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Trusts and Estates Law Section Newsletter

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

A Message from the Chair

Ronald J. Weiss

Each Fall, the New York Bankers Association holds a trust and investment conference in upstate New York. This year's conference was held at the Otesaga Resort Hotel in Cooperstown.[1] While famous as the home of the Baseball Hall of Fame, Cooperstown is a beautifully preserved village filled with charming houses, including several fine examples of Second Empire architecture, a style of architecture popular in the 1870s. And for a conference held in early October, the hills around Cooperstown were ablaze with autumn colors.

The Cooperstown area has special memories for me. The first estate I handled when I was a young trust officer with a bank in Albany was in Richfield Springs, a village about 25 miles north of Cooperstown. The decedent was a widow who had a life estate in a farm. The remainder was left to her husband's children from his first marriage. Besides the usual issues in an estate involving a second marriage, the widow had permitted a neighbor to mine gravel on the property, an activity about which the remaindermen had not been entirely pleased. Also, in the barn was a vintage (1952) Mercury coupe that I was told (and from the condition of the car believed) was literally only driven to church on Sundays. It was an interesting introduction to the world of trusts and estates.

I was invited to speak to the Bankers Association to explain our Section's goals and our legislative agenda for the coming year. The speaker before me included in her remarks an update on the bills that had recently passed the New York legislature. It was quite satisfying to hear her presentation, since our Section had drafted most of the bills that she discussed. The few that we had not drafted were bills that our Section had commented favorably upon. That record goes to demonstrate the wealth of activities the various committees of the Section perform, not only for the benefit of our members, but for the public in general. If you are not currently serving on a committee, I urge you to look at the list of committees in this *Newsletter*, and contact the Chair of the committee with which you would like to become involved.

In my remarks to the Bankers, I too went over our legislative accomplishments and the need for us,

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the Bankers and other interested constituents to work together to develop common goals and bring those goals to fruition. One of those goals, and one I recently charged the Elderly and Disabled and Estate and Trust Administration Committees to review, is to develop ways to improve the administration of supplemental needs trusts ("SNT").

Perhaps the decision that is emblematic of the issues a trustee of a SNT can face is Surrogate Glen's 2012 decision in *Matter of JP Morgan (Marie H.)*,[2] a case that, to quote Surrogate Glen, "raises important questions about the obligations of fiduciaries, including institutional trustees, to beneficiaries, with disabilities, of trusts that seek to provide for the welfare of those beneficiaries." While the Court's findings made it clear that the trustees—an institution and attorney—had failed to make themselves knowledgeable about their beneficiary's condition and needs, it also demonstrates some of the practical issues facing the trustee of a SNT. For example, how does a trustee who is not also the beneficiary's guardian gain access to the beneficiary's medical records? In addition, many trustees (both individuals and institutions) may not have the specialized knowledge needed to evaluate the beneficiary's medical and social needs and bring to bear the multitude of services required by a developmentally disabled beneficiary, such as was the situation in *Matter of JP Morgan (Marie H.)*. Should the trustee be permitted to retain the services of a social worker or other health care professional to assist the trustee of a SNT? Are the charges of those services a proper expense of the trust? Should the courts require that SNT trustees undergo specialized training? What will be the effect of all of this on the continued willingness of individuals, and especially institutions, to take on the trusteeship of a SNT? I think that these are important questions that our Section, together with our colleagues in the Elder Law and Special Needs Section and banking community, should begin to address.

For those of you who attended the Fall meeting in Rochester, it was great seeing you and I look forward to seeing you all at the Annual Meeting in New York City this coming January.

Ronald J. Weiss

Endnotes

1. Trivia questions (one for upstate and downstate members).

   Question 1: Cooperstown is situated on the south end of what lake?

   Question 2: The Otesaga was developed by Edward and Stephan Clark. What famous apartment house in Manhattan did the Clark family also develop?

   Answer to Question 1: Lake Otsego.

   Answer to Question 2: The Dakota.

2. 38 Misc. 3d 363, 956 N.Y.S.2d 856 (Sur. Ct., N.Y. Co. 2012).

Editor's Message

Keeping with our objective to incorporate topics relevant to all aspects of trusts and estates practice, this edition of the *Newsletter* contains articles on issues pertinent to the planner, litigator and administration attorney alike.

Richard Nenno's article offers an in-depth analysis of avoiding the taxation of trusts in light of New York's 2014-2015 budget legislation, while Stephen J. Krass and Lee A. Snow discuss a recent Tax Court decision on the estate taxation of a decedent's Madoff account. Purely on the litigation side, John R. Morken provides a thorough discussion of hearsay issues arising in Surrogate's Court proceedings, and Gary E. Bashian explains the basics of gifts and gifting in the context of contested matters.

Our next submission deadlines are December 5, 2014 for publication in Spring 2015, and March 12, 2015 for publication in Summer 2015.

Jaclene D'Agostino

Minimizing New York Income Taxes on Trusts After the 2014-2015 Budget Bill

By Richard W. Nenno

I. Introduction

New York fiduciaries pay a lot of New York income taxes. Thus, for 2010, 40,643 resident estates and trusts paid approximately $237 million of New York income tax and 3,100 nonresident and part-year resident estates and trusts paid approximately $28 million of such tax.[1] This is remarkable because clear rules for avoiding the taxation of trusts have existed for many years. This article will survey the pertinent authorities and offer planning ideas in the post-2014-2015 budget bill world.

II. Cliff's Notes Version

New York long has defined a "Resident Trust" as a trust established by a New York resident testator or trustor. Following the *Mercantile-Safe Deposit and Trust Company v. Murphy*[2] and *Taylor v. State Tax Commissioner*[3] decisions, the Department of Taxation and Finance ("Department") adopted a regulation in 1992 confirming their holdings (*i.e.*, that the trustee of a trust created by a New York testator or trustor is not taxable if the trust has no New York trustees, assets, or source income),[4] thereby creating an exemption for an Exempt Resident Trust. As covered in Section V, below, the Division of Tax Appeals subsequently rendered three decisions and the Department's Technical Services Division issued several advisory opinions indicating that Exempt Resident Trusts were not taxable, and the Department announced that trustees of such trusts did not have to file tax returns.[5] The Exempt Resident Trust exemption was codified in 2003, effective January 1, 1996.[6]

In 2010, Governor Paterson proposed to repeal the exemption for Exempt Resident Trusts,[7] but his proposal was not enacted. Later that year, though, the Department announced that, effective January 1, 2010, new and existing Exempt Resident Trusts must file informational returns.[8] That reporting requirement became statutory in 2014.[9]

The 2014–2015 New York budget bill[10] made two substantive changes to how New York taxes trust income. First, the bill requires New York State and New York City residents to pay tax on accumulation distributions (which, as noted below, might not include capital gains) from Exempt Resident Trusts[11] and imposes reporting requirements on the trustees of such trusts.[12] Second, the bill classifies incomplete gift nongrantor trusts as grantor trusts for New York State and New York City income-tax purposes.[13]

III. Early Cases

A. *Mercantile-Safe Deposit and Trust Company v. Murphy* (1964)—No Income Taxation of Inter Vivos Trust Funded During Life and by Pourover Solely Based on Domicile of Trustor and Income Beneficiary

In *Mercantile-Safe Deposit and Trust Company v. Murphy*,[14] the New York Court of Appeals, affirming an intermediate appellate court decision, held that the Due Process Clause of the United States Constitution prohibited New York from taxing the accumulated income of an *inter vivos* trust, funded in part during life and in part by a pourover of assets under the decedent's Will, that had no New York trustee, New York assets, or New York source income. Relying on the United States Supreme Court's 1929 *Safe Deposit and Trust Company v. Virginia* decision,[15] the court stated that:[16]

> The lack of power of New York State to tax in this instance stems not from the possibility of double taxation but from the inability of a State to levy taxes beyond its border.… [T]he imposition of a tax in the State in which the beneficiaries of a trust reside, on securities in the possession of the trustee in another State, to the control or possession of which the beneficiaries have no present right, is in violation of the Fourteenth Amendment.

Mercantile is significant because it confirmed that the presence of a New York resident trustor and current discretionary beneficiary did not justify the income taxation of a nonresident trustee.

B. *Taylor v. State Tax Commissioner* (1981)—No Income Taxation of Testamentary Trust Solely Based on Domicile of Testator

In *Taylor v. State Tax Commissioner*,[17] a New York intermediate appellate court considered whether New York income tax was payable on gain incurred upon the sale of Florida real property held in a trust created by the Will of a New York decedent. Although the Will appointed two nonresident individual trustees and a New York corporate trustee, Florida law prohibited the corporate trustee from serving so that only the nonresident trustees served with respect to the Florida real estate. The sale proceeds of the Florida property were held by the New York corporate co-trustee in an agency account in New York. The court held on due process grounds that New York could not tax the gain as follows:[18]

> New York's only substantive contact with the property was that New York was the domicile of the settlor of the trust, thus creating a resident trust. The fact that the former owner of the property in question died while being domiciled in New York, making the trust a resident trust under New York tax law, is insufficient to establish a basis for jurisdiction.

Note that depositing the sale proceeds of the Florida real estate in an agency account at a New York financial institution did not affect the outcome.

IV. Current Rules

A. New York State

1. General

In New York State, a trustee must file a return if it must file a federal return, had New York taxable income, had tax preference items for minimum income tax purposes in excess of the specific deduction, or was subject to a separate tax on lump-sum distributions.[19]

New York State treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[20] and the Empire State permits trustees of nongrantor trusts to take a distribution deduction.[21] In 2013, New York State taxed the New York taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 8.82% on such income over $1,029,250,[22] and the current rate schedule applies through 2017.[23]

New York State defines "Resident Trust" as a trust that is created by a New York State testator or trustor as follows:[24]

> (B) a trust, or a portion of a trust, consisting of property transferred by will of a decedent who at his death was domiciled in this state, or
>
> (C) a trust, or portion of a trust, consisting of the property of:
>
>> (i) a person domiciled in this state at the time such property was transferred to the trust, if such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable; or
>>
>> (ii) a person domiciled in this state at the time such trust, or portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

Given that taxation is based on the testator's or trustor's domicile, the statutory resident test does not come into play.[25]

The statute describes when a trust is deemed to be "revocable" or "irrevocable":[26]

> For the purposes of the foregoing, a trust or portion of a trust is revocable if it is subject to a power, exercisable immediately or at any future time, to revest title in the person whose property constitutes such trust or portion of a trust, and a trust or portion of a trust becomes irrevocable when the possibility that such power may be exercised has been terminated.
>
> A "Nonresident Trust" is a trust that is not a "Resident Trust."[27]

New York State taxes all New York taxable income of Resident Trusts[28] but only New York-source income of Nonresident Trusts.[29] Trustees must make estimated tax payments for trusts.[30]

2. Exempt Resident Trust Exemption

Importantly, as mentioned above, the Tax Law was amended in 2003, effective for tax years beginning in 1996, to codify an exemption for an Exempt Resident Trust. Hence, a Resident Trust is not taxable if it has no New York State trustees, assets, or source income as follows:[31]

> (D) (i) Provided, however, a resident trust is not subject to tax under this article if all of the following conditions are satisfied:
>
>> (I) all the trustees are domiciled in a state other than New York;
>>
>> (II) the entire corpus of the trusts, including real and tangible property, is located outside the state of New York; and
>>
>> (III) all income and gains of the trust are derived from or connected with sources outside of the state of New York, determined as if the trust were a non-resident trust.

Regarding (I) above, the Technical Services Division has issued guidance on how to determine the residence of a corporate trustee and the circumstances in which resident advisors, protectors, and committee members will be treated as resident trustees.[32]

Regarding (II) above, the Tax Law provides, "(f)or purposes of item (II) of clause (i) of this subparagraph, intangible property shall be located in this state if one or more of the trustees are domiciled in the state of New York."[33]

Thus, if a trust only has nonresident trustees and intangible assets (e.g., stocks and bonds), the trust will meet the exemption. If a trust holds New York tangible personal property and/or real property, the trustee might consider placing it in a family-limited partnership ("FLP") or a limited liability company ("LLC") to convert it into intangible personal property. Guidance on the circumstances in which this approach will succeed is discussed in Section VI, below, regarding source income.

Regarding (III) above, a single dollar of source income might prevent a trust from satisfying the Exempt Resident Trust exemption. Hence, to minimize tax, the trustee of a trust that holds assets that produce source income should consider dividing it into separate trusts, one of which holds the source-income assets and one of which does not. Source income is described in Section VI, below.

One might read the Exempt Resident Trust provision to say that a trust that has New York source income but no New York trustee or assets is taxable just on the source income (not on the entire income of the trust), and this appears to be what the New Jersey Tax Court concluded in a 2013 case interpreting that state's similar rule.[34] But, the prudent course is to treat the provision as a safe harbor and to assume that a trust that does not satisfy all three tests will be taxed on all income.

In 2010, the Department announced a change in the filing responsibilities of trustees of Exempt Resident Trusts as follows:[35]

> [U]nder the policy described in TSB-M-96(1)I, *Resident Trusts*, a resident trust that was not subject to tax because it met the conditions described in section 605(b)(3)(D) of the Tax Law was not required to file a return….
>
> Effective for tax years beginning on or after January 1, 2010, the policy in TSB-M-96(1)I is revoked, and a resident trust that meets the conditions of section 605(b)(3)(D) of the Tax Law will be required to file a New York State fiduciary income tax return if it meets the filing requirements for resident trusts.

In 2011, it clarified that the new filing requirement applies to trustees of Exempt Resident Trusts that satisfied § 605(b)(3)(D)(i)'s requirements before 2010:[36]

> As of tax year 2010, even though the Trusts meet the conditions set forth in Tax Law § 605(b)(3)(D), they are required to file Form IT-205 *Fiduciary Income Tax Return* and attach Form IT-205-C *New York Resident Trust Nontaxable Certification* to Form IT-205.

Thanks to the 2014–2015 budget bill, this filing requirement now is imposed by statute. Hence, the new § 658(f)(2) of the Tax Law provides:[37]

> Every resident trust that does not file the return required by section six hundred fifty-one of this part on the ground that it is not subject to tax pursuant to subparagraph (D) of paragraph three of subsection (b) of section six hundred five of this article for the taxable year shall make a return for such taxable year substantiating its entitlement to that exemption and providing such other information as the commissioner may require.

3. Throwback Tax

As noted above, the 2014–2015 budget bill imposes a throwback tax on distributions of accumulated income to New York resident beneficiaries from Exempt Resident Trusts. The provision in question provides that the income on which such a beneficiary is taxed includes:[38]

> In the case of a beneficiary of a trust that, in any tax year after its creation including its first tax year, was not subject to tax pursuant to subparagraph (D) of paragraph three of subsection (b) of section six hundred five of this article (except for an incomplete gift non-grantor trust, as defined by paragraph forty-one of this subsection), the amount described in the first sentence of section six hundred sixty-seven of the internal revenue code for the tax year to the extent not already included in federal gross income for the tax year, except that, in computing the amount to be added under this paragraph, such beneficiary shall disregard (i) subsection (c) of section six hundred sixty-five of the internal revenue code; (ii) the income earned by such trust in any tax year in which the trust was subject to tax under this article; and (iii) the

> income earned by such trust in a taxable year prior to when the beneficiary first became a resident of the state or in any taxable year starting before January first, two thousand fourteen. Except as otherwise provided in this paragraph, all of the provisions of the internal revenue code that are relevant to computing the amount described in the first sentence of subsection (a) of section six hundred sixty-seven of the internal revenue code shall apply to the provisions of this paragraph with the same force and effect as if the language of those internal revenue code provisions had been incorporated in full into this paragraph, except to the extent that any such provision is either inconsistent with or not relevant to this paragraph.

The provision does not apply to distributions made before June 1, 2014.[39] The bill also imposes reporting requirements on trustees making accumulation distributions.[40]

Although the result might not have been intended, it is possible that accumulation distributions will not include capital gains because the taxable amount is based on undistributed net income under the first sentence of § 667(a) of the Internal Revenue Code ("I.R.C.").[41] If this is the correct reading, the accumulation tax will not be burdensome in many instances given that the largest tax savings usually involve capital gains. Also, the throwback tax does not reach income accumulated before 2014 or income accumulated before a beneficiary is born, reaches age 21, or moves to New York. In addition, there is no interest charge for the deferred payment of tax.

4. Incomplete Gift Nongrantor Trust

As also mentioned above, the 2014–2015 budget bill treats incomplete gift nongrantor trusts as grantor trusts for New York income tax purposes. The statutory language is as follows:[42]

> In the case of a taxpayer who transferred property to an incomplete gift non-grantor trust, the income of the trust, less any deductions of the trust, to the extent such income and deductions of such trust would be taken into account in computing the taxpayer's federal taxable income if such trust in its entirety were treated as a grantor trust for federal tax purposes. For purposes of this paragraph, an "incomplete gift non-grantor trust" means a resident trust that meets the following conditions: (i) the trust does not qualify as a grantor trust under section six hundred seventy-one through six hundred seventy-nine of the internal revenue code, and (ii) the grantor's transfer of assets to the trust is treated as an incomplete gift under section twenty-five hundred eleven of the internal revenue code, and the regulations thereunder.

The provision did not apply to income of such trusts that were liquidated before June 1, 2014.[43]

B. New York City

In New York City, a trustee of a Resident Trust for New York City tax purposes must file a return if it must file a New York State return.[44]

New York City treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[45] and the city permits a distribution deduction.[46] In 2013, the city taxed the city taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 3.876% on such income over $500,000,[47] and the current rate schedule is not scheduled to change.[48]

Like New York State, New York City defines "Resident Trust" as a trust that is created by a New York City testator or trustor.[49] A "Nonresident Trust" is a trust that is not a "Resident Trust."[50]

New York City taxes all city taxable income of Resident Trusts; it does not tax Nonresident Trusts.[51] Trustees must make estimated tax payments for trusts.[52]

Also like New York State, New York City does not tax trustees of Exempt Resident Trusts but requires them to file informational returns.[53] The 2014–2015 budget bill also added the throwback tax requirements[54] and the incomplete gift nongrantor trust rules[55] described above to the taxation of New York City trusts and their beneficiaries.

C. New York State and City

If a trust was a Resident Trust for New York State and New York City purposes in 2013, then the trustee was subject to tax at rates up to 12.696% on taxable income over $1,029,250.[56]

D. CRTs

A Charitable-Remainder Trust ("CRT") is exempt from federal income tax.[57] It therefore is exempt from New York State and City income tax under the following statute:[58]

> A trust or other unincorporated organization which by reason of its purposes or activities is exempt from

> federal income tax shall be exempt from tax under this article (regardless of whether subject to federal and state income tax on unrelated business taxable income).

V. Cases and Rulings

A. Introduction

In addition to *Mercantile* and *Taylor*, New York courts and administrative agencies have issued numerous cases and rulings that involve the income taxation of trustees by New York State and New York City.

B. *In re Joseph Lee Rice III Family 1992 Trust* (2010)—Trustee Denied Refund for Closed Years Based on Change of Residence of Trustee

This 2010 decision of the Division of Tax Appeals illustrates the importance of paying attention to detail.[59] In 1992, the trustor, who resided in New York City, created an irrevocable nongrantor trust in which he named his attorney, also a New York City resident, as trustee. The trust initially was subject to New York State and City income tax because of the trustor's and the trustee's New York City residences. In 1995, the trustee moved to Florida but continued to file tax returns using his law firm's Manhattan address and to pay State and City tax. Subsequently, it was discovered that the trustee should have ceased paying tax upon his move to Florida. The Division of Taxation granted refunds for the open years—2001–2003, but the administrative law judge upheld the Division of Taxation's refusal to pay refunds for the closed years—1996–2000.[60] The amount of tax was not disclosed, but the trustee and/or the accountant might face liability for the tax erroneously paid for those years.

C. *In re the Petition of the Amauris Trust* (2008)—Trusts Created at End of GRIT Term Not Resident Trusts

This 2008 decision of the Division of Tax Appeals considered the taxation of two trusts that were funded at the expiration of the initial 10-year term of a Grantor-Retained Income Trust ("GRIT").[61] The trustor was a New York resident in 1990 when he created the GRIT, but he resided in Connecticut at the end of the initial term in 2000. Because the trusts had source income, the establishment of the trustor's residence determined whether the trusts were taxed on all income or on source income only. Several million dollars were involved. The administrative law judge concluded:[62]

> [S]ince the transfers were not effectuated until July 30, 2000, the ten-year anniversary of the Peterffy Trust, the Amauris and Niavius Trusts could not properly be taxed as resident trusts by the State of New York because, pursuant to Tax Law § 605(b)(3), Thomas Peterffy was a Connecticut and not a New York domiciliary at the time the stock was transferred to these trusts. As such, since the Timber Hill, Inc., stock was not transferred to the Amauris Trust and the Niavius Trust until July 30, 2000, at a time that the grantor of the Peterffy Trust was a Connecticut domiciliary, it is hereby determined that the Amauris Trust and the Niavius Trust were not resident trusts as defined by Tax Law § 605(b)(3)(C).

D. TSB-A-04(7)I (2004)—Rules Set for Determining Residence of Corporate Trustee and for Evaluating Role of Advisor, Committee, Etc.

In 2004, the Technical Services Division considered whether proposed actions by a committee acting under five irrevocable trusts entered into by John D. Rockefeller, Jr., and Chase National Bank in 1934 would enable the trustees to avoid New York State and City income tax as follows:[63]

> The issue raised by Petitioner, JPMorgan Chase Bank, as Trustee of the 1934 Trusts, is whether the trusts, described below, will be subject to New York State or New York City income tax if (a) the Committee, described below, replaces the trustee with a trustee not domiciled in New York State, and (b) the two Committee members who are currently domiciled in New York State are replaced by individuals who are not domiciled in New York State.

First, the five-member committee, which directed the trustee on investment and distribution matters, proposed to replace the New York corporate trustee with its Delaware affiliate. The ruling said that the residence of the proposed successor trustee should be determined as follows:[64]

> [F]or purposes of section 605(b)(3)(D) of the Tax Law and section 105.23(c) of the Regulations, the domicile of the Proposed Successor Trustee will be the state where its principal place of business is located, as set forth in the above guidelines for determining the domicile of a corporation.

However, the ruling declined to decide this issue because "[t]he determination of domicile is a factual matter that is not susceptible of determination in this Advisory Opinion."[65]

Next, the two members of the committee who resided in New York proposed to resign. The ruling observed:[66]

> An advisor to a trustee has been interpreted by the courts to include not only a person who has been designated by particular terminology in the trust instrument but also any other individual who, by the terms of the trust instrument, has been given power to direct or control a trustee in the performance of some part or all of that trustee's functions and duties, or who has been invested with a form of veto power over particular actions of a trustee through the medium or device of requiring that those actions be taken only with the consent and approval of such advisor.…
>
> Under the facts in this case, the Committee has been granted broad powers over the assets of the Trusts. For example, the Committee may direct the Trustee to take or refrain from taking any action which the Committee deems it advisable for the Trustee to take or refrain from taking. All of the powers of the Trustee under the Trust Agreements are subject to the directions of the Committee. Since the Committee is an advisor having the controlling power over the Trustee,…the members of the Committee are considered to be co-trustees of the Trusts. Therefore, for purposes of the first condition under section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations, the individuals comprising the Committee are considered to be trustees of the Trusts.
>
> However, the determination of whether Petitioner or any other investment management firms or former Committee members that may be retained by the Proposed Committee to provide investment advice or management services would also be treated as co-trustees of the Trusts for purposes of section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations is a factual matter that is not susceptible of determination in this Advisory Opinion.

Regarding New York State income tax, the ruling concluded:[67]

> Petitioner states that all real and tangible property included in the corpus of the Trusts, is located outside New York and all the income and gains of the Trusts are derived or connected from sources outside of New York State, determined as if the Trusts were a nonresident. Pursuant to section 605(b)(3)(D)(ii) of the Tax Law, any intangible property included in the corpus of the Trusts is located in New York State if any of the trustees are domiciled in New York State. Therefore, the determination of whether the Trusts will be exempt from New York State personal income tax for purposes of section 605(b)(3)(D) of the Tax Law and section 105.23(c) of the Regulations will depend on whether the Proposed Successor Trustee, any member of the Proposed Committee or any other investment advisor or manager that is considered to be a co-trustee is domiciled in New York State. The Trusts will meet the three conditions of section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations only if all of the trustees are domiciled outside of New York State. In the case of the Proposed Successor Trustee, pursuant to the concept of domicile with respect to an individual, the domicile of the corporation is the principal place from which the trade or business of the corporation is directed or managed. In the case of any member of the Proposed Committee or any other investment advisor or manager that is considered to be a co-trustee, pursuant to section 105.20(d)(1) of the Regulations, the domicile of an individual is the place which such individual intends to be such individual's permanent home.

Regarding New York City income tax, the ruling concluded:[68]

> The New York City personal income tax is similar to the New York State personal income tax and is administered by New York State the same as Article 22 of the Tax Law. Accordingly, for the taxable years that the Trusts have not met the three conditions contained in section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations, New York State personal

> income tax is imposed on the Trusts, and if any of the trustees are domiciled in New York City, New York City personal income tax authorized under Article 30 of the Tax Law is imposed on the Trusts for those taxable years that a trustee is domiciled in New York City.

I often am asked about the circumstances, if any, in which a New York resident advisor, protector, or committee member may participate in the administration of a New York Resident Trust having a nonresident corporate trustee without subjecting the trust to tax. Based on this ruling, the safest course clearly is to have absolutely no participation by New Yorkers. According to the Technical Services Division, serving in a fiduciary or nonfiduciary capacity might have no bearing on this analysis.

E. TSB-A-03(6)I (2003)—Rules Set for Powers of Appointment

The Technical Services Division provided guidance in 2003 on whether or not the donee of a power of appointment is the "transferor" to the appointive trust for New York income-tax purposes in six situations.[69] The ruling concluded that:[70]

> [T]he residency of an appointive trust created by the exercise of a power of appointment is determined based on the domicile of the donor of the property who transferred the property to the trust. A person who transfers property held in trust to an appointive trust by the exercise of a general power of appointment over the trust property is considered the donor of the trust property for purposes of determining the residency of the appointive trust. Conversely, a person who transfers property held in trust to an appointive trust by the exercise of a special power of appointment over the trust property is not considered the donor of the trust property for purposes of determining the residency of the appointive trust. The donor of the special power of appointment is considered the donor of the trust property for purposes of determining the residency of the appointive trust.

A trustee considering exercising a decanting power with the hope of escaping tax by changing the creator of the trust should keep this Advisory Opinion in mind because, "An exercise of the power to invade trust principal…shall be considered the exercise of a special power of appointment.…"[71]

F. Cases and Rulings Recognizing Exempt Resident Trust Exemption

- **TSB-A-94(7)I (1994)—Resident Trust Not Taxable Once Trustee Became Nonresident**

In this 1994 ruling,[72] a New York City resident established an irrevocable complex inter vivos trust in 1976. Although the sole individual trustee initially resided in New York City, he moved to Connecticut in 1985. During the years in question, the corpus consisted solely of intangible personal property (some of which was held by a New York financial institution), and the trust earned no source income.

Regarding New York State tax, the ruling said:[73]

> [T]he Charles B. Moss Trust is a New York resident trust. However, since the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations have been met, for the taxable years at issue, 1990, 1991 and 1992, no New York State personal income tax is imposed on such trust for said years.

Regarding New York City tax, the ruling concluded:[74]

> The New York City personal income tax is similar to the New York State personal income tax and is administered by New York State the same as Article 22 of the Tax Law. Accordingly, since the Charles B. Moss Trust has met the three conditions contained in section 105.23(c) of the New York State Personal Income Tax Regulations and no New York State personal income tax is imposed on such trust for taxable years 1990, 1991 and 1992, no New York City personal income tax authorized under Article 30 of the Tax Law is imposed on such trust for such taxable years.

The tax preparer might have been at risk for the tax erroneously paid for the closed years—1985–1989.

- **TSB-A-96(4)I (1996)—Resident Trust Not Taxed on Capital Gain**

The issue in this 1996 Advisory Opinion was whether the trustees of a trust created by a New York City resident in 1961 had to pay New York State and City income tax on a large capital gain.[75] Initially, the two individual trustees were New York residents, but, by 1988, both trustees were nonresidents. Regarding New York State income tax, the ruling said:[76]

> In this case, after 1988 the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations have been met. First, after 1988 all of the trustees have been domiciled outside of New York State. Second, the corpus of the Trust consists of intangible assets some of which are held by Lazard Freres & Co. located in New York City. Third, none of the assets of the Trust were employed in a business carried on in New York State and all income and gains of the Trust were derived from sources outside of New York State, determined as if the Trust were a nonresident. With respect to the second condition, the situs of the intangible assets of a trust is deemed to be at the domicile of the trustee. Therefore, the situs of the corpus of the Trust is deemed to be outside of New York State.
>
> Accordingly, the Trust is a New York resident trust. However, for the taxable years that the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations have been met, no New York State personal income tax is imposed on such trust for those years.

Regarding New York City income tax, it concluded:[77]

> The New York City personal income tax is similar to the New York State Personal income tax and is administered by New York State the same as Article 22 of the Tax Law. Accordingly, for the taxable years that the Trust has met the three conditions contained in section 105.23(c) of the New York State Personal Income Tax Regulations, no New York State personal income tax is imposed on the Trust, and no New York City personal income tax authorized under Article 30 of the Tax Law is imposed on the Trust for those taxable years.

- **TSB-A-00(2)I (2000)—Resident Trust Not Taxable Even Though It Held Interest in LLC Managed by New York City Resident**

Here,[78] a New York City resident created a Delaware LLC of which she was the managing member. She kept a 1% interest and contributed a 99% interest to a trust for the benefit of New York beneficiaries but appointed a nonresident individual as trustee. The ruling concluded that the trustee was not taxable for the following reasons:[79]

> Issue 3…
>
> In this case, the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations have been met. First, the trustee is domiciled outside of New York State. Second, the corpus of the Trust consists of intangible assets. The situs of the intangible assets of a trust are deemed to be at the domicile of the trustee. Therefore, the situs of the corpus of the Trust is deemed to be outside of New York State. Third, none of the assets of the Trust are employed in a business carried on in New York State and all income and gains of the Trust were derived from sources outside of New York State, determined as if the Trust were a nonresident.
>
> Accordingly, the Trust is a New York resident trust. However, for the taxable year that the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations are met, no New York State personal income tax is imposed on such Trust for those years. Further, no New York City personal income tax authorized under Article 30 of the Tax Law is imposed on the Trust for those taxable years.
>
> Issue 4
>
> The domicile of the Trustee of the Trust does affect the taxable status of the Trust. If the Trustee is domiciled in New York State, the Trust would not meet the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations, and the Trust would be subject to New York State personal income tax. In addition, if the Trustee is a resident of the City of New York, the Trust would be subject to the New York City personal income tax authorized under Article 30 of the Tax Law. The domicile of the beneficiary does not affect the taxable status of the trust.

The significance of this technical services bulletin is that a New York City resident could manage trust investments indirectly as the managing member of an LLC in which the trustee held an interest that she could not have managed directly as trustee without subjecting the trust to tax.

- **TSB-A-04(7)I (2004)—Resident Trust Not Taxable if Corporate Trustee and Committee Members Are Not Residents**

This ruling, summarized above,[80] recognized that the trusts under consideration would qualify as Exempt Resident Trusts if the corporate trustee and the committee members were nonresidents.

- ***In re the Petition of the John Heffer Trust* (2006)—Resident Trust Not Taxable Once Resident Trustee Resigned in Accordance with Governing Instrument**

This controversy[81] involved a trust that a New York City resident created in 1973 naming individual trustees. In 1981, the last New York resident trustee resigned and was replaced by a nonresident trustee as provided in the trust instrument but without a court proceeding. Nevertheless, the trustees continued to file returns and to pay tax. In 2004, the trustees filed amended returns seeking refunds for 2000 (about $100,000), 2001 (about $6,000), and 2002 (about $100,000).

The Division of Tax Appeals granted the refunds for the following reasons:[82]

> The John Heffer Trust clearly prescribed procedures for the resignation of a trustee and the appointment of successor trustees which were carefully followed in accordance with the intent of the grantor, thereby giving legal effect to the resignation of Sidney J. Silberman on November 20, 1981.
>
> Therefore, for the years 2000, 2001 and 2002, petitioner has established that it met the requirements of 20 NYCRR 105.23(c) and was not subject to income tax.

Although the trustees obtained refunds for the open years—2000, 2001, and 2002, they, the tax return preparer, or their advisors might have been at risk for tax erroneously paid for the closed years, going all the way back to 1981.

- ***In re Joseph Lee Rice III Family 1992 Trust* (2010)—Resident Trust Not Taxable Once Trustee Became Nonresident**

This 2010 decision of the Division of Tax Appeals, summarized above,[83] recognized that a Resident Trust ceased to be taxable as soon as the sole resident individual trustee became a Florida resident.

- **TSB-A-10(4)I (2010)—Resident Trust No Longer Taxable Upon Death of Resident Trustee**

This 2010 Advisory Opinion addressed the tax-payment requirements of the surviving nonresident trustee of a New York Resident Trust due to the death of the New York resident individual co-trustee on August 1, 2008.[84] The ruling concluded:[85]

> Once a resident trust satisfies the conditions in Tax Law section 605(b)(3)(D)(i), it is no longer subject to further taxation by New York State so long as the trustee remains a non-domiciliary and the trust continues to meet the other conditions in section 605(b)(3)(D)(i). The Trusts must, however, accrue to the period of their taxable residence any income, gain, loss, deduction, items of tax preference or any ordinary income portion of a lump sum distribution accruing prior to the Trusts' change of tax status, regardless of the Trusts' method of accounting.

- **TSB-A-11(4)I (2011)—Resident Trust No Longer Taxable When Resident Trustee Resigns**

This 2011 Advisory Opinion considered the New York income-tax consequences for Resident Trusts caused by changes of residences of the grantors and trustees.[86] It concluded:[87]

> Based on the information submitted, the Trusts never owned and do not currently own any real or tangible property in New York and they have no New York source income. Therefore, the Trusts met the second and third requirements of Tax Law § 605(b)(3)(D). However, because Trustee 1 was a New York resident, the Trusts did not meet the first requirement of Tax Law § 605(b)(3)(D) and initially were subject to New York State income tax only on the New York resident portions of the Trusts. When Trustee 1 resigned as trustee, leaving only Trusty [sic] 2, a Connecticut resident, as the sole trustee, the Trusts met all the requirements of Tax Law § 605(b)(3)(D). Accordingly, when Trusty [sic] 1 resigned as trustee, the Trusts were no longer subject to New York income tax.

G. *Michael A. Goldstein No. 1 Trust v. Tax Appeals Tribunal of the State of New York* (2012)—New York Intermediate Appellate Court Holds That Interest on New York Income Tax Refund Runs from Date of Filing of Amended Return Not from Date of Filing of Original Return

This case illustrates the importance of thinking about the state income taxation of trusts at the outset rather than relying on a refund request. In *Michael A. Goldstein No. 1 Trust v. Tax Appeals Tribunal of the State of New York*,[88] the trustees filed New York income tax returns for 1995, 1996, and 1997. As the result of an Internal Revenue Service ("IRS") audit, the trustees' taxable income was decreased and the beneficiaries' taxable income was increased. The trustees filed amended returns requesting New York income-tax refunds in July 2006 that were issued in December of that year.

The Department paid interest from July 2006 rather than from the dates of the filing of the original returns based on then Tax Law § 688.[89] A New York intermediate appellate court confirmed that determination.[90]

Although the statute in question was amended as of tax year 1999, the same issue might arise in another state. In addition, even though advance planning might not have prevented the problem in this case because it resulted from an IRS audit, trustees and their attorneys should consider potential state fiduciary income taxation while a trust is being created. Even though a trustee might later be able to pry refunds out of a state tax department for open years, they might be forestalled for closed years and, as demonstrated by this case, unable to make the trust whole.

VI. Source Income

In New York, trustees of Nonresident Trusts are taxed on source income[91] and a single dollar of source income might prevent a Resident Trust from meeting the Exempt Resident Trust exemption.[92] The Department has listed items of source and non-source income.[93]

The trustee of a Nonresident Trust or of a Resident Trust that holds tangible personal property or real property might consider transferring the property into an FLP or LLC with the hope of converting it into intangible personal property that will not produce source income. In this regard, the gain incurred upon the sale of interests in certain entities that hold New York real property is source income.[94] Specifically, real property located in New York includes an interest in an entity (*i.e.*, a partnership, limited liability corporation, S corporation, or non-publicly traded C corporation with 100 or fewer shareholders) that owns real property in New York, having a fair market value that equals or exceeds 50% of all the assets of the entity on the date of sale or exchange of the taxpayer's interest in the entity.[95] Only the assets that the entity owned for at least two years before the date of the sale or exchange of the taxpayer's interest in the entity are to be used in determining the fair market value of all the assets of the entity on the date of sale or exchange.[96] The gain or loss derived from New York sources from the taxpayer's sale or exchange of an interest in an entity is the total gain or loss for federal income-tax purposes from that sale or exchange multiplied by a fraction, the numerator of which is the fair market value of the real property located in New York on the date of sale or exchange and the denominator of which is the fair market value of all the assets of the entity on the date of sale or exchange.[97] The Department has issued a Technical Services Bulletin that illustrates the operation of the provision and describes its application to trusts at the end.[98]

VII. "Moving" Trust to Escape Tax

A. Introduction

As discussed at length above, a nongrantor trust created by a New York testator or trustor is not subject to New York income tax if the trust has no New York trustees, assets, or source income. For an existing trust to be able to stop paying tax, it sometimes is necessary to involve a New York court in changing a resident trustee to a nonresident trustee. The following cases are illustrative.

B. *In re Bush* (2003)—Tax Escaped Without Changing Situs

At the beginning of this case,[99] Surrogate Preminger summarized the issue as follows:[100]

> In these companion proceedings, JPMorgan Chase Bank, as trustee of a trust created under an agreement dated September 30, 1952 between Harriet F. Bush, as grantor, and Donald F. Bush, as trustee, and JPMorgan Chase Bank, as trustee of a trust under the will of Donald F. Bush, both trusts being for the benefit of Edith B. Crawford, have petitioned for leave to resign and the appointment of J.P. Morgan Trust Company of Delaware as successor trustee. The court granted such relief by orders dated December 30, 2002. Petitioners' further requests—transfer of the situs of the trusts to Delaware, to avoid imposition of New York State fiduciary income tax—remain the sole issue before the court. All interested parties have consented to the requested relief.

In the course of the opinion, she noted that the court already had replaced the New York trustee with its Delaware affiliate.[101] She then observed, "Petitioners' ultimate goal—elimination of the imposition of a New York fiduciary income tax—can be, and has been, satisfied without the requested transfer of situs."[102]

The Surrogate therefore denied the trustee's request to transfer the trusts' situs from New York to Delaware as follows, "[t]here being no evidence of any benefit to be derived from the transfer of the situs of the trusts to Delaware, petitioners' requests are denied."[103]

C. *In re Estate of Rockefeller* (2003)—Tax Again Escaped Without Changing Situs

Surrogate Roth was presented with a similar issue in this case.[104] She began:[105]

> The trustees of the trust established under the will of William Rockefeller ask the court to allow the corporate trustee, the Chase Manhattan Bank (now known as JP Morgan Chase Bank), to resign in favor of its affiliate, JP Morgan Trust Company of Delaware, and to change the situs of the trust to the State of Delaware. By order dated May 15, 2002, the request for the change of corporate trustee was granted. The sole issue remaining is whether under the circumstances presented changing the situs of the trust is also warranted.

After reciting the facts,[106] the surrogate noted that:[107]

> Petitioners' application for a change of situs was based on the trustees' desire to eliminate the high New York State fiduciary income tax payable by the trust. But that objective concededly is met by the resignation of the New York corporate trustee and the appointment of its Delaware affiliate, as a result of which the trust will no longer be taxable by this State. Petitioners nevertheless request a change of situs.

Next, she observed:[108]

> The income tax benefit obtainable by the substitution of the corporate trustee's Delaware affiliate is clearly in the interests of the beneficiaries. Indeed, the frequency with which such applications are made reflects an understandable eagerness on the part of persons interested in trusts to be rid of the high tax price payable where the fiduciary is a New Yorker. Although no formal tally has been made of the number of such applications, it is clear that their combined result—a loss of trust business by this state—is sufficiently serious to suggest that New York's high fiduciary income tax may be counterproductive to the state's overall economic interests. The New York Legislature is urged to evaluate the present fiduciary income tax scheme in light of its negative repercussions, including the trend embodied by applications such as the one presently before the court

Surrogate Roth denied the requested change of situs and put future petitioners on notice as follows:[109]

> Petitioners' application to change the situs of this trust is accordingly denied. This decision puts future applicants on notice that, where the desired tax savings can be achieved by a change of trustee, a change of situs will not be allowed unless it would result in some benefit to the trust apart from the tax considerations themselves.

VIII. Planning

A. Third-Party Trusts

New York testators and trustors should plan their third-party nongrantor trusts to qualify as Exempt Resident Trusts. This planning should *not* cease in light of the addition of the throwback tax rules by the 2014-2015 budget bill for the reasons noted in Section IV, A, 3, above, and because tax rates might go down in the future, beneficiaries might leave New York, and distributions might go to non-New York beneficiaries. The potential tax saving for a New York State and City Resident Trust that incurred a $1 million long-term capital gain in 2013 was at least $105,991. If a trust will hold property that will generate source income, the testator or trustor might minimize tax by creating two trusts, one to hold assets that produce source income and the other to hold assets that do not generate such income. Residents of other states should consider creating trusts in New York because the state does not tax trusts created by nonresidents.

B. Self-Settled Trust Option—The DING Trust

Most domestic asset-protection trusts ("APTs") are grantor trusts for federal income-tax purposes under I.R.C. § 677(a) because the trustee may distribute income to—or accumulate it for—the trustor without the approval of an adverse party. But, if a client is willing to subject distributions to himself or herself to the control of adverse parties, he or she might use a type of domestic APT known as the Delaware Incomplete

Nongrantor Trust ("DING Trust") to avoid income tax on undistributed ordinary income and capital gains imposed by jurisdictions that follow the federal grantor-trust rules. In five 2013 private letter rulings[110] and in several 2014 private letter rulings,[111] the IRS ruled that domestic APTs that followed the DING-Trust approach qualified as nongrantor trusts. The trusts in question were created under Nevada law in large part because, at the time, Nevada was the only domestic APT state that allowed a trustor to keep a lifetime non-general power of appointment. In the meantime, Delaware has added that option.[112] The trustor of a DING Trust might be able to receive tax-free distributions of the untaxed income in later years.[113] The 2014–2015 budget bill appears to have shut down the DING Trust for New York residents, but the technique still is viable for residents of Connecticut, New Jersey, and many other states.

Endnotes

1. N.Y. State Department of Taxation and Finance, Office of Tax Policy Analysis, *Analysis of 2010 Personal Income Tax Returns* at 89 (Sept. 2013), *available at* http://www.tax.ny.gov/pdf/stats/stat_pit/pit/analysis_of_2010_personal_income_tax_returns.pdf. I would like to thank Charles R. Platt, Laura M. Twomey, and Howard M. Zaritsky for their help in developing material in this article.
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3. 85 A.D.2d 821, 445 N.Y.S.2d 648 (3d Dep't 1981).
4. N.Y. Comp. Codes R. & Reg. tit. 20, § 105.23(c) (N.Y.C.R.R.).
5. TSB-M-96(1)I (July 29, 1996), *available at* http://www.tax.ny.gov/pdf/memos/income/m96_1i.pdf.
6. Tax Law § 605(b)(3)(D)(i) (Tax).
7. A. 9710, 233d N.Y. Leg. Sess., Part G.
8. TSB-A-11(4)I, 2011 N.Y. Tax Lexis 181 (July 27, 2011), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/income/a11_4i.pdf; TSB-M-10(5)I, 2010 State Tax Today 145-10 (July 23, 2010), *available at* http://www.tax.ny.gov/pdf/memos/income/m10_5i.pdf.
9. Tax Law § 658(f)(2), added by 2014 N.Y. Laws ch. 59, part I, § 4 (Mar. 31, 2014).
10. 2014 N.Y. Laws ch. 59, Part I (Mar. 31, 2014).
11. 2014 N.Y. Laws ch. 59, Part I, §§ 1, 6 (Mar. 31, 2014).
12. 2014 N.Y. Laws ch. 59, Part I, § 4 (Mar. 31, 2014).
13. 2014 N.Y. Laws ch. 59, Part I, §§ 2, 7 (Mar. 31, 2014)
14. 15 N.Y.2d 579, 255 N.Y.S.2d 96 (1964), *aff'g*, 19 A.D.2d 765, 242 N.Y.S.2d 26 (3d Dep't 1963).
15. 280 U.S. 83 (1929).
16. *Murphy*, 15 N.Y.2d at 581.
17. 85 A.D.2d 821, 445 N.Y.S.2d 648 (3d Dep't 1981).
18. *Id.* at 822 (citations omitted).
19. Tax Law § 651(a)(2), (e); instructions to 2013 N.Y. Form IT-205 at 2.
20. *See* Tax Law §§ 611(a), 612(a); instructions to 2013 N.Y. Form IT-205 at 6.
21. *See* Tax Law § 618; 20 N.Y.C.R.R. § 118.1; instructions to 2013 N.Y. Form IT-205 at 6.
22. Tax Law § 601(c)(1)(A); instructions to 2013 N.Y. Form IT-205 at 9.
23. Tax Law § 601(c)(1)(A).
24. Tax Law § 605(b)(3)(B)–(C). *See* 20 N.Y.C.R.R. § 105.23(a)–(b).
25. *See* Tax Law § 605(b)(1)(B).
26. Tax Law § 605(b)(3), flush language at end. *See* 20 N.Y.C.R.R. § 105.23(a); instructions to 2013 N.Y. Form IT-205 at 2–3.
27. Tax Law § 605(b)(4).
28. Tax Law § 618. *See* 20 N.Y.C.R.R. § 118.1.
29. Tax Law §§ 631, 633; instructions to 2013 N.Y. Form IT-205 at 2. *See* N.Y. Tax Bull. TB-IT-615, 2011 State Tax Today 244-15 (Dec. 15, 2011), *available at* http://www.tax.ny.gov/pdf/tg_bulletins/pit/b11_615i.pdf.
30. Tax Law § 685(c)(6); instructions to 2013 N.Y. Form IT-205 at 4.
31. Tax Law § 605(b)(3)(D)(i). *See* 20 N.Y.C.R.R. § 105.23(c); instructions to 2013 N.Y. Form IT-205 at 2.
32. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 (Nov. 12, 2004), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/income/a04_7i.pdf. *See* V, D.
33. Tax Law § 605(b)(3)(D)(ii).
34. *See Residuary Trust A. v. Director, Div. of Taxation*, 27 N.J. Tax 68 (N.J. Tax Ct. 2013).
35. TSB-M-10(5)I, 2010 State Tax Today 145-10 (July 23, 2010), *available at* http://www.tax.ny.gov/pdf/memos/income/m10_5i.pdf. *See* instructions to 2013 N.Y. Form IT-205 at 3.
36. TSB-A-11(4)I, 2011 N.Y. Tax Lexis 181 at 4 (July 27, 2011), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/income/a11_4i.pdf.
37. Tax Law § 658(f)(2), added by 2014 N.Y. Laws ch. 59, Part I, § 4 (Mar. 31, 2014).
38. Tax Law § 612(b)(40), added by 2014 N.Y. Laws ch. 59, Part I, § 1 (Mar. 31, 2014).
39. 2014 N.Y. Laws ch. 59, Part I, § 9 (Mar. 31, 2014).
40. Tax Law § 658(f)(1), added by 2014 N.Y. Laws ch. 59, Part I, § 4 (Mar. 31, 2014).
41. *See* TSB-M-14(3)(I), 2014 State Tax Today 96-38 (May 16, 2014), *available at* http://www.tax.ny.gov/pdf/memos/income/m14_3i.pdf. *See also* Montesano, *New York Enacts Significant Changes to its Estate, Gift, GST and Trust Income Tax Laws*, 39 Tax Mgmt. Est., Gift & Tr. J. 165, 166 67 (July 10, 2014).
42. Tax Law § 612(b)(41), added by 2014 N.Y. Laws ch. 59, Part I, § 2 (Mar. 31, 2014).
43. 2014 N.Y. Laws ch. 59, Part I, § 9 (Mar. 31, 2014).
44. Tax Law § 1306(a), (e); instructions to 2013 N.Y. Form IT-205 at 20.
45. Tax Law § 1303; N.Y.C. Admin. Code §§ 11-1711, 11-1712.
46. *See* Tax Law § 1303.
47. Tax Law §§ 1304(a)(3)(A), 1304-B(a)(1)(ii); N.Y.C. Admin. Code §§ 11-1701, 11-1704.1; instructions to 2013 N.Y. Form IT-205 at 21. *See* TSB-M-10(7)I, 2010 State Tax Today 161-19 (Aug. 17, 2010), *available at* http://www.tax.ny.gov/pdf/memos/income/m10_7i.pdf.
48. Tax Law § 1304(a)(3)(A).
49. Tax Law § 1305(c). *See* N.Y.C. Admin. Code § 11-1705(b)(3).
50. Tax Law § 1305(d); N.Y.C. Admin. Code § 11-1705(b)(4).
51. Tax Law § 1303; N.Y.C. Admin. Code § 11-1718.
52. *See* Tax Law § 1301(b).

53. N.Y.C. Admin. Code § 11-1705(b)(3)(D).
54. N.Y.C. Admin. Code § 11-1712(b)(36), added by 2014 N.Y. Laws ch. 59, Part I, § 6 (Mar. 31, 2014).
55. N.Y.C. Admin. Code § 11-1712(b)(37), added by 2014 N.Y. Laws ch. 59, Part I, § 7 (Mar. 31, 2014).
56. Tax Law §§ 601(c)(1)(A), 1304(a)(3)(A), 1304-B(a)(1)(ii).
57. I.R.C. § 664(c)(1).
58. Tax Law § 601(h). *See* instructions to 2013 N.Y. Form IT-205 at 4.
59. *In re Joseph Lee Rice III Family 1992 Trust*, DTA No. 822892, 2010 N.Y. Tax Lexis 268 (N.Y. Div. Tax App. 2010), *available at* http://www.dta.ny.gov/pdf/archive/Determinations/822892.det.pdf.
60. *See* Tax Law § 697(d).
61. *In re the Petition of the Amauris Trust*, DTA No. 821369, 2008 N.Y. Tax Lexis 139 (N.Y. Div. Tax App. 2008), *available at* http://www.dta.ny.gov/pdf/archive/Determinations/821369.det.pdf.
62. *Id.* at 33–34.
63. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 at 1 (Nov. 12, 2004), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/income/a04_7i.pdf.
64. *Id*. at 20 (internal quotation marks omitted).
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67. *Id.* at 23–25.
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69. TSB-A-03(6)I, 2003 N.Y. Tax Lexis 313 (Nov. 21, 2003), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/income/a03_6i.pdf.
70. *Id*. at 12–13 (citation omitted).
71. EPTL 10-6.6(d).
72. TSB-A-94(7)I, 1994 N.Y. Tax Lexis 310 (Apr. 8, 1994), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/income/a94_7i.pdf.
73. *Id.* at 8.
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75. TSB-A-96(4)I, 1996 N.Y. Tax Lexis 528 (Oct. 25, 1996), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/income/a96_4i.pdf.
76. *Id.* at 6–7.
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79. *Id.* at 13–15.
80. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 (Nov. 12, 2004), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/income/a04_7i.pdf. *See* D, above.
81. *In re the Petition of the John Heffer Trust*, DTA No. 820351, 2006 N.Y. Tax Lexis 124 (N.Y. Div. Tax App. 2006), *available at* http://www.dta.ny.gov/pdf/archive/Determinations/820351.det.pdf.
82. *Id.* at 13.
83. *In re Joseph Lee Rice III Family 1992 Trust*, DTA No. 822892, 2010 N.Y.Tax Lexis 268 (N.Y. Div. Tax App. 2010), *available at* http://www.dta.ny.gov/pdf/archive/Determinations/822892.det.pdf. *See* V, B.
84. TSB-A-10(4)I, 2010 N.Y. Tax Lexis 196 (June 8, 2010), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/income/a10_4i.pdf.
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87. *Id.* at 3–4.
88. 101 A.D.3d 1496, 957 N.Y.S.2d 433 (3d Dep't 2012).
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94. Tax Law § 631(b)(1)(A)(1).
95. *Id*.
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100. *Id*. at 744–45.
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102. *Id.* at 745.
103. *Id.* at 746.
104. *In re Estate of Rockefeller*, 2 Misc. 3d 554, 773 N.Y.S.2d 529 (Surr. Ct., N.Y. Co. 2003).
105. *Id.* at 554.
106. *Id.* at 554–55.
107. *Id*. at 555 (citation omitted).
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111. PLRs 201430003 007 (Feb. 7, 2014), 201426014 (Feb. 24, 2014)) 201410001–010 (Oct. 21, 2013).
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113. *See* Akhavan, *DINGing State Income Taxes in Artwork Transactions*, 153 Tr. & Est. 31 (June 2014).

Richard W. Nenno is a Senior Managing Director and Trust Counsel in Wealth Advisory Services, Wilmington Trust Company, Wilmington, Delaware. He is a nationally known speaker and author on a variety of estate-planning topics.

This article is not designed or intended to provide financial, tax, legal, accounting, or other professional advice because such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought.

IRS Loses Summary Judgment Motion in Tax Court Estate Tax Case Involving Madoff Account

By Stephen J. Krass and Lee A. Snow

In a recent United States Tax Court Memorandum Decision, *Estate of Bernard Kessel, Deceased v. Commissioner*,[1] the Court denied the Internal Revenue Service's motion for summary judgment on two key issues relating to the estate taxation of a decedent's Madoff account. First, the Court refused to rule that the decedent's Madoff account—as opposed to the Madoff account's reported holdings—was the decedent's property interest subject to federal estate tax. Second, the Court denied the IRS motion that, as a matter of law, a hypothetical willing buyer would not reasonably know that Bernard Madoff was operating a Ponzi scheme at the time of the decedent's death. Thus, it appears that the federal estate taxation of the decedent's Madoff account will likely have to be determined at a trial.

Factual Background

Bernard Kessel died in July, 2006, more than two years before the Bernard L. Madoff Ponzi scheme collapsed. The decedent owned Bernard Kessel, Inc., a New York corporation, which created the Bernard Kessel Inc. Pension Plan (the "Plan") in 1982. Kessel was the sole participant in the Plan and designated his fiancée and his son as beneficiaries of the death benefits payable under the Plan.

In 1992, the Plan opened an account with Bernard L. Madoff Investment Securities, LLC. Following Kessel's death in July, 2006, his Will was probated, his fiancée was appointed as Executrix and his estate filed a federal estate tax return. The estate tax return reported the Plan's Madoff account as an estate asset valued at approximately $4.8 million. The value was based upon an appraisal report that detailed the values of various publicly traded securities, money market funds and options that the Madoff account purportedly held at the date of death.[2] Subsequent to Kessel's death, withdrawals were made from the Plan account in excess of $2.8 million.

As is widely known, Bernard L. Madoff was arrested in December, 2008, and thereafter pleaded guilty in Federal District Court to various charges, including money laundering, making false statements, perjury and theft. Madoff was sentenced to 150 years in prison. The Plan subsequently attempted to recover the assets purportedly held in its Madoff account. The Madoff Bankruptcy Trustee denied this claim, maintaining that the Plan was a "net winner" rather than a "net loser" because the distributions made from the Plan to Kessel during his lifetime and to his beneficiaries subsequent to his death exceeded the aggregate contributions Kessel had made to the Plan.

Following the denial of the Plan's recovery claim, the estate filed a supplemental ("amended") estate tax return valuing the Plan's Madoff account as of the date of death at zero and requesting a $1.9 million refund. The IRS denied the estate's refund request. The estate then filed a timely petition in U.S. Tax Court maintaining, *inter alia*, that the value of the Madoff account at the date of death was zero, rather than $4.8 million. In response, the IRS filed a motion for summary judgment on two issues: (i) that the asset to be valued for estate tax purposes was the Madoff account itself rather than the assets within the account, and (ii) that a hypothetical willing buyer of the Madoff account would not reasonably know or foresee that Madoff was operating a Ponzi scheme at the date of Kessel's death.

U.S. Tax Court Decision

Judge Diane Kroupa of the U.S. Tax Court denied the summary judgment motion on both issues. With regard to the first issue, the Judge ruled that property interests are defined by state law and the taxation of property interests is determined by federal law. The Judge noted that the owner of the Madoff account had what appeared to be property-like rights in the Madoff account agreement but went on to rule that, based upon the record before the Court, the Court could not determine whether the account agreement was the property interest includible in the decedent's estate for estate tax purposes separate from any interest the decedent had in what purported to be the assets held in the account. The Court said that this question would be best answered after the parties had an opportunity to develop the relevant facts at trial. Accordingly, the Court denied the IRS motion on this issue.

With regard to the IRS' second argument, that a hypothetical willing buyer could not reasonably know or foresee that Madoff was operating a Ponzi scheme at the time of the decedent's death, the Court ruled that, as a matter of law, this point was not established. The Court noted that there were persons who had suspected years before Madoff's arrest that Madoff's record of consistently high returns was "simply too good to be true," citing the U.S. Committee on Financial Services report from 2009 and a report from a hearing held before the U.S. Congressional Committee on Banking, Housing and Urban Affairs. The Court stated that whether a hypothetical willing buyer would have access to information concerning Madoff's performance and would take such information into account in valuing the Madoff account, or the assets purportedly held therein, were disputed material facts that also had to be determined at trial. Accordingly, the Court denied the IRS summary judgment motion on this point as well.

Conclusion

This case represents a partial victory for the estate and certainly a defeat, at this stage of the proceedings, for the IRS. It remains to be seen how the taxation of the Plan's Madoff account for estate tax purposes will ultimately be determined. Similarly affected taxpayers and estates are well advised to monitor the developments of this case as it proceeds in the U.S. Tax Court.

Epilogue

The IRS remains the biggest beneficiary of the Madoff Ponzi scheme, and the *Kessel* case is an egregious example. The beneficiaries of the Plan account took distributions to pay their shares of the estate taxes and then took additional distributions to pay income taxes on the first distribution, and so on. The IRS position is that the beneficiaries should pay both estate tax and income tax on non-existent assets. Then, lurking in the background is the Madoff Bankruptcy Trustee, who filed a clawback action claiming the Plan was a net winner. Finally, it is worth noting that all distributions from the Plan to the decedent and his beneficiaries were either to satisfy the minimum distribution requirements of I.R.C. Section 401(a)(9) or to pay taxes.

Endnotes

1. T.C. Memo. 2014-97 (May 21, 2014).
2. Bernard L. Madoff Investment Securities, LLC provided the estate with a statement detailing the number and price of each publicly traded security, money market fund and option the Plan's Madoff account purportedly held at the date of the decedent's death. This statement was then sent to an appraisal service, which prepared an appraisal report valuing these assets in accordance with IRS rules. This appraisal report was attached to the federal estate tax return.

Stephen J. Krass and Lee A. Snow are members of Krass, Snow & Schmutter, P.C. in New York City. Messrs. Krass and Snow represented the Kessel Estate before the Tax Court.

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Hearsay Issues in Surrogate's Court Proceedings

By John R. Morken

Introduction

A great deal of the evidence offered at a trial or hearing in the Surrogate's Court is hearsay, or at least appears to be hearsay. What did the decedent say? What did his attorney hear from others? Does it matter who the speaker was? What about diary entries and doctor's notes? These are but examples. This article is intended to highlight for the practitioner some hearsay basics which come up frequently in Surrogate's Court trials or hearings.

Definition and Rationale for Excluding Hearsay

Obviously, the starting point in an evidentiary analysis of admissibility is to be able to identify what is hearsay and what is not hearsay. The question then becomes, if it is hearsay, is it excluded or is there an applicable exception?

"[A] statement made out of court…is hearsay if the statement is offered for the truth of the fact asserted in it."[1] If the proffered evidence fits this definition, no exception is available, and an objection is raised, the evidence must be excluded.[2] Why? Since the statement was made out of court the fact finder cannot evaluate the credibility of the speaker or writer, and, most importantly, the party objecting to the evidence has no means of cross-examining the speaker or writer.[3]

Apparent Exception—State of Mind

An out-of-court statement being offered into evidence not because of its truth or falsity, but simply because it was made, is not hearsay. An example is where the statement is being offered not to prove the truth of what it asserts, but to prove its effect upon the hearer, such as explaining the hearer's conduct upon hearing the statement.[4] A more common example of the state of mind exception, at least in the Surrogate's Court, is that a declaration made out of court may be admissible to show the state of mind or the mental condition of the declarant. Statements made by a decedent are often relevant, and not hearsay, if they are submitted solely to show the relations existing between the decedent and other people, such as beneficiaries under a will, or persons who are being disinherited. The decedent's intent is almost always relevant in will, gift, and construction cases, and accordingly such statements would be admissible simply because they were made by the decedent and show how he or she felt about others. Out-of-court statements may also be admitted as not being hearsay, if meant to show that the speaker is either normal or abnormal, rationale or insane.

A well-known example of the state of mind apparent exception is found in the Court of Appeals decision in *Loetsch v. New York City Omnibus Corp.*[5] In that case, a husband sued for the wrongful death of his wife. The relationship between the husband and wife was relevant to the pecuniary loss allegedly suffered by the husband. The Court of Appeals held admissible a statement by the wife in her will that the husband had been cruel to her and had failed to support her. The will was executed just a few months before the fatal accident. In admitting the statement into evidence, the Court held: "[n]o testimonial effect need be given to the declaration, but the fact that such a declaration was made by the decedent, whether true or false, is compelling evidence of her feelings toward, and relations to, her husband."[6]

Query: As a predicate for getting a will into evidence because of a statement made in it, would the will first have to be admitted to probate? The answer is no, if the attorney draftsman can testify independently as to the statement made by the declarant/testator.[7]

Apparent Exception—Intention

Where intent is one of the elements to be proved, evidence of such intent will be admissible. For example, if the issue is domicile, statements of intent would be admissible.[8]

A very significant example of such "intent" testimony concerns declarations of intent made with respect to future conduct, as opposed to past acts. The U.S. Supreme Court addressed this issue in *Mutual Life Insurance v. Hillmon*.[9] In that case, which involved life insurance, declarations by a person with regard to his intention to go on a journey were admitted as at least some evidence that he actually did go on the journey. The U.S. Supreme Court held as follows: "[t]he existence of a particular intention in a certain person at a certain time being a material fact to be proved, evidence that he expressed that intention at that time is as direct evidence of the fact, as his own testimony that he then had that intention would be."[10]

New York's Appellate Division applied *Hillmon* in *People v. Malizia*.[11] The Appellate Division held in this case that it was "persuaded that a statement by a deceased that he intends to meet another is admissible where the statement is made under circumstances that make it probable that the expressed intent was a serious one, and that it was realistically likely that such a meeting would in fact take place."[12]

On the other hand, the U.S. Supreme Court has referred to its holding in *Hillmon* as "the high waterline beyond which courts have been unwilling to go."[13] Thus, a declaration of a presently existing state of mind is not admissible to prove a past act, as opposed to future conduct.[14]

The issue of intent is key in abandonment cases. The burden of proof is on the party asserting abandonment, which will usually require a showing that there was no consent or acquiescence in the separation between the spouses. As the Nassau Surrogate held in one abandonment case, *In re Reisman*,[15] "proof that she (the decedent) did not consent necessarily implicates her state of mind at or around the time of separation and thereafter. Generally, the mere utterance of a statement, without regard to its truth, may indicate circumstantially the state of mind of the declarant (cites omitted)."[16] Significantly, the Court in *Reisman* went on to state: "[b]ecause human relations between spouses are so complex and separations often occur with or without consent and the burden on a petitioner to show lack of consent is often frustrated by the absence of the decedent, wide latitude should be given in accepting this evidence of state of mind."[17] The Court allowed certain testimony as to what the decedent had said about her husband because such evidence was relevant on the issue of consent and, in fact, demonstrated that "she would go back to him in a heartbeat if he would let her."

The Court in *Reisman* distinguished the decision in *In re Campbell.*[18] In *Campbell*, the Surrogate had held that certain testimony as to statements made by the decedent "were pure hearsay and not receivable," because such evidence was "tendered on the theory that the declarations of deceased, if received, would establish that the separation was without fault on his part and that it was due to a willful disregard of her marital obligations by the surviving spouse."[19] In *Reisman,* similar statements were not tendered to show whether the separation was justified or unjustified, but rather solely on whether the decedent had consented to the separation. The evidence was admissible since it solely went to her intent. The different holdings in *Campbell* and *Reisman* illustrate how it is necessary clearly to articulate the basis for such testimony as solely being relevant to intent.

Apparent Exception—*Res Gestae*

Literally *res gestae* means "the thing done."[20] Generally, what is meant by this concept is that with the act or conduct being described, declarations made simultaneously may be admissible as explaining the act itself. (It should be noted that the use of the phrase "*res gestae*" has been severely criticized, as not adding anything to hearsay analysis).[21] Three examples which come up frequently in Surrogate's Court litigation, illustrating what may be called *res gestae*, are with regard to the execution of a will, revocation of a will, and statements associated with gifts.

Physical destruction of a will alone does not constitute a revocation. There must be an intent to revoke which accompanies the destruction. Consequently, a person's statements of intent which accompany the act of destruction would be admissible.[22] Similarly, in a gift case where intent is one of the elements, a declaration of intent which accompanies the delivery would be admissible to show that the gift is indeed a gift.[23]

In a probate proceeding, declarations of the testator during the will execution ceremony are admissible to satisfy the statutory publication requirement.[24] Publication requires a declaration by words or some other sign by the testator that it is his will, and that he wants the witnesses to witness it.[25] The declarations of the testator at the time of signing the will are part of the act itself and are admissible to show publication.[26] In effect, a meeting of the minds between the testator and the attesting witnesses is evidenced by the declarations of the testator to the witnesses and the conduct of the witnesses in signing the will.[27]

Additionally, besides proving publication, statements made by a testator at or about the time of the execution may be admissible for the sole purposes of evidencing the testator's state of mind at the time of the execution.[28] An example of this is illustrated in the well-known case of *Matter of Putnam.*[29] There, the Court of Appeals stated that the testator's "statements are not evidence of the facts to which they may relate. They would not be, for instance, evidence of what the lawyer did or said at the time of the making of the will or on any other occasion. Her statements, however, both before and after the making of the will, would be competent to show the state of her mind, her mental capacity, her attitude and feeling toward her lawyer, and her ability to resist his influence."[30]

Lost Wills

Proving a lost will is of course very difficult. SCPA 1407 provides that a lost or destroyed will may only be admitted to probate if:

> (i) It is established that the will has not been revoked, and (ii) Execution of the will is proved in the manner required for the probate of an existing will, and (iii) All the provisions of the will are clearly and distinctly proved by each of at least two creditable witnesses or by a copy or draft of the will proved to be true and complete.

Declarations of the testator are not admissible for the purpose of proving the contents of a lost or destroyed will. Additionally, declarations of the testator are inadmissible to prove non-revocation, and thus to establish the existence of the will at the time of death.[31] The Court of Appeals has held that oral statements of the testator that he had mistakenly destroyed his will about a year before he died was inadmissible hearsay.[32]

Exceptions—Pedigree

Statements of personal history, where the declarant is unavailable, may be admissible. Thus, in *Matter of Tumpeer*,[33] in attempting to establish her status as a niece of the decedent, an alleged distributee testified as to a conversation she had had with her mother about her family history. The alleged distributee's mother claimed that her sister, allegedly the decedent, had changed her maiden name in order to deceive her husband into believing she was Jewish, and thus had a different maiden name than the alleged distributee. The court held that the testimony could be admitted under the pedigree exception to the hearsay rule. The evidence satisfied the following requirements: the declarant was not available to testify (either as a result of death or other cause), pedigree was directly an issue, the declarant was related by blood or affinity to the family affected by the declaration, the declarations were made before the controversy arose, and there was at least some evidence to corroborate the statement.

Similarly, in a contested probate action, a contestant may be able to utilize the pedigree exception to establish that he is indeed a distributee of the decedent.[34]

Exceptions—Admissions, Declarations Against Interest and Prior Inconsistent Statements

Any out-of-court statement made by a party which is inconsistent with his position at trial may be given in evidence as an admission. As a hearsay exception, it is received as evidence of the fact admitted.[35]

An interesting exception to the general rule concerning admissions comes up in certain probate cases. If a will has only one legatee, then an admission by him will be competent evidence. On the other hand, there is a general rule that an admission by one party in interest cannot be admitted against another party of interest. That rule results in the evidence being excluded entirely, because it would be impossible to admit the will as to one legatee, but to reject it as to another.[36]

Out-of-court statements made by administrators and executors are admissible against the estate, if made while acting in their official capacity.[37]

It is important to distinguish admissions from declarations against interest. An admission need not be against interest when made. Declarations against interest, on the other hand, are admissible whether the declarant is a party or not a party. A declaration against interest is an out-of-court statement which was against the declarant's interest at the time of its making, and is admissible because it is surmised that people do not usually make statements that are against their personal interest, and such statements therefore are more likely to be reliable than not.[38]

It is also important to distinguish admissions from prior inconsistent statements. The latter is used to impeach the credibility of the witness, and not for proof of the statements contained therein.[39]

Exception—Business Records

CPLR 4518 governs business records. It is important that any practitioner in the Surrogate's Court be familiar with this section. In order for a document to be admissible as a business record, the following four foundation elements must first be shown: "that it was made in the regular course of any business and that it was the regular course of such business to make it, at the time of the act, transaction, occurrence or event, or within a reasonable time thereafter."[40] Additionally, the person who made the record must have had actual knowledge of the recorded event or received his information from someone with actual knowledge who had a business duty to report the same.[41]

The term business "includes a business, profession, occupation, and calling of every kind."[42] Accordingly, personal private records and documents cannot be admitted in evidence based upon CPLR 4518. Private memoranda not made as part of a business, such as a personal check register, may not satisfy the requirement.[43]

Hospital records provide a significant instance of records coming under the business record exception.[44] To be admissible, they must bear a certification or authentication by the head of the hospital.[45] However, to satisfy the exception, such records must "relate to the condition or treatment of a patient."[46] Thus, in any given instance, the hospital records should be carefully studied to make sure that extraneous materials, not related to the condition or treatment of the patient, are excluded.

Careful scrutiny should be given to any document, whether a hospital record or business record, to ensure that it does not contain double hearsay. Double hearsay statements are declarations made within a document which are based upon statements made to the recorder by someone else. That portion of the document will be excised by the court, unless it is shown to the court's satisfaction that it was obtained from someone whose statement itself satisfies a hearsay exception.

Exception—Prior Testimony

Prior testimony may be admitted under certain circumstances, whether it be from a deposition[47] or from a prior trial.[48] Three conditions set forth for the admission of former testimony at a trial are: (i) unavailability of the witness; (ii) identity of the subject matter; and (iii) identity of the parties.[49] Of course, such testimony can also be used for impeachment purposes.

Exception—Excited Utterance

"One of the better-known exceptions to the injunction against the reception of hearsay testimony permits the introduction of a spontaneous declaration or excited utterance—made contemporaneously or immediately after a startling event—which asserts the circumstances of that occasion as observed by the declarant."[50]

Since the person making the statement is generally not available for cross-examination, admissibility of a statement under this exception pushes the boundary, as it were, of the hearsay rule. Accordingly, the court has to carefully assess all the facts and circumstances.

> In making the determination (of admissibility), the court must ascertain whether, at the time the utterance was made, the declarant was under the stress of excitement caused by an external event sufficient to still his reflective faculties, thereby preventing opportunity for deliberation which might lead the declarant to be untruthful. The court must assess not only the nature of the startling event and the amount of time which has elapsed between the occurrence and the statement, but also the activities of the declarant in the interim to ascertain if there was significant opportunity to deviate from the truth. Above all, the decisive factor is whether the surrounding circumstances reasonably justify the conclusion that the remarks were not made under the impetus of the studied reflection.[51]

That judges may differ in assessing whether such testimony is admissible is illustrated in comparing the majority decision versus the dissent in *People v. Simpson*.[52]

The Hearsay "Residual Exception"

The Federal Rules of Evidence, and in particular Rule 807, set forth the so-called "Residual Exception," which applies in federal court.[53] Rule 807 would allow into evidence, in the court's discretion, out-of-court statements not specifically covered by a hearsay exception, if that statement is found to have "circumstantial guarantees of trustworthiness," is not available from "other evidence," and its admission "will best serve the purposes of these rules and the interests of justice."[54]

While at times it appears that courts seem to apply the Residual Exception in allowing what is otherwise hearsay evidence, New York has refused to follow the Residual Exception.[55] The reason for New York's divergence is obvious: liberally applied, the exception would swallow the rule. The right of counsel to cross-examine, which underlies the refusal of the courts to allow hearsay, will have given away to the court's determination as to what is reliable.[56]

Endnotes

1. Farrell, Prince, Richardson on Evidence, § 8-101 (11th ed.).
2. The conduct of a person, albeit non-verbal, may itself be hearsay if it is intended to communicate a statement. An obvious example is sign language. Another is a nod or shake of the head.
3. Richardson, *supra* at n.1, § 8-102.
4. *People v. Felder*, 37 N.Y.2d 779, 375 N.Y.S.2d 98 (1975); *see generally*, Younger, Hearsay: A Practical Guide through the Thicket, § 1.5 (1988).
5. 291 N.Y. 308, 52 N.E.2d 448 (1943).
6. *Id.* at 311.
7. *See e.g.*, *In re Arrathoon*, N.Y.L.J., Oct. 22, 2007, p.31, col. 5 (Sur. Ct., N.Y. Co.).
8. *In re Newcomb*, 192 N.Y. 238, 84 N.E. 950 (1908).
9. 145 U.S. 285 (1892).
10. *Id.* at 295.
11. 92 A.D.2d 154, 460 N.Y.S.2d 23 (2d Dep't 1983), *aff'd*, 62 N.Y.2d 775, 476 N.Y.S.2d 825, 465 N.E.2d 364 (1984), *cert denied*, 469 U.S. 932 (1984).
12. *Id.* at 160.
13. *Shepard v. U.S.*, 290 U.S. 96, 105, 54 S.Ct. 22 (1933).
14. *See generally*, Younger, *supra* at n.4, § 5.8.
15. *In re Reisman*, N.Y.L.J. Feb. 8, 2000, p. 33, col. 3 (Sur. Ct., Nassau Co.).
16. *Id.*
17. *Id.*
18. 186 Misc. 842, 65 N.Y.S.2d 164 (Sur. Ct., N.Y. Co. 1946).
19. *Id.* at 843.
20. Richardson, *supra* at n.1, § 8-601.
21. *See* Younger, *supra* at n.4, § 3.9.
22. *Waterman v. Whitney,* 11 N.Y. 157 (1854).
23. *See In re Romano*, 8 Misc. 3d 1010(A), 801 N.Y.S.2d 781 (Table) (Sur. Ct., Nassau Co. 2005).
24. Estates, Powers & Trusts Law 3-2.1(a) (EPTL).
25. *Id.*
26. *See In re Athanasiou*, 24 Misc. 2d 12, 202 N.Y.S.2d 675 (Sur. Ct., N.Y. Co. 1960).
27. *See* N.Y. Pattern Jury Instructions, § 7:45 (N.Y. P.J.I.).
28. *Waterman*, *supra* at n.22.
29. 257 N.Y. 140 (1931).
30. *Id.* at 144.

31. Richardson, *supra* at n.1, § 8-613.

32. *See In re Bonner*, 17 N.Y.2d 9, 266 N.Y.S.2d 971 (1966); *see also In re Kennedy*, 167 N.Y. 163, 60 N.E. 442 (1901).

33. N.Y.L.J., June 4, 2008, p. 39, col. 4 (Sur. Ct., N.Y. Co. 2008).

34. *In re Esther T*, 86 Misc. 2d 452, 382 N.Y.S.2d 916 (Sur. Ct., Nassau Co. 1976).

35. Richardson, *supra* at n.1, § 8-201.

36. *In re Kennedy, supra* at n.32.

37. Richardson, *supra* at n.1, § 8-230.

38. *Id.* at § 8-203.

39. N.Y. P.J.I. § 1:66.

40. Civil Practice Law & Rules 4518 (CPLR).

41. *See Johnson v. Lutz*, 253 N.Y. 124, 170 N.E. 517 (1930); *see also Prado v. Onor Oscar Inc.*, 44 A.D.2d 604, 353 N.Y.S.2d 789 (2d Dep't 1974).

42. CPLR 4518(a).

43. *In re Lauro*, N.Y.L.J., Dec. 26, 2001, p. 1, col. 6 (Sur. Ct., Nassau Co.).

44. CPLR 4518(c).

45. *See id.*

46. CPLR 2306(a).

47. CPLR 3117.

48. CPLR 4517.

49. *Id.*

50. *People v. Edwards*, 47 N.Y.2d 493, 496-497, 419 N.Y.S.2d, 45 (1979).

51. *Id.* at 497; *see Lagner v. Primary Home Care Services, Inc.*, 83 A.D.3d 1007, 922 N.Y.S.2d 431 (2d Dep't 2011).

52. 238 A.D.2d 611, 656 N.Y.S.2d 765 (2d Dep't 1997).

53. Federal Rules of Evidence 807.

54. *Id.*

55. *See People v. Nieves*, 67 N.Y.2d 125, 131, 501 N.Y.S.2d 1, 492 N.E.2d 109 (1986); *see also People v. Wlasiuk*, 32 A.D.3d 674, 821 N.Y.S.2d 285 (3d Dep't 2006).

56. *See* Younger, *supra* n.4, § 6.1 (providing a discussion of the Residual Exception).

The Basics of Gifts and Gifting in Surrogate's Court Litigation

By Gary E. Bashian

> **"Timeo Danaos et dona ferentes"**
> **("I fear the Danaans [Greeks], even those bearing gifts")**
> —Virgil

As experience has shown time and again, even the most hotly contested turnover and accounting proceedings involving both the largest and the smallest trusts and estates, quite often come down to the resolution of a single, basic legal issue: did the Decedent make a valid inter vivos gift of an asset, or is the asset in fact property of his or her estate? Indeed, the "gift"—what might at first glance appear to be a relatively benign aspect of contract law—is ubiquitous in the world of trusts and estates practice; a legal concept upon which the rights of countless distributees and beneficiaries turn, which is ripe for closer examination.

Overwhelmingly, the burden is on a donee to establish, by clear and convincing evidence, that the three basic elements of a gift have been satisfied: 1) that the donor had donative intent at the time the gift was made; 2) that delivery of the gift to the donee (constructive, actual, or symbolic) was completed; and 3) that the donee accepted the gift itself.[1] (One of the few exceptions to this initial burden being on the donee arises in the context of an SCPA turnover proceeding where the petitioner seeking turnover must first satisfy a pleading burden by alleging that the gift in question was not valid, a burden that once easily met then shifts to the respondent, who is obligated to establish the elements of the gift).[2]

Based upon practicality more than anything, the elements of both delivery and acceptance are often presumed, as a donee often has possession of the gift in one manner or another, and can confirm acceptance by documentary evidence. Nevertheless, the element of delivery is not subject to this presumption under certain circumstances, such as where the donee does not possess the allegedly gifted property.[3] This situation most often arises where there has been symbolic delivery of the property or it is not immediately apparent that delivery has been made. Typically, this occurs where the gift cannot be easily transported or physically delivered in any practical way, frequently because of physical size, or because the property is in the possession of another individual or entity.

Given the presumptions attached to the elements of delivery and acceptance, the element of a gift that is most frequently litigated is that of donative intent. "An inter vivos gift requires that the donor intend to make an irrevocable present transfer of ownership; if the intention is to make a testamentary disposition effective only after death, the gift is invalid unless made by will."[4]

Donative intent, or "irrevocable present transfer of ownership," can be established by the words, writings, and/or actions of both the donor and the donee. If the donor retains control of the property, engages in the continued use and/or occupancy of the property in any way, i.e., as though he is still the owner, and/or has made the gift contingent upon an independent event—including death—then this donative intent element will not be met, and the gift will not be deemed completed.

Critically, "intention or mere words cannot supply the place of an actual surrender of control and authority over the thing intended to be given. "[5] Indeed:

> Where a gift is made effective in the lifetime of the decedent and he has divested himself of all power to recall it, such transaction is a gift inter vivos, and not testamentary in its nature. If the gift does not take effect as an executed and completed transfer to the donee, either legally or equitably, during the life of the donor, it is a testamentary disposition, good only when made by a valid will.… The test is whether the maker intended the instrument to have no effect until after the maker's death, or whether he intended it to transfer some present interest.[6]

The gifting analysis changes from the relatively simple three-element test in the event the donee is in a confidential and/or fiduciary relationship with the donor. In such a scenario—which is not at all uncommon—the donee is subject to the heightened burden of proving that the gift was free of fraud and/or undue influence. This leaves the donee in the position of further proving that the gift was the product of a fair, open, and fully voluntary transaction—a burden that in most other situations is upon the party alleging undue influence.

> [W]here there is a confidential relationship between the beneficiary and the grantor, "[a]n inference of undue

> influence" arises which requires the beneficiary to come forward with an explanation of the circumstances of the transaction.[7]

A confidential relationship can arise where the donee assists the donor with his daily living needs, finances, healthcare, provides food, medication, transportation, etc. The question is generally focused on that of the donor's dependence on the donee, and if the donee has been in a position to exert undue influence as a result of the relationship enjoyed with the donor.[8]

Similarly, where a fiduciary relationship exists, which is distinct from a confidential relationship and can be created by circumstance or more commonly by the mere appointment under a power of attorney, the presumption of impropriety also attaches. This presumption increases the donee's burden so that he or she must also prove that any transfers between the donor and the donee were not only free of fraud and/or undue influence, but also that the transfer was the best interests of the donor as the principal of the power of attorney. The court will closely scrutinize these transactions, especially where withdrawals from the donor's accounts are made by a donee as agent under a power of attorney.[9] Notably, this heightened burden and fiduciary duty exists even when transactions between the donee and donor are *not* made under the authority of the power of attorney.[10]

The gifting analysis is also applicable to different types of co-tenancies involving bank accounts, such as joint accounts, for convenience accounts, and Totten trusts—all of which are pervasive throughout estate litigation.

In circumstances where a joint bank account exists, the court treats the deposit of monies into a joint account as a gift between co-tenants. However, there are statutory considerations that fundamentally influence and shape this analysis. Pursuant to Banking Law § 675, there is a rebuttable presumption that such joint deposits are intended as gifts between the joint tenants of the account.[11] If language of a joint tenancy with rights of survivorship are clearly present and noted on the account, the presumption of a gift is firmly established, and the gift will be considered complete upon the opening of the account itself, or upon the deposit of funds into the account. The burden to disprove that a gift of the funds was intended between the co-tenants shifts to the party challenging the title of the survivor. The challenging party must then establish either the presence of fraud and/or undue influence on behalf of the donee, or a lack of capacity on behalf of the donor, by tendering "direct proof or substantial circumstantial proof, clear and convincing and sufficient to support an inference that the joint account had been opened in that form as a matter of convenience only."[12] To that end, "[i]n the absence of fraud or undue influence, [the deposit of funds into a joint account constitutes] prima facie evidence of the parties' intention to create a joint tenancy,"[13] and thus a completed gift.

Importantly, survivorship language is required on any such account if this presumption is to attach. "The omission of words of survivorship on the signature card precludes application of the presumption."[14] However, "[t]he survivor may…even without the benefit of the presumption, still present evidence to establish a common law joint tenancy with right of survivorship. In that case, however, the survivor must affirmatively introduce evidence of intent."[15]

If the facts support a determination that any such joint account is in fact a "for convenience account," then rights of survivorship—i.e., the gift—will be denied. A "for convenience account" is defined as:

> Any deposit of cash…made in or with any banking organizations…in the name of the depositor and another person or persons and in a form to be paid or delivered to any of them "for the convenience" of the depositor without any right of survivorship in the account existing in favor of the other person or persons so named solely by virtue of such account designation.[16] The owner of a convenience account shall refer only to the depositor and he or she shall be clearly designated as such on the records of the depository.[17]

The test the court employs to determine whether a joint account is actually a for convenience account or in fact a true joint account, considers the following factors—with close attention to the intent of the donor at the time the account(s) were created:

1. Whether the decedent was the sole depositor to the account;[18]
2. Whether the creation of a survivorship interest would deviate significantly from the decedent's testamentary plan;[19]
3. Whether the account was used exclusively by the decedent during his or her lifetime;[20]
4. Whether the decedent retained the right to withdraw the proceeds;[21] and
5. The conduct of the surviving joint tenant.[22]

As one might expect, Totten trusts are susceptible to a gifting analysis as well—i.e., paid on death to a particular individual who has no rights to the account until the passing of the account holder. In the event that monies are placed into a Totten trust for the benefit of another individual, and there is a challenge to the intent of the donor, a similar analysis must take place—with full consideration of any confidential or fiduciary relationship between the parties and/or the presence of fraud, undue influence, or lack of capacity—so as to determine the validity and donative intent of the account/trust.

Totten trusts are considered as a tentative gifts which are completed upon the death of the donor,[23] wherein "title vests in the beneficiary immediately upon death of the donor."[24] However, the gifting analysis discussed above differs, as the "irrevocable present transfer of ownership," which is essential to the intent element, is fundamentally different; not only can the donor terminate the account and/or remove assets from the account at will, but both the delivery and acceptance elements are more nuanced given the nature of the "gift."

Accordingly, EPTL 7-5.2 was enacted, which is "clear and precise in prescribing the three ways by which a depositor can revoke a Totten trust: withdrawal of the funds, an express direction in a will, and a qualifying writing filed with the bank."[25] Absent revocation pursuant to EPTL 7-5.2, or other credible evidence that would invalidate the "gift," Totten trusts will pass to the named "beneficiary," as there will be little grounds to successfully contest the donative intent of the donor.

Lastly, one of the remaining issues that frequently arises when dealing with "gifting" in Surrogate's Court litigation is the effect of the statute of limitations. This issue emerges in the context of a conversion claim, as what one party claims was a gift, another will allege was the product of conversion. Ordinarily, the statute of limitations for conversion or replevin actions is three years.[26] However, in certain situations the limitations period may be tolled.

Where a person in possession of property acquires it in a lawful manner, i.e, the title owner knowingly and voluntarily allows an individual to take possession of the property, but not title, the three-year statute of limitations will begin to run upon a demand being made for the return of the property, and the refusal by the current possessor (known as the "demand and refusal rule"). Alternatively, where an individual surreptitiously or "unlawfully" comes into possession of the property, i.e., when their possession of the property is unknown to the title owner, then the demand and refusal rule will not apply, and the statute of limitations will begin to run at the time of the "taking." Although these rules may be somewhat counterintuitive, the courts have based this rule on the premise that an overt and positive act of conversion must be made before the statute-of-limitations period can begin. Accordingly, this overt act occurs with either the "demand or refusal" where there is a known "lawful possession," or at the time of the actual taking where there is an unknown "unlawful possession."[27]

Even based in this limited overview, the law governing "gifting" is clearly an integral piece of estate litigation as it underlies much of the practice. As most attorneys who litigate in these areas would agree—at least to the extent that attorneys can agree upon anything—effective advocacy depends upon presenting one's case to both the court and a jury with clarity and simplicity. Presenting clear, unrefuted fact patterns; making simple the technical, often opaque statutes; and applying the ever evolving body of common law to a client's financial transactions is, without question, an art that takes years to develop and to master. Complex Surrogate's Court litigation is no exception, but as highlighted in the above examples regarding "gifts," the law may often be broken down into its simplest elements so that it can then in turn be explained, understood, and built upon in order to be effectively applied a client's facts.

Endnotes

1. *See In re Parisi*, 34 Misc. 3d 1204(A), 946 N.Y.S.2d 68, (Sur. Ct., Queens Co. 2011); *In re Kaminsky*, 17 A.D.2d 690, 230 N.Y.S.2d 954 (3d Dep't 1962); *Gruen v. Gruen*, 68 N.Y.2d 48, 505, N.Y.S.2d 849 (1986).
2. *See In re Kelligrew*, 63 A.D.3d 1064, 882 N.Y.S.2d 221 (2d Dep't 2009).
3. *See generally In re McHale*, 37 Misc. 3d 1204(A), 964 N.Y.S.2d 60 (Sur. Ct., Erie Co. 2012).
4. *Hom v. Hom*, 101 A.D.3d 816, 955 N.Y.S.2d 630 (2d Dep't 2012); *citing Gruen*, 68 N.Y.2d 48.
5. *In re Szabo's Estate*, 10 N.Y.2d 94, 217 N.Y.S.2d 593 (1961).
6. *McCarthy v. Pieret*, 281 N.Y. 407, 24 N.E.2d 102 (1939); *see also Ross v. Ross Metals Corp.*, 87 A.D.3d 573, 928 N.Y.S.2d 327 (2d Dep't 2011).
7. *Juliano v. Juliano*, 42 Misc. 3d 1226(A), 984 N.Y.S.2d 632 (Sup. Ct., Kings Co. 2014); *citing In re Gordon v. Bialystoker Ctr. & Bikur Cholim*, 45 N.Y.2d 692, 412 N.Y.S.2d 593 (1978); *In re DelGatto*, 98 A.D.3d 975, 950 N.Y.S.2d 738 (2d Dep't 2012); *In re Neenan*, 35 A.D.3d 475, 827 N.Y.S.2d 164 (2d Dep't 2006).
8. *See generally In re Boatwright*, 114 A.D.3d 856, 980 N.Y.S.2d 554 (2d Dep't 2014); *citing In re Connelly*, 193 A.D.2d 602, 597 N.Y.S.2d 427 (2d Dep't 1993); *Hennessey v. Ecker*, 170 A.D.2d 650, 567 N.Y.S.2d 74 (2d Dep't 1994).
9. *In re Boatwright*, 114 A.D.3d 856; *citing Mantella v. Mantella*, 268 A.D.2d 852, 701 N.Y.S.2d 715 (3d Dep't 2000); *In re Roth*, 283 A.D.2d 504, 724 N.Y.S. 2d 476 (2d Dep't 2001).
10. *In re Cooper*, 6 Misc. 3d 1001(A), 800 N.Y.S.2d 346 (Sur. Ct., Nassau Co. 2004); *citing In re Mazak*, 288 A.D.2d 682, 732 N.Y.S.2d 707 (3d Dep't 2001); *In re Camarda*, 63 A.D.2d 837, 406 N.Y.S.2d 193 (4th Dep't 1978).
11. *See Hom v. Hom*, 101 A.D.3d 816, 955 N.Y.S.2d 630 (2d Dep't 2012).

12. *In re Stalter*, 270 A.D.2d 594, 703 N.Y.S.2d 600 (3d Dep't 2000). At common law, there was no presumption of joint tenancy in a bank deposit. *See In re Hollweg*, 67 A.D.2d 1001, 413 N.Y.S.2d 735 (2d Dep't 1979); *see also In re Hickmott's Estate*, 256 A.D. 1047, 10 N.Y.S.2d 918 (4th Dep't 1939).
13. *Jacks v. D'Ambrosio*, 69 A.D.3d 574, 892 N.Y.S.2d 503 (2d Dep't 2010); *see also, In re Yaros*, 90 A.D.3d 1063, 1064, 935 N.Y.S.2d 627 (2d Dep't 2011); N.Y. Banking Law §675(a) and (b).
14. *In re Gilman*, 6 Misc. 3d 1001(A), 800 N.Y.S.2d 346 (Sur. Ct., Nassau Co. 2004); *citing In re Schwartz*, N.Y.L.J., May 22, 1991, p. 26, col. 4 (Sur. Ct., Nassau Co.).
15. *Id.*; *In re Thomas*, 43 A.D.2d 446, 352 N.Y.S.2d 524 (3d Dep't 1974); *In re Hamburg*, 151 Misc. 2d 1034, 574 N.Y.S.2d 914 (Sur. Ct., Bronx Co. 1991).
16. 3 N.Y. Codes, Rules and Regulations § 15.1[c].
17. 3 NYCRR §15.1[d].
18. *In re Zorskas*, 20 Misc. 3d 1110(A), 867 N.Y.S.2d 22 (Sur. Ct., Nassau Co. 2008); *citing In re Van Bogelen*, 204 A.D.2d 650, 614 N.Y.S.2d 228 (2d Dep't 1994).
19. *In re Zorskas, supra*; *citing In re Johnson*, 7 A.D.3d 959, 777 N.Y.S.2d 212 (3d Dep't 2004); *In re Camarda*, 63 A.D.2d 837, 406 N.Y.S.2d 193 (4th Dep't 1978).
20. *Zorskas*, 20 Misc. 3d 1110(A); *citing Camarda*, 63 A.D.2d 837.
21. *Zorskas*, 20 Misc. 3d 1110(A); *citing In re Niesz*, N.Y.L.J., Apr. 24, 1996, p. 32, col. 1 (Sur. Ct., Westchester Co. 1996).
22. *Zorskas,* 20 Misc. 3d 1110(A); *citing In re Boyd*, 186 A.D.2d 394, 588 N.Y.S.2d 188 (1st Dep't 1992).
23. *In re Totten*, 179 N.Y. 112, 74 N.E. 748 (1904). *See also* N.Y. Estates, Powers and Trusts Law 7–5.1; EPTL 7-5.2.
24. *Eredics v. Chase Manhattan Bank, N.A.*, 100 N.Y.2d 106, 760 N.Y.S.2d 737 (2003).
25. *Id.*
26. CPLR §214 (3). *See also In re Witbeck*, 245 A.D.2d 848, 666 N.Y.S.2d 315 (3d Dep't 1997); *Matter of Kraus*, 208 A.D.2d 728, 617 N.Y.S.2d 817 (2d Dep't 1994).
27. *See In re Madris*, N.Y.L.J., Mar. 13, 2000, p. 31, col. 3 (Sur. Ct., N.Y. Co. 2000); *In re King*, 305 A.D.2d 683, 759 N.Y.S.2d 895 (2d Dep't 2003); *D'Amico v. First Union Natl. Bank*, 285 A.D.2d 166, 728 N.Y.S.2d 146 (1st Dep't 2001); *Berman v. Goldsmith*, 141 A.D.2d 487, 529 N.Y.S.2d 115 (2d Dep't 1988).

Gary E. Bashian is a partner in the law firm of Bashian & Farber, LLP with offices in White Plains, New York and Greenwich, Connecticut. Mr. Bashian is a past President of the Westchester County Bar Association. He is presently on the Executive Committee of the New York State Bar Association's Trusts and Estates Law Section, is a past Chair of the Westchester County Bar Association's Trusts & Estates Section, past Chair of the Westchester County Bar Association's Tax Section, and a member of the New York State Bar Association's Commercial and Federal Litigation Section.

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Recent New York State Decisions

By Ira M. Bloom and William P. LaPiana

Ira M. Bloom

ADMINISTRATION

Grant of Letters of Administration c.t.a. Not Appropriate Where No Property Remains to Be Administered

William H. Seward, III, the namesake of his grandfather who was governor of New York and Secretary of State during the Civil War, bequeathed the family home and its contents to a foundation. The bequest included a valuable painting by Hudson River School founder Thomas Cole. The estate was closed in 1955 and the decree approved the foundation's transfer of the house and the personal property with the exception of the painting, which the foundation kept, to the Seward House Museum where the painting was displayed. The decree also provided that the painting could be transferred to any party other than the museum only with permission of the court. In 2013 the foundation and the museum agreed to remove the painting to secure storage and replace it with a reproduction.

The decedent's great-nephew sought letters of administration c.t.a. in order to begin an action seeking an injunction to prevent sale of the painting to any person or entity other than the museum. The Surrogate denied the foundation's motion to dismiss and granted letters limited to the enforcement of the terms of the gift under the decedent's will. The issue of standing was not addressed, and the Attorney General reserved the right to contest on that basis. On appeal by the foundation the Appellate Division reversed, holding that the grant of letters was an error because no property of the estate remained to be administered. In addition, there is no evidence that the Attorney General is not protecting the decedent's wishes, and the Surrogate denied the great-nephew's request that the letter grant him the authority to commence an action, thus distinguishing *Smithers v. St. Luke's-Roosevelt Hospital*, 281 A.D.2d 127, 723 N.Y.S.2d 426 (1st Dep't 2001). The court therefore granted the motion to dismiss the petition without prejudice to seeking letters should it become necessary for the estate to participate in a proceeding or action involving the painting. *Matter of Seward*, 118 A.D.3d 1312, 988 N.Y.S.2d 326 (4th Dep't 2014).

William P. LaPiana

PARENTAGE

Child Born by AID Is Child of Mother's Same-sex Spouse under Common Law Presumption of Legitimacy

Wendy G-M and Erin G-M married in Connecticut before the passage of the Marriage Equality Act in New York. The couple undertook to conceive by artificial insemination and both the spouses and the physician who performed the procedure signed a consent in which the spouses declared that any child resulting from the procedure "shall be accepted as the legal child of our marriage." One of the spouses did conceive and gave birth to a daughter. The birth certificate lists both spouses as parents of the child. The couple separated shortly after the child's birth and three months after birth the birth-mother began divorce proceedings. The other spouse then filed for various relief including access to the child. In a comprehensive opinion, the Supreme Court held that the non-biological spouse was the parent of the child: the failure to acknowledge the signatures to the consent meant that the presumption of DRL § 73 did not apply, but under the common law of New York, there is a presumption of legitimacy of a child born to a married woman, and under the Marriage Equality Act the presumption applies to all marriages whether the spouses are of the same sex or different sexes. *Wendy G-M v. Erin G-M*, 45 Misc. 3d 574, 985 N.Y.S.2d 845 (Sup. Ct., Monroe Co. 2014).

POWER OF ATTORNEY

Familial Relationship, Health Status and Agency Alone Do Not Constitute Confidential Relationship to Shift Burden to Disprove Undue Influence

Daughter was agent under her mother's power of attorney executed in 2004. In 2010 while mother was alive her other children began a special proceeding under GOL § 5-1510(2)(e) for judicial approval of the receipts, disbursements, and transactions entered into by the agent on behalf of the principal. Principal died while the proceeding was pending and the instigators of the special proceeding sought an order declaring that a confidential relationship existed between the agent and the principal as a matter of law, so that the burden of disproving undue influence would shift to the agent-daughter. Supreme Court denied the motion without prejudice to renewal at trial. Petitioners appealed and the Appellate Division affirmed, first, because the parent-child relationship between the principal and the agent is not sufficient in and of itself to require the conclusion that a confidential relationship existed, and, second, the state of the principal's health and the existence of the principal-agent relationship is not sufficient to require the finding of a confidential relationship without evidence that the agent was controlling the principal's decisions. *Matter of Bonczyk*, 119 A.D.3d 1124, 990 N.Y.S.2d 304 (3d Dep't 2014).

STATUTES

EPTL 2-1.13 Does Not Apply to Formula Contained in GRAT

Decedent created two GRATs. Both trust instruments provided that if the creator survived the two-year term of the trusts, the trust property was to be distributed in equal shares to her three children if they all survived (which they did). If the creator died before the termination of the trusts, a fractional share of the trust property would pass to her estate and the remainder of the trust property would pass to her children in equal shares. The numerator of the fraction was equal to the value of the trust property includible in the creator's gross estate for federal estate tax purpose and the denominator was the value of all of the trust property.

The creator of the trusts died in 2010, before the termination of either trust, and the co-executors, two of the children, elected not to pay federal estate tax. Without regard to EPTL 2-1.13(a), the numerator of the fraction would be 0 as would be the fraction so that the trust property would pass equally among the decedent's three children. The co-executors, however, disagreed on the application of EPTL 2-1.13(a), which provides that if by reason of the death of a decedent property passes or is acquired under the will, trust, or beneficiary designation of a decedent who dies during 2010, and the instrument contains a bequest or other disposition based on the amount of property that can be sheltered from federal estate by reason of the unified credit (no matter how referred to), the instrument is deemed to refer to the federal estate tax as applied to decedents dying in 2010 whether or not an election is made not to have the tax apply to the estate. If EPTL 2-1.13(a) were applied, the numerator of the fraction would equal the value of the GRAT that would be includible in the gross estate so that the fraction would be 1, and all of the trust property would be required to be paid to the estate to the advantage of two of the three children.

Surrogate Anderson held that the statute did not apply and that therefore all of the trust property passed to the children in equal shares. The Appellate Division affirmed, holding that the legislative history indicated that the purpose of the statute was to prevent the destruction of marital gifts measured by reference to the amount sheltered by the unified credit; that it should not apply to the GRATs because they were not structured to take advantage of the marital deduction; and that the reference to the tax was not done to minimize taxes but rather to "account for an uncertain value to include in the taxable estate upon the death of the grantor.…" The plain language of the statute also supports the result because it applies to property that passes "by reason of the death" of a decedent dying in 2010. The remainders of the GRATs passed by reason of the trust terms and the timing of the decedent's death affected only the size of the children's shares. In addition, the decedent expected the trust property to be equally divided among her children should the trust property not be subject to estate tax. *Kirschner v. Fisher*, 117 A.D.3d 567, 986 N.Y.S.2d 441 (1st Dep't 2014).

TRUSTS

Reduction of Disposition to Pet Trust Not Appropriate

Decedent and her predeceased spouse executed wills which both provided that if the spouse did not survive, all of the property in the residuary estate, other than the testator's home, was to be sold and the proceeds distributed to trustees to pay a salary and a yearly bonus to the couple's housekeeper and to make distributions to the housekeeper to maintain the home and care for the decedent's cats. On the death of the last cat to die, the home and its contents were to be sold, a distribution of $50,000 made to the housekeeper and the rest distributed to animal-related charities named in the instrument. The inventory filed in the year of decedent's death gave the value of the estate assets as a bit over $4.75 million.

The trust was not funded, the co-executors used estate assets to carry out the trust terms and then the co-executors filed a petition requesting a reduction in the amount passing to the trust to $1,000,000 minus the $628,000 already expended, permission to sell the house, and permission to buy a new residence for the housekeeper and the cats. The charitable beneficiaries filed an answer in which they pointed out that the co-executors failed to set forth liabilities and assets on hand and that they had failed to file federal and state tax returns. The housekeeper also filed an answer denying that she was in agreement with the co-executors' plans.

Surrogate Scarpino denied the co-executor's petition, holding that to do so would violate the decedent's clearly expressed intent with regard to the care of her cats after her death, and that the co-executors offered no evidence that that amount passing to the trust was greater than necessary to carry out the decedent's intent. *Matter of Copland*, 44 Misc. 3d 485, 988 N.Y.S.2d 458 (Sur. Ct., Westchester Co. 2014).

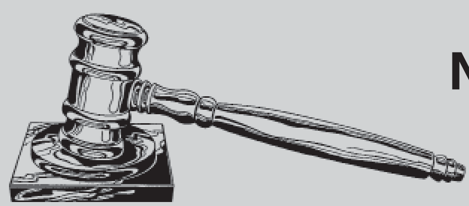
WILLS

Document Might Embody Testamentary Intent in Spite of Contradictory Language

Decedent's 2002 will was admitted to probate. The beneficiary of a second purported will dated 2012 then moved to vacate probate. Surrogate Cass denied the petition on the grounds that the affidavits of the two purported attesting witnesses could not substitute for in-court testimony because the purported will lacked an attestation clause and was not executed under the supervision of an attorney. In addition, Surrogate Cass found that the document was not testamentary in character because its final sentence stated that "[t]he above will, will take place preceding my death." On appeal, the Appellate Division reversed and remanded. While the Surrogate was justified in rejecting the witness affidavits for the reasons he stated and under SCPA 1406(1)(b), the Surrogate erred in granting without a hearing the motion to dismiss the petition on the ground that the document was not testamentary in character. The decedent labeled the document "final will" and in it stated that it represented her "final decision" with regard to her estate and included language disposing of her entire estate and all her real estate. In the court's view, it is unlikely, and there is no evidence, that the decedent intended to dispose of her possessions before death, and the language referring to the will taking place before the decedent's death could be the decedent's attempt to state that the new will revoked the 2002 document. A hearing under SCPA 1404 is required so that the witnesses may be examined. *Matter of Gehr*, 117 A.D.3d 1405, 984 N.Y.S.2d 746 (4th Dep't 2014).

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 co-authors of Bloom and LaPiana, *Drafting New York Wills and Related Documents* (4th ed. Lexis Nexis).



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

By Ilene Sherwyn Cooper

Attorney's Fees

In a contested accounting proceeding, the remaining issue before the court was the legal fees of the petitioner's counsel. Counsel filed an affirmation in support of the requested fees, pursuant to UCR 207.45, and opposition thereto was filed by the objectants. The parties agreed to waive a hearing and have the matter decided based on the papers submitted.

The court noted that petitioner's counsel had previously been paid $61,253, and was requesting an additional $15,734 for services performed, based on a gross estate of approximately $1.8 million. Pursuant to his retainer agreement with the executor, counsel's fee was to be 4 percent of the gross estate of the decedent, as shown on the New York State or Federal Estate Tax return, except in the event of litigation, in which event, fees would be charged at the rate of $300 per hour, which the court found commensurate with his experience and professional standing. To this extent, counsel indicated that the hours spent by him could be classified into one of three categories: 1) estate administration work (30 hours of time); (2) legal work in connection with the sale of the decedent's cooperative apartment (12.75 hours); and 3) litigation in connection with the accounting proceeding (80.75 hours).

In opposition to the requested fee, the objectants claimed that in view of the surcharges against the executor, attorney's fees should be denied in their entirety. The court rejected this argument, and held that reasonable legal fees for necessary work performed could nevertheless be paid from the estate.

On the other hand, the court held that the legal fees incurred in connection with the sale of the apartment should be charged against the proceeds of its sale, rather than the general estate, finding that the purpose of the sale was not to facilitate the estate administration, but rather to further the interests of only one of the estate's beneficiaries. Additionally, the court held that counsel could not be compensated for services that were executorial in nature, and denied payment of counsel fees for time spent in connection with the litigation that was solely related to the defense of the executor's personal interests.

Accordingly, the court held that with the exception of the fees disallowed in connection with the sale of the cooperative apartment, the fees paid in excess of those allowed belonged to the residuary beneficiaries, and directed that they be paid to the residuary beneficiaries in proportion to their interests, with interest at the rate of 6% from the date taken.

In re Bigus, N.Y.L.J., July 29, 2014, p. 29 (Sur. Ct., N.Y. Co.) (Mella, S.).

Discovery

In *In re Estate of Cain,* the Surrogate's Court, New York County (Mella, S.) was confronted with a petition, pursuant to SCPA §2103, seeking the turnover of $105,945.02 from the decedent's granddaughter. Although served with citation, the granddaughter failed to answer the petition. Accordingly, the court proceeded to an inquest in order to determine whether the record supported the relief requested.

The facts established that between 2006 and 2007 the decedent had co-signed four promissory notes to Sallie Mae, in the total sum of $78,000, in order to enable her granddaughter to attend college. The loan documents established that the principal debtor, the decedent's granddaughter, and co-signor, the decedent, were jointly and severally liable for repayment. Specifically, the documents indicated that the decedent was not a surety on the loan, but instead was a guarantor, against whom the creditor could proceed directly without the need to first seek collection from the principal debtor. The documents further indicated that upon the death of either one of the parties to the notes, repayment could be accelerated.

As a consequence, following the decedent's death and the appointment of the petitioner as fiduciary of the decedent's estate, Sallie Mae made demand for repayment of the outstanding balance of the unpaid loan. Repayment was made by the fiduciary in the sum of $105,945.02, who then sought indemnification from the decedent's granddaughter. When she failed to respond to the fiduciary's request, the proceeding for discovery was commenced.

In granting the relief requested by the petitioner, the court opined that a guarantor has a right to indemnification upon repaying the creditor for a loan from which the principal debtor benefited. The right of recovery by the guarantor from the principal debtor does not need to be supported by a separate contract with the principal debtor. Rather, the liability of the principal debtor is lodged in equity, which seeks to prevent unjust enrichment. As a result, the guarantor, who has repaid the creditor, stands in the shoes of the creditor as to the principal debtor for purposes of recovering any monies paid on the principal debtor's behalf.

Within this context, and based on the undisputed record, the court held that the fiduciary had made a prima facie case for indemnification against the principal debtor, the decedent's granddaughter, and she was directed to turn over to the estate the full amount requested by the petition.

In re Cain, N.Y.L.J., June 20, 2014, p. 22, col. 4 (Sur. Ct., N.Y. Co.) (Mella, S.).

Release of Power of Appointment

In *Matter of Aoki,* the Appellate Division, First Department, reversed a decree of the Surrogate's Court, New York County (Mella, S.), which invalidated two partial releases of a power of appointment executed by the decedent, and denied the motion of the decedent's children for summary judgment declaring said releases valid, on the grounds that a question of fact existed as to whether they were the result of constructive fraud perpetrated by the decedent's attorneys.

The record revealed that in 1998, the decedent, the founder of the Benihana restaurant chain, created a trust to hold stock and other assets pertaining to the enterprise. The agreement gave the decedent the power to appoint the beneficiaries of the trust through his Will. The trustees of the trust were two of his six children, and his long-time attorney.

Several years after the creation of the subject trust, the decedent married the respondent. Concerned with the fact that he did not have a prenuptial agreement protecting the trust assets, the decedent, at the urging of the trustees of the trust, requested that the respondent sign a postnuptial agreement. When she refused to do so, the decedent was advised by counsel (the partner of the attorney-trustee) that he could partially release his power of appointment under the trust so as to limit the exercise of his power of appointment to only his descendants or trusts for their benefit, and thereby restrict the disposition of Benihana assets to members of his direct family. Thereafter, the decedent met with the trustees to discuss a draft of the release, and the following day, again met with the three of them to sign the one-page document.

Subsequently, the decedent's relationship with the trustees deteriorated, and ultimately culminated in litigation. Discovery during the course of that litigation revealed that counsel informed the decedent of the effect of the release, and more specifically, the limitation that he could only exercise his power of appointment in favor of his descendants. In addition, the record indicated that the decedent had the opportunity to read the release, and that, because of a change in the tax law, later signed a second release, which again restricted his power to appoint to only his descendants.

Approximately eight months after signing the second release, the decedent met with the respondent's attorney and executed a codicil to his Will which, *inter alia,* purported to exercise his power of appointment in favor of the respondent. In response to a request from the draftsman of the codicil, decedent's counsel opined that this provision of the codicil was invalid as a result of the decedent's partial release, which made the respondent an impermissible appointee of the trust. Although the decedent signed an affidavit stating that he did not understand the import of the release, the Court noted that he took no steps prior to his death to declare the document invalid. The Court further noted that almost four years after signing the affidavit the decedent executed a new Will, which again purported to exercise the power of appointment in favor of the respondent, but added that in the event that such exercise of the power was found invalid as a result of the partial releases that were signed, the power was instead exercised in favor of two of his children.

Following the decedent's death, the trustees of his trust commenced a proceeding to determine the validity of the partial releases. The decedent's wife, and the two children who were named as default takers of the power, filed answers, and upon completion of discovery, the children moved for summary judgment. The motion was denied, and a nonjury trial was held, which resulted in a determination by the New York County Surrogate's Court that the releases were invalid.

The Appellate Division reversed, concluding that the releases should have been given effect. In reaching this result, the Court found that the Surrogate's Court had erred when it shifted the burden to the decedent's children to prove that the releases had not been procured by fraud. Indeed, the Appellate Division held that there was no basis in the record for according the respondent the benefit of the fiduciary exception, since neither one of the decedent's attorneys, who had been charged with constructive fraud, had an interest in or benefited from the subject transaction. Further, the Court found the record established that the decedent understood the releases, notwithstanding his claims to the contrary, and that the respondent had failed to demonstrate that his attorneys had misled him regarding their effect. Instead, the Court noted that counsel had made all reasonable efforts to apprise the decedent of the effect of what he was signing, and the decedent had ample opportunity to review and ask questions about the documents before doing so. The Court concluded that no valid excuse was offered for the claim that the decedent did not read the release before signing it, and that the decedent's purported unfamiliarity with the English language was insufficient to support a claim of fraud given the failure to demonstrate that any efforts were made to have someone read and explain the document to him in advance of its execution.

Most significantly, the Court found that despite the decedent's awareness that he had signed irrevocable releases for years prior to his death, he had made no attempt to have the releases declared invalid, thereby calling into question the veracity of his claims that they were contrary to his intentions.

Matter of Aoki, 117 A.D.3d 499, 985 N.Y.S.2d 523 (1st Dep't 2014).

Reformation

Before the court in *In re Isasi-Diaz* was a request for reformation of the sole dispositive provision of the decedent's Will. The decedent, testate, died survived by one distributee, her mother, with an estate of approximately $1.2 million. Article Second of her Will, which was admitted to probate, provided, *inter alia,* for the disposition of 2/3 of her residuary estate to and among her siblings, nieces and nephews, but failed to dispose of the remaining 1/3 thereof. Absent a reformation, such portion of the estate would pass by intestacy.

According to an affidavit of the attorney-draftsman, the decedent provided him with instructions for the disposition of the last 1/3 of her estate, but due to an error on his part, that dispositive provision was omitted. The threshold issue was whether this extrinsic evidence could be considered.

Citing to the Court of Appeals opinions in *Matter of Cord*, 58 N.Y.2d 539, 544 (1983) and *Matter of Piel*, 10 N.Y.3d 163, 164 (2008), the court held that extrinsic evidence will not be admissible to vary or contradict the unambiguous expressions of the decedent. With this in mind, the court turned to the language of the decedent's will and found that the instrument was unambiguous in disposing of only a portion of her estate. The court therefore concluded that the affidavit of the attorney-draftsman contradicted rather than clarified the express terms of the Will. Noting that the existence of a testamentary instrument gives rise to a presumption against intestacy, the court nevertheless concluded that it could not rewrite a will or supply an omission not reasonably implied from the language. Accordingly, the petition for reformation was denied.

In re Isasi-Diaz, N.Y.L.J., Mar. 28, 2014, p. 35 (Sur. Ct., N.Y. Co.) (Mella, S.).

Removal of Fiduciary

Before the court was a motion to dismiss a proceeding for removal of two co-trustees, on the grounds that the petition failed to state a cause of action and was barred by the statute of limitations.

The decedent died survived by a wife and three children. Pursuant to the pertinent provisions of his Will, the decedent created three trusts for the benefit of his wife and children, and named his wife, his brother, and a friend as the co-trustees. Upon admission of the Will to probate, letters of trusteeship issued to the nominated fiduciaries.

A principal asset of the decedent's estate was his one-half interest in the retailer, Modell Sporting Goods. The decedent's brother, Mitchell, owned the other half of the company and managed its operations as CEO. Several years into the administration of the trust estates, the decedent's spouse filed proceedings seeking removal of her co-trustees, and compelling them to account. In response, the court held the removal proceeding in abeyance pending the filing of accountings by all three trustees. Notably, the trust accountings filed by the decedent's spouse reported zero on each of the schedules, based on her contention that she was excluded by her co-trustees from all decisions pertaining to the trust estates.

Turning to the motion and the issue of whether the petition stated a cause of action for removal, the court noted that while the pleading did not specify the applicable subsection of SCPA 711 upon which it was based, the omission was not fatal. Rather, examination of the allegations revealed that three sub-sections of the statute were arguably relevant; to wit, SCPA 711(2), 711(8), and 711(10).

More specifically, the court found that the petition alleged a course of conduct by the fiduciaries, which included acts of self-dealing by the decedent's brother, Mitchell, in increasing his annual compensation, and causing Modell's to make improper payments to him in order to fund his "lavish lifestyle." Additionally, the court noted that the petitioner claimed that she was excluded from any meaningful participation in the management of the trusts, and that the decedent's brother, in violation of the clear directives in the decedent's Will, had retained non-income producing property, *i.e.*, the trust's interest in Modell's, for his personal benefit, and failed to make significant distributions of income from the company to the Marital Trust. The petitioner further alleged that her co-trustee, the decedent's friend, had wholly abdicated his duties and responsibilities to the decedent's brother, and had no expertise in financial matters, trust matters, or the retail business.

The court found the foregoing claims to state a sufficient cause of action for removal. Notably, the court rejected the decedent's brother's claim that his appointment was an acknowledgment by the decedent of his conflict of interest and dual roles, holding that the decedent's awareness of such conflict did not give his brother license to overreach. Further, despite the deference accorded to a testator's selection of a fiduciary, the court found that such principle could not insulate a fiduciary from allegations of wrongdoing.

As to the argument that the proceeding was barred by the statute of limitations, the court held that there is no limitations period within which to commence a removal proceeding. Moreover, although the court found that a defense of laches could be asserted in a removal proceeding, it concluded that the motion had failed to establish that defense as a matter of law.

Accordingly, the motion to dismiss was denied.

In re Modell, N.Y.L.J., July 23, 2014, p. 22, col. 3 (Sur. Ct., N.Y. Co.) (Anderson, S.).

Statute of Limitations

In a discovery proceeding pending before the Surrogate's Court, Queens County, the respondent moved for an order dismissing the claims against him requesting, *inter alia,* the turnover of estate assets and information regarding the transfer of the decedent's real property, on the grounds that they were barred by the statute of limitations. The record revealed that the decedent died on March 3, 2007, survived by her three children, each of whom had been appointed the administrators of her estate. On May 10, 2013, a discovery proceeding was commenced by one of the co-administrators against his sister. The petition initially requested, among other things, an order directing the respondent to turn over to the estate the sum of $80,000, and directing the respondent to produce any and all documentation regarding the transfer to her of the decedent's real property in North Carolina. Subsequent to the filing of the motion, that part of the petition requesting the production of documents pertaining to the real property was withdrawn, and that branch of the motion seeking dismissal of that portion of the claim was denied as moot.

With respect to the balance of the motion, the petitioner alleged that in 2006, at a time when the decedent was in ill health and incapable of making decisions on her own, the respondent removed important papers from the decedent's residence, and caused the decedent to issue her a check in the sum of $80,000 under the false pretense that respondent would utilize the funds to purchase a condominium. The petitioner further alleged that the day before the check was issued, the respondent caused the decedent to execute a deed transferring to respondent the decedent's real property in North Carolina. The decedent died eight months later.

In support of her motion to dismiss the petition, the respondent alleged that the proceeding was time barred since it was commenced more than one year after the decedent's date of death. More specifically, relying on the provisions of CPLR 210(a), respondent argued that while a three year statute of limitations applies to a turnover proceeding, because the transfer of the check was made while the decedent was alive and the statute of limitations had not yet expired by the decedent's death, the petitioner had only one year from the date of death, *i.e.*, March 3, 2008, to commence the proceeding. Since she had not commenced the proceeding until May, 2013, it was untimely.

In opposition, the petitioner maintained that the respondent should be estopped from asserting the statute of limitations as a defense, since she deliberately delayed disclosing that she had received a check from the decedent in breach of her fiduciary duty as a co-administrator of the decedent's estate until after the expiration of the statutory period.

The court opined that a discovery-turnover proceeding is akin to an action for replevin or conversion, and, as such, is generally governed by a three year statute of limitations. The accrual date runs from the date of the conversion, and not from the date of actual or imputed discovery. However, where actual fraud is alleged, the applicable statute of limitations is six years or two years from the discovery of the fraud, or the date on which it could have reasonably been discovered, whichever is later.

Within this context, the court held that respondent was incorrect in her analysis of CPLR 210(a) to the extent that she suggested that it reduced the statutory period of time within which to commence an action following death. Nevertheless, applying the three year statute of limitations to the circumstances and date of the subject transfer, the court found that the period within which to commence the proceeding would have expired on July 12, 2009. Moreover, the court opined that even if the six year statute of limitations period for fraud were applied, the proceeding was untimely, since the record revealed that the petitioner was aware of the check at least by February 4, 2011, and yet did not commence the action two years later as required.

As for petitioner's claim of estoppel, the court noted that a party may be estopped from asserting the statute of limitations as a defense where the claimant has been induced by fraud, misrepresentation or deception from bringing a timely lawsuit. Accordingly, the petitioner was required to establish that subsequent and specific actions by the respondent kept him from timely instituting suit for recovery of the proceeds represented by the check issued by the decedent. The court found that petitioner not only failed to make this showing, but, as co-administrator of the decedent's estate, had all of her bank and financial records available disclosing the subject transaction. Petitioner's claims based on estoppel were therefore denied, and respondent's motion to dismiss the proceeding was granted.

In re Dinizulu, N.Y.L.J., Jan. 17, 2014, p. 40 (Sur. Ct., Queens Co.).

Summary Judgment

In a contested probate proceeding, the petitioner moved for summary judgment dismissing the objections to probate, and the objectant cross-moved requesting that probate of the propounded instrument be denied.

The decedent was survived by a spouse, with whom he was in the midst of a divorce at death, and four children. His Will bequeathed his entire estate to his girlfriend, and nominates her the executrix thereunder. Objections to probate were filed by the spouse and children. The children's objections were subsequently dismissed as a result of their repeated failure to appear for court-scheduled conferences. The remaining objectant spouse appeared *pro se* after her attorney was relieved as counsel.

The record revealed that the Will was prepared by an attorney who was also the Deputy Inspector with the New York City Police Department. Notably, the decedent's girlfriend is also a New York City police lieutenant. The two witnesses to the Will were a New York City police department captain and a retired New York City Housing police officer. Both witnesses knew the decedent prior to his execution of the Will.

The Will was executed at the home of the decedent's girlfriend, which served as his primary residence prior to his death. About one week before it was signed, the decedent's physical condition took a turn for the worse, and family members were contacted to inform them of his failing health. As a result, all of the decedent's children, his sisters and other family members were present in the home the day that the Will was signed; the decedent's girlfriend was present for some, but not all, of the time that counsel met with the decedent.

With respect to the issue of due execution, the court opined that when the execution of a Will is supervised by an attorney, the proponent is entitled to a presumption of regularity that the instrument was properly executed in all respects. Based on this presumption, together with the testimony of the draftsman and the witnesses, the court concluded that the proponent had fulfilled her burden of proving due execution. Moreover, the court found that the objectant had failed to raise a triable issue of fact with respect to the issue, and accordingly, the objection based on due execution was dismissed.

Additionally, the court held that the objectant had failed to raise a triable issue of fact on the issues of fraud and duress, and therefore those objections were also dismissed.

On the other hand, the court denied summary judgment on the issues of undue influence and testamentary capacity. Specifically, the court noted affidavits submitted by the objectant from disinterested witnesses, stating that the decedent was agitated about going upstairs to execute his Will; that he had expressed unwillingness about executing his Will; and appeared frustrated and confused about the urgency to execute a Will. Additionally, the court found the allegations in objectant's pleadings that the decedent was incapacitated at the time he executed his Will, appearing to be disoriented and confused, and "not in his normal mental state," sufficient to raise a triable issue of fact as to the decedent's testamentary capacity, which would preclude an award of summary judgment on the issue of undue influence.

In re Galfano, N.Y.L.J., July 31, 2014, p. 26, col. 6 (Sur. Ct., Suffolk Co.).

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

Florida Update

By David Pratt and Jonathan Galler

David Pratt

LEGISLATIVE UPDATE

Exculpation of an Excluded Co-Trustee

Florida has enacted an amendment to its "directed trust" statutes. Section 736.0703(9), as amended, provides that where "the terms of a trust provide for the appointment of more than one trustee but confer upon one or more of the trustees, to the exclusion of the others, the power to direct or prevent specified actions of the trustees, the excluded trustees shall act in accordance with the exercise of the power." Critically, the excluded trustee is not liable for any consequences resulting from compliance with the direction except where the excluded trustee engages in willful misconduct. Moreover, "[a]n excluded trustee does not have a duty or an obligation to review, inquire, investigate, or make recommendations or evaluations with respect to the exercise of the power." The trustee with the power to direct bears exclusive liability to the beneficiaries "as if the excluded trustees were not in office."

Will and Trust Contests; Undue Influence

Florida's Probate Code and Trust Code specify grounds for contesting a will or trust. Until a recent legislative amendment, the law specified only that the party contesting the probate of a will has the burden of proof in such a proceeding. Section 736.0207, as amended, now similarly specifies that a party contesting the validity or revocation of all or part of a trust likewise has the burden of proof in such a proceeding. One difference remains: In a will contest, the proponent of the will has the initial prima facie burden to establish its proper execution.

In addition, Florida law provides that a presumption of undue influence arises with respect to a transaction if the contestant can demonstrate that a person in a confidential or fiduciary relationship actively procured the transaction from which he or she substantially benefits. As a matter of Florida public policy, that presumption shifts the burden of proof from the contestant to the proponent of the transaction. A recent amendment to section 733.107 clarifies that this policy against abuse of fiduciary or confidential relationships is not limited to will contests but, rather, applies to other transactions as well, such as trust contests and challenges to *inter vivos* gifts.

Jonathan Galler

Exempt Nature of Life Insurance Proceeds

Florida's Probate Code provides in section 733.808 that life insurance proceeds payable to a trust established by the insured are exempt from creditor's claims in most instances. However, the appellate court, in *Morey v. Everbank*, 93 So. 3d 482 (Fla. 1st DCA 2012), held that, under the facts of that case, insurance proceeds payable to the insured's revocable trust exposed the proceeds to creditor claims because of general language contained in the trust instrument directing the trustee to pay the decedent's debts. Accordingly, section 733.808(4) was recently amended to provide that such general language in a trust or will does not act to undo the creditor-exempt status of death benefits unless it "expressly refers to this subsection and directs that it does not apply."

Anti-Lapse Statute

The anti-lapse statute in Florida's Trust Code was recently amended to make it more consistent with the corresponding anti-lapse statute in Florida's Probate Code. Section 736.1106, as amended, provides that an outright devise to a deceased beneficiary in a revocable trust or testamentary trust lapses unless the beneficiary was a grandparent or the lineal descendant of a grandparent of the settlor. This is a default provision that can be modified in the settlor's testamentary instrument. The amended statute applies to trusts that became irrevocable after June 30, 2014.

Florida Family Trust Company Act

Florida has enacted a comprehensive Florida Family Trust Company Act (the "Act"), joining 14 other states that have laws or regulations authorizing families to form and operate a family trust company. The Act will become effective October 1, 2015. Ch. 622, Fla. Stat.

The Act provides that its purpose is to establish requirements for licensing a family trust company ("FTC"), to provide regulation of those persons who provide fiduciary services as a private FTC to family members of no more than two families and their related interests, and to establish the degree of regulatory oversight over such FTCs required by the Office of Financial Regulation.

Although the new legislation cannot be summarized in just a few paragraphs, it should be noted that the Act recognizes three different types of FTCs with varying regulatory requirements: (1) Unlicensed Family Trust Companies; (2) Foreign Licensed Family Trust Companies; and (3) Licensed Family Trust Companies.

An unlicensed FTC is generally defined in the Act as a Florida corporation or limited liability company, exclusively owned by one or more family members, that acts as a fiduciary for one or more family members. It may not serve as a fiduciary for non-family members, except that it may do so for up to 35 non-family members who are current or former employees of the FTC or of trusts, companies, or other entities that are family members. The Act defines "family members" to include certain lineal and collateral relatives, certain spouses and former spouses, certain trusts, certain charitable organizations, and the probate estates of family members.

A Foreign Licensed FTC is one with its principal place of business outside of Florida, and that is licensed and supervised by a state other than Florida. A Licensed FTC is one that operates under a current license issued by the Office of Financial Regulation.

DECISIONS OF INTEREST

Creditors' Claims Period

The battle lines continue to be drawn in the Florida appellate courts over the filing deadline of a reasonably ascertainable creditor who was never served with a copy of the notice to creditors. The claims at issue in the most recent appellate opinion were filed after the expiration of the three-month creditors' claims period. Accordingly, the trial court struck those claims as untimely. The creditor argued that because he was a reasonably ascertainable creditor who had never been served with a copy of the notice to creditors, and because his claims were filed within two years of the decedent's death, his claims period never even began to run. Florida's Fifth District Court of Appeal affirmed the trial court's ruling, siding with the holdings of Florida's First and Second District Courts on this topic and parting ways with that of the Fourth District. The appellate court reasoned that the Probate Code's remedy for not being served with a copy of the notice to creditors is the right to petition for an extension of time (which the creditor at issue did not do), not that the limitations period does not run. The split among the District Courts is presently before the Florida Supreme Court for review.

Souder v. Malone, 143 So. 3d 486 (Fla. 5th DCA 2014).

Jurisdiction Upon Death of Party to Divorce Proceedings

If one of the parties to a pending divorce proceeding dies, does jurisdiction of the divorce proceeding shift from the family court to the probate court? It depends. If no final judgment has yet been entered in the divorce proceeding at the time of the party's death, the divorce action simply terminates. But that was not the procedural posture in a case that recently came before Florida's Second District Court of Appeal. In that case, the husband was terminally ill at the time of the divorce proceeding. For that reason, the family court judge bifurcated the proceeding, entered a final judgment dissolving the marriage, and retained jurisdiction to resolve equitable distribution issues and any other matters pled by the parties. Upon the husband's death, the wife filed claims in the husband's probate proceeding. After an extended period of inactivity in both the family court and probate court proceedings, the family court judge determined that, given the death of the husband, the probate court had exclusive jurisdiction over the equitable distribution issues. The appellate court disagreed, holding the because the final judgment of dissolution had already been entered at the time of the husband's death and because the final judgment provided that the family court would retain jurisdiction to decide the remaining property issues, jurisdiction over the divorce proceeding properly remains with the family court.

Passamondi v. Passamondi, 130 So. 3d 736 (Fla. 2d DCA 2014).

David Pratt is a Co-Chair of Proskauer's Personal Planning Department and the Managing Partner of the Boca Raton office. His practice is dedicated exclusively to the areas of estate planning, trusts, and fiduciary litigation, as well as estate, gift and generation-skipping transfer taxation, and fiduciary and individual income taxation. Jonathan Galler is a senior counsel in the firm's Probate Litigation Group, representing corporate fiduciaries, individual fiduciaries and beneficiaries in high-stakes trust and estate disputes. The authors are members of the firm's Fiduciary Litigation Department and are admitted to practice in Florida and New York.

Section Committees and Chairs

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

Ad Hoc Committee on Multi-State Practice
William P. LaPiana
New York Law School
185 West Broadway
New York, NY 10013-2921
william.lapiana@nyls.edu

Charitable Organizations
Christine Woodcock Dettor
Bousquet Holstein PLLC
110 West Fayette Street
One Lincoln Center, Suite 900
Syracuse, NY 13202
cdettor@bhlawpllc.com

Mary Anne Cody
Mackenzie Hughes LLP
101 South Salina St., Suite 600
Syracuse, NY 13202
mcody@mackenziehughes.com

Continuing Legal Education
Frank W. Streng
McCarthy Fingar LLP
11 Martine Avenue, 12th Floor
White Plains, NY 10606-1934
fstreng@mccarthyfingar.com

Diversity
Ashwani Prabhakar
Chambers of
Hon. Margarita Lopez Torres
Surrogate's Court, Kings County
2 Johnson Street
Brooklyn, NY 11201
aprabhakar@courts.state.ny.us

Anta Cisse-Green
Akin Gump Strauss Hauer & Feld LLP
One Bryant Park
New York, NY 10036
antac3@aol.com

Elderly and Disabled
Cora A. Alsante
Hancock Estabrook, LLP
1500 AXA Tower I
100 Madison Street
Syracuse, NY 13202
calsante@hancocklaw.com

Estate and Trust Administration
Jill Choate Beier
Marymount Manhattan College
221 E. 71st Street
New York, NY 10021
jbeier@mmm.edu

Estate Litigation
Charles T. Scott
Greenfield Stein & Senior, LLP
600 Third Avenue, 11th Floor
New York, NY 10016-1901
cscott@gss-law.com

Estate Planning
Laurence Keiser
Stern Keiser & Panken LLP
1025 Westchester Avenue, Suite 305
White Plains, NY 10604
lkeiser@skpllp.com

International Estate Planning
Daniel S. Rubin
Moses & Singer LLP
The Chrysler Building
405 Lexington Avenue
New York, NY 10174-1299
drubin@mosessinger.com

Law Students and New Members
Michelle Schwartz
Norton Rose Fulbright LLP
666 Fifth Avenue
New York, NY 10103
mschwartz@fulbright.com

Legislation and Governmental Relations
Jennifer F. Hillman
Ruskin Moscou Faltischek, P.C.
1425 RXR Plaza
East Tower, 15th Floor
Uniondale, NY 11556
jhillman@rmfpc.com

Robert Matthew Harper
Farrell Fritz, P.C.
1320 RXR Plaza
Uniondale, NY 11556
rharper@farrellfritz.com

Life Insurance and Employee Benefits
Albert Feuer
Law Offices of Albert Feuer
110-45 71st Road, Suite 7m
Forest Hills, NY 11375-4962
afeuer@aya.yale.edu

Members and Membership Relations
Jennifer N. Weidner
Canandaigua National Bank and Trust Company
1150 Pittsford-Victor Road
Pittsford, NY 14534
jweidner@cnbank.com

Newsletter and Publications
Jaclene D'Agostino
Farrell Fritz, P.C.
1320 RXR Plaza
Uniondale, NY 11556-1320
jdagostino@farrellfritz.com

Practice and Ethics
Eric W. Penzer
Farrell Fritz, P.C.
1320 RXR Plaza
Uniondale, NY 11556-1320
epenzer@farrellfritz.com

Surrogates Court
Lisa Ayn Padilla
61 Broadway, Suite 2125
New York, NY 10006
lisa@eflm.com

Taxation
Susan Taxin Baer
Law Offices of Susan Taxin Baer
399 Knollwood Road, Suite 212
White Plains, NY 10603-1937
stbaer@baeresq.com

Technology
Gary R. Mund
P.O. Box 1116
New York, NY 10002-0914
gmund@mundlaw.com

Executive Committee District Representatives

First District
Natalia Murphy
Citi Private Bank
153 East 53rd Street, 24th Floor
New York, NY 10022
natalia.murphy@citi.com

Second District
Michael Patrick Ryan
Cullen & Dykman LLP
44 Wall Street
New York, NY 10005
mryan@cullenanddykman.com

Third District
Stacy L. Pettit
State of New York
Appellate Division, Third Dept.
P.O. Box 7288, Capitol Station
Albany, NY 122224
spettit@courts.state.ny.us

Fourth District
Cristine Cioffi
Cioffi Slezak Wildgrube P.C.
2310 Nott Street East
Niskayuna, NY 12309-4303
ccioffi@cswlawfirm.com

Fifth District
Ami Setright Longstreet
Mackenzie Hughes LLP
P.O. Box 4967
Syracuse, NY 13221
alongstreet@mackenziehughes.com

Sixth District
Albert B. Kukol
Levene Gouldin & Thompson LLP
P.O. Box F-1706
Binghamton, NY 13902
akukol@lgtlegal.com

Seventh District
Barbara R. Heck James
Harris Beach PLLC
99 Garnsey Rd.
Pittsford, NY 14534
bjames@harrisbeach.com

Eighth District
Victoria L. D'Angelo
Damon Morey LLP
9276 Main Street, Suite 3B
Clarence, NY 14031-1913
vdangelo@damonmorey.com

Ninth District
Kevin H. Cohen
Law Offices of Kevin H. Cohen, P.C.
30 Glenn Street, 2nd Floor
White Plains, NY 10603
kcohen@estatelawny.com

Tenth District
Joseph T. La Ferlita
Farrell Fritz P.C.
1320 RXR Plaza
Uniondale, NY 11556
jlaferlita@farrellfritz.com

Eleventh District
Mindy J. Trepel
Sweeney Gallo Reich & Bolz LLP
95-25 Queens Blvd, 11th Floor
Rego Park, NY 11374
mtrepel@msgrb.com

Twelfth District
Vacant

Thirteenth District
Irini Nagy Bekhit
Richmond County Surrogate's Court
18 Richmond Terrace
Staten Island, NY 10301
ibekhit@courts.state.ny.us

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

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