NYSBA SUMMER 2004 | VOL. 37 | NO. 2

Trusts and Estates Law Section Newsletter

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

A Message from the Section Chair

According to Leo Tolstoy, "All happy families are alike; every unhappy family is different." Undoubtedly Tolstoy, who studied law, would have agreed that unhappy families need sophisticated, personalized legal advice to assist them in confronting their unique issues. The Spring Section Meeting in Syracuse was designed to help practitioners address this need. Entitled "Estate Planning For Families With Problems," it presented a number of excellent speakers on issues that may not have arisen in the Donna Reed or Ward Cleaver households, but that our clients in real life experience regularly. They included Elizabeth Hartnett and Lucia Whisenand on "Representing Clients in Second or Troubled Marriages," Cora Alsante on "Planning for the Disabled Beneficiary and Child of Prior Marriage," John Sindoni and Michael O'Connor on "Life Use of Real Property in Estate Planning," Phil Burke on "Choosing Fiduciaries and Planning for Troubled Family Situations," and John King on "The Spendthrift Beneficiary."

In addition, longtime Onondaga County Surrogate Peter Wells regaled the lunchtime crowd with some of the more amusing wills and fact patterns he has come across during his years on the bench.

The afternoon before the program, the Section offered a three-hour roundtable featuring six prominent members of our Section who each chaired a discussion on subjects such as "IRAs and Qualified Plans," "Family Limited Partnership Developments," and "Using Revocable Trusts." Participants spent an hour at each of three tables of their choice discussing and asking questions about the topics of interest to them. Our thanks go to the chairs of the roundtables: Tim Thornton, Robert Baldwin, Robert Sheehan, Susan Slater-Jansen, John DeLaney and Marion Fish.

Inside

Our visit to Syracuse included an evening reception and a fine dinner at the Everson Museum of Art in downtown Syracuse, an innovative early structure designed by I.M. Pei with an outstanding collection of American ceramics among its many attractions.

Six law students attended the Syracuse meeting as guests of the Section, representing part of our continual effort to foster interest in the field of trusts and estates and involve new practitioners in our Section.

Our warmest thanks are due to program chairs Michael O'Connor and Marion Fish for putting together such an excellent and rewarding program.

Several members of our Section went to Albany in March to talk to legislators about proposed bills of particular interest to our Section. Among the bills we discussed:

- We spoke in favor of our proposed power of attorney bill, which would enlarge the definition of financial institutions that must accept the power, increase the default amount of permissible gifts to each beneficiary to the federal annual exclusion amount, and clarify the procedure for adding additional powers.
- We also supported a bill which would clarify that the required written acknowledgment of a testator that an attorney-executor will receive both a legal fee and a full commission must be separate from the will, although it may be annexed to the will.
- We spoke against the Transfer on Death Securities Act which would allow owners of securities to designate beneficiaries effective at death, on the ground that the Act did not adequately address such issues as liability for estate debts and administration expenses, tax apportionment and margin accounts and would cause owners to inadvertently skew their estate plans.

Time will tell how effective our efforts were.

We hope to see many of you in Savannah for our Fall Meeting October 14–17 (with a cocktail reception for early arrivals on Wednesday, October 13). The program will be on "The Future of Estate Planning," and will be chaired by Linda Wank. The first day will focus on advising practitioners how to plan for recent and expected future changes in the tax law. We hope to feature a presentation by a Washington official on estate tax changes and scheduled repeal: how the laws got to where they currently are, what forces are working to enact further changes and what the prospects are for the future. In addition, Jon Schumacher will talk about the future of the unitrust, including an analysis of the new Treasury Regulations defining income and their interplay with the unitrust concept. Barbara Sloan will talk on planning and drafting for scheduled changes in the estate tax law, including the increasing unified credit, the disappearing state death tax credit, possible elimination of the estate tax and its replacement by carry-over basis.

The second day will address non-tax issues that will continue to be with us whether or not we have an estate tax. There will be a joint presentation on wrongful death with the Torts, Insurance & Compensation Law Section of the NYSBA, which is having its Fall Meeting in Savannah at the same time as us. (The Section's acronym is TICL, so don't be offended if someone in Savannah asks you if you are TICLish—they just want to know which Section you belong to.) In addition, Gideon Rothschild will expound on the non-tax advantages of trusts, including asset protection trusts, and Joshua Rubenstein will speak about biotechnology issues that are changing our world as well as our practice.

For those who like to plan future trips well in advance, our 2005 Fall Meeting will be in New Orleans, with Michael O'Connor at the helm, and in 2006 Colleen Carew will lead us on a foray into Philadelphia. And the next Annual Meeting in New York City will be on January 26, 2005.

Enjoy your summer, but keep those billable hours up.

G. Warren Whitaker

Editor's Message

Although we are able to shop, invest, pay bills, file our tax returns, and find a date online, filing papers in New York Surrogate's Courts still requires a visit to the courthouse. The electronic filing ("e-filing") of court papers over the Internet is not yet an option for the New York probate practitioner. By way of comparison, e-filing isn't an option in the Denver Probate Court, either, but for a different reason. It's required.

"[D]espite the apparent benefits that e-filing would bring to probate practitioners, questions remain as to the proper balance between the public's right to wide access of information and the individual's right to privacy."

In 1999 the New York legislature authorized institution of a pilot program to test the efficacy of e-filing of court documents in selected state courts (the pilot program was recently expanded and extended to 2005). New York's Unified Court System now allows for Filing By Electronic Means in six counties for matters involving commercial and tax certiorari claims. Are New York Surrogate's Courts far behind?

E-filing is gaining nationwide momentum, as courts in numerous states and many federal jurisdictions successfully implement e-filing systems. The benefits to practitioners include the ability to file documents and to access court files around the clock, the immediate notification of case activity, and the automatic payment of court fees. Where court papers are filed and served via the Internet, the client also benefits from reductions in postage and courier charges. And in a time of declining resources and increasing caseloads, the courts have generally welcomed e-filing as a means of maximizing efficiency and minimizing costs, while at the same time increasing the courts' accessibility to all members of the public.

But the very accessibility of online court records raises troubling privacy issues. In late 2003, following widespread criticism of the electronic availability of court records in Florida, including access to documents containing social security numbers, personal financial data, and other sensitive or confidential information, the Florida Supreme Court imposed a broad moratorium on the availability of court records over the Internet.[1]

Is there a difference between the current availability of hard-copy case files, which requires an on-site visit to the courthouse, and the instant remote access which e-filing could provide? Many commentators think so. At their excellent March 2004 ABA Tech Show program, "Electronic Estates: Virtual Trips to the Courthouse," James Creamer of Colorado and Donna Killoughey of Arizona, two states that permit e-filing of probate documents, observed that in the past a veil of "practical obscurity"[2] served to insulate ostensibly public court documents from the harsh light of excessive scrutiny. This may be lost once access to court files no longer entails the inconvenience of a personal visit to the courthouse records room, but merely the click of a mouse.

Clearly, despite the apparent benefits that e-filing would bring to probate practitioners, questions remain as to the proper balance between the public's right to wide access of information and the individual's right to privacy. New York trusts and estates lawyers must play a role in identifying and solving these competing access and privacy issues *before* the implementation of e-filing in New York Surrogate's Courts. In order that appropriate policies are adopted, the Committee on Electronic Filings of the Trusts and Estates Law Section is actively studying these questions and the experiences of other states. Stay tuned.

BULLETIN

As we go to press, it appears that the Governor may soon sign into law a bill amending SCPA 2307-a to clarify that a testator must sign a separate writing (not included in the text of the will) to acknowledge that an attorney-executor will be entitled to a full commission as well as legal fees. This bill may be effective immediately. Practitioners are advised to take note.

—G. Warren Whitaker, Section Chair

Turning to this issue of the *Newsletter*, Barbara Hancock presents a thorough and thoughtful analysis of significant problem areas in the final IRS regulations governing minimum distributions from tax-favored retirement plans, and explores possible avenues for simplification of these rules. Elisabeth Hessler alerts us to a surprising development in Florida concerning the unauthorized practice of law by out-of-state attorneys—which we hope neither Elisabeth nor the *Newsletter* will be accused of by virtue of her authorship and our publication of her article.

Also in this issue, Rose Mary Bailly and Barbara Hancock reflect on the policy issues underlying the changes proposed by the New York Law Revision Commission to New York's General Obligations Law governing powers of attorney (every reader of the *Newsletter* is now well aware of this proposal, thanks to Philip A. DiGiorgio's article in the Spring issue). Gary Bashian and James Yastion take up the theoretical and practical concerns which may limit a nominated fiduciary's eligibility to serve where the nominee is, or may be, unfit to take office.

Finally, while "My Client Married an Alien" may sound like a science fiction thriller, in fact Warren Whitaker and Michael Parets explore the all-too-real tangle of tax considerations involved in planning for non-U.S. citizens and property. If you feel like you're in outer space whenever international planning issues arise, this article is for you.

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

Austin Wilkie

Endnotes

1. Supreme Court of Florida, Administrative Order AOSC04-4, February 12, 2004.
2. *See, e.g., United States Department of Justice et al. v. Reporters Committee for Freedom of the Press*, 489 U.S. 749 (1989).

The New, Final Minimum Distribution Rules: Some Problems Linger

By Barbara S. Hancock[1]

Introduction

On April 17, 2002, the Internal Revenue Service published final regulations governing minimum distributions from tax-favored retirement plans.[2] The final regulations incorporate most of the changes put forth in the proposed regulations issued in January 2001.[3] The earlier proposed regulations, issued in 1987[4] and amended in 1997,[5] were notoriously complex. The 2001 proposed regulations and now the final regulations simplify the calculation of minimum distributions and give retirement plan participants more flexibility in designating beneficiaries of their accounts. While the two-step simplification has been a very welcome development, it untangles only some of many perplexing rules, and leaves in place an extremely complicated system that does an imperfect job of expressing the policy it is supposed to carry out. Unfortunately, the 200-plus-page Portman-Cardin pension bill[6] introduced in April 2003 proposed only a few tweaks that would affect minimum distributions.[7] None of the changes would affect the problems identified below.

In this report, the authors assume that the reader is familiar with the minimum distribution rules, and therefore will not describe them here in detail. The purpose of this report is to point out significant problem areas in the final regulations and to present recommendations for simplification that accord with the policy underlying the minimum distribution rules.

1. An Estate Cannot Be a "Designated Beneficiary"

The final regulations make it clear that an estate cannot be a "designated beneficiary."

> A person that is not an individual, such as the employee's estate, may not be a designated beneficiary. If a person other than an individual is designated as a beneficiary of an employee's benefit, **the employee will be treated as having no designated beneficiary**.[8] (Emphasis supplied).

Parenthetically, we question whether this rule, which originated in the 1987 proposed regulations and causes enormous problems, is necessary at all. Assume that an IRA owner directs that 75% of the IRA be paid to his wife and the other 25% to a charity or to his estate. Why should he be treated as having no designated beneficiary? He should be treated as having a designated beneficiary for 75% of the account.

To be a "designated beneficiary," an individual must be: (1) designated by the employee (or IRA owner) on the beneficiary designation form for the retirement account, or (2) designated under the terms of the plan,[9] or (3) a beneficiary of a qualifying trust named as beneficiary.[10] The individual may *not*, however, be a beneficiary of an estate named as the beneficiary. In other words, if an employee names his estate as beneficiary on the beneficiary designation form, and his will names his only child as heir to his entire estate, then the employee has no "designated beneficiary." Although the employee clearly designated his child to inherit his estate in his will, the rules do not allow a "look through" from the named beneficiary (the estate) to the individual beneficiary named in a document other than the beneficiary designation form (the will).[11] The child will receive the entire account, but she will not be able to take minimum distributions over her life expectancy under the Single Life Table found at section 1.401(a)(9)-9, A-1 of the final regulations. Instead, she must take distributions (1) under the "five year rule,"[12] if her father died before his required beginning date, or (2) under the Single Life Table, based on her father's age at the date of his death, if he died after his required beginning date.[13]

In either case, the accelerated payouts will cost the beneficiary the benefits of long-term tax deferral on the balance in her inherited account.

The rule does not allow the individual beneficiaries of an estate to become the deceased employee's designated beneficiaries even if the estate has been closed before the determination date (September 30 of the year following the year of death) and all of its assets distributed to individual beneficiaries. By contrast, the regulations freely permit a "look through" to the individual beneficiaries when a trust is named as beneficiary. Why should beneficiaries of an estate be treated less favorably than beneficiaries of a trust? To do so furthers no apparent policy objective, and exalts form over substance. The different treatment of these two types of beneficiary is a needless complication. Elimination of the "no estate as beneficiary" rule would avoid the adverse effects of the

inadvertent, but common, error of naming one's estate as beneficiary. Indeed, the instructions accompanying IRA beneficiary designation forms commonly suggest appropriate language for naming one's estate as beneficiary, in much the same way as the equivalent instructions for life insurance beneficiary designations. While virtually all estate planners are aware of the "no estate as beneficiary rule," and can advise their clients of more advantageous alternatives, the average employee or IRA owner is not. Remember that the minimum distribution rules apply to all tax-favored retirement benefits, no matter how small. When an employee's will leaves assets to her spouse, then to her children as contingent beneficiaries, it may seem entirely logical to name her estate as beneficiary on both IRA and life insurance beneficiary designation forms so that these assets can pass according to this pattern.

The problem is exacerbated by the fact that the estate may become, or may be deemed to be, a beneficiary even without an affirmative designation by the employee or IRA owner. For instance, the estate is the default beneficiary under many plan and IRA documents, or the IRS may deem the estate to be a beneficiary if estate taxes are paid from the retirement account.[14]

2. The "Shakeout Period" Can Cure Some, But Not All, Problematic Beneficiary Designations

The regulations provide a "shakeout period" after the employee's death, allowing some room to fix a problematic beneficiary designation (e.g., one naming an individual and a charity as beneficiaries), and also providing opportunities for post-mortem planning. The designated beneficiary is determined as of September 30 of the year following the year of the employee's death (the "determination date"). Any beneficiary eliminated through distribution of the beneficiary's entire benefit, or through a qualified disclaimer, is disregarded in determining the employee's designated beneficiary.[15] Thus, in the example above, if the charity is cashed out during the shakeout period, then when the determination date arrives, only the individual remains as a beneficiary, and the account may be distributed according to the rules governing designated beneficiaries.

The shakeout period also allows the use of qualified disclaimers to eliminate named beneficiaries, in order to "stretch" plan distributions as long as possible. For example, disclaimers may be used in order to (1) leave the surviving spouse as the sole remaining beneficiary, to take advantage of the special rules available only to spouses, or (2) leave only young beneficiaries with long life expectancies.

However, the shakeout period does not apply to estates. In the preamble to the final regulations, the IRS notes that some commentators had requested that the shakeout period be applied to estates, so that

> the beneficiary of the estate or the beneficiary of the IRA named under the employee's will could replace the estate as beneficiary by September 30 of the year following the year of death. This change is not being adopted in these final regulations. The period between death and the beneficiary determination date is a period in which beneficiaries can be eliminated but not replaced with a beneficiary not designated under the plan as of the date of death. In order for an individual to be a designated beneficiary, any beneficiary must be designated under the plan or named by the employee as of the date of death.[16]

This apparently means that, even if an estate has been closed during the shakeout period, and all of its assets distributed to its individual heirs, the plan administrator has to look *back* to the date of death as if that were the date on which beneficiaries were determined, and ignore the fact that the decedent's estate no longer exists as of the determination date.

3. Problems with "Separate Accounts"[17]

When there is more than one designated beneficiary as of the determination date, the general rule is that the beneficiary with the shortest life expectancy (i.e., the oldest beneficiary) is the designated beneficiary for purposes of determining the distribution period.[18] This approach may be fine if all of the beneficiaries are close in age, because their respective required minimum distributions would not differ much. However, if there is a significant age spread between the beneficiaries, or if the surviving spouse and children are named as beneficiaries, then under the general rule, (1) the younger beneficiaries cannot take advantage of their longer life expectancies to take smaller distributions under the Single Life Table, and (2) the spouse cannot take advantage of the special rule allowing her to defer distributions until the decedent would have reached age 70½, because she is not then the "sole designated beneficiary."[19]

The establishment of "separate accounts" (or segregated shares under a defined benefit plan) allows the applicable distribution period to be determined separately for the designated beneficiary of each separate account, disregarding the beneficiaries of the other separate accounts.[20] The final regulations have

added two new twists, one having to do with establishment of the separate accounts, and the other applying to trusts named as beneficiaries.

A. Establishing Separate Accounts

The proposed regulations defined a separate account as "a portion of an employee's benefit determined by an acceptable separate accounting including allocating investment gains and losses, and contributions and forfeitures, on a pro rata basis in a reasonable and consistent manner between such portion and any other benefits."[21] The final regulations refer to actually "establishing" separate accounts.

> [S]eparate accounts . . . are separate portions of an employee's benefit reflecting the separate interests of the employee's beneficiaries under the plan as of the date of the employee's death for which separate accounting is maintained. The separate accounting **must allocate all post-death investment gains and losses, contributions and forfeitures, for the period prior to the establishment of the separate accounts on a pro rata basis in a reasonable and consistent manner among the separate accounts**. However, once the separate accounts are actually established, the separate accounting can provide for separate investments for each separate account under which gains and losses from the investment of the account are only allocated to that account, or investment gains or losses can continue to be allocated among the separate accounts on a pro rata basis. A separate accounting must allocate any post-death distribution to the separate account of the beneficiary receiving that distribution.[22] (Emphasis supplied).

The highlighted language means that a typical pecuniary gift will not qualify as a separate account.

Does "establishing" separate accounts require separate account statements from the provider (e.g., the trustee or custodian actually sets up a separate account or sub-account for each beneficiary), or does it suffice to provide each designated beneficiary's percentage interest on the beneficiary designation form? The regulations do not say.

What is not clear is whether separate accounts could somehow exist automatically without affirmative action on the part of the beneficiaries. For example, suppose an IRA is left to three children equally. The IRA provider sends them all equal distributions periodically, the total of which equals or exceeds the minimum required distribution by any measure. All gains and losses are allocated to the three beneficiaries equally by default, since they are all equal co-owners of the account. It is not clear whether the beneficiaries' respective "portions" of the account could? must? cannot? be considered "separate accounts" that were "established" as of the date of death.[23]

Separate accounts are recognized "only if the separate account is established on a date no later than the last day of the year following the year of the employee's death,"[24] in other words, within three months after the beneficiary determination date. The separately determined minimum distributions can begin with the year *after* the separate accounts were established.[25] Thus, if the decedent died in 2002, and the separate accounts are "established" in 2003, the default rule applies for 2003, so that the oldest designated beneficiary's payout period applies to all beneficiaries in determining the amount of the minimum distributions for 2003. All of the designated beneficiaries can begin taking distributions according to their own life expectancies in 2004.

B. Separate Accounts for Trust Beneficiaries

The final regulations state that "the separate account rules under A-2 of § 401(a)(9)-8 are not available to beneficiaries of a trust with respect to the trust's interest in the employee's benefit."[26] In other words, if the named beneficiary is a trust for the employee's children, the trust cannot create a separate account for each child, and take distributions based on each child's life expectancy. Instead, the child with the shortest life expectancy (i.e., the oldest) will determine the payout period for the entire trust. This appears to be the case even if the named trust splits into separate trusts for each child according to the terms of the will or trust agreement. To avoid this result, the beneficiary designation should name the children's individual trusts as beneficiaries.[27]

In PLR 200234074, based on the proposed regulations, the IRS ruled that an IRA payable to a single trust that terminated on the owner's death could be divided into separate accounts for the individual beneficiaries. However, this conclusion was reversed in three later rulings issued under the final regulations.[28] In these rulings, the IRS took the position that retirement benefits payable to a single named trust as beneficiary cannot be treated as separate accounts, even if the trust terminates at the IRA owner's death and is required to be divided into predetermined shares for the trust beneficiaries.

4. Problems with a Trust as Beneficiary

The final regulations allow the individual beneficiaries of a trust named as beneficiary to be treated as designated beneficiaries if certain requirements are met:

(1) the trust is a valid trust under state law, or would be but for the fact that there is no corpus;

(2) the trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee;

(3) the beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable from the terms of the trust instrument; and

(4) certain documentation has been provided to the plan administrator.[29]

Although these "look-through" rules have not changed, the final regulations have perpetuated confusion as to who must be taken into account as a beneficiary of the trust.[30]

We start with the basic rules: If there are several beneficiaries of a single trust named as designated beneficiary, then the oldest beneficiary's life expectancy determines the distribution period for all beneficiaries;[31] and if a non-individual is named as a beneficiary, then there is no "designated beneficiary" even if there are also individuals named as beneficiaries.[32]

It is clear enough what to do if we look only at multiple primary beneficiaries, such as a "spray" trust for the surviving spouse and children, or a pooled trust benefiting all of the surviving children. The oldest beneficiary's life expectancy determines the payout period. The problem arises with the secondary beneficiaries, who may or may not have to be taken into account in determining who is the oldest beneficiary or whether all beneficiaries are individuals. Some future interests are ignored, and others are not.

The general rule is that a **contingent beneficiary** *is* taken into account,[33] and a **successor beneficiary** is *not*.[34] The final regulations define these terms as follows:

> *Contingent beneficiary.* Except as provided in paragraph (c)(1) of this A-7, if a beneficiary's entitlement to an employee's benefit after the employee's death is a contingent right, such contingent beneficiary is nevertheless considered to be a beneficiary for purposes of determining whether a person other than an individual is designated as a beneficiary (resulting in the employee being treated as having no designated beneficiary under the rules of A-3 of § 1.401(a)(9)-4) and which designated beneficiary has the shortest life expectancy under paragraph (a) of this A-7.[35]
>
> *Successor beneficiary*. (1) A person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy under paragraph (a) of this A-7, or whether a person who is not an individual is a beneficiary, merely because the person could become the successor to the interest of one of the employee's beneficiaries after that beneficiary's death. However, the preceding sentence does not apply to a person who has any right (including a contingent right) to an employee's benefit beyond being a mere potential successor to the interest of one of the employee's beneficiaries upon that beneficiary's death. Thus, for example, if the first beneficiary has a right to all income with respect to an employee's individual account during that beneficiary's life and a second beneficiary has the right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary's death), both beneficiaries must be taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries.[36]

As one commentator has noted:

> If one interprets this literally, it would appear that in every non-conduit trust virtually all beneficiaries, down to the most contingent of contingent beneficiaries, would have to be considered, since there could always be an unusual order of death.[37]

The regulations provide two examples of the application of these rules.

First example (QTIP trust): The trust named as beneficiary of A's account provides that B, the surviving spouse, will receive all income during her lifetime. Principal is to be accumulated in the trust and distributed to child, C, after B's death. Both B and C will be taken into account because C has a right to a portion of the benefit, even though access to that portion is delayed until after B's death.[38] Because B, the wife, is older than C, her child, B's life expectancy will determine the payout period. However, since B is not considered to be the **sole** designated beneficiary, she does not qualify for the special rules available to a spouse as sole beneficiary,[39] allowing deferral of distributions until the year in which A would have turned age 70½. Instead, distributions must begin in the year after A's death.

Second example: To avoid this outcome, the regulations suggest that the trust should instead provide that all amounts distributed from A's account during B's lifetime must be paid to B, so that the trust functions as a conduit from the account. Here, because no part of a plan distribution is accumulated for eventual distribution to C, B is the sole beneficiary.[40] She can now defer distributions until A would have reached 70½, or if she decides to start taking distributions sooner, she can use the Single Life Table to determine her annual minimum distributions, recalculating annually.

However, the rules are not at all clear even for a common variation on the example given in the regulations. For example, suppose the QTIP trust in the first example provided as follows: pay income to B for life, remainder to C, but if C predeceases B, then the remainder passes to charity D. Here, C definitely counts as a beneficiary, as in the first example above. If we can assume that C will live out his life expectancy, then when C inherits the IRA, C's required minimum distributions will exhaust the account during his lifetime, and at his death nothing will remain to pass to charity D. D is merely a potential successor to C's interest and can be disregarded. The look-through rules would treat B and C as the designated beneficiaries. But if we *cannot* assume that C will live out his life expectancy, and consequently will predecease B, then charity D has the same interest C would have had if he had lived, and therefore counts as a contingent beneficiary. Since D is not an individual, the look-through rules now say that there is no designated beneficiary because not all of the beneficiaries are individuals.

A typical minor's trust may present similar problems. For example, suppose A leaves his account to child C, but if C is under the age of 35 at the time of A's death, then to a trust for C's benefit. The trust is to terminate when C reaches 35, when trust assets will be distributed to C outright. If C dies before age 35, then the trust assets are to be distributed to charity D. Here again, if we can assume that C will live out his actuarial life expectancy (into his 80s, according to the IRS's Single Life Table), then we can also assume he will live to reach age 35. At that time the trust will terminate, C will receive all of the trust assets, and nothing will pass to charity D. D is a potential successor beneficiary, and is disregarded. But if we *cannot* assume that C will reach 35, then D has a contingent interest, and must be taken into account as a beneficiary. Again, the look-through rules now say there is no designated beneficiary because not all of the beneficiaries are individuals.

To avoid any risk of accelerated payouts, it may be tempting to draft both types of trust as conduits, so that all distributions from the retirement account are paid over to the individual beneficiary. According to the regulations, remainder beneficiaries would then be considered mere potential successors to the beneficiary's interest. Presumably the conduit approach would also prevent the "wipeout beneficiary," charity, from being considered a contingent beneficiary. A child's trust would work well as a conduit, because C's small minimum distributions can pass into a custodial account until he reaches age 21, and with normal growth, the account will continue to grow, despite the required distributions, and will therefore still carry out A's intentions in creating the trust. However, a QTIP trust drafted as a conduit will likely leave nothing for C to inherit after B's lifetime, if B lives to or exceeds her life expectancy, because B's required minimum distributions must exhaust the account when she reaches her life expectancy as expressed in the Single Life Table.[41]

A generation-skipping trust runs head-on into these rules. A typical trust benefits the employee's issue, and ends 21 years after the death of the employee's youngest issue who was alive when the employee died. The trust corpus probably will not be distributed to descendants who were alive as of the determination date. Using the oldest beneficiary's life expectancy to determine required minimum distributions runs contrary to the intent of the trust, because this beneficiary's required minimum distributions will exhaust the IRA by the end of his or her life expectancy, leaving nothing for the next generations. Of course, the trust rules may not even permit the use of the oldest beneficiary's life expectancy, as we have seen above.[42] Since the best-case scenario for stretching the IRA's payouts is the life expectancy of the oldest beneficiary, then the trust rules will thwart the purpose of a generation-skipping trust named as beneficiary. While this may be an acceptable outcome

from a policy standpoint, it still illustrates an imperfect fit between a common form of trust and the trust rules.

5. Problems with Aggregating Beneficiaries' Distributions from Multiple IRA Accounts

The general rule is to calculate the minimum required distribution separately for each IRA. After totaling the distributions, an individual may then take the total distribution from any one or more of his or her IRAs.[43] This rule applies separately to (1) the IRAs that an individual holds as *owner*, and (2) the IRAs that an individual holds as *beneficiary* of the same decedent. IRAs held by an individual as owner and as beneficiary, or by an individual as beneficiary of different decedents, may not be aggregated.[44]

The regulations do not mention whether trusts named as beneficiary of a decedent may also aggregate distributions, which suggests that they may not. If this is the case, then a common post-mortem planning tool may not be available. Whenever there are credit shelter and marital trusts for the surviving spouse, the trustee can minimize estate taxes on the surviving spouse's estate by allocating discretionary distributions to the taxable marital trust, allowing the non-taxable credit shelter trust to continue to grow. If this technique is not available when credit shelter and marital trusts are named as beneficiaries of a decedent's IRA, then each trust's separate minimum distribution must be taken from that trust, and not taken entirely from the marital trust.

6. Defined Benefit Plans

The preamble to the 2001 proposed regulations included the following statement, which was not highlighted in any way:

> One of the rules in the 1987 proposed regulations that the IRS and Treasury are continuing to study and evaluate is the rule providing that if the distributions from a defined benefit plan are not in the form of an annuity, the employee's benefit will be treated as an individual account for purposes of determining required minimum distributions. The IRS and Treasury are continuing to consider whether retention of this rule is appropriate for defined benefit plans.[45]

The preamble did not specifically request comments on this issue. Nevertheless, the preamble to the new final regulations includes the following statement, which surprised most pension practitioners:

> Few comments specifically requested retention of this rule. **As a result, the IRS and Treasury have concluded that this rule has little application outside of being used to determine the portion of a lump sum distribution of an employee's vested accrued benefit that is eligible for rollover.** Accordingly, this rule has not been retained in these temporary regulations except for use in determining the amount that is eligible for rollover when a defined benefit plan pays an employee's entire vested accrued benefit in a lump sum. However, in response to comments, these temporary regulations permit a plan to treat the amount of a year of annuity payments that would have been payable under the normal form as the RMD for a year in the case of a lump sum payment.[46] (Emphasis supplied).

This interpretation of the lack of comments is completely misguided. The prior rule is very widely used, particularly by small plans, and a far more likely explanation of the lack of comments is that practitioners were happy with the rule, which dated back to the 1987 proposed regulations. If this change is adopted when this section of the regulations is finalized, it will create yet another area where defined benefit plans are at a disadvantage by comparison to defined contribution plans and IRAs.

The new temporary regulations appear to require annuity distributions at the required beginning date and to preclude a later election of a different optional form of benefit, such as a lump sum distribution, when the individual actually retires.[47] The new temporary regulations[48] make additional changes to the annuity rules in the 2001 proposed regulations, and these changes have concerned many governmental defined benefit plans which provide annuity forms that will not always satisfy the new requirements.

Rev. Proc. 2003-10 and Notice 2003-2[49]

(1) Postpone the date by which defined benefit plans must be amended to comply with these changes;

(2) Provide transition relief with respect to certain provisions of the regulations. Plans may make increasing annuity payments, as long as the payments comply with the prior rules, and

may also continue to use the "account balance" method as under the prior regulations; and

(3) Provide guidance for governmental plans.

7. Simplifying the Minimum Distribution Rules

Now let us step back for a look at the purpose of the minimum distribution rules, and explore recent proposals to simplify distributions from retirement accounts.

A. Purpose of the Minimum Distribution Rules

The Internal Revenue Code encourages individuals to save for retirement by allowing them to set up retirement accounts whose earnings accumulate income tax free. Income tax is due only as distributions are withdrawn from accounts. When a retirement plan participant dies, any balance remaining in the account passes to the participant's surviving spouse or other beneficiaries according to the participant's wishes as expressed on a beneficiary designation form.

Since no income tax is due on savings that remain within the account, the tax incentive for the plan participant is to retain the wealth in the account as long as possible, to allow it to continue to grow income tax free. Since the tax incentive encourages a plan participant to accumulate, rather than to spend, the wealth in these retirement accounts, there has to be a mechanism to compel distributions from the accounts, allowing the Treasury to begin collecting the deferred taxes. Without such distribution mechanisms, those with no need to draw from their accounts would be able to allow the plans to grow tax free throughout their lifetimes, and pass them on intact to their heirs (less any estate tax due).

The minimum distribution rules ensure that these tax-favored retirement plans must provide at least *some* income during the retirement of the plan participant and his or her spouse—and that the income so distributed will be subject to income tax.[50] They do *not* require that accounts be completely depleted during retirement or, in most cases, within a short period after the deaths of the participant and spouse.

If a balance remains in the account after the deaths of the participant and his or her spouse, then the account has already met, and exceeded, their retirement needs, and the tax incentives for the participant to save for retirement have worked as intended. Now what? The logical course of events at this point should be to distribute any remaining retirement plan funds outright to the heirs. Income tax deferral would end. The heirs would pay any income taxes due, and save or spend the balance as they see fit.

Instead, the rules allow an heir to continue to defer most of the taxes on an inherited account. The heir must take minimum distributions from the account, applying a divisor or percentage that is typically based on the heir's life expectancy as of the year after the plan participant's death, then subtracting one from the divisor with each succeeding year. Sooner or later, all of the wealth in the account is distributed and taxed. For example, by taking only the minimum required distributions, a 10-year-old heir with a 72.8-year life expectancy will deplete the account at the age of 83.[51] However, even as the heir takes the taxable minimum distribution each year, the balance in the account continues to accumulate tax-deferred. Depending upon the account's investment rate of return, the account may grow faster than minimum distributions can deplete it,[52] and funds that received favorable tax treatment to encourage saving for the *plan participant's* retirement continue to receive favorable tax treatment during the lifetime of the plan participant's *heir*. In effect, the wealthiest plan participants can leverage tax rules intended to benefit the plan participant and his or her spouse during their retirement into tax-advantaged retirements for their heirs.

B. Proposals to Coordinate Retirement Plan Distribution Rules with Tax Policy

In a report issued in 2001, the Congressional Joint Committee on Taxation wrote:

> Some would argue that the minimum distribution requirements are illogical and inconsistent with the stated purpose of the requirements, i.e., to ensure that benefits accumulated or accrued under tax-favored retirement plans are used to provide replacement of an individual's preretirement income at retirement rather than for indefinite deferral of tax on a participant's accumulation under the arrangements.[53]

Citing this policy, the Joint Committee, the Joint Economic Committee of Congress,[54] the Tax Sections of the New York State Bar Association and the California State Bar,[55] and several commentators[56] have called for a complete overhaul of the system so that the rules actually reflect tax policy. Generally, they suggest scrapping the lifetime minimum distribution rules altogether, and replacing them with a mandate to distribute any funds remaining at the death of the employee and surviving spouse within a short time after the survivor's death.

As two commentators sum up the advantages of the proposed changes,[57]

> First, they eliminate an enormous amount of complexity and, one suspects, an enormous amount of inadvertent noncompliance, particularly in IRAs.[58] Second, they limit the tax deferral to the period for which it is appropriate, the life of the participant and his or her spouse. During that period, the participant (or IRA owner) and spouse would have the flexibility to determine how much to withdraw each year, in light of their overall financial situation.

As the rising estate tax exemption under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)[59] shelters more and more estates from transfer taxation, the vast majority of families would face only the accumulated income taxes on inherited accounts.

C. Proposal to Simplify Distribution Rules for the Majority of Retirees

Other commentators have suggested allowing each person to exempt up to $50,000 of retirement account assets from the minimum distribution requirements.[60] They cite data from the Survey of Consumer Finances indicating that over 70% of households aged 55–64 hold IRA and defined contribution assets totaling less than $50,000. If the first $50,000 in retirement assets were exempted from the minimum distribution rules, the rules would no longer affect more than two-thirds of all retirees.

Any changes, such as the ones proposed above, would require congressional action, and thus are beyond the reach of any changes within the authority of the Internal Revenue Service. Unless Portman-Cardin IV or its successors address simplification of the minimum distribution rules, the new final regulations issued by the Service in 2002 define a regime that may be with us for some time.

Endnotes

1. The principal author of this article is Barbara S. Hancock. David A. Pratt also contributed comments.
2. Federal Register, April 17, 2002, 67 FR 18988.
3. Federal Register, January 17, 2001, 66 FR 3928.
4. Federal Register, July 27, 1987, 52 FR 28070.
5. Federal Register, December 30, 1997, 62 FR 67780.
6. The Pension Preservation and Savings Expansion Act of 2003, H.R. 1773, was introduced April 11, 2003 and approved by the House Ways & Means Committee on July 18, 2003. As of submission of this article for publication in early April 2004, a revised version of the bill is expected any day.
7. The bill would gradually increase the required beginning date for minimum distributions from age 70½ to age 75 and would reduce the 50% excise tax for failure to comply with the minimum distribution rules to 20% of the amount not distributed. It would also change the required beginning date to December 31 of the year in which the retiree attains the specified age, to eliminate the possibility that a retiree would receive two minimum distributions in a single year. Bill section 201. For a critique of the bill, see Peter Orszag & Robert Greenstein, *The Ways and Means Committee Pension Tax-Cut Legislation: Unsound Tax Policy That Digs the Nation's Fiscal Hole Deeper*, July 2003, available at www.cbpp.org/7-21-03tax.pdf.
8. Reg. § 1.401(a)(9)-4, A-3. *See also* PLR 200327059 (Wife disclaimed decedent's IRAs. As a result, the IRAs passed to a trust, as part of the residue. Although the trust qualified for the look-through rule, IRS ruled that the effect of the disclaimer was to make the estate the beneficiary. Thus, there was no designated beneficiary.).
9. Reg. § 1.401(a)(9)-4, A-1.
10. Reg. § 1.401(a)(9)-4, A-5(b).
11. "The fact that an employee's interest passes to a certain individual under a will or otherwise under applicable state law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan." Reg. § 1.401(a)(9)-4, A-1.
12. Reg. § 1.401(a)(9)-3, A-1(a).
13. Reg. § 1.401(a)(9)-5, A-5(a).
14. *See, e.g.*, Virginia F. Coleman, *Providing for the Payment of Estate Tax on Retirement Plans*, ALI-ABA Course of Study Materials, Estate Planning for Distributions from Qualified Plans and IRAs, Course No. VPC0523 (May 2002). *See also* PLRs 200010055, 200221056, 200228025.
15. Reg. §1.401(a)(9)-4, A-4(a).
16. 67 FR 18990 (April 17, 2002). It is not clear what the result would be if the plan (unusually) provided specifically for a beneficiary designation to be made in the participant's will.
17. *See, e.g.*, Mervin M. Wilf, *Separate Accounts*, ALI-ABA Course of Study Materials, Estate Planning for Distributions from Qualified Plans and IRAs, Course No. VPC0523 (May 2002); Seymour Goldberg, *Special Report on the Separate Account Rule for Beneficiaries of IRA Accounts*, New York State Bar Association Trusts and Estates Law Section Newsletter, vol. 36, no. 1, Spring 2003, at 30.
18. Reg. § 1.401(a)(9)-5, A-7 (a)(1).
19. Reg. § 1.401(a)(9)-3, A(3)(b).
20. Reg. § 1.401(a)(9)-8, A-2(a)(2).
21. Prop. Reg. § 1.401(a)(9)-8, A-3 (2001).
22. Reg. § 1.401(a)(9)-8, A-3.
23. Natalie Choate, Supplement to the 2002 Edition of *Life and Death Planning for Retirement Benefits*, available at www.ataxplan.com. *See also* PLR 200208028.
24. Reg. § 1.401(a)(9)-8, A-2(a)(2).
25. Or within the year after the employee's date of death if he or she had already "established" separate accounts. Reg. § 1.401(a)(9)-8, A-2(a)(2).
26. Reg. § 1.401(a)(9)-4, A-5(c).
27. *See also* PLR 199903050, 199931048, 200052042 through 200052044, 200051053.
28. *See* PLRs 200317041, 200317043 and 200317044.
29. Reg. § 1.401(a)(9)-4, A-5(b).

30. *See* Virginia F. Coleman, *Preserving the "Designated Beneficiary" if a Trust is Named as Beneficiary of a Qualified Plan or IRA*, ALI-ABA Course of Study Materials, Sophisticated Estate Planning Techniques, Course No. SJ016 (Sept. 2003).
31. Reg. § 1.401(a)(9)-5, A-7(a).
32. Reg. § 1.401(a)(9)-4, A-3.
33. Reg. § 1.401(a)(9)-5, A-7(b).
34. Reg. § 1.401(a)(9)-5, A-7(c)(1).
35. Reg. § 1.401(a)(9)-5, A-7(b).
36. Reg. § 1.401(a)(9)-5, A-7(c)(1).
37. Coleman, *supra* note 30. *See also* Choate, *supra* note 23; PLR 200228025 (The IRA beneficiary was a trust for a minor. The trustee had power to accumulate distributions from the IRA. IRS ruled that the 67-year-old contingent remainder beneficiary was a beneficiary for purposes of the minimum distribution rules, even though the minor could withdraw all of the trust assets at age 30).; *cf.* PLR 200235038. *See also* State Bar of California, Taxation Section, Estate and Gift Tax Committee, Proposal to Clarify Treas. Reg. Section 1.401(a)(9)-5, A-7, May 2003, reprinted in Tax Notes Today, May 15, 2003, 2003 TNT 94-125.
38. Reg. § 1.401(a)(9)-5, A-7(c)(3), example 1.
39. Reg. § 1.401(a)(9)-5, A-7(c)(3), example 1 (iii).
40. Reg. § 1.401(a)(9)-5, A-7(c)(3), example 2.
41. IRS has ruled that the remainderman can be ignored if the current beneficiary has the right to withdraw 100% of the trust assets. *See* PLRs 200234074, 199903050. A right to withdraw less than 100% probably does not suffice.
42. If the trust says to pay out the remainder to the employee's then surviving issue, per stirpes, or if none are then surviving, to charity, then the charity has a contingent interest even if there are surviving issue, and the charity must be taken into account as a contingent beneficiary. Not all of the trust's beneficiaries are individuals, so there is no designated beneficiary.
43. Reg. § 1.408-8, A-9.
44. Similar rules apply to tax-sheltered annuity (403(b)) arrangements, but not to qualified plans: if an individual has interests under two or more qualified plans, the minimum distribution must be taken separately from each plan.
45. 66 Fed. Reg. at 3932.
46. Preamble, 67 Fed. Reg. at 18991; *see also* Temp. Reg. § 1.401(a)(9)-6T, Q & A 1(d).
47. See the August 28, 2003, comment letter submitted by the American Society of Pension Actuaries, available at www.aspa.org.
48. Temp. Reg. § 1.401(a)(9)-6T.
49. Rev. Proc. 2003-10, 2003-2 I.R.B. 259; Notice 2003-2, 2003-2 I.R.B. 257.
50. With one exception: Roth IRAs are not subject to minimum distribution requirements during the life of the account owner, and most Roth IRA distributions are not taxable.
51. In year one, the 10-year-old heir's minimum distribution is the account balance at the end of the previous year divided by 72.8. In year two, it is the account balance at the end of year one divided by 71.8, and so on, until year 73, when the account balance at the end of year 72 is divided by .8 to fully deplete the account.
52. For example, using the life expectancy tables, for the year after the plan participant's death, a 10-year-old heir is required to withdraw only 1.4% of the account balance, a 40-year-old must withdraw 2.3%, and a 60-year-old must withdraw 4.0%.
53. Joint Committee on Taxation, *Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986, Volume II, Recommendations of the Staff of the Joint Committee on Taxation to Simplify the Federal Tax System*, April 2001, at 196.
54. In a report issued in September 2002, the Joint Economic Committee proposed several options for reforming or repealing the rules, including repeal, limited repeal, an increase in the age at which withdrawals must begin, a limited exclusion, a credit for excess withdrawals, allowing losses to be applied to other gains, and a grace period. The report concluded that "Any of the proposals would enhance efficiency by providing seniors with the choice of determining when it is in their best interest to make a withdrawal . . . how much to withdraw and subsequently pay the appropriate tax. The individual is in the best position to know when is the right time to elect to make withdrawals, not the government. Further, forcing seniors to sell assets in market conditions that have reduced their retirement plan assets may undermine the retirement security of seniors and produce less tax revenue to the government." Joint Economic Committee, United States Congress, *The Taxation of Individual Retirement Plans: Increasing Choice for Seniors*, Sept. 2002, www.house.gov/jec.
55. New York State Bar Association, *Report on Simplification of the Internal Revenue Code*, fifth draft, January 2002, at 137; State Bar of California, *supra* note 37.
56. *See* Dianne Bennett & David A. Pratt, *Simplifying Retirement Plan Distributions*, NYU 57th Institute on Federal Taxation, Employee Benefits and Executive Compensation (1999); Jay A. Soled & Bruce A. Wolk, *The Minimum Distribution Rules and Their Critical Role in Controlling the Floodgates of Qualified Plan Wealth*, 2000 B.Y.U. Law Review 587; David A. Pratt, *Pension Simplification*, 35 John Marshall Law Review 565, 584 (2002).
57. Bennett & Pratt, *supra* note 56, at 5–16.
58. *See,* for instance, Asinof, *Oops . . . How a Variety of Basic Foul-Ups are Bedeviling the Beneficiaries of IRAs*, Wall Street Journal, March 29, 1999, at C1.
59. P.L. 107-16 (H.R. 1836).
60. William G. Gale & Peter R. Orszag, *Whither Pensions? A Brief Analysis of Portman-Cardin III*, Tax Notes, April 28, 2003, 573, 577.

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This article was originally published in the Autumn 2004 *Benefits Law Journal*, and is reprinted with permission.

Unauthorized Practice of Law in Florida: You May Be Guilty

By Elisabeth Hessler

The Florida Bar recently issued a Staff Opinion that may have widespread ramifications for the New York estate planning community. Florida Bar Staff Opinion 24894[1] (the "Florida Opinion") states that Florida attorneys should not communicate with out-of-state attorneys on matters involving Florida law. The Florida Opinion was issued specifically in regard to out-of-state attorneys interpreting Florida real estate documents and Florida law in general. However, the principles set forth in the Florida Opinion can be interpreted to mean that an out-of-state attorney engages in the unlicensed practice of law in Florida when drafting estate planning documents having Florida implications.

Florida Bar Staff Opinion 24894

A Florida Bar Staff Opinion is an informal advisory ethics opinion issued to a member of the Florida Bar who questions whether contemplated conduct fits squarely with the Florida ethics rules. The Board of Governors of the Florida Bar authorizes Florida Bar ethics counsel to issue Staff Opinions. Staff Opinions are akin to Private Letter Rulings issued by the Internal Revenue Service, and are not to be relied on by attorneys other than the inquirer. A Staff Opinion does not carry judicial force and is not a substitute for a judge's decision or the decision of a grievance committee. However, Staff Opinions provide insight into how the Florida Bar may respond to such future conduct. These opinions are not published by the Florida Bar but may be obtained on request from the Florida Bar ethics counsel.

The Florida Opinion was issued to a Florida attorney (the "inquirer") who represented clients who own property in Florida but live out-of-state for part of each year. These "snowbird" clients have counsel in other states who are not licensed in Florida. In counseling their clients, these out-of-state attorneys interpret Florida real estate documents and other issues of Florida law. It was the inquirer's practice to send the following cease-and-desist notice when contacted by out-of-state attorneys to discuss the clients' legal issues:

> It is inappropriate for me to communicate with unadmitted attorneys regarding the interpretation of Florida law and Florida real estate documents. Accordingly, I respectfully demand that you cease and desist from communication with my client. Any further communication regarding this issue should be handled through a Florida-admitted attorney, addressed to my attention. We will continue to respond to your client through your office until we receive your consent to communicate directly with him/her or until we are advised that he/she is represented by Florida counsel. We assume you will forward our correspondence as appropriate.

Upon receipt of the inquirer's notice the out-of-state attorneys frequently cried foul. The inquirer sought assurance from the Florida Bar ethics counsel that his conduct was appropriate to prevent the unlicensed practice of law by out-of-state practitioners.

In issuing the Florida Opinion, the Florida ethics counsel relied on Florida Rules of Professional Conduct and Florida caselaw, and concluded that the inquirer had acted appropriately. The Florida Opinion reminded the inquirer of his duty to alert the out-of-state attorneys of the Florida rules related to the unlicensed practice of law, and one must necessarily conclude by implication that the Florida ethics counsel believed that the out-of-state attorneys had engaged in the unlicensed practice of law.

Florida attorneys must abide by the Rules of Professional Conduct. Rule 4-5.5(b) prohibits the inquirer from assisting or encouraging an out-of-state attorney in the unlicensed practice of law:

> Rule 4-5.5
> A lawyer shall not:
> (a) practice law in a jurisdiction where doing so violates the regulation of the legal profession in that jurisdiction; or
> (b) assist a person who is not a member of the bar in the performance of activity that constitutes the unlicensed practice of law.

The Comment to the Rule provides that the definition of the practice of law is established by law; limiting the practice of law to licensed attorneys is intended to protect the public. The Comment states

that the Rule "does not prohibit lawyers from providing professional advice and instruction to nonlawyers whose employment requires knowledge of law; for example, claims adjusters, employees of financial or commercial institutions, social workers, accountants, and persons employed in government agencies."[2] The practice of law includes "the giving of legal advice and counsel to others as to their rights and obligations under the law . . . although such matters may not then or ever be the subject of proceedings in a court."[3] Based on the facts presented by the inquirer, the Florida Opinion concluded that the inquirer acted appropriately in alerting the out-of-state attorneys of the rules regarding the unlicensed practice of law in Florida.

ActionLine Article

One commentator has evaluated the applicability of the Florida Opinion to wills, trusts and estates practices. The Spring 2004 issue of *ActionLine*, the Florida Bar's Real Property, Probate & Trust Law Section's quarterly newsletter, includes an article in which the author, Keith Kromash, concludes that a literal reading of the Florida Opinion means that Florida attorneys should "probably not review estate planning documents prepared by an out-of-state attorney because such a practice is akin to assisting or encouraging in the unlicensed practice of law."[4] In reaching his conclusion, Kromash relied on the Rules of Professional Conduct as enacted in Florida and on Florida caselaw.

Kromash's article sets forth the Florida rules related to the unlicensed practice of law, which are reviewed here. An out-of-state attorney who is not licensed in Florida is a nonlawyer.[5] The Comment to Rule 4-8.5 of the Rules of Professional Conduct states that if a lawyer's activity in the jurisdiction is "substantial and continuous" that activity may constitute the practice of law in Florida.[6] Florida defines the unlicensed practice of law to be "the practice of law, as prohibited by statute, court rule, and case law of the state of Florida."[7] The practice of law includes the giving of legal advice and counsel to others about their rights and responsibilities under the law.[8]

Rule 4-5.5 mandates that Florida lawyers shall not assist nonlawyers in the unlicensed practice of law.[9] Therefore, a nonlawyer who advises her clients of their rights and responsibilities under Florida law is engaging in the unlicensed practice of law. Where a Florida lawyer enables a nonlawyer to give legal advice and counsel to others about their rights and responsibilities under Florida law, the Florida lawyer has assisted in the unlicensed practice of law.

Kromash applies his analysis to two trust-and-estate scenarios, and evaluates whether the out-of-state attorney would be engaged in the unlicensed practice of law. In the first scenario, an out-of-state beneficiary of a trust or estate administered in Florida seeks legal advice from an out-of-state attorney. Kromash concludes that "if, in giving the beneficiary advice, the out-of-state attorney interprets Florida law with respect to wills, trusts or estates, that attorney will have engaged in the unlicensed practice of law."[10] Kromash counsels Florida attorneys representing Florida trustees and personal representatives to avoid assisting out-of-state attorneys who provide legal advice on Florida law to their clients. Kromash advises these Florida attorneys contacted by out-of-state attorneys to respond with cease-and-desist notices similar to the one described in the Florida Opinion.

The second scenario involves an out-of-state attorney who seeks review by a Florida attorney of estate planning documents drafted for a "snowbird" client. Presumably the estate planning document has some nexus with Florida, although Kromash does not make clear the extent of the client's contacts with Florida. Kromash concludes that based on a literal interpretation of the rules, caselaw, and the Florida Opinion, the Florida attorney should not review the estate planning documents, since reviewing the documents may constitute assisting or encouraging the unlicensed practice of law in Florida.

Advice for the New York Practitioner

These recent developments in Florida may cause New York attorneys some difficulty in conducting their estate planning practices. This is particularly important now, as the "snowbird" clients return to New York for the summer months. Although New York attorneys are not bound by the Florida Opinion, they may be affected by it and should be aware of its existence.

New York attorneys must abide by the Code of Professional Responsibility (hereinafter the "Code"). Disciplinary Rule 6-101 addresses the lawyer's duty of competency and provides the New York attorney guidance in the face of the Florida Opinion. Rule 6-101 states that:

> A. A lawyer shall not:
> 1. Handle a legal matter which the lawyer knows or should know that he or she is not competent to handle, without associating with a lawyer who is competent to handle it.
> 2. Handle a legal matter without

preparation adequate in the circumstances.
3. Neglect a legal matter entrusted to the lawyer.

This rule poses a serious problem to a New York attorney enlisted to draft an estate plan that may have Florida implications. For example, if an attorney is drafting a will for a client who owns a condominium in Florida and the attorney is unfamiliar with the governing law, that attorney has an ethical duty to investigate the Florida law. If the New York attorney interprets Florida law, the New York attorney has engaged in the unlicensed practice of law in Florida and may be subject to discipline. In light of the Florida Opinion, Florida attorneys may now be unwilling to explain the law to a New York attorney for fear of assisting in the unlicensed practice of law. This leaves the New York attorney hard pressed to competently advise her client.

Similarly, a New York attorney may endeavor to draft an estate plan for a New York domiciliary who plans to retire to Florida. At the time the attorney drafts the will, it is unclear whether the client will die domiciled in New York or Florida. The New York attorney owes a duty to the client to ensure that the will is valid in both states and may not ignore the realistic possibility of a Florida probate. In carrying out her duty to the client, it may be necessary to enlist a Florida attorney to review the New York will. If the Florida Opinion is to be adhered to, the Florida attorney should refuse to review the document because doing so would necessarily constitute assisting in the unlicensed practice of law.

The impact of Florida Opinion on New York attorneys remains to be seen. A Staff Opinion does not carry judicial force, but it is an indication of possible future action by the Florida Bar. In light of Kromash's article in *ActionLine*, many Florida attorneys have been made aware of the Florida Opinion. Florida lawyers will likely proceed with caution when enlisted by a New York attorney in estate planning matters and may choose to send a cease-and-desist notice instead of offering advice and counsel.

On the other hand, New York Bar members should proceed with caution, knowing that the Florida Bar may be looking for a case to test the principles set forth in the Florida Opinion. Ethically speaking, nothing in the Code of Professional Responsibility prohibits a New York attorney from drafting an estate plan that may have implications in Florida. In fact, the Disciplinary Rules mandate that the New York attorney competently represent her client, which may require enlisting an expert in Florida law. However, as a non-attorney in Florida, the New York attorney may be found to have engaged in the unlicensed practice of law and enjoined from such practices. Furthermore, the New York attorney may be sanctioned by the New York Bar for engaging in the unlicensed practice of law in Florida. The New York Bar will have to monitor how aggressively the Florida Bar proceeds with this issue. While the law in this area is far from settled, it is now clear where the Florida Bar stands.

Endnotes

1. September 3, 2003.
2. R. Regulating Fla. Bar 4-5.5 (2004).
3. *Florida Bar v. Sperry*, 140 So. 2d 587, 591 (Fla. 1962), *rev'd on other grounds*, 272 U.S. 379 (1963). *See also Florida Bar v. Beach*, 675 So. 2d 106 (Fla. 1996).
4. Keith Kromash, *A Primer on Florida Attorneys' Ethical Obligation to Avoid Assisting in the Unlicensed Practice of Law—Florida Bar Staff Opinion 24894*, ActionLine (Florida Bar Real Property, Probate and Trust Law Section Newsletter), Spring 2004, at 1.
5. R. Regulating Fla. Bar 10-2.1 (2004).
6. R. Regulating Fla. Bar 4-5.5 (2004).
7. R. Regulating Fla. Bar 10-2.1 (2004).
8. *Sperry*, 140 So. 2d at 591. *See Florida Bar v. Heller*, 247 So. 2d 434 (Fla. 1971) (the practice of law includes searching public records for lands and money which may have been abandoned, or unclaimed, by true owners, locating missing heirs and offering to recover funds, upon agreement to share the proceeds of the recovery); *Florida Bar v. Lister*, 662 So. 2d 1242 (Fla. 1995) (Wisconsin attorney engaged in the unlicensed practice of law in Florida when he represented that he was an attorney, prepared a mortgage and quitclaim deed for client, improperly created and used power of attorney, described himself as "Esquire" on correspondence, identified himself as an attorney in phone conversations, and had checks imprinted with words representing that he was an attorney).
9. R. Regulating Fla. Bar 4-5.5 (2004).
10. *ActionLine* at p. 5.

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Proposed Changes to Powers of Attorney

By Rose Mary Bailly and Barbara S. Hancock

Practitioners across the state have at one time or another experienced frustration with New York's current power of attorney statute.

The statute is silent on a number of key issues involved in counseling the principal, including the attorney-in-fact's fiduciary obligations, whether the attorney-in-fact can refuse to act, the attorney-in-fact's accountability, and how the principal can revoke the attorney-in-fact's authority. Another gap in the statute allows some financial institutions to insist on the use of their own power of attorney forms containing powers that do not necessarily match the principal's needs, and to refuse to accept a valid statutory short-form power of attorney.

Practitioners encounter a frustrating lack of statutory clarity in counseling attorneys-in-fact about matters such as the nature of their authority and responsibilities; how they should sign their name in transactions on behalf of the principal; to whom, if anyone, they are accountable; and how they can compel a financial institution to accept the power of attorney. Case law in many situations likewise offers little or no guidance.

Still other gaps in the current statute frustrate Adult Protective Services and law enforcement attempts to halt financial abuse by attorneys-in-fact, and to hold attorneys-in-fact accountable for such abuse.

A recent national survey of trusts and estates and elder law practitioners found a more than 70% consensus that any power of attorney statute should include direction and guidance on all of these matters.[1]

As Philip DiGiorgio's article in the Spring 2004 issue of this *Newsletter* notes, the Law Revision Commission's proposal responds to these gaps in New York law. Addressing these gaps and updating other provisions will have significant advantages for principals, their attorneys-in-fact, and elder law and trusts and estates practitioners, alike.

I. Advantages to the Principal

The Commission's proposal offers many advantages to the principal.

A. Codified Standard of Care

The Commission's proposal would codify the common law duties of an attorney-in-fact, namely, to act in the best interest of the principal, to keep the principal's property separate from the property of the attorney-in-fact, and to keep records and provide them upon demand by specific individuals.[2] By including the standard of care in the statute and on the statutory short form, both the principal and the attorney-in-fact are put on notice of these responsibilities.

The Commission's approach to include a standard of care in the statute is consistent with the approach used in New York's Estates, Powers and Trusts Law and Surrogate's Court Procedure Act, each of which specifically addresses the duties and obligations of other types of fiduciaries.[3] Other states, likewise, have set forth the duty and/or standard of care of the attorney-in-fact by statute. Notable examples include the power of attorney statutes of Arizona,[4] California,[5] Florida,[6] Illinois,[7] Minnesota,[8] New Jersey[9] and Pennsylvania.[10] Texas,[11] Colorado[12] and Oklahoma[13] achieve a similar result by requiring that the power of attorney state that the attorney-in-fact owes a fiduciary duty.

B. Option to Require the Attorney-in-Fact to Act

Under the Commission's proposal, the principal and the attorney-in-fact may expressly agree that the attorney-in-fact has a duty to act.

Despite the advantages of a power of attorney as an inexpensive and effective alternative to a guardianship proceeding if the principal becomes incapacitated, a power of attorney is wholly ineffective if the attorney-in-fact refuses to act on its authority. As one commentator notes, "[t]he current law in most states, as in New York, is that an attorney-in-fact can pick and choose when to act, even after the principal loses competence."[14]

Under common law agency principles, if an agent is employed by a unilateral contract in which the agent does not promise to act, the agent has no duty to act and cannot be held liable for failing to act. The agent does have a duty to act if the agent has undertaken to act or has caused the principal to rely on the assumption that he or she will do so.[15] In the context of powers of attorney, if a principal executes a durable power of attorney without informing the designated attorney-in-fact, it is difficult to argue that there has been such reliance. When the designation is later discovered, the designee may be unwilling or unable to accept the duties of an attorney-in-fact. In these circumstances, the attorney-in-fact has

made no promise to act, and under agency principles has no duty to act. A designee who has agreed to act as attorney-in-fact may likewise be unwilling or unable to accept the duties of attorney-in-fact when the time comes to act. In this case the attorney-in-fact has caused the principal to rely on the assumption that the designee will act. It may seem harsh to hold an attorney-in-fact liable for failing to exercise the authority accepted earlier under what may have been very different circumstances. On the other hand, the attorney-in-fact's failure to act leaves the incapacitated principal's affairs in disarray.

New York's few published cases on the subject do not provide a clear answer as to whether an attorney-in-fact is under a duty to act.[16]

The Commission's proposal would permit the principal and the attorney-in-fact to agree to an affirmative duty to act by allowing modification of the statutory short form to include a statement that the attorney-in-fact must act for the principal as to specified transactions or types of transactions. The signature of the attorney-in-fact on a power of attorney containing that modification indicates his or her acceptance of the principal's instructions.

If the attorney-in-fact agrees to act, he or she will be liable for any harm caused by his or her action or inaction. With this approach, the attorney-in-fact's liability is clearly prescribed from the onset and the principal has a means of ensuring that his or her intent and interests are reasonably protected. If the power of attorney instrument does not impose a duty to act on the attorney-in-fact, or if the attorney-in-fact refuses to agree to accept such duty, the attorney-in-fact will not be held liable for failing to act.

This revision adopts the approach used in other states which permit the principal and attorney-in-fact to form an enforceable agreement within the power of attorney instrument.[17]

C. Accountability

Under the proposal, the principal would be able to appoint a third party to request an accounting out of court. The statutory short form notifies the principal of this option. Because the designee or designees will be listed on the form, the attorney-in-fact will be put on notice from the beginning of this third party's right to request and scrutinize the record.

The obligation to keep records and provide them upon demand to specific individuals stems from common law. Under general agency law principles, "the duty of an agent to account for moneys of his or her principal coming into the agent's hands is well recognized. Where one assumes to act for another he or she should willingly account for such stewardship."[18] Similarly, under the Surrogate's Court Procedure Act, a fiduciary must account for all transactions made in his or her fiduciary capacity.[19]

D. Revocation

The proposal provides specific directions for revoking a power of attorney and provides a simple revocation form. This provision is intended to assist the principal seeking to revoke a power of attorney, and also financial institutions, which have complained that under current law they are sometimes uncertain whether or not a power of attorney has been revoked. As one commentator explained, "a financial institution does not want to imperil the assets of its customer by accepting a [power of attorney] that no longer reflects its customer's intent."[20]

E. Updated and Enhanced Gifting Options

1. Automatically Updated Federal Gift Tax Exclusion

Under the proposal, there would be no need to update a power of attorney solely to address changes to the amount of the federal gift tax exclusion. The current gifting authority at "(M)" limits gifts to $10,000 per person per year, reflecting the amount of the federal annual gift tax exclusion in effect when this authority was added to the General Obligations Law. In keeping with the Internal Revenue Code's required adjustment of this amount in $1,000 increments to keep pace with increases in the cost of living,[21] this revision ties the permissible gifting amount to the gift tax exclusion in effect at the time of the gift. Linkage to the corresponding federal gift tax exclusion ensures that the gifting authority is not restricted to an amount lower than that authorized by law.

2. Gifts to 529 Accounts

It will no longer be necessary to modify a power of attorney to allow gifts to a "Section 529" educational account[22] because the proposal permits gifts to an existing or new account established for the benefit of a permissible donee. Authorization for "529 accounts" was added to the Internal Revenue Code after the most recent revision of the General Obligations Law. The subsequent widespread use of 529 accounts for saving for higher education prompted their inclusion in this revision.

Section 529 allows a gift to a qualified account for a designated beneficiary to be treated as a completed gift to the beneficiary. As such, the gift is eligible for the annual gift tax exclusion under section 2503(b) of the Internal Revenue Code. The intent of this newly added provision in the construction sec-

tion pertaining to gift transactions is to allow only annual exclusion gifting (and gift splitting, where applicable). Thus, in a year when the annual gift tax exclusion amount is $11,000 per donee, a gift to a beneficiary's account in that year may not exceed $11,000, or $22,000 if the principal's spouse consents to gift splitting. A gift in excess of the annual exclusion amount for the purpose of spreading an excess contribution over a 5-year period under section 529(c)(2)(B) of the Internal Revenue Code is permitted only if the statutory short-form power of attorney contains additional language expressly authorizing it.

3. Gift Splitting

The Commission's proposal authorizes gifts from the principal's assets to be split with the principal's spouse. Gift splitting, authorized by section 2513 of the Internal Revenue Code, allows one spouse to gift up to twice the annual gift tax exclusion amount per donee, per year, with the consent of the non-donor spouse. In the context of a power of attorney, gift splitting allows the attorney-in-fact to make such gifts from the principal's assets, with the consent of the principal's spouse, to a class defined as the principal's children and other descendants, and parents. For example, in a year when the annual federal gift tax exclusion amount is $11,000, and where the married principal has two children, one grandchild, and one parent, the attorney-in-fact could gift up to $22,000 to any or all of these four people from the principal's assets, with the consent of the principal's spouse. If the maximum allowable gift of $22,000 is made to each of the four recipients, the total would come to $88,000.

II. Advantages to the Attorney-in-Fact

Attorneys-in-fact will be well served by proposed additions to the General Obligations Law.

A. Notice of Responsibilities

The guidelines governing the attorney-in-fact's responsibilities are clearly delineated in the statute, removing the potential for confusion. The form provides a notice summarizing the attorney-in-fact's fiduciary duty to the principal. Several states similarly require a valid power of attorney to include language indicating that the attorney-in-fact has a fiduciary duty to the principal.[23] Of these, both California and Pennsylvania require the agent to sign the power of attorney and acknowledge these duties.[24]

B. Compensation and Reimbursement

Under current law, unless he or she is acting with respect to the administration of an estate,[25] an attorney-in-fact has no express right to compensation or reimbursement for expenses incurred in the course of acting under the power of attorney. In fact, "it is presumed that [where the two parties are related,] the services of the attorney-in-fact to a principal were rendered in consideration of love and affection, without expectation of payment."[26] However, the prospect of the principal's disability or incapacity, requiring the attorney-in-fact's time, effort, and expense over a long period of time, may make compensation a significant issue.[27] The proposal amends the law to provide that the attorney-in-fact is only entitled to compensation when the principal so indicates. Accordingly, the statutory short forms allow the principal to list the name of each attorney-in-fact who will be entitled to receive reasonable compensation. Thus, the proposal removes any ambiguity as to whether an attorney-in-fact can write himself or herself a check for the long hours devoted to preparing a tax return or other tasks undertaken for the principal.

Under the proposal, the attorney-in-fact would also be entitled to reimbursement for out-of-pocket expenses actually incurred in connection with his or her duties as attorney-in-fact, an approach consistent with general agency rules and statutory rules governing trustees and fiduciaries.[28]

Other states regulate compensation and reimbursement in varying degrees.[29] The compensation approach proposed by the Commission is a hybrid of these initiatives.

C. Signature on the Power of Attorney Activates the Power of Attorney

The requirement that the attorney-in-fact sign the power of attorney to activate it leaves no uncertainty as to when the document becomes effective. This is consistent with the approach of other states.[30] Practitioners in these states have indicated that this requirement does not pose a burden on the principal or the attorney-in-fact, or, indeed, on practitioners.[31] If the principal wants the agent to take over immediately, the agent can sign the document essentially at the same time as the principal. If not, as is often the case, the practitioner can file away the original document without the agent's signature. When the time comes to activate the power of attorney, the practitioner can notify the attorney-in-fact who can then sign the document. Clients who choose to hold their own powers of attorney can be instructed in writing that the agent will need to sign before using the document. The proposal provides that such a lapse of time between signatures is not grounds for claiming the power is invalid.[32]

In addition, the proposal provides that a third party's refusal to accept a power of attorney is unreasonable if it is based solely on a lapse in time

between the acknowledgment of the signatures of the principal and attorney-in-fact, or between attorneys-in-fact who may act separately.

A successor attorney-in-fact is not expected to execute the instrument unless the first named attorney-in-fact is unwilling or unable to act. Here again, it is permissible for the successor to sign and acknowledge the form some time after the principal has executed it.

D. Disclosure of Agency Relationship

The proposal requires that the attorney-in-fact sign any transactional document in a manner that discloses the attorney-in-fact relationship. The current statute does not tell the attorney-in-fact how to sign a document where he or she is acting on behalf of the principal. Consequently, it may be difficult to determine whether the attorney-in-fact was acting for the principal or for himself or herself. The language in the proposal benefits the principal, the attorney-in-fact and third parties by eliminating guesswork.

E. Resignation

The proposal makes clear the procedure by which the attorney-in-fact can resign if he or she is no longer willing to act. If the power of attorney requires the attorney-in-fact to act, the attorney-in-fact can resign by notifying the successor attorney-in-fact. The attorney-in-fact's resignation is effective when the successor attorney-in-fact signs the power of attorney. If no successor attorney-in-fact is appointed, or if the appointee is unable or unwilling to act, the attorney-in-fact or his or her representative must petition the court to resign. All attorney-in-fact have a fiduciary duty to notify the next successor attorney-in-fact of the intent to resign. If an attorney-in-fact is not under a duty to act, the attorney-in-fact *may* seek court approval of his or her resignation in lieu of notifying the successor attorney-in-fact. This approach places very little burden on an attorney-in-fact, while protecting the principal against abandonment.

F. Portability

Under the proposal, an attorney-in-fact appointed pursuant to a valid power of attorney executed out of state would clearly be able to act in New York. The proposed portability provisions provide that a power of attorney executed out of state and effective in that state is effective here as well, even if the other state's statutory requirements for validity differ from New York's. Such treatment of a power of attorney is consistent with New York's treatment of health care proxies and wills executed in other jurisdictions. [33]

G. Third-Party Acceptance of Powers of Attorney

The proposal should make it easier for an attorney-in-fact to get a power of attorney accepted by a third party because the proposed statute spells out valid and invalid reasons for rejecting it. An often-heard complaint is that financial institutions are reluctant to accept statutory short-form powers of attorney even though current law makes such refusal unlawful.

The Commission's proposal is intended to encourage routine acceptance of statutory short-form powers of attorney. Most significant, perhaps, is the provision providing that the attorney-in-fact's signature in a transaction made on behalf of the principal constitutes an attestation to the validity of the power of attorney and his or her authority. Thus, the third party who relies on the signature of the attorney-in-fact will escape liability unless the third party had actual notice that the power of attorney was no longer valid. Moreover, the proposal would permit the attorney-in-fact to bring a special proceeding to compel a third party to accept a power of attorney and to recover attorneys' fees.

III. Advantages to Practitioners

In addition to the benefits to their clients, many practitioners whose regular work includes counseling clients about powers of attorney should find many of the amendments useful.

A. Codification of the Law

Under the proposal, all of the law relating to powers of attorney would be codified and readily available in the statute.

B. HIPAA Privacy Rule

The requirements of the HIPAA Privacy Rule, a very complex regulation addressing privacy of an individual's health information, and which have generated much uncertainty, would be addressed.

With a provision to be added to the construction section for "records, reports and statements" (renamed "health care billing and payment matters; records, reports, and statements"), practitioners could be assured that an attorney-in-fact could appropriately access the principal's protected health information needed to verify the accuracy of bills.

The proposal creates a form by which the principal can authorize the release of protected health information under the Privacy Rule for purposes of determining whether the principal continues to have capacity. Such information is necessary in certain cir-

cumstances in order to determine whether the power of attorney is legally in effect. For example, a springing power of attorney may take effect upon the occurrence of the principal's incapacity, as certified by a physician or physicians identified in the document. The HIPAA-compliant form provided in the statute would allow the principal to authorize the release of this certification to the designated attorney-in-fact or other person specified in the form, such as the principal's attorney.

C. Certification

The proposal allows an attorney to certify a copy of a power of attorney as an alternative to recording it with the county clerk to obtain certified copies. This provision would protect the client's privacy and limit trips to the county clerk's office.

IV. Conclusion

This short article highlights a few of the advantages to trusts and estates and elder law practitioners and their clients that are included in the changes proposed by the Law Revision Commission and summarized in the Spring 2004 issue of this *Newsletter* by Philip DiGiorgio.

Endnotes

1. Linda S. Whitton, *Crossing State Lines with Durable Powers of Attorney*, Probate & Property 28, 30 (September/October 2003). The survey was conducted by the Joint Editorial Board for Uniform Trusts and Estates Acts (JEB) of the National Conference of Commissioners on Uniform State Laws of elder law and probate sections as well as the leadership of the American Bar Association's Real Property, Probate and Trusts Law Section, the American College of Trust and Estate Counsel and the National Academy of Elder Law Attorneys. There were 371 respondents representing 43 jurisdictions. *Id.*
2. *See, e.g., Mantella v. Mantella*, 268 A.D. 2d 852 (3d Dep't 2000).
3. *See, e.g.*, N.Y. Estates, Powers & Trusts Law 11-1.6 (property held as a fiduciary to be kept separate) and 11-4.7 (liability of personal representative for claims arising out of the administration of the estate) (hereinafter "EPTL"); and N.Y. Surrogate's Court Procedure Act 711 (suspension, modification or revocation of letters or removal for disqualification or misconduct) and 719 (in what cases letters may be suspended, modified or revoked, or a lifetime trustee removed or his powers suspended or modified, without process) (hereinafter "SCPA").
4. Ariz. Rev. Stat. § 14-5506 (2003).
5. Cal. Prob. Code §§ 4266, 4232 (West 2003).
6. Fla. Stat. ch. 709.08(8) (2002).
7. 755 Ill. Comp. Stat. 45/2-7 (West 2003).
8. Minn. Stat. § 523.21 (2002).
9. N.J. Stat. Ann. § 46:2B-8.13 (West 2003).
10. 20 Pa. Cons. Stat. § 5601 (2002).
11. Tex. Prob. Code Ann. § 490 (West 2003).
12. Colo. Rev. Stat. § 15-1-1302 (2002).
13. Okla. Stat. tit. 15 § 1003 (2003).
14. *See* Carolyn Dessin, *Acting as Agent Under a Financial Durable Power of Attorney: An Unscripted Role*, 75 Neb. L. Rev. 574, 610 (1996).
15. *See* 2A N.Y. Jur. 2d Agency & Indep. Contractors § 210 *citing* Restatement 2d, Agency §§ 377 and 378.
16. *See, e.g., In re Wingate,* 169 Misc. 2d 701 (Sup. Ct., Queens Co. 1996) (The court revoked a power of attorney in a guardianship proceeding for the principal. The court determined that the attorney-in-fact's failure to sell shares in the principal's cooperative apartment so that the principal could remain in a nursing home constituted a breach of fiduciary duty. However, the court imposed no liability on the attorney-in-fact for failure to act.); *In re Rochester Hospital,* 158 Misc. 2d 522 (Sup. Ct., Monroe Co. 1993) (The court revoked a power of attorney appointing the principal's son as attorney-in-fact, where the attorney-in-fact, without any apparent reason, failed to assist in the completion of a Medicaid application for the hospitalized and incapacitated principal. Although the court did not explicitly state that the attorney-in-fact had breached his fiduciary duty, the court cited the son's unwillingness or inability to act as the reason for revoking the power of attorney.). While these cases suggest that an attorney-in-fact has a duty to act, both courts chose to revoke the power of attorney without imposing liability on the attorney-in-fact who failed to act.
17. *See* Cal. Prob. Code § 4230(c) (West 2003); Mo. Rev. Stat. § 404.705(4) (2002); and Vt. Stat. Ann. tit. 14 § 3506(c) (2002).
18. 2A N.Y. Jur. 2d Agency & Indep. Contractors § 239 (1998).
19. *See, e.g.*, SCPA 708, 2307, and 1502.
20. Daniel A. Wentworth, *Durable Powers of Attorney: Considering the Financial Institutions's Perspective*, 17 Probate & Property 37, 39, November/December 2003.
21. *See* section 2503(b)(2) of the Internal Revenue Code.
22. Such accounts are authorized under section 529 of the Internal Revenue Code (qualified state tuition programs).
23. *See, e.g.,* Cal. Prob. Code § 4128 (West 2003); 20 Pa. Cons. Stat. § 5601 (2002); Tex. Prob. Code Ann. § 490 (West 2003); Colo. Rev. Stat. § 15-1-1302 (2002); Okla. Stat. tit. 15, § 1003 (2003).
24. Cal. Prob. Code § 4128 (West 2003); 20 Pa. Cons. Stat. § 5601 (2002).
25. *See* SCPA 2112 (compensation of persons acting under powers of attorney or other instruments).
26. *Mantella v. Mantella*, 268 A.D.2d 852 (3d Dep't 2000).
27. *See* California Law Revision Commission, Statutory Comment, Cal. Prob. Code § 4204 (West 1994).
28. *See, e.g., James T. Kelly Jr., P.E., P.C. v. Schroeter*, 209 A.D.2d 737 (3d Dep't 1994); EPTL 7-2.3(2); and SCPA 2307.
29. *See* Ark. Code Ann. § 28-68-310 (Michie 2002) (attorney-in-fact is entitled to reasonable compensation); Cal. Prob. Code § 4204 (West 2003) (attorney-in-fact is entitled to reasonable compensation); Ind. Code § 30-5-4-5 (2002) (permit the principal to limit compensation to which the attorney-in-fact is otherwise entitled); Mo. Rev. Stat. § 404.725 (2003) (permit the principal to limit compensation to which the attorney-in-fact is otherwise entitled); N.J. Stat. Ann. § 46:2B-8.12 (West 2003) (permit the principal to limit compensation to which the attorney-in-fact is otherwise entitled); 20 Pa. Cons. Stat. Ann. § 5609 (2002) (permit the principal to limit compensation to which the attorney-in-fact is otherwise entitled); Vt.

Stat. Ann. tit. 14 § 3504(d) (2002); Ariz. Rev. Stat. § 14-5506 (2003) (no compensation of an attorney-in-fact unless the terms of compensation are detailed in the power of attorney); Colo. Rev. Stat. § 15-1-1302 (2002) (permit the principal to choose whether compensation should be permitted by so designating in the respective statutory short-form power of attorney); Ga. Code Ann. § 10-6-142 (2002) (permit the principal to choose whether compensation should be permitted by so designating in the respective statutory short-form power of attorney); 755 Ill. Comp. Stat. 45/3-3 (West 2003) (permit the principal to choose whether compensation should be permitted by so designating in the respective statutory short-form power of attorney).

30. *See, e.g.*, Cal. Prob. Code § 4128 (West 2003); 20 Pa. Cons. Stat. § 5601 (2002).

31. E-mails from chairs of elder law and trusts and estates sections of the state bar associations of Vermont and New Hampshire, on file with the Commission.

32. The same is true for a lapse of time between the dates of acknowledgment of the signatures of attorneys-in-fact designated to act separately.

33. See N.Y. Pub. Health L. § 2990 (a health care proxy or similar instrument executed in another state or jurisdiction in compliance with the laws of that state or jurisdiction shall be considered validly executed for purposes of the Public Health Law); EPTL 3-5.1(c) (will disposing of personal property wherever situated, and real property in New York is valid and admissible to probate in this state if it is in writing, signed by the testator, and executed and attested in accordance with the law of the jurisdiction in which the will was executed, at the time of execution).

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Eligibility to Serve as Executor: What Are the Limits?

By Gary E. Bashian and James G. Yastion

You represent the beneficiary under a Will. The nominated executor has submitted his Petition to be appointed executor under the Will. A separate proceeding, however, is pending in Supreme Court against the nominated executor. The Complaint in that proceeding alleges that the nominated executor fraudulently and/or unduly influenced the decedent to transfer the family home from the decedent's sole name to the decedent and the nominated executor with right of survivorship. If such a deed were held valid, your client would be virtually disinherited. Does your client have grounds for objecting to the nominated executor being appointed fiduciary? Can your client object to the appointment of the fiduciary while ensuring that the Will is probated?

It is a well-established rule that the testatrix's selection of an executor is to be honored unless it has been clearly shown that he is ineligible to serve as fiduciary.[1] Moreover, SCPA 1412 essentially provides that applications by nominated executors for preliminary letters testamentary should be routinely granted.[2] Finally, mere conclusory allegations that the nominated executor is ineligible to serve as executor are not sufficient to deny an application for preliminary letters.[3]

Notwithstanding these basic rules, courts have denied a nominated executor's application for preliminary letters where specific, bona fide issues are raised with regard to whether the nominated executor has been guilty of undue influence or fraud or with regard to whether he can properly administer the assets of the estate.[4]

This rule is linked to the common eligibility requirements of SCPA 707. Section 707 of the SCPA lists the persons who are ineligible to receive letters, which include (1) an infant, (2) an incompetent, (3) a non-domiciliary alien (with exceptions), (4) a felon, (5) "one who does not possess the qualifications required of a fiduciary by reason of substance abuse, dishonesty, improvidence, want of understanding, or who is otherwise unfit for the execution of the office," and (6) a person declared ineligible in the court's discretion because they cannot read or write English.[5] The ineligibility of one who "does not possess the qualifications . . . or who is otherwise unfit" from acting as fiduciary contemplates a fiduciary likely to jeopardize estate property and the interests of the beneficiaries.

With these rules in mind, we address the question of whether the nominated executor in the above hypothetical should be denied letters when a turnover proceeding has been commenced, but the court has not rendered a final order or judgment finding undue influence or fraud.

On similar facts, in the case of *Estate of Alice Weiss*, the Court held that letters should be denied. There, the co-guardians in an Article 81 proceeding had, prior to the incapacitated person's death, commenced a turnover proceeding against the executor of the incapacitated person's Will on the grounds that the executor had put his name on the title of $2.6 million in assets. The incapacitated person died and the turnover proceeding was held in abeyance pending the substitution of the legal representatives of the decedent. The executor filed his petition for letters testamentary. The Court held that even though the decedent's selection of her estate's representatives should be honored, the executor's appointment in this situation was not appropriate in light of his position as Respondent in the turnover proceeding. The executor would have had to prosecute the claims of the estate against himself. The executor proposed a compromise by which he would only be prevented from acting as executor as to those assets which he allegedly converted. This solution, however, was not acceptable to the Court because the outcome of the turnover proceeding could determine his general fitness to act as a fiduciary for the estate.

To succeed in objecting to the appointment of the nominated executor, mere allegations of ineligibility will not be sufficient. The Court in *Vermilye* confirmed this rule.[6] Rather, specific bona fide issues of fitness to serve as executor must be raised.[7] In *Weiss*, not only was a proceeding commenced, which had proceeded to the point where the co-guardians filed a motion for summary judgment, but in addition, the incapacitated person, by seeking the appointment of her guardians, had implicitly acknowledged that the Respondent/executor was taking advantage of her in ways beyond her control.

In cases such as *Weiss*, where courts have found the existence of bona fide issues of undue influence or fraud, courts have exercised their discretion to appoint an administrator other than the nominated executor pending the determination of the probate contest.[8]

The question then arises whether facts short of those in *Weiss* would be sufficient to raise bona fide issues of the nominated executor's eligibility. For example, are mere allegations of undue influence, short of a turnover proceeding or proceeding to void a deed by the institution of a lawsuit in Supreme Court with a lis pendens filed, enough to meet the hurdle of "specific, bona fide" issues?

In cases with facts less compelling than those in *Weiss*, courts may opt for less stringent means of protecting the estate and its assets than outright denial of the fiduciary's petition for letters and appointment of another fiduciary in his stead. Courts may merely require the fiduciary to post a bond to ensure the faithful performance of his duties.[9] Such limited relief is more common in more modest estates.[10] To provide further relief, courts may grant the aggrieved party his own additional restricted letters under SCPA 702(9) to commence an action against the preliminary executor.[11] Finally, courts may go somewhat further and not only require a full bond of the preliminary executor, but restrict the powers of the preliminary executor to marshalling estate assets, and prohibit the fiduciary from distributing, paying out "or otherwise transferring assets of the estate without further court order."[12]

If the beneficiary in our hypothetical situation, however, seeks to have the nominated executor's application denied, she can file two documents. The first document is the Verified Objections, not challenging the propounded Will itself, but only the appointment of the nominated executor. The grounds for why the nominated executor should not be appointed should be set forth in the Objections. Section 707 of the SCPA lists the grounds for ineligibility. Where the Objectant is claiming the nominated executor should not be appointed because he is alleged to have practiced undue influence and/or fraud, this can be included under the general catchall of SCPA 707(1)(e) which makes those persons ineligible who are "otherwise unfit for the office" of executor.[13] The second document to be filed is a Petition for full or temporary Letters of Administration, c.t.a. naming the beneficiary, or someone else, to act in the nominated executor's stead.

Therefore, if there are sufficient and reasonable facts in your favor, despite the general rules favoring the appointment of the nominated executor and the admission of wills to probate, a beneficiary or other person interested in the estate may prevent the nominated executor from being granted full or even preliminary letters testamentary.

Endnotes

1. *See In re Duke*, 87 N.Y.2d 465 (1996).
2. *See* Turano, McKinney Practice Commentary, SCPA 1412, Practice Commentaries (1995): "The thrust of section SCPA 1412 is to honor the testator's wishes with respect to the appointment of a fiduciary, even on a temporary basis, and its effect is to reduce the possibility of spurious pre-probate contests."
3. *See In re Vermilye*, 101 A.D.2d 865 (2d Dep't 1984).
4. *See Estate of Alice Weiss*, N.Y.L.J., Dec. 19, 1997 (Sur. Ct., Bronx Co.).
5. SCPA 707.
6. *See In re Vermilye, supra*.
7. *See Estate of Alice Weiss, supra*.
8. *See, e.g., In re Scamardella*, 169 Misc. 2d 55, 57, *aff'd*, 238 A.D.2d 513, 657 N.Y.S.2d 930 (2d Dep't 1997); *In re Ranney*, 78 N.Y.S.2d 602, *aff'd*, 273 A.D. 1057 (4th Dep't 1948); *In re Smith*, 71 Misc. 2d 248 (Sur. Ct., Erie Co. 1972); *In re Mann*, N.Y.L.J., April 10, 1978.
9. *See, e.g., In re Roth*, N.Y.L.J., Sept. 16, 1999, at 35, col. 5 (Sur. Ct., Kings Co.).
10. *See In re Fordham*, N.Y.L.J., Dec. 16, 1998, at 22, col. 6 (Sur. Ct., Bronx Co.).
11. *See, e.g., In re Pollack*, N.Y.L.J., May 10, 1999, at 30, col. 5 (Sur. Ct., Westchester Co.).
12. *See In re Gold*, N.Y.L.J., June 5, 2001, at 23, col. 1 (Sur. Ct., Kings Co.).
13. SCPA 707(1)(e) provides: "Letters may issue to a natural person or to a person authorized by law to be fiduciary except as follows: 1. Persons ineligible . . . (e) one who does not possess the qualifications required of a fiduciary by reason of substance abuse, dishonesty, improvidence, want of understanding, or who is otherwise unfit for the execution of the office."

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My Client Married an Alien: Ten Things Everyone Should Know About International Estate Planning

By G. Warren Whitaker and Michael J. Parets

Most U.S. estate planners deal exclusively with domestic clients and assume that they do not need to know anything about cross-border matters. However, other countries do exist in the world. Citizens of those countries sometimes move to the U.S. or own property here, and our citizens occasionally move or own property outside the U.S. Estate planners need to be aware of international issues that may arise. This article describes (with apologies to David Letterman) the top ten international estate planning issues that a domestic estate planner is likely to encounter.

1. You are discussing estate planning with Sam, a U.S. citizen and resident client. Sam tells you that his wife, Carol, is a Canadian citizen with a green card who has resided in the United States for many years.

A key element in the estate planning for a married individual is the estate tax marital deduction. Because Carol is not a U.S. citizen, special rules will apply to obtain the marital deduction for Sam's estate.

The unlimited marital deduction from U.S. estate taxes will not be available for bequests that Sam makes outright to Carol or in a Qualified Terminable Interest Property (QTIP) trust for her benefit. Since Carol is not a U.S. citizen, the marital deduction is available only if certain requirements are met (I.R.C. § 2056(d)(2)(a)).

The property must be left to the surviving non-citizen spouse in the form of a Qualified Domestic Trust (QDT) which pays all income to the spouse for life, has at least one U.S. trustee and may make principal distributions only to the surviving spouse (I.R.C. §§ 2056(d)(2), 2056A). If the trust has more than $2 million in assets there must be a U.S. corporate trustee, unless a letter of credit or a bond is posted. Whenever a principal distribution is made to the surviving spouse from a QDT, an estate tax is paid out of the distribution at the applicable rate for the estate of the *deceased* spouse. On the death of the surviving spouse, the balance then remaining in the QDT is also subject to estate tax at the applicable rate for the estate of the deceased spouse (I.R.C. § 2056A).

There are special arrangements that can be entered into with the IRS to obtain the marital deduction for individual retirement accounts, other retirement benefits and other assets that cannot easily be transferred directly into a QDT (Treas. Reg. § 20.2056A-4(b)). These are cumbersome, however, involving the posting of a bond and a tax on the principal portion of all distributions from the plan to Carol. It may be preferable in some cases to use Sam's applicable exclusion amount of $1.5 million to shelter retirement plans payable to Carol.

If Sam does not create a QDT but leaves his property outright to Carol, she (or the executor of Sam's estate) can create a QDT after his death and add the assets she inherits from him to the QDT she creates. However, it is preferable for Sam to create the QDT in his will or revocable trust. Among other reasons, this alerts both Sam and Carol to the QDT requirement and allows them to plan to minimize its impact.

The greatest disadvantage to the QDT is that principal distributions to Carol are subject to estate tax. Techniques to minimize this disadvantage are:

(i) Following Sam's death, Carol may avoid the QDT requirements by becoming a U.S. citizen (I.R.C. § 2056(d)(4)). Any principal distributions made from the QDT to Carol before she becomes a citizen will be taxed (unless she becomes a citizen before Sam's estate tax return is filed), but the remaining principal in the trust can be paid outright to her or converted to a QTIP trust without tax after she becomes a citizen. This may be the easiest solution if Carol does not expect to ever give up U.S. residence.

(ii) Sam can build up Carol's estate to the extent possible, and Carol should not transfer any assets to Sam or to joint names. (See Issue 3 in this regard, however, for limitations on the amount Sam can give to Carol.)

(iii) Consider the hardship exception, which allows principal distributions to be made to Carol from the QDT without tax if she does not have sufficient income or assets of her own to meet her needs (I.R.C. § 2056A(b)(3)(B)).

(iv) Consider the use of life insurance. A life insurance policy on Sam's life owned by an insurance trust can provide a source for both income and principal distributions to Carol without estate tax either on Sam's death, at the time of distribution, or on the death of Carol. (The policy could also be owned by Carol; this will avoid the need for the proceeds to be held by a QDT on Sam's death,

but the remaining proceeds at Carol's death will be subject to estate tax if she is still a U.S. resident.)

Of course, if Sam's gross estate is under $1.5 million, he can leave his entire estate outright to Carol without using a QDT. Although his assets will not qualify for the marital deduction, they will be sheltered by Sam's unified credit. If Sam has less than $1.5 million but the total assets of Sam and Carol exceed $1.5 million, and if Carol plans to remain in the U.S. after Sam's death, Sam should leave his estate to a unified credit shelter or bypass trust for Carol to shelter his assets from estate tax at her later death.

2. Carol, a Canadian citizen residing in the United States, now asks you to prepare her estate plan.

The United States subjects both citizens and residents to estate and gift tax on their worldwide assets. Every other country in the world (except for the Philippines) taxes only its residents, and not its nonresident citizens. Therefore, it is essential to confirm that Carol is a resident of the U.S. and not a resident of Canada.

The residence test for U.S. estate tax purposes is a domicile test, based on all the facts and circumstances (Treas. Reg. § 20.0-1(b)(2)). Visa status and the number of days spent in the U.S. are relevant but not determinative. By contrast, the income tax test for residence is a "bright line" test, which includes a non-U.S. citizen who either (1) is present in the U.S. for 183 or more days in a year; (2) is present in the U.S. for an average of 122 or more days in three or more consecutive years; or (3) has a U.S. green card or permanent work visa (I.R.C. § 7701(b); Treas. Reg. § 301.7701(b)-1–(b)-9).

When Carol tells you that she has lived in the United States for twenty years on her green card with her husband and their children (all of whom are U.S. citizens), that the only property she owns in Canada is a vacation house that she visits for three weeks each year, and that her contacts (clubs, doctors, financial and banking relationships) are overwhelmingly with the United States, we can conclude that she is a U.S. resident. As such, she is fully subject to U.S. estate, gift and generation-skipping transfer taxes on her worldwide assets, and is entitled to a full unified credit. She will not need a QDT in her will because her husband, Sam, is a U.S. citizen.

It seems clear from the facts that Carol is not a Canadian resident, although if the facts were closer we might want to consult a Canadian attorney to confirm that this is a correct conclusion under Canadian law. Since Canada taxes only its residents, Carol will not be subject to Canadian death taxes on her death, except possibly on the real property that she still owns in Canada. (If Carol had changed her residence from Canada to the United States in the past year, we might have to ask Canadian counsel whether this resulted in any Canadian tax consequences; in fact, Canada does charge a capital gains tax on the assets of all departing residents.)

Carol's house in Canada can probably be disposed of by her U.S. will, but administration in Canada may be streamlined if she has a separate Canadian will to dispose of that property. The Canadian house will be subject to U.S. estate tax at Carol's death, but it also will be subject to Canadian death taxes, and we will need to consult a Canadian attorney on this issue. (The Canadian attorney will tell us that Canada does not have an estate tax, but has a capital gains tax at death with a rollover available for property passing to a surviving spouse. Pursuant to a treaty between the U.S. and Canada, the U.S. allows a credit against U.S. estate tax for this Canadian capital gains tax at death.)

3. Because Carol has few assets in her own name, Sam wishes to transfer assets to her to build up her estate.

A person may make unlimited lifetime gifts to his or her U.S. citizen spouse without gift tax consequences because the gifts will qualify for the unlimited gift tax marital deduction (I.R.C. § 2523). The unlimited gift tax marital deduction is available even when the spouse making the gifts is neither a U.S. citizen nor a U.S. resident (Non-U.S. persons are subject to gift tax only on U.S. situs real estate, tangible personal property and cash.) However, since Carol—the donee—is not a U.S. citizen, the marital deduction is not available to Sam. Instead, Sam is allowed an annual exclusion of $114,000 for these gifts (I.R.C. § 2523(i)). (The amount was originally $100,000, but it is indexed annually for inflation.) These gifts may be made outright or in trust.

If Sam prefers to make the gifts in the form of a trust, the trust must be structured so that it qualifies as a gift of a present interest (I.R.C. § 2503(b)), and would also qualify for the gift tax marital deduction under I.R.C. § 2523 if the donee spouse were a U.S. citizen. This would include, for instance, a trust in which the spouse receives all income for life and is also granted a general power of appointment at death. It would *not* include a QTIP trust because such a trust does not qualify for the marital deduction unless an election is made, and since Carol is not a U.S. citizen, no such election can be made.

Any gifts to Carol in excess of $114,000 will be subject to gift tax, against which Sam must apply the unused portion of his unified credit amount. He cannot create a "lifetime" QDT to qualify these gifts for the gift tax marital deduction.

4. Sam and Carol have a bank account and a house in joint name. The joint bank account was opened in 1992, and the house was purchased in 1995. Sam provided 75% and Carol provided 25% of the funds toward the purchase price of the house.

On Sam's death, if he is the first to die, the *entire value* of all joint property is included in his gross estate, *except* to the extent that the Carol can establish by evidence that she contributed to the acquisition cost of the property (Treas. Reg. § 20.2056A-8). If Carol were to die first, the rules under I.R.C. § 2040(b) would apply because Sam is a U.S. citizen and one-half of the value of the property would be includible in Carol's gross estate.

The creation by a husband and wife of a joint tenancy (or a tenancy by the entirety) in real property on or after July 14, 1988, is not treated as a taxable gift (Treas. Reg. § 25.2523(i)-2(b)(1)). If, however, the joint tenancy is terminated (for example, by sale of the property or change in the form of ownership), a gift is deemed to be made from Sam to Carol if Carol individually receives any proceeds in excess of her pro rata share of contributions to the purchase price (Treas. Reg. § 25.2523(i)-2(b)(2), (4)).

Upon the creation of a joint tenancy in tangible personal property, where consideration is furnished by the U.S. citizen spouse, a gift of one-half of the value of the joint property is deemed to have been made to the non-citizen spouse (Treas. Reg. § 25.2523(i)-2(c)(1)). A different rule may apply, however, in the context of a joint bank account or brokerage account that allows either joint tenant to withdraw funds without obligation to repay such amounts. In such a case, there will be a gift not at the time the joint account is funded, but rather at the time the account is terminated or at the time of a withdrawal by Carol to the extent that either spouse receives a greater portion of the account balance than he or she has contributed (See Treas. Reg. § 25.2511-1(h)(4)).

If, as a result of these rules, all or a portion of the value of a jointly-held property interest is includible in Sam's gross estate, the includible portion may be transferred to a QDT by Carol to avoid an immediate estate tax liability (Treas. Reg. § 20.2056A-8).

The federal estate and gift taxation of joint tenancies in the context of non-citizen spouses is an area of difficulty due an to intricate legislative history and an absence of judicial and regulatory interpretation. An estate planner advising clients on these matters should review and apply these rules carefully on a case-by-case basis. The best advice will generally be to avoid joint tenancies for property of any significant value where one spouse is not a U.S. citizen. Any existing joint tenancies should be severed and each party receive his or her pro rata share based on their respective contributions.

5. Sam and Carol want her brother Wayne, a Canadian citizen and resident, to be co-trustee, together with the surviving spouse, of the credit shelter, QTIP and QDT trusts they are each creating under their respective wills, and also of Sam's insurance trust.

Having Wayne serve as a co-trustee of the trusts will make each trust a foreign trust for U.S. income tax purposes. A trust is treated as a foreign trust *unless* (i) a United States court can exercise primary supervision over the administration of the trust (the "court test") and (ii) one or more U.S. persons have the power to control *all* substantial decisions of the trust (the "control test") (I.R.C. § 7701(a)(30)(E) and (31)(B); Treas. Reg. § 301.7701-7(b)). This is true even if the trusts are governed by the laws of a U.S. state and even if they are created under wills that are admitted to probate in a U.S. state.

Under the control test, powers held by any person or entity will be considered in determining whether U.S. persons control all substantial decisions—not only the trustee, but also powers exercisable by a trust protector, the grantor or even a beneficiary.

Under the Treasury Regulations, "substantial decisions" include:

(i) Whether and when to distribute income or corpus.

(ii) The amount of any distribution.

(iii) The selection of a beneficiary.

(iv) The power to make investment decisions. (However, if a trust has a foreign investment advisor who can be removed by the U.S. trustee at any time, this will not make the trust foreign.)

(v) Whether a receipt is allocable to income or principal.

(vi) Whether to terminate the trust.

(vii) Whether to compromise, arbitrate or abandon claims of the trust.

(viii) Whether to sue on behalf of the trust or to defend suits against the trust.

(ix) Whether to remove, add or name a successor to a trustee.

If the trust is a foreign trust, it is subject to U.S. income tax only on its U.S. situs income: generally dividends from U.S. corporations, rents and gains from the

sale of U.S. real estate and U.S. royalties. (Interest and capital gains on the sale of U.S. stocks are not U.S. source income.) However, a U.S. beneficiary of a foreign trust is taxed on all income received from the trust (whether the income has a U.S. or foreign source). There are also negative tax consequences for a U.S. beneficiary who receives a distribution of accumulated income from a foreign trust, including loss of capital gains treatment, an interest charge on the tax going back to the date the income was originally earned, and application of the throwback rules.

If Carol plans to leave the U.S. after Sam's death, it may be advantageous for the trusts for her benefit to be foreign trusts at that time. If she plans to remain in the U.S. this will not be advantageous. And it will probably not be advisable for the trusts for Sam and the children, who are U.S. citizens, to be foreign trusts. The best plan will probably be to ensure that the trusts remain U.S. trusts by either taking out Wayne as a trustee or adding two U.S. trustees who can outvote him. (Carol, as a green card holder, is considered to be a U.S. trustee.)

If the trust for Carol is initially a U.S. trust with two U.S. trustees, and then Wayne replaces one of the trustees, the shift of control over substantial decisions out of the hands of U.S. persons will make the trust a foreign trust at that point. The trust then has twelve months to reassert U.S. control by either a change of fiduciaries or a change of residence of a fiduciary. If such a change is made within twelve months, the trust will be treated as having remained a U.S. trust; if no such change is made, the trust will have become a foreign trust on the date the change in control occurred. This is of particular concern because when a U.S. trust becomes a foreign trust there is a triggering of capital gains recognition under I.R.C. § 684 on all trust assets.

6. Sam was told by a friend at his country club that he can put his assets in a foreign trust or corporation and pay no U.S. taxes.

Sam may obtain some tax advantages by investing in a foreign corporation that engages in an active business outside the U.S., particularly if the corporation is controlled by non-U.S. persons. However, Sam will not reduce his U.S. taxes by putting his passive investments in a foreign corporation. Such a foreign corporation will fall into one or more of four categories, each with their own tax disadvantages: a foreign personal holding company (I.R.C. §§ 551-558), a passive foreign investment company (I.R.C. § 1296), a controlled foreign corporation (I.R.C. § 957) or a foreign investment company (I.R.C. § 1226). Some of the adverse income tax consequences that result from this categorization are recognition by U.S. shareholders of undistributed income, denial of capital gains treatment on the sale of shares, inability to carry out capital losses, and denial of a step-up in basis of the shares on death.

A foreign trust, like any other non-U.S. person, generally pays no U.S. income tax except for a withholding tax on U.S. source income. However, the grantor trust rules prevent this result for most foreign trusts created by U.S. persons (I.R.C. §§ 671-679). If the grantor or the trustee of a trust or the grantor's spouse remains as a beneficiary of the trust or otherwise retains a certain power or interest, the trust will be a grantor trust for income tax purposes and all trust income will be taxed to the grantor (or the person who transferred assets to the trust), regardless of whether the income is accumulated in the trust or distributed to another beneficiary. In addition, a foreign trust will be treated as a grantor trust if the trust permits *any U.S. person* to be a beneficiary (I.R.C. § 679). Therefore, unless Sam is willing to eliminate himself, Carol *and all other U.S. persons* as permissible beneficiaries of the trust, as well as give up any power to control or revest himself with the trust assets, the trust will be a grantor trust and all income will be taxed to Sam as it is earned in the trust.

Moreover, a completed gift to a trust, whether foreign or domestic, will result in gift tax (or the application of the grantor's unified credit and annual exclusion for gift taxes). However, the trust assets, including future appreciation and income, will not be includible in Sam's estate at death. To make the gift complete, the trust may not be revocable (alone or with the consent of another person), Sam cannot retain the power to control beneficial enjoyment, and he may not have a reversionary interest or retain a testamentary power of appointment (including a limited power of appointment) over the trust. If an incomplete gift is made to the trust, no gift tax will be payable and no credits need to be used. However, the assets will be fully subject to U.S. estate taxation at Sam's death.

If Sam wants to make a completed gift, one option is available in some foreign jurisdictions that is not generally available in the U.S.: Sam may remain as one of the permissible beneficiaries of a discretionary trust. Under U.S. law (except in Alaska, Delaware, Nevada and a few other U.S. states) creditors can reach such "self-settled" trusts, and therefore the transfer to the trust is not complete for U.S. gift tax purposes and is subject to U.S. estate tax at Sam's death. However, in such offshore jurisdictions as the Bahamas, the Cayman Islands, Jersey, Guernsey, the Cook Islands and a few others, the fact that Sam is a discretionary beneficiary of a trust he has settled does not permit creditors to reach the trust, and therefore a gift to the trust can be a completed gift, even though Sam can receive distributions in case of emergency.

Sam may also structure the irrevocable foreign trust so that transfers to it are incomplete gifts for U.S. gift tax purposes, by retaining a testamentary power of

appointment and prohibiting distributions to persons other than Sam without his consent. The transfers would not be subject to gift tax, but the trust assets will be includible in Sam's estate at death.

The primary benefit of an irrevocable foreign trust for a U.S. grantor is asset protection, not tax minimization. If the trust is properly structured, it should be protected from claims of creditors of the grantor that arise after the trust is created, even though the funds are still available for distribution to the grantor in the trustee's discretion. Moreover, creditors of the grantor whose claims arose prior to the transfer of assets to the trust have a limited period within which to bring those claims (two years in the Bahamas, one year in the Cook Islands, six years in the Cayman Islands).

The creation of or the transfer of assets to a foreign trust by a U.S. person must be reported to the I.R.S., and all of its transactions must be reported to the I.R.S. annually. The penalties for failure to report are significant—up to 35% of the amount paid to the trust (I.R.C. §§ 6048; 6677(a)). The grantor of the trust is encouraged (but not required) to appoint a U.S. person as "Agent" for the trust, whose responsibility is to supply the I.R.S. with information about the trust upon request. If no agent is appointed, the I.R.S. will require additional information regarding the trust and will interpret all information in the manner most adverse to the taxpayer.

7. Carol has received a cash bequest of $200,000 from her father, who is a Canadian citizen and resident.

No U.S. gift or estate tax is due on a gift received from a non-U.S. person or estate unless it consists of U.S. property (i.e., U.S. situs real estate, tangible personal property or cash). Carol should contact a Canadian attorney regarding Canadian taxes that may be due. Many foreign countries impose succession taxes that are payable by the recipient. (Canada is not one of them; as noted, it has replaced its succession duty with a capital gains tax on appreciation in the decedent's assets at death.)

Carol must also be advised that if she receives gifts (including bequests) from a non-U.S. person that exceed $100,000 in a calendar year, she must file Form 3520 reporting receipt of the property together with her income tax return. While there is no tax payable, there is a 25% penalty for failure to file this form.

8. Carol's brother Wayne, a Canadian citizen and resident, wishes to give Carol a cash gift of $3 million.

If Wayne makes the gift to Carol outright, Carol owes no U.S. tax, although she must report gifts from a single non-U.S. person that exceed $100,000 in a calendar year on Form 3520, or face a 25% penalty (See I.R.C. § 6039F; I.R.S. Notice 97-34; Form 3520).

Instead of making an outright gift to Carol, however, Wayne could transfer the $3 million to a properly structured U.S. or foreign trust for the benefit of Carol and her descendants that qualifies as a foreign trust. Such a trust will not be subject to U.S. estate, gift or generation-skipping transfer tax for its duration.

In addition, if the trust that Wayne creates qualifies as a grantor trust, Carol can receive distributions from it free of U.S. income tax (except for 30% withholding tax on any U.S. source income such as U.S. corporate dividends). (Carol will still have to report receipt of the income.) Recent legislation, however, has made it difficult for non-U.S. persons to be treated as grantors (I.R.C. § 672(f)(1)). There are only three ways by which Wayne can be the income tax grantor of a trust for U.S. tax purposes:

(i) The grantor has the full power to revoke the trust without the consent of any person, or with the consent of a subservient third party (I.R.C. § 672(f)(2)(A)(i)). (Upon the grantor's incapacity, his or her guardian must possess the power to revoke in order for the trust to continue to qualify as a grantor trust.)

(ii) The grantor (and, if desired, the grantor's spouse) are the sole beneficiaries of the trust during the lifetime of the grantor. In this case, the grantor and the grantor's wife could receive distributions from the trust and could then make gifts to the U.S. relatives. The U.S. person would then have to report the receipt of the gifts if they met the applicable threshold, but they would not be taxable (I.R.C. § 672(f)(2)(A)(ii)).

(iii) The trust was created on or before September 19, 1995, but only as to funds already in the trust as of that date, and only if the trust was a grantor trust pursuant to either I.R.C. § 676 (concerning the grantor's power to revoke with consent of another party) or I.R.C. § 677 (concerning the grantor's retained possibility of receiving income in conjunction with other beneficiaries), but excluding I.R.C. § 677(a)(3) (income may be used to pay premiums on insurance policies on the grantor's life).

Once the non-U.S. grantor dies, the foreign trust, which previously qualified as a grantor trust under one of the exceptions, is no longer a grantor trust, and all income distributed to the U.S. beneficiary will be taxed to the beneficiary.

9. Carol has received a distribution of $50,000 from an irrevocable Canadian trust created in 1999 by her brother, Wayne, a Canadian citizen and resident.

All distributions to a U.S. person from a foreign trust must be reported to the Internal Revenue Service on Form 3520. Carol must report the name of the trust, the aggregate amount of distributions received from the trust during the taxable year, and indicate how the distribution is characterized, even if it is claimed that the distribution is not taxable because it came from a grantor trust, or from a trust that had no income, or for some other reason (I.R.C. § 6048(c)). If the distribution is not reported, the U.S. recipient may be subject to a penalty of 35% of the gross amount of the distribution (I.R.C. § 6677(a)). In addition, the distribution may be recharacterized by the Internal Revenue Service as an income distribution to the recipient, even if it would have qualified for grantor trust treatment.

In this case, since the trust is irrevocable, Carol is a beneficiary and it was created after September 19, 1995, it is not a grantor trust. Therefore, the distribution will carry out taxable distributable net income (DNI). Once DNI is exhausted, the distribution will carry out undistributed net income (UNI) from prior years of the trust, which is taxable with interest going back to the year when the income was received by the trust.

Carol should obtain from the foreign trustee a Foreign Nongrantor Trust Beneficiary Statement (or a Foreign Grantor Trust Beneficiary Statement if the trust were a foreign grantor trust) with respect to the distribution, which will provide full information about the trust. If she cannot obtain such a beneficiary statement from the trustee (which will often be the case, given the bank secrecy laws of other countries), Carol may avoid having the entire amount treated as an accumulation distribution if she provides information regarding actual distributions from the trust for the prior three years. Under this "default treatment," Carol will be allowed to treat a portion of the distribution as a distribution of current income based on the average of distributions from the prior three years, with only the excess amount of the distribution treated as an accumulation distribution (and therefore subject to the interest charge of I.R.C. § 668) (See I.R.S. Notice 97-34, Form 3520).

10. Sam and Carol tell you that they wish to leave the United States and move permanently to Canada.

If Sam gives up U.S. residence, he will remain fully subject to U.S. estate and income tax on his worldwide income because he is a U.S. citizen. He will also be fully taxed by Canada on his worldwide income and assets (although Canada will only tax his Canadian source income during the first five years that he is a resident). He (and his estate) will obtain a credit against U.S. taxes for Canadian taxes that are paid.

To end his U.S. tax obligations, Sam must not only move his residence to Canada but also give up his U.S. citizenship (expatriate). Even then, he will remain subject to U.S. taxes on a broad list of U.S. income and assets for ten years after expatriating. (This list includes interest on U.S. bond interest and capital gains on sales of U.S. stocks, which are normally not subject to tax when paid to nonresident aliens.) To avoid this ten-year tax problem, Sam may be able to obtain a ruling from the I.R.S. that tax avoidance was not a principal motive for expatriating, or he may simply sell all his U.S. assets and pay a one-time capital gains tax. He may also be refused reentry to the United States for any purpose under the Reed Amendment. These rules are presently being reconsidered by Congress and changes are possible.

Carol must move to Canada and relinquish her green card (not just allow it to expire) to rid herself of U.S. taxation. Even then, because she has had a green card for at least eight out of the last 15 calendar years, the special ten-year expatriate rules applicable to Sam will also apply to her. Again, she can seek an IRS ruling or sell all her U.S. assets to avoid this result.

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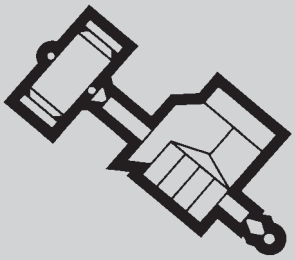
This article was originally published in *Probate & Property*, Volume 18, No. 2, March/April 2004. © 2004 by the American Bar Association. Reprinted by permission. This article is based on a presentation given by G. Warren Whitaker at the NYSBA Trusts and Estates Law Section Fall Meeting in Victoria, B.C. in September 2003.



RECENT NEW YORK STATE DECISIONS

Ira Mark Bloom and William P. LaPiana

ADMINISTRATION OF ESTATES

Non-Marital Children; Father's Statements Before Birth Amount to Open and Notorious Acknowledgment

Decedent and his girlfriend told several relatives that they were having a baby. A few weeks later decedent died in an automobile accident. Before the funeral his mother had blood and DNA samples taken from decedent's body. Seven months after death decedent's girlfriend gave birth to a daughter and subsequent testing of the samples taken from the decedent, his girlfriend and the child showed a 99.98% probability that decedent was the child's father.

Following previous cases (*see In re Bonanno*, 192 Misc. 2d 86, 745 N.Y.S.2d 813 (Sur. Ct., New York Co. 2002); *In re Seekins*, 194 Misc. 2d 422, 755 N.Y.S.2d 557 (Sur. Ct., Westchester Co. 2002)), the Surrogate held that the posthumous blood genetic marker test could not establish paternity under EPTL 4-1.2(a)(2)(D) but could satisfy the "clear and convincing evidence" component of EPTL 4-1.2(a)(2)(C) that, together with open and notorious acknowledgment by the father, will support a finding of paternity. Noting that it might be considered unusual for a decedent to have acknowledged a child still *in utero*, the Surrogate was satisfied that the decedent's statements that he and his girlfriend were having a child were sufficient under the circumstances, the decedent having done "all that he might be reasonably expected to do to openly and notoriously acknowledge that he was the father of the child" that would ultimately be born to his girlfriend. *In re Thayer*, 1 Misc. 3d 791, 769 N.Y.S.2d 863 (Sur. Ct., Madison Co. 2003).

Non-Marital Children; Posthumous Testing of Sample from Child Is Permissible

Grandmother of decedent moved for DNA testing of putative father of decedent and the decedent-child. Because decedent died in an automobile accident and blood samples had been retained by the hospital where the decedent was treated, DNA testing on the decedent-child was possible "without the drastic remedy of exhumation."

The Surrogate granted the motion, and held that the results of the tests could be used to disprove as well as to prove paternity. The court cited with approval cases allowing the results of DNA tests administered after death to provide the "clear and convincing" evidence required by EPTL 4-1.2(a)(2)(C) (*see* the discussion of *In re Thayer*, above). The court also approved of cases allowing the testing of non-parties to establish paternity (*In re Sandler*, 160 Misc. 2d 955, 612 N.Y.S.2d 756 (Sur. Ct., New York Co. 1994); *In re Nasert*, 192 Misc. 2d 682, 748 N.Y.S.2d 654 (Sur. Ct., Richmond Co. 2002)). *In re Santos,* 196 Misc. 2d 972, 768 N.Y.S.2d 272 (Sur. Ct., Kings Co. 2003).

Renunciation; Minors May Not Renounce Where Consideration Prevents Tax Qualification and Minors Are Not Benefited

Grandmother's will gave her 30% of a family partnership in equal shares to two minor grandchildren and their uncle. The result of the distribution would be that the uncle and the minors' father owned 40% of the partnership and the minors each 10%. Father has made an application to renounce the infants' bequests in order to save the generation-skipping transfer tax the minors would otherwise pay. These renunciations, which would result in a 10% interest in the partnership passing to both the father and uncle, would be followed by partial renunciations by father and uncle so that father would own 60% of the partnership, uncle 40% and the minors would be the beneficiaries of a trust funded by their father with $600,000 of the estate, thereby exhausting the decedent's GST exemption. Father and his wife would then make a gift of approximately $1.2 million to the minors in trust. After all the transactions are complete, the minors would receive a total of more than $1.8 million. Without the renunciation the minors will receive outright at age 18 approximately $1.44 million after taxes.

The Surrogate denied the application. The minors would receive compensation for their renunciations, which is necessary if the renunciations are to be approved; otherwise, the renunciations would not be advantageous to the minors. Because the minors are receiving compensation, however, the renunciations would not be qualified disclaimers for tax purposes and therefore there would be no generation-skipping transfer tax savings. Finally, father argued that grandmother did not intend for the minors to receive their share of her estate outright but rather intended the property to be held in trust until age 30. Not surprisingly, the Surrogate refused to reform the will even though tax savings might result because the renunciations would drastically alter the decedent's estate plan. *In re Carucci*, 769 N.Y.S.2d 866 (Sur. Ct., Nassau Co. 2003).

Creditors; Laches Bars Claim Against Totten Trusts

Decedent died in 1989, intestate, survived by an adult child and an estranged spouse. Decedent and spouse had lived separate and apart for over thirty-five years. The only significant assets were six Totten trusts. More than three years after death the Attorney General filed a claim under Mental Hygiene Law § 43.03(a) for services provided to the estranged spouse. The claim was deemed rejected when the administrator failed to allow it (SCPA 1806(3)).

Almost 10 years after decedent died, the Attorney General entered a judgment against the administrator in the Supreme Court, Albany County, based on a summary judgment order that the decedent was liable for his estranged wife's expenses. In 2000, the Attorney General filed a proceeding in Surrogate's Court to compel an accounting which was provided. Finally in mid-December 2002 the Attorney General began a proceeding to compel refund of the Totten trust accounts.

The administrator and the Totten trust beneficiaries objected based on the defense of laches and the statute of limitations. The Surrogate denied the petition and approved the accounting. Noting first the power of the court to make "a full, equitable and complete disposition of the matter" (SCPA 201(3)), the Surrogate observed that had the matter been litigated in Surrogate's Court the surviving spouse could have been disqualified from taking an elective share under EPTL 5-1.2(5), thus ending any legal basis for asserting the state's claim. "It is not surprising, therefore," the court wrote, "that the claim was submitted to the Supreme Court." While Totten trusts are subject to the deceased depositor's debts if the estate is insufficient and while there is a twenty-year period to enforce the money judgment (CPLR 211(b)), "rigid application" of that rule would be unfair to the Totten trust beneficiaries. "Fundamental fairness" and the state's failure to act in a timely fashion required a finding for the beneficiaries based on laches. *In re LaPine*, 1 Misc. 3d 384, 768 N.Y.S.2d 797 (Sur. Ct., Dutchess Co. 2003).

TRUSTS

Cy Pres; Class of Beneficiaries Expanded to Avoid Tax Penalty

Decedent's will created a trust whose income was to be used for the education of young women from two towns and a village in Saratoga County to become registered nurses. In 1990, a *cy pres* application was approved to expand the class. The trust has grown and the trustee cannot expend sufficient income to avoid the excise tax on undistributed minimum distributions (IRC § 4942) in accord with EPTL 8-1.8(a)(1), which requires a trust to make distributions to avoid the excess tax.

The trustee sought modification of the trust by expanding the list of potential beneficiaries to include individuals studying to become nurse anesthesiologists; laboratory technicians; physical, occupational and respiratory therapists; and cytologists. The trustee also sought approval for a second tier of beneficiaries to be used only if necessary to avoid the excise tax and suggested two alternatives: (1) a hospital and nursing home in Saratoga County that would use the money for nursing education programs and (2) expanding eligibility for awards to all residents of Saratoga County without regard to gender.

Surrogate's Court approved modifying the trust only to the extent of adding women training to be nurse anesthesiologists to the list of beneficiaries. On appeal the Appellate Division granted the petition to expand the list of eligible areas of study, noting expert testimony on changes in the nursing profession since creation of the trust and the decedent's general intent to aid local health care evidenced by a testamentary gift to a local hospital. The court also approved the second tier option of expanding the geographical scope and removing the gender requirement, finding that option closer to the decedent's general intent. *In re Post*, 2 A.D.3d 1091, 769 N.Y.S.2d 332 (3d Dep't 2003).

WILLS

In Terrorem Clause; Will Clause Applies Only to Valid Codicil

Decedent's will contained an *in terrorem* clause revoking all provisions under the will for any benefi-

ciary who contested the will or any codicil to the will. A beneficiary adversely affected by the codicil sought a construction of the will to determine the effect of the *in terrorem* clause.

The Surrogate first held that it was proper to construe the will before admission to probate. The clause was then construed to apply only to valid codicils and because the codicil is a separate document from the will the *in terrorem* clause will take effect only if the challenge to the codicil is unsuccessful. If the challenge is successful, the beneficiary will not be penalized even if the will is admitted to probate. *In re Martin*, 1 Misc. 3d 769, 771 N.Y.S.2d 292 (Sur. Ct., Nassau Co. 2003).

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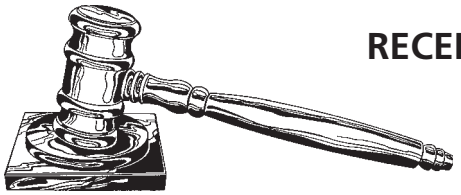
Professors Bloom and LaPiana are the current authors of Bloom and Klipstein, *Drafting New York Wills* (Matthew Bender) (Bloom as principal author, LaPiana as contributing author).

Trusts and Estates Law Section
Upcoming Meetings of Interest

September 24, 2004	"Basic Surrogate's Court Practice," Association of the Bar of the City of New York, New York, NY
October 14–17, 2004	Fall Meeting, Savannah, GA
November 4–5, 2004	Second Annual Trusts and Estates Law Institute, New York, NY
January 26, 2005	Annual Meeting, New York, NY
September 29–October 2, 2005	Fall Meeting, New Orleans, LA
September 13–17, 2006	Fall Meeting, Philadelphia, PA



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

Ilene Sherwyn Cooper

Attorney-Client Privilege

In a contested proceeding regarding the fiduciary-Bank's conduct as trustee, the objectants moved to compel disclosure of a certain internal memorandum prepared by the Bank's in-house counsel. The Bank opposed the motion, claiming the memorandum had been prepared in anticipation of litigation, and therefore was privileged.

After an in camera inspection of the memorandum, the Court found no indication that it had been prepared for the purpose of litigation. Further, the Court found that even if the document was privileged, the privilege had been waived as a result of the fiduciary's voluntary disclosure of a portion of its contents, to wit, a legal opinion rendered by the Bank's counsel. Where the client partially discloses the advice received from counsel, and places that advice in issue, the selective disclosure will lead to a waiver of the privilege. Notably, the Court, over arguments made by the fiduciary, held that a 2002 amendment to the privilege statute was not retroactive and thus was not applicable to the case before it.

Accordingly, the Court directed the production of the memorandum.

In re Estate of Charles G. Dumont, N.Y.L.J., January 27, 2004, p. 20 (Sur. Ct., Monroe Co., Surr. Calvaruso).

Burial Rights

Upon the death of the decedent, an issue arose between the children of her first marriage and the children of her second marriage as to the proper site for her internment.

The decedent's first husband predeceased her and was buried along with an infant daughter of his marriage to the decedent. The decedent's second husband also predeceased her and was buried in one of two graves apparently purchased for himself and the decedent.

In holding that the decedent should be buried with her second husband, the Court found determinative the fact that the decedent had a deeply loving marriage to him which lasted over 34 years. They supported each other through their terminal illnesses, she caring for him until his death in 1999. Moreover, although the decedent's wishes as to her place of burial had not been consistently expressed to others, the Court found significant the fact that her second husband had bought a second plot next to his, evidencing his certainty that they would be together at death.

In re Application of Bowles, N.Y.L.J., January 9, 2004, p. 21 (Sup. Ct., Suffolk Co., Henry, J.).

Discovery Proceeding

In a proceeding brought pursuant to SCPA 2103, the respondent moved to dismiss the petition on the grounds, *inter alia*, that the Court lacked subject matter jurisdiction.

The decedent died a domiciliary of Florida, leaving a last will and testament that was admitted to probate in that state. The decedent's spouse was appointed executrix of his estate in Florida, and thereafter appointed ancillary fiduciary in New York. Thereafter, she instituted the discovery proceeding, *sub judice*, in order to recover rents and profits derived from a condominium apartment in which the decedent owned a one-half interest as tenant in common at death. The respondent moved to dismiss on the grounds of, *inter alia,* lack of subject matter jurisdiction, which motion was denied in a prior decision of the Court. Subsequent thereto, the petitioner amended her petition in order to request a partnership accounting, and the respondent again moved to dismiss, claiming that the request for an accounting effectively sought the recovery of money and partnership interests—all of which were personal property not "located" in New York.

In denying the application, the Court opined that an ancillary fiduciary may appropriately commence and prosecute a proceeding concerning the New York assets of a non-domiciliary whether these assets are real or personal property. The Surrogate's Court has jurisdiction to adjudicate all matters related to a decedent's estate, including matters pertaining to partnerships between deceased non-domiciliaries and surviving partners where partnership assets are located in New York.

Contrary to the respondent's contention, the Court held that the decision by the Court of Appeals in *In re Obregon*, 91 N.Y.2d 591, did not require a different result. Unlike the circumstances in *Obregon*, stated the Court, the very asset which provides the basis for the Court's ancillary jurisdiction is the source and focus of the proceeding at bar.

In re Estate of Joseph A. Sbuttoni, N.Y.L.J., January 26, 2004, p. 33 (Sur. Ct., Westchester Co., Surr. Scarpino, Jr.).

Disqualification of Spouse

In a contested administration proceeding, the decedent's surviving daughter requested, *inter alia*, that the respondent be disqualified as the decedent's surviving spouse.

The record revealed that the decedent commenced an action for divorce against the respondent and that the respondent executed an affidavit of no contest. He consented to the matter being placed on the uncontested divorce calendar, and waived all statutory waiting periods as well as the service of all papers including the Judgment of Divorce. A note of issue was filed; however, the Findings of Fact, Conclusions of Law and Judgment of Divorce were not signed by the Special Referee until after the decedent's death.

The Court opined that when a party dies during the pendency of a divorce, the action abates. On the other hand, when the court has made a final adjudication of divorce, but has not performed the mere ministerial act of entering the final judgment prior to the death of one of the parties, the marital relationship will be deemed severed during the parties' lifetimes. The Court held that this rule does not apply where all issues, including collateral issues, have not been finally determined by the court while both parties to the action are alive.

Based upon the status of the divorce action at the time of the decedent's death, the Court held that although the matter was uncontested, there had been no final adjudication by the Court, indeed, no findings by the Special Referee, until after the decedent had died. This being the case, the post-death entry of the Judgment of Divorce was not a ministerial act, and did not serve to disqualify the respondent-surviving spouse.

In re Estate of Carol Rabalais, N.Y.L.J., November 19, 2003, p. 23 (Sur. Ct., Kings Co., Surr. Feinberg).

Domicile

Pursuant to an order of the Supreme Court, the guardian was permitted to move the decedent to Austria, where the decedent's will was admitted to probate. The nominated executors under prior wills of the decedent challenged the Austrian probate, contending that the decedent was a domiciliary of New York at the time of her death, and thus, that the Surrogate's Court had original jurisdiction over her estate.

The Court stated that a guardian, though having the power to change an incompetent's abode, has no power to change her domicile. That power is vested with the state, acting through the Supreme Court. A court of competent jurisdiction may permit the guardian of the person to change the domicile of an incompetent if it is deemed to be in her best interests.

Based upon a review of the Supreme Court's order, the Court concluded that the order directed a chain of events resulting in the complete separation of the decedent from New York, and thus was a de facto authorization to the guardian to change the decedent's domicile effective upon her removal to Austria. Particularly persuasive to this result was the Court's finding that the Supreme Court's order made no mention that the decedent be returned to New York except for burial next to her predeceased husband.

Accordingly, the Court held that any challenge to the Austrian probate, especially because all witnesses to the will were located in Austria, should take place in Austria.

In re Estate of Louise Bauch, N.Y.L.J., January 8, 2004, p. 17 (Sur. Ct., Suffolk Co., Surr. Czygier).

Probate—Alterations to Will

In an uncontested probate, the will contained a number of handwritten changes, which the petitioner asked be given no effect. Each change was accompanied by the signature of the decedent. The issue before the Court was the timing of the alterations.

The Court opined that an alteration may be established by evidence extrinsic or intrinsic to the will. Extrinsic evidence of the timing of an alteration may be in the form of an affidavit of the attorney who supervised the execution of the will, or be derived from the circumstances. Intrinsic evidence that alterations preceded the execution of the will may be derived from the signature of the testator and the attesting witnesses adjacent to each alteration, and a reference to the alterations in the attestation clause.

The question as to when an alteration is made is one of fact, to be determined upon the sufficiency of the evidence. The Court held that if the proponent offers no proof or insufficient proof as to the timing

of an alteration, all persons whose interests are affected by the alteration must be cited, and a hearing may be held. Should the petitioner fail to establish the timing of an alteration, then the burden is cast upon the person(s) whom the alteration would benefit to establish its effectiveness.

Within this context, the Court determined that the residuary legatees, the persons who stood to benefit from a determination that the alterations in issue preceded the execution of the will, had failed to adduce any evidence in this regard. Accordingly, the Court deemed that the alterations were made after the will was executed and were without effect.

In re Estate of Ethel Tier, N.Y.L.J., February 9, 2004, p. 26 (Sur. Ct., N.Y. Co., Surr. Preminger).

Revocation of Preliminary Letters

The respondents moved to vacate the Court's order issuing preliminary letters to the petitioner and for the appointment of the Public Administrator or the decedent's conservator in her place.

The decedent's conservator and her distributees were unaware that several years prior to her death the decedent had executed a will naming her caregiver as the executrix and residuary beneficiary. Objections to this instrument were filed alleging lack of due execution, lack of testamentary capacity, undue influence and fraud or constructive fraud. Objectants reasserted these allegations in their motion before the Court. Petitioner refuted their claims.

The Court opined that the appointment of a conservator does not necessarily constitute a finding by the court that the conservatee is incompetent. Thus, the fact that the decedent had a conservator is not necessarily determinative of her incapacity to execute a valid will. Nevertheless, such fact does give rise to material questions regarding the decedent's capacity which could not be resolved on the papers. Moreover, the record revealed that Petitioner was involved with the drafting of the propounded will, and failed to discuss or even reveal the existence of the propounded will to the decedent's conservator.

Based upon these circumstances, the Court held that the appointment of a neutral fiduciary was warranted. Accordingly, the preliminary letters were revoked, and temporary letters of administration were issued to the Public Administrator.

In re Estate of Bernard Silverman, N.Y.L.J., March 19, 2004, p. 27 (Sur. Ct., Westchester Co., Surr. Scarpino).

Right of Election

In a contested compulsory accounting proceeding, the executor moved to dismiss the petition of the decedent's surviving spouse on the grounds that she lacked standing. The record revealed that the decedent's spouse had received nothing under his will, nor had she filed a right of election against his estate. The decedent died on May 5, 1997, and letters testamentary with respect to his estate were issued on May 9, 1997.

In granting the application of the executor and dismissing the petition, the Court opined that a proceeding to compel an accounting can only be instituted by a "person interested" in the estate, as defined in SCPA 103(39). The Court stated that the petitioner's status as "person interested" was dependent on her right to elect against the estate.

Noting that more than twelve months had elapsed since the issuance of letters testamentary to the executor, the Court found that it could not relieve the surviving spouse of her default in timely electing against the estate, even if such an application was made, inasmuch as reasonable cause had not been demonstrated for granting such relief, and perhaps more importantly, the provisions of EPTL 5-1.1-A(d)(3) precluded its extending the statutory period set forth in EPTL 5-1.1-A.

In re Estate of William Gross, N.Y.L.J., January 23, 2004, p. 20 (Sur. Ct., Dutchess Co., Surr. Pagones).

Termination of Trust

In a miscellaneous proceeding, the Court granted an application to withdraw a petition for probate of a purported will of the decedent in order to allow the decedent's estate to pass pursuant to the laws of intestacy, despite the fact that the instrument created a trust of one-half of the residuary estate for the benefit of the proponent.

The record indicated that the nominated co-trustee of the trust, the proponent's daughter, was given broad powers to invade the trust principal, and that if the will was probated the trust would be funded with only $10,000.

The Court opined that although a testamentary trust may ordinarily not be terminated, even on the consent of all the interested parties, if it appears that this would contravene the intent of the testator, where the trust is economically impractical to administer, the corpus may be distributed outright to the beneficiary.

With this in mind, the Court noted that the testator's primary intent was to benefit his daughter, and the modest value of the trust principal would be dissipated prematurely by the costs of its administration. Accordingly, the Court concluded that granting the relief requested would be in keeping with the testator's intent.

Furthermore, the Court held that it would not compel the probate of a testamentary instrument where all persons interested consented to an intestate distribution and no practical purpose would be served by probate.

In re Estate of Siddy Walter, N.Y.L.J., December 18, 2003, p. 29 (Sur. Ct., Bronx Co., Surr. Holzman).

Transfer of Trust Situs

In a miscellaneous proceeding, the Court denied the application of the trustee, on consent of all interested parties, to transfer the situs of two trusts to Delaware in order to avoid imposition of the New York State fiduciary income tax. In a prior application with respect to the subject trusts, the Court granted leave to the trustee to resign and appointed a Delaware corporation to serve in its place and stead.

In refusing to grant the trustee's present request, the Court noted that while a transfer of situs has been allowed for the purpose of removing a trust from the imposition of a New York State tax on income and capital gains, on October 7, 2003, the Governor signed into law legislation applicable to tax years beginning on or after January 1, 1996, which permitted a New York resident trust of intangible property to be treated as a non-resident trust for tax purposes, if all the trustees are domiciled outside the state. Based upon this legislation, the Court found that transfer of the trust situs was not needed in order to accomplish the trustee's goal of eliminating the imposition of a New York State fiduciary income tax.

Further, the Court found that the relief sought was contrary to the explicit direction by the testator and grantor of the respective trusts to have New York courts supervise their administration. The Court noted, in this regard, that while a foreign court may be required to apply the substantive law of New York, it cannot be required to apply New York's procedural law. The trustee had advanced no compelling reason for the Court to cede its jurisdiction in derogation of the maker's intent that all trust beneficiaries be guaranteed the full procedural protections afforded by New York law.

In re Bush, N.Y.L.J., January 7, 2004, p. 28 (Sur. Ct., New York Co., Surr. Preminger).

Trust—Unitrust Status

In a contested proceeding, the Court, *inter alia*, denied petitioner's motion for summary judgment annulling and setting aside the trustees' decision to elect unitrust status pursuant to EPTL 11-2.4, but granted her application to the extent that she sought a determination that the unitrust election could not be made retroactive to January 1, 2002.

The record reflected that pursuant to the provisions of his will, the decedent bequeathed his residuary estate in trust for the benefit of his wife for life. Specifically, the decedent directed that his wife receive annually, in quarterly installments, the greater of $40,000 or the entire income of the trust, with any shortfall to be paid from principal. Upon the wife's death, any remaining principal was bequeathed to the decedent's four children from a prior marriage, two of whom were co-trustees of the wife's trust.

From the time of the decedent's death in 1984 to January 1, 2002, the decedent's wife received the total income from the trust which in recent years was substantial, averaging $190,000 per annum.

On March 1, 2003, the trustees filed a notice with the court electing to invoke the optional unitrust provisions of EPTL 11-2.4 and to apply the section retroactively to January 1, 2002. As a result, the widow's income from the trust was reduced to less than $70,000 per year.

The widow, by her attorney-in-fact, instituted the proceeding *sub judice* to annul the election, contending that it was a self-interested act that directly benefited the trustees to the detriment of the income beneficiary. Further, the decedent's spouse maintained that the trustees had no intention of complying with the Prudent Investor Act upon making the election, in that they were not going to diversify the trust's portfolio, which presently consisted of income-producing real estate interests, in order to invest for total return. Finally, the decedent's spouse claimed that the trustees' election was invalid inasmuch as it could not be retroactive to January 1, 2002.

In addressing the arguments raised, the Court reviewed the nature and purpose of the unitrust option, noting that there is a rebuttable presumption in its favor. However, in determining whether the unitrust option should apply to a trust, the Court opined that consideration should be given to the factors enumerated in EPTL 11-2.4(e)(5)(A). Based upon

these factors, the Court held that questions of fact existed which precluded granting summary judgment on the issue of whether the unitrust option was available to the subject trust.

Moreover, although the Court held that the trustees, despite their self-interest, were not precluded as a matter of law from exercising the unitrust option, it concluded that the issue as to whether they abused their discretion in electing the option was an issue of fact to be decided.

Finally, the Court annulled the trustees' election to apply the unitrust option retroactively to January 1, 2002. Based upon the provisions of EPTL 11-2.4(e)(4)(A) and the legislative history of the statute, the Court held that the proper and intended application of the unitrust election as it relates to preexisting trusts is prospective, and shall commence as of the first day of the first year of the trust beginning after the election is made. This being the case, the Court determined that the election with respect to the subject trust applied as of January 1, 2004, and directed that the trustees pay to the decedent's spouse the income she would have received from the trust from January 1, 2002 to January 1, 2004.

In re Estate of Jacob Heller, N.Y.L.J., January 23, 2004, p. 25 (Sur. Ct., Westchester Co., Surr. Scarpino, Jr.).

Turnover Proceeding

In a contested discovery proceeding, the fiduciary of the estate, the New York County Public Administrator, and the respondents, the beneficiary of certain Totten trust accounts and the banking institution which held the subject accounts, moved and cross-moved for summary judgment.

The record revealed that a year and a half before her death, the titles on several bank accounts were changed from the decedent's name to the decedent's name in trust for a named individual. Two days before her death, while the decedent was hospitalized in critical condition, the said individual used a durable power of attorney in order to remove $230,000 from an account in the decedent's name, alone, and deposited said funds in the Totten trust accounts previously established for her benefit. The issues presented by the discovery proceeding were the validity of the transfer using the power of attorney, the decedent's capacity, and alleged fraud and undue influence by the named beneficiary of the accounts.

In support of its motion for summary judgment, the bank argued that it was merely a stakeholder in the proceeding with no liability to the two claimants with respect to the funds in issue. Specifically, the bank submitted an affidavit from its branch manager indicating that while it could not locate the signature cards which effected a change in title to the subject accounts, its computer records evidenced the creation of the Totten trust accounts. Moreover, the affidavit confirmed that it was the bank's procedure to require proof of identification from the bank customer to confirm that he/she was, in fact, the person authorized to transact business with regard to a particular account. To the best of the manager's recollection, he was not informed of any irregularities regarding the change of account titles from the decedent's name alone to Totten trust form.

Based upon the record, the Court granted partial summary judgment in favor of the fiduciary, to the extent of directing the respondent bank to release to the decedent's estate the sum of $230,000 plus statutory interest from the decedent's date of death, and otherwise denied the motions for summary relief.

Insofar as the banking institution was concerned, the Court determined that the proof failed to satisfy the provisions of EPTL 7-5.4, upon which the bank relied, in order to absolve itself from liability. In relevant part, this statute provides that a financial institution that pays the beneficiary of a Totten trust upon the death of the depositor of the account before a restraining order or injunction "shall, to the extent of such payment, be released from liability to any person claiming a right to the funds." The Court opined that in order to gain the benefit of this section, there must be payment to a beneficiary which is defined as a "person who is described by the depositor as a person for whom a trust account is established."

While the Court noted that the bank's computer records were probative, it held that the best evidence of such a transaction would be a signature card of the decedent, or at the very least, some other admissible indication of the decedent's intent to create the Totten trust accounts. Inasmuch as the bank submitted only computer records and the affidavit of a bank manager with no personal knowledge of the transaction in issue, summary relief in the bank's favor could not be granted.

In re Estate of Carrie Clinton, N.Y.L.J., January 26, 2004, p. 26, (Sur. Ct., New York Co., Surr. Preminger).

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This *Newsletter* is distributed to members of the New York State Bar Association's Trusts and Estates Law Section without charge. The views expressed in articles in this *Newsletter* represent only the author's viewpoint and not necessarily the views of the Editor or the Trusts and Estates Law Section.

ISSN 1530-3896

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