Trusts & Estates

Standing to Enforce Restrictions On Use of Charitable Gifts

BIGSTOCK

BY JOHN C. NOVOGROD AND ANNIE L. MEHLMAN

In 2012, charitable giving rose for the third year in a row in the United States, reaching a total of $316.23 billion.[1] Individual donors were responsible for the majority of charitable gifts, making contributions in the amount of $228.93 billion.[2]

Not surprisingly, as donors become more charitably minded and make larger, more significant contributions, they desire greater control over the administration of their gifts. Unfortunately, both common law and New York statutory law impede donor enforcement of the terms of their charitable gifts, traditionally providing standing only to the state attorney general.[3] One of the purposes of this policy, as first articulated by Chief Justice John Marshall in *Trustees of Dartmouth College v. Woodward*, is to prevent "vexatious litigation" by irresponsible parties who do not have a tangible stake in the matter.[4] Increasingly, however, New York courts are recognizing the need to supplement the attorney general's powers with private enforcement of gift restrictions and have relaxed standing requirements when private parties have a "special interest" in the charitable gift.[5]

JOHN C. NOVOGROD *is a partner and* ANNIE L. MEHLMAN *is an associate of Kramer Levin Naftalis & Frankel.* MELISSA B. MILICH, *a law clerk, assisted in the preparation of this article.*

This article will discuss the general common law, New York statutory law, and recent decisional law governing charitable gift enforcement, the role of the attorney general to oversee the administration of charitable funds, and private enforcement of charitable gifts. In addition, this article will offer recommendations regarding techniques to better ensure that charities comply with donor intent when administering charitable gifts.

> Not surprisingly, as donors become more charitably minded and make larger, more significant contributions, they **desire greater control over the administration** of their gifts.

Charitable Trust Law and Enforcement under the Common Law. At common law, the attorney general represents the public interest in the administration and enforcement of charitable gifts. Thus, courts rarely grant private parties standing to pursue enforcement actions.[6] When a donor makes a completed gift to a charity, whether outright or in trust, he thereafter does not have standing to enforce the terms of his gift unless he expressly has reserved an enforcement right.[7] The reason is clear: The donor of a completed charitable gift no longer possesses a legal or beneficial interest in the gifted property and thus has no legal standing to complain about the charity's administration of his gift. Instead, in most cases, the state, acting through its attorney general, is responsible for enforcement of the terms of a charitable gift.[8]

New York Statutory Law. New York statutory law codifies common law standing principles, limiting the ability of a private party to enforce restrictions on charitable gifts. In New York, the Estates, Powers and Trusts Law (EPTL) and the Not-for-Profit Corporation Law (N-PCL) charge the attorney general with the duty to oversee the administration of charitable assets in the state, to protect the public interest in charitable dispositions, and to enforce the laws governing the conduct of fiduciaries of charitable organizations.[9]

Special Interest Standing. Although standing to sue a charitable organization for a breach of fiduciary duty traditionally has been limited to the attorney general, courts have granted standing to private parties with a "special interest."[10] This exception has been applied to charitable trusts and gifts made to charitable corporations for a specific stated purpose (such gifts are deemed to be held in trust by the charity), in contrast to gifts for general use.[11] Such gifts create a legally enforceable obligation on the charitable corporation to administer the gift consistent with the donor's intent.[12] Failure to do so is a breach of the charity's fiduciary responsibilities.[13] Together with the attorney general,[14] a donor or potential beneficiaries may have standing to sue the charity for a breach if they can establish a "special interest" in the charitable gift.[15]

Beneficiary Standing to Enforce Charitable Dispositions. Invoking the "special interest" doctrine, courts have relaxed standing requirements and have found that certain beneficiaries of a charitable gift have standing to enforce the gift's restrictions. In determining whether to exercise its discretion to grant "special interest" standing, courts will examine a variety of factors, such as the nature of the benefited class and its relationship to the gift.[16] For example, in *Alco Gravure v. Knapp*, the court afforded potential beneficiaries of a charitable corporation "special interest" standing when the class of beneficiaries was "sharply defined and limited in number."[17] In *Chase v. Pevear,* the court granted "special interest" standing to the beneficiary named in a gift over provision that stood to receive the gifted property if the donee charity did not comply with the gift's restrictions.[18]

Courts also consider whether the class of beneficiaries can easily be entered into, whether the plaintiff has a direct interest in the operation of the trust, the remedy sought by the plaintiff, fraud or misconduct by the charity or its directors, and the attorney general's » Page 14

Making Disclaimer Work for Minors

Navigate differences between N.Y. Law and the IRC.

BY DARCY M. KATRIS AND EMELIA G. SHORT

Both New York's EPTL §2-1.11 and Internal Revenue Code §2518 permit an individual to disclaim[1] an interest in property transferred to him or her if certain conditions are met. Although the conditions in the EPTL and IRC are similar in many respects, there are some differences.

If the conditions in IRC §2518[2] are not satisfied, the disclaimer will not be a "qualified disclaimer" and will be treated as a taxable gift for federal tax purposes. Under the EPTL, unless the transferor of the disposition has provided otherwise, the disclaimed interest passes as if the disclaimant predeceased the transferor, thereby satisfying one of the requirements of IRC §2518, that the property pass without any direction on the part of the disclaimant. Tax planning is a common reason why someone would want to disclaim an interest in a trust or a bequest under a will. In certain cases, it may be desirable for a minor to disclaim an interest in an estate or trust such as to avoid estate or GST tax consequences.

DARCY M. KATRIS *is a partner and* EMELIA G. SHORT *is an associate at Hodgson Russ.*

The treatment of minors as disclaimants is more liberal under the IRC than under the EPTL. IRC §2518 permits a minor to disclaim property until the later of nine months after the transfer of property or nine months after the minor reaches age 21. EPTL §2-1.11 provides that a renunciation must occur within nine months after the "effective date" of the transfer and does not contain a provision similar to the IRC to extend the period for a minor to renounce. Therefore, other approaches must be explored. One option is to request the court extend the period for a minor to renounce. EPTL §2-1.11(c)(2) provides that the court may grant such extension upon a showing of reasonable cause. This option is both expensive and uncertain. Courts have found reasonable cause to extend the period for minors to renounce in some circumstances. For example, where the minor recipient was deceased and had never received distributions from a trust, the time was extended for his personal representative to renounce his interest in the trust.[3]

In cases not involving minors, courts have granted an extension of time to renounce where: (i) the beneficiary was afflicted by shock and grief after losing both parents in a short time span,[4] (ii) three siblings intended to renounce and one missed the period due to the birth of a child,[5] (iii) the renunciation was » Page 13

BIGSTOCK

Top 10 Developments, Lessons And Reminders Of 2013

BY SHARON L. KLEIN

From landmark legislation, to important regulatory guidance to instructive case law, 2013 saw many significant New York developments, lessons and reminders.

1. Last minute reprieve prevents loss of tax abatement for apartments held in trust. Since 1996, New York City has offered a partial property tax abatement program for cooperative apartment and condominium owners. The abatement is designed to eliminate the disparity in real property tax, which is assessed at a much higher value against those unit holders than against holders of family homes. Under the abatement renewal enacted in January 2013, the abatement would have been lost if a cooperative or condominium unit were held by a trust or in a limited liability company (LLC). Although it was designed to limit the abatement's benefit to primary residence holders, the new law penalized those primary residence holders who transferred their units to trusts or LLCs as part of their estate planning or for privacy reasons. Under a new law enacted on July 3, 2013,[1] the abatement will not be lost if a unit is held in trust for a person otherwise eligible for the abatement. Among other comments made in its support of the proposal, the New York City Bar has recommended that the abatement be expanded to include single member LLC and legal life estate forms of ownership, as well as trusts.

2. Lesson & Reminder: New York does not permit incorporation by reference. *Matter of D'Elia*,[2] is a stark reminder of the general rule in New York with respect to incorporation by reference: "[A]n unattested paper which is of a testamentary nature cannot be taken as part of the will even though referred to by that instrument."[3] However, New York's Estates, Powers and Trusts Law (EPTL) §3-3.7 does permit a testator to make a pour-over bequest to a trust, provided the trust instrument is executed and acknowledged in the manner required for the recording of a conveyance of real property, prior to or contemporaneously with the execution of the will. In *Matter of D'Elia*, the decedent signed his will and a trust agreement, which created a family trust into which the residue of his estate poured, on the same date. However, the trustee did not sign the trust agreement until a week later. The will provided that, if the pour-over disposition to the trust was inoperative or invalid for any reason, the decedent incorporated by reference the terms of that trust. Because New York does not recognize incorporation by reference, that default disposition was ineffective and the only way to hold the pour-over bequest valid was to satisfy the requirements of EPTL §3-3.7. Despite acknowledging that the benefits of the decedent's estate planning would be affected by finding the pour-over invalid, the court held that the residuary bequest failed. Since the trustee did not sign the trust agreement until a week later, the trust was not in existence at the time the will was signed, and the "unavoidable result" was that the pour-over was invalid, resulting in intestacy—an important reminder for attorneys regarding the timings of executions.

SHARON L. KLEIN *is managing director of family office services and wealth strategies at Wilmington Trust, N.A. and chair of the Trusts, Estates and Surrogate's Court Committee of the New York City Bar.* THERESA FORTIN, *a wealth advisory associate at Wilmington Trust, contributed to the preparation of this article.*

Note also that EPTL §3-3.7(e) further provides that, even if the requirements of EPTL§3-3.7 are satisfied, a revocation or termination of the pour-over trust before the death of the testator will cause a pour-over disposition to fail, potentially resulting in intestacy. As a result, many attorneys laboriously restate identical dispositive provisions in the will in order to provide an alternate disposition. A bill that has been introduced in the Senate[4] would allow a testator to expressly direct in a will that, should a pour-over trust be terminated or revoked, the disposition would not fail but would constitute a disposition to a testamentary trust with identical terms to the revoked trust. The proposal was amended from a prior version to apply only to termination and revocation by someone other than the settlor (for example, an age related termination or principal exhaustion). The rationale for the change was that, if the testator revoked the trust, most likely that was an indication that the disposition in the will to the trust was intended to fail. However, the carve-out for settlor revocations would also exclude a » Page 13

Inside

Revocable Inter-Vivos Trusts: Avoid Probate but Not Substantive Wills Rules

BIGSTOCK

BY WILLIAM SCHWARTZ

The revocable inter-vivos trust is the cornerstone of modern estate planning. Despite the settlor's retention of control over the disposition of the trust's assets until the settlor's death, the trust will govern the disposition of the assets at the settlor's death without the trust being admitted to probate.

Given the extensive control retained by the settlor to revoke and/or amend the trust, in whole or in part, the question arises as to whether this "will substitute" should be subject to the substantive rules relating to wills, even though there are different formalities incident to the execution of a revocable inter-vivos trust than a will. Legislatures, courts, and legal commentators are focusing on this issue, in many instances, in the context of statutes which were enacted prior to the ascendancy of the revocable inter-vivos trust and which refer explicitly only to wills. Prof. John H. Langbein has persuasively noted:

> The owner who retains both the equitable life interest and the power to alter and revoke the beneficiary designated has used the Trust form to achieve the effect of testation. Only nomenclature distinguishes the remainder interest created by a Trust from the mere expectancy arising under a Will.[1]

To the extent that a court concludes that a substantive wills rule is applicable to the revocable trust we are then left with the further issue whether curative doctrines and statutes applicable to wills also govern the revocable trust.

Substantive Doctrines

Exculpatory Clauses. With respect to substantive rules, many of the relevant New York statutes explicitly refer only to wills or testamentary trusts. Thus, for example EPTL §11-1.7 provides that a provision in a will exculpating an Executor or a testamentary trustee from liability for negligence is contrary to public policy and void. Historically, because the statute explicitly refers only to Executors and testamentary trustees, the statute has been held inapplicable to inter-vivos trusts.[2] Yet, more recently, there have been decisions extending the policy of the statute to inter-vivos dispositions.[3]

While these cases do indicate a judicial willingness to extend EPTL §11-1.7 to inter-vivos trusts, at least to the extent they invalidate provisions which exempt a trustee from a duty to account, they do not deal specifically with the issue of an inter-vivos trust that requires accountings but that contains a clause exculpating a trustee from liability for negligence.

It is interesting to note that the New York Prudent Investor Act authorizes a trustee of an inter-vivos trust to delegate investment and management functions but requires the trustee to exercise care in making the delegation.[4] The act provides that the requirements of the statute govern trustees "except as otherwise provided by the express terms and provisions of a governing instrument within the limitations set forth by Section 11-1.7...."[5] We are then confronted with a circular dilemma. If the trust contains an exculpatory provision sanctioning negligent conduct by a trustee of an inter-vivos trust in exercising the delegation function, this clause will be given effect under the act unless the limitations of EPTL §11-7 are applicable to the inter-vivos trust. That then raises the question of whether the provisions of EPTL §11-7 are applicable to inter-vivos trusts. Support for the view that it should be applicable in the delegation context is derived from the Prudent Investor Act's provision that the delegee has a duty to exercise reasonable care and that "[a]n attempted exoneration of the delegee from liability for failure to meet such duty is contrary to public policy and void."[6] If the delegee cannot be exonerated from liability for negligence, then should the trustee be able to have sanctuary in exercising the delegation function because of an exculpatory clause in an inter-vivos trust?

Lapse. The common law rule is that a bequest or devise lapses if the legatee or devisee predeceases the testator.[7] A question arises as to whether this doctrine is applicable to a revocable trust. The problem may not arise frequently since it will be inapplicable if the trust instrument provides (as it should) for an alternative gift if the beneficiary fails to survive the settlor.[8] Yet, because of poor draftsmanship, the contingency of the remainder person not surviving the settlor may not be provided for in the trust. If the lapse rule is applicable to such a trust, we then have the secondary problem as to whether New York's anti-lapse statute is applicable. That statute specifically prevents a lapse from occurring in certain circumstances unless the will when executed provides otherwise.[9] Is the statute applicable to will substitutes such as the revocable inter-vivos trust?

Ademption. When property specifically disposed of by will is not in existence at the trustee's death or has been sold or transferred to others during the testator's lifetime, the gift is extinguished regardless of the testator's intention under the doctrine of ademption.[10] In New York, there are also statutes dealing with the doctrine. Thus, by statute, no ademption occurs merely because an executory contract to sell property (without a sale having occurred) is in force at the time of the testator's death.[11] By statute, if, during the testator's lifetime, a conservator of a now incompetent testator sells property that the testator has specifically gifted in his will, no ademption occurs with respect to the proceeds of the sale which remain at death and to any remaining property into which the sale proceeds may be traced.[12] Pursuant to statute, if insurance proceeds from property that was specifically disposed by will are paid after the testator's death, the specific legatee or devisee may reach the insurance proceeds to the extent of the value of the specific disposition.[13] The issue is whether the wills doctrine of ademption is applicable to the revocable trust and, if it is, are the curative statutes applicable as well? The curative statutes explicitly refer to wills and have no reference to inter-vivos trusts.

Wasserman v. Cohen[14] has been widely cited for the proposition that the common law doctrine of ademption is applicable to specific dispositions under revocable trusts. The case is somewhat distinguishable because the property involved in that case was sold by the settlor prior to the death of the settlor of the trust but had not been transferred to the trust prior to the settlor's death (but would have been distributed to the trust under the pour-over provisions of the settlor's will). The assets would have been part of the probate estate initially (had it not been sold) until the pour-over occurred. Thus, the case may actually be viewed as an application, in part, of the wills branch of the ademption doctrine.

Abatement of Legacies. In the case of testamentary beneficiaries, there is a statutory order for legacies to abate if there are insufficient assets to satisfy all gifts under a will.[15] Is there a similar order of abatement of dispositions under a revocable trust if there are insufficient assets to satisfy all of the dispositions after the settlor's death? An Illinois intermediate court has applied the wills rules relating to abatement to a revocable inter-vivos trust and, in the course of doing so, provided a cogent summary of the policy reasons for extending the wills doctrines to revocable trusts.[16] It should be noted, however, that more recently the Illinois Supreme Court avoided deciding the general issue of whether wills rules are applicable to will substitutes by concluding that the wills concept sought to be applied would not have been applicable evidently even with respect to a testamentary disposition in the circumstances of the case.[17]

Other Wills Statutes. The question of the applicability to a revocable trust of other statutes which explicitly refer only to wills is present with respect to other will statutes including those relating to in terrorem clauses,[18] advancements,[19] whether there is residue within a residue,[20] whether a beneficiary to whom the income of an annuity which the settlor has directed to be purchased for the benefit of a beneficiary may elect to take the capital sum,[21] exoneration of liens,[22] and if substantially all or the bulk of the decedent's assets are transferred through a revocable trust, whether a child who is born after the execution of the trust may receive a share of the trust pursuant to EPTL §5-3.2 which refers specifically to the rights of a child born after the execution of a will.

> It is interesting to note that the **New York Prudent Investor Act** authorizes a trustee of an inter-vivos trust to delegate investment and management functions but requires the trustee to exercise care in making the delegation.

Given the growing trend towards the use of pour-over clauses in wills pursuant to which probated assets are to be added to a revocable trust,[23] the will and the trust should be viewed as part of an integrated or unified estate plan and should be governed by the same substantive rules.[24]

Applying Wills Rules to Trusts

Indeed, the New York legislature has seen fit, on occasion, to amend existing legislation so as to extend the applicability of a wills statute to a revocable trust. Thus, EPTL §51.4 now provides that a divorce revokes a provision for a divorced spouse in a revocable trust as well as other will substitutes.

Similarly, the legislature has provided in EPTL §51.1-A, that the revocable trust is a "testamentary substitute" and reachable by a surviving spouse in satisfaction of the elective share. In addition, as a logical corollary to EPTL §73.1 and EPTL §1010.6, creditors of the settlor should be able to reach the assets of the inter-vivos trust at least in the instance where the settlor's estate is insolvent.[25]

The New York legislature has now modified the so-called "simultaneous death" statute so as to provide for a presumption of no survivorship unless there is clear and convincing evidence of survival by one person of another by 120 hours. The statute is explicitly applicable to inter-vivos trusts.[26]

A New York statute dealing with distributions in kind to satisfy a pecuniary disposition is applicable to trusts as well as wills.[27] By statute, a reference in an instrument to a "minor" means a person who has not attained the age of 21 or the age of 18 depending on when the instrument was executed. Because it refers to the "creator"[28] having the power to expressly provide otherwise, such statute is thus applicable to a revocable trust. "Creator" is defined in the EPTL as "a person who makes a disposition of property."[29] Likewise, the New York disclaimer statute is also explicitly applicable to revocable trusts.[30] Formula clauses which refer to tax terms such as, for example, "marital deduction" or "unified credit" are defined by statute as referring to the definition of such terms in the federal estate tax law and the statutes are explicitly applicable to trusts.[31]

Capacity

There is also the question of whether the settlor's capacity to create a revocable trust should be the same as the capacity to make a valid will. It has been held that a charitable remainder unitrust is more analogous to a contract than a will and thus the higher capacity standard for the execution of a contract is controlling.[32] Since a revocable trust is a will substitute, the will standard should govern and that is the position taken by the Uniform Trust Code.[33]

Lost Trust: Revocation Presumed

If a will is lost or destroyed, there is a rebuttable presumption that the will was revoked.[34] Is there a similar presumption with respect to a lost or destroyed revocable trust? The issue was raised in *Estate of Cohen*[35] with respect to another will substitute—a contract to make a will and to not change a will. The New York Court of Appeals, however, avoided a resolution of the issue by disposing of the matter on other grounds and noted that the Surrogate had rejected on "credibility grounds" the claimed revocation.

In *Matter of Pilafas*,[36] an Arizona court held that a lost revocable trust was not revoked. The court relied on the Restatement of Trusts, 2d, which has now been changed by Restatement of Trusts, Third.[37] The court also based its decision on the language of the trust, which provided that the trust may be revoked "by instrument in writing delivered to the Trustee" as precluding other modes of revocation.

Power of Attorney

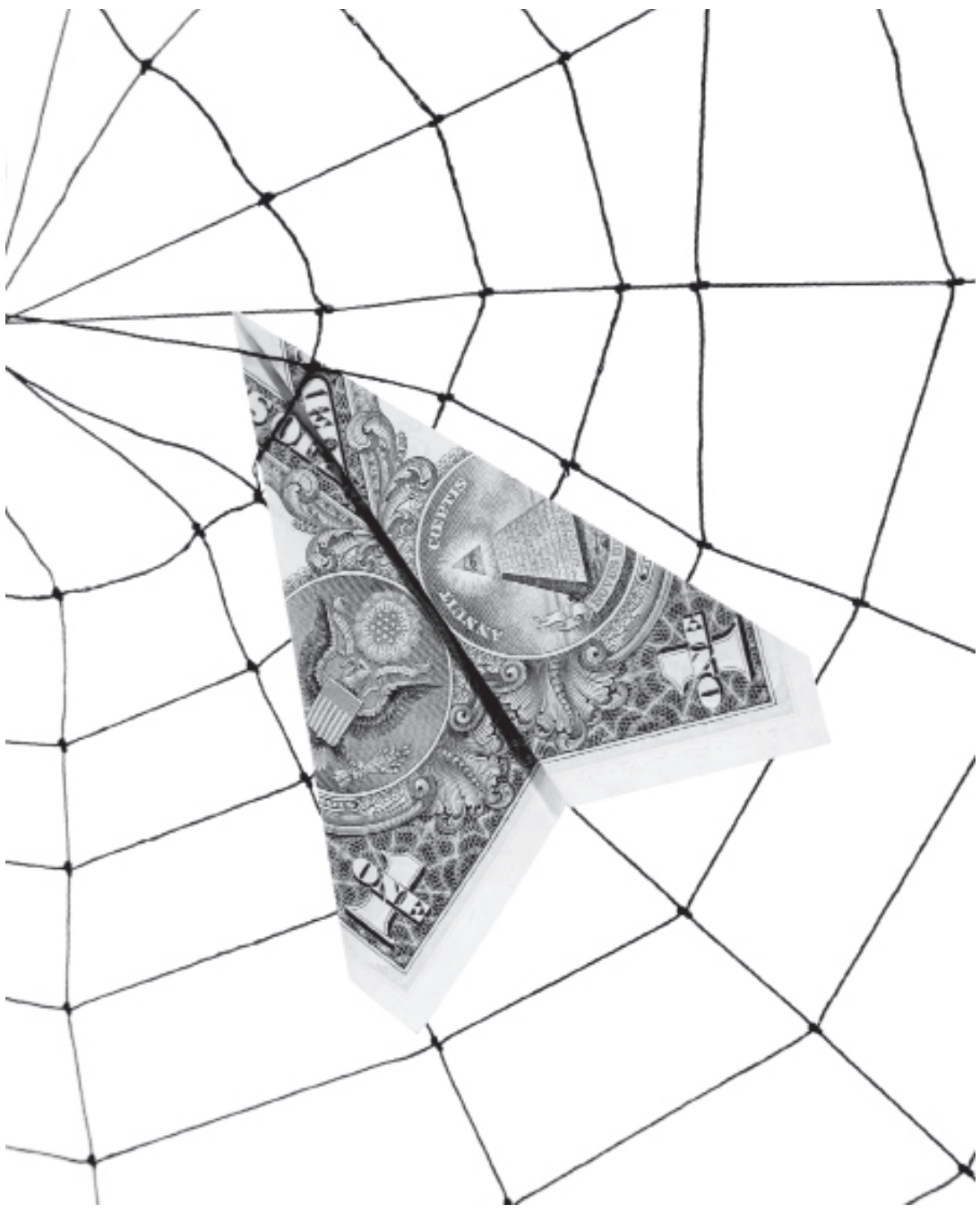
It should be noted that, pursuant to GOL §5-1514, by executing a statutory gifts rider, a principal may confer upon an agent the power to create, amend, revoke or terminate an inter-vivos trust. Evidently, no power can be conferred upon an agent to change a will.

Conclusion

While the revocable trust is deemed to be perfected, for probate purposes, upon its creation, it is not necessarily illogical to subject the trust to certain will concepts. After all, while the trust avoids probate, it is includible in the settlor's gross estate for federal estate tax purposes.[38] Furthermore, like a will, the period of the rule against perpetuities commences to run with respect to the interests created by a revocable trust, normally, on the date of the settlor's death.[39] Thus, the matter should be viewed from the perspective of relativity, in which the trust, for some legal purposes is deemed to be created immediately and for all others it remains unperfected until the settlor's death.

1. J.H. Langbein, "The Non-Probate Revolution and the Future of the Law of Succession," 97 Harv. L. Rev. 1106, 1113 (1984).
2. See, e.g., *Application of Central Hanover Bank & Trust*, 26 N.Y.S.2d 924, aff'd, 32 N.Y.S.2d 128, aff'd, 288 N.Y. 608.
3. *Matter of Kassover*, 124 Misc.2d 630 (Sur. Ct. Nassau Cty. 1984); *Petition of Kornrich*, 19 Misc.3d 663, 854 N.Y.S.2d 293 (2002).
4. EPTL §11-2.3(c).
5. EPTL §11-2.3(a).
6. EPTL §11-2.3(c)(2).
7. 12 Warren's Heaton on Surrogate Court Practice, §204.03[1].
8. Id.
9. EPTL §3-3.3.
10. Supra note 7 at §§204.01[1][4].
11. EPTL §3-4.2.
12. EPTL §3-4.4.
13. EPTL §3-4.5.
14. 414 Mass. 172, 606 N.E.2d 901 (1993).
15. EPTL §12-1.2.
16. *Handelsman v. Handelsman*, 366 Ill. App. 3d 1122, 852 N.E.2d 862 (Ill. App. 2d Dist. 2006).
17. *Estate of Boyar*, 986 N.E.2d 1170 (Ill. Supreme Court, April 4, 2013). The concept involved in the case was whether a beneficiary who accepts benefits from a trust may challenge an amendment of the trust naming an individual as the sole trustee. The trustee sought to invoke a doctrine known as "election" and the Supreme Court of Illinois held that the rule would not have been applicable even to a will.
18. EPTL §3-3.5.
19. EPTL §2-1.5.
20. EPTL §3-3.4. The question assumes that the trust has a provision comparable to a residue clause. A partial failure of a remainder interest in a trust is dealt with in EPTL §2-1.5.
21. EPTL §3-3.9.
22. EPTL §3-3.6.
23. See EPTL §3-3.7.
24. See the articulation of this view in *Clymer v. Mayo*, 393 Mass. 754, 473 N.E.2d 1084 (1985).
25. See *Estate of Martin*, 686 N.Y.S.2d 195 (App. Div. 3d Dept. 1999). It is not, however, clear whether the assets in a revocable trust may be reached by a decedent's family to satisfy the set-off rights available to the family unit under EPTL §5-3.1.
26. EPTL §2-1.6.
27. EPTL §2-1.9.
28. EPTL §2-1.10.
29. EPTL §1-2.2.
30. EPTL §2-1.11.
31. EPTL §§2-1.12 and 2-1.13.
32. *Estate of ACN*, 509 N.Y.S.2d 966 (Surr. Ct. N.Y. Cty. 1986).
33. Uniform Trust Code, §601.
34. Surrogate's Court Procedure Act, §1407.
35. 83 N.Y.2d 148, 608 N.Y.S.2d 398, 629 N.E.2d 1356 (1994).
36. 836 P.2d 420 (Ariz. App. 1992).
37. Restatement of Trusts, Third, §7.2.
38. Internal Revenue Code, §2038.
39. See Schwartz, Future Interests and Estate Planning, §§6.12, 6.13 (1965).

WILLIAM SCHWARTZ *is counsel to Cadwalader, Wickersham & Taft; University Professor of Law, Cardozo Law School; and former Dean, Boston University School of Law.*



BIGSTOCK

Automatic Allocation Of GST Exemption: Traps for the Unwary

BY JAY D. WAXENBERG, ANDREW M. KATZENSTEIN AND MAGGIE MOURADIAN

Dynasty trusts for the benefit of succeeding generations are standard tools in every estate planner's toolkit. Some practitioners and their clients rely on automatic allocation of generation-skipping transfer (GST) tax exemption to these trusts to keep them exempt from GST tax.[1]

Without careful planning, however, the automatic allocation may not take place, making the intergenerational tax savings unavailable.

'Hanging Powers' Trap

One common type of dynasty trust, the so-called Crummey trust, grants beneficiaries a right of withdrawal over contributions (Crummey powers) made to the trust. Crummey powers allow these contributions to qualify for the annual gift tax exclusion by converting what would otherwise be a future interest gift to a present interest gift.[2] Although Crummey powers can avoid gift tax on trust funding, they may result in undesirable implications in the GST context.

A Crummey power is a general power of appointment. It empowers the beneficiary to withdraw trust assets that is not limited by an ascertainable standard.[3] In most cases, the beneficiary powerholder allows this Crummey power to lapse unexercised, which is treated as a gift by the powerholder to the other trust beneficiaries.[4] There is, however, an important statutory exception to this gift tax treatment.

Under the "five-and-five rule," the lapse of a general power of appointment is not treated as a gift to the extent it does not exceed the greater of $5,000 or 5 percent of the aggregate value of the trust assets (the "five-and-five amount").[5] Most practitioners draft trusts with "hanging powers," which provide that in any given year a beneficiary's right of withdrawal continues, or "hangs," with respect to the amount of principal he or she can withdraw in excess of the five-and-five amount, avoiding a gift by the power holder caused by a lapse of the withdrawal power for any amounts in excess of the five-and-five amount. Such amount would be includible in the beneficiary's gross estate if the beneficiary died while the power was still hanging.

The problem from a GST perspective is that the beneficiary's retained hanging power can prevent the automatic allocation of GST exemption to the Crummey trust. Automatic allocation only applies to transfers made to a "GST trust."[6] A GST trust is broadly defined as any trust that could have a generation-skipping transfer occur with respect to the grantor unless it falls within one of six exceptions.[7] Under one of these exceptions, a trust is not a GST trust if any portion of it would be included in the gross estate of a non-skip person (other than the grantor) if such person died immediately after the transfer.[8]

This exception would appear to apply to Crummey trusts in which a spouse, child or other non-skip person holds a hanging power because the amount subject to the hanging power would be includible in such beneficiary's estate. However, to prevent all Crummey trusts from falling outside the definition of a GST trust, the statute provides an exception to the exception: The value of transferred property is not deemed to be includible in the gross estate of a non-skip person to the extent of the annual exclusion amount.[9] Thus, if the hanging power applies to an amount with respect to all non-skip beneficiaries of a Crummey trust that falls within the annual exclusion amount (and the trust does not fall within any of the other five exceptions, which is assumed throughout this article), the trust will be considered a GST trust, resulting in automatic allocation of GST exemption.

While this exception to the exception may qualify a Crummey trust as a GST trust in the first year an annual exclusion gift is made to the trust, it may not qualify as a GST trust in the second year if an additional annual exclusion gift is made at that time. Consider the following example:

Example. In 2013, T transfers $14,000 to a new irrevocable life insurance trust for the benefit of his son, C, remainder to C's (as yet unborn) issue. C is granted a 30-day Crummey withdrawal power with respect to the $14,000 contribution. C allows his Crummey power to lapse unexercised. T makes no other gifts during 2013.

Because C was granted a Crummey power, the entire $14,000 contribution is covered by the annual gift exclusion ($14,000 per donee in 2013). T is not required to file (and he does not file) a Form 709 (gift tax return) for 2013 since he did not make any other gifts that year.[10] Consequently, no affirmative allocation of GST exemption (made on a Form 709) was made to the trust in 2013. Because the amount subject to C's right of withdrawal is within the annual exclusion amount, automatic allocation of GST exemption applies to the trust, resulting in a zero inclusion ratio for the trust at the end of 2013.[11] However, at the end of the 30-day period, $5,000 of C's Crummey power lapses, and the remaining $9,000 hangs.

In 2014, T makes an additional transfer of $14,000 to the trust and makes no other gifts during that year. Again, this contribution is covered by the annual gift exclusion ($14,000 per donee in 2014), and T does not file a Form 709 for 2014. Because C now has a right of withdrawal as to the $14,000 contribution made in 2014 *and* the $9,000 hanging amount carried over from 2013, his total right of withdrawal is $23,000, which is greater than the annual exclusion amount. Consequently, the trust is no longer a GST trust, and the automatic allocation rules will not apply to the gifts made to the trust in 2014.

> One common type of dynasty trust, the so-called **Crummey trust**, grants beneficiaries a **right of withdrawal over contributions** (Crummey powers) made to the trust.

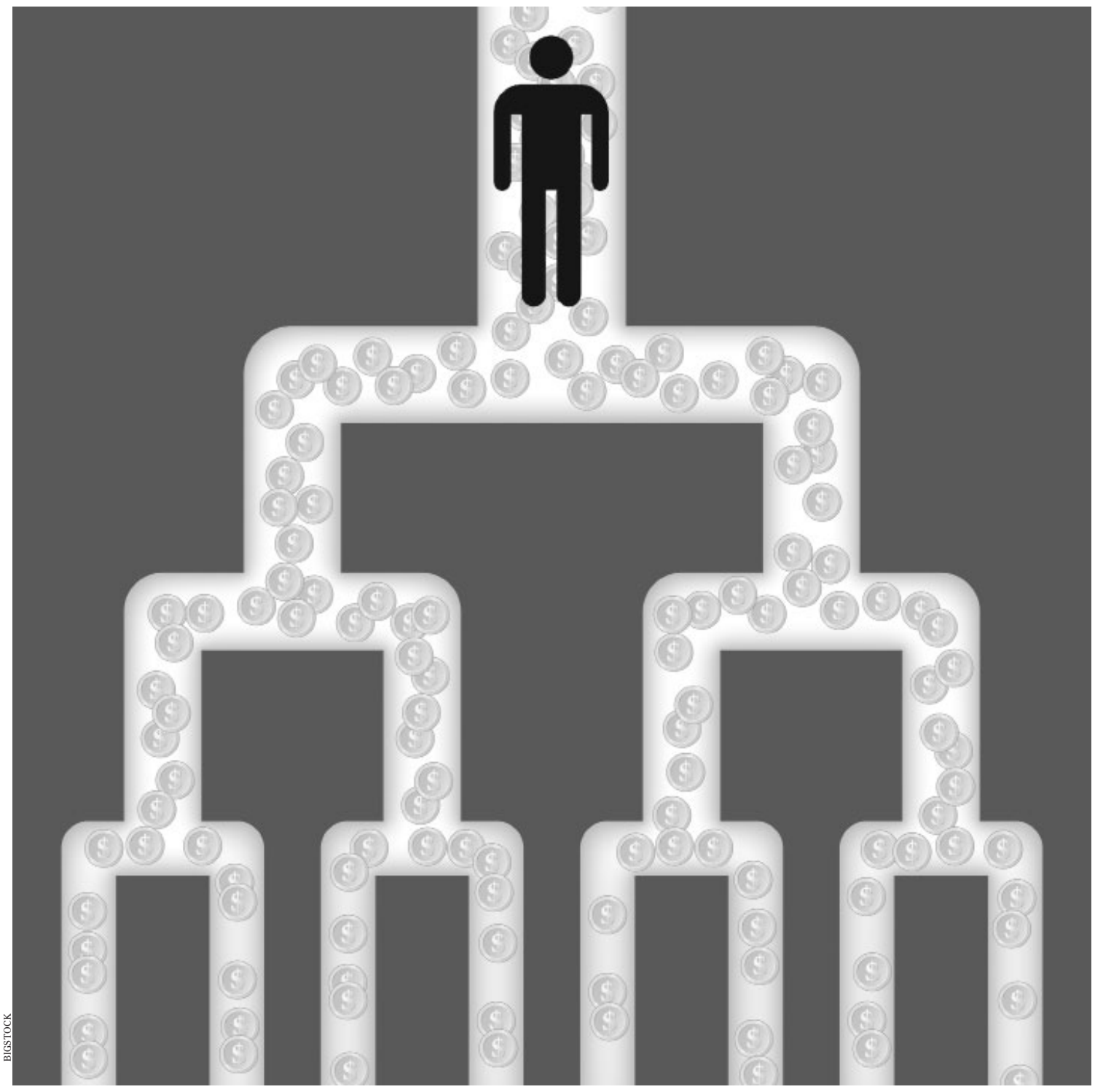
Suppose T makes $14,000 transfers to the trust each year for another 13 years. T does not file a Form 709 with respect to any of these years. When T dies, the trust collects life insurance proceeds of $2 million. Because T's GST exemption was automatically allocated to the trust only in 2013, the inclusion ratio of the trust upon T's death would be 0.9333 (i.e., 1 – (1/15)). The insurance proceeds are invested during C's lifetime so that at the time of C's death the trust is worth $4 million. Upon C's death, the entire trust estate passes to C's issue, resulting in a taxable termination and a GST tax of $1,493,333 at the applicable 40 percent rate (i.e., $4,000,000 x 0.9333 x 40 percent).

If GST exemption had been allocated on a Form 709 to all gifts to the trust (i.e., a total use of $14,000 x 15 years = $210,000 of T's GST exemption), the trust would have been fully GST exempt. The entire $4 million passing to C's issue would be » Page 14

JAY D. WAXENBERG *is a partner at Proskauer Rose in New York.* ANDREW M. KATZENSTEIN *is a partner and* MAGGIE MOURADIAN *is an associate in the Los Angeles office.*

'Brewer' Raises New Issues Regarding Estate Distribution

BY TERENCE E. SMOLEV AND CHRISTINA JONATHAN



BIGSTOCK

News reporters, law enforcement agents, attorneys and public spectators overflowed the Nassau County Surrogate's Court last month to witness the fate of Leatrice Brewer's (Brewer) claim to her children's estates. Brewer brutally murdered her three innocent children and then sought to collect hundreds of thousands of dollars from their estates.

On March 7, 2012, the Nassau County Supreme Court issued an order that directed the wrongful death proceeds of two of Brewer's children to be held in escrow until the Surrogate's Court issued a decree to distribute the same. Thus, the Surrogate's Court had to compromise the wrongful death order by first ascertaining who the distributees are, which included Brewer, the children's fathers, the children's siblings, grandparents and unknown heirs. Then the court could decide who would be qualified to take the net proceeds of the settlement, pursuant to the applicable statutes and case law.

Surrogate Judge Edward W. McCarty III, who was a former assistant district attorney, stated in his opening remarks that during his career he "walked through over 100 nightmarish homicide scenes. The photographs of [Brewer's] homicide scene makes it one of the worst that I have experienced." On Feb. 28, 2008 at about 4 a.m., 27-year-old Brewer went into her 8-year-old daughter's bedroom and slit the sleeping child's throat. She then drowned her infant son in the bathtub and laid him in his sister's bloody bed. Brewer noticed that her daughter was still alive, drowned her and returned her to bed. She then drowned her other son and laid his dead body besides his brother and sister. Finally, Brewer attempted to kill herself three times, and after failing, she called 911.

Apparently, the Westbury community and Child Protective Services (CPS) were individually and collectively absent for the cries of help from Brewer and neighbors over the years, which lead to the wrongful death action on behalf of the children. The children's brutal murders resulted in a $350,000 financial settlement by Nassau County due to CPS' negligence. Surrogate McCarty expressed his disappointment in CPS, who in 1978 also failed a young boy who was beaten and bitten over 24 times by his mother in that same New Cassel community. CPS pledged to never allow this grave negligence to happen again. The Brewer children's deaths indicate otherwise.

It was undisputed that Brewer murdered her three children. However, she was never convicted of the crime due to her severe mental illness. Brewer genuinely believed that the death of her children would break a voodoo curse under which they had been living. At first blush, it may seem obvious that Brewer should not be entitled to any part of her children's Estate since the settlement was a direct result of her murders. Surprisingly, there were very persuasive arguments made to support Brewer's claim and the current law.

Brewer's attorneys relied on several insanity cases that allowed distributees to collect from their victim's estate. Some of these cases included *Matter of Wirth*, 59 Misc. 2d 300, where a husband was entitled to his intestate distributive share even though he killed his wife, because he was found not criminally responsible by reason of insanity. In *Matter of Fitzsimmons*, 64 Misc. 2d 622, an insane man murdered his parents and was entitled to his distributive share. Further, in *Matter of Eckardt*, 184 Misc. 748, a woman was acquitted of killing her husband while sleepwalking in a somnambulist state, and was entitled to take her distributive share. Brewer's position, supported by these cases and several more, was that a person who is not found guilty by reason of mental illness is excused from criminal punishment of the crime.

In his decision dated Dec. 23, 2013, Surrogate McCarty described *Brewer* as a "classic illustration of the equitable dilemma between two moral public policies." The distinguishing factor that ultimately lead to McCarty's ruling was that none of the insanity cases were ever addressed in the context of a wrongful death proceeding. This was the first time that a New York Surrogate's Court had to decide the specific issue of "whether a person who pleads guilty by reason of mental disease or defect in a criminal proceeding is disqualified from sharing in the proceeds of a wrongful death compromise arising out of the killing of her children at her own hands."[1]

The starting point of the legal arguments was based on the well-established law that "one who takes the life of another should not be permitted to profit from his own wrong and shall be barred from inheriting from the person slain." *Riggs v. Palmer*, 115 N.Y. 506. In *Riggs*, a grandson was disqualified from taking an inheritance in his grandfather's estate because he murdered his grandfather solely to inherit. In that case, "the Court of Appeals articulated the long-accepted principle 'that no one shall be permitted to profit by his own fraud, or to take advantage of his own wrong, or to found any claim upon his own iniquity, or to acquire property by his crime,'" as noted by Surrogate McCarty in his decision. Interestingly, there are no express statutory provisions denying a murderer from inheriting from the victim. Nevertheless, the numerous cases since *Riggs* reaffirmed the common law principle that one should not profit from his crime. Such person is precluded from becoming a distributee of the victim's estate.

Brewer was not as straight forward though, since Brewer was never convicted of the three children's murders. The expert opinions of two board certified psychiatrists, hired by the Nassau County District Attorney, concluded that Brewer was not responsible for their murders due to her "inability to substantially understand the nature and consequences of her action due to the mental disease," as acknowledged by McCarty during the hearing.

Psychiatry and questions of culpability for individual actions have a significant history in the law, absolving individuals of their murders due to mental defect/disease, as previously discussed herein. However, there is a lower standard of mens rea applicable in the civil context, in which Brewer possessed the requisite intent for disqualification as a distributee. The ultimate distinguishing factors in *Brewer* is that Brewer intended to kill all three of her children that night and that the estates would not have been funded but for these murders. Hence, the unique legal principles of *Brewer* created new law, which Surrogate McCarty labeled the Brewer rule:

> [A] person found not responsible for a crime due to mental disease or defect who has the ability to recognize that her conduct was morally wrong when undertaken shall not financially benefit from that action.

It is well established that one who comes into equity must come with clean hands, a maxim known by every law student. McCarty's decision was guided by this very principle. He reasoned in his decision:

> [W]hile this court has struggled with the plea of not guilty by reason of mental disease or defect, the court is also cognizant of Leatrice Brewer's admission concerning the methodical manner in which she took the lives of her three children. To ignore Leatrice Brewer's own admissions concerning her children's deaths by allowing her to share in a fund which would otherwise not have existed but for her conduct, disturbs the conscience of the court.

Surrogate McCarty described 'Brewer' as a "classic illustration of the **equitable dilemma** between two moral public policies."

Often, judges turn to equity when a legal decision does not feel right. Here, the decision resulted from that sinking feeling of repugnancy if Brewer was allowed to financially profit from the gruesome murder of her three innocent children. Surrogate McCarty grounded the Brewer rule in equity by adopting the dissent in the Ford decision:

> [T]he fact that the state cannot criminally punish an insane defendant is irrelevant to a determination of whether it is equitable for the killer to inherit from the victim. It is one thing to say that the state should not imprison one who was insane when she committed the murder. It is quite another to say that the insane murderer can profit from her crime. The only relevant focus here must be upon the killer's moral and personal responsibility for the crime.[2]

McCarty's decision was not based on the mechanical application of the insanity defense, which would absolve a person with a mental disease or defect from a crime. Brewer was always cognizant of the fact that she murdered her three children, which she admitted in her plea allocution for the criminal trial. The children's deaths were exactly the results that Brewer intended, and the court "will not relieve Ms. Brewer from moral responsibility." The Brewer rule, grounded in morality and equity, may now have to withstand the scrutiny of the appellate courts, but as of this date, it is the controlling law on this issue.

In addition, Brewer's disqualification to collect from the children's estate opened the door to several other issues that McCarty has yet to decide, the crux of which is who is entitled to the deceased children's $350,000 estate. Pursuant to New York's EPTL Law §4-1.1, distribution shall be made first to the children's parents. If it cannot go to the children's parents, then it goes to the issue of the parents. If it cannot go to the issue of the parents, then it would go to one or more grandparents.

Brewer's deceased children had different fathers. Her oldest child, whose throat she slit and then drowned, was fathered by Ricky Ward. Ward left both Brewer and his daughter shortly after the child was born. Less than two years later, Brewer had her two sons with a man named Innocent Demesyeux. Upon information and belief, Demesyeux also left Brewer and his two sons.

According to EPTL Law §4-1.1, the fathers are entitled to their respective children's portion of the estate. However, the legal principle of abandonment may disqualify them from collecting. EPTL Law §4-1.4(a) specifically provides that a parent who has failed or refused to provide for a child under age 21, or who has abandoned such child, is prohibited from taking a distributive share. "Abandonment amounts to a voluntary breach or neglect of the duty to care for and train a child and the duty to supervise and guide the child's growth and development."[3] The law is clear for abandonment, but ascertaining whether or not the Fathers are disqualified under that provision is not as black and white. To assist in his ruling, Surrogate McCarty appointed a noted attorney, Kenneth J. Weinstein, to act as guardian ad litem for possible unknown distributees. Weinstein is responsible for investigating familial relationships with the deceased children, if any, and the cases that may support such persons' qualification to collect from the estates.

If both fathers are disqualified, by law their issue could still collect. At this time, we do not know if the two fathers had any other children. Brewer, on the other hand, had recently given birth to another baby. Under New York's EPTL Law §4-1.1, this baby is eligible to collect from her deceased half-sister and half-brothers' estates and may in fact have the best chance of receiving the money if the fathers are disqualified. This may not rest well with Brewer's grandmother, who sat in the courtroom during the hearing on Nov. 6, 2013 waiting to hear McCarty's decision, as she too may qualify as a distributee.

Brewer, which started off with the complex issue of Brewer's ability to collect from her children's estate, led to the aforementioned interesting question pending before the Nassau County Surrogate's Court, of where the money now goes. We hope to write about that decision early next year.

TERENCE E. SMOLEV *practices law at the Law Offices of Terence E. Smolev, P.C.* CHRISTINA JONATHAN *is an associate at the firm.*

1. Nassau County Surrogate's Court Decision, *In the Matter of Innocent Demesyeux*, File No: 350391/A and *In the Matter of Michael Demesyeux*, File No.: 350392/A.
2. See *Ford v. Ford*, 307 Md. 105, 138-39, 512 A.2d 389 [Ct of Appeals, Md 1986].
3. See *Matter of Wigfall*, 20 Misc. 3d 648, 652 (Sur. Ct., Westchester County 2008).

2013

« Continued from page 9

settlor's unwitting revocation, perhaps in the context of later planning with another attorney, which some believe is the scenario most in need of relief.

3. Uniform Act regarding adult guardianship adopted. The Uniform Adult Guardianship and Protective Proceedings Jurisdiction Act (UAGPPJA) addresses the issue of jurisdiction over adult guardianships and other protective proceedings, providing a mechanism for resolving multi-state jurisdictional disputes. As its name suggests, it is modeled after an act promulgated by the Uniform Law Commission, which has now been adopted in 37 jurisdictions.

According to the justification for the act, cases involving simultaneous and conflicting jurisdiction over guardianship are increasing due to population mobility. It may be unclear which state court has jurisdiction, and sometimes, guardianship or protective proceedings must be initiated in a second state because of the refusal of financial institutions, care facilities, and the courts to recognize a guardianship or protective order issued in another state.

The goal of UAGPPJA is to ensure that only one state will have jurisdiction at any one time, and it defines a three-level priority system: home state, followed by a significant-connection state, followed by other jurisdictions. New York will have primary jurisdiction as the home state if the individual was physically present for at least six consecutive months immediately before the commencement of the proceeding. Factors relevant in determining significant connection might include location of family and property and other ties, such as voter or vehicle registration, and substantial evidence must be available. The act also specifies procedures for transferring guardianships to New York from other state courts and vice versa, provides a framework for judges in different states to communicate with each other and outlines procedures for cooperation between state courts. A mechanism for registering and recognizing out-of-state guardianship and protective orders is included as well. The act[5] goes into effect on April 21, 2014.

4. Requirement for QDOT when no federal return required eliminated. In order for a disposition to a non-U.S. citizen surviving spouse to qualify for the federal marital deduction, the disposition must pass in a qualified domestic trust (QDOT). A new provision[6] eliminates the requirement to create a QDOT if no federal return is required to be filed.

For estates below the federal filing threshold, the New York estate tax is based on the taxable estate computed on a pro-forma federal return. In order to qualify for the federal marital deduction on the pro-forma return, which then flows through to the New York estate tax computation, dispositions to non-U.S. citizen spouses must be in the form of QDOTs even though there is no corresponding New York tax imposed on the termination of a QDOT or a principal distribution from a QDOT. In essence, the new law provides that, if a federal return is not required to be filed, it is not necessary that a disposition to a non-U.S. citizen spouse pass in a QDOT if the disposition would otherwise qualify for the federal estate tax marital deduction.

5. Unitrust Regime: A reminder about the benefits of retroactivity. The precepts of the Prudent Investor Rule govern the investment of trust assets. Pursuant to those precepts, a trustee is required to invest for "total return," in order to benefit both income and principal beneficiaries. However, when beneficial interests clash, the source of return becomes critical, and the tension between investing for income and investing for growth can become more pronounced. The power to adjust[7] and unitrust regimes[8] can provide trustees with the means to implement the mandate of total return investing, in effect, by preempting the definition of fiduciary accounting income. Under the power to adjust regime, the trustee is permitted to make adjustments between income and principal to be fair and reasonable to all beneficiaries. Under the unitrust regime, a trust can be converted to a unitrust, pursuant to which the income beneficiary will receive a fixed 4 percent payout of the trust's principal.

Matter of Moore (Smithers),[9] is an instructive reminder that, in New York, a retroactive application of the unitrust regime is possible. After a review of all the relevant factors, the court in *Moore* granted the income beneficiary's petition to convert a testamentary trust to a unitrust. As to the effective date, the court pointed out that the statutory default is "the first day of the year beginning *after* the decision of the court becomes final…*unless the court in its decision provides otherwise* (EPTL 11-2.4 (e)(4)(B)" (emphasis added). The petition requested a Jan. 1, 2013 effective date, which request was granted by the Sept. 12, 2013 judgment. Although the period of retroactivity requested was modest, there seems to be no reason why longer periods of retroactivity might not be ordered, if justified under the circumstances. Indeed, longer periods have been previously ordered. Contrast this potential retroactive application with the statutory language regarding the power to adjust, which appears to apply prospectively only:

> [T]he prudent investor standard also authorizes the trustee to adjust between principal and income to the extent the trustee considers advisable to enable the trustee to make appropriate *present and future* distributions…EPTL §11-2.3(b)(5)(A) (emphasis added).

6. Lesson & Reminder: Trustees must comply with the prudent investor rule. *Matter of JPMorgan Chase Bank N.A. (Strong)*,[10] serves as a reminder that the trustees must comply with the Prudent Investor Rule.[11] In particular, the fundamental duty to diversify and the necessity for record keeping are highlighted in this case, which examined three trusts established in the 1930s and 1960s and funded with concentrations of Kodak stock. In each case, the trustee had sole investment authority, there were no restrictions with respect to investments, and there were no mandates requiring the trustee to retain specific assets.

The court reiterated that the prudent investor standard is a test of prudence, not performance, and that a trustee's actions are not to be judged with the benefit of hindsight. However, under the statute, trustees are required to diversify unless the trustee reasonably determines that it is in the interests of the beneficiaries not to diversify. The court found that on numerous occasions the trustee's employees reviewed the highly concentrated holdings, recognized the need to diversify, then failed to follow any cohesive plan for divestiture, failed to undertake an adequate analysis of the trusts by creating an investment plan and failed to conduct more than a superficial review of the trusts. The court drew a conclusion of negligence from what it found to be a pattern of internally unsupported action. The court noted that adequate record keeping is part of a fiduciary's duties under New York law, that all doubts and presumptions are resolved adversely against a fiduciary who fails to maintain adequate records, and that complete lack of documentation alone is a breach of trust.

In terms of the damages computation, the court used the "lost capital" method: Damages equal the value of the stock on the date it should have been sold, minus the value of the shares when they were ultimately sold, minus any income (dividends) attributable to the stock retained, plus interest compounded from the date on which the stock should have been sold. Lost capital is calculated net of any capital gains taxes the fiduciary would have paid.[12] While acknowledging that it is within the court's discretion whether to award interest, and to determine the rate, the court relied on prior case law to hold that the appropriate statutory interest rate for damages occurring before June 15, 1981 is 6 percent, and 9 percent thereafter, compounded annually. The court rejected the trustee's submission that the U.S. treasury rate of interest would more accurately reflect the rate of return the beneficiaries would have received. The court also held that the trustee's conduct justified denial of commissions, and that the trustee had to forfeit all.

According to the court, 95 percent of the stock in each of the trusts should have been sold 30 days after the stock was received. That hypothetical sales amount, less capital gains tax, forms the beginning of a rolling balance. Moving forward, dividends are credited against the rolling balance when received and interest is calculated every year on the adjusted rolling balance. The court set the *base* surcharge value at $3,069,644, with interest and the value of trustee's commissions paid to be added to the surcharge amount. He ordered each of the parties to file a proposed order applying that calculation within 60 days, but in the interim, JPMorgan Chase has filed a Notice of Appeal.

7. New York State Department of Taxation and Finance guidance in the wake of 'United States v. Windsor.' On June 26, 2013, in *United States v. Windsor*,[13] the U.S. Supreme Court held §3 of the Defense of Marriage Act to be unconstitutional. In response, the Internal Revenue Service (IRS) issued *Revenue Ruling 2013-7*, in which they advised that they will recognize the validity of any marriage between a same-sex couple that is valid under the laws of the jurisdiction in which it was entered. The Ruling will be applied prospectively as of Sept. 16, 2013. Taxpayers may (but are not required to) rely on that Ruling for the purpose of filing returns for any prior periods in which the statute of limitations has not expired.

Based on the Windsor decision and IRS Ruling, the Department issued Technical Memoranda[14] containing estate and income tax filing guidance for same-sex married spouses. The guidance explains that equal treatment has been accorded to same-sex married spouses since the enactment of the Marriage Equality Act, which took effect on July 24, 2011. The guidance clarifies that this equal treatment now also applies to the personal income tax and estate tax for earlier periods. Amended income and estate tax returns may (but are not required) to be filed if the statute of limitations remains open, generally three years from the date a return was filed or two years from the date the tax was paid, whichever is later.

8. Decanting: Reminders and clarifications about this powerful tool. Decanting is the mechanism whereby the trustee of an irrevocable trust can appoint the assets of that trust into a new trust with different terms. Decanting can be a tremendous tool for dealing with changed circumstances, correcting mistakes, facilitating tax benefits or optimizing a trust's administration. New York, which was the first state to enact decanting legislation in 1992, passed sweeping amendments to its statute in 2011.

Matter of Kroll (Ratowsky-Schreiber)[15] serves as an excellent reminder of the power of decanting. In *Kroll*, a trust was created for the benefit of the grantor's then infant grandson, Daniel, who later was found to suffer from several disabilities. Daniel had turned 21 at the time of the proceeding, and was receiving Medicaid and SSI benefits. The trust provided for fully discretionary distributions until age 21. Upon turning 21, Daniel was permitted to withdraw all or any part of the principal. It was conceded that the withdrawal right rendered Daniel ineligible for government benefits. The trustees decanted the trust assets into a supplemental needs trust a few days before Daniel turned 21. Under the statute, the exercise of the decanting power is effective 30 days after service, unless those entitled to notice consent in writing to a sooner effective date. Ordinarily, the court would have required consent from Daniel's guardian, but the invaded trust provided that a parent who was not a trustee had the authority to act for the beneficiary—an important reminder about the importance of including such provisions in planning documents. The trustees executed the Notice of Decanting on May 1, 2012 and Daniel's father consented on May 2, 2012, five days before Daniel turned 21. The court found that the trustees complied with all the statutory requirements; that the consent was effective to shorten the otherwise applicable 30-day notice period; that the decanting occurred before Daniel turned 21; and that the appointed trust was a third-party supplemental needs trust with no requirement for a payback provision.

The court also clarified the statutory definition of "authorized trustee" for decanting purposes as any trustee except a trustee who is either (1) the creator of the trust or (2) a beneficiary to whom income or principal must be paid or who is eligible to receive discretionary income or principal.

In addition to this judicial clarification, technical corrections to the decanting statute[16] were enacted in 2013. Among other changes, the language has been clarified to:

- Permit a trustee with unlimited discretion to invade trust principal to decant to a new trust which excludes all successor or remainder beneficiaries of the original trust;
- Confirm that the interest of a discretionary income beneficiary of the original trust may be continued in the new trust; and
- Confirm that a decision to decant requires a majority determination only, not unanimity.

9. Non-Profit Revitalization Act of 2013 enacted. On Dec. 18, 2013, the governor signed the Non-Profit Revitalization Act of 2013,[17] bringing sweeping changes to New York's nonprofit laws.

The act, most provisions of which take effect on July 1, 2014, is designed to reduce burdens on the nonprofit sector while strengthening governance and accountability. The act applies to New York nonprofit corporations, wholly charitable trusts and some provisions may apply to non-New York charities registered to solicit charitable contributions in New York.

Nonprofit corporations and wholly charitable trusts will now have to ensure that they have policies and procedures in place that demonstrate compliance with the new requirements.

The act replaces the old A/B/C/D letter categorization (criticized as confusing), with two types of nonprofit corporations, charitable and non-charitable.

All nonprofits must adopt a conflicts of interest policy to ensure that directors, officers, and key employees act in the corporation's best interest. Nonprofits with 20 or more employees and annual revenue exceeding $1 million must adopt a whistleblower policy to protect those who report suspected improper conduct from retaliation. Nonprofits are prohibited from entering into related party transactions unless fair, reasonable, and in the corporation's best interests. Employees are prohibited from serving as board chairs. No employee, officer or director may participate in any decision as to his or her compensation.

In an effort to reduce unnecessary burdens, the act raises the gross revenue thresholds that trigger certain filing requirements: An independent CPA review is required at gross revenues of $250,000 (increased from $100,000), and an independent CPA audit is required at gross revenues of $500,000 (increased from $250,000), and rising to $750,000 on July 1, 2017 and $1 million on July 1, 2021). If a charitable corporation required to register to solicit charitable contributions in New York has revenue exceeding $500,000, the act creates enhanced oversight responsibilities to ensure that boards are aware of, and respond to, issues identified by auditors. Additionally, those corporations with revenue in excess of $1 million will be required to review with the auditor the scope of the audit before it commences, as well as discuss any material risks and weaknesses in internal controls identified by the auditor at the audit's conclusion.

A new EPTL §8-1.9 is created to make the requirements concerning audits, related party transactions, conflicts of interest and whistleblower policies applicable to wholly charitable trusts.

10. New York State Tax Commission Reports: Major changes afoot? Two State Tax Commission Reports issued in 2013 potentially set the basis for a major overhaul of New York's transfer and fiduciary income tax regimes.

The New York State Tax Reform and Fairness Commission, a body established by Gov. Andrew M. Cuomo in December 2012 to conduct a comprehensive and objective review of the State's tax structure, issued its final report on Nov. 11, 2013.[18] The Commission was charged with developing revenue neutral policy options to modernize the current tax system with the goals of increasing its simplicity, fairness, economic competitiveness and affordability.

The Fairness Commission recommended (1) raising the estate tax threshold from $1 million to $3 million, (2) eliminating New York's Generation-Skipping Tax (GST), (3) reinstating New York's gift tax, and (4) closing the resident trust "loophole:" a New York resident trust's exemption from tax if (a) all trustees are domiciled outside the state, (b) all real and tangible trust property is located outside the state and (c) all trust income and gain is derived from sources outside the state. The Commission positioned the gift tax as an important complement to the estate tax, which can otherwise easily be reduced by lifetime gifting. One option the Commission suggested to close the resident trust "loophole" was to treat them as grantor trusts for New York purposes (although they would be non-grantor trusts for federal purposes), so the trust income would be included in the grantor's taxable income. In addition, the Commission suggested using California's approach, which creates an addition modification equal to distributions to resident beneficiaries by trusts not subject to California tax.

The Fairness Commission Report was sent to another commission, the New York State Tax Relief Commission, to review and provide recommendations for consideration in the governor's 2014 State of the State message.

The Tax Relief Commission, which issued its report on December 6,[19] recommended equalizing the state exemption threshold with the 2013 federal level of $5.25 million, with indexing. It also recommended lowering the top estate tax rate from 16 percent to 10 percent. The proposals in the Fairness Commission Report regarding reinstituting the gift tax, closing the resident trust "loophole" and eliminating the GST tax were not mentioned in the Tax Relief Report.

On Dec. 10, 2013, Cuomo announced that he accepted the Final Report of the Tax Relief Commission. Although that report did not mention a phase-in approach, a press release issued by the governor on Jan. 6, 2014 did propose phasing in the changes:

> New York is one of only 15 states that impose an estate tax, and the current estate tax level is badly in need of reform. While the federal government exempts the first $5.25 million of an individual's estate, New York only exempts estates valued below $1 million. To end this unnecessary incentive for elderly New Yorkers to leave the state, Governor Cuomo proposes increasing the New York estate tax threshold to $5.25 million and lowering the top rate to 10 percent over four years. Beginning in 2019, the State estate tax exemption would equal the Federal exemption, which is indexed to inflation. This change would exempt nearly 90 percent of all estates from the tax, restore fairness and eliminate the incentive for older middle-class and wealthy New Yorkers to leave the State.

In his Jan. 8, 2014 State of the State address, the governor advocated reform of what he called the "move to die" tax by increasing the tax threshold and reducing the tax rates to put New York in line with other states.

The next step would be for a legislative proposal that embodies the governor's recommendations to work its way through the usual legislative process. Note, that the Fairness Commission had a revenue-neutral mandate: The loss of revenue resulting from the proposal to increase the estate tax exemption to $3 million was exactly canceled out by the revenue increase from reinstituting the gift tax and ending the resident trust exemption. It does not seem that the Tax Relief Commission had any revenue mandates. Accordingly, it will be interesting to see whether revenue considerations impact any final legislation. The reason for the phase-in portion of the proposal was presumably to soften the revenue impact.

The proposals in the Fairness Commission Report regarding reinstituting the gift tax and closing the resident trust "loophole" were not mentioned by the governor, but that does not mean that those proposals have been abandoned. They continue to be considered by the Department of Taxation and Finance, which participated in the Fairness Commission Report.

These continuing developments are certainly poised to be among those that feature in the top 10 list for 2014.

1. N.Y. RPT. Law §467-a.
2. *Matter of D'Elia*, 40 Misc.3d 355, 964 N.Y.S.2d 877 (Sur. Ct., Nassau Co. April 10, 2013).
3. Internal citation omitted.
4. New York S.5080 (2013).
5. New York A.857/S.2534 (2013).
6. New York A.6556-A/S.4851-A (2013).
7. New York Estates, Powers & Trusts Law §11-2.3(b)(5).
8. New York Estates, Powers & Trusts Law §11-2.4.
9. *Matter of Moore (Smithers)*, 41 Misc.3d 687, 971 N.Y.S.2d 419 (Sur. Ct, N.Y. Co. Sept. 12, 2013).
10. *Matter of JPMorgan Chase Bank N.A. (Strong)*, 42 Misc.3d 1231(A) (Sur. Ct., Monroe Co. Nov. 26, 2013).
11. New York Estates, Powers & Trusts Law §11-2.3.
12. The Kodak stock in one of the trusts had not received a step-up in basis for over eighty years. The application of the lost capital computation method (with the hypothetical sale "at the time it should have been sold"), including the netting out of significant capital gains taxes, resulted in no damages for this trust, despite the finding that the trustee clearly breached its fiduciary responsibilities.
13. *United States v. Windsor*, 133 S. Ct. 2675 (2013).
14. TSB-M-13(5)I,(10)M issued Sept. 13, 2013, and TSB-M-13(9)M, issued July 18, 2013.
15. *Matter of Kroll (Ratowsky-Schreiber)*, 41 Misc.3d 954, 971 N.Y.S.2d 863 (Sur. Ct. Nassau Co. Sept. 30, 2013).
16. New York A.7061/S.3790-A (2013).
17. New York A.8072/S.5845 (2013).
18. http://www.governor.ny.gov/assets/documents/greenislandandreportandappendicies.pdf.
19. http://www.governor.ny.gov/assets/documents/commission_report.pdf.

Minors

« Continued from page 9

initially filed on time, but failed to meet all of the requirements,[6] and (iv) a trust beneficiary took no distributions for 15 years and sought to accelerate the benefits to her children.[7] On the other hand, courts have declined to extend the period when the disclaimer would be used to pressure creditors into accepting a reduced settlement,[8] the beneficiary had been accepting trust benefits for at least five years,[9] and no excuse was offered for a three-year delay in requesting the extension.[10]

Another option is for a minor to renounce through a guardian. EPTL §2-1.11(d) allows for "the guardian of the property of an infant" to renounce on behalf of a minor, "when so authorized by the court having jurisdiction over the estate of the infant." However, courts will only grant such authorization when the renunciation actually benefits the minor. This option likely requires a parent to seek appointment as the guardian of the minor's property or limited letters of guardianship for the purpose of renouncing on the minor's behalf.

Showing that a renunciation actually benefits a minor is a high hurdle. In *Estate of Kerzner*,[11] the court refused to permit a mother who was guardian of her minor child to renounce the child's interest in his father's estate in order to save approximately $2.7 million in estate tax. The court reasoned that "a long line of cases establishes that a court cannot authorize the renunciation of an infant's right to receive a financial benefit unless there is commensurate consideration in return."[12] Offering consideration to the minor does not seem to satisfy the courts either. In *Estate of DeDominico*, a mother who was guardian of her three minor children wished to renounce part of the minors' intestate share of their father's estate and interests in totten trust accounts in order to claim the full marital deduction and save $40,000 in estate tax. The court disallowed the renunciation despite the fact that the mother promised to use the funds solely for the benefit of the children.[13] In *Estate of Carucci*,[14] a father sought to renounce a testamentary disposition of partnership interests on behalf of his two minor children and to give the children cash in trust instead. The court denied the request, indicating that a change in form from an outright gift to a gift in trust was not beneficial to the children.

Even if a minor is unable to make a renunciation under the EPTL, there may be an escape hatch to make a qualified disclaimer under the IRC. Pursuant to IRC §2518(c)(3), a written transfer of a person's entire interest in property to the person or persons who would have received the property had a qualified disclaimer been made and which satisfies the other requirements of IRC §2518 will be treated as a qualified disclaimer. Therefore, a minor who makes a written transfer of property between the time he or she reaches age 18 and nine months after he or she reaches age 21 to the person or persons who would have received the property if a qualified disclaimer had been made, will be treated as having made a qualified disclaimer. A valid disclaimer under state law is not required nor does the property have to pass "without any direction on the part of the disclaimant" in order to utilize IRC §2518(c)(3). However, the other requirements of IRC §2518 must be met. The transfer will be a gift for New York law purposes and a qualified disclaimer for federal tax purposes. Since New York does not currently impose a gift tax, there are no tax consequences resulting from a transfer made pursuant to this escape hatch.

Moreover, the IRC relaxes the requirement that the beneficiary must not accept the gift or its benefits while the beneficiary is a minor. Treasury Regulations §25.2518-2(d)(3) states that "any actions taken with regard to an interest in property by a beneficiary or a custodian prior to the beneficiary's twenty-first birthday *will not be an acceptance by the beneficiary* of the interest." One example given in the regulations shows a minor who receives trust distributions as being able to make a qualified disclaimer so long as she does not take any additional distributions after turning 21.

For example, assume a grantor created an inter vivos trust that passed to her descendants, per stirpes, upon its termination. At the time the trust was created, the grantor had three children and GST exemption was not allocated to the trust. During the trust term, one of the grantor's three children died and was survived by a minor child. Under these facts, there would be a taxable distribution for GST purposes upon the termination of the trust with respect to the share passing to the grantor's minor grandchild. Since there was only one trust for all descendants, a late GST exemption allocation would have to be made to the entire trust to shelter the portion that incurs a GST tax. The grantor may not want to waste her GST exemption, especially if the trust assets have appreciated.

If, following the termination of the trust, the grandchild's share is held for him pursuant to a power in trust and prior to nine months after he reaches age 21, the grandchild transfers his share to the two surviving children of the grantor, the transfer will be a qualified disclaimer due to the IRC §2518(c)(3) escape hatch. All three requirements of IRC §2518(c)(3) will have been met: The transfer will be effected within nine months after the grandchild reaches age 21, the grandchild will not have accepted any of the benefits (the grandchild may receive distributions prior to reaching age 21), and the property will pass to the individuals who would have received it pursuant to a qualified disclaimer.

Because of the IRC §2518(c)(3) escape hatch, the difference in requirements for disclaimers by minors under the IRC and EPTL is not insurmountable. Although a minor may be unable to renounce under the EPTL, a qualified disclaimer under the IRC is not precluded.

1. IRC §2518 uses the term "disclaimer" whereas EPTL §2-1.11 uses the term "renunciation."
2. The disclaimer must be in writing signed by the disclaimant and made within 9 months after the property interest is created; the disclaimant must not have accepted the property interest or any of its benefits; and as a result of the disclaimer, the property interest must pass without any direction on the part of the disclaimant to the spouse of a decedent/transferor or to a person other than the disclaimant.
3. *Estate of Kravis*, N.Y.S.2d 274 (Surr. Ct. 1992).
4. *Estate of Sittler*, 2008 N.Y. Misc. LEXIS 4904 (Surr. Ct. 2007).
5. *Estate of Siesel*, NYLJ, April 10, 1996 at 30, Col. 1 (Surr. Ct. 1996).
6. *Estate of Fernandez*, 2008 N.Y. Misc. LEXIS 6039 (Surr. Ct. 2008).
7. *Estate of Hahn*, NYLJ, July 10, 2006 at 28, Col. 1 (Surr. Ct. 2006).
8. *Estate of Ford*, NYLJ, Feb. 5, 2002 at 19, Col. 1 (Surr. Ct. 2002).
9. *Estate of Blachly*, NYLJ, Jan. 23, 2006 at 14, Col. 1 (Surr. Ct. 2006).
10. *Estate of Neely*, NYLJ, June 24, 2011 at 34, Col. 1 (Surr. Ct. 2011).
11. 2007 N.Y. Misc. LEXIS 6199 (Surr. Ct. 2007).
12. Id. (citing *Estate of DeDominico*, 48 N.Y.S.2d 1012 (Surr. Ct. 1979)).
13. The court indicated that if a parent promises to use the renounced funds for the benefit of the minor, it would probably not be a qualified disclaimer for federal tax purposes.
14. 769 N.Y.S.2d 866 (Surr. Ct. 2003).

Gifts

« Continued from page 9

availability or effectiveness in evaluating purported misconduct by a charity.[19]

Donor Standing to Enforce Charitable Dispositions. A court may grant standing to enforce the terms of a gift where the donor establishes that his gift created a fiduciary relationship, thus imposing an enforceable obligation on the charity to administer the gift according to its stated purpose and consistent with any restrictions.[20] Courts have not articulated a bright-line test to determine whether a gift instrument creates a fiduciary relationship.[21] However, courts tend to construe the gift agreement as creating a fiduciary relationship for public policy reasons, including protecting the charity and honoring the donor's restrictions.[22] When analyzing whether a donor has created a fiduciary relationship, courts look to the donor's intent, as evidenced through the restrictions stated in the gift instrument.[23]

If a fiduciary relationship exists, the charity has a legal duty to use the gift for its stated purpose.[24] Still, the fiduciary relationship alone does not allow for donor standing. Even if the court determines that a fiduciary relationship exists, the donor nevertheless must demonstrate a continuing legal interest in the gift, such as the retention of the right to supervise its administration, in order for the court to grant standing.

Courts employ an analysis similar to the "special interest" doctrine to determine whether the donor has a legal interest in the gift sufficient to grant standing. *Associated Alumni v. General Theological Seminary* was the first important New York case to apply this rationale to donors. In *Associated Alumni*, various alumni of the General Theological Seminary made a gift to the seminary in order to endow a professorship.[25] The gift instrument specified certain restrictions on the endowment and expressly reserved to the Association a right of nomination in the event that the professorial seat became vacant.[26] A dispute regarding a nomination arose, and the alumni sought to enforce their rights. The court held that the alumni-donors were entitled to standing because (i) the gift was deemed to be held in trust and (ii) the donors had retained a continuing interest in the administration of the gift by reserving a nomination right.[27]

Smithers v. St. Luke's-Roosevelt Hospital Center extended the logic of *Associated Alumni* by expressly asserting that the attorney general is not the exclusive representative of charitable donors.[28] In *Smithers*, the donor made a gift to St. Luke's-Roosevelt Hospital to establish an alcohol treatment facility.[29] The hospital had a fiduciary duty to administer the gift consistent with the donor's stated purpose. After Mr. Smithers' death, his widow discovered that the hospital was breaching its duty and was misusing the gifted funds. Mrs. Smithers implored the attorney general to pursue an enforcement action against the hospital when she concluded that the attorney general was unable to resolve the dispute satisfactorily.

After failing to negotiate a resolution with the hospital, Mrs. Smithers obtained Special Letters of Administration in order to bring suit to enforce the terms of the gift. The lower court dismissed Mrs. Smithers' complaint, but the appellate court reversed, emphasizing the attorney general's failure to properly execute his duties, stating that "circumstances of this case demonstrate the need for coexistent standing for the Attorney General."[30] Similar to the plaintiffs in *Associated Alumni*, the court found it determinative that Mr. Smithers expressly had retained and documented his right to supervise the hospital's use of his gift.[31] Referring to Mr. and Mrs. Smithers, the court remarked that there is "no substitute for a donor, who has a 'special, personal interest in the enforcement'" of his gift. The court acknowledged that the common law standard had been incorporated in New York statutory law, but disagreed with the lower court's determination that the attorney general's right to enforce charitable gifts is exclusive.[32] Moreover, the public policy of preventing "vexatious litigation" by irresponsible parties without a tangible stake in the matter did not apply to Mrs. Smithers.[33] The foregoing factors led the court to grant Mrs. Smithers, as special administratrix of her husband's estate, standing to pursue the enforcement action against the hospital.

The holding in *Smithers* suggests a judicial shift in private enforcement of charitable gifts.[34] While the holding has the potential for broad application, courts have not extended standing beyond the donor or his legal representative. In fact, courts have denied standing to relatives of the deceased donor seeking to enforce the restrictions placed by a donor on a gift.[35] Interestingly, the Smithers decision left unanswered whether the estate of a donor must still be open when the challenge is brought for the personal representative to have standing.[36]

On Dec. 31, 2013, the Appellate Division, First Department, handed down a decision that addressed donor standing to enforce the terms of a charitable gift in trust.[37] Consistent with the "special interest" doctrine, the court in *Lucker v. Bayside Cemetery* denied standing to relatives of deceased donors who sought to bring an action against the cemetery. The cemetery had breached the terms of a trust for the perpetual care of burial plots created under EPTL §8-1.5 by allowing the donors' burial plots to fall into disrepair.[38] The court denied "special interest" standing to the relatives of the deceased donors because the group was neither sufficiently "sharply defined" nor sufficiently "limited in number," as was the case in *Alco Gravure*.[39]

However, in a companion appeal, the court granted standing to the donor of a trust for the perpetual care of burial plots.[40] Relying on *Smithers* and *Associated Alumni*, the court held that *Leventhal*, the donor, had standing to enforce the trust. While the plaintiffs in both *Smithers* and *Associated Alumni* had possessed a "special interest," the Smithers court observed that its decision "does not necessitate the conclusion that no donor has standing without having retained such a right."[41] Unlike *Smithers* and *Associated Alumni*, *Leventhal* had not retained a "special interest" in the trust. Nevertheless, the court concluded that the plaintiff's status as donor of the trust entitled him to sue to enforce the trust's terms, even without a "special interest."[42] Thus, the Lucker decision clarifies the right of a donor to enforce the terms of a charitable gift. At least in the First Department, a donor of a restricted gift need not possess a "special interest" in order to have standing to bring an enforcement action. The court's liberal approach is consistent with the recent trend in favor of private enforcement of charitable gifts.

> A conditional gift containing a gift over to another charity should help to ensure that the donee charity complies with the express purposes of the gift.

Recommendations

New York donors who wish to better ensure that their gift restrictions are enforceable should consider the following recommendations.

Create a Gift Over. A conditional gift containing a gift over to another charity should help to ensure that the donee charity complies with the express purposes of the gift. A gift over clause could provide for a distribution of the gift to another charity if the donee charity fails to observe the restrictions. The prospect of losing the gift creates a sword of Damocles that should incentivize the donee charity to comply with the gift restrictions.[43]

Expressly Retain a Supervisory Role. A donor and a charity can agree on specific terms and conditions in the gift agreement. For example, the donor could retain the power to appoint staff members or to serve in a supervisory or managerial capacity.[44] As *Smithers* and *Associated Alumni* suggest, a donor's retention of this type of special interest likely will support donor standing.[45]

Reserve Right to Sue. A New York court suggested that donors of charitable gifts may be able to reserve to themselves the express right to sue the charitable donee for a breach of its fiduciary duties.[46] In addition, the gift instrument could provide for enforcement by family members or others if the charity breaches its fiduciary duties.[47]

Impose Accounting Requirements in the Gift Instrument. A New York charity is required to respond only to a request for information from the attorney general. If, however, a donor imposes requirements in the gift instrument that the charity account periodically to him or to his family, it may enhance the charity's compliance with the gift restrictions.[48]

Retain a Reversionary Interest. A donor who retains a reversionary interest in his gift has standing to enforce the restrictions on his gift.[49] However, this approach is not advisable because the donor will not be entitled to a charitable deduction unless the likelihood of reversion is so remote as to be negligible.[50]

Conclusion

Although enforcement of charitable gifts historically has been limited to the attorney general, recent case law suggests a shift in the courts in favor of increased private enforcement. By extending standing to donors and certain beneficiaries with a retained "special interest" in the charitable gift, New York courts are providing the state attorney general with necessary, albeit limited, reinforcement. The recommendations above, when employed by a savvy donor, could provide the donor (or others he selects) with the power to enforce the terms of his gift with or without resort to judicial intervention.

1. "Giving Statistics: Charity Navigator," charitynavigator.org, http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=42 (last visited Dec. 20, 2013).
2. "Giving USA: Charitable Donations Grew in 2012, but Slowly, Like the Economy," Indiana University-Purdue University Indianapolis (June 18, 2013), http://www.philanthropy.iupui.edu/news/article/giving-usa-2013#sthash.K8P5xbPD.dpuf.
3. Evelyn Brody, "From the Dead Hand to the Living Dead the Conundrum of Charitable Donor Standing," 41 Ga. L. Rev. 1183, 1187 (Summer 2007).
4. 17 U.S. 518, 628 (1819).
5. See *Smithers v. St. Luke's-Roosevelt Hospital Center*, 281 A.D.2d 127, 140 (1st Dept. 2001); see also *Associated Alumni of General Theological Seminary v. General Theological Seminary*, 163 N.Y. 417 (1900).
6. *Carl J. Herzog Foundation v. University of Bridgeport*, 243 Conn. 1, 6-7 (1997). Decided in 1844, *Vidal v. Girard*'s Executors established that statutory law and the English common law form the basis of American law of charitable trusts. 43 U.S. 127 (1844).
7. *Herzog*, 243 Conn. at 6.
8. Id.
9. EPTL §§8-1.1 & 8-1.4; N-PCL §§112 & 522.
10. See *Alco Gravure v. Knapp*, 64 N.Y.2d 458, 465 (1985).
11. Restatement (Third) of Trusts §28, cmt. a.
12. *St. Joseph's Hosp. v. Bennett*, 281 N.Y. 115, 119-20 (1939).
13. See Restatement (Second) of Trusts §391, cmt. c.
14. A co-trustee of a charitable trust or a codirector of a charitable corporation also has standing to sue a charity of breach of its fiduciary duty. See Restatement Second of Trusts §391, cmt. c.
15. See *Alco Gravure*, 64 N.Y.2d 458; see also *Smithers*, 281 A.D.2d 127.
16. *Robert Schalkenbach Foundation v. Lincoln Foundation*, 208 Ariz. 176, 183 (2004).
17. 64 N.Y.2d 458 (1985).
18. 383 Mass. 350, 353-54 (1981) (Museum of Fine Arts, as remainderman, was a party in proceeding seeking remedies against trustee); Restatement (Third) of Trusts §94, cmt. 2(g).
19. See *Schalkenbach*, 208 Ariz. at 183; see also *Smithers v. St. Luke's-Roosevelt Hospital Center*, 281 A.D.2d 127, 140 (1st Dept. 2001).
20. There are two gift scenarios where no fiduciary relationship is created: (i) a gift made to a charity for its general uses, which precludes donor standing, and interestingly, (ii) a conditional gift, which allows donor standing even where there is no fiduciary relationship. When a gift is made to a charity for its general uses, the donor does not have standing because he has relinquished all interest in, and control over, the property. When a donor makes a conditional gift, he will have standing because he likely retained a right of reentry or a reversionary interest if the charity does not abide by the conditions. See Restatement (Third) of Trusts §28, cmt. g.; see also *L.B. Research & Educ. Found. v. UCLA Found.*, 130 Cal. App. 4th 171, 178 (2005) (stating that gifts "will be construed as one of a fee simple subject to a condition subsequent if it expressly provided in the instrument that the transferee shall forfeit it or that the transferor or his heir or a third party person may enter for breach of the condition").
21. See *L.B. Research*, 130 Cal. App. 4th at 171-73.
22. Id. at 172-73; see *Adler v. SAVE*, 432 N.J. Super. 101, 124 (N.J. Sup. Ct. App. Div. 2011).
23. *St. Joseph's Hosp. v. Bennett*, 281 N.Y. 115, 118-19 (1939).
24. *St. Joseph's Hospital*, 281 N.Y. at 119-20.
25. *Associated Alumni*, 163 N.Y. at 420.
26. Id.
27. Id. at 423.
28. *Smithers*, 281 A.D.2d at 137.
29. Id. at 140.
30. Id.
31. Id. at 139.
32. Id. at 137.
33. Id. at 138.
34. *In re Estate of Smithers*, 195 Misc. 2d 510, 511 (Sur. Ct. Nassau County 2003).
35. *Rettek v. Ellis Hospital*, 2009 WL 87592 (N.D.N.Y. 2009) (holding niece could not enforce terms of charitable bequest on behalf of deceased aunt and uncle); *Board of Education of Mamaroneck Union Free School District v. Attorney General of N.Y.*, 25 A.D.2d 637 (2d Dept. 2006) (holding grandson lacked sufficient continuing interest in restrictive covenants included in deeds executed by grandparents to the school district to enforce the covenants); *In re Alaimo*, 288 A.D.2d 916 (4th Dept. 2001) (grandson in whose honor a charitable trust was created lacks standing to challenge the administration of the trust).
36. See *Smithers*, 281 A.D.2d at 140.
37. *Lucker v. Bayside*, 2013 N.Y. App. Div. LEXIS 8781 (App. Div. 1st Dept. Dec. 31, 2013).
38. EPTL §8-1.5 dictates that dispositions of property for the purpose of the perpetual care of cemeteries or private burial lots in cemeteries are deemed charitable trusts.
39. *Lucker*, 2013 N.Y. App. Div. LEXIS 8781, at *10.
40. Id. at *14.
41. *Smithers*, 281 A.D.2d at 137.
42. Id. at *16.
43. *Goodwin*, 1187; *Chase v. Pevear*, 383 Mass. 350, 353-54 (1981).
44. Donors should be aware that exerting too much control over their gifts could jeopardize their charitable tax deduction or result in estate tax inclusion.
45. *Smithers*, 281 A.D.2d at 140; *Associated Alumni*, 163 N.Y. 417.
46. "Donors can ensure their wishes are honored by expressly providing for enforcement by family members or forfeiture if their restrictions are not satisfied." *Rettek v. Ellis Hospital*, 2009 U.S. Dist. LEXIS 1607, at 13 (2009).
47. Id.
48. See 4A Austin Wakerman Scott & William Franklin Fratcher, The Law of Trusts, sct. 348.1 (4th ed. 1989). Prof. John Langbein, one of the UTC commentators, has urged a rethinking of the application of law of trusts to charitable dispositions. Langbein maintains that many avenues for reform would be opened if trusts were subsumed under the law of contracts as the functional equivalent of a third-party beneficiary contract. "The Contractarian Basis of the Law of Trusts," 105 Yale L.J. 625 (1995-1996).
49. *Smithers*, 281 A.D.2d at 147.
50. Treas. Reg. §20.2055-2(b)(1). The concept of "so remote as to be negligible" has been defined as a "chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction" and "so highly improbable and remote as to be lacking in reason and substance." *Briggs v. Commissioner*, 72 T.C. 646 (1979).

Traps

« Continued from page 11

exempt from GST tax, resulting in GST tax savings of $1,493,333.

Grantors can make sure that the automatic allocation rules apply by timely filing a Form 709 for the year of the transfer and electing into the automatic allocation of GST exemption for the initial transfer and all subsequent transfers, even if a Form 709 is not otherwise required to be filed.[12]

Practitioners should review trusts with hanging powers for which Forms 709 were not filed in order to determine whether the automatic allocation rules applied to make the trusts GST exempt. If not, clients should consider filing a Form 709 for the purpose of making a late allocation of GST exemption to make the trusts GST exempt.[13]

CGPOA Trap

Many beneficiaries of a dynasty trust are granted a "contingent general power of appointment" (CGPOA) which is deemed applicable only if (a) any trust property would be subject to a GST tax upon the death of the beneficiary and (b) the GST tax is greater than the estate tax that would be imposed if such property were includible in the beneficiary's gross estate. A CGPOA can be beneficial if a non-skip beneficiary (e.g., a child of the grantor) has only assets of nominal value outside the trust. The deemed applicability of the CGPOA will cause the subject portion of the trust to be included in the beneficiary's gross estate,[14] but the beneficiary's unified credit will avoid any transfer tax on such portion. Importantly, as a result of the deemed inclusion of such property in the beneficiary's gross estate, the beneficiary now replaces the grantor as the transferor of that property for GST tax purposes,[15] thereby avoiding a GST tax on the death of the beneficiary if the subject property passes to a member of the next younger generation.[16] In the absence of this CGPOA, the grantor would have remained the transferor for GST tax purposes, and a taxable distribution or taxable termination in favor of the successor beneficiary would have given rise to GST tax.

Although granting beneficiaries a CGPOA can result in significant GST tax savings, they may give rise to other unintended GST tax consequences. As discussed above, a trust is not a GST trust if any portion of it would be included in the gross estate of a non-skip person if such person died immediately after the transfer. This exception seems to apply to a trust in which a non-skip beneficiary holds a CGPOA and that CGPOA would be deemed applicable if the beneficiary were to die immediately.

Example. In 2013, T establishes a trust for his son, C. Upon C's death, the property remaining in the trust will be distributed outright to C's issue. The trust grants C a CGPOA. When the trust is established, the total value of the trust property is $2 million, and the total value of C's own property outside the trust is $1 million. C has not utilized any of his applicable exclusion amount. A Form 709 is not timely filed reporting T's gift.

To determine whether automatic allocation of GST exemption to the trust will occur, practitioners must assume C's death immediately after T funds the trust to ascertain whether C's CGPOA would be deemed applicable. In this case, it would be: Applicability of the CGPOA would cause inclusion of the trust in C's gross estate to be fully offset by his applicable exclusion amount (i.e., C's taxable estate of $3 million ($1 million of C's own property plus $2 million of the trust's property) would be fully covered by C's applicable exclusion amount). The trust will, therefore, not qualify as a GST trust, and the automatic allocation rules will not apply.

Suppose instead that the total value of C's other property is $5.25 million when T funds the trust. In that case, the CGPOA would not be deemed applicable because C's other property would fully absorb his applicable exclusion amount. Thus, the trust will still be deemed a GST trust, resulting in the automatic allocation of GST exemption to the trust.

Finally, suppose that the total value of C's other property is $3.75 million when T funds the trust. In that case, the CGPOA would be deemed applicable *in part*. Though $3.75 million of C's applicable exclusion amount would be used to avoid estate tax on C's property outside the trust, $1.5 million of the trust property would be includible in C's gross estate pursuant to the CGPOA because that amount would be offset by C's remaining applicable exclusion amount. The CPGOA would not apply to the other $500,000 of the trust. Automatic allocation of GST exemption would occur only with respect to 25 percent of the trust (i.e., $500,000 not includible in C's gross estate/$2 million total trust property), resulting in an inclusion ratio for the trust of 0.75.

If the value of the trust is $10 million when C dies, the GST tax (assuming an applicable GST tax rate of 40 percent) would be $3 million (i.e., $10 million x 0.75 x 40 percent). If the automatic allocation rules had applied (or if a Form 709 had been timely filed to affirmatively allocate GST exemption to the trust), this $3 million GST tax could have been avoided.

If an automatic allocation of GST exemption is desired, the better approach might be to give the trustee the power to grant the CGPOA at the trustee's discretion. In the example above, the trustee would not have actually granted a CGPOA to C at the time of trust funding, and therefore no portion of the trust estate would be includible in C's gross estate. The trust could then qualify as a GST trust through the application of the automatic allocation rules.

This analysis becomes more complicated if T makes a series of contributions to the trust during his lifetime. In that case, it appears the inquiry as to whether the CGPOA would be deemed applicable must be made each time a transfer is made to the trust. In some years, C may have nominal assets of his own outside the trust so that the CGPOA would be deemed applicable. In other years, C may have more significant assets of his own so that only a portion (or none) of the CGPOA would be deemed applicable. This fluctuation in the value of C's assets could result in the trust being treated as a GST trust in some years and not others, resulting in a mixed inclusion ratio for the trust.

To avoid the inapplicability of the automatic allocation rules, the safest course for practitioners and their clients is to timely file a Form 709 to affirmatively allocate GST exemption to the trust, rather than to rely on the automatic allocation rules.

Conclusion

As this article demonstrates, granting beneficiaries of a dynasty trust hanging powers or contingent general powers of appointment may prevent the automatic allocation of GST exemption to the trust. Understanding and planning for these issues can enable practitioners to maximize intergenerational tax savings for their clients.

1. If the grantor of a trust timely files a Form 709 (gift tax return) and elects to allocate GST exemption to the initial gift and all subsequent gifts to the trust, the problems discussed in this article are avoided.
2. Section 2503(b); *Crummey*, 397 F.2d 82 (9th Cir. 1968). Section references are to the Internal Revenue Code of 1986, as amended.
3. Section 2041(b).
4. Section 2514(b).
5. Section 2514(e).
6. Section 2632(1), (3)(A)
7. Section 2632(c)(3)(B).
8. Section 2632(c)(3)(B)(iv).
9. Flush language at the end of §2632(c)(3)(B).
10. Section 6019(1).
11. As set forth in the analysis below, however, if the trust grants beneficiaries a "contingent general power of appointment," the Crummey trust may not qualify as a GST trust in 2013.
12. Section 2632(c)(5)(A).
13. Reg. 1.2632-1(b)(4)(ii)(A)(1) requires the amount of GST exemption allocated on a late filed Form 709 to be based on the value of trust assets at the time of the late allocation.
14. Section 2041.
15. Reg. 26.2652-1(a)(1).
16. Any property included in the beneficiary's gross estate will also receive a step-up in basis to the property's fair market value at the beneficiary's date of death. See Section 1014.