

# Disclosure of Tax Returns in the Surrogate's Court

By Jennifer F. Hillman

The battle over disclosure of income tax returns and confidential financial records is a familiar one for many estate litigators. Maybe you have represented beneficiaries who insist upon the disclosure of a trustee's personal income tax returns because they know they'll find some "funny business." Other clients are certain that just the threat of this disclosure will force their adversary to cave to settlement demands. Or maybe there really is a genuine reason for the discovery demand. Whether it is legitimate or simply curiosity, the dueling motion to compel and application for a protective order are inevitable. Rarely will an adversary disclose an individual's financial records without at least a perfunctory objection to the discovery demand. This article reviews the standard for disclosure of income tax returns and other confidential financial information of individuals in the context of several recent Surrogate's Court decisions.



## Basic Standard

CPLR 3101(a) directs full disclosure of all evidence material and necessary, which will "assist preparation for trial by sharpening the issues and reducing delay and prolixity."<sup>1</sup> While tax returns are deemed confidential under 26 U.S.C. 6103, this protection is intended to protect tax information from disclosure by government officials.<sup>2</sup> However, neither the Internal Revenue Code nor any regulations issues thereunder preclude a court from requiring disclosure of a tax return by the taxpayer in connection with civil litigation to which the taxpayer is a party.

Because the disclosure of tax returns and financial records is disfavored, the party seeking to obtain production of income tax returns must make a strong showing of necessity and an inability to obtain the information contained in the income tax return from any other source.<sup>3</sup> A party will not be required to produce an income tax return if the information may be obtained from any other source.<sup>4</sup>

## Disclosure of a Fiduciary's Personal Financial Information

*Matter of Herscher*<sup>5</sup> is an interesting analysis of this standard. The trust at issue had been established by

the parties' mother. The children shared equally in the trust's remainder, but Son objected that the distribution was improperly delayed. Son demanded disclosure of Daughter's tax returns to ensure that all trust assets were accounted for and there were no improper payments by the trustee. Daughter sought Son's tax returns based upon an informal contention by Son that he may have suffered damages due to her tax accounting for the trust, even though the claim was not part of Son's formal objections.

The New York County Surrogate's Court looked at each claim separately and determined that Daughter's personal income tax returns were discoverable because of the significant allegation (supported by documentary evidence) of fiduciary misconduct, including commingling of trust assets with the trustee's personal assets. Daughter's returns were initially provided for an in-camera review by the Court. However, since no formal objections placed Son's income tax returns at issue, Daughter failed to meet even a relevance standard, much less the higher standard needed for disclosure. A protective order was thus issued preventing disclosure of Son's returns.

In this regard, because the fiduciary owes a fiduciary duty to the beneficiaries of a trust or an estate, substantiated allegations of self-dealing or other acts that may be discovered through the disclosure of personal income tax returns may warrant disclosure. For example, in *Matter of Zirinsky*,<sup>6</sup> the fiduciary's attorneys had admitted that the fiduciary's returns contained some entries attributing unallocated expenses to his personal income and other returns for some years when no such attribution was made. The allegations, combined with some facts already revealed and uncontroverted, were deemed sufficient to meet the objectants' burden, allowing them to obtain the fiduciary's personal income tax returns.

## Disclosure of a Beneficiary's Personal Financial Information

These scenarios take on a slightly different review in the context of a beneficiary. *Matter of McClusky*<sup>7</sup> involved allegations of imprudent investing by the trustee of a testamentary trust. The trustee requested objectants' personal investment portfolio to determine whether the objectants would have chosen to sell or retain the trust securities, had the trustee distributed the securities to them on an earlier date. Trustee hoped this would offset any damages resulting from his retention of the trust securities by showing the objectants would

not have sold the securities during that time period, even if they had been able to do so.

In denying the request, the Court found that the trustee's argument that an imprudent trustee can offset any losses resulting from his mistakes if he or she can show that the beneficiaries would have made the same mistakes, was positing false logic. Indeed, that rationale incorrectly implies that if the beneficiaries themselves failed to meet the investment standard set by the Prudent Investment Act, they are not entitled to recovery. To the contrary, it is the trustee who owes the fiduciary duty to the beneficiaries, regardless of what the beneficiaries may or may not have done.

Similarly, in *Matter of Winston*,<sup>8</sup> the trustee sought the beneficiary's tax returns to determine whether a distribution of principal was warranted. The Court closely reviewed the trust to determine whether it was the decedent's intent that any invasion of principal must be based upon petitioner's need for support and welfare. The Third Department found that because there was no stated requirement in the trust that invasion could only be for the beneficiary's support and welfare, decedent made clear his intent that petitioner's need should play no role in the invasion of principal of the testamentary trust. Thus, the trustee was not entitled to disclosure of the beneficiary's income tax returns.

## The Fishing Expedition

As illustrated by these recent cases, confidential financial information of parties is protected from disclosure absent the necessary strong showing that the information is indispensable. The Court will not countenance a fishing expedition. For example, in *Matter of Sandin*,<sup>9</sup> the petitioner, a beneficiary under will of her deceased father, instituted proceeding against the executor to supply information under SCPA 2102 to trace certain bank accounts that were in the name of decedent either individually or jointly with another, which may have been transferred to the executor's personal account.

After reviewing the subpoena and the allegations raised in the discovery proceedings, the court found that the bank records relating to those accounts on which the decedent's name appeared, either alone or with another, were relevant and material to identifying possible estate assets. Nonetheless, it was held that the circumstances did not justify an order directing the bank to produce the executrix's own personal accounts, some of which may have nothing to do with the decedent's estate.<sup>10</sup>

## Remedies

Rather than a protracted disclosure battle, counsel should consider alternatives, including stipulated facts or other less invasive disclosure. CPLR 3103 governs the subject of protective orders for disclosure abuses, and confers broad discretion upon a court to fashion appropriate remedies both where abuses are threatened, and where they have already occurred. This includes an order "denying, limiting, conditioning or regulating" the use of any disclosure device, with such order designed "to prevent unreasonable annoyance, expense, embarrassment, disadvantage, or other prejudice" to any person.<sup>11</sup>

In *Carvel*,<sup>12</sup> income tax returns were produced to the Court first to determine if any part should be subject to redaction for confidentiality. However, in *Zirinsky*,<sup>13</sup> the Court would not accept admissions by the fiduciary in lieu of the actual tax returns because of the alleged substantiated allegations.

Nevertheless, even if there is disclosure of tax returns, some redaction is allowable, and sometimes advisable.<sup>14</sup>

## Endnotes

1. *Matter of Carvel*, 168 Misc. 2d 442, 642 N.Y.S.2d 1012 (Sur. Ct., Westchester Co. 1996).
2. *Id.*
3. *Abbene v. Griffin*, 208 A.D.2d 483, 616 N.Y.S.2d 1025 (2d Dep't 1994); *Cosentino v. Schwartz*, 155 A.D.2d 640, 548 N.Y.S.2d 242 (2d Dep't 1989).
4. *Samide v. Roman Catholic Diocese of Brooklyn*, 5 A.D.3d 463, 773 N.Y.S.2d 116 (2d Dep't 2004).
5. N.Y.L.J. Aug. 15, 2012, p. 22, col. 6 (Sur. Ct., N.Y. Co.) (Glen, J.).
6. 26 Misc. 3d 625, 889 N.Y.S.2d 423 (Sur. Ct., Nassau Co. 2009).
7. N.Y.L.J. Oct. 19, 2012 (Sur. Ct., Nassau Co.).
8. 205 A.D.2d 922, 613 N.Y.S.2d 461 (3d Dep't 1994).
9. 134 Misc. 2d 968, 513 N.Y.S.2d 645 (Sur. Ct., Nassau Co. 1987).
10. *Id.*
11. N.Y. Civil Practice Law and Rules Section 3103; see *Estate of Carvel*, N.Y.L.J. April 15, 1998, p. 1, col. 6 (Sur. Ct., Westchester Co.).
12. *Id.*
13. 26 Misc. 3d 625, 889 N.Y.S.2d 423 (Sur. Ct., Nassau Co. 2009).
14. See *Bibeau v. Cantiague Figure Skating Club*, 294 A.D.2d 525, 741 N.Y.S.2d 864 (2d Dep't 2002), finding the lower court erred in compelling plaintiff to furnish unredacted income tax returns containing her social security number.

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