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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 Section Chair

As you read this issue of the *Newsletter*, our Section should be in the midst of what promises to be an informative and entertaining Fall Meeting in Savannah, Georgia. The program, entitled "The Future of Estate Planning," looks at looming issues in our field, such as the scheduled changes in the federal estate tax law and new concepts relating to the definition of income, as well as topics that promise to become more important in the future, such as asset protection planning and biotechnology. Also on the agenda is a Section first: a joint session with the Torts, Insurance & Compensation Law Section on "Wrongful Death Actions: The Intersection of Torts and Estates Laws," with New York County Surrogate Renee Roth as one of the participants. In addition to the educational program, we have arranged for several dinners and receptions to take advantage of Savannah's antebellum ambiance. We hope everyone finds this year's Fall Meeting to be a memorable one.

Recent Legislation

One of the major ongoing activities of our Section is proposing, commenting on and supporting or opposing legislation that affects the trusts and estates practice. As of this writing the following two bills in which our Section has had a great interest have passed both houses of the New York legislature and are about to be sent to Governor Pataki for his signature:

> **Privilege Bill:** This bill has been a priority of our Section for some time. It establishes a unified procedure for the waiver of professional privileges when the communicant has died or is incapacitated. It also permits a waiver to be made by the personal representative on behalf of the decedent or incapacitated person. The

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waiver would apply in civil actions and proceedings involving deceased persons or a person under disability, brought under the EPTL or the SCPA. It will not apply in any criminal proceeding or a civil action or proceeding directly related thereto.

The bill would permit a surviving spouse and distributees to obtain certain information concerning the mental or physical condition of the deceased from health care professionals (other than psychologists), subject to limitations on disclosure of information which would disgrace the memory or reputation of the communicant.

The Trusts and Estates Law Section has been working in support of this bill for more than ten years, and many of us were beginning to despair that it would not pass during the current geological period. However, with any luck (which this bill has not had heretofore) it will have been signed into law by the time you read this letter.

Commissions of Attorney-Executor: As we all know, under SCPA 2307-a an attorney who is named as executor of a will must obtain a writing signed by the testator acknowledging disclosure of certain information regarding commissions in order for the attorney-executor to be entitled to a full executor's commission as well as a legal fee for administering the estate. (Otherwise the attorney is only entitled to one-half a statutory executor's commission.) The legislature has recently enacted an amendment to this provision that is designed to reconcile divergent Surrogates Court opinions by clarifying that the writing must be separate from the will, and may not be included within the text of the will itself (although it may be annexed to the will). Again, we expect this bill to be on Governor Pataki's desk shortly.

The rapid introduction and passage of this bill demonstrates that the New York State legislature is capable of acting with astonishing speed, providing that the issue it is addressing relates somehow to a limitation on amounts payable to lawyers.

Annual Meeting

Looking ahead, the Annual Meeting of our Section will be held in New York City on Wednesday, January 26, 2005. We are planning to include a presentation on the recent amendment of EPTL 10-10.1, which significantly changes New York law by permitting a trustee-beneficiary to make discretionary distributions to himself or herself provided they are made pursuant to an ascertainable standard. We hope to see many of you for the morning program, the lunch and the Committee breakfast meetings the following morning.

G. Warren Whitaker

BULLETIN

As we go to print, New York has amended Sections 952 and 960 of the Tax Law to provide that the New York estate tax on New York real and tangible personal property owned by a non-New York decedent will equal the same proportion of the pre-EGTRRA federal credit for state death taxes which the New York property bears to the federal gross estate. The Legislature repealed the former provision, which computed the New York tax as the total pre-EGTRRA federal credit for state death taxes less death taxes paid to other states, which often led to an inequitable result given the phase out of the federal credit for state death taxes.

Congratulations to Joshua Rubenstein and others in our Section who worked hard in support of this legislation.

G. Warren Whitaker

Editor's Message

Summer Reading

In 1913, the first IRS Form 1040 was a mere four pages long, including a single page of instructions. For tax year 2003, the Instructions to Form 1040 came to 131 pages. And if the Instructions were unclear, one could always refer to the income tax Treasury Regulations—which at last count weighed in at 7 million words. It's no wonder that in 2003 only 40% of U.S. taxpayers prepared their own individual income tax returns.

According to author David Cay Johnston, the last member of Congress who truly understood the United States tax system was the late Representative Wilbur Mills, who last served in the House over 25 years ago. To be sure, understanding the intricacies of our tax laws has probably never been second nature to most citizens. But in "Perfectly Legal,"[1] Johnston, a Pulitzer prize-winning *New York Times* reporter, makes the case that, today, the average taxpayer is essentially being cheated by the extraordinary complexity and unfairness of our income and transfer tax systems, and thereby unknowingly duped into supplementing the wealth and extravagant lifestyles of the "super rich." As Johnston observes: "All rich countries have high taxes because wealthy societies have high demands for public goods. Supreme Court Justice Oliver Wendell Holmes said, 'Taxes are what we pay for a civilized society.' Today, though, many want their civilization at a deep discount. Some want a free ride . . ."

Johnston proceeds to illustrate the "free ride" by soberly assessing a grab-bag of techniques, available only to a select few, which have enabled them to shelter or defer tax on income and gratuitous transfers on a breathtaking scale. According to Johnston, middle class wage-earners, who are unable to employ these tax-saving stratagems, are left the burden of the gross inequity they create.

Judge Learned Hand once opined that "Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury."[2] But in Johnston's estimation, "anyone" does not mean everyone these days. For this reader, Johnston's book raises important and provocative questions about the present fairness and equity of our tax code and its administration. Although Johnston is largely bipartisan in assessing the blame, in this election season his critique is especially timely.

Florida Update

In the Summer 2004 issue of the *Newsletter*, Elisabeth Hessler alerted us to a recent Florida Bar Staff Opinion which had been interpreted by one Florida commentator, in an article appearing in the Spring 2004 issue of *ActionLine* (the Florida Bar's Real Property, Probate & Trust Law Section quarterly newsletter), to limit the ability of Florida lawyers to assist out-of-state attorneys in advising clients on matters implicating Florida law. Thus, for instance, where an out-of-state attorney with a "snowbird" client seeks review by a Florida attorney of estate planning documents drafted for the client, the *ActionLine* article suggests that such review may constitute assisting in the unlicensed practice of law in Florida.[3]

After the Summer 2004 issue of this *Newsletter* went to press, the Editors were alerted to a May 25, 2004 letter of Mary Ellen Bateman[4] of the Florida Bar to the Chair of the Florida Bar's Real Property, Probate & Trust Law Section. In her letter, Bateman states that "To the extent the [*ActionLine*] article implies that a Florida attorney is always prohibited from speaking to an out-of-state attorney, the article is incorrect and overbroad. . . . Florida attorneys are often asked to review estate planning documents drafted by out-of-state attorneys. This review is not improper, and is in fact encouraged."

The Editors welcome Bateman's interpretation of the Florida Bar Staff Opinion. In the wake of an increasing concern nationwide with the implications of the multi-jurisdictional practice of law, the issuance of further clarification and guidance from the Florida Bar would be invaluable to all.

In This Issue

The *Newsletter* is once again fortunate that its contributors have chosen to share with us the wealth of their wide experience and expertise. In this issue, the topics run the gamut, from New York substantive trust law and Surrogate's Court practice, to the latest IRS grantor trust pronouncement, to HIPAA, to trust taxation under Israeli law. And as always, ace ana-

lysts Ilene Sherwyn Cooper, Ira Mark Bloom and William LaPiana round up all of the recent New York State decisions of which readers should be aware.

Remember that the *Newsletter* relies on the members of the Section for the majority of its timely, incisive and informative articles on all areas of our practice. We strongly encourage you to contact us if you have an article, or an idea for one, to be considered for publication.

Austin Wilkie

Endnotes

1. Johnston, *Perfectly Legal: The Covert Campaign to Rig Our Tax System to Benefit the Super Rich—And Cheat Everybody Else* (Portfolio 2003).
2. *Helvering v. Gregory*, 69 F.2d 809 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935).
3. Other commentators in the national legal press have reached essentially the same conclusion. *See, e.g.*, Baskies, *Florida Ethics Opinion Highlights Multi-Jurisdictional Practice Landmine*, Lawyers Weekly USA, March 15, 2004.
4. Director of the Division on Ethics, Unauthorized Practice of Law and Professionalism of the Florida Bar.

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— Kenneth G. Standard
President, New York State Bar Association

Exculpatory Clauses in *Inter Vivos* Trusts: What Remains of a Trustee's Duty of Undivided Loyalty?

By Ian W. MacLean

I. Introduction

In the State of New York, exculpatory clauses in trusts, whether testamentary or *inter vivos*, are common. Exculpatory clauses in trusts are those provisions intended to limit or eliminate the liability of a trustee resulting from the trustee's breach of the fiduciary duty of an undivided loyalty to the beneficiaries of a trust.[1]

Notwithstanding what may be the most eloquently articulated standard of fiduciary responsibility in our nation's jurisprudence,[2] our laws have evolved to permit testators of wills creating trusts and grantors of *inter vivos* trusts certain latitude in exonerating their trustees from liability caused by the trustee's breaches of the trustee's duty of undivided loyalty to the trust and its beneficiaries. There is a significant difference, however, in the rules governing exculpatory clauses in wills and testamentary trusts and those governing such clauses in *inter vivos* trusts: the validity of exculpatory clauses in wills and testamentary trusts is governed by Estates, Powers and Trusts Law 11-1.7; there is no separate statutory provision for exculpatory clauses in *inter vivos* trusts, which EPTL 11-1.7 omits.[3]

In all but a very few cases, which are discussed herein, New York courts have declined to apply EPTL 11-1.7 to exculpatory clauses in *inter vivos* trusts. This article discusses the rules governing exculpatory clauses in *inter vivos* trusts and raises the issue of whether the New York legislature should establish a standard by which exculpatory clauses in *inter vivos* trusts should, quite literally, be judged.

II. "The Standard of Behavior"

Under New York law, a trustee owes a duty of undivided loyalty to the beneficiaries of the trust for which the trustee serves.[4] Since at least the late nineteenth century, the Court of Appeals has rearticulated this rule time and time again, in what may be characterized as an ongoing effort to get the message through. [5]

For example, in 1886, in *Munson v. Syracuse, Geneva & Corning RR Co.*,[6] the Court opined that a contract signed by a trustee who is personally interested in the subject of the sale of trust assets "is repugnant to the great rule of law which invalidates all contracts made by a trustee or fiduciary, in which he is personally interested." Over a half-century later in 1951, in *In re Hubbell's Will*,[7] the Court of Appeals made abundantly clear that "[i]n judging the conduct of trustees, the basic consideration is the fiduciary obligation which they owe to all of the beneficiaries whom they represent."[8] And during the intervening sixty-five years the Court ruled on the standard of a trustee's fiduciary duty several more times.[9] In *Meinhard v. Salmon*,[10] Chief Judge Benjamin N. Cardozo set forth what is perhaps the best known and most relied on articulation of a trustee's duty—"the standard of behavior":

> The Trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty *by the "disintegrating erosion" of particular exceptions*. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.[11]

Given such language, it would seem that *Meinhard* left little doubt, if any, of the standard to which a trustee must adhere.

III. Exceptions to the Standard

Nevertheless, that a grantor may exonerate his or her trustee from certain breaches of this undivided loyalty has survived under New York law. *Crabb v. Young*,[12] decided nearly a half-century before *Meinhard*, serves as a starting point. In *Crabb*, the exculpatory clause protected the trustees from liability for any loss except for that arising from their "own will-

ful default, misconduct or neglect."[13] Lacking any evidence of such willful conduct, the Court held that it was an error to hold the trustees liable for loss resulting from their management of the trust, even though they had acted imprudently.[14]

In an opinion by Chief Judge William C. Ruger, the Court attempted to balance the fiduciary duty of a trustee against what was decidedly the grantor's desire to insulate his trustee from certain liability. On the one hand, the Chief Judge opined that, as the testator "knew well the character and qualifications" of his selected trustees (some of his children), he had an "absolute right to . . . impose the terms and conditions" under which his trustees would serve, and the Court had no right to increase the measure of the trustees' responsibility by imposing a higher standard, absent willful or fraudulent misconduct.[15]

> Trusts of property are generally created for the benefit and support of the young, helpless and inexperienced and depend largely for their proper administration upon the honesty and capacity of those to whom they are confided. . . . [T]he court will guard their rights with jealous care and scrutinize closely the conduct of trustees with the view of holding them to a high degree of responsibility in the management and control of trust estates. But while trustees are thus held to great strictness in their dealings with the interests of their beneficiaries, the court will regard them leniently when it appears they have acted in good faith, and if no improper motive can be attributed to them, the court have even excused an apparent breach of trust, unless the negligence is very gross.[16]

While the legislature eventually saw fit to void the right of a testator to exonerate his or her trustee from liability for a failure to act in accordance with a duty of undivided loyalty,[17] it imposed no such limitation on grantors of *inter vivos* trusts. Over time, the courts of New York have embraced and cultivated the principles in *Crabb* set forth above into a set of standards that are far less restrictive and permit exculpatory clauses to relieve a trustee from liability in the absence of a showing of willful negligence, self-dealing or bad faith.[18]

In *O'Hayer v. de St. Aubin*, [19] an oft-cited case in this area, the Appellate Division set forth the rule governing the validity of exculpatory clauses in *inter vivos* trusts as follows:

> No matter how broad the [exculpatory] provision may be, the trustee [of an inter vivos trust] is liable if he commits a breach of trust in bad faith or intentionally or with reckless indifference to the interest of the beneficiaries, or if he has personally profited through a breach of trust.[20]

In *O'Hayer*, the grantor named himself, his son and three others as co-trustees of a trust. The trust held stock in the grantor's closely held business. The exculpatory provisions of the trust provided as follows:

> Although it may be a general rule of law that a trustee shall not profit from his trusteeship, I expressly declare and direct that this rule shall be completely ignored and set aside in the administration, construction and interpretation of this trust in so far as it could relate to or affect or be applied to my trusteeship or the trusteeship of my son hereunder. . . .[21]

In addition, the trustees were granted broad powers "far beyond the traditional notions of trusteeship,"[22] including the right to purchase assets from the trust for themselves and to profit from their relationship as trustees of the trust, which they did.[23] After the grantor's death, his daughter—the remainder beneficiary—challenged her trustee-brother's right to purchase shares of the corporation's stock and demanded an accounting by the trustees.[24]

With an almost perfunctory reference to the seminal Court of Appeals cases of *Meinhard v. Salmon*,[25] *Dutton v. Willner*[26] and *Munson v. Syracuse, Geneva & Corning R.R. Co.*[27] for the proposition that a trustee owes a duty of undivided loyalty to the trust, the *O'Hayer* court opined that, without a doubt, "the rule of undivided loyalty due from a trustee may be relaxed by a grantor of a trust by appropriate language in the trust instrument in which he, either expressly *or by necessary implication*, recognizes that the trustee may have interests potentially in conflict with the trust."[28]

As if to bolster this point, the *O'Hayer* court continued, "at least, our courts under these conditions enforce the desire of the settlor to secure the services of a person to act as trustee in whom he has confidence, when, without the existence of exculpatory

provisions, the trusteeship would be declined by the designee."[29]

The most troubling aspect of this part of the court's reasoning is that only one of the cases cited, *In re Balfe,* stands directly for this proposition.[30] Furthermore, while *Crabb* and its progeny support the proposition that a grantor may explicitly exculpate a trustee from certain acts or omissions, nowhere in *Crabb* does the Court of Appeals provide any support for the proposition that a court may *infer* a grantor's intent to exculpate his or her trustee from liability for violating the duty of undivided loyalty to the beneficiaries of the trust.[31]

The *O'Hayer* court did recognize that regardless of the exculpatory language in a trust, New York law requires that a trustee "always exercise good faith in his administration" of the trust; exculpatory "directions" of a settlor do not allow a trustee "free rein" in dealing with the trust.[32] Moreover, the court opined that any exculpatory language shall be strictly construed so that a "trustee's action will not be approved if he trespasses outside the boundaries of the powers granted" in the trust.[33] Nevertheless, the *O'Hayer* court seemed to give somewhat short shrift to the significance of the requirement that exculpatory language must be strictly construed, a principle that dates back at least to the beginning of the twentieth century.[34]

In *In re Mallon's Estate*, for example, a case involving a testamentary trust with two trustees, trustee one, knowing that trustee two owed the estate over $30,000, transferred the deed to an income-producing real property asset from the trust to trustee two. The exculpatory language in the will exempted a trustee "from liability for losses occurring without his own willful default."[35] The Appellate Division held that the conveying trustee had intentionally disregarded the rules that a prudent man would have followed in managing his own business affairs and was, therefore, liable to the beneficiary for the loss.[36]

The *O'Hayer* court concluded that, as a rule, a trustee was liable for a breach in his duty of undivided loyalty to the trust, regardless of an exculpatory clause to the contrary, if his breach was in bad faith or with intentional or reckless disregard for the interests of the beneficiary.[37] In the end, the *O'Hayer* court held that the brother as trustee benefited from his manipulation of the company funds, of which the trust owned a considerable share; he failed to put the beneficiary's interests before his own; he had violated the covenant of good faith and thus his fiduciary duty; and was therefore liable to his sister for the loss.[38]

IV. Contemporary Developments

In the course of the past two decades, it has become apparent that at least some of the Surrogates of New York are struggling with upholding exculpatory clauses in *inter vivos* trusts. Some Surrogates have gone so far as to suggest that EPTL 11-1.7 should apply to *inter vivos* trusts and at least two have actually applied the principles of the statute to lifetime trusts.

In *In re Helen R. Scheuer*, Surrogate Preminger (New York County) opined that exculpatory language will not necessarily absolve a trustee from liability for egregious self-dealing.[39] *Scheuer* involved an *inter vivos* trust, a family partnership, loans, lines of credit and unlimited personal guarantees. The exculpatory language in the trust provided that no trustee "shall be responsible or liable . . . for any act or omission of any other Trustee, or, unless his conduct amounts to bad faith and intentional and willful misconduct, for any act of omission of his own."[40]

Starting from the premise that "fiduciaries who place their beneficiaries at financial risk in order to further their own objectives are deemed to breach their fiduciary duties,"[41] the court held that "[i]n appropriate circumstances, a fiduciary can be held liable for his own acts and omissions and/or for the acts and omissions of his co-fiduciaries, despite purportedly exculpatory language in the governing instruments."[42] However, because the Surrogate was ruling on a motion to dismiss for failure to state a cause of action, she did not reach the issue whether the exculpatory provisions in Mrs. Scheuer's trust absolved the trustee from liability in that case.[43] Thus, it is not clear that Surrogate Preminger extended the general rule to the alleged "egregious self-dealing" of the Scheuer fiduciaries.

In *In re Wasserman*,[44] the trust language extended the trustees' powers after the termination of the trust until all of the trust assets were distributed. The trustees retained assets two years after the trust terminated and the beneficiaries sued for losses incurred by the retention of the assets. Notwithstanding the exculpatory language that afforded the trustees "broad latitude to make and retain investments not ordinarily considered suitable for trustees under usual fiduciary investment standards,"[45] Surrogate Riordan held that the retention of trust assets for a period exceeding two years after the termination of the trust was unreasonable.[46]

The Surrogate opined that "[w]hile there is a developing convergence, the law does continue to recognize a distinction between exculpatory provi-

sions in a Will as opposed to an *inter vivos* trust."[47] Moreover, according to the Surrogate, "[t]he restrictions grounded in public policy contained in EPTL 11-1.7 do not apply to the trustee of a lifetime trust whose grantor can set the standards."[48]

In *Bauer v. Bauernschmidt*,[49] the provisions of an *inter vivos* trust provided that the trustee "was not to be held liable for any act or failure to act where he acted in good faith."[50] The Appellate Division held that "exculpatory provisions like those in the present case are valid in inter vivos trust so long as there is some accountability, at least to the settlor."[51] While the *Bauer* court never cited to EPTL 11-1.7 or opined on whether the statute applies to *inter vivos* trusts,[52] the court did find that capital expenditures of $2,500 the trustee made from the trusts, and from which the trustee personally profited, constituted an improper appropriation of trust property for which the trustee was liable.[53]

In *In re Mede*,[54] a case involving the establishment of an *inter vivos* trust for the benefit of minors who were to receive the proceeds of a personal injury/wrongful death case, the Surrogate did cite to EPTL 11-1.7. The draft trust proposed to the court contained language absolving the trustee "for his failure to use reasonable care or even 'best efforts' in choosing" appropriate investments.[55] Surrogate Feinberg acknowledged that EPTL 11-1.7 makes it contrary to public policy to exonerate executors and testamentary trustees for "failure to exercise reasonable care, diligence and prudence." Nevertheless, the Surrogate held that, even though the trust at bar was an *inter vivos* trust, "the exonerating provisions in the [trust] clearly violates public policy as well as the standard of care established for fiduciaries [under New York law]."[56]

The provision of the supplemental needs trust in *In re Goldblatt*[57] exonerated the trustee from liability for "any act or omission . . . except as to gross negligence, willful neglect or unlawful act[s]."[58] In striking the provisions from the proposed *inter vivos* trust, Surrogate Radigan relied directly and exclusively on EPTL 11-1.7 for the proposition that "it is contrary to public policy to exonerate a fiduciary from liability for failure to exercise reasonable care, diligence and prudence."[59]

Correspondingly, in *In re Amaducci*,[60] the trustees of an *inter vivos* trust were alleged to have pledged or loaned trust assets to entities in which the trustees held an ownership interest. Surrogate Emanuelli relied explicitly on EPTL 11-1.7 in holding that the beneficiaries claims of negligence, self-dealing and breach of fiduciary duty by the trustees were sufficient to survive a motion to dismiss for failure to state a cause of action, notwithstanding an exculpatory clause that exonerated the trustees from liability for *any decision* made under the discretionary powers granted under the trust instrument.[61]

Similarly, Surrogate Riordan, in *In re Kassover*,[62] and the Appellate Division, Third Department, in *In re Malasky*,[63] have held that the provisions in an *inter vivos* trust excusing the trustee from a duty to account to anyone is against public policy.

Finally, on the procedural level, in at least one case the Appellate Division has affirmed the decision of a trial court granting a motion to dismiss objections to an accounting on the ground that the beneficiaries failed to allege acts of actual bad faith or purposeful malfeasance sufficient to overcome an exculpatory clause in a voting trust.[64] Therefore, as with so many objections in an accounting, it is critical for the aggrieved party to allege sufficient acts or omissions of bad faith, purposeful malfeasance, reckless indifference to the interest of the beneficiaries, or personal profiting by the trustee.

V. Conclusion

As one pair of commentators forecast,[65] it appears that different standards are emerging among the various courts of New York State. In certain courtrooms, exculpatory clauses that purport to exonerate a trustee from a breach of the trustee's duty of an undivided loyalty to the beneficiaries of an *inter vivos* trust may be upheld but only so long as the violation is not in bad faith or with intentional or reckless disregard for the interests of the beneficiary, or one from which the trustee profited. In other courtrooms, certain exculpatory clauses, such as those that purport to excuse a trustee from using reasonable care or the trustee's best efforts, may be held invalid under certain facts and circumstances. And in yet other counties, exculpatory clauses in *inter vivos* trusts may be held void as against public policy as if the standard and principles of EPTL 11-1.7 apply. Such inconsistency in the contemporary decisions of the trial courts creates an unacceptable and undesirable level of uncertainty for both attorney and client in determining whether or how to use exculpatory clauses in *inter vivos* trusts.

A solution is needed. The legislature could amend EPTL 11-1.7(a) to include *inter vivos* trusts (by deleting the word "testamentary"?); this may be too restrictive. Perhaps New York should adopt the approach of the Restatement (Second) of Trusts or that of the Uniform Trust Code. Or perhaps we should continue the dichotomy between testamen-

tary and *inter vivos* trusts by encouraging the legislature to enact a new statute that permits a grantor to provide some additional protection for the trustee while ensuring that the trustee's duty of an undivided loyalty does not fall prey to "the 'disintegrating erosion' of particular exceptions."[66] Whatever the solution, it is time for thoughtful discussion on this topic in and among the appropriate committees of the state and local bar associations, which, hopefully, will result in direction from the legislature.[67]

Endnotes

1. "A true exculpatory provision is really one which relieves the trustee from liability for performing an act, which in the absence of the provision would make him liable." Fourth Report of the Temp. State Comm'n on the Modernization, Revision and Simplification of the Law of Estates, N.Y. Leg. Doc. No. 19, at 500 (May 31, 1965) ("1965 Commission Report").
2. *E.g.*, *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546, 62 A.L.R. 1 (1928).
3. Section 11-1.7 of the Estates, Powers and Trusts Law ("EPTL") invalidates as against public policy any attempt to exonerate an executor or testamentary trustee "from liability for failure to exercise reasonable care, diligence and prudence." EPTL 11-1.7(a)(1) (McKinney's 2001 & Supp. 2004). In response to the Appellate Division decision in the once-famous case *In re Curley's Will*, 151 Misc. 664, 272 N.Y.S. 489 (N.Y. Surr. Ct. 1934), *modified*, 245 A.D. 255, 280 N.Y.S. 80 (2d Dep't), *aff'd without opinion*, 269 N.Y. 548, 199 N.E. 665 (1935), the legislature enacted the precursor to EPTL 11-1.7, Decedent Estate Law § 125 in 1936. *See* N.Y. Laws 1936, c.378 (May 2, 1936).

   For a discussion of *In re Curley's Will* and the history behind the enactment of Decedent Estate Law § 125, see Note, *Legislation*, 6 Brooklyn L. Rev. 89 (1936) ("*Legislation*"); *see also* 1965 Commission Report, at 499–501. For a discussion of exculpatory clauses in trusts before the enactment of Decedent Estate Law Section 125, *see generally* Henry A. Shinn, *Exoneration Clauses in Trust Instruments*, 42 Yale L.J. 359 (1931) and Philip M. Payne, *Exculpatory Clauses in Corporate Mortgages and Other Instruments*, 19 Cornell L.Q. 171 (1934) (both cited in *Legislation*).
4. *E.g.*, *In re Donner*, 82 N.Y.2d 574, 584, 626 N.E.2d 922, 926, 606 N.Y.S.2d 137, 141 (1993) (and the cases cited therein).
5. Other New York courts have earlier ruled on a trustee's duty of undivided loyalty to the beneficiaries. *See, e.g.*, *Davoue v. Fanning*, 2 Johns. Ch. 252, 1 N.Y. Ch. Ann. 365 (Chancellery Ct. of N.Y. 1816) (discussing 18th-century case law on the rule that a trustee owes a duty of undivided loyalty to the trust beneficiaries in the context of self-dealing and setting aside the sale of trust assets when the trustee was interested in the sale).
6. 103 N.Y. 58, 73–74, 8 N.E. 355, 358 (1886).
7. 302 N.Y. 246, 254, 97 N.E.2d 888, 891 (1951).
8. *Id.* (citing *In re Durston*, 297 N.Y. 64, 71–72, 74 N.E.2d 310, 313 (1947); *Meinhard v. Salmon*, 249 N.Y. 458, 464 & 468, 164 N.E. 545, 546 & 548, 62 A.L.R. 1 (1928); *Carrier v. Carrier*, 226 N.Y. 114, 125–26, 123 N.E. 135, 138 (1919); *Munson v. Syracuse, Geneva & Corning R.R. Co.*, 103 N.Y. 58, 73–74, 8 N.E. 355, 358 (1886).
9. For examples of such cases, see note 8.
10. 249 N.Y. 458, 164 N.E. 545, 62 A.L.R. 1 (1928).
11. *Id.* at 464, 164 N.E. at 546 (emphasis added) (quoting *Wendt v. Fischer*, 243 N.Y. 439, 444, 145 N.E. 303, 304 (1926)).
12. 92 N.Y. 56 (1883).
13. *Id*. at 65.
14. *Id.* at 66. While beyond the scope of this article, there are three types of cases involving exoneration of a trustee for retention: Cases in which the testator exonerates his trustee from loss for retaining assets that the testator has invested in and directed his trustee to retain, *see, e.g.*, *In re Clark's Will*, 257 N.Y. 132, 177 N.E. 397, 77 A.L.R. 499 (1931) (exculpatory clause upheld), cases in which the loss is occasioned by the trustee's investment and the trustee acted within the scope of his authority to retain assets, but in poor judgment, *see, e.g.*, *In re Olmstead*, 52 A.D. 515 (1st Dep't), 66 N.Y.S. 212, *aff'd*, 164 N.Y. 571, 58 N.E. 1090 (1900) (exculpatory clause upheld) and cases where, although exculpated for loss from retention of assets, the trustee acted outside the scope of his authority and breached his fiduciary duty, *see, e.g.*, *In re Hubbell's Will*, 302 N.Y. 246, 97 N.E.2d 888, 47 A.L.R.2d 176 (1951) (exculpatory clause invalid). *See also Legislation*, at 94–95 & nn. 29–31.
15. *Id*. at 65–66.
16. *Id.* at 66. (citations omitted).
17. *See* note 1, *supra.*
18. *See, e.g.*, *O'Hayer v. de St. Aubin*, 30 A.D.2d 419, 426, 293 N.Y.S.2d 147, 151 (2d Dep't 1968); *In re Cowles' Will*, 22 A.D.2d 365, 378, 255 N.Y.S.2d 160, 173–74 (1st Dep't 1965), *aff'd*, 17 N.Y.2d 567, 215 N.E.2d 509, 268 N.Y.S.2d 327 (1966); *In re City Bank Farmers Trust Co.*, 270 A.D. 572, 576, 61 N.Y.S.2d 484, 487 (1st Dep't), *aff'd*, 296 N.Y. 662, 69 N.E.2d 818 (1946).
19. 30 A.D.2d 419, 293 N.Y.S.2d 147 (2d Dep't 1968).
20. *Id*. at 426, 293 N.Y.S.2d at 151 (quoting III Scott on Trusts § 222.3, p. 1777 (3d ed. 1967). For additional secondary authority and commentary on this rule, see Restatement (Second) of Trusts § 222 (2) (2003) and G. Bogert, Law of Trusts and Trustees, Ch. 26, § 542 (Rev. 2d ed. 1993 & 2002 pocket part); *compare* Uniform Trust Code § 1008 & Comment (2000) (Section 1008 is substantially similar to Section 222 of the Restatement (Second), except that under the UTC a grantor may exculpate his or her trustee from liability for personally profiting from his actions on behalf of the trust, so long as such profiting is not the result of bad faith or reckless indifference to the purposes of the trust or interests of the beneficiaries.).
21. 30 A.D.2d at 429, 293 N.Y.S.2d at 157 (Appendix).
22. *Id.* at 421, 293 N.Y.S.2d at 149.
23. *Id.* at 429–30, 293 N.Y.S.2d at 157–58.
24. *Id.* at 421, 293 N.Y.2d at 149.
25. 249 N.Y. 458, 164 N.E. 545 (1928).
26. 52 N.Y. 312 (1873).
27. 103 N.Y. 58, 8 N.E. 355 (1886).
28. 30 A.D.2d at 423, 293 N.Y.S.2d at 151 (emphasis added) (citing II Scott on Trusts § 170.09, p. 1321 (3d ed. 1967) and one case each from the New Jersey and Pennsylvania Supreme Courts).
29. *Id.* (citing *In re Hammer*, 16 A.D.2d 111, 225 N.Y.S.2d 868 (1st Dep't 1962) (per curiam), *aff'd*, 12 N.Y.2d 893, 118 N.E.2d 266,

237 N.Y.S.2d 1001 (1963) (mem.), *In re Balfe*, 245 A.D. 22, 280 N.Y.S. 128 (2d Dep't 1935), and *Heyman v. Heyman*, 33 N.Y.S.2d 235 (Sup. Ct., N.Y. Co. 1942)).

30. The majority in *Balfe* held that a trustee was exculpated from his malfeasance because the decedent had authorized the trustee to act without regard to whether the trustee had a personal interest in the same securities or companies as the trust, thereby depriving his estate of the benefit of the doctrine that forbids a trustee from acting under a divided loyalty. 245 A.D. at 24–25, 280 N.Y.S. at 130–31. In a strongly worded dissent, however, Presiding Justice Lazansky and Justice Young found the same provisions could not exculpate the trustee of the testamentary trusts, and even if they did, the trustee failed to act in good faith. *Id*. at 26, 280 N.Y.S. at 132. Moreover, the 1935 holding in *Balfe* is clearly inconsistent with the provisions of EPTL 11-1.7, making such exoneration against public policy in testamentary trusts.

    In *Hammer*, the grantor established an *inter vivos* trust with a bank as trustee. Thereafter, the grantor guaranteed a third party's debt to the bank. When the bank filed an action against the grantor's estate to recover on the guarantee, the executor objected, arguing that the bank was subject to a divided loyalty that barred its recovery against the estate. 16 A.D.2d at 112, 225 N.Y.S.2d at 869. The court held that the bank did not waive the enforcement provision of the guarantee by agreeing to be trustee. *Id*. at 113, 225 N.Y.S.2d at 870. Therefore, *Hammer* does not stand directly for the proposition that a grantor may relax a trustee's duty of undivided loyalty to the trust. Moreover, two justices on the Appellate Division panel dissented in an opinion by Justice Bergan and would have held that the trustee owed an obligation of loyalty to the trust first and to its interest in collecting on its loan second. *Id*. at 113–14, 225 N.Y.S.2d at 870–71 (Bergan, J., dissenting). The principle that a trustee with competing fiduciary duties owes his duty to the trust first is actually well established under the laws of New York State. *See, e.g.*, *In re Pulitzer*, 139 Misc. 575, 249 N.Y.S. 87 (Surr. Ct., N.Y. Co. 1931), *aff'd*, 237 A.D. 808, 260 N.Y.S. 975 (1st Dep't 1932).

    Heyman involved an *inter vivos* trust established by a mother and father for their son's benefit. In pertinent part, the trust provided that the trustee "shall have the widest possible powers of investment embracing the right to enter into speculative transactions." 33 N.Y.S.2d at 240. The court held that although "this clause eliminates most if not all of the legal restrictions which, in the absence of the inclusion of such a specific provision, would safeguard and restrict trust investments, it clearly does not authorize the trustees to use the trust assets for their own benefit, to act in bad faith or recklessly to waste them." *Id.* While additional exculpatory provisions permitted the trustee to deal with and in assets in which both he, individually, and the trust held an interest, those provisions made specific reference to requiring the trustee to act in good faith. *Id.* at 240-41. Moreover, "in the absence of an express provision requiring a trustee to act in good faith," the law of New York would "impress such a trust character" upon the trustee." *Id.* at 241. Thus, *Heyman* stands for another proposition altogether that, despite "sweeping" exculpatory provisions, a grantor may not exculpate a trustee of an *inter vivos* trust from acting in good faith, regardless of whether good faith is explicitly stated in the trust or not. *Id.* at 242.

31. Moreover, it seems unlikely that the Court of Appeals would embrace a rule by which a trustee would be exculpated from liability by a mere inference of the grantor's intent, given the rule set forth in III Scott on Trusts § 222.4, p. 1778–79 (3d ed. 1967), that an exculpatory provision "is not effective to relieve the trustee of liability if it was inserted in the trust instrument by the person named as trustee and if in inserting it he was guilty of an abuse of a fiduciary or confidential relations to the settlor." *Id*. at 1778; *see Jothann v. Irving Trust Co.*, 151 Misc. 107, 270 N.Y.S. 721 (Sup. Ct., N.Y. Co. 1934), *aff'd*, 243 A.D. 691, 277 N.Y.S. 955 (1st Dep't 1935); *see also* Restatement (Second) of Trusts § 222 (Comment) (providing factors to be considered); UTC § 1008(b) (creating a rebuttable presumption that an exculpatory clause drafted by a trustee is invalid). The Appellate Division in *O'Hayer* cited Section 222.3 of Scott on Trusts to support the enforcement of the exculpatory clause, but evidently apparently did not consider Section 222.4, perhaps because the trustees in *O'Hayer* were the grantor and his son. *See* note 20, *supra*.

32. *Id*. (citing *Industrial & Gen'l Trust, Ltd. v. Tod*, 180 N.Y. 215, 225–26, 73 N.E. 7, 9 (1905) ("No covenant of immunity can be drawn that will protect a person who acts in bad faith, because such a stipulation is against public policy, and the courts will not enforce it. The law requires the exercise of good faith, and no matter how strong the provision to shield from liability may be, there is no protection unless good faith is observed.") and *Balfe*, 245 A.D. 22, 280 N.Y.S. 128 (2d Dep't 1935)).

33. *Id.*; *see, e.g.*, *New York State Med. Care Facilities Fin. Agency v. Bank of Tokyo Trust Co.*, N.Y.L.J., Dec. 20, 1994, p. 26, col. 4 (Sup. Ct., N.Y. Co.); *In re Akin*, N.Y.L.J., Oct. 23, 1989, p. 29, cols. 4–5 (Surr. Ct., Westchester Co.) (a trustee may be insulated from liability only so far as the specific exemption provided in an exculpatory provision); *see also* III Scott on Trusts § 222.2, p. 388–89 (4th ed. 1988); Restatement (Second) of Trusts § 174, Comment d (2003).

34. *See, e.g.*, *In re Mallon's Estate*, 43 Misc. 569, 4 Mills 323, 89 N.Y.S. 554 (Surr. Ct., Kings Co. 1904), *aff'd*, 110 A.D. 61, 97 N.Y.S. 23 (2d Dep't 1905), *aff'd without opinion, sub nom. In re Howard*, 185 N.Y. 539, 77 N.E. 1189 (1906)).

35. 110 A.D. at 62–63, 97 N.Y.S. at 24.

36. *Id.* at 63–64, 97 N.Y.S. at 24 (citing *Crabb*, 92 N.Y. at 65, for the proposition that a fiduciary has committed "willful default" of his duties if he has "intentionally disregarded the rules which control and regulate the action of prudent and careful men in conducting their own business affairs."). For a comprehensive discussion of the meaning of the word "willful" in 1905, see the Appellate Division opinion in *Mallon* at 110 A.D. at 64–67, 97 N.Y.S. at 24–26.

37. 30 A.D.2d at 423 & 425–27, 293 N.Y.S.2d at 151 & 153–54.

38. *Id.* at 424–28, 293 N.Y.S.2d at 153–54.

39. N.Y.L.J., June 9, 1992, p. 23, col. 3 (Surr. Ct., N.Y. Co.) (citing *In re Mallon's Estate*, 110 A.D. 61, 97 N.Y.S. 23 (2d Dep't 1905)), *aff'd without opinion*, *sub nom. In re Howard*, 185 N.Y. 539, 77 N.E. 1189 (1906)).

40. *Id.*

41. *Id*. (citing *In re Rothko*, 43 N.Y.2d 305, 372 N.E.2d 291, 401 N.Y.S.2d 449 (1977) and *In re Ryan*, 291 N.Y. 376, 52 N.E. 909 (1943)).

42. *Id.*

43. *See also In re Daniel P. Scheuer*, N.Y.L.J., June 3, 1992, p. 23, col. 1 (Surr. Ct., N.Y. Co.) (essentially the same opinion as *In re Helen R. Scheuer* involving another of the forty Scheuer family trusts).

44. N.Y.L.J., June 18, 2002, p. 21, col. 4 (Surr. Ct., Nassau Co.).

45. *Id.*

46. *Id*.

47. *Id.* (citing *O'Hayer*).

48. *Id.* (citing *Bauer v. Bauernschmidt*, 187 A.D.2d 477, 589 N.Y.S.2d 582 (2d Dep't 1992)); *accord*, *In re Rice's Will*, 75

N.Y.S.2d 578 (N.Y. Sup. Ct. 1940) (Schmuck, J.) In *Rice*, while providing little reasoning and citing no cases, Justice Schmuck held that clear language in the *inter vivos* trust "must be heeded unless . . . it is . . . against public policy." Thus, according to the court, because Decedent Estate Law Section 125 had no application to the *inter vivos* trust, the court held that "no remainderman is authorized to object to the acts of the trustee during the lifetime of the grantor-life income beneficiary and that the objections of the guardian ad litem filed on behalf of the infant remaindermen be stricken out." 75 N.Y.S.2d at 580.

49. 187 A.D.2d 477, 589 N.Y.S.2d 582 (2d Dep't 1992).
50. *Id.* at 478, 589 N.Y.S.2d at 583.
51. *Id.* at 478–79, 589 N.Y.S.2d at 583 (citing cases).
52. *See id.* at 477–79, 589 N.Y.S.2d at 583.
53. *Id.* at 479, 589 N.Y.S.2d at 583.
54. N.Y.L.J., July 24, 1998, p. 25, col. 3 (Surr. Ct., Kings Co.).
55. *Id.* at p. 26, cols. 4-5.
56. *Id.* at col. 5
57. 162 Misc. 2d 888, 618 N.Y.S.2d 959 (Surr. Ct., Nassau Co. 1994).
58. *Id.* at 893, 618 N.Y.S.2d at 963.
59. *Id.*
60. N.Y.L.J., Jan. 12, 1998, p. 32, col. 3 (Surr. Ct., Westchester Co.).
61. *Id.* (emphasis added). The Surrogate also cited to *In re McAllister*, 144 Misc. 2d 994 (Surr. Ct., Nassau Co. 1989) a case involving a *testamentary* trust, in which Surrogate Radigan held that trust provisions that purported to exculpate a trustee from liability for retention and negligence were void under EPTL 11-1.7 and EPTL 11-2.1.
62. 124 Misc. 2d 630, 476 N.Y.S.2d 763 (Surr. Ct., Nassau Co. 1984).
63. 736 N.Y.S.2d 151 (3d Dep't 2002).
64. *See Carey v. Cunningham*, 191 A.D.2d 336, 336, 595 N.Y.S.2d 185, 185 (1st Dep't 1993) (citing *O'Hayer* and *Balfe*) (affirming a Supreme Court New York Co. decision).
65. Peter Valente & Joann T. Palumbo, *Exculpatory Provisions*, N.Y.L.J., Apr. 29, 1998, p. 3, col. 1.
66. *Meinhard*, 249 N.Y. at 464, 164 N.E. at 546 (quoting *Wendt*, 243 N.Y. at 444, 145 N.E. at 304).
67. A definitive rule from the Court of Appeals, while as equally welcome as a statute, seems unlikely given the extraordinary expense in bringing a case to the Court and the myriad of fact patters that can make any one case distinguishable from another.

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IRS Issues Key Grantor Trust Ruling

By Shari A. Levitan

On July 6, 2004, the Internal Revenue Service issued what will become one of the Revenue Rulings that every sophisticated estate planner commits to memory. Revenue Ruling 2004-64[1] confirms the advice that many estate planners have given their clients over the years—that using an irrevocable trust that is treated as a grantor trust for income tax purposes to make gifts can provide significant additional benefits to the beneficiaries of the trust because, in most cases, the payment of the income tax on the trust's income by the grantor of the trust, and not from assets of the trust, is essentially an additional, tax-free gift to the trust. Over the years, the aggregate tax payments made by the grantor may well exceed the value of the original gift, making this an extremely valuable transfer tax planning technique.

The grantor trust rules, found in Internal Revenue Code sections 671 through 679, allocate the income tax burden for certain trusts to the grantor, notwithstanding the fact that the grantor is not a beneficiary of the trust and has no control over the management of the trust. The grantor trust rules take the position that certain administrative provisions or the identity of the trustees cause the trust's income to be considered the income of the grantor.

Without knowledge of these complex and sometimes byzantine rules, planners may draft trusts with administrative provisions that result in the inadvertent bifurcation of asset ownership and income tax responsibility, leaving a grantor without the funds necessary to pay the income tax liability the grantor assumed would be the liability of the trust. However, with careful planning, it is possible for the grantor to create a trust that deliberately is subject to the grantor trust rules[2] and provides additional tax-free gifts to children and grandchildren. Revenue Ruling 2004-64 provides the green light to do so.

What makes Revenue Ruling 2004-64 remarkable is that for the past decade the Internal Revenue Service has taken the position that payment of income tax on trust income by the grantor of a trust is in fact an additional taxable gift,[3] although that position was not supported by a plain reading of the Code and Treasury Regulations.[4] The very rules that the IRS uses to tax a grantor on trust income somehow offended the Service when used offensively by taxpayers in a manner favorable to the taxpayer.[5] In fact, the Service took the position that it would not rule favorably on the status of a trust qualifying as a Grantor Retained Annuity Trust ("GRAT") if the trust did not provide for reimbursement to the grantor for the payment of additional income taxes resulting from the trust's income. Many planners were concerned that the Service's requirement of tax reimbursement language meant that a GRAT that did *not* include such a provision could accept gifts beyond the initial contribution, which is not permitted under Code section 2702. That would be a disastrous result, and many planners began to include tax reimbursement provisions in GRAT documents and other irrevocable grantor trusts, while others took the position that the IRS was not correct, and prepared documents that were silent regarding the grantor's responsibility for taxes, neither permitting nor prohibiting reimbursement.

Revenue Ruling 2004-64 also answers other questions that have concerned planners. The Ruling provides that if a grantor trust does contain a right of reimbursement to the grantor, or if local law requires the trustee to reimburse the grantor for income taxes, the full value of the trust's assets will be included in the grantor's gross estate under section 2036 of the Code as a retained interest in the trust on the theory that the trust remains available for the use and benefit of the grantor. This portion of the ruling applies to trusts created after October 3, 2004. If the trust does contain a right of reimbursement, or if local law requires it, and no reimbursement is in fact made, an additional taxable gift to the trust by the grantor will be made, and the value of the gift presumably would be the difference between the grantor's income tax liability computed with the trust's income and without the trust's income.

The Ruling also addresses the case of trusts which provide for discretionary reimbursement of the tax liability by a disinterested trustee, and conclude that unless there is an express or implied agreement with the grantor regarding the trustee's exercise of the discretion to make reimbursement, the discretionary power of reimbursement, and the exercise or nonexercise of that power, will not cause inclusion of the trust's assets in the grantor's estate. The Ruling is careful to note that it does not address whether a particular discretionary power of reimbursement, as drafted, might be treated as a retained interest of the grantor. If the power to reimburse the grantor could be exercised by the grantor, or is deemed to be exercisable by the grantor, the existence of the power would cause the trust assets to be included in the grantor's estate.

Some states have no statutory provisions regarding reimbursement of taxes for grantor trusts. In contrast, New York's EPTL 7-1.11(a) provides that a trustee may reimburse the grantor for the additional taxes attributable to the trust income unless the governing instrument prohibits such reimbursement. Prior to Revenue Ruling 2004-64, many planners routinely prohibited tax reimbursement to the grantor. Presumably the discretionary power provided by EPTL 7-1.11(a) should not raise Code section 2036 concerns, although some planners may choose to continue to include prohibition of tax reimbursement out of an excess of caution. Prohibiting reimbursement to the grantor should not be treated as creating a gift from the grantor to the trust in the amount of foregone tax reimbursement, even if state law requires, rather than permits, reimbursement of taxes.

While the Ruling answers certain questions, it raises others. For example, it is not clear in the Ruling what the term "created" means. Does it mean that all trusts in existence on or before October 3, 2004 that contain a right of reimbursement are exempt from the application of the Ruling? Or, do contributions to such a trust after October 3, 2004 subject some or all of the trust's assets to inclusion in the grantor's estate under section 2036? In the case of the generation-skipping transfer tax, later transfers to irrevocable trusts created before September 25, 1985 are not grandfathered from the generation-skipping transfer tax,[6] with the result that a pre-September 25, 1985 trust may be partially exempt and partially non-exempt. It is possible the Service would take a similar position with respect to contributions to grantor trusts containing reimbursement provisions. Until there is further guidance on pre-October 3, 2004 trusts that contain a right of tax reimbursement, grantors should not make additional gifts to such trusts after October 3, 2004.

Also not answered by the Ruling is the case of a trust that ceases to be a grantor trust by reason of a change in trustees or the relinquishment of an administrative provision, and whether the risk of inclusion in the grantor's estate continues for an additional three-year period under section 2035.[7] If so, does it matter whether the reason for the cessation of grantor trust status was initiated by the grantor (relinquishment of the power to substitute property, removal of a family member as trustee and appointment of someone who is not related or subordinate to the grantor as successor trust) or independent of the grantor (related trustee ceases to serve as trustee and the named successor trustee is not related to the grantor)? Planners will need to be thoughtful about when and how to "turn off" grantor trust tax treatment until this question is answered.

Notably, Revenue Ruling 2004-64 does not address loans to grantor trusts or sales by the grantor to a grantor trust created by the grantor. In the current low interest environment, many grantors have made substantial loans in addition to gifts to grantor trusts as an estate-freezing technique. The additional funding by way of loans can allow the trust to invest in assets it might not otherwise be able to afford, or be permitted to purchase (as in the case of an investment requiring an accredited investor). In the case of sales to a grantor trust, particularly one that does not already have substantial independent economic substance, there remains the concern that the Service will view the sale as a step transaction, and conclude that the transaction was in reality a transfer with a retained payment, includible in the grantor's estate under section 2036, rather than a nontaxable event.

While Ruling 2004-64 is very welcome news, careful economic analysis still must be done when a grantor is considering creating a grantor trust. If the trust were not taxed as a grantor trust, but instead taxed at the trust level,[8] it is likely that the taxes paid would be higher than if the grantor pays the taxes because trusts reach the highest marginal bracket at a much lower income threshold. However, if distributions of income may be made to beneficiaries who are in much lower tax brackets, the overall income tax burden may be lower than if the trust were taxed as a grantor trust. The reduction in the grantor's estate by payment of the taxes, and the ability to reinvest within the trust dollars that would otherwise be paid in taxes, may outweigh any increase in the income tax burden. In some situations, even though it would be tax-efficient to create a grantor trust, the grantor does not have sufficient liquid resources to pay taxes on the trust's income (which income, it is hoped, will only increase over time).

It is also possible that tax rates for trusts and individuals may change in the future, which would alter the economic analysis. As a result, trusts should be drafted to permit the trust to cease to be taxed as a grantor trust in the event it becomes too burdensome to the grantor. This can be accomplished by including certain administrative provisions that can be relinquished,[9] such as the power to substitute assets (except that such power should not be used in a trust that holds life insurance on the grantor's life), or the power in the trustee to add to the class of beneficiaries. In addition, for married grantors, it may be possible to include the spouse as a discretionary beneficiary of the trust to whom trust distributions might be made if necessary to help pay income taxes.

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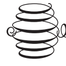

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However, including the spouse as a beneficiary will mean that the spouse cannot make gifts to the trust.

New York planners should keep in mind an unusual provision contained in N.Y. Tax Law § 639, which provides that if a New York resident taxpayer enters into an installment sale and becomes a nonresident while a balance remains outstanding, the balance of the installment payments are accelerated into the taxpayer's final year as a New York resident. If a grantor trust having a New York grantor enters into an installment sale, and the grantor ceases to be a New York resident, or if the trust ceases to be a New York trust for New York fiduciary tax purposes, the same result would occur.

The decision to use a grantor trust is only part of the planning. Care must always be taken to assure grantor trust status as to both income and principal, and to be certain that grantor trust provisions do not result in estate tax inclusion.

Finally, it is important to be sure that the client's accountant is advised of the nature of the tax treatment of the trust, and advised if there are changes that alter the taxpayer to whom income is taxed, so that tax returns for the trust and grantor are prepared consistent with the grantor trust planning.

Endnotes

1. Rev. Rul. 2004-64, 2004-27 IRB 7.
2. Grantor trusts are commonly known as intentionally defective income trusts, or IDITs.
3. See Priv. Let. Ruls. 9504021, 9444033, 9416009, 9413045 and 9352004; *But see also* Priv. Let. Rul. 9519029.
4. IRC § 671 clearly sets forth the fact that a trust's income may be taxed to the grantor. The payment of taxes that a grantor is legally obligated to pay is not gratuitous and, therefore, not a taxable gift to another person. See Treas. Reg. § 25.2511-1(d), and discussion in Zaritsky, 858-2nd T.M., *Grantor Trusts: Sections 671-679*, A-20.
5. See Priv. Let. Ruls. 9444033, 9416009, and 9352004.
6. See Treas. Reg. § 26.2601-1(b)(1)(i) (regarding GST trusts).
7. See IRC § 2035(a)(2), which addresses relinquishment of powers within three years of death that cause section 2036 estate tax inclusion.
8. See IRC §§ 673-678, which speak to the taxation of trust income to the grantor, in whole or in part.
9. See IRC § 675 regarding administrative provisions that cause grantor trust status, and section 672(c) regarding the identity of trustees that cause grantor trust status.

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Advance Directives and the HIPAA Privacy Rule: Fitting the Square Peg in the Round Hole

By Rose Mary Bailly and Barbara S. Hancock

Introduction

New federal rules protecting the privacy of individuals' health information came into being in 1996 as part of a statutory initiative to develop a simplified national health information system. At that time, Congress adopted broad-brush standards for the administration of the system, including standards for protecting the confidentiality of health records in electronic transmission through the system, and stiff penalties for violating the standards. Congress also directed the Department of Health and Human Services (HHS) to flesh out the details of the standards and protections in a new set of regulations.

Within a short time after these new health privacy regulations went into effect in Spring 2003, attorneys whose practices do not normally encompass health law—including trusts and estates attorneys and elder law attorneys—discovered that these new rules have an impact on their areas of practice. In the areas of trusts and estates and elder law, this impact is especially pervasive wherever a person's incapacity sets a course of events in motion, or where a person's incapacity raises issues about a third party's access to documents and information, thanks to the stringent new rules protecting the person's medical privacy. Thus, for example, if the person has a springing power of attorney triggered by written certifications of incapacity from two physicians, the rules appear to prevent doctors from releasing their medical opinions to those who need this information—namely, the designated attorney-in-fact and financial institutions which seek confirmation that the power of attorney has been validly triggered by the person's incapacity. Also, in the area of powers of attorney, the rules may prevent the attorney-in-fact from being able to verify the accuracy of a medical bill, because the principal's medical records may be off-limits. The rules also affect some trusts, nearly all guardianship proceedings, and many advance directives.

Our focus in this article is on the impact of the health privacy rules on advance directives in New York, specifically, on powers of attorney and health care proxies.[1]

Background of the HIPAA Privacy Rule

The Health Insurance Portability and Accountability Act of 1996 (HIPAA)[2] was enacted with several goals, including the desire to make the nation's health care system more effective and efficient.[3] To promote that goal, HIPAA encouraged a national health information system with standards and requirements for the electronic transmission of health information.[4] In providing standards for this electronic exchange of information between health care providers, HIPAA addressed security matters and safeguards, to ensure the confidentiality of the information and to protect against unauthorized uses and disclosures of the information.[5] It imposed penalties for failure to comply with the requirements and standards,[6] and directed the Department of Health and Human Services to issue detailed regulations governing the privacy of individually identifiable health information.[7]

The development of the final regulation took almost four years. After two rounds of public comment and four sets of amendments, HHS's final regulation, "Standards for Privacy of Individually Identifiable Health Information," known as the "Privacy Rule," finally went into effect on April 14, 2003.[8]

As required by HIPAA, the regulation establishes national standards for an individual's rights regarding his or her health information.[9] However, this federal regulation does not preempt any federal, state, or other law, if that law establishes requirements, standards, or implementation specifications that are more stringent than the regulation.[10]

Confusion Reigns

In the aftermath of the promulgation of the Privacy Rule, confusion about its applicability has reigned as health care providers, patients, and third parties work to understand the scope and breadth of the Privacy Rule.[11] HHS has acknowledged the widespread confusion arising during the early months of the Rule's implementation, and reported in September 2003 that it was striving to focus and prioritize its outreach efforts as it "discern[s] the need for further clarification [of the Rule]."[12]

The concern generated among health care providers by the Privacy Rule has been altogether understandable in light of the stiff monetary penalties for violating its provisions.[13] The penalty for each violation is $100, not to exceed $25,000 for identical violations within a single year; worse yet, the sheer number of potential violations under this extensive and complex regulation is truly daunting. However, several factors appear to make the Rule's bark far worse than

its bite. For example, it is possible to escape fines if the problem arose from reasonable cause rather than from willful neglect, and if the problem is corrected within 30 days of its discovery.[14] Then there is HHS's self-described "general approach to enforcement," which is to provide "guidance and a wide array of other technical assistance materials to help [providers] effectively implement the Privacy Rule."[15] The Rule itself encourages a cooperative approach on the part of both HHS and providers, such that the technical assistance provided by HHS can foster voluntary compliance by the provider.[16] Thirdly, early reports indicated that investigation of complaints had not led to a single fine,[17] covered entities having "taken appropriate action very swiftly"[18] when a problem had been identified.

Notwithstanding HHS's declared conciliatory attitude, anecdotal reports indicate that many health care providers are adopting a very conservative approach to compliance with the Privacy Rule. HHS itself acknowledges that "providers have elected to take a more restrictive approach than the Privacy Rule requires," and that some problems may arise "because of a misconception about the requirements of the Privacy Rule."[19] Thus, while it would appear that some Privacy Rule boondoggles will eventually turn out to have been quite unnecessary, this is of little consolation to attorneys who want to make sure that their current documents comply not only with the Rule but also with perceptions about the Rule; many attorneys report drafting multi-layered protective provisions in order to guarantee that certain needed disclosures can be made. With case law and rulings scant for such a recently adopted rule, nearly everyone, including us, is still feeling their way. HHS has promised continued outreach efforts to disseminate information and provide additional clarification. HHS hopes that material posted on its website will help providers educate other providers, as well as help "patients and their loved ones who seek to correct the misconceptions of hospitals and other providers who mistakenly fail to grasp the latitude afforded by the Privacy Rule to share information with loved ones."[20]

Generally, our study of the Privacy Rule leads us to agree with HHS that some interpretations of the Rule have rather overshot the mark. For example, the Privacy Rule does not prevent an incapacitated patient's health care agent from accessing the patient's medical records, as a hospital contended in a recent New York case,[21] so there should be no need to modify a standard New York Health Care Proxy to restate the laws guaranteeing this access, as some attorneys have suggested to us.

However, we do think that some document drafting changes are necessary, and that some New York statutory changes are desirable, as explained below.

Some Privacy Rule Basics

The Privacy Rule covers a fair amount of ground, including security standards for electronically transmitted health information, various administrative requirements, and compliance provisions, in addition to the privacy standards. It consists of two parts, 160, which covers general administrative requirements, definitions, and penalties, and 164, dealing with security and privacy. Subpart E of part 164, "Privacy of Individually Identifiable Health Information," provides the substantive rules for our purposes, beginning at section 164.500.

The Rule recognizes an individual's rights regarding the use and disclosure of "individually identifiable health information."[22] Individually identifiable health information is "health information created or received by a covered entity" and

> relates to the past, present, or future physical or mental health condition of an individual; the *provision of health care to an individual*, or the past, present or future *payment for the provision of health care to an individual* and that identifies the individual or with respect to which there is a reasonable basis to believe the information can be used to identify the individual.[23] [emphasis added]

When the individually identifiable health information is transmitted or maintained in electronic or other form, as "protected health information," it is protected from unauthorized use or disclosure.[24] The covered entity may disclose this protected health information to the individual[25] and is required to do so when the individual requests it.[26] Covered entities include health plans, health care clearing houses[27] and health care providers "who transmit[ ] any health information in electronic form with respect to a transaction covered by [the Privacy Rule]."[28] The covered entity may disclose protected information to third parties in specified circumstances. Subpart E sets forth the rules and guidelines for use and disclosure to third parties, including uses and disclosure when the individual agrees or has an opportunity to object, and uses and disclosure where the individual's agreement or opportunity to object is not required.[29]

An individual may authorize a covered entity to disclose protected health information to third parties.[30] To be valid, the authorization must be in writing as a separate, plain-language document that must contain certain core elements and required statements.[31] The requirements for authorizations are set forth below, in the second section of the discussion about powers of attorney.

If the individual is incapacitated and unable to request the information from the covered entity or authorize its release to a third party, the question then arises as to who may make a request and under what circumstances the information can be disclosed. The Privacy Rule addresses this situation in a variety of ways.

Under Subpart E's general rules, the covered entity must recognize the authority of the "personal representative" of the individual to request and receive such information.[32] A personal representative is the person who has authority under applicable law "to act on behalf of an individual who is an adult or an emancipated minor in making decisions related to health care."[33] The law of New York will thus determine whether a particular individual is a "personal representative." If a person has executed a valid health care proxy, under current law, the agent is the personal representative of a principal who lacks capacity to make health care decisions.[34] The personal representative's access to the protected health information is limited to information that is relevant to the personal representation.[35] Thus, if a health care proxy limits the agent's authority—for example, by restricting the authority only to decisions for a particular medical condition or during a specified time period—then the personal representative's access to the principal's health information would be restricted accordingly.

The Privacy Rule permits someone who is not a personal representative to have limited access to an individual's protected health information.[36] The person may be a family member, other relative or close personal friend, or any other person identified by the individual.[37] These disclosures are limited to health information "directly related to the person's involvement with the individual's health care" or to notification of the individual's location, general condition, or death.[38] The covered entity may make such disclosures with the individual's express or implied consent.[39] If the individual is not present or if the individual is incapacitated, the decision to disclose is within the professional judgment of the covered entity that disclosure is in the best interest of the individual.[40] This section does not envision that the disclosure would involve past medical history with no bearing on the individual's current condition.[41] One comment by the drafters explains that the intent behind this section was to allow continuation of

> most covered entities' current practices with respect to informing family members and others with whom a patient has a closed personal relationship about a patient's specific health condition when a patient is incapacitated due to a medical emergency and the family member or close personal friend comes to the covered entity to ask about the patient's condition.[42]

Another comment suggests a broader interpretation, referring to "the need that covered health care providers may have, in some cases, to have routine, informal conversations with an individual's family and friends regarding the individual's treatment."[43] Taken together, the comments indicate that the drafters of this section were trying to strike a balance, upon learning of the diversity of practices during the public comment period. It is arguable that under some circumstances, as explained below, the language of this section may provide access to information when needed for the benefit of an incapacitated person.

Under Subpart E's rules regarding disclosures where authorization or an opportunity to object are not required, certain situations create an obligation by a covered entity to disclose protected information. Such situations involve responding to an investigation of a complaint of abuse or neglect,[44] responding to a discovery device during the course of a judicial or administrative proceeding under certain circumstances,[45] or responding to an order of a court or administrative tribunal where the disclosure is required for a judicial or administrative proceeding.[46]

These various rules must be considered when attempting to obtain access to protected health information regarding an incapacitated individual; however, it is not always readily apparent whether their application will result in access to the information sought.

Planning for Incapacity

New York law allows an individual to appoint agents to make decisions and act on his or her behalf if he or she should ever become incapacitated. With a durable power of attorney, the principal can appoint an attorney-in-fact to manage the principal's financial matters. With a health care proxy, the principal appoints an agent for health care decisions.

Access to the individual's protected health information by these agents for bill paying and health care decision-making may be governed by a determination of whether they are regarded as personal representatives under the Privacy Rule, and thus entitled to the same access as the individual. The outcome for health care proxies and powers of attorney may differ, depending on the circumstances.

Powers of Attorney

1. Decision-Making for Health Care Billing and Payment Matters

Under New York's General Obligations Law, the principal may grant authority to the attorney-in-fact to handle a broad variety of financial matters on the principal's behalf, including real estate transactions, banking transactions, business operating transactions, insurance transactions, estate transactions, claims and litigation, retirement benefit transactions, gifting, and tax matters. Corresponding to each of the sixteen powers listed on the statutory form is a construction section detailing what is included in that power.[47] The principal may include additional powers, supplement or limit the attorney-in-fact's authority with respect to a particular power, or eliminate a particular power.[48]

Under a standard power of attorney, the attorney-in-fact has the authority to access the principal's funds, records, and billing statements for the purpose of paying the principal's bills. The broadly written construction section that lays out the specifics of this power dates from 1963, long before HIPAA and the Privacy Rule, and makes no specific reference to medical bills and records. Even before the Privacy Rule, attorneys-in-fact have reportedly run into trouble when seeking records related to health care billing because of a gap in New York's law governing access to patient records. Under section 18 of the Public Health Law, the attorney-in-fact could have access to bills, but not to the substantiating examination, assessment, or treatment records,[49] which are available only to "qualified persons."[50] The attorney-in-fact, who is not listed as a "qualified person," is at a loss to check the accuracy of a billing statement. However, if the principal expressly grants authority for such access in the power of attorney, under the Public Health Law (although not necessarily under the Privacy Rule, which requires a separate document)[51] the instrument may now qualify as a permissible written authorization for release of records to a third party.[52] To cover the Privacy Rule base as well, a competent principal could also execute a separate HIPAA-compliant authorization granting access to the records. If the principal is no longer competent, the health care agent, as personal representative pursuant to the health care proxy law, would be able to sign the authorization.[53]

The problem of access is exacerbated by the Privacy Rule's definition of personal representative as a person with authority to make "decisions related to health care."[54] Characterizing an attorney-in-fact as the principal's personal representative according to this definition is difficult because New York's General Obligations Law limits the authority of the attorney-in-fact to financial matters, and expressly prohibits the attorney-in-fact from making health care decisions for the principal.[55] In New York, applicable law makes a health care agent appointed pursuant to a health care proxy (or a guardian appointed pursuant to court order) the principal's personal representative.[56] Since only the principal and the health care agent (or a court-appointed guardian for the principal) have broad access to the principal's health care records under the Privacy Rule, an incapacitated principal's attorney-in-fact seeking information from these records to clarify or contest a medical bill would have to gain access through the health care agent. In this way, the Privacy Rule's restriction of access to records does not take into account a statutory structure such as New York's, which divides responsibilities for health care decisions and bill paying between two representatives, the health care agent and the attorney-in-fact.

Many people do designate the same person to serve as both health care agent and attorney-in-fact under a health care proxy and power of attorney, respectively. In those cases, the person acting in a dual capacity should have broad access to medical information and records.[57] However, in creating two separate consumer documents for people to use in planning for health care and financial matters, the New York legislature clearly intended that New Yorkers have the option to name different individuals to serve as decision-maker in these different capacities. At issue is how to assure that a person acting only in the role of attorney-in-fact can have access to underlying health care information if the attorney-in-fact finds reason to question the accuracy of a bill.

Despite the difficulties associated with the definition of "personal representative" under the Privacy Rule, the attorney-in-fact acting under a standard, statutory power of attorney could argue that the covered entity is allowed to make some disclosures of protected health information to the attorney-in-fact under the Privacy Rule's standard for permitted "uses and disclosures for involvement in the individual's care and notification purposes."[58] Under this standard, the covered entity may disclose to "[a] person identified by the individual the protected health information directly relevant to such person's involvement with . . . payment related to the individual's health care."[59] If the individual is incapacitated, the provider may determine whether the disclosure is in the individual's best interest.[60] Since the attorney-in-fact has been identified by the principal as the person involved with bill payment, this standard should apply. However, since the standard grants only as much access as the provider decides to allow,[61] it is not ideal from the point of view of the principal, who would want to assure that the attorney-in-fact has the authority to access all needed records if there were a question about a bill.

A principal who is able to do so could either execute a valid HIPAA-compliant authorization granting broad records access to the designated attorney-in-fact, or include in a new power of attorney language such as that described below in the Law Revision Commission's proposal, granting limited personal representative status to the attorney-in-fact.

To clarify concerns about the authority of an attorney-in-fact under the Privacy Rule, the New York State Law Revision Commission's proposal to amend the General Obligations Law as it relates to powers of attorney[62] includes a provision addressing access to health care billing and payment records, to make the power of attorney law consistent with the health care proxy law and the Privacy Rule. Under the Commission's proposal, the attorney-in-fact's authority with respect to "records, reports and statements" on the statutory short form would be revised to include "health care billing and payment matters." The corresponding new paragraph (1) added to construction section 5-1502K would clarify that the authorization to act with respect to records, reports and statements includes the authorization to access records relating to the provision of health care and to make decisions relating to payment for health care services to which the principal or the principal's health care agent has consented. This clarification removes any ambiguity about whether an attorney-in-fact acting under an existing or future power of attorney can access health care records in connection with the payment of health care bills. The amendment does not change current law limiting the authority of a third party to make health care decisions to a health care agent acting under a health care proxy or a guardian appointed by the court. Under the Commission's proposal, the health care agent or guardian remains the person's personal representative with respect to health care decisions as defined in the Public Health Law.[63]

The new construction section language allowing the attorney-in-fact to make decisions relating to payment for health care services echoes the language defining personal representative under the Privacy Rule as "a person [who] has authority to act on behalf of an individual . . . in making decisions related to health care."[64] The Rule says that such individual must be treated as a "personal representative . . . with respect to protected health information relevant to such representation;"[65] protected health information "relates to . . . the past, present, or future payment for the provision of health care to an individual."[66]

HHS's comments, issued in connection with the December 2000 version of the Privacy Rule, indicate that HHS recognizes this potential role of an attorney-in-fact as personal representative:[67]

> *Section 164.502(g)—Personal Representative*
>
> *Comment:* It was observed that under the proposed regulation, legal representatives with "power of attorney" for matters unrelated to health care would have unauthorized access to confidential medical records. Commenters recommended that access to a person's protected health information be limited to those representatives with a "power of attorney" for health care matters only. Related comments asked that the rule limit the definition of "power of attorney" to include only those instruments granting specific power to deal with health care functions and health care records.
>
> *Response:* We have deleted the reference to "power of attorney." *Under the final rule, a person is a personal representative of a living individual if, under applicable law, such person has authority to act on behalf of an individual in making decisions related to health care. "Decisions relating to health care" is broader than consenting to treatment on behalf of an individual; for example, it would include decisions relating to payment for health care. We clarify that the rights and authorities of a personal representative under this rule are limited to protected health information relevant to the rights of the person to make decisions about an individual under other law.* For example, if a husband has the authority only to make health care decisions about his wife in an emergency, he would have the right to access protected health information related to that emergency, but he may not have the right to access information about treatment that she had received ten years ago. [emphasis added]

The Commission's proposed amendment to section 5-1502K of the General Obligations Law would redefine the authority of the attorney-in-fact so that the attorney-in-fact becomes the individual's personal representative for purposes of accessing medical records in connection with paying medical bills.[68] This provision of the amended law, if adopted, would apply to all validly executed New York powers of attorney, including those already in effect at the time of the bill's passage. It would not be necessary to exe-

cute a new power of attorney under the amended law solely for the purpose of ensuring access to medical records.

But for now, while the Privacy Rule and New York's statutory power of attorney law remain out of sync with respect to access to health records for billing and payment purposes, a person with capacity may individually grant this access to an attorney-in-fact by executing a separate HIPAA-compliant authorization to that effect, or by modifying a power of attorney to include language defining the attorney-in-fact as personal representative with the authority to make decisions relating to payment for health care services, as above. If a person is incapacitated and thus unable to execute an authorization and does not have a health care agent who can do so, then the decision to disclose his or her protected health information to an attorney-in-fact is within the professional judgment of the covered entity.[69]

2. Authorization for the Release of Protected Health Information Related to Capacity

The Privacy Rule has another completely separate impact on certain powers of attorney, namely, whether protected health information related to a determination of an individual's incapacity can be released to a third party. This information is necessary in certain circumstances in order to determine whether the power of attorney is legally in effect. New York authorizes three types of powers of attorney, nondurable, durable and springing. A nondurable power of attorney, effective as soon as it is signed, ceases to be effective when the principal becomes incapacitated.[70] A durable power of attorney, effective as soon as it is signed, continues in effect after the principal becomes incapacitated.[71] A springing power of attorney, formally a "power of attorney effective at a future time," takes effect upon the occurrence of an event specified by the principal.[72] In many cases, the specified event is the principal's incapacity, as certified by a physician or physicians identified in the document.[73] A determination of incapacity thus plays a key role in the effectiveness of two of the three types of powers of attorney, nondurable and springing.

The Privacy Rule's protection against the unauthorized disclosure of protected health information extends to information about the individual's incapacity.[74] Unlike the situation regarding billing and payment information where the attorney-in-fact who needs ongoing access to protected health information for bill paying arguably can be considered a personal representative, in this situation, such an argument simply does not apply, because access to protected information about incapacity is needed for a purpose unrelated to health care billing and payment. The information sought determines whether the power of attorney is in effect.[75] Furthermore, the person seeking the information may not come within the parameters of the Privacy Rule's standard for uses and disclosure when the individual is incapacitated, because that information-seeker may be a financial institution or other third party not included in the standard. However, the problem of access may be resolved under the Privacy Rule by allowing disclosure pursuant to, and in compliance with, a HIPAA authorization.[76] With a HIPAA-compliant authorization, a doctor's written certification that an individual is incapacitated, potentially needed for terminating a nondurable power of attorney or triggering a springing power of attorney, can be disclosed to the attorney-in-fact, financial institutions, or other third parties, thus ensuring the principal's intention that his or her capacity properly affects the effectiveness of the power of attorney.[77]

The Commission's proposal to amend the General Obligations Law as it pertains to powers of attorney includes two new, separate forms to accompany a nondurable general power of attorney or a durable general power of attorney effective at a future time if the triggering event is the principal's incapacity. These forms are needed in order to obtain from a medical provider a written statement of the principal's incapacity.

These forms were designed to meet the requirements for a valid authorization listed in the Privacy Rule, namely: a description of the information to be disclosed, the person or class of persons authorized to request disclosure, a description of the purpose for the disclosure (e.g., "at that person's request"), an expiration date, the signature of the principal or, alternatively, his or her "personal representative," the date of signature, and several required statements.[78]

If the principal is unable to execute this form due to incapacity, the principal's health care agent appointed under the principal's health care proxy could do so in his or her role as personal representative, since the health care agent's authority begins when the principal becomes incapacitated.[79] Unless the attorney-in-fact is also the principal's health care agent, the attorney-in-fact cannot execute this document. Where the principal has no health care agent and wishes to use a nondurable or springing power of attorney, the principal should be aware that the effectiveness of his or her power of attorney may depend upon the principal's execution of this authorization form at the same time as the power of attorney.

Health Care Proxies

A principal's incapacity is also at issue in determining when a health care proxy takes effect. New York's health care proxy law allows the principal to appoint a person as agent with the authority to make

any and all health care decisions on his or her behalf, subject to any limitations specified by the principal in the proxy form.[80]

New York's health care proxy is essentially a springing instrument: the agent's authority begins when the attending physician determines that the principal lacks capacity to make health care decisions.[81] This determination of lack of capacity is solely for the purpose of empowering the health care agent.[82] The physician makes the determination in writing in the patient's medical record, specifying her opinion regarding the cause and nature of the principal's incapacity, and its extent and probable duration.[83] The determination may be requested by the agent.[84] When the attending physician has made this determination, the health care agent has full authority to make health care decisions on the principal's behalf, subject to any limitations that the principal may insert in the instrument.[85] The agent also has the right to receive health care information and records necessary to make informed decisions concerning the principal's health care.[86]

The determination of incapacity for purposes of triggering a health care proxy may appear analogous to the determination for purposes of triggering or terminating a power of attorney, but it is not. The determination for the power of attorney is for a purpose unrelated to health care decision-making. Accordingly, for a power of attorney, the principal should affirmatively grant access to this information through a HIPAA-compliant authorization, as explained above. The determination for triggering the health care proxy, on the other hand, is for the purpose of empowering someone to make treatment decisions. The Privacy Rule specifically allows disclosures without authorization when needed for treatment purposes.[87] Disclosure to the designated health care agent would qualify under the standard "uses and disclosures for involvement in the individual's care and notification purposes."[88] This standard permits disclosure to "any . . . person identified by the individual the protected health information directly relevant to such person's involvement with the individual's care."[89] The person identified by the individual is the designated health care agent, and the protected health information pertaining to incapacity is directly relevant to the agent's involvement in the principal's care. Thus, the Privacy Rule does not appear to prevent the health care agent from knowing that the principal is incapacitated and therefore that the health care proxy is in effect; in other words, the Privacy Rule should not indirectly cause denial of care to an incapacitated individual.

Congressional testimony by a representative of the Department of Health and Human Services in September 2003 is in line with this analysis. In discussing misconceptions about the Privacy Rule and overly restrictive practices that had been adopted "and, incorrectly, blamed on the Privacy Rule,"[90] the representative told the Senate Special Committee on Aging:

> [W]e have seen reports and heard from consumers, as you may have heard from your constituents, that providers cannot share information with family members, loved ones, friends, or others whom are identified by the individual as involved in their care or the payment for their care. Again, rather than foreclosing such communications, the Privacy Rule provides a number of common-sense methods which appropriately permit such disclosures while respecting and protecting an individual's right to control their health information. Under 45 C.F.R. 154.510(b), the Privacy Rule specifically permits covered entities to share information that is directly relevant to the involvement of a spouse, family members, friends, or other persons identified by a patient, in the patient's care or payment for health care. Where the patient is present and has the capacity to make health care decisions, the covered entity may discuss this information with these individuals if the patient agrees or, when given the opportunity, does not object. The covered entity may also share relevant information with these individuals if it can reasonably infer, based on professional judgment, that the patient does not object. For example, if a patient brings a friend to a medical appointment and asks if the friend can come into the treatment room, her doctor can reasonably infer that the patient does not object. Under these circumstances, a doctor or plan can disclose any information that is directly relevant to the family member or friend's involvement with the patient's care, or payment related to the individual's care.[91]

We are aware that some attorneys are taking the extra precaution of preparing separate HIPAA-compliant authorizations solely for the purpose of obtaining the determination of incapacity that triggers the health care agent's authority. Our concern with this practice is that it may inadvertently delay the trigger-

ing of the health care agent's authority, if the familiar health care proxy form, now accompanied by an additional authorization form, has to make a detour to the covered entity's in-house counsel or HIPAA compliance officer for approval. Of course, it would be helpful to have specific clarification from HHS that "springing" health care proxies such as New York's may take effect as usual, without any interference from the Privacy Rule.

Under the Privacy Rule, the health care agent qualifies as the individual's personal representative [92] who must be treated as the individual for purposes of disclosure of protected health information.[93] The Rule provides the individual or the individual's personal representative with an affirmative right of access to protected health information.[94] With such broad rights of access already assured to the personal representative under the Privacy Rule, and to the health care agent under the health care proxy law, there is no need to modify New York's statutory health care proxy to spell out the access that is already guaranteed.[95]

A recent Nassau County case affirmed the health care agent's access to health care records.[96] A woman who served as both health care agent and attorney-in-fact for her mother sought access to her mother's medical records. The hospital in which the mother had been an inpatient denied the daughter's request, on the grounds that 1) the health care agent's access to her mother's medical records ceased with the patient's discharge from the hospital; 2) state law restricts access to a patient's health care records to a defined list of "qualified persons" which includes neither a health care agent nor an attorney-in-fact; 3) the General Obligations Law expressly prohibits health care decisions by an attorney-in-fact; and 4) the Privacy Rule prohibits a covered entity from disclosing protected health information without a signed written authorization from the patient. The court began its analysis with a discussion of the Privacy Rule, noting that the regulations must be read in conjunction with existing state law enacted for maintaining the privacy of medical information. The Rule specifically defers to state law, but if that law is less stringent than the Rule, then the Rule pre-empts the state law. The court cited New York's principal statutory sources of medical privacy, and summarized the similar procedures that must be followed under state law and the Privacy Rule when the provider determines that a person's request for access to a patient's medical information and medical records must be denied. The court noted that the hospital had not followed either of the two procedures, presumably on the basis of the hospital's contention that the daughter had no standing to commence either process (because neither the health care proxy nor power of attorney complies sufficiently with the Public Health Law's list of "qualified persons" who are allowed access to health information).

The court noted the hospital's attempt at strict compliance with the Privacy Rule, and then looked for a "clear and definitive mechanism for access" to records under the Rule when a patient is incapable of providing an authorization or consent for such access. A power of attorney executed before the promulgation of the Rule, as was the mother's in this case, could not be specific enough to satisfy the Rule's strict standards. The court then cautioned attorneys to address the Rule's "heightened requirements" in preparing new powers of attorney which comply with HIPAA's standards.

Turning to the health care proxy, the court said that the right of the health care agent to medical information is "clear" under subdivision 3 of section 2983 of the Public Health Law.[97] The court concluded that the validly executed health care proxy qualified the agent to make informed decisions about the principal's care and "to stand in stead of the 'subject' for the purpose of requesting access to past medical records which may have great bearing on present day treatment determinations." Pursuant to the agent's deemed standing as a "qualified person" under section 18 of the Public Health Law, the court directed the hospital to commence and complete the process for access to the medical records pursuant to the Public Health Law and the Privacy Rule.

Conclusion

The Privacy Rule affects powers of attorney and health care proxies in several ways. For powers of attorney, the question is whether the Privacy Rule limits the attorney-in-fact's access to protected information for bill paying, and for determining whether the person is incapacitated for purposes of terminating a nondurable power of attorney or activating a springing durable power of attorney. For health care proxies, the question is whether the agent can find out about the principal's capacity in order to activate the agent's authority.

The Privacy Rule does not always provide ready answers to these questions, and further clarification of the regulations would be helpful, particularly with respect to health care proxies. Carefully targeted statutory changes, or carefully drafted modifications and authorizations in conjunction with individuals' powers of attorney can afford protection until the law can be changed.

Endnotes

1. For a survey of the interaction between the health privacy rules and guardianships (including Articles 79 and 81 of the Mental Hygiene Law, and Article 17A of the Surrogate's Court Procedure Act), see our article, *Incapacity and the Privacy Rule: With a Nip and a Tuck They Might Fit*, 9 Health L. J. No. 2, 32, 36–40 (N.Y.S. Bar Ass'n Health Law Section, Spring 2004).
2. Public Law 104-191.
3. Preamble, Public Law 104-191. (The other goals were to promote portability of health insurance coverage between employer-sponsored health insurance programs when an employee changes jobs, to reduce fraud and abuse in Medicare and Medicaid, to promote the use of medical savings accounts, and to improve access to long-term care services and coverage.)
4. Public Law 104-191 § 261.
5. Public Law 104-191 § 1173.
6. Public Law 104-191 § 1176.
7. Public Law 104-191 § 264(a).
8. In late 1999, HHS released its proposed rule for public comment. It received over 52,000 public comments. The final regulation, "Standards for Privacy of Individually Identifiable Health Information," known as the "Privacy Rule," was issued in December 2000 and subsequently amended four times, on May 31, 2002; August 14, 2002; February 20, 2003; and April 17, 2003—after having elicited another 11,000 comments. The official version is available in the Code of Federal Regulations. *See* 45 C.F.R. Parts 160 and 164. *See also* Standards for Privacy of Individually Identifiable Health Information, Regulation Text December 28, 2000 as amended: Unofficial Version, *available at* http://www.hhs.gov/ocr/combinedregtext.pdf. *See also* U.S. Department of Health & Human Services, OCR Privacy Brief, *Summary of the HIPAA Privacy Rule*, at 2, www.hhs.gov.ocr.privacysummary.pdf; statement by Richard Campanelli, Director, Office for Civil Rights, U.S. Department of Health and Human Services to a hearing before the Senate Special Committee on Aging, September 23, 2003, available at http://aging.senate.gov/_files/hr111rc.pdf.
9. Public Law 104-191 § 264(b).
10. Public Law 104-191 § 264(b); 45 C.F.R. § 160.203(b).
11. The authors ardently hope that they do not add to the confusion.
12. Campanelli, *supra* note 8, at 5–8.
13. 42 U.S.C. § 1302d-5.
14. 42 U.S.C. § 1302d-5(b)(3).
15. Department of Health and Human Services, *Civil Money Penalties: Procedures for Investigations, Imposition of Penalties, and Hearings*, Interim Final Rule, 68 Fed. Reg. 74 18895, 18897 (Apr. 17, 2003).
16. 45 C.F.R. § 160.304. Knowing violations are another matter altogether. Knowingly obtaining or disclosing individually identifiable health information can bring penalties of up to $250,000 and ten years' imprisonment, the most stringent penalties being reserved for sale, transfer, or use of individually identifiable health information for commercial advantage, personal gain, or malicious harm. 42 U.S.C. § 1302d-6.
17. Remarks of Linda Sanchez, a "staffer" in the Office for Civil Rights of the Department of Health and Human Services, before the National Committee on Vital and Health Statistics, Washington, D.C., September 23, 2003, *available at* http://ncvhs.hhs.gov/030923tr.htm; Janlori Goldman et al., *Enforcement of HIPAA Privacy: Making it Real*, Nov. 19, 2003, available online through iHealthbeat.org.
18. Linda Sanchez, *supra* note 17.
19. Statement of Richard Campanelli, *supra* note 8, at 8.
20. Remarks of Richard Campanelli, *supra* note 8, at 8–9.
21. *See* discussion of the *Mougiannis* case *infra* in the section "Health Care Proxies."
22. 45 C.F.R. § 164, Subpart E.
23. 45 C.F.R. § 160.103.
24. 45 C.F.R. § 160.103; 45 C.F.R. § 164.502(a).
25. 45 C.F.R. § 164.502(a)(1), (a)(2)(1).
26. 45 C.F.R. § 164.524(a).
27. A health care clearinghouse is an organization that "processes or facilitates the processing of health information." 45 C.F.R. § 160.103. It may be "a billing service, repricing company, community health management information system or community health information system, and value-added networks and switches. . . ." *Id.*
28. 45 C.F.R. § 160.102(a); 45 C.F.R. § 160.103(3).
29. 45 C.F.R. §§ 160.500 - 160.534.
30. 45 C.F.R. § 164.508.
31. 45 C.F.R. § 164.508(b). *See infra* "Authorization for the Release of Protected Health Information Related to Capacity."
32. 45 C.F.R. § 160.502(g)(1).
33. 45 C.F.R. § 164.502(g)(2).
34. *See* Pub. Health L. § 2982(1): "Subject to any express limitations in the health care proxy, an agent shall have the authority to make any and all health care decisions on the principal's behalf that the principal could make."
35. 45 C.F.R. § 164.502(g)(2).
36. 45 C.F.R. § 164.510(b).
37. 45 C.F.R. § 164.510(b)(1).
38. *Id.*
39. 45 C.F.R. § 164.510(b)(2).
40. 45 C.F.R. § 164.510(b)(3).
41. 65 Fed. Reg. 82665.
42. 65 Fed. Reg. 82664.
43. 65 Fed. Reg. 82663.
44. 45 C.F.R. § 164.512(c).
45. 45 C.F.R. § 164.512(e)(1)(ii).
46. 45 C.F.R. § 164.512(e)(1)(i).
47. *See* N.Y. Gen. Oblig. L. §§ 5-1502A through 5-1502O.
48. *See* N.Y. Gen. Oblig. L. § 5-1503.
49. N.Y. Pub. Health L. § 18(1)(e).
50. *See* N.Y. Pub. Health L. § 18(1)(g), which defines "qualified person[s]" as the subject [patient], MHL Article 81 guardian, parent of an infant, SCPA Article 17 guardian of an infant or other legally appointed guardian of an infant, or an attorney representing the subject or the subject's estate. Missing from the list: a SCPA Article 17-A guardian, the subject's health care agent, and the subject's attorney-in-fact.
51. 45 C.F.R. § 164.508(b)(3).
52. N.Y. Pub. Health L. § 18(6). The Advisory Committee on Civil Practice of the Office of Court Administration has recommended that section 18 of the Public Health Law should be amended to speed up the release of medical information in medical malpractice cases to attorneys holding a power of attorney from their client specifically authorizing the release of the

information. The proposed legislation has passed both houses of the legislature and as of the date of this publication is awaiting the Governor's signature. *See* A.8602-B/S.4964 ("an attorney representing a qualified person or the subject's estate who holds a power of attorney from the qualified person or the subject's estate explicitly authorizing the holder to execute a written request for patient information under this section."). *See also* Sponsor's Memorandum in Support (A.8602-B/S.4964, *available at* http://nyslrs.state.ny.us/nyslbdc1/menuget1.cgi.

53. 45 C.F.R. § 164.508(c)(1)(vi).
54. 45 C.F.R. § 164.502(g)(2).
55. N.Y. Gen. Oblig. L. §§ 5-1501, 5-1501(a), 5-1506, and 5-1502O.
56. N.Y. Pub. Health L. §§ 2980 *et seq.*
57. *See* N.Y. Pub. Health L. § 2982(3), "Right to receive information. Notwithstanding any law to the contrary, the [health care] agent shall have the right to receive medical information and medical and clinical records necessary to make informed decisions regarding the principal's health care."
58. 45 C.F.R. § 164.510(b).
59. *Id.*
60. 45 C.F.R. § 164.510(b)(3).
61. *Id.*
62. The proposal is available online at the Commission's website, www.lawrevision.state.ny.us, under "Recent Commission Reports," "Powers of Attorney."
63. "[A]ny decision to consent or refuse to consent to health care." N.Y. Pub. Health L. § 2980(6).
64. 45 C.F.R. 164.502(g)(2).
65. 45 C.F.R. § 164.502(g)(2).
66. 45 C.F.R. § 160.103.
67. 65 Fed. Reg. at 82633-4.
68. "If under applicable law a person has authority to act on behalf of an individual who is an adult or emancipated minor in making decisions related to health care, a covered entity must treat such person as a personal representative . . . with respect to protected health information relevant to such personal representation." 45 C.F.R. § 164.502(g)(2).
69. 45 C.F.R. § 164.510(b)(3).
70. *See* N.Y. Gen. Oblig. L. § 5-1501(1)(a).
71. *See* N.Y. Gen. Oblig. L. § 5-1501(1).
72. *See* N.Y. Gen. Oblig. L. § 5-1506.
73. The principal is not restricted to choosing incapacity as the triggering event, and may specify another event, and another person to certify that it has taken place.
74. New York law would have the same effect. *See* N.Y. Pub. Health L. § 18(1)(e) (defining patient information as "any information concerning or relating to the examination, health assessment . . . or treatment."). As noted above, persons defined under this section as qualified to have access to a patient's health care information do not include attorneys-in-fact. N.Y. Pub. Health L. § 18(1)(g).
75. A similar issue arises in many revocable living trusts, where the person who creates the trust (the grantor or settlor) also serves as trustee. The trust document, in naming a successor trustee to take over if the grantor/trustee becomes incapacitated, often calls for physicians' certification of incapacity.
76. 45 C.F.R. §§ 162.502(a)(1)(iv) and 164.508(a)(1).
77. The same problem can arise even with durable powers of attorney, which survive the principal's incapacity. Some clients ask their attorneys to hold their powers of attorney until needed. In this situation, prudence suggests that the attorney obtain independent confirmation of the client's incapacity before turning the instrument over to the attorney-in-fact.
78. 45 C.F.R. § 164.508(c).
79. *See* 45 C.F.R. § 164.502(g) and N. Y. Pub. Health L. § 2981(4).
80. N.Y. Pub. Health L. § 2982(1).
81. N.Y. Pub. Health L. § 2981(4). This definition by law of the triggering event distinguishes the health care proxy from a springing power of attorney, where it is the principal who determines the triggering event. *See* N.Y. Gen. Oblig. L. § 5-1506.
82. N.Y. Pub. Health L. § 2983(4).
83. N.Y. Pub. Health L. § 2983(1)(a).
84. N.Y. Pub. Health L. § 2983(2). The health care agent's authority to receive this information is not reflected in the Public Health Law section generally governing access to patient health information. *See* N.Y. Pub. H. L. § 18(1)(e) (defining patient information as "any information concerning or relating to the examination, health assessment . . . or treatment."). Persons defined under this section as qualified to have access to a patient's health care information do not include health care agents. *See*. N.Y. Pub. Health L. § 18(1)(g).
85. N.Y. Pub. Health L. § 2982(1).
86. N.Y. Pub. Health L. § 2982(3).
87. 45 C.F.R. § 164.502(a)(1)(ii).
88. 45 C.F.R. § 164.510(b).
89. 45 C.F.R. § 164.510(b)(1)(i).
90. Campanelli, *supra* note 8 at 5.
91. *Id.* at 6.
92. 45 C.F.R. § 164.502 (g)(2), *supra* note 68.
93. 45 C.F.R. § 164.502(g)(1).
94. 45 C.F.R. § 164.524(a)(1).
95. We are aware that to ensure compliance, some attorneys recommend modifying the form to authorize disclosure of protected health information to the health care agent. We do not believe such modification is necessary.
96. *Mougiannis v. North Shore*, N.Y.L.J., May 19, 2004, p. 19 (Sup. Ct., Nassau Co.).
97. "Notwithstanding any law to the contrary, the agent shall have the right to receive medical information and medical and clinical records necessary to make informed decisions regarding the principal's health."

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SCPA 2103: A Primer on "Discovery Proceedings"

By Richard S. Kwieciak and Stanley Kwieciak III

Pre-Trial Discovery Versus Discovery Proceedings

Article 31 of the CPLR provides those procedures involved in pre-trial discovery. They include the examination before trial, subpoena powers, notices to admit and the like. However, these tools are available after **issue is joined** unless a court order allowing "pre-action" discovery is allowed.[1]

A Surrogate's Court "Discovery Proceeding" is brought pursuant to SCPA 2103 and it allows for "pre-action" discovery even against a person who has no interest in the estate. "The purpose of a discovery proceeding is to determine the circumstances surrounding transfers of property from a decedent's estate, to ascertain whether particular property belongs to the estate, or to discover the circumstances surrounding a person's exercise of control over the property of the decedent."[2]

Not only can the fiduciary use this technique to insure that he or she has marshaled all of the assets of the estate, a discovery proceeding can be used to find out whether the fiduciary is personally holding back assets belonging to an individual or to the estate.[3] This is called "reverse discovery."

The Surrogate's Court has been granted broad discretion in discovery proceedings to encompass all matters that affect the affairs of a decedent, covering both real and personal property interests.[4] The Court can even direct the turnover of funds located in New York, even if the respondent resides outside New York, by application of long-arm jurisdiction.[5]

The Two Stages in a Discovery Proceeding

A. The Inquisitorial Stage

The first stage in a discovery proceeding is the "inquisitorial stage." It allows the fiduciary to inquire into what assets the respondent has or has knowledge about; who has possession of the asset; what happened to the asset, if converted; who has possession of the proceeds upon sale of an asset; what the respondent's position is as to ownership of the asset, i.e., gift, loan, ownership by purchase, etc. In brief, the inquisition is very broad provided that it deals with identity and recovery of property.[6] This is a proceeding that ought to be brought as soon as possible when a substantial asset is missing or was transferred because delays not only can result in a loss to the estate, but can also result in a dismissal.[7]

The discovery proceeding is commenced by the filing of a petition to discover property withheld from an estate, and the statute spells out the minimum requirements for the petition.[8] The allegations in the petition need not sustain a cause of action, but they should be sufficient to justify an inquiry. Usually the petition alleges that the respondent is in possession or control of an estate asset and refuses to relinquish it to the petitioner. An affidavit on information and belief about this ought to accompany the petition.[9] Although the petition can request that the respondent attend to be examined and also for delivery of the asset sought, the better practice is just to seek the respondent's attendance to be examined.[10]

When the petition is filed with the Court and there is payment of a filing fee,[11] the Court will issue an Order to Attend and Be Examined. The Court's Order is in the nature of a subpoena and must meet the requirements of SCPA 2103(5) and CPLR 8001. Sometimes it is appropriate that a temporary restraint be inserted into the Order so that the respondent does not give away, encumber or sell the asset. This would be most important if the asset is unique, i.e., a piece of art, an antique, etc. The method of delivery of the Court's Order will depend upon the relief sought, and the Court Clerk should instruct on the method and timeliness of delivery. The respondent need not file an answer at this point.[12]

While an Order to Attend and Be Examined is issued by the Court upon a petition seeking the examination of a respondent, it is possible to file a petition demanding turnover of estate assets without an examination of the respondent. In such a case the Court issues a Citation to show cause why the property should not be delivered to the petitioner.[13]

The inquisitorial stage is available against a party within New York State.[14] The Court may obtain long-arm jurisdiction over a respondent, but can require a preliminary hearing to determine whether jurisdiction can be obtained pursuant to SCPA 210(2)(a). The question in such a hearing will be whether the respondent engaged in sufficient conduct in New York to subject them to long-arm jurisdiction.[15] To obtain jurisdiction over a non-domiciliary respondent where long-arm jurisdiction is not granted, the petitioner should seek delivery of the asset in his or her petition, and the service of a Citation may create jurisdiction.

On the return date the respondent can do one of the following[16]:

a. appear for examination without filing an answer;

b. answer generally the allegations of the petition;

c. answer and claim title to the property;

d. answer and admit possession without claiming title.

While the Petitioner can examine the respondent, the respondent does not have the power to examine the petitioner in the "inquisitorial stage." The respondent can refuse to answer questions based upon valid privilege. However, the Dead Man's Statute is not applicable during the inquisitorial stage.[17]

Unless the respondent has already answered, **the petitioner should make a demand for an answer.** If the petitioner fails to do so, the "matter sits with the court, because no additional relief is required from the court until after issue has been joined and the matter is ready for trial."[18] If a question of title is raised, the Court can direct that the respondent serve and file an answer so that issue is joined.[19] While the petitioner does not have the power to require the respondent to file an answer, the Court may force the outcome under its contempt power. Depending upon the practice of the particular Court, a written Order of the Court requiring an answer may be necessary. Until an answer is filed, the matter proceeds as an inquiry.[20] Once an answer is filed, the inquisitorial stage is terminated and the issues proceed to the trial stage.[21]

B. The Trial Stage

When a verified answer is filed by the respondent, the answer will determine the burden of proof. If the answer asserts a general denial, the petitioner has the burden of proving the asset belongs to the estate. If the respondent's answer claims title to the asset, the respondent has the burden of proof. If the answer admits possession without asserting title, the court can direct delivery of the property to the fiduciary with continued proceedings on other issues.[22]

If the respondent defaults, the Court then conducts a hearing[23] to determine whether the estate is entitled to possession of the property. If it concludes affirmatively, the court will issue a decree[24] that directs delivery of the property to the fiduciary.

If the respondent does not default and if issue is joined, the usual forms of disclosure under CPLR Article 81 are now available. However, a re-examination of the respondent on the same issues is not permitted as being an "anomalous surplusage."[25] As in the inquisitorial stage, the Dead Man's Statute does not apply until the trial.[26] A Bill of Particulars is now available.

Where there is an issue of title, there is a right to a jury trial.[27] The respondent, in his or her answer, can make this request for a jury trial. If the petitioner wishes to make a demand he or she must do so within six days of service of the answer.[28]

The burden of proof generally is borne by the petitioner to prove that the asset belongs to the estate. However, the burden is shifted when the respondent alleges ownership by gift. The party alleging ownership by gift must prove delivery, acceptance and *donative intent*. This proof must be by clear and convincing evidence.[29] If the court finds a confidential relationship, an inference of undue influence may arise and this shifts the burden to the respondent to explain the circumstances. Further, it is at this point that the Dead Man's Statute creates a major obstacle for the respondent since the statute may bar crucial testimony about personal transactions or communications between the witness and the decedent.[30] *Quire*, how does one prove donative intent?[31] Though the Dead Man's Statute will bar testimony, it is not a bar to written evidence which may be admissible as an exception to the hearsay rule. (The next time you advise a client on making a potentially controversial gift to an individual, be sure to file a gift tax return for the donor to sign to establish some evidence of a gift on an official record.)

When a claim to ownership is made, the opposing party (petitioner or respondent) may avail himself or herself of an array of defenses, including[32]:

- The statute of limitations has run.[33]
- The property was given as a gift during decedent's lifetime.[34]
- A claim of gift might be countered by asserting that:
  - o The ownership of the property given by the testator is disputed.
  - o The testator lacked capacity.[35]
  - o Fraud was employed.[36]
  - o The Statute of Frauds applies.

Jointly owned bank or stock accounts are often the subject of discovery proceedings. However, unlike a gift, once the creation of a "joint account" is established, the Banking Law in New York creates a strong presumption that the decedent intended to

make a gift of the account to the surviving joint owner.[37] However, it must first be established that the accounts involved were "joint accounts." To create a joint account, the signature card or savings certificates must contain particular words of survivorship. The bankbook, passbook, or statements mailed to the customer do not control. It is the document signed by the customer upon opening the account that controls.[38] (As a result of the savings and loan crisis of the late 1980s, several banks were in danger of failure and were taken over by the RTC (Resolution Trust Corporation), a federal agency charged with the transition of depositor accounts from failed banks to successor banks. When the accounts were transferred, customers were asked to sign "Adoption Agreements" which permitted the transfer from the old to the new banks. The "Adoption Agreements" did not contain language about right of survivorship. The cases do not allow for incorporation by reference to create "survivorship" language for an account.)

Assuming that a joint account is established, the survivorship presumption can be attacked on the theory of being a "convenience" account. The petitioner would claim that the decedent established the account for convenience purposes and without the intention of conferring a right of survivorship.[39]

To prove a convenience account, these are some of the common indicators[40]:

- The decedent was the sole depositor.
- The funds were only used for decedent's benefit, not the joint tenant's.
- The decedent was elderly or infirm and housebound.
- The "joint tenant" was an attorney-in-fact for the decedent.
- The purported gift departs from the testamentary plan.

Other Issues for Discovery Proceeding

Totten Trust bank accounts[41] can be disputed with the burden of proof on the party asserting the invalidity of the account.

Real Property: Such inquiries result from a relatively recent change in the statute made in 1993.[42] The burden of proof will shift depending upon the allegations relative to ownership by gift, purchase, etc. However, in order to show that a transfer of ownership of real property took place, the claimant of ownership must establish a writing that satisfies the requirements of New York General Obligations Law section 5-703(1).[43]

Stock Certificates: Issues often arise in closely held corporations where family members are informal about transfers of stock. The Court will look at all the facts to ascertain whether a gift was made. Some courts have held that gifts were made upon delivery of the certificates even if the company stock ledger did not officially reflect the transfer.[44] In the event of "symbolic delivery," courts have held that the transfer of ownership must proceed to "the point of no return, and this point can only be reached when there is a transfer of record on the stock books of the company."[45]

Business Interests: When a party dies with an interest in a corporation or a partnership, the fiduciary may need to discover the decedent's share in the business and its value. The fiduciary may be bound by any agreement concerning dissolution or valuation of the business upon death and the fiduciary may bring a proceedings to learn financial data related to the business. The fiduciary would commence a proceedings to compel an accounting from the business partners[46] or corporate officers.[47]

Endnotes

1. CPLR 3102(c).
2. New York Estates: Probate, Administration and Litigation, Harris 5th Edition, page 22-1.
3. SCPA 2105.
4. *In re Piccione*, 57 N.Y.2d 278, 456 N.Y.S.2d 669 (1982); SCPA 103 (44); SCPA 2103 (1),(2); SCPA 2104(1).
5. SCPA 210; *Estate of Kaz*, N.Y.L.J., June 11, 2001, 33:6 (Nassau Co. Surrogate).
6. SCPA 2103, *In re Schapiro*, 95 N.Y.S.2d 430 (Westchester Co. Surrogate 1950); *In re Rosenkrantz*, 5 Misc. 2d 308, 159 N.Y.S.2d 276 (Kings Co. Surrogate, 1956).
7. *In re Castaldo*, N.Y.L.J., May 16, 1990, 30:1 (Bronx Co. Surrogate), *aff'd*, 180 A.D.2d 421, 580 N.Y.S.2d 862 (1st Dep't 1992).
8. SCPA 2103(1).
9. New York Estates: Probate, Administration and Litigation, Harris 5th Edition, page 22-8.
10. Seeking "delivery" of the asset allows the respondent to seek and, possibly, obtain a dismissal of the proceeding by the court at a stage when all the facts are not yet clear. Further facts may be obtained by using CPLR Article 31 disclosure devices when issue is joined and the second stage of the discovery proceeding moves forward.
11. The filing fee for a discovery proceeding pursuant to SCPA 2103 is $75 effective July 14, 2003.
12. SCPA 2103(3).
13. *Id.*
14. *In re Mirsky*, 145 Misc. 2d 438, 546 N.Y.S.2d 951 (Bronx Co. Surrogate 1989).
15. *In re Riebesehl*, N.Y.L.J., May 20, 1996, 33:2 (Westchester Co.).
16. New York Estates: Probate, Administration and Litigation, Harris 5th Edition, page 22-17.
17. CPLR 4519.

18. New York Estates: Probate, Administration and Litigation, Harris 5th Edition, page 22-19.
19. SCPA 2104(1).
20. *In re Kuster*, 12 Misc. 2d 239, 152 N.Y.S.2d 742 (Nassau Co. Surrogate 1956); *In re Beyer*, 3 Misc. 2d 819, 155 N.Y.S.2d 669 (Ulster Co. Surrogate 1956).
21. SCPA 2104(1); *In re Pucci*, 14 Misc. 2d 75, 179 N.Y.S.2d 43 (Nassau Co. Surrogate 1958).
22. This might occur where the asset held by a respondent was collateral for a loan from the respondent to the decedent.
23. SCPA 2104(3).
24. SCPA 2104(4).
25. *In re Gregory*, N.Y.L.J., Jan. 9, 1991, 27:6 (Nassau Co. Surrogate); quoting *In re Kevill*, 166 Misc. 230, 2 N.Y.S.2d 191 (Kings Co. Surrogate 1938).
26. CPLR 4519.
27. SCPA 502 with a filing fee of $150 established in SCPA 2409(9)(i).
28. SCPA 502(2)(a). If only the respondent requests a jury trial and then waives a jury trial shortly before trial, the petitioner may not be able to bring his or her matter before a jury. If the petitioner wishes to preserve this right, a jury demand in addition to the petitioner's should be considered.
29. *In re Abramowitz*, 38 A.D.2d 387, 329 N.Y.S.2d 932 (2d Dep't 1972), *aff'd*, 32 N.Y.2d 654, 342 N.Y.S.2d 855 (1973); *In re Kennedy*, 36 A.D.2d 549, 318 N.Y.S.2d 759 (3d Dep't 1971).
30. CPLR 4519; *In re Detweiler*, 121 Misc. 2d 453, 467 N.Y.S.2d 766 (Cattaraugus Co. Surrogate 1983).
31. This issue is taken up in detail in a case decided by the Erie County Surrogate; *see In re Hoover*, Erie County Surrogate's Court file no. 98-858.
32. New York Estates: Probate, Administration and Litigation, Harris 5th Edition, page 22-27.
33. In the absence of fraud, one year from the date of letters or three years from date of death, CPLR 214(3), 210; in the case of fraud, the time runs six years from the fraud or two years from the actual or imputed discovery of the fraud, whichever is longer, CPLR 213(8), 203(g).
34. The party alleging ownership by gift must establish delivery to the donee; donee's acceptance of the gift; and the donor's intent to make the gift. This must be proved by clear and convincing evidence. *Gruen v. Gruen*, 68 N.Y.2d 48, 505 N.Y.S.2d 849, 83 A.L.R.4th 955 (1986). This is to be compared with the lesser burden of proof by the preponderance of the evidence. See the Pattern Jury Instructions sec. 7:65 for a comparison.
35. *In re Creekmore*, 1 N.Y.2d 284, 152 N.Y.S.2d 449 (1956). However, the petitioner may also be seeking the probate of a will. If a petitioner seeks to argue that the decedent lacked capacity to make a gift, he or she may be creating an argument that the decedent lacked capacity to make a will depending upon the timing and circumstance of the two events, i.e., making of the will and gift.
36. A petitioner will have two years after the alleged fraud is discovered to bring his or her claim; *see In Re Colonna*, 271 A.D.2d 444, 706 N.Y.S.2d 134 (2d Dep't 2000).
37. Banking Law 675; *In re Creekmore*, 1 N.Y.2d 22, 241 N.Y.S.2d 413 (1963).
38. *In re Coon*, 148 A.D.2d 906, 539 N.Y.S.2d 534 (3d Dep't 1989); *In re Seidel*, 134 A.D.2d 879, 522 N.Y.S.2d 51 (4th Dep't 1987); *In re Tomoshevich*, 122 A.D.2d 1011, 521 N.Y.S.2d 311 (3d Dep't 1987); *In re Coppola*, 189 A.D.2d 933, 592 N.Y.S.2d 816 (3d Dep't 1993).
39. *In re Boyd*, 186 A.D.2d 394, 588 N.Y.S.2d 188 (1st Dep't 1992); *Brezinski v. Brezinski*, 94 A.D.2d 969, 463 N.Y.S.2d 975 (4th Dep't 1983); *Phillips v. Phillips*, 70 A.D.2d 30, 419 N.Y.S.2d 573 (2d Dep't 1979); *Russo v. Russo,* 17 A.D.2d 129, 232 N.Y.S.2d 577 (1st Dep't 1962).
40. New York Estates: Probate, Administration and Litigation, Harris 5th Edition, page 22-42 ; *Wacikowski v. Wacikowski*, 93 A.D.2d 885, 461 N.Y.S.2d 888 (2d Dep't 1983).
41. *In re Mirsky*, 154 Misc. 2d 278, 586 N.Y.S.2d 204 (Bronx Co. Surrogate 1992); EPTL 7-5.2(1).
42. SCPA 2103, 2104.
43. Other than a transfer by will, an estate or interest in real property, other than a lease for a term not exceeding one year, "cannot be created, granted, assigned, surrendered or declared, unless by a deed or conveyance in writing, subscribed by the person creating, granting or declaring the same." Also the practitioner should bear in mind the effect of the new acknowledgement clause in creating an effective deed.
44. *In re Katz*, 142 Misc. 2d 1073, 539 N.Y.S.2d 659 (N.Y. Co. Surrogate 1989); *later proceeding* 192 A.D. 2d 327, 595 N.Y.S.2d 475 (1st Dep't 1993); *In re Cristo*, 86 A.D.2d 700, 446 N.Y.S.2d 555 (3d Dep't 1982); *In re Ruszkowski*, 45 Misc. 2d 380, 256 N.Y.S.2d 983 (Bronx Co. Surrogate 1965).
45. *Schachter v. Lefrak*, 1998 Bankr. Lexis 248 U.S. Bankr. Ct. S.D.N.Y.; *see also In re Carroll*, 100 A.D.2d 337, 474 N.Y.S.2d 340 (2d Dep't 1984).
46. Partnership Law § 74; *Green v. Albert*, 199 A.D.2d 465, 605 N.Y.S.2d 395 (2d Dep't 1993).
47. *In re Granowitz*, 150 A.D.2d 446, 541 N.Y.S.2d 55 (2d Dep't 1989).

Richard S. Kwieciak, Esq. is the managing partner of Kwieciak & Kwieciak LLP, a lecturer in law on Estate Practice and Elder Law at the University of Buffalo School of Law, a retired Brigadier General, Judge Advocate General's Corps, and Department of Defense Ombudsman for enforcement of Uniformed Services Employment and Re-Employment Rights Act.

Stanley Kwieciak III is a 2L at Ohio State University Law School, a legal clerk at Kwieciak & Kwieciak LLP, a 2d Lieutenant in the U.S. Army Reserve and a student member of the New York State Bar Association.

Sample Petition

SURROGATE'S COURT OF THE STATE OF NEW YORK

COUNTY OF ERIE

IN THE MATTER OF THE ESTATE OF JOHN DOE, DECEASED	Petition by Fiduciary to Discover Property Withheld from Estate

File No________

TO THE SURROGATE'S COURT OF THE COUNTY OF ERIE:

Petitioner, Jane Doe, as the executor of the estate of John Doe, for her petition herein states that:

1. Petitioner is the Executor of the estate of John Doe.
2. Letters Testamentary were duly issued to your petitioner by the said Surrogate's Court on the 1st day of January 2004. Your petitioner duly qualified and has ever since acted and is now acting as Executor thereunder.
3. That said decedent at the time of his death was domiciled at 111 Nut Street, Buffalo, N.Y., and died on the 31st day of December 2003.
4. Money and/or personal property and/or the proceeds of personal property and/or the value of personal property hereinafter described, which should be either paid or delivered to your petitioner is in the possession or under the control of Nasty Respondent with offices at 666 Nut Street, Buffalo, N.Y., who withholds the same from your petitioner which will aid your petitioner as such Executor in making discovery of such money and/or property.
5. The aforesaid money and/or property consists of a Harley Davidson Fat Boy 1998 with 5,016 miles.
6. The petitioner states that the sole distributee is a son of the decedent under the age of 21 years and is entitled by statute to a vehicle (i.e., the Harley Davidson Fat Boy 1998) up to $15,000 in value without set-off by claim of the respondent herein.
7. The petitioner caused an inventory of the aforesaid personal property to be made at a premises owned by the respondent and leased to the decedent resulting in the knowledge of the asset mentioned hereinabove.
8. The petitioner has duly made a demand for the delivery of the said property but the said Nasty Respondent refuses to deliver the same.
9. The names and post office addresses of all the persons interested in this proceedings who are required to be cited upon this application, or concerning whom the court is required to have information are:

   Nasty Respondent, 666 Nut Street, Buffalo, N.Y.

10. The above person is not a person under a disability.
11. There are no other persons than those mentioned interested in the application or proceeding.

WHEREFORE, your petitioner prays for an inquiry respecting the above property, And that the respondent, Nasty Respondent, may be ordered to attend the inquiry and be examined accordingly, [*and to deliver the said property if in his control, to the petitioner*], and that the petitioner have such other, further and different relief as to this Court may deem just and proper in the premises.

Dated: January 2d, 2004

____
Jane Doe, Executor

VERIFICATION

State of New York)
County of Erie)

Jane Doe, the petitioner named in the foregoing petition, being duly sworn, deposes and says that she has read the foregoing petition and knows it to be true, except as to the matters therein stated to be alleged upon information and belief, and that as to those matters he believes it to be true.

____
Jane Doe, Executor

Sworn to before me this
2nd day of January, 2004

____
Notary Public

SAMPLE PETITION ORDER TO ATTEND

At a Surrogate's Court, held in and for
The County of Erie, in said County on the
___ day of January, 2004

SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF ERIE
PRESENT HON. I. M. APOLITICAL, SURROGATE

IN THE MATTER OF THE ESTATE OF JOHN DOE, DECEASED	Order to Attend and Be Examined File No. _________

Upon reading and filing the petition of Jane Doe, Executor of the estate of John Doe, duly verified the 2nd day of January, 2004, setting forth facts tending to show that money and/or personal property that should be delivered or paid to the petitioner is in the possession of Nasty Respondent, who withholds the same from the petitioner and praying an inquiry respecting it and that the respondent be ordered to attend the inquiry and be examined accordingly, and to deliver the property if in his control and the Surrogate being satisfied, on the papers so presented that there are reasonable grounds for the inquiry,

Now, on motion of Jean Laffite, Esq., attorney for the petitioner, it is

ORDERED that an inquiry respecting the matters set forth in the petition herein be held at a term of the Surrogate's Court of the County of Erie, at the Surrogate's Court, Erie County Hall, 92 Franklin Street, Buffalo, New York 14202 on the _____day of January, 2004 at _______ O'Clock in the (afternoon)(forenoon) of said day or as soon thereafter as counsel can be heard, and it is further

ORDERED that Nasty Respondent attend the said inquiry and be examined according and show cause why he should not deliver the property set forth in said petition, if in his control, to the petitioner, and it is further

ORDERED that pending the hearing of this application that Nasty Respondent is stayed from selling, transferring, encumbering, leasing or otherwise injuring the property set forth in the said petition, if in his control,

SUFFICIENT REASON appearing therefore let personal service of a copy of the certified copy of this order be made upon Nasty Respondent, 666 Nut Street, Buffalo, N.Y., together with the appropriate witness fee by ___ day of January, 2004 be good and sufficient service hereof.

____
Surrogate

SAMPLE ANSWER TO JOIN ISSUE

SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF ERIE

IN THE MATTER OF THE ESTATE OF JOHN DOE, DECEASED.	Answer File No.________

TO THE SURROGATE'S COURT OF THE COUNTY OF ERIE:

Nasty Respondent, the respondent herein, for his answer to the petition herein, by Snipem, Klipem & Plukem, PC, his attorneys:

1. Denies that he has any knowledge concerning or possession of any property which belonged to the decedent above named, or of any property of the estate of said decedent.

OR

1. Alleges that he is the owner of and possess the title to or the right to possession of the property involved in the inquiry herein.

WHEREFORE, the respondent respectfully prays that the petition herein may be dismissed with costs.

____
Otto B. Shot, Esq.
For Snipem, Klipem &, Plukem, PC
One Expensive Tower Plaza
Buffalo, N.Y.
Tel. 716-CEL-PHON

VERIFICATION

State of New York)
County of Erie)

Nasty Respondent, the respondent named in the foregoing petition, being duly sworn, deposes and says that he has read the foregoing petition and knows it to be true, except as to the matters therein stated to be alleged upon information and belief, and that as to those matters he believes it to be true.

____
Nasty Respondent

Sworn to before me this
2nd day of January, 2004

____
Notary Public

Israel Launches Trust Tax Amnesty

By Alon Kaplan, Leon Harris and Lyat Eyal

Preamble

The concept of private trusts under the Trust Law 1979 (the "Trust Law"), which recognizes common law trusts similar to those found in common law countries (U.K., U.S.A., etc.), is widely known and commonly used by Israeli professionals. However, trusts are mainly used in the form of nominee agreements and trust relationships created by law.

Israeli professionals tend to use trust structures created under foreign laws for organizing private and business affairs where a common law trust is required. Sometimes, the continental foundation entity is also utilized.

Said practice is a result of several reasons:

(a) The legal structures available under the Trust Law are usually inadequate. The establishment of a trust which would "skip" generations, often available under foreign trust laws and structures, is not available under Israeli laws. Thus, there is a need for probate proceedings of a deceased's last will and testament in order to achieve the settlor's goal of creating a trust that will exist for a number of generations.

(b) The Israeli legal system contains elaborate provisions relating to private international law that enable the courts to recognize foreign legal structures, including trusts established under foreign law in foreign jurisdictions.

(c) There is no clear definition which clarifies the difference between a revocable trust and an irrevocable trust. Under foreign laws, a revocable trust is one established by a settlor who retains the power to revoke it. An irrevocable trust is one which cannot be revoked by the settlor after its creation except upon the consent of all the beneficiaries. Under Israeli tax law, the existing Income Tax Law, Section 84, refers to a revocable trust which is regarded as a pass-through entity whereby its settlor bears the tax liability. However, there is no definition as to what constitutes a revocable trust and no reference to an irrevocable trust. Notwithstanding said reference, it is unlikely that Section 84 was legislated to include trusts established under foreign laws in foreign jurisdictions.

Tax Reform

Under existing Israeli tax law, there is no specific reference to the taxation of trusts except for revocable trusts, as mentioned above. However, on January 1, 2003, Israel implemented a comprehensive tax reform that made Israeli residents taxable on their entire worldwide income and gains. Previously, Israeli residents enjoyed a territorial tax system which did not tax foreign-source passive investment income such as dividends, interest, rent and royalties first received abroad. Nevertheless, Israeli residents have been taxable for many years on worldwide capital gains.

The tax reform legislation did not include the taxation of trusts. Rather, the matter was passed to a Public Committee (the "Committee"), headed by Frida Israeli, CPA, a Senior Officer in the Tax Commissioner's Office, which was appointed to advise the Government on the taxing of Israeli residents on foreign trust income and the contribution of assets to trusts. The Committee issued its recommendations on July 24, 2003. Although the recommendations have yet to be legislated, a draft law reflecting said recommendations is presently being formulated. As a result, the tax authorities are preparing for the implementation of the recommendations which will lead to the taxing of Israeli residents' income from trusts in Israel. The Tax Commissioner expects the new law to be enacted later this year, with effect from the beginning of 2004. Therefore, new reporting requirements have been issued as of the year 2003 and thereafter.

In light of these changes, the Israeli Tax Commissioner, Tali Yaron-Eldar, issued a notice dated March 25, 2004, announcing a procedure termed "voluntary disclosure," which is, in fact, a Tax Amnesty (the "Amnesty") for foreign trust income and gains derived up to the end of 2003.

Under the terms of the Amnesty for which the application deadline is July 31, 2004, Israeli resident settlors or beneficiaries may opt to disclose details of the trust and pay tax at the rate of zero to twenty-five percent (0%–25%), depending on the period during which the income was earned by the trust. This compares with rates ranging up to fifty percent (50%) for individuals during the same period in the absence of a trust.

Reasons for the Amnesty

The Israeli tax situation is not clear where foreign assets are placed in a trust which is administered outside Israel. Despite the Trust Law, the tax rules relating thereto are not up-to-date and are vague and insufficient.

The Amnesty is therefore a voluntary transitional measure covering years prior to 2004. The Tax Commissioner indicates the following reasons for the Amnesty:

- Trusts are a complex matter, especially where knowledge of foreign law is needed.
- The distinction between revocable and irrevocable trusts that affects the taxability of the settlor or the beneficiary is based on foreign case law and has caused substantial controversy.
- With regard to the enforcement of entities outside Israel, it is extremely difficult to locate foreign trust activity without the cooperation of the various parties and foreign bodies involved.
- Israeli resident taxpayers who apparently generated capital gains via foreign trusts have pointed out the uncertainty and lack of clarity regarding the legal position, resulting in doubt as to whether the State is entitled to tax such gains prior to 2003.
- The need for the orderly assessment of trusts and the smooth implementation of the expected law in an atmosphere of certainty and equality.
- The expansion of the tax base and knowledge by the Israeli tax authorities regarding foreign trusts "of Israeli resident parties" administered abroad is important.

Consequences of the Amnesty

What Is Covered?

The Amnesty will relate to foreign trusts, including bodies having a trust-type legal status, which is apparently intended to cover foundations and fiduciary bodies found in Continental Europe and elsewhere, where either the beneficiary or the settlor or both are Israeli residents.

Tax Rates

- No tax (0%) on foreign passive investment income that would not be taxed in Israel had the relevant assets been held directly by the settlor or the beneficiary. These include dividends, interest, rent and royalties first received abroad before the year 2003.
- A tax rate of fifteen percent (15%) for other income derived up to January 1, 2003.
- A tax rate of twenty-five percent (25%) on income derived from the sale of a controlling interest in a company, where the trust or the trustee hold ten percent (10%) or more of the shares of the relevant company, up to January 1, 2003.
- A tax rate of twenty-five percent (25%) on income derived within a trust during the year 2003.

Detailed Terms

- The Amnesty will be considered for applications submitted to the International Tax Division at the Israeli Tax Commission, headed by Yaron Shidlo, Advocate, CPA, by July 31, 2004.
- The Amnesty only applies to income accrued or derived outside Israel by the trust and/or the underlying entities held by the trust.
- The taxes under the Amnesty are final and no deductions or credits will be granted, including foreign tax credit.
- Amnesty applicants will bear the burden of proof as to: (a) the type of income; (b) the time and place in which it was earned.
- The Amnesty applies even if profits were distributed in recent years (presumably by the trust to beneficiaries, although further clarification is awaited in this regard).
- The Amnesty does not confer immunity from crimes under the Prohibition of Money Laundering Law or from criminal liability under any other laws.

Procedural Aspects

Amnesty applications should be submitted to the International Tax Division, headed by Yaron Shidlo, Advocate, CPA, at the Israeli Tax Commission accompanied by the following documents:

- Details and documentation relating to the formation of the trust, including the trust agreement.
- Details on the settlor, beneficiaries and trustee.
- Financial statements of the trust confirmed by the trustee.
- Any other reports and documents that may be requested by the International Tax Division at the Israeli Tax Commission.

Important Issues to Remember

The Amnesty only applies to foreign passive income derived outside Israel by a trust (or foundation or fiduciary or similar entity) up to the end of 2003.

It appears that such foreign passive income includes foreign capital gains, although this is not expressly stated.

The Amnesty does not cover previously undeclared business income, income derived in Israel, or income derived outside the framework of a trust (or foundation or fiduciary or other entity).

Potential advantages of the Amnesty appear to include:

- Possible peace of mind.
- Advantageous tax rates for foreign source capital gains of fifteen to twenty-five percent (15%–25%) compared with rates of up to fifty percent (50%) during the same relevant years for capital gains derived by individuals.
- A tax rate of twenty-five percent (25%) for foreign source trust income derived in 2003, compared with a rate of thirty-five percent (35%) for income derived directly by individuals from publicly traded foreign securities (or fifteen percent (15%) for bank deposit interest).

Potential disadvantages of the Amnesty appear to include:

- It is only applicable to passive income derived by a trust.
- It requires extensive disclosure, unlike the successful amnesty offered in Italy in 2003-2004.
- There is no clear definition of legal terms such as trust, settlor, trustee, beneficiary.
- It fails to include immunity from prosecution under non-tax laws and does not expressly guarantee freedom from future scrutiny.
- It does not permit credit for foreign taxes paid in foreign jurisdictions.
- It provides only a short time to accept the Amnesty offer (extension prospects are uncertain as there will be a new Tax Commissioner from July 1, 2004).

Conclusion

The Amnesty deserves special consideration if capital gains were derived by a trust and in certain other instances. Nevertheless, the disclosure requirements may deter some. The anticipated legislation relating to the year 2004 onwards has yet to be enacted but is likely to require similar measures and disclosure.

Affected readers should obtain competent advice from tax and legal advisors experienced in trust and estate matters in each relevant country on an ongoing basis.

Alon Kaplan, Advocate, was admitted to the Israel Bar in 1970, to the New York Bar in 1990 and was licensed in Germany as a Rechtsbeistand in 1991. alon@kaplex.com; http://www.kaplex.com; (fax: 972-3-695-5575). In September 2002, Alon Kaplan was appointed a member of the Committee, together with Meir Linzen, Advocate and Alex Hilman, CPA, other members of the public sector, for the purpose of reviewing and advising the Government on the status of foreign trusts in Israel and for recommending legislation for taxing trusts in Israel. Alon Kaplan was a council member of STEP, the Society of Trust and Estate Practitioners, for a period of four years, and is currently the Chairman of STEP Israel as well as the Chairman of the Tel-Aviv Branch. Alon Kaplan is the General Editor of the book *Israeli Law and Business Guide* (Kluwer, 1994), *Israeli Business Law* (Kluwer, 1999), and *Trusts in Prime Jurisdictions* (Kluwer, 2000).

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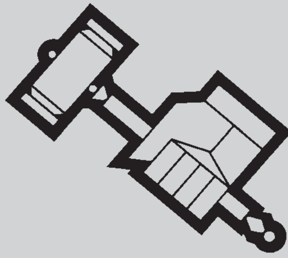

RECENT NEW YORK STATE DECISIONS

Ira Mark Bloom and William P. LaPiana

ACCOUNTING

Beneficiary Bound by Accounting in Trust Distributed to Beneficiary's Trust

As co-executor of decedent's will and co-trustee of two testamentary trusts established by the will, bank judicially settled its final accounts as executor and as trustee of one of the trusts when the income beneficiary died. That trust was added to the second trust. The individual co-trustee then died and the bank filed an intermediate account in the remaining trust. The income beneficiary of the remaining trust, who had given her waiver and consent to the account, was allowed to withdraw it. She then brought objections to the account based on the bank's failure as trustee of her trust to object to its failure as executor and then trustee to diversify the investments in the estate and in the other trust (specifically the retention of Eastman Kodak stock while it greatly declined in value). The Surrogate denied the bank's motion to dismiss. A divided Appellate Division modified the decree to dismiss those objections based on the bank's failure to contest its own prior accountings. Because the objectant had received notice of the prior accountings in accord with SCPA 2210(10), which requires notice to all persons interested in the trust by a fiduciary accounting to itself in a separate capacity as trustee, the prior decrees were *res judicata*. In the view of the majority, objections based on the trustee's failure to object to its own conduct in a different fiduciary capacity are objections to that conduct which could have been fully aired in the prior accountings of which the beneficiary had notice. *In re Hunter*, 6 A.D.3d 117, 775 N.Y.S.2d 42 (2d Dep't 2004).

DURABLE POWER OF ATTORNEY

Gifts by Attorney-in-Fact to Oneself Are Proper if Authorized by the Principal

Decedent had executed a statutory short form durable power of attorney, granting his attorneys-in-fact the statutory power to make gifts of up to $10,000 to family members and also expressly granting the attorneys-in-fact the power to make gifts to themselves in unlimited amounts. Decedent died less than one month after execution of the power of attorney, but before his death one of the attorneys-in-fact, pursuant to decedent's authorization to act separately, transferred $820,000 to himself as a gift from the principal. The residuary beneficiary of the decedent's will commenced a turnover proceeding under SCPA 2103. In dismissing the proceeding, the Surrogate noted that GOL 5-1503, which authorizes the grant of unlimited power to make gifts, contains no limitation on the grant of that authority and held that the statute overturns prior law creating a presumption of impropriety in a gift by the attorney-in-fact to himself. The power of attorney having been held valid, the petitioner had no grounds on which to proceed. The court suggested that the legislature modify GOL 5-1503 so that gifts authorized under its provision be limited to those in the best interest of the principal, the same limitation applied to the $10,000 gifts under the statutory power of GOL 5-1502M. *Salvation Army v. Ferrara*, 3 Misc. 3d 944, 775 N.Y.S.2d 470 (Sur. Ct., Rockland Co. 2004).

FIDUCIARY DUTY

Validity of Delegation Under Prudent Investor Act Requires Trial

As representative of charities interested in decedent's estate, the Attorney General objected to management fees paid by the executor to a trust company for its management of the estate's assets. The trust company had managed the decedent's assets during her life, starting in 1983 with $500,000, which had increased to $2.8 million at the time of decedent's death in 1997. The executor of decedent's will continued the arrangement, paying the trust company over $55,000 to the time of application for settlement of his account in July 2002, during which time the estate increased in value by over $500,000. In reviewing the Surrogate's denial of the Attorney General's motion for partial summary judgment, the Appellate Division agreed that the executor's delegation was not as a matter of law unreasonable under New York's Prudent Investor Act (EPTL 11-2.3) and that a trial is necessary to develop facts as to the extent of the executor's consultation with the trust company and the nature of the trust company's services. *In re Laracy*, 6 A.D.3d 853, 775 N.Y.S.2d 392 (3d Dep't 2004).

TAX APPORTIONMENT

Apportionment Based on Net Value of Bequest

The legatee of a co-operative apartment objected to executor's accounting which apportioned estate tax against the apartment at its date of death value. The shares in the co-operative were subject to a mortgage; the legatee satisfied the mortgage on the sale of the shares, and the estate took an estate tax deduction for the amount of the mortgage on Form 706. The Surrogate held that the direction in EPTL 2-1.8 that taxes be "equitably apportioned" on the value determined in the respective tax proceedings required that tax be apportioned on the net value. To do otherwise would unfairly give the other legatees the benefit of the deduction for the mortgage. *In re Tucciarone*, 3 Misc. 3d 237, 771 N.Y.S.2d 881 (Sur. Ct., Bronx Co. 2004).

TRUSTS

Once Income Tax Eliminated Situs May Not Be Changed

Under Tax Law 605(b)(3)(D), a New York resident trust consisting of intangible property will not be subject to taxation if all of the trustees are domiciled outside of New York. In two cases the New York County Surrogates have approved the resignation of a New York trust company as trustee and its replacement by the Delaware affiliate of the same bank, thus preventing the trusts from being subject to New York State fiduciary income tax. In both cases, however, the Surrogates refused to allow a change of situs to Delaware. In neither case were there any benefits to be gained by a change of situs, the elimination of the fiduciary income tax having been accomplished by the appointment of an out-of-state trustee. *In re Application of Chase Manhattan Bank*, 2 Misc. 3d 554, 773 N.Y.S.2d 529 (Sur. Ct., N.Y. Co. 2003); *In re Bush*, 2 Misc. 3d 744, 774 N.Y.S.2d 298 (Sur. Ct., N.Y. Co. 2003).

Distributions from CRAT to Discretionary Trust Belong to Income Beneficiary

Grantor created two lifetime trusts: a charitable remainder annuity trust (CRAT) and a custodial trust. Grantor was the beneficiary of the annuity paid from the CRAT. After his death the annuity was to be paid to the custodial trust whose trustee was to pay all the trust's income to the grantor's daughter, as well as principal in its discretion for the "support, maintenance, and general welfare" of the grantor's daughter. On the daughter's death the custodial trust was to be distributed to charity. After the daughter's death the trustee of the custodial trust distributed over half a million dollars of undistributed income from the trust to the daughter's estate. The charitable remainder beneficiaries objected, maintaining that the annuity payments from the CRAT to the custodial trust should be treated as distributions of principal or accumulated income which in either case should be paid to them. The charities were rebuffed. First, the distribution could not be principal because in order for the CRAT to receive favorable tax treatment the payments must be for the benefit of an individual and eventually pass to that individual's estate. In addition, there was no direction to accumulate income in the custodial trust, and all income still in the trust at the beneficiary's death belonged to her estate. *In re Chase Manhattan Bank (Pioch)*, 3 Misc. 3d 823, 775 N.Y.S.2d 484 (Sur. Ct., Monroe Co. 2004).

VENUE

Domicile of Incarcerated Individual Is Place of Incarceration

Decedent was imprisoned at Clinton Correctional Facility in Dannemora, Clinton County at the time of death. His will was offered for probate in Dutchess County where he was born and buried and where he had his domicile before conviction. The Surrogate held that the decedent's domicile was the place of incarceration although that conclusion might be different had the decedent had a reasonable expectation of parole or of completion of his sentence during his lifetime. However, the Dutchess County Surrogate's Court would retain jurisdiction because of the decedent's residence in the county before conviction, the recitation of domicile in the will, the location of the decedent's personal and real property in Dutchess County, the residence of the four identified distributees in the county and the fact that any new proceedings relating to the criminal conviction would be heard in the county. *In re Andros*, 3 Misc. 3d 216, 775 N.Y.S.2d 799 (Sur. Ct., Dutchess Co. 2004).

WILLS

Presumption as to Alterations

Under EPTL 3-4.1(a)(2)(A) a physical-act alteration made to a will after execution that does not actually revoke the will is ignored. The timing of the alteration may be determined by intrinsic or extrinsic evidence, but where there is no evidence the standard for determining when the alteration was made is less than clear. At issue was a three-decades-old will on which handwritten changes had been made deleting preresiduary bequests and the nomination of a successor executor. After an extensive analysis of the cases, the Surrogate held that in the absence of evidence the burden of establishing the timing of the alteration is upon the person whom the alteration would benefit. In the instant case, the absence of evidence leads to the conclusion that the alterations were made after execution and were therefore without effect. The will was admitted to probate as an ancient document. *In re Tier*, 3 Misc. 3d 587, 772 N.Y.S.2d 500 (Sur. Ct., N.Y. Co. 2004).

Anti-Lapse Statute Does Not Apply Where Only Certain Children of Legatees Named in Will

Decedent's will divided his estate among his five siblings living at the time the will was executed (seven siblings had predeceased the execution), the son of one of the predeceased siblings, an unrelated individual, and three charities. The will directed that lapsed gifts were to be divided among the survivors. Four of the five siblings predeceased the decedent. Alone among the gifts to the five siblings, the gift to the survivor was given to him or his issue. The Appellate Division affirmed the Surrogate's grant of summary judgment for the executor on the grounds that EPTL 3-3.3 did not apply. The decedent clearly intended to benefit only those of his forty nieces and nephews mentioned in the will. In addition, the Surrogate properly considered the affidavit of the attorney who drafted the will, stating that he explained the lapse statute to the decedent who made it clear that he wanted only the nephew named in the will and the children of his surviving brother to benefit. The extrinsic evidence was properly used because it did not vary or contradict the will or show an intention different from that disclosed by the language of the will. *In re Sawyer*, 4 A.D.3d 800, 772 N.Y.S.2d 170 (4th Dep't 2004).

Agreement Is Not a Contract and Anti-Lapse Statue Does Not Apply Given Survivorship Requirement

Decedent's son challenged her will and lost, thereby triggering an *in terrorem* clause which deemed him to predecease decedent. He then alleged that a letter signed by his mother (and drafted by his attorney) was a contract to make a will treating him and his sisters equally. The letter stated as "consideration" love and affection and son's willingness to take care of the decedent's property and business affairs. Decedent's will left $200,000 to the son conditioned on his surviving decedent, and expressly stated that it made no further provision for him or his issue except for bequests to his children. The Surrogate held first that the letter was not a contract to make a will under EPTL 13-2.1. Any ambiguity in the document must be construed against the son, and the document did not expressly link the services of the son with the making of a new will by the decedent. Second, EPTL 3-3.3, the anti-lapse statute, did not apply because under the will the son was required to survive the decedent. *In re Camac*, 2 Misc. 3d 894, 772 N.Y.S.2d 792 (Sur. Ct., Bronx Co. 2004).

Ira Mark Bloom is Justice David Josiah Brewer Distinguished Professor of Law, Albany Law School. William P. LaPiana is Rita and Joseph Solomon Professor of Wills, Trusts and Estates, New York Law School.

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

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Trusts and Estates Law Section Newsletter Index

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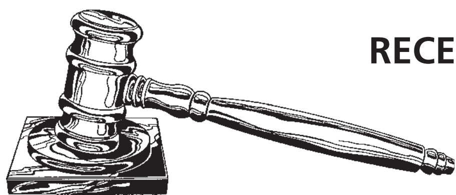

CASE NOTES—RECENT NEW YORK STATE SURROGATE'S AND SUPREME COURT DECISIONS

Ilene Sherwyn Cooper

Advice and Direction

In a proceeding for advice and direction, the Court authorized the executors of the estate to transfer a parcel of realty, subject to lien, to a corporation organized and solely owned by them in order to qualify as a "person" or "debtor" entitled to file for bankruptcy. The Court reasoning that the case law excluding an estate from filing for bankruptcy appeared to be based primarily on the conclusion that it was not the legislative intent behind the Bankruptcy Code to permit the bankruptcy courts to interfere with the administration of estates. The Court distinguished such holdings, finding that a bankruptcy proceeding may be the only hope of salvaging any equity in the subject realty, and would thus serve as a benefit to the administration of the estate rather than an infringement upon the Court's jurisdiction.

In re Estate of Kaufman, N.Y.L.J., June 4, 2004, p. 32 (Sur. Ct., Nassau Co., Surr. John B. Riordan).

Attorney's Fees

In an action for legal fees, the Court was confronted with the question of whether a party could defeat a properly pleaded account stating a cause of action in an attorney-client relationship by claiming that the legal fees were excessive pursuant to DR 2-106, rendering the agreement to pay the outstanding fees illegal and unenforceable.

In granting summary judgment in the plaintiff/law firm's favor, the Court concluded that the firm had established a prima facie claim under the account stated doctrine and that the defendant had no defenses to this claim. Specifically, the Court noted that the defendant had never objected to the bills within a reasonable time, had made partial payments, and had even explicitly promised to pay the outstanding balance of the debt. As to the reasonableness of the fees, the Court found, upon the evidence, that the underlying dispute in which defendant had retained counsel, was an "extravagant" effort authorized by the defendant which was foreseeably costly. Indeed, the defendant did not question the hourly rate of counsel, but simply asked the Court to determine as a matter of law that the fees were excessive. The Court rejected the defendant's request, holding that it would "not police the conduct of wealthy litigants who choose to share their wealth with counsel through extravagant litigation."

Paul, Weiss, Rifkind, Wharton & Garrison, N.Y.L.J., May 26, 2004, p. 17 (Sup. Ct., N.Y. Co. (Acosta, J.)).

Attorneys-in-Fact

Pursuant to a January 25, 2000 power of attorney, the decedent's nephew, as attorney-in-fact, transferred to himself substantial assets belonging to the decedent. The power of attorney authorized the attorney-in-fact to make gifts to himself without limitation. Petitioner argued that the transfers were invalid because they involved self-dealing, and the respondent did not rebut the presumption of invalidity. The Court held that under the General Obligations Law, when a post-1997 power of attorney authorizes the attorney-in-fact to make gifts, the presumption of impropriety does not apply and the agent does not bear the burden of proving the gift's invalidity. Finding that the petitioner had failed to show that the transfers were invalid, the Court dismissed the discovery proceeding.

Salvation Army v. Ferrara, N.Y.L.J., April 19, 2004, p. 20 (Sur. Ct., Rockland Co., Surr. Weiner).

Costs on Appeal

In a contested accounting proceeding, the executor of the estate submitted a proposed supplemental decree to the Court which, *inter alia*, sought to assess the costs of an appeal against the decedent's surviving spouse, who was a beneficiary of the estate. These costs included legal fees and disbursements. The application was opposed by the surviving spouse.

The Appellate Division had, in its Order on appeal, directed that "costs be paid by the appellant personally." The appellant/surviving spouse argued that this language did not authorize the Court to assess the legal fees of the appeal against her. The Court disagreed, holding that this language has been

interpreted to justify the appellate court's deferral of the issue of fees to the Surrogate's Court. In support of this conclusion, the Court cited the provisions of SCPA 2302(5), which specifically authorize the Court, after appeal, to award a fiduciary "such sum as it deems reasonable for counsel fees and other expenses necessarily incurred on appeal."

The Court further noted that this result comported with the unique role played by the Surrogate's Court in supervising the administration of an estate, and in particular, its inherent authority to fix legal fees. The Court opined that the general rule prohibiting fees from being assessed against the distributive share of an estate beneficiary do not apply with respect to fees incurred on appeal. *See, e.g., In re Scuderi*, N.Y.L.J., Aug. 10, 1998 (Sur. Ct., Nassau Co.).

Accordingly, the Court found that counsel for the executor was entitled to fees for services rendered on appeal, and directed that they be paid by the surviving spouse personally.

I*n re Estate of Lucia*, N.Y.L.J., March 17, 2004, 31 (Sur. Ct., Nassau Co., Surr. John B. Riordan).

Equitable Deviation

In a miscellaneous proceeding, the petitioner requested the Court, *inter alia*, to reform Article Seventh(B) of the decedent's will under the doctrine of equitable deviation.

Under the provisions of Article Seventh, the decedent created a trust for the benefit of her son, comprised of 50% of the residue of her estate. The trust provided that income and principal be applied for the beneficiary's "welfare and support" in the sole discretion of the trustee. The trust further provided that principal and reinvested or accumulated income were to be retained in bank accounts or certificates of deposit insured by the FDIC. Upon the death of the income beneficiary, the trust would terminate, and the remaining principal would be distributed to the decedent's daughter, or to her "legal children" per stirpes.

In addressing the relief requested by the petitioner, the Court noted that the doctrine of equitable deviation requires a finding that there has been an (1) unforeseen change in circumstances, and (2) frustration of the testator's main objectives if her instructions are strictly followed.

Based upon this criteria, the Court concluded that application of the doctrine was warranted and relieved the trustee of the restrictions in the will regarding trust investments, authorizing the trustee instead to invest in a manner consistent with the standards set forth under EPTL Article 11-2.3 and EPTL 11-A. In reaching this result, the Court specifically relied upon the decision of Surrogate Radigan in *In re Singer*, N.Y.L.J., March 11, 1992, wherein the Court found that the investment restrictions in the will were no longer realistic under prevailing market conditions, and the decision of Surrogate Preminger in *In re Siegel*, 174 Misc. 2d 698, where the Court found that the investment directions in an *inter vivos* trust limiting investments to savings bank accounts and certificates of deposit required an expansion of the trustee's investment discretion, given circumstances which revealed that the settlor clearly intended to create a favorable income stream for his spouse and market conditions that had changed substantially since the trust was created.

In re Estate of Flesch, N.Y.L.J., April 19, 2004, p. 31 (Sur. Ct., Suffolk Co., Surr. John M. Czygier).

HIPAA—Health Care Agents

In a case of first impression, the Supreme Court, Nassau County, held that a woman who served as the health care proxy of her mother could seek, under state law and HIPAA, to acquire medical records related to her mother's care. The Court observed that HIPAA provides no clear and definitive mechanism for access to medical records when a patient is not competent to give consent. Though the Court reasoned that the provisions of a general power of attorney were not specific enough to comply with HIPAA, the status of a health care agent under a proxy was uncertain. However, the Court concluded that the New York Public Health Law makes the right of a health care agent to medical information clear. As a result, a properly executed health care proxy qualifies the agent as a person entitled to medical records pursuant to state and federal laws.

Mougiannis v. North Shore-Long Island Jewish Health System, N.Y.L.J., May 19, 2004, (Sup. Ct., Nassau Co., (LaMarca, J.)).

HIPAA—Subpoenas Duces Tecum

In a contested proceeding to determine the validity of the surviving spouse's right of election, a respondent/beneficiary of the estate moved for an order compelling the surviving spouse to execute a consent authorizing the deposition of her physician and the production of her medical records. The surviving spouse opposed the motion. Prior to the motion being made, the attorney for the fiduciary served the spouse's physician with a subpoena and subpoena duces tecum requesting his testimony and the production of all medical and/or psychiatric

records in his custody pertaining to the surviving spouse. The doctor responded by letter indicating that because of the rules of confidentiality he could not discuss anything about his patient without her consent. Accordingly, he did not appear for his deposition or produce any medical records.

The Court noted that the provisions of CPLR 3120 permit a party to serve a subpoena duces tecum to produce and permit inspection of documents in the possession of a non-party without court order, but that recent amendments to CPLR 3122(a) affect discovery of protected health information in the context of a subpoena duces tecum served upon a health care provider. In addition to the statutory provisions of the CPLR, courts have also required that the subpoena comply with the HIPAA rules and the regulations promulgated thereunder.

Finding that the subpoena duces tecum did not comply with these standards, the Court determined that the doctor properly ignored it.

The Court further found that under circumstances where a patient refuses to execute a consent or authorization for the release of medical records, the party seeking the records must obtain a court order. The question of whether a court order should issue necessarily depends on the parties' claim of privilege.

The discovery requested from the doctor pertained to three areas: (1) deposition testimony regarding conversations between the doctor and the decedent; (2) deposition testimony regarding conversations between the doctor and the surviving spouse to the effect that she did not want to see the decedent again; and (3) all medical and psychiatric records pertaining to the doctor's treatment of the surviving spouse.

The Court opined that while the physician-patient privilege may be waived by the patient, as in the case where the patient affirmatively places his/her medical condition in issue, the Court concluded that a proceeding for the determination of an elective share did not fall within that category. Accordingly, the motion, insofar as it sought the medical records of the surviving spouse and the deposition of the doctor regarding privileged conversations with his patient, was denied. On the other hand, the doctor was required to testify regarding all non-privileged conversations with the decedent and with the surviving spouse, and was cautioned that his failure to respond could result in remedies being sought pursuant to CPLR 2308(b).

I*n re Estate of Carella*, N.Y.L.J., April 2, 2004, p. 37 (Sur. Ct., Nassau Co., Surr. John B. Riordan).

Joint Bank Accounts

In a contested discovery proceeding instituted by the fiduciary, the Court was confronted, *inter alia*, with the issue regarding ownership of the proceeds in three joint bank accounts. The respondent, joint tenant with the decedent on the accounts, argued she had a survivorship interest in the accounts and that the proceeds remaining at death belonged to her.

The banking institution at which the funds were held was unable to produce the signature cards for the accounts because they were maintained at the World Trade Center and were destroyed in the September 11, 2001 attacks. Nevertheless, the bank acknowledged, and so testified, that on the decedent's date of death the accounts were owned by the decedent and respondent as joint tenants with right of survivorship. Despite this, the fiduciary argued that because the original signature cards could not be located, respondent was not entitled to the presumptior afforded by New York Banking Law section 675(b). Respondent countered this contention based upon the holding in *In re Butta*, 770 N.Y.S.2d 343 (1st Dep't 2004), which held that the testimony of a bank employee that the signature cards used by the bank when the subject account was opened contained right of survivorship language constituted sufficient proof that such language appeared on the signature card when the account was opened.

In view thereof, the Court concluded that the statutory presumption applied to the three accounts at issue and that the fiduciary failed to rebut that presumption. The Court rejected the fiduciary's allegation that the accounts were established as a matter of convenience, concluding that the decedent was a bright, educated man who was in no need to have convenience accounts created on his behalf. Finally, the Court held that the petitioner had presented absolutely no evidence to establish fraud, undue influence or lack of capacity sufficient to rebut the statutory presumption.

On a separate note, the Court determined that the sum of $58,264.73, deposited into one of the three joint accounts, a direct deposit checking account, three days after death belonged to the estate rather than to the joint account holder. Although respondent claimed that these funds were a gift to her by the decedent of his future earnings, the Court concluded that because the decedent retained the right to change the direct deposit scheme during his lifetime, an irrevocable transfer of the earnings had not taken place.

In re Estate of Slavin, N.Y.L.J., April 1, 2004, p. 20 (Sur. Ct., Queens Co., Surr. Robert L. Nahman).

Limited Letters of Administration

In a proceeding to revoke letters of trusteeship issued to a co-trustee, the Court concluded that while revocation was not warranted, the issuance of limited letters of administration was required under the circumstances. The other co-trustee was the respondent's spouse and a beneficiary of the subject trust.

The Court concluded that the co-trustees of the subject trust had a conflict of interest with the income beneficiary of the trust, who was the decedent's surviving spouse, as well as with one of the presumptive remaindermen of the trust, toward whom the co-trustees were concededly hostile. This conflict of interest centered around the administration of the principal asset of the estate, the decedent's home in East Hampton.

The Court held that while neither a trustee's conflict of interest nor hostility between a beneficiary and a trustee necessarily constitutes grounds for suspension of a trustee's powers, it would serve the best interests of the estate to appoint an independent trustee, with the authority to determine whether the residence should be sold or retained in the trust, or administered in some other fashion.

In re Estate of Richardson, N.Y.L.J., June 24, 2004, p. 27 (Sur. Ct., N.Y. Co., Surr. Preminger).

Protective Order

In a contested probate proceeding, a brother of the decedent, a nonparty witness, moved to quash a subpoena and subpoena duces tecum, and for the issuance of a protective order pursuant to CPLR 3103.

In support of the motion, the nonparty witness submitted an affidavit of his psychiatrist which described him as an 88-year-old suffering from depression and severe anxiety disorder, and concluded that if he were forced to testify in court or at home it would precipitate a "major decompensation which would be life threatening." However, two earlier letters from this same psychiatrist made no mention of a possible life-threatening situation to the witness but did mention a "major decompensation" if he were to be deposed. In addition, the witness's own affidavit merely stated that the deposition would be emotionally taxing and possibly dangerous to his health and well-being.

In assessing the propriety of the relief, the Court indicated that the proponent of a motion for a protective order must make an appropriate showing that he or she is entitled to such relief. Generally, under such circumstances, the Court must balance the general preference for allowing discovery against the objecting party's prerogative to be free from unreasonable annoyance, expense, embarrassment, disadvantage, or other prejudice.

Insofar as the relevance of the deposition was concerned, the Court concluded, upon review of the record, that the requested examination would provide information which would be "material and necessary" to the objectants' case.

Turning next to the question of whether the deposition should proceed, the Court examined the sufficiency of the medical evidence submitted. The Court noted that in a number of cases granting a protective order for health reasons, the medical evidence is "uncontradicted." However, in the case before it, the Court found that the objectants had no opportunity to challenge the conclusions drawn by the witness's doctor as to his claims that a deposition would be "life threatening." Moreover, on the present state of the record, the Court concluded that it could not ascertain whether this conclusion was true without further inquiry. "The opposing party has the right on behalf of itself and on behalf of the court to examine the matter in more detail."

Accordingly, the motion for a protective order was held in abeyance, and the objectants were authorized to select a physician of their choosing to consult with the nonparty witness's physician, and to review his medical records and examine the witness if necessary. Additionally, the Court urged counsel to come to terms as to the manner in which the deposition of the witness should be conducted, short of written questions. Notably, in this latter regard, the Court opined that written questions are not as conducive to an examination as oral questions, in that the former do not permit the probing follow-up questions necessary in most depositions, do not permit the examiner to observe the demeanor of the witness and evaluate his credibility during the course of questioning, and are often the result of a joint effort between the witness and his counsel.

In re Estate of Martin, N.Y.L.J., April 8, 2004, p. 32 (Sur. Ct., Nassau Co., Surr. John B. Riordan).

Security for Costs

In a contested discovery proceeding, the petitioner requested that several non-domiciliary objectants be required to post security for costs pursuant to SCPA 2303.

Objections to probate were filed by the decedent's distributees, as well as by beneficiaries of a prior testamentary instrument adversely affected by the one propounded by the petitioner. The objectants alleged that the instrument was not duly executed,

that the decedent lacked testamentary capacity on the date of its execution, and that it was procured by fraud and/or undue influence.

In support of the motion, the petitioner maintained that several objectants were nondomiciliaries of the state, and in the event that their objections to probate were dismissed, they would have no assets within the jurisdiction of the court against which an award of costs could be collected.

The Court opined that in exercising its discretion as to whether an award of costs should be granted, consideration should be given to whether the nondomiciliary had any interest in the estate to which recourse could be had in the event that costs were allowed against him, and whether there was substantial merit to the objections as filed. In addition, the Court could consider the financial circumstances of the nondomiciliary, and whether a direction to post security for costs could deprive him of his day in court.

Based upon this criteria, the Court directed that security be posted, finding that the execution of the will in question was supervised by an attorney, giving rise to the presumption that it was duly executed, that each of the subscribing witnesses attested to its due execution, and to the decedent's capacity on the date of execution, and that there was no proof in the record of any grounds supporting the objectants' claim of fraud and/or undue influence.

In re Estate of Kantor, N.Y.L.J., April 12, 2004, p. 31 (Sur. Ct., Suffolk Co., Surr. John M. Czygier).

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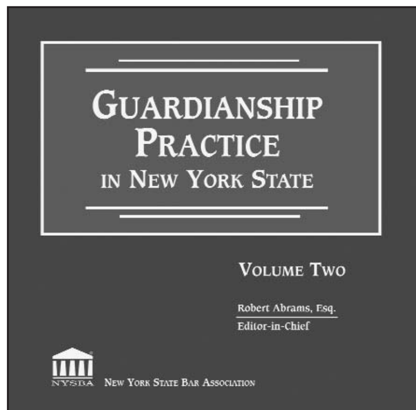

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