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Trusts and Estates Law Section Newsletter

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A Message from the Section Chair

The 2005 Annual Meeting has come to a close, and our Section program was warmly received on January 26th. The warmth was limited to the meeting room, however, since the outdoor temperatures were almost unbearable. Attendance at the substantive program was excellent and the number at the Section luncheon was record breaking.

Ron Weiss chaired the program, entitled "Current New York Estates Issues." For the first time in my memory (or anyone else's as far as I know), the substantive program began with a song. Richard Miller entertained us with his excellent singing voice before educating us on estate planning for non-residents with New York situs property. The next speaker, Professor Ira Bloom, spoke on Trust Drafting Considerations for the New York Lawyer. Rose Mary Bailey, the Executive Director of the New York Law Revision Commission, then spoke about powers of attorney in the new century. She was followed on the topic by Linda Whitton, a Professor of Law at Valparaiso University, and Elizabeth Loewy, an Assistant District Attorney in Manhattan. Our luncheon speaker was our own Executive Committee member, Honorable John M. Czygier, Jr., Surrogate of Suffolk County. He entertained us and gave us some perspective on what the trusts and estates practitioner faces upon becoming Surrogate. We thank all of the speakers for a superb program.

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NYSBA

United States Trust Company hosted the Section in the evening at their beautiful offices. Judge Doyle was the lucky winner of the raffle for an Apple iPod. (She tried to negotiate for a few more to have one for each of her children, with no success.) The entertainment at the reception was once again Rich Miller, with a chorus of 65 wonderful voices, treating us to Gilbert and Sullivan tunes.

Our spring meeting is scheduled for Rochester on Monday and Tuesday, May 9th and 10th, 2005, at the Hyatt Regency. On Monday afternoon, a round-table discussion program will be held, allowing participants to choose a table to discuss a topic of common interest, and periodically rotate to other tables of interest. Each table will be manned by an expert discussion leader, but everyone at the table will be encouraged to participate in the discussion. Bring your specific questions on estate planning issues and share the insights of the group. A reception and dinner at the Eastman House will follow on Monday evening. Tuesday will be a full day substantive program, along with a luncheon for all in attendance.

Our fall meeting this year will take place in New Orleans, where The Royal Sonesta Hotel on Bourbon Street will serve as our headquarters. Jack Barnosky is chairing the substantive program, with an excellent set of topics planned. The centerpiece of the program will be a panel made up of medical and legal experts to consider issues of competence and undue influence from the perspective of both the legal and medical communities. Early arrivals will be greeted on Wednesday, September 28, 2005 and the program will close on Sunday, October 2, 2005. I recommend you save a few extra days to fully sample the wonderful food of New Orleans, the professional jazz found even on street corners, and the general ambiance of the city.

G. Warren Whitaker has completed his term as Chair of the Section. Following in a long tradition of Section Chairs, Warren was tireless in his efforts on behalf of the Section, and always available to everyone. As I prepared to succeed him, Warren advised me on what to expect in my new role, and how the expected should be accomplished. An excellent Section Chair has two goals. First, the Chair must oversee and guide work of the Section during the term. Second, the Chair must ensure a seamless transition when the term ends. Both goals are equally important, and Warren had both in mind at all times. I thank him both on my own behalf, and on behalf of the Section.

Michael E. O'Connor

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Editor's Message

Figures recently released by the Internal Revenue Service concerning the number of estate tax returns filed in 2003[1] only reconfirm the fact often reported in the popular press that relatively few estates pay estate tax. Although the National Center for Health Statistics reports 2.4 million deaths occurring in the U.S. in 2003, we learn from IRS that of the some 114,000 federal estate tax returns filed, only 30,000 resulted in the imposition of any federal estate tax, after taking deductions and credits into account. Only 3,486 returns resulting in federal estate tax were filed on behalf of gross estates of $5 million or more.

On a state-by-state basis, 2,255 returns resulting in the imposition of federal estate tax were filed by New York estates in 2003 (third in the nation behind California and Florida).[2] Assuming New York mirrors the national pattern, only 12% of those returns, or 270, were filed on behalf of New York gross estates of $5 million or more.

Some commentators have predicted that a likely outcome of President Bush's efforts to repeal the "death" tax may instead be a significant increase in the applicable exclusion amount.[3] If the estate tax applicable exclusion amount were increased to allow estates of $5 million or less to pass free of federal estate tax, the 2003 figures suggest that the number of estates subject to federal estate tax in New York, and nationwide, would decline precipitously. Under such a regime, an individual with assets of $5 million or less would completely escape the federal estate tax, and his heirs would still enjoy a full income tax basis step-up for appreciated assets owned by the decedent at death.

If, on the other hand, the phase-out of the federal estate tax enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) comes to pass, while the estate tax would disappear completely for all in 2010, so would the generous income tax basis step-up rules. Unless modified, the EGTRRA basis provisions would force many heirs to inherit property under a carryover basis regime, with the consequence of being less well off than if the applicable exclusion amount had simply been increased to shelter $5 million from the estate tax and the tax basis step-up rules retained. Among those unhappy heirs? They would include the beneficiaries of the some 2,000 New York estates valued at between $1 million and $5 million, based on the 2003 figures. Sometimes the only thing worse than not getting what you want is getting what you want.

The editors will not attempt to predict whether the federal estate tax will in fact be phased out by EGTRRA in 2010, or perhaps fully repealed at some earlier date. But in either event, what would the disappearance of the estate tax mean for the estates and trusts practitioner? Author Lou Mezzullo recently offered a comprehensive list of areas that will likely be unaffected by repeal.[4] For instance, trusts and estates practitioners in New York will still be in demand to counsel clients in planning for state death taxes, for asset protection, for business succession, for retirement, for handicapped and spendthrift children, for non-US individuals and property, for avoiding gift taxes, for carryover basis issues, if carryover basis is ultimately adopted, and for fiduciary litigation, to name just a few.

Meanwhile, in January 2005 the Joint Committee on Taxation proposed a number of revenue-raising options in the estate and gift area.[5] These measures include imposing limitations on Dynasty trusts; curbing the availability of minority, marketability and other valuation discounts; curtailing the use of "Crummey" powers in connection with trusts; providing for more consistency in income tax basis reporting as between estate tax valuations and sales of assets by heirs; and modifying transfer tax provisions as they relate to Section 529 Qualified Tuition Accounts. Even if we're in the twilight of the estate tax, no one need be idle.

Remember

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. Internal Revenue Service, "Table 1—Estate Tax Returns Filed in 2003: Gross Estate by Type of Property, Deductions, Taxable Estate, Estate Tax and Tax Credits, by Size of Gross Estate," Unpublished SOI Data, Excel ver. 4, October 2004, available at http://www.irs.ustreas.gov/taxstats/index.html.
2. Internal Revenue Service, "Table 5—Estate Tax Returns Filed in 2003 with Gross Estates of $1 Million or More: Gross Estate, Total Deductions, State Death Tax Credit, and Net Estate Tax, by State of Residence," Unpublished SOI Data, Excel ver. 4, November 2004, available at http://www.irs.ustreas.gov/taxstats/index.html.
3. Herman & Silverman, "Republicans Consider Keeping Estate Tax Alive For Very Rich," Wall Street Journal, January 19, 2005.
4. Mezzullo, "Estate Planning After the 2004 Election," available at http://www.mcguirewoods.com.
5. Joint Committee on Taxation, "Options to Improve Tax Compliance and Reform Tax Expenditures," JCS-02-05, January 27, 2005, available at http://www.house.gov/jct/s-2-05.pdf.

Amendment of SCPA 2307-a
(Effective Nov. 16, 2004)

By Surrogate John M. Czygier, Jr. and Marilyn G. Ordover

Practitioners may recall the concerns which culminated in the enactment of SCPA 2307-a on August 2, 1995. This provision reduced the statutory commissions payable to an attorney who had been involved in the preparation of a will for a client nominating the attorney as executor, unless the testator had acknowledged the disclosure to him or to her of certain prescribed elements. The background of this statute was the perception on the part of more than a few Surrogates that too many attorneys were being named executor in their clients' wills and thereby obtaining double compensation for the same services, by way of commissions and legal fees. There was a concern that clients believed the attorney acting as executor would do the executor's work without additional charge, and it appeared that some Surrogates shared this belief. A line of cases was developing an inference of impropriety for the attorney-drafter nominated as executor to rebut, in order to receive any commissions. In other cases, the attorney's legal fee was substantially reduced by the court because he or she received statutory commissions.

"[T]he first two sub-paragraphs of 2307-a have been amended . . . to endorse the requirement that disclosure be acknowledged in a document 'which must be separate from the will, but may be attached to the will.'"

Various statutory proposals were made to the legislature, and the joint efforts of several bar associations are reflected in the text of 2307-a, which confines the commissions of an attorney executor involved in the preparation of the will to one-half of an executor's statutory commissions, unless there was a written acknowledgment of disclosure signed by the testator, and witnessed.

The statute provided models of the acceptable form of disclosure statement. Disclosure that "conforms or substantially conforms" to the model complies with the statutory requirements (2307-a(4)). In a written acknowledgment of disclosure executed "prior to, concurrently with or subsequently to a will," the testator was to state, in substance, that he or she was informed that: (a) any person, including an attorney, could serve as executor; (b) absent an agreement to the contrary, an executor was entitled to receive statutory commissions for serving as executor; and (c) an attorney so serving was entitled to reasonable compensation for legal services in addition to commissions.

The statute represented a significant change in the practice and contained specific provisions with regard to how it was to be applied in the case of wills in place and those subsequently executed. SCPA 2307-a expressly provided that it was applicable to wills executed on or after the January following its enactment (January 1, 1996), and "irrespective of the date of any will, to estates of decedents dying after December 31, 1996." In the case of wills executed before January 1, 1996, courts are expressly authorized to excuse non-compliance for "good cause shown."

The text of the statute was unclear on its face as to whether the required disclosure statement could be included in the text of a will or was required to be free-standing. Case law has not been uniform on this issue, although the trend has favored the requirement of a separate instrument.[1]

Under the sponsorship of Senator DeFrancisco, the Chair of the Senate Judiciary Committee, the first two sub-paragraphs of 2307-a have been amended (S.6986, effective November 16, 2004) to endorse the requirement that disclosure be acknowledged in a document "which must be separate from the will, but may be attached to the will."

The amendment also adds an additional paragraph to the terms of the model disclosure forms, which may create its own uncertainty. The amendment requires that the testator acknowledge that he or she was informed that:

> (iii) absent execution of this disclosure acknowledgment, an attorney who serves as an executor shall be entitled to one-half of the commissions he or she would otherwise be entitled to receive; . . .

The uncertainty is as to whether a free-standing disclosure statement executed before November 16, 2004, which contains all of the elements of disclosure specified by the statute in effect at the time the statement was executed, but does not contain the new provision describing the effect of failure to execute a disclosure acknowledgment, satisfies the statutory test. Would this represent the substantial conformity with the model required by 2307-a(4)? Practitioners are asking whether they must contact their clients and ask them to execute new disclosure statements containing the additional provision.

This topic was discussed at the December meeting of the Executive Committee of the Trusts and Estates Law Section, attended by the authors. It was the majority view that the fundamental purpose of 2307-a had been served where the disclosure statement conformed to the model in the statute at the time the statement was signed, and that the re-execution of disclosure statements to incorporate the new language was not required. The thought was that the additional disclosure provided by the amendment was cumulative, rather than fundamental, and therefore need only be given prospective effect. The client had been alerted to the fact that the attorney executor will be compensated in both capacities, which was the principal reason for adopting 2307-a, as well as to the fact that it was not necessary to appoint a lawyer as executor. The prophylactic effect of the added provision describing the consequence of the failure to execute a disclosure statement was thought to be insufficient to impose on the attorney-client relationship the awkwardness of asking the client to execute another document of this kind. Contacting a client for a self-serving purpose burdens the relationship in a manner which does not serve the public interest in that relationship.

While there were some dissenting voices who pointed to the retroactive application of SCPA 2307-a upon its original enactment, most of the committee believed that this was distinguishable because of the significant regulatory purpose to be accomplished by the original statute. We note that the original statute also provided expressly for retroactive application, which this amendment does not do, and need not in consequence be read to do. This discussion assumed that disclosure statements executed after November 16, 2004 would be required to contain the additional language, but even in such a case it might conceivably be argued that the execution of an "old form" of disclosure statement represented substantial conformity to the model.

There was no discussion at the meeting of the retroactive application of this 2004 amendment to disclosure statements which are contained in wills executed before November 16, 2004, in the case of estates administered in counties where a separate disclosure statement has not been mandated. The premise of the question which was discussed, however, would seem to be that it is not safe to rely on the efficacy of a disclosure which is not contained in a separate instrument.

"It was the majority view [of the Section's Executve Committee] that the fundamental purpose of 2307-a had been served where the disclosure statement conformed to the model in the statute at the time the statement was signed, and that the re-execution of disclosure statements to incorporate the new language was not required."

Other questions that have been generated by 2307-a were not resolved by the amendment discussed, such as the application of the statute to wills executed in another state,[2] or the binding effect of a decision regarding the application of 2307-a made in a probate proceeding as the statute requires when the legatees affected were not formally made parties to that proceeding.

Endnotes

1. See *In re Weygand*, 4 Misc. 3d 190; 777 N.Y.S. 2d 263 (Sur. Ct., Greene Co. 2004), which discusses the precedents.
2. *In re Newell*, N.Y.L.J., June 6, 2002, p. 27, col.4 (Sur. Ct., Suffolk Co.).

Acknowledgment of Disclosure

Prior to signing my Will, I was informed that:

(i) subject to limited statutory exceptions, any person, including an attorney, is eligible to serve as my executor;

(ii) absent an agreement to the contrary, any person, including an attorney, who serves as an executor for me is entitled to receive statutory commissions for executorial services rendered to my estate;

(iii) absent execution of this disclosure acknowledgment, an attorney who serves as an executor shall be entitled to one-half the commissions he or she would otherwise be entitled to receive; and

(iv) if such attorney serves as my executor, and he or she or another attorney affiliated with such attorney renders legal services in connection with the executor's official duties, he or she is entitled to receive just and reasonable compensation for those legal services, in addition to the commissions to which an executor is entitled.

________________________ (Witness)

________________________ (Testator)

Dated: ____________________

Dated: ____________________

Corporate Fiduciaries, Advisors and Other "Co-Trustees"—Perhaps Your Trust Isn't Exempt from New York State Income Tax

By Paul Comeau and Jack Trachtenberg

The New York State Department of Taxation and Finance (the "Department") recently issued an advisory opinion, *Petition of JPMorgan Chase Bank* (the "Advisory Opinion"),[1] that raises serious concerns for certain taxpayers who are currently treating their New York resident trusts as exempt from New York State income tax. In particular, the Advisory Opinion indicates that the Department may treat certain out-of-state corporate fiduciaries as New York trustees, and may consider certain advisors, committee members and other non-fiduciaries to be co-trustees. Both of these potentialities could cause a New York resident trust that was once thought to be exempt from New York income tax to be taxable. Though the reasoning of the Advisory Opinion is questionable in many respects, it raises new issues that must be considered in trust tax planning and administration.

Introduction: The Taxation of New York Resident Trusts

Certain resident trusts (i.e., trusts created by individuals while domiciled in New York) have long been exempted from New York's fiduciary income tax. The exemption applies if: (1) all of the trustees are domiciled in a state other than New York; (2) the entire corpus of the trust, including real and tangible property, is located outside of New York; and (3) all of the income and gains from the trust are derived from or connected to sources outside of New York.[2] This three-part test was derived from the Court of Appeals decision in *Mercantile-Safe Deposit and Trust Co. v. Murphy*,[3] where it was held that New York could not constitutionally impose its income tax on a resident trust that lacked certain minimum connections to the state. The three-part test was first put forth in regulations promulgated by the Department, and in October 2003, it was codified by the New York State Legislature in Tax Law § 605(b)(3)(D).

For years, this exemption has provided a useful planning tool for taxpayers wishing to minimize or avoid New York State fiduciary income tax, especially where the trust's assets consist entirely of intangibles, such as cash, securities or government obligations. In such cases, the intangible assets are treated as being located at the domicile of the trustee, regardless of the actual physical location of the assets.[4] This rule, first established by the Department in *Petition of Charles B. Moss Trust*,[5] was also codified in October 2003 in Tax Law § 605(b)(3)(D)(ii). Consequently, taxpayers have had the option to exempt such resident trusts from New York State income tax by simply appointing a non-New York individual or trust company as trustee. The Advisory Opinion, however, has brought a cloud of uncertainty over the taxability of such trusts.

"Though the reasoning of the Advisory Opinion is questionable in many respects, it raises new issues that must be considered in trust tax planning and administration."

The Advisory Opinion

The issue in the Advisory Opinion was whether certain New York resident trusts would be subject to New York State and City income taxes if: (1) the existing New York corporate trustee was replaced by a Delaware trust company; and (2) a committee established by the grantor to advise the trustee replaced its two New York domiciled members with individuals domiciled outside of New York.

The trusts in the Advisory Opinion were formed in 1934 by John D. Rockefeller. The trust agreements name The Chase National Bank as trustee (the "Trustee"), and establish a committee of five individuals to oversee the Trustee (the "Committee"). The Trustee has broad powers over the trusts' assets, subject to direction by the Committee should it decide that a particular course of action should be taken or avoided. Since Mr. Rockefeller was domiciled in New York at the time he created the trusts, and since the existing corporate Trustee is incorporated and domiciled in New York State, the trusts are New York resident trusts subject to the state's fiduciary income tax.

In order to eliminate New York income taxes, it was proposed that the existing Trustee would be replaced by its affiliate, J.P. Morgan Trust Company of Delaware (the "Successor Trustee").[6] The Succes-

sor Trustee, which was incorporated in Delaware, would take title to and become the custodian of the trusts' assets. To administer the trusts, the Successor Trustee would purchase certain services from its affiliate, J.P. Morgan Chase Bank, a New York State banking company. These services could include tax preparation, client support, processing and other ministerial services, and would be provided in accordance with the terms of an existing agency agreement. Occasionally, the Successor Trustee would also retain certain non-Delaware service providers, such as accountants, investment managers, and legal counsel.

It was also proposed that two members of the Committee who are domiciled in New York State would resign. They would be replaced by individuals domiciled outside of New York. At times, the Committee would meet in New York, and it would continue to retain one or more non-member advisors who may be domiciled in the state. These advisors could include one or both of the committee members who resigned.

After reviewing the applicable law, the Advisory Opinion declined to rule on whether the proposed changes would avoid New York taxation. First, the Advisory Opinion declared that the Successor Trustee could be treated as having a New York domicile, even though it was incorporated in Delaware. The Advisory Opinion recognized that the Tax Law and regulations do not define corporate domicile for personal income tax purposes, and noted that the Court of Appeals has ruled that the domicile of a corporation is the state in which it is incorporated. Nonetheless, the Department determined that the domicile of a corporation is the "principal place from which the trade or business of the corporation is directed or managed." Unfortunately, the Advisory Opinion does little to explain what this means. Moreover, the Department refused to definitively rule on whether the Successor Trustee would be considered a New York domiciled trustee under the "principal place of business" test.[7]

The Advisory Opinion goes on to determine that the trusts in question would be subject to New York State income tax if any member of the Committee was domiciled in the state. According to the Advisory Opinion, the Committee and its members should be treated as co-trustees because they have the power to direct and control the Trustee in the performance of its functions and duties. Similarly, the Advisory Opinion states that investment managers, the former committee members or other advisors could also be treated as a co-trustees depending on the nature of their activities. Again, however, the Department refused to rule on whether the particular advisors in question would be treated as co-trustees for purposes of determining the trusts' taxability in New York.

Is the Advisory Opinion Correct?

While some support is seemingly provided, a taxpayer could certainly dispute the two fundamental legal conclusions that form the basis for the Advisory Opinion's determinations. Specifically, it is not clear that a corporation's domicile for New York State income tax purposes should be determined based on its "principal place of business." It is also questionable whether advisors, committee members and other non-fiduciaries should be treated as co-trustees for purposes of determining a resident trust's taxability in New York.

Two factors weigh against the conclusion that a corporate trustee's domicile should be based on its "principal place of business." First, the New York Court of Appeals has held that the domicile of a corporation is the state in which it is incorporated.[8] Second, neither the Tax Law nor the regulations define corporate domicile for New York State personal income tax purposes.[9] In the absence of such legislative or regulatory guidance, the Department may be exceeding its authority in sidestepping a ruling from New York's highest court and asserting a contrary theory of corporate domicile. And though the Advisory Opinion correctly notes that the "principal place of business" test has been employed by federal courts for purposes of determining whether federal diversity jurisdiction exists, the Advisory Opinion does not cite a single source where the same test was applied for New York personal income tax purposes.[10] The Advisory Opinion also fails to explain that in these federal cases, the "principal place of business" test was one imposed on the courts by Congress pursuant to a statutory amendment.[11] No such statute exists in New York.

The assertion that the committee members and advisors should be treated as co-trustees for purposes of determining the trusts' tax status is also troubling. For this proposition, the Advisory Opinion relies entirely on *In re Rubin*,[12] a case in which the Nassau County Surrogate's Court addressed the propriety of designating advisors to direct the actions of individuals named as co-executors of a decedent's estate. While the Advisory Opinion correctly reads *In re Rubin* as holding that the designation of an advisor is a valid limitation on a fiduciary's powers, it goes too far in stating that the decision endorses the treat-

ment of such advisors as co-trustees for all purposes. In fact, the Advisory Opinion fails to mention two other cases, *Brown v. Spohr*[13] and *In re Fontanella*,[14] which indicate that advisors and similar individuals should not be treated as trustees at all.

In *Brown*, the Court of Appeals laid out the rule that "an essential element of a valid trust [is] . . . the actual delivery of the fund or other property, or of a legal assignment thereof to the trustee, with the intention of passing legal title thereto to him as trustee."[15] This principle was later employed by the Appellate Division in *Fontanella*, where it was determined that the decedent's sister-in-law was not a trustee because title to the assets in question never passed to her.[16] *Brown* and *Fontanella* remain good law, and were decided by higher-level courts than *Rubin*. Accordingly, it could be argued that committee members and advisors, such as those in the Advisory Opinion, should not be treated as trustees if the grantor never intended to pass, or did not actually pass, legal title over the trust assets to them.

What Should Taxpayers Do?

Taxpayers should recognize that the Advisory Opinion probably foreshadows the position that the Department would take in an audit of a similar New York resident trust that claims to be exempt from fiduciary income tax. While a taxpayer could challenge the legal underpinnings of the Department's position, steps should be taken now to ensure that the exemption from tax is maintained under the Advisory Opinion. Given the Advisory Opinion's holdings, several things should be considered.

In the case of a corporate trustee, thought should be given to where the corporation manages, conducts and directs its business. The location of corporate offices, the board of directors and employees should be reviewed. So should the location where director and shareholder meetings are held. It may even be important to think about the location where checks or other documents are signed on behalf of the company.

Similar issues should be considered by advisors, committee members and others who may be treated as co-trustees. Their domicile and other contacts to New York should be reviewed. For instance, if the individual provides administrative, legal or other services for the trust in New York, it may serve as a basis for imposing income tax on the trust. Certainly, this is not an exhaustive list, and given the ambiguity of the Advisory Opinion, it is unclear precisely what the Department would review in making its determination.

Other issues that should be considered relate to the second prong of the three part test—i.e., the location of intangible assets owned by the trust. Assume, for instance, the use of a New York money manager who will maintain physical custody of, and manage, a resident trust's intangible assets. Will this result in a determination that the property has a New York situs? Based on recent experiences, the authors believe that the answer could be yes. Specifically, we believe that the Department may deem an otherwise exempt resident trust (i.e., one with intangible assets and a trustee domiciled outside of New York) to have New York situs assets simply because those assets are in the "possession and control" of a New York-based brokerage firm, bank or trust company. If such a theory of trust taxation were to prevail, New York resident trusts with even the most minimal of connections to the state could lose their tax-exempt status.

"Given the vague standards invoked in the Advisory Opinion, as well as the Department's unwillingness to rule on the basis of represented facts, taxpayers are left with little guidance regarding their tax obligations."

Conclusion

The Advisory Opinion has created a lack of certainty in the area of trust taxation in New York, a result the legislature attempted to avoid when it "clarified" the law in October 2003. Given the vague standards invoked in the Advisory Opinion, as well as the Department's unwillingness to rule on the basis of represented facts, taxpayers are left with little guidance regarding their tax obligations. The Advisory Opinion may also have dramatic and adverse consequences for New York-based trustees, banks and businesses, as taxpayers may now be hesitant to employ their services in connection with resident trusts. For New York, the potential loss of business and jobs could not have come at a worse time. Surely, these uncertainties and negative economic outcomes could not have been intended when the legislature laid out the unambiguous three-part test in the Tax Law. Perhaps the legislature should consider clarifying the meaning of "domicile" and "trustee" for income tax purposes. In the meantime, taxpayers should carefully reassess the exempt status of their resident trusts.

Endnotes

1. TSB-A-04(7)I (Nov. 12, 2004).
2. N.Y. Tax Law § 605(b)(3)(D)(i); 20 N.Y.C.R.R. § 105.23(c).
3. 242 N.Y.S.2d 26, 19 A.D.2d 765 (3d. Dep't 1963), *aff'd*, 15 N.Y.2d 579.
4. N.Y. Tax Law § 605(b)(3)(D)(ii); *Petition of Charles B. Moss Trust*, TSB-A-94(7)I (Apr. 8, 1994).
5. TSB-A-94(7)I.
6. This change had already been approved by the New York County Surrogate in May 2002. *See Application for Judicial Approval of the Resignation of The Chase Manhattan Bank as Trustee and the Appointment of Chase Manhattan Bank USA, N.A.*, 2 Misc. 3d 554, 773 N.Y.S.2d 529 (Sur. Ct., New York Co. 2003).
7. The Department maintains that a determination of domicile is a factual matter that is not susceptible of determination in an advisory opinion. The Department has, however, ruled on such questions of fact in previous advisory opinion requests. *See, e.g.*, TSB-A-00(3)I (ruling that the taxpayer was domiciled in Virginia, as opposed to New York); TSB-A-98(23)S (declaring that the question of whether or not a particular improvement is a capital improvement constitutes a question of fact, but ruling that the pool improvements discussed in the advisory opinion were capital improvements); *see also*, TSB-A-04(4)I (ruling that the taxpayers home was not a permanent place of abode).
8. *Sease v. Central Greyhound Lines, Inc.*, 306 N.Y. 284 (1954).
9. *See* N.Y. Tax Law §§ 601, *et. seq*.
10. The existence of diversity jurisdiction permits the federal district courts to exercise original jurisdiction over controversies between "citizens of different states." 28 U.S.C. § 1332. The amount in controversy must also exceed $75,000. *Id.*
11. *See* 28 U.S.C. § 1332; *see also Scot Typewriter Co. v. Underwood Corp.*, 170 F.Supp. 862 (S.D.N.Y. 1959), which was cited by the Advisory Opinion. This case explicitly relied on 28 U.S.C. § 1332 to justify the use of the "principal place of business" test.
12. 143 Misc. 2d 303, 540 N.Y.S.2d 944 (Sur. Ct., Nassau Co. 1989).
13. 180 N.Y. 201, 73 N.E. 14 (1904).
14. 33 A.D.2d 29, 304 N.Y.S.2d 829 (3d. Dep't 1969).
15. *Brown*, 180 N.Y. at 209.
16. *Fontanella*, 33 A.D.2d at 31.

Paul R. Comeau is a member of the firm of Hodgson Russ LLP in Buffalo, New York. He is co-editor of *New York Tax Service*, co-editor of *New York Tax Cases*, and is co-chair of the Multistate Tax Committee of the New York State Bar Association Tax Section, where he has also served as chair or co-chair of the New York Tax Matters Committee, Interstate Taxation, Sales Tax, and Tax Tribunal Subcommittee.

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Seven Defensive Will Drafting Tips for the Wills, Trusts and Estates Practitioner

By Anthony J. Enea

With the disintegration of the nuclear family and approximately 70 million "baby boomers" coming of age, it is inevitable that the number of Will contests filed will significantly increase in the future. The attorney-draftsperson of a Last Will may find himself or herself on the front lines of a Will contest. While it is obviously necessary that all of the statutory requirements of EPTL 3-2.1 be complied with, undertaking the seven steps delineated below will help insure that any challenge to the Last Will is successfully defeated, and that the statutory requirements are satisfied.

1. Determine Who Your Client Is

Often family members and friends will schedule and accompany a senior to the initial consultation with an attorney. Thus, during the initial consultation, individuals other than the person for whom you are preparing a Last Will often interject their views and comments.

This creates difficulties for the attorney, who needs to insure that the client is acting free of any undue influence and/or fraud. During the initial consultation, make it clear to all in attendance that the individual the attorney (i.e., you) will be representing is the individual for whom the attorney will be drafting the Last Will, Trust and/or any other documents. If, during the consultation, there is any discussion of the client not making any provision for one or more children, or any other distributee of his or her estate, ask to speak with the client alone to ascertain the reasons for his or her decision, and to determine that the decision is being freely made.

2. Obtain Biographical, Filial, Medical and Financial Information

Obtaining as much information as possible about the client and his or her family is critical to being able to defeat a Will contest. All too often attorneys are reluctant to pry into the private affairs of clients, such as the details of the client's finances, because the attorney feels it is a private matter. This reluctance to make inquiry could prove to be disastrous if the Will is challenged. One of the necessary inquiries an attorney should make for purposes of establishing testamentary capacity is whether or not the Testator knows and understands the nature, extent and objects of his/her bounty. The attorney should always endeavor to obtain a complete financial portrait of the client.

Obtaining all of the foregoing information, whether through the use of a questionnaire or the direct questioning of the client, with copious note taking, will provide the attorney with a complete portrait of the client. This paper portrait is often the first line of defense to a Will contest, and an invaluable asset to the attorney at his or her deposition.

Inquiring about the client's medical conditions will also alert you to whether the client is suffering from any illnesses, or taking any medications, that could affect his or her reasoning or judgment. This often acts as a red flag to the attorney that it may be prudent to obtain the opinion or statement from a physician that the client has the requisite capacity to execute a Last Will.

3. Take Thorough Notes About the Client's Testamentary Wishes

Document exactly what the client stated about his or her testamentary wishes. If, for some reason, the client articulated why he or she wanted Cousin Johnny to get twenty-five percent of his/her estate, you should make note of it. The statements of the client become particularly important if the client has decided to exclude a child or a distributee from his or her testamentary plans.

The ability of the client to articulate logical and cogent reasons for his or her testamentary wishes, and your notes of these reasons, will go a long way in helping to defeat a Will contest. Counsel should thoroughly review with the client all testamentary dispositions and the names and addresses of all beneficiaries to be named, as well as any alternates.

4. Mail a Draft of the Last Will to the Client

Many attorneys find it more convenient and less time-consuming to prepare the Last Will, and once it is prepared, to schedule an appointment for its execution. It is a much more prudent procedure to mail the client a proposed draft of the Last Will, and allow the client the opportunity to review the Last Will without the time constraints of a scheduled appointment.

This procedure helps to insure that the client is given an adequate amount of time to review the Last Will and any other documents. This is especially helpful when the client is a senior who may be accompanied by family members to any appointment.

5. Meet With the Client Alone to Review Terms of Last Will Prior to its Execution

As a matter of practice, immediately prior to the Will signing the attorney should meet with the client alone to review the terms of the Will and any other

documents to be signed, such as a health care proxy and durable power of attorney. This meeting will again allow the attorney an opportunity to assess the testamentary capacity of the client, and to determine that the client is acting free of any undue influence or fraud. Testimony from an attorney that he or she reviewed the Last Will in the presence of the beneficiary who is later accused of having asserted undue influence is not uncommon.

Additionally, by meeting with the client again, the attorney has another contact with the client that the attorney will be able to document. If any modifications are made by the client to the Last Will, they should also be noted by the attorney.

6. Follow Consistently Identical Will Execution Procedures

Unless you have an exceptional memory, it is highly unlikely that years later you will be able to recall and testify about the specifics of a particular Will execution ceremony and the client. It is also highly unlikely that the attesting witness will have the ability to recall any specifics. However, if the attorney consistently follows the same procedures, the attesting witnesses and the attorney will be more likely to be able to recall, and testify as to, the procedures followed.

For example, you may want to adhere to procedures similar to the following practice which will satisfy all of the requirements for the due execution of a Will pursuant to EPTL 3-2.1:

(a) Clear the writing surface of all documents other than the Last Will and other documents to be executed.

(b) Introduce the Testator to witnesses and make some conversation to allow witnesses to observe Testator's capacity. You may also wish to have the Testator read a portion of the Will or another document.

(c) In the presence of the witnesses make the following inquiries of the Testator:

1. Have you read this document?
2. Is this document your Last Will and Testament?
3. Does this document dispose of your assets and worldly possessions in accordance with your wishes?
4. Is anyone forcing you to sign this document?
5. Would you like the others and me to act as witnesses to your Last Will?

Some attorneys prefer not to act as a witness to the Last Will. However, the potential of conflicting testimony is reduced where the witnesses are the attorney and one other individual.

(d) Once the Testator has appropriately responded to all of the above stated inquiries, have the Testator initial each page and sign and date the Last Will at the end thereof in the presence of all of the attesting witnesses.

(e) Read the attestation clause aloud and have the witnesses sign on the same page as the Testator beneath the attestation clause, and also have the witnesses sign a self-proving affidavit, all of which should be signed by the witnesses in the presence of each other. Not having a self-proving affidavit attached to the Will only further complicates having the Will admitted to Probate.

In recent years many attorneys have opted to videotape or audiotape the Will execution ceremony. While in many cases the audiotape or videotape could deal a devastating blow to any attempted challenge, when dealing with an elderly or frail client the use of such a recording may only serve to magnify those frailties.

7. Take Steps to Insure that the Last Will Is Properly Assembled and Stapled

The attorney should review the signed Last Will in its entirety to ensure that all pages have been initialed, that the Testator and witnesses have signed on the appropriate lines, and that it is assembled in proper order.

Treating each Last Will and its execution as a potential Will contest, and taking defensive steps to ensure the integrity of the Will, should enable you to defeat any Will contest and avoid having to give embarrassing testimony at a deposition. It is important to remember that when a Will challenge is successful, it is often because of the existence of numerous bits and pieces of circumstantial evidence. The attorney-draftsperson of the Will should endeavor to avoid being one of those bits and pieces.

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Lifetime Transfers Can Reduce New York Estate Taxes

By Ira Mark Bloom

In this article, I want to show how the making of lifetime transfers can reduce the New York estate tax burden, thereby increasing the benefits for decedents' beneficiaries. My focus will be on lifetime transfers made close to death for decedents who are New York residents at death.[1]

First, however, it is important to understand how New York's estate tax system operates, including the impact of the frozen $1 million unified credit under the system. In addition, it is important to understand how newly effective Internal Revenue Code Section 2058 (hereinafter Internal Revenue Code sections will be referred to by section number, e.g. Section 2058) will apply to determine the federal estate tax liability. For estates of decedents dying after 2004, Section 2058 allows a deduction for New York estate taxes and other state death taxes.

I. The New York Estate Tax System

A. The Statutory Scheme

For decedents who were New York residents with no relevant out-of-state property, the imposition of estate tax under New York Tax Law § 952(a) is deceptively simple: "an amount equal to the maximum amount allowable against the federal estate tax as a credit for state death taxes under Section 2011 of the internal revenue code."[2] But on review, the system is made difficult because of Tax Law § 951(a).[3]

Translated into comprehensible English, and applicable to decedents dying in 2005 and beyond, the first sentence of Tax Law § 951(a) provides that the Internal Revenue Code provisions in effect on July 22, 1998, including Section 2011, generally apply. The next two sentences provide an exception: The unified credit amount is frozen at $345,800, which is the credit equivalent of a $1 million exemption.

In effect, Tax Law § 952(a) is not to be applied based on current federal estate tax law. Indeed, if current federal tax law applied, New York would impose no estate tax since Section 2011 was repealed at the end of 2004. *See* Section 2011(f) (current version).

Based on Section 2011, as of July 22, 1998,[4] there are effectively two computations that need to be made, with the smaller amount controlling. The first determines the maximum credit allowable by applying the rate table of Section 2011(b) (Computation #1 Amount). The rate table is based on the federal adjusted taxable estate (hereinafter "adjusted taxable estate"), which is the federal taxable estate (hereinafter "taxable estate") as reduced by $60,000. *See* Section 2011(b) (last sentence).

The second calculation—and here is where the frozen $1 million exemption comes into play—determines the federal estate tax that would be produced by reducing the federal estate tax imposed under Section 2001 by the unified credit amount under Section 2010 (Computation #2 Amount). For estates of decedents dying in 2005 and thereafter, Section 2011(f) incorporates by reference Section 2001 as it was in effect on July 22, 1998. *See* Tax Law § 951(a) (first sentence).

The relevant portions of Section 2001, on July 22, 1998, and Section 2010, based on its July 22, 1998 form, but with a credit equal to an exemption equivalent of $1 million by dint of Tax Law § 951(a) (last sentence), are set forth in the endnotes to this article.[5]

B. Examples Under New York Estate Tax System

Example where New York estate tax will be imposed: Decedent dies in 2005 with a taxable estate of $1.5 million. As a result, the Computation #1 Amount, based on an adjusted taxable estate of $1,440,000, produces a maximum credit under the Section 2011(b) rate table of $64,400. The Computation #2 Amount is $210,000: The federal estate tax imposed under Section 2001 is $555,800, reduced by the credit allowed under Section 2010 of $345,800.

Because the Computation #1 Amount ($64,400) is smaller than the Computation #2 Amount ($210,000), the Computation #1 Amount of $64,400 is the maximum credit allowable under Section 2011. As a result, the New York estate tax imposed under Tax Law § 952(a) will be $64,400.

Example where no New York estate tax will be imposed: Decedent dies in 2005 with a taxable estate of $1 million. The Computation #1 Amount, based on an adjusted taxable estate of $940,000, produces a maximum credit under the Section 2011(b) rate table of $33,200. However, the Computation #2 Amount is ZERO. The federal estate tax

imposed by Section 2001 is $345,800, which is then reduced by the credit allowed under Section 2010 of $345,800. As a result, there will be no New York estate tax imposed under Tax Law § 952(a) since there is no credit allowable under Section 2011.

These two examples involved decedents with only a federal taxable estate. What will be the effect of adjusted taxable gifts, which are defined by Section 2001(b) as taxable gifts made after 1976 that are not included in the gross estate?[6] The answer is that adjusted taxable gifts will be taken into account for purposes of determining the Computation #2 Amount but not to determine the Computation #1 Amount. As a result, even if the taxable estate is reduced to $1 million, there will still be a New York estate tax imposed because the adjusted taxable gifts are not completely disregarded.[7]

Example where New York estate tax will be imposed because of adjusted taxable gifts: Decedent dies in 2005 with a taxable estate of $1 million. In 2004, decedent had made an adjusted taxable gift of $500,000. The Computation #1 Amount, based on an adjusted taxable estate of $940,000, produces a maximum credit under the Section 2011(b) rate table of $33,200. The Computation #2 Amount is $210,000, determined as follows: The estate tax imposed by Section 2001(b) is determined by adding the taxable estate ($1 million) and the adjusted taxable gift ($500,000) amounts to produce a unified tax base of $1.5 million. The estate tax imposed on $1.5 million is $555,800, which is then reduced by the credit allowed under Section 2010 of $345,800.

Because the Computation #1 Amount ($33,200) is smaller than the Computation #2 Amount ($210,000), the Computation #1 Amount of $33,200 is the maximum credit allowable under Section 2011. As a result, the New York estate tax imposed under Tax Law § 952(a) will be $33,200.

Example where New York estate tax will be imposed because gift tax was payable on adjusted taxable gifts: In late 2004, D, who was close to death, made an adjusted taxable gift of $1.5 million, and on April 15, 2005, paid federal gift tax of $210,000 thereon. D died on April 20, 2005, with $290,000. Because D died within three years of making the gift, the gift tax of $210,000 is included in the gross estate under Section 2035(b). Assuming no estate tax deductions, D's taxable estate will be $500,000.

The Computation #1 Amount, based on an adjusted taxable estate of $440,000, produces a maximum credit under the Section 2011(b) rate schedule of $10,000.

The Computation #2 Amount is $225,000, determined as follows: Adding the adjusted taxable gift amount of $1.5 million to the $500,000 taxable estate amount, produces a tax base of $2 million, and a tentative tax under Section 2001(b)(1)(A) of $780,800. Section 2001(b)(1)(B) effectively allows a credit for the gift tax of $210,000 so that the estate tax imposed under Section 2001 for purposes of the Computation #2 Amount will be $570,800, which is then reduced by the credit allowed under Section 2010 of $345,800.

Because the Computation #1 Amount ($10,000) is smaller than the Computation #2 Amount ($225,000), the Computation #1 Amount of $10,000 is the maximum credit allowable under Section 2011. As a result, the New York estate tax imposed under Tax Law § 952(a) will be $10,000.

C. Relationship Between New York Estate Tax and Federal Estate Tax Systems Starting in 2005

The last example involves a situation where federal estate tax will be payable. The amount of federal estate tax payable must take into account two significant factors. First, a deduction under Section 2058 will be allowed for the amount of New York estate tax of $10,000.

As a result, the taxable estate will be $490,000.[8] Thus, the tax imposed under Section 2001 to determine the actual federal estate tax payable is $566,300.[9] The second factor in determining the federal estate tax payable is to use the actual credit allowed under Section 2010 in 2005, which is $555,800, rather than the "pretend" credit of $345,800, which we use to determine the Computation #2 Amount. Accordingly,

the actual federal estate tax payable will be $10,500. And, taking into account the gift tax of $210,000, and the $10,000 of New York estate tax, the total federal transfer taxes and New York estate taxes will be $230,500.[10]

II. Lifetime Planning Strategies to Reduce the New York Estate Tax

A. In General

Based on the operation of the New York estate tax system and the interrelationship between the New York estate tax system and the federal transfer tax system, I believe that it is fair to say that, all things being equal,[11] the making of qualified lifetime transfers can reduce the New York estate tax that otherwise would be payable.[12] By qualified lifetime transfers, I mean lifetime transfers that are not included in the gross estate—for example, by a pullback provision such as Section 2036 or 2038.[13] In effect, the client must be willing to give up enough dominion and control to make a completed gift for gift tax purposes, thereby avoiding gross estate inclusion.[14]

Because the making of qualified lifetime transfers can reduce New York estate taxes, an additional incentive exists for clients to make qualified lifetime transfers. Indeed, the established benefits of freezing estate tax value by making qualified lifetime transfers will be increased because the federal taxable estate base upon which the New York estate tax depends will be lowered.

I want to focus my attention on one fertile area where qualified lifetime transfers can reduce New York estate taxes: the making of qualified lifetime transfers close to death (deathbed transfers). Although qualified lifetime transfers whenever made can reduce New York estate taxes, many clients will be unwilling to make non-deathbed qualified lifetime transfers because dominion and control must be relinquished. Often, a client will say: "Let them wait until I die."

When a client is close to death, he or she may be more willing to make qualified lifetime transfers, especially when advised of the many tax benefits, including the ability to reduce the impact of New York estate taxes. Unfortunately, many clients close to death will not have the capacity to make qualified lifetime transfers. As a result, it is indispensable for clients to have durable powers of attorney for property with appropriate gift-making, including trust creation, authority. Indeed, if an existing client has executed a New York statutory short form durable general power of attorney without specific gift-making authority, only annual gifts of $10,000 to certain family members can be made. Of course, the agent–in-fact should be advised of the significant benefits of qualified lifetime transfers. For revocable trusts, it may be appropriate to include trust distribution powers, although the same result could be accomplished if the trust creator obtained the trust property and then gifted it.

One important point: The deathbed transfer need not be an outright gift. Instead, the transfer can be in trust or otherwise, with the result that the qualified lifetime transfer can replicate the will disposition that it replaces.

B. Rules of Thumb

I've tried to come up with some rules of thumb. There may be others. One day, if that day has not already come, a software program might be developed to help in the process.

Note on Examples: The rules of thumb are illustrated by examples. Each example is based on the decedent dying in 2005. The results will vary if death occurrs thereafter because the federal exemption is scheduled to increase to $2 million in 2006–2008.

> **RULE OF THUMB #1: THE MOST ATTRACTIVE QUALIFIED LIFETIME TRANSFERS WILL BE THOSE GIFTS THAT DO NOT CONSTITUTE TAXABLE GIFTS.**

Here I have in mind the premier qualified lifetime transfer device: the gift tax annual exclusion. By making deathbed annual exclusion gifts, the taxable estate will be reduced and hence the New York estate tax.

> **Example:** D is on her deathbed and otherwise will have a taxable estate of $1,511,000. Decedent made no adjusted taxable gifts. If nothing is done, New York estate tax of $65,104 will be payable.
>
> D herself, or through her agent with appropriate gift-making powers, gifts $11,000 to a donee-will beneficiary. As a result of the annual exclusion gift, the taxable estate will be reduced to $1.5 million and $64,400 in New York estate taxes will be payable. $704 in New York estate taxes was saved.

Not impressed? How about making 10 deathbed annual exclusion gifts? Now the savings will be over $7,000.

Of course, the beauty of the deathbed annual exclusion gift is that it is not a taxable gift, so the

frozen federal $1 million gift tax exemption is not reduced. *See* Rule of Thumb #2.

Qualified lifetime transfers may also be in the form of certain transfers for educational expenses or medical expenses under Section 2503(e). Such transfers, like annual exclusion gifts, will not constitute taxable gifts.

A transfer to a spouse that qualifies for the gift tax marital deduction under Section 2523 is another type of qualified lifetime transfer that will not constitute a taxable gift. Indeed, by making qualified lifetime transfers to the donee-spouse it may be possible to completely eliminate the New York estate tax on the decedent-spouse's estate.[15]

> **Example:** D is on her deathbed and otherwise will have a taxable estate of $1,511,000. D made no adjusted taxable gifts. If nothing is done, New York estate tax of $65,104 will be payable.
>
> D herself, or through her agent with appropriate gift-making powers, gifts $511,000 to the donee-spouse outright, thereby reducing D's taxable estate to $1 million. Because there were no adjusted taxable gifts, the Computation #2 Amount will be zero and no New York estate tax will be payable.

Lifetime transfers that qualify for the gift tax marital deduction can ensure that the New York estate tax is reduced or eliminated. Although the same result could be reached by planning and drafting for the estate tax marital deduction, the result will fail if the spouse predeceases the decedent.[16]

Qualified lifetime charitable transfers can also be used to reduce or eliminate New York estate taxes.

> **RULE OF THUMB #2: QUALIFIED LIFETIME TRANSFERS THAT CONSTITUTE TAXABLE GIFTS SHOULD BE MADE UP TO THE $1 MILLION GIFT TAX EXEMPTION LEVEL.**[17]
>
> **Example:** D is on her deathbed and otherwise will have a taxable estate of $1.5 million. Decedent made no adjusted taxable gifts. If nothing is done, New York estate tax of $64,400 will be payable.
>
> D herself, or through her agent with appropriate gift-making powers, gifts to a donee-will beneficiary $1 million, having previously made an annual exclusion gift to the donee of $11,000. No federal gift tax will be payable. Result: By reducing the decedent's taxable estate to $500,000, New York estate tax of $10,000 will be payable based on an adjusted taxable estate of $440,000, saving $54,400 in New York estate taxes.
>
> **Caveat:** Had the decedent made a taxable gift in excess of $1 million, federal gift tax would have been payable and the federal gift tax, which would be at the 41% bracket, would more than offset the reduction in New York estate tax, which at the highest would have been at the 3.2% bracket.
>
> **Example:** D is on her deathbed and otherwise will have a taxable estate of $2 million. Decedent made no adjusted taxable gifts. If nothing is done, New York estate tax of $99,600 will be payable along with a federal estate tax of $180,180. Total death taxes will be $279,780.
>
> D herself, or through her agent with appropriate gift-making powers, gifts $1 million to donee-will beneficiary, having previously made an annual exclusion gift to the donee of $11,000. No federal gift tax will be payable. Result: By reducing the decedent's taxable estate to $1 million, New York estate tax of $33,200 will be payable based on an adjusted taxable estate of $940,000, with a savings of $66,400 in New York estate taxes. With an Internal Revenue Code Section 2058 deduction of $33,200, the federal estate tax payable will be $210,060, based on a federal taxable estate of $1,966,800. The combined federal and New York estate taxes would be $243,260, with a net savings in death taxes of $36,520.
>
> **RULE OF THUMB #3: QUALIFIED LIFETIME TRANSFERS THAT CONSTITUTE TAXABLE GIFTS AND EXCEED THE $1 MILLION GIFT TAX EXEMPTION LEVEL MAY BE APPROPRIATE IN CERTAIN CASES EVEN THOUGH**

FEDERAL GIFT TAX IS PAYABLE AND THE GIFT TAX IS INCLUDED IN THE GROSS ESTATE.

Will it ever make sense to make a taxable gift that causes federal gift tax to be paid? The answer is yes. Consider how overall taxes can be reduced by comparing the making of deathbed transfers of a taxable gift of $1 million, which resulted in an overall tax savings of $36,520, with the making of a taxable gift of $1.5 million, where almost $50,000 in overall taxes can be saved.

> **Example:** D is on her deathbed and otherwise will have a taxable estate of $2 million. D made no adjusted taxable gifts. If nothing is done, New York estate tax of $99,600 will be payable along with a federal estate tax of $180,180. Total death taxes will be $279,780.
>
> D herself, or through her agent with appropriate gift-making powers, gifts $1.5 million to donee-will beneficiary, having previously made an annual exclusion gift to donee of $11,000. Result: By reducing the decedent's taxable estate to $500,000, New York estate tax of $10,000 will be payable based on an adjusted taxable estate of $440,000, with a savings of $89,600 in New York estate taxes. However, federal gift tax of $210,000 will be payable.
>
> When D dies, the gross estate will include the gift tax of $210,000, so that the taxable estate, taking into account the Internal Revenue Code Section 2058 deduction of $10,000, will be $490,000. The federal estate tax will be calculated on a tentative tax base of $1,990,000 (an adjusted taxable gift of $1,500,000, plus the taxable estate of $490,000), producing an estate tax imposed of $566,300 (after subtracting the gift tax paid of $210,000) from which the Section 2010 credit of $555,800 is subtracted, leaving an estate tax payable of $10,500. The combined federal transfer taxes and New York estate taxes would be $230,500, with a net savings in taxes of $49,280.
>
> **Caveat:** If the decedent made gifts that exceeded $1.5 million, then the savings in New York estate taxes would be outweighed by the increased gift tax cost. If the decedent died in 2006 when the estate tax exemption level is $2 million, then it would not have made sense to make a taxable gift above $1 million because undesirable gift tax would have been payable.

Planning Note: The overall tax savings can increase significantly with greater wealth. For example, if in 2005 a deathbed individual will have a taxable estate of $10 million before the Section 2058 deduction, an adjusted taxable gift of $6.5 million will save in the range of $440,000 in overall transfer taxes.

Based on the foregoing, another rule of thumb is that qualified lifetime gifts on deathbed that generate gift taxes are attractive from a transfer tax perspective, but only if there still would be federal estate tax payable (or ideally, no estate tax would be payable, but the Section 2010 credit was fully used). Applying this rule of thumb may not be easy due to many variables, such as determining the precise value for the projected estate, or predicting the year of death or how and when the federal estate tax system might change. Until the federal estate tax uncertainty is resolved, it will be highly risky for healthy individuals to make qualified lifetime gifts that generate significant gift tax because no estate tax may ultimately be payable.

RULE OF THUMB #4: IN SOME CASES, NEW YORK ESTATE TAXES MAY BE ELIMINATED BY THE MAKING OF QUALIFIED LIFETIME TRANSFERS, BUT THE PRICE TO PAY FOR ELIMINATING NEW YORK ESTATE TAXES MAY OUTWEIGH THE BENEFIT.

Qualified lifetime transfers can also eliminate New York estate taxes. We've already seen one example—the marital deduction—in combination with the gift tax annual exclusion to reduce the taxable estate to $1 million without making adjusted taxable gifts. *See* discussion under Rule of Thumb #1. Here's another example involving just deathbed annual exclusion gifts.

> **Example:** D, on her deathbed, would have had a taxable estate of $1,050,000 but for the making of 5 annual exclusion gifts totaling $50,000. Because D's taxable estate will be reduced to $1 million (and assuming D had made no taxable gifts that would be adjusted taxable gifts), no New York estate tax would

> be payable because the Computation #2 Amount would be zero.

As the above example illustrates, New York estate tax can be eliminated if the Computation #2 Amount is zero. In many estates, it will not be possible to produce a Computation #2 Amount of zero by making a qualified lifetime transfer because the gift, or a least a significant portion, will be an adjusted taxable gift.

> **Example:** D is on her deathbed and otherwise will have a taxable estate of $1.5 million. D made no adjusted taxable gifts. If nothing is done, New York estate tax of $64,400 will be payable.
>
> D herself, or through her agent with appropriate gift-making powers, gifts to a donee-will beneficiary $500,000, having previously made an annual exclusion gift to the donee of $11,000. No federal gift tax will be payable.
>
> Because the gift will be an adjusted taxable gift, the tax base will still be $1.5 million, so that the Computation #2 Amount will be $210,000. Hence the Computation #1 Amount of $33,200 will be smaller, and New York estate tax of $33,200 will be payable based on an adjusted taxable estate of $940,000.

The New York estate tax can also be eliminated if the Computation #1 Amount is zero. This will result if the taxable estate is reduced to $100,000 or below since there is no credit allowable under Section 2011(b) on an adjusted taxable estate of $40,000.

> **Example:** Consider a deathbed individual who would otherwise have a federal estate of $1,100,000 who had utilized the gift tax annual exclusion for the donee-will beneficiary. If a taxable gift of $1 million is made to the donee, the decedent's taxable estate will be $100,000. As a result, the Computation #1 Amount would be zero and no New York estate tax will be payable.

Realistically, in most estates it will not make sense to reduce the federal taxable estate to $100,000 or below $100,000, even if such reduction is possible.[18] The reason is that unnecessary federal gift tax will need to be incurred and the gift tax liability will more than outweigh the elimination of the New York estate tax.

> **RULE OF THUMB #5: QUALIFIED LIFETIME TRANSFERS WILL RESULT IN CARRYOVER OF BASIS, BUT THE POTENTIAL INCOME TAX COST MIGHT BE AVOIDED.**

The potential downside of deathbed transfers is that the carryover basis rules of Section 1015 will apply, with the loss of basis step-up under Section 1014 had the property been subject to estate taxation. As a result, the donee could be saddled with a capital gains tax on disposition. Consider an example involving a highly appreciated asset: A deathbed client would be willing to gift Securities A that had a basis of $1,000 and a fair market value of $11,000. On immediate sale, the donee would have a $10,000 gain with federal and New York state capital gains tax exposure. These income taxes could far outweigh the reduction in New York estate tax, especially in the smaller estates.

Consider the borrowing technique (and assume a gift will be made by an agent under a durable power but no gift tax liability will be incurred) as explained in Fox IV, Pomeroy, and Abbott, *Ramification for Estate Planners of the Phase-Out of the Federal State Death Tax Credit: Boom, Bust or Unknown?*, 29 ACTEC Journal 26, 35 (2003):

> [T]he attorney-in-fact might be able to use the donor's assets as collateral for a loan, the proceeds of which would then be given away. As soon as the donor died, the collateral could be sold without significant capital gain and the loan repaid.

In effect, the appreciated property will be included in the gross estate with a stepped-up basis, however, the debt will be deductible under Section 2053.

If the gift generates gift taxation, this should not be problematic. As explained in Fox IV, Pomeroy, and Abbott, *Ramification for Estate Planners of the Phase-Out of the Federal State Death Tax Credit: Boom, Bust or Unknown?*, 29 ACTEC Journal 26, 35 (2003):

> In addition, a gift tax would ultimately be due. However, in most cases, the tax would not likely be due until after the donor had passed away, at which point assets could be sold, presumably without significant gains tax consequences, to generate the funds to pay the gift tax liability.

Although the gift tax will be included in the taxable estate under Section 2035(b), the gift tax liability will be deductible under Section 2053, thus offsetting the inclusion of the asset in the gross estate, which will receive a stepped-up basis under Section 1014.

> **Caveat:** Unless the qualified lifetime transfer is to a donee-spouse, property that has an adjusted basis in excess of its fair market value should be sold, not gifted.

III. Conclusion

The making of qualified lifetime transfers can reduce, and in some instances eliminate, New York estate taxes. Caution should be exercised to ensure that the benefits of New York estate reduction or elimination are not outweighed by other circumstances. In the final analysis, each case should be separately evaluated. But for many decedents and their beneficiaries, the making of deathbed qualified lifetime transfers will make sense and should be encouraged.

Endnotes

1. The discussion may also apply to lifetime transfers generally and to estates of non-resident decedents.
2. Tax Law § 952(b), as amended in 2004 and retroactive to January 1, 2002, provides for a reduction in the New York estate tax for New York resident decedents who owned real or tangible personal property having an actual situs outside of New York.
3. Tax Law § 951. Applicable internal revenue code provisions

   (a) Dates. For purposes of this article, any reference to the internal revenue code means the United States Internal Revenue Code of 1986, with all amendments enacted on or before July twenty-second, nineteen hundred ninety-eight, and, unless specifically provided otherwise in this article, any reference to December thirty-first, nineteen hundred seventy-six or January first, nineteen hundred seventy-seven contained in the provisions of such code which are applicable to the determination of the tax imposed by this article shall be read as a reference to June thirtieth, nineteen hundred seventy-eight or July first, nineteen hundred seventy-eight, respectively. Notwithstanding the foregoing, the unified credit against the estate tax provided in section two thousand ten of the internal revenue code shall, for purposes of this article, be the amount allowed by such section under the applicable federal law in effect on the decedent's date of death. Provided, however, the amount of such credit allowable for purposes of this article shall not exceed the amount allowable as if the federal unified credit did not exceed the tax due under section two thousand one of the internal revenue code on a federal taxable estate of one million dollars.
4. Sec. 2011. Credit for State death taxes

   (a) In general. The tax imposed by Section 2001 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia, in respect of any property included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent).

   (b) Amount of credit. The credit allowed by this section shall not exceed the appropriate amount stated in the following table:

If the adjusted taxable estate is:	The maximum tax credit shall be:
Not over $90,000.	8/10ths of 1% of the amount by which the adjusted taxable estate exceeds $40,000.
Over $90,000 but not over $140,000.	$400 plus 1.6% of the excess over $90,000.
Over $140,000 but not over $240,000.	$1,200 plus 2.4% of the excess over $140,000.
Over $240,000 but not over $440,000.	$3,600 plus 3.2% of the excess over $240,000.
Over $440,000 but not over $640,000.	$10,000 plus 4% of the excess over $440,000.
Over $640,000 but not over $840,000.	$18,000 plus 4.8% of the excess over $640,000.
Over $840,000 but not over $1,040,000.	$27,600 plus 5.6% of the excess over $840,000.
Over $1,040,000 but not over $1,540,000.	$38,800 plus 6.4% of the excess over $1,040,000.
Over $1,540,000 but not over $2,040,000.	$70,800 plus 7.2% of the excess over $1,540,000.
Over $2,040,000 but not over $2,540,000.	$106,800 plus8% of the excess over $2,040,000.
Over $2,540,000 but not over $3,040,000.	$146,800 plus 8.8% of the excess over $2,540,000.
Over $3,040,000 but not over $3,540,000.	$190,800 plus 9.6% of the excess over $3,040,000.
Over $3,540,000 but not over $4,040,000.	$238,800 plus 10.4% of the excess over $3,540,000.
Over $4,040,000 but not over $5,040,000.	$290,800 plus 11.2% of the excess over $4,040,000.
Over $5,040,000 but not over $6,040,000.	$402,800 plus 12% of the excess over $5,040,000.
Over $6,040,000 but not over $7,040,000.	$522,800 plus 12.8% of the excess over $6,040,000.
Over $7,040,000 but not over $8,040,000.	$650,800 plus 13.6% of the excess over $7,040,000.
Over $8,040,000 but not over $9,040,000.	$786,800 plus 14.4% of the excess over $8,040,000.
Over $9,040,000 but not over $10,040,000.	$930,800 plus 15.2% of the excess over $9,040,000.
Over $10,040,000.	$1,082,800 plus 16% of the excess over $10,040,000.

   For purposes of this section, the term "adjusted taxable estate" means the taxable estate reduced by $60,000.

   (f) Limitation based on amount of tax. The credit provided by this section shall not exceed the amount of the tax imposed by Section 2001, reduced by the amount of the unified credit provided by Section 2010.
5. Sec. 2001. Imposition and rate of tax

   (a) Imposition. A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

   (b) Computation of tax. The tax imposed by this section shall be the amount equal to the excess (if any) of—

   (1) a tentative tax computed under subsection (c) on the sum of—

(A) the amount of the taxable estate, and

(B) the amount of the adjusted taxable gifts, over

(2) the aggregate amount of tax which would have been payable under chapter 12 with respect to gifts made by the decedent after December 31, 1976, if the provisions of subsection (c) (as in effect at the decedent's death) had been applicable at the time of such gifts.

For purposes of paragraph (1)(B), the term "adjusted taxable gifts" means the total amount of the taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.

(c) Rate schedule

(1) In general

If the amount with respect to which the tentative tax to be computed is:	**The tentative tax is:**
Not over $10,000.	18 percent of such amount.
Over $10,000 but not over $20,000.	$1,800, plus 20 percent of the excess of such amount over $10,000.
Over $20,000 but not over $40,000.	$3,800, plus 22 percent of the excess of such amount over $20,000.
Over $40,000 but not over $60,000.	$8,200, plus 24 percent of the excess of such amount over $40,000.
Over $60,000 but not over $80,000.	$13,000, plus 26 percent of the excess of such amount over $60,000.
Over $80,000 but not over $100,000.	$18,200, plus 28 percent of the excess of such amount over $80,000.
Over $100,000 but not over $150,000.	$23,800, plus 30 percent of the excess of such amount over $100,000.
Over $150,000 but not over $250,000.	$38,800, plus 32 percent of the excess of such amount over $150,000.
Over $250,000 but not over $500,000.	$70,800, plus 34 percent of the excess of such amount over $250,000.
Over $500,000 but not over $750,000.	$155,800, plus 37 percent of the excess of such amount over $500,000.
Over $750,000 but not over $1,000,000.	$248,300, plus 39 percent of the excess of such amount over $750,000.
Over $1,000,000 but not over $1,250,000.	$345,800 plus 41 percent of the excess of such amount over $1,000,000.
Over $1,250,000 but not over $1,500,000.	$448,300, plus 43 percent of the excess of such amount over $1,250,000.
Over $1,500,000 but not over $2,000,000.	$555,800, plus 45 percent of the excess of such amount over $1,500,000.
Over $2,000,000 but not over $2,500,000.	$780,800, plus 49 percent of the excess of such amount over $2,000,000.
Over $2,500,000 but not over $3,000.000.	$1,025,800, plus 53% of the excess over $2,500,000.
Over $3,000,000.	$1,290,800, plus 55% of the excess over $3,000,000.

(2) Phaseout of graduated rates and unified credit. The tentative tax determined under paragraph (1) shall be increased by an amount equal to 5 percent of so much of the amount (with respect to which the tentative tax is to be computed) as exceeds $10,000,000 but does not exceed the amount at which the average tax rate under this section is 55 percent.

Note: The rate reduction changes made by the 2001 Tax Act are not taken into account. Also, currently effective Section 2001 does not impose the surcharge that existed on June 22,1998 under Section 2001(c)(2), as set forth above.

Sec. 2010. Unified credit against estate tax

(a) General rule. A credit of the applicable credit amount shall be allowed to the estate of every decedent against the tax imposed by Section 2001.

(b) Adjustment to credit for certain gifts made before 1977. The amount of the credit allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under Section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976.

(c) Applicable credit amount. For purposes of this section, the applicable credit amount is the amount of the tentative tax which would be determined under the rate schedule set forth in Section 2001(c) if the amount with respect to which such tentative tax is to be computed where the applicable exclusion is $1,000,000.

(d) Limitation based on amount of tax. The amount of the credit allowed by subsection (a) shall not exceed the amount of the tax imposed by Section 2001.

6. Fortunately, New York has relied on the federal gift tax system to determine the amount of the taxable gift, which in turn will be an adjusted taxable gift if the taxable gift was made after 1976 and the gift was not included in the federal gross estate. *See* Form ET-706, Sch A, Line 27. In effect, New York should recognize the currently effective gift tax annual exclusion amount of $11,000, even though the gift tax annual exclusion amount was $10,000 in 1998. As a result, the $1,000 differential should not be treated as a taxable gift, nor as an adjusted taxable gift.

7. In my paper, "Trust Drafting Considerations for the New York Lawyer: Selected Aspects," delivered at the Trusts and Estates Law Section Annual Meeting on Wednesday, January 26, 2005, I erroneously stated that, because the New York estate tax system does not take into account adjusted taxable gifts, no New York estate tax will be imposed if the federal taxable estate was reduced to $1 million when adjusted taxable gifts are present. The correct analysis is that adjusted taxable gifts are not taken into account to determine the Computation #1 Amount but are taken into account to determine the Computation #2 Amount. As a result, New York estate tax will be imposed even if the federal taxable estate is $1 million where the decedent made adjusted taxable gifts. However, no New York estate tax will be imposed if the sum of the federal taxable estate and the adjusted taxable gifts is $1 million or less. Nor will New York estate tax be imposed if the federal taxable estate is $1 million or less and no adjusted taxable gifts were made. And, in limited cases, no New York estate tax will be imposed based on the Computation #1 Amount if the taxable estate is reduced to $100,000 or less, even though the Computation #2 Amount, taking into account adjusted taxable gifts, is a positive amount. See discussion under Rule of Thumb #4.

8. In the example, the taxable estate was $500,000 for Computation #1 and #2 Amount purposes. The $10,000 difference arises because no Section 2058 deduction was allowed under the Internal Revenue Code as of July 22, 1998, the relevant Code date for Computation #1 and #2 Amount purposes.

9. New York has recognized the current federal $1 million gift tax exemption to compute the gift tax payable amount. See Form ET-706, Line 30 Worksheet, Column e.

10. If the decedent had not made a taxable gift of $1.5 million, and incurred a gift tax liability of $210,000 thereon, the total federal and New York estate taxes would have been $279,780. See discussion under Rule of Thumb #3.

11. Let me suggest how all things may not be equal. If the gifted property declines in value, then it may have been better not to have made the gift. For example, consider the making of a taxable gift of $500,000 that would reduce the eventual taxable estate to $1 million. If the gift had not been made, the federal taxable estate would still be $1 million if the property was worthless at the decedent's death and no New York estate tax would be payable because the Computation #2 Amount would be zero. Unfortunately, the worthless gift will still be an adjusted taxable gift of $500,000 so that New York estate tax of $64,400 would be payable.

    Even if the New York estate tax will be reduced by gifting, the capital gains problem caused by carryover basis may outweigh the benefits of reducing the New York estate tax. See Rule of Thumb #5.

12. Although the following discussion assumes that the decedent was a New York resident with only New York situs property, qualified lifetime transfers can also reduce or even eliminate the New York estate tax for New York residents who own real and tangible personal property with a situs outside New York. Qualified lifetime transfers can also reduce or even eliminate the New York estate tax for non-resident decedents who own real property and tangible personal property with a New York situs.

13. Such non-qualifying transfers cannot reduce the federal taxable estate because the entire property interest transferred will be included in the federal gross estate. Some benefit may be obtained by lifetime transfers where less than the entire property interest is included in the gross estate, but such transfers will be unusual.

14. The gift tax on qualified lifetime transfers will be included in the gross estate under Section 2035(b) if the gift is made within three years of the decedent's death.

15. Of course, the price to pay for the marital deduction is that property can be subject to transfer taxation at the donee-spouse's level. Indeed, in some estates, it may make sense to forgo the reduction or elimination of New York estate taxes because the benefits will be outweighed by much higher taxes at the donee-spouse's level.

16. Some have argued that the best of all worlds can be realized by obtaining relief under Rev. Proc. 2001-38, 2001-1 C.B. 1335 (procedure to have unnecessary QTIP election under Section 2056(b)(7) treated as nullity). *See, e.g.*, Gans and Blattmachr, *Estate Tax Decoupling*, N.Y.L.J., June 25, 2004, p. 4. Assuming one is comfortable with the risk that the donee-spouse will survive and that relief under Rev. Proc. 2001-38 will be granted (*cf*. Fox IV, Pomeroy, and Abbott, *Ramification for Estate Planners of the Phase-Out of the Federal State Death Tax Credit: Boom, Bust or Unknown?*, 29 ACTEC Journal 26, 33 (2003) (raising questions)), then a marital deduction for gift tax purposes would not be recommended. It is also possible that New York could enact favorable legislation that might not apply to lifetime QTIP dispositions. *See* A.9728 (amending Tax Law § 952(a), pending before Assembly Ways and Means).

17. Qualified lifetime transfers that constitute taxable gifts may also be used in conjunction with qualified lifetime transfers that do not constitute taxable gifts, most notably, deathbed annual exclusion gifts.

18. If a gift tax will be payable, and the donor dies within three years of the gift, the gift tax will be included in the gross estate, which will increase the taxable estate base.

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The New York State Estate Tax on Estates of Non-Resident Decedents: The Final Chapter

By Edward A. McCoyd

I. New York State Adopts (and Quickly Abandons) the "Sop Tax"

1. New York Joins the Crowd

After years of taxing estates at rates ranging from 2% to as high as 21%, New York adopted a so-called "Sop Tax" system in 1997, in part to stem the flow of retired New Yorkers to states such as Florida where more favorable temperatures and tax systems could be had. The legislation passed in 1997 provided that, commencing with decedents dying on or after February 1, 2000, New York would impose estate taxes no higher than the amount available as a credit against a decedent's federal estate tax, thus reducing its maximum estate tax rate to 16% and eliminating taxes entirely on smaller estates.

2. New York "Walks" After a Federal "Double Cross"

When the federal government decided in 2001 to exempt increasingly larger estates from federal estate taxation, but to reduce the credit it would allow against the federal estate tax for estate taxes paid to the states, New York, by then facing a new budget crunch, decided that it had gone far enough in reducing its estate tax and refused to exempt estates larger than $1 million dollars from the tax. It also decided to assess estates of its resident decedents with taxable assets in excess of $1 million with the full amount which had previously been allowed as a credit by the federal government for state death taxes paid by those estates. This "decoupling" began to take effect with the estates of decedents dying on or after January 1, 2002.

II. New York and the Non-Resident Decedent

1. You Don't Have to Be a New Yorker to Pay Taxes

Under the 1997 New York legislation, the tax on non-resident decedent's estates was also to be determined with reference to the available state death tax credit. Here, however, since the tax was to be assessed only with respect to real and tangible personal property having a situs in the State of New York, the tax would presumptively be equal to the pro rata share of the non-resident decedent's total gross estate that was represented by the decedent's New York realty and tangible personalty.

2. Tax Simplification, New York Style

To accomplish this, Section 960 of the New York Tax Law took a rather roundabout approach to calculating the tax on the estate of a non-resident decedent. It provided that the tax would be the same as the tax assessed on a resident decedent's estate (determined under Section 952 of the Tax Law by subtracting the portion of the available estate death tax credit attributable to non-New York realty and tangible personalty from the total available credit), except that the decedent's intangible personalty would in effect be treated as non-New York realty or tangible personalty in making this calculation. Then, for some reason, an alternate method of determining the New York estate tax was incorporated into Section 952 (and, by reference, into Section 960). The alternate method was to subtract from the maximum allowable state death tax credit only so much of the credit as was owed to another state by the decedent's estate.

3. The "Stealth" Provision

In providing these alternate methods of calculating the New York estate tax, Section 952 provided that the tax would be equal to the *greater* of the two alternatives. Therefore, *New York would collect at least its proportionate share of the available state death tax credit from its resident decedents, and, if another state in which realty or tangible personalty was located did not collect its proportionate share of the credit, New York would take that as well.* The constitutional basis for, in effect, assessing taxes on property over which New York had no jurisdiction was questionable, but as a practical matter (at least judging by the lack of publicity about such problems)[1] there seems to have been few problems generated by the language of Section 952 with respect to the estates of resident decedents, presumably because the Internal Revenue Service was not questioning what appeared to be unremarkable claims to state death tax credits on the federal estate tax returns filed by these estates.

III. But What's This? Grotesquely Excessive Assessments of Tax on Non-Resident Estates Puzzle the Profession

1. If You're Not Using That Credit, I'll Take It

In 2003, after the new provisions had taken effect, a curious situation began to develop in some non-resident estates. Articles started appearing in various publications commenting on what appeared to be an emerging nightmare for the estates of non-residents, which were finding themselves in situations where the Department of Taxation and Finance was demanding New York estate taxes that in some cases exceeded the value of the New York assets, but where the eligibility of these taxes for the state death tax credit on the estate's federal return was at best questionable. Some of these articles suggested planning strategies for non-resident clients with New York assets. One suggested litigation tactics for estates of decedents already facing such assessments. Another pointed to a line of United States Supreme Court decisions indicating that New York's new method of assessing tax on non-resident estates was unconstitutional, and predicted that the Department of Taxation and Finance would eventually surrender to estates challenging these assessments:

(a) In an article entitled "The Application of the New York Estate Tax to Nonresidents of New York State," by Lee A. Snow, that appeared in the Summer 2003 issue of this *Newsletter*, an example was given of an estate of an Arizona resident in which the New York State estate tax would equal 31% of the value of the decedent's New York assets—a percentage far in excess of the maximum state death tax credit (16%). A second example in the same article suggested that a New York tax of 150% of the value of the New York assets would be possible in such an estate. The author mentioned that in discussions with estate tax attorneys in Albany, he was advised that the Department of Taxation and Finance felt bound to a literal application of the language of Section 960 of the Tax Law (i.e., we'll take it [the credit] if no one else does), notwithstanding the apparently unfair (or perhaps unconstitutional) assessments it could generate.

(b) In another article in the Fall 2003 issue of this *Newsletter*, Jocelyn D. Margolin noted that the situation would get worse after 2001, when the federal government would stop allowing a full state death tax credit but New York would still collect tax equal to the credit even if other states did not. She suggested various methods for non-residents to turn their New York realty and tangible personalty into an intangible asset not subject to New York tax (e.g., transfer to a LLC), or even getting rid of the property altogether, but these of course worked only if the decedent had not already become a decedent.

(c) Finally, in the Winter 2003 issue of this *Newsletter*, in an article entitled "The New York Non-Resident Estate Tax: A Tax That Can Be Less Than It Seems to Be," Mal L. Barasch and Kara B. Schissler wrote of a "recent unreported case" in which the Department of Taxation and Finance had attempted to assess over $400,000 in New York estate taxes on approximately $50,000 of New York property, but later relented and assessed a tax of about $3,000 against the non-resident estate. The Barasch/Schissler article analyzed the situation that led to the reversal of the state's position, describing several United States Supreme Court holdings that a state has no power to tax the transfer of a non-resident decedent's property over which it has no jurisdiction. These decisions also prohibited states from assessing indirectly taxes that they are constitutionally prohibited from assessing directly. The article also mentioned Revenue Ruling 56-230 (1956-1 CB 660) in which the Internal Revenue Service determined that any estate taxes assessed by a state in violation of these constitutional prohibitions would not qualify for the state death tax credit in determining the estate's federal estate tax liability.

2. What Do New York, Alabama and Mississippi Have in Common?

In the meantime, the New York State situation began to attract national attention:

(a) In the Summer 2003 issue of "ACTEC Notes" (The quarterly publication of the American College of Trust and Estate Counsel), in referring to "an almost comical situation" developing in Alabama and Mississippi, whose current statutes would take a decedent's entire estate for the state's estate tax if their laws are not changed by 2005, the authors of an article on the phaseout of the state death tax credit under EGTRRA mentioned that "other states, such as New York, could impose a tax larger than the value of property in New York on non-residents because of the formulas used to apportion tax between the state of residence and New York."[2]

(b) Course materials for a nationwide American Bankers Association teleconference presented by the Illinois office of Schiff Haradin LLP on February 5, 2004 on the ramifications of the state death tax credit phaseout also made reference to the problem, but indicated that the New York State Department of Taxation and Finance had decided to relent and limit its assessments on non-residents' estates to the proportionate share of the state death tax credit attributable to the New York realty and tangible personalty.

3. State Tax Passes the Buck

Although such a change of position was clearly contemplated, and perhaps tentatively decided upon in the Department of Taxation and Finance, the staff members eventually decided that it was up to the legislature, and not to them, to make such a decision.

IV. Expatriates Beware!

1. The Department of Taxation and Finance Finds its "Dream" Non-Resident Estate

In the estates of U.S. citizens domiciled abroad, it is often the case that little or no estate tax is imposed by any of the 50 states, thus leading to the possibility that New York will interpret its statute to permit it to assess taxes equal to all or virtually all of the available state death tax credit should it find any realty or tangible personalty owned by the decedent within its borders.

2. Closing the Budget Deficit in One Easy Lesson

In one case, New York assessed $93,468.97 in New York estate tax on $855.00 of New York tangible personalty owned by a decedent domiciled in China at the time of his death, an effective tax rate of 10,932%! This assessment was protested, and the protest was "under review" in Albany for over two years.

V. The Governor Steps In

1. Good News and Bad News

In his 2004 Budget Bill, Governor Pataki proposed an amendment to Sections 952 and 960 of the Tax Law[3] that would solve the problem by eliminating the language of Section 952 that allowed New York to collect any portion of the available state death tax credit that was not being claimed by another state. Unfortunately, perhaps due to confusion caused by the decoupling of New York State's estate tax system and the federal system after 2001 due to the passage of EGTRRA, the governor's bill would apply only to estates of decedents dying on or after January 1, 2002, thus leaving the estates of decedent's dying between February 1, 2000 (the initial effective date of New York's Sop Tax) and December 31, 2001 "out in the cold."

2. Senator Hannon to the Rescue

Long Island's Senator Kemp Hannon, having learned of the effective date problem, then introduced his own bill (Senate 7048) on April 19, 2004. This bill provided for the same modifications to Sections 952 and 960 as the governor's bill, but made them effective with respect to the estates of decedents dying on and after February 1, 2000, thus providing relief to all affected estates.

VI. The Final Chapter

On August 20, 2004, Governor Pataki signed into law the Budget Bill containing amendments to Sections 952 and 960 of the Tax Law. These changes, which are contained in Part I, Sections 3, 4 and 5 of Chapter 60 of laws of 2004, correct the problem, but only for the estates of decedents dying on or after January 1, 2002. The estates of both resident and non-resident decedents who died between February 1, 2000 and December 31, 2001 are still potentially subject to unconstitutional estate taxation of property over which New York State has no jurisdiction.

The failure of the legislature to pass the Hannon bill, which would have corrected the problem for all affected estates, was apparently due to the concern of the Department of Taxation and Finance that it would have to make significant refunds to the estates of decedents who had died within that 23-month period. However, if the estate tax proceedings remain open in those estates, the Department has indicated that it will treat the estates as if they were covered by the new legislation, and withdraw its claims for taxes assessed under the old versions of Sections 952 and 960.[4]

The logic behind the refusal of the state to change its position with respect to the February 1, 2000 through December 31, 2001 estates whose tax proceedings were already closed was that tax payments by those estates had been fully allowed as a credit against the estates' federal estate tax liability, the federal phaseout of the State Death Tax Credit not having commenced until January 1, 2002. Although this logic seems to be the equivalent of "Why change something we've already gotten away with?", it might be more gently described as a simple "No harm, no foul" determination, or, perhaps more appropriately, "We need the money more than Washington does."

Endnotes

1. A careful reading of Sections 952 and 960 as they existed prior to February 1, 2000 indicates that similar problems could have been encountered during that era, but were less likely to have surfaced because New York's tax almost always exceeded the available state death tax credit in those years.
2. Charles D. Fox IV, Robert C. Pomeroy and Susan L. Abbott, "Ramification for Estate Planners of the Phase-Out of the Federal State Death Tax Credit: Boom, Bust or Unknown?"
3. Senate 6060-A, later renumbered S.6060-B; Assembly 9560-A, later renumbered A.9560-B.
4. The Department has been true to its word in the "China expatriate" estate (*see* IV(2), *supra*), canceling its $93,468.97 assessment and fixing the tax at $22.71.

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Alternatives to Funding Life Insurance Premiums

By Michael Markhoff

Clients who are facing an estate tax are often confused by the "alphabet soup" approach to advanced estate planning. Implementing gifting techniques such as GRATs, QPRTs, FLPs and CRUTs can be daunting and intimidating, even to the most sophisticated individuals. While they acknowledge the problem their heirs face, the only acronym which is appealing to them is KISS (keep it simple, stupid). For these individuals, life insurance continues to be the easiest and cleanest solution to paying the estate tax. The reason is that the client is not risking premature death and IRS scrutiny. Instead, the client is, in essence, prepaying the estate tax out of current assets at the cost of a life insurance premium. Unless the client self-insures (by continuing to pay premiums beyond his or her life expectancy in an aggregate amount equal to the death benefit), the client's heirs will receive a windfall, especially if the client dies prematurely.

Whether the client purchases a single life or a survivorship life insurance policy, to the extent that an irrevocable trust is the owner and beneficiary of such policy, the proceeds will pass free from estate tax to the trust beneficiaries. The trust beneficiaries may then loan the proceeds to the executor who will use this money to pay the estate tax.

The most common obstacle estate planning attorneys and financial advisors encounter when coordinating life insurance in the estate plan is determining if the premium payments fit within the "Crummey" powers in the irrevocable trust. Ordinarily, paying life insurance premiums to an irrevocable trust is considered to be a gift, since the proceeds will ultimately benefit the trust beneficiaries after the insured dies. This type of gift will exhaust a portion of the donor's $1 million lifetime exemption from gift tax. The preferable option is to qualify the premiums for the annual exclusion from gift tax, which is now $11,000 per year per donee (or $22,000 if the spouse consents to the gift). In order to do so, this gift must be of a present interest, which means that it must be enjoyed immediately. This is accomplished by giving each trust beneficiary a "Crummey" power or withdrawal power. However, permanent life insurance products such as whole life and variable life are frequently purchased to satisfy the estate tax problem, and the premiums for these products often exceed the $11,000 (or $22,000) "Crummey" withdrawal power per beneficiary.

One solution that should be considered is to fund the irrevocable trust with an asset that produces sufficient income to pay the life insurance premiums without requiring additional contributions. For example, assume H and W are married and have three adult children and no grandchildren. H owns 100% of DelBocaVista Industries, Inc., which is a plastics manufacturer. H owns the building where the business is located in his sole name. H is concerned about his ever-growing estate tax liability and decides to purchase a $3 million life insurance policy for an annual premium of $50,000. The policy will also provide income replacement for W and his children. H creates an irrevocable trust, with W and his friend X as trustees, to be the applicant, owner and beneficiary of the policy. The trust will "sprinkle" income and principal for W and W's issue, and upon the death of W the trust will be divided into shares for W's children with distribution of the trust principal in installments at ages 30 and 35. Besides permitting the life insurance proceeds to pass to the children free from estate tax, the trust is drafted as a "defective" grantor trust for income tax under § 677(a)(2) of the Internal Revenue Code. Thus during H's lifetime, to the extent there are assets in the trust subject to income tax (such as real estate or marketable securities), H will be responsible for paying that tax even though he does not receive any income or principal from the trust.

The office real estate is worth $2 million, but since it was recently refinanced, H owns only $66,000 of equity. H first transfers the office real estate to a member-managed limited liability company called Newman, LLC. H and W each own a 1% membership interest in the LLC and both also serve as the managers. H gifts the remaining 98% of the membership interests he owns to the irrevocable trust. The transfer of Newman, LLC interests is a gift for gift tax purposes, but it is only a gift of $64,680 (or less taking into account discounts for lack of marketability and minority interest), which will exhaust most of the annual exclusions from gift tax.

DelBocaVista, Inc. is the tenant and will pay Newman, LLC, as the landlord, rent each month of $20,000 (determined as fair market rent by an appraisal) pursuant to a "triple net lease" (or $240,000 per year). The rent check will be deposited into a bank account under the name of Newman, LLC. Newman, LLC will make mortgage payments totaling $140,000 per year in the aggregate. This leaves $100,000 extra in the Newman, LLC bank account.

At the end of the year, Newman, LLC will make a pro rata distribution to its members. In other words, H will receive $1,000, W will receive $1,000 and the irrevocable trust will receive $98,000. The irrevocable trust will then use the $98,000 distribution to pay the $50,000 life insurance premium on the life insurance policy owned by it. The extra $48,000 of income will stay in the trust.

All three members will receive a K-1 from Newman, LLC reflecting these distributions. H and W will obviously report each of the $1,000 distributions on their Form 1040. Since the irrevocable trust is drafted to be a defective grantor trust, H must report the $98,000 distribution on his Form 1040 as well, even though the $48,000 remains in the trust.

The advantages of this technique are that H and W have found a source to pay for the life insurance premiums without having to worry about the annual gift tax limitation previously described. The side benefit is that the real estate, which is an appreciating asset, is removed from the taxable estate. The only gift is the initial transfer of the 98% membership interest in Newman, LLC to the irrevocable trust which was covered by the annual exclusion from gift tax. Also, the $48,000 which is left over after paying the $50,000 life insurance premium, including its subsequent appreciation, will eventually pass to the children free from estate tax. Furthermore, since H is paying the income tax out of his own pocket, in effect, the $48,000 is growing income-tax free as well, similar to a qualified pension or profit-sharing plan. This is helpful estate planning in that H is reducing his taxable estate by the amount of income tax paid without that payment being considered as a gift.

By comparison, if H and W, or an LLC owned individually by them, owned the office real estate, they would receive all the rent, pay income tax on it, pay the life insurance premiums (subject to the gift tax limitation stated above) and keep the excess, which would be included in H's and W's estates. By integrating the LLC into the life insurance planning, H and W will continue to pay all of the income tax on the rent received by them or the irrevocable trust, but the life insurance premiums will be satisfied from the rental receipts, eliminating any concern over exhausting the annual gift tax limitations.

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New Zealand Revises Proposed Changes to Foreign Trust Rules

By Peter A. Cotorceanu

The New Zealand Inland Revenue Department ("IRD") recently revised its proposed new rules governing foreign trusts. If enacted, the latest proposals will be substantially less burdensome than the previous proposals. However, the consequences for violating the rules will be harsh.

Background

Under New Zealand law, a "foreign trust" is one where the settlor and all the beneficiaries are non-residents of New Zealand, regardless of the residency of the trustee. The income of a foreign trust is not subject to New Zealand tax unless it is earned inside New Zealand. This favorable tax treatment, coupled with the fact that New Zealand is not on any country's "black list" of tax havens, has been a major reason for New Zealand's popularity as an international trust jurisdiction.

Details of Revised Proposal

1. Required Disclosures

Under the revised proposal, a New Zealand-resident trustee of a foreign trust would be required to provide the following information to the IRD upon being appointed (and to update such information as the trustee becomes aware of any changes):

> The name of the trust or other identifying feature (e.g., the trust number or date of settlement);
>
> The name and contact details of the trustee(s); and
>
> The country of residence of the settlor, but only if the country is explicitly listed in the governing New Zealand law.

Gone are the requirements under the original proposal that the trustee obtain an IRD number (the application for which requires the trustee to provide a copy of the trust instrument), automatically disclose the names and addresses of the settlor and beneficiaries, and annually disclose a full set of financial accounts. Instead, the trustee is required to *maintain* financial records and details of trust distributions (including the names and addresses of the distributees) for at least seven years. However, the trustee need not *disclose* this information until requested to do so by the IRD.

If the settlor is an Australian resident, the IRD will request that the trustee disclose some or all of the additional information (e.g., the trust's financial records, details of distributions, and the identity of the settlor) and will automatically provide such information to the Australian Taxation Office. (The Australian government's concern that Australian funds were being channeled through New Zealand trusts to tax havens were a major impetus behind the new proposals.) The IRD will provide information to New Zealand's other tax-treaty partners on a case-by-case basis.

2. Penalties

As mentioned above, the penalties for violating these rules will be harsh. If a New Zealand-resident trustee fails to disclose required information, the trust will be taxed as if it were a New Zealand trust (i.e., it will be taxed on its worldwide income at a flat rate of 33%), unless the trustee exercised reasonable care in determining that the trust was not a foreign trust. In addition, trustees who fail to keep the required records or to disclose the required information will be subject to criminal prosecution.

3. Professional Trustee Requirement

The amended proposal would also require that a New Zealand-resident trustee of a foreign trust be a member of a professional body acceptable to the IRD, such as a lawyer or an accountant. (If the trustee is a company, one of the directors would have to be such a person.) This professional-trustee requirement, which was not contained in the original proposal, is designed to ensure that the trustee has the necessary expertise to maintain the required records.

Conclusion

Consultations on the amended proposal ended on December 23, 2004. It remains to be seen what form the final rules will take. Nevertheless, by toning down the automatic disclosure requirements of the initial proposal, the New Zealand government appears to be sensitive to the concerns of the country's foreign-trust industry. As a result, the final rules are likely to be "user-friendly" to foreign trusts, and New Zealand will likely remain a major off-shore trust jurisdiction.

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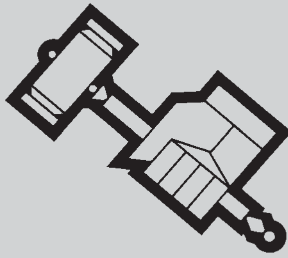

RECENT NEW YORK STATE DECISIONS

Ira Mark Bloom and William P. LaPiana

POWER OF APPOINTMENT

Language Giving Power of Disposition Creates Power of Appointment

Decedent's will directed that an interest in real property be distributed in the absolute discretion of his two sisters, to be exercised jointly. The Appellate Division reversed the Surrogate's adoption of a Referee's report finding that the will made a defective disposition of the property because of the failure to name a particular appointee. The language creates a valid general power of appointment by giving the decedent's sisters absolute control over the property. *In re Ramdin*, 11 A.D.3d 698, 783 N.Y.S.2d 643 (2d Dep't 2004).

POWER OF ATTORNEY

Grant of Authority Respecting Estate Transactions Extends to Actions as Fiduciary

Co-trustee of trust brought action against bank alleging that it improperly honored checks written by the attorney-in-fact of the other co-trustee. The Appellate Division affirmed dismissal of the complaint. The grant of authority with respect to estate transactions expressly applies to matters with respect to which the principal is a fiduciary (General Obligations Law § 5-1502G(2)). There is no impediment to the principal's delegation of authority as trustee to the attorney-in-fact, and because the principal would be estopped from asserting that he lacked the authority to delegate, the co-trustee is similarly estopped. *Burton v. PNC Bank, N.A.*, 12 A.D.3d 264, 784 N.Y.S.2d 544 (1st Dep't 2004).

RULE AGAINST PERPETUITIES

Rule Does Not Apply to Preemptive Right in Commercial Lease, but Preemptive Right Was Voided by Rule Against Unreasonable Restraint on Alienation

The rule against perpetuities has been held not to apply to a preemptive right in a lease between a cooperative housing corporation and the operator of a coin laundry on the corporation's premises. The contract gave the laundry operator a preemptive right allowing the operator to match any bid received by the corporation and thus secure renewal of the lease. The court held that the provision fell under the commercial exception created by *Metropolitan Transportation Authority v. Bruken Realty Corp.*, 67 N.Y.2d 156, 492 N.E.2d 379, 501 N.Y.S.2d 306 (1986), even though it involved a residential cooperative corporation. The lease was executed by persons acting in their capacity as officers of the corporation and involved a space outside of the residential area of the building owned by the corporation.

The court held, however, that the preemptive right was an unreasonable restraint on alienation, primarily because there was no time limit on the exercise of the right. The operator could remain in possession even after the lease expired so long as the corporation had not received a competing offer, and even if such an offer were received there was no obligation on the operator to exercise its preemptive right within a reasonable time. In essence, the preemptive right deprived the corporation of the ability to lease its premise indefinitely. *Inwood Park Apartments, Inc. v. Coinmach Industries Co.*, 783 N.Y.S.2d 453 (Sup. Ct., N.Y. Co. 2004).

SURROGATE'S COURT

Court Has Jurisdiction Over Proceeding to Vacate Liens

Public administrator brought a proceeding in Surrogate's Court to vacate liens against real property that arose from questionable activities by life tenant who was also executor of the will creating the life estate. The lien holder moved to dismiss, maintaining that Surrogate's Court lacked jurisdiction. The court's assertion of jurisdiction was upheld by the Appellate Division. The action to vacate the liens involves the life tenant's authority under the will as well as her actions as executor, issues which clearly relate to the decedent's affairs and administration of the estate and therefore can be heard by the Surrogate's Court. *In re Elderenbosch*, 11 A.D.3d 685, 783 N.Y.S.2d 658 (2d Dep't 2004).

TRUSTS

Reformation Not Warranted to Create Supplemental Needs Trusts

In two separate actions, trustees petitioned to reform trusts so that trust property would not be considered assets of a beneficiary in determining eligibility for governmental assistance. In one proceeding the requested reformation would involve transferring trust assets to a new trust which would quality as a supplemental needs trust; in the other the trustees sought to place the share of a disabled remainder person into a supplemental needs trust. The Surrogate refused to reform the trusts, holding that reformation may not be used to change the terms of a trust to deal with unforeseen changes in circumstances. Nor could the requested changes be made through the doctrine of equitable deviation, which applies usually to administrative provisions. Moreover, where the doctrine has been applied in the current context, the revision of the trust did not alter the testamentary scheme or change the interest of any beneficiary (citing *In re Ciraolo*, N.Y.L.J., Feb. 9, 2001 at 31 (Sur. Ct., Kings Co.)). In addition, the presumed intent of the creators of these trusts can be accomplished through the creation of self-settled supplemental needs trusts under EPTL 7-1.12(5)(v) which require, of course, that trust property remaining at the death of the beneficiary first be applied to reimbursement of the state for its expenditures for the beneficiary. *In re Rubin*, 4 Misc. 3d 634, 781 N.Y.S.2d 421 (Sur. Ct., N.Y. Co. 2004).

WILLS

Objectant Has No Standing Where Interest Under Will Is Same as in Intestacy

Testator's will disposed of her estate to her three sons who were also her distributees in the same amounts they would receive in intestacy. One son objected to admission of the will to probate and to the portion of the will nominating his brother as executor. The Appellate Division upheld dismissal of the objections, holding that the objectant was without standing under SCPA 1410. Because the objectant's share of the intestate estate was the same as his share under the will, his pecuniary interest was not adversely affected by the will. *In re Hall*, 12 A.D.3d 511, 784 N.Y.S.2d 605 (2d Dep't 2004).

Adoption by Strangers Prevents Application of Anti-Lapse Statute

Decedent's will made a specific bequest of real estate and also gave one-half of the residuary estate to her son who had been adopted by non-relatives after his birth outside of marriage. The son, who predeceased his birth mother, was survived by four children. Held, that the anti-lapse statute (EPTL 3-3.3(a)(1)) did not apply to the children because, under Domestic Relations Law § 117(2)(a), the son's adoption by non-relatives severed all family relationships to his birth parents, thus making him and his children strangers to his birth mother. *In re Murphy*, 11 A.D.3d 947, 784 N.Y.S.2d 760 (4th Dep't 2004).

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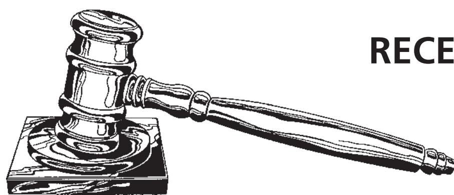
Professors Bloom and LaPiana are the current authors of Bloom and Klipstein, *Drafting New York Wills* (Matthew Bender) (Bloom as principal author; LaPiana as contributing author).



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

Ilene Sherwyn Cooper

Attorney's Fees

In multiple proceedings seeking permission to collect and distribute awards from the September 11 Victim Compensation Fund, the court was asked to approve the contingency fees of the lawyers who presented the claims. The novel issue, as described by the court, was the appropriateness of contingency fees in such cases involving Victim Compensation Fund awards, given the distinction between such cases and the usual tort action for which contingency fees are charged.

In analyzing the issue, the court reviewed the legislative and administrative background of the Fund. The court found that the legislation attempted to assure redress for 9/11 victims and their families to the extent practicable, while also protecting the public's interest in preserving the aviation industry. Towards this end, and in order to induce claimants to look to the Fund rather than tort litigation as a source of compensation, Congress made liability absolute, and established a mechanism for determining the amount of the award payable to eligible recipients. To this extent, the process is basically simple and nonadversarial, with a relatively predictable outcome. This being the case, the court reasoned that counsel for the claimants did not bear the risks that ordinarily justify contingency fees in conventional tort litigation.

On the other hand, in the cases before it, the court noted that the circumstances might warrant granting the fees requested by counsel, in view of the fact that the percentage retainers were less than the percentages typical to contingency fee arrangements, and that none of the interested parties had objected to the fees sought. Although the court opined that none of these factors were dispositive, it concluded that an examination of the details of the work performed by counsel could reveal that the fees set by the retainers were reasonable.

Accordingly, inasmuch as the record failed to disclose the efforts engaged in by counsel in obtaining the ultimate awards, the court directed the firms to file affidavits of legal services which set forth all relevant facts, including whether there was a hearing to establish extraordinary circumstances and whether and to what degree the award exceeded the standard amount.

In re Estate of Gomez, N.Y.L.J., October 7, 2004, p. 31 (Sur. Ct., N.Y. Co., Surr. Roth).

Attorney's Fees

In *In re Estate of Feroleto*, counsel sought the fixation of his legal fees. The respondent, former client, objected to the fees sought, and the parties agreed to submit the matter for decision.

Significantly, the issue before the court was whether counsel was precluded from receiving any fee as a result of his failure to comply with the court rule (22 N.Y.C.R.R. § 1215.1) requiring an attorney to obtain a written letter of engagement or written retainer agreement from his client.

In evaluating the question, the court referred to the result in *Feder, Goldstein, Tanenbaum & D'Errico v. Ronan*, 195 Misc. 2d 704 (2003), where it was held that counsel's failure to comply with the rule warranted a denial of legal fees. The court in *Feder* based its result on an analogy between 22 N.Y.C.R.R. § 1215.1 and 22 N.Y.C.R.R. § 1400.3, relating to Domestic Relations matters.

The court, in *Feroleto*, however, found significant differences between the two rules. Most notably, the court found that § 1400.3 was promulgated to address abuses in the practice of matrimonial law, while § 1215.1 was designed to prevent a misunderstanding about fees. Additionally, the court noted that while § 1400.3 requires that the letter of engagement be filed with the court, the provisions of § 1215.1 have no such requirement and do not apply if the anticipated fee is less than $3,000.

Nevertheless, the court reasoned that while no rule of the Appellate Division should be ignored, where the failure to comply is not willful and the client is aware that counsel is to be compensated for services rendered, the more appropriate result, rather than a denial of fees, should be to resolve any misunderstanding arising from the lack of a letter of engagement or signed retainer in favor of the client.

Accordingly, upon evaluation of counsel's affidavit of legal services, the court awarded fees in the sum of $3,000.

In re Estate of Feroleto, N.Y.L.J., December 15. 2004, p.26 (Sur. Ct., Bronx Co., Surr. Holzman).

Construction Proceeding

Before the court was a request for a construction of those provisions of the decedent's Will for the benefit of her husband. The petitioner suggested that the decedent intended to create an outright gift to her spouse of her entire estate.

The court disagreed, finding that the provisions of Article Second devising and bequeathing all of the income earned from the decedent's stocks to her husband "for as long as he shall live" created a life estate. The court held that the powers granted to the executor in Article Sixth to dispose of the decedent's estate, both real and personal, did not change this result, inasmuch as the provisions did not extend to the shares of stock subject to the life estate, which was subject to the possession of the life tenant and not the executor.

Moreover, the court held that since the decedent's Will only relieved the executor and not the life tenant of the requirement of filing a bond, and the life tenant had no interest in or dispositive powers over the principal of the legacy to him, he would be required to post a bond to provide adequate security for the payment and delivery of the legacy to the remaindermen.

In re Estate of Freilich, N.Y.L.J., November 18, 2004, p. 31 (Sur. Ct., N.Y. Co., Surr. Preminger).

Construction Proceeding

In an accounting proceeding, the petitioner requested the court to exercise its *cy pres* powers in order to avoid a disposition of the decedent's estate by intestacy. The decedent's Will lacked a residuary clause, but did contain specific bequests to the Tai Chi Society, or in the alternative, to the Buddha Law Foundation.

The petitioner argued that the decedent had a general charitable intent as was evidenced by the bequests to charity. The court disagreed.

The court opined that where a will lacks a residuary clause and fails to disclose an intention on the testator's part to dispose of his residuary estate, the presumption against intestacy cannot be invoked to supply the deficiency. Moreover, the court found that the omission of a residuary clause in the Will was not an ambiguity which would have allowed the introduction of extrinsic evidence in order to determine the decedent's intent. Finally, the court concluded that the language of the Will failed to support a gift by implication.

Accordingly, the court held that the testator's residuary estate passed by intestacy.

In re Estate of Da Liu, N.Y.L.J., December 17, 2004, p. 32 (Sur. Ct., N.Y. Co., Surr. Preminger).

Open Commission

In a contested probate proceeding, the objectants moved for an open commission to take the testimony of an out-of-state non-party witness. The witness, who received a nominal residuary bequest under the propounded instrument, questioned the capacity of the testator in an affidavit filed with the court. Previously, the witness had traveled to the court to be deposed; however her deposition was never taken due to the prolonged deposition of another non-party witness.

The petitioner for probate opposed the motion, but alternatively requested the right to cross-examine the witness at another time. Additionally, a 50% residuary beneficiary under the Will opposed the motion, claiming that an open commission was inconvenient and costly. All parties, however, conceded that the witness's testimony was relevant to the proceeding.

In view of the foregoing, the court granted the application. Further, the court held that while it had the discretion to deviate from the general rule which imposes the expenses of an open commission upon the respective parties, it was declining to apportion those expenses differently, pending application for such relief upon the conclusion of the proceeding.

In re Estate of Kruk, N.Y.L.J., November 3, 2004, p. 31 (Sur. Ct., Suffolk Co., Surr. Czygier).

Right of Election

In a miscellaneous proceeding, the decedent's surviving spouse sought to excuse his default in timely filing a notice to elect against the decedent's Will and requested an extension of time for filing same.

The decedent died, testate, on December 23, 2001, survived by her husband, who was the petitioner. Her Will was filed with the court approximately one year later, however it was not offered for probate until December 2, 2003. On March 23, 2004, the decedent's Will was admitted to probate, and let-

ters testamentary issued to the decedent's sister. In April 2004, the decedent's husband made application to be excused from his default in electing against the instrument, which application was denied as procedurally defective. Thereafter, this miscellaneous proceeding was commenced.

In analyzing the timeliness of the petitioner's application, the court referred to the provisions of EPTL 5-1.1-A(d)(1), (2) and (3), noting that significant debate existed as to whether they created a statute of limitations for asserting a right of election. More specifically, the question posited by this debate is whether the statutory period created by the provisions of EPTL 5-1.1-A(d)(1) can at all be extended, such that a surviving spouse can be excused from a default even if the application is made more than two years after the decedent's death.

In concluding that the two-year period set forth in EPTL 5-1.1-A(d)(1) permits no judicial discretion, the court opined that while the right of election statute should generally be liberally construed in favor of a surviving spouse, the need for establishing a definite period of time for the disposition of a testator's estate is of paramount importance.

Accordingly, inasmuch as the decedent's surviving spouse sought to be excused from his default more than two years after the decedent's date of death, the court held that his application was time-barred and denied the relief as a matter of law.

In re Estate of Wolfe, N.Y.L.J., November 3, 2004, p. 31 (Sur. Ct., Suffolk Co., Surr. Czygier).

Stipulations of Settlements

Although all parties to an out-of-court oral settlement did not dispute its terms, the Court of Appeals in *Bonnette v. Long Island College Hospital* held that the settlement was unenforceable because it was not reduced to a writing or entered into in open court.

The court referred to the provisions of CPLR 2104 for its opinion that an agreement relating to any matter in an action must be in writing and subscribed by a party or his attorney in order to be binding. Although the plaintiff argued, in pertinent part, that correspondence between her and the defendant memorialized the understanding between them, the court rejected her contentions under the circumstances, opining that a contrary result would undermine the purpose of CPLR 2104, and policy concerns of certainty, judicial economy and "flexibility to engage in settlement negotiations without fear of being bound by preliminary offers."

Bonnette v. Long Island College Hospital, N.Y.L.J., October 22, 2004, p. 19 (New York Court of Appeals).

Trust Assets

In a miscellaneous proceeding concerning an *inter vivos* trust, the trustees, one of whom was a son of the decedent, sought enforcement of the trust's ownership rights over a membership in the New York Stock Exchange. The estate executrix and legatee of the NYSE seat moved for summary judgment dismissing the petition. She was joined in her request by the guardian *ad litem* appointed to represent the decedent's second son, who was incapacitated.

The record revealed that, pursuant to the terms of the decedent's Will, his spouse was the primary beneficiary and named executrix of his estate. Pursuant to the terms of the *inter vivos* trust, however, the decedent/grantor principally provided for his son, the co-trustee thereof, and his son's issue. Schedule A of the trust instrument listed four assets constituting the corpus of the trust estate, including but not limited to the decedent's membership on the New York Stock Exchange.

In support of her motion, the executrix argued that the NYSE seat was never an asset of the trust inasmuch as 1) the rules of the NYSE prohibit a trust from owning a seat/membership in the Exchange and 2) the seat was never properly transferred to the trust in accordance with the provisions of EPTL 7-1.18.

With respect to the first asserted ground for relief, although the court noted that at least one court in this jurisdiction has held that a NYSE seat is an unassignable intangible property interest, it nevertheless denied respondent's motion, finding that she had failed to submit a copy of the Constitution and Rules of the Exchange—i.e. proof in admissible form—in order to satisfy her burden of proof.

However, as to the second branch of respondent's motion, the court granted her application, finding that the mere inclusion on Schedule A of the NYSE seat, without more, was insufficient to constitute a valid transfer of the seat to the trust under EPTL 7-1.18. The court noted that, even if, as petitioners argued, the seat was transferable to the trust, the decedent failed to "deliver" it to the co-trustees under the prevailing common law standards for the validity of *inter vivos* gifts. Specifically, in this regard, the court found it significant that the decedent continued to receive the income derived from the seat, rather than to yield control thereof to the trustees.

In re Estate of Hoffman, N.Y.L.J., October 26, 2004, p. 27 (Sur. Ct., Westchester Co., Surr. Scarpino).

Validity of Deed Upheld

Plaintiff sued his sister for a declaratory judgment that a deed to certain realty owned by the decedent was null and void, and that he was entitled to 50 percent of the proceeds derived from the sale of the property. Defendant moved for summary judgment dismissing the complaint.

The record revealed that prior to his death, the decedent had resided at the subject property with his daughter, the defendant in the action, and her husband and children. The decedent was in his mid-70s at the time, and had asked his daughter to live with him because he did not want to live alone. Under their living arrangement, the defendant was not required to pay rent, but agreed to care for her father "if and when his aging process required."

Several years into this arrangement, the decedent decided to change his Will. The defendant was asked to make an appointment with counsel on her father's behalf, and to drive her father to counsel's office. Apparently, at the time of this meeting, the decedent informed counsel that he wished to convey the subject realty to his daughter. A deed was prepared to that effect. Additionally, the decedent's Will also devised the property to his daughter.

Thereafter, the decedent became increasingly weak and his health began to deteriorate. On May 22, 2001, the decedent died. Objections to the probate of his Will were filed by his son. In the interim, the defendant sold the subject realty. Thereafter, during the pendency of the probate proceeding, the action for declaratory relief was filed seeking recovery of the property or its proceeds on the grounds that the deed was the product of undue influence, duress and constructive fraud. Defendant moved for summary judgment dismissing the action, and plaintiff cross-moved for judgment in his favor.

In addressing the motions, the court opined that while the burden of proving undue influence is on the party asserting it, where a confidential or fiduciary relationship exists between the parties so that they do not act from positions of equality, only slight evidence is required to shift the burden to the party charged to demonstrate by clear and convincing evidence that the transaction in issue was entered into freely and voluntarily. On the other hand, the court noted that an inference of undue influence will not arise from the confidential relationship between family members, unless coupled with other factors, such as where the donor is completely dependent upon the donee for the management of his affairs, and is unaware of the legal consequences of the transaction.

Assessed in this context, the court concluded that the record was devoid of proof indicating that the decedent was under the complete control of the defendant, or that his mental faculties were impaired at the time he executed the deed. Further, the evidence revealed that the decedent had selected the law firm that prepared the deed, and that he fully expressed his intentions respecting the real property to the draftsperson of the instrument.

Accordingly, the court granted summary judgment in the defendant's favor, and dismissed the complaint.

Connelly v. Connelly, N.Y.L.J., September 15, 2004, p. 20 (Sup. Ct., Kings Co.).

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

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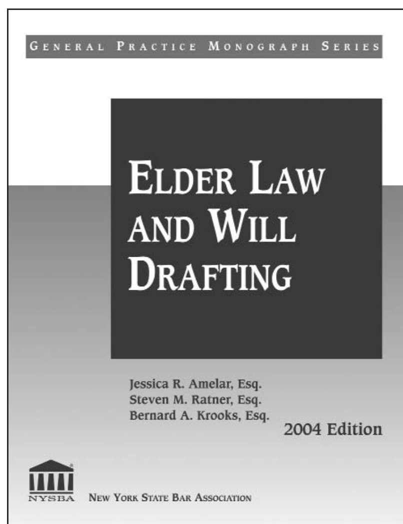

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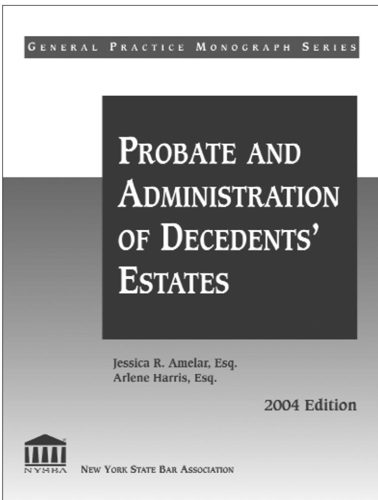

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