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# Trusts and Estates Law Section Newsletter

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

## A Message from the Section Chair

One would think that living each winter in Syracuse would permanently dull all weather-related stress. We have learned in the last few months that this is not necessarily the case.

Our Fall Meeting in New Orleans was shaping up to be a program with record-breaking attendance. The substantive program promised to be excellent, and everything was progressing very smoothly. In fact, it was too smooth. Hurricane Katrina destroyed all of the Meeting plans just as it destroyed everything else in its path. I think this message will be a good opportunity to let all members of the Section know what went on in the course of the storm and following it.

The Fall Meeting is a large one. It is planned years in advance of the actual event. Lodging, meals and cocktail parties have to be arranged. Social events are scheduled, and transportation is secured to get the group from one place to another. Only the larger hotels are capable of hosting such a meeting, and those hotels also tend to book their events years in advance. When a meeting site is lost, it is effectively impossible to shift it to another similar facility or to offer similar activities. Katrina gave us only about one month's notice that we would not be meeting in New Orleans.

As soon as the hurricane hit, Kathy Heider, the NYSBA Meetings Director, began efforts to get information from the hotel and from its parent company in Boston to assess whether there was any possibility of going forward with the Meeting. A few days following the hurricane, it became clear that there would be no chance of staying with New Orleans. At the same time Kathy was trying to clarify that situation, she was also looking for alternative sites. As expected, there were no hotels available in other cities that she investigated capable of handling a meeting of this size.

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NYSBA

Our speakers for New Orleans had prepared all of their materials and submitted them and were ready to go. After numerous calls and emails among Section Officers and staff, it was decided that if the substantive program was delayed, it could be rescheduled only a year from now. The possibility of presenting it at the Annual Meeting was unworkable because the time set aside in New York in January was insufficient for such an extensive program. We decided therefore that it would be preferable to present the program at an available hotel in New York as a free-standing Section program with only limited social activity. Kathy Heider tried frantically to find a hotel with available meeting facilities. After trying all of the facilities on her lists, she found only one with available space. Le Parker Meridien hotel could accommodate 170 people in a seminar, but that was the absolute limit, and there would be no writing surfaces, just chairs. Kathy scheduled this not knowing what the turn-out would be. It was a tribute to our program chair, Jack Barnosky, and to the program he scheduled that these 170 places sold out almost immediately. In fact, registrations continued to pour in, which had to be returned because of the lack of space. The interest in attending this program proved to us that the high registration in New Orleans was not simply because of the entertainment and fine food.

We learned this fall that the best laid plans may fail, and "things happen." We learned that the NYSBA Meetings Department staff and Lisa Bataille, our Staff Liaison, are skilled professionals, capable of making the best of any situation they encounter. We learned that our Section members and Executive Committee are flexible and always willing to do whatever is asked of them to allow things to run smoothly.

The Officers have discussed possible changes to the Fall Meeting to avoid weather-related problems in the future. Perhaps we should consider only meetings in the western part of the country, since the southeast seems to be so hurricane-prone in the fall, with each season's hurricanes getting more intense. In the alternative, the Fall Meeting could be changed to the spring, such as March, with the upstate meetings being changed to the fall. This would allow southeast designations outside of hurricane season. There are a number of issues which would have to be considered in adopting such a change, and we hope to consider those in the coming months and year. Anyone with thoughts on the subject is certainly invited to share them with the Officers.

We were very pleased to learn that Kate Madigan has won the designation of the Nominating Committee for election as President-Elect of the New York State Bar Association. I have had the pleasure of following Kate through the offices of the Elder Law Section. She has also been very active in the Trusts and Estates Section, having served many years on the Executive Committee. Kate will bring a long experience in the Trusts and Estates practice, but even more importantly, she will bring her good cheer and class to the job she is about to embark on.

**Michael E. O'Connor**


SAVE THE DATE


TRUSTS AND ESTATES LAW SECTION

ANNUAL MEETING

WEDNESDAY, JANUARY 25, 2006

NEW YORK MARRIOTT MARQUIS

# Editor's Message

"This Will is necessarily uncommon and capricious because I have no dependents or near relations and no duty rests upon me to leave any property at my death and what I do leave is proof of my folly in gathering and retaining more than I required in my lifetime."

Last Will and Testament of Charles Vance Millar (1853-1926)[1]

While the Roaring Twenties are now remembered for the entertaining exuberance of marathon dancing, goldfish swallowing and flagpole sitting, the Great Stork Derby was a competition of quite a different order. It began with the admission to probate of the Will of Toronto resident Charles Vance Millar, who died on Halloween Day in 1926. A lawyer by profession and a well-known member of the Ontario bar, the bachelor Millar had amassed a not inconsiderable estate by the standards of 1926—the residue amounted to approximately $100,000.

Most estate planners are familiar with so-called "incentive" trusts—that is, the transmission of wealth in a manner designed to encourage a certain kind of behavior, such as the pursuit of education or personal industry, or to discourage another, such as reckless consumption or sloth. Millar left a Will which contained one of the most peculiar incentive trusts on record.

By the Will's design, the ultimate beneficiaries of Millar's estate would not be determined until 1936, ten years after Millar's death. The reason? Article 9 of the Will directed that the estate residue be invested and reinvested for a period of ten years, at the conclusion of which it would be distributed to "the Mother who has since my death given birth in Toronto to the greatest number of children as shown by the registrations under the Vital Statistics Act."

The provisions of Millar's Will were widely debated in the press in the weeks and months that followed. Some members of the public found the Will amusing, but it struck others as offensive, immoral and disturbingly misogynistic. Margaret Sanger, the noted birth control advocate, pronounced the prospect of a ten-year fertility competition "utterly revolting."[2] Ten years also left ample opportunity for various distant Millar relations, and the provincial government of Ontario, to attempt to set the Will aside on public policy grounds, deploring the "disgusting nature of the competition among mothers to obtain the benefit of this bequest,"[3] and claiming that Millar's Will promoted illegitimacy and loose morals, and threatened the general health of mothers and children alike. Needless to say, over the ensuing years periodic tallies of Toronto's most fruitful mothers appeared regularly in newspapers across Canada and the United States.

Ultimately the Supreme Court of Canada refused to declare Article 9 of the Will invalid: "We find it impossible to affirm from any knowledge we have that a policy of encouraging large families by pecuniary rewards to the parents or donations to the children would have a tendency injurious to the state or to the people as a whole. . . . One could easily conjure up the possibility that similar temptations might be inspired by a bequest of a large fortune to the grandchildren of the testator, to be divided equally among them, as inviting each of the children to have a numerous offspring in order to secure for his family as large a proportion as possible of the inheritance."[4] In the meantime, Ontario courts were also called upon to decide a number of ancillary issues: As a geographical matter, what constituted giving birth "in Toronto"? What about children whose births were not registered in exactly the manner Millar had specified in his Will? Did illegitimate children count?

*"Millar left a Will which contained one of the most peculiar incentive trusts on record."*

Finally, on Halloween Day in 1936, the Great Stork Derby drew to a close. The final result? A tie among four Toronto women, each of whom demonstrated nine properly registered live births apiece during the specified ten-year period. In the interim, despite the onset of the Great Depression, the value of Millar's estate had magically appreciated to over $500,000, now to be divided among the four mothers. As each family included nine children under the age of eleven years, each could undoubtedly make very good use of this windfall.

In life, Millar was reputed to have been an adroit and accomplished lawyer, well respected in Toronto's business and civic communities, but not above orchestrating the occasional practical joke. Did Millar intend his Will to be his final shenanigan? Not in the reported opinion of one of his close confidants: "Charlie believed that a lot of human misery and poverty resulted from uncontrolled childbearing, which he blamed on the ban against birth control information. Charlie's hope was that by turning the spotlight on unbridled breeding, and making Toronto a laughingstock before the world, he could shame the government into legalizing birth control."[5]

Millar's true intentions will never be known. But the notoriety of the Great Stork Derby over its ten-year course may indeed have contributed to raising public consciousness of family planning issues, and the need for legislative reform to address them, in the first half of the 20th Century—hardly a capricious folly after all.

**REMEMBER**

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

## Endnotes

1. A complete account of the administration of Millar's estate is the subject of Orkin, *The Great Stork Derby*, General Publishing Co., 1981.
2. Orkin, at 60.
3. *Re Millar*, 1936 O.R. 554.
4. *In Re Millar*, 1938 S.C.R. 1.
5. Orkin, at 62.

**Austin Wilkie**


We take great pleasure in announcing

**Howard S. Krooks**, J.D., CELA

has joined us as partner in the firm.

Mr. Krooks is the Immediate Past Chair of the Elder Law Section of the New York State Bar Association

He will continue his practice in the following areas:

Asset Preservation Planning • Medicaid • Trusts • Guardianship • Disability Planning

Estate Planning • Estate Administration • General Elder Law Matters

*Mr. Krooks will serve as Of Counsel to Littman Krooks LLP*

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# New York vs. Florida: A Forum Selection Guide for Will Contests

By Amy B. Beller

We are all familiar with "Snowbirds"—retired or semi-retired New Yorkers who spend the winter months in Florida.[1] A recent study by the University of Florida reported that approximately 920,000 people temporarily reside in Florida in the winter and that 13 percent of those are New Yorkers over age 55.[2]

The Snowbird phenomenon raises interesting legal issues relevant to our practice, since New York-to-Florida Snowbirds often own real property and personalty, and may have bank or investment accounts, in both states. (And indeed, Snowbirds may be up to more mischief than just keeping property in both states—the *New York Daily News* reported in August of 2004 that at the time of the 2004 presidential election, over 46,000 voters were registered to vote in both New York *and* Florida[3]).

Multi-state property ownership by testators provides estate litigators with a unique opportunity for forum selection with respect to any challenge concerning the validity of a Snowbird's will.[4] For instance, imagine representing a wealthy Snowbird who wants to disinherit her children in favor of a second spouse. Defensive estate planning with a probable will contest in mind might accomplish the goal of establishing jurisdiction over the litigation in one state or the other. Perhaps there will be enough at stake to warrant a change of domicile.[5] Even post-mortem, there may be strategies, such as filing for original probate in one jurisdiction over another, which may determine the law applicable to the eventual will contest.

Of course, the jurisdictional and conflicts of law analyses are complicated, and will not be considered here. In the end, an estate litigator seeking to validate his choice of one forum's law over another may not succeed. However, even if unsuccessful, creating an additional strategic hurdle—one in which the opposing party's lawyer will have to fight to prevent the application of the unfavorable law of the chosen jurisdiction—in itself may be advantageous.

This article will compare the laws of New York and Florida with respect to a number of key factors inherent in most will contests (based on lack of capacity, undue influence or fraud) on which these states' laws differ: (1) notice and standing; (2) discovery; (3) *in terrorem* clauses; (4) mediation; (5) the Dead Man's Statute; (6) burdens of proof; (7) right to a jury trial; and (8) homestead.

### 1. Notice and Standing

In New York, all interested persons must be served in advance with citation on a petitioner's application for probate and for issuance of letters testamentary.[6] Interested persons include distributees of the decedent, persons designated in the propounded will, or persons named in a prior will on file with the court, whose interests are adversely affected by probate of the propounded instrument.[7] The proponent has no choice—he must serve all potential objectants with advance notice and hope that they simply do not object to probate on the return date of the citation.

In Florida, however, there is no provision for advance notice of probate unless the prospective contestant has filed a "caveat" in the Probate Court.[8] The caveat requires the probate petitioner to serve the "caveator" with formal notice of the petition, giving the caveator twenty days in which to object.[9] Assuming no caveat has been filed (as is usually the case), probate is routinely granted *ex parte*, and letters are issued to the named "Personal Representative" (*i.e.*, the executor), with notice of administration served only upon those persons named in the propounded will.

How does this apply in practice? Suppose our wealthy Snowbird, who is leaving all of her assets to her second husband, has three estranged adult children who are scattered across the United States. In New York, each of the adult children must be served with a citation informing him or her of the return date on the probate petition. In Florida, the will is likely to be admitted to probate and letters issued to the named Personal Representative in short order, without notice to any of the children despite their status as distributees. Although the children can bring a proceeding to revoke probate up until the time when the Personal Representative is discharged,[10] the momentum in the Personal Representative's favor renders a revocation proceeding difficult.

### 2. Pre- and Post-Objection Discovery

### a) Pre-Objection Discovery: 1404s

New York estate litigators are almost universally enamored with SCPA 1404, which permits a potential objectant to obtain discovery and take the depositions of the proponent, the drafting attorney, and the attesting witnesses, *before* deciding whether to file objections to probate. The advantage of such pre-objection discovery is clear—the potential objectant is given a one-way license to fish for possible grounds for her will contest. For the lawyer, SCPA 1404 provides an opportunity to assess the case before committing to represent the potential objections in full-blown litigation.

In Florida, there is no specific statutory authority allowing pre-will contest discovery. Florida Probate Rule 5.080(c) permits the use of all available discovery devices even when there is no adversarial proceeding pending. However, Rule 5.080(c) seems rarely utilized and a potential objectant's pre-litigation discovery demand is likely to be met with a motion to quash or for a protective order. In all probability, the Florida litigant will have difficulty obtaining any meaningful discovery until after a petition to revoke probate has been filed.

#### b) Post-Objection Discovery: Bills of Particular and the Three-Year/Two-Year Rule

Post-objection discovery is substantially similar in New York and Florida. Both forums provide for comparable discovery from parties and non-parties and for motion practice in connection with such discovery attempts. One difference, however, is the unavailability in Florida of a bill of particulars. The bill of particulars, although often overlooked, can be a very useful weapon in a will contestant's discovery arsenal, requiring the objectant to particularize her objections based on undue influence and fraud.[11]

Another difference in the discovery arena is that Florida has no equivalent to the three-year/two-year rule set forth in section 207.27 of the Uniform Rules for Surrogate's Court. Section 207.27 states that in any contested probate proceeding, the items upon which an examination before trial may be held is confined to a period of three years prior to the date of the propounded instrument and two years thereafter (or to the decedent's death). The limitation of section 207.27 has been applied to all kinds of discovery.[12] The three-year/two-year framework can be expanded by the court only upon a showing of "special circumstances."[13]

Since Florida has no periodic limitation on discovery, it may be the preferred forum if one seeks to uncover evidence outside the applicable three-year/two-year period that frames discovery in New York will contests. On the other hand, if one wishes to keep some older skeletons in the closet, New York might be the better option.

### 3. *In Terrorem* Clauses

*In terrorem*, or no contest, clauses, which are designed to discourage will contests, have created conflicts among the various states' courts and statutes. On one hand, enforcement of such clauses discourages frivolous litigation, family feuds and the unnecessary waste of a decedent's assets. On the other hand, enforcement of *in terrorem* clauses may chill meritorious challenges to probate, possibly allowing for dispositions of property which are contrary to the testator's true intent.[14]

In New York, *in terrorem* clauses are enforceable and are a frequently used strategy at the estate planning stage to prevent litigation.[15] In Florida, however, *in terrorem* clauses are unenforceable.[16] Thus, if our wealthy Snowbird is willing to leave enough money to her children to dissuade them from bringing suit, then there may be an enormous benefit to executing a will which will be governed by New York law so that her *in terrorem* clause will be upheld.

In many cases, however, the testator is unwilling to leave estranged family members enough to deter them from litigation, if anything at all. In such cases, whether or not the forum jurisdiction will enforce an *in terrorem* clause is inconsequential, since it will not prevent a will contest.

### 4. Mediation

Although New York permits alternative dispute resolution on consent of the parties, Florida has instituted a court-sanctioned mediation process. Florida judges are authorized to refer civil matters to mediation, and frequently require mediation before trial. Mediation in Fort Lauderdale's Fifteenth Judicial Circuit was successful in resolving over 4,000 cases in 2004.[17]

Often the biggest obstacle to settling litigation is simply getting the parties to sit down at the bargaining table. From a lawyer's perspective, neither side wants to be the first to suggest settlement negotiation, as it is traditionally viewed as a sign of weakness or lack of confidence in one's case. Court-ordered mediation resolves that problem, and for that reason it may be advantageous to both sides.

### 5. The Dead Man's Statute

To the delight of some and frustration of many others, New York's Dead Man's Statute, CPLR 4519, is still alive and well. Florida repealed its Dead Man's Statute, section 90.602, effective July 1, 2005. In New York, the Dead Man's Statute bars the admission of any evidence of a transaction with a decedent in which the witness offering the evidence has an interest.

To all but the experienced estate litigator, the Dead Man's Statute may seem like a minor consideration. However, application of the Dead Man's Statute can significantly affect the outcome of a case. Suppose our wealthy Snowbird told her new spouse, on her deathbed, that she wished to leave everything to him because he was the only one who cared for her during her final illness—her ungrateful children didn't even send her a card. Under New York law, the Snowbird's spouse cannot testify to this conversation during trial because of CPLR 4519. In Florida, however, there is no such bar. Assuming the will proponent gets past a hearsay objection, the testimony will be admissible. Imagine the effect of the Snowbird's own words on the finder of fact!

It is worth mentioning that in collateral, non-probate estate litigation, such as a discovery proceeding pursuant to SCPA 2103 to recover assets claimed to belong to the estate, the application the Dead Man's Statute can be *the* pivotal issue in the case. For example, suppose an executor of a decedent's estate seeks to recover a substantial sum of money from the decedent's housekeeper. The housekeeper claims the money was given to her shortly before the decedent's death, and that the decedent told her she wanted to reward the housekeeper for her hard work and loyalty. In the ensuing litigation in New York, the housekeeper would be barred from testifying at trial as to the decedent's statements concerning the gift. The fact-finder would hear only that a sum of the decedent's money was transferred to the housekeeper. Without the missing piece of information—why the decedent made the gift—the fact-finder would be free to speculate as to all kinds of suspicious facts concerning the decedent's transfer of significant assets to her employee. Depending on the identity and relationship of the parties, and of course on the facts of the specific case, the exclusion of such information may cause an unfortunate frustration of the decedent's intent.

The hypothetical case discussed above demonstrates the importance of the Dead Man's Statute in our area of practice which, by definition, involves the disposition of the assets of a decedent. Supporters of the Dead Man's Statute argue that Florida's elimination of the rule is dangerous, as testimony may be fabricated. To avoid such false testimony is the very purpose for the Dead Man's Statute—the decedent is not present to verify the truth of the interested witness's testimony.[18]

In an effort to level the playing field, simultaneous with repeal of its Dead Man's Statute, Florida enacted a new exception to the hearsay rule. Florida Statute § 90.804 provides that where the declarant is unavailable as a witness (*i.e.*, deceased or incompetent), evidence of any statement of the declarant which is similar in subject matter to statements of the declarant previously admitted into evidence shall not be excluded as hearsay. Only time will tell what effect these changes in Florida law will have on the trial of will contests.

### 6. Burdens of Proof

In a Florida will contest, the proponent has the burden of proof on due execution only, and the objectant carries the burden of proving testamentary incapacity, undue influence and fraud.[19] A New York proponent must prove testamentary capacity as well as due execution, but the burden on undue influence and fraud, as in Florida, rests with the contestant.[20]

However, in New York, the proponent can usually establish a *prima facie* case on testamentary capacity simply with the testimony of the attesting witnesses.[21] The burden then shifts to the will contestant to prove incapacity. Thus, the actual difference between Florida's and New York's respective burdens of proof on testamentary capacity may be inconsequential in practice.

In both Florida and New York, a confidential relationship between the testator and a person alleged to have unduly influenced the testator will shift the burden of proof on undue influence. Florida Statute § 733.107 actually provides for a presumption of undue influence, which expressly implements the public policy against abuse of fiduciary or confidential relationships.

### 7. Right to a Jury Trial

The right of a will contestant to a trial by jury is established in New York by statute, SCPA 502. Such right is a cornerstone of any New York will contest, and it shapes the course of the litigation from its inception. Proponents, especially those with confidence in their cases, frequently prefer bench trials. Contestants, on the other hand, may rely on juries to reach beyond the rigid standards for invalidating a testamentary instrument, often playing upon some unusual or unsavory facts disclosed during discovery to tip the scales in their favor.

In Florida, there is no constitutional right to a jury trial in a will contest.[22] Nor is there any statutory authority requiring a jury trial when demanded by a party to a will contest. A Florida court, in its discretion, may submit a factual question to a jury, or it may consider the verdict of an advisory jury, but it is not required to do so.[23]

That a will contestant may be unable to obtain a jury trial in Florida can be either an enormous benefit or a serious detriment, depending on one's perspective and the facts of a given case. In any event, this is a significant difference which must enter into any analysis relating to forum selection between New York and Florida.

### 8. Homestead

Florida's homestead laws serve many public policy goals. Although the complexities of Florida homestead are beyond the scope of this article, for the purpose of this discussion the relevant homestead provisions concern the devise and descent of homestead property. Simply put, a testator who is survived by a spouse and a minor child cannot validly devise homestead property, although if the testator is survived by a spouse and no minor child, the homestead may be devised to the spouse.[24] In default of a valid devise of homestead property, in the case of a testator survived by a spouse and children, the spouse will take a life estate in the property, with the remainder interest passing to the testator's children.[25]

New York, of course, has no equivalent to homestead. Subject to a spouse's right of election, a testator can devise his real property to whomever he chooses.

The effect of homestead laws on Florida estate litigation is significant. Consider our original hypothetical in which the Snowbird is survived by a spouse and adult children from a prior marriage. The Snowbird's Will devises the homestead property to her spouse, which is a valid disposition. However, even if the children are successful in establishing that the Snowbird's Will is invalid, the Snowbird's spouse will retain a life estate in the homestead property. If the spouse is significantly younger than the testator, this may mean that the Snowbird's children will have to wait decades before they can obtain possession of the homestead property. Coupled with a spouse's right of election (in Florida, equal to thirty percent of the estate[26]) which is in addition to homestead,[27] the contestants may conclude that there is not enough to be gained to justify litigation.

Consider another example: Suppose a testator is estranged from his ex-wife and minor children. If he is not remarried, he will not be able to devise his Florida homestead property to anyone other than his minor children. In effect, the homestead provisions operate as a forced inheritance scheme in favor of the testator's children, potentially overriding the testator's wishes. However, note that this will only apply when the children are minors—if the testator is survived by no spouse and only adult children, he may devise his homestead as he pleases.

## Conclusion

Assuming that the estate litigator can choose her forum for the contest of a will of a New York-Florida Snowbird, either by careful pre-mortem planning or clever post-mortem tactics, there are many factors to be considered in assessing the strategic advantages of one jurisdiction over the other. Of course, these factors must always be analyzed based upon the specific facts and circumstances of a given case.

## Endnotes

1. See www.wordsmith.org, archives for March 25, 2004, defining a Snowbird as a person who moves to a warmer climate for the winter. Example: "Song has grabbed some of the snowbird business that JetBlue relies on to fill its seats between New York and Florida." Jeremy Kahn, Investors Head for the Exits at JetBlue: Fortune (New York: Feb. 10, 2004).
2. "UF Study: New York leads in snowbirds moving temporarily to Florida," November 22, 2004 (http://news.ufl.edu/2004/11/22/snowbirds-2/).
3. "The News Rocks the Vote," *New York Daily News*, August 23, 2004.
4. SCPA 205 gives the New York Surrogate's Courts jurisdiction over the estate of any New York domiciliary, and SCPA 206 provides jurisdiction over the estates of non-domiciliaries who leave property in the State. Section 733.101 of Florida's Probate Code infers jurisdiction over the estate of a non-domiciliary with Florida assets, and section 731.106 provides that a non-resident may nonetheless elect to have Florida law apply to the testamentary disposition under his will. With respect to the disposition of real property, case law in both New York and Florida indicates that only the courts of the State in which such property is located can determine the disposition of such property (hence ancillary administration proceedings), and that the law of such forum State will apply. *See Lynes v. Townsend*, 33 N.Y. 558, 561 (1865); *DeFrance v. DeFrance*, 710 N.Y.S. 2d 612, 613 (2d Dep't 2000); *Kyle v. Kyle*, 128 So. 2d 427 (Fla. 2d DCA 1961); *Conner v. Elliott*, 85 So. 164 (Fla. 1920); *Beale v. Beale*, 807 So. 2d 797 (Fla. 1st DCA 2002).
5. There may be very important tax or other financial considerations which effect a choice of domicile, including but not limited to the decoupling of the New York estate tax, the fact that Florida has no income tax, and the protections of Florida homestead property from creditors. These issues are the subject of another article for another day.
6. *See* SCPA 304, 306 and 1403; *see also* SCPA 1410: Who may file objections to probate of an alleged will.
7. SCPA 1403.
8. See Florida Statute § 733.212. and Probate Rule 5.201 (required notice); Florida Statute § 731.110 and Probate Rule 5.260 (regarding procedures for filing a caveat).
9. Probate Rules 5.260(f) and 5.040(a).
10. Florida Statute § 733.109.
11. See Rule 207.23 of the Uniform Rules of Surrogate's Court.
12. *In re Abbate*, N.Y.L.J. 6/25/2003 (Sur. Ct., N.Y. County).
13. Uniform Rules for Surrogate's Courts, § 207.27.
14. Dukeminier, Johanson, Lindgren and Sitkoff, *Wills, Trusts and Estates*, *7th ed.* (Aspen Publ. 2005), at p. 167.

15. *See, e.g.*, *In re Ellis*, 252 A.D.2d 118, 683 N.Y.S.2d 113 (2d Dep't 1998), *appeal denied*, 93 N.Y.2d 805, 689 N.Y.S.2d 429 (1999) (decedent's sons violated *in terrorem* clause and therefore forfeited right to bequests under Will).

16. Florida Statute § 732.517 provides: "A provision in a will purporting to penalize any interested person for contesting the will or instituting other proceedings relating to the estate is unenforceable."

17. 2005 Florida Mediation and Arbitration Programs: A Compendium, 18th ed., prepared by Florida Dispute Resolution Center (available at www.flcourts.org).

18. The Committee Report for Bill CS/SB, 4/27/05, states: "The main purpose of the prohibition on testimony by an interested party is to protect the decedent's estate from false or fraudulent claims. It was also thought that it would be unfair to the estate of the deceased person to allow an interested party to have the benefit of giving testimony that cannot be contradicted by the other party to the oral communication, who is now deceased or incompetent."

19. Florida Statute § 744.107 and Probate Rule 5.275.

20. *In re Kumstar*, 66 N.Y.2d 691, 496 N.Y.S.2d 414 (1985); *In re Walther*, 6 N.Y.2d 49, 188 N.Y.S.2d 168 (1959); *Delafield v. Parish*, 25 N.Y. 9 (1862); *Estate of Watson*, 37 A.D.2d 897, 325 N.Y.S.2d 347 (3d Dep't 1971).

21. *See In re Fiumara*, 47 N.Y.2d 845, 418 N.Y.S.2d 579 (1979) (jury verdict finding testamentary capacity based on testimony of attesting witnesses would not be set aside); *In re Leach*, 3 A.D.3d 763, 772 N.Y.S.2d 100 (3d Dep't 2004) (affidavit of attesting witnesses creates presumption of testamentary capacity); *but see Estate of Warsaki*, N.Y.L.J. 1/4/1996 (Sur. Ct., N.Y. County) (attesting witnesses did not demonstrate that testator was free from insane delusion).

22. *See Estate of Howard*, 542 So. 2d 395 (Fla. 1st DCA 1989); *Estate of Fanelli*, 336 So. 2d 631 (Fla. 2d DCA 1976).

23. *Estate of Fanelli, supra* note 22.

24. Florida Statute § 732.4015.

25. Florida Statute § 732.401. Technically, the provision applies if the testator is survived by a spouse and "lineal descendants."

26. Florida Statute § 732.2065.

27. Florida Statute § 732.2105.

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# An Overview of the New Israeli Tax Law Applicable to Trusts

By Alon Kaplan, Adv.; Lyat Eyal, Adv.; Shai Dover, CPA (Isr)

The tax reform enacted in Israel in January 2003 introduced the concept of personal taxation. The main object of the reform was to change the tax regime from one based on a territorial system to one based on personal taxation.

Pursuant to the reform, an Israeli resident is taxed on worldwide income. Over the years, Israeli residents formed overseas trusts for investment purposes and for the management of their financial assets. As a result, the taxation of trusts had to be carefully examined since the legislation of the tax reform did not include this subject. After long deliberations, the Knesset (Israeli Parliament) legislated the Taxation of Trusts Law.

In order to understand the Taxation of Trusts Law, it may be beneficial to review some basic points about trusts in Israel.

## I. The Use of Trusts in Israel

The concept of a private trust under the Trust Law 1979 (the "Trust Law") is widely known and used by professionals in Israel. The most common application of the Trust Law is in the capacity of nominee agreements and trust relationships created by law.

Israeli professionals tend to use foreign trust structures for organizing private and business affairs where a common law type of trust is required. Sometimes the continental foundation entity is also used.

One can identify several reasons for the above formation of trusts in foreign jurisdictions:

1. The legal structures available under the Trust Law are mostly insufficient. The establishment of a trust which would "skip" generations, often available under foreign trust structures, is not available in Israel. Therefore, there is a need for probate proceedings in order to achieve the settlor's goal of creating a trust that will exist for a number of generations.
2. Israel recognizes the common law concept of trusts. Israeli law distinguishes between revocable and irrevocable trusts. The classification of a trust as revocable or irrevocable depends on the level of control preserved by the settlor in the management of the trust assets. An irrevocable trust is usually one in which the settlor transfers the trust assets to a trustee who is provided with discretionary powers to manage said trust assets. There is a complete separation between the settlor, other assets owned by the settlor and the assets transferred to the trustee. The taxation of revocable trusts is currently regulated by existing tax laws. The new law aims to regulate the taxation of irrevocable trusts.

## II. The Main Features of the Tax Law Applicable to Trusts

The Taxation of Trusts Law comes into effect on January 1, 2006. The law defines three types of trusts:

A. A foreign resident settlor trust;

B. A trust of residents of Israel; and

C. A foreign resident beneficiary trust.

### A. A Foreign Resident Settlor Trust

#### 1. Definition

The Foreign Resident Settlor Trust managed by an Israeli trustee may appeal to foreign residents. For a trust to be classified as a foreign resident settlor trust: (i) the settlor must be a non-resident of Israel at the time of formation of the trust and during the tax year; or (ii) the settlor and the beneficiaries must be non-residents of Israel during the tax year. This trust is designed either for non-resident family members of Israeli residents who wish to provide for their family in Israel or for foreign residents who wish to appoint an Israeli trustee, rather than trustees in various offshore jurisdictions, to manage family assets and wealth.

#### 2. Taxation

A foreign resident settlor trust is viewed as the foreign resident personally, regardless of whether the trust is classified as revocable or irrevocable. The assets held by the trustee are viewed as though such assets were held by the foreign resident personally. As a result, the income of the trust is regarded as the income of a foreign resident. Trust profits that are not derived from sources in Israel are not taxable in Israel. Further, there are no reporting obligations in Israel. The legislation chose to emphasize this point in order to ensure that foreign residents are not dissuaded from establishing such trusts that could result in taxation in Israel simply due to the appointment of local trustees. This emphasis is evident in Section 75O(E) which provides that trustees of a foreign resident settlor trust, of a foreign resident beneficiary trust and of a testamentary trust by last will and testament of which there is no beneficiary who is a resident of Israel, will not be obligated to submit a report required by Section 131[1] of the Israeli Tax Ordinance (governing reporting requirements) with respect to income derived from sources outside Israel. No such reports are required to be submitted even if the trustee is a resident of Israel and submitted a report in accordance with Section 131 with respect to other income that was produced or derived in Israel.

Further, Section 75P(C) provides that a trustee who is a resident of Israel will not incur any tax liability or be obligated to submit tax reports with respect to the trustee's (i.e., the trust's) income, in addition to requirements detailed in this chapter, that would not otherwise exist had all the trustees been foreign residents.

This tax and reporting exemption relates to income derived from sources such as rental, interest, dividend, capital gains and business profits outside Israel. The foreign resident settlor trust, in certain cases, may also be exempt from tax on certain income derived within Israel from interest or capital gains, as such income may be viewed as income of a foreign resident.

### 3. Israeli Resident Beneficiaries

In Israel, a country which encourages immigration, many residents have family members residing abroad. Income derived by a trust established by a foreign resident settlor for the benefit of an Israeli resident beneficiary is not likely to be taxable in Israel if the settlor of the trust would not be taxable in Israel on such income (i.e., income derived from sources outside Israel). The exemption from tax on such income would not apply if the non-resident family member were to transfer the ownership of the assets to the Israeli resident rather than establish a trust for the benefit of the Israeli resident.

The foreign settlor trust for an Israeli resident beneficiary may be established either during the lifetime of the settlor or as a testamentary trust.

## B. A Trust of Residents of Israel

### 1. Definition

A trust is a trust of residents of Israel if, at the time it is established: (i) at least one settlor and one beneficiary are residents of Israel; or (ii) during the tax year, at least one settlor or one beneficiary are residents of Israel.

In addition, a trust will automatically be regarded as a trust of residents of Israel if it does not match the definition of any other type of trust. It is clear that if neither the settlor nor the beneficiary are residents of Israel, the trust cannot be a trust of residents of Israel.

### 2. Taxation

A trust of residents of Israel is taxable in accordance with Israeli tax laws and in accordance with the relevant tax rates applicable to individuals.

In Israel, tax rates are progressive for income from a business (that is, the rate increases when the level of income increases) and are fixed for income derived from capital, such as: (i) a rate of 15% to 20% on interest; (ii) a rate of 20% to 25% on dividends; (iii) a rate of 20% to 25% on capital gains. Similar tax rates will apply to trust income. Where the trust earns business income (as opposed to capital income), the tax rate will be the highest tax rate for individuals (currently 49%).

The trustee is obligated to make the tax payments, and distributions of income to the beneficiary will be made after the deduction of the taxes owed, that is, from the net value. Therefore, the beneficiary does not have any additional tax liability and is released from any obligations with respect to the payment of taxes on the distributions.

A trustee of an irrevocable trust may distribute the income to the beneficiary within six months from the end of the tax year and such income will be considered income of the beneficiary. This may be advantageous where the beneficiary may be entitled to special tax benefits due to disability or where the beneficiary may be entitled to deduct losses from the income. (This model adopts the model that is accepted in New Zealand for the taxation of trusts.)

## C. A Foreign Resident Beneficiary Trust

### 1. Definition

A trust of a foreign resident beneficiary is a trust established by an Israeli resident for the benefit of a foreign resident beneficiary.

The assets, and any income derived therefrom, are not subject to Israeli tax. The legislation devotes several sections (and includes severe sanctions) to ensure that an Israeli settlor is, in fact, not connected to such assets and that the beneficiary is, in fact, a foreign resident.

Such a trust requires all of the following conditions:

a. It does not fall within the definition of a trust of Israeli residents.

b. It is an irrevocable trust.

c. All of the beneficiaries are foreign resident individuals, all of whom are identified.

d. At least one settlor is an Israeli resident.

In addition, there are different reporting duties and declarations under which the settlor and the trustee must declare that no beneficiary of the trust is an Israeli resident, and in certain cases, that an Israeli resident beneficiary may not be added as a beneficiary of the trust.

### 2. Taxation

Similar to the foreign resident settlor trust, a foreign resident beneficiary trust will be regarded as the foreign resident personally and will be taxed in the same manner in which an individual foreign resident is taxed in Israel. If the assets, and the income derived therefrom, are outside of Israel, there should be no taxation in Israel. If the assets, or the income derived therefrom, are within Israel, the double tax treaty that would have applied if the beneficiary had held the assets directly may be applicable. As in the foreign resident settlor trust, the appointment of an Israeli trustee has no relevance for the purpose of taxation.

A beneficiary of a foreign resident settlor trust who immigrates to Israel renders the trust a trust of Israeli residents and therefore taxable in Israel, although the trust may enjoy certain tax benefits permitted by law for new immigrants.

## III. The Underlying Company in Israel

The Taxation of Trusts Law provides for the establishment of an underlying company within Israel or abroad. The underlying company is used for the legal separation between the trustee's personal assets and the trust's assets.

An underlying company is a "group of persons" holding the trust's assets for the trustee, directly or indirectly. This group can be, for instance, a typical company, foundation or partnership. Every group of persons which possesses assets that are not its own, but belong to the trustee by virtue of his duty, fulfill the definition of an underlying company.

Before the new law was enacted, every Israeli trustee holding such a company would, through the "management and control" test, cause it to be regarded as an Israeli company and subject it to corporation tax and reporting requirements in Israel. The new law provides that this underlying company is now regarded as a "flow-through entity" and the "management and control" test is no longer relevant. The Israeli tax authority should ignore the company and treat the assets, and the income derived therefrom, as if they were held directly by the trustee.

As the trustee of a foreign settlor trust is not subject to tax or reporting requirements, the trustee may utilize an underlying company, whether in Israel or abroad, to hold the trust's assets. Neither the trustee nor the underlying company is subject to tax or reporting obligations on the income derived outside Israel. Where the underlying company derives income from sources within Israel, for example, by leasing a building, the income will be considered the trust's income and the trustee will have to file reports and pay the taxes (but only on income derived from Israeli sources).

The concept of an underlying company is simple and advantageous in constructing the most efficient trust arrangement possible. Until now, settlors and practitioners preferred appointing foreign trustees out of concern that having an Israeli trustee could create tax liabilities in Israel. Under the new law, the place of residence of the trustees will not affect the taxation of the trust. It is the tax status of the beneficiary and the settlor that will determine Israeli tax liability.

## Conclusion

This is an important development in the Israeli tax system. It provides opportunities to both Israeli and overseas trust companies and trust and estate practitioners. The appointment of Israeli trustees is encouraged by the Income Tax Authority. Not only will it advance the use of domestic professional services, but it will also enable the Income Tax Authority to communicate directly with trustees. Foreign trustees seeking assistance and better communication with the tax authorities may co-operate with Israeli trustees in order to fulfill their duties in Israel.

Israel, with a population of 6.7 million, is a vibrant economy with a developed banking system and almost 40 double taxation treaties. It remains to be seen how the new law should be implemented in order to establish a new financial center in Israel.

## Endnote

1. Note: Section 131 is the section in the Israeli Tax Ordinance that requires reporting of income.

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# Departing Is Such Sweet Sorrow: Giving Up U.S. Citizenship or Residence

By G. Warren Whitaker and B. Dane Dudley

While millions of people around the world are trying to get into the United States by obtaining U.S. legal residence or citizenship, a few others are headed in the opposite direction. Those leaving are often U.S. citizens by birth or naturalization who have lived outside the U.S. for many years and have stronger connections to another country. They also include many U.S. permanent residents or "green card" holders who are returning to their home countries or moving elsewhere. (According to the U.S. Treasury's own studies, the image of thousands of wealthy Americans with no prior foreign ties suddenly picking up stakes and expatriating each year to avoid taxes is an urban myth.)

Whatever mixture of human motivations may lead to this decision, giving up U.S. citizenship and residence can lead to the sweet result of escaping U.S. income, estate and gift taxation. The sweetness may be tinged with sorrow, however, if the departing person is ensnared by the U.S.'s Alternative Tax Regime. While the U.S. does not have a formal exit tax like some other countries including Canada, there are a series of complex provisions that can trap a departing citizen or resident in the U.S. tax net for up to ten years after departure. These rules were recently revised as part of the Jobs Protection Act of 2004. The revised rules (contained primarily in I.R.C. § 877) operate as follows:

## General Rules

(a) **Income and Capital Gain Taxes—**United States citizens and residents generally are subject to U.S. income taxation on their worldwide income. Non-residents who are not U.S. citizens ("non-U.S. persons") are subject to U.S. income tax only on income from U.S. sources. Keep in mind the definition of "resident" is different for estate and income tax purposes. A U.S. resident for estate tax purposes is a person whose primary residence or domicile is in the U.S. This is a subjective test aimed at determining whether a person who lives in the U.S. has no definite present intent to leave, as shown by the surrounding facts and circumstances.[1] The residence determination for U.S. income tax purposes is a more objective test. Generally, a resident for U.S. income tax purposes is a green card holder (or other lawful permanent resident) who is present in the U.S. for any day of a calendar year or a person who meets the "substantial presence" test: (i) is present in the U.S. for 183 days in that year, or (ii) is present in the U.S. for at least 31 days of that year and has been present in the U.S. for an average of more than 121 days per year over that year and the two prior years.[2] Non-U.S. persons are taxed at regular graduated rates on "active" income derived from a U.S. trade or business.[3] Non-U.S. persons are generally taxed at a flat rate of 30 percent (or a lower treaty rate) on certain types of "passive" income derived from U.S. sources, such as (i) dividends paid from U.S. corporations; (ii) rents from U.S. real property; and (iii) interest on debts of U.S. obligors (other than interest that qualifies as "portfolio interest," which includes bank interest and nearly all interest on publicly traded bonds).[4] Non-U.S. persons pay no tax on gain realized on the sale of U.S. assets other than U.S. real property.

> *"While the U.S. does not have a formal exit tax like some other countries including Canada, there are a series of complex provisions that can trap a departing citizen or resident in the U.S. tax net for up to ten years after departure."*

(b) **Estate and Gift Taxes—**U.S. citizens and residents are subject to U.S. gift tax on transfers during life and estate tax at death on their worldwide assets.[5] Non-U.S. persons are generally subject to U.S. gift tax only on gifts of real property and tangible personal property located in the U.S. and not, for example, on gifts of shares of U.S. corporations.[6] Non-U.S. persons are subject to U.S. estate tax at death only on assets deemed to be situated in the U.S., such as (i) real estate located in the U.S.; (ii) tangible personal property located in the U.S.; and (iii) shares of U.S. corporations (but U.S.-situs assets held by non-U.S. corporations are normally not subject to U.S. estate tax).[7]

## Alternative Tax Regime After Expatriation

(a) **Generally—**An individual who relinquishes U.S. citizenship with a principal purpose of avoiding U.S. taxes is subject to an alternative method of taxation for ten years after expatriation (the "Alternative Tax Regime").[8] For persons who expatriate after June 3, 2004, an expatriate is **presumed** to have expatriated with a principal purpose of tax avoidance and, therefore, generally is subject to the Alternative Tax Regime if: (i) the individual's average annual net income **tax** for the period of five years ending before the date of the loss of the U.S. citizenship is greater than $124,000; (ii) the individual's net worth as of the date of loss is $2,000,000 or more; *or* (iii) the individual fails to certify under penalty of perjury that she has met the requirements of the Code for the five preceding tax years, or fails to submit evidence of her compliance as the IRS may require.[9] **The prior process by which expatriates could seek a ruling from the IRS that their expatriation was not primarily motivated by tax considerations has been repealed.**[10] There are two very narrow exceptions for certain dual citizens and certain minors.[11]

The $124,000 amount will be increased for years after 2004 by an amount determined by reference to the cost-of-living adjustment rounded to the nearest $1,000. Note that the $124,000 figure refers not to taxable income but to the average annual net income **tax** paid or payable by the individual for the period of five taxable years ending before the date of expatriation.[12]

If a U.S. citizen expatriates and is below the dollar thresholds for the tax avoidance presumption of $124,000 and $2,000,000 described above, but fails to certify under penalty of perjury that he or she has met all of the requirements under the Internal Revenue Code for the five preceding taxable years, he or she will be subject to the Alternative Tax Regime.[13]

A person who formally renounces his permanent work visa or green card after he or she has held it for part or all of at least 8 of the past 15 calendar years is subject to the same Alternative Tax Regime as one who has given up his U.S. citizenship.[14] Persons in both categories will be referred to as "expatriates" in this article.

(b) **Income Tax—**An expatriate subject to the Alternative Tax Regime is taxed on all U.S.-source income at the rates applicable to U.S. citizens (up to 35%), rather than the withholding rates applicable to non-U.S. persons.[15] In addition, U.S.-source income has a broader definition under the Alternative Tax Regime for non-resident aliens who fall within the scope of the regime than it does for other non-residents. It includes, for example, gain from the sale of U.S. corporate stock or debt obligations and interest on all U.S. government, corporate or bank obligations. Accordingly, the Alternative Tax Regime generally applies to an exchange of property that produces U.S.-source income for property that produces foreign-source income. In addition, amounts earned by expatriates through controlled foreign corporations are subject to the Alternative Tax Regime, and the ten-year period is suspended during any time an expatriate's risk of loss with respect to property subject to the Alternative Tax Regime is substantially diminished. **Another important change is that a tax-motivated expatriate will be treated as a U.S. citizen for a calendar year during the ten-year period following expatriation, fully subject to U.S. gift and estate taxes on worldwide assets and U.S. income tax on worldwide income if she is present in the U.S. for any reason for more than thirty days in that calendar year.**[16] There are two narrow exceptions to this thirty-day trap. For example, a day of physical presence in the U.S. will be disregarded if the individual is performing services for her employer and the employer is not related to the expatriate (under I.R.C. § 207 and 707) and the employer meets all requirements the IRS may establish in this context. The other exception is where the expatriate became at birth a citizen of the U.S. and another country and continues to be a citizen of the other country after expatriating and has had no "substantial contacts" with the U.S.[17]

(c) **Estate and Gift Taxes—**In addition, the Alternative Tax Regime includes special estate and gift tax rules. Under these rules, certain closely held foreign stock owned by the tax-motivated expatriate is included in her gross estate to the extent that the foreign corporation owns U.S.-situs property if the expatriate dies within ten years of expatriation.[18] This rule prevents expatriates who are subject to the Alternative Tax Regime from avoiding U.S. estate tax by transferring U.S.-situs property to a foreign corporation. Moreover, under the Alternative Tax Regime, an expatriate is subject to gift tax on gifts of U.S.-situs intangibles, such as shares of U.S. corporations (and gifts of stock in some closely held foreign corporations that own U. S. assets) made during the ten years following expatriation.[19]

(d) **Reporting Requirements—**In order to avoid being treated as a U.S. citizen, a person expatriating must give notice to the Secretary of State or the Secretary of Homeland Security of her renunciation of U.S. citizenship or residency.[20] The tax-motivated expatriate must also file an information statement that includes (i) the mailing address of her principal foreign residence, (ii) the foreign country in which she is residing, (iii) her country of citizenship, (iv) a complete list of her worldwide assets and liabilities, (v) information relating to her worldwide income for the year, and (vi) the number of days that she was physically present in the U.S. during the year.[21] **The**

**tax-motivated expatriate must file a detailed information statement similar to the one described above each year during the ten-year period, even if no U.S. tax is due.** There is a $10,000 penalty for failing to file the annual information statement.[22]

### The Reed Amendment

In addition to the tax rules discussed above, Congress enacted the Reed Amendment in 1996 as part of the Illegal Immigration Reform and Immigrant Responsibility Act.[23] This law allows the U.S. Attorney General to place tax-motivated expatriates on a list of undesirables who cannot reenter the United States for any reason—lumping them together with former Nazis, pedophiles and international terrorists. Although to date no tax-motivated expatriate has been placed on this list, the possibility cannot be ignored.

### The Not-So-Simple Solution

To avoid the continuing U.S. income, gift and estate tax aspects of the Alternative Tax Regime, a person contemplating expatriation could sell all U.S.-situs assets, pay whatever U.S. capital gain tax is owed and reinvest the net proceeds entirely in non-U.S. assets. In this way, all of the person's ties to the U.S. tax would be cut. Besides the potentially substantial capital gain tax that might be generated, this solution does not eliminate:

- The thirty-day limit on the number of days that can be spent in the U.S. during the ten-year period,
- The annual reporting requirements, or
- The risks associated with the Reed Amendment.

The person wishing to expatriate must also (i) have or acquire citizenship in another country, (ii) physically move to another country and make that country her permanent home or domicile, and (iii) go to the U.S. embassy or consulate in that country, present the information statement discussed above and formally renounce U.S. citizenship or permanent residence status.

**IN SUMMARY:** It is possible to leave the U.S. tax maze, but the exits are not clearly marked and an informed guide is required. And further changes in this area can be expected.

### Endnotes

1. Treas. Reg. § 20.0-1(b)(1).
2. I.R.C. § 7701(b)(3)(A).
3. I.R.C. § 871(b).
4. I.R.C. § 871(a).
5. I.R.C. §§ 2501 and 2001.
6. I.R.C. § 2501(a).
7. I.R.C. §§ 2103, 2104 and 2105.
8. I.R.C. § 877(b).
9. I.R.C. § 877(a)(2).
10. P.L. 108-357 Sec. 804(a)(1),(2),(c) (applicable to individuals who expatriate after 06/03/04, as provided by Sec. 804(f) of P.L. 108-357), which replaced the prior subsection (a) of I.R.C. § 877.
11. I.R.C. § 877(c)(2) and (3).
12. I.R.C. § 877(a)(2).
13. *Id.*
14. I.R.C. § 877(e).
15. I.R.C. § 877(d).
16. I.R.C. § 877(g).
17. I.R.C. § 877 (c)(2).
18. I.R.C. § 2107(b).
19. I.R.C. § 2501(a)(3).
20. I.R.C. § 7701(n).
21. *Id.*
22. I.R.C. § 6039G.
23. 8 U.S.C. § 1182(a)(10)(E).

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# The Irrevocable Income Only Trust (Medicaid Qualifying Trust): What Every Attorney Should Know

By Anthony J. Enea

Before discussing the intricacies of Irrevocable Income Only Trusts (Medicaid Qualifying Trusts) and the relevant drafting considerations, it is important to understand the enabling legislation which provides for such trusts and the major legislative changes that have had an impact on them.

## I. Historical Perspective

### A. COBRA 1985

Prior to 1985 and the enactment of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA 1985), Medicaid did not distinguish between trusts and other assets. The assets and income of a trust were treated like any other resource or income for Medicaid eligibility purposes.

COBRA 1985 changed this by authorizing the establishment of certain irrevocable *inter vivos* trusts referred to as "Medicaid Qualifying Trusts." A Medicaid Qualifying Trust was defined as an irrevocable *inter vivos* trust established by an individual, or by an individual's spouse, under the terms of which the trustee is granted discretion to make payments to the individual. For Medicaid eligibility purposes, full exercise of the trustee's discretion was presumed, irrespective of whether or not the trustee actually paid income or other trust resources to the individual. COBRA 1985 required the inclusion of unpaid income or other resources for purposes of determining Medicaid eligibility.

Although COBRA 1985 presumed full exercise of discretion granted by the trust, it did not expand discretionary trust provisions which were limited by language of the trust. For example, if the trust capped the trustee's ability to distribute income to $10,000 annually, then only $10,000 of income would be deemed available annually.

On April 7, 1985, New York enacted enabling legislation for Medicaid Qualifying Trusts (EPTL 7-3.1(c)). With this enabling legislation in place, New York Elder Law attorneys began drafting trusts that gave the trustee the discretion to distribute income to the beneficiary but not principal. Many attorneys pushed the envelope and started drafting trusts that authorized income and/or principal payments so long as the individual was "well and living in the community." These trusts were commonly known as "Trigger Trusts."

A "Trigger Trust" typically provides that if the beneficiary entered a nursing home, or if the beneficiary applied for Medicaid, the trustee's discretion would terminate and no further payments of income and/or principal could be made.

Thus, under the specific terms of the trust, the trustee had no discretion to pay income and/or principal at the time a Medicaid application was made. Therefore, under the provisions of COBRA 1985, the assets of the trust were not available for Medicaid eligibility purposes.

New York's enactment in 1997 of EPTL 7-3.1(c) (and 18 N.Y.C.R.R. § 360-4.5) closed this loophole by treating as void any provision in an *inter vivos* trust created on or after April 2, 1992 that directly or indirectly suspended, terminated or diverted principal, income or any beneficial interest of the creator of the trust or the creator's spouse based on a Medicaid application or requirement of medical care.

### B. OBRA 1993

With Congress's enactment of the Omnibus Budget and Reconciliation Act of 1993 (OBRA 1993), if the trustee of the trust had any discretion to distribute income and/or principal to the individual or the individual's spouse, then the entire amount of such income and/or principal would be considered fully available to the individual for Medicaid eligibility purposes. Even if the trust limited the trustee's discretion to pay only $100 per month of the trust's total monthly income of $500, all $500 of income was deemed available under OBRA 1993.[1] The Federal mandates of OBRA 1993 were adopted by New York in 1994.[2]

OBRA 1993 defined a trust for Medicaid purposes as a trust created by the individual, his or her spouse, a third person, or a court with authority to act on behalf of the individual or his or her spouse, or anyone acting at the direction of the individual or his or her spouse. By specifically including third parties or a court acting on behalf of the individual as potential creators of the trust, the provisions of OBRA 1993 removed any questions as to whether a court-ordered trust could avoid its provisions.

OBRA 1993 affected all trusts created or funded after August 10, 1993. OBRA 1993 also created a new 60-month "lookback" period for assets transferred to an irrevocable trust.[3] Thus, if the Medicaid applicant created an irrevocable trust, he or she would be required to provide Medicaid with his or her financial records for the 60 months prior to the date Medicaid was sought. Depending on the value of assets transferred to the trust, and the divisor (average nursing home rate) used by the county of the applicant's residence, the transfer of assets to the irrevocable trust could create a 60-month period of ineligibility.

With careful planning, and by using a combination of outright transfers and transfers to an irrevocable trust, it is possible to transfer large sums and create only a 36-month period of ineligibility. After the enactment of OBRA 1993, the most commonly used Medicaid Qualifying Trust, the Irrevocable Income Only Trust, became one in which the individual or his or her spouse was entitled to all income from the trust, but not any principal of the trust.

## II. Drafting an Irrevocable Income Only Trust

It is important to remember that the primary purpose of the Irrevocable Income Only Trust is to preserve assets for the purpose of eventually securing Medicaid eligibility. In drafting the terms of the trust, the attorney should scrupulously avoid any provisions which might jeopardize this asset protection purpose.

The drafter must understand the Medicaid, gift tax, income tax and estate tax ramifications of creating the Irrevocable Income Only Trust. While the trust may have other benefits, such as providing an asset with stepped-up income tax basis upon the death of the grantor, it is important to make clients understand the trust's primary purpose.

The more complex the trust is, the more difficult it will be for the client to understand it. Furthermore, the inclusion of certain kinds of provisions may create a risk that the trust principal will be deemed an available resource by Medicaid. For example, in recent years we have seen the inclusion of a limited power of appointment, the grantor's right to change the trustees, and the trustees' power to make loans subject to attack by Medicaid.

The following basic drafting considerations should be borne in mind:

1. The trust must be in writing, executed and acknowledged by the grantor and the trustee in the same manner required for conveyance of realty (EPTL 7-1.17(a)).

2. The trust must be "irrevocable." The grantor must relinquish the right to alter, amend, revoke or terminate the trust.

A statement as to irrevocability should be made in the body of the trust preferably at the very beginning. Additionally, the following form is often used to title the trust: "John Smith Irrevocable Income Only Trust."

3. The grantor should not be appointed as the trustee. Although there is no statutory prohibition, the draftsman should avoid the possibility of Medicaid challenging the trust because of grantor/trustee's discretionary powers.

4. The trust should contain a specific prohibition against invasion of the trust principal for or on behalf of the grantor or the grantor's spouse. The trust should also contain a prohibition of payments to third parties who are providing services to the grantor.

However, if the grantor wishes, he or she can allow the trustee the discretion to invade principal for the benefit of third parties who are issue of the grantor, for example, the children or grandchildren of the grantor. This is often a touchy subject with seniors who may be reluctant to give their children access to the principal of the trust. However, if the provision is properly drafted, it will create greater flexibility and a potential for limited access to trust principal.

If a child of the grantor is selected as a trustee with the power to invade the principal for issue of grantor, it is important to provide that the trustee is not permitted to invade the principal of the trust for his or her own benefit, but only for the benefit of the other issue of the grantor.

The draftsman should avoid any provision granting the trustee/child a general power of appointment over the trust principal to avoid the possibility that the trust assets might be considered part of the child's estate upon the child's death pursuant to IRC § 2036(a).

5. Generally, the grantor will want to retain the right to receive all of the net income generated by the trust principal. Payments are typically required to be made at least quarter-annually or more frequently during grantor's lifetime.

Net income can be defined as "investment interest, dividends and rent, after all taxes, direct and indirect expenses chargeable to their production, such as bank charges, and accountant fees are deducted." The client should be made aware that net income does not include the appreciated value of trust assets or capital gains from the sale of trust assets.

A problem commonly encountered in practice is that instead of paying the net income to the grantor, the trustee reinvests it. If all net income is to be paid to the grantor, one way of insuring its payment is to have the financial institution where the trust assets are kept automatically sweep the net income on a regular basis, and arrange that payment be made automatically directly to grantor or to an account for grantor.

There is no statutory requirement that the net income be paid to the grantor, and the trust can provide that the net income be paid to the adult children of the grantor or to other individuals. However, from a practical prospective, in most cases the grantor will want to reserve the right to the income.

The drafter should also consider granting the trustee the power to "hold, retain or convert any and all trust assets in non-income producing form." If the trustee is granted this authority, the trustee will have the option of converting the trust assets from income producing to non-income producing once the grantor is receiving Medicaid. It should be emphasized that Medicaid will be entitled to all net income produced by trust once the grantor is receiving Medicaid, and it remains uncertain whether Medicaid would challenge a trustee who exercises this discretionary power.

## III. Tax Considerations

The Irrevocable Income Only Trust is considered a simple trust for Federal income tax purposes, since it requires the distribution of all income to or for the benefit of the beneficiary each year. Income is taxed to the beneficiary whether or not it is actually distributed to the beneficiary. However, trust capital gains would typically be taxed to the trust. Therefore, it may be beneficial to structure the Irrevocable Income Only Trust as a "grantor trust" under I.R.C. § 677 so that such capital gains are taxed to the grantor and not to the trust.

In addition, if the income beneficiary of the Irrevocable Income Only Trust is not the grantor, and the trust is a grantor trust, the income generated by the trust will be taxed to the grantor at his or her individual tax rate—which may be important if the grantor is taxed at a lower income tax rate than the income beneficiary.

Compliance with I.R.C. grantor trust rules will occur if the trust contains one or more of the following provisions:

1. The grantor is given the power in a non-fiduciary capacity, and without the approval and consent of a fiduciary, to reacquire all or any part of the trust corpus by substituting other property of an equivalent value. The grantor will be considered the owner for income tax purposes (I.R.C. § 675(4)).

This is of importance if an appreciating asset, such as the primary residence which may be sold during the grantor's lifetime, is transferred to trust. By giving the grantor this power, the grantor will be able to use the personal residence exclusion for capital gains under I.R.C. § 121.

2. The trustee is given the power to distribute income to the grantor or the grantor's spouse, or to hold or accumulate income for future distributions to the grantor or the grantor's spouse, without the approval of an adverse party (I.R.C. § 677(a)).
3. The grantor is given the unrestricted power to remove or substitute trustees and to designate any person, even one related to or subordinate to the grantor, as a replacement trustee (I.R.C. § 1.674(d)-(2)).
4. The grantor reserves a special or limited power of appointment under I.R.C. § 674 (a power to appoint trust assets to a limited class not including the grantor, the grantor's estate, the grantor's creditors or the creditors of the grantor's estate).

For gift tax purposes, the retention of a special or limited power of appointment by the grantor will cause the gift or transfer of assets to the trust to be deemed an incomplete gift (I.R.C. Regs. § 25.2511-2(b), (c)). Thus, none of the grantor's credit against the Federal gift tax will be utilized if a special or limited power of appointment is reserved by the grantor.

Also, if the grantor wants the option to be able to change the ultimate beneficiaries of the trust or the percentage the beneficiaries will receive, the reservation of the special power should be considered.

However, the use of a special or limited power of appointment may not always be appropriate. In many cases, there will be no gift tax exposure by virtue of the Federal gift tax credit (which shields the first $1 million of gifts from Federal tax) and repeal of the New York gift tax. The inclusion of a power of appointment may also further complicate an already complicated document. It could pave the way for a senior to become the victim of undue influence or fraud at a time when he or she suffers from diminished capacity if the senior is induced to execute a Will wherein the power's execution alters the original beneficiaries or percentages the beneficiaries were to receive under the terms of the trust.

In addition, although there are presently no Medicaid restrictions on the use of special/limited powers of appointment, in recent years there have been a string of fair hearing decisions which determined that by the retention of a special or limited power of appointment, the grantor maintained sufficient control to make the trust principal an available resource.

Remember, not all grantor trust provisions are appropriate for an Irrevocable Income Only Trust. For example, allowing the grantor the power to revoke the trust would not be appropriate.

## IV. Transfer of Primary Residence to Trust

For many seniors, the prospect of transferring their primary residence to a trust causes them great consternation. Properly drafted trust provisions that will give a senior a level of comfort in knowing that he or she cannot be forced to leave the residence is often critical to having the trust executed and the Medicaid planning undertaken.

The trust should have language that specifically allows the grantor the exclusive right to the use and possession of any real property constituting trust corpus during his or her lifetime. The grantor could also be given the right to veto any sale or lease. The trust should specifically reserve to the grantor the right to all real property tax exemptions which are available. The trustees should also have the ability to purchase or rent substitute property to be used by grantor.

The trust may provide that the grantor is not required to pay rent for the use and possession of the premises, but shall be responsible for and required to pay all of the expenses of the maintenance of the property, including, but not limited to, taxes, insurance, utilities, mortgage charges and normal costs of maintenance and upkeep.

It is important to advise the client to take steps to arrange that fire and liability insurance for the premises is changed to reflect ownership by trust and not the grantor. Depending on the insurance company, this may require that a separate policy for tangible personal property, such as furniture and jewelry, be obtained in the name of the grantor.

Pursuant to I.R.C. § 2036(a) and I.R.C. § 1014, the grantor’s retention of the right to income from the trust, and the right to exclusive use and possession of any residence owned by the trust, will cause the fair market value of the assets comprising trust principal to be included in the grantor’s estate for estate tax purposes. Thus, under existing Federal tax law, the remainder beneficiaries of an Irrevocable Income Only Trust will receive a stepped-up basis for the trust assets they receive equal to the full fair market value of the trust asset on the date of the grantor’s death. However, it is important that the attorney advise clients that these income and estate tax rules are subject to legislative change, and a full step-up in basis may not be available in the future.

## V. Other Considerations

### A. EPTL 7-1.6(b)

EPTL 7-1.6(b) specifically authorizes a court having jurisdiction over a trust to order the invasion of principal and income to or for the benefit of a beneficiary for whom support or education is not being sufficiently provided. To prevent this from occurring, the Irrevocable Income Only Trust should specifically state that EPTL 7-1.6(b) will not apply, and thus prevent the court from authorizing any invasion of income and principal.

In *In re Tutino v. Perales*[4] the Court held that the principal of the trust created by a Medicaid applicant was a potentially available resource because the trust was silent as to the application of EPTL 7-1.6(b). Thus, Medicaid benefits were denied.

### B. EPTL 11-2.4

The Irrevocable Income Only trust should have a provision renouncing EPTL 11-2.4 (Optional Unitrust Provisions) and its application to the trust.

If the provisions of EPTL 11-2.4 were applied to an Irrevocable Income Only Trust, Medicaid could argue that the trustee has the right to invade the principal of the trust for the grantor, and thus that trust principal is an available resource for Medicaid eligibility purposes. To prevent this, it is imperative to include a provision in the trust renouncing the provisions of EPTL 11-2.4.

### C. EPTL 11-2.3(b)(5)

The Irrevocable Income Only Trust should include a provision renouncing the application of EPTL 11-2.3 (b)(5) (Prudent Investor Act) to the trust. Effective September 4, 2001, EPTL 11-2.3(b) gives the trustee the power to make discretionary allocations between income and principal. The statute specifies a number of factors the trustee should consider in making or declining to make a discretionary allocation between income and principal. These include:

(1) the intent of grantor, as stated in trust;

(2) the assets held by trust;

(3) the extent a trust asset is actually used by a beneficiary; and

(4) whether an asset was received from the grantor or purchased by the trustee.

EPTL 11-2.3(b)(5) prevents the trustee from exercising the power if, among other things, the trust is a

Medicaid trust, and the adjustment power would result in additional income or principal being treated as available income or resources. Nevertheless, to foreclose any argument that the trustee failed to make an appropriate adjustment between principal and income and violated the Prudent Investor Act, it may be safer to renounce the statute's application to the trust.

### D. Other Provisions

Some other provisions that might be included in the Irrevocable Income Only Trust include:

(1) Providing that the grantor or any third party can make additions to the trust;

(2) Providing for the contingency that ultimate remainder beneficiaries may be minors or persons under a disability.

For example, the trust could specify that the share of any disabled person is to be distributed to a supplemental needs trust created for such person's benefit, or that the distribution to the disabled person be deferred until such person is no longer disabled, or that such share be distributed to a guardian of the disabled person.

With respect to a remainder beneficiary who is a minor, the trust should provide that income and principal be distributed to the minor's custodian under the Uniform Transfers to Minors Act, be held in further trust for the minor until he or she reaches a specific age, or that payment of income and principal be made to the parent or guardian of the minor.

(3) Providing for the potential subsequent disability or incapacity of the grantor during term of trust.

The trust should provide that during the disability of the grantor, the trustee may (1) pay income directly to the grantor, (2) pay income to the grantor's guardian or committee, (3) pay income to the grantor's issue for the grantor's health, maintenance or support, or (4) use income directly for the grantor's care.

## Conclusion

The preparation of an Irrevocable Income Only Trust requires the consideration and analysis of a host of complex and often competing issues. In the author's view, keeping the trust provisions as straightforward and as easy for the client to understand as possible is usually the safest course.

## Endnotes

1. 42 U.S.C. § 1396 p(b)(3)(B); Social Services Law § 360-4.5(b).
2. Social Services Law § 366(2)(b)(2)(ii).
3. Prior to OBRA 1993 there was a single 30-month lookback period for all transfers. OBRA 1993 also increased the lookback period to 36 months for all outright transfers.
4. 153 A.D.2d 181, 550 N.Y.S. 2d 21 (2d Dep't 1990).

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# RECENT NEW YORK STATE DECISIONS

Ira Mark Bloom and William P. LaPiana

## Administration of Estates

### Creditors: Laches Does Not Bar State's 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 the refunding 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.

The Appellate Division reversed the Surrogate on the law, holding that the administrator was deemed to be aware of the State's claim because (1) she knew that her mother was a patient in a state psychiatric facility; (2) it is "common knowledge" that recipients of public assistance must reimburse the State if they have the means to do so; and (3) it is "well settled" that an individual must pay for services rendered to a disabled spouse. In addition, laches cannot be asserted against the State where it is acting in a governmental capacity to enforce a public right or protect a public interest, and this was not a case where exceptions to that rule apply. *In re LaPine*, 18 A.D.3d 552, 795 N.Y.S.2d 294 (2d Dep't 2005).

### Elective Share: Guardian May Not File Notice of Election Without Court Permission Granted Before Surviving Spouse's Death

Surrogate's Court refused to accept a notice of exercise of the right of election filed by surviving spouse's guardian without an order from the guardianship court authorizing the election. The order to show cause applying for such authority was signed one day after surviving spouse's death. The guardianship court then held the application to be moot. The right of election is personal to the surviving spouse and therefore does not survive the death of the spouse. Because the guardian was not granted the right to exercise the right of election in the Article 81 proceeding that created the guardianship, a separate grant of authority to the guardian to exercise the elective share right was required. That authority not having been granted before the incapacitated person's death, the application to exercise the right was denied. *In re Rivera*, 8 Misc. 3d 746, 799 N.Y.S.2d 391 (Sup. Ct., New York Co. 2005).

### Executors: Acceptance of Conditional Appointment Limits Commissions

Decedent's will nominated two individuals as co-executors and a corporate alternate executor, limited total compensation to the lesser of statutory commissions or $800,000, and required that each executor agree in writing to the compensation provision as a condition of qualifying. The nominated individuals received preliminary letters and the will was admitted to probate seven months later. One of the executors renounced the compensation provision under SCPA 2307(5) fours months after admission of the will and requested one-half of full statutory commissions of more than $5.3 million in the executors' final accounting.

The Appellate Division affirmed the Surrogate's denial of the request, agreeing with the lower court that the executors accepted their conditional appointment through the petition for preliminary letters and therefore could not avail themselves of the statutory option (SCPA 2307(5)) of renouncing a will provision providing a specific sum in favor of statutory commissions. *In re Othmer*, 18 A.D.3d 758, 796 N.Y.S.2d 109 (2d Dep't 2005).

## TRUSTS

### Trustees: Informal Rejection of Trusteeship Overcome by Subsequent Actions

Creator of lifetime trust named herself and one of her two daughters as trustee. On the creator's death, creator's lawyer (not the drafter of the trust) was named as successor trustee. The trust required a trustee to resign by written instrument and authorized an existing trustee to name a successor trustee after all the named parties had failed to qualify or ceased to act. After creator's death, the surviving trustee asked the named successor to resign so that she could appoint her future husband as co-trustee. The court found that the successor trustee orally agreed to do so, but before he knew of the provisions of the trust. Once he learned of the provisions of the trust, his conduct clearly indicated that he accepted the appointment as trustee. The other trustee's appointment of her future spouse as co-trustee was therefore premature and without effect and she was enjoined from interfering with the successor trustee's performance of his duties. *Sankel v. Spector*, 8 Misc. 3d 670, 799 N.Y.S.2d 356 (Sup. Ct., New York Co. 2005).

### Principal and Income: Distributions from CRAT to Lifetime Trust Classified as Income

Grantor created two lifetime trusts: a 6% charitable remainder annuity trust (CRAT) and a charitable remainder trust that did not appear to qualify for tax benefits. The court referred to the second trust as the lifetime trust (LTT). Grantor was the beneficiary of the annuity paid from the CRAT. After his death, the annuity was to be paid to the LTT, whose trustee was to pay or apply all of the trust's income to the grantor's daughter, as well as principal in its discretion for the "support, maintenance, and general welfare" of the grantor's daughter. On the daughter's death, the LTT was to be distributed to charity.

By the time of the daughter's death, the trustee of the LTT had received over $500,000 from the CRAT, which the trustee had not paid to or applied for the daughter's benefit. After the daughter's death, the trustee of the LTT distributed these sums to the daughter's estate, which redounded to the benefit of the daughter's distributees as the daughter died intestate. The charitable remainder beneficiaries objected, maintaining that the annuity payments from the CRAT to the LTT trust should be treated as distributions of principal or as accumulated income which in either case should be paid to them.

A divided Appellate Division affirmed the Surrogate's dismissal of the charities' objections. The two trusts must be read together, and when they are so read indicate the grantor's intention that he and his daughter would have income generated by both trusts available for their living expenses. The income from the assets of the LTT trust alone would fall far short of covering those expenses. In addition, the definition of principal in EPTL 11-2.1(b)(2) refers to property disposed of in trust, and with regard to the annuity the trust in question is the CRAT, which required that the annuity be first payable from trust income. Finally, the retention of income in a "needs trust" was not a void accumulation because the income so accumulated was the property of the income beneficiary, which properly passed to her distributees.

The two dissenting justices believed that the payments from the CRAT to the LTT were principal, and the classification as principal would carry out grantor's intention to give all the trust property not expended on the needs of his daughter to the charities. The dissenters read the reference in EPTL 11-2.1(b)(2) to property disposed of in trust as clearly describing the annuity received by the custodial trust from an "outside source." *In re Chase Manhattan Bank (Pioch)*, __ A.D.3d __, 798 N.Y.S.2d 615 (4th Dep't 2005).

### Principal and Income: Interested Trustees May Make Retroactive Unitrust Election

Decedent's testamentary trust provided that all income was to be paid to his widow. The trustees were his sons by a previous marriage who, together with their sisters, were the remainder beneficiaries. In February of 2003, the trustees elected unitrust treatment for the trust, retroactive to the effective date of the unitrust statute (EPTL 11-2.4), January 1, 2002. Before the election, the widow received the entire trust income of approximately $190,000 a year. The 4% unitrust interest would pay approximately $70,000 a year. Widow's daughter and attorney-in-fact moved for summary judgment to annul the unitrust election. The Surrogate denied the petition but granted the petitioner summary judgment to annul the retroactive application of the election.

The Appellate Division affirmed the Surrogate's denial of the summary judgment motion to annul the election. There is no obstacle to an election by an interested trustee. The statute is silent on the question, but the law does prohibit the exercise of the power to adjust by an interested trustee (EPTL 11-2.3(b)(5)(C)(vii)), clearly indicating that the Legislature did not intend such a prohibition to apply to unitrust elections. The factors the court must consider in deciding whether or not to approve a unitrust election (EPTL 11-2.4(e)(5)(A)) do not include the status of the trustee. In addition, the unitrust election is not a per se violation of the trustees' fiduciary duties given the common practice of beneficiaries serving as trustees. The question of the propriety of the unitrust election by these trustees for this trust must be adjudicated according to the statutory criteria and would require the resolution of questions of fact. Therefore, summary judgment was not appropriate.

The court then reversed the annulling of the retroactive application of the election. The statute unambiguously allows the trustees to specify the effective date of the election (EPTL 11-2.4(d)(1)) and therefore, if the election is upheld, the trustees' decision to make the election retroactive to the effective date of the statute must be honored. *In re Heller*, __ A.D.3d __, 800 N.Y.S.2d 207 (2d Dep't 2005).

## WILLS

### Construction: Shares of Residue Increased to Total 100%

Testator's will gave 15% of her estate to her brother, 20% to another relative and 7% to each of three nephews, the widow of a predeceased nephew and a niece. She gave the remaining 30% to another nephew, but only if a residence specifically devised to him was sold prior to the testator's death. The residence was not sold and the executor sought construction of the will. Noting that several New York cases had decreased percentage gifts in order to resolve ambiguities, the Surrogate held that nothing prevented shares from being increased in order carry out the testator's intent to dispose of her entire estate. The beneficiaries other than the devisee of the residence therefore divided the entire residuary estate in proportion to their original gifts (21.43%, 28.57 % and five shares of 10% each). *In re Steflik*, 9 Misc. 3d 354, 800 N.Y.S.2d 302 (Sur. Ct., Broome Co. 2005).

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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).**

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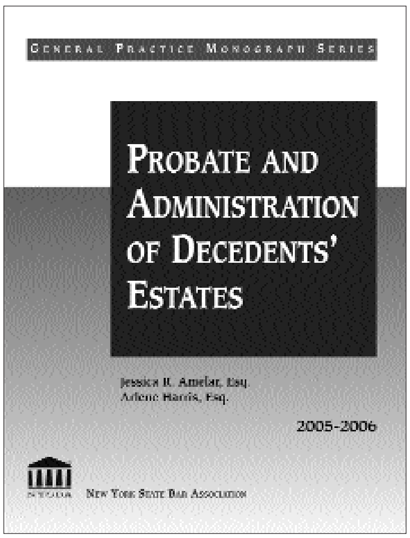


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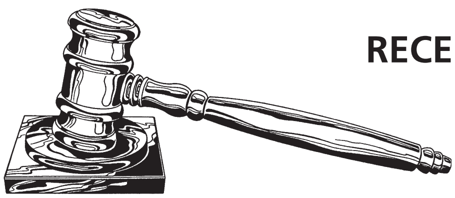

# CASE NOTES— RECENT NEW YORK STATE SURROGATE'S AND SUPREME COURT DECISIONS

Ilene Sherwyn Cooper

## Attorneys Fees

In *Kroll Associates Inc. v. Sands Brothers & Co.*, the issue before the court was the liability of a law firm for outside investigative services rendered in connection with litigation being handled by the firm.

In reviewing the issue the court distinguished between the prevailing authority in the First and Second Departments. In the First Department, the rule is that the attorney is responsible for the services performed in connection with litigation, in the absence of an express indication to the provider of the services to the contrary. In the Second Department, the Court opined that as the agent for the client, the attorney is not responsible for the services of a third-party provider, unless the attorney assumed that responsibility.

Based upon the foregoing, the court held that the evidence failed to establish that counsel disclaimed liability for the investigative services rendered, and denied counsel's motion for summary judgment dismissing the action for fees for investigative services rendered.

*Kroll Associates Inc. v. Sands Brothers & Co.*, N.Y.L.J., 8/25/05, p. 22 (Supreme Ct., New York Co.) (Justice Lehner).

## Attorneys Fees

In a dispute over attorney's fees, the Civil Court, Kings County, addressed the rules regarding retainer agreements and letters of engagement as they impacted an award of legal fees.

The circumstances surrounding the dispute arose when plaintiff was retained by the defendant, whom he had represented in the past with respect to real estate purchases and transfers, to represent him and a corporate entity in connection with a real estate closing involving the mortgaging of six properties. The bill for the work which was sent to the defendant was considerably higher than prior bills. Defendant claimed that he called plaintiff to dispute the bill, and sent plaintiff the sum of $3,500 as full payment, which was less than half the sum due. Plaintiff stated that he had no time to send a letter of engagement or retainer agreement to the defendant and that he treated the payment as a sum paid on account.

At trial, plaintiff could not produce any time records or a written diary of work performed. He testified that it was his general practice to perform work and to then send a bill based upon what he thought the work was worth. Defendant did not dispute the work plaintiff claimed he had performed, but stated that he had never been charged more than $100-$125 per hour for services rendered.

After referring to the court rule regarding letters of engagement and written retainers, the court noted that, absent a finding that counsel fell into one of its exceptions, reported decisions either denied fees for failure to comply with the rule's terms, or allowed fees based upon quantum meruit. Upon consideration of the record and the testimony of plaintiff, the court concluded that plaintiff offered no basis for being excepted from the rule's general requirements, and as such, was not entitled to the full amount he billed. Nevertheless, the court held that counsel was entitled to fees for work performed based upon a theory of quantum meruit. Accordingly, in view of the fact that plaintiff failed to present evidence or testimony as to the standard billing rates for the work performed, or expert testimony as to the difficulty of the services rendered, the court allowed plaintiff the fees he had been paid and nothing more.

*Grossman v. West 26th Corp.*, N.Y.L.J., 8/3/05, p. 19 (Civil Ct., Kings Co.) (Judge Nadelson).

## Attorneys Fees

In an action to recover for legal services rendered, the defendant moved for summary judgment dismissing the action, together with attorney's fees, costs and sanctions. The record revealed that plaintiff sued defendant for fees amounting to $4,000. Although plaintiff and defendant had not entered into a written retainer agreement or written letter of engagement for the services rendered, plaintiff alleged that he had informed defendant that his billing rate was $250 per hour, and that defendant had agreed to pay said sum for work performed. Defendant denied that he had made any such agreement.

In addressing the issue of plaintiff's entitlement to fees, the court considered the provisions of 22 N.Y.C.R.R. 1215.1 which require an attorney who undertakes to represent a client and who enters into an arrangement for, or who charges or collects, a fee from a client to provide to the client a written letter of engagement or a written retainer agreement. Plaintiff conceded that he did not provide defendant with a written retainer agreement or written letter of engagement, and offered no excuse for his noncompliance. In view thereof, the court held that plaintiff was not entitled to fees on a quantum meruit basis.

Nevertheless, citing the provisions of 22 N.Y.C.R.R. 1215.2, plaintiff argued that the circumstances fell within the exception to the rule requiring a retainer in that at the time he commenced performing services on the defendant's behalf, he did not anticipate that his fees would exceed $3,000. Despite these contentions, defendant persisted in his claim that he had never had a conversation with plaintiff regarding the payment of fees for legal services rendered.

Based upon the conflicting allegations, the court held that factual issues existed relating to such matters as to whether plaintiff and defendant had ever had a conversation regarding fees, and whether plaintiff's expectation that the fee to be charged would not exceed $3,000 was reasonable.

Accordingly, defendant's motion for summary relief, as well as for fees, costs and sanctions, was denied.

*Nadelman v. Goldman*, N.Y.L.J., 5/12/05, p. 19 (Civil Ct., N.Y. Co.) (Judge Oing).

### Attorney-in-Fact

Before the court in *In re Estate of Goetz* was the issue of whether an attorney-in-fact could use the authority conferred to amend a trust created by another person to grant to herself a limited power of appointment over the trust remainder. Pursuant to the terms of the trust in issue, the grantor reserved to himself the right to amend or revoke its terms during his lifetime.

The court reviewed the general authority of an attorney-in-fact, finding that such an agency authorizes the recipient of the power to act for the principal in all matters which do not require that the principal act for himself. With regard to the amendment of trusts, New York EPTL 7-1.16 provides that a lifetime trust is irrevocable, unless it expressly provides that it is revocable, and if so, the trust may be amended or revoked by the grantor's will or by a written instrument executed by the person authorized to revoke or amend the trust (EPTL 7-1.17). In this latter regard, the court found that although the terms of the subject trust gave the grantor the right to revoke or alter its terms by an instrument in writing executed and acknowledged by him and delivered to the trustees during his lifetime, it did not confer the same authority upon the grantor's agent or upon any other person. Moreover, neither the terms of the power of attorney in issue, nor the provision of the General Obligations Law expressly conferred such authority. The court held that the instruments must to be construed as written, and that it could not add to or alter their provisions in the guise of interpreting them.

Accordingly, the court declared the trust amendment by the grantor's attorney-in-fact to be void and of no effect, and the attempted alteration of the trust remainder to be invalid.

*In re Estate of Goetz*, N.Y.L.J., 8/2/05, p. 27 (Surrogate's Ct., Westchester Co.) (Surr. Scarpino).

### Loss of Consortium

Recently, the Supreme Court, Westchester County, had occasion to pass upon the question of whether a registered domestic partner could maintain a derivative action for loss of services and consortium.

In answering the question in the negative, the court held that while domestic partners may be extended certain rights insofar as health care and other benefits are concerned, they have not achieved the status of married couples. Because the State has always held that a lawful marriage is a prerequisite to a claim for loss of consortium and services, domestic partners may not recover with respect to such a claim.

*Lennon v. Charney,* N.Y.L.J., 7/1/05, p. 21 (Supreme Ct., Westchester Co.) (Justice LaCava).

### Paternity

The issue before the court was whether three alleged non-marital children could inherit from the estate of the decedent pursuant to EPTL 4-1.2(a)(2)(C). The petitioner was the mother and guardian of the property of the children. The respondent, who was the decedent's surviving spouse, did not list the children in her petition for letters of administration, but instead, listed three other non-marital children borne of her relationship with the decedent before she married him.

A trial was held at which the testimony revealed that the decedent immediately began to date the petitioner after they were introduced. Soon a child of the relationship was born, whom the decedent cared for. He began to reside with the petitioner and the child, and thereafter, two other children were born of the relationship. The decedent continued his residence with the petitioner and the children, and only lived separate and apart from them when he and the petitioner were arguing. The decedent took the petitioner and his children to the home of his mother and sister and introduced them as his children. He supported them financially, providing for clothes, food and rent.

The petitioner testified that the decedent was her only boyfriend during the entire period from their introduction until his death, and that during that time she had no sexual relationships with anyone other than the decedent.

The respondent was the only one to testify on her behalf. She stated that she married the decedent in 1989, and never separated from him. She further stated that the decedent slept at their residence every night of their marriage but for three times a year when he visited his mother for the weekend in New Jersey.

Finally, the proof revealed that the decedent listed one of the three children as a dependent on his tax returns, albeit as a niece.

The court held that it could not fully accept both the petitioner's and the respondent's version of how many nights a week the decedent spent with each, nor would it speculate as to why neither the decedent's sister nor his mother were called as witnesses. Nevertheless, based upon the evidence and testimony adduced, including the fact that (i) the decedent made rent payments on the apartment in which the petitioner and her children resided, (ii) the decedent visited his mother with the children, and introduced them as his children, (iii) the decedent listed one of the children on his tax returns for years, and (iv) the respondent was apparently aware that the decedent had fathered children out of wedlock, the court held that the petitioner had established by clear and convincing evidence that the decedent openly and notoriously acknowledged paternity of the children.

*In re Estate of Michael A. Francis,* N.Y.L.J., 8/31/05, p. 25 (Surrogate's Court, Bronx Co.) (Surr. Holzman).

## Post-Nuptial Agreement

In a matrimonial action, defendant wife sought to enforce the terms of a post-nuptial agreement she had entered with the plaintiff husband. The agreement was executed in the State of Florida, although the certificate of acknowledgment revealed that it was made before a New York notary. The plaintiff opposed the application, claiming that the agreement was invalid and unenforceable on the grounds that it was not acknowledged or proven in a manner required to entitle a deed to be recorded.

Initially, the court denied the defendant's application, relying upon the opinion by the Court of Appeals in *Matisoff v. Dobi*, 90 N.Y.2d 127 (1997), which applied a bright-line rule requiring marital agreements to be acknowledged in the manner required to entitle a deed to be recorded, regardless of the circumstances.

Noting that the acknowledgment at issue was taken by a New York notary in the State of Florida, the court concluded that it could only be made before a notary qualified in the State of Florida, or a commissioner of deeds appointed in New York State to take acknowledgments outside the State. No evidence of compliance by the notary with these requirements was presented to the court. Absent such proof, the court held that a notary public qualified in New York State is only empowered to receive and certify acknowledgments within and throughout New York State.

Subsequent to the decision being rendered, the court, on reargument, reversed its opinion, concluding that the Executive Law 142-a made the acknowledgement by the New York notary in Florida valid. Pursuant to the provisions of that statute, the "official certificates" or other acts of notaries are not to be invalidated or impaired or in any manner deemed defective because the action was taken outside the jurisdiction where the notary was authorized to act.

*Kudrow v. Kudrow*, N.Y.L.J., 7/21/05, p. 20 (Supreme Ct., Kings Co.) (Justice Krauss).

## Preliminary Letters Testamentary

In a pending probate proceeding, the executrix named in the will applied for preliminary letters testamentary and a distributee of the decedent applied for temporary letters. Both parties agreed that the appointment of a fiduciary was necessary during the pendency of a will contest which was anticipated between the parties.

The court observed that the appointment of a preliminary executor should not serve as the occasion for a mini-probate contest, and that if at all possible deference should be given to the appointment of the named executor in the propounded will, rather than a temporary administrator. Only a strong showing of fraud or undue influence should serve as the basis for disqualifying the named fiduciary from receiving preliminary letters.

Accordingly, the court held that since the issues raised in connection with the preliminary appointment would be the same issues as those litigated in the underlying contested probate, it would be in the best interests of all concerned to issue restricted letters to the nominated fiduciary subject to the posting of a bond.

*In re Estate of Estelle Roth,* N.Y.L.J., 8/12/05, p. 30 (Surrogate's Ct., Suffolk Co.) (Surr. Czygier).

### Reformation

The trustee of a trust sought reformation of the instrument in order to eliminate certain restrictions on its authority to invest trust property.

The trust was created by the settlor to provide income for his daughter for life, with principal to be distributed as she appointed, or in default thereof, to her surviving spouse, per stirpes. The terms of the trust restricted the trustee's investment authority by prohibiting the trustee from selling, investing or reinvesting trust property without the written approval of the settlor's nephews. The trust also prohibited the trustee from requesting court permission to deviate from the requirement that the nephews approve investment decisions. The settlor died in 1964. Both of the nephews resigned from their appointment to approve the trustee's investments in 1976, leaving the trustee without authority to make further investments.

The court granted the application, holding that deviation from the express terms of an *inter vivos* trust has been authorized when unanticipated circumstances, such as a change in economic conditions, has occurred and compliance with the express terms of the trust would defeat or substantially impair the settlor's intent. Based upon the circumstances surrounding the subject trust, the court opined that the financial environment, as well as the beneficiary's needs, had evolved in ways that the settlor could not have anticipated when the trust was created. Specifically, the court noted that the income stream derived from the trust was insufficient to provide for the beneficiary's needs, and that a wider choice of financial tools was now available, with less risk than had existed at the time the trust was created, to increase the flow of income. Further, prudent investment responsibilities required expansion of the restrictive authority of the trustee.

*Matter of Bossong,* N.Y.L.J., 6/14/05, p. 23 (Surrogate's Ct., New York Co.) (Surr. Preminger).

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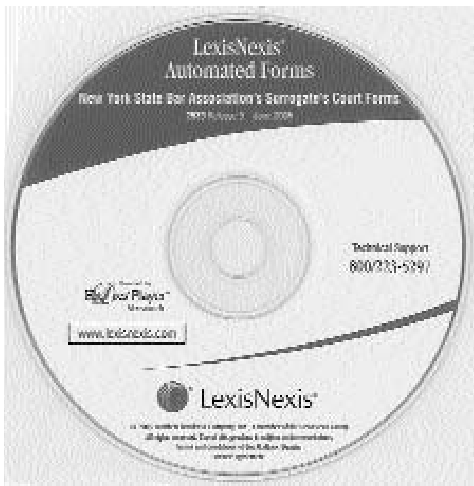


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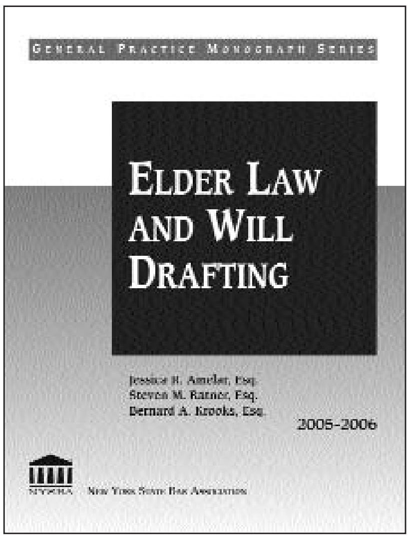


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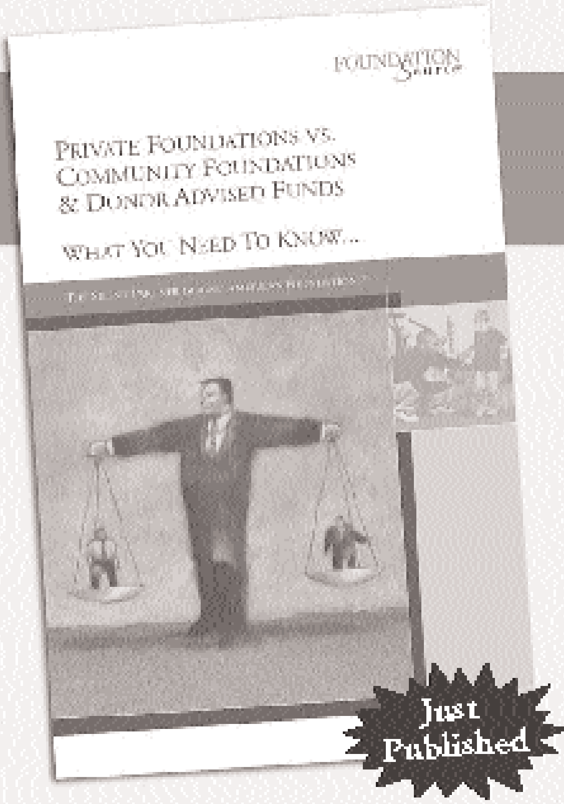


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