills.[26]

Family mission statements and ethical wills are supplements that can be extremely useful in turning a dry or packaged estate plan into a dialogue about the client's values and ultimately lead to a transfer of human capital from one generation to the next. Ideally, this process should create a fuller understanding for those charged with protecting and fulfilling their legacies.

Timing

Although it's now commonplace, the creation of an estate plan when a person is in good health is a historically new phenomenon. In the Middle Ages, there was a direct personal connection to death due to increased mortality rates and deadly plagues. The phrase, "memento mori," a Latin term that means "remember you must die," was frequently used.[27] In the late 18th century, the creation of death bed wills became more common. As a result, they included more personal and immediate hands-on provisions than the packaged documents of today.[28] Only in recent decades, with increased life expectancies coupled with the prevalence of marketing by the estate-planning industry and the rise of individual wealth, has the mindset shifted towards creating an estate plan well in advance of illness or old age.[29]

Of course, trying to change the course of a family's path later in life when descendants may already be spoiled might be too late. In reality, hard work and philanthropy, as well as investing in human capital, must start when children are very young. But, there's no reason to compound the problems by transferring excessive wealth that might cause more harm than good.

Better Off With Less?

If our clients wish to create the most successful and beneficial estate plans for their families, research suggests that heirs may be better off with less wealth. As planners, we need to be aware of this critical data and raise these issues in candid conversations with our clients. Additionally, more learning, focus and research on this topic is necessary. While the greater use of mission statements, ethical wills, incentive trusts, open family dialogue and teaching descendants hard work and philanthropy may help, we must face the reality of what the data suggests: Leaving descendants more assets than is necessary for their basic needs may be detrimental. Instead, the transfer of human capital from one generation to the next may be the link towards a successful transfer of values and long lasting, self-sustaining prosperity, and this transfer should begin long before the estate-planning documents are signed.

Endnotes

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2. Disclaimer: Although we represent affluent clients for whom we structure plans and draft documents with the express goal of maximizing wealth transfers, rethinking the very purpose of estate planning is a worthwhile endeavor for our own knowledge and awareness as professionals. More importantly, armed with this insight, we can educate our clients about the true ramifications of their planning on their loved ones.
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Ira M. Bloom

CHARITIES

"Unforeseen Circumstances" Are Not Required to Justify Equitable Deviation

Courts sometimes blur the distinctions between *cy pres* and equitable deviation as applied to charitable trusts. Consider a recent case that carefully makes the distinction. Decedent died in 1999, and by will made three gifts in trust to three different churches. Each gift was accompanied by a restriction limiting investment of the funds to insured bank accounts and government securities. The churches petitioned the Surrogate's Court for relief from the investment restrictions under the authority of EPTL 8-1.1(c). The Surrogate denied the petition because of the absence of "unforeseen circumstances" requiring a modification. The churches appealed and the Appellate Division reversed. The court acknowledged that while some cases do state that the existence of unforeseen circumstances are a necessary predicate to the application of equitable deviation, that is not case when relief is sought under EPTL 8-1.1(c). Because the investment restrictions are now impractical, the court reversed the Surrogate and granted the petition. *Matter of Chamberlin,* 135 A.D.3d 1052, 23 N.Y.S.3d 658 (3d Dep't 2016).

Cy Pres Appropriate Where Religious Corporation Law Does Not Apply

Decedent's will made a pecuniary disposition to "United Lutheran" at a street address. No church bearing that name at the address could be identified, and the court therefore accepted extrinsic evidence showing that Redeemer Lutheran Church did exist at the street address stated in the will but it ceased to exist before the decedent's death. The congregation was never formally dissolved under the Religious Corporation Law. While Religious Corporation Law § 17-c(2)(c)(ii) provides that the property of a Lutheran congregation which ceases to exist belongs to the synod to which the congregation is related, there is no provision for bequests received after the congregation is no longer in existence. Disposition of the gift is therefore a matter for *cy pres* under EPTL 8-1.1(c). Because the several charitable dispositions in the will disclosed the general charitable intent necessary to invoke *cy pres*, the court substituted the synod to which the congregation belonged as the beneficiary of the disposition in the will. *Matter of Geng*, 50 Misc. 3d 475, 20 N.Y.S.3d 515 (Sur. Ct., Nassau Co. 2015).

William P. LaPiana

FUTURE INTERESTS

Permissible Appointee of Unexercised Testamentary Power of Appointment Has No Interest in the Appointive Property

Decedent's will created a trust for his surviving spouse and gave her a special testamentary power of appointment, the objects of which are her issue and his issue. Although the surviving spouse had no issue, the decedent had issue of a prior marriage. The takers in default of exercise of the power are five named individuals who are not objects of the power. The decedent's son petitioned for a construction of the will on the ground that he had a vested remainder interest in the trust. The Surrogate dismissed his petition and on appeal the Appellate Division affirmed. It is well-established law that interests of takers in default of exercise of a power of appointment "take effect in the same manner as if no power existed," subject to being divested by exercise of the power. Since there are no other limitations on the estates given the takers in default, they and not the decedent's son, who is only an object of the power, have vested remainder interests in the trust. *Matter of Levitan*, 134 A.D.3d 716, 21 N.Y.S.3d 303 (2d Dep't 2015).

MARRIAGE

Same-Sex Commitment Ceremony Is Not the Equivalent of a Marriage

Decedent's will was executed in 2001, named his same-sex partner as executor, and made significant bequests to the partner. In 2002, the couple had a commitment ceremony that was without legal effect in New York. The couple later separated and the decedent died in 2013 without writing a new will. The decedent's relatives sought to disqualify the former partner as executor and to have the bequests to him revoked on the theory that the couple would have married had the law allowed them to do so, and that the former partner should be treated as a former spouse whose nomination as executor and gifts under a will are revoked by EPTL 5-1.4.

The Surrogate rejected the argument and the First Department affirmed, stating that the decision by the United States Supreme Court in *Obergefell v. Hodges*, ___ U.S. ___, 135 S. Ct. 2584 (2015) does not compel a "retroactive declaration" that the commitment ceremony was the equivalent of marriage. And, even assuming such recognition is required, the revocation on divorce provisions of the statute require that the marriage end by a formal judicial "decree or judgment" which was not present here. In addition, the couple's separation in 2010 was informal. There was no dissolution ceremony analogous to the commitment ceremony and even when same-sex marriage was legalized in New York in 2011, they took no steps to obtain any sort of judicial recognition of the end of their union. *Matter of Leyton*, 135 A.D.3d 418, 22 N.Y.S.3d 422 (1st Dep't 2016).

RIGHT OF ELECTION

Parties Objecting to Spouse's Exercise of Election Have Burden to Prove Facts Justifying Forfeiture by a Preponderance of the Credible Evidence

Surviving spouse petitioned to determine the validity of her right of election in the estate of her deceased spouse. The decedent's executors opposed the petition on the ground that the decedent lacked capacity to marry, that the petitioner knew he lacked capacity at the time of the marriage, and that she procured the marriage through undue influence. The Surrogate awarded the petitioner summary judgment and the Appellate Division reversed, holding that there was an issue of fact as to whether the surviving spouse had forfeited her right of election by the alleged wrongdoing, *Matter of Berk*, 71 A.D.3d 883, 897 N.Y.S.2d 475 (2d Dep't 2010) .

On remand the parties submitted proposed statements of the issues to be decided at trial, as well as a proposal concerning the burden and standard of proof on those issues. The Surrogate ruled that the issues to be decided—did the petitioner know that the decedent lacked capacity of marry, and, if so, did petitioner take unfair advantage of the decedent by marrying him for the purpose of obtaining the pecuniary benefits of marriage—must be proved by the executors by clear and convincing evidence.

The executors appealed, and the Appellate Division held that while the executors did indeed have the burden of proof on the issues to be decided, the standard of proof is preponderance of the credible evidence. This holding is consistent with precedent under which allegations of wrongful conduct leading to an equitable remedy must by proved by those alleging the conduct by the preponderance of the evidence. The court stated that evidence of a confidential relationship, in this case resulting from the marriage, is not enough to shift the burden to the petitioner. *Matter of Berk*, 133 A.D.3d 850, 20 N.Y.S.3d 559 (2d Dep't 2015).

TRUSTEES

Appointment of Successor Co-Trustee Forbidden by Statute

Decedent's will created a trust for his daughter and nominated his son and a bank as co-trustees. No successor trustees were named. After the son's death, decedent's third child, who is a contingent remainder beneficiary of one-half of the trust, petitioned to have her son appointed successor co-trustee. The life beneficiary of the trust and two of three children of a son who are the contingent remainder beneficiaries of the other half of the trust opposed the petition. The Surrogate granted the petition, concluding that the decedent intended that a family member serve as co-trustee with the bank for the duration of the trust.

On appeal the Appellate Division reversed. First, SCPA 1502(1) says that the court may appoint a successor trustee or co-trustee if there is no trustee able to act and the appointment is necessary to execute the trust or to execute any power created by the will or lifetime trust instrument. SCPA 1502(2) then limits the appointment power by providing that the court shall not appoint a trustee if the appointment would contravene the express terms of the trust or a successor has been named and is qualified to act. Second, and more importantly, SCPA 706(1) provides that when one of two or more fiduciaries dies, a successor shall not be appointed except where the appointment is necessary to comply with the express terms of the trust. This provision, the court notes, is not a canon of construction but a rule limiting the court's authority to appoint successor fiduciaries.

Because of the above provisions, denial of the petition was required. The remaining trustee is completely capable of carrying out its duties under the trust and the trust terms themselves say nothing about successor co-trustees. Although the Surrogate found, based on a "sympathetic reading of the will as an entirety," that the decedent had the intent that a family member serve as co-trustee with the bank, that rubric, while a long-accepted part of New York law, cannot be used to create the express terms of the will required by the SCPA 706(1). *Matter of Schulyer*, 133 A.D.3d 1160, 20 N.Y.S.3d 456 (3d Dep't 2015).

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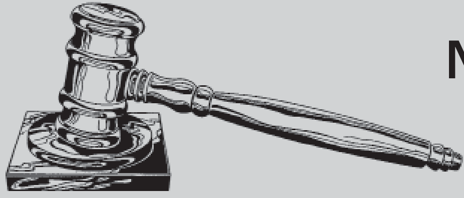

Case Notes— New York State Surrogate's and Supreme Court Decisions

By Ilene Sherwyn Cooper

Releases

Before the court in *In re Bronner* were proceedings for a compulsory accounting with respect to four trusts. The trustee opposed three of the petitions on the grounds that the petitioner had waived her right to an accounting by executing releases. With respect to the fourth petition, the trustee alleged that the petitioner was not a beneficiary of the subject trust, and thus lacked standing to seek an accounting. The petitioner moved for summary judgment in connection with the three trusts of which she concededly was a beneficiary, alleging that the releases were not fairly obtained from her due to allegedly inadequate disclosure and an explanation of the transaction by the trustee. Additionally, the petitioner claimed that the releases were fraudulent. The trustee opposed the petitioner's motion, and cross-moved for partial summary judgment seeking dismissal of the petitioner's fraud claims.

The court observed that because a transaction between a trustee seeking a release from a beneficiary is, essentially, self-dealing, the law requires that there be proof of full disclosure by the trustee of the facts of the situation and the legal rights of the beneficiary, as well as adequate consideration paid. Moreover, the court noted that the mere absence of misrepresentation, fraud, or undue influence in the procurement of a release will not insulate the instrument from subsequent attack by the beneficiaries. Rather, the fiduciary must affirmatively demonstrate that the beneficiaries were made aware of the nature and legal effect of the transaction in all of its particulars. Within this context, based on the allegations of the petitioner, and the lack of documentary evidence to the contrary, the court found that the petitioner had made a prima facie case that the releases in issue were not obtained fairly, and thus did not necessarily foreclose her right to accountings.

In an attempt to resist summary judgment, the trustee alleged that although an informal account was not provided to the petitioner at the time the releases were executed, adequate and full disclosure was made to her by her husband and a trusted friend, who was the asset manager for the real property interests held by the trusts. Additionally, documentary evidence submitted by the trustee suggested that the petitioner was intimately aware of the trust assets, and the transactions underlying the releases involving the trustee's decision to terminate the trusts and transfer the assets contained therein to a new trust for her benefit.

Based on the foregoing, the court concluded that the trustee's evidence was sufficient to raise genuine questions of fact as to what was known or disclosed to the petitioner. In reaching this result, the court opined that while a fiduciary acts at his peril in seeking a general release without an accounting, there is nothing in the law that mandates it as a necessary precondition to its validity. Indeed, the court noted that if the trustee's version of the events surrounding the releases could be credited as true, it was the petitioner and her husband, as beneficiaries and grantors of the subject trusts, who sought to terminate the trusts without the expense of an accounting. The court opined that nothing forbids a trustee from pursuing a time and cost-effective route of foregoing an accounting if requested and agreed to by informed beneficiaries.

Moreover, the court rejected the notion that only the trustee could make the requisite disclosure surrounding the procurement of a release to the beneficiary. Rather, the court held that the appropriateness of a disclosure must be determined in light of the circumstances, with the touchstone being fairness. Accordingly, the court directed that a hearing be held regarding the validity of the releases.

In re Bronner, N.Y.L.J., Jan. 21, 2016, p. 28, col. 6 (Sur. Ct., N.Y. Co.) (Surr. Mella).

Removal

In *In re Burack,* one of the decedent's four children, a co-trustee of the testamentary trust created for the benefit of the decedent's surviving spouse, petitioned the Surrogate's Court, New York County, seeking the removal of one of her co-fiduciaries.

The terms of the subject trust, of which the petitioner, the decedent's spouse, and the respondent were co-trustees, provided principally for the decedent's spouse during her lifetime, and for his children and grandchildren upon her death. The trust was funded with two of the decedent's apartments, one, located in

New York, and the other in Florida, and gave the decedent's surviving spouse the right to live in one or both of the properties, or to direct the trustees to sell same and to use the proceeds thereof to purchase a replacement property.

In support of her application for removal, the petitioner alleged that the respondent was ineligible to serve as trustee by virtue of his disbarment from the practice of law in 1995, as a result of his commingling of client funds. In addition, the petitioner claimed that the respondent engaged in self-dealing by approving a loan of trust funds to the decedent's spouse in order to facilitate her purchase of a home to be used as her residence.

The court noted that courts are required to exercise the power of removal sparingly and to nullify the testator's choice of fiduciary only upon a clear showing of serious misconduct that endangers the safety of the estate. Within this context, the petitioner alleged that the respondent's disbarment for the mishandling of client funds was evidence of his dishonesty that put the assets of the trust estate at risk. The court opined that as a general matter, an attorney's disbarment, particularly for conduct involving dishonesty, fraud, deceit or misrepresentation, would raise reasonable apprehension that the funds of an estate would be in jeopardy, or at the very least, create cause for concern.

Nevertheless, the court found the facts and circumstances of the case alleviated any apprehension that the trust estate was in danger. More specifically, the court noted that the respondent was one of three trustees and could not act alone. Additionally, the record indicated that the respondent had voluntarily resigned from the practicing bar after acknowledging that he was the subject of an investigation that he had commingled client funds. Although petitioner alleged that the respondent had deceived the decedent and his family into believing that he was still an attorney at the time he executed his Will and after relinquishing his license, the court found that petitioner had failed to demonstrate the truth of these allegations, and that, instead, the record revealed that the decedent regarded the respondent as a friend and employed him for his services as an accountant and financial advisor, rather than as an attorney. In fact, it appeared that the decedent had sought legal advice from someone other than the respondent in connection with his estate plan and legal affairs.

In addition to the foregoing, petitioner claimed that the respondent should be removed for aiding and abetting the self-dealing of his co-trustee, the decedent's spouse. Specifically, the petitioner pointed to the fact that in order to purchase her home, the decedent's spouse was required to advance her personal funds to the estate as a loan, pending the sale of the two apartments owned by the trust in New York and Florida. The record reflected that when those properties were sold, the decedent's spouse was repaid, without interest.

Based on these facts, the court concluded that the advance of funds to the trust by the decedent's spouse as a loan, in order to facilitate the purchase of a new home upon the sale of the decedent's apartments, was not an act of self-dealing, but rather, was in keeping with the terms of the trust. Indeed, the court held that the subject loan did not constitute self-dealing, as the decedent's spouse did not personally benefit from the transaction, nor place her interests in competition with those of the trust.

Accordingly, the court concluded that petitioner had failed to demonstrate that the respondent had neglected his fiduciary duties, and denied her application for removal.

In re Burack, N.Y.L.J., Sept. 11, 2015, p. 23, col. 2 (Sur. Ct., N.Y. Co.) (Surr. Mella).

Removal

In *In re Thomas,* the Surrogate's Court, Kings County, was confronted with a petition by the decedent's son, who was a beneficiary of the estate, to revoke the letters testamentary issued to his brother, and to appoint the Public Administrator in his place and stead.

The decedent died in 2011 leaving a Will, which essentially left her entire estate in equal shares to her two sons, who were her sole heirs, and nominated them both as co-executors. Because the petitioner was ineligible to serve as fiduciary, letters testamentary issued solely to the respondent. Notably, while the petitioner had objected to his brother's appointment as executor, the court determined, after a hearing, that he was qualified and eligible to serve.

Approximately two years later, the petitioner sought the removal of his brother. At the hearing of the matter, the petitioner testified in support of his application. No testimony was offered on behalf of the respondent.

Specifically, the petitioner alleged that the respondent had mismanaged the real property of the estate, which had not been sold, and was generally unkempt. Moreover, petitioner argued that the respondent had caused the tenant, who had rented the apartment on the property, to vacate the premises, and that some of the decedent's personal property, and even some of his own personal belongings, were missing, albeit it had allegedly been placed into storage by the executor.

Further, the petitioner alleged that the respondent had obtained his letters through a material misrepresentation of fact, on the grounds that he purportedly testified at the prior hearing seeking his disqualifica-

tion, that he did not possess keys to the decedent's home prior to her death, when it appeared that he had entered the premises following her death with two men, who were there to install an alarm system, and left with two shopping bags filled with items he refused to disclose.

Finally, although petitioner claimed that respondent had failed to comply with a stipulation filed with the court requiring him to complete certain paperwork regarding a joint bank account in which the parties were interested, at the hearing of the matter, the petitioner admitted that the respondent did, in fact, fulfill his responsibilities under the stipulation.

The court opined that pursuant to the provisions of SCPA 711(1), (3) and (4), the court has the authority to remove a fiduciary where, *inter alia,* the fiduciary has improvidently managed or injured the property committed to his charge, obtained the grant of letters by a false suggestion of a material fact, or refused or without good cause neglected to obey any lawful direction of the court. Although the court found that none of the allegations of the petitioner rose to the level of mandating the executor's removal under any of the foregoing statutory provisions, it recognized that disqualification was warranted where the friction between a fiduciary and beneficiary endangers or seriously impedes the proper administration of the estate.

Within this context, the court noted that the decedent's estate had a history of animus between the petitioner and respondent, evidenced by numerous applications and proceedings instituted by the petitioner against his brother, the executor, and their inability to cooperate with respect to even the most basic issues. Under such circumstances, the court found that the situation between the petitioner and respondent was so uncooperative and "pernicious" as to be harmful to the administration of the estate and delay its closure. Based on the foregoing, the court found that the appointment of a neutral fiduciary was required to preserve, administer, and manage the assets of the estate. Accordingly, the respondent's letters testamentary were revoked, and the Public Administrator was appointed in his place and stead.

In re Thomas, N.Y.L.J., Nov. 13, 2015, p. 27 (Sur. Ct., Kings Co.).

Spoliation

In *Warren v. Amchem Prods. Inc.*, the court granted plaintiff's motion for spoliation sanctions, finding that the defendant's inexplicable loss of documents constituted gross negligence at a minimum. The court added that as a result of the defendant's bad faith, the plaintiff was entitled to an instruction that would allow the jury to infer that the missing documents would not have supported the defendant's defense and would have supported plaintiff's claims.

Warren v. Amchem Prods., Inc., N.Y.L.J., Nov. 25, 2015, p. 34 (Sup. Ct., N.Y. Co.).

Summary Judgment

In *In re Cookson,* the Queens County Surrogate's Court granted the proponent's motion for summary judgment, dismissing the objections to probate alleging lack of due execution, lack of testamentary capacity, undue influence, fraud and mistake.

The decedent died on November 2, 2013, survived by a son and a daughter. Pursuant to the pertinent provisions of her will, dated March 14, 2012, the decedent devised her home to her son, and the residue of her estate in the following percentages: 65% to her son, 15% to her daughter, and 10% each to her daughter's two children. The instrument nominated her son as the executor, and her daughter as the alternate executor. The decedent's son petitioned for probate of the instrument, and objections thereto were filed by the decedent's daughter. Following the completion of discovery, the decedent's son moved for summary judgment.

In granting the motion, the court noted that summary judgment in a contested probate proceeding is proper where the petitioner submits a prima facie case for probate and the objectant fails to raise any genuine factual issues regarding the validity of the propounded instrument. To defeat a motion for summary judgment, an objectant must present affirmative proof demonstrating the existence of triable issues of fact. Allegations must be specific and substantiated by evidence in the record, rather than based upon mere conclusory assertions, bearing in mind that the motion papers are scrutinized in a light most favorable to the opposing party.

With respect to the issue of due execution, the objectant alleged that the testator did not publish the instrument as her last will and testament, that she did not request the witnesses to sign the instrument as witnesses, that the witnesses did not sign the instrument in the testator's presence or in the presence of each other, and that the notarization on the self-proving affidavit affixed to the instrument was defective.

The court noted that in support of his motion for summary relief, the petitioner included a copy of the will offered for probate, which contained an attestation clause. The clause indicated that the will was signed, sealed, published and declared by the testator as her last will and testament in the presence of the witnesses, and that the witnesses, at the testator's request and in her presence and in the presence of each other, subscribed their names as witnesses. The court opined

that where an attestation clause is complete, the signatures genuine, and the circumstances corroborative of due execution, there is a presumption that the will was duly executed, even when the attesting witnesses are unable to recall the execution ceremony. Additionally, a presumption of due execution arises where, as in the instant case, the execution of the will was supervised by an attorney.

In further support of his motion, the petitioner also submitted a copy of the transcript of the SCPA 1404 examination of one of the two attesting witnesses to the execution, who testified that the testator reviewed the propounded instrument in her presence, and in the presence of the supervising attorney, that counsel asked the testator if she wanted the two of them to act as witnesses to its execution, that the testator responded affirmatively to the inquiry, and that all three signed the instrument at the same time. The court noted that the objectant declined to take the testimony of the supervising attorney, who was also the draftsman of the instrument, even though he was present and available for an examination.

Based upon the foregoing, the court held that the proof established that the testator had published her will. Although the testator did not expressly declare the instrument to be her will and request that the witnesses sign the instrument, the court found that publication could be inferred from the circumstances, which included an announcement by the supervising attorney that the instrument was the decedent's will, and a request by him, in the presence of the testator, and with her tacit approval, that the witnesses sign in that capacity.

The court found that the objectant had failed to submit any proof contraindicating the due execution of the instrument, or that the self-proving affidavit affixed to the will was defective. Indeed, the court noted that a self-proving affidavit was not an integral part of a will, and thus not essential to its validity. Accordingly, summary judgment dismissing the objection on the grounds of due execution was granted.

With respect to the issue of testamentary capacity, the court found that the petitioner had established a prima facie case of the testator's capacity, based upon the SCPA 1404 testimony of one of the attesting witnesses, the affidavits of both attesting witnesses in support of the motion, and the attestation clause. The court concluded that the objectant had failed to produce any medical records or other evidence establishing an issue of fact regarding the capacity of the testator at the time of execution of the will, and thus, on the basis of the undisputed record, granted summary judgment in petitioner's favor on this issue.

Similarly, the court granted summary judgment in petitioner's favor on the issues of fraud and undue influence. The court found that based upon the documentary evidence and testimony of the attesting witnesses, the petitioner had established a prima facie showing that the decedent was free from fraud or restraint at the time she executed her will. On the other hand, the court held that the objectant had failed to demonstrate, with particularity, that any false statements were actually made by the petitioner to the decedent that would require a trial on the issue of fraud, or to proffer any evidence that created a triable issue of fact on the issue of undue influence.

Finally, the court dismissed the objectant's claims that the propounded instrument was executed by the decedent by mistake, in that she did not understand the contents of the instrument at the time of its execution. More specifically, the objectant alleged that the decedent did not understand the value of her residuary estate at the time the will was executed, and what the value of the estate would be at her death. Moreover, the objectant maintained that the decedent believed that the changes made to her will in favor of the petitioner were based on a mistaken belief in his trustworthiness to fulfill her testamentary wishes.

The court held this objection to be "essentially nonsensical," concluding that very few testators will know the exact size of their residuary estate at the time of their death, especially if a will, such as the decedent's will, is executed at a time when death is not imminent. The court, thus, concluded that a mistake or misapprehension on the part of the testator as to the size of her estate at the time of death is not grounds for denying probate. Further, the court held that probate will not be denied on the grounds that the terms of a will may later need to be construed, or that the decedent allegedly misconstrued the legal import of its terms. "What the testator has done, not what she meant but failed to do, is to be given effect…"

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

In re Cookson, N.Y.L.J., Dec. 18, 2015, p.42 (Sur. Ct., Queens Co.).

Ilene S. Cooper, Farrell Fritz, P.C., Uniondale, New York.

Florida Update

By David Pratt and Jonathan A. Galler

David Pratt

DECISIONS OF INTEREST

Trustee's Reasonable Compensation

Florida's Trust Code authorizes the payment of compensation to a trustee but, unlike the treatment of compensation for a personal representative, the Trust Code does not provide an actual schedule of fees that are presumed to be reasonable. Instead, the statute simply provides for "compensation that is reasonable under the circumstances." Fla. Stat. § 736.0708(1). And, in most instances, trust instruments do not include a specific provision addressing the calculation of trustee compensation. As a result, trustees in Florida are left to discern what a court may deem to be reasonable compensation under the statute. In this recent case, the decedent was, in the words of the Second District Court of Appeal, an "iconic and prolific artist and philanthropist." The sole remainder beneficiary of his trust was a foundation, which challenged an award of nearly $25 million in compensation for the trust's three individual trustees. The foundation argued that the trial court should have calculated the trustees' compensation using the lodestar method typically used in calculating attorneys' fees (*e.g.*, essentially hours reasonably expended multiplied by reasonable hourly rates). The trial and appellate courts, however, rejected that argument and held, instead, that trustee compensation is calculated by considering a series of factors outlined in the seminal case of *West Coast Hospital Ass'n v. Florida National Bank of Jacksonville*, 100 So. 2d 807 (Fla. 1958). These include factors such as the capital and income received and disbursed by the trustee, the wages customarily granted to agents for like work in the community, the success or failure of the administration of the trustee, the time consumed, and the character of the work done. Here, the appellate court held that the trial court correctly applied the various *West Coast* factors to the circumstances of the case and noted that, on the trustees' watch, the trust assets at issue had increased in value from approximately $605 million to approximately $2.1 billion.

Robert Rauschenberg Found. v. Grutman, 2016 WL 56456 (Fla. 2d DCA Jan. 6, 2016) (not yet final).

Jonathan A. Galler

Elective Share Not Reduced by Estate's Attorneys' Fees

In the words of Florida's Fourth District Court of Appeal, reiterated in this recent case, a "surviving spouse's elective share is purely a creature of statute created by Florida's Legislature as a replacement for the common law doctrine of dower and curtesy." The purpose of that statutory creature is "to ensure provision for a surviving spouse's needs." With that public policy interest in mind, the appellate court was called upon to decide whether a spouse's elective share can be reduced by a portion of the attorneys' fees incurred by the personal representative in litigating claims against the estate. The Fourth District held that the elective share may not be reduced by such attorneys' fees. Florida's elective share statute provides that the elective share consists of an amount equal to 30 percent of the fair market value of all assets identified in the statute, computed after deducting (i) all valid claims against the estate, and (ii) all mortgages, liens or security interests on the assets. Fla. Stat. § 732.207. Because the statute does not include attorneys' fees among the types of expenses or costs that are to be deducted from the value of those assets, the Fourth District held that it is improper for the personal representative to reduce the elective share by a portion of the attorneys' fees incurred in litigating claims against the estate.

Blackburn v. Boulis, 2016 WL 231405 (Fla. 4th DCA Jan. 20, 2016) (not yet final).

Renunciation Not Always Required in Trust Contest

The equitable doctrine of renunciation demands that before a plaintiff will be permitted to contest a trust in which he or she has a beneficial interest, the contestant must renounce any such interest in the trust. Under Florida law, a contestant satisfies this requirement by making a qualified or conditional renunciation, typically in the pleading itself, through which he or she renounces any interest in the trust that is under attack; but if the trust contest fails, that renunciation is automatically withdrawn, and the contestant reverts to his or her original position. The Fourth District Court of Appeal, however, recently re-

versed a trial court's decision to dismiss a trust contest in which the contestant failed to renounce his interest in the trust. The trust at issue had been amended five times. The plaintiff contested the validity of the fourth and fifth amendments but did not renounce his interest in the trust and did not return the trust assets that had already been distributed to him. The trial court dismissed the complaint on that basis, but the appellate court reversed because under the third amendment to the trust—the document that the plaintiff was seeking to reinstate—the plaintiff would have been entitled to a greater interest than that which he was entitled to under the trust amendments he was challenging. The appellate court held that, under these factual circumstances, the policy behind the renunciation rule did not mandate that the plaintiff renounce his interests or return the assets already received.

Gossett v. Gossett, 182 So. 3d 694 (Fla. 4th DCA 2015).

Personal Representative Not Always an Indispensable Party

In Florida, the personal representative of an estate is an indispensable party to a will contest and nearly every other type of contested and uncontested probate proceeding. An indispensable party is one who is so essential to a suit that no final orders can be rendered without the party's participation as a party to the proceeding. It may be surprising, then, to learn that the personal representative is not an indispensable party to a lawsuit challenging a series of transfers made during a decedent's lifetime. In this recent case, the plaintiffs filed a complaint after the decedent's death seeking to set aside the decedent's lifetime transfer of property on grounds of tortious interference with an inheritance and unjust enrichment. The trial court dismissed the complaint because the plaintiffs failed to name the decedent's personal representative as a party to the lawsuit. The trial court relied, in part, on section 733.607(1), Florida Statutes, which provides that a personal representative has the right to and shall take possession of the decedent's property. The appellate court reversed, holding that the statute gives the personal representative rights only to property that remains in the decedent's possession at death. Because the properties at issue were not in the decedent's possession at the time of his death, the appellate court held that the personal representative was not an indispensable party to a lawsuit challenging the lifetime transfers of those properties.

Parker v. Parker, 2016 WL 404636 (Fla. 4th DCA Feb. 3, 2016) (not yet final).

Beneficiaries' Right to Intervene in Trust Proceedings

Florida Rule of Civil Procedure 1.230 provides that anyone claiming an interest in a pending litigation may be permitted to assert his or her rights by intervening in the litigation. This can be an important procedure in Florida trust proceedings, which are governed by the rules of civil procedure, because many people can often claim an interest of one sort or another in such a proceeding. For example, in a recent case decided by the Fourth District Court of Appeal, the beneficiaries of a trust moved to intervene in an attorneys' fees dispute that was being waged between the current trustee and the attorney for the predecessor trustee. As the appellate court stated, on a motion to intervene, a trial court must first determine if a person's interest is of such a direct and immediate character that the intervenor will either gain or lose by direct operation and effect of the judgment. Further, if the court allows intervention, it must then determine the parameters of the intervention. Notably, courts have held that the intervention should be limited to the extent necessary to protect the interests of all parties. The issue before the appellate court in this case was whether the trial court's order, which granted intervention but prohibited the beneficiaries from filing papers or engaging in discovery, had limited the intervention to such an extent that it effectively constituted an improper denial of the motion. The appellate court held that the beneficiaries were proper intervening parties because they stood to lose $150,000 of their inheritance if the attorney for the predecessor trustee was successful, but the appellate court held that the trial court erred in limiting the beneficiaries' participation to such an extent that they would be unable to effectively protect their own interests.

Genauer v. Downey & Downey, P.A., 41 Fla. L. Weekly D136 (Fla. 4th DCA Jan. 6, 2016) (not yet final).

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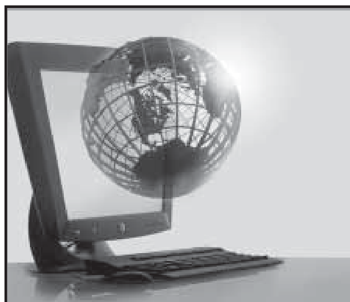

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