What Every Matrimonial Attorney Should Know About the Latest Trusts and Estates Developments

By Sharon L. Klein

With the increasing overlap between the matrimonial and trusts and estates disciplines, family law attorneys can benefit from being apprised of the latest trust and estates developments that can potentially have a dramatic impact on their practice. From critical estate planning considerations in marital agreements, to documents that require review in light of a contemplated divorce, to powerful tools that can potentially change otherwise irrevocable trust terms and distributions in the divorce context, to the importance of credit solutions in divorce, to important considerations regarding the use of life insurance, there is much to be gained from having cross-disciplinary fluency.

I. Key Estate Related Considerations in Pre-Marital Planning

A. Portability of Federal Estate Tax Exemption Amount—A Valuable Asset to Consider

The federal estate tax, imposed at a top bracket of 40% in 2017, generally does not apply to transfers between U.S. spouses. In addition, each person has an exemption from federal estate tax, which, in 2017, was $5.49 million. That exemption amount, which is indexed for inflation, was estimated to increase to $5.6 million on January 1, 2018. At the time of this writing, the House and Senate versions of the "Tax Cuts and Jobs Act" and the conference committee report released on December 15, double estate and gift tax exemption amounts, starting in 2018, to $11.2 million per person, $22.4 million per married couple.

Before 2010, the federal exemption amount was a "use-it-or-lose-it" proposition. To give a simple example, assume a married couple both died in 2009 when the exemption amount was $3.5 million, and they each owned assets worth $3.5 million. If they each used their $3.5 million exemption amounts, with trust planning for example, zero federal estate tax would have been due on the death of the survivor. Assume, however, that the first spouse to die did not use her exemption amount and instead left everything to the survivor. If the survivor died with a $7 million estate, the exemption of the first spouse to die would have been wasted and federal estate taxes of $1.575 million would potentially have been payable.

Portability—a concept introduced in 2010, and made permanent since 2012—obviates the use-it-or-lose-it nature of the federal exemption amount. If one spouse does not use the entire exemption amount, it is possible to transfer or "port" the unused portion—called the Deceased Spouse's Unused Exclusion Amount, or "DSUE" Amount—to the surviving spouse.

DSUE is a valuable asset to consider when drafting marital agreements, particularly so if the exemption amount doubles, as seems likely. Consider a prospective husband (H) and wife (W) who are negotiating their pre-marital agreement. H has assets totaling $11 million, while W has assets of only $1 million, which would pass to her heirs other than H, leaving $4.49 million of DSUE in 2017 based on the 2017 $5.49 million federal exemption amount. Generally, H would not ask for any financial considerations from W because of the imbalance in the assets tilted in his favor. However, if W predeceases H and her executor (who could be H) elects to use portability, her $4.49 million DSUE would pass to H. Assuming H dies in 2017, with a top 40 percent federal estate tax rate and a $5.49 million exemption, having W's additional exemption amount to shield estate taxes in his estate could save his heirs over $1.7 million in estate taxes! The potential savings can increase to millions of dollars if estate tax exemption amounts double, and each person can pass a DSUE that would shield the federal estate taxes on $11.2 million of assets. Accordingly, the wealthier spouse (H in this example) should view the DSUE as an important asset, and the less wealthy spouse (W in this example) should use the DSUE as a negotiating tool.

Federal Estate Tax Return Filing Required—Regardless of the size of the decedent's estate, DSUE can only be preserved by a timely filed federal estate tax return (Form 706), which is due nine months from the date of death, 15 months on extension.[1] This means that estates under the federal filing threshold ($5.49 million in 2017) must still incur the cost of filing a federal return, although the standards for Form 706 filing have been relaxed if the return is necessary only for a portability election. Since the return can be filed only by the executor (not the surviving spouse), the need to file the return should be negotiated in the prenuptial agreement to avoid a hostile executor spitefully refusing to file. Although it might be possible to bring a petition to request that a court grant someone other than the executor temporary executorial powers solely for the purpose of filing a return, and although there has been one reported case in which the court required the recalcitrant executor to file a return and elect portability, it is much better practice to plan ahead for this

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important matter. A case involving the recalcitrant executor—*Estate of Anne S. Vose v. Lee* [2]—was recently decided by the Oklahoma Supreme Court. The court required the personal representative (decedent's son from a prior marriage) to make the portability election requested by the surviving spouse, even though the surviving spouse waived all of his rights to the decedent's estate in a prenuptial agreement.

It is also important to consider the consequences if a return, not otherwise required to be filed, must be filed solely in order to protect the DSUE. Costs of filing the return, and costs associated with any audit proceedings, might logically be apportioned to the surviving spouse benefiting from the election. If a return must be filed because the estate is over the filing threshold in any event, consider whether the total cost should be borne by the estate.

B. The Delaware Advantage

1. Another Pre-Marital Agreement Option: Asset Protection Trusts

A Delaware Asset Protection Trust (DAPT) is an irrevocable trust created under Delaware law, with a Delaware trustee. In most jurisdictions, including New York, it is not possible for a person to create a trust for himself and protect the assets from his creditors. Under Delaware law, however, the DAPT generally limits the ability of an individual's creditors to reach the trust assets, while allowing the creator of the trust to remain a trust beneficiary. That includes the right to receive current income distributions, the right to receive a 5 percent annual unitrust payout and the ability to receive income or principal in the discretion of an independent trustee.

Delaware requires a creditor to bring an action against a DAPT in the Delaware Court of Chancery. For claims arising after an individual creates a DAPT, there is a four-year statute of limitations.[3] For claims arising before an individual creates a DAPT, a creditor must bring suit within four years after creation of the trust or, if later, within one year after the creditor discovered (or should have discovered) the trust.[4] For all claims, the creditor must prove by clear and convincing evidence that creation of the trust was a fraudulent transfer as to that creditor.[5] A very limited number of creditors can pursue claims against a DAPT. In the family context, a spouse, former spouse, or minor child who has a claim resulting from an agreement or court order for alimony, child support, or property division incident to a judicial proceeding with respect to a separation or divorce may reach the assets of a DAPT,[6] but a spouse whom the client marries *after* creating the trust may not take advantage of this exception. Accordingly, since future spouses cannot generally assert claims against a DAPT, a client's children can establish these trusts to protect assets from such claims, without providing the financial disclosure that ordinarily is required for enforceable prenuptial agreements.[7]

Giving an independent corporate trustee broad discretion to make distributions to a class of beneficiaries, instead of predicating distributions on an ascertainable standard, is also recommended since a court would be less likely to find such a discretionary interest reachable in divorce.[8] Some practitioners are also recommending inserting provisions in the documents that require a beneficiary's spouse to waive marital rights to trust assets each time the beneficiary is eligible to receive a principal distribution, before the distribution can be made.

2. Silent Trusts

Delaware permits the creation of so-called "Quiet" or "Silent" Trusts, so the trust creator can restrict beneficiary access to information under certain circumstances, even if that information would be required under the laws of other jurisdictions. This might be an effective tool to use in blended marriage situations, in order to minimize friction by restricting information access to children of a prior marriage while a trust is in existence for the life of a second spouse. This is particularly so if the family members know that the trustee administering the trust is a corporate, impartial trustee, with fiduciary obligations to treat beneficiaries fairly within the context of a specific trust agreement.

II. In the Event of Separation and/or Divorce, All Estate Planning Documents, Account Titles and Beneficiary Designations Need to Be Reviewed

All of the client's important planning documents, account titles, and beneficiary designations will need to be updated to be certain chosen heirs are still appropriate, as well as designees for health care and power of attorney documents. Documents to consider include:

- **Will and trusts**

These documents must be reviewed immediately. Consider that not all states provide for revocation on divorce of bequests in wills or other estate planning documents. Even if revocation on divorce does apply, the statute will be inapplicable during the pendency of the divorce, until the final divorce decree is entered.

In New York, Estates Powers and Trusts Law Section (EPTL) 5-1.4 addresses the revocatory effect of divorce on dispositions and fiduciary appointments (such as the appointment of an executor). Unless a will expressly states otherwise, divorce, judicial separation, or annulment of a marriage revokes all dispositions or appointments of property from the divorced spouse to the former spouse and all nominations of the former spouse as executor and trustee. However, because the statute does not cover events during the pendency of a divorce proceeding, it is important to update documents during this time. The following cases serve as reminders of why diligence in planning can be so important.

In *In re Leyton*,[9] the decedent's mother and sister sought to disqualify the decedent's former same-sex partner as executor and a beneficiary under the decedent's will. They argued that he was the equivalent of a former spouse, disqualified from inheriting pursuant to EPTL 5-1.4. The decedent and his former partner had entered into a commitment ceremony in New York in 2002, but were separated before the decedent died.

The Surrogate determined that it is for the legislature to decide matters regarding same-sex marriage, which New York did not recognize until 2011. Accordingly, the court could not retroactively apply the Marriage Equality Act to deem the commitment ceremony to have sanctified the marriage, so the parties could not be deemed divorced. The result was that the former partner, who had actually married another man before the decedent's death, was permitted to act as executor and inherit under the decedent's will. In affirming the decision, the appellate court also noted that, in order for EPTL 5-1.4's "former spouse" provision to apply, there must be a formal decree or judgment ending the marital relationship. No such decree was issued.

While EPTL 5-1.4 provides that divorce revokes dispositions to, and fiduciary nominations of, former spouses, the revocatory effect of the section does not extend to the relatives of an ex-spouse. In *In re Lewis*,[10] EPTL 5-1.4 disqualified the decedent's ex-husband from inheriting under her will or acting as executor. However, the ex-husband's father (the decedent's ex-father-in-law), was the successor beneficiary and executor and he was not disqualified under the terms of the statute. Presumably the ex-husband would inherit or obtain the property from his father, causing an end-run around the statute. While the court acknowledged this, it opined that the statute was clear and unambiguous in omitting the relatives of ex-spouses from disinheritance.

Under a proposal introduced in New York in both houses,[11] dispositions to divorced spouses would continue to be expressly revoked, and there would be a rebuttable presumption revoking dispositions to family members of the ex-spouse. The revocatory effect of divorce would be presumed to apply to a person in any relationship to the divorced individual that was based upon the marriage, including but not limited to step-children, step-grandchildren and parents-in-law, unless there is substantial evidence of the divorced individual's contrary intention. As is currently the case, spouses who are in the *process* of getting divorced, but are not yet divorced, will not be able to rely on any statutory presumption without a formal decree or judgment ending the marital relationship.

The most prudent course of action is *not* to rely on state default law at all. Divorced spouses, spouses in the process of getting a divorce, and unmarried couples who are separated, should give immediate attention to their planning documents, to ensure they reflect their intent (subject to elective share statutes and other legal restrictions).

Importantly, there is generally no revocation on divorce regarding an ex-spouse's interest in an irrevocable trust. Some practitioners use the concept of a "floating spouse," defined as the spouse to whom the trust creator or beneficiary is married from time to time. If an ex-spouse actually is named as a trust beneficiary, other techniques may have to be considered to restructure the trust, including decanting, discussed below.

- **Powers of attorney and health care directives**

It is obviously important to carefully review powers of attorney, which allow a designated person to conduct financial transactions, and health care directives, which allow a designated person to make important health care and potentially end-of-life decisions, to ensure that an estranged spouse is removed from those roles.

- **Retirement accounts and plans, other beneficiary designations, such as life insurance**

State laws that do provide for revocation on divorce may not apply to retirement plan beneficiary designations, which should be reviewed promptly. Spousal rights in retirement plans governed by ERISA are subject to special rules. It is also important to reconsider designated beneficiaries of life insurance policies, discussed further below.

- **Jointly named real estate and financial accounts**

These documents similarly need immediate attention.

- **Authorizations to access digital accounts, including financial accounts, email accounts, social media accounts, etc.**

Note that authorizations to access online financial accounts, social media accounts, and other sensitive information are generally not revoked on divorce and must be changed as soon as possible. In the context of an account owner dying, a uniform law [Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA)] has been adopted in almost every jurisdiction, including New York.[12] RUFADAA provides guidance regarding an executor's and trustee's access to electronic records after the death of the account owner. RUFADAA takes a three-tiered approach:[13]

1. Directions given via a provider's online tool that can be modified or deleted at all times (for example, Google's "Inactive Account Manager," or Facebook's "legacy contacts") prevail over any other direction in a will, trust, power of attorney or other record;
2. If the user has not utilized an online tool, or if the custodian has not provided one, a user's direction in a will, trust, power of attorney or other record prevails; and
3. In the absence of any direction, the generic terms of service agreement ("TOS") controls, which might provide that the account is terminated at death, and all data is deleted.

Accordingly, in order to avoid a provider's generic TOS Agreement from potentially controlling, it is important to use a provider's online tool, if one is provided, to keep that designation updated during lifetime. This is particularly crucial in the event of separation or divorce, and to address these issues in estate planning documents, which are also to be appropriately updated. Otherwise, even if an individual was divorced on death, the former spouse may be authorized to access all the decedent's digital accounts.

III. Trust Decanting Can Be a Powerful Tool: Revising an Otherwise Irrevocable Trust

There has been continued state-level activity regarding "decanting," which allows the trustee of an otherwise irrevocable trust to transfer the trust assets into a new trust with different terms. The rationale behind decanting is that, if a trustee has the ability to make discretionary distributions to or for the benefit of a beneficiary, the trustee should also be permitted to exercise that discretion to distribute trust assets into another trust for that beneficiary. Decanting can be a tremendous tool for dealing with changed circumstances, correcting mistakes, facilitating tax benefits or optimizing a trust's administration.

Uses of decanting include;

- Limiting a beneficiary's rights or eliminating a beneficiary;
- Trustee changes; and
- Changing investment limitations.

Ferri v. Powell-Ferri[14] is a recent example of the power of decanting in the divorce context. Trust assets were successfully moved out of reach of a divorcing wife, although they were considered for alimony purposes. Husband was the beneficiary of a trust (the "1983 Trust") created by his father under which he had the right to receive the trust assets at certain ages. The trust was valued between $69-$98 million. The trustees, who were concerned divorcing Wife would reach trust assets, transferred the assets to a new trust (the "2011 Trust") without the knowledge or consent of Husband. At the time of the creation of the 2011 Trust, Husband had a right to request outright 75 percent of the 1983 Trust assets, and during the course of the legal proceedings, his right matured to 100 percent. The new 2011 Trust extinguished Husband's power to request trust assets at stated ages, making distributions solely discretionary with the trustees. Wife had filed to dissolve the marriage in Connecticut. The trusts were settled in Massachusetts. The Connecticut Supreme Court asked the Supreme Judicial Court of Massachusetts to determine whether the trustees, one of whom was Husband's brother, validly exercised their powers under the 1983 Trust to distribute the trust property to the 2011 Trust. The Massachusetts court determined that since the father, who created the 1983 Trust, intended to convey to the trustees almost unlimited discretion to act, the decanting was authorized. The Massachusetts court did not rule on whether the trust assets must be considered in the divorce, including for alimony purposes.

The Connecticut Supreme Court issued two opinions in the *Ferri* matters, one related to the decanting, the other related to the divorce action.

The *Ferri* Action for Declaratory Judgment: Decanting Was Authorized[15]

The trustees sought a judgment declaring that they were authorized to decant assets to the new trust, and that Wife had no right or interest in those assets. The Connecticut Supreme Court adopted the opinion of the Massachusetts Supreme Judicial Court and held that the decanting was proper.

The Connecticut Supreme Court did affirm the determination of the Connecticut trial court that Wife had standing to challenge the trustees' actions because their actions regarding the original trust directly affected the dissolution court's ability to make equitable financial orders in the underlying dissolution action. Under Connecticut law, the 1983 Trust was a marital asset because Husband had an absolute right to withdraw up to 75 percent, and later 100 percent of the principal.

The *Ferri* Action for Dissolution of Marriage: 2011 Trust Not Marital Asset, but Could Be Considered in Alimony Determination[16]

The court noted that the Massachusetts Supreme Judicial Court determined that the decanting was appropriate: "Consequently, the assets from the 1983 Trust cannot be considered as part of the dissolution judgement..." With regard to the 2011 trust, because that was a so-called "spendthrift trust" (protected from creditors), it was not considered an asset of the marital estate that the court could divide under Connecticut law. Wife's status was that of a creditor and the court held that, although the court could divide the assets while they were held in the

1983 Trust, it could not reach them once they were moved into the 2011 Trust—the decanting was successful in removing the assets from division.

However, the court noted that, although the trial court could not consider the assets decanted to the 2011 trust for equitable distribution purposes, it could and did consider Husband's ability to earn additional income when creating its alimony orders. The trial court found that the trust funds had routinely supported Husband's investments. Notably, the trial court ordered Husband to pay Wife $300,000 in alimony annually, despite the fact that, when the action was commenced, he had been earning only $200,000 annually.

Some Further Thoughts About Decanting

Note that about half the states, including New York,[17] provide statutory authority to decant. Most states require that notice be given to beneficiaries. It was important in the *Ferri* case that the decanting occurred without Husband's permission, knowledge or consent. Query if the same result would follow if a beneficiary was given notice of the decanting, or whether notice alone would not detract from the Connecticut Supreme Court's holding that Husband took "no *active* role in planning, funding or creating the 2011 Trust" (emphasis added).

Including decanting provisions in trust instruments may maximize flexibility without resort to state default law. Indeed, in a recent New York case, *In re Hoppenstein*,[18] the trustees successfully relied on their powers under a trust document to distribute a life insurance policy on the settlor's life to a new trust that excluded an estranged daughter of the settlor and her issue. Dismissing an objection that the transfer did not satisfy the requirements of the New York decanting statute, court held that the New York decanting statute had no bearing on the case since the trustees relied on their powers under the document to effectuate the transfer.

IV. Other Potential Ways to Revise Trust Distributions: Power to Adjust and Unitrust Regimes

A trustee must invest assets pursuant to the so-called Prudent Investor Rule. Under that rule, a trustee is required to invest for "total return." That is, a trustee must invest in a way that benefits both income and principal beneficiaries. However, when beneficial interests clash, as they typically do in a divorce scenario, the source of return becomes critical, and the tension between investing for income and investing for growth can become more pronounced. More specifically, how does a trustee invest without considering whether return is produced from income or from capital appreciation when the income beneficiary (perhaps a second spouse) is pressuring the trustee for more income and the remainder persons (perhaps children from a prior marriage) are pressuring the trustee for more growth?

Fortunately, there are two regimes that provide trustees with the means to implement the mandate of total return investing—the power to adjust and unitrust regimes. Under a power to adjust regime,[19] the trustee is permitted to make adjustments between income and principal to be fair and reasonable to all beneficiaries. In other words, even if a principal distribution is not permitted under a trust document, or is permissible pursuant only to a very limited standard (like health or education), the trustee can "redefine" a portion of the principal as income, and pay that to the income beneficiary. Under the unitrust regime, the trustee can convert an income beneficiary's interest into a unitrust payout of a fixed percentage of the trust's principal. Most states allow a trustee to determine the appropriate unitrust payout within a band of 3-5 percent. In New York, the unitrust payment is fixed at 4 percent.[20]

These two regimes are intended to ease the tension between competing income and remainder beneficiaries and align interests, so that all beneficiaries benefit from the trust's growth, wherever that growth may emanate. Every state in the country has enacted one or both of these regimes, and every trustee or advisor should be aware of these powerful tools.

In particular, consider whether existing trust terms should be evaluated in the event of divorce to potentially adjust beneficial interests. Note that even if a divorce action is taking place in one state, a spouse may be a beneficiary of a trust governed by the laws of another jurisdiction, so familiarity with the operation of that other state's power to adjust or unitrust laws may be important. Typically, the state statutes provide a number of factors for a trustee to consider in determining whether or not to make an adjustment or opt into the unitrust regime.

See, for example, the use of the unitrust regime in *In re Jacob Heller*.[21] The trustees defended a challenge to their determination to opt into the unitrust regime. Jacob Heller created a trust under his will for the benefit of his second wife, who was to receive income for her life. Decedent's children from a prior marriage were named as remainder beneficiaries, and two of those stepchildren, the decedent's sons, became trustees.

When Mrs. Heller's two stepsons became trustees of the trust, Mrs. Heller's annual trust payment was $190,000—far above a 4 percent payout. In 2003, the co-trustees opted into the unitrust regime pursuant to New York law to reduce the payment to their stepmother to 4 percent *and* opted to make their election retroactive to January 1, 2002 (the date the unitrust regime became effective in New York). As a result of the unitrust election, Mrs. Heller's annual income from the trust was reduced from $190,000 to $70,000. As result of making the election retroactive, Mrs. Heller would have owed the trust $360,000 ($120,000 a year from the date of the 2005 decision, back to each of the three preceding years).

Mrs. Heller commenced a proceeding seeking to annul the unitrust election on the grounds that the co-trustees were also remainder beneficiaries of the trust and conflicted from making that decision, and a determination that the unitrust election could not be made retroactive to January 1, 2002.

The court reasoned that the co-trustees owed fiduciary duties to Mrs. Heller as an income beneficiary, but also to all remainder beneficiaries, including the trustees' siblings. The fact that the remainder beneficiaries' interests aligned with the interests of the co-trustees did not disqualify them from opting into the unitrust regime. As such, a question of fact remained as to whether the co-trustees were reasonable in their unitrust election, precluding summary judgment on that issue.

In addition, the Court of Appeals held that, since the New York statute allowed a trustee to specify the effective date of a unitrust election, the co-trustees' retroactive application of the unitrust election was proper. Note that in some jurisdictions the unitrust election can only be made prospectively. Since the decision in *Heller*, New York law was revised and a retroactive unitrust election is still possible, but only with court approval.[22]

V. Use of Leverage: Credit Solutions During Divorce

Leverage may be very useful in a divorce proceeding. There are many instances in which the marital estate being divided is comprised of assets that don't lend themselves to easy division and the remaining assets are not sufficient to make both spouses whole. This might occur in cases including:

- Closely held business interests;
- Partnership interests;
- Real Estate (personal and investment);
- Artwork and other collectibles;
- Private market interests with liquidity restraints;
- Aircrafts, watercraft.

In these circumstances, custom credit and leverage solutions can potentially provide the necessary liquidity to effectuate the asset division without major disruption to ownership of the underlying assets. Credit solutions can be tailored to the need, whether it is short-term borrowing with lines of credit or longer-term borrowing through defined term loans.

VI. Life Insurance—Using ILITs and Policy Reviews

Utilizing an Irrevocable Life Insurance Trust (ILIT) can be an advantageous way to purchase and maintain life insurance in divorce and other contexts. An ILIT is an irrevocable trust created to hold ownership of an insurance policy. The trust can hold existing policies (so long as the insured lives for three years following the transfer so the proceeds are removed from the insured's estate), newly issued policies, or both. To create an ILIT, an individual establishes a trust and transfers funds to the trust. The trustee then purchases a life insurance policy payable to the trust upon the insured's death. The primary benefit of using an ILIT is that, upon the death of the insured, policy proceeds pass to heirs free of estate taxes.

In many divorce proceedings, life insurance plays an integral role as part of the ultimate resolution/settlement, whether it is an asset to be allocated between the parties, or a requirement placed upon parties to maintain for some period of time. It is critical to review life insurance policies periodically to ensure they are performing as intended at the best cost, and that the premiums are being paid by the responsible party.

A policy review may uncover some or all of the following factors:

- The interest rate environment could have affected the policy performance, particularly if initial illustrations were run in a different interest rate environment.
- Market returns may have underachieved expectations.
- Policies issued prior to 2009 are based on 1980 mortality tables. Life expectancies have increased over time which may generate lower premium rates in newer policies.
- Newer policies have guaranteed and/or extended Death Benefit Guarantees that may not have been available with the original policy.

Insurance Policy Reviews Focus Attention on Important Details

Other important issues that may be uncovered by having a disciplined policy review procedure in place include:

- **Are premium notices being sent to the correct address and are premiums being paid on time?**

In *Orchin v. Great-West Life & Annuity Insurance Company*,[23] the insured's friend and fellow dentist, Orchin, served as trustee of a trust holding a life insurance policy. He did not miss a single premium payment from 1993 (when the policy was assigned to the trust) through January 2009. In April 2009, Orchin moved homes. Though he claimed to have told the post office his forwarding address, the insurance company was never notified of this change. It continued to send payment notifications to Orchin's old address, and as a result, Orchin never received them, nor the notices that the policy was in default or that it eventually lapsed.

On January 15, 2010, the insured died suddenly. At this point, Orchin realized he failed to pay the previous premium payments. Omitting to mention that the insured had died, Orchin convinced a supervisor to exercise her authority to make a one-time exception and reinstate the policy.

When Great-West discovered that the insured had died before the insurance was reinstated, they denied the claim. The insured's wife and Orchin brought suit against Great-West for improper termination of the policy and breach of contract, and the insured's wife also brought suit against Orchin for breach of fiduciary duty.

The court held that Great-West's decision to reinstate the coverage was unenforceable. Although "a close question," the court denied Orchin's summary judgment motion because issues of fact remained. Specifically, there were questions regarding whether it was reasonable for Orchin to expect the insurance notices to reach his new address and whether he exercised ordinary diligence.

As well as emphasizing the importance of having a reliable policy review mechanism in place to prevent a policy lapse, this case also highlights the issue that, when friends or family members are appointed as trustees, oftentimes they are simply unaware of the myriad duties to which they are subject. One important step a trustee can take to minimize fiduciary risk is to hire trusted professional advisors who are cognizant of the responsibilities imposed on fiduciaries, and have expertise in fulfilling those responsibilities.

- **Is the insurance fulfilling the originally planned intention?**

For example, to provide a source of funding for college education. If not, what changes are appropriate to consider?

- **Is the insurance contract the appropriate option for the trust based on the current insurance market?**

If market conditions have changed, what other options should be considered?

- **Are there any significant lifestyle or health changes and/or improvements?**

Are there any activities in which the insured no longer participates that were considered hazardous?

Has the insured's medical history changed?

- **Is the policy properly titled from an ownership perspective?**

Until recently in New York, absent fraud, strict privity was required to maintain a legal malpractice claim against an estate planning attorney. Since negligence in the estate planning context is usually not discovered until after a client's death, the strict privity requirement often resulted in the cause of action dying with the client.

In *Estate of Saul Schneider v. Finmann*,[24] the decedent's estate commenced a malpractice action against the decedent's estate planning attorney, alleging that the attorney negligently advised the decedent to transfer, or failed to advise decedent not to transfer, an insurance policy into his own name. The result was that the insurance proceeds were includable in the decedent's estate and subject to estate tax. With proper planning, the policy should not have been in the decedent's name, and the proceeds should have passed to heirs free of estate tax.

The New York Court of Appeals held that sufficient privity existed between the personal representative of the estate and the estate planning attorney for the personal representative to maintain a malpractice claim against the attorney on the estate's behalf. According to the Court, the strict privity rule leaves the estate with no recourse against an attorney who planned the estate negligently, and the estate essentially "stands in the shoes of a decedent," giving the estate capacity to maintain the malpractice action.

Most importantly, in order to avoid adverse tax consequences, ownership of insurance policies must be carefully considered.

- **Does the policy have the correct beneficiary designation and are taxes apportioned as intended?**

A case recently decided in Georgia underscores the importance of having both the correct beneficiary designation and the tax apportionment result that was intended. In *Smoot v. Smoot*,[25] decedent's ex-wife, Dianne Smoot, was the named beneficiary of life insurance and retirement assets that were included in the taxable estate. The decedent and Dianne had divorced in 2006, but the decedent had not changed any of his beneficiary designations. Having lost a previous action in which the decedent's son from a prior marriage claimed that Dianne was not entitled to the decedent's retirement benefits, the son argued in this action that Dianne was responsible for paying her pro-rata share of the federal estate taxes. The tax apportionment clause in the decedent's will provided for taxes to be pro-rated against those who received property included in his taxable estate.

The court held that federal law governed the tax apportionment concerning the life insurance proceeds. However, with regard to the retirement benefits, the court noted that, under Georgia law "[a]ll provisions of a will made prior to a testator's final divorce…in which no provision is made in contemplation of such event shall take effect as if the former spouse had predeceased the testator...." According to the court, because the will made no provision in contemplation of divorce, the tax apportionment clause had to be construed as if Dianne had predeceased the decedent. Accordingly, the tax apportionment clause did not apply to her, with the harsh result that not only did the ex-wife receive the retirement benefits, but she received them tax-free.

Although states may have default laws that would have prevented this result (because designations are revoked in the event of divorce or because of default pro-rata tax apportionment provisions), this case is a stark reminder not to rely on state law but to carefully update beneficiary designations.

VII. The Bottom Line: Collaboration Is Key

Clients will benefit when matrimonial, trusts and estates, and investment professionals partner to integrate considerations that cross disciplines. Advisors will be well-served in taking a collaborative approach to ensure they consider the many nuanced factors in this arena, and effectively represent clients.

Endnotes

1. Note that, with the exception of Hawaii (and Maryland in 2019), portability is generally not available for state level estate tax exemption amounts. Although Delaware also allowed portability, the repeal of the Delaware state estate tax in 2018 will render state level portability moot.
2. 390 P.3d 238, 2017 OK 3, 2017 WL 167587 (Okla. 2017).
3. 12 Del. C. § 3572.
4. *Id*.
5. *Id*.
6. 12 Del. C. § 3573(1).
7. There is a risk that a court in the state where the divorce is proceeding might decide that its law, not Delaware law, applies. However, at the least, a properly designed DAPT will raise formidable obstacles for creditors.
8. *Pfannenstiehl v. Pfannenstiehl* (Massachusetts Supreme Judicial Court) 475 Mass 105, 55 N.E. 3d 933.
9. *In Matter of Leyton*, 135 A.D.3d 418 (1st Dep't 2016).
10. *In re Estate of Lewis*, 25 NY3d 456 (2015).
11. New York A.6229/S.6503 (2017).
12. EPTL Article 13-A.
13. In New York, for example, see EPTL 13-A -2.2.
14. *Ferri v. Powell-Ferri*, 476 Mass. 651 (2017).
15. *Ferri v. Powell-Ferri*, SC19432, SC19433.
16. *Powell-Ferri v. Ferri*, SC19434.
17. EPTL 10-6.6.
18. *In re Hoppenstein*, 2015-2918/ANYLJ 1202784244139 (Sur. Ct. N.Y. Co, March 31, 2017); 2017 N.Y. Slip Op. 30940(U).
19. New York's power to adjust regime is found in EPTL 11-2.3.
20. EPTL 11-2.4.
21. *In re Jacob Heller,* 23 A.D.3d 61 (2d Dep't 2005), *aff'd*, 6 N.Y.3d 649 (2006).
22. See, for example, *In re Will of Kruszewski*, 116 A.D.3d 1288 (3d Dep't 2014).
23. *Orchin v. Great-West Life & Annuity Insurance Company*, 2015 WL 5726334, 133 F. Supp. 3d 138 (2015).
24. *Estate of Saul Schneider v. Finmann*, 15 NY3d 306 (2010).
25. *Smoot v. Smoot*, 2015 TNT 69-13, No. 2:13-cv00040 (U.S.D.C. S.D. Ga. March 31, 2015).