Trusts & Estates

Planning for the **Suddenly Wealthy:** Call in the **SWATT Team**

BY JONATHAN RIKOON AND STEVEN OLENICK

Coming into money can be both a blessing and a curse. Whether the client is a rookie professional athlete who just signed a multiyear, multi-million dollar contract; a young entertainer with a hit show and endorsements; the beneficiary of a trust that has terminated; a lottery winner; or the winner of a large verdict or settlement in a personal injury or divorce case, special attention from a team of professional advisors can avoid negative consequences from the windfall.

What's more, implementing a Sudden (or Substantial) Wealth Accumulation and Transmission Trust (SWATT) can mean the difference between the client enjoying lifelong comfort or ending up worse off financially than before the sudden wealth.

Concerns

Taxes: The influx of wealth may be taxable itself and when the proceeds are invested there will likely be taxable income and gains. Mostly newly wealthy clients will be unfamiliar with their new tax requirements and may be faced with substantial federal and (perhaps multiple) state income taxes. The client may also now confront human resources issues under labor laws, and state and local payroll tax and insurance filings.

Requests from friends and family: Newly wealthy individuals often discover that they can't say no to requests for financial assistance from family and friends, which can create cash flow problems and even generate gift tax obligations. A client who decides to make generous loans instead of gifts face issues regarding documentation and taxation of interest.

> The simplest way to structure a client's assets might be a "management trust." Such a trust will be tax neutral.

Philanthropy: Charities will solicit the newly wealthy and the client will need guidance about evaluating institutions, rationalizing a coherent charitable program, impact on cash flow and tax-efficient mechanisms for contributions or pledges.

Investments and Insurance: New-found wealth can be poorly invested due to lack of experience and oversight. Building an effective wealth management team is of the utmost importance. There will be critical issues of appropriate wealth allocation—for example, how much money to allocate toward non-financial assets such as residences, vehicles, jewelry and art. The purchase of such assets in turn creates a need for liability, and real and personal property, insurance. Life, health and disability insurance will be critical as well, the latter especially for the athlete or entertainer.

Without appropriate counsel on all of these issues, many newly wealthy individuals end up losing everything, despite their influx of money. We often hear of actors or other entertainers, sports figures and lottery winners who wind up with nothing because they don't know how to deal with these concerns and don't seek proper guidance.

A variety of professionals will be eager to provide advice: business managers (at least for athletes and entertainers), investment managers, tax accountants, and insurance brokers. Lawyers can take the lead on coordinating the different professionals, designing and implementing the optimal legal structure and promulgating clear lines of responsibility.

Goals

• Consider whether large, ongoing infusions of cash are likely—and for how long. Entertainers and athletes may have a relatively short period of years when very substantial remuneration may be expected. Lottery winners, beneficiaries of trusts, and winners of lawsuit settlements or verdicts may receive only a one-time windfall which should be shepherded very carefully.

• In many cases, the client will have significant intellectual property needs, such as handling endorsements, contracts, and the right of publicity. Intellectual property rules vary greatly from state to state. For example, the right of publicity passes through the estate to beneficiaries in California but not in New York.

• Asset protection is key for the newly wealthy. A client may be inexperienced with normal business practices, and special attention should be paid to bookkeeping formalities and use of separate LLCs for different types of property, residences and vehicles.

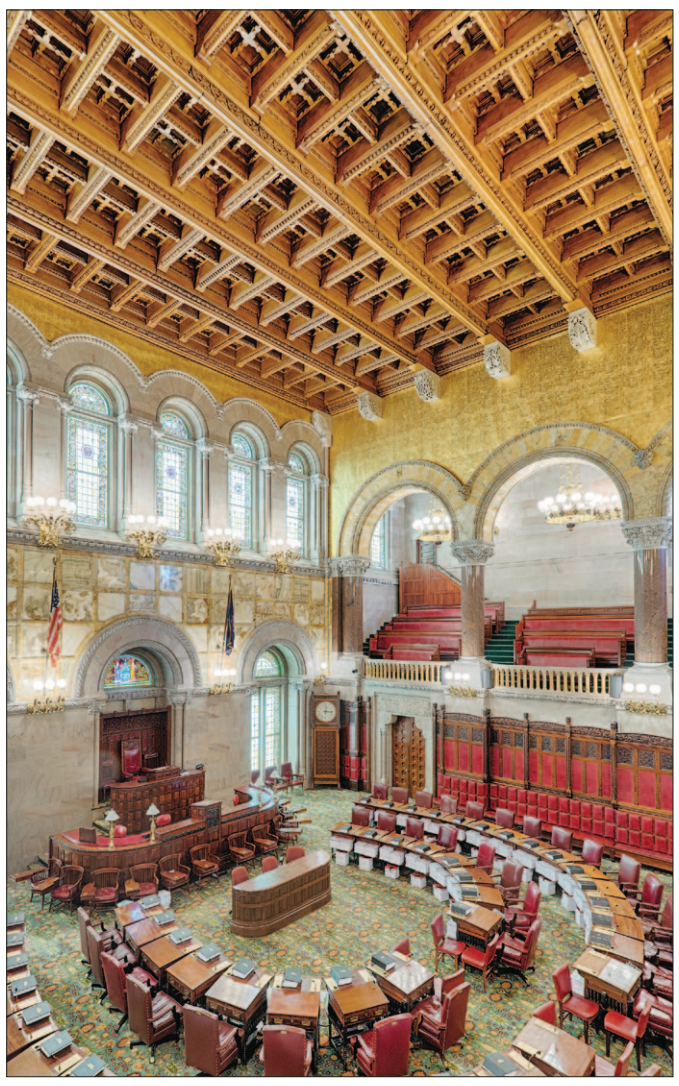
Lawyers can effectively guide a client to these goals. Lawyers can negotiate service and employment agreements, commercial agreements, endorsement contracts, acquisition of real estate and other tangibles, charitable pledge agreements, wills, trust agreements, and other estate planning documents. Additionally, a lawyer can design, explain and implement an overall structure strategy geared toward protecting the client's assets while also enabling the client to retain ultimate control.

The SWATT

Basic Structure: The simplest way to structure a client's assets might be a "manage-

» Page 10

JONATHAN RIKOON *is a partner in the trusts & estates department and* STEVEN OLENICK *is a partner in the sports practice of Loeb & Loeb.*



© SHUTTERSTOCK

NY's Latest Legislation: What Passed, What Didn't, What's Next

BY SHARON L. KLEIN AND REBECCA H. LOMAZOW

The 2017-18 legislative session officially opened on Jan. 4, 2017 and recessed on June 21, 2017. It is instructive to review what passed before the June recess, what failed to pass and what lies ahead when the session resumes in January 2018. Among the most noteworthy measures are the following:

1. Nonresident Income Tax Loopholes Closed (Enacted April 10, 2017), New York A.3009-C/S.2009-C (2017):

Co-operative Shares Included in Definition of Real Property When Determining New York Source Income. New York Tax Law §631 imposes a personal income tax on a nonresident's New York source income. New York source income is defined to include gains from the sale of real property or co-operative apartment interests located in New York. N.Y. Tax Law §631(b). Real property located in the state was further defined to include interests in certain legal entities[1] if the value of the real property located in New York was at least 50 percent of the entity's value. N.Y. Tax Law §631(b)(1)(A)(1). Notably, this rule omitted co-operative apartment shares from the definition of real property. This enabled a nonresident to exclude from source income the gain from the sale of a New York co-operative apartment that was held in an entity. However, the 2017-18 Executive Budget, signed by Gov. Andrew M. Cuomo on April 10, 2017, revises the definition of "real property located in this state" to include ownership interests in entities that own co-operative shares. Accordingly, if more than 50 percent of an entity's value consists of co-operative apartment shares, gains from the sale of an ownership interest in that entity will be taxable to a nonresident as source income. The changes apply to tax years beginning on or after Jan. 1, 2017.

Sales of Certain Partnership Interests Will Generate New York Source Income to Nonresidents. In order to close a loophole that allowed nonresidents to sell a partnership interest and classify the transaction as the sale of a nontaxable intangible partnership interest, an amendment treats the sale by a nonresident of a partnership interest as New York source income when trade or business assets held by the partnership were in New York and the sale is treated as an asset sale under Internal Revenue Code (IRC) §1060. N.Y. Tax Law §632(a)(1). The changes are effective April 10, 2017.

2. Top Personal Income Tax Rate and Charitable Deduction Limitations Extended (Enacted April 10, 2017), New York A.3009-C/S.2009-C (2017).

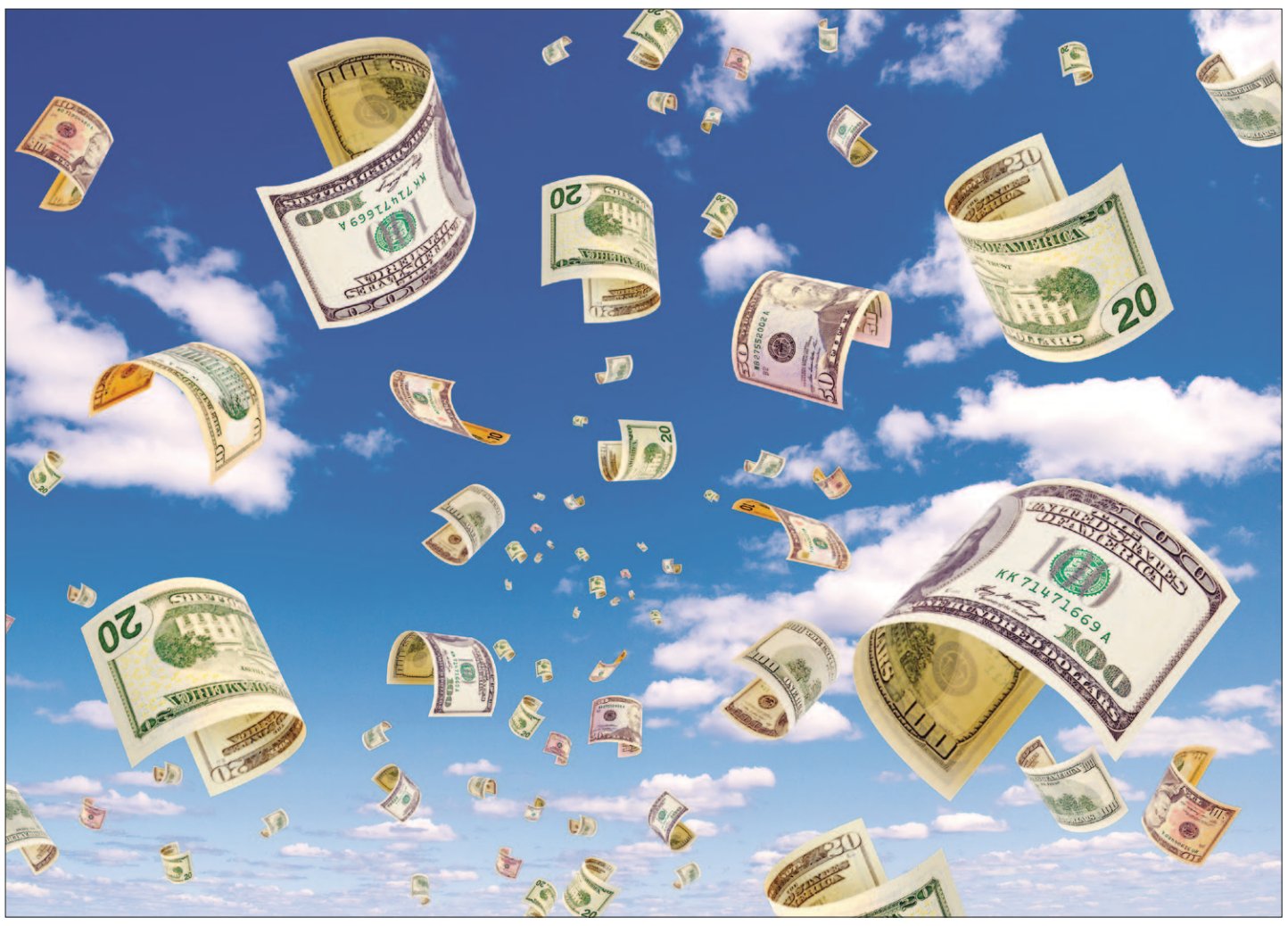
New York's top income tax bracket of 8.82 percent was scheduled to expire and revert to a 6.85 percent rate after 2017. The 2017-18 Executive Budget extends the top bracket for 2018 and 2019. N.Y. Tax Law §601. The itemized charitable income tax deduction is currently limited to 50 percent of the federal deduction for individuals whose income is between $1 million and $10 million and 25 percent of the federal deduction if income exceeds $10 million. These limits, which were slated to expire after 2017, have been extended through the end of 2019. N.Y. Tax Law §615(g)(1)-(2).

3. Proposal Regarding Recharacterizing Amounts Subject to a Trustee's Power to Adjust for Purposes of Calculating Trustee's Commissions (Passed Both Houses, Awaiting Delivery to Governor), New York A.1482/S.2079 (2017).

Under New York's power to adjust regime in Estates, Powers and Trusts Law (EPTL) §11-2.3(b)(5), a trustee is permitted to make adjustments between income and principal to be fair and reasonable to

» Page 12

SHARON L. KLEIN *is the Tri-State Region President at Wilmington Trust, N.A.* REBECCA H. LOMAZOW *is a Wealth Strategist at Wilmington Trust, N.A.*



© SHUTTERSTOCK

Multigenerational Estate Planning In Times of **Anticipated Change**

BY MARK B. RUBIN AND MICHAEL P. HEDDEN

The estate planning community has benefited from low interest rates, initially coupled with low asset values, for nearly a decade. During this period, many families took advantage of tax incentives to transfer both wealth and ultimate control of those assets to younger generations, while ensuring that the older generation still enjoyed sufficient income.

The economic and tax factors that encouraged families and non-family groups to engage in this type of planning still exist, and so do various techniques that accomplish a broad range of tax, financial, and family objectives.

One popular option is a freeze partnership, which enables a senior generation to "freeze" the value of its economic interests in the business assets, with future appreciation and risks of ownership typically held in trust for the next generation, so that substantially all future capital appreciation of those assets will be exempt from estate tax.

Classes of Interest

Parties to a freeze partnership typically have one of two classes of interest: preferred and common. In a traditional freeze partnership, the senior generation will contribute its ownership interest as a preferred interest. A professional appraiser determines the preferred interest value, along with a rate of return that will pay fixed, cumulative, annual returns, and a liquidation preference. The remaining common membership interest—the younger generation—is entitled to any future capital appreciation in the value of the business, as well as profits above and beyond the preferred rate of return on the preferred interest that the senior generation holds.

Let's take for example an existing partnership with assets worth $1,000, that generates $60 annually in cash flow. The owner, Margaret, recapitalizes the partnership by creating $900 of preferred interests and $100 of common interests. She then transfers the $100 of common interests to her children, through sale or gift, either directly, or in trust.

Margaret effectively has fixed her interest in the asset at $900. Her children will enjoy all the appreciation. However, Margaret must follow the applicable tax rules under IRC §2701, or she will be deemed to have given the equivalent of $1,000 to her children. (Section 2701 of the IRC provides regulations, guidelines, and restrictions related to preferred corporate stock and partnership interests related to intra-family transfers.)

First, she must determine the appropriate coupon, or fixed, cumulative annual return on her pre-

» Page 12

MARK B. RUBIN *is a senior managing director and leads the Family Enterprise Services practice in the real estate & infrastructure industry group at FTI Consulting.* MICHAEL P. HEDDEN *is a managing director in the real estate & infrastructure industry group.*

Inside

The **Digital Footprint After Death:** Who Wears the Shoes?

BY PETER B. SKELOS, LESLI P. HILLER AND ROBERT M. HARPER

© SHUTTERSTOCK

Email, Facebook, LinkedIn, Twitter, Instagram, Snapchat, Tumbler, online banking, online shopping and other forms of electronic communications comprise our digital footprint. They are seemingly ubiquitous and omnipresent in the life of our business, social, and personal affairs.

But, on death, who has the right of access to a decedent's digital footprint? More importantly, what is the scope of that access? Can a fiduciary figuratively step into the decedent's shoes and gain full access to the decedent's digital assets and electronic communications?

The digital world has been hurtling through space at the speed of light. The law, however, until recently, has been moving like the Pony Express and is quite a few steps behind when it comes to addressing access to a decedent's digital assets. This article addresses New York's recently-enacted digital asset legislation, Article 13-A of the Estates, Powers and Trusts Law (hereinafter "Article 13-A"), as well as the decision in *Matter of Serrano*, 56 Misc.3d 497 (Surr. Ct., New York County, 2017), which appears to be the first reported case in New York to examine the nature and extent of a fiduciary's access to the "digital assets" and "electronic communications" of a decedent. See generally EPTL §13-A-1 for the statutory definitions of the quoted terms referenced in this article.

In 2016, the New York legislature, following the lead of 19 other states, enacted its version of the Uniform Law Commission's Revised Uniform Fiduciary Access to Digital Assets Act (the Act). The legislature recognized the urgency of placing the administration of the digital assets of a "user" on par with a fiduciary's ability to manage a decedent's more traditional tangible assets. Assembly Sponsor's Mem., Bill Jacket, L. 2016, ch. 354. The reach of Article 13-A is not limited to requests by an executor or administrator to gain access to the digital assets of a decedent but also extends to requests by the fiduciary of an incapacitated person, an agent acting pursuant to a power of attorney and a trustee, regardless of whether the appointment was before, on or after the effective date of the legislation. The statute does not apply to digital communications used by an employee in the ordinary course of employment. EPTL §13-A-1-2.1(c).

Prior to the enactment of the various state versions of the Act, "custodians" or "electronic communication services" relying on the "terms-of-service agreement" and the federal Stored Communications Act, 18 U.S.C. §2701, successfully thwarted efforts by fiduciaries and family members who sought access to a decedent's digital assets. The Stored Communications Act generally precludes an electronic communication service from knowingly divulging the contents of certain electronic communications to persons other than the intended recipients of the communications, 18 U.S.C. §2702, and criminalizes intentional unauthorized access to certain electronic communications, 18 U.S.C. §2701. In addition, the Stored Communications Act distinguishes between content and non-content based communications, authorizing an electronic communications service to disclose certain non-content-oriented information to parties other than the user of a particular account. 18 U.S.C. §2702.

Article 13-A seeks to balance the tension that may exist between (1) the well-settled notion that the fiduciary of a decedent's estate stands in the user's shoes after death, and (2) the public policy that favors respecting the user's privacy upon death.

Under Article 13-A, access to digital assets and electronic communications is user-directed. EPTL §13-A-2.2. That is, Article 13-A permits the user the benefit of self-direction and provides a hierarchy for the instruments by which the user may express the user's intent regarding disclosure to others. A user may direct, by means of an "online tool," the custodian to disclose or not to disclose some or all of the user's digital assets, including the "content of electronic communications," to designated recipients. EPTL §13-A-2.2(a). The directive contained in the online tool overrides any communication to the contrary in a will or an inter vivos instrument. Id. In the absence of any such online directive, the user may direct disclosure by means of a will or inter vivos instrument. EPTL §13-A-2.2(b). That directive may address "some or all of the user's digital assets, including the content of electronic communications sent or received by the user." Id. Any such directive by means of an online tool, will or inter vivos instrument overrides contrary provisions in the terms-of-service agreement that does not require the user to act affirmatively and distinctly from the user's assent to the terms of service. EPTL §13-A-2.2(c). Thus, the online tool has the highest rank, followed by a will or inter vivos directive, and the terms-of service agreement is most subordinate.

As to the custodian's obligation to disclose, Article 13-A makes a critical distinction between disclosure of digital assets and disclosure of the content of electronic communications. A custodian's obligation to disclose the digital assets of a deceased user, first involves an inquiry as to whether the user made a directive *prohibiting* disclosure. EPTL §13-A-3.2. On the other hand, a custodian's obligation to disclose the content of electronic communications of a deceased user first involves an inquiry as to whether the user made an *affirmative* directive to disclose the content. EPTL §13-A-3.1. This distinction was central to Surrogate Mella's well-reasoned opinion in *Matter of Serrano*.

Except where a user has prohibited disclosure of digital assets before death, or a court orders otherwise, the custodian of digital assets, has a statutory obligation to disclose to the fiduciary "a 'catalogue of electronic communications' [EPTL §13-A-1(d)] sent or received by a deceased user and digital assets, other than the content of the electronic communications" upon receipt by the custodian of a written request for disclosure, a copy of the death certificate and a certified copy of the instrument appointing the fiduciary as such. EPTL §13-A3.2 (a-c). The custodian may, prior to disclosure, request certain enumerated identifying and linking information as well as an affidavit from the fiduciary attesting to the reasonable necessity of the digital assets for the administration of the estate. EPTL §13-A3.2(d) (1-3). Disclosure is mandated by the statute upon compliance with the foregoing conditions. However, a custodian may seek further protection from claims of violation of privacy by taking the additional step of seeking a court order directing disclosure. EPTL §13-A-3.2(d)(4)(A-B).

With respect to the "content of electronic communications," Article 13-A provides that the custodian's obligation to disclosure is founded upon an affirmative directive by the user followed by the fiduciary's written request for such disclosure, a copy of the death certificate, a certified copy of the letters appointing the fiduciary and "unless the user provided direction using an online tool, a copy of the user's will, trust or other record evidencing the user's consent to disclosure of the content of user's electronic communications." EPTL §13-A-3.1(a-d). Again, the custodian may, prior to disclosure, request certain additional enumerated identifying and linking information. EPTL §13-A-3.1(e) (1-2). However, recognizing the primacy of the user's affirmative directive, the statute does not permit a custodian to demand a statement of reasonable necessity of disclosure for the administration of the estate. Nevertheless, the recalcitrant custodian has the option to seek a judicial determination that (1) the deceased user "had a specific account with the custodian"; (2) "disclosure of the content of electronic communications … would not violate [the federal Stored Communications Act (18 U.S.C. §2701, et seq), or other applicable law"; (3) "unless the user provided direction using an online tool, the user consented to disclosure of the content of electronic communications"; or (4) "disclosure of the content of electronic communications of the user is reasonably necessary for administration of the estate." EPTL §13-A-3.1(e)(3)(A-D). The statute thereby, again, recognizes the primacy of the custodian's contractual obligation created by the user's directive by means of an online tool.

> Article 13-A represents a **significant step forward** in resolving some of the inherent tension between privacy and inheritance rights.

In *Serrano*, 56 Misc.3d 497, Surrogate Mella addressed the extent to which the fiduciary of a decedent's estate has a statutory right under Article 13-A to access the decedent's Google "email, contacts and electronic calendar." *Matter of Serrano*, 56 Misc.3d 497 (Surr. Ct., New York County, 2017). The fiduciary argued that he needed such access in order to inform the decedent's friends of the decedent's passing and to "close [the decedent's] unfinished business." Id. Google responded to the fiduciary's application by requesting "a court order specifying that … disclosure of the content [of the requested electronic information] would not violate any applicable laws, including but not limited to the Electronic Communications Privacy Act and any state equivalent." Id.

The recited facts do not state whether the decedent directed disclosure of digital content to the fiduciary of his estate. Since *Serrano* involved a small estate administration, we assume there was no will. We also assume that there was no online directive or some other instrument directing disclosure of content. Thus, as to content disclosure, the statutory scheme, EPTL §13-A-3.1, does not precisely cover these facts. Relying upon the distinction between disclosure of digital assets and disclosure of the content of electronic communications under Article 13-A, Surrogate Mella concluded that the fiduciary was entitled to disclosure of the contacts and calendar information associated with the decedent's Google email account, but not the content of the emails attached to that account. Id. This is because, under Article 13-A, Google has a statutory obligation to disclose the non-content material associated with the decedent's Google email account to the fiduciary of the decedent's estate in the absence of a prohibition. EPTL §13-A-3.2. However, in the absence of an affirmative directive by the decedent, Google had no statutory obligation to disclose the content-based material associated with the decedent's Google email account. EPTL §13-A-3.1.

Under these circumstances, the fiduciary had the burden to justify disclosure of the content of the decedent's email account by showing that the content disclosure was reasonably necessary to the administration of the decedent's estate. EPTL §13-A-3.1(e)(3)(D). The fiduciary failed to make that showing as to disclosure of the content. The Surrogate denied the fiduciary's application for access to the content of the decedent's Google account, without prejudice to a future application on notice to Google.

Absent from the *Serrano* opinion is a determination whether disclosure of the content of the decedent's electronic communications would violate the applicable federal and state laws, despite the fact that Google requested such a finding. However, because the fiduciary failed to meet the necessity element, the Surrogate apparently did not need to address that question. EPTL §13-A-3.1(e)(3)(D).

Until recently, New York law struggled to keep pace with the development of digital assets and the associated privacy and inheritance rights. Fortunately, Article 13-A represents a significant step forward in resolving some of the inherent tension between those rights. Yet, many questions remain unanswered, left only to arguments of counsel for fiduciaries, custodians and electronic communication services and ultimately the Surrogate's Courts as they come to interpret Article 13-A going forward.

PETER B. SKELOS, *formerly an Associate Justice of the Appellate Division, Second Department, is an arbitrator and mediator with NAM (National Arbitration and Mediation) and a partner at Forchelli, Curto, Deegan, Schwartz, Mineo & Terrana.* LESLI P. HILLER *is principal law clerk to Judge Margaret C. Reilly, Surrogate's Court of Nassau County.* ROBERT M. HARPER *is counsel at Farrell Fritz.*

SWATT

« Continued from page 9

ment trust." Such a trust will be tax neutral. There should be a bank as an administrative trustee, a trusted individual trustee, and a trust protector (to protect the client from being taken advantage of by a once-trusted individual).

The trust should permit distributions to the settlor/client, but it may also include discretion for distributions to specific relatives or classes of relatives. Initially, the client may not be ready to make estate planning decisions, and so at inception the remainder of the trust upon the settlor's death may simply be left to the settlor's estate. Establishing the management trust structure immediately is critical, even if the client is not yet prepared to decide on estate dispositions.

Situs: The trust should have a situs in a flexible trust and LLC jurisdiction because there will be multiple fiduciaries with different roles and a variety of special purpose entities or assets held by the trust (usually LLCs). At the moment, New York trust law is still evolving in these respects, so many practitioners will use Delaware trusts and Delaware LLCs.

Fiduciaries: The bank administrative trustee can keep track of investments and custody assets and, as necessary, implement trades and track results. Obviously the location of the financial institution can provide a jurisdictional nexus for the choice of law. Having the bank handle routine administration matters will free up the other professionals (trustee, trust protector, distribution and investment directors, lawyers and accountants) for more discretionary and globally important decisions. Some banks can also provide ancillary services such as LLC maintenance, family office services or even investment management.

Often, the individual (non-administrative) trustee will also be the business manager. Perhaps yet another individual would be responsible for directing distributions to beneficiaries (whether from inception or after death of the client). Investments may be supervised by either the business manager/trustee or a separate investment director.

A trust protector provides the safety feature of preventing one of the other fiduciaries (bank or individual trustee, distribution director, investment director) from taking advantage of the client or just doing a poor job. An alternative would be for the settlor/client to retain the unfettered right to remove and replace fiduciaries and the right to revoke or amend the trust, but that would leave the risk that a third party might improperly prevail on the client to bring down the entire structure without the participation or at least consent of any of the professionals who set up the trust in the first place.

> When a client's assets are appropriately structured, the upsides are clear: strong monitoring and supervision and authorization of the right people (the SWATT team!) to handle their respective areas of responsibility.

Amendments: To retain maximum flexibility and to deal with changes in tax or substantive law or family and financial circumstances, the settlor/client should have broad power to amend or revoke the trust or remove fiduciaries but (here's the critical part) only with consent of the trust protector (or in the case of removal of the trust protector, consent of the trustee). By the same token, the trust might give the trustee and the trust protector the right to make technical and administrative amendments even without the settlor's consent, for example, if the settlor becomes incapacitated.

LLC Structures

The SWATT will usually own a master holding LLC (managed by the individual trustee) with different classes of assets held in different LLCs. There may be separate subsidiary LLCs for each residence, boat or plane, valuable automobiles and portfolio investments. There may also be separate subsidiary LLCs to deal with all human resources issues and perhaps also to deal with insurance functions. Finally, there may be a separate LLC to deal with intellectual property, endorsements, branding and related issues.

Each of these LLCs will have a manager, who may also provide professional advice in that area. The individual trustee, as manager of the master LLC that holds the subsidiary LLCs, should be able to change the managers if there are any problems. However, the trustee would not need to be involved in the day-to-day management of each of these LLCs unless and until there is a problem.

Add in Estate Planning

Once the client is prepared to deal with estate planning, the management trust can also become a testamentary substitute because it already holds all or most of the client's assets. That will truly make it a SWATT. For privacy purposes, the management trust might pour over into a separate revocable trust at the settlor's death, so that any counterparties who need to see the management trust are not privy to the estate plan. In designing and drafting the testamentary revocable trust, all of the usual estate planning questions will arise, but there may be particular and sensitive issues regarding liquidity and tax allocations.

The client will still need a pour-over will to dispose of assets not in the trust, as well to name guardians for minor children and to exercise any testamentary powers of appointment. A will is also needed to appoint an executor to deal with postmortem financial claims, paternity claims, and any personal rights that were not or could not be assigned to the trust.

Finally, to facilitate estate planning transactions, including GRATs, installment sales, and creation of completed-transfer trusts, the management trust itself should authorize all of these techniques as well as decanting as needed. The trust instrument could also allow the trustee and the trust protector to engage in estate tax savings transactions even if the settlor becomes incapacitated, as long as the trust's general pattern of dispositions is followed.

Conclusion

Lawyers are well-equipped to meet the challenge of representing a suddenly wealthy client. An effective lawyer can ascertain each client's needs and goals, circumstances and resources, strengths and weaknesses, and then coordinate a team of advisors to administer a SWATT trust and LLC structure. When a client's assets are appropriately structured, the upsides are clear: strong monitoring and supervision and authorization of the right people (the SWATT team!) to handle their respective areas of responsibility. Then the client is free from administrative headaches and also free to make necessary changes in goals or personnel.

© SHUTTERSTOCK

Dead Hand Control and Estate Tax Considerations

BY CHRISTINA JONATHAN AND TERENCE E. SMOLEV

The will of Pulitzer and Tony Award winning author and playwright Edward Albee was recently admitted to probate in the Suffolk County Surrogate's Court, which directed his executors to destroy some of his works.

Albee passed away on Sept. 1, 2016 without a spouse, children or close relatives. His executors are accountant Arnold Toren and designer William Katz. As of this date, it appears that no one with legal authority (if any) has contested his last will and testament, which has been sparking controversial debates regarding these final wishes.

The specific directive appearing in the will instructs his executors to destroy any incomplete manuscripts, in any medium (electronic, writing or other) as well as all copies of same. Once a will is admitted to probate, the executors have an obligation to comply with the will's instructions. The problem is that courts generally do not examine a decedent's will to see if each provision has been fulfilled, absent someone contesting same, or if an accounting is required. Thus, Albee's executors can themselves decide whether or not to honor his last wishes.

During Albee's life, he certainly possessed the right to destroy his property whenever he chose. Albee had elected to further exercise dead hand control, thereby controlling his property post mortem. The law generally allows certain control after death, limited by some policy reasons and violations of the rule against perpetuities.

There are only a handful of cases that address issues where executors had to destroy decedent's property. Other famous deceased artists, such as German Novelist Franz Kafka, had instructed that all his works be destroyed by his friend and literary agent. Luckily for the literary world, Kafka's friend did not follow his wishes. In addition, the will of Beastie Boys founder Adam Yauch prohibited any of his music to be used for advertising purposes.

There was at least one case from 1998 wherein a will contest arose to prevent an executor from demolishing a decedent's real property pursuant to an article in her will. *In Re Estate of Beck*, 177 Misc.2d 203. In *Beck*, Erie County Surrogate ruled that he was not going to substitute the interests of a quasi-public agency for that of decedent in a valid will, and specifically held:

> The court's responsibility in overseeing the administration of a decedent's estate is rooted in the principle of implementing the decedent's testamentary plan as determined from the words used within the four corners of the will. That intent, where discernible, must be given effect unless contrary to law or public policy. Statutes or public policy may limit the manner in which a testatrix may otherwise legally dispose of certain property.

Of course, there are cases taking different viewpoints from the Beck Court. As to Albee, with no one having objected to the will's validity or the instructions therein, it appears that there is no roadblock to prohibit the executors from following Albee's instructions.

In addition, there exists a strong possibility that Albee's estate will face future litigation should one of his unpublished works debut after his death. Whether the executors can seek court intervention to prohibit this release to the public raises issues of possession and whether Albee's will can bar a third party from finishing and/or releasing any of his unpublished works.

The executors of the Albee estate will also be subject to preparing and filing accurate estate tax returns, with the task of determining how to report the value of partially complete or fully complete manuscripts. As a general rule, 26 U.S. Code §2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States. This taxable estate includes all of the taxpayer's property at the time of death, less any applicable deductions. The executors may also elect alternate valuation, which generally allows the value to be determined six months after decedent's date of death, as opposed to the actual value at the date of death, pursuant to 26 U.S. Code §2032.

There are two issues that Albee's executors have to consider herein. First, what is the value of the manuscripts considering all of the relevant facts? Second, how does the destruction of the manuscripts affect the value of the gross estate so as to be in compliance with applicable Internal Revenue Law, Rules and Regulations?

Generally, fair market value is defined as "the price at which the property would exchange hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." 26 CFR 20.2031-1. The simplest way to determine the value of any property is obviously to obtain a certified appraisal report. There are actually several sophisticated appraisers who specifically value certain manuscripts and fine art-related documents.

Since Albee was a renowned playwright, the value of his manuscripts will possibly be worth significantly more now that the artist has passed away. For example, playwright Eugene O'Neill provided written instructions that his play, "Long Day's Journey Into Night," not be made public until 25 years after his death. His wife disregarded these instructions and released it three years after his death. This was deemed to be his finest work. Albee was best known for his work "Who's Afraid of Virginia Woolf," which was turned into a drama starring Elizabeth Taylor and Richard Burton. Albee won the Pulitzer Prize three times, as well as two Tony Awards. Thus, like O'Neill, his unfinished works very well could contain his next masterpiece. In addition, Eva E. Subotnik, a St. John's University School of Law professor, correctly states that "there is something special about these kinds of assets—they're not just like a mansion or a fancy watch, but they're socially valuable, and that has to play into the calculus."

Unfortunately, Albee directed his executors to "treat the materials herein directed to be destroyed as strictly confidential and to ensure that such materials are not copied, made available for scholarly or critical review or made public in any way." If his executors are carrying out his wishes to the fullest extent, then it is worthless, since a willing buyer will pay zero for property that will be "destroyed" pursuant to Albee's will. But then again, what happens from a tax point of view if Albee's works *appear* after his death?

Nevertheless, taxing authorities may still consider the value of some of Albee's manuscripts before they would be destroyed in an effort to increase the value of his taxable estate. The information made public for at least one manuscript is that a play entitled "Laying an Egg" was scheduled twice in the Signature Theater. This Off-Broadway nonprofit theater had the play "withdrawn by Albee, who said it wasn't ready." Id. Surely, some value can be calculated for this one piece about a middle-aged woman struggling to become pregnant. Thus, it appears that at least one of the unfinished manuscript's value may have to be reported on Albee's estate tax return, especially if there are copies of this piece already distributed.

> Dead hand control generally allows **certain control of property after death**, limited by some policy reasons and violations of the rule against perpetuities.

Furthermore, the usual rule for taking a deductible loss on tax returns is that any damage, destruction or loss of property resulting from an identifiable event that is sudden, unexpected or unusual, i.e., a casualty loss, can be claimed. It can be argued that the destruction of the manuscripts can be considered an "unusual casualty loss." However, a willful act clearly disqualifies any deductions that could have otherwise been claimed. So, ill-advisedly for Albee's estate, this destruction of the manuscript may now cost his estate additional taxes at no benefit to the estate whatsoever.

Perhaps Albee knew that the value of his unfinished works would be considered by the Internal Revenue Service as part of his gross estate, and therefore he strategically decided to destroy same. But more than likely, the artist simply wanted to retain dead hand control over his manuscripts, especially given his reputation for discriminating against actors while casting his plays. Moreover, he could have easily left the manuscripts to his Foundation, qualifying as a charitable deduction if he was concerned about the estate tax.

Meanwhile, the unfinished works of a great writer may never see the light of day. What a shame for the art-loving community and for historical, as well as theatrical, purposes.

CHRISTINA JONATHAN *is a partner at the firm Berkman, Henoch, Peterson, Peddy & Fenchel.* TERENCE E. SMOLEV *is of counsel to the firm.*

Legislation

« Continued from page 9

all beneficiaries. In order to effect consistency in how adjusted amounts are treated for purposes of computing commissions, the proposal would treat an adjustment as a recharacterization of the adjusted amount from income to principal or principal to income, as the case may be, in order to calculate commissions.

4. Proposal to Reform Powers of Attorney (Passed Assembly, Introduced in Senate), New York A.8120-B/S.6501-A (2017).

In response to the difficulties experienced by many practitioners and clients with New York's Power of Attorney (POA) form, the New York Bar Association created a POA Task Force. The Task Force concluded that reform legislation is necessary for three major reasons: The POA form is too complex and prone to improper execution, the requirement that the form contain the exact statutory wording is unduly burdensome and a trap for the unwary, and financial institutions or others who unreasonably refuse to accept a POA are not currently subject to any sanctions.

The memorandum in support of the proposal cites the report of the Task Force. The proposal would eliminate the Statutory Gifts Rider, which has different execution formalities from the POA, allow for substantially compliant language, provide safe harbors for those who accept a POA in good faith without actual knowledge that the signature is not genuine, allow sanctions against third parties who unreasonably refuse to accept a properly executed POA, including costs and attorney fees, and expand an agent's power to make gifts in a calendar year that aggregate $5,000 instead of the current $500.

There was some opposition to the bill concerning potentially making the POA approval process more onerous and increasing the opportunity for financial elder abuse.

5. Proposal to Extend Attorney-Client Privilege to Lifetime Trustees (Passed Assembly, Introduced in Senate), New York A.7088 (2017).

Pursuant to Civil Practice Law and Rules (CPLR) §4503(a)(2), the attorney-client privilege extends to a client who is a personal representative. Under that section, absent an agreement to the contrary, no beneficiary of the estate is treated as a client of the attorney solely by reason of his status as beneficiary, and the existence of the fiduciary relationship between the personal representative and the beneficiary does not by itself constitute a waiver of the privilege between the attorney and the personal representative. CPLR §4503(a)(2) does not extend to lifetime trustees the attorney-client privilege afforded to personal representatives. According to the memorandum in support of this proposal, it was due to an omission that lifetime trustees were not included within the definition of "personal representative," and there is no reason to exclude lifetime trustees from the protection of the attorney-client privilege. This proposal simply includes "lifetime trustee" in the definition of personal representative. Additionally, the measure makes clear that a fiduciary does not waive the privilege by merely asserting he or she relied upon the advice of counsel when acting in such capacity.

6. Proposal Conforming the EPTL and SCPA to the Marriage Equality Act (Passed Assembly, Introduced in Senate), New York A.3387/S.0262 (2017).

The Marriage Equality Act was enacted on June 24, 2011. 2011 Sess. Law News of N.Y. Ch. 95. It makes clear that all provisions of law should be interpreted neutrally to promote gender equality in marital relationships. This proposal would conform the EPTL and Surrogate's Court Procedure Act (SCPA) by removing any gender-specific references to "mothers," "fathers," "husbands," and "wives" and inserting in their place gender-neutral references to "parents" and "spouses."

7. Proposal to Enact the Uniform Voidable Transactions Act (Passed Assembly, Introduced in Senate), New York A.1853-A/S.6180-A (2017).

In 2014, the Uniform Law Commission refined the Uniform Fraudulent Transfers Act (UFTA), renaming it the Uniform Voidable Transactions Act (UVTA). The UVTA, formerly the UFTA, seeks to strengthen creditor protection by providing remedies for certain transactions by a debtor that are unfair to a debtor's creditors. The 2014 amendments, which are not a comprehensive revision of the Act, are intended to generate consistency among the courts in applying the law relating to "voidable transfers," as opposed to "fraudulent transfers"—a term that caused much confusion leading some courts, in error, to apply the stricter pleading requirement for "fraud" or require the plaintiff to prove its case by a higher standard of proof.

New York proposes adopting the UVTA to modernize its fraudulent conveyance laws. New York's Fraudulent Conveyances Act was enacted in 1925. As a result of major developments since then, New York's law has not kept pace with federal bankruptcy laws and the laws in most other states. Forty-four states have enacted the UFTA or UVTA. Only New York and Maryland retain the Uniform Fraudulent Conveyance Act.

8. Proposal Regarding "Pour Over" Wills (Passed Assembly, Introduced in Senate), New York A.6809 (2017).

EPTL §3-3.7 permits an individual to make a testamentary "pour over" disposition into trust. This proposal would remove an apparent conflict with a different EPTL section (N.Y. EPTL §7-1.18) and clarify that the trust need not hold any assets prior to the individual's death.

Additionally, the proposal would change the current requirement that the trust agreement is executed prior to or contemporaneously with the will. This would address the harsh result in *Matter of D'Elia*, 40 Misc.3d 355 (Surr. Ct., Nassau County 2013), in which the court ruled that a residuary gift to a trust was not valid because, although the testator executed the trust prior to his will, the trustee did not sign the agreement until seven days later. Under the proposal, as long as the grantor signed the trust agreement prior to or contemporaneously with his will, the trustee need only sign prior to the testator's death.

> Divorced spouses, spouses in the process of getting a divorce and unmarried couples who are separated **should give immediate attention to their planning documents,** to ensure they reflect their intent.

9. Proposal to Allow a Trustee to Allocate Realized Capital Gains to Income (Passed Senate, Introduced in Assembly), New York S.4866 (2017).

A trustee's ability to allocate capital gains to income has become increasingly important, given the rise in capital gains tax rates (including the 3.8 percent tax on undistributed income, which includes realized capital gains). In order to achieve reasonable and impartial results, a trustee must be able effectively to determine whether to tax gains to the income beneficiaries or the trust. This proposal would amend the New York Principal and Income Act, N.Y. EPTL Article 11-A, to clarify that a trustee can, in a reasonable and impartial exercise of discretion, allocate gains to income. The power to do so would apply where the trustee is investing for total return pursuant to the power to adjust, or if the trustee has unlimited discretionary power to distribute principal (which in effect permits total return investing because the power to distribute principal can be used in a similar manner as the power to adjust).

10. Proposal to Extend Revocatory Effect of Divorce (Introduced in Both Houses), New York A.6229/S.6503 (2017).

EPTL §5-1.4 provides that divorce revokes dispositions to, and fiduciary nominations of, former spouses. However, the revocatory effect of the section does not extend to the relatives of an ex-spouse. In *Matter of Lewis*, 25 N.Y.3d 456 (2015), EPTL §5-1.4 disqualified the decedent's ex-husband from inheriting under her will or acting as executor. However, the ex-husband's father (the decedent's ex-father-in-law), was the successor beneficiary and executor and he was not disqualified under the terms of the statute. Presumably the ex-husband would inherit or obtain the property from his father, causing an end-run around the statute. While the court acknowledged this, it opined that the statute was clear and unambiguous in omitting the relatives of ex-spouses from disinheritance.

Under a proposal introduced in New York in both houses, dispositions to divorced spouses would continue to be expressly revoked, and there would be a rebuttable presumption revoking dispositions to family members of the ex-spouse. The revocatory effect of divorce would be presumed to apply to a person in any relationship to the divorced individual that was based upon the marriage, including but not limited to stepchildren, stepgrandchildren and parents-in-law, unless there is substantial evidence of the divorced individual's contrary intention.

The most prudent course of action, however, is not to rely on state default law at all. Divorced spouses, spouses in the process of getting a divorce and unmarried couples who are separated should give immediate attention to their planning documents, to ensure they reflect their intent.

11. Proposal Regarding Lapse of Crummey Withdrawal Powers (Introduced in Assembly), New York A.5432 (2017).

In order to qualify for the annual gift tax exclusion for transfers to trusts, beneficiaries are often given "Crummey powers," or withdrawal rights from the trusts for limited periods of time that create present interests. A beneficiary who has a withdrawal power, or has allowed it to lapse, released it or waived it, is treated as the owner of the property subject to the power, making it includable in the beneficiary's estate. However, under IRC §§2041(b)(2) and 2514(e), the power can lapse without federal tax consequence if the value of the property subject to the power does not exceed $5,000 or 5 percent of the trust assets.

An issue in New York is that the law does not clearly address creditors' rights to the property that was subject to the lapse. Under EPTL §7-3.1(a) and CPLR §5205(c), an individual's contributions to a trust created for that individual's own use are subject to that individual's creditors. If a withdrawal power is waived or allowed to lapse, the amount subject to the power could be treated as having been withdrawn and then contributed to the trust by the beneficiary for his own use, subjecting it to the claims of the beneficiary's creditors, which could in turn subject it to estate tax inclusion.

The proposed legislation would revise EPTL §7-3.1(a) and CPLR §5205(c) to clarify that no individual will be treated as having made a disposition in trust for his use because of a lapse of a power of withdrawal.

1. This includes an interest in a partnership, limited liability corporation, S corporation, or non-publicly traded C corporation with one hundred or fewer shareholders.

Change

« Continued from page 9

ferred interest, so that it will have a legal value of $900. To do this, she will engage a valuation expert who will consider the:

- nature of the assets
- amount of income produced by the property
- risk profile of the property
- current market yields
- general economic factors

The valuation expert will then recommend an appropriate preferred coupon. If the coupon is 5 percent, Margaret will receive $45 annually. Her children will receive the balance. If the income decreases, Margaret still will be entitled to the first $45, and her children will receive less. The role of the valuation expert is crucial, and the expert should have the experience and credentials required to meet a possible IRS challenge.

A freeze partnership can also be beneficial in a "negative capital account" situation, where Margaret owns the property in an existing partnership, and the debt exceeds the tax basis of the property. Take for example a property that is subject to $600 of debt, but has a tax basis of $300. If Margaret were to transfer her partnership interest to her children, she could have $300 or more of taxable gain. But suppose that the children (perhaps using funds provided by Margaret) make a capital contribution equal to 10 percent of the value of the equity of the partnership. Margaret can then recapitalize her interest, so that it's substantially all preferred interest. The tax rules will permit the partnership to allocate debt to Margaret so that she does not trigger her negative capital account and avoid triggering the $300 of taxable gain. When she dies, under current rules, her basis will be stepped up to fair market value and the negative capital account will be eliminated.

Accordingly, when properly structured, a freeze partnership avoids capital gains tax, even where the current owners have negative capital accounts. At their death, the senior generation will receive a step up in basis, wiping out their negative capital accounts. Meanwhile, the preferred interest owned by the senior generation will provide a reliable source of fixed income.

The freeze partnership is ideally suited to high-net-worth individuals not reliant on capital appreciation from future dispositions of real estate or businesses. The freeze works best with assets that currently generate a consistent stream of cash flow that equals, or exceeds, the preferred interest coupon of the senior generation. Any cash flow in excess of this fixed coupon will flow through to the younger generation. A freeze partnership is especially appropriate for a property asset that combines both current cash flow and the opportunity for appreciation.

Control of the freeze partnership must also be addressed. If working in the business, including members of the younger generation would make sense. The allocation of business interest among family members can be used to reward those members involved in operations. In addition, the management operations often have a value itself which can be captured and factored into the overall plan. Many families work with consultants who can guide the family through this process and set up governance that will enable the family to work together peacefully.

> Today, partnership interests often are able to be **valued at a discount**, reflecting lack of marketability and control.

Valuation

Revenue Ruling 83-120 by the Internal Revenue Service gives basic guidelines for determining the value of a closely held business's preferred stock. The ruling states that the valuation should include analysis of the stated dividend rate and the risk associated with this payment. It should identify cumulative and non-cumulative dividends, and assess the company's ability to pay the preferred stock's liquidation preference at liquidation. Voting rights and redemption privileges should also be considered. The preferred stock's value would equal the present value of anticipated future cash flows. The rate of return on the preferred stock, and its value, relate to its perceived risk.

How to determine the value of the preferred and common interests amounts to more than basic number-crunching. It can be complex and tricky, and should be entrusted to trained professionals—as should the entire implementation of the estate freeze transaction. Today, partnership interests often are able to be valued at a discount, reflecting lack of marketability and control. The Internal Revenue Service (IRS) has proposed regulations that would eliminate these discounts for family partnerships, although the Trump Administration has asked the Treasury Department to review the proposals. The process involves extensive planning, involving valuation analysts from the beginning. Professional wealth management advisors, tax professionals, and certified appraisers can:

- determine an adequate reasonable rate of return on the preferred interest
- appraise the real estate
- determine valuation discounts
- navigate IRC §2701 surrounding the particular method of freezing asset values
- structure the freeze while paying attention to the liquidity of a business
- determine the potential market for sale of the business interests
- establish the value of the business for future disposition
- come up with structural variations to provide even greater benefits.

Questions to Consider

The freeze partnership is just one of several alternatives available to families and other privately held business owners planning their estates and arranging their retirement. Before deciding on the best technique for an asset/management transfer, a family should address the following questions:

- Is the family transferring the future appreciation in assets, or a current interest in the assets, to the younger generation?
- Who will remain in control of the assets, and who will operate the business?
- Should the new structure reward members of the younger generation who are working in the business with a larger share of future profits? How will this impact relations among the siblings or cousins?
- Should the new structure provide the senior generation with a guaranteed fixed income?
- Do certain stable assets offer less upside than others that involve more risk? Should the stable assets be placed in separate pools? Do some assets require substantially more work? If so, how should this effort be compensated?
- Is the transfer intended to avoid future estate tax liability? What if the transfer creates additional income tax liability for the next generation?
- What is the current tax basis of the assets? Is the debt on the assets substantially more than its tax basis? Do the current owners have negative capital accounts?

While considering these questions, families must consider the tax, economic and emotional consequences, including current and potential tax rates, current and proposed regulatory environments, and current and potential asset values.