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Trusts and Estates Law Section Newsletter

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A Message from the Section Chair

Wallace Leinheardt

Same-Sex Marriage—What Will New York Do?

With the change in the majority of the New York State Senate, it is widely expected that bills previously passed in the New York State Assembly, but which were never voted out of Senate committees, will likely come to the Senate floor.

During the 2008 legislative session, Assembly Bill A8590 passed, but never came out of, Senate committee. That bill would amend the Domestic Relations Law by adding a new section, 10A, to read as follows: "A marriage that is otherwise valid shall be valid regardless of whether the parties to the marriage are of the same or different sex."

In 2006, the Court of Appeals dealt with the issue of same-sex marriage in *Hernandez v. Robles*, 7 N.Y.3d 338. The Court held (4 to 2, with 1 taking no part) that the New York State Constitution did not compel recognition of same-sex marriages, that the issue "is a question to be addressed by the legislature."

Both prior to and since the Court's determination in *Hernandez*, the State Bar Association has supported the enactment of legislation to permit same-sex couples the ability to obtain the same rights and responsibilities afforded opposite-sex couples.

The Association House of Delegates formed a Special Committee on Legal Issues Affecting Same-Sex Couples, which issued a report to the Association in 2004 indicating numerous instances of unequal treatment of same-sex couples under various laws.

Indeed, more recently a joint publication of the Empire State Pride Agenda Foundation and the New York City Bar Association, June 12, 2007, entitled *1324 Reasons for Marriage Equality in New York State*, identified 1324 legal rights and duties granted married opposite-sex couples through laws and regulations.

In April 2005, after considering the report of the Special Committee, the House of Delegates resolved that "The New York State Legislature should enact legislation that will afford same-sex couples the ability to obtain the comprehensive set of rights and responsibil-

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ities now afforded opposite-sex couples . . . in the form of a statute creating a domestic partnership registry, a civil union statute, or an amendment to the statutory definition of marriage to include same-sex couples."

The Association designated the "enactment of legislation to provide same-sex couples the ability to obtain the comprehensive set of rights and responsibilities now available to opposite sex couples" as one of its legislative priorities for 2008.

Except as indicated above, the legislature has not passed any same-sex bill since the adoption of the House of Delegates resolution, or the Court of Appeals decision in *Hernandez.*

To the contrary, since the adoption of the resolution, the highest courts in three states, California, Connecticut and Massachusetts, have held that domestic unions or civil partnership laws were insufficient to create equality for same-sex couples (although recently, the voters in California adopted Proposition Eight, which bans same-sex marriages).

Also since 2005, same-sex marriage legislation has been adopted in Connecticut, as well as civil union bills in New Hampshire, New Jersey and Vermont.

New York law recognizes same-sex marriages and civil unions if valid in the same place they were entered. See *Martinez v. Monroe County*, 850 N.Y.S.2d 740 (4th Dep't 2008) (ruling same-sex marriage granted in Canada is entitled to recognition in New York); *see also Beth R. v. Donna M.*, 853 N.Y.S. 2d 501, 506 (N.Y. Sup. Ct. 2008) (recognizing same-sex marriage entered into in Canada and considering it as a factor in determining issues related to divorce and child custody and visitation); *Godfrey v. Spano*, 836 N.Y.S.2d 813, 817 (N.Y. Sup. Ct. 2007) (declining to enjoin an executive order requiring county agencies to recognize same-sex marriages where validly contracted out of New York State).

In addition, Governor Paterson issued an executive order dated May 14, 2008, which instructed all state agencies that same-sex couples married outside New York "should be afforded the same recognition as any other legally performed union."

Those opposed to any form of same-sex marriage argue that whereas marriage between a man and a woman is a pre-political institution, same-sex marriage is not. They believe that bans against same-sex marriage are not unconstitutional and should be left to the legislature to determine on a state-by-state basis. They also note that adoption by individual states will have no effect on Federal income, gift, or estate taxes.

Supporters argue the issue is akin to the anti-miscegenation laws declared unconstitutional in *Loving v. Virginia*, 388 U.S. 1 (1967).

The Executive Committee of our Section will be considering whether to adopt a Report supporting a bill similar to Assembly Bill 8590, which is expected to be introduced at the next session of the state legislature.

If adopted by the Section Executive Committee, the Report will be submitted to the Association Executive Committee and to the House of Delegates.

It will be interesting to see whether Chief Judge Judith Kaye's observation, writing for the minority, that "I am confident that future generations will look back on today's decision as an unfortunate misstep" will come to pass.

Elder Abuse Study Group

I am pleased to report that as a result of replies to my call to create a commission to study elder-abuse law, a group is being formed which will consist of trust and estate and elder law attorneys, prosecutors, social workers and others with experience in elder abuse, to examine existing laws and procedures and consider appropriate changes. Anyone wishing to join the group, or who has an experience that he or she wishes to share, should please contact me at wleinheardt@jaspanllp.com.

Financial Officer Position

NOTICE: The Executive Committee has authorized the creation of a new Financial Officer Position. Please see details on page 20 of this *Newsletter*.

Thanks to All

As I prepare to pass the Chair gavel to Prof. Ira Bloom, Chairperson-Elect, I would like to thank the officers, Executive Committee members and Association staff for their help and support this past year. The accomplishments of the Section this past year are the result of a truly joint effort. I urge all Section members to become active on committees. It is from such activity that future leaders are chosen.

Wallace L. Leinheardt

Saving for College: State-Run Plans vs. Effective Estate Planning

By Sanford J. Schlesinger and Christina L. Porter

According to current College Board statistics, average college expenses (i.e., tuition and other related educational expenses) for both public and private colleges continue to increase yearly. In the last year alone expenses at public and private colleges increased more than 6%[1] and, as we all know, the cost for college is likely to continue increasing every year. In fact, it was recently published that the expenses for attending New York City's premiere private colleges, Columbia University and New York University, have surpassed $50,000 per year.[2]

A college degree is no longer a lofty goal for the majority of Americans but an absolute necessity for even the most basic of entry-level professional jobs, yet finding the means to pay for higher education is increasingly difficult. Fortunately, there are estate planning and investment options, including trusts and state-run savings programs, to assist families in planning financially for the expense of college. We can only hope that available estate planning and investment options will become even more effective in years to come, as they must.

In an effort to encourage families to consider long-term investments for their children's education, much has been published in recent years about state-run Qualified Tuition Programs (i.e., "529 Plans"), although it remains a fact that the majority of American parents are still not taking advantage of them.[3] However, aside from the push to inform Americans of 529 Plans and their potential benefits, it is our belief that these plans do not provide the flexibility or investment performance to justify enrollment in them. State-offered 529 Plans may have evolved since they were originally developed in the 1980s, but we believe that there are more flexible and potentially far more successful methods of ensuring that the educational goals of future generations are financially attainable.

State-Run Plans

529 Plans were originally developed at the state level in the 1980s when states began to recognize a growing need to encourage and assist families in saving for college. More than a decade after their initial start, the federal government stepped in and Section 529 of the Internal Revenue Code (IRC) was enacted in 1996 formally recognizing state-run savings programs as tax-exempt investment vehicles.

Despite the intention to create programs to assist families with college expenses, for wealthier and more sophisticated investors 529 Plans may not be the best option to financially prepare for college. The largest drawback is that 529 Plans are inherently inflexible with regard to how the assets are to be used and how they may be invested. Withdrawals from 529 Plan earnings may only be used for a beneficiary's "qualified higher education expenses,"[4] meaning the tuition, books and supplies that are required for enrollment and housing at eligible institutions.[5] When a withdrawal from a 529 Plan is made for any other purpose, such withdrawal is subject to a threat of federal, state and local income taxes in addition to a 10% federal tax penalty and potential state tax penalties.

On the investment side of the equation, increasing complaints from investors due to high management fees, lack of options and poor performance have forced investment firms involved in 529 Plans to improve their services. There are now dozens of state-managed 529 Plans nationwide and plan participants are free to pick and choose among them (i.e., non-residents are typically free to participate in other states' plans with varying tax consequences although there is a trend toward states enacting tax laws more favorable to out-of-state tuition plans). In fact, a minority of states still manage their plans through state-employed money managers although more states are outsourcing the management of such plans to professional financial service companies. However, the performance of the state-run plans, whether through a state-employed money manager or an outsourced financial service company, is typically mediocre compared with more personalized and carefully selected investments. In fact, it is only recently that plans have begun to offer more investment options or even to provide participants with performance reports. Further, 529 Plan participants typically are only permitted to change how assets are invested once every year or when a beneficiary is changed, which may be extremely detrimental to investors in what can be a rapidly evolving economic environment, as recent headlines have confirmed.

Participants in 529 Plans do receive tax incentives for investing in such plans. Currently, contributions to 529 Plan accounts qualify for the federal gift tax annual exclusion (i.e., currently $12,000 per donee per year, scheduled to increase to $13,000 in 2009, when indexed for inflation). In addition, participants can make a contribution to a 529 Plan account for one beneficiary of up to $60,000 ($120,000 for married couples filing jointly, scheduled to increase in 2009 to $65,000 for individuals and $130,000 for married couples filing jointly, when

indexed for inflation, i.e., five times the annual federal gift tax exclusion amount) in one year, provided no additional annual exclusion gifts are made to that particular beneficiary over the five-year period. However, participants can only contribute to 529 Plan accounts for any one beneficiary until the aggregate value of the accounts reaches a maximum account balance (which amount varies from state to state). The maximum balance limitation for 529 Plans can be a serious drawback for wealthier families. In New York, for example, the aggregate value of 529 Plan accounts for the same beneficiary currently cannot exceed $235,000. As noted above, with the cost of tuition alone at some private universities exceeding $50,000, at the current maximum balance for 529 Plans permitted in New York, for example, it is not certain that such accounts would be capable of holding sufficient funds to cover the cost of college.

Another drawback to 529 Plans concerns long-term and multi-generational planning. Participants in 529 Plans are permitted to change the beneficiary on such plan at any time but only a change in beneficiary to "qualified family members" will be allowed without penalty. Qualified family members include the designated beneficiary's spouse, children, siblings, parents, nieces, nephews, aunts, uncles or in-laws.[6] A 529 Plan account will be taxed if the beneficiary falls outside of the qualified family members' category as it will be recognized as a distribution from the plan. If a beneficiary of a 529 Plan does not attend college or there are funds remaining at the completion of the beneficiary's college education and there are no other family members that can be named as a beneficiary, the account may have to be transferred to a non-family member or closed, exposing any remaining funds to federal income taxes on any earnings plus a 10% federal income tax penalty, as well as state and local income taxes.

Effective Estate Planning Alternatives

As an alternative to 529 Plans, we recommend creating so-called "2503(c)" trusts or "Crummey" trusts for high-net worth families because they offer more flexibility and the potential for greater investment success. The greatest benefits provided by such trusts are that contributions qualify for the federal gift tax annual exclusion and, unlike 529 Plans, they can have unlimited balances and are flexible with regard to how the assets are used and how the assets are invested. A 2503(c) trust is also named after the section of the Internal Revenue Code under which the conditions for the qualification of these trusts for the federal gift tax annual exclusion are provided. Under I.R.C. § 2503(c), gifts to a trust for a minor made in accordance with the conditions of the section will qualify for the federal gift tax annual exclusion.

Under usual circumstances, a gift of a future interest in property (i.e., money held in trust and not accessible until the beneficiary reaches a certain age) does not qualify for the federal gift tax annual exclusion because a qualifying gift typically means that the recipient will have immediate use of or access to the property. However, a gift made to a trust in accord with I.R.C. § 2503(c) will qualify for the federal gift tax annual exclusion. The required conditions under I.R.C. § 2503(c) that must be met for a gift to a minor to be considered a gift of a present interest (and therefore qualify for the federal gift tax annual exclusion) are (i) that a trustee has the discretion to expend principal and income in the trust for the benefit of the minor (i.e., to make distributions on the child's behalf or to make distributions directly to the child) until he or she reaches 21 years of age, (ii) that the trust will be included in the beneficiary's estate if the beneficiary dies before reaching 21 years of age, (iii) that all undistributed principal and income must be distributed to the beneficiary upon his or her 21st birthday, and (iv) that all gifts to the trust be irrevocable. Although a condition of a 2503(c) trust is that it terminate upon the beneficiary's 21st birthday, such trusts can be drafted to include a provision that, upon the beneficiary's 21st birthday, the beneficiary can exercise his or her right to request the assets of the trust during a limited time frame. If the right is not exercised within that time frame, the assets can remain in further trust for the beneficiary (possibly to convert to a Crummey trust, discussed below).

A Crummey trust is so named after the first taxpayer to win the approval of the Internal Revenue Service for this type of trust, D. Clifford Crummey. A Crummey trust, too, permits contributions to the trust to qualify for the federal gift tax annual exclusion. The aspect of a Crummey trust that creates a present interest in the gift and, therefore, qualifies the gift for the federal gift tax annual exclusion, is that the beneficiary must have the right to withdraw the contribution to the trust during a certain time frame (i.e., usually 30 to 60 days).[7] A beneficiary would not be permitted under the trust instrument to withdraw all of the assets of a trust but is only given the right to withdraw up to the amount of the donor's annual contribution to the trust (or his or her respective share of the annual contribution, if there are multiple beneficiaries of the trust) not exceeding the applicable annual exclusion amount (i.e., for gift-splitting couples, contribution amounts per beneficiary can be up to $24,000 in 2008, increasing to $26,000 in 2009).[8] In comparison to 2503(c) trusts, Crummey trusts can be created for multiple beneficiaries; they are not limited to being for the benefit of minors and they can exist for as long as is specified in the trust agreement. Subject to the inclusion in a Crummey trust of certain so-called "hanging powers," which permit the beneficiary to have a continuing right to withdraw certain trust property and which are desired to avoid gift tax issues under I.R.C. § 2514 in connection with the lapse of a withdrawal where the trust has multiple beneficiaries (which is beyond the scope of this article), once the withdrawal

time frame on a Crummey trust has passed without a beneficiary exercising his or her right, the trustee will administer contributions, now treated as a part of the trust *corpus*, according to the terms of the trust.

Both 2503(c) trusts and Crummey trusts have their own benefits and one planning option, as suggested above, is to combine the two by having a 2503(c) trust convert to a Crummey trust upon the beneficiary's 21st birthday, which will allow contributions to the trust to continue to qualify for the federal gift tax annual exclusion.

In terms of flexibility, a 2503(c) trust or Crummey trust may be created to allow for distributions to be made to or for the benefit of a beneficiary at the trustee's sole discretion for purposes not limited to education (as distributions are required to be made under a 529 Plan to avoid tax penalties), but also the very broad categories of a beneficiary's general maintenance, health, support, welfare or comfort as well as education. With regard to investments, a 2503(c) trust or Crummey trust may be created to allow a trustee to select the trust's investments and to personally determine how aggressively or conservatively to invest or to delegate such decisions to a professional investment adviser, which may result in enhanced performance through a customized investment plan.

Although earnings on 2503(c) trusts or Crummey trusts are subject to income tax, contributions to these types of trusts also qualify for the aforementioned federal gift tax annual exclusion, as discussed above, with the added bonus that there are no limitations on the total value of such trusts—a major benefit considering the constrictive state limitations on 529 Plan account balances. Further, there is no concern that a 2503(c) trust or Crummey trust will suffer tax penalties for becoming irrelevant (as a 529 Plan account would if there are no remaining college-bound beneficiaries). When a beneficiary of a 2503(c) trust reaches 21 years of age, the beneficiary must receive the remaining balance of the trust. Alternatively, a 2503(c) trust can be structured to provide the beneficiary with a right to withdraw such remaining trust balance upon reaching the age of 21 years and, to the extent that the beneficiary fails to exercise such right, the trust assets not withdrawn would remain subject to a continuing trust for the benefit of the beneficiary. Lastly, 529 Plans may receive federal and state income tax benefits, for example, participants in New York's 529 Plan receive tax deductions of up to $5,000 from state taxable income for contributions to such accounts ($10,000 for married joint filers). However, with 2503(c) trusts and Crummey trusts, any potential tax consequences can be minimized by investing in long-term capital gain investments such as stock or real estate and/or tax-exempt vehicles, including municipal bonds.

Conclusion

With the "gifting season" quickly approaching and year-end tax planning opportunities being considered, high-net worth families with young and possibly college bound children should consider (or consider anew) their estate planning options with regard to saving and paying for college. In light of their flexibility, adaptability and potential for greater investment success, among other benefits, 2503(c) trusts and Crummey trusts are generally preferable college saving options for high-net worth families.

Endnotes

1. As reported by the College Board in their 2007 Trends in College Pricing Report.
2. *See Cost of Tuition at Colleges Breasts [sic] $50,000 a Year*, The New York Sun, Sept. 3, 2008.
3. According to an ABC News Poll, as recently as the beginning of 2007, two-thirds of parents have never heard of 529 Plans and only 8% of those who had heard of them are actually using them.
4. I.R.C. § 529(3).
5. "Eligible" institutions are institutions described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) as in effect on Aug. 5, 1997, and which are eligible to participate in a 529 program under Title IV of the Higher Education Act of 1965. I.R.C. § 529(5).
6. I.R.C. § 529(e)(2).
7. *Also note Cristofani v. Commissioner*, 97 T.C. 74, July 29, 1991, which involved a trust with Crummey powers that gave the beneficiaries a 15-day time frame during which they had to exercise their right to withdraw a contribution; the U.S. Tax Court approved the Crummey power finding the narrow time frame sufficient to create a "present interest" in the contributions, thus qualifying the contributions for the federal gift tax annual exclusion.
8. I.R.C. § 2513 permits a gift (which otherwise meets various additional requirements to qualify as a gift) by one spouse to a third party to be considered as made one-half by each spouse provided both spouses have signified their consent to the application of a gift split (as reflected on a Gift Tax Return).

Sanford J. Schlesinger is a founding partner in the law firm of Schlesinger Gannon & Lazetera LLP, an affiliate of Dreier LLP, in New York City. He is also a Fellow of the American College of Trust and Estate Counsel and immediate past downstate New York chairman. Mr. Schlesinger is a past Chair of the Trusts and Estates Law Section of the New York State Bar Association, former Chairman of the N.Y.U. Tax Institute Advisory Board and regularly writes and lectures on estate, trust and charitable planning.

Christina L. Porter is an associate with Schlesinger Gannon & Lazetera LLP in New York City.

Coming to America

By Gideon Rothschild and Ira Zlotnick

Background. Historically, many non-U.S. persons who have settled trusts have failed to consider establishing them in a U.S. jurisdiction. In the past, these individuals were often concerned about unnecessarily exposing their foreign assets to taxation in the U.S. In 1996, the Internal Revenue Code was amended so as to enable foreigners to settle trusts which would be governed under the laws of a particular jurisdiction in the U.S. but still be treated as foreign trusts for U.S. income tax purposes (commonly referred to as "hybrid trusts"). The ability of foreigners to create these hybrid trusts and avail themselves of many substantive advantages of having U.S. law govern their trusts, has forced many to abandon traditional thinking and instead consider settling new trusts (and/or re-domiciling older trusts where permitted under the terms of the existing trust) in the U.S.

In order to create a hybrid trust, a non-U.S. person must be given substantial decision making power over at least one key aspect of the trust. IRS Regulations offer several examples of what types of decisions constitute substantial decision making ability, including the ability to determine (i) whether and when to distribute income and/or principal, (ii) the amount of any distribution, (iii) the selection of a beneficiary, (iv) whether to terminate the trust, and (v) whether to remove, add or name a successor trustee, to name just a few. Given this fairly expansive list, the threshold for creating a hybrid trust is not very difficult to meet. Assuming that hybrid trust status is achieved, such trust will only be subject to U.S. income tax on its U.S. source income which will effectively leave the non-U.S. person in the same situation as he or she would have been in had such trust not been created. Depending on the nature of the powers retained by the settlor, it may be necessary, however, to own any U.S. situs assets such as U.S. securities in an underlying foreign company to avoid U.S. estate tax.

Given that it is possible for a non-U.S. person to create a U.S. sitused trust with no adverse U.S. tax consequences, the next question that needs to be examined is what the potential advantages are for such person in creating such a trust.

Self-Settled Trusts. Traditionally, most offshore jurisdictions have cited public policy considerations for denying settlors of "self-settled" spendthrift trusts (i.e., trusts which benefit the settlor) the ability to withstand the challenge of the settlor's own creditors. These jurisdictions still follow the Statute of Elizabeth thereby permitting fraudulent transfer challenges even years after the trust is settled. This has been true even where a settlor's only beneficial interest in the trust is the possibility of receiving distributions within the discretion of an independent trustee. Moreover, in such jurisdictions it is also deemed irrelevant whether the settlor's creditors are present or future, reasonably anticipated or impossible to foresee, as having intent to defraud creditors is not required for the application of this rule. Over the last eleven years, ten U.S. states have enacted legislation providing creditor protection to a settlor-beneficiary of a discretionary trust. The ability to create a trust while remaining a discretionary beneficiary thereof can be an extremely useful tool for someone who is concerned with asset protection.

Rule Against Perpetuities. Many offshore jurisdictions still have statutes that mandate that a trust terminate within a set period of time from its creation (often twenty-one years after the death of a set class of lives in being). Currently there are eighteen jurisdictions in the U.S. that have repealed the so called "rule against perpetuities" and instead permit a trust to last indefinitely (and seven other jurisdictions which permit trusts to last for a period in excess of three hundred and sixty years). The benefit of creating a perpetual trust (also commonly referred to as a "dynasty trust") is two-fold: first, it provides a lifetime trust for the beneficiaries, thereby protecting them against potential creditors, including an ex-spouse; second, it may enable the transferred property to pass down innumerable generations in a tax efficient manner.

Forced Heirship Rules. For those non-U.S. persons who reside in civil law countries, forced heirship rules often limit one's ability to dispose of property as he or she sees fit and instead generally require the testator to leave a portion of his or her estate to a spouse and children. (In fact, similar rules are applicable in Muslim countries that have adopted Sha'ria law.) By creating a trust in a U.S. jurisdiction, however, a domiciliary of a civil law jurisdiction (or a jurisdiction that applies Sha'ria law) can potentially circumvent these rules and dispose of his or her property in a manner that might be more appropriate given such person's individual circumstances.

Investment Control. Oftentimes, settlors of trusts are particularly concerned about relinquishing investment control over the assets being transferred. In response to these concerns, several U.S. states have passed legislation explicitly permitting the trust to remove investment authority from the hands of the trustee and instead shift such authority to a third-party investment advisor. In addition to removing investment responsibility from some third-party institutional trustee with whom the settlor has little or no relationship, these so called "directed trusts" also have the

effect of providing the trustee with reduced liability which in turn permits trustees to charge significantly reduced fees for serving in such capacity.

Tax Savings. Depending upon a settlor's country of residence and the tax regime applicable in such home country, a non-U.S. person might prefer to shy away from the hybrid trust formula described above and instead create a U.S. situsted trust that is taxed as a domestic trust for U.S. income tax purposes because of lower income tax rates. In general, the tax benefits associated with creating a domestic trust may inure to the benefit of residents of countries with whom the U.S. has income tax treaties and results from the fact that the U.S. currently applies relatively low tax rates to passive income (i.e., fifteen percent long-term capital gains tax rate and a tax of fifteen percent on corporate dividends). The low rate of taxation on the federal side, coupled with the fact that a number of U.S. states do not impose a state level of taxation on income accumulated in or capital gains taxes on assets held in an irrevocable trust (so long as the beneficiaries reside out-of-state), may result in significant tax savings for the non-U.S. person and may be a decisive factor in determining where the trust is situsted and how the trust is structured.

Additional tax savings can be realized where non-U.S. persons wish to benefit U.S. persons by creating a perpetual trust for the U.S. person (and his or her descendants) thus escaping both the U.S. estate tax and the U.S. generation-skipping transfer tax that would otherwise be imposed at each generational level.

Oftentimes non-U.S. persons owning U.S. real property are unaware that the property is subject to U.S. estate tax upon their death (currently at a rate of forty-five percent). The use of a properly structured trust with an underlying entity might also avoid the imposition of such tax.

Other Advantages. Additional advantages associated with the creation of U.S. situsted trusts (whether hybrid or domestic) include the ability to benefit from well-established trust law in a jurisdiction that is not on any blacklist or considered a tax haven (which is of substantial import in that it avoids the potential application of special tax rates and reporting requirements), as well as having the opportunity to have a greater degree of security with regard to investments.

Summary. A non-U.S. person's ability to create a U.S. situsted trust (either hybrid or domestic) is a powerful tool, and, although such trusts are not for every non-U.S. person, should be considered by both foreigners and their advisors when contemplating the creation of a new trust.

Gideon Rothschild is a partner at Moses & Singer and Chair of the New York branch of STEP. Ira Zlotnick is a partner at Moses & Singer and concentrates his practice on domestic and international estate planning.

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How to Prevent Family Conflicts in the Event of Incapacity: Using Article 81 of the Mental Hygiene Law When a Clash Is Inevitable

By Anthony J. Enea

Unfortunately in our litigious society, it has become commonplace for siblings, family members and friends to battle for control of the finances and care of their aging parents and loved ones. While the litigation may superficially be for the authority to make day-to-day financial and health-care decisions, often at the root of the litigation is inheritance and monetary control.

It is anticipated that litigation involving aging parents, such as litigated under Article 81 of the Mental Hygiene Law (MHL) guardianship proceedings, will rapidly grow in direct proportion to the aging population of the United States. In addition, the largest transfer of inter-generational wealth, estimated to be approximately $10 trillion, will be transferred from the World War II generation to the "baby boomers." The transfer of such a great amount of wealth will inherently generate additional conflicts and controversies.

Unfortunately, the victim in these controversies is often the family unit. The author has witnessed first hand the bitterness, resentment and destruction of relationships among parents, siblings and loved ones. The effect is best described as a "family divorce," the impact of which may be felt for generations.

Fortunately, there are steps that can be taken to minimize the risk of such controversies affecting families. As is often the case, it is imperative that the potential solutions be implemented well before the problems begin to manifest themselves. Some potential solutions are:

(a) ***The execution of a general durable power of attorney, with broad powers being given to the agent.*** If the general power of attorney is durable, its efficacy will continue even after the subsequent disability or incompetence of the principal. It is best to utilize a customized durable general power of attorney form which grants the agent the broadest powers to act on behalf of the principal, including, but not limited to, the powers to engage in various types of Medicaid and estate planning. In the author's opinion, the standard Blumberg Form Power of Attorney is too limiting and restrictive, especially as to the potential need to make transfers of assets for estate and Medicaid planning purposes.

In drafting a power of attorney with broad gifting powers, it is imperative to consider the New York Court of Appeals decision in *In re Ferrara.*[1] The Court of Appeals in *Ferrara* reversed the decision of the Appellate Division, Second Department, and revoked gifts that were made under a power of attorney. The Court of Appeals, in finding for the Salvation Army, held that all gifting must be in the ". . . best interest of the principal." Additionally, with respect to the *Ferrara* case, it should be noted that on April 15, 2008, the Appellate Division, Second Department, affirmed the decree of the Rockland County Surrogate's Court denying the request for a hearing on the issue of whether gifts of the decedent's property made by one heir to himself were in the best interest of the principal under the power of attorney.[2] Additionally, the Appellate Division, Second Department, remitted the matter to the Surrogate's Court of Rockland County for the computation of prejudgment interest to be awarded to the Salvation Army. The Court opined that the Salvation Army's possession of property as residuary beneficiary of the decedent's estate was "interfered with."

The selection of the individual or individuals who will be the named agent(s) under the power of attorney is of great importance. The individual selected must be someone the principal has a great deal of trust and confidence in. If the attorney-in-fact will have broad powers, including broad gifting powers, the principal should give serious consideration to the appointment of two attorneys-in-fact who will be required to act jointly. In spite of the potential administrative difficulties it may cause by requiring that two agents execute all documents, having at least two agents will create a system of checks and balances, and help reduce the likelihood of financial abuse, fraud and self dealing.

(b) ***Execute a health-care proxy,*** wherein a health-care agent is selected. The individual selected is permitted by New York law to make all health-care decisions when the principal is no longer able to make these decisions. The health-care proxy can specify which treatments and medical care one wishes and does not wish to have administered. Under New York law, only one health-care agent at a time can be designated in the health-care proxy.[3] The principal should take the time to tell his or her agent exactly what his or her wishes are with respect to medical care, and specifically end-of-life decisions, e.g., hydration and the use of ventilators and respirators. One should provide a copy of the health-care proxy to his or her physician.

(c) ***Execute a living will,*** wherein one is able to state his or her wishes not to be kept alive by extraordinary measures. While a living will is not statutorily recognized in New York, it is still additional written evidence of one's wish not to be kept alive by extraordinary measures.

(d) ***Execute a Do Not Resuscitate Order (DNR),*** which is a document executed by the individual and his or her physician. The DNR can explicitly specify the circumstance wherein an individual does not want to be resuscitated. The author often recommends that the client keep a pocket DNR in his or her wallet and purse, and on the refrigerator and provide copies to loved ones. It is especially helpful in cases where the client suffers from a chronic and persistent life-threatening illness.

(e) ***Execute a Burial Agent Designation Form*** wherein one is able to appoint an agent to dispose of his or her remains. The form permits specifying the location of burial, any wishes regarding cremation, and even the location of the wake and funeral.[4]

The execution of these documents will go a long way in obviating the possibility of litigation regarding end-of-life and burial decisions, by designating a family member or trusted friend to make financial and/or health-related decisions if the individual is no longer able to do so.

If, because of alleged financial, physical or emotional abuse, it becomes necessary or inevitable that legal action be undertaken, in most instances Article 81 of the Mental Hygiene Law for the appointment of a guardian will be the appropriate legal proceeding. Typically, allegations are made that a physically or mentally incapacitated person is the victim of financial or physical abuse. The Petition in the Article 81 guardianship proceeding will seek to obtain control over the person and property of the alleged victim of abuse by seeking a determination that the person is an incapacitated person as defined by Article 81. The Petition can also seek to void documents and contractual arrangements entered into by the alleged incapacitated person.

As part of an Article 81 proceeding, the courts have voided powers of attorney, health care proxies, trusts, and wills executed by the incapacitated person and have also voided transfers of assets made by the incapacitated person.[5] The courts as part of an Article 81 proceeding have also voided a marriage as a contractual arrangement pursuant to Article 81.29(d) of the MHL.[6]

In many cases, because of ongoing financial abuse and other alleged improprieties, it may be necessary that as part of the Article 81 proceeding a Temporary Restraining Order (TRO) be issued. Section 81.23(b)(2) of the MHL specifically authorizes the issuance of a TRO upon a showing that if a TRO was not issued, the property of the alleged incapacitated person (AIP) would be dissipated to the financial detriment of the AIP. However, pursuant to the MHL the Court is not permitted to issue a TRO against the AIP. Furthermore, where the TRO provides for a restraining notice, the person with custody or control over the person or property of the IP or the AIP is forbidden to make or suffer any sale, assignment, transfer or inheritance with any property of the IP or the AIP except pursuant to the order of the court.[7]

Clearly, an Article 81 proceeding with a properly drafted TRO will help put a halt to ongoing financial abuse during the pendancy of the Article 81 proceeding. In fact, Section 81.23(b) of the MHL is sufficiently broad to be applied to restrain the use of a power of attorney during the pendency of the Article 81 proceeding. Additionally, a TRO as part of an Article 81 proceeding can be utilized to prevent the alleged abuser (both financial and physical) from having any contact with the IP or AIP during the pendency of the Article 81 proceeding. In a recently litigated matter, the author was able to have the court issue a TRO enjoining the alleged abuser from living at the home of his alleged victims and restraining him from visiting the home of his alleged victims.

An additional potential benefit of commencing an Article 81 proceeding is the possibility under Section 81.23(a)(1) of the MHL that the court may appoint the petitioners as Temporary Guardians for the AIP. Section 81.23(a)(1) specifically authorizes the appointment of a Temporary Guardian ". . . upon showing of danger in the reasonably foreseeable future to the health and well being of the alleged incapacitated person, or danger of waste, misappropriation or loss of property of the alleged incapacitated person."

The powers granted to the Temporary Guardian can be fashioned to address the exigencies and needs of each particular case and the AIP involved. In requesting the court to appoint a Temporary Guardian, it is imperative to document the existence of an emergency and that the powers requested in light of the emergency are the least restrictive alternative.

Based on the foregoing considerations, it is clear that taking appropriate steps to prevent clashes by family members over an incapacitated person's assets is imperative. However, if a clash is inevitable Article 81 of the Mental Hygiene Law will serve as a powerful vehicle to help rectify any wrongdoing.

Endnotes

1. 7 N.Y.3d 244, 852 N.E.2d 138, 819 N.Y.S.2d 215 (2006).
2. 2008 NY Slip Op. 3455.
3. NYS Public Health Law § 2981.
4. NYS Public Health Law § 4201.
5. *In re Loretta I.*, 34 A.D.3d 480 (2006); *In re Rita R.*, 26 A.D.3d 502 (2006); *In re Shapiro*, N.Y.L.J., April 19, 2001 (Sup. Ct., Nassau Co.).
6. *In re Sierra*, 15 Misc. 3d 1116A (Sup. Ct., Westchester Co. 2007).
7. NYS MHL § 81.23(b)(4).

Anthony J. Enea, Esq. is a member of the firm of Enea, Scanlan & Sirignano, LLP of White Plains, New York. He is the Treasurer of the Elder Law Section of the New York State Bar Association and is the Editor-in-Chief of the *Elder Law Attorney*, a quarterly publication of the Elder Law Section of the New York State Bar Association. Mr. Enea is Co-Chair of the Guardianship Committee of the Elder Law Section of the New York State Bar Association, and is also a member of the Guardianship Court Committee of the Office of Court Administration of the State of New York.

The New U.S. Expatriation Tax

By G. Warren Whitaker

Republicans and Democrats in Congress and the President cannot agree on health-care reform, estate tax repeal or conduct of the war in Iraq. But they are able to reach consensus regularly on one issue—expatriation. For the third time in 12 years, the U.S. has amended its tax laws regarding expatriates—people who give up U.S. citizenship, or who give up a permanent residence visa ("green card") after holding it for at least 8 of the prior 15 years.

The popular notion of American billionaires expatriating by the hundreds to avoid U.S. taxes is an urban legend: according to the Treasury's own studies, more than 99% of the 4,000 or so persons who give up U.S. citizenship each year have an overwhelming prior relationship to another country. They are naturalized citizens returning home, persons born in the U.S. to a non-U.S. family and then raised abroad, or Americans who have lived outside the U.S. for many years. (This is obviously even more true for those who have never become U.S. citizens but have only obtained a U.S. green card.) The real offshore tax drain comes not from people who legally expatriate, but from the thousands who leave the U.S. every year without giving up their citizenship or green card and simply stop paying their U.S. taxes. However, Congress has chosen to focus its energy on the small number of people who comply with all the legal formalities to change their citizenship.

The new law (I.R.C. § 877A) provides that for "covered expatriates" who expatriate after the date of enactment (June 17, 2008), an immediate mark-to-market tax on all appreciation in the value of a covered expatriate's *worldwide* assets is imposed.

Gone (for persons expatriating after enactment of the new law) is the 10-year tail of U.S. income, gift and estate taxation of a broad list of U.S.-source income and U.S.-situs assets under I.R.C. § 877. Gone also is the prior rule that a covered expatriate who spends 30 days or more in the U.S. in any of the 10 years following expatriation will be taxed on his or her worldwide income and assets for that year. (This 30-day rule probably did more than anything else to deter expatriation over the past few years.) The prior provisions still apply for up to 10 years to persons who expatriated before June 17, 2008.

A "covered expatriate" is a person who, after the date of enactment, either (i) gives up U.S. citizenship, or (ii) gives up a U.S. lawful permanent residence visa (green card) after holding it for all or part of at least 8 out of the prior 15 calendar years. To be a "covered expatriate," the person must also meet one of the three tests in I.R.C. § 877(a)(2):

(A) his or her average net income tax liability for the prior five years exceeds $139,000 (indexed each year for inflation);

(B) his or her net worth (including interests in trusts) exceeds $2 million; or

(C) he or she fails to certify under penalty of perjury compliance with all federal tax obligations for the previous five years.

There are certain exceptions, which are broader than under prior law. They are:

(i) persons who were dual citizens of the U.S. and another country from birth, are tax residents of that country at the date of expatriation, and have not been U.S.-income-tax residents for more than 10 of the past 15 years; and

(ii) persons who expatriate before age 18½ and have not been U.S.-income-tax residents for more than 10 years.

The tax is computed as though the expatriate had sold all assets for their fair market value the day before expatriating. Losses are taken into account, but the "wash sale" rules of Section 1091 (providing for non-recognition of loss in the case of a sale and purchase within 30 days) do not apply.

There is an exemption of the first $600,000 of net appreciation (to be indexed annually for inflation). In addition, the covered expatriate may elect to defer the tax on any asset until the asset is sold, or until the death of the covered expatriate, if sooner. A bond must be posted or other satisfactory security arrangement made for any asset as to which deferral is elected.

For a person who moved into the U.S. and is now expatriating, the basis of assets for purposes of the mark-to-market tax is the fair market value on the date he or her first became a U.S. resident. This differs from the normal U.S. income tax rule, which is that the taxpayer has acquisition basis even if the asset was received before he or she became a U.S. resident.

Deferred compensation items and certain tax-deferred retirement accounts are exempt but are subject instead to their own special rules, generally to a withholding tax of 30% on distributions to the covered expatriate.

Beneficial Interests in Trusts: Grantor trusts of which the covered expatriate is the grantor are subject to the mark-to-market tax. For non-grantor trusts (both domestic and foreign) of which the covered expatriate was a beneficiary immediately before expatriation, the section imposes a withholding requirement on the trustee of 30% on the "taxable portion" of all distributions to the covered expatriate. The "taxable portion" of a distribution is the portion that would have been includible in gross income if the expatriate were still a U.S. person. In addition, if a non-grantor trust distributes appreciated assets to a covered expatriate beneficiary, the trust is taxed by the U.S. on the gain.

Many issues remain regarding these trust provisions, including:

- Does the withholding apply to a covered expatriate who is only a contingent beneficiary of a non-grantor trust (probably not) or who is one of a large number of potential discretionary beneficiaries (probably), or who is not currently a beneficiary but may be added as a beneficiary later (probably not absent regulations)?
- How will the withholding tax be enforced against foreign trustees of foreign trusts, with only foreign assets and foreign beneficiaries, who will be subject to these withholding requirements and payment of capital gains tax on distributions of appreciated assets for the duration of the trust?
- How will interests in Charitable Remainder Trusts, Grantor Retained Annuity Trusts, Qualified Personal Residence Trusts and other estate-planning vehicles be treated?

New Transfer Tax: The new law also enacts a new I.R.C. § 2801, which imposes a special transfer tax on all covered gifts and bequests from a covered expatriate to a U.S. citizen or resident. The rate of tax is the highest estate tax rate under I.R.C. § 2001 or, if higher, the highest gift tax rate under I.R.C. § 2502(a) (currently both are 45%). The amount of the annual exclusion under I.R.C. § 2503(b) (currently $12,000) is exempt, and gifts and bequests that are subject to U.S. estate tax, or that pass to a surviving spouse or a charity, are not covered gifts. (If the spouse is not a U.S. citizen, the bequests must pass to a Qualified Domestic Trust, and gifts will qualify for the exception only up to $128,000 per year.)

Covered gifts and bequests to a U.S. trust are subject to the tax. If covered gifts are made to a foreign trust, distributions from that trust to a U.S. person are subject to the tax.

A covered expatriate is one who expatriates after enactment of the law and who, *at the time of such gift or immediately before death*, meets the $2 million or $139,000 threshold described above. (It is certainly unusual that the time for applying the asset or income test is the time of the gift or at death, which could be decades after expatriation.) There is no $1,000,000 gift tax exemption or $2,000,000 estate tax exemption, but there is still a marital deduction and credit for foreign tax paid.

The reporting requirements of Section 6039G are amended to apply to covered expatriates under new Section 877A. However, it appears that reporting is only required for the year of expatriation, and not for the following 10 years, since the 10 year "tail" provisions have been repealed.

Who Gains? Who Loses? Whether an expatriate is better or worse off than under prior law will depend on his or her individual facts.

Worse off is the expatriate who owns significant appreciated property with non-U.S. situs. Under prior law, such property would not have been taxed by the U.S. either at the time of expatriation or upon later sale. Now there will be an immediate capital gains tax (normally at a 15% rate if held for over a year) unless deferral is obtained, with security posted, until sale or death. The fair market value will have to be obtained, and traditional domestic valuation techniques (minority interest, illiquidity and blockage discounts, etc.) may be used.

Better off is the person who has just had a liquidation event and holds only cash, in whatever amount. There is no expatriation tax on cash and other assets that have no imbedded appreciation. The expatriate can immediately reinvest in U.S. stocks and bonds (using a holding company to protect stocks from estate tax if appropriate) without waiting 10 years to make such investments, as was necessary to avoid U.S. tax under prior law. He or she can enter the U.S for at least 121 days per year and perhaps more without being subject to worldwide taxation, as opposed to 29 days under prior law. And he or she no longer has onerous U.S. information filings for the next 10 years, as under prior law.

Worse off is the expatriate who wants to give or bequeath property to U.S. relatives after expatriating. Use of the $1,000,000 gift tax exclusion to make gifts to those relatives before expatriating may be advisable.

Better off are dual citizens of the U.S. and another country from birth who are tax residents of the other country on the date of expatriation, and have not been U.S. income tax residents for more than 10 of the past 15 years. These people are exempt from the current expatriation tax but would in most cases have been covered under the prior law, which had a much more narrow exemption.

G. Warren Whitaker is a partner at Day Pitney LLP in New York City, focusing on international and domestic estate and trust planning. He is a former chair of the Section.

Recent New York State Decisions

By Ira Mark Bloom and William P. LaPiana

ATTORNEYS

Dead Man's Statute Does Not Apply in Disciplinary Proceeding

After client's death, lawyer took for himself monies in his escrow account which represented the down payment on the purchase of property owned by the client. Approximately one year after client's death, her daughters, as co-administrators of the estate, filed a complaint with the appropriate disciplinary committee. The referee hearing the charges allowed the lawyer to testify as to conversations with the decedent in which she acknowledged that the lawyer had performed services for her for many years for which she had never received a bill and told the lawyer to reimburse himself from the down payment. The referee overruled the disciplinary committee's argument that the Dead Man's Statute, CPLR 4519, barred the lawyer's testimony, ruling that because the disciplinary proceeding was not "against the executor, administrator, or survivor of a deceased person," the statute did not apply. The Appellate Division overruled the referee because, if the lawyer's testimony were admitted and found persuasive, it would adversely affect the co-administrators by preventing any order that the lawyer make restitution.

The Court of Appeals granted leave to appeal and reversed. The Court agreed with the referee that the disciplinary proceeding was not the sort of proceeding described in the statute and also held that the statute does not exclude testimony contrary to the interests of the decedent's successor in a future proceeding that may or may not occur. *In re Zalk*, 10 N.Y.3d 669, 862 N.Y.S.2d 305, 892 N.E.2d 369 (2008).

DEAD BODIES

Surviving Spouse Disqualified from Making Burial Arrangements

Decedent's mother petitioned to be allowed to make burial arrangements for her daughter and was opposed by daughter's husband. Daughter's death was under investigation as a homicide. In deciding in favor of mother's petition, the Court gave great weight to testimony that the decedent hated and feared her husband, concluded that the couple was "separated" and "estranged" "in every practical sense of those words," and held that husband was not decedent's surviving spouse for purposes of Public Health Law § 4201. Although the statute does not define "surviving spouse," the Court found no indication that by enacting the statute the legislature intended to alter prior case law which excludes from the definition of surviving spouse those separated or estranged from their spouses at time of that spouse's death. In addition, the evidence of decedent's fear of her husband and her desire not to be near him meant that even if the husband is regarded as the surviving spouse he is disqualified under the statute as "not competent" to control the disposition of decedent's remains. *Maurer v. Thibeault*, 20 Misc. 3d 631, 860 N.Y.S.2d 895 (Sup. Ct., Cortland Co. 2008).

GUARDIANS

Guardian Lacks Authority to Challenge Accounting of Incapacitated Person's Lifetime Trust

Corporate successor trustee of incapacitated person's revocable trust who is also attorney-in-fact for the incapacitated person brought a proceeding to settle its account as trustee. The trustee was compelled to account on the petition of the guardian of the person of the incapacitated adult, which the Appellate Division granted because the guardian had a legitimate need for information about her ward's financial situation to facilitate her making decisions in the best interest of her ward.

On submission of the accounting, Supreme Court appointed a guardian *ad litem* who filed objections, as did the guardian of the person. Supreme Court dismissed the guardian of the person's objections as beyond the scope of her authority. On appeal the Appellate Division affirmed, stating that its prior order was predicated on the guardian's need for information which was satisfied by submission of the accounting. The guardian's authority does not extend to her ward's financial affairs. In addition, given the guardian's "litigious history" in relation to the trust and her ward, Supreme Court was correct to appoint a guardian *ad litem* to protect the ward's interest in the trust. Finally, the guardian's status as remainder beneficiary of the trust does not give her standing to challenge the accounting while the creator of the trust is alive. *In re*

Mary XX, 52 A.D.3d 983, 860 N.Y.S.2d 656 (3d Dep't 2008).

GUARDIANS *AD LITEM*

Guardian May Retain Medical Expert at Estate's Expense

Guardian *ad litem* for infant distributees filed objections to probate of decedent's will, as did adult distributees. The guardian petitioned the court for permission to hire a medical expert at the estate's expense in order to help establish decedent's lack of capacity, or that the will was the product of insane delusion, and requested $40,000 to pay the expert for consultation and a review of the decedent's medical records. The Court held that under SCPA 2111 it has authority to authorize advance payment of a guardian *ad litem*'s fees and also has discretion in fixing the amount of the guardian's fee and disbursements. The Court then granted the petition, finding that hiring the expert would further zealous representation of the guardian's wards and that the possibility that the adult objectants might benefit from the expert's testimony was irrelevant. The Surrogate also noted that the value of the estate is estimated to be between $26 million and $35 million. *In re Greene*, 20 Misc. 3d 599, 860 N.Y.S.2d 396 (Sur. Ct., Westchester Co. 2008).

IN TERROREM CLAUSE

Deposition of Testator's Former Attorney Violates Clause

The Appellate Division has affirmed Surrogate Lopez-Torres' holding that the deposition of the testator's former attorney violates an *in terrorem* clause prohibiting any attempt to contest the will "in any manner." The Court agreed with the Surrogate that a deposition of the testator's former attorney does not fall within the safe harbor provisions of EPTL 3-3.5 and SCPA 1404, which make no mention of the testator's former attorney and refer only to the attorney who prepared the will in addition to the attesting witnesses, the nominated executor and the proponents. *In re Singer*, 52 A.D.3d 612, 859 N.Y.S.2d 727 (2d Dep't 2008).

INHERITANCE

Parent Disqualified from Wrongful Death Proceeds under EPTL 4-1.4

Child died from injuries sustained in a motor vehicle accident while she was a passenger in a car driven by her father, who fell asleep at the wheel. Father had also failed to secure the child in a safety seat or otherwise properly secure her. Child's mother settled the child's tort action against her father, who had died in the meantime. The recovery was allocated to the cause-of-action for conscious pain and suffering. Mother sought to disqualify father's estate from receiving any part of the settlement.

The Court dismissed the mother's reliance on *Riggs v. Palmer* because the father's wrongful conduct was not criminal in nature. The Court also found that the father's negligent acts did not amount to abandonment under EPTL 4-1.4(a)(1) and that EPTL 4-1.4(a)(2) was not applicable since it deals with parents whose rights have been the subject of proceedings in family court. However, the mother's allegations that father never made any effort to be part of decedent's life and never provided any financial support were unanswered by the representative of father's estate, and therefore accepted as true to establish that father abandoned or failed to support decedent so that he is disqualified as a distributee under EPTL 4-1.4(a)(1). *In re Wright*, Misc. 3d, 859 N.Y.S.2d 864 (Sur. Ct., Westchester Co. 2008).

TRUSTS

Equitable Deviation Applied to Allow Sale of Specifically Disposed of Co-operative Apartment

Decedent's will made a specific bequest of his co-op apartment into trust, directing the trustee to maintain the apartment as a residence for his granddaughter and making all expenses related to the apartment the responsibility of the beneficiary. The trust further provided that the trustee could sell the apartment with the beneficiary's consent and invest the proceeds in another residence for the use of the beneficiary. After granddaughter's death, any apartment held in trust is to be sold and the proceeds added to another trust created under the will, income from which is to be paid in equal shares to granddaughter and to a grandson. The trustee may also invade principal for a beneficiary's health, support or maintenance. On the death of the two grandchildren, the trust property is to be distributed to the descendants of a son of the decedent. At the time of decedent's death, there was one remainder beneficiary who was a minor.

The executor learned that the co-op board would not approve a transfer of the apartment to the trust. In addition, the executor concluded that the co-op board would not approve the beneficiary as a tenant in any event because it was unlikely that she would be able to pay the expenses related to the apartment. The executor asked the beneficiary to approve sale of the apartment but never received a definitive response. The executor therefore petitioned the Court to approve a modification of the terms of the trust created to hold the apartment.

The Court found that the testator's intention to provide the granddaughter with a place to live was clear and also found that the testator did not foresee the beneficiary's inability to maintain the apartment or the co-op board's refusal to allow the transfer to the

trust. These circumstances justify an equitable deviation from the trust terms. The Court authorized the sale of the apartment with the net proceeds distributed to the trust after the second trust is reimbursed for funds used to pay for expenses related to the apartment. In addition, there must be an evidentiary hearing to determine if the granddaughter is able to pay the expense of upkeep of a substitute residence. If she cannot, the trust is to be combined with the second trust of which granddaughter is a beneficiary. *In re Carniol*, 20 Misc. 3d 887, 861 N.Y.S.2d 587 (Sur. Ct., Nassau Co. 2008).

Identification of Children as "Contingent Beneficiaries" Means Interest Is Not Transmissible

Lifetime trust named the creator as beneficiary for her life and on her death directed that the trust property passes in equal shares to creator's three children, identified by name, and described as "contingent beneficiaries." One of the children predeceased the creator and on the creator's death his children sought to have one-third of the trust property distributed to them. The Appellate Division affirmed the judgment of Supreme Court in favor of the two surviving children based on the application of EPTL 2-1.14, which gives a failed gift of a trust remainder to the other remainder beneficiaries, if any. The Court apparently assumed that the description of the children as "contingent beneficiaries" meant there their interests were contingent on surviving the creator of the trust. *Wagner v. Desalvio*, 52 A.D.3d 504, 860 N.Y.S.2d 146 (2d Dep't 2008).

PERPETUITIES

Right of First Refusal in Tenants-in-Common Does Not Violate Rule

Plaintiff brought a cause of action for partition of property in which he held a one-third interest as tenant-in-common with two other tenants-in-common who also hold undivided one-third interest in the property. About a year after acquiring his interest, plaintiff and the other tenants-in-common entered into an agreement that entitled each party to occupy a specified portion of the premises and also gave each party a right of first refusal with respect to the sale by any other co-tenant. Supreme Court granted the motion for partition, holding that the right of first refusal violated the Rule Against Perpetuities and therefore did not bar the partition action.

The Appellate Division reversed, holding that precedents stating that rights of first refusal related to condominium developments are outside of the rule are applicable because the property is effectively operated as a condominium with each co-tenant controlling his respective space and sharing control over common areas. Just as in formal condominium developments, the right of first refusal encourages productive use of the property by giving the co-tenants an incentive to improve their occupied spaces, and it is clear that the entire agreement was designed to keep the property in the hands of the co-tenants or their families. In addition, the right of first refusal does not violate the common law prohibition on unreasonable restraints on alienation. Partition is incompatible with the rights of first refusal, at least during the 30-day period during which the right may be exercised. *Sanko v. Mark*, 52 A.D.3d 225, 859 N.Y.S.2d 83 (1st Dep't 2008).

Ira Mark Bloom is Justice David Josiah Brewer Distinguished Professor of Law, Albany Law School. William P. LaPiana is Rita and Joseph Solomon Professor of Wills, Trusts and Estates, New York Law School. Professors Bloom and LaPiana are the current authors of Bloom and Klipstein, *Drafting New York Wills* (Matthew Bender) (Bloom as principal author, LaPiana as contributing author).

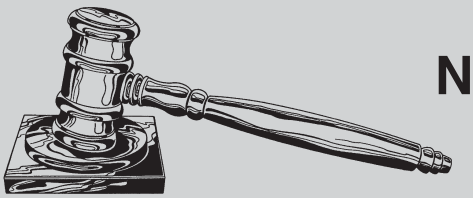
Trust and Estates Law Section Golf Tournament at the Broadmoor, Colorado Springs

Brown Brothers Harriman Trust Company LLC sponsored the event. Many teams participated and scoring was close. The winning teams were:

1st Place Team: Meg Gaynor
Tom Loizeaux
Peter Bronstein

2nd Place Team: Brandon Sall
Harvey Besunder
Larry Keiser

In addition, Rich Miller and Clover Drinkwater won Closest to the Pin contest. Please note that another tournament is scheduled for the Amelia Island meeting in March.



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

By Ilene Sherwyn Cooper

Construction of Decedent's Will

In an uncontested proceeding, the petitioners/trustees requested that the decedent's charitable trust be reformed and construed to resolve certain ambiguities within the trust agreement.

The decedent created a charitable remainder unitrust several years prior to his death. One of the trustees was also the attorney-draftsman of the instrument. Subsequent to the decedent's death, a charitable foundation was created for the benefit of three charities. Pursuant to Paragraph D of Article VIII of the trust, the foundation was to benefit the three charities in stated percentages of unequal amounts. Pursuant to Paragraph F of that same article, the trustees were directed to make specified payments to the charities for a 30-year period, and thereafter to commence making additional distributions so that all principal and income of the trust was fully distributed to the charities within 40 years after the decedent's death. However, as compared to Paragraph D, Paragraph F required the trustees to distribute or apply the funds thereunder in equal shares to the charities.

The petitioners maintained that the discrepancy was due to a scrivener's error. According to the draftsman, when he prepared the final draft of the trust instrument containing the percentages set forth in Paragraph D, he inadvertently failed to make corresponding changes in Paragraph F. Petitioners thus requested that Paragraph F be reformed to conform with the percentages in Paragraph D.

In granting the requested relief, the Court considered the extrinsic evidence offered by the draftsman, opining that an ambiguity was created by the inconsistent provisions of the instrument. Based upon this evidence, the Court held that it was the decedent's intent to provide for distributions in the percentages set forth in Paragraph D.

Application of Merrill Lynch Trust Company and Martin W. Ronan, Jr. for Construction of Charitable Trust, N.Y.L.J., Aug. 12, 2008, p. 33 (Sur. Ct., N.Y. Co.) (Surr. Glen).

Disclosure Pursuant to SCPA 2307-a

In an uncontested probate proceeding, the Court was confronted with the issue of whether the acknowledgment of disclosure submitted by the nominated attorney-fiduciary was in compliance with the dictates of SCPA 2307-a.

In support of his appointment, the petitioner submitted an acknowledgment executed by the decedent. The Court noted that while the statements contained in the acknowledgment did not comply with the current requirements of SCPA 2307-a, they did appear to comport with those required by the statute at the time the acknowledgment was executed. Citing *In re Griffin*, 16 Misc. 3d 295, the Court recognized that the acknowledgment was sufficient, despite its failure to comply with the statute effective on the decedent's date of death.

Nevertheless, the Court noted that an essential element missing from the acknowledgment was the signature of the witness to the instrument. In an effort to cure this defect, the petitioner submitted an affidavit from the attorney who supervised the execution of the propounded will, who alleged that he witnessed the execution of the acknowledgment of disclosure along with the other two attesting witnesses. An affidavit of one of the attesting witnesses was also submitted, which alleged that she observed the decedent execute the disclosure statement.

The Court opined that while substantial compliance with the model disclosure provided by the statute will entitle an attorney-fiduciary to full commissions, omission of any of the material requirements of the acknowledgment will deprive an attorney-fiduciary of the full statutory rate. To this extent, the Court held that inasmuch as both model statements included in the statute contained a line for the witness' signature, the signature was a substantial component of the statutory requirement that could not be overlooked. Because the statute failed to provide any remedy for failure to include the signature of the witness to the statement, the Court found, under the circumstances, that the petitioner could not utilize the affidavits of witnesses obtained post-mortem to rectify the omission, and that his commissions should be reduced to one-half.

In re Estate of Wrobleski, N.Y.L.J., June 4, 2008, p. 41 (Sur. Ct., Kings Co.) (Surr. Johnson).

Disclosure Pursuant to SCPA 2307-a

In two uncontested probate proceedings, the Court had occasion to review the disclosure statements pro-

vided by the attorney-draftsmen fiduciaries under the propounded will.

The facts of the first case (*Moss*) revealed that the decedent executed a will in which she left the bulk of her estate to her issue and named as executors a friend, who predeceased her, and the attorney-draftsman of the instrument. At the time she executed her will, the decedent signed a disclosure statement under SCPA 2307-a. Two years later the decedent executed a codicil to her will that did not involve any fiduciary appointments. At the time the codicil was executed, no disclosure statement was again signed. Accordingly, the issue before the Court was whether the disclosure statement is effective to shield the attorney-draftsman from a reduction of commissions pursuant to SCPA 2307-a.

Upon review of the legislative history and purpose of the statute, and upon consideration of the fact that the codicil did not involve any fiduciary appointments, the Court concluded that the circumstances surrounding the execution of the said instrument did not require that a further disclosure statement be procured from the testator. Therefore, full statutory commissions were allowed to the named executor.

In the second case before the court (*Hess*), the Court reached a different result. There, the record revealed that the decedent executed a will in which he left the bulk of his estate to his three children equally, and named one of his children and a lawyer to serve as executors. He also executed two codicils subsequent to the date of the will. While the first codicil made no changes in the fiduciary appointments, the second codicil changed the original fiduciary designations by naming as executors the draftsman of the instrument and two of the decedent's children.

At the time he executed his will, the decedent executed a disclosure statement that conformed to the requirements of SCPA 2307-a as then in effect. His signing of such statement was witnessed by the attorney-draftsman of the will and the two codicils, who was a partner of the named attorney-fiduciary in the propounded instrument and a named fiduciary in the second codicil.

The question before the Court was whether the partner was qualified to serve as a witness to the disclosure statement for purposes of the statute. The Court noted that under the express terms of the statute, a nominated executor is affiliated with the draftsman if the two are "affiliated." That being the case, the Court opined that in view of the affiliation between the attorney-executor and the draftsman/partner, the disclosure statement was not "witnessed" in accordance with the purpose of the statute, but rather a nominee of the attorney-fiduciary. The Court observed that the law universally requires that a witness to a deed or other legal transaction be disinterested in the event. Thus, the Court held that because of the partner's relationship with the named attorney-fiduciary, he was not independent, and could not serve as a witness to the disclosure statement. The commissions of the attorney-fiduciary were therefore limited to one-half as provided in the statute.

In re Estate of Moss, N.Y.L.J., Sept. 24, 2008, p. 40 (Sur. Ct., N.Y. Co.) (Surr. Roth).

Disinterment of Remains

The wife of the decedent sought to disinter his remains after 13 years of internment. The wife contended that she wanted to relocate the deceased to another gravesite inasmuch as she and her daughter were unable to visit the grave as often as they wished, and wanted to have a family plot in New Jersey. The application was opposed by the decedent's son, who argued that his father had chosen to be buried where he was along with other family members and, in fact, had purchased the plot.

The Court opined that the final resting place of a deceased will not be disturbed unless "good and substantial reasons" are shown. Consideration in this regard is given to the wishes of the family in the disinterment petition, but more significantly, to the wishes of the decedent. Based upon these criteria, the Court denied the application, finding that it was motivated for the convenience of the petitioner rather than a desire to satisfy the decedent's wishes.

Coraggio v. Coraggio, N.Y.L.J., Sept. 11, 2008, p. 28 (Sup. Ct., Richmond Co.) (McMahon, J.).

Due Execution

After a non-jury trial of a contested probate proceeding, the Court held that the propounded instrument was not duly executed.

The record revealed that the propounded instrument was not executed under the supervision of an attorney. Instead, it was simply witnessed by three persons, who were accountants, and who testified they were familiar with the statutory formalities, having participated as attesting witnesses in other will executions.

Based upon the testimony of these witnesses, the Court concluded that none of them had a failed or imperfect memory of the execution ceremony, and that their testimony was contrary to the due execution of the instrument. The decedent did not ask any of the witnesses to act as such, and did not make it known to the witnesses that the instrument he was signing was his will.

Accordingly, probate of the instrument was denied on the grounds that its execution failed to comply with the provisions of EPTL 3-2.1.

In re Estate of DiPasquale, N.Y.L.J., Sept. 12, 2008, p. 25 (Sur. Ct., Rockland Co.) (Surr. Walsh II).

Eligibility of Named Fiduciary

In *In re Estate of Isaacson*, each of the named co-executors in the decedent's will—a nephew of the decedent, who was an attorney, and a distant relative of the decedent through marriage, who was also the attorney-draftsman of the instrument—objected to each other's appointment.

Pursuant to the pertinent provisions of the propounded instrument, the decedent devised and bequeathed his residuary estate in four equal shares: one, for the benefit of his sister, and three for the benefit of the living issue of each of his pre-deceased siblings. In addition to his will, the decedent executed a durable power of attorney naming his nephew as his attorney-in-fact.

The record revealed that prior to his death, the decedent was admitted to various medical facilities, where he remained until his demise. During this period, his nephew requested and received from the attorney-draftsman the original power of attorney in which he was named as the decedent's attorney-in-fact, and thereupon utilized same to transfer more than $500,000 from the decedent's accounts into joint accounts in his name and the decedent's. Thereafter, three checks amounting to $30,000 were drawn by the nephew from the account made payable to his father, his brother and his sister-in-law. Despite arguments by the nephew to the contrary, the Court found that the actions taken by him, as the decedent's attorney-in-fact, were detrimental to the decedent and his estate, and demonstrated improvidence and a want of understanding. Most particularly, as to the joint account, the Court found nothing in the record to substantiate any intention by the decedent to diminish his estate for his nephew's benefit or to benefit his nephew with the bulk of his assets. Rather, as evidenced by the propounded will, the Court found that the decedent desired to divide his estate equally among his sister and the issue of his pre-deceased siblings.

Further, the Court was concerned by statements by a non-lawyer/employee of the nephew's law firm, who testified at the hearing of the matter regarding alleged violations of the Code of Professional Responsibility committed by the nephew in sharing legal fees with him in cases he recommended to the firm.

Insofar as the attorney-draftsman's eligibility was concerned, the nephew alleged that he was unfit to serve due to alleged misstatements made in the change of address form filed with the Post Office in order to have the decedent's mail forwarded to the nephew's law firm. The Court held that the misstatements were of no consequence to counsel's qualification to serve, and that his actions to preserve the decedent's mail demonstrated that he was acting responsibly.

Based upon the foregoing, the Court disqualified the decedent's nephew from serving as executor of the decedent's estate pursuant to SCPA 707(1)(e), and the objections to the appointment of the attorney-draftsman were dismissed.

In re Estate of Isaacson, N.Y.L.J., June 23, 2008, p. 35 (Sur. Ct., Kings Co.) (Surr. Torres).

Examinations Pursuant to SCPA 2211

Before the Court in a trust accounting proceeding was a motion for a further deposition of the fiduciary, as well as to compel the production of documents, and a cross-motion for a protective order regarding the said examination.

The subject trust was established by the decedent during her lifetime for the purpose of creating an irrevocable family trust. The trust was to have been funded with a $1 million life insurance policy issued by The Hartford Insurance Company. Nevertheless, it appeared that the trust was never funded, as the account reflected schedules with zero balances. The objectants alleged, *inter alia*, that the accounting was deficient for failing to show any trust assets or any distributions from the trust.

During the course of discovery, Hartford produced documents relevant to the issues raised. As a consequence, objectants sought a further examination of the fiduciary concerning the creation and administration of the trust, as well as the production of documents the fiduciary shared with the attorney-draftsman of the trust prior to the draftsman's deposition. Petitioner opposed and cross-moved for a protective order, arguing that he was previously deposed in a prior proceeding for a compulsory accounting, as well as in the pending accounting proceeding, pursuant to SCPA 2211. Further, petitioner maintained that the records objectants had recently obtained from Hartford could have been obtained by them prior to his examination, and that objectants' failure to obtain them sooner did not constitute "special circumstances" requiring that he be deposed again.

Objectants responded by asserting that they were not at fault for failing to obtain the Hartford records, and that the documents were directly relevant to the issues raised in the accounting proceeding. Moreover, they maintained that the attorney-draftsman's file was in the fiduciary's possession at the time of the initial document demand but their existence had not been disclosed until months later.

In assessing the motion and cross-motion, the Court reviewed the deposition of the fiduciary and noted that he was questioned in the compulsory accounting proceeding about cancelling the policy that had funded the trust and forwarding the check representing the cash-surrender value to the grantor. The fiduciary further testified about the funding of the trust, the payment of premiums on the insurance policy, and the factors contributing to the decision to cancel and surrender the policy.

The examination of the fiduciary pursuant to SCPA 2211 covered the same subjects. In addition, both examinations reflected that the fiduciary could not recall or did not know the specifics about some of these events.

The Court also examined the documents received by the objectants from Hartford, which included copies of the policy, the insurance application, internal memoranda, and cancelled checks.

Having considered these records, and the prior examinations of the fiduciary, the Court held that it was unclear whether there was "new material" that would justify a further examination of the fiduciary. Specifically, the Court found that petitioner's examinations thus far had delineated the circumstances surrounding the funding and distribution of the subject trust. Consequently, the Court denied the motion for a further examination of the fiduciary and granted the cross-motion for a protective order.

As for the additional documents requested, the fiduciary turned over the records sought during the pendency of the motion, thus rendering the issue moot.

In re Piecuch Family Trust, N.Y.L.J., July 23, 2008, p. 32 (Sur. Ct., Suffolk Co.) (Surr. Czygier).

Subpoenas

In *In re Estate of Cavallo*, the Court granted a protective order and quashed subpoenas issued by petitioner to objectants' counsel. Petitioner claimed that counsel possessed evidence regarding the mental capacity of the decedent, which was both material and relevant to the probate of his will. Nevertheless, the Court held that public policy mandated that counsel not be compelled to testify. Further, the Court found that petitioner had failed to demonstrate that no other means existed to obtain the information allegedly in the possession of opposing counsel, and that granting petitioner's request could place the objectants in the untenable position of having to defend a motion to disqualify their attorneys, who had represented them for more than seven years.

In re Estate of Cavallo, N.Y.L.J., May 16, 2008, p. 25 (Sur. Ct., Richmond Co.) (Surr. Gigante).

Summary Judgment

In a contested probate proceeding, the objectants appealed from an order of the Surrogate's Court, Fulton County, which granted summary judgment to the petitioners.

The record revealed that the decedent's will was offered for probate by the named executor, who was the decedent's live-in companion of nearly 30 years. Three of the decedent's four children objected to probate, claiming undue influence and fraud by the petitioner. After a substantial amount of discovery, the petitioner moved for summary judgment. The application was granted, and two of the objectants appealed.

On appeal, the objectants claimed, for the first time, that the decedent lacked testamentary capacity at the time the propounded will was executed. Although the Appellate Division held that the issue had not been preserved properly for appeal, it nevertheless concluded, based upon the uncontroverted deposition testimony of the attorney-draftsman-witness to the will, that at the time the decedent executed the propounded instrument the decedent was of sound mind and memory, was aware of the nature and extent of his property, and knew the persons who were the natural objects of his bounty. The Court held that the objectants had only provided bare assertions regarding the decedent's illiteracy and incapacity that were insufficient to raise a triable issue of material fact.

As to the issue of undue influence, the Court held that while the petitioner may have had the opportunity to exercise undue influence, objectants had not offered sufficient facts to prove that any undue influence was exerted. Petitioner had, indeed, demonstrated that she lacked motive to exercise undue influence since she had a sizable estate in her own right, most certainly as compared with the relatively small estate of the decedent. Furthermore, the Court found that petitioner did not participate in the drafting of the propounded will, and that the provisions of the instrument were rational, given the decedent's long-lasting relationship with the petitioner and his strained relationship with two of his children.

With respect to the issue of fraud, the objectants alleged that petitioner falsely induced decedent to leave his entire estate to her by promising him that she would execute her will in order to leave the bulk of her estate to two of his children. However, the record revealed that the petitioner executed a will on the same date as the decedent, and did in fact leave her estate as she had promised. Accordingly, the Court held that the objectants had failed to allege sufficient facts to prove fraud.

As a consequence, the order of the Surrogate's Court was affirmed.

In re Estate of Colverd, N.Y.L.J., June 23, 2008, p. 20 (App. Div. 3d Dep't).

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

Trusts and Estates Law Section

Financial Officer Position

The Trusts and Estates Law Section is looking for a member to be the Financial Officer for the Section. The responsibilities of the Financial Officer would include:

- Financial oversight, including budget forecasting and control; work with Section liaison on budget.
- Resource for Executive Committee to answer questions regarding Section finances and policies.
- Liaison with NYSBA Director of Finance (Kristin O'Brien) and NYSBA Section Accounting Coordinator (Vinnie Titus).
- Analyze Program income and expenses; assist Program and CLE Chairs in planning.
- Review and recommend charges and changes for dues, program fees, sponsors, new initiatives, etc.
- Review and recommend changes to guidelines for reimbursement of travel expenses and speaker honoraria consistent with NYSBA financial policies.
- Chair the Ad Hoc Committee on Budget Surplus.
- Recommend charitable contributions in conformance with NYSBA financial policies.

The appointment would be on non-officer track and a long-term commitment would be expected. The Financial Officer would receive an annual stipend in an amount set by the Executive Committee and reimbursement of necessary travel expenses.

The Financial Officer will report to and serve at the pleasure of the Trusts and Estates Law Section Chair with concurrence of the Executive Committee. If you have an interest in this position, please contact Elizabeth A. Hartnett, Esq. at ehartnett@mackenziehughes.com or Ira M. Bloom at ibloo@albanylaw.edu.

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The Trusts and Estates Law Section encourages members to participate in its programs and to contact the Section Officers or Committee Chairs for information.

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Electronic Filings
Joseph T. La Ferlita
Farrell Fritz PC
1320 RexCorp Plaza
Uniondale, NY 11556
jlaferlita@farrellfritz.com

Estate and Trust Administration
Linda J. Wank
Frankfurt Kurnit Klein & Selz PC
488 Madison Avenue, 9th Floor
New York, NY 10022
lwank@fkks.com

Estate Litigation
Barbara Levitan
Surrogate's Court, New York County
Law Department
31 Chambers Street, Room 401
New York, NY 10007
barbara.levitan@gmail.com

Estate Planning
Ian William MacLean
The MacLean Law Firm, P.C.
100 Park Avenue, 20th Floor
New York, NY 10017
ianwmaclean@maclean-law.com

International Estate Planning
Richard E. Schneyer
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New York, NY 10022
schneyer@thshlaw.com

Legislation and Governmental Relations
Michael K. Feigenbaum
Ruskin Moscou & Faltischek PC
1425 Reckson Plaza
East Tower, 15th Floor
Uniondale, NY 11556
mfeigenbaum@rmfpc.com

John R. Morken
Farrell Fritz PC
1320 RexCorp Plaza
Uniondale, NY 11556-1320
jmorken@farrellfritz.com

Life Insurance and Employee Benefits
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Bond, Schoeneck & King, PLLC
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Syracuse, NY 13202-1355
bhaynes@bsk.com

Membership and Relations With Local Bar Associations
Robert W. Constantine
HSBC Private Bank
One HSBC Center, 23rd Floor
Buffalo, NY 14203
robert.constantine@hsbcpb.com

Newsletter and Publications
Austin T. Wilkie
Holland & Knight LLP
195 Broadway
New York, NY 10007
austin.wilkie@hklaw.com

Practice and Ethics
Nora S. Anderson
Seth Rubenstein, PC
26 Court Street, Suite 1501
Brooklyn, NY 11242
rubensteinseth@yahoo.com

Surrogates Court
John G. Farinacci
Jaspan Schlesinger & Hoffman LLP
300 Garden City Plaza
Garden City, NY 11530-3324
jfarinacci@jshllp.com

Taxation
Deborah S. Kearns
Albany Law School
Law Clinic & Justice Center
80 New Scotland Avenue
Albany, NY 12208
dkearns06@aol.com

Technology
Gary R. Mund
Kings County Surrogate's Court
2 Johnson St., Room 212
Brooklyn, NY 11201-1802
garymund@aol.com

Ad Hoc Committee on Multi-State Practice
Andrea Levine Sanft
Paul Weiss Rifkind
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1285 Avenue of the Americas
New York, NY 10019
asanft@paulweiss.com

Executive Committee District Representatives

First District
Jonathan J. Rikoon
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919 Third Avenue
New York, NY 10022
jjrikoon@debevoise.com

Second District
James H. Cahill, Jr.
Cahill & Cahill PC
161 Atlantic Avenue, Suite 201
Brooklyn, NY 11201
james.cahilljr@verizon.net

Third District
Thomas J. Collura
Tuczinski Cavalier Gilchrist
& Collura PC
54 State Street, Suite 803
Albany, NY 12207
tcollura@tcgclegal.com

Fourth District
Bonnie McGuire Jones
Jones Wilcenski & Pleat PLLC
5 Emma Lane
Clifton Park, NY 12065
bjones@jwplaw.com

Fifth District
John S. King
Scolaro, Shulman, Cohen, Fetter
& Burstein, PC
507 Plum Street, Suite 300
Syracuse, NY 13204
jking@scolaro.com

Sixth District
John G. Grall
Levene Gouldin & Thompson, LLP
P.O. Box F-1706
Binghamton, NY 13902
jgrall@binghamtonlaw.com

Seventh District
Timothy Pellittiere
Woods Oviatt Gilman LLP
700 Crossroads Boulevard
2 State Street
Rochester, NY 14614
tpellittiere@woodsoviatt.com

Eighth District
Lisa J. Allen
Harris Beach PLLC
726 Exchange Street, Suite 1000
Buffalo, NY 14210
lallen@harrisbeach.com

Ninth District
Frank W. Streng
McCarthy Fingar LLP
11 Martine Avenue, 12th Floor
White Plains, NY 10606
fstreng@mccarthyfingar.com

Tenth District
Stephen B. Hand
Jaspan Schlesinger & Hoffman, LLP
300 Garden City Plaza
Garden City, NY 11530
shand@jshllp.com

Eleventh District
Howard F. Angione
80-47 192nd Street
Queens, NY 11423
angione@att.net

Twelfth District
Cormac McEnery
562 City Island Avenue
City Island, Bronx, NY 10464
cormac@cormacmcenery.com

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Editor

Austin T. Wilkie
Holland & Knight LLP
195 Broadway
New York, NY 10007
austin.wilkie@hklaw.com

NEW YORK STATE BAR ASSOCIATION
TRUSTS AND ESTATES LAW SECTION
One Elk Street, Albany, New York 12207-1002

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