Trusts&Estates

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Addiction, Disinheritance and Enabling: An Avoidable Outcome

BY DAVID E. SIEGFELD

'That's it! He's out of the Will!" "He's just going through a stage … he stopped using for a whole week and he's a different person." "That liar will NEVER change." "I'm sure financial security will stop her from using."

The truth of the matter is that our loved ones suffering from the disease of addiction will be unable to break the cycle of perpetual relapses and suffering until they experience an event sufficient enough to bring about a moment of clarity and humility resulting in an honest desire for change. It is when that limited window of opportunity opens that the loved one's family and community should be prepared to assist in implementing a plan of action to ensure success in rehabilitation, treatment and recovery. This sort of change cannot be brought about by begging, shaming, reasoning, emotional pleading or implementing *tough love*, including disinheritance resulting from anger, fear or retaliation. While families must refrain from stoking the fire of addiction through enabling a loved one's habits through countless methods of well-intentioned acts, implementing certain estate planning strategies can avoid providing direct resources to family members suffering from active addiction while ensuring that carefully managed funds will still be available when help is desired and honestly sought.

Family members, especially parents, have difficulty in addressing how to plan their estates when a loved one (i.e., child, grandchild, sibling, etc.) is struggling with the disease of addiction. While most clients do not wish to disinherit a love one because of the hope that a solution will be found, they struggle with how to ensure success without bequeathing additional resources to fuel the addict's destructive actions. A proper estate plan can help establish certain benchmarks in order to ensure that a bequest is properly safeguarded against abuse,

> A proper estate plan can help establish certain benchmarks in order to ensure that a bequest is **properly safeguarded against abuse,** while at the same time provide resources to the intended beneficiary for both their personal needs and to assist with their struggles in addiction.

while at the same time provide resources to the intended beneficiary for both their personal needs and to assist with their struggles in addiction.

Disinheriting a child or loved one could create conflicts among children and other family members, potential delays and costs due to legal challenges in the implementation of an estate plan, and/or resentments that might fuel or accelerate the self-destructive path of one suffering from addiction.

One of the basic ways that an estate can be planned to avoid disinheritance is to create a trust (either during a parent's/grandparent's lifetime or upon death) which could include various provisions tying the beneficiary's receipt of principal or income distributions to the beneficiary meeting and maintaining certain benchmarks. These trusts have sometimes been referred to as "Incentive Trusts," "Spendthrift Trusts," "Addiction Trusts" or even "Recovery Trusts." Usually, the criteria will be based upon what efforts the beneficiary undertakes to seek treatment for the physical addiction, and also to ensure that he or she continues to maintain sobriety in recovery. A Recovery Trust could be structured to tie any principal or income distributions to completing or maintaining one or all of the following milestones:

Detox and Continued Sobriety: Commitment to seek recovery from the physical symptoms which could be followed-up with periodic blood/urine screening to ensure ongoing sobriety (as recommended in consultation with a counselor).

A Treatment Plan: Commitment to an in-patient/out-patient program followed by group/individual therapy to assist with the mental addiction which can be verified by reports from physicians and/or counselors with specific experience in addiction care.

A Recovery Plan: Commitment to a 12-step program, mindfulness, readings, yoga, etc., to bring about a lifestyle change to help ensure long-term sobriety. Being part of a fellowship and sharing the common peril of addiction is key to ensuring long-term sobriety. An addict left to their own devices will most likely relapse.

A Recovery Trust would be administered by a trustee who would be granted the responsibility and authority to ensure that any distributions would only be made to or for the benefit of a beneficiary to: (1) seek treatment and recovery as would be deemed necessary and/or advisable by the trustee after consultation with professionals who may or may not be directly counseling the beneficiary; (2) ensure that a program of recovery is being maintained, as evidenced by periodic chemical screening and obtaining reports from counselors or other medical professionals; and (3) provide for the personal needs of the beneficiary, especially in early sobriety (or in cases of relapse). This is not an exhaustive list, but rather an idea of some of the basic expenditures which the trustee can be authorized to satisfy. The Recovery Trust should also reflect that, if it is the desire for the trustee to independently verify health care information and test results directly from the health care providers, that the beneficiary be required to execute such HIPAA authorizations as a precondition to receiving any benefits from the trust.

A Recovery Trust should be worded in such a way as not to be unduly burdensome or punitive to the beneficiary, but rather to provide a financial incentive to seek out assistance, if they have not done so already, and to ensure that sobriety and continued recovery is maintained. The Recovery Trust can be drafted in such a manner that if a program of recovery is maintained over a period of time, the trustee could begin "sprinkling" unrestricted principal distributions to the beneficiary with the hope that the trust could eventually terminate. While the trust can provide for the termination and final distribution to the primary beneficiary upon an adequate show-

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DAVID E. SIEGFELD *is a partner with Lippes Mathias Wexler Friedman and co-leader of the firm's trusts and estates practice team.*

'Estate of Seiden': An Opening of the Floodgates, or a Crack in the Wall?

BY ROBERT W. BENJAMIN AND HELEN C. HEINTZ

The interplay of related tax statutes does not always produce logical results. Consider the following facts:

Husband died a resident of New York in 2010 when there was no federal estate tax. His will created a qualified terminable interest property (QTIP) trust for the benefit of his surviving spouse. Wife died a resident of New York in 2014. At the time of her death, the value of her individual assets exceeded the New York estate tax threshold then in effect.

Under federal law, the assets in the 2010 QTIP trust were not subject to federal estate tax upon Wife's death. But what about in New York, where there was no state estate tax repeal in 2010? Logically, shouldn't the postponed New York estate tax on the 2010 QTIP trust assets finally come due after Wife's death in 2014?

In a case of first impression, Estate of Seiden (N.Y.L.J., Nov. 23, 2018), the New York County Surrogate's Court said No. How did Surrogate Rita Mella reach that conclusion based on the tax laws then (and now) in effect? The authors, who presented the case to the court, will take you through the analysis.

Husband's estate claimed a marital deduction for New York purposes for a portion of the QTIP trust by attaching a pro forma federal estate tax return to the New York estate tax return and making the QTIP election on the pro forma federal return. After Wife died in 2014, her executor filed both a federal and a New York estate tax return and paid the New York estate tax due on her assets excluding the value of the QTIP trust assets.

The New York State Department of Taxation and Finance (the Tax Department) issued a notice of deficiency, asserting that the assets of the QTIP trust should have been included in Wife's New York gross estate even if they were not subject to federal estate tax. The executor paid the deficiency and thereafter brought a motion to vacate the deficiency pursuant to New York Tax Law §998.

Determination of New York Gross Estate

A resident's New York gross estate is determined by New York Tax Law §954, which provides that a resident's New York gross estate is her federal gross estate as defined in the Internal Revenue Code (whether or

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ROBERT W. BENJAMIN *and* HELEN C. HEINTZ, *partners at Wiggin and Dana, represented the Estate of Seiden in the New York County Surrogate's Court proceeding. The authors acknowledge the contributions of the estate's prior counsel, Wilk Auslander, in framing the issues.*

Top 10 Developments, Lessons and Reminders of 2018

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BY SHARON L. KLEIN

From new legislation, to important proposals, to instructive case law, 2018 saw some significant developments, lessons and reminders.

10. Prenuptial Agreements Must Be Acknowledged.

Under Domestic Relations Law §236(B)(3), agreements made by parties before or during marriage must be acknowledged with the same formality required to record a deed. In *In re Koegel*, 70 N.Y.S.3d 540 (2018), the Second Department addressed the question of whether a defective acknowledgement to a prenuptial agreement could be cured. In an agreement signed before marriage, a decedent and his wife each waived rights to the other's estate and their signatures were acknowledged by their respective attorneys as notaries. However, the acknowledgements did not specifically attest to whether the parties were known to the notaries. Although the wife received substantial benefits under the will, she filed a right of election. She alleged that the prenuptial was defective pursuant to the Court of Appeals decision in *Galetta v. Galetta,* 969 N.Y.S.2d 826 (2013), which invalidated a prenuptial agreement because the acknowledgments omitted language expressly stating that the notaries knew the signers or had ascertained, through proof, that the signers were the persons described. The *Galetta* court left open the issue of whether a defective acknowledgment could be cured by extrinsic evidence provided by the notary public who took a party's signature. The *Koegel* court determined that affidavits submitted by the attorney notaries (30 years after the agreement was signed) cured the defect. Those affidavits confirmed that they each observed the document being signed and personally knew the signer, so it was unnecessary to ask for identification.

This case highlights the importance of checking boiler plate signatory provisions to ensure that prenuptial agreements, and all other agreements requiring acknowledgement, are duly signed with the requisite formality.

9. New York Decouples From Certain Federal Income Tax Changes.

In TSB-M-18(6)I, issued Dec. 28, 2018, the Department of Taxation and Finance (the Department) affirms that the state and federal tax treatment of certain items of income and deductions will differ for tax years 2018 and thereafter.

Alimony Continues to Be Deductible. Until 2019, alimony payments were characterized as taxable income to the recipient and deductible by the payer (Internal Revenue Code [IRC] §§71(a) and 215(a)). With the spouse paying alimony likely to be in a higher income tax bracket than the recipient spouse, the recipient potentially could pay taxes on the alimony at a lower rate. This bracket play often resulted in overall tax savings between the parties. Pursuant to federal changes effected by the 2017 Federal Tax Cuts and Jobs Act (the Federal Tax Act), alimony payments made pursuant to a divorce or separation agreement signed after Dec. 31, 2018 will no longer be treated as taxable income to the recipient or be deductible by the payer. Since New York has decoupled from the federal treatment of alimony payments, alimony can be subtracted from federal adjusted gross income in computing New York taxable income (N.Y. Tax Law §612(w)).

Deductions Can Be Itemized, Even If Not Itemized for Federal Purposes. Taxpayers may claim some deductions on their New York returns that are no longer available for federal purposes (N.Y. Tax Law §615(a)), including:

- State and local real estate taxes, including amounts over the $10,000 federal limit; and
- Certain miscellaneous deductions that are no longer allowed federally, such as tax preparation fees and investment expenses.

529 Plan Withdrawals for K-12 Grade Tuition Are Nonqualified. A 529 plan is an investment account created for the purpose of paying educational expenses of a designated beneficiary. Funds invested in a 529 plan will accumulate and grow federal income tax free, and if the funds are used for qualified educational expenses (such as tuition, room & board, fees, books, supplies and equipment for college [IRC §529(e)(3)]), funds are exempt from federal income tax. New York accords similar favorable tax treatment to 529 plans and allows taxpayers to take an income tax deduction up to $5,000 ($10,000 for a married couple filing jointly) for contributions to New York's 529 plan.

As a result of changes effected by the Federal Tax Act, as of Jan. 1, 2018, 529 plans (up to $10,000 annually) can now be used to pay for tuition for elementary and secondary schools for federal tax purposes. According to the TSB, however, New York limits qualified withdrawals to post-secondary educational institutions. Withdrawals for tuition payments to elementary or secondary schools will be considered nonqualified.

8. Department Reaffirms Closing of Nonresident Income Tax Loopholes.

Co-operative Shares Included in Definition of Real

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SHARON L. KLEIN *is President of Family Wealth, Eastern US Region, at Wilmington Trust, N.A. This article includes developments through Dec. 31, 2018*

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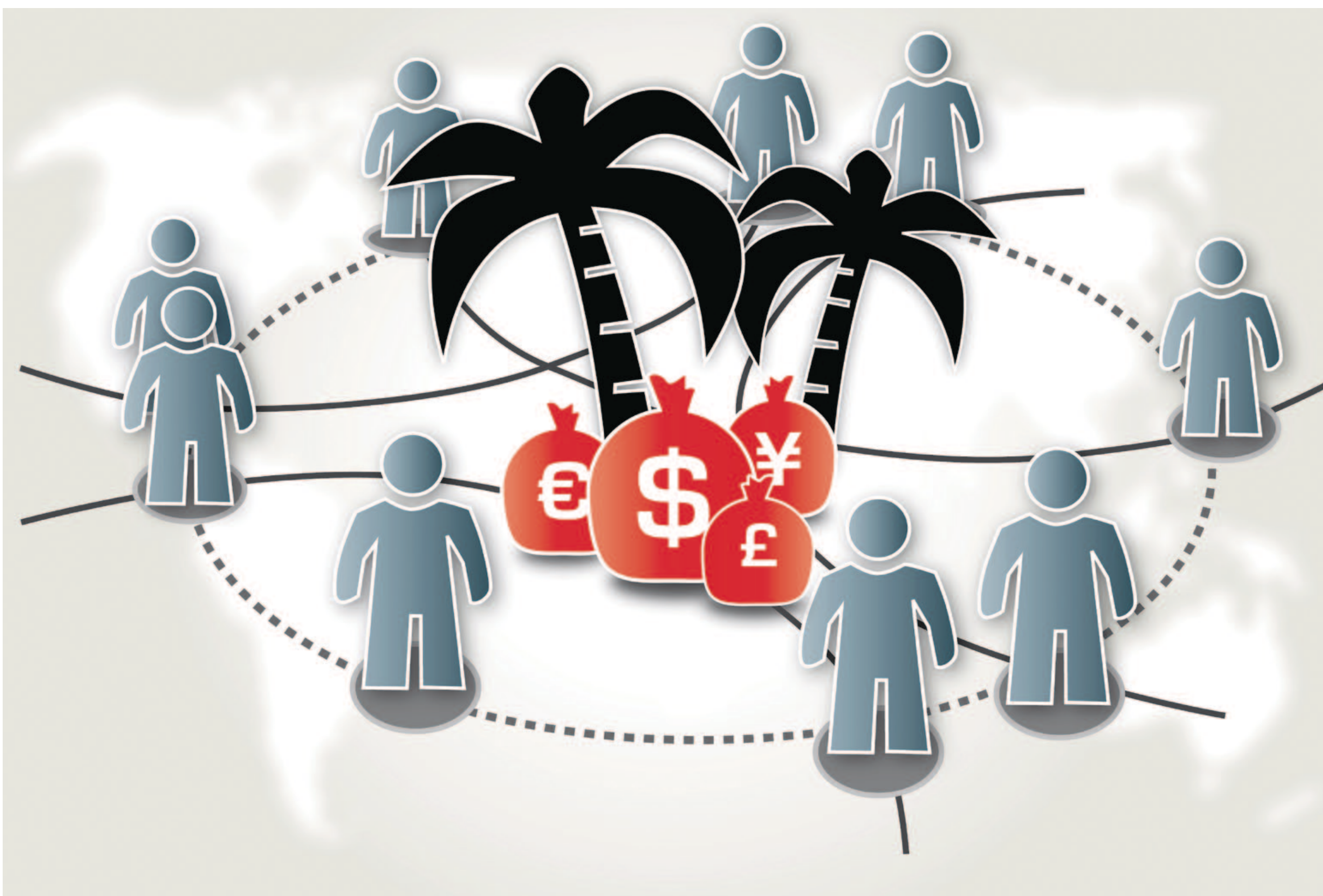
When an **Asset Protection Trust** Affords **No Protection**

Essential considerations for judgment creditors seeking to attack offshore asset protection trusts.

BY PETER TYERS-SMITH AND JONATHAN D. COGAN



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The offshore asset protection trust (OAPT) is typically perceived as a "Grishamesque" invention habitually used to lock away billions of dollars on palm-fringed shores, far away from tax authorities and creditors. The practical reality is far less sensational and trusts established under the laws of leading international financial centers such as the British Virgin Islands (BVI) and the Cayman Islands are routinely used as sophisticated but entirely legitimate wealth management, estate planning and diversification tools.

As stakeholders vie for market position on the international stage, the question of whether OAPTs are becoming redundant in favor of U.S. domestic asset protection trusts (DAPTs) which provide similar (if not identical) levels of utility in legitimate wealth management and planning strategies, comes to the fore. But how do the OAPT and DAPT compare from a vulnerability perspective when creditors seek to monetize their arbitral awards and judgments from the assets of such trusts?

Settlor-Beneficiaries

In the United States, although as many as 17 states have enacted specific legislation permitting the formation of self-settled DAPTs (DAPT states), these types of trusts are often susceptible to attack where the resident of a non-DAPT state attempts to use the more favorable laws of a DAPT state to create an asset protection trust. In non-DAPT states, subject to a limited number of exceptions, a judgment creditor may reach the trust assets of a self-settled DAPT, whether revocable or irrevocable, in order to satisfy its judgment to the maximum amount that the settlor-beneficiary could receive by way of distribution. It makes no difference whether the settlor-beneficiary's interest arises under a purely discretionary DAPT or a foreign-law governed OAPT, provided the settlor is subject to the jurisdiction of the U.S. court (see for example New York EPTL §§7-3.1 and 10-10.6).

In most offshore jurisdictions, there is no statutory prohibition against self-settled trusts and indeed the settlor of an OAPT may also be a beneficiary without automatically undermining the existence of the trust, and more specifically, without exposing the assets of the trust to enforcement processes by his or her creditors.

To this extent and in the light of the "uneven" playing field amongst DAPT and non-DAPT states, it would appear that the OAPT has more appeal to settlors that wish to maintain an interest in the assets the trust, whilst also shielding that interest from her or his creditors. From a creditor perspective, one can readily appreciate the lack of appetite in seeking to monetize awards and judgments from OAPTs from within the jurisdiction whose laws appear to allow a settlor to transfer her or his assets to a trustee whilst maintaining an interest in those assets.

Indeed, a creditor's lack of interest in seeking to challenge OAPTs in the jurisdiction of creation and administration is likely to be buttressed by the perception that Courts will unhesitatingly uphold any arrangement as a valid OAPT under which a settlor is also a beneficiary and holds reserved powers (including powers of revocation) relating to the administration of the trust. The long-held view is that most offshore jurisdictions have enacted debtor-friendly legislation that will ensure a judgment creditor's ability to satisfy a judgment from purported trust assets fails.

But are OAPTs truly that infallible to creditors' claims?

PETER TYERS-SMITH *is an attorney with Kobre & Kim, in the British Virgin Islands and Cayman Islands offices.* JONATHAN D. COGAN *is an attorney in the firm's New York office.*

Illusory Trusts

Like several other leading international financial centers, the BVI and Cayman Islands adopt principles of English common law. Under those principles, where the proper interpretation of the terms of the trust document shows that the fundamental characteristics of a trust are illusory, a creditor will effectively be able to treat the assets of purported trust as those of the settlor. For example, where the terms of the purported trust document permit a settlor-beneficiary to veto the exercise of the trustee's discretion and to dismiss or replace the trustees without cause, and to ignore the interests of other beneficiaries in doing so, the true effect of the document will preserve the settlor's ownership of beneficial interest in the trust property rather than divest it (*JSC Mezhunarodniy Promyshlenniy Bank v. Pugachev & Ors* [2017] EWHC 2426 (Ch) at 244-5, 278). In these circumstances, the document purporting to create the trust will fail to do so because the settlor-beneficiary will retain effective control over and ownership of the assets.

Although the BVI and Cayman Islands have enacted statutes which create a presumption that a trust is valid even though the settlor is also beneficiary and has reserved powers, it is not conclusive. In the BVI, the fact that a settlor is also a beneficiary with reserved powers is not "*necessarily inconsistent with the existence of a trust*" (Trustee Ordinance 1961 (Cap 303) §2(4)). But where a document purporting to create an OAPT, when properly interpreted, shows that a settlor-beneficiary retains full control over the assets of the purported trust, the document will fail to satisfy the requirements of a valid trust under BVI law. The same is true under Cayman Islands law because the presumption of validity and effect of an OAPT (Trusts Law (2017 Revision) §§13-14) only applies where the settlor-beneficiary retains a "*limited beneficial interest in the trust property.*" A settlor-beneficiary that can exercise non-fiduciary powers to fully control the trust effectively retains *complete* ownership of the beneficial interest in the purported trust property and therefore the presumption of validity stands to be rebutted.

How do the offshore asset protection trusts and domestic asset protection trusts compare **from a vulnerability perspective** when creditors seek to monetize their arbitral awards and judgments from the assets of such trusts?

Sham Trusts

Although most U.S. states take a harder, more creditor-friendly line on "self-settled" trusts, they are indisposed to finding that a trust under which a settlor retains powers of control is a "sham" (see Christopher Reimer, "International Trust Domestication: Migrating an Offshore Trust to a U.S. Jurisdiction," 25 Quinnipiac Probate L. J. at 188).

However, in the BVI and the Cayman Islands, where a settlor-beneficiary retains powers that, when properly interpreted, are of a fiduciary nature (i.e., powers which must be exercised for the benefit of all beneficiaries, not just the settlor), but actually exercises those powers selfishly, the document purporting to be a valid OAPT may nonetheless be a "sham."

Provided the creditor can show that, regardless of what the instrument creating the OAPT states, the true intention was the for the settlor-beneficiary to retain control over the assets of the purported OAPT, a judgment creditor can reach those assets to satisfy her or his judgment or award. Although proving intention may be challenging, a carefully-formulated discovery strategy can reveal the all too familiar pattern in which a submissive trustee unhesitatingly follows the orders of the settlor-beneficiary. Such a pattern allows the BVI and Cayman Islands Court to infer that when the OAPT was created, the settlor-beneficiary and trustee always intended that the former would retain control contrary to the appearance created by the trust instrument.

Fraudulent Transfers

Both the BVI and Cayman Islands have modern well-established legislation which enables a creditor to avoid transfers and dispositions of property made with the intent to defraud creditors. Therefore, even if a creditor is unable to undermine the existence of the OAPT through deploying the illusory or sham arguments, it is still possible to set aside the transfer of the settlor's property to the trustee on the basis that it was made with the intent to defraud.

Conclusions

Whilst settlors and trustees decide whether the time has come to repatriate assets held in a traditional OAPT to a U.S. DAPT, it is important for award and judgment creditors to appreciate the landscape in which they are able to challenge both types of trusts in order to monetize their judgments. The time has come for judgment creditors to realize that there is nothing to fear and all to gain by taking the fight to the offshore jurisdiction in which the OAPT was constituted. In particular:

(1) OAPTs under which the settlor is also a beneficiary can be attacked by creditors *within* the offshore jurisdiction whose laws govern the creation and administration of the OAPT. The courts of these jurisdictions enforce a globally recognized policy that arbitral awards and judgments should be enforced and executed and creditors have recourse to a strong legal armory to achieve that end.

(2) Formulating and deploying an aggressive cross-border discovery strategy to uncover interests held by an award or judgment debtor in OAPTs is key to executing an effective monetization campaign.

(3) Where the terms of the document purporting to create an OAPT give a settlor-beneficiary significant powers that can be exercised selfishly and in a manner that effectively preserves complete beneficial ownership of the trust property with the settlor, the trust will be ineffective under common law principles applicable in offshore jurisdictions such as BVI and the Cayman Islands.

(4) Where the terms of the document purporting to create an offshore asset protection trust give a settlor-beneficiary significant powers of control that have the characteristics of legitimate fiduciary powers but are exercised only in the interests of the settlor, the trust could be labeled a "sham" under applicable common law principles. In order to do so, it must be shown that the true intention of the settlor and trustee was for the former to retain full control over the assets of the purported trust.

(5) Demonstrating that a purported offshore asset protection trust is illusory or a sham under the governing foreign law presents an alternative route to enforcing judgments against U.S.-based settlors where the only other means by which to compel compliance is through the more draconian contempt jurisdiction of the U.S. court. However, this may not always bring about the desired result of monetization, particularly where the trust instrument contains an anti-duress clause.

'Seiden'

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not a federal estate tax return is required to be filed), subject to three exceptions, none of which applied here. Further, §954 refers to Internal Revenue Code §2044 which provides, in relevant part, that the value of the gross estate shall include the value of any property for which a "deduction was allowed" under §2056(b)(7), which deals with the deductibility of QTIP trust assets on the death of the first spouse.

Here the QTIP trust assets were not includable in Wife's federal gross estate because no deduction was claimed or allowed after Husband died in 2010, when there was no federal estate tax. Therefore, the executor argued that the QTIP trust assets should not be includable in Wife's New York gross estate as well.

Tax Department's Response

The Tax Department cited its Technical Services Bureau Memorandum TSB-10(1)M dated March 16, 2010 (the TSB Memorandum) in its favor. Foreseeing this very issue, the authors of the TSB Memorandum wrote, even if no federal estate tax return was filed when the first spouse died, the value of any "QTIP property must be included in the estate of the surviving spouse."

The problem is that is not what the statutes say. As Surrogate Mella stated in her decision, the "Tax Department cannot use a TSB Memorandum to override statutory provisions." With respect to the Tax Department's argument that an adverse decision would "open the floodgates" to tax avoidance, the Surrogate noted that "the legislature could still amend the Tax Law to apply to future estates."

Would a court reach a different conclusion if the impact of its decision extended beyond the limited world of 2010 QTIP trusts? **Unless and until the New York State Legislature addresses the issue, the answer is not clear.**

Finally, there is no guarantee that QTIP trust assets will be subject to New York estate tax when the surviving spouse dies. As the Surrogate rightly observed, the "trust property might decrease in value; it might be distributed and spent down; or the surviving spouse might change domicile to another state."

Are the Floodgates Now Open?

Clearly, the decision is good news for New York residents who are beneficiaries of 2010 QTIP trusts. (The Tax Department did not appeal, and the executor received a refund check, with interest.) But might other taxpayers benefit as well?

Possibly. The same arguments could be made following the death of a beneficiary of a QTIP trust in the far more common situation where, due to the spread between the federal and New York estate tax exemptions, only a New York return must be filed after the first spouse dies. (A federal return filed solely to elect portability of the deceased spouse's unused exclusion amount presents another twist in any application of the relevant statutes.)

Again, the Tax Department anticipated these arguments in the same TSB Memorandum that dealt with 2010 QTIP trusts. "If no federal return is required, the [QTIP] election must be made on the pro forma federal estate tax return attached to the New York State return … [and] the value of the QTIP property for which the election is made must be included in the estate of the surviving spouse."

In *Seiden*, however, the Surrogate held that the TSB Memorandum "is merely a statement of the Tax Department's position and has no legal effect." Would a court reach a different conclusion if the impact of its decision extended beyond the limited world of 2010 QTIP trusts? Unless and until the New York State Legislature addresses the issue, the answer is not clear.

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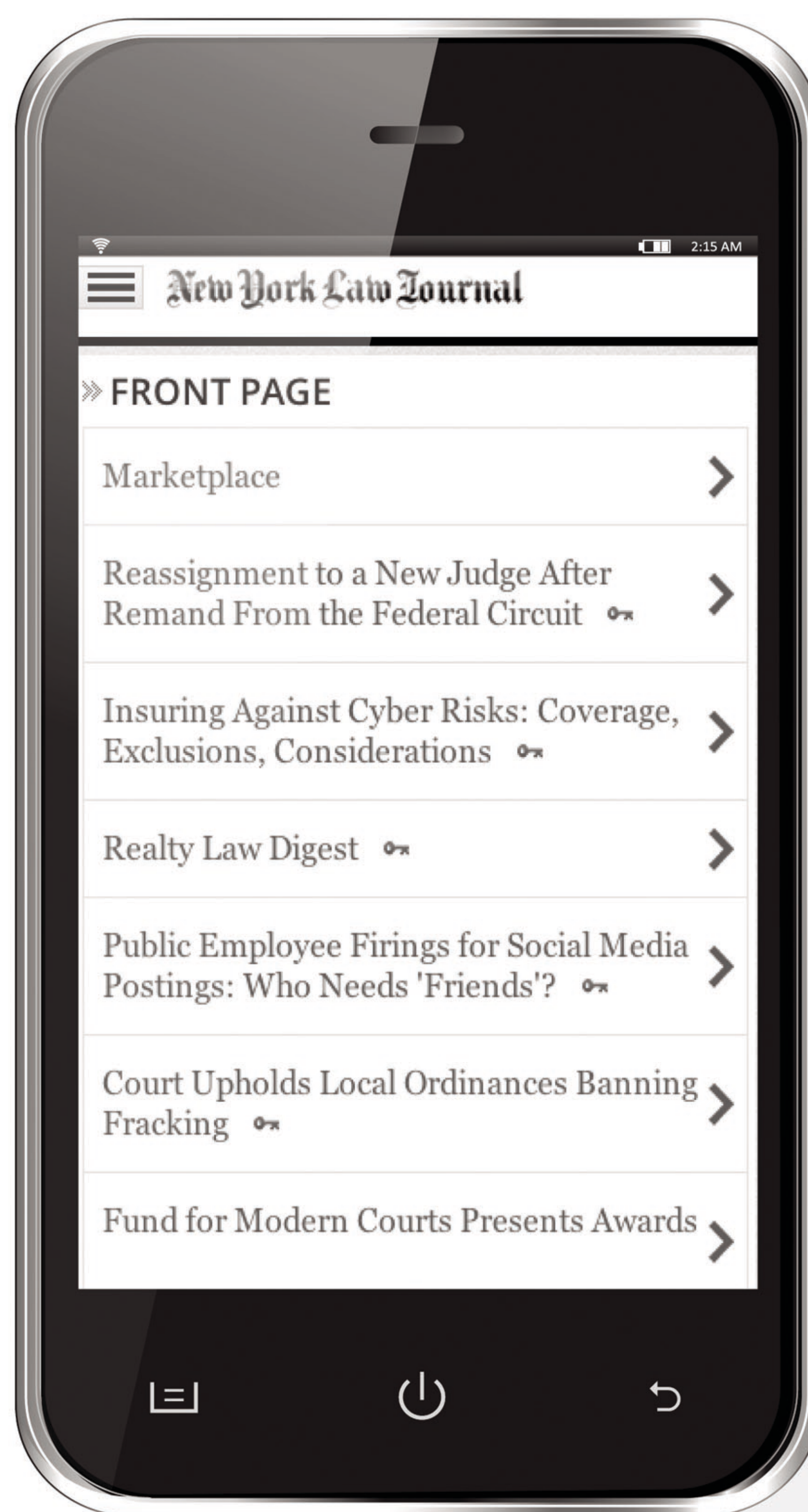

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Property When Determining New York Source Income. The definition of a nonresident's New York source income was expanded in the 2017-2018 Executive Budget. As explained in TSB-M-18(1)I, issued April 6, 2018, if more than 50 percent of an entity's value consists of co-operative apartment shares, gains from the sale of an ownership interest in that entity will be taxable to a nonresident as source income (N.Y. Tax Law §631(b)(1)(A)(1)). Previously, although gains from the sale of a cooperative apartment in New York generated New York source income (N.Y. Tax Law §631(b)), the nonresident could exclude the gain from source income if the apartment was held in an entity. The TSB provides that these rules apply to part-year residents, entities in tiered structures and resident trusts that previously were not subject to New York tax because they satisfied the resident trust exception under N.Y. Tax Law §605(b)(3)(D) (no New York Trustee, no New York situs assets, and no New York source income).

Sales of Certain Partnership Interests Will Generate New York Source Income to Nonresidents. Previously, a nonresident could sell a partnership interest and classify the transaction as the sale of a nontaxable intangible partnership interest. In TSB-M-18(2)I, issued April 6, 2018, the Department explains that a 2017-18 Executive Budget amendment treats the sale by a nonresident of a partnership interest as New York source income when trade or business assets held by the partnership were in New York and the sale is treated as an asset sale under IRC §1060 (N.Y. Tax Law §632(a)(1)).

7. Limitations on Using Exculpatory Provisions Extended to Trustees of Inter Vivos Trusts.

Under Estates, Powers and Trust Law (EPTL) §11-1.7, it is against public policy to exonerate an executor or testamentary trustee from failure to exercise reasonable care, diligence and prudence. An amendment, signed into law by Gov. Cuomo on Aug. 24, 2018, extends the prohibition on exonerating testamentary fiduciaries to trustees of inter vivos trusts.

6. Battle over Cap on State and Local Tax (SALT) Deductions Continues.

The Federal Tax Act limits an individual's SALT deduction to $10,000 for tax years beginning after Dec. 31, 2017, and before Jan. 1, 2026. In response, the 2018-19 Executive Budget introduced state proposals to provide relief, including two state-operated charitable funds, one for health, the other for education, effectively allowing taxpayers to make deductible charitable contributions instead of state tax payments (N. Y. Tax Law §606(iii)). However, on Aug. 27, 2018, the IRS and Treasury Department issued proposed regulations 83 FR 43563, which provide that taxpayers must reduce their charitable deductions by the amount of any state or local tax credit they receive or expect to receive, if that credit exceeds 15 percent of the contribution. According to Gov. Cuomo, in a notice issued on Aug. 24, 2018:

> *We are confident that our recently enacted opportunities for charitable contribution … are consistent with federal law and follow well-established precedent, and I have made it very clear that we will use every tool at our disposal, including litigation, to fight back to ensure New Yorkers aren't being used as a piggy bank to pay for tax cuts for big corporations.*

On July 17, 2018, four states—New York, Connecticut, New Jersey and Maryland—filed a law suit against the federal government in the U.S. District Court for the Southern District of New York, alleging that the SALT deduction cap is unconstitutional. On Nov. 2, 2018, the federal government moved to dismiss the suit on jurisdictional grounds, and for failure to state constitutional violations (18 Civ. 6427 (JPO)).

5. Intent to Minimize Taxes Can be Sufficient to Reform Clear and Unambiguous Instruments

In *Matter of Sukenik*, 75 N.Y.S.3d 422 (2018), the Appellate Division allowed a petition to reform an inter vivos trust and IRA beneficiary designation form, even though the documents were clear and unambiguous on their face. The purpose of the reformation was to remedy "inefficient estate and income tax planning," resulting in an income tax liability of $1.6 million.

The decedent designated his wife as the beneficiary of his IRA, which triggered the substantial income tax liability. He named a foundation as a beneficiary of an inter vivos trust. By swapping the IRA assets received by the wife with trust assets, and naming the foundation as the IRA beneficiary, the income tax liability could have been avoided. The Surrogate denied the petition. She pointed out that tax-related reformations are normally sought to correct drafting errors or cure an instrument's failure to comply with subsequent changes in the law, there being no authority to support the reformation of a clear and unambiguous instrument in order to remedy the adverse tax consequences of poor tax planning. The Appellate Court reversed, despite the Surrogate's warning that:

> *To reform instruments … based only upon the presumption that one who executes testamentary instruments intends to minimize taxes would expand the reformation doctrine beyond recognition and would open the flood gates to reformation proceedings aimed at curing any and all kinds of inefficient tax planning.*

The Appellate Division found that the decedent's intent to minimize taxes and provide for his wife of 39 years was apparent in the donative instruments, which demonstrated his intent to take full advantage of all deductions and exemptions provided by law.

4. Informal Accountings Can Be as Effective as Judicial Settlements.

In *In re Spacek*, 64 N.Y.S.3d 65 (decided at end of 2017), the decedent provided for her residuary estate to be split equally among six beneficiaries. The executor sent an agreement, in lieu of a formal accounting and judicial settlement, to the estate beneficiaries. The agreement, amongst other things, released her from any claims relating to her acts as executor. The estate's tax return and other financial documents were annexed to the agreement. After the executor petitioned to judicially settle her account, one of the beneficiaries who signed the release sought to revoke it, alleging she was not made aware that the executor was to receive a larger share of the estate assets because the executor was a joint holder of various bank accounts with the decedent. The Surrogate's Court denied the motion to set aside the release. The Appellate Division affirmed, holding that, while formal estate accountings are generally done in the context of a judicial proceeding, a fiduciary may also account informally:

> *Such an informal accounting is as effectual for all purposes as a settlement pursuant to a judicial decree … [I]f a fiduciary gives full disclosure in his [or her] accounting to which the beneficiaries are parties…they should have to object at that time or be barred from doing so after the settlement of the account.*

This case illustrates the importance of a fiduciary's obtaining releases from beneficiaries, even pursuant to an informal accounting, to sever otherwise lingering liability. Particularly in a state like New York, where there is no requirement for recurring trust accountings, for example, trustees might consider periodic accountings, particularly if an investment strategy or proposed distribution could be contentious.

3. Three-Year Gift Add-Back Expires.

While New York does not impose a current gift tax, as a result of 2014-15 Executive Budget changes, the New York gross estate of a deceased resident was increased by the amount of any taxable gift made within three years of death. The gift add-back does not apply to estates of individuals dying on or after Jan. 1, 2019 (N.Y. Tax Law §954(a)(3)). Accordingly, even if a gift was made before Jan. 1, 2019, it will not be brought back into the estate if the donor dies after Jan. 1, 2019.

(Note, the proposed 2019-2020 Executive Budget, released Jan. 15, 2019, includes a proposal to extend the three-year add-back to Jan. 1, 2026 and would apply to estates of individuals dying on or after Jan. 1, 2019.)

2. Estate Tax Refund Claims for State Only Qualified Terminable Interest Property (QTIP) Trusts Could Soar.

In *Estate of Evelyn Seiden*, 2018 N.Y. Slip Op 32541(U), the New York Surrogate's court found that a QTIP trust, created for state purposes after a husband died in 2010, was *not* includible in the estate of the surviving wife for New York estate tax purposes**.** Specifically, since the federal estate tax had lapsed in 2010 when the husband died, no federal estate tax return was filed. The husband's executor made a QTIP election on a pro-forma federal return filed with the New York return, taking a marital deduction for New York estate tax purposes. The Department issued a closing letter in 2012. After the wife died, her executor excluded the value of the trust property on her federal estate tax return on the basis that no federal marital deduction had been claimed or "allowed" in her husband's estate, as is required to trigger inclusion in the second estate under IRC §2044. The Internal Revenue Service issued a closing letter accepting the return as filed. The estate also excluded the trust property on the wife's New York estate tax return, taking the position that New York law defines its gross estate by reference to the federal gross estate, which clearly excluded the property. The Department disagreed and assessed additional tax and interest of almost $530,000. However, the New York court rejected the Department's various arguments that IRC §2044 applied, finding that the husband's executor simply did not make that election. Consequently, the property was not included in the wife's federal gross estate, nor in the New York gross estate.

Accordingly, the QTIP property escaped New York and federal estate taxation in both estates! Further, the rationale of the case does not seem to be limited to estates of surviving spouses where the first spouse died in 2010. If an estate was under the federal filing threshold and filed only a New York estate tax return with a pro forma federal return that contained a QTIP election, the same logic should apply to exclude QTIP trust assets from a survivor's estate.

(Note, the proposed 2019-2020 Executive Budget, released Jan. 15, 2019, includes a proposal to prevent the result in the *Seiden* case by requiring an executor to make a QTIP election on the New York return in order to claim a marital deduction, whether or not a federal return was required to be filed. As explained in the Memorandum in Support, the bill expressly requires QTIP property to be included in the surviving spouse's estate if a New York marital deduction for the property was previously allowed. The new law would apply to estates of individuals dying on or after April 1, 2019.)

1. Estate Planning Needs Revisiting in Light of New Tax Laws.

The Federal Tax Act doubled the federal estate and gift exemption, which rose to $11.4 million per person ($22.8 million per married couple) on Jan. 1, 2019, and is slated to sunset after 2025 to $5.6 million (plus inflation adjustments after 2018).

The New York estate tax exemption amount is $5.74 million in 2019, but it is not portable between spouses. If spouses each die in 2019, each has a $5.74 million estate and each uses his/her exemption with appropriate planning, no New York estate tax will be due. If, however, the first to die leaves everything to the survivor, who dies in 2019 with an $11.48 million estate, the exemption of the first spouse to die will have been lost, potentially generating unnecessary taxes of over $800,000 in the second estate.

Further, the substantial gap between state and federal exemption amounts could have potentially significant dispositive and tax consequences. Dispositive provisions can be distorted if linked to federal exemption amounts that have increased beyond what was originally envisioned. From a tax standpoint, care must be taken with formula bequests designed to take advantage of the full federal exemption amount, particularly because an estate that exceeds 105 percent of the New York exemption faces a cliff, causing the estate to be taxable from dollar one. In 2019, if a credit shelter disposition is pegged to the largest amount that can pass free of federal taxes, that might generate a state estate tax of close to $1 million. This tax bite might be further compounded with an interrelated tax computation if the tax is payable from a marital or charitable residuary.

Since New York does not impose a current gift tax and the three-year gift add back has expired, utilizing the increased federal exemption through lifetime gifting might be very attractive: Individuals could leverage the full federal exemption while reducing their New York estate tax since the gifted assets will be excluded from the New York estate. Given that the enhanced gift tax exemption is slated to disappear after 2025, this also presents a limited window of opportunity. It is particularly attractive in light of the fact that the IRS published proposed regulations on Nov. 23, 2018 (83 FR 59343) that eliminate the concern that an individual's increased gift exemption may be "clawed back" if exemption levels are lower on the date of death.

The bottom line is that practitioners should consider reaching out to their clients to discuss whether they should sign new wills and revocable trusts or make changes to otherwise irrevocable documents through a decanting or other revision process to take advantage of new planning opportunities and ensure their existing plans still accord with their intent.

'In re Koegel' highlights the importance of **checking boiler plate signatory provisions** to ensure that prenuptial agreements, and all other agreements requiring acknowledgement, are duly signed with the requisite formality.

Addiction

« Continued from page S1

ing of a long-term commitment to recovery (as can be measured by an established criteria or by directions and guidelines for the trustee), the trust can also provide for the withholding of payments or the termination of the trust in favor of alternate beneficiaries should the primary beneficiary fail to meet the stated objectives within a designated period of time or upon the occurrence of a significant event (i.e., conviction of a crime related to the addiction), within the sole and absolute discretion of the trustee or with a majority consensus of certain family members or counselors.

The designation of the trustee also requires some thorough consideration and discussion. While family members are sometimes appropriate parties to undertake a trustee position for a trust for children under a certain age, the same people may not be appropriate to assume the fiduciary responsibilities when the unique challenges are that of a family member in crisis. Sometimes the appointment of a third party (i.e., a non-family member) serving in the role of either an independent trustee or co-trustee serving with a family member will ease the burden of a loving family member or close family friend making difficult decisions when faced with a brother, sister, child or grandchild struggling with addiction.

At the end of the day, individuals suffering from addiction need to find the ability within themselves to surrender to the fact that they are suffering from a disease, seek treatment and settle into long-term recovery. The financial incentives and the availability of funds offered under a properly drafted Recovery Trust can remove one major hurdle (or excuse) that might prevent an individual from seeking such assistance.

Professional planners must appreciate that this is a very difficult and private topic for most clients to discuss, especially if you are counseling a client where no prior relationship existed. However, we must comfort clients with the concept that these issues are more common than most people think. Clients must realize that it is important to address these issues rather than ignore the fact that addiction is prevalent in society and that providing unrestricted resources is dangerous in the hand of one that suffers from this disease. Recovery from the mental and physical symptoms of addiction is possible, but the disease is chronic and a perceived remission is only subject to a daily reprieve contingent upon an honest and vigorous program of treatment and recovery. As such, the estate plan needs to be flexible enough to meet the ever challenging and changing needs of the beneficiary.

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Times Have Changed in NYC Coop Real Estate

Co-op apartments, rare outside of New York City and its surrounding suburbs maintain a substantial presence in the region's real estate market. Co-op properties range from income-restricted, affordable units to luxury apartments occupying entire floors of buildings on Fifth Avenue. While the majority of new construction projects in the city are condo developments, by a large margin most apartments in the five boroughs are still units within co-op buildings; owner-occupied co-op apartments outnumber condo units by nearly 3-to-1 in New York City. The average sale price of a co-op unit city-wide was over $800,000 in 2018. Despite their prevalence in the market and the significant investment purchasers make when buying a unit, title insurance policies are not typically issued to buyers. Attorneys representing clients who are buying a co-op unit may want to reevaluate this position and consider recommending their clients obtain title insurance.

LIMITS TO THE TRADITIONAL CO-OP LIEN SEARCH

Conventionally, attorneys representing the purchasers of co-op units or lenders financing transactions address potential title issues by relying on the information and protections of a lien search prepared by a title company. The parameters of such a product are restricted - only the information provided by the attorney requesting the search are used to populate the report. For such searches, it is outside the scope of the title company to determine if all appropriate parties are being searched or if any items returned in such a search affect the subject property. It is thus the responsibility of the attorneys to make such determinations. Even if the lien search is accurate, the distinct nature of co-op ownership requires additional diligence beyond a review of a lien search. Unlike real property, there is no evidence of ownership recorded in the public records. With the exception of UCC Financing Statements (and in New York City in more recent years, transfer tax cover pages,) there are no recorded documents directly connecting an owner to a unit. Only possession of the stock certificate and proprietary lease evidences one's interest in the co-op unit. In instances where these documents have been lost, uncertainties arise. A purchaser or lender might have to rely upon representations and records from various third parties: lenders which might have held the documents as collateral for loans, stock ledgers maintained by co-op corporation's board, maintenance records of the managing agent, etc.

A BETTER ALTERNATIVE – TITLE INSURANCE

With these limits in mind, title insurance might be an appealing option for purchasers and lenders. The insurance shifts the risk of loss covered by the title policy to the title company for the above title matters. When preparing to issue a title policy, the title company may identify matters which would never be disclosed in a standard lien search. It becomes the responsibility of the title insurance underwriter to determine if additional searches may be required and that any potential issues are satisfactorily addressed. Once issued, the title company's policy covers the insured for matters covered by the policy for losses up to the full purchase price or loan amount. The coverage provided under the policy is therefore monetarily and conceptually much broader than the errors and omissions coverage under a co-op lien search.

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SPECIAL AREAS OF RISK

FEDERAL TAX LIENS

Out of convention, lien searches follow the real property standard of searching the sellers for federal tax liens only in the county in which the property is located. For condos and conventional homes, this is sufficient to discover liens which might attach to the property. However, as personal property, liens upon the shares in co-ops work differently. The IRS may file federal tax liens in alternate jurisdictions in which the taxpayer resides, and enforce that lien upon the co-op shares. Unlike money judgment creditors, the IRS does not need to levy or serve a notice of execution upon the shares to perfect its lien. In other words, liens filed outside the subject property's county- even outside the state- may attach to a unit and such a lien would never be disclosed in a standard co-op search.

Without title insurance, the buyer or lender must rely on the borrower or seller to provide all possible jurisdictions in which liens might be filed, and manage the complexity of arranging the searches. There is no method to search for federal tax liens on a national level; the liens are recorded accordingly to the local custom in various offices (at the city, county, and/or state level) and with different indexing standards.

ESTATES

Another area in which the particular treatment of co-ops versus realty which might induce a purchaser to consider title insurance is when a sale is being made out of an estate. In any sale of a co-op by an estate, the personal representative of the estate must be the party effectuating the transfer- heirs or the surviving spouse (except in specific instances) cannot do so. Typically, the transfer agents require standard documentation of any estate before the corporation will consent to the sale: a current certification that letters testamentary remain in effect, the New York State Release of Lien of Estate Tax, and the affidavit of debts and domicile as requirements for an estate to transfer shares. Even if the co-op's transfer agent has reviewed this documentation, additional problems which might be apparent only through a thorough examination of the Surrogate's Court file, such as subsequent challenges to the personal representative's authority or specific bequests would not be apparent.

Recent changes to the IRS's policy regarding the release of federal estate tax have also complicated co-op closings and created the potential for delays or uncertainty over title being clear. In the past, the IRS would issue a Release of Lien upon receipt of the tax return, basic estate documentation and a proposed closing statement; this would be provided in advance of the closing and could be relied upon as proof that no lien of federal income tax would attach to the unit. However, the current practice for the IRS requires far more documentation than what was once required, and will only provide a conditional commitment to release a lien. A particularly onerous requirement is for an escrow agent to hold the net proceeds in escrow for an indeterminate amount of time until the final closing letter is issued. At some point following closing, the Release of Lien specific to the unit will be issued. The title company would obtain and review the documentation to reach a comfort level whereby it would issue a policy insuring there is no lien upon the unit.

CONCLUSION

As the monetary value of the average co-op unit in New York City now far exceeds the liability covered under a co-op lien search, buyers, lenders, and their attorneys face potential exposure resulting from incomplete or inaccurate searches. Furthermore, the scrutiny applied to sellers by the co-op corporation's management may not be as comprehensive as a transaction should demand. Buyers may presume that their full investment is protected against any potential title issues - in today's market, attorneys might present them with the option of obtaining the added security provided by a title policy.

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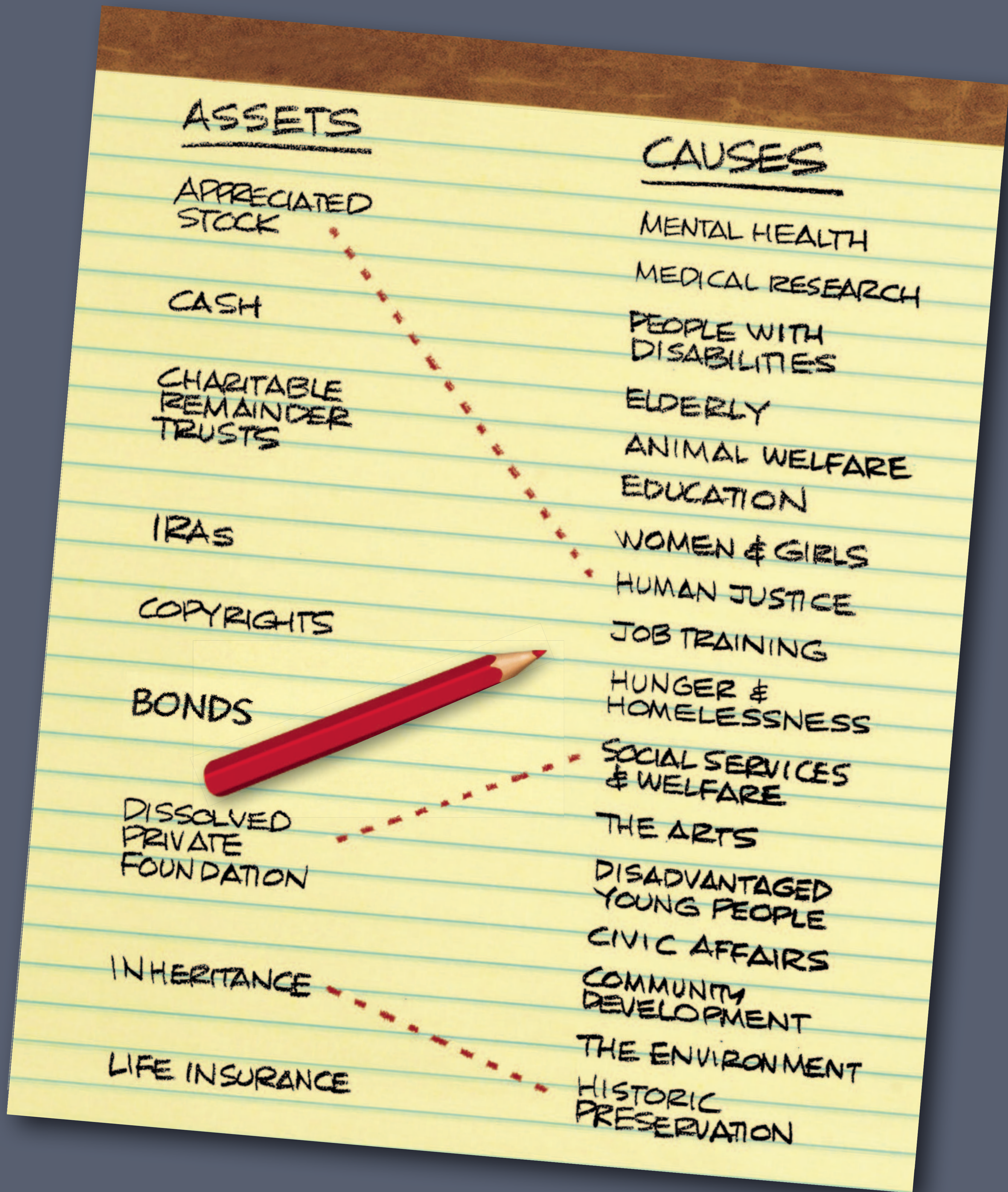

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